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November 1, 2012

Burl W. Haar  
Executive Secretary  
Minnesota Public Utilities Commission  
121 7<sup>th</sup> Place East, Suite 300  
St. Paul, Minnesota 55101

RE: *Response Comments* of the Minnesota Department of Commerce, Division of Energy Resources to Northern States Power Company's *Reply Comments*  
Docket No. E002/M-12-50

Dear Dr. Haar:

Attached please find the Minnesota Department of Commerce, Division of Energy Resources (DOC or the Department) *Response Comments* to the *Reply Comments* of Northern States Power Company, d/b/a Xcel Energy (Xcel or the Company).

Based on our review of Xcel's *Reply Comments*, the DOC recommends that the Minnesota Public Utilities Commission (Commission) adopt the DOC's recommendations, as discussed in greater detail herein. The Department is available to answer any questions that the Commission may have.

Sincerely,

/s/ MARK A. JOHNSON  
Financial Analyst

MAJ/sm  
Attachment

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

RESPONSE COMMENTS OF THE  
MINNESOTA DEPARTMENT OF COMMERCE  
DIVISION OF ENERGY RESOURCES

DOCKET No. E002/M-12-50

**I. BACKGROUND**

On August 1, 2006, Northern States Power Company d/b/a Xcel Energy (Xcel or the Company) filed a petition requesting approval of a Transmission Cost Recovery (TCR) Rider. The TCR Rider is intended to replace the existing Renewable Cost Recovery (RCR) Rider and reflect changes required by Minn. Stat. §216B.16, subd. 7(b) adopted during the 2005 legislative session.

On November 20, 2006, the Minnesota Public Utilities Commission (Commission) issued its Order in Docket No. E002/M-06-1103 approving Xcel's proposed tariff for the TCR Rider with the condition that Xcel must maintain separate tracker accounts for projects approved under the renewable cost recovery statute (Minn. Stat. § 216B.1645), and those approved under the transmission cost recovery statute (Minn. Stat. § 216B.16, subd. 7(b)).

On January 13, 2012, Xcel filed its petition for approval of its 2012 Transmission Cost Recovery Rider, Project Eligibility, TCR Rate Factors, and 2011 True-up (2012 TCR filing).

On June 13, 2012, the Minnesota Department of Commerce, Division of Energy Resources (Department or DOC) filed its comments. The Department recommended that Xcel explain the following in their reply comments:

- whether the \$30 million in transmission upgrades identified in the instant petition is in addition to the \$70-\$100 million in upgrades identified in the CAPX Certificate of Need (CN) proceeding, and if so, the basis for why ratepayers should pay this amount;
- the basis for an appropriate escalator for the cost of the Bemidji Project; and

- why there are Buffalo Ridge Restoration costs included in the Company's 2011 TCR Compliance Filing, True-up Report, and Tracker Balance.

In addition, the Department recommended that Xcel provide in reply comments its revised 2012 TCR revenue requirements and updated TCR rate adjustment factors using the allocation factors and the overall rate of return approved by the Commission in the Company's 2010 rate case.

Further, the Department recommended that the Commission:

- Approve Xcel's petition with the following modifications:
  - Exclude from the rider the costs of repairs to the existing transmission system on Buffalo Ridge. Such costs can be requested in a subsequent rate case.
  - Disallow from recovery in the rider costs that the Company did not include in previous requests for eligibility (e.g. Certificates of Need), including the cost estimates for rights-of-way, permitting ancillary costs and additional costs for transmission upgrades. Such costs can be requested in a subsequent rate case.
  - Deny Xcel's proposal to recover internal capitalized costs amounting to \$1.5 million in revenue requirements in its 2012 TCR Rider.
- Require Xcel to explain in its initial filing in its next rate case whether the Company received any insurance proceeds for storm damage related to its Buffalo Ridge Restoration Project.

On August 31, 2012, Xcel filed its reply comments.

## **II. DOC ANALYSIS**

### **A. *\$30 MILLION TRANSMISSION UPGRADE COSTS***

On page 20 of their reply comments, Xcel clarified that the \$30 million in transmission upgrades for the Brookings Project were included in the initial \$70-\$100 million estimate provided in the CAPX CN proceedings. The Department appreciates Xcel's clarification and thus concludes that this amount is reasonable to include in the TCR Rider.

