

## Monticello LCM/EPU Rate Base Adjustment

PUC Staff - Jerry Dasinger

### Xcel

Xcel stated<sup>7</sup> that the Life Cycle Management/Extended Power Uprate (LCM/EPU) project will support continued operations at the Monticello nuclear plant, provide improved reliability and safety margins, and add approximately 71 MW of additional capacity.

According to the Company, the Monticello extended power uprate is being implemented in three phases corresponding with three scheduled refueling outages in 2009, 2011 and 2013. Initial work was completed during the 2009 refueling outage, and significant additional work was completed in the spring of 2011. Final implementation will take place during the spring 2013 outage.

The final implementation was planned for 2013 because of the delay in the NRC's review of its license amendment request (LAR). The delay in the NRC's review is primarily related to issues raised regarding credit for containment-accident pressure during an accident to provide the necessary net positive suction head to safety-related pumps. The Company stated it is working with the NRC to address the issues, and it now expects to complete the license proceeding in 2013.

The project remains in the construction phase. Final work to be completed in the spring 2013 outage includes several major projects including:

- Replacement of the Condensate Pump Impeller and Motor.
- Replacement of the #13 Feedwater Heaters.
- Replacement of the 13.8 kV Switchgear Bus #11 and #12.
- Replacement of the 1R and 2R Transformers.
- Replacement of the Feedwater Pump and Motor.
- Replacement of the Reactor Recirculation Motor.
- Completion of the Moisture Separator Drain Tank Injection.
- Completion of the #11 and #12 Feedwater Heater Drain Lines.

According to the Company, the estimated total costs for the project based on the current total project budget are \$587 million. The Company stated it had spent approximately \$494 million on the project as of August 31, 2012.

Approximately \$236 million was placed in service in 2011, of which \$173 million was included in rate base in its last rate case. The Commission approved a 2012 step increase which resulted in current rates reflecting a full year's depreciation for the 2011 in-service amounts. Its 2013 test year includes an additional \$380 million of plant in-service over what was included in the last rate case. This includes in-service amounts of approximately \$63 million in 2011 (beyond the in-

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<sup>7</sup> O'Connor Direct p 12 – 24

service amounts included in rate base), \$18 million for investments in-service in 2012, and \$299 million for investments in-service in 2013.

The Company stated that while there were cost increases overall from the start of the project, the most significant cost increases have related to four major modifications: 1) steam dryer acoustic monitoring and replacement of the steam dryer; 2) installation of the 13.8 kV electrical distribution system; 3) replacement of reactor feedwater pumps, valves, flow transmitters, and feedwater heaters; and 4) replacement of the condensate pump and impeller system and replacement of the condensate demineralizer system.

According to the Company, all of the Monticello LCM/EPU projects placed into service will be used and useful in the test year. At each phase of the LCM/EPU Project as equipment has been installed, during the 2009 refueling outage and the 2011 refueling outage, it has been placed into service to support generation of electricity at the thermal power level authorized under the current NRC operating license. Similarly, Xcel argued that placing the equipment in service that will be installed during the Spring 2013 outage will be necessary for Monticello to operate and produce power at the current power level and as such will be used and useful.

The Company reiterated its commitment to perform the after-the-fact prudence review and agreement to return any costs recovered that were subsequently determined to be imprudent. The Company stated it will submit a prudence review after the project is complete and agrees to waive any defense of retroactive ratemaking with respect to this review and will return the revenue requirements since January 1, 2011, that have been collected in rates associated with any costs the Commission finds were not prudently incurred.

In response to the Department's concerns, Xcel stated<sup>8</sup> the costs of its nuclear projects have increased substantially since the time they were originally envisioned and authorized to proceed. While the cost increases have been substantial, the costs it has incurred have been legitimate and necessary, the Project has been prudently managed, and its experience is consistent with that of other utilities.

The Project cost estimate at the time of the CON in January 2008 was \$320 million, (in 2006 dollars) including a risk allowance for the potential replacement of the plant's steam dryer. At the time of the 2010 rate case filing, the Monticello LCM/EPU Project costs were estimated to be \$399.1 million. In November 2011, the Company testified at hearing that the final cost of the Project was expected to be approximately \$550-600 million. The estimated cost included in this case in November 2012 was \$586.7 million. According to the Company the estimate was updated in its response to Information Request DOC-160,<sup>9</sup> but it is not seeking to recover costs in excess of the \$586.7 million estimate filed in this case.

The Company stated the increases in costs stem from the following:

- Outside events have affected the NRC's schedule and requirements, adding time and cost to the Project. Evolving NRC standards and requirements due to developments at other

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<sup>8</sup> O'Connor Rebuttal pp. 4 - 26

<sup>9</sup> Attached as O'Connor Rebuttal Exhibit \_\_\_\_ (TJO-2), Schedule 1.

plants that have undergone license renewals, EPUs, and the 2011 events at Fukushima have added to licensing and engineering costs and contributed to Project delays. NRC licenses now require that current industry experience lessons learned be implemented while the license review period is in progress thus causing the license review process, and the related impacts to our Project to evolve continuously.

- The original estimate was based on preliminary engineering and a conceptual framework. The Project was neither fully defined nor engineered when Xcel prepared the Certificate of Need. Subsequent, more detailed engineering, design, and cost analysis revealed that significantly more and more expensive work was needed to execute the Project.
- Xcel discovered additional work necessary once its planned work entered the construction phase. The Project has required it to address emergent work required by the plant's "as found" condition.

The NRC must approve Xcel's License Amendment Request (LAR) before it can operate the Monticello plant at its uprated power level and produce an additional 71 MW electric (MWe). The EPU LAR application was originally submitted to the NRC in 2008.

According to Xcel, the delay in the NRC's review of the Monticello EPU LAR stems from several causes, the primary being the NRC's response due to developments at other plants that have undergone EPUs, and the nuclear accident that occurred at the Fukushima Daiichi nuclear plant. For example, as the NRC reviewed and approved EPU licenses at other plants, it identified issues and possible situations that it then began to incorporate into all pending license reviews.

