

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

LeRoy Koppendrayer	Chair
Marshall Johnson	Commissioner
Ken Nickolai	Commissioner
Thomas Pugh	Commissioner
Phyllis A. Reha	Commissioner

In the Matter of an Application by Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Natural Gas Service in the State of Minnesota

ISSUE DATE: August 11, 2005

DOCKET NO. G-002/GR-04-1511

ORDER ACCEPTING AND MODIFYING SETTLEMENT AND REQUIRING COMPLIANCE FILINGS

PROCEDURAL HISTORY

I. Initial Filings

On September 17, 2004, Northern States Power Company d/b/a Xcel Energy (Xcel or the Company) filed a general rate case seeking an annual rate increase of \$9.9 million, or approximately 1.7%. On October 22, 2004, the Company filed revised testimony, rate schedules, and work papers, correcting a discrepancy between the gas costs used in its petition to set a new base cost of gas and the gas costs used in its general rate case filing.

On November 12, 2004, the Commission issued two Orders finding the rate case filing substantially complete as of October 22, accepting the rate case as of that date, and referring the case to the Office of Administrative Hearings for contested case proceedings. On November 16, 2004, the Commission issued its Order Setting Interim Rates, authorizing the Company to collect an across-the-board interim rate increase of \$6,423,000 per year. Interim rates are collected subject to refund under Minn. Stat. § 216B.16, subd. 3.

II. The Parties and Their Representatives

There were four active parties to the case: the Company, the Minnesota Department of Commerce, the Residential and Small Business Utilities Division of the Office of the Attorney General, and the Suburban Rate Authority.

There were four other parties who filed successful intervention petitions but did not file testimony or briefs or otherwise participate: Northern Natural Gas Company; Marathon Ashland Petroleum,

LLC; Local Union 23, International Brotherhood of Electrical Workers; and Gerdau AmeriSteel.

The Minnesota Chamber of Commerce requested and was granted non-party, participant status.

The Company was represented by Megan J. Hertzler, Senior Attorney, Xcel Energy, 800 Nicollet Mall, Suite 2900, Minneapolis, Minnesota 55402, and Richard J. Johnson, Attorney at Law, Moss & Barnett, 4800 Wells Fargo Center, 90 South Seventh Street, Minneapolis, Minnesota 55402.

The Department of Commerce was represented by Julia Anderson and Karen Finstad Hammel, Assistant Attorneys General, NCL Tower, Suite 1400, 445 Minnesota Street, St. Paul, Minnesota 55101.

The Residential and Small Business Utilities Division of the Office of the Attorney General was represented by Ron Giteck, Assistant Attorney General, NCL Tower, Suite 900, 445 Minnesota Street, St. Paul, Minnesota 55101.

The Suburban Rate Authority was represented by James Strommen, Attorney at Law, Kennedy & Graven, 200 South Sixth Street, Suite 470, Minneapolis, Minnesota 55402.

Northern Natural Gas Company was represented by James R. Talcott, Assistant General Counsel, 111 South 103rd Street, Omaha, Nebraska 68124.

Gerdau AmeriSteel was represented by Richard J. Savelkoul, Attorney at Law, O'Neill, Grills & O'Neill, PLLP, W1750 First National Bank Building, 332 Minnesota Street, Saint Paul, Minnesota 55101.

Marathon Ashland Petroleum was represented by Robert S. Lee, Attorney at Law, Mackall, Crouse & Moore, PLC, 1400 AT&T Tower, 901 Marquette Avenue, Minneapolis, 55402.

Local Union 23, International Brotherhood of Electrical Workers appeared by their Business Manager, Joseph V. Plumbo, 932 Payne Avenue, Saint Paul, Minnesota 55101.

The Minnesota Chamber of Commerce appeared by Sandra Hofstetter, 10157 Ivywood Court, Eden Prairie, Minnesota 55347.

III. Proceedings Before the Administrative Law Judge

The Office of Administrative Hearings assigned Administrative Law Judge Kathleen D. Sheehy to hear this case. Judge Sheehy held a pre-hearing conference at which procedural and scheduling issues were resolved. The Company, the Department of Commerce (the Department), and the Residential and Small Business Division of the Office of the Attorney General (RUD-OAG) all filed written testimony in the case.

