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PUBLIC SERVICE COMMISSION

HAND DELIVERY

Darrell Nitschke
Executive Secretary
Public Service Commission
600 E. Boulevard, Dept. 408
Bismarck, ND 58505-0480

Re: Northern States Power Company Electric Rate Increase Application

Dear Mr. Nitschke:

Enclosed please find the original and ten copies of the Advocacy Staff Reply Brief and Affidavit of Service by Mail.

Thank you.

Sincerely,

Douglas A. Bahr
Solicitor General

jjt

cc: Megan Hertzler (w/encs.)

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STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Northern States Power Company)
Electric Rate Increase)
Application)

**ADVOCACY STAFF
REPLY BRIEF**

Case No. PU-07-776

STATEMENT OF THE CASE

This Reply Brief is limited to responding to arguments made by Northern States Power Company (NSP) in the Initial Brief of Excel Energy (NSP Br.). Advocacy staff does not abandon any arguments or waive any issues raised in the Advocacy Staff's Post-Hearing Brief by not repeating them here, and incorporate that brief by reference.

ARGUMENT

I. NSP mischaracterizes the issues.

A. The issue is whether the rate increase is just and reasonable.

NSP repeatedly asserts it acted prudently.¹ But as acknowledged at the hearing and in Advocacy Staff's Post-Hearing Brief, Advocacy Staff does not assert NSP acted imprudently when everything is taken into account, including the Minnesota Metropolitan Emission Reduction Program (MERP) legislation.² This Commission, however, considers much more than just prudence when deciding whether to approve a rate increase. Under N.D.C.C. § 49-02-03, the Commission must also determine whether the public utility demonstrated the rate increase is just and reasonable.³ To ascertain whether a rate is just and reasonable, the Commission considers, among other things, whether the utility demonstrates its property was used and useful to serve customers in North Dakota.⁴ NSP did not meet its burden for the reasons outlined in this and the

¹ NSP Br. at 4-5, 7-8.

² Tr. 639, ll. 15-25; Tr. 640, ll. 1-5; Post-Hearing Br. 22.

³ See also N.D.C.C. §§ 49-04-02, 49-05-06; Mont.-Dakota Utils. Co. v. Pub. Serv. Comm'n, 413 N.W.2d 308, 315 (N.D. 1987).

⁴ N.D.C.C. § 49-06-01.

Advocacy Staff's Post-Hearing Brief.

The issue is also not whether “all prudently incurred costs are recoverable.”⁵ As explained at the hearing and in Advocacy Staff's Post-Hearing Brief, NSP should recover all of its prudently incurred costs.⁶ The issue in this case is whether costs incurred based on Minnesota policy and for Minnesota's benefit should be collected from Minnesota or North Dakota customers. It is unjust and unreasonable to require North Dakota ratepayers to pay for costs not incurred for their benefit.

B. The issue is not NSP's future quality of service to North Dakota customers.

In what sounds more like a threat than an argument, NSP asserts Advocacy Staff's position would undercut NSP's ability to continue providing quality service to North Dakota customers, and prohibit NSP from making future generation investments in the state of North Dakota.⁷ NSP's purported concern with being able to make future generation investments in the state of North Dakota is interesting in light of the fact NSP has been doing business in North Dakota since 1910, but still does not own any generation assets in North Dakota. Given NSP's history over the last 100 years, it is difficult to believe that the Commission's decision in this proceeding will impact NSP's future deployment of generation assets in North Dakota. NSP's history also belies its promises to work with the Commission and make changes in the future.⁸

This proceeding will not impact NSP's ability to provide quality service. First, as previously mentioned, Advocacy Staff does not argue prudently incurred costs should not be recovered. The issue is from whom should the costs be recovered.⁹ Second,

⁵ NSP Br. at 5.

⁶ Tr. 625, ll. 1-9; Ex. 23, p.9, ll. 8-15; Advocacy Staff Post-Hearing Br. 19.

⁷ NSP Br. 3. NSP points out its decisions have resulted in low costs and high quality service for its North Dakota customers. NSP Br. 5. One would expect that a utility serving concentrated customer areas in three of North Dakota's larger cities would indeed be low cost.

⁸ Tr. 124, l. 25; Tr. 125, ll. 1-20.

⁹ Tr. 625, ll. 13-21.

NSP's earnings levels are determined primarily by NSP's management, including decisions whether and when to file rate cases. If it chooses, NSP could recover costs excluded by the Commission from Minnesota ratepayers. Furthermore, NSP can file for a rate increase in North Dakota as often as it deems appropriate, permitting it to recover from North Dakota ratepayers capital prudently invested to serve North Dakota ratepayers. Thus, by prudently investing capital and seeking appropriate rate increases from the appropriate jurisdictions, NSP is ensured cost recovery and adequate earnings to provide quality service.

