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 EL14-058

Commission Staff (Staff) submits this Memorandum in support of the Settlement Stipulation (Settlement) of June 1, 2015, between Staff and Northern States Power Company (NSP or Company) in the above-captioned matter.

BACKGROUND

On June 23, 2014, the Company filed an application with the South Dakota Public Utilities Commission (Commission) requesting approval to increase rates for electric service to customers in its South Dakota retail service territory by approximately $15.6 million annually or approximately 8.0%. A typical residential electric customer using 750 kWh per month would see an increase of $8.49 per month, or 9.71%.

NSP's proposed increase was based on a historical test year ended December 31, 2013, adjusted for what NSP believed to be known and measurable changes, a 10.25% return on common equity, and a 7.84% overall rate of return on rate base.

NSP's proposed revenue deficiency includes $2.595 million in capital project changes occurring in 2015 that the Company proposed could be recovered through a new infrastructure rider, as an alternative, rather than base rates.

The Commission officially noticed NSP's filing on June 26, 2014, and set an intervention deadline of September 12, 2014. On July 8, 2014, the Commission issued an Order Assessing Filing Fee. On November 12, 2014, NSP filed a Notice of Intent to Implement Interim Rates effective on and after January 1, 2015.

Settlement discussions between Staff and NSP (jointly, the Parties) commenced on February 19, 2015. Thereafter, the Parties held numerous settlement discussions in an effort to arrive at a mutually acceptable resolution of the issues presented in NSP's filing. Ultimately, the Parties reached a comprehensive agreement on NSP's overall revenue deficiency and other issues presented in this case including, but not limited to, class revenue responsibilities, rate design, and tariff concerns.

OVERVIEW OF SETTLEMENT

Staff based its revenue requirement determination on its comprehensive analysis of NSP's filing and information obtained during discovery. Staff accepted some Company adjustments, made corrections where necessary, modified other adjustments, and rejected those that did not qualify as known and reasonably measurable. Lastly, Staff introduced new adjustments not reflected in NSP's filed case.

Company and Staff positions were discussed thoroughly at the settlement conferences. As a result, some 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 additional costly and unnecessary litigation.

The Parties agree NSP's revenue deficiency recovered through base rates is approximately $6,922,000. 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.

The settlement also revised the Infrastructure Rider tariff to include recovery of major capital additions placed in-service in 2015, with the intent of including additional projects in 2016 and 2017. The estimated 2015 revenue requirements associated with the Infrastructure Rider is $872,740.

When the base rate increase is combined with the Infrastructure Rider, the estimated 2015 overall revenue increase is $7,794,740, justifying an approximate 4.01% increase in retail revenues. NSP's currently estimated proposed revenue requirements associated with the Infrastructure Rider are approximately $9,318,000 in 2016 and $10,775,000 in 2017.

STAFF OVERVIEW OF BASE RATE SETTLEMENT

Staff's determination of the settlement revenue requirement begins with total Company test year costs for the twelve months ended December 31, 2013, and allocates those total Company amounts to the South Dakota retail jurisdiction. Staff then adjusted the December 31, 2013, test year results for known and measurable post-test year changes. Staff Exhibit___(BAM-1), Schedule 3 illustrates Staff's determination of NSP's *pro forma* operating income under present rates. Staff Exhibit___(BAM-2), Schedule 2 illustrates Staff's calculation of NSP's South Dakota retail rate base, and Staff Exhibit___(BAM-1), Schedule 2 and Staff Exhibit___(BAM-2), Schedule 1 summarize the positions. Staff Exhibit___(BAM-1), Schedule 1 summarizes Staff's determination of NSP's revenue deficiency and total revenue requirement collected through base rates.

The base revenue increase by rate schedule is shown on Staff Exhibit___(PJS-2), Schedule 1. Staff Exhibit___(PJS-2), 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 for the Residential Service rate schedules is shown on Exhibit___(PJS-2), Schedule 3.

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

RATE BASE

Average Rate Base – Both the Company and Staff arrived at a test year average rate base based on an average of the 13 month-end account balances, December 31, 2012, through December 31, 2013.

Depreciation Study – During the 2013 test year, NSP recorded depreciation expense using the depreciation rates approved in Docket EL12-046. Those rates reflected reductions expected to result from the on-going depreciation study conducted every five years. In its present rate filing the Company proposed a "Depreciation Study" adjustment to the recorded expense consisting of three components. Staff accepted the adjustment, with one modification to operating revenues.

