Minnesota Public Utilities Commission

Staff Briefing Papers

Vol. III of VII - Cost of Capital

Meeting Dates: March 19 & 26, 2015 .... Agenda Item No. _____

Company: Northern States Power Company ("Xcel" or the "Company")

Docket No. E002/GR-13-868

In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota

Issue(s): What is the Appropriate Cost of Equity (Return on Equity "ROE") for Xcel?
What is the Appropriate Cost of Debt for Xcel?
What is the Appropriate Capital Structure for Xcel?
What is the Appropriate Rate of Return for Xcel?
Should there be an Adjustment to the Return on Equity if the Commission Approves a Decoupling Mechanism?

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Statement of the Issues

What is the appropriate cost of equity for Xcel?
What is the appropriate cost of debt for Xcel?
What is the appropriate capital structure for Xcel?
What is the appropriate rate of return for Xcel?
Should there be an adjustment to the return on equity if the Commission approves a decoupling mechanism?

Introduction

Four parties sponsored ROE witnesses. The Department witness Dr. Amit recommended a return on equity of 9.64 percent; Xcel witness Mr. Hevert recommended a cost of equity of 10.25 percent; ICI witness Mr. Glahn recommended a cost of equity of 9.0 percent, and the Commercial Group witness Mr. Chris recommended that the cost of equity should be adjusted downward from Xcel's last approved rate of 9.84 percent but did not have a specific recommendation.

The AARP recommended that if the Commission approves NSP's proposal for decoupling, then NSP's allowed ROE should be adjusted downward.

The Company and the Department agreed on an appropriate capital structure and cost of debt. The ICI recommended that the Commission limit the amount of equity to the level employed by its parent company as projected by Value Line, 47.5 percent in 2014 and 49.0 percent in 2015.

The parties' and the ALJ's recommendations are summarized in the tables below. The ICI Group values assume a capital structure comprised of 47.5 percent common equity, 50.6 percent long-term debt, and 1.9 percent short-term debt in 2014, and 49.0 percent common equity, 49.1 percent long-term debt, and 1.9 percent short-term debt in 2015.

	Capital Structure	**Cost of Capital Components 2014 Test Year**							
	Proposed	**XCEL**		**DOC**		**ICI GROUP**		**ALJ**	
	Ratio	Cost	Weighted Cost	Cost	Weighted Cost	Cost	Weighted Cost	Cost	Weighted Cost
Long-Term Debt	45.60%	4.90%	2.234%	4.90%	2.234%	4.90%	2.479%	4.90%	2.234%
Short-Term Debt	1.90%	0.62%	0.012%	0.62%	0.012%	0.62%	.012%	0.62%	0.012%
Equity	52.50%	10.25%	5.381%	9.64%	5.061%	9.0%	4.275%	9.77%	5.129%
WACC			7.62%		7.31%		6.77%		7.38%

	Capital Structure	Cost of Capital Components 2015 Step Year							
	Proposed	XCEL		DOC		ICI GROUP		ALJ	
	Ratio	Cost	Weighted Cost	Cost	Weighted Cost	Cost	Weighted Cost	Cost	Weighted Cost
Long-Term Debt	45.61%	4.94%	2.253%	4.94%	2.253%	4.94%	2.43%	4.94%	2.253%
Short-Term Debt	1.89%	1.12%	0.021%	1.12%	0.021%	1.12%	.021%	1.12%	0.021%
Equity	52.50%	10.25%	5.381%	9.64%	5.061%	9.0%	4.41%	9.77%	5.129%
WACC			7.65%		7.34%		6.86%		7.40%

Because it did not have specific numerical recommendations, staff did not try to develop a weighted average cost of capital based on the Commercial Group's testimony.

Background

The ALJ addressed cost of capital issues on pages 51 through 96 of her Findings of Fact, Conclusions of Law, and Recommendations ("ALJ Report").

Xcel addressed these issues on pages 15 through 32, and 117 through 120 of its Initial Brief, pages 12 through 25, and pages 99 through 101 of its Reply Brief, and pages 11 through 14 of its Exceptions to the ALJ Report.

Department discussion of these issues can be found on pages 10 through 45 of its Initial Brief, pages 4 through 10 of its Reply Briefs, and pages 5 through 16 of its Exceptions to the ALJ Report.

The ICI Group discussed the cost of capital on pages 12 through 15 of its Initial Brief, pages 2 through 6 of its Reply Briefs, and pages 24 through 40 of its Exceptions to the ALJ Report.

The Commercial Group discussed the cost of capital on pages 2 through 9 of its Initial Brief. It did not file Reply Briefs or Exceptions to the ALJ Report.

The Clean Energy Intervenors discuss changes to the cost of equity from a decoupling proposal on page 30 of its Initial Brief and pages 19 and 20 of its Reply Brief.

AARP discussed changes to the cost of equity from a decoupling proposal on pages 14 through 16 of its Initial Brief, page 7 of its Reply Brief, and pages 10 through 12 of its Exceptions to the ALJ Report.

Capital Structure

All other things equal, more equity (less leverage) in a capital structure makes investing a safer decision for an outside investor. A greater proportion of equity reduces the possibility that there will not be enough earnings to pay interest on the (reduced amount of) debt and, additionally, it increases the probability that sufficient earnings remain to pay dividends on the equity. Where the proportion of debt is small, lenders will also have reduced concerns about recovering their investment in the event of bankruptcy.

However, because it is the highest cost form of capital, equity in too great a proportion increases costs to ratepayers, who both pay for too much high-cost equity and too little low-cost debt, and it reduces shareholders' chances to leverage a higher return out of their investment and diminishes the Company's ability to attract equity capital. It is necessary, therefore, to strike an appropriate balance with enough equity for safety but not so much that costs are unnecessarily high.

XCEL

Pages 117 through 119 of Xcel's Initial Brief, pages 99 through 101 of Reply Brief.

Xcel proposed to use the actual test year (and step year) capital structures. These capital structures are comprised of 52.50 percent common equity, 45.60 percent long-term debt, and 1.90 percent short-term debt for 2014 and 52.50 percent common equity, 45.61 percent long-term debt, and 1.89 percent short-term debt for 2015.

Responding to the ICI Group's comment that Northern States Power is an accounting fiction, Xcel stated that the ICI Group is mistaken. The Company has demonstrated that it is a separate legal entity from its parent, Xcel Energy Inc. (XEI) and that its:

> Actual capital structure provides the direct financial support for the Company's separate debt ratings and for the Company's $3.9 billion of outstanding publicly traded long term debt securities.
>
> Separate capital structure is regularly reported to the Securities and Exchange Commission in filings related to the Company's publicly traded long term debt.
>
> Equity ratio is needed to support its current debt ratings.
>
> Actual capital structure is reasonable in comparison to other utilities.

ICI GROUP

Pages 12 through 15 of the ICI Group's Initial Brief, pages 2 through 6 of Reply Brief.

The ICI Group argued that Northern States Power is an accounting fiction as an entry on the books of Xcel Energy, Inc. It stated that Xcel Energy's equity ratio can be directly observed while Northern States Power's cannot. Therefor the common equity percentage allowed in

Xcel's capital structure should be limited to the equity ratio employed by the parent company, Xcel Energy, Inc.; 47.5 percent in 2014 and 49.0 percent in 2015.

DEPARTMENT

Pages 35 through 45 of the Department Initial Brief, page 9 of the Reply Brief.

The Department supported Xcel's proposed capital structure. It argued that the ICI's position is unreasonable because NSP has its own capital structure.

ADMINISTRATIVE LAW JUDGE

Findings 391 through 425, pages 89 through 96, of the ALJ Report.

In finding 420 the ALJ recommended that the Commission approve the Company's proposed capital structure, as updated in Rebuttal Testimony, for the 2014 test year and the 2015 step year.

The ALJ's findings 422 through 424 include the following:

- The Company's capital structure is generally consistent with the capital structures of other utilities, both at the operating subsidiary level as analyzed by the Company, and at the parent company level as analyzed by the Department.
- The methodology used to calculate the components of the proposed capital structure is consistent with that used in the Company's previous rate case.
- ICI Group's assertion that the Company is merely "an accounting fiction" has no factual support in the record. To the contrary, the record demonstrates that the Company has an actual and market-based capital structure that is separate from that of XEI. The Company's separate capital structure is reflected in financial reporting and in its communications with financial markets. Adoption of the approach recommended by the ICI Group would be contrary to the well-established regulatory principle that the Company should be allowed to recover all of its prudent costs.

In finding 425 the ALJ stated:

> Accordingly, the Administrative Law Judge recommends that the Commission approve the following capital structures:
>
> 2014 test year:
> - 52.50 percent common equity;
> - 45.60 percent long-term debt; and
> - 1.90 percent short-term debt.
>
> 2015 Step:
> - 52.50 percent common equity;
> - 45.61 percent long-term debt; and
> - 1.89 percent short-term debt.

CAPITAL STRUCTURE ALTERNATIVES

Some Commission alternatives for the capital structure are:

1. Use the Company's proposed capital structure comprised of 52.50 percent common equity, 45.60 percent long-term debt, and 1.90 percent short-term debt for 2014 and 52.50 percent common equity, 45.61 percent long-term debt, and 1.89 percent short-term debt for 2015. (Xcel, DOC, ALJ)

2. Determine that the Company's proposed 2014 capital structure comprised of 52.50 percent common equity, 45.60 percent long-term debt, and 1.90 percent short-term debt should be used for both years.

3. Determine that the Company's proposed 2015 capital structure comprised of 52.50 percent common equity, 45.61 percent long-term debt, and 1.89 percent short-term debt should be used for both years.

4. Determine that the equity percentage allowed in Xcel's capital structure should be limited to the ratio employed by the parent company, Xcel Energy, Inc. (XEI); 47.5 percent in 2014 and 49.0 percent in 2015. (ICI Group)

5. Determine that another capital structure is more appropriate.

(Note: These decision alternatives correspond to alternatives III, A (1 through 5) on p. 20 of the deliberation outline.)

Cost of Debt

Pages 117 through 120 of Xcel's Initial Brief, and pages 99 through 101 of its Reply Brief.
Pages 37 through 40 of the Department's Initial Brief.
Findings 395 through 413, pages 89 through 96, of the ALJ Report.

To calculate long-term cost of debt, XCEL proposed using its actual cost of long-term debt of 4.90 percent and a short-term debt rate of 0.62 percent for 2014, and the actual cost of long-term debt of 4.94 percent and a short-term debt rate of 1.12 percent for 2015.

The Department agreed that the Company appropriately estimated the costs of its short- and long-term debt.

In Finding 403 the ALJ noted:

> In its Surrebuttal Testimony, the Department agreed with the updated capital structure and the updated costs of short- and long-term debt.

(The ALJ reflected the agreed upon cost of short-and long-term debt in her overall cost of capital recommendation in finding 426.)

COST OF DEBT ALTERNATIVES

Some Commission alternatives for the cost of debt are:

A. Long Term Debt

6. Adopt Xcel's proposed cost of long-term debt of 4.90 percent for 2014. (Xcel, DOC, ALJ)

7. Adopt Xcel's proposed cost of long-term debt of 4.94 percent for 2015. (Xcel, DOC, ALJ)

8. Adopt some other cost of long-term debt that the Commission considers more appropriate for 2014 or 2015.

B. Short-term Debt

9. Adopt Xcel's proposed cost of short-term debt of 0.62 percent for 2014. (Xcel, DOC, ALJ)

10. Adopt Xcel's proposed cost of short-term debt of 1.12 percent for 2015. (Xcel, DOC, ALJ)

11. Adopt some other cost of short-term debt that the Commission considers more appropriate.

(Note: These decision alternatives correspond to alternatives III, B (1 and 2) on pp. 20-21 of the deliberation outline.)

Cost of Equity and Overall Cost of Capital

BACKGROUND

As noted above, four parties supported cost of capital witnesses. Xcel requested a return on equity of 10.25 percent, the Department recommended a return on equity of 9.64 percent, the ICI Group recommended a rate of return of 9.0 percent and the Commercial Group stated that the record demonstrates that 9.64 percent is generally consistent with investor expectations and may be overly generous.

The cost of equity witnesses recommended that the Commission should authorize a rate of return on common equity that satisfies the requirements from the *Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia* 262 U.S. 679 (1923) and the *Federal Power Commission v. Hope Natural Gas Company* 320 U.S. 591 (1944) cases (together the "Bluefield and Hope" decisions). As discussed by Department witness Dr. Amit, the requirements from these cases are that:

1. The rate of return should be sufficient to enable the regulated company to maintain its credit rating and financial integrity.

2. The rate of return should be sufficient to enable the utility to attract capital at reasonable terms.

3. The rate of return should be commensurate with returns being earned on other investments having equivalent risks.

The ALJ supported these standards in findings 239 and 240 of her Report.

METHODS FOR ESTIMATING COST OF EQUITY

DCF Method

Financial theory postulates that the price of the stock in the present period equals the present value of all the expected future dividends discounted by the appropriate rate of return. If annual dividends grow at a constant rate over an infinite period, the required rate of return on common equity capital can be estimated with the following formula (in %s):

> The expected (required) rate of return on equity = the expected dividend yield + the expected growth rate in dividends.

This formula, known as the Discounted Cash Flow (DCF) method, is a market-oriented method that requires the determination of the appropriate dividend yield and the appropriate growth rate to be used in this analysis.

A variation of the DCF model is the Two Growth Rate DCF (TGDCF). This model is sometimes used when an analyst thinks the short-term earnings growth rate may be either unusually low or unusually high for a relatively short number of years and is not expected to be sustained over a long time period. To the degree that such growth rates may not be sustainable in the long-run, the TGDCF method accommodates two different growth rates: short-term and sustainable, long-term growth rates.

Capital Asset Pricing Model

The Capital Asset Pricing Model (CAPM) defines risk as the relationship of a security's returns with the market's returns. This relationship is measured by beta ("β"), an index measure of an individual security's volatility relative to the market. A beta less than 1.0 indicates lower volatility than the market and a beta greater than 1.0 indicates greater volatility than the market. The CAPM assumes that all non-market, or unsystematic, risk can be eliminated through diversification and that investors require compensation for risks that cannot be eliminated through diversification.

This model is applied by adding a risk-free rate of return to a market risk premium. The market risk premium is adjusted proportionally to reflect the systematic risk of the individual security relative to the market as measured by beta.

Risk Premium Analysis

The Risk Premium Analysis (RP) is based upon the theory that the cost of common equity capital is greater than the prospective company-specific cost rate for long-term debt capital. The cost of equity is the expected cost rate for long-term debt capital plus a premium to compensate common shareholders for the added risk of being unsecured and last-in-line in any claim on the corporation's assets and earnings.

METHODS USED BY PARTIES

The Company's recommendation was based on the results of the constant growth and multi-stage DCF model. It also considered the CAPM, and the Risk Premium approach to assess the reasonableness of the DCF results.

The Department based its recommendation on a DCF and two growth rate DCF analyses. The Department also conducted CAPM which it stated supported the DCF and TGDCF analyses.

The ICI Group based its recommendations on a DCF analysis.

The Commercial Group based its recommendation on a comparative review of the return on equity authorized by other jurisdictions.

COST OF EQUITY ESTIMATES

XCEL

Xcel addressed these issues on pages 15 through 32 of its Initial Brief, and pages 12 through 25 of its Reply Briefs.

Background

Xcel stated that establishing the correct ROE is a critical part of every rate case. In this case it is critical because the Company is crossing the peak of its capital investment cycle. The practical implications of the Company's ability to attract capital and retain its financial integrity are more pronounced considering continued capital market instability and sustained increase in interest rates.