On April 19, 2005, the Company and the Department filed an Offer of Settlement; that document, together with an Addendum filed on April 29 and an Amendment filed on May 4 resolved all issues in the case between the two parties and are collectively referred to in this Order as “the settlement.”

The settlement was unopposed, except as to one issue – the residential customer charge. The RUD-OAG and the Suburban Rate Authority contended that the \$8.00 charge contained in the Offer of Settlement was too high and urged retention of the current \$6.50 charge.

On May 4, 2005, the Administrative Law Judge held an evidentiary hearing, at which the Company presented a witness to answer questions about the settlement.

The Administrative Law Judge also held three public hearings in Xcel’s natural gas service area – in St. Paul, Woodbury, and St. Cloud. Approximately 67 members of the public submitted letters or e-mails on the proposed rate changes to the Administrative Law Judge.

IV. Proceedings Before the Commission

On June 22, 2005, the Administrative Law Judge filed her Findings of Fact, Conclusions, and Recommendation, in which she recommended accepting the Offer of Settlement.

On July 6, 2005, the RUD-OAG filed exceptions to the Administrative Law Judge’s Report on the issue of the residential customer charge. On July 7, 2005, the Suburban Rate Authority filed a letter withdrawing its objection to the settlement.

On July 21, 2005, the Commission held oral argument, and the record closed under Minn. Stat. § 14.61, subd. 2. At that hearing, the Energy Cents Coalition appeared and urged rejection of the settlement provision raising the service reconnection charge for residential customers from \$15.00 to \$45.00. The RUD-OAG concurred in this position.

Having reviewed the entire record and having heard the arguments of the parties, the Commission makes the following findings, conclusions, and order.

FINDINGS AND CONCLUSIONS

I. The Legal Standard

Under the Public Utilities Act, utilities seeking a rate increase have the burden of proof to show that the proposed rate change is just and reasonable. Minn. Stat. § 216B.16, subd. 4. Any doubt as to reasonableness is to be resolved in favor of the consumer. Minn. Stat. § 216B.03.

The Act requires the Commission to set rates to encourage conservation and renewable energy use “to the maximum reasonable extent.” Minn. Stat. § 216B.03. The Commission is permitted to

consider ability to pay as a factor in setting utility rates and is authorized to establish programs to ensure affordable, reliable, and continuous service to low-income residential ratepayers. Minn. Stat. § 216B.16, subd. 15.

The Act also encourages settlements. Before beginning contested case proceedings on a general rate case, Administrative Law Judges are required to convene a settlement conference for the purpose of encouraging settlement of some or all of the issues in the case. They are authorized to reconvene the settlement conference at any point before the case is returned to the Commission, at their own discretion or at the request of any party. Minn. Stat. § 216B.16, subd. 1a (a).

The Commission is authorized to accept, reject, or modify any settlement. It can accept a settlement only upon finding that to do so is in the public interest and is supported by substantial evidence. Minn. Stat. § 216B.16, subd. 1a (b).

While the Commission recognizes that compromise is a key ingredient of any settlement, it also recognizes that resolving disputed issues in rate cases is fundamentally different from resolving disputes between private litigants:

In deciding whether to accept the Offer of Settlement, the Commission must apply a different standard than is normally used by the courts. Unlike the traditional function of civil courts, the Commission's primary function is not to resolve disputes between litigants. Instead, it is an affirmative duty to protect the public interest by ensuring just and reasonable rates.

In the Matter of a Petition by the U.S. Department of Defense, the General Services Administration, and All Other Federal Executive Agencies of the United States Challenging the Reasonableness of the Rates Charged by Northwestern Bell Telephone Company, Docket No. P-421/CI-86-354, ORDER ACCEPTING OFFER OF SETTLEMENT (February 10, 1988) at 3.

Because rate case decisions can have far-reaching consequences for persons who were not at the negotiating table, the Commission has long required settling parties to document that all issues have been settled within the zone of regulatory reasonableness:

In non-ratemaking settlement negotiations it is common for parties to concede some issues to obtain a more favorable resolution of others they value more highly. This is reasonable and appropriate in private disputes, where the goal of the settlement process is to reach a result satisfactory to all parties. In Commission proceedings, however, the goal of the process is to serve the public interest.