The Company requires approval of two separate LARs from the NRC to achieve the Monticello EPU. The first is the EPU LAR, which will allow the plant to operate at uprate conditions. The second is for permission to operate pursuant to General Electric's Maximum Extended Load Line Limit Analysis Plus licensing topical report (GE LAR).

The current EPU LAR was submitted to the NRC in late November 2009. The second LAR, the GE LAR, was submitted to the NRC in January 2010.

According to the Company, it anticipates receipt of the EPU LAR in September or October of 2013. Receipt of the EPU LAR will permit it to begin the power ascension to the EPU output levels. Receipt of the GE LAR approval is anticipated either concurrently with the approval of the EPU LAR or during the ascension to the EPU output levels.

However, the Company explained that the schedule assumptions are subject to the ability of the NRC to meet its commitments to complete its review during summer 2013. Recent developments related to the federal government's budget and sequestration present risk that the NRC staff will be unable to complete their review on the current schedule. In addition, it is always possible that the NRC could seek more information from the Company, which could further delay the approval process. Nonetheless, Xcel's expectation that it will receive NRC approval in 2013 is based on current information from the NRC.

Xcel stated it disagreed with MCC's and XLI's contentions that the company should not recover project costs until the project is complete. First, that position appears to stem from a misunderstanding of the dual purpose of the Monticello LCM/EPU Project. The project increases the capacity of the Monticello facility and replaces or refurbishes components to extend the life of the facility while meeting the required aging management NRC program requirements. More importantly, a majority of the Project is currently in-service and providing LCM-related benefits to Xcel's customers and has been since 2009.

The projects anticipated to be in service during the 2013 test year are shown in Exhibit \_\_\_\_ (TJO-2), Schedule 5 which lists each of the modifications the Company has previously placed in-service or proposes to place in-service in the current test year and provides:

- A description of each modification,
- The in-service costs of each modification,
- The actual or forecast in-service date, and
- A discussion of the reasons supporting the determination that these investments are in-service and used and useful for Company customers. As shown, the Company's investments in the Monticello LCM/EPU Project are in-service for the purpose of serving our customers.

The Company stated that the following example of one of these projects illustrates how it is currently providing service to customers. The new main power transformer was placed into service on May 25, 2011, at a total installed cost of approximately \$26.5 million. This component was required to replace the existing main power transformer to support both LCM and operations at EPU levels. The replacement main power transformer is currently installed at the plant and energized to support ongoing operations. Its function is to increase the generator's output voltage to the level necessary to connect the Monticello facility to the transmission network for distribution of electricity to customers.

The Company stated the 2012 licensing additions have been placed in service. Although the EPU licensing process requires the licensee to demonstrate that the plant's system and components can operate at uprate conditions, in many instances the licensee must also update the current design basis to meet safety standards that have evolved since the plant was originally licensed. The NRC licensing fees incurred in 2012 to update specific component design bases to current standards were placed in-service with the component part. Those components cannot operate in the plant without passing NRC review to those design basis analyses and as such those license fees were necessary for the plant's ongoing and current generation. In contrast, the 2013 licensing additions pertain exclusively to the EPU LAR and GE LAR efforts.

In response to Department, XLI and MCC testimony, Xcel stated<sup>10</sup> it believes the intervenor proposals are intended to address two concerns: 1) the delay in receiving the final NRC license for the EPU; and 2) the increases in the cost of the project. Xcel argued that none of the intervenor proposals asks the Commission to determine that the actual investments made cannot be included in rate base in the future. Rather, they seek to remove some of the cost from current recovery until a prudence review has been completed and a license received. The Company

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<sup>10</sup> Robinson Rebuttal pp. 10-19

stated it understands the desire of parties to have a full prudence review following completion of the spring 2013 outage before additional costs are added to rates. However, the intervenor proposals do not include a mechanism to recover costs that will not be recovered in this current case. A permanent disallowance of our costs in 2013 does not balance customer interests with the Company's need to recover its cost of service, including a return on and the return of investment for those costs currently in-service or to be placed in-service in the test year.

Xcel made an alternative proposal with it argues better balances the interests of customers and the Company. The proposal has three elements: 1) lower current cost; 2) a deferral mechanism that allows eventual recovery of costs; and 3) a prudence review in the 2014 test year rate case, with a return of LCM/EPU costs collected to customers if the Commission were to determine the Company acted imprudently with respect to those specific costs, consistent with the Company's prudence review commitment in its 2010 rate case.

Xcel stated the license fees incurred in 2012 were tied to specific NRC component requirements and were not related to the pending NRC licenses. The costs are already in plant in service and, therefore, entitled to both a return on and return of investment, subject to refund under the prudence review process.

In the filed 2013 test year, these license costs had a planned in service of August and November of 2013. Given the NRC delays experienced to date and some further required technical analyses, Xcel stated it has determined that it is inappropriate to place these costs in plant in-service until the NRC approves the licenses (see below). As a result, the Company will modify the test year and not place these investments in-service in 2013.

The second portion of the proposal addresses the test year costs associated with the primary 2013 LCM/EPU plant addition scheduled to be placed in service in May of 2013. The Total Company value of this addition is \$247 million. The other Parties were concerned about the inclusion of all of the increased costs associated with this project in 2013 prior to the prudence review process. As a response, the Company proposed to defer the 2013 depreciation expense on those investments until it receives a Commission Order finding the costs to be prudent. To minimize the impact of this deferral on future customers, the Company proposed to recover the deferred depreciation expense over the remaining useful life of Monticello, which will be approximately 17 years as of January 1, 2014.

