

## Working Paper: Legal and Regulatory Framework for Energy Utilities in Minnesota

The e21 Initiative is convened by:



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## **MINNESOTA RATEMAKING OVERVIEW<sup>1</sup>**

Minnesota regulation continues to be reasonably constructive and stable. The state's electric utilities are regulated under a traditional framework. Recently authorized equity returns typically have approximated or been slightly above the industry averages when established. Several mechanisms are in place that tend to mitigate regulatory lag. For example, as permitted by statute, significant interim rate increases are typically requested and authorized. Also, adjustment clauses or riders permit the timely recovery of electric fuel, gas commodity, transmission, and certain environmental and reliability project costs. In addition, statute permits utilities to file rate requests that annually adjust rates for up to three years (*i.e.*, multi-year plan).

In the gas industry, large-use customers have been permitted to purchase gas from competitive suppliers for a number of years, but there is no movement to extend choice to small volume customers. Legislation has established aggressive renewable portfolio standards and greenhouse gas reduction requirements, but the recovery of the compliance costs does not appear to be in question in Minnesota. Also, the PUC has adopted a partial revenue decoupling mechanism and a full revenue decoupling mechanism on a pilot basis for two of the state's gas utilities.

The PUC generally relies upon an average original-cost rate base for a test year that is partly forecasted at the time a decision is issued. This use of a forward-looking test year, in combination with the Commission's interim rate policy, generally permits a significant part of a requested increase to be in place for the entire 12 month test period. A cash return on construction work in progress (CWIP) is permitted for mercury emissions reduction projects, certain other emissions reduction projects, certain renewable energy projects, and certain transmission projects.

Incentive demand-side-management (DSM) mechanisms are in place for regulated electric and gas utilities. It is a shared savings mechanism that increases the incentive as performance improves. State law permits the PUC to approve cost-recovery riders that include performance-based incentives for mercury emissions reductions in excess of 90%. To date, no incentives have been requested.

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<sup>1</sup> Text largely from Regulatory Research Associates (updated 3/28/13)

<b>Historic or Future Test Year</b>	<b>Interim Rates</b>	<b>Riders/ Trackers</b>	<b>Multi-Year Rate Plan</b>	<b>Decoupling</b>
<p>Future/Current. The test year typically begins shortly after the rate case is filed. It allows for use of actuals during the rate case proceeding.</p>	<p>Yes (Minn. Stat. 216B.16, subd. 3)</p>	<ul style="list-style-type: none"> <li>- Fuel Cost Rider</li> <li>- CIP</li> <li>- State Energy Policy</li> <li>- TCR</li> <li>- Renewable Development Fund</li>   <li>Past riders include:</li> <li>- EIR/MERP</li> <li>- Mercury Cost Recovery</li> <li>- Renewable Energy Standard</li> </ul>	<p>Allowed by Minn. Stat. 216B.16, subd. 19.</p> <p>2-year plan proposed in 2013 electric rate case</p>	<p>Allowed by Minn. Stat. 216B.2412. Criteria and standards in Docket 08-132.</p> <p>Proposed for 2nd year of MYP in 2013 electric rate case</p>

## **PRELIMINARY ANALYSIS**

- Commission has broad authority to set rates to facilitate energy conservation, renewable energy and distributed generation (Minn. Stat. 216B.03), provided the resulting rates are reasonable and non-discriminatory.
- Under the regulatory compact, we retain the obligation to serve (or be prepared to serve) customers in our service territory, regardless of whether a customer has self-generation or disconnects from the system.
- Parties have often turned to the Legislature to create more specific authority for special ratemaking mechanisms. New mechanisms would likely require the same treatment to be successful.
- The Legislature has provided specific authority for the Commission to approve multi-year plans and decoupling pilots (Minn. Stat. 216B.16, subd.19 and 216B.2412).
- There is a history of using performance-based incentives to motivate desired behaviors. The Commission has specific authority to approve:
  - Energy efficiency and qualifying solar project performance incentives (Minn. Stat. 216B.16, subd. 6c and 216.241, subd. 5a)
  - Incentives to achieve lower natural gas costs, as measured by benchmarks required in the gas purchasing performance plan. (Minn. Stat. 216B.167)
  - Increased rate of return or other performance-based incentives to exceed 90% reduction in Mercury emissions. (Minn. Stat. 216B.683)
- Gas utilities are permitted to file performance-based regulation plans “in order to provide quality service at rates materially lower than under current regulation and to reduce the cost of regulation.” The plans must be three years or longer and provide the utility with increased earnings for efficient performance and decreased earnings for inefficient performance. (Minn. Stat. 216B.1675)
- Minn. Stat. 216B.82 allows the Company to create an enhanced reliability zone provided all customers in the zone cover the cost.

