BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE APPLICATION OF NORTHERN STATES POWER COMPANY DBA XCEL ENERGY FOR AUTHORITY TO INCREASE ITS ELECTRIC RATES

STAFF MEMORANDUM SUPPORTING SETTLEMENT STIPULATION

DOCKET EL12-046

Commission Staff (staff) submits this Memorandum in support of the Settlement Stipulation of March 15, 2013, between staff and Northern States Power Company (NSP or Company) in the above-captioned matter.

BACKGROUND

On June 29, 2012, the Company filed an application with the South Dakota Public Utilities Commission (Commission) seeking an increase in annual base rate revenues of approximately $19,368,000 or a 11.53 percent increase in retail revenue for electric service to customers in its South Dakota retail service territory. NSP is proposing to offset, in part, its increased nuclear decommission cost accrual by using funds expected to be received from the Department of Energy (DOE) under a settlement between the DOE and NSP over the DOE's cost responsibility for storing spent nuclear fuel.

NSP's proposed increase was based on an historic test year ended December 31, 2011, adjusted for what NSP believes to be known and measurable changes, a 10.65 % return on common equity, and a 8.51 % overall rate of return on rate base. NSP witnesses submitted testimony stating that the increase is needed to: (1) maintain, improve, and replace infrastructure on its system; (2) address increases in operating and maintenance expenses, largely related to increased operating costs at generating facilities; and (3) comply with increasing regulatory requirements.

The Commission officially noticed NSP's filing on July 5, 2012, and set an intervention deadline of September 7, 2012. On July 23, 2012, the Commission issued an Order of Assessment of Filing Fee and Suspension of Imposition of Tariff. On September 6, 2012, Shetek Wind Inc. filed a Petition to Intervene. On September 21, 2012, Xcel filed an Answer of Northern States Power Company to Petition to Intervene by Shetek Wind Inc. On September 24, 2012, Shetek filed a Reply of Shetek Wind Inc. to Answer of Northern States Power Company. On October 1, 2012, the Commission issued an Order Denying Intervention to Shetek Wind Inc. On October 29, 2012, the Commission issued its Order for and Notice of Procedural Schedule and Hearing ordering a hearing be held on December 13 and 14, 2012. Staff filed testimony and exhibits supporting its case on November 15, 2012. On November 30, 2012, the Company filed its Notice of Intent to Implement Interim Rates based on current rate design for service provided on and after

January 1, 2013, pursuant to SDCL 49-34A-17. On December 4, 2012, NSP filed a motion requesting to suspend the procedural schedule by approximately one month to allow for settlement discussions. On January 4, 2013, NSP filed a motion requesting to suspend the procedural schedule for an additional month to allow settlement discussions to proceed. On February 1, 2013, NSP filed a motion requesting that the procedural schedule be extended further by an additional week. On February 8, 2013, NSP filed a motion requesting that the procedural schedule be suspended while the parties finalize the settlement documents for submission.

Settlement discussions commenced on November 26, 2012. Thereafter, staff and NSP (jointly the Parties) held several settlement discussions in an effort to arrive at a mutually acceptable resolution of the issues presented in NSP's rate filing. Ultimately, the Parties reached a comprehensive agreement on NSP's overall revenue deficiency and other issues presented in the case including, but not limited to, class revenue responsibilities, rate design, and a new rider to recover the costs associated with major capital additions.

OVERVIEW OF SETTLEMENT

Staff's filed case on November 15, 2012, indicated a rate increase of approximately $6,359,000 would allow the Company to recover its ongoing costs and allows for the opportunity to earn a reasonable and fair return on utility investments. Company and staff positions were discussed thoroughly at the 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. Staff believes the settlement is based on sound regulatory principles and avoids costly and unnecessary litigation costs.

Staff and NSP agree NSP's revenue deficiency recovered through base rates is $11,570,000. The revenue requirement and supporting calculations described in this Memorandum and attachments depict staff's positions regarding all components of NSP's South Dakota jurisdictional revenue requirement, including a reasonable return allowance on the Company's rate base investments.

