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January 12, 2015

—Via Electronic Filing—

Mr. Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101

RE: REPLY COMMENTS
TRANSMISSION COST RECOVERY RIDER PETITION
DOCKET NO. E002/M-14-852

Dear Mr. Wolf:

Northern States Power Company, doing business as Xcel Energy, submits the enclosed Reply Comments in response to the January 2, 2015 Comments of the Department of Commerce, Division of Energy Resources and the December 31, 2014 Comments of the Office of the Attorney General – Residential Utilities and Antitrust Division regarding our 2015 Transmission Cost Recovery Rider.

Pursuant to Minn. Stat. § 216.17, subd. 3, we have electronically filed this document, and served copies on the parties on the attached service list.

If you have any questions regarding this filing please contact me at (612) 330-7529 or paul.lehman@xcelenergy.com.

Sincerely,

/s/

PAUL J LEHMAN
MANAGER, REGULATORY COMPLIANCE AND FILINGS

Enclosures
c: Service List

STATE OF MINNESOTA
BEFORE THE
MINNESOTA PUBLIC UTILITIES COMMISSION

Beverly Jones Heydinger	Chair
David C. Boyd	Commissioner
Nancy Lange	Commissioner
Dan Lipschultz	Commissioner
Betsy Wergin	Commissioner

IN THE MATTER OF THE PETITION OF
NORTHERN STATES POWER COMPANY
FOR APPROVAL OF A MODIFICATION TO
ITS TCR TARIFF, 2015 TCR RATE
FACTORS, AND 2014 TCR TRUE-UP AND
COMPLIANCE FILING

DOCKET No. E002/M-14-852

REPLY COMMENTS

OVERVIEW

Northern States Power Company, doing business as Xcel Energy, appreciates the opportunity to respond to the January 2, 2015 Comments of the Minnesota Department of Commerce, Division of Energy Resources and the December 31, 2014 Comments of the Office of the Attorney General – Residential Utilities and Antitrust Division regarding our Petition seeking approval of a Transmission Cost Recovery (TCR) Rider rate factor for 2015. Our response below addresses issues raised by the Department and the OAG.

REPLY

A. MISO ROE

The Company recommended that should the Federal Energy Regulatory Commission (FERC) order a change in the Midcontinent Independent System Operator (MISO) Return on Equity (ROE), the appropriate recognition of this change would be to recognize the impact in the TCR Rider by including a true-up for all affected wholesale transmission revenue and expenses, including both the portion included in the TCR Rider and the portion included in base rates in the pending rate case (Docket No. E002/GR-13-868).

The Department disagreed with the Company's position that this situation is similar to the Renewable Energy Standard/Production Tax Credit (RES/PTC) true-up

scenario which would allow for the recovery of the change in base rate revenue requirements through a rider. The Department therefore recommended that the Company not be authorized to true-up the portion of wholesale transmission revenue and expenses included in base rates in the pending rate case through the TCR.

As described in our Petition, the timing of the complaint filed with the FERC is such that it would be reasonable to true-up any change to base rate wholesale transmission revenues and expenses that may occur as a result of the complaint. The complaint was filed at the FERC twelve days after our current rate case was filed. Since the rate case was under a different schedule (set by the Commission) than the complaint filed with the FERC (where the FERC was not required to act on any specified timeframe), and there was no certainty what the FERC might do or when, we could not realistically propose an adjustment in the rate case. As a result, we informed the record in the rate case with the information that we had available which was simply to indicate through the surrebuttal testimony of Mr. Christopher B. Clark (Exhibit No. 101 (CBC-3)) that the complaint had been filed.

Both the Organization of MISO States (filings signed by the Commission) and the Joint Public Interest Intervenors (filings signed by the Department and regulatory agencies in other states) advocated for a reduction in the MISO regional ROE. The NSP Companies, on the other hand, did not join the MISO Transmission Owners' answer supporting the current 12.38 percent ROE. There were significant uncertainties as to how the complaint might be handled by the FERC, given the challenge to Association of Businesses Advocating Tariff Equity's standing to bring the complaint, which is subject to a rehearing request. Unlike several other pending ROE complaints, the FERC did not take initial action on the complaint in June 2014, but instead did not act until October 2014, when the record in the rate case was essentially closed.