### **B. *ESCALATOR FOR THE BEMIDJI PROJECT***

In our initial comments, the Department concluded that the appropriate cap for the Bemidji Project was \$60.6 million. However, the Department noted that it may be reasonable to escalate those costs to current dollars based on an index such as the producer price index (PPI) published by the Bureau of Labor Statistics. Moreover, the Department stated that if Xcel believed that

costs for the Bemidji Project should be escalated to current-day dollars, Xcel could provide an escalation factor in its reply comments, along with an explanation of its appropriateness.

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

The Department agrees that the estimated costs for the Bemidji Project changed from \$60.6 million in the CN proceeding to \$66.2 million in the Route Permit proceeding. As a result, the Department concludes that the appropriate cap for the Bemidji Project (before inflation) should be \$66.2 million.

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

#### C. *COST RECOVERY CAPS AND THE BEMIDJI PROJECT*

In our initial comments, the Department noted that the Commission set the following standard for evaluating TCR project cost recovery going forward in its 2010 TCR Order in Docket No. E002/M-10-1048:

...the Commission finds that TCR project cost recovery through the rider should be limited to the amount of the initial cost estimates at the time the projects are approved as eligible projects, with the opportunity for the Company to seek recovery of excluded costs on a prospective basis in a subsequent rate case. A request to allow cost recovery for project costs above the amount of the initial estimate may be brought for Commission review only if unforeseen or extraordinary circumstances arise on a project.

As a result, the Department recommended a cost recovery cap for the Bemidji Project and noted that the Company could seek recovery for costs over the cap in their next rate case.

Xcel disagreed with our recommendation in their reply comments. Moreover, as explained below, the Company opposes any cost recovery caps for the Bemidji Project.

##### *1) Xcel's Reply*

Xcel addressed cost recovery caps on pages 12-20 of its reply comments. While Xcel acknowledged that previous Commission orders imposed cost recovery caps in TCR and RES Riders, the Company noted that the TCR and RES Statutes do not contain provisions for cost

recovery caps. As a result, Xcel asserts that the Commission can, in this case, consider whether the use of cost recovery caps continues to be appropriate.

Xcel stated that the Commission first considered the issue of a cost cap on a transmission project in Xcel's 2009 TCR Rider (Docket No E002/M-09-1048) where the Company sought recovery for a project under the RCR Statute. In that case, the Commission did not allow recovery in the TCR Rider of the anticipated \$1.7 million increase related to the Blue Lake – Wilmarth 345 kV line, which was initially expected to cost \$6 million. Xcel stated that the Company did not ask the Commission to reconsider the decision at that time because they received a contribution in aid of construction which reduced their total investment to less than \$6 million, meaning the Company's total investment was ultimately less than the cap.

According to Xcel, the Commission initially established the cost cap concept when considering RES rider recovery for the Nobles Wind Project. In that case, the Commission limited RES Rider recovery to the cost estimates provided in the CN proceeding, and ruled that costs above that level would be reviewed for possible inclusion in a subsequent rate case, subject to a prudence determination. Xcel claimed that part of the Commission's reasoning was that the initial project cost estimates were used in a bidding process where the Nobles project competed against other generation projects. Therefore, since costs were a factor and were related to competition with other generation projects, the Commission determined that allowing RCR Rider recovery was not appropriate without additional review in a rate case.

Xcel stated that it does not believe the same rationale is applicable to eligible transmission projects; while cost is considered in determining whether a transmission line is needed, more important are reliability and customer demand considerations. Xcel stated that it moves forward with transmission projects when needed to meet demand or improve reliability, and utilities are the only entities allowed to construct such facilities. According to Xcel, one of the reasons the Legislature enacted the TCR Statute and allowed rider recovery was because it recognized the complexity of the transmission permitting, siting, routing, and construction process and length of time required to complete projects.

Xcel claimed that imposing a cap on rider recovery and deferring review of certain costs to a future rate case is contrary to the intent of the statute. Xcel stated that the estimates included in a CN application are outdated by the time the Company begins seeking rider recovery of costs for eligible transmission projects. In addition, Xcel stated that in order to facilitate the need determination, the Company provides high-level planning cost estimates; detailed design and engineering is not performed at this stage in order to minimize total costs in the event the CN is not granted. Permitting, land acquisition, and ancillary project costs are difficult to predict during this initial phase as well, as the route and pole alignments are not known.