**SUMMARY OF RATE-RELATED STATUTES & POLICY GOALS**

Statute/ Rule	Summary
<b>General Ratemaking</b>	
<b>216B.03 REASONABLE RATE.</b>	<ul style="list-style-type: none"> <li>• All rates shall be just and reasonable.</li> <li>• Rates shall not be unreasonably preferential, prejudicial or discriminatory.</li> <li>• To the maximum reasonable extent, the commission shall set rates to encourage energy conservation and renewable energy use and to further the goals of cogeneration and small power production, energy conservation, renewable energy.</li> <li>• Any doubt as to reasonableness should be resolved in favor of the consumer.</li> </ul>
<b>216B.16 RATE CHANGE; PROCEDURE; HEARING.</b>	<p>Subd. 1 - Notice</p> <ul style="list-style-type: none"> <li>• 60 days notice for rate change.</li> <li>• Request for rate change must be supported by statements of facts, expert opinions, substantiating documents, and exhibits.</li> </ul> <p>Subd. 2 – Suspension</p> <ul style="list-style-type: none"> <li>• 10 month suspension period with 90 day extension permitted.</li> </ul> <p>Subd. 3 – Interim Rate</p> <ul style="list-style-type: none"> <li>• Unless exigent circumstances exist, interim rates placed into effect within 60 days of initial filing.</li> <li>• Not allowed within four months of decision on previous rate case unless the delay would unreasonably burden the utility, customers, or shareholders or the rate case filing is at least 12 months after it has filed a previous case for which the suspension period was extended.</li> </ul> <p>Subd. 4 – Burden of Proof</p> <ul style="list-style-type: none"> <li>• The burden of proof to show that the rate change is just and reasonable is on the utility.</li> </ul> <p>Subd. 5 – Determination after finding rate unacceptable</p> <ul style="list-style-type: none"> <li>• Commission can adjust rates after the hearing if found to be unjust, unreasonable, or discriminatory.</li> </ul> <p>Subd. 6 – Factors considered, generally</p> <ul style="list-style-type: none"> <li>• To determine just and reasonable rates, commission shall give due consideration to the public need for adequate, efficient, and reasonable service and to the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing the 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.</li> <li>• In determining the rate base upon which the utility is to be allowed to earn a fair rate of return,</li> </ul>

	<p>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 on each, to construction work in progress, to offsets in the nature of capital provided by sources other than the investors, and to other expenses of a capital nature.</p> <ul style="list-style-type: none"> <li>For purposes of determining rate base, the commission shall consider the original cost of utility property included in the base and shall make no allowance for its estimated current replacement value.</li> </ul> <p>Subd. 6a - Construction work in progress</p> <ul style="list-style-type: none"> <li>Current return on CWIP can be included in rate base with certain considerations.</li> </ul> <p>Subd. 6b - Energy conservation improvement</p> <ul style="list-style-type: none"> <li>All energy conservation investments and expenses shall be included in determination of just and reasonable rates.</li> </ul> <p>Subd. 17 – Travel, entertainment, and related employee expenses</p> <ul style="list-style-type: none"> <li>May not allow these expenses if commission deems them unreasonable and unnecessary for provision of public service.</li> </ul>
<p><b>216B.16, subd. 15- LOW-INCOME AFFORDABILITY PROGRAMS</b></p>	<ul style="list-style-type: none"> <li>Commission must consider ability to pay as factor in setting utility rates</li> <li>Public utility serving low-income residential ratepayers who use natural gas for heating must file an affordability plan.</li> </ul>
<p><b>216B.16, subd. 19 – MULTIYEAR RATE PLAN</b></p>	<ul style="list-style-type: none"> <li>MYP refers to plan establishing the rates the utility may charge for each year of the plan, which is not to exceed 3 years.</li> <li>Commission may only approve plan if it finds that the plan establishes just and reasonable rates</li> <li>Commission may establish terms, conditions and procedures to implement MYP.</li> <li>Commission may extend time period allowed for review by 90 days.</li> </ul>
<p><b>216B.1695- ENVIRONMENTAL PROJECTS; ADVANCE DETERMINATION OF PRUDENCE</b></p>	<ul style="list-style-type: none"> <li>A utility may petition for ADP for project to comply with federal or state air quality standards if cost to MN ratepayers is at least \$10M.</li> <li>Utility may begin recovery in the next rate case following the ADP.</li> <li>Petition for ADP may not be filed after Dec 31, 2015.</li> </ul>
<p><b>216B.2412- DECOUPLING OF ENERGY SALES FROM</b></p>	<ul style="list-style-type: none"> <li>Commission shall establish criteria and standards for decoupling.</li> <li>Commission shall allow one or more rate-regulated utilities to participate in a pilot program to</li> </ul>

