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STATE OF MINNESOTA
IN THE SUPREME COURT

In the Matter of the Review of the 2005 Annual Automatic Adjustment of Charges For All Electric and Gas Utilities

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BRIEF OF RESPONDENT CENTERPOINT ENERGY MINNESOTA GAS

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STATEMENT OF THE LEGAL ISSUE

WHETHER THE COMMISSION ERRED IN DENYING A VARIANCE AND THEREFORE DEPRIVING CENTERPOINT ENERGY RECOVERY OF ANY OF $21 MILLION IN PRUDENTLY INCURRED GAS COSTS, WHERE THAT DENIAL: (1) CONFLICTED WITH LEGISLATIVE POLICY, (2) FAILED TO APPLY THE COMMISSION'S PRIOR PRECEDENT, (3) PROVIDED NO RELEVANT DISTINCTION OR EXPLANATION FOR DEPARTING FROM THAT PRECEDENT, AND (4) RELIED UPON UNSUPPORTED ASSERTIONS, SPECULATION, AND CONTRADICTORY STATEMENTS, ALL REFLECTING THAT THE COMMISSION EXERCISED ITS WILL RATHER THAN ANY GENUINE EXPERTISE OR INFORMED JUDGMENT.

The Court of Appeals held that the Commission acted arbitrarily and capriciously by denying CenterPoint Energy's requested variance where, on the basis of the record before the Commission, the denial could not be reconciled with the Commission's prior precedent and where the Commission had articulated no new standard for deciding such requests.

Apposite Authority:

Trout Unlimited, Inc. v. Minn. Dep't of Agric., 528 N.W.2d 903 (Minn. Ct. App. 1995), *rev. denied* (Minn. Apr. 27, 1995)

In re Cities of Annandale and Maple Lake NPDES/SDS Permit Issuance for the Discharge of Treated Wastewater, 731 N.W.2d 502 (Minn. 2007)

Peoples Natural Gas Co. v Minn. Pub. Utils. Comm'n, 342 N.W.2d 348 (Minn. Ct. App. 1983)

Minn. Stat. § 216B.01 (2006)

Minn. Stat. § 216B.16, subd. 7 (2006)

STATEMENT OF THE CASE

This appeal arises from an order of the Minnesota Public Utilities Commission ("Commission") that denied recovery of $21 million by CenterPoint Energy Minnesota Gas ("CenterPoint Energy") for the wholesale cost of gas that it provided to its Minnesota customers, but failed to collect because of an inadvertent accounting error.

In 2006, CenterPoint Energy discovered that it had been under-recovering its pass-through cost of gas, going back to 2000. CenterPoint Energy petitioned the Commission for a variance to the Commission's True-Up Rule. The True-Up Rule limits the recovery (or refund) of under-collected (or over-collected) costs of gas to the past 12 months.

The Commission had adopted a procedural rule that requires granting a variance to the True-Up Rule where, among other things, the 12-month limitation would impose an "excessive burden." In the only two other cases where a variance to the True-Up Rule had been considered, the Commission granted a variance to Northern States Power Company to allow it to recover under-collected gas costs of $1 million for a one-year period and to Interstate Power Company to allow it to recover under-collected gas costs of $165,000 for a two-year period, finding for each utility that the limitations of the True-Up Rule would impose an excessive burden.

In denying CenterPoint Energy a variance, the Commission's Order of December 6, 2006, first made a fundamental factual error, finding that the under-collection was $2.4 million, instead of $21 million. Next, without any record evidence in support of the claim, the Commission speculated that CenterPoint Energy had perhaps already recovered these gas costs through intervening rate cases. Because the only record

evidence indicated that CenterPoint Energy had *not*, in fact, been compensated for its gas costs through these rate cases, the Commission ordered that an expert audit be performed to resolve the issue. But, without waiting for the results of that audit or ordering a contested case hearing to examine these claims, as requested by CenterPoint Energy, the Commission concluded that CenterPoint Energy's under-collection was "minor" and would not impose an excessive burden. Accordingly, it denied CenterPoint Energy's request for a variance and prevented recovery of any of the unrecovered gas costs.

On CenterPoint Energy's petition for reconsideration, the Commission recognized the factual error and corrected the calculation in its finding of the under-recovery of actual gas costs from $2.4 million to $21 million. However, the Commission made no other changes to the former Order, and therefore concluded that the under-collection of $21 million—a nine-fold increase of the amount stated in its original Order—was also "minor" and did not impose an excessive burden on the company.

The Court of Appeals unanimously concluded that the Commission's decisions regarding CenterPoint Energy's request for a variance "cannot be reconciled with its decisions in the two prior cases" where the Commission had granted similar variance requests. The Court of Appeals therefore held that:

> The commission failed to faithfully apply its applicable precedent and did not announce a modification of that precedent when it considered CenterPoint's request for a variance. Thus, the commission's denial of CenterPoint's request was arbitrary and capricious. We therefore reverse and remand this matter to the commission.

The Commission petitioned for further review, which was granted by this Court on July 15, 2008.

STATEMENT OF FACTS

A. The Regulatory Framework.

Minnesota Statutes Chapter 216B sets forth the regulatory scheme for natural gas utilities in Minnesota. There, the legislature has stated:

> It is hereby declared to be in the public interest that public utilities be regulated as hereinafter provided in order to provide the retail consumers of natural gas and electric service in this state with adequate and reliable services at reasonable rates, *consistent with the financial and economic requirements of public utilities and their need to . . . obtain energy supplies.*

Minn. Stat. § 216B.01 (2006) (emphasis added).

Consistent with this overarching goal of providing adequate and reliable service at reasonable rates, while recognizing the need for utilities to recover their costs of obtaining energy supplies, the legislature has also provided for unique and separate treatment of a utility's gas costs, compared to the treatment of its general operating costs and profits,[1] by providing:

> Notwithstanding any other provision of this chapter, the commission may permit a public utility to file rate schedules containing provisions for the *automatic adjustment of charges for public utility service in direct relation to changes in . . . direct costs for natural gas delivered.*

Minn. Stat. § 216B.16, subd. 7 (2006) ("Purchased Gas Adjustment ('PGA') Statute") (emphasis added).

The PGA Statute allows a natural gas utility such as CenterPoint Energy dollar-for-dollar recovery of its costs of obtaining adequate supplies of natural gas for its

[1] These general operating costs and profits are examined in utilities' general rate cases.

customers. The PGA Statute does not impose any time limitation on how quickly a utility must seek recovery of its actual natural gas costs.

To implement the PGA Statute, the Commission adopted the PGA Rules. Minn. R. 7825.2400-7825.2920 (2005). In accordance with the PGA Rules, utilities such as CenterPoint Energy make their annual automatic adjustment ("AAA") or "true-up" filings each year, detailing their gas costs and gas revenues. Minn. R. 7825.2910, subp. 4 (2005). The PGA Rules describe the true-up adjustment for natural gas utilities as:

> The difference between the commodity and demand gas revenues by class collected by the utility and the actual commodity-delivered gas cost and demand-delivered gas cost by class incurred by the utility during the year.

Minn. R. 7825.2700, subp. 7 (2005) ("True-Up Rule").

The plain language of the True-Up Rule makes clear that a utility is entitled to recover (or is required to refund) in its true-up adjustment the difference between the cost of gas incurred and the gas revenues collected—no more and no less. *Id.* That is, if the utility's annual filing shows that it has received less gas revenues than the cost of gas incurred in the prior year, it collects that unrecovered amount from customers going forward. Conversely, if the utility has received greater gas revenues than the cost of gas in the prior year, it refunds those excess revenues to its customers. In this way, the True-Up Rule effectuates the legislative intent that Minnesota utilities receive precise dollar-for-dollar recovery of the cost of obtaining adequate natural gas supplies, so long as the costs are prudently incurred. As Commission Chair Koppendrayer stated: "gas cost is separate . . . and you don't make anything on this gas cost and [if you are denied

recovery] you're writing off something you never had an opportunity to make any money on anyway." Respondent's Appendix ("RA") 5.

When enacting the PGA Statute and promulgating the PGA Rules, the legislature and Commission recognized that utilities must have confidence in the recoverability of their natural gas supply costs. These costs represent by far the single largest cost component included in the bills of Minnesota natural gas customers. Over 80% of every dollar paid to CenterPoint Energy by its customers simply reimburses the company for its direct cost of natural gas. Administrative Record Document ("R") 76, p. 8. In fact, during the time period at issue in this proceeding, CenterPoint Energy spent approximately $4.2 billion to obtain natural gas supplies for its Minnesota customers. *Id.* Allowing separate recovery of these substantial costs not only addresses the utilities' concerns regarding recoverability, but avoids the necessity for expensive and time consuming general rate cases every time there is a change in the cost of gas.

To further ensure that customers pay no more and no less than the actual cost of gas incurred to provide them with service, the PGA Rules also explicitly recognize that variances from the PGA Rules will sometimes be required. The PGA Rules specifically require that a utility's annual filing include a listing of "*purchased gas adjustment rule variances in effect* or requested during the 12-month reporting period and reasons why those variances were necessary." Minn. R. 7825.2810, subp. 2A (emphasis added).

Such variances are decided under the Commission's "Variance Rule." The Variance Rule provides that the Commission "*shall* grant a variance" when it determines that: (1) enforcement of the rule would impose an excessive burden upon the applicant or

others affected by the rule; (2) granting the variance would not adversely affect the public interest; and (3) granting the variance would not conflict with standards imposed by law. Minn. R. 7829.3200, subp. 1 (2005) (emphasis added).

