414 Nicollet Mall
Minneapolis, MN 55401

October 14, 2016

—Via Electronic Filing—

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

RE: RESPONSE COMMENTS
RENEWABLE ENERGY STANDARD (RES) RIDER
DOCKET NO. E002/M-15-805

Dear Mr. Wolf:

Northern States Power Company, doing business as Xcel Energy, submits the enclosed Comments in response to the August 3, 2016 Response Comments of the Department of Commerce, Division of Energy Resources regarding our Revised Petition and Supplement in the above-referenced docket.

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

If you have any questions regarding this filing please contact me at (612) 215-5367 or amy.s.fredregill@xcelenergy.com

Sincerely,

/s/

AMY S. FREDREGILL
MANAGER, RESOURCE PLANNING AND STRATEGY

Enclosures
c: Service List

STATE OF MINNESOTA
BEFORE THE
MINNESOTA PUBLIC UTILITIES COMMISSION

Beverly Jones Heydinger	Chair
Nancy Lange	Commissioner
Dan Lipschultz	Commissioner
Matthew Schuerger	Commissioner
John Tuma	Commissioner

IN THE MATTER OF THE REVISED PETITION AND SUPPLEMENT OF NORTHERN STATES POWER COMPANY FOR APPROVAL OF THE RENEWABLE ENERGY STANDARD (RES) RIDER TRUE-UP REPORT FOR 2015, REVENUE REQUIREMENTS FOR 2016, AND A REVISED RES ADJUSTMENT FACTOR	DOCKET NO. E002/M-15-805 **RESPONSE COMMENTS**

INTRODUCTION

Northern States Power Company, doing business as Xcel Energy, submits to the Minnesota Public Utilities Commission this response to the August 3, 2016 Response Comments of the Minnesota Department of Commerce, Division of Energy Resources regarding our Revised Petition and Supplement requesting approval of our Renewable Energy Standard (RES) Rider for 2016. In these Comments, we respond to the issues raised by the Department in its Response Comments, including recommendations related to the treatment of Accumulated Deferred Income Taxes (ADIT) and North Dakota Investment Tax Credits (NDITCs).

We appreciate the Department's response to our Reply Comments and confirmation that our treatment of Allowance for Funds Used During Construction (AFUDC) appears reasonable. The Department also concluded in its Response Comments that use of the tracker balance going forward for the next true-up and RES rider filing is appropriate as the Commission will likely be approving this petition later than the proposed implementation date of January 1, 2016.

A. IRS Regulations Require Proration

In addition, the Department also recommended that (1) ADIT proration is not required, and further that (2) ADIT proration at true-up is not required. With regards

to the first matter, we note that all utilities are required to follow IRS regulations, and the regulations *clearly* and *without question* state that ADIT proration is required. There is not any uncertainty on this topic in the industry.

However, while the Company must prorate its ADIT balances, we understand there is some level of inconsistency in the industry regarding treatment of the ADIT true-up. The Company's understanding of the IRS regulations is that the true-up balances also must be prorated, whereas the Department asserts that the true-up should not be prorated.[1]

B. Decision on Treatment of True-Up Should be Deferred

While we disagree with the Department's recommendations regarding the treatment of ADIT proration at true-up, we do not believe a decision is necessary on the issue at this time. With this in mind, we respectfully request the Commission confirm ADIT proration is appropriate and defer a decision on the treatment of true-up calculations to a future proceeding. Since there is still some uncertainty on the issue, deferral would allow additional development of the subject including potential guidance from the IRS, the Federal Energy Regulatory Commission (FERC), and Commission proceedings.[2]

Should the Commission decide a resolution is necessary at this time, we note that if either of the Department's recommendations related to ADIT proration are adopted, the Company would be in violation of IRS guidelines. Not only would we be required to notify the IRS of a violation but this would ultimately harm our customers because they would no longer be able to experience the lower rates that come from beneficial tax depreciation treatment.

