

**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**

**DOCKET NO. EL12-046**

Testimony and Exhibits of  
**David A. Jacobson**  
On Behalf of Commission Staff

November 15, 2012

1 **Q. Please state your name, business address, and current position.**

2 A. My name is David Jacobson and my business address is Public Utilities Commission, State Capitol  
3 Building, 500 East Capitol Avenue, Pierre, South Dakota 57501. I am employed as a Utility  
4 Analyst with the South Dakota Public Utilities Commission (Commission).

5 **Q. Please describe your educational background and work experience.**

6 A. I received a Bachelor of Science Degree in Business Administration majoring in business  
7 management from the University of South Dakota in 1980. I subsequently returned to the  
8 University in 1982 and completed major course work in accounting. I have been with the  
9 Commission since 1984. I have previously presented testimony in numerous general rate case  
10 applications and have provided testimony and analysis in other docketed matters before the  
11 Commission.

12 **Q. Are you familiar with Xcel Energy's ("Xcel" or "Company") application for an increase in  
13 electric rates in South Dakota, Docket EL12-046?**

14 A. Yes. I have examined Xcel's testimony, exhibits, and work papers included in the initial filing as  
15 well as responses to data requests relating to the issues I will be addressing in this testimony.

16 **Q. What is the purpose of your testimony in this docket?**

17 A. I shall present testimony addressing the following adjustments to rate base and operating  
18 income.

- 19 1. Working Capital  
20 2. Interest on Customer Deposits  
21 3. Employee Compensation  
22  
23

24 **WORKING CAPITAL**

25 **Q. How has the Company determined its cash working capital requirements in this case?**

26 A. Xcel utilized a lead-lag study to measure the cash flows of operating revenues and expense to  
27 determine the amount of cash working capital required as shown on Company Witness Thomas  
28 Kramer's Exhibit \_\_\_\_(TEK), Schedule 2A, Page 6 of 6.

29 **Q. Would you please describe how a lead-lag study measures working capital requirements?**

30 A. A lead-lag study measures the period of time between (1) when a service is provided to a  
31 customer and when the revenue from that provision of service is received by the Company and  
32 (2) when a service is received by the Company and when the Company pays for that service. The  
33 time periods determined above are expressed in days . This measurement of days is then  
34 applied to the corresponding expense or revenue resulting in a quantifiable dollar amount either  
35 required by the company or available to ratepayers.

36 **Q. Have you accepted Xcel's lead-lag study?**

37 A. The majority of the study was accepted but certain modifications were made. The primary  
38 changes to Xcel's cash working capital calculation were: 1. The inclusion of interest on long term  
39 debt, depreciation expense, investment tax credit and deferred income taxes in the cash  
40 working capital calculation; 2. Separation of vacation from labor expense; 3. Revision of revenue  
41 lag and expense lead days for interchange revenues and expenses; 4. Inclusion of the South  
42 Dakota Public Utilities Commission's Gross Receipts Tax expense lead. The detail for this  
43 adjustment can be found on my Exhibit \_\_\_\_(DAJ-1), Schedule 1.

44 **Q. Why have you included long term debt interest as an additional source of cash available for  
45 working capital purposes in the calculation of cash working capital?**

46 A. This item is included because it is a fixed obligation with periodic payment dates and thus is a  
47 source of funds available to the Company until it is paid. Customers of Xcel are required to pay  
48 rates based on a cost of service which includes these payments and pay for this cost in advance  
49 of the Company's obligation to make payments to their bondholders. Recognition of this source  
50 of cash working capital is consistent with Commission precedent.

51 **Q. Why have you included depreciation expense, investment tax credit and deferred income  
52 taxes in the cash working capital calculation at zero expense days?**

53 A. These items are included at zero days to recognize that the rate base deduction precedes by the  
54 amount of the revenue collection lag, the receipt of cash. This treatment is also consistent with  
55 Commission precedent.

56 Q. **Why have you separated vacation pay from labor expense as an expense lead item?**

57 A. Vacation pay is accumulated by employees until used, which is quite different than the ongoing  
58 periodic payment of regular wages. It is appropriate to recognize this difference in expense lead  
59 and therefore the separation is appropriate.

60 Q. **How have you modified the expense lead and revenue lag for interchange transactions?**

61 A. The primary change I have made is to utilize the 10 day maximum payment period specified in  
62 Article X, section 10.5 of the Interchange Agreement supplied in Volume 4 of Xcel's rate case  
63 Docket EL11-019, as opposed to the longer period utilized by Xcel.

64 Q. **Why was South Dakota Gross Receipts Tax included as an item in your expense lead  
65 calculation?**

66 A. Although a relatively minor item, we have the information to quantify its effect so it is  
67 appropriate to include it.

