
STAFF MEMORANDUM

TO: COMMISSIONERS AND ADVISORS
FROM: BRITTANY MEHLHAFF, KARA SEMMLER, RYAN SOYE, AND ROSS PEDERSEN
RE: EL12-035 - In the Matter of the Petition of Northern States Power Company dba Xcel Energy for Approval of its 2011-2012 Transmission Cost Recovery Eligibility and Rate Adjustment
DATE: August 7, 2012

Commission Staff (Staff) submits this Memorandum in support of the Settlement Stipulation of August 7, 2012, between Staff and Northern States Power Company dba Xcel Energy (Xcel or Company) in the above-captioned matter.

BACKGROUND

On April 30, 2012, the Commission received a petition from Xcel for approval of a revised Transmission Cost Recovery (TCR) rider adjustment factor for 2011 and 2012. The filing also requested approval of the tracker report for approved transmission project investments, expenditures, and revenues received since the implementation of the first adjustment factor, effective on February 1, 2009. This petition replaces the Company's petition filed in Docket EL10-014, which was withdrawn. Xcel filed the new petition following several discussions with Staff regarding cost allocation issues pertaining to regional transmission projects.

South Dakota Codified Laws Chapter 49-34A, Sections 25.1 through 25.4 authorize the Commission to approve a tariff mechanism for the automatic annual adjustment of charges for the jurisdictional costs of new or modified transmission facilities with a design capacity of thirty-four and one-half kilovolts or more and which are more than five miles in length.

In Docket EL07-007, the Commission approved the establishment of the TCR rider to recover the costs associated with six transmission projects. These costs were incorporated into base rates during Xcel's 2009 rate case, Docket EL09-009. As such, in January 2010, the TCR rider adjustment factor was adjusted to remove the costs related to the six transmission projects and to collect only the remaining balance in the tracker account.

In this filing, Xcel requests to recover a projected 2012 revenue requirement of \$2,471,069 associated with fifteen transmission projects and MISO Schedule 26 expenses. The request includes the 2011 unrecovered balance of \$792,211, consisting of 2011 revenue requirements, the 2010 unrecovered balance of \$152,825, and credit of the TCR revenues received in 2011. The proposed 2011-2012 revenue requirement results in a rate of \$0.001453 per kWh, calculated based on a March 1, 2012 effective date. The result is an increase of \$0.001359 per kWh to the current TCR rate. Xcel filed the petition on April

30, 2012 and proposes to implement rates in the billing cycle that immediately follows Commission approval or “within thirty days after filing the petition.”

STAFF’S ANALYSIS AND SETTLEMENT RESOLUTIONS

Staff’s recommendation is based on analysis of Xcel’s filing, discovery information, relevant statutes, and previous Commission orders. Staff reviewed the tracker report and the forecasted 2011-2012 revenue requirement associated with new transmission projects.

Staff and Xcel (jointly the Parties) positions were discussed thoroughly at settlement conferences. As a result, some party positions were modified and others were accepted where consensus was found. Ultimately, the Parties agreed on a comprehensive resolution of all issues.

The Parties agree the over-collection of the remaining balance as of December 31, 2010 is \$41,316. The TCR rate rider is based on estimated costs of eligible transmission projects incurred with revenue requirements beginning January 1, 2011 for 6 projects and beginning January 1, 2012 for 9 additional projects. The attachments to the Settlement Stipulation reflect the estimated 2012 revenue requirement subject to later “true-up” to actual costs and actual recoveries. The revised TCR adjustment factor would be \$0.003038 effective September 1, 2012.

TRACKER REPORT

The filed 2010 TCR tracker report contained actual tracker activity from July 2008 through December 2010. Attachments 34, 35, and 40 attached to the Settlement Stipulation summarize the tracker activity by month for the years 2008 through 2010. Individual project detail for the six initial projects is found on Attachments 8 through 13.