In our view, here are three of the Commission's options (in order of Xcel Energy's preference) as well as the associated outcomes of those options:

1. Approve our RES Rider rate factor for 2016, confirm ADIT proration is required, and defer a decision on proration of ADIT at true-up to a future proceeding.
    - This RES proceeding does not include a true-up of the ADIT balance, and thus our 2016 revenue requirements can be approved as proposed even if the Commission defers a decision on the treatment of the true-

[1] See the Direct Testimony of Ms. Nancy Campbell in Docket No. E002/GR-15-826.
[2] For example, the ALJ Report on Otter Tail Power's (OTP) rate case (Docket No. E017/GR-15-1033) is expected by January 5, 2017.

up balance. If additional guidance from the IRS, the FERC, or other proceedings shows our ADIT proration treatment to be unsupported, we would credit to customers any difference through the RES tracker.

2. Defer the entire ADIT proration decision, as well as our 2016 RES Rider rate factor.
    - If the Commission takes this action, it should note that the Company is not collecting any revenue requirement, as the RES Rate Adjustment factor is currently set at zero. The Company would expect to recover incurred costs, including historical costs, through use of the tracker balance going forward.

3. Order the Company to not prorate ADIT in general or at true-up as the Department has suggested.
    - If the Commission takes either of these actions, the Company would be required to notify the IRS of the Commission's Order that results in the Company being in violation of Tax Normalization Rules.

While the Company recommends the Commission defer a decision on true-up proration at this time, we further clarify our position on ADIT proration treatment in the below Response Comments. We provide:

- Background on accelerated depreciation and Tax Normalization Rules;
- Support for why ADIT proration is necessary;
- Support for why Private Letter Rulings (PLRs) can and should be used as guidance;
- Recent IRS guidance that supports the proration methodology;
- Support for why maintaining proration in the true-up to actuals is required;
- Recent FERC decisions that support proration of the true-up balance;
- An explanation for why the current FERC tariffs do not include the proration method;
- A discussion of why the use of an historic test year is not the appropriate solution to address ADIT; and
- An explanation of the harm to customers should the Commission accept the Department's recommendation that the Company not be allowed to prorate ADIT.

RESPONSE

The Department recommends that the Commission not allow the Company to use any prorated ADIT balances or, in the alternative, require our RES Rider to be based solely on historical costs. Below we provide a background on accelerated depreciation and Tax Normalization Rules and then support why ADIT proration is required, why the proration of the ADIT true-up is required, and the customer harm that will come if the Department's recommendation is adopted.

A. Background on Accelerated Depreciation and Tax Normalization Rules

Accelerated depreciation refers to the depreciation method used for income tax purposes. This method accelerates tax depreciation in the early years of an asset's life, faster than the use of the straight line depreciation method. In contrast to accelerated depreciation, straight line depreciation recovers the cost of an asset in equal amounts each year over the asset's expected productive life. The difference between the income taxes based on straight-line book depreciation and accelerated tax depreciation are reflected as ADIT.[3]

The ADIT deferral is a significant tax incentive that Congress adopted with the specific intent of encouraging businesses to make capital investments. In public utility rate cases, many regulatory agencies, including this Commission, consider the related accumulated deferred income tax liabilities to be cost-free capital available to the utility and, consequently, require that they be credited to rate base for ratemaking purposes.

ADIT provides the Company access to cost-free capital it would not otherwise have. ADIT is subtracted from rate base, thus reducing the financing costs included in the revenue requirement. Annual deferred tax expense is part of the revenue requirement, and there is an equal and offsetting decrease to current tax expense. Thus, all customers benefit from the tax deduction of the asset cost ratably over its useful life.

In fact, Congress has imposed specific requirements and restrictions on a utility's ability to use accelerated and bonus depreciation. Congress (and the IRS acting under

[3] There are four categories of ADIT recognized in the Uniform System of Accounts in four separate accounts; however, only three of these categories of ADIT are related to accelerated depreciation for plant assets included in rate base, including bonus depreciation: Accounts 190, Accumulated Deferred Income Taxes; 281, Accumulated Deferred Income Taxes-Accelerated Amortization Property; and 282, Accumulated Deferred Income Taxes-Other Property.

Congressional authority and direction) has established specific preconditions for a utility to use accelerated and bonus depreciation for federal income tax purposes, which are called the Tax Normalization Rules.