C. The issue is not NSP's promise of future action.

NSP asserts the Commission should not look "backward and withhold essential revenues needed to provide service to [its] North Dakota customers."¹⁰ But the very role of the Commission is to determine that rates are fair and reasonable based on prudent investments in North Dakota. To do so requires the Commission look backward to determine the purpose and need of the assets included in rate base. The Commission would be derelict in its duties to approach a rate case application any other way. Had NSP not wanted the Commission to be looking "backward," it should have sought an advance determination of prudence from the Commission. It is inappropriate for the Commission to simply ignore NSP's past actions and accept whatever NSP has done to this point, and start anew by accepting NSP's promise to now develop a resource planning process that will actually consider North Dakota's interests. The Commission must look backwards to determine the appropriateness of NSP's requested rate increase.

D. The benefits of an integrated system are not at issue.

NSP essentially argues that, because it has an integrated system, and because all customers benefit from that system, all customers must pay the costs associated

¹⁰ NSP Br. 4.

with the system.¹¹ NSP's argument eviscerates this Commission's regulatory oversight.¹² Of course all customers benefit from an integrated system. That does not mean, however, that it is just, reasonable, or fair to charge all costs of the integrated system to all customers. "Used and useful" requires North Dakota ratepayers have received a quantifiable benefit. Accordingly, the Commission must consider why expenditures were incurred and the amount of quantifiable benefit, if any, received by North Dakota ratepayers because of the claimed expenditures.

NSP asserts its reasonable expectation of cost recovery for operation of its integrated system will be undercut if the Commission does not allow NSP to recover North Dakota's proportionate cost.¹³ But the Commission cannot delegate its statutory responsibility for determining the appropriateness of a rate increase to another commission or to a cost allocation method just so NSP will be assured of full cost recovery. Again, if NSP wanted assurance that it could recover costs from North Dakota rate payers, it could have sought an advance determination of prudence from the Commission. Because it did not do so, NSP accepted the risk that this Commission would not approve all costs.

It is unfair and improper for NSP to make significant expenditures for the benefit of Minnesota and then expect this Commission to simply accept carte blanche whatever Minnesota requested, approved, or mandated. The Commission's duty is to review NSP's rate request based on state law, not to kowtow to whatever Minnesota approved in order to ensure NSP full cost recovery. And again, as previously noted, NSP should obtain full cost recovery. Advocacy Staff simply argue the costs should be recovered from the appropriate ratepayers.

¹¹ NSP Br. 8-9.

¹² Under NSP's theory, the same would be true of all jurisdictions because NSP has a multi-state system, meaning NSP would circumvent all regulatory oversight.

¹³ NSP Br. 8.

E. The issue is not whether Advocacy Staff has proved its case.

NSP repeatedly argues that Advocacy Staff failed to provide studies to justify its position. But the burden of proof is not on Advocacy Staff; it is on NSP. Specifically, and as discussed herein, it is not Advocacy Staff's responsibility to prove that the wind resources constructed in Minnesota were less cost effective than wind resources constructed in North Dakota. It is NSP's responsibility to demonstrate that the Minnesota wind resources are the least costly of all available alternatives. It is not Advocacy Staff's responsibility to demonstrate that the system-wide distribution plant depreciation rates are not suitable for North Dakota. Rather, it is NSP's responsibility to demonstrate that they are suitable to North Dakota. It is not Advocacy Staff's responsibility to demonstrate that the King and High Bridge projects were not initiated in response to the Minnesota MERP and without regard to alternative lower-cost solutions. It is NSP's responsibility to demonstrate that they are the lowest cost solutions consistent with North Dakota environmental objectives. Finally, it is not Advocacy Staff's responsibility to demonstrate that the service life of the Sherco units will be a fraction of the average service life of steam plants nationwide. It is NSP's responsibility to explain why these units should only survive for such a short time.

II. NSP has not demonstrated its depreciation rates are fair and reasonable.

A. Removal costs.

NSP falsely asserts that "Mr. King's methodology [for recovering removal costs] is inconsistent with well established accounting principles and shifts current cost responsibility to future customers."¹⁴ The methodology recommended by Advocacy Staff, and described by Mr. Charles W. King and Mr. Michael J. Majoros at the hearing, is prescribed for legally required removal costs in SFAS 143.¹⁵ Mr. King only recommended the Commission use the five-year average as a stopgap because he did

¹⁴ NSP Br. 54.

¹⁵ Tr. 531, ll. 4-6; Tr. 533, l. 25; Tr. 534, ll. 1-8.

not have the data for a SFAS 143 application.¹⁶

The second part of NSP's statement is also inaccurate. The present-value approach proposed by Advocacy Staff is fairest to ratepayers because it charges the cost of each year's inflation to the ratepayers in that year.¹⁷ The present-value approach achieves "matching" as contemplated in both regulatory and generally accepted accounting principles, while not denying NSP any future costs of removal.¹⁸ NSP's method, on the other hand, charges present ratepayers with all inflation that will occur between now and when the assets are retired.¹⁹ Frontloading future inflation into current depreciation rates, as is done by NSP, results in a significant overstatement of depreciation rates.²⁰ NSP's method results in intergenerational inequity because it overcharges current ratepayers and undercharges future ratepayers.²¹ Advocacy Staff recommends the Commission adopt the present-value approach so costs are properly matched to the periods in which they are incurred.

