STAFF MEMORANDUM

TO: COMMISSIONERS AND ADVISORS

FROM: BRITTANY MEHLHAFF AND KAREN CREMER

RE: EL13-006 - In the Matter of the Petition of Northern States Power Company dba Xcel Energy for Approval of its 2013 Transmission Cost Recovery Eligibility and Rate Adjustment

DATE: November 26, 2013

Commission Staff (Staff) submits this Memorandum in support of the Settlement Stipulation of November 26, 2013, between Staff and Northern States Power Company dba Xcel Energy (Xcel or Company) in the above-captioned matter.

BACKGROUND

On February 27, 2013, the South Dakota Public Utilities Commission (Commission) received a petition from Xcel for approval of a revised Transmission Cost Recovery (TCR) rider adjustment factor for 2013. The filing also requested approval of the tracker report for approved transmission project investments, expenditures, and revenues received since the implementation of the previous adjustment factor, effective on September 1, 2012.

South Dakota Codified Laws § 49-34A-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 Docket EL12-035, the Commission approved TCR recovery of the 2011-2012 revenue requirement associated with fourteen new transmission projects and MISO[1] Schedule 26 expenses. The Commission approved the Settlement Stipulation supporting the "refined split method" approach for allocating MISO approved cost-shared projects with company investment. The 2011-2012 TCR rider implemented a rate of $0.003038 per kWh for all customer classes effective September 1, 2012.

[1] Midcontinent Independent System Operator, Inc.

In this filing, Xcel requests to recover a projected 2013 revenue requirement of $2,450,956 associated with 22 transmission projects and MISO Schedule 26 expenses. The request includes the 2012 over-recovered balance of $227,462. The proposed 2013 revenue requirement results in a rate of $0.000612 per kWh, calculated based on an April 1, 2013, effective date. The result is a decrease of $0.002426 per kWh to the current TCR rate.

The 22 transmission projects included in the Company's 2013 revenue requirement determination consist of 8 new projects in addition to 14 projects approved for recovery in Docket EL12-035. The Company also removed 2 projects that were previously approved for recovery in Docket EL12-035. The St. Cloud project was removed as the project was discontinued and the North Mankato project was removed as the project no longer meets the minimum 5 miles in length requirement outlined in SDCL 49-34A-25.1.

On June 10, 2013, Xcel filed a supplement to its 2013 TCR Petition requesting the TCR rate be set at $0.00 beginning on July 1, 2013, for the remainder of 2013. On June 25, 2013, the Commission issued an Order Approving Tariff Revision, authorizing this request.

STAFF'S ANALYSIS AND SETTLEMENT RESOLUTIONS

Staff's recommendation is based on its analysis of Xcel's filing, discovery information, relevant statutes, and previous Commission orders. Staff reviewed the tracker report and the forecasted 2013 revenue requirement associated with new transmission projects.

Staff and Xcel's (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 under-collection of the remaining balance as of December 31, 2012, is $160,508. The 2013 TCR rate rider is based on estimated costs of eligible transmission projects subject to later "true-up" to actual costs and actual recoveries.

2011-2012 TRACKER REPORT

The rate approved in Docket EL12-035 was based on the balance in the tracker account and the 2011-2012 estimated revenue requirements. In this docket, Staff reviewed the actual 2011-2012 capital costs to determine if the costs were prudent and at the lowest reasonable cost to ratepayers. Staff also reviewed the Company's calculation of the under/over collection of costs incorporated in the new TCR rates, comparing actual recoveries to actual costs.

Attachments 6 and 7 attached to the Settlement Stipulation summarize the tracker activity by month for 2011 and 2012. Individual project detail for the projects is found on Attachment 14.

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

CAPX2020 – La Crosse MISO-WI

The Company's petition incorrectly treated the CAPX2020-LaCrosse-WI project as if it had not received MTEP[2] approval by MISO as a cost-shared project. During discovery, the Company corrected this error and changed the project name to CAPX2020-LaCrosse MISO-WI to appropriately identify that this project is MISO cost-shared. The settlement reflects this change.

2012 CAPX2020 – Brookings Credit

In the Company's original filing, an incorrect formula resulted in the omission of the credit the Company receives from other MISO members for the CAPX2020 – Brookings project. Since the total Schedule 26/26A revenue credit shared with ratepayers is adjusted to remove the revenues the Company receives from others as part of the refined split method, the total revenue credit included in the initial filing was too large, resulting in a lower revenue requirement. The settlement corrects the formula and includes the appropriate amounts for the CAPX2020 – Brookings project in the calculation of the revenues received from others.