Tax Normalization Rules encompass requirements from the Internal Revenue Code (IRC), Treasury Regulations and related guidance provided by the IRS, such as PLRs. Specifically, Tax Normalization Rules are set forth in IRC § 168(f)(2) and § 168(i)(9), provided as Attachment A. These rules require that deferred taxes created based on accelerated tax methods cannot flow back any faster than straight line depreciation would provide for over book life. The associated regulations further define how the deferred tax balance for the federal portion of FERC Account 282 must be calculated for the future test year. (See Treasury Regulations Section 1.167(l)-1(h)(6)).

Congress did not directly prohibit regulators from using other methods to set rates; however, the consequences of a regulator doing so is the utility's loss of accelerated depreciation, including bonus depreciation, for federal income tax purposes. In light of the potential loss of accelerated deductions and for other reasons, Minnesota and virtually all other jurisdictions have adopted the normalization method of tax accounting for rate setting purposes.

The consequences of violating Tax Normalization Rules are severe. The Company would lose the ability to use accelerated tax depreciation on utility assets, greatly decreasing the ADIT offset to rate base, which provides a significant benefit for our customers in the form of lower rates. The ADIT offset to rate base is forecasted to be in excess of $2 billion on a Total Company basis for the electric business.

B. IRS Proration Method is Required

The proration method is required by the Tax Normalization Rules. The purpose of the proration requirement is to prevent the flow-through of the benefits of accelerated depreciation to ratepayers any earlier than realized. The IRS assumes the benefits are received on the last day of the period over which the deferral is recognized (monthly for NSPM). If we were to follow the Department's recommendation to not use proration, the Company would be in violation of the Tax Normalization Rules and, as previously discussed, would no longer be able to take advantage of accelerated depreciation.

The requirement and the formula are described in Treasury Regulation Section 1.167(l)-1(h)(6)(ii), and examples are provided in Treasury Regulation Section 1.167(l)-1(h)(6)(iv). Section 1.167(l)-1(h)(6)(ii) of the Treasury regulations mandate the use of a very specific proration procedure in measuring the amount of future test

period ADIT that can reduce rate base. This regulation requires that, if a utility uses a "future" test period to determine depreciation, "the amount of the reserve account for the period is the amount of the reserve at the beginning of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during such period."

The Company is not alone in our understanding of the IRS guidance on proration requirements. Due to the fact that the proration requirements of Treasury Regulation Section 1.167(l)-l(h)(6) were a source for a number of inconsistent positions by different utilities. Consequently, some electric utilities requested rulings from the IRS regarding the calculation of ADIT when using forward-looking ratemaking and a true-up mechanism. Consequently, in July and August 2015, the IRS Chief Counsel's Office (the National Office) issued four PLRs that, for the first time in many years, addressed the ADIT proration requirement and some of the circumstances under which it applies.[4]

The four IRS PLRs that were published in July and August 2015 address the ADIT proration requirement and the specific normalization requirement for forecasted rate setting. In these PLRs, the IRS reasserts that in the case of future test periods, the ADIT proration methodology described in Treasury Regulation Section 1.167(l)-1(h)(6) must be used. The PLRs also found that the taxpayers' Commissions and the taxpayers themselves "intended at all times to comply with the normalization rules." Because of this and because the taxpayer committed to take corrective actions, the IRS determined it is not appropriate to apply the sanction of denial of accelerated depreciation to the taxpayer. A citation and discussion summary of each of these four PLRs, as well as an additional fifth PLR[5] that was released in October discussed in more detail below, is provided as Attachment B.

C. Private Letter Rulings Can and Should Be Used as Guidance

The Department states that the PLRs on which we have based our opinion that proration of the ADIT true-up is necessary do not apply to the Company. However, the Supreme Court has acknowledged that PLRs "reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws."[6] As we explain below, PLRs are often relied upon by other companies to interpret tax regulations.

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[4] PLR 201531010, 201531011, and 201531012 released in July of 2015 and PLR 201532018 released in August of 2015

[5] PLR 201541010 released in October of 2015

[6] *Hanover Bank v. Commissioner*, 369 U.S. 672, 686 (1962).