As noted above, the True-Up Rule looks at costs and revenues from the prior 12-month period to determine the appropriate amount for recovery or refund. However, there have been two prior occasions in the Commission's history when utilities have requested variances to the True-Up Rule due to inadvertently leaving gas costs unrecovered from prior years. *In the Matter of the Review of the 1994 Annual Automatic Adjustment of Charges for All Gas and Elec. Utils.*, MPUC Docket No. E,G-999/AA-94-762, *Order Accepting Annual Automatic Adjustment Reports*, July 13, 1995 *("NSP")*, Appellant's Addendum ("Add.") 47-63; *In the Matter of the Review of the 1997 Annual Automatic Adjustment of Charges for All Gas and Elec. Utils.*, MPUC Docket No. G,E-999/AA-97-1212, *Order Reviewing 1997 Annual Automatic Adjustment Reports and True-Up Filings,* May 28, 1998 *("Interstate")*, Add.64-74. In both cases, the Commission granted a variance in order to ensure dollar-for-dollar recovery of the utilities' past incurred natural gas costs "as contemplated under the PGA rules." Add.54.

B. CenterPoint Energy's Gas Cost Recovery Filings And The Administrative Record.

The current case began on September 1, 2005, when CenterPoint Energy submitted its annual PGA filing to the Commission. R.2. Prior to any Commission action on that filing, CenterPoint Energy advised the Commission that the company had discovered that it had overstated its system sales volumes in its annual filings going back

to calendar year 2000, requiring correction. R.42. The company requested that the Commission hold open CenterPoint Energy's current filing until CenterPoint Energy and its internal auditors completed a review of this matter. *Id.*

In subsequent filings with the Commission, R.51, 85 (together, "Gas Cost Recovery Filings"), CenterPoint Energy provided detailed presentation and analysis of these prior overstatements of sales volumes. The Gas Cost Recovery Filings explained that throughout the time period at issue CenterPoint Energy had accurately stated its natural gas supply costs. Appellant's Appendix ("APP") 65. However, during this same time period, CenterPoint Energy overstated its sales volumes, and therefore overstated the revenues to be credited against those costs. *Id.* This accurate accounting of costs, together with the overstatement of revenues received, created a shortfall in the amounts billed to customers under the PGA Rules and, ultimately, in unrecovered gas costs. *Id.*

The Gas Cost Recovery Filings also discussed the fact that, in approximately November 2000, these overstatements began due to one time system changes that unknowingly triggered systematic errors being made in the monthly accounting for lost and unaccounted for gas and in the monthly accounting of unbilled revenues (sales made in the time period at issue but not yet billed to customers). APP65-66. Once these errors became a part of CenterPoint Energy's monthly accounting process, they necessarily recurred on a monthly basis and, because of the nature of the error, the amounts accumulated each and every month. *Id.* The Gas Cost Recovery Filings further explained that, on either a monthly or annual basis, these errors in sales volumes, in the context of CenterPoint Energy's total system sales, did not stand out and call for further

analysis. *Id.* The overstatement of sales volumes ultimately became apparent when CenterPoint Energy identified that the total volume of unbilled sales not only continued to grow over time but became unreasonably large. *Id.*

CenterPoint Energy's Gas Cost Recovery Filings provided a year-by-year breakdown of the amount of unrecovered costs. As CenterPoint Energy showed, over the total time period of its accounting errors, it failed to recover a net total of over $28.3 million in gas costs prudently incurred to serve its Minnesota customers. R.85, Ex. A. Of that amount, approximately $7.3 million related to the 2005 annual filing year, which could be considered under the Commission's True-Up Rule without a variance. *Id.* However, the remaining $21 million related to the years included in the company's four prior annual filings, with the impact each year as follows:

Year	Under-Recovery	Over-Recovery
2001	$2,975,000	
2002		$847,000
2003	$7,300,000	
2004	$11,500,000	

Id. In order to properly true-up its gas costs with its gas revenues during this time period, CenterPoint Energy petitioned for a variance from the one year look back called for in the True-Up Rule, as the Commission had granted to NSP and Interstate.

CenterPoint Energy also showed that, given the direct pass through nature of these natural gas supply costs, any denial of recovery of prudently incurred costs decreases, on

a dollar-for-dollar basis, the operating income, or profit, of CenterPoint Energy. APP26-32. CenterPoint Energy explained that these gas costs, while a small portion of the total gas costs incurred by the company, had a substantial adverse impact on CenterPoint Energy's annual profit. *Id.* In fact, CenterPoint Energy explained that the denial of recovery would reduce the company's return on equity by 13.8% to 15.31% for the three most recent years.[2] *Id.* The impact of the denial of such huge percentages of CenterPoint Energy's return to its shareholders caused CenterPoint Energy's parent company, CenterPoint Energy Resources Corporation, to issue a Form 8-K to investors to inform them of the Commission's refusal to allow recovery. APP38-40.

In contrast to this severe impact on the company, the Gas Cost Recovery Filings explained that the impact to customers of CenterPoint Energy recovering these costs would be a total of approximately $30 per customer, for gas already provided to customers. R.76, p. 8. To lessen any impact associated with recovery of that amount, CenterPoint Energy proposed spreading recovery over three years, *id.*, p. 9, meaning a monthly bill impact of about 83 cents per customer. The company also proposed to time that recovery to coincide with the implementation of a new gas supply contract the company had negotiated which would bring *savings* to customers far in excess of the bill impacts at issue in this docket. APP28.

At no point in the proceedings before the Commission did any party challenge the appropriateness of the gas costs incurred by CenterPoint Energy on behalf of its

[2] The impact on return on equity was substantially smaller in the two oldest years, given that the errors led to an inadvertent over-recovery of costs in the 2002 filing year.

Minnesota customers. In fact, Commissioner Reha specifically stated that "the company made the purchase of gas in a prudent manner." RA6.

Further, no party disputed CenterPoint Energy's evidence that it inadvertently overstated its sales volumes for the reasons set forth in the Gas Cost Recovery Filings. Indeed, CenterPoint Energy explained that it had every incentive to state these volumes accurately throughout the time period at issue. APP35. Given the dollar-for-dollar ongoing nature of the recovery and the time value of money, CenterPoint Energy's failure to timely recover these dollars had already cost the company over $8 million in unrecovered carrying costs alone by the time the Commission considered CenterPoint Energy's request for a variance. *Id.*

C. Commission And Court Of Appeals Actions On CenterPoint Energy's Petition For A Variance.

The Commission considered CenterPoint Energy's petition for a variance and issued its December 6, 2006 Order Denying Variance And Ordering Independent Audit ("Order"). APP11. In the Order, the Commission required an expert auditor's analysis on a number of items, including: (1) a reexamination of CenterPoint Energy's computations of the PGA factors and true-ups; (2) examination of the original accounting entries, reversing entries, and subsequent entries; and (3) a determination of whether the errors led to CenterPoint Energy's filing of two general rate cases during the time period at issue and whether the company had somehow already recovered any shortfall through those rate cases. APP19. However, rather than awaiting the results of this independent audit and without providing for a contested case hearing, as requested by the company,

the Order decided the merits of CenterPoint Energy's petition for a variance. APP16-17. In contrast to its decisions in *NSP* and *Interstate*—where the Commission granted variances and allowed for recovery of $1 million and $165,000, respectively—the Commission denied CenterPoint Energy a variance, thereby denying the company recovery of any of gas costs prudently incurred to serve its Minnesota customers. *Id.* In denying this recovery, the Commission characterized the losses at issue as "minor," *id.*, even though the losses far exceeded the amounts at stake in *NSP* and *Interstate*, both in nominal terms and in terms of their impact on CenterPoint Energy's earnings.

By deciding the merits of this matter without first holding a contested case hearing or at least waiting for the independent auditor's report that it had ordered, the Commission committed serious errors in its Order. For example, the Order stated: "The Commission also *finds persuasive* the Department's analysis of the Company's pro forma financial statements for the five-year period, which show that the cumulative impact of the Company's errors was *only $2.4 million.*" APP16 (emphasis added). The Commission subsequently acknowledged that this "persuasive" analysis understated CenterPoint Energy's losses by a factor of nearly nine times and that the losses at issue were actually *$21 million* and yet continued to characterize this amount as "minor."[3] APP43 (emphasis added). In addition, with no record support whatsoever, the Order

[3] The Commission corrected its error after CenterPoint Energy petitioned for reconsideration, with Commissioner Reha stating: "I guess I didn't understand the entire amount of the write off that you have in the one year of the 21 million, and I was thinking that the impact was significantly less than that." RA2. While acknowledging the magnitude of its error, the Commission did not change its analysis regarding the impact of this substantially larger loss on CenterPoint Energy. APP43.

speculated that CenterPoint Energy's two general rate cases during the time period at issue may have somehow already compensated the company for the gas costs at issue. APP17. By definition, the Commission implicitly acknowledged the lack of any record support for this conclusion when it simultaneously ordered that an expert independent auditor examine this very issue. APP19. In fact, the independent auditor's report ("Report") has since confirmed the invalidity of the Commission's suggestion that CenterPoint Energy had recovered these gas costs in the intervening rate cases.[4]

Pursuant to Minn. Stat. § 216B.27 (2006) and Minnesota Rules 7829.3000 (2005), CenterPoint Energy requested reconsideration of the Commission's decision. APP25-41. At the Commission meeting to consider this request, two separate motions to reconsider the Order deadlocked on two-to-two votes.