The settlement also establishes a Rate Phase-In rider to recover specific major capital additions that were placed in-service in late 2012 or are expected to be placed in-service in 2013, and any changes in 2013 property taxes from the property taxes included in the test year. In exchange for the rider, the Parties agree that NSP shall not file any rate application for an increase in base rates which would go into effect prior to January 1, 2015. The estimated 2013 revenue requirements associated with the Rate Phase-In rider is $3,714,485. In 2014, the Company forecasts an additional $2,648,296 will be recovered through the rider.

When the base rate increase is combined with the Rate Phase-In rider, the estimated 2013 overall revenue increase will be $15,284,485 justifying an approximate 9.06% increase in retail revenues. In 2014, estimated retail revenues would increase by an additional $2,648,296 or approximately 1.44% through the Rate Phase-In rider.

Staff Exhibit___ (BAM-8), Schedule 3 illustrates staff's determination of NSP's pro-forma operating income under present rates. Staff Exhibit___ (BAM-9), Schedule 2 illustrates staff's calculation of NSP's South Dakota retail rate base, and staff Exhibit___ (BAM-8), Schedule 2 and staff Exhibit___ (BAM-9), Schedule 1 summarize the positions. Staff Exhibit___ (BAM-8), Schedule 1 supports NSP's revenue deficiency and total revenue requirement collected through base rates. Exhibit E attached to the Stipulation supports the Rate Phase-In rider revenue requirement and rate calculation.

The base revenue increase by rate schedule is shown on staff Exhibit___(BAM-10), Schedule 1. Staff Exhibit___(BAM-10), Schedules 2-1 through 2-4 reflect the settlement base rates for each rate schedule. The comparison between present and settlement rates and resulting bill impacts, including the Rate Phase-In rider, for the E01 Residential Service and E01 Residential Service – Electric Space Heating rate schedules is shown on Exhibit___(BAM-10), Schedule 3.

STAFF OVERVIEW OF BASE RATE SETTLEMENT

Staff believes the settlement provides NSP with an annual level of revenues relative to its service costs that is fair, just, and reasonable. These settlement rates allow NSP a reasonable opportunity to earn a return adequate for it to continue the provision of safe, adequate, and reliable service to its South Dakota retail customers.

As referenced in Table 1, Staff accepted certain Company adjustments in its filed testimony on November 15, 2012, that were based on sound regulatory theory and supported by NSP.

Table 1 – Staff Accepted Company Adjustments

Adjustment	Staff Witness	Staff Testimony Reference	Staff Exhibit Reference	NSP Witness	NSP Testimony Reference	NSP Exhibit Reference
Fuel Lag	Mehlhaff	5-6	BAM-1, Sch 3	Kramer	25-26	PF1
Production Tax Credits	Mehlhaff	6	BAM-1, Sch 3	Kramer	34-35	PF14
Wholesale Billing	Mehlhaff	7	BAM-1, Sch 3	Kramer	58-59	PF37
Weather Normalized Allocator	Mehlhaff	7-8	BAM-1, Sch 3	Kramer	62	PF41
EL11-019 Outcome	Mehlhaff	8	BAM-1, Sch 3	Kramer	64	PF42
ECR Rider Removal	Mehlhaff	9	BAM-1, Sch 3	Kramer	66	PF48
Rider Amortization	Mehlhaff	9-10	BAM-1, Sch 3	Kramer	69-70	PF52
Interest on Customer Deposits	Jacobson	4	BAM-1, Sch 3	Kramer	30-31	PF9
Union Wage Adjustment	Jacobson	4-5	BAM-1, Sch 3	Kramer	55-56	PF35
Executive Compensation	Jacobson	7-8	DAJ-3	N/A	N/A	N/A
SFAS 106 PAYGO	Peterson	8	BAM-1, Sch 3	Kramer	32-33	PF12
Corporate Allocations	Peterson	8	BAM-1, Sch 3	Kramer	63	PF44
Steam Remaining Life	Peterson	8-9	BAM-1, Sch 3	Kramer	51-52	PF29
Other Production Remaining Life	Peterson	8-9	BAM-1, Sch 3	Kramer	52	PF30
Remaining Life MN Valley	Peterson	8-9	BAM-1, Sch 3	Kramer	52-53	PF31
Remaining Life BL/GC/KC	Peterson	8-9	BAM-1, Sch 3	Kramer	53	PF32
EL11-019 Depreciation Adjustment	Peterson	8-9	BAM-1, Sch 3	Kramer	53-54	PF33

