

Minnesota Public Utilities Commission
Staff Briefing Papers

Meeting Date: January 26, 2017 **Agenda Item #5

Company: Northern States Power Company, dba Xcel Energy (Xcel)

Docket No. E-002/M-15-805

In the Matter of the petition 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 Adjustment Factor

Issues: Should the Commission approve Xcel Energy's request to modify its RES Tariff, update its 2016 RES rate factors and allow a true-up in the RES rider for 2015?

Should the Commission require Xcel to credit Minnesota ratepayers for their proportionate share of used North Dakota Income Tax Credits (NDITC) associated with the Courtney Wind Project, based on the pro-rata share of the costs of the Courtenay project that is charged to Minnesota ratepayers?

Should Accumulated Deferred Income Tax (ADIT) balances be prorated or non-prorated when the Company forecasts its test year for rate base. And, if the Commission decides proration of the ADIT balances is required, must the true-up also be calculated using the proration method when adjusting for actual ADIT?

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Relevant Documents

Xcel – Initial Filing¹ September 1, 2015
Xcel – Revised Petition..... September 8, 2015
Xcel – Second Revised Petition..... September 29, 2015
Xcel – Supplemental Filing..... February 2, 2016
Department –Comments..... May 2, 2016

¹ The initial filing was withdrawn by Xcel due to some information included in the filing that should have been designated as trade secret.

Xcel – Reply CommentsMay 12, 2016
Department – Response to Reply Comments.....August 3, 2016
Xcel – Letter.....September 1, 2016
Xcel – Response to Reply CommentsOctober 14, 2016
Xcel – Response to Reply Comments Resubmitted.....October 28, 2016
Department – Response to Reply CommentsNovember 4, 2016

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Statement of the Issues

Should the Commission approve Xcel Energy's request to modify its Renewable Energy Standard (RES) Tariff, update its 2016 RES rate percentage and allow a true-up in the RES rider for 2015?

Should the Commission require Xcel to credit Minnesota ratepayers for their proportionate share of used North Dakota Income Tax Credits (NDITC) associated with the Courtney Wind Project, based on the pro-rata share of the costs of the Courtenay project that is charged to Minnesota ratepayers?

Additional Topic for Discussion

Should Accumulated Deferred Income Tax (ADIT) balances be prorated or non-prorated when the Company forecasts its test year for rate base. And, if the Commission decides proration of the ADIT balances is required, must the true-up also be calculated using the proration method when adjusting for actual ADIT?

Introduction

Generally, a public utility may not change its rates without undergoing a rate case in which the Commission comprehensively reviews the utility's costs and revenues. However, the Legislature has created exceptions to this general policy, allowing a utility to implement a rider to expedite recovery of certain costs not reflected in the company's current base rates.

Minn. Stat. § 216B.1645, Subd. 2a² states that a utility may petition the Commission to approve a rate schedule that provides for the automatic adjustment of charges to recover prudently incurred investments, expenses, or costs associated with facilities constructed, owned, or operated by a utility to satisfy the requirements of section 216B.1691,³ provided those facilities were previously approved by the Commission.

The RES Rider is designed to allow for the automatic adjustment of charges to recover prudently-incurred investments, expenses, or costs associated with facilities constructed, owned, or operated by a utility to satisfy the RES Statute, provided those facilities were previously approved by the Commission. For the past several years, Xcel's RES Rider contained only costs associated with the true-up of Production Tax Credits (PTC) related to energy production at Company-owned wind farms. In this filing, the Company has calculated the RES Rider revenue requirement to include costs and expenses associated with a new Company-owned wind farm, Courtenay Wind, in addition to a true-up of actual PTCs for 2015.

² Minn. Stat. §216B.1645 Power Purchase Contract or Investment, Subd. 2a Cost Recovery for Utility's Renewable Facilities.

³ Minn. Stat. §216B.1691 Renewable Energy Objectives.

Background

September 8, 2015: Xcel Energy submitted a Revised Petition⁴ and requested the Commission approve its RES rider true-up for 2015, the 2016 RES rider forecasted revenue requirement of \$17.244 million. The Company proposed to allocate costs using the percentage of revenue (interim rates) methodology to determine the percentage factor based on the quotient of the RES rider cost over the base revenues. The base revenues exclude the cost of fuel, riders and taxes. The percentage increase is then applied to existing base revenues and is applicable to all customer classes. Using Xcel's proposed percentage of 0.821, the average residential customer would see a bill increase of approximately \$0.55 per month, or \$6.60 annually.

The Company stated its revenue requirement in this petition includes capital costs and expenses associated with the Courtenay Wind project and actual and forecasted 2015 Production Tax Credits (PTCs) for all Company-owned wind farms scheduled to be in-service by the end of 2015. The total is off-set by proceeds received from the sale of Renewable Energy Credits (RECs).

September 29, 2015: Xcel submitted a Second Revised Petition in which the Company updated the REC sales credit amount which increased the portion of REC sales credited to customers. The Company also updated the petition to reflect the Commission's issuance of its September 2, 2015 Order in Docket No E002/M-15-401.⁵ The Order allowed Xcel to:

- Recover the project costs under the automatic rate adjustment authorized in Minn. Stat. § 216B.1645, subd. 2a. In Xcel's case the recovery is allowed through the RES rider.
- Purchase, complete and operate the Courtenay Wind Farm as a reasonable and prudent approach to satisfying the Company's renewable energy standard obligations under Minn. Stat. § 216B.1691, subd. 1.
- Recover actual, reasonable and prudently incurred costs, up to the Company's initial cost estimate of \$300,000,000 in capital costs and associated AFUDC. The cost cap relied on the Company's and the Department's analysis that the project can be completed at or below cost.

February 2, 2016: The Company submitted a Supplemental filing to adjust the requested revenue requirement in relation to the plant related ADIT. The Company argued that proration of ADIT is required under IRS regulation Section 1.167(1)-1(h)(6). The Company stated the ADIT adjustment is \$38,754 and results in an increase in the revenue requirement from \$17.244 million to \$17.283 million and an increase in the proposed RES rider percentage from 0.820 percent to 0.822 percent.

⁴ The initial filing on September 1, 2015 was withdrawn by Xcel due to some information included in the filing that should have been designated as trade secret.

⁵ In the Matter of the Petition of Xcel Energy for Approval of the Acquisition of 200MW of Wind Generation.

May 2, 2016: The Department submitted comments and agreed with the following proposals made by the Company:

- REC fees were correctly factored into the Company's calculation of its REC sales credit refunded to customers;
- The treatment of a return on CWIP complies with Minnesota statutes;
- The estimated 25-year life for the Courtenay Project is reasonable;
- Internal labor costs were not included in the rider;
- The rider includes collection of only incremental costs; and
- The Customer notice is acceptable with minor revisions.