The initial TCR rider implemented a rate of \$0.000935 per kWh for all customers effective February 1, 2009. The costs associated with the six initial transmission projects were included in the TCR rider from July 2008 through January 17, 2010. Effective January 18, 2010, the costs associated with these six transmission projects were reflected in base rates as a part of Xcel’s 2009 general rate filing, Docket EL09-009. The rate was adjusted accordingly to \$0.000094 per kWh in order to collect the remaining balance in the tracker account.

Staff reviewed the capital costs to determine if the costs were prudent and at the lowest reasonable cost to ratepayers. Unless otherwise noted, all of the changes discussed below are changes from the Company’s originally filed position.

2010 Schedule 26 Expenses

The Company’s tracker activity for 2010 included the actual Schedule 26 expenses, net of revenues, for January 2010 through December 2010. Staff felt it was inappropriate to include these costs in the TCR for the year 2010 as these costs were not approved for recovery in the Company’s initial TCR rider. Further, during 2010 the Company recovered Schedule 26 expenses through base rates set at the level

approved in Docket EL09-009. The Settlement removes the Schedule 26 expenses from the 2010 tracker activity.

Capital Structure

The Settlement reflects the use of the Company's actual capital structure from the preceding calendar year as described in the Settlement Stipulation in EL07-007 for the years 2008, 2009, and 2010. For example, 2010 investments are multiplied by a rate of return based on Xcel's actual capital structure as of December 31, 2009 to determine the required operating income.

Return on Equity

The Company's filing developed TCR revenue requirements for the true-ups of all past requirements and collections for the years 2008 through 2010 by applying a 9.5% ROE. The Settlement reflects the proposed ROE for the years 2008 through 2010. This ROE value continues to apply the ROE that was established in the initial TCR filing in Docket EL07-007 and falls within Xcel's current cost of equity capital range as determined by Staff's cost of capital consultant, Basil L. Copeland in Docket EL11-019.

After incorporating the above changes into the revenue requirement calculation, the over-collection of the remaining balance as of December 31, 2010 is \$41,316.

2011-2012 TCR RIDER PROJECTS AND METHODOLOGY

The 2011-2012 TCR Adjustment Factor is based on the 2010 over-collection in the tracker account and the estimated 2011-2012 revenue requirements associated with fifteen transmission projects and MISO Schedule 26 expenses. The projects are needed for several reasons including: ensuring system reliability, meeting customer demand due to load growth in the area, alleviating low voltage and excessive transmission line loading during high system load conditions and transmission outages, and satisfying interconnection obligations.

SDCL 49-34A Section 25.1 allows utilities to include costs associated with transmission facilities in the TCR rider with a design capacity 34.5 kV or more and which are more than five miles in length. All projects included for recovery in this filing, except the Hiawatha project, satisfy these eligibility requirements. The Hiawatha project is not eligible for cost recovery through the TCR rider as its length is less than 5 miles. Therefore, the Settlement reflects exclusion of the costs associated with this project.

The TCR legislation requires consideration of whether the projects have and are expected to achieve transmission system improvements at the lowest reasonable cost to ratepayers. The Company evaluated several alternatives for the transmission project plans to ensure the options chosen were economical. Materials and services for the transmission projects were or will be subject to a competitive bidding process in accordance with the Company's procurement policies.

Staff looked to previous Commission action regarding this subject as guidance in its analysis. In November 2011, the Commission approved the Settlement Stipulation entered into between Otter Tail Power Company and Staff in Docket EL10-015. In processing EL10-015, Staff and Otter Tail discussed

three different types of transmission projects, each with separate treatments under the TCR rider. Specifically, the project types were:

- (1) New or modified projects, ineligible for cost-sharing through the Midwest Independent Transmission System Operator (MISO) tariff;
- (2) MISO Transmission Expansion Plan (MTEP)-approved cost-shared projects without company investment; and
- (3) MTEP-approved cost-shared projects with company investment.

The projects included for recovery in Xcel's filing can also be allocated into these 3 project types, as detailed below.

