Chesapeake Regulatory Consultants, Inc.
1698 Saefern Way
Annapolis, MD 21401-6529

Phone: 410.849.3210 Fax: 410.849.3220
eMail: rgtsbs@comcast.net

Robert G. Towers
Basil L. Copeland, Jr.
David E. Peterson

March 22, 2007

via eMail and US Mail
Bob Knadle, Utility Analyst
South Dakota Public Utilities Commission
500 E. Capitol Avenue
Pierre, South Dakota 57501

RE: Consulting Services Proposal
Xcel Energy, Inc. - Proposed Transmission Cost Recovery Rider
SDPUC Docket No. EL07-007

Dear Bob:

Thank you for sending me Xcel's proposed TCR Rider and the enabling legislation. I understand that this filing is the first such filing under the legislation which allows the Commission to approve a tariff mechanism providing for automatic annual rate adjustments to recover the costs of new transmission facilities with a capacity of at least 34.5 kV and which are more than five miles in length.

You asked me to review this material and to let you know if we would be available to assist the Commission Staff with its analysis of the filing and, if so, to provide you with an estimate of the cost of our services. We are available to assist the Staff and we are interested in doing so. I propose a budget of $25,000 for our services.

Potential Issues

I see at least four categories of issues raised by Xcel's filing:

(1) Do the facilities qualify for automatic rate adjustment cost recovery under the statute?

(2) Will the proposed rate adjustment mechanism accurately and fairly provide for recovery of the facilites' costs?

(3) Are the cost calculations reflected in the present, initial filing correct? and

(4) Is the proposed tracker mechanism consistent with transmission system cost recovery that occurs by operation of FERC-jurisdictional transmission rates, in particular, those of the Midwest Independent System Operator (MISO) and the recovery of MISO charges in Xcel's Fuel Clause Adjustment?

Do the facilities qualify?

The statute seems clear in limiting cost recovery to transmission facilities – both lines and associated facilities -- of 34.5kV or higher where the transmission lines are more than five miles in length (SDCL 49-34A-25.1). The Company's assertion that the facilities subject to this initial rate adjustment satisfy these criteria should be easily verifiable. More difficult is a determination that the decision to construct these facilities results in "the lowest reasonable costs to ratepayers" (SDCL 49-34A-25.3 (4)). For example, I understand that Xcel's cost calculations -- and the proposed initial rates -- are based on a transmission line alignment and pole configuration for which it has not yet received a permit and that an alternate pole configuration could substantially increase its costs – and the proposed rates. Under such circumstances a showing would have to be made by the Company that other alternatives do not exist or, if they do, that their costs would be greater.

Will the proposed rate adjustment mechanism accurately and fairly provide for the recovery of the facilities' costs?

The need for and proper operation and application of the proposed adjustment clause requires a comprehensive review of the mechanics of the tracker mechanism.

For example, the proposed allocation of system costs to South Dakota using current cost allocation factors seems reasonable but one cannot be convinced that the use of weighting factors based on class load factors derived from NSP's 1992 rate case to produce tracker rates that vary by customer class within South Dakota results in an accurate or fair distribution of the incremental transmission costs.

Moreover, in addition to eliminating the reliance on out-of-date allocators, a single *uniform energy rate* for transmission costs incurred to achieve energy savings from wind generation would be justified by the fact that the savings in generation costs will inure in greater portion to the higher load factor, non-Residential customers. Using a single, composite TCR factor would reduce the burden on Residential customers by approximately $76,000, or 23%, based on Xcel's claimed 2007 costs.[1]

SDCL 49.34A-25-2 (1) requires that any revenues generated by the transmission project be recognized as an offset to the claimed costs and the tracker mechanism contains a "revenue credit for Non-Retail Transmission Recovery" which takes place through Xcel's FERC-approved Open Access tariff (OATT) (see Exhibit 2, Attach. 2, Sch. 2). However, the revenue credit will not match the costs reflected in the tracker because FERC's accounting does not reflect rate base treatment of CWIP and, in addition, it is unclear how the OATT revenue effects of specific transmission facilities will be identified.

The rate of return proposed for the tracker to be implemented in 2007 is taken from a rate determination made fifteen years earlier in response to NSP's 1992 rate filing and, even thought this would appear to satisfy the SDCL 49-34A-25.2 (2) criterion of using a rate of return from the utility's "last general rate case", such a return is not likely to be "consistent with the public interest" as the law also requires.

<u>Are the cost calculations calculations correct?</u>

The projected revenue requirement upon which the tracker rate is based is similar in its components to the revenue requirement determination made in general cases although those determinations are based closely on actual or otherwise known costs. Accordingly, the tracker calculations need to be reviewed in detail to insure that they are consistent with the South Dakota Commission's treatment of the cost elements.

