

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE PUBLIC UTILITIES COMMISSION

In the Matter of the Petition
of Northern States Power Company
FACT
(NSP) for Authority to Increase
AND
Its Rates for Electric Service
ORDER
in Minnesota

FINDINGS OF
CONCLUSIONS
RECOMMENDED

The above-captioned matter came on for evidentiary hearings before Administrative Law Judge Richard C. Luis at the Large Hearing Room of the Public Utilities Commission, 780 American Center Building, St. Paul, Minnesota on April 5-8, April 11 and April 12, 1988. The record in this matter closed on June 17, 1988.

Public Hearings for the purpose of receiving the comments and questions of affected ratepayers were held as follows (persons attending) (public witnesses testifying):

March 14--Bloomington	(20)	(3)
March 15 -Winona	(19)	(3)
March 16 -Mankato	(19)	(2)
March 17--Minneapolis (afternoon)	(37)	(7)
March 17--Brooklyn Park (evening)	(17)	(1)
March 21--St. Paul (afternoon)	(25)	(5)
March 21--St. Paul (evening)	(19)	(3)
March 22--Pipestone	(13)	(2)
March 23--St. Cloud	(21)	(3)

Commissioner Peterson attended the meetings in Bloomington and Mankato, Commissioner McKanna attended in Winona and St. Paul (evening), and Commissioner Kitlinski attended in Minneapolis, Brooklyn Park and St. Paul (afternoon). Commission staff personnel attended in all locations but Pipestone. The Office of Attorney General had counsel present at all

Metropolitan Area hearings and the Department of Public Service had personnel at all the public hearings. Counsel and staff personnel attended all public hearings on behalf of NSP.

Appearances at the evidentiary hearing were as follows: David A. Lawrence and David M. Sparby, Northern States Power Company, 414 Nicollet Mall, Minneapolis, Minnesota 55401, on behalf of NSP; Michael J. Bradley, Assistant Attorney General, 340 Bremer Tower, 7th Place and Minnesota Street, St. Paul, Minnesota 55101, on behalf of Hubert H. Humphrey, 111, Attorney General of Minnesota (OAG); Ann M. Seha, Special Assistant Attorney General, 200 Lafayette Park Building, 520 Lafayette Road, St. Paul, Minnesota 55155, Joan C. Peterson and Mary Jo Murray, Special Assistant Attorneys General, 1100 Bremer Tower, 7th Place and Minnesota Street, St. Paul, Minnesota 55101, on behalf of the Minnesota Department of Public Service (DPS); Thomas J. Weyandt, Assistant City Attorney, 647 City Hall, St. Paul, Minnesota 55102 on behalf of the City of St. Paul and the St. Paul Board of Water Commissioners (St. Paul); William E. Flynn and David Sasseville, Lindquist & Vennum, 4200 IDS Center, 80 South Eighth Street, Minneapolis, Minnesota 55402-2205 for the St. Paul area Chamber of Commerce (Chamber); Glenn E. Purdue, LeFevre, Lefler, Kennedy, O'Brien and Drawz, 2200 First Bank Place West, Minneapolis, Minnesota 55402 for the Suburban Rate Authority (Suburban); William Mahlum and Christina Stalker, 2222 North Central Life Tower, St. Paul, Minnesota 55101 on behalf of District Heating Development Company, d/b/a District Energy of St. Paul (District Heating); Peggy Wells Dobbins, 915 Aduana Avenue, Coral Gables, Florida 33146, on behalf of Champion International (Champion); Byron E. Starns, Leonard Street and Deinard, 100 South Fifth Street, Suite 1500, Minneapolis, Minnesota 55402 for the Metalcasters of Minnesota (Metalcasters); Elmer W. Scott, 190 Iris Park Place, 1885 University Avenue West, St. Paul, Minnesota 55104, on behalf of the Metropolitan Senior Federation (MSF); Scott Wilensky, 2512 Delaware Street Southeast, Minneapolis, Minnesota 55414 for the Minnesota Public Interest Research Group (MPIRG); George W. Crocker, 1519A East Franklin Avenue, Minneapolis, Minnesota 55404, on behalf of the North American Water Office (NAWO); Special Assistant Attorney General Gregory Dittrich, and Richard Lancaster, Lee Larson, Janet F. Gonzalez, Diane Sorrells, James Lindell and David Jacobson on behalf of the Commission Staff.

Notice is hereby given that, pursuant to Minn. Stat. 14 61, and the

Rules of Practice of the Public Utilities Commission and the Office of Administrative Hearings, exceptions to this Report, if any, by any party adversely affected must be filed within 20 days of the mailing date hereof with the Executive Secretary, Minnesota Public Utilities Commission, 160 East Kellogg Boulevard, St. Paul, Minnesota 55101. Exceptions must be specific and stated and numbered separately. Proposed Findings of Fact, Conclusions and Order should be included, and copies thereof shall be served upon all parties. If desired, a reply to exceptions may be filed and served within ten days after the service of the exceptions to which reply is made. Oral argument before a majority of the Commission will be permitted to all parties adversely affected by the Administrative Law Judge's recommendation who request such argument. Such request must accompany the filed exceptions or reply, and an original and 13 copies of each document should be filed with the Commission.

The Minnesota Public Utilities Commission will make the final determination of the matter after the expiration of the period for filing exceptions as set forth above, or after oral argument, if such is requested and had in the matter.

Further notice is hereby given that the Commission may, at its own discretion, accept or reject the Administrative Law Judge's recommendation and that said recommendation has no legal effect unless expressly adopted by the Commission as its final order.

STATEMENT OF ISSUES

Whether Northern States Power should be authorized to increase its rates for electric utility service to customers in Minnesota by 75 million dollars and to collect the revenues in accordance with the rate design proposed by the Rate Design Settlement herein.

Based upon all of the proceedings herein, the Hearing Judge makes the following:

FINDINGS OF FACT

Jurisdiction and Procedural History

1. On November 2, 1987, Northern States Power Company (NSP, Company or Utility) filed a Petition with the Minnesota Public Utilities Commission (Commission, PUC) for an increase in electric rates of 99.3 million dollars (9.54% increase over current rates). The Company also filed a Petition for Interim Rates in the amount of \$97,008,000 (a 9.35% increase).