Type (1) Projects

Projects in this category are ineligible for cost-sharing through MISO. As was approved in Docket EL07-007, all of Xcel's investment associated with these projects is placed into rate base in the TCR rider, which is then allocated to South Dakota.

The non-cost shared projects included in Xcel's filing are: Chisago-Apple River, North Mankato, Pleasant Valley Byron, Glencoe-Waconia, St. Cloud Loop, Sioux Falls Northern, Grove Lake-Glenwood, Hiawatha, Sauk Center-Osakis, Hollydale, and Meadow Lake. In addition, a portion of the La Crosse project is non-cost shared and is treated as a type (1) project. The other portion of the La Crosse project is eligible for MISO cost-sharing and is discussed below under type (3) projects. In Docket EL10-014, Xcel also requested recovery of the BRIGO and Blue Lake-Wilmarth projects. The BRIGO and Blue Lake-Wilmarth projects were incorporated into base rates in Docket EL11-019 and thus Xcel no longer requests inclusion of these two projects in Docket EL12-035. The Company does not plan on rolling any transmission projects included for recovery in Docket EL12-035 into base rates in its current rate case, Docket EL12-046. Also, as previously noted, the costs associated with the Hiawatha project have been removed due to ineligibility for recovery in the TCR rider.

Under the MISO Tariff, revenue requirements for non-cost shared projects are recovered under Attachment O. Transmission assets are included in the Open Access Transmission Tariff (OATT) revenue requirement under Attachment O and Xcel collects revenue from other transmission users in MISO. These revenue collections are returned to customers through the TCR rider under the form of an OATT revenue credit.

Type (2) Projects

Expenses incurred by a utility as a result of MISO's cost allocation methods are considered by Staff to be a cost of MISO membership. In Docket EL10-015, when Otter Tail was not a project investor, Staff agreed to flow these expenses through the TCR rider. Staff inquired of Xcel as to how the Schedule 26 expenses charged to Xcel were recovered. Prior to Docket EL11-019, these expenses were recovered through base rates. Staff and Xcel agree these expenses can be appropriately recovered through the TCR rider as they are a cost of transmission due to MISO membership. Thus, in Docket EL11-019, the

Schedule 26 expenses were removed from the test year to facilitate recovery in the TCR rider. The TCR rider includes recovery of Schedule 26 expenses beginning in 2011. Schedule 26 expenses were included in base rates in Docket EL09-009 and interim rates in Docket EL11-019 were effective January 2, 2012. As such, the Settlement adjusts the 2011 expenses to remove the expenses recovered through base rates in 2011, \$12,230. Full recovery of Schedule 26 expenses should be allowed in the TCR rider for 2012 and future years as these costs were removed from base rates in Docket EL11-019.

Type (3) Projects

The TCR rider recovery methodology for projects eligible for MISO cost-sharing was also discussed in Otter Tail's TCR, Docket EL10-015. Staff and Otter Tail explored three proposed recovery methods for these projects and the Commission approved the Settlement Stipulation supporting the "hybrid" or "split method" approach. In the approved approach, only the portion of the MISO cost-shared project investment that SD ratepayers are responsible for, as determined by MISO, was included in the TCR rider rate base. Ratepayers also received the benefit of Schedule 26 revenues associated with the retail load portion of the transmission investment. The Schedule 26 revenues offset the Schedule 26 expenses associated with the project, leaving ratepayers paying for the retail load responsibility of the project at the South Dakota rate of return. Please refer to the Staff Memorandum filed in Docket EL10-015 for a complete description of the methods considered.

Xcel's initial TCR filing, Docket EL07-007, included only traditional non-cost shared projects. Thus, the treatment of MISO cost-shared projects was not addressed and this is a new issue for Xcel. Staff and Xcel discussed use of the "split method" for the cost-shared projects in this filing. These projects include La Crosse, Fargo, Bemidji, and Brookings. Fargo, Bemidji, and the majority of the La Crosse project all qualify for regional cost sharing as Baseline Reliability Projects¹ (BRPs). The Brookings project was approved by MISO as a Multi-Value Project² (MVP) in December 2011. As such, all four projects fall under the category of type (3) projects and the "split method" was considered for these four projects.

