

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair  
Commissioner  
Commissioner  
Commissioner  
Commissioner

In the Matter of the Complaint by Myer Shark  
*et al.* Regarding Xcel Energy's Income Taxes

ISSUE DATE: October 1, 2004

DOCKET NO. E,G-002/C-03-1871

ORDER AMENDING DOCKET TITLE AND  
DISMISSING COMPLAINT

**PROCEDURAL HISTORY**

On November 24, 2003, Mr. Shark filed his complaint seeking potential refund of income taxes collected in Xcel's gas and electric rates, but likely will not be paid to the taxing authorities due to Xcel Energy, Inc.'s (Xcel's) losses on NRG Energy, Inc. (NRG), one of its non-regulated affiliates.

On March 9, 2004, Mr. Shark supplemented his filing with the signatures of 61 Xcel customers joining the complaint. Subsequently, additional signatures were filed: seven signatures on April 1, 17 on April 18, and six on May 4, 2004.

On March 16, 2004, the Commission requested comments on jurisdiction, public interest and grounds, and procedures.

On May 3, 2004, the Minnesota Department of Commerce (the Department ), Xcel, the Residential Utilities Division of the Office of the Attorney General (RUD-OAG), Rebecca S. Winegarden and Mark D. Luther filed comments.

On May 13, 2004, reply comments were filed by Xcel, Mr. Shark, Ms. Winegarden, Mr. Luther, and the Department.

On July 28, 2004, the RUD-OAG filed supplemental comments.

On August 13, 2004, Mr. Shark filed a petition to intervene and to amend the title of this docket..

On August 16, Xcel filed reply comments to the RUD-OAG's July 28, 2004 supplemental comments.

The Commission met on August 26, 2004 to consider this matter.

## FINDINGS AND CONCLUSIONS

### **I. Preliminary Issues**

#### **A. Myer Shark's Petition to Intervene**

On August 13, 2004, Myer Shark filed a motion to intervene in this complaint proceeding. The motion is superfluous since Mr. Shark is already a party to this proceeding by virtue of having initiated the complaint along with, eventually, a statutorily sufficient number of additional consumers, as provided in Minn. Stat. § 216B.17. In these circumstances, no separate intervener status is warranted.

#### **B. Myer Shark's Request to Amend the Title of This Docket**

Also in comments filed August 13, 2004, Mr. Shark requested that the title of this docket be amended by adding the words "*et al.*" after his name to reflect that the complaint was brought by many ratepayers, not just one. This request is reasonable and will be adopted. Inclusion of the words "*et al.*" is consistent with the statutory requirement that a ratepayer complaint must be supported by 50 or more ratepayers to authorize complaint proceedings under Minn. Stat. § 216B.17.

Mr. Shark also asked that the docket title be changed to indicate that it was NSP rather than Xcel that collected the income taxes at issue in this matter. Without ruling on the issue of whose tax collection should be referenced, the Commission notes that docket titles do not determine the merits of the matter. Moreover, the current docket title has been used by parties throughout the proceeding to date and serves adequately. To avoid confusion and to discourage parties from arguing over unnecessary refinement of docket titles, the Commission will not grant Mr. Shark's request in this regard.

### **II. Process for the Initial Consideration of a Formal Complaint**

Minn. Rules, Part 7829.1800 outlines the process for the Commission's initial consideration of a formal complaint. Subpart 1 requires the Commission to review a formal complaint as soon as practicable to determine 1) whether the Commission has jurisdiction over the matter and 2) whether there are reasonable grounds to investigate the allegation. Minn. Stat. § 216B.17 also allows the Commission to dismiss any complaint without a hearing if in its opinion a hearing is not in the public interest.

### **III. Summary of Commission Action Regarding the Complaint of Myer Shark *et al.***

For reasons explained below, the Commission finds that it has jurisdiction over the complaint but that there are not reasonable grounds to investigate the complaint further and will therefore dismiss it.

As part of its evaluation of the complaint leading to these two determinations, the Commission proceeded pursuant to Minn. Stat. § 216B.17, subd. 2 and 3 to give notice of the complaint, give notice of a formal hearing on the complaint, and to conduct such hearing on August 26, 2004. In addition to the statutorily required steps (notices and hearing), the Commission has made such investigation as it has deemed necessary: soliciting comments from interested parties and receiving and reviewing written comments, reply comments, and supplemental comments from interested parties. Based on the record compiled in this manner, the Commission has concluded that no reasonable grounds exist to investigate this matter further.

