Chesapeake Regulatory Consultants, Inc
1698 Saefern Way
Annapolis, MD 21401-6529

Phone: 410.849.3210
eMail: rgtsbs@comcast.net

Robert G. Towers
Basil L. Copeland, Jr.
David E. Peterson

RECEIVED
AUG 03 2009
SOUTH DAKOTA PUBLIC
UTILITIES COMMISSION

July 30, 2009

via eMail and US Mail
David A. Jacobson, Utility Analyst
Bob Knadle, Utility Analyst
South Dakota Public Utilities Commission
500 E. Capitol Avenue
Pierre, South Dakota 57501

**RE: Report and Consulting Services Proposal
Northern States Power Company - Application to Increase Electric Rates in South Dakota
SDPUC Docket No. EL09-009**

Dear Dave and Bob:

Thank you for sending Xcel's NSP rate filing and for the opportunity to submit the following report and proposal to assist the Staff in processing the application. Basil Copeland has reviewed the Company's cost of capital evidence and Dave Peterson and I have reviewed the testimony, exhibits and filing statements pertaining to all other aspects of the Application.

Overview of the Filing

By letter dated June 30, 2009, Northern States Power Company ("NSP", Xcel" or "the Company") filed with the Commission an Application seeking to increase its rates for electric service in South Dakota. The proposed rates were designed to increase its annual base rate revenue from these customers by $18.6 million, or 12.7% above 2008 test year revenues billed at the base tariff rates established in its last general rate case in 1992. However, as a result of Transmission Cost Recovery and Environmental Cost Recovery Riders implemented in February, 2009, NSP's customers are currently paying the equivalent of $2.9 million above the 1992 base rates. Thus, because the proposed new base rates incorporate the costs reflected in the Riders, the net increase above billings at current billing rates is about $15.7 million.

NSP attributes the need for rate relief at this time to new capital investments that have been made in system generation and transmission facilities both to increase its system capacity and to extend the life of existing facilities; to new investments in South Dakota distribution plant and to increases in operations and maintenance expenses. (See Heuer testimony, pp. 8-12 for the relative importance of these factors.)

The proposed rates are based on a revenue requirement developed from a 2008 test year, weather normalized and adjusted for cost level and operational changes that are claimed to be known and measurable. The claimed return on the test year average net investment rate base (9.02%) reflects the Company's unadjusted test year capital structure and embedded cost of long term debt and a return on common equity capital of 11.25%. The proposed 11.25% ROE is recommended by the same consultant who filed testimony on behalf of Otter Tail Power Company in its recently-settled rate case, using the same approaches to measuring equity costs as he used in that case.

Rate adjustments by customer class, measured from current billing rates (i.e. current base rates plus the TCR and ECR Riders) range from 10.9% for the Large Commercial and Industrial class to 14.5% for the Residential class. For Small C&I and Lighting classes, the proposed increases are 11.7% and 14.4%. For all classes combined the proposed increase is the previously-mentioned 12.7%. However, within each customer class, the increases to customers served on different rate schedules reflect a wider range – from 9.9% to 17.3%. (See Huso, p. 6) The proposed class rates are developed in a class cost of service study (CCOSS) based on embedded costs. However, in the allocation process, fixed production costs are "stratified" by defining the capacity-related portion of these costs on the basis of peaking plant costs and the "peaking-plant equivalents" of base load facilities; the remaining fixed production costs are treated as energy related and allocated using an energy allocator reflecting relative class usage in each hour of the year. This process is said to produce class cost responsibilities comparable to those that would result from a marginal cost based study. (Peppin, p. 4).

Another feature of the CCOSS is to treat the "discounts" received by interruptible customers as a power supply peaking cost to be shared by all customers.

Also, the Company proposes to modify its recovery of fuel costs by removing all fuel costs from base energy rates and recovering these costs plus fuel cost changes (presently recovered by the Fuel Cost Adjustment (FCA)) and shared margins on wholesale transactions by determining a monthly system Fuel Clause Factor (FCF). The FCF would then be translated into Fuel Clause Charges (FCC) for each of four service categories by the application of energy cost responsibility factors used in the 2008 CCOSS. Customer bills would contain one line item representing all current energy costs.