Next, NSP incorrectly asserts that "[b]ecause Mr. King's methodology returns a greater portion of the investment later in the asset's life, the offset to rate base is delayed, increasing the return on investment included in rates."²² In reality, the increase in rate base from a reduction in depreciation does not nearly offset the benefit of a reduction in depreciation expense. That is because every dollar reduction in depreciation is immediately passed through to ratepayers, while the increase in rate base resulting from a lower depreciation reserve is just the return on one half of the amount of the test year depreciation expense increase.

¹⁶ Tr. 524, ll. 9-17; Tr. 632, ll. 1-18; Tr. 677, ll. 12-17.

¹⁷ Tr. 523, ll. 4-25; Tr. 524, ll. 1-8; Tr. 564-74; Tr. 589, ll. 6-25; Tr. 590, ll. 1-9; Tr. 734, ll. 1-25; Tr. 735, ll. 1-15; Tr. 750, ll. 16-25; Tr. 751, ll. 1-14.

¹⁸ Tr. 524, ll. 14-15; Tr. 542, ll. 22-24; Tr. 564, ll. 11-16; Tr. 588, ll. 19-22.

¹⁹ Tr. 618, ll. 22-25; Tr. 619, ll. 1-4.

²⁰ Tr. 618, ll. 22-25; Tr. 619, ll. 1-4.

²¹ See Exs. 34 and 35.

²² NSP Br. 58.

NSP argues there has been no over-collection.²³ That is true, of course, if the Commission accepts the rationale underlying NSP's methodology. However, if the Commission accepts Advocacy Staff's recommended removal cost methodology, then the removal cost reserve is severely over-funded.²⁴ Because the company uses whole life depreciation for mass property accounts, this over-collection will never be returned to the ratepayers (from whom the money was extracted) absent some explicit mechanism for doing so. For that reason, Advocacy Staff recommends the North Dakota portion of the excess removal cost reserve be amortized through a reduction in depreciation expense over a ten-year period. If, on the other hand, the Commission does not accept Advocacy Staff's removal cost methodology, then the removal cost reserve will grow indefinitely because removal cost accruals will continue to exceed removal cost expenditures.

Service lives.

NSP asserts the whole-life methodology is recognized and appropriate for transmission plant, distribution plant, and general structure plant accounts.²⁵ That statement is true, with an appropriate qualification that NSP ignores. The whole-life methodology is an accepted procedure provided there is an alternative calculation which amortizes any disparities or imbalances in the depreciation reserves.²⁶ But to use the whole-life methodology without some mechanism to adjust for reserve imbalances is unacceptable.²⁷ Thus, NSP's statement is incomplete, and its practice is unacceptable.

NSP asserts Mr. King offered no support, other than the average of other steam plants, for his proposal to increase the life expectancy of the two Sherco units.²⁸ But

²³ NSP Br. 59.

²⁴ Ex. 23, p. 30, ll. 5-7; Tr. 532, ll. 23-25; 533, l. 1; Tr. 545, ll. 23-25; Tr. 546, ll. 1-4.

²⁵ NSP Br. at 39.

²⁶ Tr. 633, ll. 10-23.

²⁷ Tr. 633, ll. 23-25.

²⁸ NSP Br. 44.

NSP, not Advocacy Staff, has the burden of proof. And all NSP offered was unsupported conclusions that the Sherco plants, NSP's newest coal units, will retire 12 years from now.²⁹ Although the burden is not on Advocacy Staff, a national study of the service lives of steam plants carries more weight than unsupported, self-serving conclusions.³⁰

NSP correctly notes that investments will be needed to extend the life of the Sherco units.³¹ But future investment is no reason to accelerate the depreciation of the existing investment in the plant. The future investment will be depreciated over the remaining life of the plant when that investment is made.³²

NSP's methodology is based on the erroneous proposition that the depreciation of existing plant should be accelerated because further investments will be made in the future. This is a violation of the basic tenets of depreciation that investment should be recovered over its useful life in a rational manner.³³

Distribution plant.

NSP challenges Mr. King's assumptions regarding possible differences in the useful life of overhead conductors in North Dakota and Minnesota because his testimony "was not based on any studies" or "supported by any studies."³⁴ Yet, conveniently, NSP ignores the fact that its assumptions to the contrary are not based on any studies.³⁵ But NSP, not Advocacy Staff, has the burden.

NSP's criticism of Mr. King highlights one of the fundamental problems with NSP's position – NSP assumes facts (relies on "gut feelings") but provides no supporting data.³⁶ But mere speculation, which NSP admits it is doing, does not meet

²⁹ Tr. 634, ll. 20-25; Tr. 635, ll. 1-8.

³⁰ Ex. 23, p. 22, ll. 8-17.

³¹ NSP Br. 46.

³² Tr. 635, ll. 9-22; Tr. 636, ll. 19-23; Tr. 689, l. 25; Tr. 690, ll. 1-20; Tr. 700, ll. 12-21.

³³ Ex. 23, p. 16, ll. 15-23. p. 17, ll. 1-26.

³⁴ NSP Br. 51, 52.

³⁵ Tr. 426, ll. 12-15, 22-25; Tr. 427, ll. 1-3, 8-12; Tr. 435, ll. 3-10.