The ROE complaint is unlike other external business changes cited by the Department in that both the Commission and the Department took an active role seeking a reduction in the MISO regional ROE with the understanding that a change would affect wholesale revenues. Now that the ROE may be reduced retroactively, and NSP Companies' transmission revenues thus reduced retroactively, it seems reasonable for the Commission to consider a ratemaking mechanism that would recognize the potential impact of a reduced MISO regional ROE on the Company. However, at this point we do not know, and cannot calculate, the magnitude of a change in the MISO ROE, as the FERC proceeding will not be concluded for quite some time. On January 6, 2015, a prehearing conference order was issued anticipating commencement of a hearing in August and Administrative Law Judge

report issued in late November. There would then be exceptions filed in December and replies in January 2016. Further, a decision from the FERC is not expected until approximately September 2016. The Company certainly recognizes that it is difficult to assess the Company's proposal in theory, without fully understanding the financial ramifications of the FERC complaint. As a result of the uncertainty surrounding the timing of the complaint, the Commission may prefer to table this issue until better information is available. Thus, the Commission could decide to not make a decision on this issue in the present TCR docket. In that case, the Company requests that the decision be made without prejudice to the Company seeking recovery (either in a future rate case or a future TCR Rider proceeding) of the difference between the 2014 test year revenues and the adjusted net revenues after a future FERC decision.

B. Escalation of Transmission Project Costs

The Department recommends that the Company be permitted to recover at least \$950.2 million of costs related to the CapX2020 projects and as much as \$969.6 million of costs. While we appreciate the Department's discussion of two cost recovery options, below we provide a discussion regarding why it is both reasonable and consistent with precedent for the Commission to permit recovery of \$969.6 million of CapX2020 project costs through this proceeding.¹

First, in prior TCR proceedings, the Commission has ruled that there should be a cap for TCR cost recovery based on the costs that the Commission approved in the projects' Certificate of Need dockets. At the time of the CapX2020 345 kV projects' approval, the Company had identified a total cost in 2007 year dollars of \$1,031.4 million for our ownership share². Explicit in this was an understanding by the Company, the Department and the Commission that the actual installed cost would be influenced by a variety of factors including the escalation in transmission facilities' construction costs between 2007 and when these projects would be placed in-service. This is best exemplified by the testimony of Department Witness Dr. Steve Rakow in Docket No. E002/CN-06-1115. Dr. Rakow provided a variety of cost-related information in his testimony, and when faced with adjusting those cost values through time, Dr. Rakow converted 2007 year cost estimates to future-year cost estimates by use of a "standard 2.5 percent inflation rate used in this testimony." Specifically, Dr. Rakow's Exhibit No. 295 (SSR-13) provided a table of costs for the three CapX2020 345 kV projects, and in that table Dr. Rakow "inflated at 2.5%" the

¹ The values provided by the Department are the project construction costs through 2015 for the three CapX2020 345 kV projects. In this TCR proceeding, the Company has specifically requested approval of recovery of the revenue requirements associated with the construction costs of these projects through 2015. The revenue requirement associated with these three projects in 2015 is \$65.8 million.

² Based on the current ownership shares agreed to in the construction agreements for each project.

costs the Company had presented in 2007 year dollars to a future year (2008). Interestingly, Dr. Rakow's estimation made in his 2008 testimony was a good prediction. As demonstrated by the Company in Docket No. E002/M-12-50 (the 2012 TCR proceeding), the average transmission facility construction cost annual escalation that occurred between 2007 and 2012 was approximately 2.8 percent. As presented in this docket, after considering somewhat lower increases in transmission facility construction costs over the last two years, the average annual increase in transmission facility construction costs between 2007 and 2014 has been just under 2.4 percent – very close to the prediction made by Dr. Rakow in 2008.

