



Megan J. Hertzler
Assistant General Counsel

414 Nicollet Mall, 5th Floor
Minneapolis, Minnesota 55401
Phone: 612.215.4589
Fax: 612.215.4544

January 29, 2007

Illona A. Jeffcoat-Sacco, Executive Secretary
North Dakota Public Service Commission
State Capitol Building, Dept. 408
Bismarck, ND 58505-0480

Re: *Application of Northern States Power Company, a Minnesota corporation and wholly owned subsidiary of Xcel Energy Inc. for Authority to Increase Rates for Natural Gas Service in North Dakota*
Case No. PU-06-525

Dear Ms. Jeffcoat-Saco:

The North Dakota Public Service Commission (the "Commission") conducted an informal hearing, on January 24, 2007, related to setting interim rates in the above-entitled docket. During that hearing, the issue arose whether the return on equity ("ROE") calculated by Commission Staff as an undisclosed component of a settlement in the prior rate case, PU-400-04-578, should be considered in setting interim rates. NDCL § 49-05-06 requires in part:

The interim rate schedule must be calculated using ... a rate of return on common equity for the public utility equal to that authorized by the commission in the public utility's most recent rate proceeding.

Commission Staff asserted that it was entitled to disclose the underlying ROE because the data necessary for calculating the ROE was contained in Staff notes related to the settlement, which, in turn, could be obtained by a requesting party under the State's open records law. While there might be a duty to disclose such information to an outside party upon request, under North Dakota law, the information is not admissible in evidence.

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To help encourage settlements, the North Dakota Rules of Evidence, Rule 408, provides in part: “Evidence of conduct or statements made in compromise negotiations is . . . not admissible.” This privilege is applied to administrative proceedings pursuant to NDCC 28-32-06(2), which states in part:

Upon proper objection, evidence that is irrelevant, immaterial, unduly repetitious, or excludable on constitutional grounds, or on the basis of evidentiary privilege recognized in the courts of this state, may be excluded. . . . **The North Dakota Rules of Evidence in regard to privileges apply at all stages of an administrative proceeding under this chapter.**

(Emphasis added.) The Commission’s Rules on Practice and Procedure, Section 69-02-05-06, similarly provide:

Evidence is admissible in accordance with the North Dakota Rules of Evidence. The commission or the hearing officer, however, may waive the rules of evidence where such waiver is necessary to ascertain the substantial rights of a party but only relevant evidence may be admitted.

Based on the express terms of the Settlement Agreement in Case No. PU-400-04-578, a waiver of the privilege is unsupported. The Settlement Agreement at page 7 expressly recognizes that all underlying information used to reach the settlement is privileged and would not be used as evidence in either that proceeding or any other proceeding:

It is understood and agreed that all offers of settlement and discussions related to this Settlement Agreement are privileged and may not be used in any manner in connection with proceedings **in this case or otherwise**, except as provided by law.

(Emphasis added.)

Staff argues that the language “except as provided by law” justifies disclosure under the North Dakota open records law.¹ Even assuming Staff is correct and the information is subject to disclosure, that would not permit the information to be introduced into evidence. This distinction was recognized by the North Dakota

¹ Article XI, Section 6 of the North Dakota Constitution and NDCC 44-04-18.

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Supreme Court in *Northern States Power Company v. North Dakota Public Service Commission*, 502, N.W.2d 240, 244 (N.D. 1993), requiring the disclosure of trade secret contracts filed with the Commission in part because nondisclosure was an evidentiary privilege and an administrative proceeding had not been initiated. In the current case, an administrative proceeding has been initiated and the setting of interim rates is part of that proceeding, making the privilege fully applicable.

If the Commission were to allow into evidence the ROE used by Staff to calculate a revenue requirement in the Settlement Agreement, it would have a significant chilling effect on settlements. The concept of a “black box” settlement is that while neither party agrees on the justification for the agreed upon revenue requirement (*e.g.* the appropriate ROE to use in that case and as interim rates in the next case) they do agree on the overall reasonableness of the settled upon revenue requirement. The Explanatory Note for Rule 408, requiring exclusion of settlement discussions, states that “the policy underlying this rule is the furtherance of compromise and settlement of disputes among parties.” Allowing the Staff’s calculation of the ROE in the prior settlement to be used as evidence when setting interim rates would set a poor precedent in direct conflict with Rule 408.

The Settlement Agreement did not adopt any specific ROE or any other expense, stating:

The Settlement Agreement does not establish any principle or precedent, nor adopt or recommend any specific type of amount of expense or rate base, **for this or any future proceeding.**

Settlement Agreement at 7 (emphasis added). Because the resolution of the most recent North Dakota rate case did not result in a “rate of return on common equity for the public utility,” the use of the most recently authorized Commission return from Case No. PU-400-00-521 provides a reasonable result and is consistent with both the language and spirit of Section 49-05-06. The purpose of using a prior authorized return is to set the interim return at a reasonable level. In this case, the reasonableness of that authorized return is demonstrated by the Company’s direct testimony supporting an 11.3 percent return on common equity for final rates. In addition, if the Commission later approves a lower return for final rates, any resulting reduction in the revenue requirement below the interim revenue requirement will be refunded with interests. Thus, the interests of ratepayers are fully protected.

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Please contact me with any questions, or if I can be of further assistance.

Sincerely

A handwritten signature in black ink, appearing to read "Megan J. Hertzler". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Megan J. Hertzler
Assistant General Counsel