The first component of the Depreciation Study adjustment was developed to reflect the *actual* results of the completed five year study of South Dakota Transmission, Distribution and General plan. The differences between the expected and actual results included generally longer average service lives, somewhat larger allowances for removal costs, and a change from average service life-based accrual rates to remaining life rates to effectively spread an existing depreciation reserve excess over the plants' remaining lives. The concept of using the actual rather than the estimated results of the five year study is consistent with the acceptance of the five year study in Docket EL12-046. The elimination of a theoretical/actual reserve imbalance by converting to a remaining life rate achieves the goal of recovering plant investment over its useful life and is equitable to both the Company and ratepayers.

The second component of the Depreciation Study adjustment provided an additional removal cost allowance for the Black Dog Units 3 and 4, scheduled for retirement in 2015, based on an agreement with the State of Minnesota to fully remediate the land where the coal pile is located, including the ash ponds. The remaining lives of the Black Dog units is less than two years from the end of the test year but the additional removal costs are proposed to be amortized over a fifteen year period, thereby substantially reducing the burden on current ratepayers.

The third component of the Depreciation Study adjustment extended the existing assumed remaining life of Sherco Unit 3 by two years, from 19 to 21 years to account for the unanticipated suspension of its operations during the two-year period, 2011-2013.

The combined effect of the three components increased South Dakota depreciation expense with offsetting adjustments to rate base (Workpaper PF1-1).

The Company's proposed adjustment also included an associated adjustment to interchange revenues. The settlement revised this portion of the adjustment to reflect the impact of the settlement rate of return on the calculation of interchange revenues[1]. The impact of this change reduced operating revenues by approximately $46,000.

TCR Rider Removal – The Company proposed to remove all revenues and costs included in the test year associated with projects that will continue to be recovered through the TCR rider. The revenue requirements associated with projects approved for recovery in Docket EL14-080 will remain in the TCR rider, and thus should not also be included in the calculation of base rates. During discovery, it was

[1] NSPM receives revenues from NSPW according to the interchange agreement. The authorized rate of return for NSPM will impact the amount charged to NSPW. Therefore, all interchange revenue adjustments must be recalculated based on the settlement rate of return.

noted that an incorrect 5.37% composite allocator was used in the calculations. The settlement revised this allocator to 5.20%, thereby increasing rate base by approximately $140,000.

Tax Collections Available – The Company included a rate base deduction for tax collections which the Company receives in advance of turning the related payments over to the taxing authorities. Staff carefully examined NSP's calculations and made the following modifications:

1. Corrected South Dakota per books amounts for employee FICA and federal withholding due to an allocation error;
2. Revised expenses per day to incorporate into the analysis the impacts of Staff's recommended adjustment to *pro forma* South Dakota sales tax;
3. Revised lead days for employee FICA and federal withholding to incorporate a weight for incentive compensation lead days into the calculation; and
4. Revised lead days for South Dakota sales tax to reflect revised revenue lag days.

These modifications decreased rate base by approximately $272,000.

Remove Expired Amortization Items – The SO_2 Emission Credit and Rate Case Expense amortizations expired at the end of 2014. Thus, the Company proposed adjustments to remove these items from test year operating expense and rate base. Staff accepted this adjustment.

Infrastructure Rider Roll-in for 2015 – The Company proposed an adjustment to shift recovery of projects currently being recovered through the Infrastructure Rider to base rates. The settlement revised this adjustment to 1) reflect actual costs through December 2014; 2) reflect 50% bonus depreciation through December 21, 2014; 3) reflect the impact of the settlement rate of return on the calculation of interchange revenues; and 4) exclude the costs associated with the Monticello EPU/LCM project, which is further discussed under the Infrastructure Rider section below.

Plant Additions – The Company proposed several adjustments to include in base rates the costs associated with capital projects placed in-service post-test year. The settlement includes the following projects in rate base, with the following revisions: 1) Reflect actual costs through December 2014; 2) reflect 50% bonus depreciation through December 21, 2014; and 3) reflect the impact of the settlement rate of return on the calculation of interchange revenues.

- AS King Boiler Waterwall Tube Replacements
- Nuclear Plant Cyber Security
- PI License Renewal Baffle Bolt Inspection
- PI License Renewal Safety Margin
- PI Site Administration Building
- PI Unit 1 Generation Step-Up Transformer
- PI Unit 1 Life Cycle Mgmt Modifications
- PI Unit 1 Reactor Coolant Pump Seal Re-Design
- PI Unit Spent Fuel Heat Exchange System
- Prairie Island License Renewal
- Sherco Unit 2 Mercury Control
- Sherco Unit 1 Mercury Control

The settlement excludes the following projects from base rates as they are not yet in-service and therefore do not meet the used and useful standard. These projects are further discussed under the Infrastructure Rider section below.