First, as Commissioner Reha stated:

> [T]his issue is one of a procedure, and it's one of trying to be evenhanded in how we deal with procedure here. And I think you have to look at what's required. We have to determine, number one, whether there was an excessive burden, . . . and I think we said in the NSP order that failure to recover one million in gas costs would undoubtedly place a burden upon NSP Gas. Well, *certainly here the numbers are even more significant* and I think it's an excessive burden to the company.

---

[4] Given the Commission's decision to rule on the merits of this matter in advance of the Report, the Report was necessarily not before the Commission at the time of its Order. However, as discussed further below, given the Commission's continued insistence to this Court that the presence of CenterPoint Energy's rate cases is somehow relevant, the Court should be aware that the Commission's independent auditor publicly filed its Report on March 3, 2008, in MPUC Docket No. G-008/AA-05-1423 and the Report disproves the Commission's claims on this issue. The Report finds, in pertinent part, that "the accounting errors did not affect either the Company's 2004 or 2005 rate case," and that "the shortfall caused by the accounting errors has not been collected" as a result of those rate cases.

> . . . [T]he company made the purchase of gas in a prudent manner, there's no indication that they did not, and that that gas cost would have been paid by customers had there not been this mistake, this error. And so to me I don't think the . . . trueup would harm ratepayers since the recovery should have and could have occurred in the prior period.
>
> . . . [P]unishing the company for a clerical error in the tune of $21 million, . . . if we're going to hand out a variance in one case, *we can't be arbitrary* and not hand a variance in another case when the same standards and criteria apply to both companies. And in the NSP case we looked at those standards and said, yes, it had a significant impact, excessive burden, and it would not be against the public interest to allow this and we gave them a variance. Now here *with another company in the same circumstances, and even more seriously so, we're saying we shouldn't give them a variance. . . . [I]t seems awful arbitrary to me to hand it out in one and not in another.*

RA5-6 (emphasis added).

In order to conform the Commission decision in this case with its precedent, Commissioner Reha moved to reconsider the Commission's denial and allow recovery of only the most recent unrecovered gas costs. RA15.

CenterPoint Energy indicated it agreed that Commissioner Reha's motion provided a reasonable resolution to this matter, RA2, and Commission Chair Koppendrayer observed:

> [A]ny time somebody says I made a mistake and I didn't charge you enough for the last five years, but I'd appreciate it if you could find it in your heart to pay me two out of the last five years, and I won't even charge you interest, I'll do business with that company from now until I die. That's the best guy I know on the planet.

RA6. Nonetheless, Commissioner Reha's motion ended in a two-to-two deadlocked vote. RA15-16.

Next, Commissioner Reha moved to "neither grant nor deny CenterPoint's request for a rule variance at this time, and to defer a decision until after the completion of an independent audit," so that the Commission would have the benefit of the auditor's Report before making a final decision. RA16-17. That motion, too, resulted in a two-to-two deadlock. *Id.*

Finally, a motion to deny reconsideration also resulted in a two-to-two vote, thus leaving the Commission's original decision in place. RA19.

These three deadlocked votes left the Commission unable to either modify or affirm its original decision, which by default left the original decision in place. A majority of Commissioners agreed only to correct the original Order to acknowledge that the losses resulting from the Commission action were nearly nine times as great as the Commission initially found, or $21 million, not $2.4 million. APP43. The Commission issued its Order Clarifying Order Denying Variance And Ordering Independent Audit on February 22, 2007, constituting the Commission's final decision. APP42-44.

CenterPoint Energy appealed this matter, and a unanimous Court of Appeals applied well-established case law to hold the Commission's decision arbitrary and capricious and unsupported by substantial evidence. *In re Review of 2005 Annual Automatic Adjustment of Charges for All Elec. And Gas Utilities*, 748 N.W.2d 322 (Minn. Ct. App. 2008). Noting that the Commission stated that it intended to create no new criteria for considering CenterPoint Energy's request, the Court of Appeals held the Commission had failed to follow its precedent and failed to provide relevant distinctions upon which to depart from that precedent. *Id.* Therefore, the Court of Appeals reversed

and remanded the matter to the Commission for further proceedings consistent with the Court of Appeals' opinion. *Id.*

ARGUMENT

I. STANDARD OF REVIEW.

Minnesota's Administrative Procedure Act governs this proceeding and provides that a reviewing court may reverse or modify an administrative agency's decision if it is:

(a) In violation of constitutional provisions; or

(b) In excess of the statutory authority or jurisdiction of the agency; or

(c) Made upon unlawful procedure; or

(d) Affected by other error of law; or

(e) Unsupported by substantial evidence in view of the entire record as submitted; or

(f) Arbitrary and capricious.

Minn. Stat. § 14.69 (2006).

As a general rule, this Court shows deference "to the agencies' expertise and their special knowledge in the field of their technical training, education and experience." *Reserve Mining Co. v. Herbst,* 256 N.W.2d 808, 824 (Minn. 1977). However, the Court "is not bound by an administrative agency's determination on a question of law" and "need not defer to agency expertise" on such matters. *No Power Line, Inc. v. Minn. Envtl. Quality Council*, 262 N.W.2d 312, 320 (Minn. 1977). This lack of deference in such circumstances is consistent with the overarching principle that questions of law receive *de novo* review. *Minnegasco v. Minn. Pub. Utils. Comm'n*, 549 N.W.2d 904, 910 (Minn. 1996).

This Court has further stated that "when a decision turns on the meaning of words in an agency's own regulation, it is a question of law that we review de novo." *In re Cities of Annandale and Maple Lake NPDES/SDS Permit Issuance for the Discharge of Treated Wastewater*, 731 N.W.2d 502, 515 (Minn. 2007). In *Maple Lake*, this Court explained that:

> If a court concludes that the meaning of the words in the regulation is clear and unambiguous, it need not defer to the agency's interpretation and may substitute its own judgment for that of the agency. If a court concludes that the meaning of the words in an agency's regulation is unclear and susceptible to different reasonable interpretations, the court must then determine whether the agency's interpretation is reasonable. When determining whether an agency's interpretation is reasonable courts may consider the agency's expertise and special knowledge, especially when the construction of the regulation's language is *so technical in nature that the agency's field of technical training, education, and experience is necessary* to understand the regulation.

Id. at 516 (emphasis added).

Of course, if agency expertise is either not required, or not applied in a particular matter, then the basis for agency deference vanishes. *See Cities of Carlisle and Neola, Iowa v. Fed. Energy Regulatory Comm'n*, 741 F.2d 429, 433 (U.S. App. D.C. 1984) ("While agency expertise deserves deference, it deserves deference only when it is exercised."); *NLRB v. Nationwide, Inc.*, 923 F.2d 506, 518 n.16 (7th Cir. 1991) ("The deference given to an agency is not granted freely, it is purchased; the agency must exercise its touted expertise and 'explain the rationale and factual basis for its decision'.") (citing *Bowen v. Am. Hosp. Ass'n*, 476 U.S. 610, 627, 106 S. Ct. 2101, 2112 (1986). In the current matter, the Commission decision did not require interpretation of any "technical" statutes or rules, nor did it utilize any particular agency "expertise" which

might warrant significant judicial deference. Rather, the Commission's decision rested on its legal interpretation of straightforward statutes and rules, including its interpretation of whether a $21 million loss would impose an "excessive burden" on CenterPoint Energy.

The Commission nonetheless seeks substantial deference from this Court, suggesting that the Court's holding in *Minnesota Center For Environmental Advocacy v. Minnesota Pollution Control Agency*, 644 N.W.2d 457, 464 (Minn. 2002) *("MCEA")* should apply in this case. (Commission Br. pp. 16-17). However, while *MCEA* correctly stands for the proposition that deference is accorded when a decision "necessarily requires application of the agency's technical knowledge and expertise to the facts presented," 644 N.W.2d at 464, *MCEA* involved a very different type of agency decision that required a detailed technical analysis of the underlying facts, in contrast to the current case in which the relevant facts were straightforward and unrebutted. Indeed, the current case did not require any technical expertise on the part of the agency, particularly given the factors that had been considered relevant in its prior decisions to grant variances to NSP and Interstate.

In *MCEA*, the Minnesota Pollution Control Agency conducted a lengthy environmental assessment, in cooperation with the Minnesota Department of Natural Resources, regarding an increase in timber harvesting in the state. That environmental assessment included use of both an Environmental Assessment Worksheet ("EAW") completed in 1999, and reliance on a comprehensive statewide Generic Environmental Impact Statement for Timber Harvesting and Forest Management ("GEIS") completed

over a five-year period from 1989 to 1994, as well as an analysis of the effect of ongoing mitigation efforts related to timber harvesting impacts governed by Minnesota's Sustainable Forest Resources Act. *Id.* at 460-465. Thus, the Court correctly concluded that the environmental review delved deep into the factual record and required application of the agencies' scientific knowledge and expertise. *Id.* at 464.

In contrast, the current case involved a failure to recover $21 million in gas costs. As Commissioner Reha aptly noted:

> [W]e said in the NSP order that failure to recover one million in gas costs would undoubtedly place a burden upon NSP Gas. Well, *certainly the numbers are even more significant* . . . [P]unishing the company for a clerical error in the tune of $21 million, . . . if we're going to hand out a variance in one case, *we can't be arbitrary and not hand a variance in another case when the same standards and criteria apply to both companies.* . . . Now here with another company in the same circumstances, and *even more seriously so*, we're saying we shouldn't give them a variance.