The ROE authorized by the Commission is a signal to the investor community. When the Commission authorizes a ROE for the Company which is consistent with (and, when appropriate, higher than) other large, vertically integrated electric utilities, the signal that is sent is that Xcel's capital investments are supported and consistent with the State's public policy. For that reason, Xcel believes the Commission should authorize a ROE which furthers the energy policy goals of the State and, thus, result in just and reasonable rates.

Xcel's Unique Risk Factors

The Company argued that there are unique circumstances that support its requested 10.25 percent ROE. It stated that the Department has provided a consistently applied sophisticated analysis, resulting in a recommendation of 9.64 percent. However, the Company believes that its recommendation of 10.25 percent is more reflective of the business risks it faces in a rapidly changing environment. Xcel argued that its authorized ROE should not be reduced while it is making significant investments in infrastructure and clean energy projects.

Xcel stated that there circumstances surrounding this rate case are unique enough to support its request such as:

1. This is a Multi-Year Rate Plan (MYRP), not a traditional rate case, and there is a longer time lag between the Commission's authorization of a new ROE and the last time an updated ROE analysis was provided in the record of this case;

2. Recognized prolonged financial market volatility;

3. The comparable ROEs recommended are approaching those of gas and distribution only electric companies and no longer reflect the risk of vertically integrated electric utilities; and

4. It is in Xcel customers' interest not to let ROE erode during this period of major capital expansion because investors could lose confidence that the Commission is supportive of the investments Xcel is making to continue to provide safe and reliable service, consistent with the State's evolving energy policies.

Xcel stated that in addition to these unique circumstances, adopting the Department's recommendation of a 9.64 percent would indicate that Xcel's business is more analogous to a distribution only utility, and/or a natural gas only utility. The evidence on the record demonstrates that the average ROE authorized for vertically integrated utilities in 2014 is 9.84 percent, the average ROE authorized for distribution only utilities in 2014 is 9.51 percent.

Xcel noted that the Commission recently authorized a 9.59 percent ROE for CenterPoint, and the ALJ recommended 9.79 percent for MERC. (Staff note: in the October 28, 2014 Order in Docket G-011/GR-13-617, the Commission authorized a 9.35 percent ROE for MERC.)

Xcel argued that the Department's updated DCF results incorporate unsustainable utility stock levels by using a time period when utility stocks were trading high. It stated that there is no basis to conclude that stock prices from June 7 to July 7, 2014, the period used by the Department, will be fairly representative of utility stock prices of the dividend yields and the cost of equity for the two year term of the ROE decision in this case.

XCEL's Analysis

Sample Group

The Company selected two proxy groups for its ROE analysis: an electric proxy group (Xcel Electric Comparison Group or (XECG)) and a combination proxy group (the Xcel Combination Comparison Group or (XCCG)).

The XECG was composed of companies with substantial electric utility operations. Xcel's witness, Mr. Hevert, began with the 48 domestic United States utilities that Value Line classifies as Electric Utilities, and applied the following screening criteria:

a. Excluded companies that do not consistently pay quarterly cash dividends;

b. Excluded companies that were not covered by at least two utility industry equity analysts;

c. Excluded companies that did not have investment grade senior bond and/or corporate credit ratings from Standard & Poors (S&P);

d. Excluded companies whose regulated operating income over the three most recently reported fiscal years comprised less than 60.00 percent of the respective total operating income for that company;

e. Excluded companies whose regulated electric operating income over the three most recently reported fiscal years represented less than 90.00 percent of total regulated operating income; and

f. Excluded companies that were known to be involved in a merger or other significant transaction.

Of the remaining companies in the sample, Xcel excluded Edison International because of significant, recent financial losses. Mr. Hevert then excluded two companies with mean DCF results of less than 8.00 percent, IDACORP Inc. and Hawaiian Electric Industries Inc.

The final XECG included the following 14 companies:

American Electric Power Co. Inc.
Cleco Corp.
Duke Energy Corp.
Empire District Electric Co.
Great Plains Energy Inc.
Northeast Utilities
Otter Tail Corp.
PNM Resources Inc.
Pinnacle West Capital Corp.
Pepco Holdings Inc.
Portland General Electric Co.
Southern Co.
UniSource Energy Corp.
Westar Energy Inc.

In rebuttal testimony the Company excluded Pepco Holding Inc., UniSource Energy Corp, and Empire District Electric Co. from its revised XECG and added Hawaiian Electric Industries to the group.

To select companies for is XCCG, consisting of utility companies that have combined electric and gas operations, Mr. Hevert started with the 59 domestic United States utilities that Value Line classifies as Electric Utilities and Natural Gas Utilities. The Company then applied the following screening criteria:

a. Excluded companies that do not consistently pay quarterly cash dividends;

b. Excluded companies not covered by at least two utility industry equity analysts;

c. Excluded companies that did not have investment grade senior bond and/or corporate credit ratings from S&P;

d. Excluded companies whose regulated operating income over the three most recently reported fiscal years comprised less than 60 percent of the respective total operating income for that company;

e. Excluded companies whose regulated electric operating income over the three most recently reported fiscal years represented less than 10.00 percent of total regulated operating income;

f. Excluded companies whose regulated natural gas utility operating income over the three most recently reported fiscal years represented less than 10 percent of total regulated operating income; and

g. Excluded companies that were currently known to be party to a merger or other significant transaction.

Sixteen companies met these screening criteria. The Company then excluded any companies with mean DCF results of less than 8.00 percent. This resulted in the exclusion of Consolidated Edison Inc. and Sempra Energy. The final XCCG included the following 14 companies:

Alliant Energy Corp.
Avista Corp.
Black Hills Corp.
CenterPoint Energy Inc.
CMS Energy Corp.
Dominion Resources Inc.
DTE Energy Company
Integrys Energy Group Inc.
NiSource Inc.
NorthWestern Corp.
SCANA Corp.
UIL Holdings Corp.
Vectren Corp.

Wisconsin Energy Corp.

In rebuttal testimony the Company excluded CenterPoint Energy Inc., Dominion Resources Inc., and UIL Holdings Corp., from its revised XCCG and added Sempra Energy to the group.

DCF Analysis

The Company applied the DCF model to its two proxy groups. The Two Growth DCF approach was used if growth rates were atypically high or low. To estimate the expected growth rate, the Company used three sources of earnings growth rates:

The Zacks consensus long-term earnings growth estimates;
The First Call consensus long-term earnings growth estimates; and
The Value Line long-term earnings growth estimates.

Because Zacks and First Call growth rates represent consensus estimates, their use in the DCF approach ensures no single analyst's estimate unduly influences the model's results.

To estimate the expected dividend yield, the Company used the average daily closing stock prices for the 30-trading days, 90-trading days, and 180-trading days ending September 30, 2013. The annualized dividend per share was also based on September 30, 2013. In rebuttal testimony the Company updated the stock prices for the periods ending May 30, 2014.

To calculate the dividend rate, Xcel calculated the expected dividend yield by applying one-half of the long-term growth rate to the current dividend yield.

Xcel calculated the flotation cost of 0.13 percent based on the weighted average issuance costs.

To determine the recommended ROE, Xcel applied an 80/20 percent weighting to the results of the XECG and XCCG. Xcel argued that since approximately 91 percent of its total regulated income comes from electric utility operations, the weighting of the combination proxy group should not exceed 20 percent. The Company's original DCF resulted in the following estimates:

	Low Growth Rate	Mean Growth Rate	High Growth Rate
Electric Proxy Group Results (XECG)			
30-Day Average	9.44%	10.18%	10.90%
90-Day Average	9.28%	10.02%	10.73%
180-Day Average	9.24%	9.97%	10.69%
Combination Proxy Group Results (XCCG)			
30-Day Average	9.08%	9.63%	10.21%
90-Day Average	9.00%	9.55%	10.12%
180-Day Average	9.04%	9.59%	10.16%
Weighted Average			
30-Day Average	9.37%	10.07%	10.76%
90-Day Average	9.22%	9.92%	10.61%
180-Day Average	9.20%	9.90%	10.58%

The Company's updated DCF values are:

	Low Growth Rate	Mean Growth Rate	High Growth Rate
Revised Electric Proxy Group Results			
30-Day Average	9.04%	9.97%	11.18%
90-Day Average	9.09%	10.02%	11.23%
180-Day Average	9.20%	10.13%	11.34%
Revised Combined Proxy Group Results			
30-Day Average	8.93%	9.70%	10.45%
90-Day Average	9.05%	9.82%	10.57%
180-Day Average	9.20%	9.97%	10.72%
Revised Weighted Average Results			
30-Day Average	9.02%	9.92%	11.03%
90-Day Average	9.09%	9.98%	11.10%
180-Day Average	9.12%	10.01%	11.13%

CAPM

For his CAPM, Company witness Mr. Hevert used three different estimates of the risk-free rate:

1. The current 30-day average yield on 30-year Treasury bonds (i.e., 3.79 percent);
2. The projected 30-year Treasury yield (3.95 percent); and
3. The long-term projected 30-year Treasury yield (5.40 percent).

For the market risk premium, Mr. Hevert used a forward-looking estimate of market risk. To develop the estimate, he relied on data from Bloomberg and Value Line. He calculated the market capitalization weighted expected dividend yield (adjusted using one-half of the growth rate), and combined that amount with the market capitalization weighted projected earnings

growth rate to arrive at the market capitalization weighted average DCF result. He then subtracted the current 30-year Treasury yield from that amount to arrive at the market DCF-derived ex-ante Market Risk Premium estimate.

Mr. Hevert used these values with the current, near-term projected, and long-term projected 30-year Treasury bond yields as inputs to his CAPM analyses.

For the Beta coefficients, he used the values reported by Bloomberg and Value Line. For each source, Mr. Hevert used the average of the reported Beta coefficient for each proxy group company.

CAPM Results for the Electric Proxy Group

	Bloomberg Derived Market Risk Premium	Value Line Derived Market Risk Premium
Average Bloomberg Beta Coefficient		
Current 30-Year Treasury (3.79%)	10.95%	9.80%
Near Term Projected 30-Year Treasury (3.95%)	11.11%	9.97%
Long Term Projected 30-Year Treasury (5.40%)	12.56%	11.42%
Average Value Line Beta Coefficient		
Current 30-Year Treasury (3.79%)	10.81%	9.69%
Near Term Projected 30-Year Treasury (3.95%)	10.97%	9.85%
Long Term Projected 30-Year Treasury (5.40%)	12.42%	11.30%

Summary of CAPM Results for the Electric and Combination Proxy Groups

	Bloomberg Derived Market Risk Premium	Value Line Derived Market Risk Premium
Average Bloomberg Beta Coefficient		
Current 30-Year Treasury (3.79%)	10.94%	9.80%
Near Term Projected 30-Year Treasury (3.95%)	11.10%	9.96%
Long Term Projected 30-Year Treasury (5.40%)	12.55%	11.41%
Average Value Line Beta Coefficient		
Current 30-Year Treasury (3.79%)	10.85%	9.72%
Near Term Projected 30-Year Treasury (3.95%)	11.01%	9.88%
Long Term Projected 30-Year Treasury (5.40%)	12.46%	11.33%

Based on updated market information, Mr. Hevert’s CAPM analyses produce a range of ROE estimates from 10.65 percent to 13.13 percent. Mr. Hevert stated that he did not place any specific reliance on his CAPM analysis. He used the CAPM as a check on the results of his DCF analyses.

Bond Yield Plus Risk Premium Approach

Risk premium approaches estimate the cost of equity as the sum of the equity risk premium and the yield on a particular class of bonds. Since the equity risk premium is not directly observable, it typically is estimated using a variety of approaches. An alternative approach is to use actual authorized returns for electric utilities to estimate the equity risk premium.

Mr. Hevert defined the risk premium as the difference between the authorized ROE and the then-prevailing level of the long-term (i.e., 30-year) Treasury yield. Based on data from 1,417 electric utility rate proceedings between January 1980 and September 2013 and the prevailing level of interest rates during the pendency of the proceedings, he calculated the equity risk premium in each case.

Mr. Hevert stated that his analysis demonstrates that, over time, there has been a statistically significant, negative relationship between the 30-year Treasury yield and the equity risk premium. As the 30-year Treasury Yield has fallen, the equity risk premium has increased. Mr. Hevert argued that simply applying the long-term average equity risk premium of 4.44 percent to the current Treasury yield would significantly understate the cost of equity. Based on the regression coefficients, Mr. Hevert estimated that the ROE is 10.33 to 10.90.

Using the updated values, Mr. Hevert's risk premium resulted in values from 10.16 percent to 10.77 percent. Mr. Hevert relied on the bond yield plus risk premium analysis to corroborate the results of his DCF analysis.

Decoupling Impact

Mr. Hevert argued that the principal analytical issue is whether the proposed decoupling would meaningfully distinguish the Company from its peers, including the utilities in the Electric Proxy Group. The fact that the Company's revenues may be affected by the mechanism does not affect the cost of equity unless it can be demonstrated that (1) the Company is materially less risky than the proxy group by virtue of the structure, and (2) the financial markets react to the incremental effect of the mechanism and measurably reduce their return requirement for the Company.

Mr. Hevert provided a summary of revenue stabilization and cost recovery mechanisms currently in effect at each electric utility within the Electric Proxy Group, and the Combination Proxy Group of utilities. Of the 28 companies in the proxy groups, 14 have some form of decoupling mechanism in place (seven of the fourteen Electric Proxy Group utilities and seven of the fourteen Combination Proxy Group utilities). He argued that given the breadth and scope of those structures, he does not believe that equity investors would reduce their return requirements for NSP relative to the Electric Proxy Group or the Combination Proxy Group utilities as a result of NSP's partial decoupling proposal. If anything, absent such a structure the Company may be seen as incrementally more risky because of the prevalence of revenue stabilization mechanisms, including decoupling mechanisms, employed by the proxy companies.

Multi-year Rate Plan Impact on the Cost of Equity

Mr. Hevert claimed that it is important to consider the effect that potential increases in the level of interest rates during the term of a MYRP would have on the cost of equity. Electric utility companies are long duration investments whose valuations are sensitive to changes in the required rate of return. Consequently, the interest rate risk to which utility company equity holders are exposed relates to the long end of the yield curve, (i.e., the 30-year Treasury yield). He claimed it is reasonable to assume that on balance, long-term rates are more likely to increase than decrease during a MYRP, representing a significant element of risk for equity investors.

Aside from the effect of changes in long-term interest rates, equity valuations remain at risk to increases in broad market instability, movement of investments out of the utility sector on the part of institutional investors, unexpected credit contractions, and other factors that affect both fundamental equity valuations and investor trading patterns. If the Company is unable to recover increases in its market-required cost of equity as part of a MYRP during a period of rising interest rates and increasing price instability, investors necessarily will incorporate a larger risk premium as compensation for that forgone option. Mr. Hevert argued that a MYRP would support a premium to the current cost of equity.

Xcel ROE Recommendation

Mr. Hevet stated that a rate of return on common equity in the range of 10.00 percent to 10.70 percent represents the required rate of return for NSPM in today’s capital market environment. Within that range, he recommended an ROE of 10.25 percent.

Xcel Comments on Recommendations of Other Parties

In its Reply Brief, Xcel stated that:

1. It is not appropriate or necessary to use a 30 day period to estimate the cost of equity.

2. Weighting DCF results is subjective.

3. A 9.64 percent ROE would be below the mainstream.

4. No adjustment to the Department or Company’s recommendations is warranted.

Use of a 30 day Period to Estimate ROE

Xcel disagreed with the Department’s reliance on a 30 day period to estimate the cost of equity. Xcel stated that there is no need for the Commission to rely exclusively on data from a single 30-day period and argued that the current instability of utility stocks shows that no single 30-day period will be fairly representative of the cost of equity during the two-year term of the ROE in this case.

