Decision No. C04-1566

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

DOCKET NO. 03I-134E

IN THE MATTER OF THE EARNINGS TEST FOR PUBLIC SERVICE COMPANY OF COLORADO FOR CALENDAR YEAR 2002.

DOCKET NO. 04I-098E

REGARDING THE INVESTIGATION INTO THE RELIABILITY OF THE ELECTRIC DISTRIBUTION SYSTEM OF PUBLIC SERVICE COMPANY OF COLORADO.

ORDER APPROVING/MODIFYING STIPULATION AND SETTLEMENT AGREEMENT

Mailed Date: December 30, 2004
Adopted Date: December 30, 2004

TABLE OF CONTENTS

I. BY THE COMMISSION

A. Procedural History of Docket No. 03I-134E

1. The genesis of Docket No. 03I-134E can be traced back to Docket No. 95A-531EG wherein we approved an application by Public Service Company of Colorado (PSCo) to merge with Southwestern Public Service Company. Our decision approving that application, No. C96-1235, instituted a performance-based regulatory plan (PBR) with an annual earnings-sharing mechanism. Under the PBR, PSCo was required to file an earnings test report (ETR) on April 1, 2003, describing its earnings for 2002.

2. On March 25, 2003, PSCo was granted until May 1, 2003, to file its 2002 ETR. *See,* Decision No. C03-0354. By that decision we also opened Docket No. 03I-134E for the purpose of addressing PSCo's 2002 ETR and all related matters. It also directed the Commission's Staff (Staff) to file the results of its investigation concerning the subject ETR by June 16, 2003.

3. On May 1, 2003, PSCo filed its 2002 ETR. It indicated that PSCo did not realize earnings above the authorized return on equity threshold under the PBR. It further stated that the PBR Adjustment remained at 0.00 percent.

4. On July 15, 2003, the Colorado Office of Consumer Counsel (OCC), filed a Protest and Request for Hearing. On July 16, 2003, Staff filed its response to PSCo's 2002 ETR.[1] Both Staff and the OCC requested a hearing based on concerns regarding the cost of new debt issued to PSCo in 2002 and the effect it might have on the company's capital structure.

[1] Staff requested and was granted extensions of time to file its responsive report. *See,* Decision Nos. C03-570 and C03-0793.

On August 21, 2003, we granted the Staff’s and OCC's hearing requests. *See*, Decision No. C03-0995.

5. A pre-hearing conference was held on November 6, 2003. *See*, Decision No. C03-1066-E. A procedural schedule establishing deadlines for filing written direct, answer and rebuttal testimony and exhibits was established and we ordered that a hearing be held on September 9 and 10, 2004. We also found that the Staff and the OCC would bear the burden of proof and the burden of going forward in this matter. *See*, Decision No. C04-0195. We subsequently granted a number of requests to modify the procedural schedule and to continue the hearing, ultimately, to December 15 and 16, 2004. *See*, Decision Nos. C04-0482, C04-0883, C04-1105 and C04-1164.

6. The Staff and the OCC filed their direct testimony and exhibits on May 28, 2004. PSCo filed its answer testimony and exhibits on August 25, 2004.

7. On November 9, 2004, the Staff filed an unopposed motion indicating that a settlement of the issues raised in Docket No. 03I-134E had been agreed to in principle. The motion indicated that a settlement agreement would be filed on or before December 8, 2004. We approved this procedure on November 18, 2004. *See*, Decision No. C04-1302.

B. Procedural History of Docket No. 04I-098E

8. The genesis of Docket No. 04I-098E can be traced back to Commission receipt of a number of consumer complaints from PSCo customers concerning power outages they experienced during the summer of 2003.

9. The Staff and the OCC conducted an initial investigation concerning these complaints and filed an initial report concerning the reliability of PSCo’s electric distribution system (Initial Report) on January 14, 2004. PSCo filed its response to that report (Initial

Response) on February 17, 2004. The Initial Response contained the company's action plan addressing distribution system reliability issues. PSCo's representatives then presented this action plan to us at our February 25, 2004, Deliberations Meeting.