- Border Winds
- Pleasant Valley Wind
- Prairie Island Casks (#39-47)
- Prairie Island ISFSI Relicensing
- PI Unit 2 Electric Generator Replacement
- PI Unit 2 GSU Transformer Replacement
- Sherco Unit 1 Couton Bottom Replacement

Cash Working Capital – NSP's proposed rate base included an allowance for cash working capital based on a lead-lag analysis. A lead-lag analysis examines the timing of the Company's receipt of service revenues from customers in relation to the Company's payment of expenses to vendors and employees. Staff carefully examined NSP's revenue lag and expense lead day determinations and made the following modifications, which are consistent with Staff adjustments in prior rate cases:

1. Revised the expense lead days for interchange expense, payroll, incentive compensation, and federal income tax;
2. Included a separate lead for vacation pay, depreciation, deferred federal income tax, investment tax credit, gross receipts tax, and interest on long term debt;
3. Revised revenue lag days to eliminate late payment revenue and decrease interchange and retail revenue lag days; and
4. Revised expenses per day to incorporate into the lead-lag analysis the impacts of Staff's recommended adjustments to *pro forma* operating expenses.

These modifications decreased rate base by approximately $658,000.

Net Operating Loss – Over the past several years, bonus depreciation previously approved by Congress significantly increased NSP's annual tax deductions. The increased deductions, however, exceeded NSP's income resulting in a tax loss. Because of the tax loss position, NSP was not able to utilize all of its allowable deductions in the year they were earned. It had recorded deferred taxes relating to these tax deductions, nevertheless. The accumulated deferred taxes are used as an offset to NSP's rate base. Therefore, it was necessary to adjust NSP's rate base to reflect the unused tax deductions. NSP will now be able to utilize more of its previously unused tax deductions given the revenue increase agreed to by the Parties. The impacts of this greater utilization of tax deductions on NSP's rate base and on NSP's deferred tax expense have been reflected in the settlement revenue requirement.

Other Working Capital – The settlement reflects a more recent 13-month average for materials and supplies, fuel stocks, prepayments, and customer advances. The net effect of these changes decreased rate base by approximately $822,000.

Rate Case Expense – NSP proposed to amortize projected rate case costs for EL14-058 over 1 year and not include any of the costs in rate base. The Settlement reflects a three-year amortization of $357,579 in actual costs as of February 9, 2015. Half of the rate case costs, or $178,790, is included in rate base, representing the average unamortized balance over the three year period. The net effect of these changes increased rate base by approximately $179,000. The settlement also established a tracker for the potential recovery of the residual costs associated with Docket EL14-058 in the next rate case filing.

Remove Retired PI Admin Bldg – The Settlement removed the test year rate base amounts associated with the Prairie Island office structures being removed in 2015 due to the construction of the new Prairie Island Administration Building. This adjustment reduced rate base by approximately $25,000.

Private Fuel Storage Re-amortization – In Docket EL09-009, an adjustment was approved to amortize over six years the expenses related to the formation of a LLC to obtain authorization to site and construct a private independent spent fuel storage installation for the storage of nuclear waste within the Goshute Indian tribal land in Utah due to delays in the development of a Federal repository. As this amortization had one year remaining at the time interim rates went into effect, the settlement re-amortized the unamortized amount to coincide with the three year moratorium. This re-amortization decreased rate base by approximately $421,000.

OPERATING INCOME

Depreciation Study – Refer to the discussion above under Rate Base.

Economic Development Labor – NSP proposed an adjustment to remove economic development labor. Staff accepted that adjustment.

Production Tax Credit to FCA – The Company receives federal renewable electricity production tax credits for electricity generated by wind energy resources. In Docket EL11-019, the Commission approved a Settlement Stipulation that credits customers through the fuel clause for tax credits associated with NSP's wind generation. Accordingly, the Company proposed an adjustment to remove the production tax credits from the test year. Staff accepted that adjustment.