The revised rates and trackers were proposed to become effective for service rendered on and after August 1, 2009 but, by Commission Order dated July 21, 2009, the rates have been suspended for 90 days.

The Company does business in South Dakota as NSP-Minnesota, a subsidiary of Xcel Energy, Inc.. NSP-M provides electric service to 1.4 million retail customers in South Dakota, North Dakota and Minnesota, of which 81,000 are in South Dakota. Electric production and transmission is operated as an integrated system with its affiliate, NSP-Wisconsin with transactions between the two affiliates governed by an FERC-approved Interchange Agreement. NSP-M has two direct subsidiaries, United Power and Land Company and NSP Nuclear Corp. Xcel Energy, Inc. has other rate-regulated utility subsidiaries (Public Service Company of Colorado, Southwestern Public Service), Xcel Energy Services (providing corporate services to all subsidiaries, including NSP-M), and numerous other unregulated companies.

Potential Issues and Division of Workload

NSP's filing raises issues similar to those which Staff has dealt with in most other general rate filings – the development of a revenue requirement based on actual experience during 2008 with adjustments to "normalize" the actual experience (see Heuer, pp. 25-26); to reflect prevailing "regulatory practices" (Heuer, p.30); and others to reflect purported "known and measurable" changes (Heuer, pp. 35-36). The end result of this process is referred to as the "2008 Pro Forma " test year. The support for each of the major adjustments should be examined and an assessment made of whether or not it maintains the necessary balance among other elements of the revenue requirements equation, e.g. test year sales levels, operational productivity, price levels and investments. Test year weather normalized sales are declared to be reasonable because they compare favorably to NSP's forecasts for 2009 and 2010; the weather normalization should stand on its own as valid.

Other adjustments might be required to reflect changes or conditions not recognized by NSP. For example, while NSP acknowledges that it has applied for and is "cautiously optimistic" that it will be granted, by 2010, a 20-year extension of its license to operate its Prairie Island nuclear plant, its adjustment reflects only a three year extension. Moreover, the benefit of the three-year extension is diminished by adjustments for a not-yet-approved estimate of future nuclear decommissioning costs.

Incentive payments to management are another potential issue. Although no such payments were made during 2008, the Company proposes to "normalize" this non-event by claiming a multi-year average for such payments.

Another potential issue concerns the Company's claim for Federal income taxes. Its claimed revenue requirement assumes that NSP-M (more precisely, the South Dakota portion of this entity) is a single, stand-alone taxpayer taxed at the corporate rate of 35% of its own "taxable income". In fact, NSP-M joins with all of its affiliates and the parent holding company (Xcel Energy, Inc.) in the filing of a single consolidated tax return. The stand-alone procedure ignores the fact that, by filing a consolidated return, the taxpayer offsets any taxable income generated by some participants – here, in particular, the regulated utilities like NSP-M -- by the tax losses of other affiliates. Whenever this occurs with regularity (i.e. where it is "normal") it is appropriate to reduce the hypothetical "stand-alone tax" by a representative credit for the actual taxes paid with the consolidated return.

As mentioned earlier, Xcel Energy Services provides corporate services to NSP-M and others; some service costs are directly assigned; others are allocated. The process for assignments and the methods of allocation should be tested for reasonableness.

The 11.25% return on equity ("ROE") reflected in the Company's claimed cost of capital purports to be supported by various measures of equity costs of a "proxy group" of comparable companies, including alternative DCF, Risk Premium, and Capital Asset Pricing Model analyses. (Hevert, pp. 46-7). An allowance for "flotation costs" is added to the costs to reach the witness' 11.0 –11.75% conclusion and his 11.25% recommendation. By contrast our on-going analyses of equity costs for combination gas and electric utilities suggests a range extending below 10.0%.

Moreover, the Company has combined its 11.25% ROE with Xcel's average capital structure and average debt costs during 2008, thereby failing to recognize that these components at the end of 2008 – a "known change" -- would have produced a lower overall rate of return – the proposed 9.02% versus 8.93% (see Statement G, pp. 1 and 2). Furthermore, the year end common equity appears to be inflated by the inclusion of NSP-M's investments in its subsidiaries.