³⁶ Tr. 426, ll. 19-25; Tr. 427, ll. 1-3; Tr. 435, ll. 3-10.

NSP's burden of proof. Furthermore, NSP's criticism that Mr. King's testimony is not based on a study is particularly troublesome, and ironic, when one considers that Mr. King requested information so he could study the life expectancy of North Dakota distribution plant, but NSP refused to provide it.³⁷

III. Costs incurred due to MERP should not be included in NSP's revenue requirement.

A. NSP's documents support Advocacy Staff's position regarding the King plant.

Blatantly mischaracterizing the evidence, NSP asserts that Mr. King "provided no evidence that the [Allen S. King] plant would not have shut down or that the plant should not have been rehabilitated in 2005."³⁸ NSP asserts Mr. King's "sole justification for disallowing all of the cost of the King Plant rehabilitation was an out-of-context comment by Ms. Engelking during an informal presentation."³⁹

Although Mr. King testified that Ms. Engelking stated in a May 6, 2008 conference call that the King rehabilitation would not have occurred as soon as it did without the MERP legislation,⁴⁰ that was not the sole basis of Mr. King's testimony and conclusions on this issue. Rather, Mr. King relied on NSP's own Integrated Resource Plan (IRP). Mr. King testified the best way to determine whether the King rehabilitation was accelerated due to MERP is to look at NSP's last pre-MERP IRP.⁴¹ He then testified, and as a review of NSP's 2000 IRP shows, the 2000 IRP does not mention rehabilitation of the King plant.⁴² Even a casual review of recent IRP's shows how unusual this is and provides objective evidence that the King rehabilitation would not have been undertaken absent MERP.

NSP tries to overcome the objective evidence by "reading into" the 2000 IRP

³⁷ Tr. 701, ll. 8-14; Tr. 703, ll. 14-22.

³⁸ NSP Br. 12.

³⁹ Id.

⁴⁰ Ex. 23, p. 7, ll. 13-14; Tr. 612, ll. 21-25; Tr. 645, ll. 18-24.

⁴¹ Tr. 613, ll. 1-5; Tr. 626, ll. 23-25; Tr. 626, ll. 1-2; 640, ll. 2-10; 644, ll. 9-13.

⁴² Tr. 756, ll. 3-11.

information that is not there. NSP quotes from the IRP, which states: “For the most part this Resource Plan assumes the existing fossil fleet will continue to operate as it does now through the fifteen-year planning period.”⁴³ NSP then concludes that “[b]ecause the King Plant only had a remaining life of five years, its rehabilitation was assumed.”⁴⁴

But the IRP never recognized NSP’s now argued assumption. In fact, following the paragraph quoted by NSP, there is a summary of the planned fossil fleet additions and conversions expected to take place in the future. The summary describes NSP’s program of making small incremental improvements at existing plants that will result in an additional 40 MW of capacity, NSP’s plans to convert Black Dog Units 1 and 2 from coal-fired power to natural gas, and NSP’s plans to continue investigating the feasibility of converting some of its coal fired plants to natural gas, including High Bridge and Riverside. Yet absolutely nothing is mentioned about the rehabilitation of the King Plant.⁴⁵ Continuing in the Executive Summary, under the caption “Five-Year Plan” NSP lays out its plan to ensure continued reliable electricity supply to its ratepayers by adding mandated wind and other all-source generation through its requests for proposals.⁴⁶ Again, no word of the King Plant overhaul and its capacity improvements is mentioned.

As evidenced by the 2000 IRP and other IRPs, if the King plant rehabilitation was scheduled for rehabilitation, the rehabilitation would have been mentioned in the IRP. It was not. This Commission should base its decision on the objective evidence, not NSP’s self-serving assertions made eight years later.

NSP relies on Figure 3-1 of its 2002 IRP to support its assertion that additional

⁴³ NSP Br. 18, n. 39.

⁴⁴ Id.

⁴⁵ 2000 IRP at 6-7.

⁴⁶ Id. at 14-16.

capacity was needed in 2008.⁴⁷ That statement misses the point. Even if some additional capacity was needed, that does not mean that absent MERP the King and High Bridge rehabilitations were the lowest cost method to obtain that capacity. The point is NSP's decision to rehabilitate King and High Bridge was made in light of MERP, not the lowest cost alternative of achieving the allegedly needed additional capacity. In fact, the assertion the High Bridge conversion was the lowest-cost option is belied by the 2002 MERP plan, which showed that rehabilitating the plant as a coal plant would have cut the cost in half.⁴⁸

B. Costs incurred due to Minnesota's renewable mandates were not incurred for the use of the North Dakota public.

Concerning the Grand River Wind Farm, Advocacy Staff agree with NSP that "[n]o lower-cost North Dakota project was available."⁴⁹ But the statement does not go far enough. The reality is that initially there were no North Dakota projects available because Minnesota mandated that all wind generation be derived from Minnesota facilities.⁵⁰ Thus, in light of Minnesota's protectionist law, not only was no lower-cost North Dakota project available, but no North Dakota project was available at all.