68 Q. **Has Xcel reflected a 20 day customer payment period in its revenue lag calculation and  
69 removed late payment charges from test year revenues for ratemaking purposes?**

70 A. Xcel has made an adjustment reducing revenue lag to reflect the effect of a 20 day payment  
71 period. The Company has correspondingly removed late payment charge revenues from its  
72 revenue requirement calculation. This treatment is consistent with Commission precedent.

73 Q. **Are there any other sources of cash working capital available to Xcel that should be  
74 recognized?**

75 A. Yes. Sales taxes and employee taxes are collected and available for Company use until paid to  
76 the taxing authority. Xcel proposed this adjustment in this case. My primary modification to that  
77 adjustment is to reflect South Dakota's sales tax remittance statute in determining the related

78 collection lead days. The detail for this adjustment can be found on my Exhibit\_\_(DAJ-1),  
79 Schedule 2.

80 Q. **What is your recommendation regarding materials and supplies, fuel stocks, prepayments and**  
81 **customer advances?**

82 A. I have adjusted these items to reflect the most recent 13 point annual average which is  
83 consistent with Commission precedent. The detail to this adjustment can be found on my  
84 Exhibit\_\_(DAJ-1), Schedule 3.

85 **INTEREST ON CUSTOMER DEPOSITS**

86 Q. **What is your position regarding Xcel's proposed adjustment to not include customer deposits**  
87 **in rate base and allow Xcel to recover interest paid on those deposits?**

88 A. I have accepted these adjustments as proper for ratemaking purposes.

89 **EMPLOYEE COMPENSATION**

90 Q. **Please identify the adjustments proposed by Xcel in this proceeding.**

91 A. Xcel has proposed adjusting test year union labor expense for purportedly known and  
92 measureable post test year increases. The Company has also proposed removing certain  
93 incentive compensation expenses from the cost of service that are based on financial  
94 performance and normalizing incentive compensation by including a four year average of annual  
95 expense in the cost of service, as opposed to just recognizing test year expense.

96 Q. **What is your opinion regarding the union labor increases proposed by Xcel?**

97 A. Xcel has proposed increasing test year expense due to post test year increases taking place  
98 January 1, 2012, and also January 1, 2013. Through responses to data requests, Xcel provided all  
99 Union Contracts in effect as of 9/18/2012. I have reviewed the contracts and with a few minor  
100 exceptions, the contracts specify increases in labor rates of 2.75% on January 1, 2012, and  
101 increases of 3.25% on January 1, 2013, which are the amounts Xcel is requesting in this case. I  
102 therefore would opine that these increases are known and measurable at this time. It should be

103 noted that with minor exceptions, these contracts are then set to expire and do not specify  
104 increases for 2014.

105 Q. **Has commission staff routinely agreed with allowing such contracted rate increases in the**  
106 **past?**

107 A. In general, staff has historically been agreeable to increases specified in contracts with union  
108 labor when those increases actually take effect before or close to the time new rates take effect  
109 due to a rate case proceeding. Wage increases taking effect beyond that point increasingly  
110 concern staff as the period of time between rate implementation and subsequent wage increase  
111 widens. While these increases may pass the known and reasonable test, other ratemaking  
112 principles become increasingly stretched including such principles of matching costs with  
113 revenues during a test period and matching employee levels with a projected cost. In this case  
114 however, given that the union contracts specify an increase one day after the test period and  
115 subsequently one year after the test period, which should be very close to the time of rate  
116 implementation in this case, I would accept both the January 1, 2012, increase and the January  
117 1, 2013, increase.

118 Q. **Are any other adjustments to Xcel labor expense warranted in this case?**

119 A. Xcel did not request an increase for non-union employees above test year expense explaining in  
120 testimony that wage increases were suspended for these employees during 2012. However  
121 responses to data requests revealed that in the first half of 2012, 21 positions in Xcel Energy  
122 Services and 5 positions in Northern States Power MN had been eliminated. Further discussions  
123 with the Company indicated that these employee reductions were permanent and these  
124 employees were not scheduled to be replaced. Such a personnel reduction does warrant an  
125 adjustment removing the cost associated with these eliminated employees, which I have  
126 proposed. The result of this reduction can be found on Staff Witness Brittany Mehlhaff's  
127 Exhibit \_\_ (BAM-1), Schedule 3, Column (bf).

128 Q. **Have you reviewed Xcel's incentive compensation programs and are these plans appropriate**  
129 **for inclusion in rates?**

130 A. Xcel had four incentive compensation plans for employees in effect during the test year which  
131 were supplied in response to staff's data request. Xcel indicated there have been no changes to  
132 those plans post test year. Each of these plans explains the goals that employees must achieve  
133 (the targets) and the resulting compensation that will be paid if the goals are met (the awards).  
134 The plans are attached to my testimony as Confidential Exhibit\_\_(DAJ-2), Schedules 1, 2, 3, and  
135 4.