<b>REVENUES</b>	assess merits of rate-decoupling strategy.
<b>Automatic Cost Adjustments/ Riders</b>	
<b>216B.16, subd. 6b- ENERGY CONSERVATION IMPROVEMENT</b>	<ul style="list-style-type: none"> <li>• Annual rider for costs of energy conservation improvements</li> <li>• Exempt customers not charged the rider</li> </ul>
<b>216B.16, subd. 7- ENERGY AND EMISSION CONTROL PRODUCTS COST ADJUSTMENT</b>	<ul style="list-style-type: none"> <li>• Automatic adjustment of charges related to: 1) federally regulated wholesale rates for energy delivered through interstate facilities, 2) direct costs for natural gas delivered, 3) costs for fuel used in generation of electricity of manufacture of gas, 4) prudent costs incurred for sorbents, reagents, or chemicals used to control emissions.</li> </ul>
<b>216B.16, subd. 7b- TRANSMISSION COST ADJUSTMENT</b>	<ul style="list-style-type: none"> <li>• Annual rider for new, approved transmission facilities and charges that accrue from other transmission owners’ regionally planned projects that have been determined by MISO to benefit the utility.</li> <li>• Allows a return on investment at level approved in last rate case, unless different return is found to be consistent with the public interest.</li> <li>• Provides current return on CWIP.</li> <li>• Commission shall approve provided costs included for recovery were or are expected to be prudently incurred and achieve transmission system improvements at the lower feasible and prudent cost.</li> </ul>
<b>216B.16, subd. 7d- CENTRAL CORRIDOR UTILITY ZONE COST ADJUSTMENT</b>	<ul style="list-style-type: none"> <li>• Automatic adjustment of charges for new, replaced, or relocated facilities installed under subdivision.</li> </ul>
<b>216B.1635- RECOVERY OF GAS UTILITY INFRASTRUCTURE COSTS</b>	<ul style="list-style-type: none"> <li>• Annual rider for gas utility infrastructure costs, including rate of return, income taxes on rate of return, incremental property taxes, incremental depreciation expense and any incremental O&amp;M costs.</li> </ul>
<b>216B.1636- RECOVERY OF ELECTRIC UTILITY INFRASTRUCTURE COSTS</b>	<ul style="list-style-type: none"> <li>• Annual rider to recover costs that replace or modify existing electric utility infrastructure, if shown to conserve energy or use energy more efficiently, including waste heat recovery converted into electricity.</li> <li>• May recover rate of return, income taxes on rate of return, incremental property taxes, incremental depreciation expense.</li> </ul>
<b>216B.1645, subd. 2a- COST RECOVERY FOR UTILITY’S RENEWABLE ENERGY FACILITIES</b>	<ul style="list-style-type: none"> <li>• Automatic adjustment of charges to recover costs associated with facilities constructed to comply with Renewable Energy Objectives.</li> <li>• Includes return on investment, depreciation, ongoing O&amp;M, taxes and cost of transmission and other ancillary expenses directly related to transmitting electricity from renewable resources.</li> <li>• Includes current return on CWIP.</li> </ul>
<b>216B.1692- EMISSIONS REDUCTION RIDER</b>	<ul style="list-style-type: none"> <li>• Allows rider to recover costs from installation of emissions-reduction technology on large electric generating power plants.</li> </ul>