Xcel noted that other commissions, including FERC, traditionally look at price data from periods significantly longer than 30 days, and noted that in the recent Minnesota Energy Resource Corporation rate case deliberation on September 25, 2014, the Commission recognized that

unstable market conditions may justify looking at data from more than a single 30-day period to determine the ROE.

Xcel argued that there is no basis to conclude that stock prices from the June 7 to July 7, 2014 period will be fairly representative of utility stock prices or the dividend yields and cost of equity for the two year term of the ROE decision in this case. The volatility of stock prices is shown in the changes to dividend yields between the Company's Direct and Rebuttal DCF analyses and the Department's Direct and Surrebuttal DCF analyses. The Department's FECG and FCCG dividend yields fell by 54 and 26 basis points from Direct to Surrebuttal Testimony.

The dividend yields of the Company's Electric Proxy Group and Combination Proxy Group fell by 34 and 48 basis points from Direct to Rebuttal testimony. The question is whether the 30-day stock prices relied upon by the Department will prove to be representative of the two-year period in which the ROE in this case will remain in effect.

Xcel argued that if stock prices from a single 30-day period fully reflect the cost of equity, it reflects a period of unstable costs of equity, as shown by the price changes described by Mr. Hevert and the resulting changes in the dividend yield. That instability itself would support taking a more moderate approach to setting an authorized ROE that will remain in effect to the two-year term of the ROE decision in this case.

Weighting of Proxy Groups

Mr. Hevert stated that it would be reasonable to develop NSP's cost of equity in this proceeding without reference to combination companies because the case is concerned with electric rates, and NSP's concentration in electric service already is highly consistent with the average of Dr. Amit's FECG and Xcel's Revised Electric Proxy Group. Mr. Hevert stated that his proposed 80 percent/20 percent weighting of electric company/combination company results is conservative, as it understates the effect of electric operations relative to NSP's operations.

Xcel noted that from 2011 through 2013, NSP derived an average of 91.67 percent of its net income from electric utility operations and 8.30 percent from its natural gas utility operations. Dr. Amit's FECG includes companies which, on average, derived 90.00 percent of their net income from regulated electric utility operations. That group already incorporates companies that reflect proportions of regulated electric operations that are consistent with NSP.

The Department's FCCG includes companies that, on average, derived 78.39 percent of their operating net income from regulated electric utility operations, which is approximately 13 percentage points less than the Company's proportion of regulated electric utility operations. Assigning weights of 60 percent to Dr. Amit's FECG and 40 percent to his FCCG produces results that are weighted 85.35 percent by electric utility operations, which therefore under-weights the cost of equity for the electric utility operations relative to the proportion of NSP's electric utility operations. Because the DCF results are lower for combination companies than for electric companies, the 60.00 percent weighting of the FECG understates the cost of equity for NSPM's electric operations.

Xcel noted that there are significant differences between the DCF results for the electric comparable companies and for the combination comparable companies which suggests that their

investment risks may not be similar. The Company's updated DCF results for the Electric Proxy Group and the Combination Proxy Group vary by 16 to 55 basis points.

Mainstream ROE Awards

Adopting the Department's recommended ROE would put the Company's ROE into the bottom 20 percent of ROE awards for vertically integrated electric utilities (such as the Company) since August 2013 and would reflect ROEs more typical of gas distribution and electric distribution-only utilities. Investors compare awards between states and draw conclusions regarding the regulatory environment and the resulting business risks of those utilities.

The Company presented all of the ROE awards for integrated electric utilities occurring between January, 2012 and May, 2014. For the period beginning November 2013, the ROE awards for vertically integrated electric utilities averaged 9.93 percent. Only four of the 19 ROE awards in that period were as low as, or lower than, the Department's recommended 9.64 percent ROE. The ROE awards for 51 vertically integrated electric utilities since November 2012 had an average of 9.99 percent and a median of 10.00 percent.

Xcel stated that for the period of August 2013 through May 2014, the Company's currently authorized ROE is in the bottom 39th percentile. Moving downward to 9.64% would put the Company in the bottom 10 percent of ROEs since 2012, and within the bottom 20 percent of returns authorized since August 2013.

Xcel stated that it is clear that investors are attuned to the regulatory environment in which the Company operates and argued that the ROE award in this case will send a signal to investors. That signal will be negative if the Department's ROE recommendation is adopted.

Because it would be the second successive ROE decrease, and would represent a return near industry lows, the 16 basis point difference between 9.80 percent and 9.64 percent would have a disproportionately negative effect.

Adjustments to the Department or the Company's Recommendations

Xcel stated that none of the comments by AARP, the ICI Group, or Commercial Group would justify any adjustment to the ROE recommendations of the Department or the Company. Xcel stated that the AARP position, that acceptance of a decoupling mechanism should lead to a reduction in ROE, fails to recognize that:

1. ROE is determined by the comparative risk of the Company in relation to its comparable companies, not on the basis of the Company in isolation;

2. There is no basis to believe that decoupling leads to any noticeable reduction in relative risk; and

3. The Company's comparable companies also have comparable revenue mitigation mechanisms.

The ICI Group criticized the elimination of companies with DCF results under 8 percent from Xcel's and the Department's proxy groups. Xcel stated that the ICI Group's argument ignores the point that when the results of a model are obviously not reasonable, those results should not be included in an analysis of what reasonable investors will rely upon. The fact that investors hold stocks in companies with unreasonably low DCF results does not mean that investors would actually accept the return shown by the DCF model. It simply means that investors know that those DCF results are not representative.

Addressing the position of the Commercial Group, Xcel noted that the Commercial Group relied entirely on ROE decisions from other jurisdictions, a comparison of Mr. Hevert's recommendations in other jurisdictions to the decisions in those jurisdictions, and a discussion of long-standing Commission policies on ROEs. Xcel stated that none of this discussion was based on the testimony of its own witness.

XCEL Recommendation

Xcel Energy requested that the Commission approve the following capital structure and overall cost of capital for the Company:

2014 ROR

Capital Component	Percent of Capital Structure	Cost of Component	Weighted Cost
Long-Term Debt	45.60%	4.90%	2.23%
Short-Term Debt	1.90%	0.62%	0.01%
Common Equity	52.50%	10.25%	5.38%
Total	100.00%		7.62%

2015 ROR

Capital Component	Percent of Capital Structure	Cost of Component	Weighted Cost
Long-Term Debt	45.60%	4.94%	2.25%
Short-Term Debt	1.90%	1.12%	0.02%
Common Equity	52.50%	10.25%	5.38%
Total	100.00%		7.65%

Department ROE Analysis

Department discussion of these issues can be found on pages 10 through 45 of its Initial Brief, and pages 4 through 10 of its Reply Briefs.

Cost of Equity for Xcel

The Department noted that the cost of equity capital for Xcel is the rate that it must pay to investors to induce them to invest in its regulated operations. To estimate this cost, Department

witness Dr. Amit used a market oriented approach and relied on the concept of "opportunity costs." Dr. Amit relied primarily on the Discounted Cash Flow method of determining a reasonable cost of common equity for Xcel. Dr. Amit, in his Direct Testimony analysis, applied the Two Growth Rate DCF to five companies in its Final Electric Comparison Group because they either had high or low growth rates in comparison to the mean expected growth rate for a group of comparable companies. Dr. Amit used the CAPM to check the reasonableness of the results of his DCF and TGDCF analyses.

The Department initially recommended an ROE of 9.8 percent on Xcel's common equity. Relying on the most recently available dividend yields and expected growth rates for companies in his comparable group, Dr. Amit, in the Department's Surrebuttal Testimony, updated his ROE recommendation to 9.64 percent. Dr. Amit's updated ROE recommendation is sixteen basis points lower than his initial recommendation.

Comparable Group

NPS is not a publicly traded company so no DCF could be directly performed on NSP. However, since Xcel received a significant percent of its 2012 revenues and net income from its regulated electric operations, a DCF analysis directly applied to Xcel Energy could provide useful information regarding the cost of equity for NSP.

Because a DCF analysis on a single company may be more sensitive to the random nature of stock prices and an analyst's specific growth-rate predictions, Dr. Amit performed a DCF analysis for Xcel as part of his DCF analysis for his combination group.

To attract investors, Xcel must pay investors an equity return similar to the equity return they expect to earn on investments of comparable risk. As a result, the cost of common equity capital for companies with comparable risk provides a proxy for the cost of common equity capital for Xcel. To estimate the cost of equity for NSP, Dr. Amit used DCF and TGDCF analyses for groups of companies with investment risks similar to that of NSP.

The DOC selected companies for two comparable groups (the electric group, called the Final Electric Comparison Group (FECG), and the combination electric and gas group called the Final Combination Comparison Group (FCCG) that passed the following screens:

> Has an SIC code of 4911 (Electric Services) for the Electric Comparison Group, and 4931 (Electric and other Services) for the Combination Comparison Group.
>
> Publicly trades shares on a stock exchange.
>
> Is domestic, not a foreign company.
>
> Currently pays dividends.
>
> Mainly provides regulated retail electric services.
>
> Has bond ratings within the BBB- to A+ range (Xcel's rating is A-).

Had 2012 regulated revenues and regulated operating incomes that were at least 60 percent of total revenues or operating incomes.

Has both a beta and standard deviation that deviated by no more than one standard deviation from the group's mean (both are measures of investment risk).

Is not expected to merge into or be acquired by another company in the near future.

Has positive growth-rate projections from expert analysts.

DOC witness Amit eliminated companies whose DCF analyses resulted in ROEs that were too low to be reasonable. He used an ROE of less than 8 percent for this criterion.

The DOC checked the investment risk comparability of its FECG and FCCG groups to that of Xcel and NSP by evaluating readily available measures of investment risk. Based on the measures of beta and bond ratings, Xcel's investment risk is somewhat smaller than the investment risks of the two comparison groups. Based on the equity ratios, the long-term debt ratios and the bond rating for NSP, Dr. Amit concluded that NSP is somewhat less risky than the two comparison groups.

DCF Analysis

Expected Growth Rate

Under DCF methodology, the required rate of return is equal to the expected growth rate of dividends plus the expected dividend yield. For the first component, Dr. Amit testified that historical growth rates may be poor indicators of their future growth rates because most utilities' returns on equity and dividend payout ratios have not remained constant, and growth in book value has occurred due to retained earnings as well as issuance of new shares of common stock.

For the growth rate, Department witness Dr. Amit used the projected growth rates in earnings per share (EPS) provided by three investor services: Zacks Investment Research, The Value Line Investment Survey, and First Call Consensus long-term earnings growth rate estimate provided by Thomson Financial Network.

The Department argued that relying solely on the projected EPS growth rate is reasonable for several reasons including that long-run, sustainable dividend growth is solely driven by earnings' growth.

In Surrebuttal, the Department, based on the most recently available projected growth rates, updated the projected growth rates. They ranged from 4.98 percent to 7.33 percent with an average of 6.19 percent for the FECG, and 5.73 percent for the FCCG.

Updated Expected Growth Rates

Group	Low Expected Growth Rates	Mean Expected Growth Rates	High Expected Growth Rates
FECG	5.25%	6.19%	7.33%
FCCG	4.98%	5.73%	6.43%

The Department substituted the Two Growth DCF analysis for the constant growth DCF analysis for companies whose mean expected growth rates deviated from the group's mean expected growth rates by more than one standard deviation. Due to the change in the expected growth rates, the Two Growth DCF method was applied to two companies in its updated analysis: PNM Resources Inc. and Pinnacle West Capital Corp.

Expected Dividend Yield

The other component, the expected dividend yield, is calculated using the current price and the dividend in the next year. Regarding the price component, the Department argued that recent prices must be used since the current price per share incorporates all relevant publicly available information. Using historical prices in calculating the expected dividend yield would be inappropriate. Therefore, it is necessary to use a recent period since the current price per share incorporates all relevant publicly available information. The Department noted that historical prices in calculating the expected dividend yield would be inappropriate, and share prices are volatile in the short run. As a result, the period used for the estimate must be long enough to avoid short-term aberrations in the capital market, yet short enough to avoid including irrelevant historical information. To address these issues, the DOC used the most recently available four-week period of daily closing prices.

In Surrebuttal Testimony, the Department used the period from June 7, 2014 to July 7, 2014. The updated average dividend yields for FECG and FCCG are 3.60 percent and 3.84 percent. These dividend yields include an increase by one half of the expected growth rates.

DCF Recommendation

Based on the updated information, the Department's ROE analysis for the FECG ranges from a low of 8.80 percent to a high of 10.48 percent and a midpoint of 9.61 percent, excluding flotation costs. Including flotation costs the ROE ranges from a low of 8.90 percent to a high of 10.59 percent and a midpoint of 9.72 percent. The ROE for FCCG ranges from a low of 8.90 percent to a high of 10.09 percent with a midpoint of 9.52 percent. These ROEs include TGDCF analyses for NiSource, Inc. (NI) and Westar Energy (WR) and flotation costs.

Updated DCF/TGDCF results for FECG and FCCG

Group	Low	Mean	High
FECG	8.90%	9.72%	10.59%
FCCG	8.90%	9.52%	10.09%

Dr. Amit assigned a weight of 60 percent to the FECG results and 40 percent to the FCCG results. Based on these weights, he concluded a reasonable ROE for NSP ranges from a low of 8.90 percent to a high of 10.39 percent, with a midpoint of 9.64 percent.

CAPM Analysis

Dr. Amit used a CAPM as a check on the results of the DCF/TGDCF analyses. Dr. Amit stated that while the CAPM is theoretically sound, its use raises some difficult issues including

difficulties in determining the appropriate beta, the appropriate riskless asset, and the effect of taxes. For this reason, Dr. Amit used the CAPM results only as a check on the DCF analyses.

Dr. Amit used 20-year U.S. Treasury bonds for the risk free asset, the Value-Line betas for beta and the S&P 500 Index for the market portfolio.

In his Surrebuttal Testimony, Dr. Amit updated both his CAPM analyses to check the reasonableness of his updated DCF/TGDCF analyses. Using the CAPM formula, k = r + beta (km-r), the DOC's updated ex-ante CAPM estimates were:

FECG: 10.05% including flotation costs.

FCCG: 9.55% including flotation costs.

The Department's updated checks on the reasonableness of the updated DCF analyses resulted in ROE calculations that were inside the DCF's ranges for the FECG and FCCG. Dr. Amit concluded that when using expected risk premiums, the ex-ante CAPM is useful in confirming the reasonableness of his updated DCF estimates for the required rate of return on equity for NSP.

Flotation Costs

The Department agreed with XCEL that the DCF and TGDCF analyses must be adjusted to allow for the cost of issuing new shares of common stock without causing dilution. This adjustment is appropriate even if no new issuances are planned in the near future because failure to allow such an adjustment may deny Xcel the opportunity to earn its required rate of return in the future.

Dr. Amit agreed that Xcel's calculated flotation cost of 2.926 percent is reasonable and adjusted his DCF results accordingly. The Department stated that Xcel's flotation cost calculations appropriately account for the zero flotation costs of non-public common equity issuances.

Comments on the Company's Analyses

Xcel's DCF

Department claimed that Xcel's DCF analysis is flawed for two main reasons:

Xcel used longer-term historical prices to calculate the dividend yield. The Company performed DCF analyses using prices for a 30-day, 90-day and 180-day period to calculate the dividend yields.

Xcel's DCF analysis did not show that it is reasonable to assign at least an 80 percent weight to its electric comparison group and no more than a 20 percent weight to its combination comparison group.

Addressing the first point, the Department claimed that using a 30-day period to calculate the dividend yield is appropriate because it is consistent with the basic financial principle that financial markets are efficient such that the current stock prices fully reflect all publicly available

information. Xcel's use of longer-term historical prices may result in biased dividend yields that reflect irrelevant outdated information.

Dr. Amit showed that Xcel's 90-day and 180-day average dividend yields are 16 basis points and 30 basis points lower than its 30-day average dividend yield. The Department stated that using 90-day and 180-day average dividend yields may create a mismatch between dividend yields and more recent projected growth rates.