This requires protecting the interests of the Company, the public, and all customer classes, whether or not their interests are vigorously represented. It requires resolving every issue within the bounds of acceptable regulatory practice, since future rate structures are built on the foundations established in past rate cases. For these reasons the Commission scrutinizes settlements with care and requires

documentation of the reasonableness of the disposition of all issues.

In the Matter of the Application of Interstate Power Company for Authority to Change its Rates for Natural Gas Service in the State of Minnesota, Docket No. G-001/GR-90-700, ORDER ACCEPTING AND ADOPTING STIPULATION AND OFFER OF SETTLEMENT (June 27, 1991), at 6-7.

II. Summary of Commission Action

The settlement filed by the Company and the Department cites to record evidence to support and explain its disposition of every issue, and the evidentiary hearing conducted by the Administrative Law Judge clarified the record at several key points. With one exception, the Commission finds that all issues have been settled within the zone of regulatory reasonableness, in a manner supported by substantial evidence, and on terms consistent with the public interest.

The one exception is the settlement's treatment of the service reconnection charge for residential customers. For the reasons set forth below, the Commission will modify the settlement and set that charge at \$22.50, instead of the \$45.00 proposed in the settlement and recommended by the Administrative Law Judge. As to all other issues, the Commission will accept and adopt the settlement and the Administrative Law Judge's findings, conclusions, and recommendations.¹

These actions are explained below.

III. The Residential Customer Charge

A. Introduction

The residential customer charge is a fixed monthly charge assessed without regard to usage levels. It is designed to recover fixed costs that do not vary with usage, such as constructing and maintaining infrastructure, reading meters, and conducting billing and collection services.

The customer charge has two main functions, one practical and one grounded in ratemaking policy. Its practical function is to help stabilize utility revenues and reduce the risk that the utility will over- or under-recover its revenue requirement due to weather-related fluctuations in gas usage and sales. Its ratemaking function is to ensure that each customer bears responsibility for a certain level of the Company's fixed costs regardless of usage.

¹ The Commission will also make one technical correction to the settlement, noting that the stipulated revenue deficiency, \$5,793,000, reflects an 8.76% overall rate of return, not a 8.75% return, as stated in the settlement. This incongruity results from a slight imprecision in rounding.

Theoretically, the Company recovers its revenue requirement whether customer charges are high or low; all the costs it is authorized to recover are built into either the customer charge or usage charges, which are carefully calibrated, based on normalized weather data and forecasted sales volumes, to yield the authorized revenue requirement. As a practical matter, however, companies usually prefer the certainty of fixed monthly charges to the fluctuation of usage charges.

Xcel's current monthly residential customer charge is \$6.50. In its original filing, the Company sought to increase the residential customer charge to \$14.00, unless the Commission approved its proposal to partially decouple usage charges and fixed charges for the residential class. Its Class Cost of Service Study, required in every rate case, determined that the approximate, average, fixed monthly cost of serving a residential ratepayer is \$21.07.

In the Offer of Settlement, the Department and the Company agreed upon an \$8.00 monthly residential customer charge, which the Administrative Law Judge found to be just and reasonable.

B. Positions of the Parties

The Company and the Department supported the \$8.00 customer charge in the settlement as a reasonable means of reducing Xcel's risk of under-recovery, preventing or reducing high-usage customers' subsidization of low-usage customers' bills, and reducing volatility in the monthly bills of customers not using levelized monthly payment options.

The RUD-OAG – and initially, the SRA – opposed the increase from \$6.50 to \$8.00 on grounds that it would act as a disincentive to conservation and have a disproportionate, negative impact on low-income ratepayers.

The SRA subsequently withdrew its opposition in light of Commission action in the CenterPoint rate case, decided some four weeks earlier, in which the Commission adopted the SRA's alternative recommendation to modulate the increase proposed in that utility's residential customer charge.² The SRA found the \$8.00 charge in this case analogous to the \$6.50 charge the Commission adopted in *CenterPoint*, both in terms of the percentage of fixed costs the proposed charge would recover and in terms of the percentage increase between the old and new customer charges.

The Administrative Law Judge concurred with the Company and the Department that the proposed charge would result in just and reasonable rates. She also stated that the \$8.00 charge represented a moderate increase and was duly responsive to public comments condemning the much larger increase initially proposed.