The "split method," as originally contemplated in EL10-015, was designed to address a situation where the utility's investment in a project exceeds its retail load responsibility as determined by MISO. "Retail load responsibility" is a determination made by MISO regarding the utility's use of the project to serve its own retail customer needs. When implemented, the "split method" assures the Company's retail load responsibility for the project is included in the TCR rate base. In other words, the investment amount included in rate base is consistent with the company's determined retail load. The portion of the utility's investment above rate payer retail use responsibility is then recovered through the excess Schedule 26 revenues not credited to ratepayers. Two of Xcel's projects, La Crosse and Brookings, fall under this scenario.

The remaining projects, Fargo and Bemidji, create a new scenario however not previously contemplated by the Commission. Specifically, Xcel's investment in Fargo and Bemidji is less than its MISO determined responsibility. This factual situation was not addressed in EL10-015 as the scenario did not exist for

¹ Projects qualifying as BRPs are required for regional reliability purposes.

² Projects addressing regional public policy and providing reliability and economic value are categorized as MVPs.

Otter Tail. The new factual situation caused Staff to reexamine the “split method” in relation to this type of project.

For this new type of project in which Xcel’s investment is less than its MISO responsibility, use of the “split method” could require the inclusion of Xcel’s total project responsibility in rate base. That amount, in these circumstances, is more than the Company invested. Staff does not believe the “split method” intended rate base to include more than the Company’s investment. Thus, Staff engaged in discussions with Xcel to determine Xcel’s interpretation of the “split method” and how it applies to projects in which Xcel’s investment is less than its responsibility.

Xcel explained its responsibility for project cost can be separated into (i) responsibility for its own investment in the project and (ii) responsibility for other MISO members’ investment in the project. Under the original “split method” the Company includes its responsibility for others’ investment in the TCR rate base and thus earns the South Dakota return on this portion of the investment. However, the Company is charged Schedule 26 expenses at the FERC return through MISO for this responsibility in others’ investment. The original “split method” only allows the Company to earn the South Dakota return, not the FERC return on these charges. It is important to remember, these Schedule 26 charges do not represent Xcel investment. Rather, the charges allocated to Xcel due to its responsibility level in MISO are simply a cost of membership in MISO. These charges are no different than the Schedule 26 charges Xcel must pay for projects when the Company has no investment level.

Staff argues the state rate making approach cannot decrease the return Xcel is allowed from other MISO members. Staff argues, the Commission should not deny the utility its right to recover that federally allowed return. Therefore, Staff and Xcel agree a more sophisticated version of the “split method” should be introduced for all cost-shared projects in which only the Company’s responsibility for its own investment in the project is included in the TCR rate base. Staff has termed this method the “refined split method”.

A major factor in Staff’s previous recommendation of the “split method” centers on a legal jurisdictional issue. The distinction remains not only important, but is a focus for staff in its recommendation of the “refined split method.” Staff believes it is responsible to not only advocate for the most reasonable and economic rates, but also to advocate for the most legally correct solution. The “refined split method” is legally correct as it respects the limits of state regulation recognizing the jurisdiction of the Federal Energy Regulatory Commission (FERC). FERC, an independent federal agency, regulates interstate transmission and wholesale sales of electricity. FERC action is reviewable by the Federal Courts. As a member of MISO, Xcel is subject to the MISO tariff process. MISO tariffs are filed according to and in compliance with FERC Orders and Federal Code. It is improper for a state agency to disallow a rate approved by a federal agency through a federal tariff process. Schedule 26 charges and the federal return allowed Xcel for participation in MISO are approved through the FERC tariff process.