The Department recommended the Commission require Xcel to:

- File relevant 2015 tax forms supporting its 2015 actual PTC figures in the Company's next RES true-up filing;
- Credit the slightly higher level of actual PTCs for 2014 to ratepayers in the RES true-up;
- Provide detailed revenue collections by customer class in addition to the summary it provides in future RES rider filings;
- Implement the 2016 Adjustment Factor in the beginning of the month following the Commission's Order;
- Credit its Minnesota ratepayers for their proportionate share of used NDITCs associated with the Courtney Project, based on the pro-rata share of the costs of the Courtenay project that is charged to Minnesota ratepayers. Alternatively, none of the costs of the Courtenay project should be charged to Minnesota ratepayers in this rider petition; and
- Replace its forecasted pro-rated ADIT balances with actual non-prorated ADIT balances in its beginning-of-month and end-of-month average calculations for true-up purposes in future RES Rider filings. Alternatively, the Commission could require Xcel's riders to be based solely on historical costs.

May 12, 2016: Xcel filed reply comments and agreed with the Departments recommendations to:

- Provide all the relevant 2015 tax forms supporting 2015 actual Production Tax Credit (PTC) figures in its next RES true-up filing. The Company stated it will also provide the

previous year's tax forms in future filings at the time of filings or when they become available. In addition, it will provide detailed revenue collections by customer class in future RES Rider filings.

- Credit the higher level of actual 2014 PTCs in this RES true-up. Xcel noted that the small change to the PTCs does not result in any change to the RES Adjustment Factor, as filed in its Second Revised Petition. The bill impact associated with the revised RES Adjustment Factor of 0.822 percent remains unchanged from the bill impact with the 0.820 percent RES Adjustment Factor.
- Implement the 2016 Adjustment Factor in the beginning of the month following the Commission's Order. The Company noted that the Commission will be approving this petition later than the proposed implementation date of January 1, 2016, and the rate has been at zero for the intervening months. As a result, the true-up balance at the end of the year will be higher than calculated, causing a higher rate charged to customers for 2017. The Company will collect the same 2016 Revenue Requirement but the recovery of these costs will occur in 2017.

The Company responded to the Department's recommendation that the Company be required to credit its Minnesota ratepayers for their proportionate share of used NDITCs associated with the Courtenay Wind Project, based on the pro-rata share of the costs of the Courtenay project that are charged to Minnesota ratepayers. The Company stated that the NDITCs for the Courtenay Wind project are \$0 in 2016 and 2017. The Company recommended the Commission explore the issue of whether it is appropriate to share the NDITC with Minnesota ratepayers in the Company's current rate case rather than in this docket.

The Company responded to the Department's alternative recommended that the Commission disallow all cost recovery of the Courtenay project in the rider petition and stated the Commission does not need to make a decision on the issue at this time. The Company recommended addressing the issue in the pending rate case rather than in this docket.

Xcel responded to the Department's recommendation to replace its forecasted pro-rated ADIT balances with actual non-prorated ADIT balances and noted that it plans to address the ADIT issue in its currently pending rate case. The Company argued the rate case is a more appropriate forum for this issue for two reasons. First, the potential consequences of the outcome of this complex issue go beyond riders and developing the issue in the rate case will allow further analysis and comments. Second, due to the timing of the true-up, the issue does not need to be decided immediately so the rate case procedural schedule will allow a more thorough discussion and perhaps additional clarity on the topic before our next series of annual rider filings are heard at the Commission.

With regard to the Department's alternative solution, using historical test years for riders, the Company noted that there are customer benefits associated with the use of accelerated tax methods in the forecast period that would disappear with the use of a historical test year. Xcel stated that if the Commission wishes to explore the use of historical test years for riders, it

believes there should be additional record development in a subsequent proceeding.

August 3, 2016: The Department submitted comments and found:

- The Company's treatment of AFUDC within the rider is reasonable; and
- The Company's proposal of implementing the RES factor is reasonable.

The Department continued to recommend the Commission:

- Require Xcel to credit its Minnesota ratepayers for their proportionate share of used NDITCs associated with the Courtney Project, based on the pro-rata share of the costs of the Courtenay project that is charged to Minnesota ratepayers. Alternatively, none of the costs of the Courtenay project should be charged to Minnesota ratepayers in this rider petition;
- Require Xcel to replace its forecasted prorated ADIT balances with actual non-pro-rated ADIT balances in its beginning-of-month and end-of-month average ADIT balance calculation for true-up purposes in future TCR rider filings. Alternatively, the Commission could require Xcel to base its recovery through the rider on historical costs, since the issue applies only in cases with forward looking revenue requirement calculations and rates; and
- Deny Xcel's request to explore either the NDITC, or the ADIT issue in its current general rate case rather than in this docket. Due to a "black box" settlement agreement which resolved all financial issues between Xcel and the Department, the Department is concerned these issues will be overlooked and recommended discussion of the issues in this proceeding.

September 1, 2016: Xcel filed an informational letter and stated because decisions made by the Commission in the 2016 RES rider could affect the calculation of its 2017 RES rider, it would delay filing its 2017 petition until the Commission issues an Order in this proceeding.

October 14, 2016: Xcel submitted response comments and requested that the Commission:

- Approve its petition filed on February 2, 2015;
- Confirm the Courtenay revenue requirements be included in the RES rider and confirm the Company's treatment of the NDITCs is appropriate;
- Defer a decision on treatment of the ADIT true-up to a future proceeding. Deferral would allow additional development of the subject including potential guidance from the IRS, the FERC and Commission proceedings.

October 28, 2016: Xcel resubmitted its filing from October 14, 2016 as it realized some of the attachments it intended to include were not included.

November 4, 2016: The Department submitted additional response comments and stated it does not agree with Xcel that Internal Revenue Service regulations require proration of ADIT and recommended the Commission deny the Company's request for proration of ADIT.

The Department made an alternative recommendation in order to resolve the issue and minimize the use of limited state resource. The Department's alternative recommendation is to:

- 1) allow the prorated ADIT only for recovery of forecasted costs (costs that are not historical, actual costs at the time the rates go into effect); and
- 2) require a true-up in the following year (once all amounts are historical/actual) by using actual non-prorated ADIT amounts.

The Department made an additional recommendation that if Xcel continues to pursue this issue to the detriment of ratepayers, the Commission should consider either denying rider recovery or limiting rider recovery to historical costs. Both of these approaches would eliminate the need for the Company to prorate its ADIT balances.