The allocated Minnesota retail jurisdictional portion of the monthly depreciation expense associated with the \$247 million Total Company addition to plant in-service included in the test year for the months of May through December, 2013, will be deferred and placed in a regulatory asset account. This jurisdictional amount totals a decrease in test year depreciation expense of \$6.6 million. Upon completion of the prudence review, the amortization of these costs will begin and will be included in the final revenue requirement in the Company's 2014 test year rate case. Because the deferral will remain in effect until after the prudence review, the amortization of those 2013 costs will not be included in the revenue requirement for interim rates.

Xcel argued that the Department's proposal would effectively require the Commission to start down the path of judging the prudence of the Company's actions with respect to the Monticello LCM/EPU project, because the Company would not recover a return on or return of the plant not

allowed in test year rate base in this case. Without a full record on this very complex issue, it is premature to make any judgments about whether costs should be disallowed from rate base. The Company's proposal provides for an adjustment for 2013 at a level similar to that proposed by the Department, while preserving the Company's ability to recover its costs for the Monticello LCM/EPU project, except for any costs that may be found to have been imprudently incurred.

The Company stated that until it receives the license, it will not be able to generate at the higher MW capacity level made possible by the EPU. Xcel argued that the fact that it cannot currently use the additional capacity does not mean that a portion of the investments are not currently used and useful; those investments do provide value in terms of reliability. Nor does it mean those investment costs that are not currently used and useful should not be recorded as CWIP until the investments are used and useful.

In response to XLI's assertion that the Monticello LCM/EPU costs are not used and useful, the Company stated it proposed to keep the 2013 licensure costs in CWIP with an AFUDC offset during the 2013 test year because projects do not need to be used and useful to be placed into CWIP with an AFUDC offset.

According to the Company,<sup>11</sup> the basic definition of in-service is the date when the asset is in use for its intended purpose, for example, electricity is being generated, lines are energized, or meters are spinning.

The estimated in-service date for the investment associated with obtaining the 2013 NRC license is not as simple because there is no specific point where the 2013 NRC license generates electricity because it is an intangible asset. The Company stated that it was determined that the license will be in use for its intended purpose when it can run the unit at higher capacity. Many of the NRC licenses are considered to be in their intended use when received, such as the 2012 NRC license. In contrast, the investment associated with obtaining the 2013 NRC license is not in service until the unit has completed its power ascension testing such that the unit is reliable to operate at a higher capacity level.

As for the additions relating to the 2013 NRC license, the Company evaluated whether the asset's in-service date, as forecasted in 2012 for this case, was still the current expected in-service date. Based on that evaluation, Xcel believes the estimated in-service date should be early 2014

Based on the early 2014 estimated in-service date, the Company recommended the investments associated with the 2013 NRC license scheduled to go into service in August and November of 2013 remain in CWIP with an AFUDC offset for all of 2013; and that the \$52.3 million addition for 2013 related to the license, along with its depreciation, be removed from the test year revenue requirement calculation. The depreciation for the equipment being placed in service with the main May plant addition is \$8.9 million for Total Company (\$6.6 million for the Minnesota jurisdiction) for May through December 2013 and, under its proposal will be deferred until the prudence review is completed in the 2014 test year rate case.

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<sup>11</sup> Perkett Rebuttal pp 11 – 15

Xcel stated that as with the proposal to defer depreciation and property tax costs for Sherco Unit 3, the Company cannot defer the 2013 depreciation expense for the main May 2013 addition unless the Commission authorizes the creation of a regulatory asset by order. The Company thus requested that the Commission's order in this proceeding explicitly authorize the Company to:

1. Create and adjust a regulatory asset by an amount equal to any difference between:
  - a. The level of depreciation recovered through the base rates approved in this proceeding that are associated with the equipment being placed in service with the main May plant addition; and
  - b. The amount of depreciation that would otherwise have been charged in 2013 under GAAP accounting for the equipment being placed in service with the main May plant addition;
2. Amortize the regulatory asset over the remaining life of Monticello when the Commission determines the additions associated with the deferred depreciation were prudent; and
3. Recover a return of and a return on such regulatory asset balance as the balance exists when general rates are established in future rate proceedings after the prudence review is completed.

The Company<sup>12</sup> stated it recommends its proposal (described above) for the Monticello LCM/EPU issue. However, if the Commission instead chooses the Department's adjustment, the Company recommended the following refinements to the Department's calculation. First, the Department developed an inflation factor for the costs as stated in the certificate of need related to this project, but did not compound the inflation factor over the time period, as is typical for inflation calculations. Second, the Department's calculation does not account for billings to NSPW through the Interchange Agreement. Implementing these changes would decrease the Department adjustment to rate base from \$47.013 million to \$39.217 million.<sup>13</sup> The changes would also reduce the State of Minnesota electric jurisdiction revenue requirement from \$5.719 million to \$4.771 million.

## **Department of Commerce**

The Department<sup>14</sup> stated [according to the Company (Heuer Direct p 45)] that Xcel's 2013 test-year includes \$6.3 million of revenue requirements for the NRC licensing costs for the Monticello EPU project. Of that amount, \$3.3 million is related to the additions for 2012 and \$3.0 million is related to the additions for 2013.

The Department disagreed with the Company's position that in the event the NRC does not approve the Monticello EPU, the 2012 NRC license costs are appropriately included in the 2013 test-year but the 2013 NRC license costs would be excluded. The Department's position is that

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<sup>12</sup> Heuer Rebuttal pp 22 - 25

<sup>13</sup> These refinements are shown on Exhibit\_\_\_(AEH- 2), Schedule 7, page 1, Recommended Corrections to DOC Adjustments.

<sup>14</sup> Campbell Direct pp 95-107

the full \$6.3 million revenue requirements related to NRC fees would be excluded from the 2013 test-year since these capitalized costs would no longer be used and useful.

According to the Company on a total company basis the impact of the Monticello LCM and EPU in this rate case is \$81 million related to nuclear production, \$34 million related to Monticello LCM/EPU and \$10 million related to PI Unit 2 steam generators.

