

G-002/M-93-773 ORDER DENYING PETITION FOR RECOVERY OF ACQUISITION
PREMIUM THROUGH THE PGA

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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In the Matter of a Petition by Northern States Power Company to Recover the Acquisition Premium Associated with Its Purchase of the Viking Gas Transmission Company

ISSUE DATE: November 21, 1994

DOCKET NO. G-002/M-93-773

ORDER DENYING PETITION FOR RECOVERY OF ACQUISITION PREMIUM THROUGH THE PGA

PROCEDURAL HISTORY

On August 11, 1993, Northern States Power Company (NSP or the Company) filed a petition to recover in retail gas rates a prorated portion of the acquisition adjustment it incurred in its purchase of the Viking Gas Transmission Company (Viking). Viking is an interstate pipeline regulated exclusively by the Federal Energy Regulatory Commission (FERC). The pipeline will not become an asset of the regulated NSP utility and will not be subject to the jurisdiction of this Commission.

The total acquisition adjustment for the Viking purchase (the difference between Viking's book value and the purchase price) was \$29,713,203. The Minnesota portion was \$21,107,190, which NSP proposed to amortize over 15 years at \$1,407,146 per year.

NSP claimed its purchase of Viking had resulted in gas cost savings from the discount the Company negotiated with Northern Natural Gas Company (Northern), a prime NSP gas transporter. NSP argued that the gas cost savings exceed the amount of the acquisition adjustment, making recovery of the adjustment reasonable. The Company proposed to offset the acquisition premium amortization against the savings in gas costs realized by Minnesota ratepayers. Under NSP's proposal, the overall rate adjustment would take place within the Company's Purchased Gas Adjustment (PGA).

The Department of Public Service (the Department) and the Residential Utilities Division of the Office of the Attorney General (RUD-OAG) intervened to oppose rate recovery of the acquisition adjustment.

On February 9, 1994, the Commission issued its NOTICE AND ORDER FOR HEARING. In that Order the Commission noted that the disputed facts in this matter would best be developed in formal evidentiary hearings. The Commission referred the matter to the Office of Administrative Hearings, which assigned Administrative Law Judge (ALJ) Bruce Campbell to the proceedings.

In the NOTICE AND ORDER FOR HEARING, the Commission ordered parties to address the following issues in the contested case proceedings:

1. Is the causal connection between the gas cost savings claimed by the Company and its

purchase of the Viking pipeline firm enough to justify recovery of the acquisition adjustment?

2. What is the amount of gas cost savings attributable to NSP's purchase of the Viking pipeline?
3. Does Minnesota law allow rate recovery of the acquisition adjustment and if so, does it allow recovery through the Purchased Gas Adjustment?

On February 24, 1994, ALJ Campbell conducted a prehearing conference. At that meeting the parties and the ALJ agreed that the parties would first brief and argue the third issue from the NOTICE AND ORDER FOR HEARING. It was agreed that judicial economy requires that this threshold legal issue be determined before the other issues are addressed.

Both the Department and the RUD-OAG filed motions to dismiss the contested case proceedings for lack of subject matter jurisdiction and for failure to state a claim upon which relief can be granted.

On June 8, 1994, the ALJ filed his Recommended Order on Motions to Dismiss for Failure to State Claim. The ALJ made three major findings regarding Commission jurisdiction and the possibility of recovery of an acquisition premium through the PGA.

On June 27, 1994, NSP, the Department, and the RUD-OAG filed exceptions to the ALJ's Recommended Order. The parties filed replies to exceptions on July 7, 1994.

On September 1, 1994, the Commission met to consider the issues raised in the ALJ's Recommended Order.

FINDINGS AND CONCLUSIONS

The ALJ made three major findings in his Recommended Order:

1. The Commission is not preempted by Federal Energy Regulatory Commission (FERC) jurisdiction.
2. The Commission has the authority under Minn. Stat. § 216B.16, subd. 6 (1992) to authorize the amortization as an unusual expense of a reasonable acquisition premium for nonjurisdictional property. The Company must prove in a rate case that it prudently incurred the expense to benefit Minnesota retail ratepayers.
3. NSP's petition for authority to recover the acquisition premium through the PGA must be dismissed, because PGA recovery for this cost is not allowed under relevant statutes or rules.

The Commission adopts ALJ Campbell's findings and reasoning on these three issues. The Commission will analyze the three issues in turn.

I. COMMISSION JURISDICTION

A. The ALJ's Finding

The ALJ found that the Commission is not preempted from consideration of the Company's petition by FERC jurisdiction. The ALJ noted that the FERC has exclusive jurisdiction over setting wholesale rates, and that state commissions cannot examine the reasonableness of those rates. In this case, however, NSP does not seek to alter or vary FERC wholesale rates. Rather, NSP is seeking rate recognition of the cost of the savings at retail level which stem from the difference between two wholesale rates. FERC exclusive jurisdiction over wholesale rates is not impacted.