2012 Actual Schedule 26 Revenue

The Company's filing inadvertently excluded one general ledger account from the actual 2012 Schedule 26 revenue. The settlement includes the additional ledger account in the actual 2012 Schedule 26 revenue.

2012 Rate of Return

The Company's filing reflected a 2012 rate of return of 7.72%. However, the capital structure and cost of debt differed from those agreed to in Docket EL12-035. The 2012 ROR agreed to in Docket EL12-035 was 7.79%, based on the actual capital structure and cost of long term debt as of December 31, 2011, and an ROE of 9.25%, as determined by the Commission in Docket EL11-019. The Settlement reflects a 7.79% ROR for 2012, consistent with the settlement in Docket EL12-035.

Jurisdictional Allocation Factors

After incorporating the above changes into the revenue requirement calculation, the under-collection of the remaining balance as of December 31, 2012, is $160,508.

2013 TCR REVENUE REQUIREMENT AND RATES

The total estimated 2013 revenue requirement of $2,754,889, subject to later true-up to actual costs and recoveries, is based on the 2012 under-collection in the tracker account and the estimated 2013 revenue requirement associated with 22 transmission projects and MISO Schedule 26 and 26A expenses. Fourteen of these projects were approved for recovery in Docket EL12-035. In this filing, the

[2] MISO Transmission Expansion Plan

Company seeks approval to include eight additional projects in the TCR rider beginning in 2013. The projects are needed for several reasons including: ensuring system reliability, alleviating low voltage and excessive transmission line loading during high system load conditions and transmission outages, and serving regional needs.

SDCL § 49-34A-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 satisfy these eligibility requirements.

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. In addition, Xcel developed a standard design for collector stations, minimizing design and engineering costs.

Xcel's TCR rider continues to apply the methodology approved in Docket EL12-035. Projects are separated into three types:

(1) New or modified projects, ineligible for cost-sharing through the MISO tariff;
(2) 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 are allocated into these 3 project types, as detailed below.

Type (1) Projects

Projects in this category are ineligible for cost-sharing through MISO. 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 the 2013 TCR that were approved for recovery in Docket EL12-035 are: Sioux Falls Northern, Grove Lake – Glenwood, Sauk Center – Osakis, Hollydale, Meadow Lake, Chisago – Apple River, and CAPX2020 La Crosse – Local.

Docket EL12-035 also included recovery of the Pleasant Valley – Byron and Glencoe – Waconia projects, which were designated as non-cost shared. In this filing, the Company corrected the TCR rider to reflect that these projects are lower voltage transmission projects that MISO has designated as cost-shared. These projects are more fully discussed below under "Type (3) Projects". Docket EL12-035 also included recovery for the St. Cloud Loop project and the North Mankato project. Xcel removed these two projects from the TCR rider in the current filing since the St. Cloud Loop project was discontinued and the North Mankato project no longer meets the 5 miles requirement outlined in SDCL § 49-34A-25.1.

The Company also requested to include six new non-cost shared projects beginning in 2013 and the Settlement includes these projects as proposed. These projects are discussed individually below:

Bluff Creek – Westgate: This project upgrades approximately 20 miles of 69 kV transmission line to 115 kV capacity in several cities located southwest of the Twin Cities in Minnesota. As part of this project, Xcel is also converting approximately 5.3 miles of 115/69 kV double circuit transmission line to 115/115 kV double circuit. Xcel states the line is needed to prevent significant low voltage and line overload conditions during certain contingencies.

Chaska – Hwy 212 Conversion: Xcel's Chaska Area project consists of upgrading approximately 9 miles of existing 69 kV transmission line to 115 kV near the cities of Chaska and Carver, MN, constructing about 3 miles of new 115 kV line, upgrading two existing substations, and building a new West Creek substation in the city of Chaska. Xcel states the project is needed to prevent significant low voltage and line overload conditions during certain contingencies.

Maple River – Red River: The Maple River – Red River project involves building a new 5.16 mile 115 kV line between Maple River and Red River substations in Fargo, ND, converting the Red River substation to 3 position ring bus, and adding a new line termination at the Maple River substation. This project is needed to meet NERC standards and avoid overloading.