Remove Demand Side Incentive – NSP proposed an adjustment to remove the demand side management incentive from the test year. Staff determined it to be necessary to remove all DSM expenses and revenues from the test year since the DSM allowance is determined in its own docket outside of a rate case. The net effect of Staff's adjustment is approximately the same reduction in operating income as the adjustment filed by the company. The effect of this adjustment reduced operating revenues by approximately $1,012,000 and reduced operating expenses by approximately $1,012,000.

Rider Removal – Infrastructure – NSP proposed an adjustment to remove the revenues recovered through the Infrastructure Rider in 2013 from the test year. Staff accepted that adjustment.

TCR Rider Removal and Revenue Credit - The Company proposed to remove all revenues and costs included in the test year associated with projects that will continue to be recovered through the TCR rider. The revenue requirements associated with projects approved for recovery in Docket EL14-080 will remain in the TCR rider, and thus should not also be included in the calculation of base rates. During discovery, it was noted that an incorrect 5.37% composite allocator was used in the calculations. The settlement revised this allocator to 5.20%, thereby decreasing jurisdictional operating expense by approximately $45,000 and jurisdictional operating revenue by approximately $42,000.

It should be noted that no revisions to this adjustment were needed due to the removal of the Hollydale and Meadow Lake projects in Dockets EL14-016 and EL14-080, respectively. Since the 2013 test year contains revenues and costs associated with these two projects, it is appropriate to include them as part of this adjustment.

Storm Damage – NSP proposed an adjustment to average storm damage operations and maintenance expenses over a five year period from 2009 through 2013. Staff accepted that adjustment.

Vegetation Management – NSP proposed an adjustment to average vegetation management expenses over a 5 year period from 2009 to 2013. An error was discovered for the amount listed in the 2011 SD Transmission expenses filed in PF9-1 and was therefore corrected accordingly. The effect of this adjustment increased operating expenses by approximately $2,000.

Weather Normalization & Fuel Lag – The Company proposed an adjustment to 2013 test year sales and revenues to reflect normal weather based on the 20 year moving average of historical heating degree day (HDD) and temperature humidity index (THI) data. The Company's adjustment also adjusted test year fuel revenues to an actual 2013 calendar-month basis, eliminating the recovery lag of approximately 2.5 months. The settlement revised the Company's adjustment to: 1) Calculate the weather effect from heating based on the 30 year National Oceanic and Atmospheric Administration (NOAA) HDD normal developed using the thirty-year period, 1981-2010; 2) Calculate the weather effect from cooling based on normal THI scaled to reflect 30 year NOAA normal by using the ratio of actual CDDs to normal CDDs per NOAA applied to the actual THI; and 3) Adjust test year fuel expenses to an actual 2013 calendar-month basis corresponding with the revenue adjustment. The details for this adjustment can be found on Exhibit___(BAM-3), Schedule 5. The net effect of these changes increased operating revenues by approximately $125,000 and reduced operating expenses by approximately $361,000.

Advertising – NSP proposed an adjustment to remove advertising expenses that should not be recovered from ratepayers. The settlement accepted this adjustment and further removed additional advertising costs which do not provide for the provision of safe, adequate, and reliable electric service for South Dakota ratepayers. The effect of this adjustment reduced operating expenses by approximately $5,000.

Association Dues – NSP proposed an adjustment to remove association dues expenses that should not be recovered from ratepayers. The settlement accepted this adjustment and further removed additional association dues costs that did not provide for the provision of safe, adequate, and reliable electric service for South Dakota ratepayers. The effect of this adjustment reduced operating expenses by approximately $14,000.

Aviation Expense – NSP proposed an adjustment to remove 50% of aviation expenses. Staff accepted that adjustment.

Chamber of Commerce Dues – NSP proposed an adjustment to add in approximately $4,000 in Chamber of Commerce Dues. Staff concluded that Chamber Dues did not provide for the provision of safe, adequate, and reliable electric service for South Dakota ratepayers. Staff rejected this adjustment.

Customer Deposits – The Company proposed an adjustment to recover the interest paid on customer deposits. This treatment is consistent with past rate cases, and Staff accepted that adjustment.

Economic Development Donations – NSP proposed an adjustment to add in approximately $50,000 in Economic Development Donations. NSP has had an economic development recovery program in place since the early 1990's and did not propose any changes to their economic development plan from what is currently in effect and proposed to continue their current plan. NSP records all economic development donation expenses below the line as they are incurred. This adjustment adds back in to the test year their recoverable portion of the 50/50 split of $100,000 in expenses related to economic development donations, excluding labor. Staff accepted this adjustment.