C. Commission Action

² *In the Matter of an Application by CenterPoint Energy Minnegasco, a Division of CenterPoint Energy Resources Corp., for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-008/GR-04-901, Order Accepting and Modifying Settlement and Requiring Compliance Filing (June 8, 2005).

The Commission gives proposals to increase residential customer charges careful scrutiny, not just because, like all rate design proposals, they require careful balancing of competing policy goals, but because

Customer charges tend to confuse and alienate customers, neutralize conservation incentives, burden low income households, and perpetuate pricing structures ill-suited to competition. . . .

Customer charges are especially troublesome in the residential context. The cardinal goals in residential ratemaking are making rates understandable, making them easy to administer, and maintaining public confidence in their fairness. Customer charges work at cross purposes with these goals.³

At the same time, however, customer charges play an important role in the rate structure. They reduce utilities' capital costs by ensuring baseline levels of revenue, thereby reducing consumers' rates. They help mitigate rate volatility between seasons by recovering some fixed costs during the low-usage, summer months. They promote equity by ensuring that the rate structure does not shift the full system-costs imposed by low-usage and seasonal customers to normal-usage, high-usage, and year-round customers. And to do these things effectively, customer charges must be adjusted occasionally to reflect changes in overall costs.

The Commission concurs with Xcel, the Department, the Administrative Law Judge, and the Suburban Rate Authority that such an adjustment is appropriate here and that the proposed increase in the customer charge is narrowly tailored to achieve these goals. Neither the percentage increase in the customer charge nor the percentage of fixed costs that the charge will recover is large enough to cause rate shock, to harm low-usage or low-income households, to shake public confidence in the fairness or coherence of the rate structure, or to jeopardize the efficacy of conservation efforts.

For all these reasons, the Commission will decline the recommendation of the RUD-OAG and will accept the settlement's resolution of this issue.

IV. Residential Service Reconnection Charge

A. Introduction and Parties' Positions

The settlement increased the charge for reconnecting previously disconnected residential service from \$15 to \$45.

The Energy Cents Coalition appeared and objected to the increase, pointing out that many, if not

³ *In the Matter of the Application of Minnegasco, a Division of NorAm Energy Corp., for Authority to Increase Its Natural Gas Rates in Minnesota*, Docket No. G-008/GR-95-700, Findings of Fact, Conclusions of Law, and Order (June 10, 1996), at 64-65, footnote omitted.

most, customers seeking reconnection were low-income persons whose service had been disconnected for failure to pay. The Coalition argued that sound public policy counseled against increasing the financial burden on these households. The Coalition also argued that the proposed increase would deplete the public funds available to reconnect low-income households without commensurate public gain.

The RUD-OAG joined the Coalition in opposing the increase.

The Department and the Company explained that Xcel's response to a Department information request had set the average residential reconnection cost at \$42.30, that the new \$45 charge was intended to move the rate to cost, and that the rate had been rounded up for administrative efficiency. Since the increase had not been contested earlier, its potential effects on the Company and ratepayers had not been exhaustively analyzed. The Company did state, however, that it believed the amount of money at issue was extremely small.

B. Commission Action

The Commission concurs with Energy Cents and the RUD-OAG that this 300% increase in the residential reconnection fee should be rejected. Whatever advantages moving rates to cost may hold, those advantages are outweighed in this case by potential harm to low-income households, to publicly and charitably funded energy assistance programs, and to the public interest.

The Public Utilities Act recognizes the need to ensure “affordable, reliable, and continuous service to low-income utility customers” by explicitly authorizing the Commission to consider ability to pay in setting rates and by empowering the Commission to establish programs for low-income residential ratepayers.⁴ Tripling the reconnection fee for disconnected households is inconsistent with this statutory concern.

Furthermore, the proposed increase would reduce the number of households served by energy assistance programs, public and private, by diverting a larger percentage of available funds from energy bills to reconnection fees. This, too, is inconsistent with the statutory emphasis on ensuring affordable, reliable, and continuous service to low-income customers and with the public interest in universal service.

The Commission will therefore reject the increase proposed in the settlement. The Commission will, however, adjust the fee from \$15.00 to \$22.50, recognizing that overall cost increases justify some adjustment even to fees maintained below cost for reasons of public policy.