10. We formally opened Docket No. 04I-098E on March 11, 2004, in order to establish a repository for information submitted concerning the investigation and to make such information easily accessible to interested persons. *See*, Decision No. C04-0237. That decision scheduled a public hearing at 6:00 p.m. on March 17, 2004. We conducted a public hearing at the assigned date and time and heard testimony from two witnesses, a city councilwoman from Centennial, Colorado, and a representative of a large international shipping company.

11. Subsequent to the time we formally opened Docket No. 04I-098E, the following additional reports were submitted for our review and consideration: a Report on Public Service Company of Colorado's Plan to Improve the Electric Distribution System prepared by the Liberty Consulting Group (Liberty Report) filed by the OCC on June 17, 2004; the Final Report to the Colorado Public Utilities Commission Concerning the Reliability of Public Service Company of Colorado's Electric Distribution System (Final Report) filed by the Staff on July 9, 2004; and the Verified Response to the Final Reports of the Staff and OCC Regarding the Investigation into the Reliability of Public Service Company of Colorado's Electric Distribution System (Final Response) filed by PSCo on August 6, 2004.

C. Motion to Approve Settlement of Docket Nos. 03I-134E and 04I-098E

12. On December 8, 2004, PSCo, the Staff, and the OCC filed a Motion to Approve the Stipulation and Settlement Agreement (Motion) in both the captioned dockets. The parties' Stipulation and Settlement Agreement (Stipulation) was filed contemporaneously therewith.

According to the parties, the Stipulation resolves all disputed issues that have arisen or could have arisen in Docket Nos. 03I-134E and 04I-098E.

13. On December 10, 2004, we vacated the remaining procedural schedule applicable to Docket No. 03I-134E and ordered that an Administrative Law Judge (ALJ) conduct a hearing in connection with the Motion and, further, to draft an initial decision in these matters on or before December 31, 2004. *See,* Decision No. C04-1474. That decision also contained a number of questions concerning the Stipulation that we requested the parties address at the hearing.

14. On December 10, 2004, ALJ Kirkpatrick scheduled an evidentiary hearing concerning the Motion and Stipulation commencing at 9:00 a.m. on December 23, 2004, and a public comment hearing commencing at 4:00 p.m. on that same day. *See,* Decision No. R04-1475-I. On December 15, 2004, ALJ Isley vacated the public hearing scheduled for December 23, 2004, and re-scheduled it for 4:00 p.m. on December 21, 2004. *See,* Decision No. R04-1495-I.

15. The public comment hearing was held at the assigned time and date. Only one public witness, Mr. Skip Arnold, the Director of Energy Outreach of Colorado (EOC), appeared at the hearing. He testified that the EOC has an immediate need for additional funds with which to provide energy assistance to low income individuals. Therefore, EOC strongly supports that portion of the Stipulation that requires PSCo to make a $2 million contribution to EOC in 2004.

16. The evidentiary hearing concerning the Motion and Stipulation was held at the assigned time and date. PSCo presented testimony in support of the Motion and Stipulation from Mr. Fredrick C. Stoffel, the Vice President for Policy and Development for Xcel Energy Services, Inc., Mr. Tim E. Taylor, the Vice President of Field Operations for Xcel Energy Services, Inc., and Mr. Byron Craig, the Manager of Electric System Performance for Xcel

Energy Services, Inc. The Staff presented testimony in support of the Motion and Stipulation from Ms. Geri Santos-Rach, its Section Chief. The OCC presented testimony in support of the Motion and Stipulation from Dr. P.B. Schechter, its Rate/Financial Analyst. Exhibits 1 through 12 were identified, offered, and admitted into evidence.[2]

D. Position of the Parties in Docket 03I-134E

17. As indicated previously, both the Staff and the OCC were concerned that PSCo had improperly stated its average cost of debt in its 2002 ETR. They believed that PSCo's average cost of debt was high due to the bankruptcy of Xcel Energy's subsidiary NRG Energy, Inc. ("NRG"). Both alleged that PSCo paid a coupon rate associated with a 10-year note that was higher than it otherwise would have been because of the negative influence arising from NRG's financial difficulties. Even though the Staff and OCC indicated that it was unlikely that a recalculation of PSCo's average cost of debt would result in its 2002 earnings being subject to savings under the PBR, it feared that ratepayers might still be harmed. Using different methods, both the Staff and the OCC imputed a lower coupon rate for the subject PSCo debt and argued that PSCo should use the lower cost in calculating its weighted average cost of capital in future earnings test and general rate proceedings.