Beginning on page 13 of its reply comments, Xcel stated that:

The Legislature foresaw significant investment in transmission was needed to accommodate projected new electric generating capacity when enacting the TCR Statute. To encourage the Company and other utilities to invest in transmission facilities, the Legislature

provided the Commission with the authority to grant cost recovery through a rider outside of a general rate case. The Commission was authorized to approve an annual cost recovery mechanism and make prudence determinations as part of those proceedings. As noted, the TCR Statute provides:

the commission shall approve the annual rate adjustments provided that, after notice and comment, the costs included for recovery through the tariff *were or are expected to be prudently incurred* and achieve transmission system improvements at the lowest feasible and prudent cost to ratepayers. (Emphasis added.)

The Department comments do not assert that specific project costs were not prudently incurred. Indeed, the Commission has never previously determined any Company transmission project costs to be ineligible for rate recovery as imprudent, and we believe the estimated Bemidji project costs reflected in our TCR Rider petition can be expected to be prudent. Our annual TCR Rider proceedings can be the appropriate forum for making any prudence determination. Alternatively, if the Commission prefers, however, prudence review for individual projects could be deferred to the rate case after a project is placed in service. However, under the “expected to be prudently incurred” standard in the TCR Statute, the Commission should not disallow TCR Rider recovery of the costs of eligible projects if there is no assertion of imprudence.

We appreciate that the Department’s comments indicating some flexibility in the level of costs allowed in the TCR Rider may be appropriate. For example, the Department indicates use of an appropriate escalator to reflect increasing costs over time, or allowing recovery of additional costs incurred due to unforeseen or extraordinary circumstances may be appropriate.

However, as we make significant transmission investments going forward – for example, we plan to invest over \$1 billion in the CapX2020 projects – the TCR Rider mechanism for recovering these costs is important to provide the benefit intended by the statutes. The statutes were designed to promote investment in the transmission system to improve reliability and access to renewable generation for our customers. Allowing TCR Rider to recover the capital costs incurred between rate cases is consistent with the intent of the legislation. For these reasons, we believe the Commission should reconsider whether cost caps are appropriate for major transmission projects or alternatively, how they should be established.

In light of these policy considerations, we discuss further below the specific cost increase related to the Bemidji project. We believe this additional information demonstrates our concern with applying the “cost cap” principle to individual transmission projects, and demonstrates that recovery of Bemidji project costs in 2012 TCR Rider rates should not be capped at the level in the 2007 Certificate of Need application, even adjusted for a cost escalator.

In addition, Xcel stated on page 19 of its reply comments that:

Even if the Commission were to decide to continue to apply the cost cap principle to TCR eligible projects, it would be inappropriate to apply such a cap to the CapX2020 Bemidji project. At the time the project applicants submitted the Certificate of Need application for the Bemidji line in 2007, the Commission had not applied a cost cap to a TCR eligible project. The Commission did not apply this principle to a transmission project until its April 2010 order regarding the Wilmarth/Blue Lake line. Thus, the project applicants could not have known the Commission might later seek to limit TCR Rider rate recovery to the estimates in the CON or Route Permit applications. It would be arbitrary and capricious to apply the cost cap ratemaking principle where the Certificate of Need application was submitted and approved before the Commission ever announced the cost cap principle.

Moreover, while the Bemidji project Certificate of Need estimates did not include cost estimates for all necessary work and permitting, the fact that the project would incur some additional costs was disclosed and known. Consistent with Certificate of Need and Route Permitting practice at that time, the project applicants provided high-level estimates to construct the transmission line along various route alternatives. It is not feasible to estimate costs to the granularity needed for rate making purposes when a route and the issues associated with constructing a transmission line are not known. (Footnotes Omitted).

## 2) *Department’s Response*

The Department reviewed Xcel’s reply comments regarding cost recovery caps. The Department remains unpersuaded by Xcel’s arguments and continues to support the essential use of cost recovery caps. The Department notes that cost estimates are an important part of CN and Route Permit proceedings, regardless of whether a bidding process is used. Cost estimates are used extensively throughout CN and Route Permit proceedings and are relied upon by the Commission, particularly in considering alternatives to the proposed project. Further, approval of projects in CN and route proceedings is not a blank check for cost recovery in riders or rate

cases. Therefore, it is important for CN and Route Permit applicants to include all costs in their estimates.

Xcel's arguments suggest that, with riders, the burden of proof turns on its head; that is, rather than utilities having the burden of proof to show that rates are reasonable, Xcel suggests that all costs requested for recovery in a rider must be granted unless there is a showing of imprudence, meaning that the burden of proof is on regulators to show why utility requests are unreasonable. Clearly, there is nothing in the statutes to suggest that the burden of proof changed under riders.