The forced construction of a transmission line to Buffalo Ridge,⁵¹ of course, dictated where subsequent wind generation would be constructed, Buffalo Ridge being the only place with adequate transmission facilities in place. Because Minnesota had already forced NSP to spend \$300 million to construct a transmission line to Buffalo Ridge, a North Dakota wind project could not compete with a Minnesota project. "No lower-cost North Dakota project was available" because Minnesota mandated the initial transmission lines be built in Minnesota, making it impossible for North Dakota to compete, not because constructing wind generation and transmission lines in Minnesota

⁴⁷ NSP Br. 18-20.

⁴⁸ Ex. 23, p. 7, ll. 13-20; p. 8, ll. 1-2.

⁴⁹ NSP Br. 28-29.

⁵⁰ Ex. 23, p. 10, ll. 11-14; Tr. 233, ll. 15-22; Tr. 234, ll. 1-4; Tr. 614, ll. 22-24.

⁵¹ Tr. 614, l. 25; Tr. 615, ll. 1-7.

was the lowest cost alternative. North Dakota rate payers should not have to pay the cost of the suboptimal situation created by Minnesota's self-serving laws.

The key to NSP's statement that "[a]ll of the evidence supports the conclusion that the existing wind energy was the lowest-cost alternative at the time"⁵² is the last three words – "at the time." Buffalo Ridge was initially the lowest-cost alternative "at the time" because Minnesota mandated that all wind generation be derived from Minnesota facilities. And later the Grand River project was the lowest-cost alternative "at the time" because NSP had already spent \$300 million to construct a transmission line to Buffalo Ridge because of the Minnesota mandate. But NSP has not demonstrated that either project would have been the lowest-cost alternative for North Dakota ratepayers absent the Minnesota legislation.⁵³

Although Mr. King produced evidence that North Dakota has significantly better wind resources than Minnesota,⁵⁴ and NSP agreed,⁵⁵ Advocacy Staff agree Mr. King "offered no evidence that wind generation in North Dakota is actually less costly."⁵⁶ But the burden of proof is not on Advocacy Staff; it is on NSP. And NSP failed to prove that Minnesota wind resources were the lowest cost alternative to meeting North Dakota's limited wind resource requirements.⁵⁷ NSP should not be permitted to shift its burden to Advocacy Staff.

Finally, NSP asserts there were certain advantages to the Grand Meadow project, such as federal tax benefits and approval to access the Midwest Independent

⁵² NSP Br. 32.

⁵³ NSP compares the cost of transmission to Buffalo Ridge with the projected cost of the CapX Fargo-Twin Cities 345 kV line. NSP Br. 32. NSP, of course, is comparing apples to oranges because the Buffalo Ridge line is already built. NSP makes no attempt to compare the cost of the two lines in present day dollars.

⁵⁴ Tr. 616, ll. 2-3; Tr. 659, ll. 19-23; Tr. 660, ll. 13-21; Ex. 23, pp. 12, ll. 20-21; 13, ll. 1-8; Ex. 23 (CWK – 6).

⁵⁵ Tr. 216, ll. 2-3.

⁵⁶ NSP Br. 30.

⁵⁷ Tr. 662, ll. 2-8; Tr. 664, ll. 9-21.

Transmission System Operator (MISO) transmission network.⁵⁸ What NSP conveniently ignores, however, is that those same advantages would have also accrued to a North Dakota operation had Minnesota not mandated that the initial wind generation be derived from Minnesota facilities.⁵⁹

C. Costs incurred due to the Minnesota Renewable Development Fund were not incurred for the use of the North Dakota public.

NSP argues it incurred costs and made investments that were required as a condition of continued operation of its nuclear generating facilities, and that NSP's decision to incur the comparatively modest costs required by Minnesota (such as payments made to the Renewable Development Fund) were more cost effective than closing the nuclear facilities.⁶⁰

While payments of \$16 million a year is comparatively modest to the cost savings resulting from operating a low cost nuclear facility, fairness and reasonableness goes beyond a simple cost benefit analysis. Fairness and reasonableness mandate that Minnesota ratepayers pay the costs above and beyond normal and reasonable levels that are caused by the Minnesota legislature, particularly when those costs have no quantifiable benefits for North Dakota ratepayers. Minnesota, not North Dakota, policymakers chose to incur, and thus bear, those costs.

It is one thing for North Dakota to pay for its share of Minnesota property taxes for reasonably assigned common plant, and quite another to require North Dakota ratepayers to fund a super-tax on dry cask nuclear waste storage, which is to be redistributed by Minnesotans for renewable development research and development. North Dakota policy establishes that these types of costs may not be considered in setting the rate for providing electric service.⁶¹ Accordingly, NSP should recover 100%

⁵⁸ NSP Br. 31.

⁵⁹ Tr. 663, ll. 12-25; Tr. 664, ll. 1-4.

⁶⁰ NSP Br. 6.

⁶¹ See N.D.C.C. §§ 49-02-23; 49-06-24.

of these extraordinary costs, which do not provide any quantifiable benefit to North Dakota ratepayers, from Minnesota.