18. PSCo contended that the cost of the subject debt reflected generally unstable market conditions and could not be specifically attributed to the difficulties of NRG. It argued that the Staff and OCC's recommended disallowance of debt expense was inappropriate in light

[2] The first six hearing exhibits relate to Docket No. 04I-098E and consist of the following: Initial Report (Exhibit 1); Initial Response (Exhibit 2); Liberty Report (Exhibit 3); Final Report (Exhibit 4); Final Response (Exhibit 5); and Xcel Energy Electric Asset Management Colorado 500kcmil Cable Performance Management Program Report dated October 8, 2004 (Exhibit 6). Exhibit 7 is the Stipulation. The last five hearing exhibits relate to Docket No. 03I-134E and consist of the following: Staff's Direct Testimony and Exhibits (Exhibit 8); OCC's Direct Testimony and Exhibits (Exhibit 9); Answer Testimony and Exhibits of PSCo witness Fredric C. Stoffel (Exhibit 10); Answer Testimony and Exhibits of PSCo witness Ben Fowle (Exhibit 11); and Answer Testimony and Exhibits of PSCo witness John Reed (Exhibit 12).

of the reasonableness of its weighted average cost of capital overall, the inability to isolate and identify the effect that NRG’s financial difficulties may have had on the actual cost it paid for debt, and the lack of evidence of any imprudence on PSCo’s part.

E. Position of the Parties in Docket No. 04I-098E

19. The six areas of Staff’s and OCC’s concern regarding the reliability of PSCo’s distribution system identified in the Initial Report are summarized at pages 4 and 5 of the Stipulation. As indicated previously, the Initial Response contained PSCo’s action plan for dealing with these concerns.

20. The Liberty Report commissioned by the Staff and the OCC alleged that several measures of plant investment, maintenance expenses and system reliability showed downward trends and recommended that the Commission initiate a detailed audit of PSCo’s electric distribution system operations. In the Final Report, the Staff expressed its concern that PSCo’s action plan does not ensure that problems with the distribution system will be sufficiently mitigated by infusions of additional capital or personnel. Staff was concerned that PSCo was not setting its performance goals or deploying resources sufficient to return to service levels equivalent to or better than 2001 results.

21. PSCo’s Final Response addressed the issues raised in the Final Report. It also contained the results of PSCo’s action plan and a response to the trend analysis contained in the Liberty Report. It identified premature distribution cable failure as one of the primary causes of difficulties experienced with PSCo’s distribution system. Apparently, PSCo had experienced premature failures of its late 70’s and 80’s vintage main feeder cables within the last few years. This problem has been experienced throughout the industry and does not reflect problems with

overloading or with PSCo's maintenance practices. PSCo contends that it has been proactive and reactive in dealing with this problem.

F. Terms of the Stipulation

22. The terms of the Stipulation, as couched by the parties, are premised on a recognition that the financial difficulties previously experienced by NRG are resolved and, as a result, PSCo can now refocus on its core utility business on a going forward basis.

23. With this in mind, PSCo has agreed to accelerate its feeder and URD cable repair and replacement programs by investing an additional $12 million in 2005 over and above the $13 million it has budged for this purpose. It has also committed to spend an additional $13 million in 2006 and 2007, over and above the $13 million in each of these years it expects to budget for cable replacement and repair. This will result in an additional expenditure of $38 million over three years, an amount that the parties agree will be recoverable through PSCo's utility rates.

24. The Stipulation calls for PSCo to file an annual report with the Commission on or about April 1 of each year detailing its progress in implementing the distribution cable replacement program. It also provides that no change to depreciation accounting methods is necessary in connection with the cable replaced and that the retired segments of cable will be removed at a fully depreciated status and that no loss will be recognized.