The IRS strives to achieve consistency in its interpretations of tax statutes and regulations and PLRs offer understanding as to the IRS's interpretation of the IRC and related regulations. As it relates to the prorate method for ADIT for a forecast test period, the IRS has issued multiple PLRs that reach a consistent conclusion. While PLRs respond to a specific fact-pattern or transaction of the requesting company and provide audit protection only to the requesting company, they are published and made available to all. The process of publishing the rulings assists other taxpayers with similar fact patterns, avoids the requirement to submit a ruling request, and eliminates the need for the IRS to respond to such requests when there is a clear interpretation of the IRS position expressed in the PLRs.

The IRS has provided some official direction to its employees as to how PLRs and memorandums should be used and interpreted. The Internal Revenue Manual (IRM) provides that "[e]xisting private letter rulings and memorandums . . . may be used as a guide with other research material in formulating an area office position on an issue."[7]

In addition, the IRM goes on to say that the "application of a private letter ruling is confined to the specific case for which it was issued, unless the issue involved was specifically covered by statute, regulations, ruling, opinion, or decision published in the Internal Revenue Bulletin." The proration of ADIT requirement and methodology is specifically covered in Treasury Regulation Section 167(l)-l(h)(6). Accordingly, practitioners frequently look to PLRs for purposes of formulating their opinion with respect to tax issues where the facts are substantially similar

D. The Company's Proposal Provides the Maximum Benefit to Customers

The Company's approach is conservative since it is preserving the rate base offset for customers and complying with IRS requirements. An aggressive position would be challenging compliance with the IRS require ments as the Department is proposing. In addition, the previously noted Tax Normalization Rules that the Company is relying on provide that the proration calculation is applicable when the Company's overall ADIT balance is increasing, as is the case presently, or *decreasing*. As such, if/when the Company's overall ADIT balance begins to reverse in the future, causing an increase to rate base, proration will reduce the amount of the ADIT reversal in a given year.

[7] I.R.M. 4.10.7.2.10(4) (2006).

The proration adjustment could reduce the overall revenue requirement instead of increase it. When rate base is growing (plant additions outpace depreciation expense) in a year coupled with bonus depreciation, the deferred tax liability is growing as well. In this situation the proration adjustment does increase the revenue requirement overall. In contrast, when the rate base is stable (plant additions equal depreciation expense), the deferred tax liability may begin to unwind or shrink. In this situation, the proration adjustment will decrease the overall revenue requirement.

The Company is providing the entire amount of ADIT offset to rate base that it is allowed to. Congress created the Tax Normalization requirement to ensure the benefits of accelerated depreciation did not flow through to customers more quickly than intended in order to maintain an incentive for regulated utilities to make capital investments. If the Company provides more than the full amount, it would violate the Tax Normalization Rules.

E. Proration Methodology is Supported By the Most Recent IRS Guidance

The Department states that our proposed ADIT treatment is inconsistent with the way ADIT has been handled for many years for ratemaking purposes. The Company believed its actions to date and the Commission's approvals were in line with the Tax Normalization Rules. However, recent IRS guidance has made the Company aware that historic ADIT treatment was not consistent with IRS regulations. Now that we understand that the Tax Normalization Rules require proration—and the utility industry and the FERC are in agreement with the need to prorate— we must make this correction going forward. The Company recommends the Commission adopt the proration method at this time. If the Commission follows this recommendation, the Company does not believe that the IRS would invoke any normalization sanctions and deny the ability to claim accelerated depreciation.

As discussed above, the Tax Normalization Rules, including recent guidance from the IRS, mandate the use of the proration method when calculating ADIT. Violation of the Tax Normalization Rules means that the Company cannot make use of the accelerated methods of depreciation and must file its taxes using the straight line basis that it uses for its financial books. While this approach would avoid a small increase to revenue requirements, it would also eliminate a large rate base reduction which would result in more customer harm than preserving normalization in ratemaking.

F. Maintaining Proration in True-Up to Actuals is Required

Should the Commission accept the prorate method for ratemaking, the Department's testimony in our current rate case[8] disputes the need to use the prorate method on the true-up calculation. As discussed above, the Commission should accept the prorate method for determining the ADIT adjustment to rate base because the prorate method is required by the Tax Normalization Rules and the consequences of violating Tax Normalization Rules are severe. In addition, the true-up must use the proration method when adjusting a forecasted rate even if the adjustment is to actuals. Recent IRS rulings as well as FERC rulings indicate this is the necessary calculation method.