2. On December 4, 1987, the Commission accepted the Company's filing and suspended the proposed rates until the Commission determines the reasonableness of the proposed rates, or until September 2, 1988, whichever occurs first.

3. On December 29, 1987, the PUC issued an Order setting Interim Rates in this matter, which Order authorized the Company to collect \$94,980,000 (9.15%) in additional annual revenues as Interim Rates beginning on or after January 1, 1988. NSP is collecting Interim Rates subject to refund if they are found to be in excess of the final rates determined by the Commission.

4. On December 4, 1987, the PUC issued a Notice and Order for Hearing directing that a contested case hearing be convened to determine the reasonableness of the rate changes proposed by the Company.

5. On December 30, 1987, a Prehearing Conference was held before the Administrative Law Judge in St. Paul. Petitions to Intervene were filed by Hubert H. Humphrey, 111, Minnesota Attorney General; the City of St. Paul and Board of Water Commissioners of the City of St. Paul; Suburban Rate Authority; District Heating Development Company, d/b/a District Energy St. Paul, Inc.; Union Carbide Corporation; Champion International Corporation; Metalcasters of Minnesota; National Solid Waste Management Association; Metropolitan Senior Federation; Minnesota Public Interest Research Group; North American Water Office; the St. Paul Chamber of Commerce; and the Minnesota Department of Public Service. All of the Petitions to Intervene were granted. Union Carbide Corporation remains a party to this proceeding, although it made no appearance at the evidentiary hearings. The National Solid Waste Management

Association subsequently withdrew its Petition to Intervene.

6. On January 26, 1988, the Administrative Law Judge issued a Prehearing Order establishing the hearing schedule and procedural guidelines governing the conduct of the case.

7. On March 2 and 3, 1988, five parties, NSP, DPS, OAG, MPIRG and MSF, reached a Stipulation as to all but one of the financial issues in the rate case. The issue specifically reserved from this Stipulation concerns certain amounts in NSP's Conservation Improvement Plan (CIP) Deferred Debit ("Tracker") Account related to the Good Cents Program and Administrative and Regulatory expenses. An Explanation of Stipulation was filed by the five parties with the Administrative Law Judge on April 27, 1988.

8. By April 5, 1988, all of the parties to the rate case reached a Settlement on the majority of the rate design issues. The issues not settled are: The special rate discount for customers who have medical needs which require greater electrical usage, proposed by the DAG; conservation incentives in the design of residential rates as proposed by the MSF; and the demand/side management issues and associated rate structures raised by NAWO. The parties filed Explanatory Comments to the Rate Design Settlement with the Administrative Law Judge on April 27, 1988.

9. On May 27, 1988, the Administrative Law Judge issued an Order Certifying Rate Design Settlement to the Commission. The Order found that the Rate Design Settlement was supported by substantial evidence in the record, with certain reservations. The parties filed Exceptions to the Administrative Law Judge's Certification of Rate Design Settlement on June 17, 1988.

Summary_of Public testimony

10. At the hearings in Winona, Mankato, Minneapolis, St. Paul (afternoon) and St. Cloud, representatives of local economic development organizations appeared and presented testimony praising NSP for providing assistance, including employee volunteers and financial support, to the economic development of the specific localities. The prepared remarks of some of these witnesses were entered into the record as exhibits.

11. In Winona, the Director of Economic Development for the City and the City's Port Authority cited specific instances where the Utility worked with her office to attract a new industry (a producer of fibrous composites) to the Winona area. She believes the new industry was attracted to Winona, in part, because of NSP's competitive rates.

12. In Mankato, the Executive Director of the Mankato Valley Industrial Development Corporation cited the instrumental role played by NSP in the consolidation of several industrial development organizations, which had separately represented and promoted Blue Earth County, Nicollet County, the City of Mankato and the City of North Mankato, into one economic development entity. The Utility also aided in the preparation of a promotional video for

the Industrial Development Corporation and assisted in the Corporation's economic development study for the region.

13. The Group Vice President--Economic Development of the Greater Minneapolis Chamber of Commerce testified that NSP is promoting the Minneapolis area well and had volunteered the time of some of its personnel to help attract companies in the service and industrial sectors to the area. The Chamber is concerned about both attracting new business and not losing some local operations because of a presumption that the "business climate" in the area is poor. The Chamber is grateful to NSP for addressing that concern.

14. Robert De La Vega, an Assistant Commissioner at the Minnesota Department of Trade and Economic Development, outlined NSP's participation in a "partnership" with his agency for attracting business and recruitment of industries to locate in Minnesota. The goals of the partnership are to add jobs in industry, which will operate to increase the State's tax base and the Company's revenues. NSP has placed advertisements promoting the State in industrial trade journals, has prepared a packet of promotional-- informational literature used by the Department and has assisted companies considering moving to Minnesota in site selection processes.

15. NSP is a member of the St. Cloud area Economic Development Partnership, Inc., an organization founded to promote and facilitate business development in the Greater St. Cloud vicinity. The Company has referred businesses considering locating to the St. Cloud area to the Partnership and has provided technical support in promotions made by the Partnership in an effort to attract new industry. It has also assisted the Partnership in market research and it is providing service and rate information to interested companies.

16. The Company's proposal to eliminate the Conservation Rate Break for its residential customers drew a large amount of comment at the public hearings, all of it against elimination of the Break. The speakers stressed that the existence of the Break makes them conscious of conserving energy and gives them an incentive to practice that conservation. Several speakers cited the importance of continued eligibility for the Break for persons on fixed incomes and persons with lower incomes. Several persons challenged the Company's assertion that the Break simply favors persons who choose an apartment life-style by pointing out that many persons rent apartments because they can not afford to buy or live in houses. They consider it inaccurate for NSP to portray apartment living as the "life-style of the rich and famous".