Perhaps even more importantly, Xcel's arguments miss the important role that cost caps provide. TCR riders give utilities the extraordinary ability to charge their ratepayers for costs of facilities prior to the ordinary timing: the first rate case after the project goes into service. In exchange, ratepayers need some assurance that utilities are being held accountable for the costs they charge to ratepayers. Requiring utilities to wait until the first rate case after a project is in service to justify recovery of cost overruns of projects is the least that can be done to assure ratepayers that utilities are being held accountable.

As Xcel's narrative above indicates, absent cost recovery caps, utilities have little incentive to expend the effort needed to accurately report project costs in CN and Route Permit proceedings. Moreover, disregarding CN and Route Permitting cost estimates and allowing utilities to recover all costs jeopardizes the integrity of the CN and Route Permitting process and the figures relied upon by the Commission.

The Department notes that the Commission has a well-established precedent on this issue. Further, Xcel has no reasonable basis to argue that the Company believed it was entitled to recover cost overruns, let alone to do so prior to making a showing of prudence in the first rate case after the project went into service. Cost recovery caps in TCR proceedings are critical to hold utilities accountable for: 1) minimizing cost overruns, and 2) for meeting their burden to show why ratepayers should pay for the cost overruns. The Department notes that Xcel can seek recovery for costs above initial estimates in a future rate case.

#### D. *BUFFALO RIDGE RESTORATION PROJECT COST RECOVERY*

##### 1) *Xcel's Reply*

Beginning on page 7 of their reply comments, Xcel responded to the Department's recommendation that the Commission exclude Buffalo Ridge Restoration Project costs from the TCR Rider. Xcel asked that the Commission and the Department consider the following response:

First, the purpose of the RCR Statute is to encourage utilities to make investments in infrastructure to meet the wind, biomass, and renewable mandates. The RCR Statute specifically allows recovery of "investments and expenditures...to transmit electricity" if directly related to the transmission of that renewable energy. The costs we are seeking to recover are directly related to



transmission of renewable wind energy from Buffalo Ridge to our customers. The project costs were reasonable and necessary to restore the interconnection and transmission of renewable generation developed to comply with Minnesota's renewable energy objectives and standards. Completion of the restoration project allowed the approximately 350 MW of wind generation to reconnect to the transmission system through the restored 34.5 kV feeder collection system, and allowed approximately 1200 MW of wind generation to reliably transmit energy to our customers. Without rebuilding these facilities, wind generation on Buffalo Ridge would have been undeliverable or subject to transmission curtailment risk for up a year or more.

Second, the RCR Statute does not limit recovery of investments to new projects. In this case we are not talking about the replacement of a few poles or a small section of line, but rather an extensive rebuild of nearly 100 miles of facilities. Therefore our request is consistent with the purpose of the RCR which is for any significant transmission investments to deliver wind to market, not normal wear and tear on our system. Even if we assumed this was a limitation, the full removal and complete replacement of the existing 115 kV line and the 34.5 kV collector systems at 2011 transmission engineering and construction standards means the reconstructed facilities are new facilities.

Third, the RCR Statute also does not limit recovery to only generation facilities. If the Legislature had intended to limit rider recovery to generation facilities, it could have modified the RCR Statute when it adopted the TCR Statute. Instead, by retaining the RCR Statute (enacted in 1997) when the TCR Statute was enacted (in 2005), the Legislature allowed that there could be transmission projects not eligible for recovery under the TCR Statute that could still be recoverable under the RCR statute. We believe the Buffalo Ridge Restoration Project is one of the situations where such recovery of a transmission investment is authorized under the RCR Statute.

Fourth, granting approval of recovery under the RCR Statute in this instance will not, as the Department asserts, provide a means to assert that the costs of any transmission line restoration on our system is recoverable because any line arguably can be considered to transmit some level of renewable energy. Attachments A and B show that the reconstructed facilities were integral components of the transmission system in the Buffalo Ridge area and clearly necessary to collect and deliver wind energy from Buffalo Ridge to our customers. The wind collector systems collect the output of

hundreds of wind towers and deliver this energy to the higher voltage system. The collector systems are used exclusively for wind generation. The 115 kV line is an integral part of the Buffalo Ridge outlet transmission system that includes the 425 MW Outlet, 825 MW Outlet and Buffalo Ridge Incremental Generation Outlet projects, which provided approximately 1250 MW of outlet capacity to transmit renewable energy from the Buffalo Ridge area to our customers. The extraordinary circumstances of the storm and the reconstruction project will not create precedent regarding rider recovery with unintended consequences.