In response to DOC IR 160, Xcel provided information about cost overruns for all CN projects where the costs were included in the 2013 test-year. The details of the cost overruns are found in the table on pages 100 – 101 of Campbell Trade Secret Direct.

Based on its review, the DOC stated that as shown in the table, the costs of the Monticello project are significantly higher than the CN cost estimate of \$320 million. The DOC's assessment was that the Company provided little information in their case to explain this significant cost overrun. While the DOC acknowledged that the Fukushima Daiichi nuclear plant disaster added to the costs of the Monticello projects, it did not expect the costs of the projects to increase by \$266.7 million, or 83.3 percent, over the CON costs based on the October 2012 estimate used in the 2013 test-year. The Company's more recent January 2013 estimate shows an estimated cost of \$639.9 million.

The DOC stated that the cost estimate for adding the 13.8 kilovolt (kV) distribution system (item 2 in the table), which was not included in the original estimate, increased significantly from the \$28.2 million estimated in December 2010, to the \$64.1 million estimated in October 2012, to \$96.8 million in the January 2013 estimate.

The replacement of the reactor feedwater pump and heater (items 3 to 5 in the table) is another example of a significant cost increase: starting at \$12.7 million in the January 2008 estimate, to \$59 million<sup>15</sup> in the December 2010 estimate, to \$145 million<sup>16</sup> in the October 2012 estimate, to \$178.1 million<sup>17</sup> in the January 2013 estimate.

Finally, the condensate demineralization system replacement (item 6 in the table) is yet another example of a significant cost increase, starting at \$9.0 million in the January 2008 estimate, to \$42.9 million in the December 2010 estimate, to \$62.8 million in the October 2012 estimate, with no increase in the January 2013 estimate.

The DOC stated it has concerns about nuclear capital costs in total based on the following statement by Xcel:<sup>18</sup>

Many of our capital intensive projects have been underway prior to the test year. Although the capital expenditure budget for 2013 is \$438 million for 2013 (excluding nuclear fuel), total capital additions for nuclear facilities in service since our 2011 test year are approximately \$800 million, including approximately \$67.6 million of capital projects in-service in 2010 and 2011 not included in that

<sup>15</sup> This is the total of lines 2 – 5. The total of lines 3 – 5 is \$30.8 million.

<sup>16</sup> The total of lines 3 -5 is \$118.4 million.

<sup>17</sup> The total of lines 3 – 5 is \$118.9 million.

<sup>18</sup> O'Connor Direct page 6



2011 test year, \$32.9 million in-service in 2012, and \$699.5 million in-service in 2013.

The DOC stated that in Xcel's last rate case in 2010, it had a forecasted 2011 test-year and was allowed a 2012 step-in for nuclear plant in the last rate case. Thus, it is difficult to understand why the Company under-recovered \$67.6 million related to capital projects in service in 2010 and 2011. Also in its last rate case, the Company updated its nuclear plant in service for 2011 on November 1, 2011 by decreasing its revenue requirement by \$1.086 million.

The DOC asked about discrepancy. The Company's response was that Mr. O'Connor's testimony should have referred to major capital additions of \$48.9 million for nuclear capital projects not included in the 2011 test year (not 2010 also). In addition, there were no individual major capital additions that occurred in 2010 that were not included in the 2011 test year.

According to the DOC, the Company did not answer the information request question, but simply stated that the \$67.6 million is for major capital additions not included in 2010 or 2011 test-year. The Company did not explain what happened between November 1, 2011 and December 31, 2011 that caused the Company to go from a \$1.086 million reduction in revenue requirements (roughly a \$15 million decrease in capital costs) to a \$67.6 million under recovery.

Because Xcel did not provide an adequate basis for the significant cost overrun, the DOC recommended disallowing a large portion of the overrun. According to the DOC it was necessary to make the calculation due to on-going concerns with the Company's inability to accurately estimate costs for rate case purposes. The disallowance was calculated<sup>19</sup> by inflating the CN cost of \$320 million, averaging that amount with the \$586.7 million October 2012 estimate, then subtracting that average from \$586.7 million. The result was the end of year balance of \$106.95 million which was then averaged with a beginning of year balance of \$0 to determine a total Company rate base exclusion. The jurisdictional adjustment was a \$47,013,295 disallowance.

In its Surrebuttal, the DOC<sup>20</sup> acknowledged two minor corrections in the calculation of its proposed disallowance and stated that the corrected adjustment is now a reduction of \$39.217 million for the rate base of Monticello LCM and EPU projects.

The DOC clarified that its adjustment did not include an adjustment for depreciation expense; therefore, the adjustment pertains only to the loss of return on rate base related to the \$39.217 reduction in plant for Monticello LCM/EPU, or assuming 15% to calculate the effect on Xcel's revenue requirement, a downward adjustment of approximately \$5.883 million.

The basis for the downward adjustment to the Company's Monticello LCM/EPU project was due largely to the fact that the Company had not supported in this rate case the significantly higher costs of this project – \$586.7 million – for which Xcel requests recovery in this rate case.

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<sup>19</sup> See page 106 Campbell Direct

<sup>20</sup> Campbell Surrebuttal pp 95 – 112

The DOC stated it is concerned by Xcel's<sup>21</sup> comment that without a full record, it is premature to make any judgments in the current rate case about whether costs should be disallowed. Given the record in this proceeding, this statement seems to suggest that Xcel has no burden of proof to recover even significantly high cost overruns. The Company indicated in its initial filing that the nuclear costs were approximately 25% of the total revenue requirements driver in this rate case, yet the Company did not provide in its Direct Testimony a reasonably complete record for the Commission to consider. Xcel did not provide in its Direct Testimony, for example, a reasonable basis upon which to support these significant nuclear investments including the PI Unit 2 steam generator replacement and the Monticello LCM/EPU projects, did not provide detailed support for the reasons causing significant costs increases compared to the CN amounts approved, or detailed reasons and support for the cancelled PI EPU project.