25. Regarding PSCo's cost of debt, the Stipulation recognizes that the PSCo debt issue discussed above may have been impacted by NRG's financial difficulties. However, the parties have agreed that PSCo shall be allowed to include the actual cost of the debt issue (which consists of the September 2002 $600 million First Collateral Trust bonds) in the calculation of its weighted cost of capital for purposes of the 2002 ETR and all future earnings test or rate proceedings in which its cost of capital is at issue.

26. The Stipulation discusses the Treatment of Prematurely Retired Electric Distribution Plant for Depreciation Purposes. In the Stipulation Public Service represents that the cable being replaced as a result of this Agreement is part of a continuous property group, meaning that many vintage groups are combined to form a common group. In this case the original cost of the assets being retired is not statistically large in comparison to the value of the entire continuous property group. PSCo agrees that there will be no change to depreciation accounting methods for these accounts , the retired segments will be removed at a fully depreciated status and no loss will be recognized.

27. The terms of the Stipulation also call for PSCo to contribute $2 million to EOC in 2004 for the purpose of assisting clients served by that agency with the payment of heating bills. This contribution will not be recoverable in rates and shall not be included as part of the earnings sharing calculation for 2004.

28. Finally, the Stipulation calls for Docket No. 04I-098E to be closed and for PSCo to initiate a proceeding on or about July 1, 2005, addressing needed modifications to its current Quality of Service Plan (QSP) and the future of the QSP after January 1, 2007. PSCo has agreed to work collaboratively with the Staff and the OCC to identify, collect, and provide data that may assist the Staff and the OCC in proposing alternative QSP measures.

G. Hearing on the Stipulation

29. As indicated previously, PSCo called Messrs. Stoffel, Taylor, and Craig to testify in support of the Stipulation at the December 23, 2004, hearing and to respond to the questions we posed in Decision No. C04-1474.

30. Regarding Docket No. 03I-134E, Mr. Stoffel indicated that the sole issue the parties had concerning the 2002 ETR involved the potential adverse effect NRG's financial

difficulties might have had on PSCo's cost of debt. All parties agreed that the imputed cost of debt proposed by the Staff and the OCC would not produce excess earnings for sharing purposes in calendar year 2002. The parties have agreed that the company will use the actual cost of debt that was issued by it in September of 2002 and that it will use that for the purposes of the earnings test for 2003, 2004, 2005, and 2006, as well as in any future regulatory proceedings where the cost of debt and cost of capital is an issue. Although the parties have agreed to this term of the Stipulation, this Commission cannot bind future Commissions to this term of the Stipulation.

31. Regarding Docket No. 04I-098E, Mr. Stoffel stated that the company received a number of interrogatories from Staff and the OCC with respect to questions that related to reliability and investment and funding of operation and maintenance expenses. Mr. Stoffel stated that the company responded to all of the issues raised by the Staff and the OCC, and provided an action plan with respect to the efforts that they have undertaken this year and will continue to undertake to improve reliability.

32. Mr. Stoffel stated that the Stipulation allows PSCo to look at these issues and to provide a forward-looking solution that addresses reliability, the investment in reliability, and the primary cause of the reliability problems. He indicated that the premature cable failure problem identified above is the primary cause of outages. He testified that the Stipulation provides for additional significant investment over the next three years in the cable replacement program and that such investment would not have been undertaken but for the settlement. As a result, PSCo believes that it has addressed a significant aspect of the reliability investigation as well as the other components of their action plan that the company has undertaken.

33. Mr. Stoffel explained why the parties linked these two proceedings for purposes of resolution and addressed why the linkage is in the public interest. He explained that disallowance of the cost of PSCo's debt initially advanced by the Staff and the OCC would serve to reduce funds (approximately $10 million annually in his opinion) otherwise available to the company for use in improving its electric distribution system. Allowing PSCo to use the actual cost of debt incurred should, therefore, enhance its ability to use these resources for distribution system improvements.