Advocacy Staff's arguments regarding Minnesota directed or required investments and expenditures boils down to the age old ratemaking principle and statutory requirement of "used and useful." If an investment or expenditure is not used and useful for providing service to North Dakota customers, then the investment or expenditure should be rejected for purposes of rate recovery.

D. NSP's IRPs support Advocacy Staff's position.

NSP's old IRPs reveal the true impetus of the MERP projects. NSP's submittal letter to MPUC for NSP's pre-MERP 2000 Resource Plan indicates that, as part of its merger proceeding, NSP "agreed to investigate the feasibility of converting units at High Bridge and Riverside to natural gas combustion and to include the results as resource options in the next resource plan."⁶² The submittal letter references MPUC's 1998 Resource Plan Order, which references Minnesota's requirements NSP make certain investments in wind-generated energy. The February 17, 1999 Resource Plan Order states:

One of the conditions imposed by the Legislature when it gave NSP permission to store nuclear waste from the Prairie Island plant in dry casks on site was that the Company make significant investments in renewable energy. The Company was required to add 425 megawatts of wind-generated energy and 125 megawatts of biomass-generated energy by specified dates. The Company was also required to add another 400 megawatts of wind energy if the Commission so ordered, subject to resource planning and least cost planning requirements. Minn. State. § 216B.2423.⁶³

Yet NSP opposed making the wind-generated energy investments because it was not cost efficient. The Order explains:

NSP opposed adding another 400 megawatts of wind generation, at least in the near term. Under any set of assumptions the Company thought reasonable, its cost models showed the cost of wind exceeding the cost of natural gas by 32 to 81 million dollars over the life of the contract. The Company also argued that this

⁶² Letter from James Alders, Manager, to Dr. Burl Haar, Executive Secretary (July 10, 2000).

⁶³ Order Modifying Resource Plan 4.

would be a particularly inopportune time to add more wind—in its view the technology is still developing and over-priced, and the Company has not yet had enough experience with its first 425-megawatt wind purchase to profit from it.

NSP read the statute's December 31, 2002 deadline as the deadline for installing the additional 400 megawatts of wind energy, should the Commission require it, and its cost models were based on this assumption.⁶⁴

Despite investments in wind-generated energy not being the most prudent investments, due to Minnesota's policy not to approve a new or refurbished nonrenewable energy facility, MPUC required the investments. The Order explains:

The statute requires the Commission to order the additional wind generation "subject to resource planning and least cost planning requirements in section 216B.2422." Minn. Stat. § 216B.2423, subd. 2. The Commission reads this language to mean that it should order the additional wind generation unless such an Order would be inconsistent with the resource planning and least cost planning requirements of section 216B.2422.

The resource planning and least cost planning requirements of section 216B.2422 require a public interest approach to resource selection. The Commission is to approve, reject, or modify a proposed resource plan "consistent with the public interest." Section 216B.2422, subd. 4 also includes an explicit preference for renewable energy over nonrenewable energy:

Preference for renewable energy facility. The commission shall not approve a new or refurbished nonrenewable energy facility in an integrated resource plan or a certificate of need, pursuant to section 216B.243, nor shall the commission allow rate recovery pursuant to section 216B.16 for such a nonrenewable energy facility, unless the utility has demonstrated that a renewable energy facility is not in the public interest.

Minn. Stat. § 216B.2422, subd. 4.

Besides stating an explicit preference for renewable energy, the statute requires utilities to include in their resource plans least cost plans for meeting 50% and 75% of new and refurbished capacity needs with conservation and renewable energy resources. Minn. Stat. § 216B.2422, subd. 2. It also requires utilities to consider environmental and socioeconomic costs in selecting new resources, a requirement which reinforces and provides insight into the origins of the preference for renewable energy. Minn. Stat. § 216B.2422, subs. 3 and 5.

The Commission must integrate the two statutes, one limiting new generation to renewable fuel sources unless the utility demonstrates that that is not in the public interest, the other directing the Commission to order 400 megawatts of wind generation, subject to the requirements of the first statute. The Commission begins then, with the presumption that the 400 megawatts of wind energy is in the public interest and examines the record to determine whether

⁶⁴ Id. at 5.

this presumption has been disproved. The Commission concludes that it has not.

The only reason given by any party for finding the additional wind generation not in the public interest is that it will allegedly cost more than natural gas generation, currently the lowest priced competitor. The Commission finds that this cost differential, if it exists, is not large enough to overcome the strong public policies favoring the development of this wind resource.⁶⁵

The Order further explains that Minnesota law requires the MPUC to factor non-internalized environmental costs into all resource selection decisions. It states:

The resource planning statute required the Commission to establish a range of monetary values for the environmental costs of all forms of generation and to use these values in any proceeding which involved evaluating or selecting resources. Minn. Stat. § 216B.2422, subd. 3. The Commission established interim values on March 4, 1994 and permanent values on January 3, 1997 and July 2, 1997. Since that time environmental costs have been factored into all resource selection decisions in one way or another.

The environmental cost values established in the Commission's Orders set a range of monetary values for each ton of six common and measurable emissions from power plants: sulfur dioxide, nitrogen oxides, carbon monoxide, particulate matter, lead, and carbon dioxide. There are separate cost ranges for plants in urban, metropolitan fringe, and rural areas.