The Department does not agree with Xcel's position that its Minnesota ratepayers should not benefit from NDITCs. The Department concluded that Minnesota ratepayers should benefit from the NDITCs equal to the Minnesota jurisdictional portion of the costs that are recovered through the rider and paid for by Minnesota ratepayers. Because Xcel (parent company) uses the NDITC on its consolidated tax return, the credits should be returned to Minnesota ratepayers via Xcel's RES Rider or Xcel's Deferred Tax Tracker (Docket No.E002/GR-10-971). The Company should be required to show how this NDITC for Borders Winds and Courtney is being returned to ratepayers.

Minnesota Revenue Requirements

If the Commission approves the current proposal, it would be approving Xcel's 2016 Revenue Requirement Forecast:

Project	2016 Revenue Requirement Forecast	2017 Revenue Requirement Forecast
2015-2016 Courtenay Wind:	\$14,877,961	\$28,938,515
Property Taxes		664,124
Courtenay PTCs	(43,433)	(18,022,294)
O&M	871,630	4,886,185
Transmission Costs	200,778	1,606,225
Net Balance of:		
2015 PTC Balance (Jan-July)	Trade Secret	Trade Secret
2015 Forecast (Aug-December)	Trade Secret	Trade Secret

2014 PTC Refund Credit to Customers	Trade Secret	Trade Secret
REC Sales Proceeds Credit to Customers	Trade Secret	Trade Secret
ADIT Proration	38,754	490,939
Manual Billing Revenue True-up	Trade Secret	Trade Secret
2016 RES Rider Revenue Requirement	\$17,283,149	\$18,563,703

Currently, the RES factors in effect are set at \$0.00. Xcel has proposed an adjustment factor of 0.822 percent of the base charges on the customer's bill. The typical residential customer using 750 kWh per month would see a bill impact of \$0.55 per month.

Proposed Customer Notice

The Company plans to provide the following notice in a bill message to customers regarding the increase to the Resource Adjustment as a result of the RES rider reflected in their electric bill:

This month the Resource Adjustment has increased due to changes in the Renewable Energy Standard Rider, which recovers our investments and expenses to add renewable energy systems to our generation resources. The RES Rider portion of the Resource Adjustment is 0.820% of these charges on your bill: basic service charge, energy charge, and demand charge.

The Company stated they will work with the Department of Commerce and the Commission Staff if there are any suggestions to modify this proposed customer notice. The Department stated the Company's notice is acceptable with minor revisions.

North Dakota Investment Tax Credits

The Commission issued an Order on September 2, 2015 approving the acquisition of the Courtenay Wind Farm⁶. The Order stated that:

"The Commission defers the disputed issue regarding the allocation of the North Dakota Investment Tax Credit to the Company's initial, comprehensive cost-recovery filing including Courtenay costs, whether that is its next rate case or its next annual Renewable Energy Standards Rider filing."

Because the NDITC issue primarily impacts rate recovery of the Border Winds project which is included in base rates, the Company stated it complied with this decision option in its current rate case instead of in the present RES rider petition and recommended the issue be explored within the context of its rate case.

However, the Department recommended that the Commission deny Xcel's request to explore the issue in its current general rate case rather than in this docket. Due to a "black box" settlement

⁶ Docket No. E002/M-15-401 In the Matter of the Petition of Xcel Energy for Approval of the Acquisition of 200MW of Wind Generation.

agreement which resolved all financial issues between Xcel and the Department, the Department is concerned this issue will be overlooked and recommended discussion of this issue in this proceeding. It is unclear whether such a discussion and decision would be made in Xcel's rate case.

The Department asked Xcel to explain why the Company did not address the NDITC related to the Courtenay Project in its 2016 RES Rider in accordance with the Commission's Order above. In its response, the Company stated the following:

"The potential for North Dakota Income Tax Credits (NDITCs) pertains primarily to the Border Winds project. This project is included in the Company's request to increase base rates in Docket No. E002/GR-15-826, filed November 2, 2015. The rate case filing was the first opportunity to discuss ratepayer cost recovery. In the 2015 rate case, a discussion of the Company's position with respect to the Minnesota treatment of NDITCs is contained in the direct testimony of Company witness Anne E. Heuer.⁷"

The Department asked Xcel to provide the proportionate share of the NDITC associated with the Courtenay Project by month and year for the years 2016 and 2017. In response, the Company stated the following:

"The North Dakota Investment Tax Credit (NDITC) for the Courtenay Wind project is \$0 in 2016 and 2017. Although the Courtenay Wind project qualifies for the NDITC, the credit is limited by NSPM's North Dakota taxable income. The Border Winds project will be in service sooner than Courtenay and is expected to generate sufficient NDITC to offset the Company's anticipated tax liability for all but the last year that Courtenay qualifies for the NDITC.

Although the NDITC related to the Courtenay Wind project is \$0, there is no amount that would be proportionately shared with Minnesota ratepayers.

The logic is that income taxes (state and federal) for jurisdictional cost of service are calculated on a stand-alone basis by applying the state-specific and federal defined deductions and credits to the calculation of current taxes. By consistently applying this stand-alone logic, Minnesota ratepayers are not asked to sponsor North Dakota current state income taxes and North Dakota ratepayers are not asked to sponsor Minnesota current state income taxes. For these reasons, the Company has not applied any North Dakota specific state tax credit to the calculation of Minnesota state and federal current income taxes in the jurisdictional cost of service study."

The Department argued that the Courtenay Wind facility is a resource based on Xcel's integrated system that consists of Minnesota, North Dakota, South Dakota and Wisconsin and Michigan. As the name NDITC implies, these tax credits would not have materialized were it not for the fact that Xcel chose to invest in acquiring and building this cost effective system resource. As indicated in the Company's Revised Petition and Supplement, Minnesota ratepayers are being

⁷ See section IX. Compliance with Prior Commission Orders, Part E, Other Compliance Requirements, Item 6, North Dakota Income Tax Credits.

asked to bear the costs for this system resource.

The Department stated that it appears Xcel has changed its position on whether Minnesota ratepayers should be credited for their proportionate share of NDITCs. In a previous Renewable Energy Rider in Docket No. E002/M-10-1066 Xcel stated that:

“North Dakota Investment Tax Credit: In order to calculate this credit, we first calculated an average of the North Dakota state taxes calculated in our annual cost of service study over the last six years. We used six years in order to get an adequate representation of the effect of other tax credits. Based on this representation of taxes, we calculated the total tax credit that would be available over the next 25 years and assigned the applicable portion to the MN jurisdiction. We included this in the revenue requirement calculations from the time the Merricourt Wind Project goes into service in 2011 forward.”