17. Darlene Morse is a quadriplegic person whose consumption of electricity is higher than it otherwise would be because of her medical condition. She requires the use of an electric-powered iron lung to breathe and her home environment is constantly controlled by electric appliances (air purifier, humidifier and dehumidifier). Ms. Morse uses a wheelchair powered by electrically-charged batteries to move from place to place, to raise and lower her body and to adjust her posture. She is on a monthly budget for NSP electric payments of \$58 per month. Approximately \$37 per month of her electric bill goes for the maintenance and operation of medically necessary equipment. She consumes approximately 562 kwh per month to operate that equipment. She believes that amount is "a little high" compared to the costs

of others who use electricity for medically necessary equipment.

Ms. Morse supports the Medical Needs Discount Rate proposal sponsored in this proceeding by the OAG. If she was not required to operate and maintain medically necessary equipment, Ms. Morse believes she would qualify for the Conservation Rate Break.

18. The OAG, at each hearing where it was not represented in person by Assistant Attorney General Bradley or Special Assistant Attorney General Gary Cunningham, presented a written argument in support of the Medical Needs Discount Rate, which was read into the record.

19 . A variety of billing complaints were registered by speakers at several of the public hearings. Representatives of NSP and Consumer Affairs personnel from the PUC staff were present at the hearings for individual conferences with these witnesses after their testimonies concluded.

20. Testimony generally complaining that the Company's costs were too high was offered at several locations, and reasons for high costs were identified by the witnesses: the Company's union contracts are said to be too costly; executives' salaries are too high; and the Company has too much invested in plants and not enough in conservation. It was suggested that NSP should build smaller plants to keep down its required reserve capacity, and several requests for more research into and reliance on wind-generated and solar energy were heard. One suggestion was to design rates so that peak energy charges would be paid only by persons who had air conditioning.

21. Two witnesses at the Minneapolis hearing suggested that the Public Utilities Commissioners be elected rather than appointed officials. The speakers stressed the need for accountability of the Commissioners to the public in the wake of recent publicity involving former Commissioners who subsequently accepted jobs and payments from the utilities they had regulated.

Test Year

22. The appropriate test year for determining the Company's revenue deficiency, if any, is the twelve month period from January 1, 1988 to December 31, 1988, as filed by NSP. No party challenged the appropriateness of this test year as representative of the future period during which rates will be in effect.

The Revenue_Requirements Stipulation

23. The Revenue Requirements Stipulation (Appendix A) features an agreement by NSP to a \$75,000,000 annual rate increase (7.2%). The amount of increase is just and reasonable.

24. The test year rate base agreed to in the Stipulation is \$2,350,498,000. This rate base figure is found to be reasonable.

25. The overall rate of return agreed to by the parties entering into the Stipulation is 9.68%. The rate of return on common equity is stipulated to be 11.7%. Reducing the rate of return on equity to 11.7% from the Company's originally-proposed 12.81% results in a reduction of \$20.1 million in annual revenues. The costs of debt (8.35%) and preferred stock (6.74%) originally proposed by NSP remain unchanged by the Stipulation. An 11.7 rate of return on common equity is found to be reasonable.

26. In its initial filing, the Company proposed a capital structure of 45.25% equity, 43.69% debt and 11.06% preferred stock. The Stipulation provides the same proportions. A capital structure for NSP of 45.25% equity, 43.69% debt and 11.06% preferred stock is found to be reasonable.

27. Application of an overall rate of return of 9.68% to NSP's rate base (\$2,350,498,000) yields a required operating income of \$227,528,000. The

Company's stipulated after-tax income deficiency is \$44,932,000, which is the difference between its required operating income and the stipulated total of

its operating income (\$176,956,000) and Allowance for Funds Used During Construction (AFDC) (\$5,640,000). Multiplication of the Income Deficiency by the Gross Revenue Conversion Factor (to account for the combined effect of Federal and State income Taxes) yields a stipulated Revenue Deficiency of \$75,225,000. The Company stipulates that it will seek only \$15,000,000 of this total. The facts stipulated to in this Finding, which yield a Revenue Deficiency of \$75,000,000 for NSP during the test year, are supported by substantial evidence in the record. The \$75,000,000 Revenue Deficiency is found to be just and reasonable.

28. The NAWO proposes a reduction in the rate base of \$470,000,000, representing a disallowance of the Sherco 3 Plant that began operations in November of 1987. NAWO proposes to allow NSP still to collect an additional \$75,000,000 in revenue, all of which would be spent on demand-side management programs to conserve energy. \$45.5 million dollars of the stipulated revenue increase is raised by applying the stipulated overall rate of return to the \$470,000,000 increase in rate base for the Sherco 3 Plant. If NAWO's proposal is accepted, the Company's authorized rate of return on equity would have to rise to 17%, with an overall rate of return of 12.1%, in order to raise \$75,000,000 in additional rates. NAWO's proposal is found to be unreasonable, contrary to state law and not support by the record.

29. The Administrative Law Judge has treated the Revenue Requirements Stipulation as an evidentiary item for purposes of the record. All non-signatory parties were given the opportunity to present evidence and/or file briefs in opposition to any of its terms. With the exception of the NAWO recommendation mentioned in the previous Finding, none of the non-signatory parties to the Revenue Requirements Stipulation in this case have opposed any of the terms of the Stipulation.

30. The Administrative Law Judge has examined the Revenue Requirements Stipulation (Appendix A) and the Explanation of Stipulation (Appendix B) filed by the parties to the Stipulation on April 21, 1988. It is found that the Stipulation is supported by substantial evidence in all respects. It is further found that the terms of the Revenue Requirements Stipulation result in rates that are just and reasonable. Its adoption is in the public interest. The Stipulation and Explanation of Stipulation are hereby adopted as Findings of Fact, Conclusions and the Recommendation of the Administrative Law Judge with regard to the stipulated issues.

Conservation Improvement Plan(CIP) Tracker Account

31. The Company and the DPS disagree on treatment of certain portions of the CIP Tracker Account. NSP agrees that the resolution of these uncontested revenue issues will not affect the stipulated \$75,000,000 revenue increase

proposed. Any Tracker Account monies disallowed by the PUC in its resolution on the disputed items are proposed to be applied to the Interim Rate refund that will result if the Commission's final Order accepts a \$75,000,000 general rate increase.