Employee Expense – NSP proposed an adjustment to remove approximately $7,000 in employee expenses that NSP determined are inconsistent with the Company's guidelines in its Employee Expense Policy or were identified as generally not being needed for the provision of utility service. Staff accepted that adjustment.

Foundation Administration – NSP proposed an adjustment to remove approximately $23,000 in Foundation Administration expenses. Staff accepted that adjustment.

Incentive Pay – During 2013, NSP incurred expenses in South Dakota totaling approximately $2.33 million for incentive compensation payments to employees, managers, and officers. For ratemaking purposes, NSP proposed to reduce this expense amount by $754,642 to exclude incentive compensation amounts that were paid out for achieving financial goals. Excluding incentive compensation associated with achieving financial goals is consistent with the Staff's position in prior NSP cases and with other rate cases involving South Dakota utilities. Therefore, the Staff accepted NSP's $754,642 adjustment to exclude incentive compensation expenses associated with achieving financial goals. This adjustment is reflected in the settlement revenue requirement.

Remove Non-Asset Trading – The Company proposed an adjustment to remove test year revenues and expenses associated with non-asset based transactions, as the Company's fuel clause contains a mechanism for sharing these margins with ratepayers. Staff accepted that adjustment.

Remove Expired Amortization Items – The SO2 Emission Credit and Rate Case Expense amortizations expired at the end of 2014. Thus, the Company proposed adjustments to remove these items from test year operating expense and rate base. Staff accepted that adjustment.

Current Rate Case Expense Amortization – NSP proposed to amortize projected rate case costs of $551,400 over a one-year period. The settlement reflects a three-year amortization of $357,579 in actual costs incurred as of February 9, 2015. The net effect of these changes is a reduction in operating expenses by approximately $432,000. The settlement also established a tracker for the potential recovery of the residual costs associated with Docket EL14-058 in the next rate case filing.

Infrastructure Rider Roll-in for 2015 – Refer to the discussion above under Rate Base.

Plant Additions – Refer to the discussion above under Rate Base.

Property Taxes for 2014 – The Company proposed this adjustment to capture the incremental increase in property tax payments for 2014 compared to those expenses incurred in the 2013 test year. Staff generally agreed with the adjustment but replaced the budgeted costs used by NSP with actual costs. The result of Staff's revisions decreased jurisdictional operating expense by approximately $846,000.

Wage Adjustment – The Company proposed an adjustment to 2013 test year union labor costs to recognize increases taking place on January 1, 2014 and January 1, 2015, based on contracts in place. The Company also proposed a non-union test year adjustment for actual increases experienced on March 1, 2014. Staff examined NSP's calculations and made the following modifications:

1. Removed gas and non-utility wages from union and non-union test year amounts;
2. Added fuel handling labor to union and non-union test year amounts;
3. Annualized 2013 non-union wage test year amount to fully reflect March 1, 2013 increase;
4. Corrected 2015 portion of non-union wage increase on March 1, 2014; and
5. Corrected South Dakota allocation factor for union and non-union wages.

These modifications increased jurisdictional operating expense by approximately $45,000.

Property Taxes for 2015 – The Company proposed this adjustment to capture the incremental increase in property tax payments for 2015 compared to 2014. Staff did not accept this adjustment, as actual costs are not known at this time, only estimates. However, the settlement does allow this and future property tax adjustments to be recovered through the fuel clause. The result of this disallowance in base rates is a decrease to jurisdictional operating expense of approximately $694,000.

Infrastructure Rider Revenue Credit – The rate case moved some investments that had been in Infrastructure Rider recovery to Base Rate recovery. In order to illustrate the incremental impact to customers, the Company proposed an adjustment for the 2014 forecast of Infrastructure Rider revenues. The proposed adjustment would reduce the base rate revenue deficiency by the $8.481 million in revenue replacement needed because an equal amount of revenues are being eliminated from the Infrastructure Rider. By making this adjustment, the base rate increase does not appear distorted because customers are already paying for these investments via the Infrastructure Rider. The settlement revised this adjustment to use the $7.749 million revenue amount presented in the October 1, 2014, Infrastructure Rider Compliance Filing. However, this adjustment did not impact the overall base rate increase. The revenue credit was only used to estimate the incremental rate impact to customers. In determination of rate design, the revenue amount used for the riders was consistently changed from $8.481 million to $7.749 million, resulting in a consistent calculation of the incremental and the overall base rate increase.

Interest Synchronization – The Settlement synchronized the tax deduction for interest expense with the weighted cost of long-term debt and the historic test year rate base as adjusted for known and measurable changes.