Lake Marion – Burnsville: This project consists of upgrading the capacity of approximately 14 miles of the 115 kV line between the Lake Marion and Burnsville substations in Minnesota. This is an underlying facility associated with the CAPX2020 Brookings – Twin Cities 345 kV line. Although Xcel has included this project as part of the CAPX2020 Brookings – Twin Cities project in previous TCR filings, Xcel has separated the two projects in this filing because Xcel internally treats the Lake Marion – Burnsville project as a stand-alone project.

Maple Lake – Annandale: The Maple Lake – Annandale project is to re-build 6.1 miles of 69 kV to higher capacity between Maple Lake and Annandale substations in West Central Minnesota. This project is required to avoid thermal overload and low voltages during transmission outages. Xcel states that upgrading the existing line is the most effective way to address these concerns as it mitigates both planning and reliability related deficiencies.

Wilmarth – Carver County: Xcel's Wilmarth – Carver County project includes reconstructing 10 miles of existing 69 kV line between the Arlington Substation, a 3-way switch structure that serves as a tap to the City of Arlington Substation, to the Green Isle Substation and ending at the double circuit portion of the line to Carver County Substation in Minnesota. The project also includes associated work required at the Arlington Substation and Crystal Foods Substation. Xcel states this project is needed to reduce flows on the underlying 69 kV system in the area, for the loss of the Wilmarth – Blue Lake 345 kV line.

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. The 2013 TCR rider continues full recovery of Schedule 26 and 26A expenses as approved in Docket EL12-035.

Type (3) Projects

The Settlement approved by the Commission in Docket EL12-035 implemented the use of the "refined split method" for projects that qualify for regional cost allocation through MISO's tariff. This method aims to recognize the appropriate separation of state and federal jurisdiction regarding interstate transmission and wholesale charges. A detailed explanation of the method and Staff's arguments for using the method was provided in Staff's Memorandum in Docket EL12-035. A review of the mechanics of the method is provided again below.

Refined Split Method: 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.

Large Regional Transmission Projects: The large regional cost shared projects approved for recovery in Docket EL12-035 and that continue to be recovered in the 2013 TCR are the CAPX2020 Fargo, CAPX2020 Brookings – Twin Cities, CAPX2020 Bemidji, CAPX2020 LaCrosse – MISO, and CAPX2020 LaCrosse – MISO – WI. CAPX2020 LaCrosse – MISO and CAPX2020 LaCrosse – MISO – WI were previously referred to collectively as CAPX2020 LaCrosse 2 in EL12-035. As discussed above under "2011-2012 Tracker Report", the Company's initial filing incorrectly treated the CAPX2020-LaCrosse-WI project as if it had not received MTEP approval by MISO as a cost-shared project. During discovery, the Company corrected this error and changed the project name to CAPX2020-LaCrosse MISO-WI to appropriately identify that this project is MISO cost-shared. The Settlement reflects this correction.

The Settlement reflects inclusion of one additional large regional transmission project, the Big Stone – Brookings project, beginning in 2013. The Big Stone – Brookings project is a 70 mile 345 kV transmission line proposed to be constructed between the Big Stone Plant substation and Xcel's Brookings County substation in South Dakota. This project was approved as a Multi-Value Project (MVP) by MISO in December 2011, and will serve multiple regional needs including load-serving, generation outlet, and the improvement of energy market performance. MVPs are designed to reduce the wholesale cost of energy delivery for the consumers across MISO by enabling the delivery of low cost generation to load, reducing congestion costs, and increasing system reliability. Both Xcel and Otter Tail Power are participating in the construction and ownership of this project. Xcel's responsibility for the project includes: adding protective equipment for a new transmission line, adding line reactors and protective equipment, and constructing an approximately 45 mile double-circuit capable 345 kV line. Xcel and Otter Tail's joint application for a siting permit is currently pending with the Commission.