#### **IV. Commission Jurisdiction Over the Complaint of Meyer Shark *et al.***

Minn. Stat. § 216B.17 requires that a consumer complaint must be sponsored by at least 50 consumers. As initially filed November 24, 2004, Mr. Shark's filing did not meet that requirement. In subsequent months, signatures from additional Xcel consumers supporting the complaint were filed, ultimately surpassing the statutory requirement in this regard.

The complaint also meets the requirement of Minn. Stat. § 216B.17 regarding the substance of a consumer complaint. It is a fair reading of the complaint that it fits a complaint category established by the statute in that it alleges, in effect, that Xcel's rates for furnishing of electricity are unreasonable.

No party contended that the Commission did not have jurisdiction over the complaint and, applying the provisions of Minn. Stat. § 216B.17, the Commission finds that it does, indeed, have jurisdiction over the complaint.

#### **V. No Reasonable Grounds to Investigate the Complaint Further**

##### **A. No Precedent for the Requested Refund or Credit**

The complaint asserted that ratepayers have a sound claim to a refund of tax funds they have paid to Xcel in rates but which Xcel has not paid to taxing authorities and therefore still holds. The complaint asserted that its claim was based on Commission precedent and policy and considerations of fundamental fairness.

The Commission agrees with Xcel, the Department and the Office of the Attorney General that the Commission decisions cited by Mr. Shark as precedent do not, in fact, support the refund requested:

- On September 4, 2002, the Commission issued an Order in Docket No. E-002/M-02-514 refunding \$13,510,041 to NSP's ratepayers pursuant to Minn. Stat. § 216B.1646, the property tax refund statute. The property tax refund statute directs the Commission to immediately reduce utility rates in order to pass on to ratepayers the savings from tax reductions resulting from this legislation. Without the immediate pass-through provided by the statute, the tax reduction would not have been considered until the next rate case. Hence, as the Office of the Attorney General noted, the refunds directed in Docket No. E-002/M-02-514 were pursuant to a unique and specific legislative directive and constitute no precedent for a refund of tax savings resulting from NRG's business losses.
- On January 14, 1994 in Docket No. E-002/GR-92-1185, the Commission ordered Xcel to refund approximately \$1.4 million to ratepayers following a decrease in its incentive compensation. The refund as credits to active customers' accounts of all amounts not paid out under the Company's incentive compensation plans is an anomaly and not one of general applicability. Pursuant to the Commission's decision in the rate case proceeding, changes in the amount of incentive compensation awarded to its employees by NSP are treated differently from other rate components and NSP's rates are periodically adjusted to reflect changes in those actual expenses. As the Office of the Attorney General noted, the exceptional treatment of incentive compensation in the 1185 Docket has no bearing on the issue of unpaid income taxes.

In later filed comments, Mr. Shark acknowledged the argument that refund of the personal property tax (Docket No. E-002/M-02-514) and incentive compensation (Docket No. E-002/GR-92-1185) were not precedents for the refund of income tax because the facts in those cases differ from the current case. Mr. Shark contended, however, that the precedent he was referring to was not the decisions themselves, but the rule he alleged was firmly established by the Commission: the mandate that if funds collected in rates for a specific purpose are not actually paid by the utility, they must be refunded to the ratepayers.

In fact, the Commission has established no such rule. Rather, the Commission has firmly established a precedent exactly to the contrary. The ratemaking policy and practice adopted by the Commission is as follows. Rates that ratepayers currently pay are based on representative levels of revenue, costs, and investments in a "test year" determined at the time of the most recent rate case. Once rates are set, they are considered to be reasonable until they are changed in the next rate case, or pursuant to any pass-through mechanisms that have been approved by the Commission. Although individual cost components that were used to develop the rates may vary (increase or decrease) after the rates are set, no adjustment (with the exception of the pass-throughs) is made outside of a rate case for increases or decreases in the individual components of rates.