Employee Elimination – Company responses to Staff data requests revealed that five positions for NSP Energy Services Inc. were eliminated post-test year. The settlement removed the South Dakota allocated amount of these positions from the test year. This removal decreased jurisdictional operating expense by approximately $21,000.

Late Payment Revenues – Consistent with prior treatment of late payment revenues in cash working capital, this settlement removed late payment revenues from the test year while reducing retail revenue lag to account for this removal. This removal decreased jurisdictional operating revenue by approximately $372,000.

Net Operating Loss – Refer to the discussion above under Rate Base.

Remove Retired PI Admin Bldg – The Settlement removed the test year expenses associated with the Prairie Island office structures being removed in 2015 due to the construction of the new Prairie Island Administration Building. This adjustment reduced operating expenses by approximately $1,000.

PI Admin Bldg Operational Cost Savings – The Company indicated that the construction of the Prairie Island Administration Building would result in operational cost savings. The Settlement reduced test year expenses by approximately $50,000 to reflect these savings.

Private Fuel Storage Re-amortization – In Docket EL09-009, an adjustment was approved to amortize over six years the expenses related to the formation of a LLC to obtain authorization to site and construct a private independent spent fuel storage installation for the storage of nuclear waste within the Goshute Indian tribal land in Utah due to delays in the development of a Federal repository. As this amortization had one year remaining at the time interim rates went into effect, the settlement re-amortized the unamortized amount to coincide with the three-year moratorium. This re-amortization decreased jurisdictional operating expense by approximately $112,000.

JURISDICTIONAL COST OF SERVICE

Xcel Energy has four operating companies, one of which is NSPM. Xcel Energy also has a Service Company that provides administrative, human resources and other services to the four operating companies and to Xcel Energy's non-utility affiliate companies. A jurisdictional cost of service study is therefore necessary to separate and to allocate joint and common costs between NSPM's South Dakota retail operations and all non-South Dakota jurisdictional operations. NSP's filed jurisdictional cost of service study in this proceeding is consistent with the allocation procedures that were used and approved by the Commission in NSP's last South Dakota rate case (Docket No. EL12-046) and is consistent with the jurisdictional cost studies filed by NSPM in its recently completed Minnesota electric rate case (MPUC Docket No. E002/GR-13-868) and the last rate case filed with the North Dakota Public Service Commission (PU-12-813). Staff accepted the Company's jurisdictional cost study and the results of that study are reflected in the settlement revenue requirement determination.

COST OF CAPITAL AND RATE OF RETURN

NSP's initial filing requested a 7.84 percent overall rate of return using a capital structure of 46.14 percent debt and 53.86 percent common equity, based on a 13 month average for 2013. The embedded debt cost associated with this capital structure was 5.04 percent, and the requested rate of return on equity was 10.25 percent. Staff's analysis initially challenged all three components of the overall rate of return: (1) embedded cost of debt, (2) the capital structure, and (3) the required return on equity.

[Begin Confidential] [redacted]

[redacted]

[redacted]

[redacted] **[End Confidential]**, the settlement overall rate of return is 7.22 percent.

RATE DESIGN ISSUES

The Parties agree in principle on all issues regarding rate design and the class revenue distribution. The settlement position reached between Staff and NSP is discussed below.

Class Cost of Service/Spread of the Increase – NSP's filed case included a class cost of service study ("CCOSS"). A CCOSS is useful in assigning revenue responsibility to the rate classes that NSP serves and in designing rates within each class. While certain refinements were made, the allocation methods reflected in NSP's CCOSS are generally the same as those that were reflected in previous CCOSS studies filed by NSP and accepted by Staff and the Commission. The Staff, however, continues to object to NSP's use of the minimum distribution system approach to allocate a significant portion of its distribution system (i.e., conductors and transformers) based on the number of customers served. Doing so results in far too many costs being allocated to the Residential and Commercial Non-Demand classes. As a result, NSP recommended larger increases, on a percentage basis, to those classes than it recommended for the Commercial and Industrial class.

On the other hand, the Staff contends that the distribution facilities in question are designed and built to serve customers' maximum loads and, therefore, should be allocated on a non-coincident demand basis. Staff's approach shifts more cost responsibility to the Commercial and Industrial rate classes.

To resolve this issue, both Parties agreed to increase revenues by a uniform percentage increase across all classes. This approach preserves the relative revenue-to-cost differentials between rate classes that were established in NSP's last electric rate case – Docket No. EL12-046. The following table compares the revenue increase by rate class on a percentage basis that NSP originally proposed and the class increases agreed to in the Settlement.