A true-up is determined by reference to what was used to originally set customer rates. If a rate proceeding uses a forecast period and the rates are charged to the customers before the forecast period becomes actuals, proration must be used. The test is whether an historical or a future test period was used to set the general rates and that the rates were first charged to customers before the forecasted test year was complete. Performing a true-up at a later date does not change the fact that when rates were collected from customers, they were reduced by the benefits of accelerated depreciation before the Company received those benefits. According to PLR 201541010, "The addition of the true-up increases the ultimate accuracy of the rates but does not convert a future test period into a historical test period as those terms are used in the normalization regulations."

Our current rate case as well as our RES rider present a forecasted test year, and the first time the rate was charged to customers is through interim rates. Therefore, the true-up must use the proration method when adjusting for actuals.

If actual ADIT is greater than the forecasted amount, the proration adjustment remains the same and is not recalculated because the incremental amount of actual ADIT over the forecasted amount will be reflected in rates *after* the test year, which is when the accelerated depreciation benefits were earned by the Company. As such, this incremental amount is not an accelerated depreciation benefit that is provided to customers before they are received by the Company, which is the situation the proration rules are concerned with. In PLR 201541010 the IRS referred to this incremental amount as the true-up component and stated that, in this instance, the actual amount added to the ADIT in the original projection is not modified by the proration formula.

[8] Docket No. E002/GR-15-826, Direct Testimony of Ms. Nancy Campbell

The four PLRs issued in July and August 2015 addressed the ADIT proration requirement and some of the circumstances under which it applies, but they did not resolve all outstanding proration issues. The utilities that requested these PLRs did not ask specifically how the proration requirement applies to the true-up calculation. Consequently, the proration requirement at true-up, while briefly mentioned, remained uncertain.

Subsequent to the issuance of those four PLRs, in October 2015 the IRS issued a fifth PLR that affirmed the requirement to use proration and *also* clarified that proration is required in the true-up calculation in order to preserve the effect of the originally estimated proration. In this fifth PLR, the IRS stated that, "[i]n calculating the true-up, proration applies to the original projection amount,"[9] and notes that the originally projected amount is thus carried forward into the true-up, and therefore is not "unwound" by reversing the proration calculation.[10] The IRS also reasserted that in case of future test periods, the ADIT proration methodology described in Reg. Sec. 1.167(l)-1(h)(6) has to be used.

The fifth PLR addressed that proration applies to the originally forecasted amount. The IRS also made it clear in this fifth PLR that the true-up process cannot be used to unwind the proration calculation of ADIT. The IRS's view is that forward-looking formula rates with true-up procedures employ a future test period subject to Tax Normalization Rules, and such formula rates must use the proration formula in estimating ADIT amounts, including carrying forward the amounts of ADIT calculated using the proration formula into the true-up. The PLR states that, "[i]n calculating the true-up, proration applies to the original projection amount." The originally projected amount is thus carried forward into the true-up, and therefore is not "unwound" by reversing the proration calculation.

Ms. Campbell's testimony discussed a PricewaterhouseCoopers (PwC) article that appears to contradict the need to prorate ADIT on true-up. This article was issued August 2015, prior to the fifth PLR (PLR 201541010) referenced above for the use of the prorate method for a true-up. We have discussed the intent of the language in the article referenced with PwC in their role as our tax advisor. We believe the Department may not have interpreted the PwC article in the manner for which it was intended with regard to the ADIT proration at true-up. While the true-up is to actual ADIT balances, the original prorated ADIT is not disturbed.

[9] IRS PLR 201541010 at 8.
[10] IRS PLR 201541010 at 12.

G. Recent FERC Decisions Support Proration of the True-Up Balance

In addition to the recent IRS guidance, the latest FERC actions also support our interpretation on ADIT balance treatment. The FERC initially decided that there should be no prorate on true-up in their December 30, 2015 Order in Dominion's MISO case (Docket No. ER14-1831-001). And, while they also rejected our request to clarify that there should be prorate on true-up in our MISO case (December 30, 2015 in Docket No. ER16-197), the reasoning was different as the FERC did not rule that there should be no prorate at true-up. Instead, the FERC stated that we did not fully justify our request.