(Emphasis added.) Determining, as Commissioner Reha did, that the impact of denial on CenterPoint Energy was even more significant than the impact on other utilities previously granted recovery, did not require the application of "technical expertise." Rather, it called for a simple comparison of the numbers, just as the Commission had done when it granted the variances in *NSP* and *Interstate*.

Considering the statutory standards for review and these overarching principles regarding the degree of deference to be accorded agency decisions, this Court reviews an agency decision to determine whether it is "unreasonable, arbitrary or capricious, with review focused on the legal sufficiency of and factual basis for the reasons given." *Iron Rangers For Responsible Ridge Action v. Iron Range Res.*, 531 N.W.2d 874, 880 (Minn.

Ct. App. 1995), *rev. denied* (Minn. July 28, 1995). "An agency's decision is arbitrary and capricious if it represents the agency's will and not its judgment." *Trout Unlimited, Inc. v. Minn. Dep't of Agric.*, 528 N.W.2d 903, 907 (Minn. Ct. App. 1995), *rev. denied* (Minn. Apr. 27, 1995) (internal quotes omitted). Further,

> A decision will be deemed arbitrary and capricious if the agency relied on factors which the legislature had not intended it to consider, if it entirely failed to consider an important aspect of the problem, if it offered an explanation for the decision that runs counter to the evidence, or if the decision is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.

Id. (citing *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 103 S. Ct. 2856, 2867 (1983); *see also Citizens Advocating Responsible Dev. v. Kandiyohi County Bd. of Comm'rs*, 713 N.W.2d 817, 832 (Minn. 2006) (citing *In re Charges of Unprofessional Conduct Contained in Panel File 98-26*, 597 N.W.2d 563, 567 (Minn. 1999)).

This Court will intervene where there is "a combination of danger signals which suggest the agency has not taken a 'hard look' at the salient problems" and has not genuinely engaged in reasoned decision-making. *Cable Commc'ns Bd. v. Nor-West Cable Commc'ns P'ship*, 356 N.W.2d 658, 669 (Minn. 1984) (citing *First Nat'l Bank v. Dep't of Commerce*, 350 N.W.2d 363, 368 (Minn. 1984), *Reserve Mining Co. v. Herbst*, 256 N.W.2d 808, 825 (Minn. 1977)).

An agency decision can also be arbitrary and capricious when it fails to conform with agency precedent. The Court of Appeals correctly noted that Minnesota law on this matter has its roots in federal administrative law and provides that:

> "An administrative agency concerned with furtherance of the public interest is not bound to rigid adherence to precedent." This does not mean, however, that an agency may abandon its own precedent without reason or explanation. "An agency must either conform to its prior norms and decisions or explain the reason for its departure from such precedent."

Peoples Natural Gas Co. v Minn. Pub. Utils. Comm'n, 342 N.W.2d 348, 352-353 (Minn. Ct. App. 1983) (internal citations omitted) (citing *McHenry v. Bond*, 668 F.2d 1185 (11th Cir. 1982); *Hatch v. Fed. Energy Regulatory Comm'n*, 654 F.2d 825 (D.C. Cir. 1981).

In *Hatch*, the Court explained that "an agency must provide a reasoned explanation for any failure to adhere to its own precedents." 654 F.2d at 834. That "reasoned explanation" must be set forth in the agency's orders themselves and cannot come from an agency's appellate pleadings. *NLRB*, 923 F.2d at 518 (stating that the court "may not accept appellate counsel's *post hoc* rationalizations for agency action") (citing *SEC v. Chenery Corp.*, 318 U.S. 80, 87-88, 63 S. Ct. 454, 459 (1943)); *Alltel Corp. v. Fed. Commc'ns Comm'n,* 838 F.2d 551 (D.C. Cir. 1988). The *Hatch* Court also explained that, "[w]ithout any explicit recognition by the Commission that the standard has been changed, or any attempt to forthrightly distinguish or outrightly reject apparently inconsistent precedent, we are left with no guidepost for determining the consistency of administrative action in similar cases, or for accurately predicting future action by the Commission." *Hatch,* 654 F.2d at 834-835 (footnote omitted).

Courts have consistently held that a "fundamental norm of administrative procedure requires an agency *to treat like cases alike.* If the agency makes an exception in one case, then it must either make an exception in a similar case or *point to a relevant distinction between the two cases.*" *Westar Energy, Inc. v. FERC*, 473 F.3d 1239, 1241

(D.C. Cir. 2007) (emphasis added) (citing *Green Country Mobilephone, Inc. v. FCC*, 765 F.2d 235, 237-238 (D.C. Cir. 1985); *NLRB v. Wash. Star Co.*, 732 F.2d 974, 977 (D.C. Cir. 1984)). "An agency must provide an adequate explanation to justify treating similarly situated parties differently. . . . Where an agency applies different standards to similarly situated entities and fails to support this disparate treatment with a reasoned explanation and substantial evidence in the record, its action is arbitrary and capricious and cannot be upheld." *Burlington N. & Santa Fe Ry. Co. v. Surface Transp. Bd.*, 403 F.3d 771, 776 (D.C. Cir. 2005) (citing *Petroleum Commc'ns, Inc. v. FCC*, 22 F.3d 1164, 1172 (D.C. Cir. 1994); *Willis Shaw Frozen Express, Inc. v. ICC,* 587 F.2d 1333, 1336 (D.C. Cir. 1978); *Ace Motor Freight, Inc. v. ICC*, 557 F.2d 859, 862 (D.C. Cir. 1977)).

As another court has stated, "the Commission's dissimilar treatment of evidently identical cases . . . seems the quintessence of arbitrariness and caprice." *Colo. Interstate Gas Co. v. FERC*, 850 F.2d 769, 774 (D.C. Cir. 1988). When an agency claims that two cases are different or distinguishable, the agency must "provide a *meaningful distinction* between the two situations." *Westar Energy*, 473 F.3d at 1243 (emphasis added).

Moreover, an agency's "brief, generalized statement fails to provide an 'adequate explanation' to allow the [agency] to ignore factors and reasoning it has previously—and consistently—found controlling." *N.Y. Cross Harbor R.R. v. Surface Transp. Bd.,* 374 F.3d 1177, 1183 (D.C. Cir. 2004). Similarly, "[a]n agency's failure to come to grips with conflicting precedent constitutes 'an inexcusable departure from the essential requirement of reasoned decision making'." *Ramaprakash v. FAA,* 346 F.3d 1121, 1125 (D.C. Cir.

2003) (Roberts, J.) (quoting *Columbia Broad. Sys. v. FCC*, 454 F.2d 1018, 1027 (D.C. Cir. 1971)).

The Court also reviews the administrative record to determine whether there is substantial evidence supporting the agency finding. *Cable Commc'ns Bd. v. Nor-West Cable Commcn's P'Ship*, 356 N.W.2d 658, 668-669 (Minn. 1984). This Court has defined substantial evidence as: "(1) such evidence as a reasonable mind might accept as adequate to support a conclusion; (2) more than a scintilla of evidence; (3) more than some evidence; (4) more than any evidence; and (5) evidence considered in its entirety. *Id.* (citations omitted). Similar to the arbitrary and capricious standard, the Court will intervene when "there is a 'combination of danger signals which suggest the agency has not taken a hard look at the salient problems' and the decision lacks 'articulated standards and reflective findings'." *Id.* (citations omitted).

In the current case, a unanimous Court of Appeals correctly held that the Commission's decision could not withstand review. Specifically, the Court of Appeals held that the Commission failed to follow the criteria established by its own rules and precedent, failed to articulate a reasoned basis for ignoring that precedent and acknowledged that it did not intend to create any new criteria for reviewing CenterPoint Energy's request. Therefore, the Court of Appeals justifiably held the Commission's denial of the recovery of $21 million in prudently incurred gas costs to be arbitrary and capricious, requiring reversal.

II. THE COMMISSION ACTED ARBITRARILY AND CAPRICIOUSLY IN DENYING CENTERPOINT ENERGY RECOVERY OF ITS PRUDENTLY INCURRED GAS COSTS.

A. Prior To The Current Proceeding, The Commission Uniformly Followed The Legislative Policy Of Providing Dollar-For-Dollar Recovery Of Past Incurred Gas Costs.

The fundamental construct of public utility regulation is that the utility is provided the right to recover its costs, in exchange for accepting the obligation to provide adequate, reliable service to its customers. *See Transmission Access Policy Study Group v. Fed. Energy Regulatory Comm'n,* 225 F.3d 667, 700 (D.C. Cir. 2000) (stating that "utilities invest[] money, buil[d] facilities, and enter into long-term fuel or power contracts, relying on the 'regulatory compact' under which utility shareholders accepted lower rates of return on their investment in exchange for *the certainty of regulated rates and ability to recover prudently incurred costs.*") (emphasis added).

The legislature has structured public utility regulation in Minnesota in accordance with this fundamental construct, declaring in its "Legislative Findings," setting forth the purpose of state regulation of utility companies:

> It is hereby declared to be in the public interest that public utilities be regulated as hereinafter provided in order to provide the retail consumers of natural gas and electric service in this state with adequate and reliable services at reasonable rates, *consistent with the financial and economic requirements of public utilities and their need to construct facilities to provide such services or to otherwise obtain energy supplies.*

Minn. Stat. § 216B.01 (2006) (emphasis added).