<b>Special Rates/ Rate Design</b>	
<b>216B.16, subd. 14- LOW-INCOME ELECTRIC RATE DISCOUNT</b>	<ul style="list-style-type: none"> <li>• Utility shall fund an affordability program for low-income customers in an amount based on 50% electric rate discount on the first 400 kWh for low-income residential customers.</li> <li>• Target lowest income and highest energy cost customers.</li> </ul>
<b>216B.161- AREA DEVELOPMENT RATE PLAN</b>	<ul style="list-style-type: none"> <li>• Utilities may offer area development rates to assist with industrial revitalization projects in service area.</li> </ul>
<b>216B.1612- COMMUNITY-BASED ENERGY DEVELOPMENT; TARIFF</b>	<ul style="list-style-type: none"> <li>• Tariff to facilitate CBED projects</li> </ul>
<b>216B.162- COMPETITIVE RATE FOR ELECTRIC UTILITY</b>	<ul style="list-style-type: none"> <li>• Commission shall approve competitive rate schedule given conditions, including if the customer has the ability to receive energy requirements from a non-rate regulated energy supplier.</li> <li>• Rate schedule may change the rate for an individual customer or group of customers.</li> <li>• Utility can seek recovery of difference between regular rate and competitive rate.</li> <li>• While interim competitive rate is in effect, utility cannot recover rate difference.</li> <li>• Commission may approve discretionary rate reduction to customer or potential customers.</li> <li>• In the event commission has approved unbundled rates, the reduction is not offered for any unbundled service other than generation, unless the unbundled service is available to the customer from a competitive supplier.</li> <li>• No rate recovery of discretionary rate reductions.</li> </ul>
<b>216B.163- FLEXIBLE TARIFF</b>	<ul style="list-style-type: none"> <li>• Utility may set or change the rate for a natural gas customer within range of prices approved by commission without prior approval for customers subject to effective competition (can bypass utility).</li> </ul>
<b>216B.169- RENEWABLE and HIGH-EFFICIENCY RATE OPTIONS</b>	<ul style="list-style-type: none"> <li>• Utility may offer its customers options that allow customer to have a certain amount of electricity generated or purchased on customer’s behalf is renewable or generated by high-efficiency, low-emissions, distributed generation, such as fuel cells and microturbines fueled by renewable fuel.</li> </ul>
<b>216B.82- LOCAL POWER QUALITY ZONES (new in 2005)</b>	<ul style="list-style-type: none"> <li>• Utility and any customer can jointly petition for creation of a zone where the utility will install additional, redundant, or upgraded components of the distribution infrastructure designed to decrease the risk of power outages.</li> <li>• All customers in the zone must approve the installation and financial recovery plan.</li> <li>• Commission shall authorize utility to collect all costs through tariffs and surcharges that reflect cost to service customers in the zone.</li> <li>• Nothing in this section limits the ability of the utility and any customer to enter into customer to enter into customer-specific arrangements pursuant to applicable statute, rule or tariff provisions.</li> </ul>



<b>Incentives/ Penalties</b>	
<b>216B.16, subd. 6c- INCENTIVE PLAN FOR ENERGY CONSERVATION IMPROVEMENT</b>	<ul style="list-style-type: none"> <li>• The commission may set rates to encourage the vigorous and effective implementation of utility conservation programs. The commission may:                             <ol style="list-style-type: none"> <li>(1) increase or decrease any otherwise allowed rate of return on net investment based upon the utility's skill, efforts, and success in conserving energy;</li> <li>(2) share between ratepayers and utilities the net savings resulting from energy conservation programs to the extent justified by the utility's skill, efforts, and success in conserving energy; and</li> <li>(3) adopt any mechanism that satisfies the criteria of this subdivision, such that implementation of cost-effective conservation is a preferred resource choice for the public utility considering the impact of conservation on earnings of the public utility.</li> </ol> </li> </ul>
<b>216B.16, subd. 7a- PERFORMANCE-BASED GAS PURCHASING ADJUSTMENT</b>	<ul style="list-style-type: none"> <li>• A public utility to file rate schedules providing for annual adjustments reflecting rewards or penalties provided for in performance-based gas purchasing plans approved by the commission under section <u>216B.167</u>.</li> </ul>
<b>216B.167- PERFORMANCE-BASED GAS PURCHASING PLAN (new in 1995)</b>	<ul style="list-style-type: none"> <li>• Plan may provide incentives for the utility to achieve lower natural gas costs, as measured by benchmarks required in the plan, by linking financial rewards and penalties to natural gas costs.</li> <li>• The potential benefits of the plan must apply to each customer class purchasing firm natural gas service from the utility.</li> <li>• The plan must provide that the utility cannot curtail or interrupt service to any customer class purchasing firm gas service during the term of the plan except for causes outside the reasonable control of the utility.</li> <li>• Plan must include a mechanism to share the difference between actual gas costs and plan's benchmark costs.</li> <li>• Financial rewards or penalties shall not be considered in the determination of a utility's revenue requirement in a general rate case.</li> <li>• Plan must allow for imposition of penalties if service quality standards are not met.</li> </ul>
<b>216B.16, subd. 16- PERFORMANCE REGULATION PLAN TARIFFS</b>	<ul style="list-style-type: none"> <li>• A public utility providing natural gas services that has a performance regulation plan approved pursuant to section <u>216B.1675</u> shall file tariff provisions incorporating the provisions of that plan. Changes in the cost recovery of natural gas supplies must not be included within the plan.</li> </ul>
<b>216B.1675- PERFORMANCE REGULATION PLAN FOR</b>	<ul style="list-style-type: none"> <li>• Perf-based regulation plans are authorized for gas utilities in order to provide quality service at rates materially lower than under current regulation and to reduce the cost of regulation.</li> </ul>