32. The Commission approved the Deferred Debit (Tracker) Account by Order dated April 29, 1985. In NSP's last electric rate case (PUC Docket No. E-002/GR-85-558) the Commission allowed NSP to establish a conservation cost recovery method whereby NSP could track Conservation Improvement Plan (CIP) expenditures. The Commission allowed the Company to establish a specific

account, referred to as a "Deferred Debit" or "Tracker". As the Company recovers CIP expenditures from rates, this Account is credited; and as the Company incurs CIP expenditures, this Account is charged. The Tracker Account is then reviewed within the context of a General Rate case.

33. The current Tracker Account balance NSP seeks to recover is \$1,701,300. NSP proposes to recover this amount from the Interim Rate refund.

34. The DPS recommends that the amount recovered by NSP from Interim Rates to balance the Tracker Account be reduced to \$123,500 to reflect disallowance from the Tracker Account of \$734,400 of Good Cents program expenditures and \$843,400 in general administrative expenditures.

35. In its April 29, 1985 Order Approving the Deferred Debit Accounting of Certain Conservation Related Costs, the PUC provided that NSP must show that costs were in fact incurred as part of an approved plan before it can recover any CIP costs in rates. As part of its ruling in The Matter of the Petition of Northern States Power company for authority to change its schedule of Rates for Electric_utility service for customers within the state of Minnesota, Docket No. E002/GR-85-558, an NSP general rate case Order issued on June 2, 1986, the PUC denied the Company's attempt to include costs of the Good Cents Program in its Deferred Debit Account for purposes of that rate case. The PUC held that the Company had not proven that the advanced costs were incurred prudently. Therefore, it held that it was inappropriate to include the Good Cents Program component of CIP costs from recovery through the rate structure. Recovery for the Good Cents Program was denied because NSP failed to request and obtain Commission approval for the program, and thus did not meet the standards for allowed Deferred Debit Account treatment.

36. On October 7, 1986, the PUC issued an Order approving the Company's CIP Program, which Order specifically denied coverage for Good Cents Program expenses. The Commission found that NSP had begun to offer the Good Cents Project to customers in May 1985, "although it was never approved by the Commission . . .". See DPS Exhibit 102, p. 3.

The Commissioner rejected the inclusion of the Good Cents Program as a CIP program because it was not cost effective, not tailored to low-income ratepayers and was a marketing program. The Commission added that NSP would be allowed to submit its proposal on the Good Cents Program for "Commission review" if it was able to resolve the afore-mentioned concerns and provide adequate assurances in documentary form that the project will promote

conservation and not sales. See DPS Exhibit 102, p. 13.

37. The PUC issued an Order Approving Good Cents Home Project for NSP on March 5, 1987. Approval was granted because of modifications made by NSP in the program, specifically:

1. NSP will target the project at electrically heated attached multi-family dwelling units which typically are used as rental units.
2. NSP will charge builders of detached single-family dwellings of size greater than two thousand square feet, a fee of one hundred dollars for the service.

3. NSP, DPS and DEED will jointly develop an adjusted performance standard for attached multi-family housing units.

See DPS Exhibit 103, p. 2.

The Commission's Order in that particular Good Cents docket provided that the modified project, which provides a reasonable means to achieve the goals of conservation improvement and reducing the amount of electricity used, as opposed to having the goal of increasing the market for electricity, was approved as part of NSP's Conservation Improvement Program.

38. The \$743,400 associated with the Good Cents Home Program, which amount represents expenses incurred prior to the PUC's approval of the Program as a CIP, should be excluded from the Tracker Account.

Discussion

The Administrative Law Judge is persuaded that the intent of the Commission with respect to timing the inclusion of Good Cents Home Program expenditures for CIP Tracker Account treatment is to allow such expenditures to be incurred only after approval of the Program (or any other individual CIP) has been Ordered. As DPS witness Scala stated in her testimony, in the past NSP has petitioned for Commission approval in advance to implement a pilot program to cover start-up expenses incurred in initial implementation of new conservation programs. In the instance of the Good Cents Program, NSP failed to follow that procedure. The fact that the Company incurred expenditures in good faith, prior to receiving commission approval for the spending, is not enough to merit inclusion.

39. NSP seeks Tracker Account treatment for \$843,400 in Administrative and Regulatory (A & R) expenditures for CIP program years 1985 and 1986. The DPS recommends a denial of such inclusion for those monies because the Company failed to seek prior Commission approval for incurring those expenses and because it is reasonable to infer from the record that the monies are already incorporated in specific CIP accounts for those years.

40. The Utility has not presented substantial evidence accounting for expenditures of \$843,000 in A & R costs not attributable to specific CIP program budgets for program years 1986 and 1987. The Utility has established that some amount of A & R monies were spent on CIP programs that cannot be isolated to a single program budget, but it has not offered evidence establishing a precise amount.

41. For program years 1986 and 1987, whenever it was not possible to charge A & R expenses to individual CIP programs, the Company charged such expenses to a general administrative account which included administrative expenses for all CIP and operating programs.

42. Administrative costs associated with CIP and operating programs include monies for office equipment, office supplies, stationary, copying, postage, data processing equipment, labor for regulatory reporting, training of staff for performance of that reporting, overload labor, telephone, printing and a variety of other tasks and equipment for which NSP does not

budget separately. See NSP Exhibit 41 (KHW-2), Sch. 5, p. 1 of 3. Such expenses are ongoing and part of routine business operation.

43. For CIP program year 1988, NSP established that it will spend an allocated amount of \$83,421 in A & R expenses attributable to Residential CIP programs and \$95,595 in A & R expenses attributable to Commercial and Industrial CIP programs. \$52,800 each was allocated for A & R expenses attributable to Commercial and Industrial CIP and Residential CIP programs for CIP program year 1985. For program years 1986 and 1987, no specific amount was allocated to evidence an attempt by the Company to identify A & R costs that support all CIP programs, as distinct from A & R costs that support operating programs.

44. For program year 1986 and 1987, it is reasonable to allocate \$284,616 to A & R expenses attributable to CIP programs for monies spent to support the programs which can not be specifically attributed to any specific CIP program. The \$284,616 is computed by totalling approved or uncontested comparable amounts allocated for 1985 and 1988. \$558,784 in A & R expenses sought by the Utilities for tracker account treatment should be denied.