B. Positions of the Parties

1. NSP

NSP supported the ALJ's finding that the Commission is not preempted by the FERC. NSP argued that the case is not about recovery or disallowance of filed wholesale rates. NSP instead seeks recovery of a cost incurred to achieve a rate reduction (in rates paid to Northern) to a level below the filed maximum rate.

2. The Department

The Department argued that the FERC has exclusive jurisdiction over the Viking pipeline, NSP's purchase of the pipeline, and the relationship among Viking, Northern Natural, and NSP. The Commission does not have jurisdiction to allow retail rates to reflect the acquisition premium for purchase of the federally-regulated asset.

3. The RUD-OAG

The RUD-OAG argued that NSP seeks a remedy for an above-book purchase of the federally-regulated Viking pipeline; this remedy is within the exclusive jurisdiction of the FERC. If the Commission grants the Company's request, Minnesota ratepayers will, in effect, pay a substantial part of the Viking FERC jurisdiction rate of return.

C. Commission Action

The Commission agrees with the ALJ's finding that the Commission is not preempted by FERC jurisdiction. The Commission has authority under Minn. Stat. § 216B.16, subd. 6 to set just and reasonable rates for Minnesota utilities. This authority includes the discretion to set rates which reflect costs incurred to obtain savings from the Northern Natural discount if the savings flow to Minnesota ratepayers.

The Commission agrees with the ALJ that the relief sought by NSP would not require the Commission to set or alter FERC wholesale rates, or to oversee NSP's purchase of FERC-regulated property. As the ALJ noted, the situation is more analogous to a state commission's disallowance of part of a utility's rates if the commission found that the utility did not choose a prudent wholesale source. In that case, as in the present set of facts, the commission is looking at the utility's actions on a federal level, only to determine their direct impact on state-regulated retail rates.

If NSP can show that the Viking acquisition costs brought direct gas cost savings to Minnesota ratepayers, rate recovery of the costs would not disturb federal jurisdiction. It is within the Commission's authority, and part of its core regulatory duties, to examine utility costs which impact state ratepayers and to determine if those costs are just and reasonable.

II. EFFECT ON RATES OF UTILITY ACQUISITION OF NON-JURISDICTIONAL ASSETS

A. The ALJ's Finding

The ALJ found that "Minn. Stat. § 216B.16, subd. 6 is broad enough to authorize the amortization as an unusual expense of a reasonable acquisition premium for nonjurisdictional property." ALJ Recommended Order at p. 8.

The ALJ cited commission decisions in North Dakota and Wisconsin, in which NSP was allowed to amortize the nonjurisdictional Viking acquisition premium and to include a reasonable portion of that amortization in jurisdictional expenses.

The ALJ stated that the correct standard to apply is the prudence and reasonableness of the expense. This standard is distinguishable from the used and useful analysis applied in the determination of rate base treatment. The used and useful approach is designed to protect utilities from the imposition of confiscatory rates. It is not designed to preclude amortization of a prudent, reasonable expense which benefits ratepayers.

The ALJ reasoned that the Department's and RUD-OAG's insistence on the used and useful analysis would disincentivize utilities from incurring nonjurisdictional expenses which benefit ratepayers, if consideration of their propriety were beyond the Commission's authority.

B. Positions of the Parties

1. NSP

NSP supported the ALJ's finding that the amortization of the Viking acquisition premium could be recovered if it were found to be a prudent and reasonable expense.

NSP noted that it is not seeking rate base recovery, the only situation in which the used and useful approach applies. A reasonable ratemaking principle must be applied: if a non-jurisdictional cost can result in ratepayer benefit through reduced total rates, both the costs and benefits should be reflected in rates.

2. The Department

The Department argued that in order for a utility to recover costs, whether as rate base or expense, those costs must be incurred by the utility for regulated expenses or assets. Because NSP seeks recovery of costs for purchasing a nonutility company that is not part of the NSP gas utility, granting recovery would amount to a subsidy of the nonutility business by utility ratepayers.

3. The RUD-OAG

The RUD-OAG stated that NSP seeks recovery of a premium paid for non-Minnesota property, the Viking pipeline. NSP does not claim that the purchase price relates to the current operation of the NSP gas utility. For these reasons, the RUD-OAG argued, the proposed cost fails the "used and useful" standard and may not be recovered. Even if the costs were properly considered expenses, NSP cannot recover expenses connected to the purchase price of a nonregulated facility now owned by NSP's non-utility entity.

C. Commission Action

The Commission agrees with the ALJ that the Commission's discretion to consider NSP's proposal derives from the Commission's authority to set just and reasonable rates pursuant to Minn. Stat. § 216B.16, subd. 6. The statute gives the Commission the authority to examine the prudence and reasonableness of costs which impact Minnesota rates. If the Company can eventually prove a nexus between the Viking acquisition premium and lower Minnesota retail rates, consideration of the prudence and reasonableness of the costs will be squarely within Commission authority.