The Department stated that in previous RES rider calculations⁸ Xcel credited Minnesota ratepayers for their proportionate share of NDITCs associated with the Merricourt Wind Farm and the Wind2Battery Project in their initial revenue requirement calculations. Although the Merricourt Wind Farm was later cancelled by Xcel and removed from the revenue requirement calculations, the Wind2Battery Project remained in the final revenue requirement calculations and included NDITC credits to Minnesota ratepayers.

The Department noted that Otter Tail Power Company credited Minnesota ratepayers for their proportionate share of NDITCs associated with several wind farms in their Renewable Energy Rider in Docket No. E017/M-09-1484. In both cases, the Commission’s determinations in those dockets were consistent with the proposed NDITC treatment. The Department concluded that Xcel and Otter Tail Power Company have credited Minnesota ratepayers for their share of NDITCs in previous renewable riders.

The Department also noted that the Commission recently decided in Docket No. E015/M-14-962 that Minnesota Power’s NDITCs should be given back to Minnesota ratepayers.⁹

The Department recommended that the Commission require Xcel to credit its Minnesota ratepayers for their proportionate share of used NDITCs associated with the Courtney Project, based on the pro-rata share of the costs of the Courtenay project that is charged to Minnesota ratepayers. Alternatively, until Xcel meets its burden of proof to show that Minnesota ratepayers should not receive a pro-rata share of the North Dakota Investment Tax Credit, none of the costs of the Courtenay project should be charged to Minnesota ratepayers in this rider petition.

The Company maintained its position that no amount of NDITCs should be proportionately shared with Minnesota ratepayers. The NDITC is a credit to North 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. The Company also noted that the Minnesota Cost of Service does not currently include a

⁸ Docket No. E002/M-10-1066.

⁹ Order Determining Treatment of North Dakota Investment Tax Credit for Bison Wind Project, November 30, 2016.

portion of the North Dakota income tax liability, which this credit would offset.

The Company stated it does not expect to have taxable income in North Dakota until 2020 due to the extension of bonus depreciation in the 2015 PATH. 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).

Xcel argued that 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.

The Department continues to disagree with Xcel's statement that "no amount of NDITC should be proportionately shared with Minnesota ratepayers" and the Department referenced Docket No. E002/GR-15-826 in the Direct Testimony of Department witness Ms. Campbell on pages 27-35 for the discussion on NDITC. Specifically, the Department noted on page 33 that although the Company says it is allocating taxes on a stand-alone state tax basis, the reality is the Company is using a consolidated/blended tax rate of federal/MN/ND for rate base purposes. As a result, the Department concludes that Minnesota ratepayers should benefit from the NDITC equal to the Minnesota jurisdictional percentage of Courtney wind facility costs being paid for by Minnesota ratepayers.

The Department summarized that because Xcel (parent company) is able to use the NDITC on its consolidated tax return, these credits should be returned to Minnesota ratepayers via Xcel's RES Rider or Xcel's Deferred Tax Tracker (Docket No. E002/GR-10-971). The Company should be required to show how this NDITC for Borders Winds and Courtney are being returned to ratepayers or, the Commission should disallow cost recovery of the Courtenay project in this rider petition.

Staff Analysis

The goal of the NDITC was to incentivize the building of electric generation in North Dakota.

Xcel's main reason for its proposed treatment is that both state and federal income taxes, when calculated for the jurisdictional cost of service study are calculated on a stand-alone basis by applying the state-specific and Federal defined deductions and credits in the calculation of current taxes.

The Company stated the NDITC is the only non- Minnesota state credit used by NSPM. The Company is arguing that because Minnesota ratepayers are allocated 100% of Minnesota

Research & Experimentation (R&E) credits and North Dakota gets 100% of the NDITC. In the Company's current rate case, it argued that Minnesota is better off because the Minnesota R&E expense is less than the NDITC.

The Company did not discuss NDITCs and other North Dakota taxes that are included in Minnesota rates. According to testimony filed in Xcel's current rate case,¹⁰ Minnesota ratepayers pay the following North Dakota taxes:

- Property Taxes – Income Statement
- Payroll Taxes – Income Statement
- Deferred & Accumulated Deferred Income Taxes – Rate Base

Minnesota ratepayer do not pay or do not receive credit for the following North Dakota taxes:

- Income Taxes – Income Statement
- Investment Tax Credits – Income Statement.

The Company stated that it is allocating state taxes on a stand-alone basis but the reality is the Company is using a consolidated/blended tax rate of federal, Minnesota and North Dakota to allocate these taxes for rate base purposes. The Company is then picking and choosing which taxes are being paid by, or credited to Minnesota ratepayers on the income statement.

There is no dispute that Xcel's acquisition and development of Courtenay Wind generated the NDITCs. The facility is a resource based on Xcel's integrated system that consists of Minnesota, North Dakota, South Dakota and Wisconsin and Michigan. As the name NDITC implies, these tax credits would not have materialized were it not for the fact that Xcel chose to invest in acquiring and building this cost effective system resource. Minnesota ratepayers are being asked to bear the costs for this system resource. It is for this reason that staff recommends the Commission require Xcel to allocate the NDITCs based on the Minnesota jurisdictional allocator to Minnesota ratepayers.

Recent Commission Decision

In a recent case concerning NDITCs, Minnesota Power built the Bison Wind 1, 2, 3, and 4 electric generation facilities (Bison Projects) in North Dakota. The Bison Projects are eligible North Dakota Investment Tax Credits (tax credits, or credits) based on the amount spent to construct the projects.

Minnesota Power projected that ALLETE, Inc. and its affiliated consolidated group would utilize approximately \$22 million of the available tax credits over the respective carryforward periods of the credits and assign \$10.7 million to Minnesota Power and the remaining \$11.3 million to affiliates.

¹⁰ See Campbell Direct Testimony.

North Dakota state income tax law allows Minnesota Power's investment tax credits to be applied against the aggregate income tax liability of all corporations included in its consolidated state tax return filing. The Bison Projects' costs, however, are wholly assigned to Minnesota Power's regulated operations.

The primary issue the Commission was asked to decide in the case was the proper treatment of the tax credits in calculating Minnesota Power's revenue requirement. In that matter, the Commission took the following actions and required Minnesota Power to:

- Reflect all Bison Wind Project North Dakota Investment Tax Credits actually realized in tax-return filings, or monetized through other permissible means in the Company's revenue requirements;
- Amortize the actual North Dakota Investment Tax Credits realized over the remaining life of the Bison Wind Projects; and
- File supplemental compliance filings if there are: 1) material changes (greater than ten percent or \$2.2 million) to the estimated North Dakota Investment Tax Credit utilization on a consolidated/unitary tax return; and/or 2) legislative changes that allow additional means to monetize these credits.