However, the FERC later reversed their ruling in the Dominion case. On February 23, 2016 the FERC issued an *Order on Revised ADIT Treatment.* In this reversal order the FERC accepted Dominion's proposal to continue to apply the proration methodology to the originally projected ADIT balances in performing the annual true-up calculations. Through its September 22, 2016 *Order Denying Rehearing*, in this Dominion docket, the FERC upheld its February 23, 2016 Order accepting the ADIT proration at true-up. These Orders are provided as Attachments C and D.

The FERC has taken additional action that supports the Company's proration on true-up approach. On April 12, 2016, the FERC issued an order for formula rates for two of Xcel Energy's subsidiaries, PSCo (Public Service Company of Colorado) and SPS (Southwestern Public Service Company) in Docket Nos. ER16-236 and ER16-239. The PSCo and SPS formula rates use proration for the calculation of ADIT in the forecast and the true-up. The proration was approved by the FERC for ADIT true-up in line with the method that was approved for Dominion in February 2016. The Order is provided as Attachment E.

In response to the December 30, 2015 Order in the Company's MISO case where the FERC said the Company did not fully support its request, we filed a Motion to Lodge with the FERC on March 11, 2016 and provided additional support for our position. In addition, on September 22, 2016, the FERC issued its Order in the MISO docket clarifying that the December 30, 2015 Order does not prevent the Company from submitting tariff revisions that reflect ADIT proration at true-up. As a result, the Company intends to submit tariff revisions to the FERC providing additional support for the ADIT proration calculation. We expect FERC action on that filing before the end of 2017. This Order is provided as Attachment F.

H. FERC Tariffs Will be Updated to Use the Proration Method

The Department states that the Company is inconsistent in applying ADIT prorate between the current proceedings in Minnesota and proceedings at the FERC. Specifically, the Department references the July 25, 2016 compliance filing on behalf of Xcel Energy Transmission Development Company, LLC. (XETD), which is part of the same consolidated tax entity as NSPM.[11] The purpose of the compliance filing was to address specific issues identified in the FERC Order issued on June 23, 2016, which were unrelated to the ADIT topic.

Now that additional IRS guidance has been issued through the PLRs regarding ADIT proration, the XETD tariff will be updated to reflect the same treatment as used in Xcel Energy's recent Minnesota regulatory filings. Because XETD does not yet own operational transmission facilities (i.e., there are no assets to include in the formula rate), the ADIT treatment is not being applied by XETD to any assets at this time. The tariff will be updated to reflect the ADIT proration methodology when it is administratively appropriate at a time when other changes need to be made to the formula rate template.

I. Use of Historic Test Year for Riders is Not Warranted

With regard to the Department's alternative solution to use historical test years for riders, we note that the use of a historical test year may solve this one issue, but there are better, less drastic options to solve the ADIT proration issue at hand. A historical test year creates a whole host of new issues as well.

In an environment where capital investments are high, rates based on historical test years do not provide balanced recovery. The rates are effectively out of date as soon as the new rates go into effect. As a result, due to this regulatory lag, the use of historical test years essentially prevents utilities from earning its allowed rate of return, which increases risk and the cost of capital which could eventually be reflected in higher rates. In sum, the use of forward- looking test years better represents actual costs in rates and as a result produces better results for utilities and our customers. There are better, less blunt options to solve the issue. Such a change in rider treatment has wide-ranging impacts, and there should be additional record development if the Commission would like to explore this alternative.