Congress has the power to preempt or supersede state laws that interfere with, conflict with, or are contrary to federal law. *Hillsborough County v. Automated Medical Laboratories, Inc.*, 471 U.S. 707, 712 (1985). A "state law is pre-empted where it regulates conduct in a field that Congress intended the Federal Government to occupy exclusively." *English v. General Electric Co.*, 496 U.S. 72, 79 (1990). A

court may infer this intent "where the pervasiveness of the federal regulation precludes supplementation by the States, where the federal interest in the field is sufficiently dominant, or where the object sought to be obtained by the federal law and the character of the obligations imposed by it... reveal the same purpose." *Schneidewind V. ANR Pipeline Co.*, 485 U.S. 293, 300 (1988) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)).

In this case we are not debating federal regulation versus state statute. However, federal regulations have the same "preemptive effect" as federal statutes if promulgated pursuant to the discretion and within the authority given by Congress. *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 699 (1984). Federal regulations also are "indicative" of what powers Congress intended for an agency to exercise and of the parameters of the occupied regulatory field. *Schneidewind v. ANR Pipeline Co.*, 485 U.S. at 309 n. 12. Congress intended to give FERC exclusive authority regarding interstate transmission and wholesale charges. Schedule 26 is a wholesale charge outside the jurisdiction or review of this Commission. As a result Staff's recommendation makes it possible for Xcel to both comply with and enjoy the benefit of the federal tariff while remaining consistent with South Dakota rate making principles.

The "refined split method" allows all cost-shared projects to be treated equally and eliminates Staff's concerns about the application of the "split method" to projects in which the Company's investment is less than its responsibility. Staff offers the following detailed explanation of the "refined split method" to clearly identify all aspects of this new level of sophistication.

As discussed above, to fully honor the federal/state jurisdictional divide, the "refined split method" only places into the TCR rate base the Company's MISO determined retail responsibility for its own investment. Xcel is also responsible for a portion of the line invested in by others and is charged Schedule 26 expenses through the MISO tariff for this responsibility. These Schedule 26 charges flow through the TCR as an expense. Thus, rate payers are responsible for Xcel's entire financial responsibility. The Company's financial responsibility is partially paid for through rate base at the South Dakota return and partially through expenses at the FERC return. Other members of MISO are financially responsible for the remaining portion of the line invested in by Xcel. These MISO members are charged Schedule 26 expenses, through the MISO tariff, for this responsibility and Xcel receives this amount as revenues from MISO. In sum, Xcel is charged Schedule 26 expenses relating to its total financial responsibility, including Xcel's responsibility for its own investment and Xcel's responsibility for the portion of the line invested in by others. Xcel receives revenues relating to its total investment in the projects, including Xcel's responsibility for its own investment and others' responsibility for Xcel's investment. In the "refined split method" the total Schedule 26 charges flow through to ratepayers as an expense and the total revenue is adjusted to remove the revenues the Company receives from others, leaving a revenue credit to ratepayers relating to Xcel's responsibility for its own investment. Since rate base only includes the costs associated with the Company's responsibility for its own investment, ratepayers do not receive a credit for the revenues the Company receives from others. The Company uses this revenue to pay for the portion of its investment for which other members of MISO are responsible.

Exhibit___(BAM-1), Schedule 1 attached to this memorandum details the Company's investment and responsibility percentages for the cost shared projects. Please see Exhibit___(BAM-1), Schedule 2 for a comparison of the 2012 TCR revenue requirement using the "Refined Split Method" recommended for Docket EL12-035, the "Split Method" as implemented in Docket EL10-015, and the "All-in Method". Exhibit___(BAM-2), Schedules 1 through 9 and Exhibit___(BAM-3), Schedules 1 through 9 provide supporting exhibits for the "Split Method" and "All-in Method".

Staff notes that the revenue requirement for the Bemidji project was incorrectly allocated to South Dakota using total project revenue requirements as opposed to allocating the revenue requirements based on Xcel's responsibility for its investment. The Settlement revises the South Dakota jurisdictional revenue requirement for the Bemidji project to reflect the appropriate cost allocation.