Fifth, with respect to the question of whether the projects eligible under the RCR Statute require pre-certification, the Company's Petition included both a request for (a) an eligibility determination, and (b) approval for TCR Rider recovery. At the time the Company initially filed and the Commission approved our RCR Rider tariff in Docket No. E002/M-02-474, the process used by the Commission was a two-step approval process: first the Company obtained an eligibility determination for each RCR project, and then we separately filed for calculation of the RCR Rider rates after the eligibility determination. That process proved cumbersome and did not allow timely cost recovery, so in 2006, the Company proposed, and the Commission approved, a TCR Rider process that included both the eligibility determination and the rate recovery calculation in a single filing. (Footnotes omitted).

## 2) *Department's Response*

The Department reviewed Xcel's reply comments and the accompanying information provided in Attachments A and B. The Department also met with Xcel to discuss their comments. Based on our review and discussions with the Company, the Department agrees with Xcel on points on points 1, 3, and 5 above.

The Department agrees with Xcel that the RCR statute allows for recovery of transmission costs directly allocable to transmitting electricity generated from a project needed to meet the requirement of the RES. Clearly, in this case, the 34.5 kV collector system is needed to transmit the output of specific renewable generators to the transmission system, and thus those costs should be included. However, Xcel also requests recovery for a 115 kV line that is part of the transmission system on the Buffalo Ridge.

One of the Department's concerns with Xcel's proposal was that, due to the integrated nature of the transmission system, any transmission facility could be said to deliver at least some renewable energy and would, therefore, be eligible for cost recovery under the RCR Statute. The Department discussed this issue extensively with Xcel. Because the 34.5 kV collector system was used exclusively for wind generation and is necessary to deliver wind energy to the

transmission system, the Department concludes that the capital repairs to the collector system are eligible for cost recovery under the RCR Statute.

On a similar note, the Department understands that the storm damage caused to the 115 kV transmission facilities also severely limited the deliverability of wind energy.<sup>1</sup> According to Xcel, nearly all the wind energy produced in this region was unable to be delivered to load. In fact, as stated in Xcel's initial filing, the Company was required to exercise several force majeure provisions under its wind purchase power agreements, a standard that is not easily met. As a result, the Department concludes that, in this case, Xcel's capital repairs to its 115 kV facilities qualify for cost recovery under the RCR Statute.

E. *BUFFALO RIDGE RESTORATION COSTS INCLUDED IN THE COMPANY'S 2011 TCR COMPLIANCE FILING, TRUE-UP REPORT, AND TRACKER BALANCE*

Since the Buffalo Ridge Restoration Project was one of four new projects proposed for recovery in the instant filing, the Department recommended, in our initial comments, that Xcel explain why these revenue requirement amounts were included in the Company's 2011 TCR Compliance Filing, True-up Report, and Tracker Balance.

Beginning on page 10 of its reply comments, Xcel stated that:

The Department requested that we provide additional information to explain why we included the Buffalo Ridge restoration project in the 2011 TCR True-Up Report and Tracker Balance. Consistent with past practice, we included this project in the tracker balance because it went into service in 2011, with the understanding that inclusion in the 2011 tracker balance is subject to Commission approval of project eligibility under the RCR Statute in this proceeding.

The Commission approved similar treatment of the Blue Lake/Wilmarth 345 kV transmission line in their Order dated April 27, 2010 in our 2010 TCR proceeding (Docket No. E002/M-09-1048). In that case, we requested approval to include the Blue Lake/Wilmarth project in the TCR Rider in 2010 under the RCR Statute, and proposed to include the revenue requirements in the TCR Tracker Balance beginning in March 2009 for the portion of the project that went into service at that time. The Commission approved tracker balance treatment, since it found the project eligible for TCR Rider recovery. We believe our proposed inclusion of the Buffalo Ridge restoration project costs in the 2011 tracker is consistent with this past practice, assuming the

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<sup>1</sup> See attached maps in DOC Attachment No. 1. The 115 kV line provides the necessary outlet for the renewable generators shown.

Commission agrees the Buffalo Ridge project is eligible for TCR Rider recovery. (Footnotes omitted).