The DOC concluded that it is clear that the Company did not put together a well-supported case to demonstrate that Xcel's nuclear investments are reasonable. Because Xcel has not done so, it is not reasonable to charge ratepayers for costs for which Xcel has not met its burden of proof.

The Company is asking to defer ruling on the 2013 costs until Xcel's 2014 rate case where, via deferred accounting, the Company may be allowed the opportunity to bring 2013 test year costs into the 2014 test year of that next rate case, along with consideration of 2014 test-year costs. It would not be appropriate to allow Xcel a "do-over" by deferring proposed 2013 cost recovery in this rate proceeding which would allow Xcel to try again later.<sup>22</sup> The DOC agreed that it would be premature to decide that Monticello costs should be permanently disallowed. The DOC argued as a result, that its recommendation to allow Xcel recovery of the costs from its CN, plus a generous level of cost recovery in this rate proceeding is fair, reasonable and transparent.

The DOC stated that Xcel's proposal regarding the Monticello LCM/EPU prudence review is reasonable, with the following exceptions:

- Make clear that the burden is on the Company to support its final cost for Monticello LCM/EPU project, including a clear explanation for the reasons and support for the significant costs increase from the CN estimate of \$320 million to the final in service costs the Company will propose in its 2014 test year; and,
- Require the prudence review for Monticello LCM/EPU to be filed 30 days prior to the filing of the Company's rate case, with transparent and detailed analysis and support, to allow parties adequate time to review this significant cost increase in Monticello LCM/EPU projects.

In response to the Company's new two-part proposal for Monticello LCM/EPU project, the DOC stated it agreed with the Company's proposal to continue to leave 2013 NRC license fees in CWIP, since it appears that the NRC testing and approval will likely happen later in 2013 based on current information provided by the Company.

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<sup>21</sup> Robinson Rebuttal

<sup>22</sup> Throughout this proceeding Xcel has insisted on sticking to a 10 month timeline.

It did not agree that it is reasonable to defer the depreciation expense for Monticello for the period May (in-service date of Monticello LCM/EPU) to December of 2013, for the following reasons. The Monticello LCM/EPU does appear likely to be in-service in the 2013 test year; however, Xcel has not justified its proposal to defer this depreciation expense into the next rate case and onto future ratepayers. The Department noted that deferred accounting is used for extraordinary, unusual and significant costs that occur outside of a rate case, where the Company wants to preserve these costs for an opportunity to argue for rate recovery in their next rate case.

The DOC argued that it is not appropriate to use deferred accounting in a pending rate case to allow a utility to try again, in its next rate case, to meet the burden of proof that the Company did not meet in the pending case.

The DOC stated it continues to support its downward adjustment to the Company's Monticello LCM/EPU project. The corrected adjustment is a reduction of \$39.217 million for the rate base of Monticello LCM and EPU projects.

### **Minnesota Chamber of Commerce (MCC)**

The MCC<sup>23</sup> stated that Xcel is requesting rate base additions totaling \$810.2 million, of which Monticello additions are \$462.7 million and Prairie Island additions are \$347.5 million. The \$462.7 million is comprised of new construction totaling \$382.2 million, \$62.6 million carryover from 2011 and \$17.9 million carryover from 2012. In spite of the step-in adjustment negotiated in the last Xcel rate case, these 2011 and 2012 rate base additions apparently were not included.

According to the MCC, the problem with Xcel's request is that much of its requested recovery is for investments that are not providing benefits to current ratepayers, so they are not used and useful for ratepayers. Recovery should be reduced to limit rate base for ratemaking purposes. To be eligible for rate base classification for ratemaking purposes, a project must not only be placed in service but must also be used and useful for the purpose designed and intended.

Xcel stated that LCM investments and EPU investments are comingled and inseparable, and therefore, all must be allowed into rate base at the same time that both are placed in service.

The MCC disagreed with the Company's proposed ratemaking treatment of the EPU/LCM because Xcel plans to consider the completed project as placed in service immediately after the spring, 2013 outage and added to rate base in spite of the fact that the EPU may not be deliverable because of operating permit limitations.

The MCC stated it considers projects categorized as construction work in progress (CWIP) to be excluded from rate base because although CWIP is added to plant investment on the Company's balance sheet, any revenue requirements on this investment are offset by the entry of Allowance for Funds used During Construction (AFUDC) in the Company's income statement. AFUDC essentially defers any earnings requirement on CWIP until the project classified as CWIP has been placed in service and approved as used and useful for ratemaking purposes. Therefore,

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<sup>23</sup> Schedin Direct 12 – 18

CWIP in connection with AFUDC essentially insulates current ratepayers (who are not benefiting from use of the assets) from costs of the construction program.

The MCC recommended that Xcel be ordered to estimate the EPU investment portion of the LCM/EPU project (including carryovers from 2011 and 2012) and to classify that investment as CWIP until the power uprate is demonstrated, the operating permit amendment is received, and a prudence review is completed.

In Surrebuttal, the MCC<sup>24</sup> stated that the initial project (LCM and EPU) cost was set at \$320 million, of which \$133 million was allocated to the EPU project, based on the initial Certificate of Need (CON) proceeding. So 41.6% was associated with the EPU portion.

Because of Xcel's inability to separate the current LCM portion from the EPU portion, the MCC recommended that CON 41.6% of the project be considered the EPU portion with that amount be placed into CWIP with an AFUDC offset until the NRC license is received and the prudence review is complete. The adjustment to revenue requirements is approximately \$4.6 million. Since the LCM/EPU project is presently under construction, Xcel should not have any accounting reason why this cannot be done.

### **Xcel Large Industrials (XLI)**

The XLI<sup>25</sup> stated that NSP is proposing to complete the Monticello EPU/LCM project during the test year. Consequently, it is proposing full cost recovery of the related costs. The Monticello EPU/LCM represents about \$62.8 million of NSP's proposed test year revenue requirements.