2011-2012 CAPITAL STRUCTURE AND RETURN ON EQUITY

Capital Structure

The Company's filing reflected a 2011-2012 capital structure based on a 13-month average for the 2010 test year, as initially filed in Docket EL11-019. The settlement reflects the use of the actual capital structure at the end of the preceding calendar year as reflected in the Settlement Stipulation approved in Docket EL07-007 and the Commission's decision on capital structure in Docket EL11-019. 2011 and 2012 investments are multiplied by a rate of return based on Xcel's actual capital structure as of December 31, 2010 and December 31, 2011, respectively, to determine the required operating income.

Return on Equity

In Docket EL10-014, Xcel proposed to develop TCR revenue requirements for the determination of a prospective (2011) TCR rate by applying the ROE incorporated in the settlement of its most recent general base rate case, Docket EL09-009. The ROE incorporated in the settlement of Docket EL09-009 was **Begin Confidential** **End Confidential**. Staff was uncomfortable using the return on equity from the last rate case, particularly due to the passage of time since Docket EL09-009. Thus, Staff believed an evaluation of Xcel's current cost of equity capital was necessary. However, Xcel filed a general rate case before the completion of this TCR docket. As a result, Staff and Xcel agreed to wait to finalize the TCR return until completion of Docket EL11-019. We believe the delay avoids unnecessary duplication regarding the cost of equity analysis.

The Settlement incorporates a return on equity of 9.25% for 2011 and 2012, consistent with the Commission's decision in Xcel's most recent rate case, Docket EL11-019.

CARRYING CHARGE

Docket EL07-007 implemented a carrying charge to be calculated at the TCR overall rate of return, adjusted for related Federal income taxes. The Settlement continues to apply a carrying charge to the monthly over-or-under recoveries based on the overall rate of return implemented for each year 2008-2012.

RATE DESIGN

As proposed by Xcel, the Settlement continues to incorporate the rate design approved in Docket EL07-007 in which a single rate is applicable to all customer classes.

EFFECTIVE DATE

Xcel's filing in Docket EL10-014 proposed the TCR adjustment factor be revised effective January 1, 2011. Staff and Xcel agree that the TCR should have been implemented effective January 1, 2011 in accordance with the tariff. Since the Chisago-Apple River, North Mankato, Bemidji, Fargo, LaCrosse, and Brookings projects were included in the EL10-014 filing, the TCR is based on the revenue requirements associated with these transmission projects beginning January 1, 2011 (the eligibility date)³. The remaining projects have proposed eligibility dates beginning January 1, 2012. Staff and Xcel agree that had the Commission issued an order in Docket EL10-014 for the TCR rate to be effective January 1, 2011, in the fall of 2011 Xcel would have filed a 2011 tracker report and 2012 projected revenue requirements associated with these additional projects, resulting in a rate to be effective January 1, 2012. Thus, Staff and the Company agree a January 1, 2012 eligibility date is appropriate for these projects. The TCR rate is designed to be implemented effective September 1, 2012, using actual 2011-2012 TCR revenues received through June 2012 and forecasted sales from July through December of 2012.

The net effect of the changes outlined in this memo is an estimated -2012 South Dakota revenue requirement of \$2,094,106 associated with transmission investments, including the 2011 unrecovered balance of \$532,704. The 2011 unrecovered balance consists of the 2010 over-collection of \$41,316, 2011 revenue requirements, and the TCR revenues received in 2011. This results in a rate of \$0.003038 to be effective September 1, 2012.

OTHER ISSUES

Reasonableness of Overall Earnings from Regulated Rates

The Company has agreed to continue to file, by June 1 of each year, an annual report with the Commission detailing its South Dakota jurisdictional earnings for the preceding calendar year. Staff believes the report is necessary to monitor the Company's earnings and the potential effect of adding the TCR rider to its South Dakota tariff.

RECOMMENDATION

Staff recommends the Commission approve the Settlement Stipulation for the reasons stated above.

³ The TCR revenue requirement includes a current return on capital expenditures beginning with the cumulative CWIP balance for each project at eligibility date, or the date construction expenditures begin after that date, whichever is sooner. The beginning CWIP balance includes AFUDC incurred prior to project eligibility date.