

E-002/M-93-162 ORDER REJECTING PROPOSED COMPETITIVE RATE

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner

In the Matter of the Petition of Northern States Power Company for Approval of a Competitive Rate for Rahr Malting Company	ISSUE DATE: May 28, 1993 DOCKET NO. E-002/M-93-162 ORDER REJECTING PROPOSED COMPETITIVE RATE
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**PROCEDURAL HISTORY**

**I. Proceedings to Date**

In 1990 the Minnesota Legislature enacted legislation allowing electric utilities to offer service at reduced rates to large customers capable of meeting their energy needs through unregulated suppliers. Minn. Stat. § 216B.162 (1990). The goal was to protect captive customers from the rate increases that would be necessary if these large customers left the system and no longer contributed to fixed costs.

The statute established detailed requirements for reduced rates, called competitive rates, to prevent abuse. The statute also required that the Commission approve each utility's competitive rate schedule and each application of the schedule to a particular customer. As part of its last general rate case, Northern States Power Company (NSP or the Company) proposed a competitive rate schedule, which the Commission approved.

On March 3, 1993, NSP filed a petition to offer rates under its competitive rate schedule to Rahr Malting Company (Rahr).

On March 16, 1993, the Commission issued a notice requesting comment regarding NSP's filing.

On April 9, 1993, the Minnesota Department of Public Service (the Department) filed its comments and recommendation regarding NSP's proposal.

On April 19, 1993, NSP filed reply comments to the Department's April 9 filing.

On April 20, 1993, the Department filed further comments.

On May 5, 1993, NSP filed a non-proprietary version of its March 5, 1993 petition.

On May 12, 1993, the Department filed a revised recommendation and NSP filed its reply to the Department's revised recommendation on May 19, 1993.

On May 20, 1993, the Commission met to consider this matter.

## FINDINGS AND CONCLUSIONS

### **II. The Company's Competitive Rate Proposal**

NSP proposed to Offer Rahr a discounted rate from the General TOD Service rate that Rahr is currently served under. The Special Competitive Discount would be effective from January 1, 1994 through January 1, 1999.

### **III. Commission Analysis**

The threshold issue in this case is whether the Company's competitive rates proposal complies with the terms of the competitive rates statute. If the Commission found compliance with those terms, the Commission would then consider 1) whether the Company's proposal is consistent with the terms of the cogeneration statute [Minn. Stat. § 216B.164 (1992)] and 2) whether it is consistent with the Company's integrated resource plan.

#### **A. The Competitive Rates Statute**

Before approving the competitive rate proposed for Rahr, the Commission would have to make the following findings:

1. Rahr can meet its energy requirements from a supplier that is not rate-regulated by the Commission;
2. Rahr is not likely to take service from NSP at standard rates;
3. It is in the best interest of all other NSP customers for Rahr to receive competitive rates;
4. The proposed rate meets the following conditions, unless the Commission finds they should be waived:
  - a. the proposed rates will recover at least the incremental cost of serving Rahr, including any additional capacity or on-peak or off-peak differential that such service may require;
  - b. the difference between the standard rate and the proposed rate does not exceed the difference between the standard rate and Rahr's lowest cost energy alternative;

- c. the contract with Rahr runs at least one year and no longer than five years;
- d. NSP will be allowed to seek recovery of the difference between the standard rate and the competitive rate in its next general rate case;
- e. NSP offers the competitive rate on a non-discriminatory basis to all customers within Rahr's customer class;
- f. the proposed rate does not compete with any heating or cooling rate offered by a district heating utility;
- g. NSP does not have a financial interest in Rahr exceeding 50 percent.

Minn. Stat. § 216B.162, subd. 7 (1992).

#### **B. Commission Findings**

If the Commission is unable to make even one of these unwaived findings<sup>1</sup>, the proposed rate cannot be approved. Based on the record in this matter and as discussed more thoroughly below, the Commission is unable to find that the rate reduction NSP proposed for Rahr did not exceed the difference between the Company's applicable standard tariff and the cost of the lowest cost competitive energy supply, as required by Minn. Stat. § 216B.162, subd. 4 (2) (1992). There is no basis in the record for the Commission to waive this requirement. Therefore, the Commission cannot approve the proposed rate.

##### 1. Noncompliance With Subd. 4 (2)

Minn. Stat. § 216B.162, subd. 4 (2) (1992) requires that the competitive rate reduction not exceed the difference between the Company's applicable standard tariff and the cost of the lowest cost competitive energy supply. This is an important provision whose purpose is to prevent a utility from providing savings greater than could be otherwise attained by the customer by securing its energy needs outside the system.

In this case, NSP has alleged that Rahr will opt for a competitive energy supply (i.e. that it will construct a cogenerating facility) and reduce its demand from the NSP system unless NSP can offer Rahr electricity at a substantially reduced rate. The question under Subd. 4 (2) is whether the proposed

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<sup>1</sup> Unwaived findings: the Commission is authorized by Minn. Stat. § 216B.162, subd. 7 (1) (1992) to waive the requirements listed in Minn. Stat. § 216B.162, subd. 4 (1992) if it finds that such waiver is in the public interest. NSP did not request a waiver and provided nothing to persuade the Commission that waiver of any of the requirements of Subd. 4 would be in the public interest.

rate reduction is greater than the difference between the current rate and the cost to the customer of the lowest cost competitive energy supply.