Private Fuel Storage	Steffensen	2	BAM-1, Sch 3	Kramer	67-68	PF49
SO2 Emission	Steffensen	2	BAM-1, Sch 3	Kramer	68	PF50
Storm Damage	Steffensen	3	BAM-1, Sch 3	Kramer	27	PF5
Aviation Adjustment	Steffensen	3-5	PJS-1, Sch 3-5	Kramer	62	PF43
Employee Expense Reduction	Steffensen	5	BAM-1, Sch 3	Kramer	59	PF39
Contributions Donations	Tysdal	2	BAM-1, Sch 3	Kramer	31-32	PF11
Advertising	Tysdal	2	BAM-1, Sch 3	Kramer	29-30	PF7
Economic Development	Tysdal	3	BAM-1, Sch 3	Kramer	30	PF8
Economic Development Labor	Tysdal	3	BAM-1, Sch 3	Kramer	35-36	PF15
Conservation/DSM Cost Removal	Tysdal	3	BAM-1, Sch 3	Kramer	63-64	PF45
Foundation Administration Costs	Tysdal	3	BAM-1, Sch 3	Kramer	59	PF38
Black Dog Write Off Amortization	Thurber	20	JPT-14	Kramer	68-69	PF53

For settlement purposes, the Company accepted certain adjustments recommended by staff in its filed testimony. Table 2 provides a list of these adjustments with references to testimony and exhibits.

Table 2 – Company Accepted Staff Adjustments

Adjustment	Staff Witness	Staff Testimony Reference	Staff Exhibit Reference
Weather Normalization	Mehlhaff	2-5	BAM-3
Margin Sharing	Mehlhaff	6-7	BAM-4
TCR Rider Removal	Mehlhaff	8-9	BAM-5
Riverside/Black Dog One-Time Expenses	Mehlhaff	10-11	BAM-6
Margin Sharing Lag	Mehlhaff	11	BAM-7
Cash Working Capital Updates	Jacobson	4	DAJ-1, Sch 3
Eliminated Positions	Jacobson	5	BAM-1, Sch 3
Vegetation Management	Steffensen	2	PJS-1, Sch 2
Claims and Injury Compensation	Steffensen	2-3	BAM-1, Sch 3
Association Dues	Tysdal	2-3	MAT-1
EL11-019 Rate Case Expense	Thurber	22-28	PJS-1 Sch 1; JPT-19
Monticello Appendix R Cable Replacement	Thurber	13	JPT-5
Lawrence Creek Substation Land Sale	Thurber	21	JPT-16
Fines	Thurber	20-21	JPT-15
Class Cost of Service Study	Peterson	16-25	DEP-1, DEP-2
Rate Design – Customer Charges	Peterson	25-27	DEP-3

The differences between the Company and staff were discussed thoroughly during settlement conferences, and further information and supporting documentation was supplied by the Company. As a result of these discussions, each party modified certain positions it had previously taken and accepted certain provisions of the other with the objective of reaching a comprehensive resolution of the issues based on sound regulatory principles, thus avoiding unnecessary litigation costs. Table 3 provides a summary of the changes made to staff's filed case to reach a settlement.

Unless otherwise noted, all of the changes discussed below are changes from staff's filed position.