The remaining EPU/LCM capital additions will not be placed in service until the planned spring 2013 outage of the Monticello plant. Further, the Monticello plant will not be able to operate at a higher power level until the Nuclear Regulatory Commission (NRC) has approved NSP's Power Uprate License.

Until the NRC has approved the EPU License application, the EPU portion of the project is not used and useful and must be excluded from rates. Excluding the EPU investment from rates is consistent with Minn. Stat. § 3 216B.16 subd. 6 which provide that property must be used and useful in rendering service to the public.

The XLI stated that NSP has not identified the portion of the EPU/LCM project that is attributable to the electric power uprate. However, based on its Certificate of Need filing, the EPU represents about 41.6% of the total EPU/LCM project cost.

The Commission has yet to conduct a prudence review of the entire project. Further, the costs continue to spiral out of control therefore NSP should not be allowed to unconditionally recover all the remaining portion of the EPU/LCM project.

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<sup>24</sup> Schedin Surrebuttal pp. 8 – 11

<sup>25</sup> Pollock Direct pp. 26 – 29

The XLI recommended that NSP should be ordered to track the revenues collected in its approved rates that are associated with the Monticello EPU/LCM project to the extent that any of this investment is included in rate base in this proceeding. Should the Commission subsequently disallow any of the investment, the associated revenues should be refunded to customers with interest at NSP's authorized rate of return.

In Surrebuttal, the XLI<sup>26</sup> stated it recognizes that the EPU Project is separate from the LCM Project. Its recommendation is that the EPU-related project costs should be removed from revenue requirements in this case.

The XLI stated it did not agree with NSP's revised proposal for the ratemaking treatment of the Monticello EPU/LCM project. The revised proposal is far from a balanced approach because NSP would be allowed to earn a return on the EPU portion of the project investment, even though that investment is not used and useful. Inclusion of any portion of these costs would therefore be contrary to Minnesota law.

The XLI argued that there is no dispute that the EPU portion of the project is not used and useful until the NRC has approved the power uprate license. While there are benefits of replacing aging equipment, this does not justify allowing a full return on the EPU investment prior to the Commission finding that the investment is both prudent and used and useful. NSP has committed to address the prudence of the Project in its next rate case. And, until the Power Uprate license is approved by the NRC, the EPU investment is not used and useful. Accordingly, NSP should not be allowed to earn a return on the EPU portion of the Project.

XLI stated that Xcel claims that the majority of the project it seeks to include in rate base is currently in service and providing benefits. That ignores the fundamental purpose of the Project and the design of the equipment allegedly providing LCM-related benefits. In referencing the equipment that is allegedly necessary for both the EPU and LCM, NSP conceded: The equipment necessary to implement the EPU at Monticello is also necessary to ensure the safe and efficient operation of the plant throughout the remainder of the Plant's life, to 2030. The equipment has been designed to specifications that support the EPU's increased capacity level and is in various stages of procurement and fabrication.

XLI argued that NSP's claim is irrelevant to its proposal that NSP should not be allowed to recover the EPU portion of the Project in the rates to be approved in this proceeding. While many of the costs and investments may have been for components that had reached or would soon reach the end of their useful life, that argument ignores the fact the equipment had been designed to specifications supporting the EPU's increased capacity. Because NSP can't take full advantage of the specifically designed equipment until it receives NRC approval, NSP's customers aren't receiving the full benefits of those investments (i.e., the EPU portion of the investment isn't used and useful). This is particularly concerning given the significant cost overruns. Fair and equitable treatment for both NSP and ratepayers would be to limit cost recovery until the completion of the prudence review.

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<sup>26</sup> Pollock Surrebuttal pp. 13 – 17

The XLI's recommendation would not result in a permanent disallowance. It would only result in regulatory lag. NSP will still be allowed an opportunity to earn a return on and recover its prudent and used and useful investment in the EPU/LCM project in the next rate case. However, NSP is compensated for regulatory lag through its authorized return on equity.

The XLI recommended that the Commission deny recovery of the EPU portion of the Project until after the NRC has approved the Power Uprate license and the prudence of the investment can be determined. The Company has stated its intent to provide a full prudence review in its next rate case. The next rate case is the appropriate forum to determine the prudent/used and useful EPU/LCM costs that should be recovered in rates.

## **ALJ**

(Report, paragraphs 49 – 85)

82. Thus, contrary to the assertion of the Company, the fact that the project investments are being used to generate electricity at current levels for LCM purposes does not mean that the entire LCM/EPU project is “in service” or “used and useful” for purposes of Minn. Stat. § 216.16, subd. 6. Because the plant is only generating power at existing levels, the EPU portion of the project is not “in service” or “used and useful.” Any other interpretation of Minn. Stat. § 216B.16 would improperly allow the Company to recover EPU costs, with a return, before ratepayers ever receive the benefit of the additional 71 MW of EPU capacity. To allow recovery of the EPU costs before the plant provides the additional power would result in unreasonable rates for ratepayers.

83. Because the EPU portion of the project is not “used and useful,” the Administrative Law Judge recommends that the Commission adopt MCC's proposal to hold the EPU capital costs in CWIP (with an AFUDC offset) in this rate case. MCC's proposal appropriately balances the interests of the ratepayers and the Company by recognizing that the ratepayers are not currently receiving the benefits of the EPU while also allowing the Company a future return on the EPU investment at the time when the plant is actually providing the additional power to ratepayers.

84. The Administrative Law Judge also concludes that MCC's proposal to keep 41.6 percent of the combined LCM/EPU project costs in CWIP, with an AFUDC offset, is reasonable. The 41.6 percent apportionment of costs between the EPU and LCM represents the Company's own estimate of the proportion of costs attributable to the EPU part of the project. While the Company maintains that the estimate was an early, high level figure, the Company has not produced an incremental cost study or any other reliable accounting study to show that the estimate is no longer reasonable. Thus, a preponderance of the evidence in the record demonstrates that MCC's proposal is reasonable and should be adopted.