The public policy grounds for adopting such an approach are sound. The Commission has summed up the reasons for the test year approach as follows:

. . . Basing revenue requirements on financial data from a test year, a representative slice of the utility's normal operations, is intended to base rates on experience instead of conjecture. It is also intended to replace the fiscal discipline of the marketplace, which is absent for monopolies, with the fiscal discipline of prior determination of reasonable costs. Finally, it is intended to give utilities and ratepayers the assurance that their rates will not be changed retroactively. . . .<sup>1</sup>

In a similar vein, it has been the Commission has noted that isolated changes in test year data can skew the rate case process for or against the Company, for or against the ratepayers.

. . . the test year method by which rates are set rests on the assumption that changes in the Company's financial status during the test year will be roughly symmetrical – some favoring the Company, others not. Not adjusting for either type of change maintains this symmetry and maintains the integrity of the test year process. Anomalies are likely to exist in and beyond any test year.<sup>2</sup>

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<sup>1</sup> *In the Matter of the Application of Northern States Power Company for Authority to Increase its Rates for Electricity Service in the State of Minnesota*, Docket No. E-002/GR-89-865, ORDER DENYING PETITIONS FOR RECONSIDERATION AND DENYING TRANSITIONAL RATE INCREASES (November 26, 1990) at page 6.

<sup>2</sup> *In the Matter of the Petition of Minnesota Power & Light Company, d/b/a Minnesota Power, for Authority to Change Its Schedule of Rates for Retail Electric Service in the State of Minnesota*, Docket No. E-015/GR-87-223, ORDER AFTER RECONSIDERATION AND REHEARING (May 16, 1988).

This rate-setting approach gives the utility an incentive to decrease costs between rate cases and protects customers from having to pay for every increase in costs between rate cases.

Nor is Mr. Shark's argument for refund or credit supported by sound public policy or fairness considerations. Ignoring precedent and well-established ratemaking principles and practice in midstream (between rate cases) would be the antithesis of fair play, sound regulation, and good government. It would also be unfair to use the Commission's well-established ratemaking principles and practice to shield ratepayers from paying for utility costs that exceed the amounts used when setting rates but then to ignore that approach and order a refund or credit just because the actual costs for a rate component (income tax payments) turned out to be lower than was legitimately projected when the rates were set to recover those costs.

Although there may be alternative approaches to ratemaking that parties may want the Commission to consider in future rate cases, the Commission cannot between rate cases legally abandon its well-established rate-making principles and practice articulated above by ordering the refunds and credits sought by Mr. Shark. To do so would clearly violate the policy against retroactive ratemaking, and subject the Commission to a costly legal battle that it would lose.

#### **B. No Contested Case is Warranted**

In the same later filed comments, Mr. Shark also stated that his goal at this stage of the docket was not to prove that a refund or credit was in fact due, but to show that there are reasonable grounds to investigate further to determine if further Commission action toward a refund or credit is warranted.

Specifically, Mr. Shark asked that the Commission refer the matter to the Office of Administrative Hearings (OAH) for a contested case hearing to determine seven specific facts, such as the size of the income tax component collected in monthly bills, the amount of income tax paid by Xcel, the tax years reflected in the 2003 refund claimed by Xcel, etc.

In light of the fact that no refund is due under Mr. Shark's theory of recovery, the facts that Mr. Shark wanted the Commission to determine through a contested case proceeding are simply not relevant. Since no refund or credit is due under Mr. Shark's theory of recovery, a contested case proceeding to determine the facts delineated by Mr. Shark would build a costly bridge to nowhere.

#### **VI. Comments of the RUD-OAG Regarding the Complaint of Myer Shark *et al.***

The RUD-OAG is not a complainant in this matter but did offer comments regarding the complaint. As noted previously, the RUD-OAG did not disagree with the Department and Xcel that the immediate refund or credit requested by Mr. Shark would be single-issue ratemaking. The RUD-OAG also distinguished the Commission decisions that Mr. Shark had cited as precedent for his request.

As an alternative to the complainants' request for an immediate refund or credit, the RUD-OAG proposed in its May 3, 2004 comments that the Commission give deferred accounting treatment to the amount of tax refund properly due to NSP and credit that amount to ratepayers in NSP's next rate case.