Increases by Major Rate Class

Rate Class	NSP Proposed	Settlement
Residential	9.45%	3.56%
C&I Non-Demand	9.71%	3.56%
C&I Demand	6.75%	3.56%
Street Lighting	-0.02%	3.56%
Total	8.0%	3.56%

As is shown in the table above, the percentage increases under the Settlement is more favorable to the Residential and C&I Non-Demand classes than under NSP's original proposed spread of the increase, which is consistent with Staff's rejection of the minimum distribution system approach to allocate distribution facilities.

Rate Design (Residential Customer Service Charge) – NSP claimed that its filed CCOSS supported an $18.97 residential customer charge. Rather than impose this charge, however, NSP proposed a $1.00 per month increase in the residential customer charge. Staff's analysis of the Company's underlying cost of service indicated a much different result. In fact, Staff concluded that the existing monthly customer service charges already exceed what Staff believes is a reasonable allocation of customer-related costs and that no increase in the monthly customer charge is justified at this time. For settlement purposes, the Parties agreed to maintain the existing monthly customer service charges.

STAFF OVERVIEW OF INFRASTRUCTURE RIDER SETTLEMENT

The settlement approved by the Commission in Docket EL12-046 established an Infrastructure Rider to allow recovery of specific major capital additions that were placed in-service in late 2012 or were 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 this current rate case, NSP proposed to roll the costs associated with the now completed projects from the Infrastructure Rider into base rates. The settlement shifts cost recovery of all Infrastructure Rider projects to base rates with the exception of the Monticello LCM/EPU project. The Parties agreed to keep the Monticello LCM/EPU project in the Infrastructure Rider in order to more easily accommodate possible true-ups and corrections.

[Begin Confidential] [redacted]

[redacted]

[redacted] **[End Confidential]**.

NSP also proposed to include in base rates several plant additions with estimated 2015 in-service dates. As an alternative, NSP proposed to include these plant additions in a refreshed infrastructure rider. Since these plant additions are not yet in-service and do not meet the Commission's standard for a known and measurable adjustment, the Parties agreed use of the Infrastructure Rider was the most appropriate recovery option. The projects included in the rider starting in 2015 include:

- Border Winds
- Pleasant Valley Wind
- Prairie Island Casks (#39-47)
- Prairie Island ISFSI Relicensing
- PI Unit 2 Electric Generator Replacement
- PI Unit 2 GSU Transformer Replacement
- Sherco Unit 1 Couton Bottom Replacement

In addition to the 2015 projects proposed in testimony, the Infrastructure Rider also includes 12 additional projects with 2015 revenue requirements.

- BS-Fcst-BD-SW-CM-M
- Dynamic EMS Environment Phase
- GIST-III Computer Software
- MNGP Fukushima Modifications
- MNGP EDG Tornado Missile Protection
- PI U2 HDTP Speed Control Upgrade
- PI LR Ph II-U2 MRP-227A Implementation
- BDS-C Install Package Boiler
- Midtown 115kV line
- Hiawatha Dam Interconnect Substation
- Scott County 345 kV Expansion, Substation
- PI-Repl Instrument Air Compressor

The estimated revenue requirements associated with the total 2015 projects included in the Infrastructure Rider, excluding Monticello LCM/EPU, is $2,224,626. Staff believes the estimated revenue requirements associated with these projects would cause an immediate significant revenue deficiency and necessitate another rate case in 2015. Further, NSP's planned investments for 2016 and 2017 are significant as well, which could indicate the need for annual rate cases. Staff continues to be concerned about the rate shock annual rate cases would cause and therefore collaborated with NSP to refresh the Infrastructure Rider in order to alleviate the need for additional rate cases in the near future.

In Docket EL12-046, the Parties used SDCL 49-34A-73 through 49-34A-78 (phase-in statutes) as a guide when developing the Infrastructure Rider. However, the Infrastructure Rider deviated from the specific statutes in two regards. First, the Infrastructure Rider included any changes in 2013 property taxes from the property taxes included in the test year. While SDCL 49-34A-73.1 discusses the inclusion of operations and maintenance expenses, it dictates that these expenses must be directly related to the plant additions being recovered through the rate phase in rider. Second, the Infrastructure Rider included projects which were already under construction. SDCL 49-34A-74 states that the "commission may approve a phase in rate plan as provided in § 49-34A-73 if: (1) The electric utility makes application for a phase in rate plan prior to the commencement of construction or acquisition of the plant additions".