45. The adjustment to NSP's refund of Interim Rates, if a refund is Ordered, attributable to correction of the Company's Tracker Account is a surcharge to the refund (which reduces the amount available for refund) of \$408,116. The total correction to the surcharge proposed by NSP should be \$1,293,184, instead of the \$1,577,800 proposed by the DPS.

Discussion

The DPS recommends an adjustment (surcharge) of \$123,500 in the customer refund of Interim Rates based upon its argument that the Tracker Account should be reduced, to the detriment of NSP, by \$1,577,800 (\$734,400 for the pre-1987 Good Cents adjustment and \$843,400 in Administrative and Regulatory expenses). The Administrative Law Judge recommends that \$284,616 of the \$843,400 Administrative and Regulatory expenses proposed by NSP for the tracker account treatment be allowed. See Finding 44. The Judge's Finding that \$408,116 should be surcharged to any interim rate refund results from his recommended denial of all of the Good Cents program CIP monies proposed for Tracker Account treatment and a recommended denial of Tracker Account treatment of \$558,784 in A & R expenses.

The Administrative Law Judge concludes that to adopt the DPS recommendation that no A & R expenditures can be attributable to the CIP program, apart from A & R monies that can be isolated into specific program accounts, ignores business operations reality in a company as large and complex as NSP. It is reasonable to assume that monies were spent by the Company for items noted at Finding 42 during the period in dispute.

For program year 1988, the Company allocated its estimated A & R expenditures of \$876,429 into amounts of \$697,413 for operating programs, \$95,595 for Commercial and Industrial CIP and \$83,421 for Residential CIP. See NSP Exhibit 41 (KHW-2), Sch. 5, p. 1 of 3. The DPS does not contest these figures, nor does it contest an analogous allocation for program year 1985.

For program years 1986 and 1987, the Company has not made comparable allocations. The treatment reflected in the above Findings represents an attempt to make the allocations not prepared by NSP, allocations that average the uncontested allocated amounts for program years 1985 and 1988.

DPS proposal for depreciation studies

46. The DPS proposes that NSP be Ordered to perform studies every five years to examine the expected economic costs of power plant life extensions or reductions.

47. The parties, including NSP, agree that for purposes of this rate case the 33-year depreciable life span of the Company's Sherco 3 plant should not be altered.

48. The PUC currently requires NSP to seek a depreciation Order annually to establish proper depreciation methods. Current depreciation methods allow for the assessment of current generation and life extension technologies.

49. Although NSP assumes a 33-year life for new plants, some plants are retired prior to the end of 33 years and many, after retrofitting and/or conversion from base load to peak-use function, have useful lives longer than 33 years.

50. The mandatory studies proposed by the DPS require estimation of numerous variables such as alternative generation costs, fuel and maintenance costs which will occur more than 30 years from the studies' dates.

51. The record does not establish that the mandatory periodic studies regarding plant depreciation proposed by the DPS are necessary.

Discussion

The concern raised by the DPS is valid. Plants which are retired prior to 33 years of useful life cause ratepayers to underfund the consumption of such assets during the period of useful life, and plants that are used for over 33 years result in overpayments by ratepayers during the originally-presumed lifespan. The Department's proposal is very general, and provides insufficient details as to how these studies would operate and what they would cost for the Administrative Law Judge to be able to recommend that they be Ordered at this time. See DPS Ex. 93, p. 8

Rate Design

Principles_of Rate Design

52. The Company bears the burden of proof that the proposed rate design is just and reasonable and not unreasonable, preferential or discriminatory. Minn. Stat. sec. 216.03 and 216B.16.

53. When the Commission allocates the revenue deficiency among classes of customers to provide for the recovery of a revenue requirement, it acts in a quasi-legislative capacity. *Hibbing Taconite Co. v. Minnesota Public Service Commission*, 302 N.W.2d 5, 9 (Minn. 1980); *St. Paul Area Chamber of Commerce v. Minnesota Public Service Commission*, 312 Minn. 250, 262, 251 N.W.2d 350, 358

(1977).

54. Having established a revenue deficiency, if Northern States Power does not establish the reasonableness of its proposed rate design, then the

Commission must determine just and reasonable rates to allow for the recovery of the revenue deficiency. Minn. Stat. sec. 216B.1b, subd. 5.

55. The principles of rate design governing the exercise by the Commission of its quasi-legislative authority may be summarized as follows:

- a) Rates should be designed to provide the company with a reasonable opportunity to earn its revenue requirement as determined in the proceedings;
- b) While cost of services is an important factor to be considered by the Commission in determining the allocation of rates among customers, the Commission must also consider non-cost factors inherent in a proper balancing of public policy and private need. *Reserve Mining Co. v. Public Utilities Commission*, 344 N.W.2d 389, 393 (Minn. 1983); *Ste Paul Area Chamber of Commerce v. Minnesota Public Service Commission*, supra, at 358 (1977);
- c) Rates should provide a reasonable continuity with past and future rates to prevent inordinate and immediate impact on existing and future customers;
- d) Rates should be as simple, understandable and easy to administer as is practical; and
- e) In *Reserve Mining Co. v. Public Utilities Commission*, supra, 344 N.W.2d at 393, the Court listed the following relevant noncost factors: whether the rates would be disruptive; revenue stability; affordability; the ability to pass costs on to others; and the ability to decrease the impact of a rate increase through tax deductions.

The Rate Design Settlement

56. On May 27, 1988, the Administrative Law Judge issued an Order Certifying Rate Design Settlement in this matter (Appendix C) in that Order, the Judge certified the Offer of Settlement attached thereto (Appendix D) to the Commission to determine whether acceptance of the Offer of Settlement was in the public interest and whether the Settlement is supported by substantial evidence in the hearing record. Subject to the limitations and conditions more particularly described in the Memorandum of his Order, the Administrative Law Judge recommended to the Commission that the Offer of Settlement be accepted by it as appropriately resolving the rate design issues in this proceeding, with the exception of the special rate discount for customers that have medical needs which require greater electric usage, as proposed by the Office of the Attorney General, and the conservation incentives in the design of residential rates, as proposed by the Metropolitan Senior Federation. With those qualifications, it was recommended that the Commission accept the Offer

of Settlement as an appropriate device for implementing the revenue increase, if any, it grants in its final Order in this case.