136 The plan shown in Schedule 1 is named the XCEL ENERGY NON-BARGAINING EXEMPT  
137 EMPLOYEE, MANAGING DIRECTOR AND BUSINESS UNIT VP ANNUAL INCENTIVE PROGRAM (AIP  
138 plan). This plan contains targets for several areas such as operational excellence, safety, and  
139 environmental leadership. Page 3 of the plan however, specifies that before the program will  
140 pay any awards, certain financial targets must be achieved by the Company and that earnings  
141 per share achieved by the Company determines the overall payout.

142 Schedule 2 contains the 2005 LONG-TERM INCENTIVE PLAN RESTRICTED STOCK UNIT  
143 AGREEMENT. Section 7 on page 2 of the agreement describes the targets required to be met in  
144 order for awards to be offered. The targets appear to be wholly based on earnings per share.

145 Schedule 3 contains the 2005 LONG-TERM INCENTIVE PLAN PERFORMANCE SHARE  
146 AGREEMENT. Section 7 on page 2 of the agreement describes the target of the plan which  
147 consists of a comparison of Xcel's Total Shareholder Return (TSR) to the TSR of the companies  
148 that are included in the Edison Electric Institute's Electrics Index.

149 Schedule 4 contains the final incentive compensation plan, also named the 2005 LONG-TERM  
150 INCENTIVE PLAN RESTRICTED STOCK UNIT AGREEMENT. Section 7 shown on page 2 and Exhibit  
151 A, shown on page 5 describe the targets of this plan to be met in order for awards to be granted.  
152 The targets appear to be entirely based on emissions reductions during the January 1, 2011,  
153 through December 31, 2013, time frame.

154 Q. **What is your opinion regarding the plans shown on Schedules 1, 2, and 3 with respect to**  
155 **allowing recovery in rates paid by South Dakota customers?**

156 A. I believe the costs of these plans not be allowed in rates paid by South Dakota customers.  
157 Incentive compensation plans that utilize targets predominately or solely based on earnings per

158 share or total shareholder return should be paid for by the beneficiary of those plans, namely  
159 shareholders.

160 Q. **What is your opinion regarding the plan contained in Schedule 4?**

161 A. The cost of this plan, with targets based solely on emissions reductions should not recovered  
162 from South Dakota ratepayers. The cost of reducing emissions paid for by South Dakota  
163 ratepayers should be limited to those required by law and because they are required by law,  
164 there is no need for further incentive to accomplish those levels of reductions. The results of all  
165 of my proposed incentive compensation adjustments can be found on Exhibit\_\_(BAM-1),  
166 Schedule 3, Column (e).

167 Q. **Have you reviewed Xcel's claim for recovery of executive compensation expense?**

168 A. Xcel has not proposed an adjustment to test year compensation expense for their officers and  
169 executives but as is normal in a rate case proceeding, staff submitted data requests to the  
170 Company regarding the reasonableness of compensation levels. Attached as Confidential  
171 Exhibit\_\_(DAJ-3), Schedule 1 is a Company response to staff questions. Also attached as  
172 Exhibit\_\_(DAJ-3), Schedule 2 are Company responses to questions asked by staff in  
173 Docket EL11-019 which include further information. As one can see, the Company refers to  
174 several studies and reports that purportedly support compensation levels but was unable to  
175 provide those studies and reports due to confidentiality protection. While the Company's  
176 responses themselves lend a certain degree of comfort in compensation levels, it would be very  
177 beneficial for staff to receive these studies and reports for review. Ultimately a more important  
178 question and determination however is whether the amount of compensation expense being  
179 recovered from South Dakota ratepayers is reasonable. Executive compensation expense not  
180 recovered from South Dakota ratepayers can be considered as recovered from shareholders or  
181 other jurisdictions.

182 Q. **Is the information provided by Xcel sufficient to allow agreement with officer and executive  
183 compensation recovered from South Dakota ratepayers?**

184 A. Exhibit\_\_(DAJ-3), Schedule 1 contains a spreadsheet which details the amount of executive  
185 compensation cost recovery Xcel is seeking from South Dakota customers. As the footnote



186 indicates, the amounts shown are net of the reductions to compensation proposed by Xcel in  
187 this case. The amounts shown do not reflect the additional disallowance of incentive  
188 compensation costs proposed in my testimony above.

189 As we can see from this exhibit, once the various jurisdictional allocations and proposed  
190 adjustments to executive compensation are taken into account, South Dakota ratepayers  
191 actually pay a greatly reduced amount for this category of expense as opposed to total company  
192 cost. Because of the parent company's large size and South Dakota's relatively small portion of  
193 electric service operations, in effect, economies of scale benefit South Dakota ratepayers by  
194 reductions reflected on the exhibit. One can hypothesize that a much smaller company, that  
195 served only in South Dakota, would legitimately have a much higher executive compensation  
196 cost. In my opinion the proposed compensation levels, as adjusted by staff, are reasonable.

197 Q. **Does this conclude your testimony?**

198 A. Yes.