In assessing whether NSP's proposed discounted rate for Rahr complies with this provision, a critical element to establish is the cost to Rahr of its lowest cost competitive energy supply. In calculating the cost to Rahr of building its own energy supply in its initial March 3, 1993 filing, NSP included 1) no cost of capital (the return on its investment in the alternative energy supply) and 2) no depreciation expense (return of its investment in the alternative energy supply). Failure to include these costs was error.

Subsequently, in its May 19, 1993 filing, NSP acknowledged that depreciation and cost of capital are properly considered costs in determining the cost to Rahr of its lowest cost competitive energy supply. However, NSP argued 1) that Rahr's cost of capital should be calculated as 3 percent and 2) that depreciation of the cogeneration facility should be considered a cost of the alternate energy supply for tax purposes (reducing the company's tax liability and lowering the net cost of the competitive energy supply) but then be added back into after-tax savings so that Rahr's after-tax net under the build-a-cogenerator scenario is not reduced by that amount. Using 3 percent as its cost of money and treating depreciation as indicated, NSP argued that its proposed discount did not exceed the difference between NSP's standard tariff and Rahr's cost for its lowest cost competitive energy supply and therefore complied with the requirement of Subd. 4 (2). The Commission disagrees.

#### Cost of Capital

The Commission rejects NSP's proposed cost of capital. At a minimum, the opportunity cost of capital should be based on an alternative investment of similar life and risk. NSP's proposed 3 percent cost of capital is based on its investment in Treasury Bills, a short term, risk free investment which differs greatly from an investment in a cogeneration system that is long term and higher risk. Rahr's overall capital costs are likely to be somewhat higher than the cost of capital for Minnesota's regulated electric utilities. However, for the cogeneration project it is reasonable to assume that the cost of capital is not significantly higher than the cost of capital for an electric utility, in the range of 12 to 14 percent.

#### Depreciation

Although NSP properly subtracted the depreciation on the cogenerator from savings to determine the income tax effect of the cogenerator project, it erred in adding the depreciation back into Rahr's after-tax savings. Depreciation of the plant is a cost that reduces the savings to Rahr and should not be added back. The Company's error results in further understating the cost to Rahr of the cogeneration option and overstating Rahr's net savings under the build-a-cogenerator scenario.

Combined Effect of Reasonable Cost of Capital and Proper Treatment of Depreciation

Once depreciation is treated properly and the appropriate cost of Rahr's capital is included in the cost of the cogenerator, the discount proposed by NSP clearly exceeds the difference between NSP's standard tariff and Rahr's cost for its lowest cost competitive energy supply in violation of Subd. 4 (2).

2. Subd. 4 (1) Requirement

An additional consideration is Minn. Stat. § 216B.162, subd. 4 (1) which requires

(1) that the minimum rate for the schedule recover at least the incremental cost of providing the service, including the cost of additional capacity that is to added while the rate is in effect and any applicable on-peak or off-peak differential;

The Department argued that it was proper to estimate NSP's incremental capacity cost by using the Company's estimated annual economic carrying costs associated with NSP's future gas turbine unit. The Department alleged that, using this measure of the Company's incremental cost, the revenues received by NSP from the competitive rate exceed its incremental costs in the first four years of operation but that its incremental costs are greater than the revenue received under the competitive rate in the fifth and final year in violation of Subd. 4 (1). On the basis of that analysis, the Department recommended that, if the Commission approved the competitive rate, the Commission approve it for four years only.

Since failure to comply with any one of the requirements listed in Minn. Stat. § 216B.162, subd. 4 (1992) is sufficient to render a proposed competitive rate unacceptable and the Commission has noted noncompliance with subd. 4 (2), it is not necessary to determine at this time whether there are grounds for partial rejection under Subd. 4 (1) as urged by the Department.

**C. Commission Options and Action**

Having found that the proposed competitive rate does not meet all the unwaived requirements of Minn. Stat. § 216B.162 (1992), the Commission has two options under the statute: to reject or to modify the proposal. As between rejecting or modifying the Company's proposal, then, the Commission will simply reject the proposal. This will allow the parties to restart the process afresh if they choose and fully restore the 90 day reviewing period. If the Commission had chosen to modify the proposal and the parties had submitted a revised version of the Commission's modified proposal, the Commission would have had only 30 days to accept or reject that revised version. In view of the fact the effective date for the rate sought by NSP was not until January 1, 1994, the additional review time made available

through simply rejecting the current proposal will not prejudice the parties. Instead, it will provide sufficient time to review any new information.

#### **IV. Concern Regarding Claims of Proprietary Status**

It has come to the Commission's attention that NSP labeled its entire filing as proprietary rather than designating only the specific trade secret information as proprietary. While the Commission has adopted practical policy for handling materials marked proprietary consistent both with companies' needs to protect trade secret material and parties' rights to obtain government data, that balance is disrupted if a company uses its "Proprietary" stamp in an overly broad manner. Additionally troubling is that the Company only filed a non-proprietary version of its petition on May 5, 1993, several months after its initial filing and only after repeated requests from Commission Staff. Reasonable accommodation between company interests in trade secrets, parties' rights to government data, and the Commission's regulatory imperatives coexist in a delicate balance. The Company is cautioned not to exceed itself in these matters.

#### **ORDER**

1. Northern States Power Company's proposed competitive rate for Rahr Malting Company is rejected.
2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster  
Executive Secretary

(S E A L)