57. The Rate Design Settlement arrived at by the parties was explained in detail in Explanatory Comments by the Parties to the Rate Design Settlement (Appendix E) filed on April 27, 1988. The judge hereby adopts his order

Certifying Rate Design Settlement, the Offer of Settlement and Explanatory Comments by the parties to the Rate Design Settlement package as his Findings of Fact, Conclusions and Recommendation to the PUC with respect to the rate design issues settled therein.

58. The Rate Design Settlement contains the agreement of all parties regarding revenue apportionment. The percentages of increase to each customer class are based upon a \$75,000,000 increase in annual revenues stipulated to by NSP. The increase to the Residential class is 7.71%. A 6.9% increase in rates to Commercial and Industrial customers, an increase of 7.52% for Other Sales to Public Authorities, and a 2.59% increase for Street and Area Lighting are the other rate increases in the Settlement.

59. If the Public Utilities Commission determines a different revenue deficiency than \$75,000,000, the parties agree that the inter class and intra class revenue and rate relationships contained in the Offer of Settlement and its accompanying Exhibits (See Appendices D and E) should be applied to the Commission-determined revenue deficiency.

Discussion

The Administrative Law Judge adopts as his Discussion of the Rate Design Settlement the Memorandum (pp 3-5) to his May 27, 1988 Order Certifying Rate Design Settlement (Appendix C).

While adopting, without change, his Order of May 27, 1988, the Administrative Law Judge notes that the Exceptions filed by the parties on June 17 contain different explanations for the portions about which the Judge expressed reservations than those he had before him prior to certifying the Settlement.

The Medical Needs Discount

60. The OAG proposes a 25% discount on the monthly energy charge for Residential Class customers whose medical needs require high electric usage. The discount would apply to all usage up to 1000 kwh per month.

61. Any household which has a full time member who is a paraplegic or quadriplegic person or who requires the regular use of a power wheelchair, hemodialysis machine or special respiratory equipment (such as iron lung machines) can qualify for the proposed discount by submitting a form signed by a physician declaring their eligibility. The OAG proposes setting the medical needs discount at 25% as an extension of the Conservation Rate Break (CRB), which currently provides approximately a 25% energy discount to customers whose low usage allows access to that discount.¹ The 1000 kwh limitation includes an assumed medical related usage level of 600 kwh plus the 400 kwh of personal usage contemplated by the CRB.

¹the CRB currently provides a \$4.00 discount to customers who use less than 300 kwh per month, and, if usage is between 300 and 400 kwh per month,

the discount is \$2.00. Under the Rate Design Settlement recommended for adoption in this case, the CRB is \$3.50 for usage of up to 300 kwh and \$1.75 per month if the customer's usage falls between 301 and 400 kwh. See Offer of Settlement (Appendix C), p. 6.

62. The OAG estimates approximately 1000 NSP Residential customers would qualify for the proposed Discount. The estimated maximum discount is \$200 per year for an annual cost to other Residential customers of \$200,000. Setting 1000 kwh as an appropriate amount of usage to which to apply the Discount represents the OAG's estimate of the electric needs of persons who would qualify for the Discount. Implementing a more exact method of matching need to usage would involve expenses that could exceed the total amount discounted.

63. NSP opposes the Medical Needs Discount for several reasons, including the lack of showing of a need for a discount, the lack of any income test, the lack of integration with assistance programs and a concern that the PUC should be cautious in becoming involved in Rate Discounts based on perceived needs of various customer groups.

64. The OAG proposes the establishment of a task force to determine whether it is appropriate to include other special medical needs as eligibility criteria for the Discount. The record fails to establish a need for such a task force, in light of the next Finding.

65. The record does not establish a basis for estimating how many households in NSP's service territory could qualify for the Medical Needs Discount. In the absence of information regarding the potential cost to other NSP customers of implementing the Medical Needs Discount as proposed, it should not be adopted.

Discussion

The proposal for establishing a Medical Needs Discount in the Residential Rate structure is a response to a valid concern--there are people whose electrical bills are higher than they would otherwise be but for those persons' handicapping conditions. As pointed out by the OAG, the PUC has acted to set rate relief for handicapped persons whose handicap results directly in increased utility bills (the discount in toll rates available to hearing-impaired customers of Northwestern Bell who use specialized telephonic equipment). The Judge is persuaded that the Commission has the authority to grant such a rate discount, even if the discount only partially alleviates a state wide problem, because there is a direct connection between the handicapping conditions and increased, otherwise unnecessary electrical usage.

The Administrative Law Judge stops short of recommending implementation of the Discount at this time, however, because the record contains only the hearsay testimony of OAG witness Schmidt to establish that there are about 1000 customers who could qualify. Schmidt's information, allegedly from the United Handicapped Federation, is not documented and does not represent research done by the witness. Another problem with the evidentiary foundation

for establishing the reasonableness of the Discount in this record is that the only testimony establishing the appropriate usage level for application of the Discount is that of witness Morse, who expressed the view that her electrical usage was "a little high" when compared to others who might qualify for the discount. See Public Hearing Testimony-St. Paul (afternoon), T., p. 31. This evidence is too vague to substantiate a conclusion that 1000 kwh is an appropriate upper limit on the usage level qualifying for the discount.

Inverted-Rate-Proposal- of the Metropplityn Senior Federation

66. The MSF proposes the adoption of an inverted rate schedule similar to that used by Philadelphia Electric. That rate structure uses a flat winter rate as a base rate, adds a surcharge to the base rate for the first 300 kwh of summer usage and a higher surcharge to all other summer usage. MSF's proposal also features a credit to persons who consume less energy than they had in the past.

67. Adoption of the inverted rate proposed by the MSF would result in a large, but unquantified impact on some residential customers. It would eliminate the winter end-step discount, thus increasing significantly the rates for space heating customers. The extent of the 'rate shock' under such a scenario is unknown because the MSF has not calculated the dollar effect of implementing its proposed inverted rate at various usage levels.