The Commission determined:

"The Bison Wind Projects are generating the tax credits. There is no dispute that Minnesota Power's regulated operations bear all the costs and expenses of the Projects. The Commission is persuaded by the Department's analysis that to the extent there is a benefit generated by the credits, that full benefit should flow back to the ratepayers who paid for it, to help offset the cost of the Bison Wind investment.

Thus, the Commission will align the tax credits with the cost responsibility. The Commission agrees that the stand-alone method as described by FERC should be used..."

The Commission additionally noted that this is consistent with how Xcel Energy and Otter Tail Power both make use of North Dakota tax credits in their Renewable Resource filings. See, e.g. Docket Nos. E-002/GR-05-1428 (Xcel Energy); and E-017/M-09-1484 and E-017/GR-10-239 (Otter Tail Power).

Having decided that ratepayers should receive the full value of all tax credits utilized, the Commission also addressed how and when to recognize the credits in rates.

Commission staff observed that the tax credits could be amortized in the same manner that was used in Otter Tail Power Company's 2010 Resource Rider docket, and the Department did not disagree.¹¹ Otter Tail had sought cost recovery of three company-owned wind projects, all

¹¹ In the Matter of the Application of Otter Tail Power Company's Request for Approval of Its 2010 Renewable Resource Cost Recovery Adjustment Factor, Docket No. E-017/M-09-1484.

located in North Dakota, through its 2010 Renewable Resources Cost Rider. All three projects qualified for the North Dakota Investment Tax Credit.

In that case, the Commission approved Otter Tail's proposal to amortize the tax credits over the life of the projects. In this way, intergenerational equity for the tax benefits was achieved consistent with traditional investment tax credits. The Commission reasoned that this was appropriate, as the project cost was recovered from ratepayers over its life, and to be consistent, the Commission ordered that the credit be amortized over the plant life.

In Minnesota Power's case, the Commission found that the amortization approach is preferable. With amortization, there will be a better alignment of the cost-recovery and benefit-flow periods; there will be a minimization of potential rate fluctuation; and, there will be ease in incorporating a level credit amount into base rates.

The Commission required rates to reflect the actual, and not estimated, benefits realized, and required amortization of the benefits to mitigate potential rate variability and will spread the benefits to be realized by ratepayers paying these project costs over the Bison Wind Projects' useful life.

Accordingly, the Commission required the Company to amortize the actual tax-credit benefit realized over the remaining life of the Bison Wind Projects. At the onset of the actual realization of the benefit, the Commission required the Company to commence amortization and inclusion of the tax credit in revenue requirement. Further, any credits realized from year to year will be added to the amortizable balance. Further, the Commission will allow an appropriate adjustment to rate base to account for the unamortized balance of the actual credits realized.

It should be noted that MP has filed for Commission reconsideration of the issue which will be heard at the Commission's February 2, 2017 agenda meeting. Regardless of the reconsideration request, staff recommends the Commission require Xcel to treat and implement the NDITCs in the same fashion as Otter Tail Power to the extent a cost is allocated to/recovered from a jurisdiction, the benefits should likewise be allocated.

Accumulated Deferred Income Taxes (ADIT) Proration

In between the time of the initial filing and the writing of the briefing paper, several decisions were made concerning the treatment of ADIT proration.

Otter Tail Power Private Letter Ruling

During OTP's evidentiary hearing in its pending general rate case¹² OTP proposed

¹² Docket No. E-017/GR-15-1033, In the Matter of Application of Otter Tail Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota. Volume 2, Evidentiary Hearing, October 14, 2016, Stuart Tommerdahl Testimony.

a procedure for obtaining a Private Letter Ruling on the ADIT proration issue. That procedure anticipated that a request for a Private Letter Ruling or “PLR” would be developed for submission to the IRS by the end of December 2016. Based on general IRS practice, and the timelines of normalization PLRs issued in 2015, OTP stated it is reasonable to expect that the IRS would respond by issuing a PLR by June 2017, to a request for a PLR filed by the end of December 2016. Staff notes that the PLR has been submitted to the IRS for ruling.

The procedure provided that all stakeholders would have the opportunity for input into the request for a PLR prior to submission to the IRS. This would include input from the Department and Commission staff, consistent with customary IRS practices regarding PLRs addressing normalization issues.

It is anticipated that the parties would present their arguments addressing the ADIT Proration issues following the same timetable as other issues in this case, while recognizing that the process to obtain the PLR would continue as described. The Commission would not be prevented from resolving all issues of the OTP rate case other than those included in the PLR on the established timeline. The procedure suggests an August 31, 2017 date by which the PLR would either have been received or the Commission would resolve the issue without the PLR.

While some features of this procedure are not typical, OTP believes that the advantages of obtaining guidance from the IRS merit the use of this process.

Xcel Transmission Cost Recovery

The Department and Xcel agreed to compromise on the ADIT decision as posed in the TCR rider.¹³

In its September 29 comments and in proposed decision options filed December 7, Xcel suggested that the Commission defer a decision on proration of ADIT in the TCR rider true-up while the Company seeks a private letter ruling from the IRS to resolve the issue.

At the Commission’s December 8 hearing, the Department stated that it would support allowing Xcel to recover its actual costs for 2016—eliminating the need for proration—and taking up the question again when Xcel makes its next TCR rider filing, with the benefit of a utility-specific PLR.

The Commission concurred with the parties that a ruling from the IRS, specific to Xcel’s circumstances, would greatly aid the Commission in resolving the complex tax issues related to ADIT proration. Because it is now 2017, all costs incurred in 2016 are historical, and the Commission can authorize their recovery without implicating the proration requirements of 26 C.F.R. § 1.167(l)-1(h)(6)(ii). Between now and when the Commission takes up Xcel’s next rider filing, the Company can work with the Department and Commission staff to develop and submit

¹³ See E-002/M-15-891, January 17, 2017 Order.

a PLR request to the IRS, which may resolve the parties' dispute over ADIT proration.

Accordingly, the Commission approved Xcel's proposed 2016 revenue requirement of approximately \$78.4 million and authorize the recovery of actual 2016 costs through the TCR rider. The Commission further approved the resulting TCR adjustment factors by class to be included in the Resource Adjustment on bills for the Company's Minnesota electric customers, and authorize Xcel to recalculate the TCR adjustment factors at the completion of its pending rate case.¹⁴

Finally, the Commission approved Xcel's proposed revised tariff sheet and proposed customer notice and require the Company to submit a compliance filing reflecting the Commission's decisions in this order and replacing forecasted numbers with actual numbers.

Staff Analysis

Accumulated Deferred Income Tax (ADIT) Proration in this Docket

The issue of proration was first discussed in depth in Xcel's Transmission Cost Recover rider briefing papers. Because the issue and testimony is the same in both the TCR rider and the RES rider, staff will repeat the discussion in this docket.