The Commission is not persuaded by the Department's and RUD-OAG's argument that rate recovery cannot be allowed because the Company seeks recovery of costs for a nonjurisdictional purchase (the Viking pipeline), which cannot be used and useful to the utility. The Company is not seeking asset recovery through rate base treatment, which would include return of the purchase price and a return on the investment. The Company is rather seeking recovery of an amortization of the premium paid, which the Company claims has brought about lower retail rates. This is a situation calling for a prudence and reasonableness analysis as the Commission determines just and reasonable rates.

It is especially important to clarify the Commission's authority to examine costs such as NSP's acquisition premium in today's gas utility era. Beginning with FERC Order 436 and more recently, FERC Order 636, the gas industry is experiencing the unbundling of gas service elements and burgeoning competition. In the new competitive atmosphere, utilities have the opportunity to creatively seek supply and transportation sources through negotiations and competitive bids. This new mode of procuring gas supply can work to the benefit of ratepayers, as the FERC envisioned, so long as state commissions maintain their regulatory oversight. State commissions must examine the impact on ratepayers of utilities' seeking competitive gas sources. Although the costs of procuring the gas supply may be new, the commissions' analysis will remain the same: was the cost prudent and reasonable? did the expense bring a direct benefit to ratepayers? Through careful analysis of the prudence and reasonableness of costs such as NSP's acquisition premium, the Commission can ensure that greater competition works to the benefit, and not to the detriment, of ratepayers.

The Commission also notes that if the Company's acquisition cost is eventually found prudent and reasonable and rate recovery is allowed, any issue of possible subsidization of a nonutility enterprise by utility ratepayers will also be addressed as part of the Commission's analysis.

II. RATE RECOVERY THROUGH THE PGA

A. The ALJ's Finding

The ALJ recommended that the Commission dismiss NSP's petition because PGA recovery of the Viking acquisition premium is not available. In so finding, the ALJ examined the historical purpose of the PGA, treatment of the issue in other jurisdictions, and Minnesota authority.

The ALJ noted that PGA clauses arose in the 1970's, in an effort to level the effects of volatile fuel costs. The PGA was meant to be narrowly construed and was not meant to substitute for the general ratemaking proceeding.

The ALJ also noted that the North Dakota commission found the inclusion of Viking acquisition costs in the PGA to be inappropriate. The ALJ stated that the Minnesota Public Utilities Commission has also refused to expand the concept of PGA pass-through to include nonfuel concerns.

Finally, the ALJ found that the Company had not cited any argument or exigent circumstance which would justify a PGA pass-through of these costs rather than rate case review.

B. Positions of the Parties

1. NSP

NSP pointed to a 1986 amendment to the PGA statute, Minn. Stat. § 216B.16, subd. 7, which

expanded the PGA recovery concept from wholesale rates charged to "direct costs for natural gas delivered." According to NSP, this amendment showed that the legislature favored a broader scope for the PGA pass-through in the more competitive gas industry era. NSP stated that it is now up to the Commission to provide guidance for the expanded concept of PGA recovery. NSP urged the Commission to reward utility investment in the competitive era with rate recovery through the PGA.

2. The Department

The Department stated that Commission rules and Orders prohibit PGA recovery for costs such as the Viking acquisition premium. The Department cited Minn. Rules, part 7825.2400, subpart 12, which defines "cost of purchased gas" for purposes of PGA recovery. The rule does not include FERC Account 807, which would include costs such as the Viking premium. NSP's Viking acquisition costs therefore may not flow through the PGA.

3. RUD-OAG

The RUD-OAG agreed with the Department's analysis: Commission rules do not allow PGA recovery of costs such as the Viking acquisition premium. If the Commission finds that this cost is otherwise eligible for possible rate recovery, the Commission must defer consideration of the proposed cost to a general rate case.

C. Commission Action

The Commission agrees with the ALJ that the Company may not recover the amortization of the Viking acquisition premium through the PGA. Recovery of this type of cost through the PGA is not provided for in Commission rules (which were adopted after the 1986 amendment to the PGA statute).

The Commission does not find any reason to abandon the narrow focus the PGA is meant to encompass. The PGA has been an effective tool to accommodate fluctuating fuel costs and thereby limit otherwise unnecessary rate cases. The PGA, and the PGA true-up process, are not meant to replace rate case scrutiny of nonfuel utility costs.

The Commission does not agree with the Company that greater competition in the gas industry means that the PGA should be widened to pass through a greater range of costs. The Commission will not respond to greater competition by effecting regulatory modifications, when the modifications would reduce protections for ratepayers.

The Commission will deny the Company's petition to recover acquisition costs through the PGA. If NSP wishes to pursue recovery of the costs, it must present its case in a general rate proceeding. In a rate case, the Company would be required to prove a nexus between the cost of the acquisition and benefits to ratepayers, the amount of the benefits if they exist, and the prudence and reasonableness of the expense.

ORDER

1. The Commission denies NSP's August 11, 1993, petition for recovery of the Viking acquisition premium through the PGA.
2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)