Table 3 – Summary of Changes from Staff's Filed Case

	Change in Revenue Deficiency	Revenue Deficiency
Staff's Position as filed on 11/15/2012 ($000's):		$6,359
Issues:		
Incentive Compensation	879	
EL12-046 Rate Case Expense	108	
Black Dog CT Exhaust Replacement	12	
Prairie Island ZE Pipe	2	
Prairie Island Receiving Warehouse	(3)	
Prairie Island Fire Model	328	
Monticello Extended Power Uprate	(36)	
Nuclear Decommissioning Costs	816	
Net Operating Loss	(369)	
Pension and Insurance	751	
Interest Synchronization	(19)	
2012 Non-union Wage Increase	218	
2012 Property Tax Adjustment	892	
South Dakota Gross Receipts Tax	7	
Cash Working Capital	(115)	
Rate of Return (ROE/Capital Structure/Debt Costs)	1,740	
Changes in Staff's Filed Position		5,211
Settlement Position - Base Rates		**$11,570**

Incentive Compensation – NSP had four incentive compensation programs in effect during the test year as described on page 6 of staff witness Jacobson's testimony and staff Exhibit __(DAJ-2). For settlement purposes, staff allowed rate recovery of a portion of the costs of one program, the Annual Incentive Program (AIP). As described in testimony, this program contains targets for several areas including operational excellence and safety but specifies that before any awards are paid, certain financial targets must be achieved and that earnings per share achieved determines the overall payout. The costs of this program were adjusted by (1) normalizing costs based on actual payouts for the period of 2008 through 2011; (2) removing payouts based on financial based awards; and (3) removing payouts to non-exempt employees who are no longer eligible for incentive compensation. This ratemaking treatment is consistent with the settlement position agreed to by staff and approved by the Commission in Docket EL11-019. This change resulted in an increase in the revenue deficiency of approximately $879,000.

EL12-046 Rate Case Expense – The settlement determination includes a two year amortization period and tracking treatment as recommended on page 6 of staff witness Steffensen's testimony, and the rate base treatment of the unamortized rate case expense as proposed by NSP. The only change from staff's filed position is to update rate case expense to reflect actual costs incurred through January 28, 2013. This change resulted in an increase in the revenue deficiency of approximately $108,000. The details for this adjustment can be found on staff Exhibit__(PJS-2), Schedule 1.

Black Dog Combustion Turbine Exhaust Replacement Project, Prairie Island ZE Piping Replacement Project, and Prairie Island Receiving Warehouse – Staff accepted the post test year plant additions related to these three projects as described in staff witness Thurber's testimony. During settlement discussions, the Company indicated that additional costs were incurred related to the Prairie Island ZE Piping and Black Dog CT Exhaust Replacement projects since staff filed its case. In addition, the costs related to Prairie Island Receiving Warehouse were adjusted to correct an accounting entry. The settlement reflects the actual costs through October 2012 related to these projects, increasing the revenue deficiency by approximately $11,000.

Prairie Island Fire Model – At the time staff filed its testimony, the Company had been unable to provide actual costs or confirmation that the model was placed in-service. The Company provided supplemental documentation that indicated the project was placed in-service during September 2012 and actual costs were available. Prairie Island was required to develop a model to evaluate fire protection compliance with regulation NFPA 805 as promulgated by the Nuclear Regulatory Commission. The fire model is now used and useful, and the change is known and measurable. This adjustment increases the revenue deficiency by approximately $328,000.

Monticello Extended Power Uprate (EPU) – In its filed case, staff annualized the Monticello EPU investments placed in-service during the 2011 test year and 2012 to date. As mentioned on page 17 of staff witness Thurber's testimony, the major plant additions related to this project are expected to occur in 2013. The Company proposed to remove this adjustment from the test year, and reflect capital additions related to this project in the Rate Phase-In rider. Staff has no objections to shifting cost recovery to the rider since the major capital additions related to this project are expected to occur during the upcoming year. This change decreases the revenue deficiency by approximately $36,000.

Nuclear Decommissioning Costs – NSP agreed to accept staff's adjustment that eliminated contingency allowances from the decommissioning accrual and to credit ratepayers directly with settlement proceeds from the Department of Energy over the agency's responsibility for the storage of spent fuel as ordered in Docket EL11-023. Upon recalculating the revenue requirement effect of these changes, the Company discovered that it had incorrectly included adjustments for deferred taxes as well as accumulated reserve and accumulated deferred income tax rate base items. For the South Dakota jurisdiction, all decommissioning accrual payments are made to a 100% qualified external decommissioning fund. As such, all payments are therefore tax deductible in the current year and there is no deferred tax transaction associated with this adjustment.