Using Xcel's 30-day dividend yield analysis, Dr. Amit calculated the required ROE for NSP, using Xcel's comparison groups. The DCF ROE for Xcel's comparison groups, HECG and HCCG, including flotation costs, were:

Group	Low	Mean	High
HECG	9.44%	10.18%	10.90%
HCCG	9.06%	9.63%	10.21%

Addressing the second issue, the Department argued that the required rate of return for a company is closely related to the financial and business risk of the company. Thus, as long as the investment risks for Mr. Hevert's HECG and HCCG groups are similar and the companies in both his comparison groups operate under similar economic and regulatory environments, there should not be a significant difference between the weights assigned to the estimated ROEs for the two groups.

Value Line lists all of the companies in Mr. Hevert's HECG and HCCG groups as electric utilities. The difference in the percentage of net income derived from electric operations may not be a significant indicator of risk and therefore, may have an insignificant impact on the required rate of return on equity.

Xcel's CAPM

The Department identified three main flaws of the Company's CAPM analysis:

1. It used the 30-year U.S. Treasury bonds as the risk-free asset. The yield on such an asset includes interest risk premium.

2. It used the wrong yield to calculate the risk premium. It used the projected yield on 30-year bonds rather than the current yield.

3. Mr. Hevert incorrectly estimated the ROEs for his market portfolio because he applied his DCF analyses to individual companies that issue no dividends.

Correcting for these flaws results in the following CAPM ROE estimates:

Group	Low ROE	Mean ROE	High ROE
HECG	9.07%	9.65%	0.22%
HCCG	9.22%	9.72%	10.21%
60/40 Percent Weights	9.13%	9.68%	10.22%

The Department stated that using the current yield on twenty-year Treasury bonds, and adjusting Mr. Hevert's market portfolio DCF analyses to account for companies with no dividends, Mr. Hevert's corrected CAPM's ROE estimates are close to Dr. Amit's CAPM's ROE estimates:

	Electric Group	Combination Group
Dr. Amit	9.73%	9.66%
Mr. Hevert	9.65%	9.72%

Xcel's Risk Premium Analysis

Xcel witness Mr. Hevert estimated the risk premium between the allowed returns on equity for regulated electric utilities and the yields on thirty-year U.S. Treasury bonds. Using an econometric model he estimated the risk premium as a function of the yields on long-term U.S. Treasury bonds. He used the following equation:

Risk Premium = Constant (c) + a * NL (Treasury yield)

Where the risk premium = allowed rate of return for electric utilities minus the yield on thirty-year U.S. Treasury bonds, and NL = natural logarithm.

Dr. Amit concluded that Mr. Hevert's Bond Yield Plus Risk Premium analysis was not reasonable. Dr. Amit explained that Mr. Hevert's regression analysis assumes that both coefficients, c = -0.0308 and a = -0.0294, are stable over time and do not depend on investors adjusting their expectations depending on different Federal monetary and fiscal policies. To the degree that investors adjust their behavior to adapt to changing Federal policies, both of the coefficients are not stable and cannot be used to estimate the expected risk premium.

The Department noted that the recent economic environment has two significant impacts on the risk premium. First, while the risk premium as measured by historical data declined, the expected risk premium may have actually increased due to the increased risks of investing in common equity relative to investment in U.S. Treasury bonds. Second, due to the increased risk of investing in common equity, investors substituted investment in common equity for investment in fixed income securities, such as Treasury bonds. As a result, current yields on risk-free assets are lower than they would have been, absent the economic crisis.

Recent yields on U.S. Treasury bonds have started to rise due to the increased uncertainty regarding continuation of the Federal Reserve's "Quantitative Easing" policies. On December 18, 2013, the Federal Open Market Committee announced that starting in January 2014, the

Federal Reserve will reduce its open market purchases of long-term treasuries and mortgage-backed securities by $10 million. The factors previously mentioned may have caused the estimated values of "c" and "a" to change, counter to Mr. Hevert's regression analysis that assumes the coefficients "c" and "a" are stable over time. The Department stated that for this reason, Mr. Hevert's regression-based risk premium analysis may be inappropriate.

Response to ICI Group

In his Direct Testimony, ICI Group witness William L. Glahn recommended that the Commission grant NSP an ROE of 9.00 percent. The Department indicated that Mr. Glahn's recommended ROE was not reasonable, for two overall reasons:

1. Mr. Glahn's selection of companies for the Glahn Comparison Group was not reasonable.

2. Mr. Glahn's DCF analyses were incorrectly performed.

Mr. Glahn stated that he eliminated the companies listed in Value Line that were listed under the Electric Utility Industry and had negative projected earnings per share and/or dividend per share growth rates. The Department stated that Mr. Glahn eliminated from his comparison group several companies with positive projected earnings per share and dividend per share growth rates. At the evidentiary hearing, Mr. Glahn could not reconcile this discrepancy. Therefore, Dr. Amit concluded that the Glahn Comparison group is arbitrary and should be rejected.

Mr. Glahn performed four different DCF analyses: dividend growth rates, earning growth rates, sustainable 2014 growth rates and sustainable growth rates. For these analyses Mr. Glahn used incorrect expected growth rates and incorrect expected dividend yields. Therefore, Mr. Glahn's DCF analyses are without merit and should be rejected.

Mr. Glahn argued that because Xcel does not plan to issue common stock in 2014, the DCF should not include flotation cost adjustment. This claim is not reasonable. The Department argued that Dr. Amit demonstrated that flotation costs adjustments are required even if no new common equity issuances are planned for the test-year.

The Department argued that for these reasons, Mr. Glahn's proposed ROE is unreasonable and must be disregarded.

Response to Commercial Group

Commercial Group witness Mr. Chriss testified that the Commission should consider the authorized ROEs in other states to help determine the appropriate ROE for NSP. Mr. Chriss also testified that inclusion of construction work in progress (CWIP) in the rate base reduces NSP's risk, and therefore, such an inclusion should result in a lower ROE for NSP.

The Department argued that the use of recently authorized ROEs in other states to determine Xcel's ROE in this rate case is flawed for the following reasons:

> First, to avoid circularity, it is necessary to include non-regulated companies in any analysis comparing ROEs, since the allowed rates of return for regulated companies are highly influenced by the regulatory process.
>
> Second, the state decisions cited by Mr. Chriss are based on outdated data, with decisions issued over the period 2012, February 2013 and the first part of 2014. These decisions are based on analyses completed at least six months, if not nine months, prior to the decision's issuance. As a result, the ROE's cited by Mr. Chriss are outdated.

Regarding the issue of CWIP, the Department stated that investors are aware of its regulatory treatment. NSP's treatment of CWIP in this rate case is consistent with its treatment of CWIP in its prior Minnesota rate cases. To the degree that the treatment of CWIP impacts NSP's investment risk, such an impact is fully reflected in investors' required return on equity for NSP, and no additional adjustment is required.

Effect of Decoupling on Xcel's ROE

The Department argued that it would be unreasonable to adjust NSP's ROE downward if the Commission approves decoupling. Xcel witness Mr. Hevert and CEI witness Mr. Cavanagh both concluded that it would not be reasonable to adjust NSP's ROE downward to recognize the impact of decoupling.

The majority of the companies in Xcel's comparison groups have either decoupling provisions or other revenue stabilizing policies. As a result, Mr. Hevert concluded that his comparison groups appropriately capture any lower risk associated with decoupling provisions requested by NSP. Mr. Cavanagh relied on a study by the Brattle Group that concluded that decoupling may not lower utilities' cost of capital.

In Rebuttal Testimony Mr. Hevert compared the estimated beta of Pepco Holding Company, which has over 65 percent of its revenue subject to decoupling mechanisms, with the companies in his two comparison groups and found it to be around one. This indicates that Pepco's investment risk is similar to the investment risk of Mr. Hevert's comparison group. It is reasonable to conclude that Mr. Hevert's comparison groups capture any decoupling impact on risk.

Dr. Amit explained that the March 20, 2014 study by the Brattle Group showed that there is no significant difference in the cost of capital between electric utilities with and without decoupling.

The Department stated that based on the Brattle Group study and Mr. Hevert's estimated beta for Pepco Holdings, shown on pages 50-51 of Mr. Hevert's Rebuttal Testimony, Dr. Amit concluded that AARP witness Ms. Brockway's proposal to adjust NSP's ROE downward if the Commission approves a decoupling mechanism for NSP is not reasonable.

ICI Group

Pages 12 through 15 of its Initial Brief and pages 2 through 6 of its Reply Brief.

DCF Analysis

ICI Group witness Mr. Glahn stated that the Commission should rely more on DCF analyses and less on CAPM and other risk premium analyses to determine the cost of common equity for electric utilities in Minnesota. He argued that employing a DCF model using current stock price, dividend, and dividend growth rate information produces a cost of common equity estimate that satisfies the rate of return criteria for regulated businesses as set forth in the U.S. Supreme Court's Hope and Bluefield cases.

For his DCF analysis, Mr. Glahn used a form of the DCF model which adjusts the current annual dividend rate for one half year's growth, to estimate the dividend expected during the next twelve months.

Mr. Glahn estimated the current stock price by taking an average of the month-end stock prices over the three-month period March through May 2014. He calculated the average dividend yield for the 27 electric utility companies in his sample to be 3.6 percent. To estimate the expected dividend growth rate he used four approaches:

Value Line's forecasted dividends.

Value Line's forecasted earnings.

A fundamental analysis of sustainable dividend growth using estimated 2014 returns and retention ratios from Value Line (2014 ratios).

An analysis of sustainable dividend growth using Value Line projections for future returns and retention ratios (projected ratios).

The estimated annual per share dividends and earnings used in Mr. Glahn's analyses are from the March 21, May 2, and May 23, 2014, issues of the Value Line Investment Survey. To calculate the estimated dividend growth rates he took the simple average of the compound annual growth rates of annual per share dividends estimated by Value Line between the periods 2014 and 2017-19. The average dividend growth rate estimate for a sample of 27 companies was 4.8 percent. The average earnings growth rate estimate was 5.4 percent.

The 2014 and projected earnings and retention ratios produced sustainable dividend growth rate estimates of 4.1 and 4.3 percent.

The cost of common equity produced by these four methods of estimating dividend growth rates ranges from 7.7 percent to 9.0 percent.

Projection Method	Dividend Yield	Projected Growth	Return on Equity
Dividend Growth	3.6%	5.4%	9.0%
Earnings Growth	3.6%	4.8%	8.4%
Sustainable Growth (2014)	3.6%	4.1%	7.7%
Sustainable Growth (Future)	3.6%	4.3%	7.9%

Mr Glahn concluded that a 9 percent return on common equity would be an appropriate level of return for Xcel. The cost of 9 percent is at the high end of the range produced by the four growth estimates.

Mr. Glahn noted that:

> Value Line reported on February 21, 2014, an electric rate case decision by the Maryland commission for Baltimore Gas and Electric that resulted in a 9.75 percent return on equity.
>
> On March 21, 2014, Value Line reported that the Arkansas commission granted a rate increase to Entergy based on a return on equity of 9.3 percent.
>
> On May 23, 2014 Value Line reported that the New York commission approved a rate settlement involving Con Ed's electric utility based on a return on equity of 9.2 percent.

Mr. Glahn stated that all of these developments have occurred since Xcel originally filed its petition in this case.

Mr. Glahn stated that there should not be a flotation cost adjustment because Xcel Energy will not be selling common shares to finance its electric utility operations or investments during the period in which rates are expected to be in effect. Therefore, neither Northern States Power Minnesota, nor its corporate parent Xcel Energy, will be incurring flotation costs.

In response to Xcel witness Mr. Hevert's and Department witness Dr. Amit's criticisms of Mr. Glahn's DCF models, the ICI Group stated that Mr. Glahn's direct testimony adequately explains the approach he took in conducting these analyses. The Commission should disregard these arguments because they are unfounded, and the criticisms by Mr. Hevert and Dr. Amit are not credible or reliable.

The ICI Group stated that the criticisms that Dr. Amit has of Mr. Glahn's analyses can be described as academic disagreements on how to run DCF models. Mr. Glahn has valid criticisms of Dr. Amit's analysis. Most notably, both Dr. Amit and Mr. Hevert arbitrarily choose to ignore companies that have an ROE lower than eight percent. Such disagreements do not warrant the wholesale dismissal of Mr. Glahn's testimony or analyses.

Mr. Hevert based his criticism of Mr. Glahn on the assumption that Mr. Glahn only used a "single" DCF model. In reality, Mr. Glahn used four DCF models.

ICI Group witness William Glahn testified that his DCF analysis indicates reasonable rate of return for Xcel would be 9.0 percent. The ICI Group recommended that the Commission adopt a rate of return of 9 percent. This will allow Xcel to earn a competitive return without requiring its rate payers to needlessly pay higher rates, i.e. rates that would not be "just and reasonable."

Comparable Group

ICI Group witness Mr. Glahn developed a group of comparable companies to estimate a cost of equity capital for Xcel. He explained that to calculate an appropriate cost of capital for Xcel's Minnesota electric utility operations, it is necessary to select a group of companies whose

businesses are closely matched in scope and kind and would share similar risks to the company at issue. His comparable group was taken from the group of companies identified by the Value Line Investment Survey as the Electric Utility Industry segment. This segment was used because it includes the closest companies to the Minnesota retail electric utility business of Xcel Energy. Mr. Glahn did not include Xcel because its inclusion would introduce an element of circularity into the calculations.

Companies that Value Line did not expect to have earnings and/or dividend growth during the period studied were removed from Mr. Glahn's comparable group. This screen eliminated Ameren, Entergy, First Energy, Integrys, Otter Tail, PG&E, PPL, TECO Energy, and UIL Holdings. Any utility not paying dividends consistently for the past three calendar years was also eliminated from consideration, resulting in Empire District being dropped from the list. ITC Holdings was not included in the group because its principal business involves the transmission of electric power, rather than sale of electricity to retail customers. Mr. Glahn also eliminated Exelon and Pepco because they are currently involved in a merger.

Both Xcel and the Department contend that many of these companies should not have been excluded because they are projected to have earnings and/or dividend growth. The ICI Group argued that this ignores reality in the sense that many of these companies have experienced negative earnings or dividends growth in the recent past.

Mr. Glahn was cross-examined by the Department regarding the selection of companies in his comparison group. He was questioned regarding a Value Line Investment Survey reporting on Ameren Company, Avista Corp., Edison International, Hawaiian Electric, IDACorp., Integrys Energy, Otter Tail Corp., PG&E Corp, and TECO Energy, which are companies eliminated from Mr. Glahn's comparison group. Mr. Glahn was asked to read numbers from the Value Line reports that show Value Line projects positive earnings or positive dividend growth rates from 2011 through 2013 for these companies. Mr. Glahn noted that all other numbers on the Value Line reports indicate negative actual or expected earnings and dividends growth rates for periods in the past ten years.

The ICI Group argued that the Department's cross-examination showed that the financial evidence indicated that these companies have experienced negative growth trends for earnings and dividends in the recent past. The Department asked Mr. Glahn to read only the positive numbers on the reports. The ICI Group argued that Xcel pointed out that the times periods from which some of these numbers were taken were aberrant.

The ICI Group argued that Xcel and the Department summarily dismissed Mr. Glahn's comparison group, when the record indicates that Mr. Glahn's recommendations are based on the selection of a reasonable comparison group. The arguments of Xcel and the Department should be ignored and the Commission should consider Mr. Glahn's analyses based on his comparison group.

Comments on Xcel's and Department's Analyses

The ICI Group argued that neither Xcel's nor the Department's ROE recommendations rest on proper analysis and should be disregarded.