<p><b>GAS UTILITY SERVICE</b> (new in 1997)</p>	<ul style="list-style-type: none"> <li>• Perf-based regulation plans are intended to provide the utility with increased earnings for efficient performance and decreased earnings for inefficient performance, but plans must contain a reasonable limit on utility earnings.</li> <li>• Plan’s term shall be no less than 3 years.</li> </ul>
<p><b>216B.241, subd. 5a- QUALIFYING SOLAR ENERGY PROJECT</b></p>	<ul style="list-style-type: none"> <li>• Qualifying solar projects are eligible for performance incentive distinct from energy conservation incentive and based on the competitiveness and cost-effectiveness of solar projects in relation to other potential solar projects available to the utility.</li> </ul>
<p><b>216B.683- MERCURY EMISSIONS REDUCTION; COST RECOVERY; FINANCIAL INCENTIVES</b></p>	<ul style="list-style-type: none"> <li>• May file an emissions-reduction rider for mercury control and other environmental improvements under 216B.1692.</li> <li>• Mercury emissions rider may include performance-based incentives if Commission determines that the incentives will increase the likelihood that the utility will exceed 90% reductions, provided the incentives do not impose excessive costs.</li> <li>• Incentives may include increased returns on investments or other performance-based incentives.</li> </ul>
<p><b>STATE POLICY GOALS/MANDATES</b></p>	
<p><b>216B.1691- RENEWABLE ENERGY OBJECTIVES</b></p>	<ul style="list-style-type: none"> <li>• Xcel Energy must generate or procure sufficient renewable energy to meet:                         <ul style="list-style-type: none"> <li>○ 15% by 2010</li> <li>○ 18% by 2012</li> <li>○ 25% by 2016</li> <li>○ 30% by 2020</li> </ul> </li> <li>• In addition to the above, each utility shall have 1.5% energy from solar resources by 2020.</li> <li>• Solar standard excludes sales to iron mining, paper milling and related industries.</li> </ul>
<p><b>216B.2401- ENERGY CONSERVATION POLICY GOAL</b></p>	<ul style="list-style-type: none"> <li>• Achieve annual energy savings equal to 1.5% of annual retail energy sales of electricity and gas.</li> </ul>
<p><b>216B.2423- WIND POWER MANDATE</b></p>	<ul style="list-style-type: none"> <li>• Xcel Energy must construct and operate, purchase or contract for 225 MW of wind energy by Dec 31, 1998 and an additional 200 MW by Dec 31, 2002.</li> </ul>
<p><b>216B.2424- BIOMASS POWER MANDATE</b></p>	<ul style="list-style-type: none"> <li>• Xcel Energy must construct and operate, purchase or contract for 50 MW of energy generated by farm-grown, closed loop biomass by Dec 31, 1998 for operation by Dec 31, 2001 and an additional 75 MW by to be operational by Dec 31, 2002.</li> <li>• Biomass mandate reduced from 125 MW to 110 MW.</li> </ul>
<p><b>216B.8109- HYDROGEN ENERGY ECONOMY GOAL</b></p>	<ul style="list-style-type: none"> <li>• It is the goal that MN move to hydrogen as an increasing source of energy for its electrical power, heating and transportation needs.</li> </ul>
<p><b>216C.05, subd. 2- ENERGY POLICY GOALS</b></p>	<ul style="list-style-type: none"> <li>• Reduce per capita use of fossil fuel as an energy input by 15% by the year 2015, through increased reliance on energy efficiency and renewable energy alternatives.</li> <li>• 25% of the total energy used in the state be derived from renewable resources by 2025.</li> </ul>

<b>216H.02- GREENHOUSE GAS EMISSIONS CONTROL</b>	<ul style="list-style-type: none"><li>• Goal to reduce statewide GHG emissions across all sectors to a level at least<ul style="list-style-type: none"><li>○ 15% below 2005 levels by 2015</li><li>○ 30% by 2025</li><li>○ 80% by 2050</li></ul></li></ul>
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