85. Given the conclusions and recommendations above, the Administrative Law Judge does not believe it is necessary to address the alternative proposals of XLI and the Department.

## Exceptions to the ALJ

Xcel took exception (on pages 9 – 11) with the findings and conclusion that the EPU project is not useful.

XLI agreed with the ALJ but expressed concern with the application of the recommendation: These findings and conclusions in the Recommendations contain a sound interpretation of Minnesota law and the “used and useful” standard. XLI agrees with the ALJ’s detailed and thoughtful analysis. But XLI is concerned that NSP’s calculation of the Chamber’s proposal may not be correct. In any event, XLI believes the appropriate and easiest method for calculating the reduction is to remove the \$62.846 million Xcel seeks to recover in rate base by 41.6%, or \$26.1 million.

## Staff Analysis

### Required Adjustment

The ALJ recommended that the Commission adopt MCC’s proposal to hold the EPU capital costs in CWIP (with an AFUDC offset) in this rate case. The Company stated that it had considered the LCM/EPU as a single project and had not kept track of each project separately.

As pointed out by the ALJ the only information in this record separating the cost of the two projects is the calculation by the MCC and XLI using the cost information from the CON docket. That calculation resulted in allocating 41.6 percent of the total cost to the EPU project.

Staff interrupts the ALJ recommendation as exactly what it states, that 41.6 percent of the total project costs are the cost of the EPU. According to the Company, the estimated costs as of October, 2012 of \$586.7 million were included in this rate case. 41.6 percent of that amount is \$244.1 million which is the amount Xcel should have in CWIP for the EPU.

In the initial filing, the overall CWIP in rate base was found in Heuer Direct Exhibit\_AEH-1) Schedule 16. Page 2 of the exhibit shows the Minnesota jurisdictional production plant CWIP in the rate case as \$557,969,000. A portion of that presumably is the EPU, however the specific amount is not identified.

In the financial schedules submitted by Xcel that are its interpretation of the ALJ decisions, the Company transferred \$39.772 million to CWIP for the Monticello EPU. However, that amount is just the investments associated with the 2013 NRC license scheduled to go into service in August and November of 2013. As noted above under exceptions, XLI believes the adjustment should be \$62.846 million.

The Company needs to identify the total LCM/EPU cost that was in CWIP in its initial filing. 41.6 percent of that amount would be the EPU CWIP. The adjustment to CWIP to reflect the ALJ decision should be the difference between that amount and \$244.1 million. It is Staff’s understanding that a portion of the costs for the EPU have been moved to plant in service. Those

costs would have to be removed as well as the related depreciation expense as part of the required adjustment.

### **CWIP with AFUDC Offset**

The MCC recommendation adopted by the ALJ was to include the cost of the EPU in CWIP in this case. The following describes the MCC's understanding of the result of putting the costs in CWIP with an AFUDC offset.

The MCC stated it considers projects categorized as construction work in progress (CWIP) to be excluded from rate base because although CWIP is added to plant investment on the Company's balance sheet, any revenue requirements on this investment are offset by the entry of Allowance for Funds used During Construction (AFUDC) in the Company's income statement. AFUDC essentially defers any earnings requirement on CWIP until the project classified as CWIP has been placed in service and approved as used and useful for ratemaking purposes. Therefore, CWIP in connection with AFUDC essentially insulates current ratepayers (who are not benefiting from use of the assets) from costs of the construction program.

The ALJ appears to have reached a similar conclusion where she stated: MCC's proposal appropriately balances the interests of the ratepayers and the Company by recognizing that the ratepayers are not currently receiving the benefits of the EPU while also allowing the Company a future return on the EPU investment at the time when the plant is actually providing the additional power to ratepayers.

Those conclusions appear to be based on the belief that inclusion in CWIP with an AFUDC results in revenue neutrality. That is not correct. The Accounting for Public Utilities manual states the following:

On the other hand, some commissions have effectively allowed a partial return on CWIP investment through a procedure whereby CWIP is allowed in the rate base, while the capitalization of AFUDC continues with the AFUDC earnings included above-the-line in operating income. To the extent that the overall allowed return exceeds the AFUDC capitalization rate, the utility is currently earning a return on a portion of its construction investment.

That situation is illustrated by three examples from this rate case. The Company's adjustment for the Monticello EPU put \$39.772 million into CWIP with an AFUDC offset of \$2.850 million. Multiplying the \$39.772 million by the recommended rate of return (ROR) in this rate case of 7.45 percent, results in a return of \$2.963 million which is \$113,000 greater than the AFUDC offset.

The Company's adjustment for the PI EPU removed \$74.603 million from CWIP and decreased the test year AFUDC by \$4.443 million. \$74.603 million times 7.45 percent results in a return of \$5.558 million, \$1.115 million greater than the AFUDC offset.

In the Company's initial filing on an overall basis it included \$732.105 million of CWIP in rate base. The AFUDC offset in the operating income was \$51.132 million. The CWIP of \$732.105



million times 7.45 percent results in a return of \$54,541,823, which is \$3,409,823 greater than the AFUDC offset.

The Company's initially requested rate of return was 7.90 percent which would have resulted in a greater variance. The magnitude of the difference likely relates to how the AFUDC offset was calculated. That information is not in the record. However, the point is that CWIP with an AFUDC offset is not revenue neutral.

There has been much discussion in this rate case where the parties conclude how they believe a cost should be treated for ratemaking purposes. They then make their recommendations based on the accounting entries they believe would reflect the desired result. Staff emphatically points out that accounting does not dictate ratemaking. In fact the reality is exactly the opposite. The Commission makes the decision of how a cost is to be treated for ratemaking purposes and then the company has to determine the necessary accounting to reflect the Commission's decision.

Any party that tells the Commission that it must make a decision in a certain way because accounting requires that is plain wrong. In those situations, the Commission should just ignore those arguments.