The ICI Group stated that Mr. Hevert retreated from his initial recommendation of 10.25 percent at the evidentiary hearing. His opening statement repeatedly stated that a return of less than the current level of 9.83 percent should not be allowed. Mr. Hevert seemingly realized that his initial recommendation was inflated and based on improper analysis. Mr. Hevert testified regarding the fact that he consistently testifies in rate case proceedings, and consistently gives rate of return recommendations that are at least 25 basis points higher than what various commissions have awarded.

The ICI Group argued that Dr. Amit's analysis is faulty because Dr. Amit does not consider comparable companies with a rate of return lower than 8 percent. These comparable companies all have shareholders. Dr. Amit testified on cross-examination that the shareholders of these companies do not act irrationally by holding stock in a utility with a rate of return lower than 8 percent. Thus, setting such a minimum threshold for comparable companies for a DCF analysis is arbitrary and distorts the analysis.

The ICI Group noted that Xcel gave several reasons why it is seeking a higher ROE. In response the ICI Group argued:

> A large amount of planned capital investment does not mean that Xcel deserves a higher ROE.
>
> Xcel chose to pursue a multiyear rate case, and Xcel should bear the interest-rate risk associated with such a decision. The Commission should err on placing such risks on Xcel in a multiyear case, to avoid their receiving a substantial windfall should the market move in the other direction.

The ICI Group stated that the arguments made by Xcel and the Department in their initial briefs are merely recitations, meritless, and should be disregarded. Mr. Glahn relied on reasonable assumptions and used reliable DCF models; his analyses should be strongly considered by the Commission in setting just and reasonable rates.

Commercial Group

Pages 2 through 9 of its Initial Brief.

Introduction

The Commercial group argued that significant evidence has been presented of objective yardsticks that the Commission can use to measure how reasonable are these ROE analyses and recommendations. These yardsticks indicate that a reasonable range for NSP's ROE is from 9.21 to 9.91 percent with a mid-point of 9.57 percent.

The Commercial group stated that according to Exhibit 228, during the one-year period preceding Mr. Hevert's testimony in this rate case, Mr. Hevert's ROE recommendations (comprising 16 electric ROE cases) have on average been 100 basis points above the ROE mark the respective utility commissions ultimately authorized. According to Exhibit 85, in Docket No. 12-961, over the 17 cases preceding his testimony in that docket, Mr. Hevert's ROE recommendations on average were 106 basis points above the ROEs authorized by the state

commissions. The Commercial Group argued that given that Mr. Hevert provides testimony in up to half of the major electric utility rate cases nationwide, which should lead investors to expect an outcome in this rate case that is generally in line with the results in those cases. Based on those past results, investors would expect a result in this case generally in the range of the recommendations of Mr. Amit and Mr. Glahn.

Overview of Available ROE Yardsticks

The Commercial Group discussed investor expectation and the importance of the regulatory environment. It noted that its witness, Mr. Chriss testified that comparisons to returns other utilities have been receiving provide an unbiased reference point for the Commission to use to evaluate the other ROE evidence. There are two main ways that investor expectations can be measured in this regulatory context:

1. Applying the yardstick of actual (authorized) returns over a significant recent period to evaluate the ROE recommendations in a given rate case. And

2. Where one ROE witness has provided ROE testimony in a significant percentage of reported cases, comparing the recommendations of that witness to actual ROEs authorized in those same cases (and over a significant period of time). Both of these yardstick comparisons show that NSP's proposed ROE is unreasonably high and that the reasonable range of ROEs in this case is from 9.21 percent to 9.91 percent, with a midpoint of 9.57 percent.

Average Authorized ROEs for Electric Utilities

The average ROE authorized for electric utilities by the various utility commissions in 2012, 2013 and the first five months of 2014 is 9.91 percent. The trend has been downward. With respect to vertically integrated utilities like NSP, the average of awarded ROEs has dropped from 10.10 percent in 2012, to 9.95 percent in 2013, to 9.84 percent through the first five months of 2014.

Interest rates have dropped steadily in the one-year period since Mr. Hevert performed his analysis for this case, and even since May 2014. (The 30-year treasury yield dropped nearly 20 percent from September 2013 to August 2014.) At the time of the evidentiary hearing, these interest rates stood at their lowest levels in that 12-month period. Thus, the 9.84 percent figure for 2014 ROEs is a significant yardstick data point and given the steady drop in interest rates this past year, that figure may need to be adjusted downward.

Decisions Involving Mr. Hevert's Recommendations for Electric Utilities

The record in this proceeding contains evidence concerning ROE awards approved by state commissions through May 2014, a significant portion of which involved recommendations by Mr. Hevert. The Commercial Group provided a table covering the 42-month period from December 2011 through May 2014, showing that Mr. Hevert testified on ROE in 34 proceedings in which the utility commissions have issued final orders authorizing ROEs for the respective electric utility. Every one of the decisions authorized an ROE that was below the bottom of Mr.

Hevert's range. The Commercial Group stated that no state commission has authorized an ROE that has come even close to the low end of Mr. Hevert's range.

The table shows that these respective utility commissions authorized ROEs that on average were 104.0 basis points below Mr. Hevert's recommended ROEs. A similar decision in this NSP case would put NSP's ROE at 9.21 percent. The Commercial Group noted that the closest Mr. Hevert's recommended ROE got to any authorized ROE was 55 basis points above the authorized ROE. With respect to the range of Mr. Hevert's recommended ROEs, the authorized ROE in the 33 electric cases was an average of 68.7 basis points below the low point of Mr. Hevert's recommended ROE range. A similar decision in this NSP case would put NSP's ROE at 9.31 percent (10.00 less 0.69).

The Commercial Group argued that investor expectations are a fundamental aspect of setting utility rates of return. Investors are sophisticated and well-informed concerning the procedure and outcomes of rate cases. Exhibit 114 is an example of the type of detailed information that investors receive from Xcel, and includes information concerning the ROEs recommended by parties in this rate case.

The Commercial Group noted that in 2012, 2013 and where decisions have been made through May 2014, Mr. Hevert testified in 33 cases, roughly one-third of the 98 decisions RRA reported during that period. During the 12-month period from June 2013 through May 2014, Mr. Hevert provided ROE testimony in nearly half of the reported electric utility rate cases.

The Commercial Group noted that Mr. Hevert employs a relatively consistent method of analysis in order to provide state utility commissions with a dependable methodology to which he then applies his expert judgment to make his recommendations in individual cases. The important point is that however he adjusts his analysis in a given case and whether the cases are for electric-only or vertically-integrated or distribution-only utilities in "supportive" "more supportive" or "less supportive" jurisdictions, the actual results are remarkably consistent - with each and every utility commission authorizing an ROE that is significantly below Mr. Hevert's recommended ROE and the low point of his ROE range. Sophisticated investors understand this rate case process and expect an outcome in this NSP rate case that is generally consistent with these past results.

The Commercial Group noted that in his opening statement, Mr. Hevert stated that decisions in other regulatory jurisdictions provide an observable and relevant benchmark for investors to assess their return expectations. The Commercial Group noted that sophisticated investors understand that utility witnesses routinely warn that if their ROE recommendations are not accepted, the utility's credit ratings will be significantly harmed, yet the consistent actual recommended results speak for themselves.

The Commercial Group provided a table that summarizes the yardsticks the Commission could use as reference points of investor expectations.

Average authorized returns for vertically integrated electric utilities from 2012 – May 2014	9.91
Average of authorized returns for vertically integrated electric utilities	

from 2014	9.84
Applying average of authorized ROEs compared to Hevert recommendations from December 2011 – May 2014	9.21
Applying average of authorized ROEs compared to low point of Hevert range from December 2011 – May 2014	9.31
Average of yardstick range of 9.21 to 9.91	9.57

The Commercial Group argued that investors reasonably expect NSP to be awarded an ROE of between 9.21 to 9.91 percent, with a mid-point of 9.57 percent. Given that no state commission has authorized an ROE in the past 3.5 years that has come closer than 25 basis points of the low end of Mr. Hevert's range, no investor could reasonably expect an ROE in this case that is higher than 9.75 percent.

Impact on ROE of Multiple Risk-mitigation Measures

Once the Commission determines the reasonable range of ROE for NSP, any move within that range should be downward, to reflect the specific risk-mitigation measures that NSP has in place (or proposes) and the financial stress ratepayers are facing. Those risk mitigation measures include:

1. The use of a future test year.

2. The ability of the Company to implement an interim rate increase prior to the full examination of the rate filing.

3. The inclusion of large amounts of CWIP in rate base, in this case NSP proposed that CWIP constitute 8.6 percent of its entire rate base.

4. The multi-year nature of this current rate case, which would allow NSP to increase rates for costs it incurs beyond the 2014 test year. And

5. The proposed revenue decoupling mechanism that would allow NSP to collect an additional $62 million above rates approved in this proceeding .

Mr. Hevert's "additional factors" analysis shifts his recommended ROE in any given case toward the higher or lower ends of his range based not on one isolated factor but a combination of additional factors. In this case, Mr. Hevert concluded that his recommended ROE (of 10.25 percent) should fall near the lower third of his ROE range (of 10.00 percent to 10.70 percent) for NSP. This indicates that NSP has a lower risk profile when considering all the additional risk factors under consideration, an observation consistent with the testimony of Mr. Chriss concerning the impact of the large number of NSP risk-mitigation measures. Therefore, NSP's ROE should be adjusted downward toward the low end of any reasonable ROE range determined by the Commission.

Conclusion on ROE

The Commercial Group believes the record evidence in this proceeding demonstrates that the 9.64 percent ROE recommendation of Mr. Amit is generally consistent with investor expectations, and may in fact be overly generous toward NSP.

AARP

Pages 14 through 16 of its Initial Brief and page 7 of its Reply Brief.

AARP witness Ms. Brockway argued that decoupling mechanisms, such as that proposed by the Company shift risks from shareholders to ratepayers. She stated that Xcel's ROE recommendation fails to account for any such effect. Ms. Brockway recommended that there be a downward adjustment to the Company's ROE if the Commission approves the proposed decoupling mechanism.

The AARP disputed Xcel's claim that a downward adjustment is unnecessary because there are several utility companies in the proxy groups that already have some form of decoupling. The AARP argued that Mr. Hevert's proxy groups are not representative of utilities with the type of revenue decoupling mechanism sought by Xcel in this rate case. Of the 28 companies in Xcel's proxy groups, only half have some form of decoupling mechanism in place. Mr. Hevert made no effort to demonstrate or quantify that the decoupling proposals of his proxy group utilities have the kind of "breadth and scope" such that equity investors will not take the presence of a Revenue Decoupling Mechanism (RDM) for Xcel into account.

AARP argued that it is an unavoidable fact that decoupling would shift sales risk onto consumers and stabilize the company's revenues going forward. Xcel would be a less risky utility if its RDM is adopted; it is otherwise hard to explain why the utility would even care enough to make such a proposal. Xcel's witness Mr. Hevert admitted that Xcel's proposed RDM tariff is designed as a "revenue stability mechanism".

Mr. Hevert also acknowledged that reducing the utility's revenue volatility is viewed positively from an investor's perspective. Revenue risk is a business risk. It should be self-evident to the Commission that reducing the utility's revenue volatility would necessarily increase rate volatility for consumers, and that revenue risk would clearly be transferred from one side of the ratemaking equation to the other via decoupling. The final order issued by the Commission in this rate case should recognize this reality by only adopting the RDM if the utility's allowed return on equity is adjusted downward to match its altered risk profile.

The AARP noted that Mr. Cavanagh argued that decoupling should not be presumed to reduce utility risk, claiming that decoupling reduces both an upside and a downside risk. To support this opinion, he quotes from a Brattle Group study that claims no presumption can be made that decoupling automatically lowers return on equity. The AARP argued that the study was premised upon the idea that only non-diversifiable risks should be evaluated when estimating the return on equity; however, this is not the only theory in finance. The authors (Mr. Cavanagh included), further assert that adoption of decoupling policies could be coincident with other influences that may be increasing non-diversifiable risk.

AARP argued that this assertion acts as an intellectual hedge against associating lower returns with decoupling. Lower returns could be driven by these other influences. The Brattle study method does not control for any such eventualities. Nor does the Brattle Group study consider the role of incentives or rate design in contributing to rate of return results. The AARP stated that a number of public utility commissions have ordered that the allowed return on equities for utilities in their states be reduced upon the implementation of a decoupling mechanism, or they have approved settlements in which such a reduction was made. The range of these reductions has been from 10 basis points to 50 basis points. At least four of the settlement orders incorporated a 10 basis point reduction.

Clean Energy Intervenors

Page 30 of its Initial Brief and pages 19 and 20 of its Reply Brief.

The Clean Energy Intervenors recommend no prospective adjustment in the utility's authorized return on equity. It stated that such an adjustment removes both an upside and a downside from utility recovery of non-fuel revenue requirements, with effects on cost of capital that cannot be presumed. The CEI argued that the AARP offers no substantive evidence that such an adjustment is necessary, other than the blanket statement that "Xcel would be a less risky utility if its RDM is adopted." But it does not follow that Xcel's business risk will be reduced in the event decoupling is approved, and thus cannot be a basis for such a reduction.

It stated that the AARP's focus on a elements of the Brattle Group's study methodology serves only to obscure the Brattle Group's fundamental finding – that revenue decoupling has had no statistically significant effect on electric utilities' cost of capital, based on a comprehensive empirical review.

ADMINISTRATIVE LAW JUDGE

The ALJ addressed cost of capital issues on pages 51through 96, in findings 235 through 426, of her Report. Findings 235 through 390 address cost of equity issues. In finding 373 and through finding 390 the ALJ provides analysis of the record, ROE conclusions, and recommendations. Findings 391 through 426 address capital structure and the overall cost of capital.

Cost of Equity Conclusion and Recommendation

In finding 373 the ALJ recommended that the Commission approve a Return on Equity of 9.77 percent.

In finding 375 the ALJ stated that both the Company and the Department followed generally accepted practices in developing their proxy groups and conducting their DCF analyses, including using a combination of the constant growth DCF model and the Two Growth DCF model. In addition, each conducted a CAPM analysis as a check on their DCF analysis. The Company also conducted a Bond Yield Plus Risk Premium analysis.

In finding 376 the ALJ addressed the ICI Group's DCF analysis. She stated:

> The ICI Group's DCF approach, on the other hand, suffers from a number of serious defects. First, the proxy group used by the ICI Group is not sufficiently comparable to the Company to be reliable. For example, the ICI Group's proxy group includes companies involved in mergers or other significant transactions, and includes companies with substantial unregulated operations. Second, even if the proxy group were sufficiently comparable, the ICI Group's DCF analyses are not analytically sound because the ICI Group relied on a single source of data, Value Line, for its growth rates. The ICI Group's reliance on Value Line alone is problematic because it "exposes the analysis to a degree of estimation error that can easily be mitigated by including other sources (such as Zacks and First Call)." It is for that reason that both the Department and the Company relied on three sources: Value Line, Zacks, and First Call. Moreover, the ICI Group used a sustainable growth analysis to estimate the growth rate in two of its four DCF analyses. This approach has not been accepted by the Commission, is biased downward, and is based on questionable assumptions. For these reasons, the Administrative Law Judge concludes that the ICI Group's DCF results are not reliable and should be given no weight in the determination of a reasonable ROE.

In finding 377 the ALJ supported the analyses of Xcel and the Company stating:

> The DCF analyses of the Company and the Department, on the other hand, are generally analytically sound and their results warrant serious consideration in the determination of a reasonable ROE. As in the last rate case, there are two main differences in approach between the Company and the Department that affect the resulting recommended ROEs: (1) the weighting of the proxy group results; and (2) the time periods to be used for average stock prices.