Staff agrees with this correction, increasing the revenue deficiency by approximately $816,000.

Pension and Insurance – During discovery, the Company provided two actuarial reports to support its pension expense and retiree medical, long term disability, and workers compensation insurance expenses. Staff reviewed these reports and concluded that the actuarial analyses did not establish a level of costs for 2012 that would satisfy the known and measurable standard. Consequently, staff rejected the adjustment. During settlement discussions, NSP provided additional information indicating that, while the actuarial report provided a measure of these 2012 expenses for the entire company, its original adjustment allocated these amounts to South Dakota based on 2011 labor costs and that, using available labor costs for 2012, consisting of ten months of actual and two months of estimated costs, for the allocations, the South Dakota test year revenue requirement should be increased by approximately $751,000. The settlement reflects this adjustment.

2012 Non-union Wage Increase – NSP's filed case did not include a non-union wage adjustment. Subsequent to staff filing its case, Xcel proposed to recover the costs associated with a 2.5% non-union wage increase which became effective October 1, 2012. Staff agreed to this adjustment as the increase was known and measurable and occurred within a reasonable time from the end of the test period. This change resulted in an increase in the revenue deficiency of approximately $218,000.

2012 Property Tax Adjustment – NSP reflected its 2011 property tax accruals in the test year. In December 2012, the Company received Truth in Taxation notices from various counties in Minnesota reflecting generation and transmission property valuations as of July 2012 for property owned as of 12/31/2011. These notices also reflect an increase in property tax rates from 3.4% to 3.5%. Staff accepted the property tax update as the most recent actual tax paid on property is more reflective of current operational expenses and not within the Company's control. The net result of these two changes increases the revenue requirement by approximately $892,000.

Interest Synchronization, Cash Working Capital, Net Operating Loss, and South Dakota Gross Receipts Tax – The Company accepted staff's method of determining interest synchronization, cash working capital, and South Dakota gross receipts tax. As stated in staff witness Peterson's testimony, staff concurred with the Company's method for recognizing the test year net operating loss. While the Parties agreed with the specific method for these adjustments, the precise revenue requirement value of each adjustment needed to be recalculated to reflect other adjustments to rate base, operating income, and rate of return incorporated in the settlement. The net result of these changes reduced the revenue deficiency by approximately $496,000.

Rate of Return – The Company requested an overall rate of return of 8.51 percent, using a capital structure of 52.89 percent equity and 47.11 percent long term debt, with cost rates for debt and equity of 6.12 percent and 10.65 percent, respectively. Staff filed testimony supporting an overall rate of return of 7.46 percent, using a capital structure of 52.67 percent equity and 47.33 percent long term debt, with cost rates for debt and equity of 6.03 percent and 8.75 percent, respectively. Staff's recommend range of return on equity was 8.25 percent to 9.25 percent. The overall rate of return accepted in settlement is 7.78 percent, using a **[Begin Confidential]** [redacted] [**End Confidential]**

STAFF OVERVIEW OF RATE PHASE-IN RIDER

As indicated in staff witness Thurber's filed testimony, there were multiple post-test year plant additions that had projected in-service dates in late 2012 and 2013 that did not meet the Commission's standard for a known and measurable adjustment. During settlement discussions, NSP provided staff with the estimated annual revenue requirements associated with the plant adjustments proposed in the filing as identified on Table 4.