34. Mr. Stoffel indicated that the Final Response addressed the questions we posed in Decision No. C04-1474 notwithstanding the fact that the Stipulation does not specifically address each of the six questions. Mr. Stoffel testified that he is confident that PSCo has isolated the cable problem discussed above as the primary cause of distribution system failures. He also acknowledged that one of the contributors to the subject power outages was the failure of the distribution transformers. He generally described the efforts directed at the distribution transformer replacement program and other processes that have been implemented to forecast when these transformers might fail.

35. Mr. Stoffel confirmed that PSCo continues to refine and follow the action plan previously presented to the Commission with regard to components of the distribution system that might require attention. Mr. Stoffel believes that the Staff and the OCC agree that these efforts are satisfactory. PSCo has investigated the causes of customer complaints and customer dissatisfaction concerning the frequency and duration of outages. He described the changes made by PSCo designed to identify the causes of repeat outages and their length. PSCo has implemented new measurements, new controls, and new practices in its field operations with its customer group designed to track customer complaints. This allows its area engineers better

methods of investigating outages and provides customers more current information regarding the cause of outages and the time needed to make necessary repairs. He indicated that the level of outages and customer complaints concerning outages are down significantly this year.

36. Mr. Stoffel stated that the Stipulation recognizes that PSCo will continue to look at quality of service issues. Those issues are now reflected in some of the measurements that PSCo makes when examining system reliability. These include the System Average Interruption Duration Index (SAIDI) and the response time to customer complaints. He emphasized that these aspects of PSCo's business will be addressed in the QSP proceeding PSCo has agreed to initiate no later than July 1 next year.

37. Mr. Stoffel also addressed that portion of the Stipulation requiring PSCo to make a contribution to EOC and, specifically, our concern that this contribution would be used to fund non-PSCo customers or gas utility customers notwithstanding the fact that both these dockets deal with electric utility issues. He indicated that the disallowance of debt remedy proposed by the Staff and the OCC would have an impact on the company's gas and steam businesses over time. Therefore, the disallowance would carry over as an adjustment to the cost of capital in any of PSCo's future rate proceedings, including natural gas. That is the mechanical linkage between the electric earnings test and PSCo's gas business. Therefore, the contribution to EOC stems from the interaction of the electric business earnings test and the possible remedy suggested by the Staff and OCC. While 75% of the beneficiaries of EOC are PSCo customers, the guidelines established by EOC allow it to target the PSCo donation to its own customers. Mr. Stoffel also noted the subject contribution would be beneficial by reducing PSCo's accounts receivable and any possible debt write-off.

38. Mr. Stoffel indicated that delaying the EOC contribution until 2005 would not be a serious problem. Nor would it cause PSCo to withdraw from the Stipulation. However, he urged the Commission to approve the Stipulation expeditiously so that the contribution is used as soon as possible to assist needy utility customers. This would also allow PSCo to finalize its budget and begin the cable replacement program more quickly.

39. Mr. Stoffel testified that the contribution to EOC was not directly intended to compensate ratepayers that might have been negatively affected by distribution reliability problems that were addressed in Docket 04I-098E or by ratepayers that might have been negatively impacted by the NRG problem that was addressed in Docket No. 03I-134E.

40. Mr. Taylor's testimony addressed the distribution transformer failure issues, systems and energy practices used to identify localized areas of unreliable service, the adequacy of operations and maintenance expenses, and anticipated capital expenditures for maintaining and upgrading the distribution system. He described the steps PSCo has taken to address overloading transformers. PSCo has deployed a Distribution Asset Optimization (DAO) model to predict the loading on transformers. In 2003 it replaced 323 transformers on the basis of the results of the DAO model before they failed. This prevented its customers from experiencing interruptions. PSCo carried this initiative forward into 2004 by replacing an additional 607 transformers.

41. Another measure PSCo has implemented to correct transformer problems is to replace the fuse in the transformer at the time of failure. This puts a transformer back into service within four hours. PSCo then replaces the defective transformer with a larger one within 24 hours so its customers will not experience multiple interruptions of service resulting from

transformer overloads. Mr. Taylor stated that PSCo would continue its proactive replacement of transformers in 2005 and future years.