There is the outstanding issue for discussion of whether ADIT balances are required to be prorated or not prorated when the Company forecasts its test year for rate base. And, if the Commission decides proration of the ADIT balances is required, must the true-up also be calculated using the proration method when adjusting for actual ADIT.

The Department recommended that the Commission deny Xcel's request to explore the issue in its current general rate case rather than in this docket. Due to a "black box" settlement agreement which resolved all financial issues between Xcel and the Department, the Department is concerned this issue will be overlooked and recommended discussion of this issue in this proceeding. It is unclear whether such a discussion and decision would be made in Xcel's rate case.

The issue of ADIT proration has also been raised by at least two other Minnesota regulated utilities: Minnesota Power¹⁵ and Otter Tail Power.¹⁶ Xcel also posed the issue in its currently pending General Rate Case and its Transmission Cost recovery filing.¹⁷ The Department recommended the Commission consider this issue in this proceeding.

While reading the discussion, please keep in mind the party positions:

¹⁴ Docket No. E-002/GR-15-826.

¹⁵ See E-015/GR-16-664.

¹⁶ See E-017/GR-15-1033.

¹⁷ See E-002/15-805.

Xcel Position

- ADIT proration is required because of IRS regulations when the Company forecasts its test year for rate base.
- The true-up must also be calculated using the proration method when adjusting for actual ADIT.

Department Initial Position

- Proration should not be applied when determining future revenue requirements.
- Proration should not be applied to the true-up.

Department Alternative Position

- If proration is applied when determining future revenue requirements;
- The true-up to actuals should not be prorated.

Staff notes that to remove one element of complexity from the issue, the issue will be addressed as it pertains to Xcel's rate case, and not the TCR rider. Xcel provided the background on Accelerated Depreciation and Normalization Rules in the following section.

Background & Definitions

Accelerated Depreciation

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.

Bonus Tax Depreciation

Like accelerated tax depreciation, bonus tax depreciation is a depreciation method used for income tax purposes that reflects more depreciation in the early years of an asset's useful life compared to straight-line depreciation. Straight-line depreciation is used for financial accounting and regulatory purposes and is the method on which gas and electric utility rates are set. Bonus depreciation is used for federal tax accounting purposes and defers income taxes by reducing taxable income in the early years of an asset's life and increasing taxable income in the latter years. The difference between straight-line depreciation (constant through an asset's life) and bonus depreciation is a matter of timing, which in turn generates a deferred tax liability.

The revenue requirement is impacted by bonus depreciation as a decrease to rate base when the bonus depreciation is factored into the ADIT calculation. The ADIT generated by bonus depreciation represents government-supplied funds to the utility and, consequently, requires the balance to be credited to rate base. Under normalized accounting for income taxes, ADIT signifies amounts paid by customers for current taxes that the utility will not have to pay the government until a later period.

Accumulated Deferred Income Taxes

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.

The main issue being discussed in this case is whether the ADIT balances should be prorated or not prorated when the Company forecasts its test year for rate base. And, if the Commission decides proration of the ADIT balances is required, must the true-up also be calculated using the proration method when adjusting for actual ADIT.

Normalization

Deferred taxes are a result of an accounting process called “normalization”, which is the timing difference between book and tax accounting. The difference is then multiplied at the current tax rate to determine the current deferred tax. This amount in turn is added to the Accumulated Deferred Income Tax (ADIT) balance. Deferred taxes derive from tax depreciation being greater than book depreciation (in the early years of an assets life.) The Company’s ADIT balance has been growing in large part due to bonus tax depreciation. The Company strives to maximize the tax benefits by using accelerated methods to depreciate its assets, which are often taken in the early years of an asset’s life. Deferred taxes, from a rate making perspective, allow the Company to share the early tax benefits with all customers equally over the asset’s straight line book life.

Congress has imposed specific requirements and restrictions on a utility’s ability to use accelerated and bonus depreciation. Congress (and the IRS acting under Congressional authority and direction) have 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). 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 Federal Energy Regulatory Commission (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 the ability to use 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 stated if it

were to lose the ability to use accelerated tax depreciation on utility assets, it would significantly reduce the ADIT offset to rate base. The ADIT offset provides a significant benefit for Xcel's 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.

Benefit of ADIT

ADIT provides the Company access to cost-free capital it would not otherwise have. ADIT is subtracted from rate base and reduces 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.

Proration of ADIT

Department Position

The Department stated it agreed with the Company's explanation of deferred taxes and bonus depreciation and how it affects the rate case revenue requirements. The Department disagreed with Xcel's statement that ADIT generated by bonus depreciation or any accelerated tax method represent government-supplied funds to the utility. Rather, it is the ratepayer that has prepaid normalized deferred income taxes before the taxes are due. This fact is why ratepayers received an ADIT credit, which reduces rate base, because ratepayers have pre-paid the tax amount owed by the Company to the Internal Revenue Service (IRS).

The Department and Xcel agreed that the Internal Revenue Code (IRC) sets the standards that apply to tax normalization and cited IRC Section 168(i)(9)(B)(i) as follows:

*[T]he 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...*¹⁸

The Effect of Changing to Prorated ADIT

The Department's initial position is that proration should not be applied when determining future revenue requirements and proration should not be applied to the true-up.

Since at least 2005 and likely much earlier, the Company has included non-prorated ADIT balances in its forecasted test-year rate base. The Company is now proposing to prorate the ADIT balances in its forecasted test-year rate base. The Department objected to the Company's proposal to change how it calculates the forecasted test-year ADIT balances in its rate case. The Department stated it is concerned with the change because ratepayers are continuing to pay the same depreciation and related taxes on investment. If the change is allowed, ratepayers will not be receiving the full ADIT offset or credit to rate base.

¹⁸ 28 U.S.C.A. § 168(i)(9)(B)(i) (West 2015).

The Department argued that it is inappropriate and inconsistent to require ratepayers of a fully regulated utility such as Xcel to pay for higher income tax expenses based on an assumption of straight-line depreciation (rather than accelerated depreciation used for tax purposes) and to lose the long-standing offsetting ADIT credit to rate base. Instead of treating ADIT as the timing issue it has always been, Xcel is now proposing to charge higher rates to ratepayers by charging ratepayers a tax expense that is higher and to no longer provide a matching ADIT credit for rate base because of the one-sided proration to only the rate base credit and not the tax expense.

The Department argued that since the Company is not agreeing to the true-up in the following year when amounts become actual, the Company would be inappropriately keeping for its shareholders the benefits of tax expense being higher than the ADIT credit. Charging ratepayers for a full tax expense that is not prorated and at the same time lowering the credit for ADIT due to proration without a true-up in the following year when costs become actual results in the Company unreasonably overcharging ratepayers. The Department stated that Xcel's proposal does not meet the requirement of Minnesota Statute section 216B.03, that rates must be just and reasonable.