The Department is concerned with Xcel's proposal to include Buffalo Ridge Restoration Project costs in the 2011 tracker since this project was never approved for recovery in the prior TCR proceeding (Docket No. E002/M-10-1064). It is the Department's view that the projects included for recovery in a specific TCR proceeding should remain fixed once they are approved by the Commission. In the event that a utility incurs project costs before it is deemed eligible for recovery, the Department recommends that these costs be included in the current period revenue requirements in the TCR proceeding in which the Commission deems the project to be eligible for recovery.

As shown in Attachment 15, page 1 of 12 in Xcel's initial filing, the Company proposed to include \$156,999 of revenue requirements in the 2011 tracker for the Buffalo Ridge Restoration Project. Therefore, the Department recommends that, if the Commission approves this project for recovery in the current proceeding, the prior period revenue requirements of \$156,999 should be removed from the 2011 Tracker account and added to the 2012 revenue requirements.

#### F. *CAPITALIZED INTERNAL COSTS*

In our initial comments, the Department noted that Minnesota regulation has a history of denying recovery of capitalized internal costs outside of a rate case since representative amounts of such costs are already being recovered from ratepayers through base rates. More recently, in Minnesota Power's 2010 TCR filing (Docket No. E015/M-10-799), the Commission required Minnesota Power to exclude capitalized internal costs from its TCR Rider. As a result, the Department recommended that the Commission do the same in this docket, and deny Xcel's proposal to recover capitalized internal costs in its TCR Rider.

##### *1) Xcel's Reply*

As explained on pages 21-24 of their reply comments, Xcel disagreed with the Department's recommendation, and continued to recommend that they be allowed to recover capitalized internal costs in the TCR Rider.

Xcel stated on page 21 of their reply comments that the Commission's Order in Minnesota Power's 2010 TCR Rider filing (Docket No. E015/M-10-799) also stated that "The Commission's evaluation of a request for rider recovery is based on the specific facts presented in each case...."

Xcel also stated that they believe the record, in this case, demonstrates that recovery of capitalized internal labor costs in the TCR Rider is appropriate and should be approved. According to Xcel, their reply comments demonstrate that:

- Internal labor costs incurred for capital projects after the 2011 rate case test year are not being recovered in the Company's current rates;

- Allowing recovery through the Company's TCR Rider is consistent with state policy and statutes, Commission rules and Commission precedent; and
- Including all capitalized labor (both internal and external) for TCR Rider projects will avoid unnecessary accounting and ratemaking complexity.

2) *Department's Response*

The Department reviewed Xcel's reply comments. The Department continues to recommend that the Commission deny Xcel's proposal to recover capitalized internal costs in their TCR Rider for several reasons. First, the Department notes that there is nothing inherently different in the way that Xcel and Minnesota Power account for capitalized internal costs. Therefore conceptually, the Department concludes that there is no reason to view Xcel's proposal to recover capitalized internal costs in their TCR Rider differently than Minnesota Power's.

Second, the Department notes that Xcel's bulleted statements above are only partially correct. While the Department agrees that specific internal labor costs incurred for capital projects after the 2011 rate case test year are not being recovered in current rates, the Department notes that Xcel is recovering a representative amount of the Company's internal labor costs in current rates. In addition, while the Department acknowledges that denying recovery of internal capitalized costs in riders can cause some accounting and ratemaking complexities, the Department notes that riders themselves are a departure from traditional ratemaking practices and already cause significant accounting and ratemaking complexities, which only adds to the burden and time constraints of all parties, including the Department and the Commission.

Third, as noted in our initial comments, the Commission has a well-established precedent on this matter, including the treatment in Minnesota Power's 2010 TCR Rider filing. The Department maintains its position and continues to conclude that the Commission's decision regarding this issue was correct. Therefore, the Department continues to recommend that the Commission exclude recovery of capitalized internal costs in Xcel's 2012 TCR Rider.

G. *REVISED 2012 TCR REVENUE REQUIREMENTS AND RATE ADJUSTMENT FACTORS*

Xcel provided its revised 2012 TCR revenue requirements and rate adjustment factors in Attachment G of its reply comments. The Company used the allocators and overall rate of return approved by the Commission in its most recent rate case. Xcel also stated that Attachment G had been updated with actual sales data through June 2012, and reflects an October 1, 2012 implementation date for the rate adjustment factors.

The Department notes that, due to these changes, Xcel's proposed 2012 TCR revenue requirements have decreased slightly from \$29,594,035 to \$27,775,238. The Department recommendations would reduce the 2012 revenue requirements further for the cap on the Bemidji Project and the removal of capitalized internal costs.