42. Mr. Taylor also testified that the number of transformer failures had declined within the past several years due to implementation of a Reliability Monitoring System (RMS). This program allows PSCo engineers to better identify, investigate and repair distribution problems in a localized area. He testified that PSCo monitors performance metrics for these devices so they can track them and so that appropriate personnel are aware of potential problems. Mr. Taylor also identified a variety of other programs and processes PSCo has in place for monitoring and improving electric reliability.

43. Mr. Taylor also emphasized the necessity for a timely Commission decision concerning the Stipulation. This will allow PSCo to begin the cable replacement program as soon as possible thereby avoiding large segments of its cable system from being out of service during periods of greatest demand.

44. Mr. Craig sponsored Exhibit 6, a summary of recent trends relating to the failure of PSCo's cable system. It also summarizes the effectiveness of replacement programs PSCo currently has in place and forecasts trends over the next two to five years. Exhibit 6 tends to support the prior testimony of PSCo's witnesses that cable failure is the primary cause of distribution system problems.

45. Ms. Geri Santos-Rach testified in support of the Stipulation on behalf of Staff. She testified that the transformer failure issue is unique and difficult to solve. She testified that, notwithstanding the testimony presented by PSCo's witnesses indicating that the percentage of transformer outages and minutes of outages compared to the total number of system outage minutes is minimal, the level of customer frustration when a transformer fails is significant. In

general, she indicated that PSCo's action plan, which calls for a more proactive approach in replacing transformers, satisfies Staff's concerns regarding this issue. Staff is also satisfied with PSCo's continued commitment to do further research on the predictive model discussed above. Staff believes that approval of the Stipulation is in the public interest.

46. Dr. P.B. Schechter testified in support of the Stipulation on behalf of the OCC. He indicated that the Stipulation resolves the concerns the OCC had in connection with both of the captioned dockets. The OCC believes that approval of the Stipulation is in the public interest.

H. Discussion and Conclusions

47. At our Deliberation Meeting on December 30, 2004, our advisors and legal counsel provided a comprehensive presentation on the terms of the Stipulation, as well as the findings of facts from the evidentiary hearing held before Administrative Judge Isley on December 23, 2004. Additionally, we also reviewed the transcript from this evidentiary hearing and each Commissioner met individually with advisors to discuss the details of the settlement as well as the testimony presented at hearing.

48. Now, having been fully advised in the matter, we will approve the Stipulation with one modification.

49. Mr. Stoffel, in his testimony at the evidentiary hearing of December 23, 2004, stated that the contribution to EOC stems from the interaction of the ETR and the possible remedy suggested by the Staff and the OCC in that Docket. In his testimony, Mr. Stoffel noted that while 75 percent of the beneficiaries of ECO are PSCo's customers, the guidelines established by ECO allow it to target the PSCo donations to its own customers.

50. We find that since the $2 million contribution targeted to EOC was the result of the settlement of the ETR, PSCo should direct that its donation to EOC be used for PSCo customers only and not for the benefit of other utilities' customers who were not part of the ETR Docket.

II. ORDER

A. The Commission Orders That:

1. The Motion to Approve Stipulation and Settlement Agreement filed on December 8, 2004, by Public Service Company of Colorado, the Staff of the Colorado Public Utilities Commission, and the Colorado Office of Consumer Counsel, is approved with the modification that the $2 million contribution to Energy Outreach Colorado shall be designated solely for the use of Public Service Company of Colorado customers.

2. The Stipulation and Settlement Agreement, a copy of which is attached hereto as Attachment A, is incorporated into this Order as if fully set forth herein.

3. Docket Nos.03I-134E and 04I-098E are closed.

4. The 20-day period provided for in § 40-6-114, C.R.S., within which to file applications for rehearing, reargument, or reconsideration begins on the first day following the Mailed Date of this Decision.

5. This Order is effective upon its Mailed Date.

B. ADOPTED IN COMMISSIONERS' DELIBERATIONS MEETING December 30, 2004.

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

____

____
Commissioners

CHAIRMAN GREGORY E. SOPKIN
NOT PARTICIPATING.

L:\final\C04-1566_03I-134E_04I-098E.doc:LP