68. The records contains insufficient evidence to support adoption of the inverted rate proposal of the MSF. The proposal should be rejected.

Discussion

The inverted rates proposed by the MSF are premised on the assumption that costs vary as a function of an individual customer's consumption, without other variables. That assumption ignores the fact that regardless of consumption level, individual customers impose high capacity and energy costs on the system if they consume during peak periods. Inverted rates are inappropriate as a method to achieve conservation because an inverted rate structure sends inappropriate price signals and may not encourage economic conservation.

Without information on the impact that the MSF inverted rate plan would have on NSP's customers it is inappropriate for the PUC to adopt such a rate at this time. In addition, it is evident that the rate would have an immoderate impact on space-heating customers, which contravenes one of the goals of regulatory rate design. While the goals of such a possibly-drastic rate design proposal are laudable-to wake our society up to the reality that we must conserve our burning of coal in order to prevent acid rain and the "greenhouse effect" on our earth and atmosphere, the MSF has failed to provide evidence of the monetary impact of its proposal. Without such evidence, the Administrative Law Judge is unable to recommend adoption of the inverted rate.

It is also noted that the proposal to provide credits for conservation of energy in comparison to 'past' usage has the potential of awarding persons who waited until after the proposed Rate Design went into effect, at the expense of customers who showed conservation awareness in the past and already made energy-saving improvements.

NAWO's Demand-Side Management Proposals

69. Finding 28 details the revenue impact of NAWO's proposals in this case. That Finding is incorporated by reference herein.

70. A stated purpose of NAWO's involvement in this case is to propose adoption of rate structures that bring the company and the PUC to aggressive, proactive demand-side management with a major emphasis on insuring the

efficiency of lighting, appliances, drivepower, low and high temperature heating and other "end-use" electrical technologies. NAWO Exhibit 55, p. 6. NAWO advocates implementation of cost-effective, efficient methods of producing low cost electrical energy to meet the threats it sees posed by acid rain, the greenhouse effect and reliance on nuclear power.

71. NAWO considers NSP to be better than most electric utilities in the implementation of programs that increase electrical end-use efficiency. However, in relation to capturing the full potential for increased end-use efficiency, NAWO believes the Company has far to go.

72. To illustrate the importance of implementing end-use efficiency, assuming that a unit of energy saved by implementation of conservation programs is equivalent to a potential unit of energy produced by constructing a plant for capacity purposes (Sherco 3), NAWO presented cost comparisons for the production of a kwh of electricity and the cost of a kilowatt hour saved by the Company's Appliance Rebate, Good Cents Homes, Chiller Efficiency Improvement, Lighting Efficiency Improvement and Motor Efficiency Improvement Programs. NAWO Exhibit 55, pp. 10-12. For each program, NAWO's figures purport to show "production" of electrical energy and capacity at a fraction of the cost it takes the Company to build capacity and produce energy in its plants.

73. In order to capture greater end-use efficiency, NAWO advocates spending the amount of the revenue increase stipulated in this proceeding on existing company conservation programs and development of new endeavors such as additional rebates, "buying back" of energy saved (using a competitive bidding process), the marketing of negotiable instruments secured by the Utility's promise to pay a building or factory owner a certain amount of money for consuming no more than a certain level of energy, deployment of a sliding scale for connection fees whereby the less electrically-efficient customers would be charged more for getting on NSP's system and targeted retrofitting. NAWO Exhibit 55, pp. 15-18. NAWO asserts that the rates NSP seeks in this proceeding are almost three times higher than the cost-effective limit of implementing such programs.

74. NAWO proposes the restructuring of the Company's rates to include an "efficiency clause" that adjusts rates, month-by-month, in a fashion comparable to the current monthly fuel adjustment clause, according to changes in NSP's revenue requirements caused by electrical end-use efficiency improvements within the Company's system.

75. The proposed investment of an additional \$75,000,000 in end-use efficiency, demand-side management programs, which monies would be made available, in part, by excluding the Sherco 3 Plant from Rate Base, should be rejected and the programs for conservation improvement advocated by NAWO in this proceeding should not be implemented at this time.

76. NAWO's proposal for an "efficiency clause" that adjusts rates according to savings attributable to the demand-side management programs advocated in this proceeding should be rejected.

Discussion

Minn. Stat. sec. 216B.01 (1986) declares that it is in the public interest that public utilities be regulated so as to provide retail customers of

electric service in Minnesota 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. sec. 216B.16, subd. 6 (1986) lists the factors to be considered by the Public Utilities Commission in the exercise of its powers to determine just and reasonable rates for public utilities. The statute mandates due consideration be given to the need of the public utility for revenue sufficient to enable it to meet the costs of furnishing its service, including adequate provision for depreciation of its utility property used and useful in rendering service to the public, and to earn a fair and reasonable return upon the investment in such property. Subdivision 6 further provides:

In determining the rate base upon which the utility is to be allowed to earn a fair rate of return, the Commission shall give due consideration to evidence of the cost of the property when first devoted to public use, to prudent acquisition cost to the public utility less appropriate depreciation . . . and to other expenses of a capital nature.

Minn. Stat. sec. 216B.243 (1986) requires a public utility to receive prior approval for construction of a new large energy facility by justifying the need for the facility via the Certificate of Need process. Where a facility has received approval by way of a Certificate of Need and where that property is prudently acquired and used and useful in rendering service to the public, the PUC must allow the public utility to recover revenue sufficient to cover the costs of providing that service.

In 1982, a Certificate of Need was granted for construction of the Sherco 3 Plant which the NAWO seeks to exclude from rate base in this case. The Plant began commercial operation in November, 1987. Sherco 3 was prudently constructed and is currently used and useful in rendering service to the public. As a result, and in accordance with the statutory scheme outlined above, there is no legal basis for exclusion of Sherco 3 in the rate base component for purposes of computing an appropriate rate adjustment in this proceeding.

In order to implement NAWO's proposal to grant NSP a \$75,000,000 rate increase while excluding Sherco 3 from rate base, the Commission would have to grant a rate of return on common equity slightly greater than 17%. Such a return in today's market is excessive. The granting of that high a rate of return is not supported by any rate of return analysis in this record. The testimonies of rate of return witnesses in this proceeding clearly support the stipulated amount of 11.7% return on common equity.