While the Commission did approve the EL12-046 Settlement Stipulation including the Infrastructure Rider under its general authority provided in SDCL 49-34A, since there are specific statutes regarding riders of this nature, Staff felt it would be best to strictly follow these statutes in the future. The first deviation regarding property taxes is no longer an issue since this Settlement allows the incremental property taxes to be recovered through the fuel clause, as allowed by SDCL 49-34A-25. The second deviation, the application being made prior to the commencement of construction of the plant additions, has been addressed by a recent amendment to the statute. During the 2015 legislative session, the South Dakota Legislature amended SDCL 49-34A-74 to read as follows: "The Commission may approve a phase in rate plan as provided in § 49-34A-73 if: (1) The electric utility makes application for a phase in rate plan prior to the commencement of or during construction, or prior to acquisition of the plant additions". This change is effective July 1, 2015, which corresponds with the agreed upon implementation date for the Infrastructure Rider in 2015.

The Infrastructure Rider continues to use the cost of service model created in EL12-046. The rider is currently designed to collect revenue requirements after the plant addition has been completed and placed in-service. However, the Parties agree SDCL 49-34A-73 through 49-34A-78 allows for construction work in progress which may be considered in the future. The Infrastructure Rider is based on estimated costs of the 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.

In addition to the revenue requirements associated with the projects that will be in-service by the end of 2015 and the **[Begin Confidential]** [redacted] **[End Confidential]**[2], the 2015 Infrastructure Rider includes the 2014 true-up in the amount of $(928,556). These items combined result in an estimated 2015 revenue requirement of $872,740.

The Infrastructure Rider will be subject to an annual filing to be approved by the Commission. The Company may request inclusion of additional projects annually. NSP will make its annual filing by October 1st of each year for rates effective January 1st.

OTHER ISSUES

Property Taxes – The Parties agree the incremental property tax above the amount included in base rates will flow through the fuel clause, as allowed by SDCL 49-34A-25.

50% Earnings Sharing Mechanism – The Company agrees to share 50% of actual weather-normalized earnings above the authorized amount for base rates and infrastructure rider revenue. Customers will not be charged for earnings below the authorized level. Pursuant to the settlement regarding NSP's

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[2] 2015 revenue requirements associated with 2015 projects excluding Monticello LCM/EPU is $2,224,626. 2015 revenue requirements associated with **[Begin Confidential]** [redacted] **[End Confidential]**.

transmission cost recovery rider and environmental cost recovery rider, NSP files an annual report of jurisdictional earnings by June 1 of each year. This filing will be the source for determining whether the Company needs to share 50% of earnings above the authorized amount with its customers each year. If such a sharing is necessary, NSP will notify the Commission within 30 days of filing the annual report of jurisdictional earnings.

Rate Moratorium – 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, 2018.

Implementation of Rates – The tariffs shown on Exhibit A attached to the Settlement are proposed to be implemented for service rendered on or after July 1, 2015. Customer bills will be prorated so that usage prior to that date is billed at the interim rates and usage on and after that date is billed at the new rates.

Interim Rate Refund – Interim rates were implemented on January 1, 2015. Approval of the Settlement will authorize a rate increase less than the interim rate level. The Company agreed to refund customers the difference between interim rates and new rates collected, during the period January 1 through June 30, 2015. As part of the refund, NSP will include interest, calculated by applying 7% annual interest to the average refund balance for each month that interim revenues were collected. Attached to the Settlement is the Company's Interim Refund Plan.

Annual Report on Wind Projects Performance – Two of the projects included in the 2015 Infrastructure Rider are Borders Wind and Pleasant Valley Wind. While the Company's analysis showed these projects are economical, this analysis is based on several assumptions which may or may not hold true. Since these projects are being built for economical purposes and not on a need basis, Staff feels it is necessary to review the future performance of the projects to ensure they are a good deal for ratepayers. Staff has the ability to review the projects costs, performance, and any other aspects, and propose alternative treatment or adjustments every year their costs are recovered through the Infrastructure Rider and again before they are rolled into base rates in a future rate case. NSP has agreed to provide an annual informational report regarding the performance of these two wind projects in order to provide Staff the information it needs to assess the actual economics of the wind projects. NSP agrees to provide updates regarding average annual capacity factors, congestion costs, O&M costs, and capital costs.

RECOMMENDATION

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