Staff believes the MCC's and the ALJ's intent is to not allow Xcel to earn any return on the EPU cost prior to the uprate being in service, generating the increased electricity, and that ratepayers should not pay for the EPU costs prior to that time. If the Commission were to adopt the ALJ recommendation with the intent of having revenue neutrality, the only way to achieve that goal is to determine that the EPU costs must be removed from rate base in this case.

If in making the above determination, the Commission's goal is to allow Xcel to recover those costs once the EPU is in service subject to the plant being used and useful and that the costs are determined to be prudent, then the Commission's decision should include a statement of that intent. Making such a statement would provide the Company the assurance of future recovery required by GAAP accounting which would be necessary so it would not have to write off the EPU costs.

### **Xcel Request for Depreciation Deferral**

In this case, Xcel proposed that the investments associated with the 2013 NRC license scheduled to go into service in August and November of 2013 remain in CWIP with an AFUDC offset for all of 2013, and that the \$39.0 million addition (for the Minnesota jurisdiction) for 2013 related to the license, along with its depreciation, be removed from the test year revenue requirement calculation. The depreciation for the equipment being placed in-service with the May plant addition is \$6.6 million (for the Minnesota jurisdiction) for May through December 2013. Under our proposal, that depreciation will be deferred until the prudence review is completed in the 2014 test year rate case.

Regarding this proposal, Staff notes that only plant that is included in plant in service is depreciated. If the Commission were to determine that the EPU costs should all be included in CWIP or completely removed from rate base for this case, then there would be no depreciation expense so there would be nothing to defer.

## Prudence review

Staff notes that even though Xcel offered to provide a prudence review of its Monticello LCM/EPU project, it is the Commission that would conduct the review and make a determination on whether Xcel was prudent and whether its proposal for cost recovery is reasonable. Xcel's role in the prudence review process is to provide parties and the Commission information that shows Xcel was prudent. The Department and other parties investigate the information Xcel provides and make recommendations as to whether they believe Xcel was prudent. If Xcel is allowed a "do-over" or to continue providing information about its cost recovery proposal in its next rate case (after insisting on sticking to the ten-month timeline in this case), the Commission may want consider moving the Monticello LCM/EPW prudence review into a separate proceeding rather than doing this in Xcel's next rate case under a ten-month timeline. This would allow Xcel and parties more time to develop a record and to evaluate the prudence of Xcel's Monticello LCM/EPU costs.

Staff also notes that the Commission has the authority, on its own motion, to hire auditors and consultants for special investigations and to charge the utility for the cost of the audit, pursuant to Minn. Stat. § 216B.62, subd. 8.<sup>27</sup> However, the statute does require the Department of Commerce to "carry out the investigation in the manner directed by Commission" so there would need to be a great deal of coordination between the two state agencies. If the Department is interested, the auditor or consultant could be used to help investigate various technical aspects (engineering, accounting, etc.) of the prudence of Xcel's handling of the Monticello LCM/EPU project (and perhaps the PI EPU).

## Decision Alternatives

1. Determine that 41.6 percent of the LCM/EPU cost should be placed in CWIP with an AFUDC offset. (ALJ, MCC)
2. Determine that 41.6 percent of the LCM/EPU cost should be removed from rate base (plant in service or CWIP as applicable) in this as well as the related depreciation reserve, deferred taxes, depreciation expense, AFUDC and any other applicable costs. Xcel will be allowed to recover those costs in future rate cases once the EPU is in service subject to the plant being used and useful and that the costs are determined to be prudent. (Staff alternative based on ALJ/MCC)

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<sup>27</sup> Minn. Stat. § 216B.62, subd. 8. Audit investigation costs; account, appropriation. ... If the commission, in a proceeding upon its own motion, on complaint, or upon an application to it, determines that it is necessary, in order to carry out its duties imposed under this chapter or chapter 216, 216A, 216E, 216F, or 216G, to conduct an investigation or audit of any public utility operations, practices, or policies requiring specialized technical professional investigative services for the inquiry, the commission may request the commissioner of commerce to seek authority from the commissioner of management and budget to incur costs reasonably attributable to the specialized services. If the investigation or audit is approved by the commissioner of management and budget, the commissioner of commerce shall carry out the investigation in the manner directed by the commission and shall render separate bills to the public utility for the costs incurred for such technical professional investigative services.

3. Deny recovery of the EPU portion of the Project until after the NRC has approved the Power Uprate license and the prudence of the investment can be determined resulting in a reduction of the test year revenue requirement of \$26.1 million. (XLI)
4. Reduce the rate base of Monticello LCM and EPU projects by \$39.217 million because the cost increases have not been justified. (DOC)
5. Allow the investments associated with the 2013 NRC license scheduled to go into service in August and November of 2013 to remain in CWIP with an AFUDC offset for all of 2013; and that the \$52.3 million addition for 2013 related to the license, along with its depreciation, be removed from the test year revenue requirement calculation. The depreciation for the equipment being placed in service with the main May plant addition (\$6.6 million for the Minnesota jurisdiction) will be deferred until the prudence review is completed in the 2014 test year rate case. Authorize the Company to:
  - a. Create and adjust a regulatory asset by an amount equal to any difference between:
    - i. The level of depreciation recovered through the base rates approved in this proceeding that are associated with the equipment being placed in service with the main May plant addition; and
    - ii. The amount of depreciation that would otherwise have been charged in 2013 under GAAP accounting for the equipment being placed in service with the main May plant addition;
  - b. Amortize the regulatory asset over the remaining life of Monticello when the Commission determines the additions associated with the deferred depreciation were prudent; and
  - c. Recover a return of and a return on such regulatory asset balance as the balance exists when general rates are established in future rate proceedings after the prudence review is completed. (Xcel)

(Note: These decision alternatives correspond to alternatives 3 through 7 on pp. 1-2 of the deliberation outline.)