V. Overall Financial Schedules

⁴ Minn. Stat. § 216B.16, subd. 15.

A. Gross Revenue Deficiency

The above Commission findings and conclusions result in a Minnesota jurisdictional gross revenue deficiency of \$5,793,000, as shown below:

REVENUE REQUIREMENTS SUMMARY (000's omitted)

Average Rate Base	\$	402,648
Rate of Return		8.76% ⁵
Required Operating Income	\$	35,272
Operating Income	\$	31,875
Income Deficiency	\$	3,397
Gross Revenue Conversion Factor		1.705611
Gross Revenue Deficiency	\$	5,793

B. Rate Base Summary

Based on the above findings, the Commission concludes that the appropriate rate base for the test year is \$402,648,000, as shown below:

RATE BASE SUMMARY (000's omitted)

PLANT IN SERVICE		
Production	\$	13,457
Storage		27,522
Transmission		27,368
Distribution		611,355
General		8,199
Common		50,547
TBT Investment		<u>21</u>
Total Plant in Service	\$	<u>738,469</u>

RESERVE FOR DEPRECIATION

⁵ The Settlement document states that the parties agree to an overall rate of return of 8.75%, and a revenue deficiency of \$5,793,000. However, note that the revenue summary calculating \$5,793,000 uses an 8.76% return instead of the agreed upon 8.75% overall rate of return. Inserting 8.75% in the calculation would result in a revenue deficiency of approximately \$5,725,000, not \$5,793,000.

Production	\$	9,834
Storage		19,769
Transmission		14,989
Distribution		241,911
General		8,987
Common		<u>26,369</u>
Total Reserve for Depreciation	\$	<u>321,859</u>

NET PLANT IN SERVICE

Production	\$	3,623
Storage		7,753
Transmission		12,379
Distribution		369,444
General		(788)
Common		24,178
TBT Investment		<u>21</u>
Total Net Plant in Service	\$	<u>416,610</u>

OTHER RATE BASE ITEMS

Construction Work in Progress	\$	17,082
Accumulated Deferred Income Taxes		(59,601)
Cash Working Capital		(7,945)
Materials & Supplies		1,883
Gas in Storage		30,889
Non-Plant Assets and Liabilities		(6,345)
Prepayments		8,760
Rate Case Expense Amortization		0
Annualize CRS		0
New Business CIAC		0
SCADA		0
Customer Advances		(177)
Other Working Capital		<u>1,492</u>
Total Other Rate Base Items	\$	<u>(13,962)</u>

TOTAL AVERAGE RATE BASE

\$ 402,648

C. Operating Income Summary

Based on the above findings, the Commission concludes that the appropriate Minnesota jurisdictional operating income for the test year under present rates is \$31,875,000, as shown below:

OPERATING INCOME SUMMARY
Test Year Ending December 31, 2004
(000's omitted)

UTILITY OPERATING REVENUES

Gas Retail Revenue \$ 577,166

Interdepartmental & Transportation	8,055
Other Operating Revenue	3,662
Gross Earnings Revenue	<u>6,557</u>
Total Operating Revenue	\$ 595,440
UTILITY OPERATING EXPENSES	
Purchased Gas	\$ 452,859
Other Production	2,953
Transmission	773
Distribution	21,252
Customer Accounting	9,612
Customer Service & Information	5,716
Administrative & General	14,519
Amortization	471
Sales, Econ Development & Other	<u>108</u>
Total Operating Expenses	\$ 508,263
Depreciation	\$ 25,849
Taxes:	
Property	\$ 12,225
Gross Earnings	6,557
Deferred Income Tax & ITC	5,511
Federal & State Income Tax	4,149
Payroll & Other	<u>1,997</u>
Total Taxes	\$ 30,439
AFUDC	<u>\$ 987</u>
UTILITY OPERATING INCOME	<u>\$ 31,875</u>

D. Cost of Capital Summary

The above findings result in the following capital structure and rate of return:

<u>Component</u>	<u>% of Capitalization</u>	<u>Cost</u>	<u>Weighted cost</u>
Long Term Debt	48.65%	7.12%	3.46%
Short Term Debt	1.11%	6.29%	0.07%
<u>Equity</u>	<u>50.24%</u>	10.40%	<u>5.22%</u>
Total	100.00%		8.75%

VI. Conservation Cost Recovery Charge (CCRC)

In section 3.3.9 of the Offer of Settlement, the parties agreed to test year conservation improvement (CIP) costs of \$4,185,000, less \$360,829 in expenses for a program not yet approved by the Commissioner, for total test year CIP costs of \$3,824,171.