For example, it is not clear whether the return on the transmission investment in plant under construction (CWIP) is based principally on the cost of short term debt or whether it utilizes a return on plant in service approach.[2] Once the plant is placed in service the rate of return should change to reflect the exclusion of short term debt.

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[1] The rate would be reduced from $0.00065/kWh to $0.00050/kWh. See Exhibit 2, Attachment 1, Schedule 3.
[2] Typically, short term debt is assigned first to CWIP and capitalized as an Allowance for Funds Used During Construction.

The depreciation rate(s) used and applied when the transmission plant is placed in service should be supported if they have not been recently reviewed and approved by the Commission. I believe, but am not certain, that Xcel periodically reviews and adjusts its depreciation rates.

Is the proposed tracker consistent with transmission system cost recovery that occurs by operation of FERC-jurisdictional transmission rates, in particular, those of the Midwest Independent System Operator (MISO), Xcel's OATT and the recovery of FERC-jurisdictional charges in Xcel's Fuel Clause Adjustment?

By providing for a revenue offset to the transmission costs to be recovered through the tracker, Xcel acknowledges that the facilities will generate benefits provided through rates established by the FERC. But it is not clear what those benefits might include or whether benefits accruing through FERC-regulated transactions might duplicate the effects of the South Dakota tracker incentive. In recent Orders, the FERC has (1) as required by the Energy Policy Act of 2005, established a menu of ratemaking incentives for transmission grid investments by all transmission owners [3] and (2) resolved debate over the procedures to be used to allocate MISO grid costs among affected utilities and established procedures for determining rates for cost recovery [4].

At this time it is not clear whether the transmission facilities that would be subject to the initial South Dakota tracker would be eligible for incentive treatment under the new FERC rules or whether Xcel will request incentive treatment. However, potential complications of subjecting the same facilities to different ratemaking treatments and then providing for the allocation of these costs among the grid users should be explored.

Perhaps a more fundamental question is whether or not the South Dakota tracker incentive is in the public interest given the array of incentives now available through the FERC,

[3] Order No. 679-A issued December 22, 2006 in Docket No. RM06-4-001.
[4] Order on Rehearing and Clarification issued March 15, 2007 in Docket No. ER06-18-006 and Order Conditionally Accepting Tariff Revisions issued March 15, 2007 in Docket Nos. ER06-18-004 and ER06-18-005.

Proposal

As you know, we have considerable experience with general rate increase requests by electric and gas utilities including experience with the types of potential issues that we have identified here. In addition to our participation with South Dakota Staff in more than thirty formal rate proceedings since 1976, we are presently engaged by the Colorado Consumer Counsel, the New Jersey Rate Counsel (formerly "Ratepayer Advocate") and the Staff of the Delaware Public Service Commission as consultants in gas, electric and water rate cases before the regulatory commissions in those states.

In this proceeding, we propose to assist the Staff in analyzing all of the issues described generally above. I would be primarily responsible for our activities, obtaining input from Basil Copeland on cost of capital issues and assistance from David Peterson as required on accounting issues. We are proposing however that, while we would participate actively in all of the required analyses, discovery and the formulation of recommendations, we would serve primarily as advisors to Commission Staff, allowing Staff members to participate fully in negotiations with the Company and in providing testimony if the case goes to hearing.

This project is unlike a general rate case where the process tends to be routine. Consequently, for the purpose of preparing a cost estimate, I have not tried to estimate our time by specific task or to estimate where Basil Copeland or Dave Peterson might be logging time in lieu of the allowances that I have made for myself. Likewise, I have not made a specific allowance for trips to South Dakota. Instead, my cost estimate of $25,000 was developed as follows:

Robert G. Towers	160 hrs. @ $140	$ 22,400.00
Basil L. Copeland, Jr.	12 hrs. @ $140	1,680.00
David E. Peterson	6 hrs. @ $140	840.00
Total fees		$ 24,920.00
Misc. out of pocket expenses (FedEx, etc.)		80.00
TOTAL		$ 25,000.00

Of course, our actual charges would be based on actual time spent on the project and actual out of pocket costs. The cost estimate would not be exceeded without additional further authorization.

Please let me know if you have any questions about my discussion of the issues, division of the workload between Staff and our firm or any other aspect of this . proposal. We look forward to working with you again.

Sincerely,

Robert G. Towers
President

Attachment: Fee Schedule (January 2007)

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Phone: 410.849.3210 Fax: 410.849.3220
Email: rgtsbs@comcast.net

Robert G. Towers
Basil L. Copeland, Jr.
501.851.8619
David E. Peterson
410.286.0503

FEE SCHEDULE

		Hourly Rate
Robert G. Towers Annapolis, MD	Senior Consultant	$ 140.00
Basil L. Copeland, Jr. Maumelle, AR	Senior Economist	$ 140.00
David E. Peterson Dunkirk, MD	Senior Consultant	$ 140.00

January 1, 2007