An increase in the Company's authorized overall rate of return from the stipulated 9.68% to 12.1%, the amount needed to finance the stipulated revenue requirement if Sherco 3 is excluded from rate base, is also an excessive return in today's economy. Therefore, NAWO's proposal that NSP be allowed to earn a rate of return sufficient to finance \$75,000,000 and demand-side energy conservation improvements has been found to be unreasonable.

Finally, NAWO did not present sufficiently specific proposals for how NSP should spend the \$75,000,000 in conservation improvements. It would be more

appropriate for NAWO to present specific conservation proposals in the annual Conservation Improvement Plan proceedings conducted by the Commission or in a presentation before a generic, industry-wide advisory board. Through such processes, the Commission could adequately examine the proposals and determine how NSP, or any other electric utility, should spend the funds dedicated to such projects. There are insufficient guidelines and information for appropriate and cost-effective use of the \$75,000,000 proposed annual rate increase for conservation in this record.

Concepts-to Govern

77. It is the intention of the Administrative Law Judge that the concepts set forth in the Findings herein should govern the mathematical and computational aspects of the Findings. Any mathematical or computational errors are unintentional and should be corrected to conform to the concepts expressed in the Findings.

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

CONCLUSIONS

1. The Minnesota Public Utilities Commission and the Administrative Law Judge have jurisdiction over the subject matter of this hearing pursuant to Minn. Stat. Ch. 216B and sec. 14.57-14.62, and Minn. Rules 1400.5100-.8300.
2. The Commission gave proper notice of the hearing in this matter, has fulfilled all relevant substantive and procedural requirements of law or rule and has the authority to take the action proposed.
3. Any of the foregoing Findings more appropriately considered Conclusions of Law are hereby adopted as such.
4. The proper test year for determining Northern States Power's revenue deficiency for general rates is the 12-month period between January 1, 1988 and December 31, 1988.
5. It is appropriate to adopt the Revenue Requirements Stipulation filed in this matter.
6. The Company's appropriate rate base for purposes of this case is

\$2,350,498,000.

7. It is inappropriate to deduct \$470,000,000 from the Company's rate base for the purposes of this case to reflect disallowance of the Sherco 3 Plant as a component of the rate base.

8. NSP's appropriate test year required operating income is \$227,528,000.

9. It is appropriate to deduct \$408,116 from the Interim Rate refund, if any, Ordered in this case to permit recovery by NSP of past conservation expenditures.

10. It is appropriate to disallow recovery by NSP from the Interim Rate refund of \$743,400 associated with the Good Cents Home Program, which amount

represents expenses incurred prior to the Commission's approval of the Program as a Conservation Improvement Program.

11. It is appropriate to disallow recovery by NSP from the Interim Rate refund of \$558,784 in Administrative and Regulatory expenses for Conservation Improvement Program years 1986 and 1987.

12. The appropriate capital structure for Northern States Power is 45.25% common equity, 43.69% debt and 11.05% preferred stock.

13. The appropriate cost of debt for NSP is 8.35%.

14. The appropriate cost of preferred stock for NSP is 6.74%.

15. The appropriate cost of common equity for NSP is 11.70%.

16. NSP's appropriate test year overall rate of return is 9.68%.

17. NSP's test year revenue deficiency is \$75,000,000.

18. It is appropriate to reject the DPS proposal for an order mandating periodic studies regarding plant depreciation.

19. It is appropriate to adopt the Rate Design Settlement of the parties in this matter in accordance with the Administrative Law Judge's May 27, 1988 Order Certifying Rate Design Settlement, after due consideration of the parties' Exceptions to the Order.

20. It is appropriate to retain the relative inter class and intra class rate relationships stated in the Rate Design Settlement if the Commission Orders a revenue deficiency different from \$75,000,000.

21. It is appropriate to increase rates for the Residential Class by 7.71%.

22. It is appropriate to increase rates for the Commercial and Industrial Class by 6.90%.

23. It is appropriate to increase rates for Other Sales to Public Authorities by 7.52%.

24. It is appropriate to increase rates for Street and Area Lighting by 2.59%.

25. It is appropriate to reject the proposed adoption of a Medical Needs Discount proposed by the OAG.

26. It is appropriate to reject the Inverted Rate proposal for the Residential Class sponsored by the Minnesota Senior Federation.

27. It is appropriate to reject NAWO's proposal for restructuring of the Company's rates to include an efficiency clause that adjusts rates according to revenue requirements caused by electrical end-use efficiency improvements within the Company's system.

28. It is appropriate to reject NAWO's proposal to require NSP to invest the monetary equivalent of the rate increase authorized, if any, in this proceeding in demand-side management programs advocated by NAWO.

THIS REPORT IS NOT AN ORDER AND NO AUTHORITY IS GRANTED HEREIN. THE PUBLIC UTILITIES COMMISSION WILL ISSUE THE ORDER OF AUTHORITY WHICH MAY ADOPT OR DIFFER FROM THE FOLLOWING RECOMMENDATIONS.

It is the recommendation of the Administrative Law Judge to the Public Utilities Commission that it issue the following:

ORDER

1. Within 30 days of the date of this Order, Northern States Power shall file with the Commission for its approval, and provide to all parties in this proceeding, a revised schedule of rates and charges, incorporating the decisions made herein, so as to allow the production of revenues for the test year equal to the revenue requirement herein, in accordance with the rate design provided for herein.

2. Within 30 days of the date of this Order, the Company shall file with the Commission for its review and approval, and serve upon all parties to this proceeding a proposal to refund to its customers any monies collected in excess of the revenue requirement authorized herein.

3. This Order shall become effective immediately.

Dated this 23rd day of June, 1988.

RICHARD C. LUIS
Administrative Law Judge

Reported: Harold M. Reiner & Associates

Transcripts Prepared

NOTICE

Pursuant to Minn. Stat. 14.62, subd. 1, the agency is required to serve its final decision upon each party and the Administrative Law Judge by first class mail.