In finding 378 the ALJ addressed weighting of the proxy groups stating:

> With regard to the weighting of the proxy group results, the Administrative Law Judge concludes that the Department's proposal to assign 60 percent weight to the electric comparison group results and 40 percent weight to the combination comparison group results is more reasonable than the 80/20 weighting proposed by the Company. First, both the electric and combination proxy groups were developed based on screening criteria that ensure the groups have similar investment risks to that of the Company. Second, an analysis of the Department's two proxy groups, based on direct market-oriented risk measures, confirms that the proxy groups have similar investment risks to the Company. Therefore, it is appropriate to assign a 60/40 weighting. Third, while the purpose of this proceeding is to set the Company's electric rates, it is important to recognize that the Company is a subsidiary of Xcel Energy Inc., which includes combined electric and gas operations. The 60/40 weighting is a more appropriate reflection of these facts. Finally, the 60/40 weighting is consistent with the Commission's decision in the last rate case, wherein both the Administrative Law Judge and Commission concluded that a 60/40 weighting was more reasonable than an 80/20 weighting.

In finding 379 the ALJ stated:

> With regard to the time periods, the Company based its analysis on average prices over 30-, 90-, and 180-day periods. In contrast, the Department based its analysis on a 30-day period only. In addition, the Company calculated the dividend yields for its updated 30-day period analysis using the average prices over the period of May 1, 2014 to May 30, 2014, while the Department's updated dividend yields are based on the average prices over the more recent period of June 7, 2014 to July 7, 2014.

In finding 380 the ALJ stated:

> Normally, more recent information will better reflect current market expectations regarding the expected ROE for the Company. Use of a single, shorter time period for averaging, however, can lead to anomalous results. The averaging period should be reasonably representative of expected capital market conditions over the long term.

In finding 382 the ALJ stated:

> In this case, however, the Administrative Law Judge concludes that the record shows that the 30-day period used in the Department's Surrebuttal Testimony may not be representative of the time period in which the ROE will remain in effect. More specifically, the record shows that the dividend yields used in the Department's Surrebuttal Testimony were significantly lower than the dividend yields used in its Direct Testimony, falling by 54 and 26 basis points, respectively, from the Department's initial analysis. These decreased dividend yields were the result of unusually high stock prices during the June-July 2014 time period used in the Department's Surrebuttal Testimony. Since that time, utility stock prices have declined relative to the overall stock market and moved more in line with historic expectations. As a result, the Department's updated 30-day dividend yields included in its Surrebuttal Testimony may reflect a short-term anomaly.

In finding 383 the ALJ stated:

> Because the Company has proposed a MYRP and to minimize the potential effect of any market idiosyncrasies that may have contributed to the variability in the dividend yields, the Administrative Law Judge concludes that the authorized ROE should be based on data from more than just the one 30-day period used in the Department's Surrebuttal Testimony. Similar to the approach taken by the Commission in the recent MERC rate case, the Administrative Law Judge recommends that the Commission consider the DCF results from the three most recent 30-day time periods. More specifically, the Administrative Law Judge recommends that the Commission consider the DCF results from: the 30-day period included in the Department's Direct Testimony (covering October 1-31, 2013); the 30-day period included in the Company's Rebuttal Testimony (covering May 1-30, 2014); and the 30-day period included in the Department's Surrebuttal Testimony (covering June 7-July 7, 2014).

In finding 384 the ALJ stated:

Using the 30-day DCF results from the three analyses (Department Direct, Company rebuttal, and Department Surrebuttal) and applying a weighting of 60/40 provides an estimated ROE of 9.77 percent. The calculation is set forth below:

Department Direct	9.80%
Company Rebuttal	9.86%
Department Surrebuttal	9.64%
Total	29.30%
Divided by 3	
Average	9.77%

In finding 385 the ALJ stated:

The reasonableness of a 9.77 percent ROE for the Company is confirmed by other evidence in the record. First, a 9.77 percent ROE is similar to the 9.85 ROE calculated by the weighted CAPM results provided in the Department's Surrebuttal Testimony. In addition, the Company's need to access capital for its substantial capital investment plans strongly suggest that a 9.77 percent ROE is more reasonable than the 9.64 ROE recommended by the Department in Surrebuttal Testimony. A 9.64 percent ROE could send a negative signal to potential investors because it is at the low end of ROEs approved since the beginning of 2014, whereas 9.77 percent reflects the average. For these reasons, the Administrative Law Judge recommends that the Commission adopt a ROE of 9.77 percent, including flotation costs.

In finding 386 the ALJ stated:

Several parties suggested downward adjustments to the recommended ROE for various reasons. The Administrative Law Judge concludes that no downward adjustment to the recommended 9.77 percent ROE is necessary.

In finding 387 the ALJ addressed flotation costs:

First, the ICI Group argued that flotation costs should be excluded from the ROE calculation. The Administrative Law Judge concludes that flotation costs are properly included even if no new issuances of securities are planned because flotation cost adjustments are made not only to reflect current or future financing costs, but also to compensate investors for costs incurred for past issuances. Failure to allow such an adjustment may deny the Company the opportunity to earn its return.

In finding 388 the ALJ addressed adjustments for CWIP:

Second, the Commercial Group asserted that there should be a downward adjustment if CWIP is included in rate base because CWIP shifts the risk from the Company to the ratepayers. The Commercial Group also maintained that the use of a future test year and the recovery of interim rates favor a lower ROE. The Administrative Law Judge concludes that no adjustment is necessary based on the inclusion of CWIP, the use of a future test year, or the recovery of interim rates because these are common practices in Minnesota rate proceedings. As such, investors would have already taken these

practices into account. In addition, a significant number of companies in the proxy groups use forecasted test years and include CWIP in rate base.

In finding 389 the ALJ addressed adjustments for decoupling:

Finally, AARP suggested that the recommended ROE be reduced by ten basis points if the Commission authorizes a revenue decoupling mechanism because decoupling stabilizes a company's revenues and shifts the sales risk onto consumers. As the Department and the Company correctly noted, however, the issue for establishing ROE is not whether decoupling reduces the Company's sales risk but rather how the Company's investment risk compares to that of other comparable companies with and without decoupling. The Company demonstrated that many of the companies in its proxy groups have some type of decoupling in place. Thus, its comparison groups already factor in decoupling. In addition, a Brattle Group study found that there is "no statistically significant evidence of a decrease in the cost of capital following adoption of decoupling." Finally, the Company showed that Pepco Holdings Inc., which has decoupling in place for over 65 percent of its revenue, has a similar risk profile to other electric utilities. This analysis of Pepco Holdings Inc.'s risk profile indicates that decoupling does not measurability affect a utility's risk profile. For these reasons, the Administrative Law Judge concludes that no downward adjustment is necessary if the Commission adopts a decoupling mechanism in this case.

Finding 390 states:

In summary, for the reasons stated above, the Administrative Law Judge recommends that the Commission adopt a ROE of 9.77 percent.

Overall Cost of Capital Recommendation

In finding 426 the ALJ stated:

If the Commission adopts the 9.77 percent ROE as recommended by the Administrative Law Judge and the Commission also adopts the Company's updated capital structure and agreed upon cost of debt, the result is an overall cost of capital of 7.375 percent for the 2014 test year and 7.403 percent for the 2015 Step year. The table below summarizes the calculations.

Table 10
2014 Test Year Overall Cost of Capital

Component	Capitalization Ratio (%)	Cost (%)	Weighted Cost (%)
Long-Term Debt	45.60	4.90	2.234
Short-Term Debt	1.90	0.62	0.012
Common Equity	52.50	9.77	5.129
Total	100.00%		7.375%

Table 11

2015 Step Year Overall Cost of Capital

Component	Capitalization Ratio (%)	Cost (%)	Weighted Cost (%)
Long-Term Debt	45.61	4.94	2.253
Short-Term Debt	1.89	1.12	0.021
Common Equity	52.50	9.77	5.129
Total	100.00%		7.403%

EXCEPTIONS TO THE ALJ REPORT

Xcel

Pages 11 through 14 of Xcel's Exceptions.

Xcel stated that it supports the ALJ's analysis as a reasonable floor. However, its analysis indicates that the Commission has the discretion to select a ROE between 9.77 percent and 10.25 percent. Xcel restated its arguments regarding the unique circumstances surrounding this rate case.

Xcel stated that while it supports the ALJ's analysis as a reasonable floor for the Commission's deliberations:

> Its analyses indicate that an ROE above 9.77 percent is reasonable for a vertically-integrated utility entering a MYRP.
>
> Other large vertically integrated utilities have also been granted ROEs above 9.77 percent in 2014.
>
> Its currently authorized ROE of 9.83 percent falls in the bottom one-third of returns authorized in 2012 through May 2014 for utilities that provide generation, transmission, and distribution services.
>
> The average actual ROEs authorized for vertically integrated electric utilities in the third quarter of 2014 was 9.89 percent.

Xcel noted that the Department's electric and combination company proxy groups' dividend yield fell by 54 and 26 basis points between the Department's initial analysis and its Surrebuttal position. Xcel reiterated its argument that a second successive ROE decrease for the Company could have a disproportionately negative effect. Xcel argued that the trends indicate that an ROE somewhat above 9.77 would be reasonable and appropriate. The Company proposed the following changes to the ALJ's recommendations:

> 373. After carefully considering the evidence in the record and the arguments of the parties, the Administrative Law Judge recommends that the Commission approve a Return on Equity of 9.83 ~~9.77~~ percent. The reasons for this recommendation are set forth below.

> 385. The reasonableness of a 9.77 percent ROE for the Company is confirmed by other evidence in the record. First, a 9.77 percent ROE is similar to the 9.85 ROE calculated by, the weighted CAPM results provided in the Department's Surrebuttal Testimony. In addition, the Company's need to access capital for its substantial capital investment plans strongly suggest that a 9.77 percent ROE is more reasonable than the 9.64 ROE recommended by the Department in Surrebuttal Testimony. A 9.64 percent ROE could send a negative signal to potential investors because it is at the low end of ROEs approved since the beginning of 2014, whereas 9.77 percent reflects the average. The 2-year term of the MYRP and the Company's substantial capital investment plans strongly suggest that a 9.77 percent ROE should be further modified. Further, the Company's currently authorized 9.83 percent ROE was set recently on September 3, 2013. For these reasons, the ~~Administrative Law Judge recommends that~~ Commission will adopt ~~adopted~~ a ROE of 9.83 ~~9.77~~ percent, including flotation costs.

Department of Commerce

Pages 5 through 16 of the Department's Exceptions to the ALJ Report.

The Department took exception to findings 373, 380, 382, 383 and 385 of the ALJ's Report and her recommended return on equity of 9.77 percent. The Department continued to recommend a Return on Equity for Xcel of 9.64 percent with flotation costs. The Department stated that the record does not support the Report's recommendation that a higher ROE is warranted. Determination of a reasonable ROE is a quasi-judicial function of the Commission and its decision must be based upon the facts in the record.

The Department said that it demonstrated through the testimony of Dr. Amit, that the key to a reasonable ROE for Xcel is reliance on a properly applied DCF method, based on reasonable inputs, together with confirmation of the reasonableness of the DCF analysis by use of a properly applied Capital Asset Pricing Model analysis. Having checked the reasonableness of his DCF analyses through his application of CAPM, the results of Dr. Amit's DCF analysis of 9.64 percent (with flotation costs) is supported in the record as a reasonable ROE for Xcel.

Exception to Proposed Finding 373

The Department disagrees with finding 373 because the reasons provided by the ALJ for recommending a Return on Equity of 9.77 percent are not supported by the record and are counter to fundamental financial principles. The Department stated that proposed finding 373 should be amended as follows:

> 373. After carefully considering the evidence in the record, ~~the Administrative Law Judge recommends that~~ the Commission should approve a Return on Equity of ~~9.77~~ 9.64 percent.

Exception to Proposed Finding 380

The ALJ Report Proposed Finding 380 states:

> 380. Normally, more recent information will better reflect expectations regarding the expected ROE for the Company. Use of a single, shorter time period for averaging, however, can lead to anomalous results. The averaging period should be reasonably representative of expected capital market conditions over the long term.

The Department stated that proposed finding 380 is not supported by the prefiled testimony of any witness, including Company witness Mr. Hevert. The statement that single shorter time periods for averaging can lead to anomalous results only appear in Mr. Hevert's opening statement, with no underlying analytical support. There is nothing in the record to demonstrate that Dr. Amit's 30-day average, used in his Surrebuttal Testimony, is somehow anomalous.

The statement that "the averaging period should be reasonably representative of expected capital market conditions over the long term" does not provide any support for the notion that a longer time period for averaging dividend yields provides a better reflection of the expected capital market conditions over the long term.

The Department restated its arguments against using prices from a longer time period. The Department stated that proposed finding 380 should be amended as follows:

> 380. Normally, more recent information will better reflect expectations regarding the expected ROE for the Company. Use of a single, shorter time period for averaging, however, can lead to anomalous results when there are clear indications that the financial markets are abnormal. No such indications exist for this rate case. The averaging period should be reasonably representative of expected capital market conditions ~~over the long term~~.

Exception to Proposed Finding 382

The Department also argued that proposed finding 382 is neither supported by the record, nor supported by any reasonable financial analysis. There is no valid justification to substitute proposed finding 382 for the proposed finding 381, pertaining to the prior rate case. The following reasons listed in proposed finding 382 for rejecting the Department's Surrebuttal 30-day period do not adequately support this change:

> The 30-day period used by the Department in its Surrebuttal Testimony may not be representative of the time period in which the ROE will remain in effect.
>
> The dividend yields used by the Department in its Surrebuttal Testimony were significantly lower than in its initial testimony because the unusually high stock prices have declined relative to the overall stock market. As a result, the Department's updated 30-day dividend yields may reflect a short-term anomaly.

Neither statement is supported by any testimony provided by the Company's expert. The first time they appear was in Mr. Hevert's Opening Statement, without support.

A basic financial principal postulates that the most currently available dividend yields (and projected growth rates) are the best predictors for the ROE for any time into the future until new, more recent market data is used. There is no reasonable link between the length of the historical

period used to calculate the dividend yields and the period for which the ROE would remain in effect.

The statement that, because the lower dividend yields calculated in the Department's Surrebuttal Testimony increased significantly after the period June-July, 2014, such dividend yields may reflect a short-term anomaly, is without merit.

The Department argued that pages 7 and 8 of its Reply Brief demonstrate that utility stock prices over the period June-July, 2014 did not represent a short-term anomaly. The Department explained:

> Moreover, the Company's claim that utility valuation was unusually high during the period June-July, 2014 is not supported by publicly available information. To assess this claim, it is reasonable to examine the valuation of the well-known iShares U.S. Utilities Index Fund (IDU). Over the period June 7, 2014 through July 7, 2014, the average price for IDU was $106.70, compared to an essentially unchanged price of $106.26 on October 3, 2014. Clearly then, there was no material change in electric utility valuation for these periods, and the period June-July, 2014 reflected investors' expectations about the future prices of electric utilities.

The Department provided a table listing the monthly average closing prices for the IDU over the period June-December, 2014. It stated that the table indicates that if a short-term anomaly exists, it was the temporary lower utility prices in July and August, 2014. Since then, for the period September-December, 2014, utility stock prices increased in each consecutive month and for the period October-December were significantly higher than the utility stock prices over the period June-July, 2014, which was the period used by Dr. Amit in his Surrebuttal Testimony.

Using the reasoning in the ALJ's Report, the results of the analysis in Dr. Amit's Surrebuttal indicate that the ROE is too high for Xcel. However, the Department does not recommend a lower ROE than the 9.64 percent in Dr. Amit's Surrebuttal Testimony.