In this resource plan NSP considered environmental costs by calculating for all resources under consideration their direct costs, their costs including low-range environmental costs, and their costs including high-range environmental costs. This was consistent with the requirements of the last resource plan Order, and no one challenged the treatment of environmental costs in this resource plan.⁶⁶

Minnesota's mandated approach appears to violate N.D.C.C. § 49-02-23, which prohibits the Commission from allowing electric utilities from using "environmental externality values in the planning, selection, or acquisition of electric resources or the setting of rates for providing electric service." Environmental externality values include "[e]nvironmental costs that are not internalized in the cost of production or the market price of electricity from a particular electric resource" and the "alleged costs of complying with future environmental laws or regulations that have not yet been enacted."⁶⁷

⁶⁵ *Id.* at 8-9.

⁶⁶ *Id.* at 17 (footnotes omitted).

⁶⁷ N.D.C.C. § 49-02-23.

That the primary goal of converting NSP's coal-fired plants to natural gas-fired plants was to further Minnesota policy, not cost-effectiveness or federal requirements, was implicitly, if not explicitly, stated in the Order. The Order reads:

The Izaak Walton League, joined by Minnesotans for an Energy-Efficient Economy, urged the Commission to require the Company to conduct a study of the costs and feasibility of converting the four remaining coal-fired plants in the metropolitan area to natural gas-fired plants. The goal was to reduce emissions in an area that is heavily populated and rife with other sources of pollution.

The Department supported a study, but cautioned that cost-effectiveness was unlikely because the plants were nearly fully depreciated. NSP emphasized that all four plants were in full compliance with environmental standards, and suggested limiting the study to the two units most likely to qualify for conversion on cost-effectiveness grounds: Black Dog 1 and Black Dog 2.⁶⁸

Also of significance regarding this issue is page 54 of NSP's 2000 IRP. In its 2000 IRP, NSP concludes: "With a few exceptions NSP continues to assume the fleet of fossil-fueled resources will operate as they do now, with similar costs parameters, throughout the planning period."⁶⁹ The exceptions include converting Black Dog generating station from coal to natural gas, as well as studying doing the same thing to the High Bridge and Riverside coal plants.⁷⁰ There is no mention of refurbishing the King plant.

That the King Plant refurbishment did not need to be rehabilitated to meet federal standards is born out by the Order approving NSP's 2000 Resource Plan. The Order explains:

Xcel stated that it is in compliance with all environmental regulations and argued that its environmental compliance should be considered before environmental agencies and not by the Commission in the context of resource planning.⁷¹

As a review of the pre-MERP 2000 IRP and the 1998 Resource Plan Order indicates, NSP's wind generation facilities and its MERP projects, including the

⁶⁸ Order Modifying Resource Plan at 21.

⁶⁹ 2000 NSP IRP 54.

⁷⁰ *Id.* at 54-56.

⁷¹ Order Approving EXCEL Energy's 2000-2014 Resource Plan 23.

refurbishment of the King Plant, were not born out of capacity needs or old and dilapidated generation facilities.

IV. NSP’s cost allocation approach does not demonstrate property is used and useful in a particular state.

A rate case before the Washington State Utilities and Transportation Commission (WUTC) sheds significant insight on the issue currently before this Commission. That case involved a proceeding filed by Pacific Power & Light Company (PP&L). In an order dated April 17, 2006, the WUTC rejected PP&L’s proposed rates because the WUTC found that the cost allocation methodology (Revised Protocol) used by PP&L “assigns resources to Washington which have not been proven to be ‘used and useful for service in this state,’ a statutory requirement.”⁷² Because PP&L did “not meet its burden to provide an allocation methodology,” the WUTC deemed the existing rates “fair, just, reasonable and sufficient.”⁷³

Under PP&L’s Revised Protocol, which was rejected by the WUTC, all states bore “a rolled-in share of resources acquired to replace existing resources or to meet load growth.”⁷⁴ The Revised Protocol followed “the conventional three-step process for allocating a utility’s costs: of functionalization, classification, and allocation.”⁷⁵ To allocate system costs across six states, the Revised Protocol broke down costs “into three functional categories: generation, transmission and distribution.”⁷⁶ The Revised Protocol also allocated generation and transmission demand-related costs system-wide through the twelve coincident peak (12CP) method, or demand factor.⁷⁷ This is the same method used by NSP in this proceeding.

The WUTC emphasized that “[i]n determining the fair value of company property

⁷² Order 04 (Docket UE-050684) 1.

⁷³ Id. at 2.

⁷⁴ Id. at 12.

⁷⁵ Id. at 13.

⁷⁶ Id.