The Department argued that Xcel's proposal would charge ratepayers for more than the costs of a utility-owned facility, by never returning to ratepayers the prepaid income taxes that ratepayers provided to the utility in early years of a facility's life. The Department stated its alternative proposal to:

- 1) allow the prorated ADIT only for recovery of forecasted costs (costs that are not historical, actual costs at the time the rates go into effect); and
- 2) require a true-up in the following year (once all amounts are historical/actual) by using actual non-prorated ADIT amounts;

would allow Xcel to keep the prepaid income taxes only temporarily and only for any forecasted costs. Xcel would have to refund the overcharge in the subsequent year.

The Department's alternative proposal would be a timing issue, where ratepayers would receive refunds soon after prepaying Xcel's income taxes, as opposed to Xcel's proposal to overcharge ratepayers by keeping the prepaid taxes and never refunding the money to ratepayers and charging ratepayers for more than the cost of the utility-owned facility.

Prepaid taxes are recognized in the ADIT rate base account; ADIT is an offset to rate base, and thus reduces the costs charged to ratepayers. Prorating the ADIT account, for forecasted costs, reduces the rate base credit to ratepayers. Under the Department's alternative proposal, Xcel would give ratepayers a reduced prorated ADIT credit amount for forecasted costs in the forecasted year, but require a true-up to actual non-prorated ADIT in the following year when amounts are historical/actual. This true-up restores to ratepayers the amount by which they have prepaid Xcel's income taxes in the prior year, which would then be consistent with past practice. By contrast, Xcel's request to allow pro-ration of ADIT but defer the decision to require a true-up is unreasonable and one-sided to the benefit of Xcel and would harm ratepayers.

In response to a Department information request, the Company stated that Xcel Energy on a consolidated tax basis last paid material federal income taxes in 2008 of approximately \$22.3 million. Since 2008, Xcel Energy has paid very small amounts of federal income taxes totaling less than \$1 million in total for the period 2009 to 2015.

The Department compared Xcel's position to ratepayers who are paying millions of dollars in income taxes in rates just based on the tax gross up of the revenue requirement in current and past rate cases. The Department stated that if this issue is viewed from an equity perspective, Minnesota electric utilities are not paying a significant amount of federal income taxes. This is a result of the tax legislation that has allowed significant amounts of bonus tax depreciation over one and two years. Yet, ratepayers continue to pay the full amount of income taxes imputed with the assumption that someday the utility will have to pay the tax amount.

The Department stated that in the past, ratepayers would receive the full offsetting ADIT balance or credit to rate base for this tax amount. Xcel is now proposing to reduce this offsetting ADIT balance or credit to rate base as well. Additionally, ratepayers are paying for the costs of these assets in rate base along with a return on plant investment while paying the full amount of deferred income tax expenses, but are now being denied the full offsetting ADIT balance or credit to rate base.

Xcel Position

The Company stated that if it 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 purposes 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 Protecting America from Tax Hikes (PATH) Act or enacted by Congress going forward. Therefore, proration of ADIT is in the best interests of customers to keep their rates lower.

IRS Regulations Require Proration of ADIT

Xcel stated 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). The Company stated that if 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 Company stated that the requirements and the formulas 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 stated that it is not alone in its understanding of the IRS guidance on proration requirements. The proration requirements of Treasury Regulation Section 1.167(l)-1(h)(6) became 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. 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.¹⁹

Xcel stated that four IRS PLRs were published in July and August 2015 and address the ADIT proration requirement and the specific normalization requirement for forecasted rate setting. In these PLRs, the IRS reasserts that in cases of future test periods, the ADIT proration methodology described in Treasury Regulation Section 1.167(l)-1(h)(6) must be used. Xcel provided a citation and discussion summary of each of the four PLRs, as well as an additional fifth PLR²⁰ that was released in October.

Proration of True-up Required by Recent PLRs

Xcel Position

Xcel stated that while the Company must prorate its ADIT balances, it understands that there is some level of inconsistency in the industry regarding treatment of the ADIT true-up. The Company stated its understanding of the IRS regulations is that the true-up balances also must be prorated, in contrast to the Department’s position that the true-up should not be prorated.

The Company’s position is that proration of ADIT is required due to recent PLRs issued by the IRS. Xcel stated because it proposed a forecasted test year in the rate case proceeding, the private letter rulings indicate that a utility must pro-rate the monthly incremental increases to the ADIT balance. As a result of this change, Xcel’s test-year ADIT balance would be reduced.

The Company further argued that 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. Xcel stated it does not plan to true-up or

¹⁹ PLR 201531010, 201531011, and 201531012 released in July of 2015 and PLR 201532018 released in August of 2015.

²⁰ PLR 201541010 released in October 2015.

replace its forecasted prorated ADIT balances in the following year when the balances are no longer forecasted and actual balances are known. Xcel's position is that the IRS requires Xcel to keep the prepaid income taxes provided by ratepayers for its shareholders, even after the test year has passed and actual costs are known.

Xcel stated 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 a historical or a future test period was used to set the general rates and if 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.

Department Position

The Department objected to Xcel's use of PLRs as support for its position as the PLRs were issued to other companies, not Xcel specifically. The Department stated that at the end of all private letter rulings, the IRS provides the following statement, which basically says the IRS decision is only to be used by the entity requesting the decision:

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent.

The Department stated that under the code, an exception to the general rule that PLRs may not generally be relied upon as precedent exists if the IRS, by Regulations, determines that a particular PLR will be precedential. The Department stated it is not aware that the IRS has specifically determined that any PLRs that Xcel refers to have been made precedential under the law.

The Department argued that Xcel's proposal to prorate the ADIT balances must be supported by the IRC, or a PLR that applies directly to Xcel. The Department stated that it is not aware that Congress has made any such change to the IRC, nor did the Company cite any such change to the IRC to support its position.

The Department stated it considers "guidance" through the Company's interpretation of PLRs as significantly less requisite than Xcel's claim that proration is "required by the IRS." The Department disagreed with Xcel's use of PLRs to support its position that it would commit a normalization violation if it does not prorate ADIT. The Department argued that Xcel must support its position and show a change is required under Internal Revenue Code or Treasury Regulation.

Even though Xcel concluded that the private letter rulings are basically IRS regulations, the Department's understanding is that is not the case. As noted above, the IRS states that private letter rulings are for the individual tax entity that requested the tax ruling, since the decision was made based on the facts in that particular case. Notably, just because the IRS has concluded one way in certain private letter rulings (based on particular facts that are expressly not precedential)

this does not mean that “the IRS has not disallowed” a certain method under different facts.