Finally, at the hearing on this matter, the RUD-OAG requested that the Commission seek comments regarding a theory not raised by the complainants, whether Xcel violated the tax allocation agreement that the Commission approved in Docket No. E,G-002/AI-01-124 by allocating the entire tax refund to its affiliate Xcel Energy Wholesale. Mr. Shark did not support this approach to his complaint, stating that it was out of order and not relevant to argue the case based on an analysis of the tax benefits of Xcel. Mr. Shark stressed that what was relevant to his complaint was what the Commission authorized the utility (NSP) to collect from ratepayers, what amount was collected, and what amount was actually paid.

#### **A. May 3, 2004 Comments**

In comments filed May 3, 2004, the RUD-OAG explained why the Commission Orders cited by Mr. Shark in support of his request for a refund were not in fact precedent for that action. Nevertheless, the RUD-OAG urged the Commission to consider carefully issues regarding the treatment of utility income taxes and ratepayer responsibility raised by the complaint.

Specifically, the RUD-OAG urged the Commission to take an approach to the underlying issues not raised by Mr. Shark and consider rejecting the “stand-alone” approach that the Commission and the Federal Energy Regulatory Commission (FERC) have adopted to date with regard to taxes filed by affiliated companies.

The RUD-OAG stated that the United States Supreme Court’s reasoning in a 1967 decision (*United Gas*<sup>3</sup>) endorsed the Federal Power Commission’s tax cost treatment of advanced the tax benefit allocation issue. The RUD-OAG stated that this decision opened the door for an argument that when a group of affiliated companies elects to file a consolidated tax return a regulatory company may pass the resulting benefits on to customers in the form of lower rates.

The RUD-OAG acknowledged that the FPC changed its tax treatment policy in 1972, departing from the policy of requiring that ratepayers receive the benefits of consolidated tax savings and opting instead for what has been called a “stand-alone” approach. In adopting the “stand-alone” approach, the FPC declared that a “utility should be considered as nearly as possible on its own merits and not on those of its affiliates.”<sup>4</sup>

The RUD-OAG also noted that the FPC’s successor agency, the Federal Energy Regulatory Commission (FERC) has also rejected the *United Gas* method and adopted the “stand-alone” approach of calculating the tax allowance for an affiliate.

The RUD-OAG acknowledged that the current “stand-alone” approach places the refunded taxes at the disposal of Xcel Wholesale, Inc. but stated that the Commission is poised to revisit the issue of tax benefit allocation in NSP’s next rate case. The RUD-OAG stated that if the Commission were to adopt the principle of *United Gas*, the Commission would be limiting cost of service to real

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<sup>3</sup> *Federal Power Commission v. United Gas Pipe Line Company*, 386 U.S. 237 (1967).

<sup>4</sup> *Florida Gas Transmission Co.*, 47 F.P.C. 341 (1972) at page 363.

expenses. The RUD-OAG recalled that the original purpose of the current 1346 Docket<sup>5</sup> was to insulate Minnesota ratepayers from Xcel's non-regulated activities and urged further inquiry into whether some allocation of the tax refund in question would provide a more equitable distribution of benefits and burdens than a strict stand-alone approach.

### **B. July 28, 2004 Comments**

The RUD-OAG clarified its recommendation, stating that NSP's ratepayers should be credited with that portion of the NSP rate that was allocated for tax payments but never paid. Diverging from Mr. Shark's requested relief (immediate refund or credits), however, the RUD-OAG stated that the tax benefit properly apportioned to ratepayers should be applied in the next NSP rate case.

As a means of advancing the tax benefit "properly apportioned to ratepayers" into the next rate case where it could be credited to ratepayers, the RUD-OAG proposed that the Commission grant deferred accounting status to that amount. The RUD-OAG stated that deferred accounting status for this amount was warranted because the tax benefit in question met the "significant and unusual" test that the Commission historically applies to requests for deferred accounting.

### **C. Comments at the August 26, 2004 Hearing**

At the hearing, the RUD-OAG referred to Xcel's tax allocation agreement that the Commission approved in Docket No. E,G-002/AI-01-124 and asserted that Xcel had violated that agreement by allocating the entire tax refund to its affiliate Xcel Energy Wholesale. The RUD-OAG argued that the allocation in question was controlled by Section 2C of the agreement and that properly applied, Xcel would have allocated a portion of the tax refund to NSP. The RUD-OAG clarified that what it sought in this docket was for the Commission to solicit comments from the parties on the question whether the Commission-approved tax allocation method was followed in this case.