H. *INSURANCE PROCEEDS AND OTHER COMPENSATION*

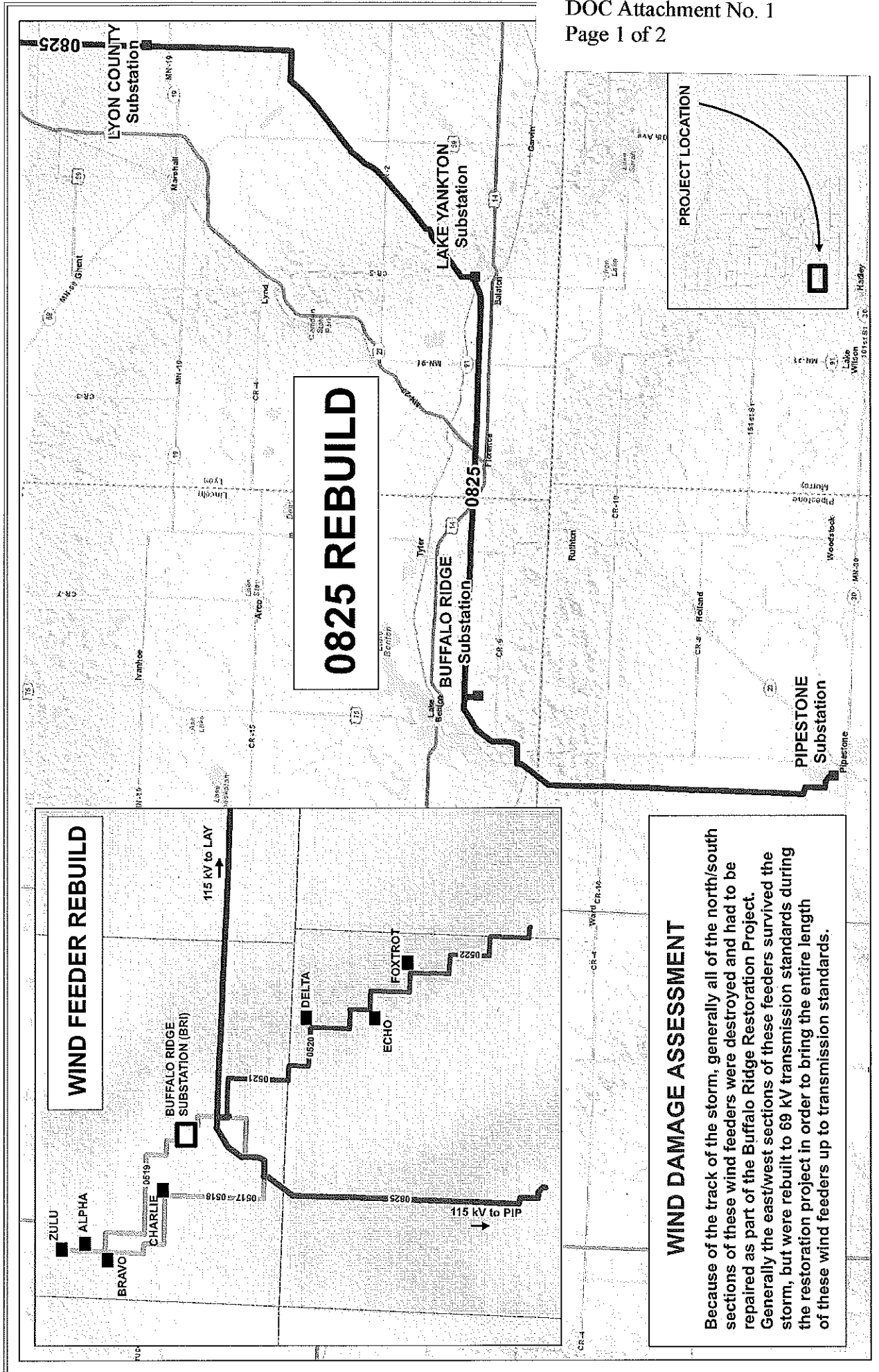
Xcel stated on page 11 of its reply comments that it will not receive any insurance proceeds or other compensation related to the storm damage on Buffalo Ridge. According to Xcel, it is less expensive over the long term to pay for the costs of repairing storm damaged facilities than it is to purchase insurance.