Questions concerning the Company's proposed CCOSS and rate design are identified by the earlier description of these portions of its filing.

Proposal

As you know, we have considerable experience with general rate increase requests by electric and gas utilities including experience with the types of issues that we have identified here. In addition to our participation with the South Dakota Staff in more than thirty formal rate proceedings since 1976, we are presently engaged by the Colorado Consumer Counsel and New Jersey Rate Counsel as consultants in gas, electric and water rate cases before the regulatory commissions in those states, including a pending filing by NSP-M's affiliate, Public Service Company of Colorado. We also serve as rate consultants to municipalities, municipal utilities and industrial groups that are consumers of utility services.

In this case, with precedent to guide the Staff on many of the recurring revenue requirement issues, including the rate base adjustments for plant additions and working capital, it would be most efficient to have Staff review and develop positions on these adjustments, We would provide assistance to Staff in defining and developing positions on these issues, as needed. Indeed, all of our activities would be carried out with as much participation as possible by Staff.

We offer Basil L. Copeland, Jr. to analyze and testify on the cost of capital and capital structure issues, including the question of differentiating the ROE used for the base rate determination and that used to reconcile the currently-effective TCR and ECR Riders. Mr. Copeland will also assess the Company's proposed weather normalization adjustments and assist Staff in developing any recommended adjustments. David E. Peterson and I would be responsible for accounting issues that are delegated to us by Staff, depreciation rates, corporate expenses and tax issues, the jurisdictional and class cost of service determinations, and the distribution of the rate increase and rate design issues. In all instances, our efforts would be to assist the Staff in developing the issue and, where necessary, to present our own testimony. We anticipate that the required testimony would be presented by Basil Copeland and David Peterson.

We will prepare the necessary data requests to obtain the information needed for our analyses, review the Company's responses, and confer with their witnesses as necessary. We would prepare testimony and supporting exhibits describing our analyses, and recommendations (or assist Staff in doing so). As needed, we will assist Staff witnesses in developing other issues on which they will testify. We will also assist Staff Counsel in preparing for hearing and with the preparation of post-trial briefs and other pleadings.

For the purposes of preparing a cost estimate, I have assumed that two or three man-days will be required for participation at hearings in Pierre.

We estimate that the cost of performing these services would amount to approximately $69,825, including out-of-pocket expenses. Of course we would bill only for time actually spent working on the assignment and for our actual out-of-pocket costs, principally air fare for 2 man-trips to Pierre, per diem expenses in Pierre, copier and courier services. Our estimate is derived as follows:

Tasks	Hours		
	Towers	Copeland	Peterson
• Analyze the filing, identify issues, discovery;	50	24	60
• Developing positions; preparation of testimony and exhibits, including coordination with other witnesses;	40	42	60
• Review rebuttal testimony and preparation for hearing;	20	18	30
• Participation in hearing; and	4	8	24
• Assisting counsel with briefs.	16	8	16
Total hours	130	100	190

Cost Summary

Fees:	Towers	130 hrs. @ $160		$20,800
	Copeland	100 hrs. @ $160		16,000
	Peterson	190 hrs. @ $160		30,400
	Total fees			67,200
Out-of-pocket expenses:				
	Air fare		$1,800	
	Hotel		300	
	Courier		125	
	Data base charges for ROE analysis		300	
	Other		100	
				2,625
Total cost				**$69,825**

Please let me know if you have any questions about my discussion of the issues, division of the workload between Staff and our firm or any other aspect of this report and proposal. We look forward to working with you again.

Sincerely,

Robert G. Towers
President

Attachment: Fee Schedule (January 2009)

Chesapeake Regulatory Consultants, Inc.

1698 Saefern Way
Annapolis, MD 21401-6529

Phone: 410.849.3210
Email: rgtsbs@comcast.net

Robert G. Towers
Basil L. Copeland, Jr.
501.851.8619
David E. Peterson
410.286.0503

FEE SCHEDULE

		Hourly Rate
Robert G. Towers Annapolis, MD	Senior Consultant	$ 160.00
Basil L. Copeland, Jr. Maumelle, AR	Senior Economist	$ 160.00
David E. Peterson Dunkirk, MD	Senior Consultant	$ 160.00

January 1, 2009