⁷⁷ Id.

for rate making purposes, i.e., establishing the appropriate rate base, [it] must determine whether the property is ‘used and useful for service *in this state*.’”⁷⁸ If it is not, costs may not be recovered in rates.⁷⁹ The WUTC explained that “used and useful for service in this state” means it benefits ratepayers in the state either directly or indirectly.⁸⁰ This requires the applicant demonstrate a “quantifiable benefit” to the state ratepayers.⁸¹ The fact that the integrated system has benefits as a whole is not enough.⁸² The allocation methodology must demonstrate a state-specific benefit for particular resources before they can be recovered in a particular state’s rates.⁸³ The WUTC explained that it “cannot delegate [its] statutory responsibilities for determining prudence and protecting the interests of Washington ratepayers to other states or to a cost allocation formula that does not comport with the requirements of [its] governing statutes.”⁸⁴

PP&L made arguments similar to the arguments NSP makes in this case – “it is entitled to full recovery of its prudently incurred costs systemwide and should not bear the risk that state decisions about cost recovery will not, in combination, ensure this entitlement.”⁸⁵ The WUTC explained that the law does not provide for such an entitlement, and that the risk is inherent in a multi-state system.⁸⁶ It should be noted that NSP could avoid such a risk, at least as to North Dakota, by seeking an advance determination of prudence from the Commission.

Rejecting the rate increase, the WUTC emphasized that the “fundamental question” is whether the resources allocated to the state can be shown to be “‘used and

⁷⁸ Id. at 21.

⁷⁹ Id.

⁸⁰ Id.

⁸¹ Id. at 22.

⁸² Id. at 22-23.

⁸³ Id. at 23.

⁸⁴ Id.

⁸⁵ Id.

⁸⁶ Id.

useful for service in this state.”⁸⁷ The Company alone carries the burden to prove that resources in other service territories provide “tangible and quantifiable benefits” to customers in this state.⁸⁸ “[G]ood faith ‘guesstimates’ fail to meet this test.”⁸⁹ The WUTC concluded:

In setting rates that are fair, just, reasonable and sufficient, we must balance the interests of the public, i.e., the ratepayers, and the utility. Because we find the Company has not met its burden to show that the resources included in the Revised Protocol are used and useful for service in this state, we find the Company has not met its burden to show that the rates proposed in this proceeding would be fair, just and reasonable.⁹⁰

The parallels between the PP&L case and this case are obvious. Like PP&L, NSP is attempting to justify its rate increase based on an allocation, not by showing expenditures resulted in a tangible and quantifiable benefit to North Dakota ratepayers. Most of the rate increase application is based on Minnesota environmental and renewable resource wants and desires, not the interest of North Dakota ratepayers. Although those costs may benefit the integrated system generally, NSP has not demonstrated the full costs are used and useful (directly or indirectly benefit) North Dakota ratepayers.

Like the WUTC, this Commission cannot delegate its statutory responsibilities for determining a fair and reasonable rate, and protecting the interests of North Dakota ratepayers, to other states or to a cost allocation formula that does not require a determination that the property is used and useful in North Dakota.

⁸⁷ Order 04 (Docket ue-050684) 26.

⁸⁸ Id.

⁸⁹ Id.

⁹⁰ Id. (footnote omitted). A petition for reconsideration was denied on July 14, 2006. Order Denying PaciCorp’s Petition for Reconsideration (July 14, 2006). The WUTC later approved an interjurisdictional cost-allocation mechanism that proposed a West Control Area which included California, Oregon, and Washington, that isolated costs associated with certain assets, purchases, and sales, and that allocated to Washington a proportionate share of costs based on Washington’s relative contribution to the demand and energy requirements. Final Order Granting Petition in Part 13 (June 21, 2007).

Like PP&L, NSP has not met its burden to show that the rates proposed in this proceeding would be fair, just and reasonable.

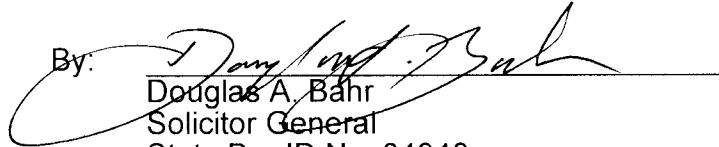
CONCLUSION

For the reasons outlined in this brief and in Advocacy Staff's Post-Hearing Brief, Advocacy Staff request the Commission dismiss the case with instructions that NSP develop a North Dakota specific depreciation study and file a new application for authority to increase its rates based on North Dakota statutes and laws. In the alternative, Advocacy Staff request the Commission adopt the adjustments proposed by Advocacy Staff.

Dated this 15th day of October, 2008.

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STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Northern States Power Company
Electric Rate Increase
Application

)
) **AFFIDAVIT OF SERVICE BY MAIL**
)

)
) **Case No. PU-07-776**
)

STATE OF NORTH DAKOTA)
) ss.
COUNTY OF BURLEIGH)

Donna J. Connor states under oath as follows:

1. I swear and affirm upon penalty of perjury that the statements made in this affidavit are true and correct.

2. I am of legal age and on the 1st day of October, 2008, I served the following, **ADVOCACY STAFF POST-HEARING BRIEF**, upon Megan Hertzler, by placing true and correct copies thereof in envelopes addressed as follows:

Megan Hertzler
Xcel Energy Inc.
414 Nicollet Mall, 5th Floor
Minneapolis, MN 55401

and depositing the same, with postage prepaid, in the United States mail at Bismarck, North Dakota.


Donna J. Connor

Subscribed and sworn to before me
this 13th day of October, 2008.


Notary Public

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