In section 3.3.12 of the Offer of Settlement, the parties agreed to an estimated sales volume of 79,121,672 dekatherms for the test year. For purposes of calculating the CCRC, it is necessary to make an adjustment for exempt dekatherm sales as detailed on Attachment A to Exhibit 43 entered to the record at the evidentiary hearing. Reducing test year sales volumes by the 5,281,985 exempt dekatherm sales results in 73,839,687 dekatherms applicable to the CCRC calculation.

Dividing the test year CIP costs by the applicable test year dekatherm sales results in a CCRC of \$0.0518 per dekatherm.

As clarified in Exhibit 43, the new CCRC is considered effective upon implementation of final rates in this proceeding. The Company will supply a schedule detailing the activity in the CIP tracker account from the time of implementation of interim rates through the implementation of final rates in this proceeding.

VII. Compliance Filing Required

The Commission will require the Company to make a compliance filing within 30 days of the date of this Order showing the final rate effects of the decisions made here and proposing a plan for refunding the difference between the amounts it collected in interim rates and the amounts it is authorized to collect in final rates. The Commission will establish a brief comment period to give interested persons a chance to review and comment on that filing.

The Commission will so order.

ORDER

1. The Commission finds that the record demonstrates that Northern States Power Company d/b/a Xcel Energy is entitled to increase its gross annual Minnesota jurisdictional revenues by \$5,793,000, in order to produce total gross annual jurisdictional operating revenues of \$601,233,000.
2. The Commission modifies the settlement submitted by the Company and the Department of Commerce to set the residential reconnection charge at \$22.50 instead of \$45.00. In all other respects, the Commission accepts and adopts the settlement, with the technical correction discussed above, setting the overall rate of return at 8.76% instead of 8.75%.
3. Within 30 days of the date of this Order, the Company shall file with the Commission, for its review and approval, and shall serve on all parties to this proceeding, a compliance filing implementing the decisions made herein and containing at least the following items:

- A. Revised schedules of rates and charges reflecting the revenue requirement and the rate design decisions herein, along with the proposed effective date, and including the following information:
 1. A breakdown of Total Operating Revenues by type.
 2. Schedules showing all billing determinants for the retail sales (and sale for resale) of gas, including but not necessarily limited to the items set forth below:
 - a. Total revenue by customer class.
 - b. Total number of customers, the customer charge and total customer charge revenue by customer class.
 - c. For each customer class, the total number of commodity and demand related billing units, the per unit commodity and demand cost of gas, the non-gas unit margin, and the total commodity and demand related sales revenues.
 - B. Revised tariff sheets incorporating authorized rate design decisions.
 - C. Proposed customer notices explaining the final rates and the monthly basic service charge.
 - D. A revised base cost of gas and supporting schedules incorporating any changes made as a result of this rate case, and automatic adjustments establishing the proper adjustments to be in effect at the time final rates become effective.
 - E. Schedules detailing the CIP tracker balance at the beginning of interim rates, the revenues (CCRC and CIP Adjustment Factor), and costs recorded during the period of interim rates, and the CIP tracker balance at the time final rates become effective.
 - F. Copies (revised as necessary) of all standard customer service agreements and contracts for inclusion in Xcel Energy's tariff book.
 - G. A proposal to make refunds of interim rates, including interest calculated at the average prime rate, to affected customers. This proposal shall include the \$300,000 amount for opportunity sales as agreed to in the April 29, 2005 Addendum to the Settlement Offer, and the \$624,909 amount for the incentive refund, if approved in docket G-002/GR-92-1186.
4. Comments on the filings required under paragraph 3 shall be filed within 15 days of the date of the filing.
 5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

This document can be made available in alternative formats (i.e., large print or audio tape) by calling (651) 201-2202 (voice) or 1-800-627-3529 (MN relay service).