The Department stated that proposed finding 382 is counter to any reasonable financial analysis and is not supported by any analysis in the record. The Department believes proposed finding 382 should be amended as follows:

> 382. In this case, ~~however, the Administrative Law Judge concludes~~ that the record shows that the 30-day period used in the Department's Surrebuttal testimony best represents the currently expected future market conditions. ~~May not be representative of the time period in which the ROE will remain in effect.~~ More specifically, the record shows that the dividend yields used in the Department's Surrebuttal Testimony ~~were~~ while significantly lower than the dividend yields used in its Direct Testimony, still represent normal market conditions at that time. ~~falling by 54 and 26 basis points, respectively, from the Department's initial analysis.~~ The lower dividend yields simply reflect the overall upward trend in the stock market valuation. The Department's updated 30-day dividend yields included in its Surrebuttal Testimony appropriately reflect current normal market conditions. ~~These decreased dividend yields were the result of unusually high stock prices during the June July 2014 time period used in the Department's Surrebuttal Testimony. Since that time, utility stock prices have declined relative to the overall stock market and~~

> ~~moved more in line with historic expectations. As a result, the Department's updated 30 day dividend yields included in its Surrebuttal Testimony may reflect a short term anomaly. [footnotes omitted]~~
>
> Exception to Proposed Finding 383

Proposed Finding 383 recommends that the Commission use an average of the ROEs recommended by:

- the Department in its Direct Testimony,
- the 30-day period dividend yield ROE estimated by the Company in its Rebuttal Testimony, and
- the ROE recommended by the Department in its Surrebuttal Testimony.

The Report offers the following support for the recommendation:

> a. Since the Company proposed a MYRP, it is desirable to minimize the impact of any market anomaly that may have contributed to the variability in the dividend yields.
>
> b. The Commission took a similar approach (averaging) in the recent MERC rate case. The Department disagrees with Proposed Finding 383 because it is based on wrong or inappropriate arguments.

The Department stated:

> A MYRP does not increase Xcel's risk because the ROE has the same likelihood of going up or down in 2015.
>
> There is no reason to reward Xcel for its choice to file an MYRP as opposed to an ordinary rate case.
>
> No market anomaly existed over the period October, 2014, through December, 2014.
>
> No unusual variability in the dividend yields existed. The Department restated its argument as contained in its Reply Brief.
>
> The finding of facts must be based solely on the record and not on a prior Commission decision regarding a natural gas utility that may reflect significantly different circumstances.

Proposed Finding 383 should be replaced with the following adjustments:

> 383. ~~Because the Company has proposed a MYRP and to minimize the potential effect of any market idiosyncrasies that may have contributed to the variability in the dividend yields, the Administrative Law Judge concludes that the authorized ROE should be based on data from more than just the one 30 day period used in the Department's Surrebuttal Testimony. Similar to the approach taken by the Commission in the recent MERC rate case, the Administrative Law Judge recommends that the Commission consider the DCF~~

> ~~results from the three most recent 30 day time periods. More specifically, the Administrative Law Judge recommends that the Commission consider the DCF results from: the 30 day period included in the Department's Direct Testimony (covering October 1-31, 2013); the 30 day period included in the Company's Rebuttal Testimony (covering May 1-30, 2014); and the 30 day period included in the Department's Surrebuttal Testimony (covering June 7-July 7, 2014).~~
>
> Based on the record in these proceedings, the Company's proposed MYRP has no impact on the required ROE for Xcel. The 30-day dividend yields calculated by the Department in its Surrebuttal Testimony represent normal market conditions and most appropriately reflect future market condition expectations. Therefore, the 30-day dividend yields calculated by the Department in its Surrebuttal Testimony are the most appropriate dividend yields to be used in a DCF analysis.

Exception to Proposed Finding 385

Proposed finding 385 states that an ROE of 9.77 percent is more reasonable than a 9.64 percent ROE because:

a. It is confirmed by the 9.85 percent CAPM ROE estimated by the Department in its Surrebuttal Testimony.

b. It is justified by the Company's need to access the capital market to finance its future substantial capital investment.

c. A 9.64 percent ROE may send potential investors negative signals because it is in the low end of the ROEs approved since the beginning of 2014.

The Department stated that based on the record in these proceedings, the reasons the ALJ provided in recommending a ROE of 9.77 percent instead of 9.64 percent are not reasonable.

First, the ALJ Report recommendation of 9.77 percent is based partially on the Department's 9.80 percent ROE recommendation in its direct testimony. The Report then states that its recommendation is confirmed by the Department's 9.85 percent CAPM-ROE in its Surrebuttal testimony. The Department notes that its CAPM ROE in its Direct Testimony was 9.63 percent. Thus, the Department CAPM ROE in its direct testimony confirms the Department ROE of 9.64 which it recommended in its surrebuttal testimony.

Second, as the Department explained in its Direct Testimony, using the CAPM involves disputed issues. Therefore, the CAPM should be used only to confirm that the DCF results are in the range of reasonableness.

Third, the ALJ Report finding that, due to NSP's future substantial capital investment, NSP should be allowed a higher ROE is not supported by the record and is not reasonable. In its direct testimony the Department concluded that NSP is not riskier than Dr. Amit's comparison groups. Therefore, no risk-related DCF ROE adjustment is appropriate. Both the higher equity ratio and the higher bond rating for NSP in comparison with the comparable group indicate a lower risk for NSP.

Fourth, the Report's finding that 9.64 percent ROE would send investors a negative signal is not supported by the record. The 9.64 percent recommended by the Department in its Surrebuttal testimony appropriately reflects the more current financial and economic environment.

The Department stated that proposed finding 385 should be replaced as follows:

> 385. ~~The reasonableness of a 9.77 percent ROE for the Company is confirmed by other evidence in the record. First, a 9.77 percent ROE is similar to the 9.85 ROE calculated by the weighted CAPM results provided in the Department's Surrebuttal Testimony. In addition, the Company's need to access capital for its substantial capital investment plans strongly suggest that a 9.77 percent ROE is more reasonable than the 9.64 ROE recommended by the Department in Surrebuttal Testimony. A 9.64 percent ROE could send a negative signal to potential investors because it is at the low end of ROEs approved since the beginning of 2014, whereas 9.77 percent reflects the average. For these reasons, the Administrative Law Judge recommends that the Commission adopted a ROE of 9.77 percent, including flotation costs.~~
>
> Based on the record in these proceedings, the 9.64 percent ROE is the most reasonable ROE in these proceedings. This ROE would allow the Company to maintain its credit rating and support the Company need to access the capital markets under reasonable terms. Moreover, an ROE of 9.64 percent is sufficient to attract potential investors to invest in the Company.

ICI Group

Pages 24 through 40 of the ICI Group's Exceptions to the ALJ Report.

The ICI Group stated that much of the ALJ's reasoning and conclusions regarding setting a 9.77 percent ROE is reasonable and should be adopted by the Commission; however, the ICI Group has some exceptions that if adopted, would result in the Commission setting a rate of return lower than 9.77 percent. These exceptions include:

1. The ALJ's conclusion that the ICI Group's DCF analyses should be given no weight.

2. The ALJ placing significant weight on the Company's unreliable DCF analyses and recommendation.

The ICI Group's DCF Analyses

In proposed finding 376 the ALJ found that:

> For example, the proxy group used by the ICI Group is not sufficiently comparable to the Company to be reliable. For example, the ICI Group's proxy group includes companies involved in mergers or other significant transactions, and includes companies with substantial unregulated operations.

The ICI Group stated that the make-up of the proxy group is subject to disagreement, and the ALJ noted extensive disagreement between Mr. Hevert and Dr. Amit. However, the ALJ relied on both the Company's and the Department's proxy group, while giving the ICI Group's proxy group no weight.

The ICI Group took exception to the ALJ's conclusion for two reasons:

1. The ICI Group's proxy group is reliable.

2. There are similar flaws with the proxy groups of both the Company and the Department, yet the ALJ determined that their analyses were entitled to significant weight.

The ALJ did not expressly make a finding regarding which companies make up the ICI Group's proxy group. Of the ICI Group's proxy group of 27 companies, only seven were not included in either the Company's or the Department's proxy groups. Two of these seven companies were excluded from the Company's and the Department's proxy groups because their DCF analyses showed a rate of return lower than 8 percent. Only five companies in the ICI Group's proxy group were not in the proxy groups of the Company or the Department based on reasonable differences in screening criteria. An analysis of the alleged issues with some of these companies shows that ICI Group's decision to include these companies was a result of differences of professional judgment and opinion.

Mr. Hevert testified that Mr. Glahn should not have included Public Service Enterprise Group because it has substantial unregulated operations. However, there is no discussion of the precise extent of unregulated operations by that company, and there is no indication that this criticism applies to any other companies in Mr. Glahn's proxy group.

Mr. Hevert criticizes the inclusion of UNS Energy because that company agreed to be acquired by Fortis Utility Group and he criticized the exclusion of EDE because that company's failure to pay dividends was the result of an extreme weather event. The ICI Group argued that these represent potentially valid theoretical disagreements with Mr. Glahn's approach regarding three companies (out of 27 total). Such criticisms should not have resulted in the ALJ's wholesale dismissal of Mr. Glahn's analyses.

Dr. Amit criticized Mr. Glahn's inclusion of four companies involved in significant restructuring. Two of these four companies (Dominion Resources and CenterPoint Energy) were also included in the Company's proxy groups. The ICI Group argued that to the extent such criticism is valid, it should apply equally to completely discredit the Company's DCF analyses.

Dr. Amit criticized the inclusion of Black Hills Corp. and Xcel in the proxy group. The ICI Group argued that the dispute regarding whether to include Black Hills Corp. is a theoretical disagreement between two experts exercising their judgment. Such a disagreement about a single company should not be sufficient to discredit the ICI Group's DCF analyses. Dr. Amit criticized the ICI Group's exclusion of Xcel from the proxy group to avoid an element of circularity; however, the Company excluded Xcel for the exact same reason. The ICI Group contends that Dr. Amit's criticism is not valid, if it were valid, it weighs equally in favor of discrediting the Company's analyses because the ALJ concluded it was sufficient to discredit the ICI Group's analysis.

Dr. Amit also criticized Mr. Glahn's failure to follow his own screening criteria by excluding companies who exhibited positive projected earnings and/or dividend growth. In finding 355 the ALJ relied on this testimony stating:

> The Department noted that the ICI Group failed to follow its own screening criteria when it eliminated companies with positive projected earnings and/or dividend growth.

The ICI Group stated that the record evidence does not support a finding that Mr. Glahn improperly applied his own screening criteria. When questioned about the future earnings and dividend growth from Value Line, Mr. Glahn clarified that he was being asked to only read future numbers and that in addition to the numbers he was reading, adjacent columns, reporting recent actual data, included negative numbers. The ICI Group argued that the record does not support a finding that Mr. Glahn failed to follow his own screening criteria, and the ALJ's finding should be rejected.

The ICI Group took exception to finding 376 which states in part:

> even if the proxy group were sufficiently comparable, the ICI Group's DCF analyses are not analytically sound because the ICI Group relied on a single source of data, Value Line, for its growth rates.

The ICI Group stated that this is not a valid reason for discounting the probative value of the ICI Group's DCF analyses for two reasons:

1. There is Commission precedent indicating that relying on multiple sources of investment data is not required.

2. Such a requirement would foist unreasonable costs on intervenors in rate case proceedings.

The analytical approach to be used in calculating a return on common equity is a matter for the Commission's expertise. There is prior Commission precedent of reliance on a single source of data as reliable to support a conclusion.

If intervenors are required to rely on three sources of data, then the cost of meaningfully participating in a rate case becomes even more prohibitive. It argued that subscriptions to investment surveys such as Value Line, Zacks, and First Call are expensive. The Company and the Department can pass on the costs of subscribing to these services to the ratepayers. The ALJ's reliance on this rationale to reject the ICI Group's analyses is unfair because the ICI Group and its witness, Mr. Glahn, had no prior notice that reliance on three sources of data would be required before the ALJ would give any weight to its DCF analyses.

Finding 376 also states:

> the ICI Group used a sustainable growth analysis to estimate the growth rate in two of its four DCF analyses. This approach has not been accepted by the Commission, is biased downward, and is based on questionable assumptions.

The ALJ does not indicate what "questionable assumptions" such an approach is based upon. To the extent the Commission agrees that such results are "biased downward," such knowledge can be taken into account when determining just and reasonable rates; however, the mere fact that an approach is biased downward should not result in the wholesale rejection of the ICI Group's DCF analyses.

Reliance on the Company's DCF Analyses

The ICI Group argued that the unique distorting effects of "anchoring" needs to be addressed. Its exceptions contained a discussion of "anchoring" and its impacts.

The ICI Group noted that to arrive at a reasonable ROE figure, the ALJ averaged the numbers recommended in the Department's direct (9.80%), the Company's rebuttal (9.86%), and the Department's Surrebuttal (9.64%), which resulted in an overall figure of 9.77%. The ICI Group argued that this number is too high because:

1. It gives weight to the Company's rebuttal testimony (which was very similar to the analysis in the Company's direct testimony, which the ALJ rejected).

2. Because it weights the various analyses without accounting for anomalous changes in proxy group composition between the comparisons.

The ICI Group argued that the Company's analysis is not entitled to as much weight as it was given by the ALJ. Several criticisms that the ALJ found sufficient to reject the ICI Group's analyses are equally valid criticisms of the Company's DCF analyses. The record reveals that Mr. Hevert consistently provides inflated analyses and recommendations as an attempt to push the ROE number unreasonably high. Thus, the final ROE figure should not be based so heavily on the Company's recommendations, nor should the Commission be influenced by the mere fact that the Company initially submitted such a high ROE recommendation.

The ICI Group reiterated some of its concerns regarding the Company's and the Department's screening criteria to select their proxy groups. It argued that the Company's and the Department's analyses were biased upward because they arbitrarily decided to exclude companies with DCF results below 8.0 percent. The ALJ's methodology of averaging the three results is biased upward for failure to account for such proxy group composition changes between analyses. The ALJ determined that the ICI Group's analyses were biased downward and rejected the ICI Group's analyses for that reason. The Commission should reject the ALJ's methodology because it is biased upward.

AARP

Pages 10 through 12 of its Exceptions to the ALJ Report.

AARP argued that managing utility risk through ratemaking is a zero-sum endeavor. To the extent that decoupling alleviates the utility's risk of revenue variability or volatility there will be a corresponding transfer of that risk onto consumers who must pay additional RDM rate

adjustments. The AARP reiterated many of its arguments in support of an adjustment to the ROE if a decoupling proposal is approved.

The AARP argued that there are revenue volatility risks which are not related to energy efficiency or conservation programs that can be affected by an RDM. One of these revenue risks relates to the potential for broad economic downturns. Central Maine Power Company ("CMP") pioneered revenue per customer decoupling in 1991. Its initial three-year trial was discontinued as a result of substantial revenue deferrals under the RDM, amounting to over $50 million. This effect occurred because shortly after initiating decoupling, Maine suffered an economic downturn. The RDM was increasingly viewed as a mechanism that shielded CMP against the economic impact of the recession, rather than providing the intended energy efficiency and conservation incentive impact.

Had a RDM decoupling mechanism been in place for Xcel in 2008-2009, the economic recession would have likely contributed to higher electric bills for Minnesota consumers. ALJ Finding 389 contends that no specific downward adjustment to ROE is needed because many of the comparable companies used in the Discounted Cash Flow estimation for Xcel's proxy group already have some type of decoupling program in place. AARP disagreed with this assumption.

The AARP stated that Xcel would no doubt be a less risky utility if a RDM is adopted. Mr. Hevert admitted that Xcel's proposed RDM tariff is designed as a "revenue stability mechanism". Mr. Hevert further acknowledged that reducing the utility's revenue volatility is viewed positively from an investor's perspective. The AARP stated that the final order issued by the Commission in this rate case should recognize this reality by only adopting a decoupling pilot program if the utility's allowed return on equity is adjusted downward to match its altered risk profile.