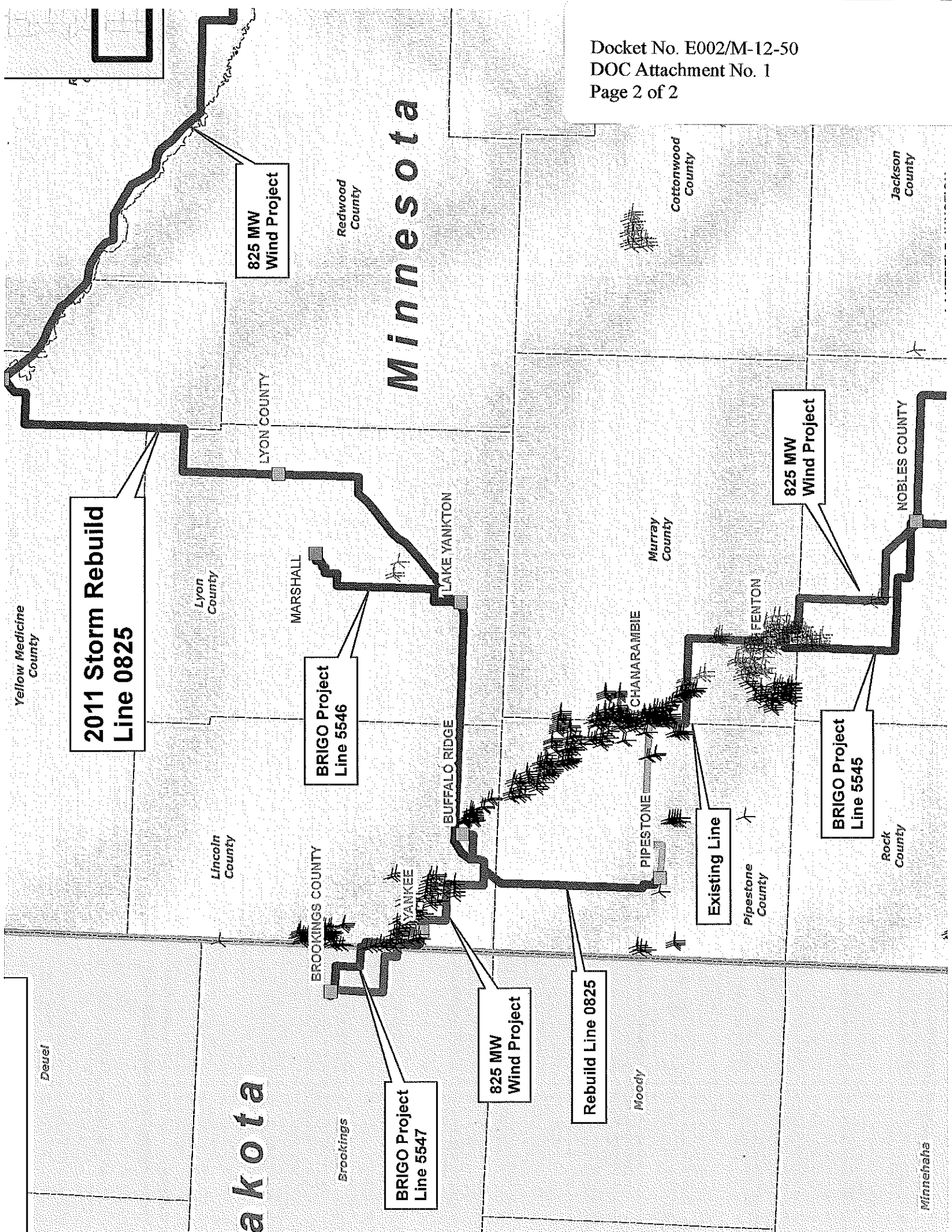
**IV. SUMMARY AND RECOMMENDATIONS**

The Department recommends that the Commission approve Xcel's petition with the following modifications:

- Accept Xcel's proposed cost escalator for the Bemidji Project, which increases the cost recovery cap for this project from \$66.2 million to \$74 million, or by \$8.2 million.
- Deny Xcel's proposal to recover costs associated with the Bemidji Project that are over the inflation-adjusted cap of \$74 million. Such costs can be requested for recovery in a subsequent rate case.
- Deny Xcel's proposal to recover internal capitalized costs amounting to \$1.5 million in annual revenue requirements in its 2012 TCR Rider.

/sm







## **CERTIFICATE OF SERVICE**

I, Sharon Ferguson, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, e-mail, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

**Minnesota Department of Commerce  
Response Comments**

**Docket No. E002/M-12-50**

Dated this **1<sup>st</sup>** of **November, 2012**

**/s/Sharon Ferguson**

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