Further, the Commission has already addressed the appropriate way to account for escalation in transmission facility construction costs, for purposes of setting TCR-related cost caps, in the Company's 2012 TCR proceeding. Here the Company presented the actual installed cost for the CapX2020 Bemidji project and compared it to the initial estimate of the project cost presented in the CN and Route Permit filings. The Commission evaluated the effect of escalation on transmission facility construction costs for the CapX2020 Bemidji Project and approved an escalation adjustment of \$7.8 million (\$74 million of cost cap) over the \$66.2 million cost estimate from the time the project was approved. This approval was an agreement with the recommendation of the Department for the inclusion of escalation for the Bemidji Project. Specifically the Department stated the following in their November 1, 2012 Response Comments in Docket No. E002/M-12-50:

B. ESCALATOR FOR THE BEMIDJI PROJECT

In our initial comments, the Department concluded that the appropriate cap for the Bemidji Project was \$60.6 million. However, the Department noted that it may be reasonable to escalate those costs to current dollars based on an index such as the producer price index (PPI) published by the Bureau of Labor Statistics. Moreover, the Department stated that if Xcel believed that costs for the Bemidji Project should be escalated to current-day dollars, Xcel could provide an escalation factor in its reply comments, along with an explanation of its appropriateness.

On page 20 of its reply comments, Xcel stated that the Handy-Whitman Index is the appropriate cost escalator for the Bemidji Project. According to Xcel, based on the Handy-Whitman Index, the cost estimate for the Bemidji Project in 2012 dollars is approximately \$74 million, or \$8.2 million higher than the original cost estimate of \$66.2 million contained in the Route Permit proceeding (Docket No. E017, E015, & ET-6/TL-07-1317).

The Department agrees that the estimated costs for the Bemidji Project changed from \$60.6

million in the CN proceeding to \$66.2 million in the Route Permit proceeding. As a result, the Department concludes that the appropriate cap for the Bemidji Project (before inflation) should be \$66.2 million.

Given that the original CN and Route Permit proceedings for this project were based on 2007 figures, the Department concludes that it is appropriate to allow the Company to use a cost escalator for this project, specifically the Handy-Whitman Index. As a result, the Department recommends that cost recovery for the Bemidji Project be limited to \$74 million in the TCR Rider.

While we understand that the Commission's decision to allow the above-referenced escalation amount was specific to the Bemidji Project, we believe the Department's recommendation and the Commission's approval of escalation for that project was reflective of all parties' understanding that it is reasonable to consider escalation for all transmission projects for purposes of setting TCR cost caps.

With this understanding of how transmission facility construction cost escalation should impact the cost cap applied to the Company's cost recovery request in the present docket, we would have expected the Department to have evaluated the level of escalation that was reasonable and use this to set a cost cap for the CapX2020 projects. If the Department would have done this, all of the CapX2020 projects would be well below the escalation adjusted level of costs that we presented in the CN for these projects. However, the Department has taken a different approach in this proceeding.

The Department suggests on page 7 of their comments that the Commission could exclude \$19.3 million by not allowing the Company to recover the \$969.5 million we presented, but instead be limited to only \$950.2 million for all three of the CapX2020 projects. The Department arrived at this potential reduced level by using our proposed costs through 2015 for the Fargo Project at \$213.9 million as well as our proposed cost through 2015 of the Brookings Project at \$459.8 million, but for the La Crosse Project the Department recommends we should be allowed to recover only the original CN estimate of \$276.5 million that is based on 2007 year dollars. The Department provides no rationale for why they are not reflecting any escalation impact on the estimated construction costs for the La Crosse Project or why it is reasonable for the Commission to base the project cost cap on 2007 year dollars in contradiction to its already-approved approach of setting cost caps. The Company demonstrated in its Petition that if escalation is included, as the Commission has previously approved, the cost cap for the La Crosse Project should be set at \$330.3 million. Thus both the Company's requested level of cost recovery through 2015

(\$295.8 million) or the Company's estimated cost at completion of the La Crosse Project (\$299.1 million) are well below the escalated level of cost that would be appropriate to use as a cost cap for the project.

The Company believes the Commission should accept the Department's alternative recommendation that includes full recovery of the additional \$19.3 million of costs for the CapX2020 345 kV projects and continues to request full recovery of our costs as identified in the petition.

C. Use of Handy Whitman Index

The Department requests the Company explain in reply comments why it uses indices for "All Regions" instead of the indices for the North Central Region in the calculation of the Handy-Whitman escalation factor. The reason that the Company makes its escalation factor calculation as it does is because the factors that influence many of the costs of constructing transmission facilities are national, not just regional. While in the past these factors may have been more regional in nature, today the Company is operating in a market where costs of capital projects follow the national average of month-to-month price fluctuations. That is, the prices of many materials used in these projects, such as overhead conductor, underground conductor, fabricated steel, steel plates, steel poles, and power transformers, are subject to national trends in commodity pricing. The only exceptions to this are local labor and concrete for foundations work. These two items follow a more regional pricing average, and the Company's calculation methodology has incorporated those regional trends.