Lower Voltage Regional Transmission Projects: In Docket EL12-035, Xcel included Pleasant Valley – Byron and Glencoe – Waconia as non-cost shared projects. However, the Company overlooked the cost allocation treatment MISO had assigned to these two projects. For projects included in MTEP Appendix A prior to June 1, 2012, the MISO regional cost sharing methodology for transmission projects below 300 kV is similar to the methodology for those over 300 kV except the use of a 20 percent MISO wide allocation ("postage stamp") treatment is not used[3]. Instead, the entire cost of the transmission project is afforded the Line Outage Distribution Factor[4] (LODF) treatment methodology. MISO has since eliminated the regional cost sharing methodology for all transmission projects below 300 kV, effective with projects included in MTEP Appendix A after June 1, 2013. Going forward, the costs of such projects will be assigned to the transmission zone in which the assets are located.

Since the Pleasant Valley – Byron and Glencoe – Waconia projects were included in MTEP09 and MTEP08, respectively, they qualify for MISO regional cost sharing for projects less than 300 kV. Pleasant Valley – Byron was determined to be a Generator Interconnection Facility in which one-half of the cost is paid for by the Generator Interconnection Customer and the other half is given Baseline Reliability Project (BRP) cost sharing, using the LODF treatment only. Xcel's share of the Glencoe – Waconia project was given BRP cost sharing, with the cost allocation done using the LODF treatment only. The Settlement reflects the proper cost sharing, appropriately categorizing these projects as cost shared instead of non-cost shared.

The Settlement also reflects inclusion of one additional project that qualifies for regional cost sharing as a project less than 300 kV, the Minn Valley project, which was not included in Docket EL12-035. The

[3] Projects 345 kV and higher qualifying as a Baseline Reliability Project (BRP), have 20% of costs allocated on a system-wide basis to all transmission customers in MISO and 80% of costs allocated on a sub-regional basis to all transmission customers in designated pricing zones based on power flow analysis.
[4] LODF is an engineering measure of the benefits of a new line used to allocate costs on a more local level based on power flows.

Minn Valley project was included in MTEP 11 and given BRP cost sharing treatment, using the LODF cost allocation only. This project reconstructs 27 miles of 115 kV line to a higher capacity. The line runs from the Minnesota Valley substation to the transmission tie at Kerkhoven just east of the city of Willmar in West Central Minnesota. Xcel states this project is required to mitigate excessive transmission line loading during transmission outages. This line was built in the late 1930s or early 1940s and is reaching the end of its useful life; therefore upgrading this line also helps alleviate any reliability concerns due to the age of the line.

2013 Rate of Return

Xcel's filing proposed a 2013 rate of return equal to the proposed 2012 rate of return of 7.72%. The Settlement reflects a 2013 rate of return of 7.23%, based on the Company's actual capital structure, including short-term debt, actual long-term debt costs as of December 31, 2012, 12-month average short-term debt costs as of December 31, 2012, and an ROE of **Begin Confidential** [redacted] **End Confidential**.

The 2013 rate of return in the TCR uses an AFUDC rate that includes short term debt per the FERC methodology. However, the ROE in the AFUDC rate applied to tracker investments is the ROE approved by the Commission in Docket EL12-046. With this treatment, the earned return on CWIP as a result of the tracker will be the same as the deferred return that, in the absence of the tracker, would be capitalized for future recovery. This approach captures for ratepayers the benefit of lower cost short term debt used during construction.

Jurisdictional Allocation

The demand allocators used to allocate costs to the South Dakota jurisdiction reflect the actual demand allocation for the given year (i.e. – 2013 revenue requirements based on the 2013 demand allocation). The current TCR filing incorporates a forecast demand allocator for 2013. The Company will update the 2013 allocator to reflect the 2013 actual demand allocator once available. This method of jurisdictional allocation has been utilized for Xcel's TCR and ECR riders since implementation, on the basis of Staff's settlements with the Company. Staff agrees in this Settlement to continue updating the allocation factors each year as this is the practice that has been followed for Xcel's TCR rider since the rider was first established. However, Staff believes the jurisdictional allocations should be reviewed during the Company's next rate case.

Carrying Charge

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.

Rate Design

As proposed by Xcel, the Settlement continues to incorporate the rate design approved in Dockets EL07-007 and EL12-035 in which a single rate is applicable to all customer classes. The TCR rate was set at

$0.00 beginning on July 1, 2013, for the remainder of 2013, due to a projected over-recovery of the 2013 TCR revenue requirements. As such, no new rate is proposed to be implemented at this time. Xcel will make another filing requesting recovery of its 2014 TCR revenue requirements and at that time a new rate will be implemented.

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.