Notably, these Legislative Findings call out the financial and economic requirements of Minnesota's utilities in obtaining energy supplies as a critical issue to be

addressed by state regulation. Further recognizing the importance of energy supply costs, the legislature also adopted the PGA Statute, allowing for precise dollar-for-dollar recovery of a utility's prudently incurred natural gas supply costs, by allowing for automatic adjustments "in direct relation to changes in . . . direct costs for natural gas delivered." Minn. Stat. § 216B.16, subd. 7 (2006). Of course, this legislative policy also means that gas cost recovery is a two-way street: over-charged costs must be refunded to customers, just as under-charged costs should be recoverable by utilities.

Following passage of the PGA Statute, the Commission adopted the PGA Rules which, in accordance with the overarching legislative policy, provide for dollar-for-dollar recovery on gas costs. The PGA Rules accomplish this, in part, through the True-Up Rule, which calls for annual filings to reconcile gas costs incurred with gas revenues received. Minn. R. 7825.2700, subp. 7 (2005). In the event of errors or mistakes in the true-up process, the PGA Rules also specifically acknowledge that variances will sometimes be required to effectuate the purpose and intent of the PGA Statute and PGA Rules and requires a listing of any such variances in effect or requested as part of each year's filing. *See* Minn. R. 7825.2810, subp. 2A (2005). Those variances are granted under the Commission's Variance Rule, which provides:

> The commission *shall grant* a variance to its rules when it determines that the following requirements are met:
>
> A. enforcement of the rule *would impose an excessive burden upon the applicant* or others affected by the rule;
>
> B. granting the variance would not adversely affect the public interest; and

C. granting the variance would not conflict with standards imposed by law.

Minn. R. 7829.3200, subp. 1 (2005) (emphasis added).

Prior to the current proceeding, there were only two occasions where utilities requested variances to the True-Up Rule to allow recovery of prior incurred gas costs. The Commission granted the variances in both cases.

In *NSP,* the Commission granted a variance to allow recovery of approximately $1 million, left unrecovered from a prior year due to "an internal reporting change" instituted by NSP. Add.51. To determine whether enforcement of the True-Up Rule would impose an excessive burden, the Commission noted that this was an "accounting error" and looked to: (1) the dollar amount at issue and (2) the impact on profitability of the company if recovery was denied. Add.53. The Commission stated: "Failure to recover over $1 million in gas costs would *undoubtedly* place a burden on NSP Gas. As the Company pointed out, the loss would represent *almost 10% of the return on equity* allowed in the Company's most recent rate case." *Id.* (emphasis added).

For its public interest determination in *NSP*, the Commission looked to the fact that, "when the entire period covered in this matter is considered, no harm has befallen ratepayers . . . this amount could have and should have been collected as a normal cost" during the prior period. Add.53-54. The Commission also noted that the recovery would take place with a ratepayer list that differs from the list of ratepayers when the under-recovery occurred. However, the Commission found that "this circumstance does not

outweigh the *benefit of allowing the company full gas cost recovery as contemplated under the PGA rules*." Add.54 (emphasis added).

In *Interstate*, the Commission considered the fact that Interstate "inadvertently omitted" approximately $165,000 in gas costs from its *two* prior annual filings. Add.67. No year-by-year breakdown of those costs was provided, nor was any percentage impact on Interstate's earnings in the event of denial discussed. Rather, in analyzing whether strict enforcement of the True-Up Rule would pose an "excessive burden" on Interstate, the Commission looked solely at the potential loss of $165,000 to Interstate. *Id.* The Commission agreed that such a loss would mean "an unequal sharing of gas cost for a service which customers have used" and that "the [$165,000] is *significant and could adversely affect the Company* if it is not allowed to recover the expense." *Id.* (emphasis added).

For its public interest analysis in *Interstate*, the Commission simply agreed that "the variance would not conflict with the public interest if the variance is considered in the context of a three year period . . . because there would be no net impact on ratepayers." Add.67.

In both *NSP* and *Interstate*, the Commission concluded, without discussion, that "granting the variance would not conflict with standards imposed by law." Add.54, 68.

By granting a variance in both *NSP* and *Interstate*, the Commission correctly adhered to the legislative policy of allowing Minnesota utilities full recovery of the cost of obtaining adequate energy supplies, by holding true to the purpose and intent of the PGA Statute and PGA Rules. Indeed, in *NSP*, the Commission specifically recognized

"the benefit of allowing the Company full gas cost recovery as contemplated under the PGA rules" as a basis for its decision. Add.54. Similarly, in *Interstate*, the Commission recognized that denying recovery would lead to "an unequal sharing of gas cost for a service which customers have used." Add.67.

B. The Commission's Decision To Deny CenterPoint Energy Recovery Of Its Prudently Incurred Gas Costs Failed To Adhere To The Criteria Established By Commission Precedent.

The current case presented the Commission with the same legal issue faced in *NSP* and *Interstate*—whether to grant a variance to the True-Up Rule—with similarly situated parties and substantially similar material facts. However, the Commission reached an opposite result. Moreover, as discussed below, the Commission construed the law differently in the current case, while simultaneously maintaining that it intended to create no new standard.[5] These actions clearly indicate an agency acting arbitrarily and capriciously. *See* Ron Beal, *Administrative Law 2004 Update and Analysis*, 57 Baylor L. Rev. 359, 367-371 (2004). The Commission's radical departure from its precedent, from the overarching legislative policy of recovery of gas supply costs, and from the purpose and intent of the PGA Statute and PGA Rules, denied CenterPoint Energy recovery of any of the $21 million in previously unrecovered gas costs. This denial

[5] The Court of Appeals specifically noted: "Counsel for the commission acknowledged at oral argument that when it considered CenterPoint's request, the commission did not intend to depart from its previous interpretations of the variance rule or from the principles articulated in NSP and Interstate." 748 N.W.2d at 330. The Commission continues to argue in its brief to this Court that it has not departed from its previous decisions. (Commission Br. at 32).

imposed a significant financial hardship on the company, and the Court of Appeals correctly reversed this result.

1. The Commission's Decision That A $21 Million Loss Does Not Impose An Excessive Burden On CenterPoint Energy Cannot Be Reconciled With Commission Precedent Or With The Record Of This Proceeding.

The first prong of the Variance Rule requires a petitioner to demonstrate that a strict application of the True-Up Rule would impose an "excessive burden" on the petitioner. Minn. R. 7829.3200, subp. 1A (2005). The Commission's decision on this matter did not require interpretation of any "technical" statutes or rules, nor did it utilize any particular agency "expertise," which might warrant significant judicial deference. *See Maple Lake,* 731 N.W.2d. at 515. Rather, the Commission's decision required only a straightforward view of the impact of a $21 million loss on CenterPoint Energy, guided by Minnesota law, including the legislative policy of full gas cost recovery and the criteria set forth in the Commission's PGA Rules and precedent. Review of the Commission's decision demonstrates that its finding that a $21 million loss would not impose an excessive burden on CenterPoint Energy cannot be reconciled with this existing law or with the unrebutted evidence in the record.

a. Inadvertence.

In determining whether failure to fully recover past gas costs would impose an excessive burden on an applicant, Commission precedent has commented on the fact that the errors that led to the failure to fully recover past costs were "inadvertent." In *NSP*, the Commission stated that NSP "discovered that, *due to an internal accounting change,*

certain commodity gas costs were inadvertently deducted twice in its true-up report" submitted in the prior period. Add.51. Similarly, in *Interstate*, the Commission noted that Interstate "inadvertently omitted" certain charges from its costs for the two prior filing periods. Add.67.

In the current case, no party disputed that CenterPoint Energy's errors were also inadvertent. That is not surprising, since no company would purposefully fail to recover over $21 million in gas costs. There is no incentive to do so, and every incentive to avoid any errors that might delay the recovery of such costs.

In denying CenterPoint Energy a variance, the Commission attempted to place significance on the fact that CenterPoint Energy's errors "were repeated every month for a five-year period" without being noticed by the company. APP44. However, CenterPoint Energy explained that the errors were introduced as a result of changes made to its monthly accounting process for estimating unbilled sales. APP66. Necessarily, once these errors became part of its monthly process, the errors recurred until they were discovered. *Id.* The company discovered the errors when the total unbilled sales volumes not only continued to grow, but became unreasonably large. *Id.* Upon discovery, CenterPoint Energy promptly brought the matter to the Commission's attention. Thus, CenterPoint Energy's request for a variance cannot be meaningfully distinguished from the *NSP* and *Interstate* precedent on the basis of "inadvertence" of the underlying error.

b. The magnitude of the dollars at issue.

Second, in determining "excessive burden," the Commission precedent has looked to the dollar amount at issue. In fact, in *Interstate*, the Commission began and ended its inquiry on "excessive burden" by noting that an amount of slightly less than $165,000 over two years "is significant and could adversely affect the Company if it is not allowed to recover the expense," making the potential loss an excessive burden. Add.67. Given its decision in *Interstate*, the Commission cannot legitimately attack the Court of Appeals' decision by claiming that: "Addressing only the nominal dollar amount fails to address whether an amount imposes an excessive burden . . . [thus] the court's primary analysis is flawed."[6] Commission Br. at 27. "Addressing the nominal dollar amount" was, in fact, the entirety of the Commission's "excessive burden" analysis in *Interstate*.

The total dollars at issue played a similarly prominent role in the Commission's analysis in *NSP*. There, the Commission stated that "[f]ailure to recover over $1 million in gas costs would *undoubtedly* place a burden on NSP Gas." Add.53 (emphasis added). Findings that dollar amounts of $165,000 and $1 million in unrecovered losses, in and of themselves, place an excessive burden on a utility cannot be reconciled with the Commission's bald conclusion here that a $21 million loss is "minor" and would not impose an excessive burden on CenterPoint Energy.