Table 4 – Estimated Annual Revenue Requirements Associated with 2013 Major Capital Additions

Plant Adjustment	2013	2014
Sherco 3 Plant Transferred From HFU	141,839	187,750
Sherco Cooling Tower	77,218	79,450
Monticello EPU	2,032,196	2,810,411
Monticello Fire Model	40,129	183,368
Prairie Island Casks	281,296	307,727
Prairie Island H Line Protection Replacement	35,323	34,739
Prairie Island Steam Generator	541,483	2,194,109
South Dakota Revenue Requirements	**3,149,485**	**5,797,553**

Based on the approximate $5,800,000 of annualized revenue requirements associated with these seven projects, staff believes rejecting these adjustments would cause an immediate significant revenue deficiency and necessitate another rate case in 2013. The revenue deficiency figure listed above does not include any other cost increases from the test year, such as labor expense, operations and maintenance expense, nuclear refueling outage costs, and other expenses affected by general inflation. While sales growth in 2013 and 2014 is not known, if the recent three year weather normalized sales growth average of approximately 0.75% is indicative of future sales growth, anticipated sales growth will not likely offset the revenue deficiency related to these projects.

If NSP were to file another rate case in 2013, that would make three consecutive years of rate case filings and four rate cases in the last five years. Staff is concerned about the rate shock another filing would cause, and we pursued a solution that would alleviate the need for another filing and protect customers.

During the 2012 legislative session, the South Dakota Legislature authorized the Commission to approve a tariff mechanism for a rate plan to provide for the phase in of rate increases prior to the commercial operation of major plant additions (see SDCL 49-34A-73 through 49-34A-78). A mechanism that phases in the rates related to capital additions would result in gradual, smaller increases. Staff used this recently passed legislation as a guide to develop the Rate Phase-In rider as the spirit and intent of the law seems to encompass this scenario.

The Rate Phase-In rider uses a cost of service model similar to NSP's previously approved Environmental Cost Recover (ECR) rider. Although the rate phase-in legislation contemplates the inclusion of construction work-in-progress, this rider is designed to collect revenue requirements after the plant addition has been completed and placed in-service. The Rate Phase-In rider is based on estimated costs of the seven capital projects subject to later true-up to their actual costs, in-service dates, and recoveries. The Parties have agreed to apply the rate of return established in this settlement to the rider until the next general rate filing.

In addition to capital projects, the rider will also collect any changes in 2013 property taxes from the property taxes included in the test year. Using NSP's estimated generation and transmission property value as of 12/31/2012 and its forecasted tax rate, the Company anticipates a $565,000 increase from test year property taxes. Property taxes are assessed by government agencies and not within the Company's control. The Rate Phase-In rider will allow for the true-up to actual property taxes levied. Table 5 identifies the estimated costs to be recovered through the rider in 2013 and 2014.

Table 5 – Estimated Rate Phase-In Rider Costs

	2013	**2014**
Sherco 3 Plant Transferred From HFU	141,839	187,750
Sherco Cooling Tower	77,218	79,450
Monticello EPU	2,032,196	2,810,411
Monticello Fire Model	40,129	183,368
Prairie Island Casks	281,296	307,727
Prairie Island H Line Protection Replacement	35,323	34,739
Prairie Island Steam Generator	541,483	2,194,109
2013 Property Taxes	565,000	565,000
South Dakota Revenue Requirements	**3,714,484**	**6,362,554**

The Rate Phase-In rider would be subject to an annual filing, and would exist until the capital projects are rolled into base rates and the remaining balance in the rider is either recovered from or refunded to customers. The Company has agreed to file the annual rate adjustment by October 1 of each year for rates effective January 1. Staff reserves the right to review the capital costs for prudency.

OTHER ISSUES

Rate Moratorium - In exchange for the rider, the Parties agree that NSP shall not file any rate application for an increase in base rates which would go into effect prior to January 1, 2015.

Implementation of Rates – The tariffs shown on Exhibit A attached to the Stipulation are proposed to be implemented for service rendered on or after May 1, 2013. Customer bills will be prorated so that usage prior to that date is billed at the previous rates and usage on and after that date is billed at the new rates.

Interim Rate Refund – Interim rates were implemented on January 1, 2013. Approval of the Stipulation will authorize a rate increase less than the interim rate level. The Company agrees to refund customers the difference between interim rates and new rates collected, during the period January 1 through April 30, 2013. As part of the refund, NSP will include interest, calculated by applying a 7% annual interest to the average refund balance for each month that interim revenues were collected. The Company will file a separate proposal for the interim rate refund.