## **VII. Commission Analysis: No Reasonable Grounds to Order Deferred Accounting or Comments Regarding Implementation of the Tax Allocation Agreement as Requested by the RUD-OAG**

### **A. Deferred Accounting Not Appropriate**

Deferred accounting is normally granted prospectively to funds that have not yet been expended. The RUD-OAG's proposal contains an element of retroactivity that violates the Commission's established ratemaking principle and practice.

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<sup>5</sup> See *In the Matter of an Inquiry Into Possible Effects of Financial Difficulties at NRG and Xcel on NSP and its Customers and Potential Mitigation Measures*, Docket No. E,G-002/CI-02-1346 (the 1346 Docket). On October 22, 2002, the Commission opened an inquiry, the 1346 Docket, to explore potential impacts of the financial difficulties of Xcel and its subsidiary NRG, Inc. on another Xcel subsidiary, the regulated utility Northern States Power Company (NSP), and NSP's ratepayers. The Commission also sought ways to protect NSP's ratepayers from any negative impacts of those difficulties.

Stated differently, the RUD-OAG's proposal of deferred accounting as a way to get these funds before the Commission in the next rate case assumes that this would avoid the problem of single-issue retroactive ratemaking. The Commission finds that it does not do so. In light of established ratemaking principles, the RUD-OAG's underlying premise that it is appropriate to bring a past income tax benefit to bear on future rates, not as an aid in predicting the likelihood of future income tax payments, but as an amount to credit, is not acceptable.

Hence, the RUD-OAG's proposal for deferred accounting will not be adopted because the ultimate action sought (crediting the deferred amount to ratepayers in the future rate case) would violate the prohibition against single issue ratemaking.

## **B. Comments on Tax Allocation Agreement Not Warranted**

At the hearing on this matter, the RUD-OAG asserted for the first time that notwithstanding the Commission's well-established policy of treating utility income taxes on a stand-alone basis, the Commission's adoption of the Tax Allocation Agreement in Docket No. E,G-002/AI-01-124<sup>6</sup> modified that position and that Xcel, in failing to allocate a portion of the tax refund it received due to the NRG losses, violated Section 2(c) of that agreement. As a consequence of that violation, the RUD-OAG claimed, certain tax benefits properly allocated to NSP under the Tax Allocation Agreement were allocated to Xcel Energy Wholesale.

Xcel disputed the RUD-OAG's claim and asserted that Section 2(b) of the agreement applied. Xcel maintained that it fully complied with Section 2(b). Faced with this response from Xcel, the RUD-OAG asked that the Commission authorize a round of comments from the parties on this issue.

The Commission will not authorize comments on this issue as requested by the RUD-OAG. The issue was not addressed in written comments but was raised and discussed for the first time at the hearing. Section 2(c), the provision that the RUD-OAG claimed applied, requires allocation or sharing of the tax refund benefit. It states:

If Parent [Xcel Energy, Inc.] would have a negative separate return tax, then each member having a positive separate return tax shall receive a negative allocation in an amount equal to such negative separate return tax multiplied by the member's share of the sum of the positive separate return tax. [Bracketed material added.]

Section 2(b), the provision that Xcel claimed applied, requires no allocation or sharing of the tax refund benefit. It states:

A member, other than Parent [Xcel Energy, Inc.], that would have a negative separate return tax shall receive a negative allocation in an amount equal to such negative separate return tax. [Bracketed material added.]

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<sup>6</sup> See *In the Matter of a Request by Northern States Power Company d/b/a Xcel Energy, Inc. for Approval of the Tax Allocation Agreement Between Xcel Energy, Inc. and Northern States Power Company*, Docket No. E,G-002/AI-01-124, ORDER (June 8, 2001).

The RUD-OAG asserted its belief that the NRG-related loss and tax refund were experienced by the parent Xcel Energy, Inc., which therefore would have had a negative separate return tax, as described in Section 2(c), based on news reports. The RUD-OAG argued that if Section 2(c) applied, NSP (as a member of Xcel Energy, Inc.) would have been entitled to share in the benefit of the parent's negative separate tax return.