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[6] In fact, contrary to the Commission's claim in its brief, the Court of Appeals did *not* address "only the nominal dollar amount." The Court also looked to the substantial impact these losses would have on CenterPoint Energy's earnings as the Commission did in *NSP*.

c. Impact on profitability.

In *NSP*, the Commission also considered that "the loss would represent almost 10% of the return on equity allowed in the Company's most recent rate case," supporting its finding that failure to recover $1 million would "undoubtedly place a burden on NSP gas." Add.53. In this proceeding, CenterPoint Energy demonstrated that a $21 million loss would equate to over 25% of its annual operating income in 2006, or approximately 45% of the allowed return on equity for the company. APP27. If looked at year-by-year, CenterPoint Energy established that the denial of recovery would reduce the company's return on equity by 13.8% to 15.31% for the three most recent years.[7] APP32. Given these substantial negative impacts, CenterPoint Energy's parent company filed a Form 8-K with the Securities and Exchange Commission, informing investors of the Commission's denial. APP31, 38-41.

No party disputed the total dollar amount at issue, or the year-by-year impact of those losses. Thus, the only substantive record evidence in this proceeding showed far *more* significant adverse impacts on CenterPoint Energy than the Commission found to have imposed an excessive burden on *NSP*, as noted by Commissioner Reha. RA6. Again, the Commission's finding in the current case is arbitrary and capricious and simply cannot be reconciled with its precedent.

[7] The impact on return on equity was substantially smaller in the two oldest years, given that the accounting errors here led to an inadvertent *over*-recovery of costs in the 2002 filing year.

d. The Commission's initial order grossly understated CenterPoint Energy's losses.

In the face of uncontradicted evidence of the magnitude of CenterPoint Energy's losses, the Commission nonetheless characterized these losses as "minor." In so doing, the Commission first misstated the losses, saying they were only $2.4 million. APP16. After CenterPoint Energy identified this error, the Commission corrected its finding, accurately increasing the losses incurred due to the Commission's denial by nearly nine times, to $21 million. APP43. Nonetheless, because of a two-to-two deadlock vote of the Commissioners on CenterPoint Energy's request for reconsideration, the Commission continued to insist that these losses were insignificant. *Id.* The Commission's unwillingness to reconsider the impact of losses nine times greater than originally found demonstrates an agency exercising its will and not its judgment.

e. The Commission used a new and irrelevant yardstick for measuring the impact of a utility's loss.

Given the Commission's deadlocked vote, and its inability to reconsider the true impact of a $21 million loss on CenterPoint Energy, the Commission continued to seek to minimize this enormous loss through an invalid comparison, never considered in its earlier cases. For CenterPoint Energy, the Commission compared the $21 million in losses to the total gas costs incurred by the company over the time period at issue. APP43. This new and entirely irrelevant yardstick cannot withstand analysis.

As discussed above, and as correctly noted by the Court of Appeals, a comparison of losses to total gas costs ignores the fact that CenterPoint Energy earns no profit on the actual cost of gas. *See* 748 N.W.2d at 329-330. Indeed, as Commission Chair

Koppendrayer acknowledged, there is no opportunity to make any money on these gas costs. Yet, gas costs constitute an overwhelming percentage of a natural gas utility's total costs and these gas costs dwarf a utility's profits. R.76. Because of that, a denial of even a relatively small percentage of gas costs can obliterate a utility's earnings. Indeed, as CenterPoint Energy incurs approximately $1 billion in gas costs each year, while earning only approximately $65 million in net operating income, denial of recovery of even a small fraction of the company's gas costs could completely eliminate CenterPoint Energy's profits. Nonetheless, using a total gas cost comparison approach, even that scenario would not constitute an excessive burden on the utility.

Additionally, since the true-up process works both ways, the Commission's new comparison could allow a utility to *retain* substantial over-recoveries from prior periods as well, since those amounts too would look small when compared to total gas costs. If $21 million in *under*-recovery is not an excessive burden on a utility because it represents a small portion of a utility's total gas costs, then, correspondingly, a $21 million *over*-recovery must also not be an excessive burden to customers since it would be only a small portion of what they have already paid. However, it is hard to imagine that the Commission would not grant a variance, and order refunds, in this latter situation.

Comparing losses (or over-recoveries) with total gas costs is inherently meaningless as it would allow virtually *any* loss (or gain) to be characterized as insignificant. Such a comparison could lead to decisions completely eviscerating a utility's earnings or, conversely, to decisions allowing the utility to retain substantial over-recoveries. Neither of these absurd results would conform to the legislative policy

of full gas cost recovery, no more and no less; nor would these results conform to the purpose and intent of the PGA Statute and PGA Rules, or to Commission precedent.

The Commission's reliance on this new comparison of the dollars at issue to total gas costs for CenterPoint Energy also cannot be reconciled with its insistence that it has simply applied its precedent here and has not attempted to create and adopt any new standard. Commission Br. at 39. The Commission's confusing and contradictory statements on this matter embody the concerns expressed by the District of Columbia Circuit Court in *Hatch v. Fed. Energy Regulatory Comm'n*, 654 F.2d 825 (D.C. Cir. 1981). There, the Court explained that "an agency must provide a reasoned explanation for any failure to adhere to its own precedents." 654 F.2d at 834. The Court also explained that, "without any explicit recognition by the [agency] that the standard has been changed, or any attempt to forthrightly distinguish or outrightly reject apparently inconsistent precedent, *we are left with no guidepost for determining the consistency of administrative action in similar cases, or for accurately predicting future action by the [agency]*." *Id.* at 834-835 (emphasis added).

Comparison of losses to gas costs is, in fact, a radical departure from Commission precedent and one that can lead to the absurd results discussed above. In the current proceeding, this new comparison allowed the Commission to claim that $21 million is a "minor" amount and that losing 13.8% to 15.3% of a company's return on equity each of the past three years is "insignificant," despite previously finding far smaller losses (both in terms of gross dollars and in terms of impact on return on equity) *were* significant and *did* impose an excessive burden.

While administrative agencies "are not bound by rigid adherence to precedent," *Peoples Natural Gas Co. v Minnesota Public Utilities Commission*, 342 N.W.2d 348, 352-353 (Minn. Ct. App. 1983) (internal citations omitted) (citing *McHenry v. Bond*, 668 F.2d 1185 (11th Cir. 1982); *Hatch v. Federal Energy Regulatory Commission*, 654 F.2d 825 (D.C. Cir. 1981)), courts have always recognized that "administrative procedure requires an agency *to treat like cases alike.* If the agency makes an exception in one case, then it must either make an exception in a similar case or *point to a relevant distinction between the two cases.*" *Westar Energy, Inc. v. FERC*, 473 F.3d 1239, 1241 (D.C. Cir. 2007) (emphasis added) (citing *Green Country Mobilephone, Inc. v. FCC*, 765 F.2d 235, 237-238 (D.C. Cir. 1985); *NLRB v. Wash. Star Co.*, 732 F.2d 974, 977 (D.C. Cir. 1984)). An agency's "dissimilar treatment of evidently identical cases . . . seems the quintessence of arbitrariness and caprice." *Colo. Interstate Gas Co. v. FERC*, 850 F.2d 769, 774 (D.C. Cir. 1988). When an agency claims that two cases are different or distinguishable, the agency must "provide a *meaningful distinction* between the two situations." *Westar Energy*, 473 F.3d at 1243 (emphasis added).

Moreover,

> A[n agency] decision will be deemed arbitrary and capricious if the agency relied on factors which the legislature had not intended it to consider, if it entirely failed to consider an important aspect of the problem, if it offered an explanation for the decision that runs counter to the evidence, or if the decision is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.

Trout Unlimited, Inc. v. Minn. Dep't of Agric., 528 N.W.2d 903, 907 (Minn. Ct. App. 1995), *rev. denied* (Minn. Apr. 27, 1995).

In the current matter, in deciding whether a $21 million loss would impose an "excessive burden" on CenterPoint Energy, the Commission: (1) failed to follow its precedent, (2) claimed to have established no new standard while simultaneously relying on a new and irrelevant yardstick, (3) committed a serious error of fact yet failed to recognize that error with any new analysis, (4) relied on unfounded speculation regarding the potential that CenterPoint Energy had already been compensated for the gas costs at issue, and (5) failed to provide meaningful distinctions that could justify finding that a $21 million loss did not impose an excessive burden on CenterPoint Energy when a $165,000 loss and a $1 million loss did impose excessive burdens in *Interstate* and *NSP* respectively.

Applying the long-standing case law embodied in *Peoples Natural Gas* and *Trout Unlimited*, the Court of Appeals correctly held the Commission's findings to be arbitrary and capricious.

2. The Commission's Decision That Allowing Recovery Of $21 Million In Prudently Incurred Gas Costs Would Adversely Affect The Public Interest Cannot Be Reconciled With Commission Precedent Or With The Record Of This Proceeding.

The Variance Rule also requires a petitioner to show that granting a variance "would not adversely affect the public interest." Minn. R. 7829.3200, subp. 1B (2005). As with the "excessive burden" provision, the "public interest" provision of the Variance Rule does not require interpretation of any "technical" statutes or rules, nor does it require any particular agency "expertise," which might warrant significant judicial deference. *See Maple Lake,* 731 N.W.2d at 515. Indeed, the Commission's public

interest analysis in both *NSP* and *Interstate* was straightforward and applies with equal force to CenterPoint Energy. Thus, "the Commission's dissimilar treatment of evidently identical cases . . . seems the quintessence of arbitrariness and caprice." *Colo. Interstate Gas Co. v. FERC*, 850 F.2d 769, 774 (D.C. Cir. 1988).

a. Net impact on customers.