D. Inclusion of Two Out-of-State Transmission Projects

Both the Department and the OAG recommend the Commission not allow the Company to include in its 2015 TCR cost recovery any costs for the two new TCR-eligible transmission projects listed (Couderay – Osprey and Big Stone – Brookings). The Company understands the reasons provided for these recommendations and appreciates the Department's and OAG's careful consideration of the issues associated with including these two projects in TCR cost recovery. As part of those considerations, the Department provided its view on what information the Company should include in a future TCR filing (2016) to support inclusion of costs for an out-of-state transmission project. The Department recommended that the Company should show that:

- 1) the projects are built to serve Minnesota ratepayers in the same manner as other transmission projects;
- 2) the costs the Company proposes to charge to Minnesota ratepayers are the same as the costs that would be charged in a rate case; and
- 3) the proposed costs are reasonable.

We thank the Department for their insight and offer the following information in response to the Department's recommendations so that the Commission can determine if this additional information is sufficient to decide the reasonableness for inclusion of out-of-state transmission projects. While the Company is not expecting approval of these costs in advance of our 2016 TCR filing, we would appreciate any guidance parties wish to offer regarding our responses to the Department's questions.

1. Projects Built to Serve Minnesota Ratepayers

The 2013 amendment to the Transmission Statute allows recovery of out-of-state transmission costs of new transmission facilities approved by the regulatory commission of that state and determined by MISO to benefit the utility or integrated transmission system. Both of these requirements provide assurance to the Minnesota Commission that the purposes of the projects have been approved for the benefit of the ratepayers of the Company in Minnesota. The Company operates an integrated transmission system which is a part of the MISO transmission system. The requirement that MISO has determined the proposed transmission projects benefits the utility or the integrated transmission system means that the ratepayers in Minnesota will benefit from the projects. As support for meeting the requirements of the Statute, the Company offers the following approvals for each of the two out-of-state transmission projects listed in our petition.

The Couderay-Osprey project's Certificate of Authority was filed with the Wisconsin Public Service Commission on May 15, 2012 in Docket No. 4220-CE-178 and received state regulatory approval in an Order dated October 25, 2012. The project received MISO approval in MTEP12.

The Big Stone-Brookings project's first permit was filed on December 19, 2012 with the South Dakota Public Utilities Commission in Docket No. EL12-063 and was approved in April 2013. A second permit was filed on June 3, 2013 in Docket No. EL13-020 and was approved by the SDPUC in February 2014. The project received MISO approval in MTEP11.

2. *Costs Charged to Minnesota Ratepayers*

The cost allocation the Company presented in our initial petition showing the 2015 and 2016 TCR revenue requirements for both of these out-of-state projects is the same allocation we have used for all of the TCR transmission projects. Therefore, we are complying with the Commission's past approval for how transmission project costs are recovered through either the TCR or base rates.

3. *Project Cost Reasonableness*

The statutory requirement that out-of-state projects included in TCR must receive approval of the regulatory commission of the state in which they are being built is the same requirement for those projects to be included in base rates. Therefore, these projects have the same level of review for cost reasonableness they do now. They are first reviewed for reasonableness by the out-of-state regulatory commission and then reviewed by the Minnesota Commission when TCR recovery is requested in Minnesota. Thus the Company expects to provide the same level of support and justification of cost reasonableness for these projects as we do for all TCR-eligible transmission projects.

CONCLUSION

We appreciate the opportunity to respond to the Department's and the OAG's Comments. We ask that the Commission approve our petition as originally filed, with the exception that the Company's request for recovery of future reductions in MISO ROE be tabled at this time.

Dated: January 12, 2015

Northern States Power Company

CERTIFICATE OF SERVICE

I, Tiffany Hughes, hereby certify that I have this day served copies of the foregoing document on the attached list of persons.

xx by depositing a true and correct copy thereof, properly enveloped with postage paid in the United States mail at Minneapolis, Minnesota

xx electronic filing

DOCKET No. E002/M-14-852

Dated this 12th day of January 2015

/s/

Tiffany Hughes

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