[11] FERC Docket No. ER14-2752-004

J. Other Minnesota Utilities' Approaches

Other Minnesota utilities, like OTP, agree with the Company's interpretation of IRS guidelines regarding ADIT proration. In its recent rate case, OTP stated its "goal is to comply in good faith with a well-documented IRS normalization requirement."[12] Failure to use ADIT proration is non-compliance with the IRS normalization requirements which could result in losing the ability to take accelerated depreciation.[13]

However, regarding the ADIT true-up, some Minnesota utilities are approaching treatment of the true-up differently than Xcel Energy, though we do not know what they have based their decisions on. We have reason to believe their approach to the ADIT true-up may need to be updated due to the earlier timing of their filings that addressed the issue. The Company's decision to maintain ADIT proration at true-up is based on the most recent IRS rulings, FERC guidance, and numerous consultations with accounting firms, tax advisors, in-house counsel, outside counsel, and internal experts; these consultations confirm that our approach to maintaining ADIT proration in the true-up is consistent with the most recent guidance available. We do not believe we have the choice of not maintaining ADIT proration in a true-up calculation if we are to remain in compliance with the Normalization Rules.

K. Customers Would Be Harmed if ADIT is Not Prorated

If the Company is ordered to violate Tax Normalization Rules by not being allowed to prorate the ADIT, customers would be harmed. If the Company is not able to use accelerated depreciation, then tax depreciation would revert to straight-line depreciation over the useful life of the assets, or what is commonly known as book depreciation. Using book depreciation for tax treatment would eliminate any increase in ADIT rate base deduction going forward. Thus, the beginning deferred balance would stop increasing and would decrease causing a substantial increase to revenue requirements. For 2016, the average ADIT offset to rate base is forecasted to be in excess of $2 billion on a Total Company basis. A violation would cause this $2 billion balance to systematically go away, which would increase the return on rate base in general rates. Additionally, the Company and ratepayers would not have access to any accelerated depreciation, including bonus depreciation resulting from the 2015 Protecting Americans from Tax Hikes (PATH) Act or other actions by

[12] *In the Matter of the Application of Ottertail Power Company for Authority to Increase Rates for Electric Utility Service in Minnesota*, Docket No. E017/GR-15-1033, Rebuttal Testimony of Stuart D. Tommerdahl, page 17.
[13] Id. at pages 17-18.

Congress going forward.[14] Therefore, proration of ADIT is in the best interests of customers to keep their rates lower.

L. Benefits of Deferring a Commission Decision

A number of proceedings are in progress which may bring more clarity to the ADIT proration treatment issue. It may be beneficial to wait to have a further developed record on this issue in other currently pending Commission proceedings. In addition, the FERC has clarified that the Company may submit a revised tariff applying the ADIT proration to the true-up. We expect a FERC decision approving our revised tariff, consistent with the PSCo and SPS tariff treatment of the ADIT true-up proration, by the end of 2017. Further IRS guidance may also be forthcoming. If necessary, we could potentially submit our own PLR to the IRS for a definitive ruling.

If additional guidance from the IRS, the FERC, or Commission proceedings shows our ADIT treatment to be unsupported, we would credit to customers any difference through the RES tracker. We also agree to bring forward to the Commission any newly issued guidance as it emerges to help clarify the issue.

M. North Dakota Investment Tax Credit (NDITC)

The Company accepts the Department's correction to labeling this topic from North Dakota Income Tax Credit to North Dakota Investment Tax Credit. Often these are used interchangeably because the Investment Tax Credit is a type of Income Tax Credit on North Dakota state taxes.

In its Response Comments, the Department is recommending that the Company must meet its burden of proof to show that Minnesota should not receive a pro-rata share of the North Dakota Investment Tax Credit (NDITC), or else none of the Courtenay Wind project costs should be allowed to be recovered through the RES Rider.

The Company maintains its position that no amount of NDITCs should be proportionately shared with Minnesota ratepayers[15]. The NDITC is a credit to North

[14] Specifically, the Protecting Americans from Tax Hikes Act of 2015 (PATH Act) which is part of the Consolidated Appropriations Act of 2016.

[15] The Company's position with respect to the Minnesota treatment of NDITCs is contained in Docket No. E002/GR-15-826 in the Direct Testimony of Company witness Ms. Anne E. Heuer in section IX Compliance with Prior Commission Orders, part E, Other Compliance Requirements, Item 6, North Dakota Income Tax Credits.

Dakota income tax that only offers a tax benefit to the extent the Company has an income tax liability in the state of North Dakota. We also note that the Minnesota Cost of Service does not currently include a portion of the North Dakota income tax liability, which this credit would offset.