In *NSP*, the Commission looked to the fact that, "when the entire period covered in this matter is considered, no harm has befallen ratepayers . . . this amount could have and should have been collected as a normal cost" during the prior period. Add.53-54. The Commission also noted that the recovery would take place with a ratepayer list that differs from the list of ratepayers when the under-recovery occurred. Add.54. However, the Commission nonetheless found that "this circumstance does not outweigh the *benefit of allowing the company full gas cost recovery as contemplated under the PGA rules*." *Id.* (emphasis added).

In *Interstate*, the Commission looked exclusively at the fact that "the variance would not conflict with the public interest if the variance is considered in the context of a three year period . . . because there would be no net impact on ratepayers." Add.67. Despite the fact that multiple years were involved in *Interstate*, the Commission found simply that "the net impact upon ratepayers was zero." Add.68. Therefore, the Commission held that "allowing recovery would not violate the public interest." *Id.*

In the current case, the same facts hold true. As Commissioner Reha stated:

> [T]he company made the purchase of gas in a prudent manner, there's no indication that they did not, and that *that gas cost would have been paid by customers had there not been this mistake, this error.* And so to me I don't

> think the . . . trueup would harm ratepayers since *the recovery should have and could have occurred in the prior period.*

RA6 (emphasis added).

Indeed, the Commission's orders in the current proceeding do not dispute the undeniable fact that customers would have already paid these costs but for CenterPoint Energy's accounting errors. The current case is indistinguishable from *NSP* and *Interstate* on this matter.

b. The passage of time.

The Commission's final order, following the hearing on reconsideration that ended in the series of deadlocked votes, did not address either the "no net impact" issue or the issue of potentially differing lists of customers due to the passage of time. *See* APP42-44. However, in its initial order, the Commission stated that: "The losses at issue are minor; they do not pose the kind of severe financial threat that might trump general regulatory principles of inter-generational equity and the resulting practice of matching, as closely as possible, the set of ratepayers for whose benefit the costs were incurred." APP17. Of course, the Commission made this finding at a time when it incorrectly found the losses were $2.4 million, not $21 million. Thus, the Commission's initial order language on this point is obsolete. As discussed above, the record simply cannot support a finding that a $21 million loss—an amount nearly nine times larger than the loss stated in the Commission's initial order—is "minor." Moreover, if "the benefit of allowing the company full gas cost recovery as contemplated under the PGA rules"

outweighed any concern over differing ratepayer lists where $1 million was at stake in *NSP*, Add.54, it surely outweighs those concerns when $21 million is involved.

The current matter involves more years than either *NSP* or *Interstate*. However, this is not a material distinction, as demonstrated by the fact that the Commission has approved refunding to a customer list some *eighteen (18) years* different than the list of customers originally charged when a variance to the PGA Rules was required to *refund* money to customers. *In the Matter of the Request to Vary Supplier Refund Rules Regarding A Kansas Ad Valorem Production Tax Refund Made By Mobil Oil Corp.*, MPUC Docket No. G-999/AA-98-332, *Order Directing Refund,* Aug. 8, 2001 ("*Kansas Ad Valorem*"). Add.75-85. In *Kansas Ad Valorem*, this 2001 order of the Commission granted three separate variances to the PGA Rules so that over $21 million in principle and interest that had been improperly charged to customers between 1983 and 1988 could be refunded to customers, with a portion of the funds used for low-income energy assistance. *Id.* Moreover, the Commission's 2001 order came following a 1998 order in that same docket, granting still another variance to the PGA Rules. *See* RA20-26. In its 1998 order, the Commission approved a variance to the PGA Rules' requirement for refunds within 90 days—a variance that would ultimately delay the refund by an additional three years. The Commission stated:

> *a match between the customers who were overcharged between 1983 and 1988 and the customers currently on each [utility's] system is already impossible* because of the changes that have occurred in the customer composition.

RA23 (emphasis added).

When $1 million in unrecovered costs were at issue, stretching back one year beyond the True-Up Rule time frame, the Commission granted a variance to allow recovery of that one year of costs. When $165,000 in unrecovered costs were at issue, stretching back two years beyond the True-Up Rule time frame, the Commission granted a variance to allow recovery of those two years of costs. When approximately $21 million in refunds were at issue, with the corresponding over-collections having occurred as much as 18 years prior, the Commission granted a variance to enable the refund of those prior over-collections. As the Court of Appeals held, the decision here—to disallow *any* recovery of costs related to the prior four years—cannot be reconciled with this precedent and is arbitrary and capricious.

c. The only evidence in the record contradicts the Commission's finding that granting a variance would provide no incentive for accurate filings.

The Commission attempted to buttress its "public interest finding" in this matter with arguments not discussed in either *NSP* or *Interstate*. However, these alleged "distinctions" cannot survive analysis. For example, the Commission's claim that granting a variance would provide "literally no incentive" for a company to avoid such errors in the future, APP16, is directly contradicted by the only record evidence on this point. CenterPoint Energy explained that, as of December 2006, the company's failure to gain timely recovery of these gas costs had already imposed over $8 million of impact on the company due to the time value of money.[8] APP26, 35. That, together with Securities

[8] The Commission attempts to dismiss the significance of this cost by stating that Minn. Stat. § 216B.098, subd. 4 (2006) precludes recovery of carrying charges. The

and Exchange Commission and other reporting requirements provide strong incentives for accurate true-up filings, whether or not a variance is granted here. *Id.* No party provided any evidence to the contrary.

d. The Commission's speculation regarding the impact of CenterPoint Energy's rate cases has no support in the record.

The Commission also continues to suggest that it appropriately considered CenterPoint Energy's 2004 and 2005 rate cases in the course of its public interest analysis, calling this a "significant" issue that distinguishes this case from *NSP* and *Interstate* and devoting an entire section of its brief to this argument. (Commission Br., pp. 13, 26, 28 n.15, 37-38). However, under the PGA Statute and PGA Rules, gas costs receive separate treatment from a utility's other costs and revenues, which are examined in those general rate cases, a point recognized by Chair Koppendrayer. RA5. Thus, as CenterPoint Energy explained, as a matter of fact and as a matter of law, these rate cases could not have compensated and did not already compensate the company for the $21 million at issue. APP33; RA14. Again, no party provided any evidence to the contrary, and the Commission merely speculated that the rate cases could somehow have an impact. In fact, as the Court of Appeals noted, the Commission's own staff briefing papers acknowledged that the ratemaking and gas cost True-Up processes are separate

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Commission's argument misses the point. The fact that CenterPoint Energy cannot recover the $8 million in interest or carrying costs affirmatively demonstrates the strong incentive for CenterPoint Energy to *avoid* accounting errors in the first place. Given the inability to recover these interest or carrying costs, the only reason the company would not have sought immediate recovery of the gas costs at issue would have to be a genuine, unintentional, inadvertent mistake.

and distinct, such that rate cases do not and cannot provide a vehicle for recovery of previously unrecovered gas costs. 748 N.W.2d at 331; R.86, pp. 12-13.

More importantly, it is telling that the Commission chose to speculate that the rate cases may have already compensated the company, while it simultaneously ordered an independent auditor to look at this exact issue. APP19. The Commission has now received the auditor's Report, which verifies CenterPoint Energy's position. The Report specifically finds, in part, that "the accounting errors did not affect either the Company's 2004 or 2005 rate case," and that "the shortfall caused by the accounting errors has not been collected" as a result of those rate cases.[9] Given this Report, the Commission's insistence that the rate cases had relevance to its decision reflects that the Commission acted arbitrarily and imposed its will and not its judgment.

"A fundamental norm of administrative procedure requires an agency *to treat like cases alike*. If the agency makes an exception in one case, then it must either make an exception in a similar case or *point to a relevant distinction between the two cases*." *Westar Energy, Inc. v. FERC*, 473 F.3d 1239, 1241 (D.C. Cir. 2007) (emphasis added) (citing *Green Country Mobilephone, Inc. v. FCC*, 765 F.2d 235, 237-238 (D.C. Cir. 1985); *NLRB v. Wash. Star Co.*, 732 F.2d 974, 977 (D.C. Cir. 1984)). "An agency must provide an adequate explanation to justify treating similarly situated parties

[9] As noted above, the Report was necessarily not a part of the record when the Commission issued its orders in this matter, since the Commission order jumped to the merits at the same time that it first ordered the Report. CenterPoint Energy moved the Court of Appeals to submit the Report for the record, a motion which was denied by the Court of Appeals due to the scope of its decision on the merits. However, given the Commission's continued claims that the rate cases are a relevant issue here, the Court should be aware that the Commission's own auditor has found to the contrary.

differently . . . . Where an agency applies different standards to similarly situated entities and fails to support this disparate treatment with a reasoned explanation and substantial evidence in the record, its action is arbitrary and capricious and cannot be upheld." *Burlington N. & Santa Fe Ry. Co. v. Surface Transp. Bd.*, 403 F.3d 771, 776 (D.C. Cir. 2005) (citing *Petroleum Commc'ns, Inc. v. FCC*, 22 F.3d 1164, 1172 (D.C. Cir. 1994); *Willis Shaw Frozen Express, Inc. v. ICC*, 587 F.2d 1333, 1336 (D.C. Cir. 1978); *Ace Motor Freight, Inc. v. ICC*, 557 F.2d 859, 862 (D.C. Cir. 1977)).