AARP recommended that the Commission strike ALJ Findings 366-373 and 389-390, and instead make a specific finding that a decoupling pilot program would stabilize the utility's revenue and make it less risky, and that therefore Xcel's allowable ROE should be reduced by ten basis points from 9.77% to 9.67%.

STAFF COMMENT

The ALJ's decision to average three different ROE recommendations to determine an appropriate cost of equity has introduced several complications to this proceeding. If the Commission so desires, it can adopt the ALJ's calculation and recommendation. However, staff has some concerns with the ALJ's reasoning.

Time Period for Dividend Yield

The ALJ stated the record shows that the 30-day period used in the Department's Surrebuttal testimony may not be representative of the time period in which the ROE will remain in effect. As discussed by the Department in its Exceptions, the time period the ROE will remain in effect does not support the argument for the use of a longer historical time period. Although one may not agree that the use of a 30-day period is sufficiently long to avoid short term aberrations in the market, as the Department has stated, there is no link between the length of the historical period used to calculate the dividend yields and the period for which the rate will be in effect.

The ALJ also reasoned that the decreased dividend yields in the Department's Surrebuttal Testimony were the result of unusually high stock prices during the June-July 2014 time period. The ALJ further stated that since that time, utility stock prices have declined relative to the overall stock market and moved more in line with historic expectations. These arguments are not supported by prefiled testimony in this record. Making the argument in its Initial Brief, Xcel cites to exhibit 115, Mr. Hevert's opening statement, with no reference to prefiled testimony or analysis. In its Reply Brief, the Department provided information, from October 3, 2014, countering Mr. Hevert's opening statement. However, like Mr. Hevert's assertions on this issue, the Department's information was not provided as part of prefiled testimony.

Similarly, the prefiled testimony does not support the claim that since the June-July 2014 time period utility stock prices have declined relative to the overall stock market and moved more in line with historic expectations. The support for this line of thinking also comes from Mr. Hevert's opening statement, without supporting documentation.

Staff notes that by utilizing the Department's initial analysis and recommendation, the ALJ is relying on prices in October, 2013. When combined with the Department's Surrebuttal analysis, which uses stock prices from June 7, 2014 through July 7, 2014, the ALJ's recommendation is based on stock prices over a 9 month period. This is 3 months longer than the longest time period recommended by a party and starts 17 months prior to this issue being addressed by the Commission.

Although the ALJ indicated that 30 days was not a sufficiently long time period to determine the cost of equity in this proceeding, when averaging the recommendations she excluded Xcel's 90 day and 180 day estimates from her calculation. These values are:

	90 Day Mean	180 Day Mean
Electric Proxy Group	10.02%	10.13%
Combination Proxy Group	9.82%	9.97%
Weighted Average (80/20)	9.98%	10.10%
Weighted Average (60/40)	9.94%	10.07%

The average of Xcel's three time periods weighted at 60/40 is 9.95 percent ((9.86+9.94+10.07)/3).

Staff is concerned with the ALJ's proposed finding 383 indicating that the MYRP is one reason justifying the use of data from more than one 30-day time period. There is disagreement over whether the MYRP increases or decreases Xcel's financial risk. If a MYRP actually increases financial risk to Xcel, that issue should be specifically addressed with the amount and cost of that risk specifically identified. However, there is no empirical evidence in the record to suggest that a MYRP will increase the cost of equity to Xcel. Staff agrees with the Department that a MYRP in and of itself does not increase the financial risk to Xcel. As the Department stated, ROE has the same likelihood of going up or down in 2015. The Commission may want to consider ordering Xcel to include, in its next rate case, an analysis of the impact that a MYRP has on the cost of equity.

Source of Data for Growth Rates

Staff thinks it is unnecessary for the Commission to make a finding regarding the number or sources of data for growth rate estimates. There is value to reviewing more than one source of information for analyst estimates when trying to understand investor expectations in the financial markets. However, staff questions the ALJ's argument in finding 376 that:

> the ICI Group's DCF analyses are not analytically sound because the ICI Group relied on a single source of data, Value Line, for its growth rates.

As support, for this position the ALJ cites the rebuttal testimony of Mr. Hevert stating:

> As noted earlier, relying on a single source of data and growth rates, as Mr. Glahn has done, exposes the analysis to a degree of estimation error that easily can be mitigated by including other sources (such as Zacks and First Call).

Although Mr. Hevert's statement may be correct, there is no demonstration that Mr. Glahn's data source introduced an estimation error. Staff notes that the same source was used by Mr. Hevert for the earnings growth estimates for his comparable groups.

Comparable Group

This proceeding had several issues regarding the appropriate companies to include in a comparable group.

The comparable groups utilized by the parties in this docket are (the following includes both the electric groups and the combined groups):

Company	Ticker	Xcel Proxy	Department Proxy	ICI Group Proxy
Allete	ALE		X	X
Alliant Energy	LNT	X	X	X
Ameren Corp.	AEE		X	
American Electric Power	AEP	X	X	X
Avista Corporation	AVA	X	X	
BLACK Hills Corporation	BKH	X		
CenterPoint	CPN			X
Cleco Corporation	CNL	X	X	X
CMS Energy	CMS	X	X	X
Con. Edison	ED			X
Dominion Res.	D			X
DTE Energy	DTE	X	X	X
Duke Energy	DUK	X	X	X
Great Plains Energy	GXP	X	X	X

Company	Ticker	Xcel Proxy	Department Proxy	ICI Group Proxy
Hawaiian Electric Industries, Inc.	HE	X	X	
Integrys Energy Group	TEG	X		
MGE Energy, Inc	MGEE			X
NextEra Energy	NEE		X	X
NiSource Inc.	NI	X	X	
Northeast Utilities	NU	X	X	X
Northwestern. Corp.	NEW	X	X	X
OGE Energy	OGE			X
Otter Tail Corporation	OTTR	X		
Pinnacle West	PNW	X	X	X
PNM Resources	PNM	X	X	X
Portland General	POR	X	X	X
Public Service Ent.	PEG			X
SCANA Corp.	SCG	X	X	X
Sempra Energy	SMP	X		X
Southern Co.	SO	X		X
TECO Energy Inc	TE		X	
UNS Energy	UNS			X
Vectren Corp.	VVC	X		X
Westar Energy Inc	WR	X	X	X
Wisconsin Energy	WEC	X	X	X
Xcel Energy Inc.	XL		X	
Number of Companies	36	24	23	27

As can be seen by this table, the comparable groups vary among the three witnesses with a total of 36 companies represented. The ICI Group's comparable group includes seven companies that are not in either the Department's or Xcel's comparable groups. The Department's and the Company's comparable groups also vary. The Department's comparable group has 5 companies that are not included in Xcel's comparable group and Xcel has 6 companies not included in the Department's comparable group.

As discussed by Dr. Amit, his comparable group changed between is Direct Testimony and his Surrebuttal Testimony. In Surrebuttal he made the following changes to his Final Electric Comparable Group:

> Added Hawaiian Electric (HE) because, unlike the results from his Direct Testimony, its mean expected rate of return exceeded 8.00 percent.
>
> Excluded Empire District Electric Company (EDE) because its mean expected rate of return was below 8.00 percent.
>
> Excluded Pepco Holding which is in the process of being acquired by Excelon Corp.
>
> Excluded UIL Holding which is in the process of purchasing Philadelphia Gas Works.

Regarding his Final Combination Comparison Group, Dr. Amit included Amern Corp. because its mean rate of return now exceeds 8.00 percent.

The list above relies only on the parties' final comparable groups. The ALJ's decision relies on Xcel's final comparable group along with the Department's comparable group in its Direct Testimony and its comparable group in its Surrebuttal Testimony. As explained above, there is some change from the Direct Testimony and the Surrebuttal Testimony.

Decisions in Other Jurisdictions

Generally, staff agrees that the Commission's decisions on the cost of equity for utility operations in Minnesota should not be based on the return on equity authorized in other jurisdictions. Authorized returns reflect the unique situations and time period for each individual utility in each rate case in whatever jurisdiction the case was decided. As a result, they are not an indication of the appropriate cost of equity in this or any other rate case.

Commission Cost of Equity Options

Some Commission options regarding the cost of equity are:

Cost of Equity Options

Comparable Groups

12. Find that the companies in the Department's proxy groups have similar risks to Xcel. (DOC)

13. Find that the companies in Xcel's proxy groups have similar risks to Xcel. (Xcel)

14. Find that the companies in the ICI Group's proxy group have similar risks to Xcel. (ICI Group)

    If the Commission makes this finding it may want to adopt the ICI Group's proposal to strike Finding 355.

15. Find that the companies in the ICI Group's proxy group are not sufficiently comparable to Xcel to be reliable. (DOC, Xcel, ALJ)

16. Make no determination.

Weighting of Comparable Groups

17. Find that the weighting of the proxy group results should be 60 percent electric comparable group and 40 percent combination comparable group as utilized by the Department. (DOC, ALJ)

18. Find that the weighting of the of the proxy group results should be 80 percent electric comparable group and 20 percent combination comparable group as utilized by Xcel. (Xcel)

19. Make no determination.

Method for Determining Cost of Equity

Models

20. Find that the discounted cash flow method, utilizing the Two Growth DCF model when appropriate, checked for reasonableness, is appropriate for estimating the cost of equity for Xcel in this proceeding. (Xcel, DOC, ALJ)

21. Find that the discounted cash flow method is appropriate for estimating the cost of equity for Xcel in this proceeding. (ICI Group)

22. Find that it is not necessary to utilize a Two Growth DCF model to estimate the cost of equity for Xcel.

23. Find that a combination of methods should be used for estimating the cost of equity for Xcel in this proceeding.

24. Make no determination on the specific method for determining the cost of equity.

Decisions in Other Jurisdictions

25. Determine that the review of the authorized return on equity in other jurisdictions could be useful when determining the appropriate return on equity in this proceeding. (Commercial Group)

26. Determine that it is not appropriate to rely on the authorized return on equity in other jurisdictions when determining the appropriate return on equity in this proceeding. (DOC)

Growth Rate

Source of Growth Rate Estimate

27. Find that a single source of data is not sufficient for the determination of the growth rates to use in the DCF. (Xcel, ALJ)

28. Find that a single source of data may be sufficient for determining the growth rate to use in the DCF. (ICI Group)

    If the Commission makes this finding it may want to consider adopting the ICI Group's proposal to strike the portion of Finding 376 addressing the use of a single source of data.

29. Make no finding regarding the number of sources necessary to determine the growth rate to use in the DCF.

Factors for Determining the Growth Component

30. Determine that the record supports the use of the EPS growth rate as the most appropriate factor to estimate the growth rate component for the DCF model in this proceeding. (Xcel, DOC, ALJ)

31. Determine that the record supports the use of multiple factors to estimate the projected growth rate component for the DCF model in this proceeding. (ICI Group)

32. Make no determination regarding the appropriate factor (dividends, earnings, or sustainable growth) to use when determining the growth rate component in the DCF model.

Dividend Yield

33. Determine that, to avoid irrelevant historical prices and short-term aberrations in the capital market, it is appropriate use recent closing prices, such as 30 days, to calculate the dividend yield for a discounted cash flow analysis in this proceeding. (DOC)

    If the Commission makes this determination it may want to consider the Department's proposed modifications to Findings 380 and 382.

34. Determine that, to avoid irrelevant historical prices and short-term aberrations in the capital market, it is appropriate to use an average of the daily closing prices over a longer time period, such as six months, to calculate the dividend yield for a discounted cash flow analysis in this proceeding. (Xcel)

35. Determine that, to avoid irrelevant historical prices and short-term aberrations in the capital market, the authorized ROE should be based on data from more than the 30-day period used in the Department's Surrebuttal Testimony. (ALJ)

36. Determine that some other time period is appropriate for calculating the dividend yield to use in a discounted cash flow analysis in this proceeding.

37. Make no determination.

Flotation Cost

38. Make no specific determination regarding flotation costs.

39. Determine that the cost of equity should not reflect a flotation cost. (ICI Group)

40. Find that the flotation cost adjustment of 2.926 percent used by the Department and Xcel is appropriate. (Xcel, DOC, ALJ)

Effect of a Multi-Year Rate Plan

41. Find that a Multi-Year Rate Plan increases the financial risk for Xcel. (Xcel, ALJ)

42. Find that a Multi-Year Rate Plan does not increase the financial risk for Xcel. (DOC)

    If the Commission makes this finding it may want to modify Finding 383 as proposed by the Department.

43. Find that there is not sufficient information to determine whether a Multi-Year Rate Plan increases or decreases the financial risk for Xcel and direct Xcel, in its next rate case, to include an analysis of the effect that a Multi-Year Rate Plan has on the cost of capital for Xcel.

44. Take no action.

Cost of Equity

45. Adopt a cost of equity of 10.25 percent as requested by the Company. (Xcel recommendation)

46. Adopt a cost of equity of 9.83 as contained in Xcel's proposed changes to the ALJ recommendation. (Xcel proposed change to the ALJ recommendation)

    If the Commission adopts this option, it may want to consider adopting Xcel's proposed changes to findings 373 and 385.

47. Adopt the Department's recommended cost of equity of 9.64 percent. (DOC,)

    If the Commission adopts the Department's recommendation it may want to adopt the Department's recommended changes to Finding 373 and 385.

48. Adopt the ICI Group's recommended cost of equity of percent 9 percent. (ICI Group)

    If the Commission adopts the ICI's position, it may also want to adopt the ICI Group's recommendation to remove ALJ Findings 373 and replace it with the proposed modified Finding as discussed above.

49. Adopt the ALJ's recommendation of 9.77. (ALJ)

50. Adopt some other cost of equity the Commission considers appropriate.

Adjustment for Decoupling

51. Determine that there does not need to be an adjustment to the ROE if the Commission approves a decoupling mechanism. (Xcel, DOC, CEI, ALJ)

52. Determine that there needs to be an adjustment to the ROE if the Commission approves a decoupling mechanism for Xcel. (AARP)

    If the Commission makes this decision, it will need to determine how much of an adjustment should be made. The AARP recommended a 10 basis point adjustment. The Commission may also want to adopt the AARP's recommendation to strike Findings 366 through 373, 389 and 390.

Adjustment for CWIP

53. Find that there does not need to be an adjustment to the Company's ROE to reflect the amount of CWIP included in rate base. (Xcel, DOC, ALJ)

54. Find that if CIWP is included in rate base it transfers risk from NSP shareholders to ratepayers that should be reflected in the cost of equity. (Commercial Group)

    If the Commission makes this finding it would need to determine how to reflect that risk reduction in the cost of equity.

55. Make no finding.

(Note: These decision alternatives correspond to alternatives III, C (1 through 10) on pp. 21-26 of the deliberation outline.)

Overall Cost of Capital

If the Commission has made specific findings regarding capital and the component costs, it does not need to make a specific finding on the overall cost of capital. However, to avoid possible confusion or questions regarding the Commission's decision, it may want to adopt a specific overall Rate of Return for this proceeding.

Some Commission options regarding the overall cost of capital are:

56. Take no specific action.

57. Adopt an overall cost of capital of 7.38 percent for 2014 and 7.40 percent for 2015 as reflected by the ALJ recommendations.

58. Adopt an overall cost of capital of 7.62 percent for 2014 and 7.65 percent as recommended by Xcel.

59. Adopt an overall cost of capital of 7.31 percent for 2014 and 7.34 for 2015 as recommended by the Department.

60. Adopt an overall cost of capital of 6.77 percent for 2014 and 6.86 percent for 2015 reflecting the ICI Group's recommended cost of equity.

61. Determine that some other overall cost of capital is appropriate and have the staff calculate the proper value, based on the component parts, for inclusion in the order.

(Note: These decision alternatives correspond to alternatives III, D (1 through 6) on p. 26 of the deliberation outline.)