In response, Xcel's Director of Taxation stated at the hearing that the loss which occurred when NRG's stock turned out to be worthless (and the consequent tax refund) was experienced not by Xcel Energy, Inc. (the parent) but by Xcel Energy Wholesale, a non-regulated affiliate that owned the worthless stock in NRG. He argued that since it was Xcel Energy Wholesale, a member (affiliate) rather than the parent (Xcel Energy, Inc.) that would have had a negative separate return tax, Section 2(b) applied and no sharing of the tax refund with other members (affiliates) was required. Xcel offered to meet with the RUD-OAG informally to explain the matter in greater detail and answer any questions the RUD-OAG might have.

The Commission notes that Xcel's explanation is plausible and was not rebutted by the RUD-OAG at the hearing. Xcel's explanation is also reasonable since it is consistent with the Commission's long standing stand-alone approach and there was no comment from any party when the Commission was asked to approve the Tax Allocation Agreement that doing so would alter that approach. See the Commission's June 8, 2001 Order in Docket No. E,G-002/AI-01-124.

Moreover, the applicability of Section 2(c) asserted by the RUD-OAG would have guaranteed that NSP would share a portion of the tax refund benefit, but would not require Xcel to share that tax benefit with rate payers, which was what the RUD-OAG ultimately sought. The RUD-OAG did not address how such a sharing could be required without violating the policy against single issue retroactive ratemaking.

In these circumstances, the Commission finds that the record does not warrant the comment period requested by the RUD-OAG.

### **VIII. Looking Forward**

The RUD-OAG noted that the complaint of Mr. Shark *et al.* raised the question whether the stand-alone approach remains appropriate. The RUD-OAG cited several states that have switched from the stand-alone approach to the consolidated approach in rate-setting. While such a question cannot be acted upon outside the context of a rate case, it is understood that there will be several rate cases coming up during which interested parties could raise that issue when the Commission is establishing rates prospectively.

Indeed, the Department identified that issue as one that it wanted the Commission to leave open for reconsideration in future rate cases and the Commission has specifically done so. In its June 8, 2001 Order approving Xcel's Tax Allocation Agreement, the Commission stated:

Regarding future rate case filing requirement, the Commission accepts the Department recommendation and requires that, in the Company's next Minnesota rate case, NSP must provide both (1) its Minnesota allocated consolidated tax calculations including the allocated federal tax benefits of the Parent, and (2) the Minnesota separate return calculations as defined by the Department for purposes of the rate case;

Regarding preservation of right to raise issue in subsequent rate proceedings, the Commission accepts the Department recommendation and recognizes that the Department has reserved the right to make recommendations, concerning the allocation of tax expenses to ratepayers, in the context of NSP's next Minnesota rate case, i.e., the Department's right to make recommendations in future rate proceedings concerning the proper accounting and rate treatment of the tax benefits incurred at the Parent's level may also be reserved;

Regarding the Company showing that tax expenses are reasonable in future rate case, the Commission accepts the Department recommendation and requires NSP to demonstrate the reasonableness of its tax expense calculation in the Company's next Minnesota rate case;

Regarding this decision as a precursor or precedent in later rate proceedings, the Commission accepts the Department recommendation and clarifies that the Commission's decision for this Tax Agreement is not to be considered a precursor or precedent for purposes of the Company's next rate case. (This qualification could be extended to the review of the tax benefits incurred at the Parent level as well as the proper allocation of tax expense for purposes of determining reasonable test year tax expense in future rate proceedings.)

Likewise, Mr. Shark's comments regarding different methods of ratemaking (alternatives to the Commission's prospective rate-making process) are more timely made in the context of a rate case where any changes in the current approach may be considered and implemented.

### **ORDER**

1. Myer Shark's petition for intervention need not be granted because he is already a party to this proceeding.
2. Mr. Shark's request to amend the title of this matter is granted with respect to adding the words "*et al.*" after his name.
3. For reasons set forth in the text of this Order, the Commission finds the grounds are insufficient to warrant further investigation of the complaint of Myer Shark *et al.* and therefore dismisses it.
4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar  
Executive Secretary

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