For all of the reasons discussed above, the Commission's finding that granting CenterPoint Energy a variance would adversely affect the public interest cannot be reconciled with its precedent. Moreover, the Commission's findings regarding the public interest lack any record support, are at times directly contradicted by uncontroverted record evidence, and at other times rely on unfounded speculation. As such, the Court of Appeals correctly held that the Commission's findings on this point are arbitrary and capricious and unsupported by substantial evidence, thus requiring reversal.

3. The Commission Made No Findings Regarding Whether Granting The Variance Would Conflict With Standards Imposed By Law.

Neither the Commission's initial Order nor its order following the deadlocked votes during the hearing on reconsideration expressly addressed the third prong of the Variance Rule—that granting a variance would not conflict with standards imposed by law. Minn. R. 7829.3200, subp. 1C (2005). Because of this failure, the Court of Appeals held that it was unclear whether the Commission analyzed this third prong of the Variance Rule for CenterPoint Energy or not. 748 N.W.2d at 331. In its brief to this

Court, the Commission does not address this issue at all. CenterPoint Energy would note that in both *NSP* and *Interstate*, the Commission summarily concluded that "granting the variance would not conflict with standards imposed by law." Moreover, in *Kansas Ad Valorem*, the Commission found that granting a variance would not conflict with standards imposed by law because no statute would be violated. Add.80-81. According to the Commission, since the variance would be to a standard "created exclusively by Commission rule," the third prong of the Variance Rule was met. *Id.* In the current case, granting a variance would conflict with no statute. Indeed, granting a variance would *support* the legislative policy of full gas cost recovery. Thus, nothing in the record of this proceeding can support a conclusion different than those reached in the Commission's prior precedent.

C. The Commission's Errors Of Fact, Unsupported Assertions And Contradictory Statements Further Demonstrate An Agency Acting Arbitrarily And Capriciously.

In addition to its failure to follow its precedent, the Commission's errors of fact, unsupported assertions and contradictory statements, in and of themselves, demonstrate that it acted arbitrarily and capriciously in this matter. For example, on reconsideration the Commission acknowledged that when it first decided this case (a decision reached prior to holding a contested case hearing or without waiting for its independent expert auditor's Report), it understated the dollar amount of the burden to CenterPoint Energy by a factor of nearly nine times. APP43. Nonetheless, due to a deadlocked vote on reconsideration, the Commission failed to recognize this as a significant error. Instead,

the Commission's original finding that the losses were "minor" remained in place even though the finding on the amount of that loss changed from $2.4 million to $21 million.

The Commission further erred in its initial decision by speculating that CenterPoint Energy's rate cases were somehow relevant to the analysis of whether these unrecovered gas costs placed an excessive burden on CenterPoint Energy, despite the fact that CenterPoint Energy provided the only evidence on this issue which showed no such impact. R.76, pp. 18-20. Had the Commission waited for the results of the expert auditor's Report, it could not have made this error.

Moreover, the Commission contradicts itself in multiple ways. The Commission argues to this Court, as it did to the Court of Appeals, that its decision with respect to CenterPoint Energy simply applied precedent and adopted no new standards. Commission Br. at 43; 748 N.W.2d at 329. However, the Commission Order in this matter applied a new and wholly irrelevant comparison of a utility's losses to its total gas costs, when determining whether the loss would impose an "excessive burden," as discussed above.

Further, in *Interstate*, the Commission determined excessive burden solely by looking at the total dollars involved, declaring that $165,000 is a "significant" amount that "could adversely affect" the company. Add.67. Yet in the current case, the Commission dismissed the significance of a $21 million loss. The Commission now goes so far as to state that looking just at the dollar amount, as it did in *Interstate*, would be a "flawed" analysis and even suggests that whether or not the dollars involved are significant is not relevant to the Commission's decision. Commission Br. at 27, 30.

Finally, in *NSP*, the Commission found that $1 million would "undoubtedly" place a burden on NSP, in part because the loss would represent "almost 10% of the return on equity allowed in the Company' most recent rate case." Add.53. In CenterPoint Energy's case, uncontradicted evidence in the record demonstrates that denial of the variance would impose losses for the past three years ranging from 13.8% to 15.3%. APP32. As Commissioner Reha recognized, these impacts on CenterPoint Energy were "even more significant," affecting CenterPoint Energy "even more seriously" than either Interstate or NSP were affected when the Commission found an "excessive burden" to exist for those companies. RA6. Yet despite Commissioner Reha's acknowledgement of these impacts, the Commission made no findings addressing the impact of CenterPoint Energy's losses on its earnings and now even suggests that an excessive burden analysis need not consider the significance of the impact of losses on profitability. Commission Br. at 28.

The Commission's errors, its unfounded speculation and its contradictory statements constitute a "combination of danger signals that suggest the agency has not taken a 'hard look' at the salient problems" and has not genuinely engaged in reasoned decision-making. *Cable Commc'ns Bd. v. Nor-West Cable Commc'ns P'ship*, 356 N.W.2d 658, 669 (Minn. 1984). In basing its decision on such factors, the Commission has exercised its will and not its judgment. *See Trout Unlimited, Inc. v. Minn. Dep't of Agric.*, 528 N.W.2d 903, 907 (Minn. Ct. App. 1995), *rev. denied* (Minn. Apr. 27, 1995). As such, the Commission decision is arbitrary and capricious, requiring reversal. *Id.*

III. THE COURT OF APPEALS CORRECTLY REVERSED THE COMMISSION'S DECISION IN THIS MATTER.

For the reasons discussed above, the Court of Appeals correctly reversed and remanded this case to the Commission. Indeed, given the uncontradicted evidence in the record demonstrating that CenterPoint Energy met the Commission's criteria for a variance, as established in Commission rules and precedent, the Court of Appeals could have ordered that the variance be granted. *See Interstate Power Co. v. Nobles*, 617 N.W.2d 566, 577, 580 (Minn. 2000) (holding that where the record shows that all of the standards for a conditional use permit have been met and the denial was therefore arbitrary, the Court will remand and order issuance of the permit rather than allowing for further consideration). Instead, the Court of Appeals remanded to the Commission for reconsideration in light of the Court of Appeals' opinion. 748 N.W.2d at 332.

The Commission overstates the Court of Appeals' opinion by arguing that the Court of Appeals has directed the Commission to grant a variance for all four years of gas costs at issue. Commission Br. at 29. To the contrary, the Court of Appeals remanded for reconsideration in light of the Court of Appeal's opinion. Moreover, the Court of Appeals specifically noted that "the commission was not faced with an all-or-none decision." 748 N.W.2d at 330. While the Court of Appeals' stated that the Commission's reconsideration should be guided by "the same principles that were applied to the requests for variances in NSP and Interstate," 748 N.W.2d at 332, the Court of Appeals left to the Commission the determination of what result that requires.

The Commission also claims that the Court of Appeals' decision could lead to "virtually limitless recovery" and suggests that its decision could lead to endless variance requests. Commission Br. at 22. To the contrary, the Court of Appeals' decision merely affirmed current law and creates no such impact. First, CenterPoint Energy's filing simply seeks to recover the actual cost of gas incurred to serve its Minnesota customers as contemplated by the PGA Statute and PGA Rules, no more and no less. Asking customers to pay for gas already provided to them, and on which the company made no profit, hardly represents a request for "limitless recovery." Second, the record shows the strong incentives a company such as CenterPoint Energy has to avoid such under-recoveries occurring in the future. Third, the current case represents only the third time in Commission history that a utility has sought such a variance, with the other two requests having been granted. Obviously, the granting of those prior variances did not "open the floodgates" to more requests, nor will the Court of Appeals' decision.

CONCLUSION

The legislature has declared it is in the public interest that public utilities are regulated "in order to provide the retail consumers of natural gas and electric service in this state with adequate and reliable services at reasonable rates, consistent with the financial and economic requirements of public utilities and their need to . . . obtain energy supplies." This legislative policy direction takes fuller form in the PGA Statute, which allows for natural gas utilities such as CenterPoint Energy to receive full recovery of their prudently incurred costs of natural gas, no more and no less. The Commission's PGA Rules and precedent have uniformly upheld this dollar-for-dollar recovery of prudently incurred gas costs, even in the event that utilities inadvertently failed to recover their full gas costs in prior years—until this case.

In this case, the Minnesota Public Utilities Commission departed from legislative policy, from the purpose and intent of its rules, and from its precedent and denied CenterPoint Energy any ability to recover approximately $21 million in gas costs, prudently incurred to serve Minnesota customers. The Commission did so without holding a contested case hearing and without waiting for the results of an independent audit it ordered, leading to serious mistakes in its orders. Moreover, the Commission applied a new and irrelevant comparison to judge the burden on CenterPoint Energy, while at the same time claiming that it adopted no new standard in considering CenterPoint Energy's request. Finally, the Commission failed to identify meaningful distinctions which could reconcile its result in this case with its precedent. In fact, the

record demonstrates that the Commission's decision here simply cannot be reconciled with its prior decisions on variance requests.

Given the Commission's multiple errors, the Court of Appeals correctly reversed the Commission's decision and remanded this matter for further consideration. The Court of Appeals' decision should be affirmed in all respects.

Dated: September 16, 2008

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CERTIFICATE OF COMPLIANCE

Pursuant to Minnesota Rule of Civil Appellate Procedure 132.01, subd. 3, the undersigned hereby certifies, as counsel for Appellants, that this Brief complies with the type-volume limitation as there are 13,723 words of proportional space type in this Brief. This Brief was prepared using Microsoft Word 2003.

Dated: September 16, 2008

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