Additionally, due to the extension of bonus depreciation in the 2015 PATH, the Company does not expect to have taxable income in North Dakota until 2020. Although the Courtenay Wind project qualifies for the NDITC, the Border Winds project is in service sooner than Courtenay and is expected to generate sufficient NDITCs to offset the Company's anticipated tax liability for all but the last year that Courtenay qualifies for the NDITC (not expected until 2030).

Given the discussion above, and particularly the fact that the NDITCs for the Courtenay Wind Project are $0 in 2016 and many years thereafter, the Department's alternative recommendation – to deny the recovery of any of those costs associated with the Courtenay project from Minnesota ratepayers through this rider – is not a constructive solution to this issue. The RES Rider was designed to allow recovery of prudently-incurred investments associated with facilities constructed, owned, or operated by a utility to satisfy the RES, provided those facilities were previously approved by the Commission. The Company believes the Courtenay Wind Project qualifies for recovery in the RES Rider without regards to the NDITC issue.

CONCLUSION

We appreciate the opportunity to respond to the Department's Response Comments. We respectfully request that the Commission approve our Petition as supplemented on February 2, 2016 and through our Reply Comments, confirm the Courtenay revenue requirements be included in the RES Rider for cost recovery and confirm our treatment of NDITCs is appropriate. Also, confirm ADIT proration is appropriate and defer a decision on the treatment of ADIT at true-up to a future proceeding.

Dated: October 14, 2016

Northern States Power Company

Checkpoint Contents
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Subchapter B Computation of Taxable Income §§61-291
Part VI ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS §§161-199
§168 Accelerated cost recovery system.

Internal Revenue Code

§ 168 Accelerated cost recovery system.

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(f) Property to which section does not apply.
This section shall not apply to—

(1) Certain methods of depreciation.
Any property if—

(A) the taxpayer elects to exclude such property from the application of this section , and

(B) for the 1st taxable year for which a depreciation deduction would be allowable with respect to such property in the hands of the taxpayer, the property is properly depreciated under the unit-of-production method or any method of depreciation not expressed in a term of years (other than the retirement-replacement-betterment method or similar method).

(2) Certain public utility property.
Any public utility property (within the meaning of subsection (i)(10)) if the taxpayer does not use a normalization method of accounting.

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(i) Definitions and special rules.
For purposes of this section —

(9) Normalization rules.

(A) In general. In order to use a normalization method of accounting with respect to any public utility property for purposes of subsection (f)(2) —

(i) the taxpayer must, in computing its tax expense for purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, use a method of depreciation with respect to such property that is the same as, and a depreciation period for such property that is no shorter than, the method and period used to compute its depreciation expense for such purposes; and

(ii) if the amount allowable as a deduction under this section with respect to such property differs from the amount that would be allowable as a deduction under section 167 using the method (including the period, first and last year convention, and salvage value) used to compute regulated tax expense under clause (i) , the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

(B) Use of inconsistent estimates and projections, etc.

(i) In general. One way in which the requirements of subparagraph (A) are not met is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with the requirements of subparagraph (A) .

(ii) Use of inconsistent estimates and projections. The procedures and adjustments which are to be treated as inconsistent for purposes of clause (i) shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under subparagraph (A)(ii) unless such estimate or projection is also used, for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base.

(iii) Regulatory authority. The Secretary may by regulations prescribe procedures and adjustments (in addition to those specified in clause (ii)) which are to be treated as inconsistent for purposes of clause (i) .

(C) Public utility property which does not meet normalization rules. In the case of any public utility property to which this section does not apply by reason of subsection (f)(2) , the allowance for depreciation under section 167(a) shall be an amount computed using the method and period referred to in subparagraph (A)(i) .

(10) Public utility property.
The term “public utility property” means property used predominantly in the trade or business of the furnishing or sale of—

(A) electrical energy, water, or sewage disposal services,

(B) gas or steam through a local distribution system,

(C) telephone services, or other communication services if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962 (47 U.S.C. 701), or

(D) transportation of gas or steam by pipeline,

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

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CERTIFICATE OF SERVICE

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

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

xx electronic filing

DOCKET NO. E002/M-15-805

Dated this 14th day of October 2016

/s/

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