FERC Requires ADIT True-up to Actuals

Department Position

Tax Normalization Rules encompass requirements from the Internal Revenue Code (IRC), Treasury Regulations. 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 Federal Energy Regulatory Commission (FERC) Account 282 must be calculated for the future test year. (See Treasury Regulations Section 1.167(l)-1(h)(6)).

The Department stated that the Company is inconsistent in applying ADIT prorate between the current proceedings in Minnesota and proceedings at the FERC. The Department specifically referenced 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.²¹ 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.

The Department noted that the Company is not pro-rating its ADIT credit for rate base for XETD. This fact is inconsistent with Xcel’s claim that NSP-M must pro-rate its ADIT balance. The Department argued that because Xcel Energy files its taxes on a consolidated tax basis, the Department does not see how the Company can claim non-prorated ADIT for XETD and prorated ADIT for NSP-M, except to conclude that the Company’s claim that the IRS private ruling requires them to pro-rate the ADIT balance is not supported.

The Department stated that the FERC, which regulates wholesale electric rates has also addressed this issue. FERC’s December 2015 Order in Docket No. ER16-197 rejected NSP’s Attachment O²² filing and required NSP to correct its ADIT true-up amount in its Attachment O filing. Basically, FERC allowed the pro-ration for current forecasted ADIT, but once the balances become historical (actual) amounts in the following year, NSP/Xcel was required to true-up to actual by using beginning-of-year and end-of-year ADIT amounts.

In response to a Department IR, the Company mentioned that Ameren Illinois and NSP (which are MISO transmission owners) both raised concerns about FERC not accepting their Attachment O filing. Xcel noted in its FERC filing that Virginia Electric Power Company (which is a PJM transmission owner) was allowed not to true-up to actual ADIT amounts in the following year in Docket No. ER14-1831-001.

According to the Department, there are 24 MISO²³ transmission owners and only two (NSP and

²¹ FERC Docket No. ER14-2752-004.

²² Attachment O is the mechanism used by each Transmission Owner to annually report transmission revenue requirements to MISO. Revenue requirements include transmission related costs and a rate of return on transmission rate base.

²³ Based on MISO’s website

Ameren) of the 24 transmission owners took what the Department believes is an aggressive tax position. The other 22 transmission owners did not take this position and agreed to apply the ADIT true-up in the following year once balances become actual and are no longer “future.”

The Department noted that for 2016 all of the MISO transmission owners that had forecasted revenue requirements, including Xcel and Ameren, were allowed to use prorated ADIT for forecasted costs but were required to use non prorated ADIT balances for purposes of the true-up once the amounts become actual/historical. The Department noted that of the MISO transmission owners, only Xcel and Ameren are taking this aggressive tax position and requesting that they be allowed to continue prorating ADIT amounts for true-up purposes, which results in permanent tax differences that harms ratepayers.

The Department stated that FERC denied Xcel and Ameren’s request to prorate ADIT amounts for true-up purposes in their 2016 transmission rates, but left the door open for Xcel and Ameren to again request and support their position in future filings. Additionally, utilities are not incurring additional tax costs (and are actually paying less than ever)²⁴ yet they are proposing to unfairly reduce the ADIT credit provided ratepayers (so it is no longer equal to deferred income tax expense ratepayers continue to pay). On November 3, 2016, Xcel made an additional filing at FERC to support its continued ADIT proration for true-up purposes.²⁵

The Department stated that two Minnesota regulated utilities, Minnesota Power and Otter Tail Power, filed their Attachment O at FERC with a pro-rated ADIT balance for current year forecasted amounts, but then agreed to true-up back to beginning and end-of-year balances the following year. As a result, this issue is really a timing issue (where the Company gets a one-year temporary loan based on the current year ADIT balance) and not a permanent change in how ADIT is recovered for ratemaking.

Additionally, since a significant majority of MISO and PJM transmission owners are taking the position that they should pro-rate the current ADIT forecasted amount but then do a true-up to non-prorated actuals based on beginning-of-year and end-of-year ADIT balances in the following year, the Department believes the majority of MISO and PJM transmission owners do not seem to have a concern with the tax normalization violations that NSP is claiming. Moreover, even the IRP private letter ruling quoted above is clear that prorating is not applicable in the true-up.

On November 22, 2016, the Department²⁶ was part of a petition filed at FERC opposing revisions to Attachment O formula rates by MISO as proposed by Xcel Energy Services and Ameren Services Company. Despite this activity at FERC, the Department recommended that the Commission make its own decision based on the facts of ADIT proration in Minnesota cases and avoid a bad policy decision which would negatively impact ratepayers if ADIT proration is

²⁴ The Department noted that Xcel has paid less than \$1,000,000 in total federal income taxes from 2009 to 2015 per the Company’s response to IR 1168 in Docket No. E-002/GR-15-826. See Campbell Direct, page 22.

²⁵ Docket No. ER17-305-000.

²⁶ The Motion to Intervene and Comments were filed by the Joint Consumer Advocates (JCA). The JCA includes the states of Illinois, Indiana, Iowa, Michigan Minnesota, Missouri and Wisconsin.

allowed for true-up purposes.

Xcel Position

The Company responded that in addition to the recent IRS guidance, the latest FERC actions also support its interpretation of 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). While FERC also rejected the Company's request to clarify that there should be prorate on true-up in its 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 the Company did not fully justify its request.

On February 23, 2016, the FERC reversed its ruling in the Dominion case. The FERC issued an Order on Revised ADIT Treatment and accepted Dominion's proposal to continue to apply the proration methodology to the originally projected ADIT balances in performing the annual true-up calculations. In its September 22, 2016 Order Denying Rehearing, in the Dominion docket, the FERC upheld its February 23, 2016 Order accepting the ADIT proration at true-up.

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.

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, the Company filed a Motion to Lodge with the FERC on March 11, 2016 and provided additional support for its 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. The Company stated it expects FERC action on that filing before the end of 2017.

Xcel stated because 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.

Benefits of Deferring a Commission Decision – Xcel Recommendation

Xcel is advocating for the Commission to defer making a decision on the ADIT proration issue in this docket. Xcel stated that the TCR rider in this filing does not include a true-up of the ADIT

balance and that its 2016 revenue requirements can be approved as proposed even if the Commission defers a decision on the treatment of the true-up

Xcel stated that 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. Xcel stated it expects a FERC decision approving its 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. The Company stated that if necessary it could potentially submit its own PLR to the IRS for a definitive ruling.

If additional guidance from the IRS, the FERC, or Commission proceedings showed that Xcel's ADIT treatment is unsupported, the Company would credit customers any difference through the TCR tracker. The Company stated it would also agree to bring forward to the Commission any newly issued guidance as it emerges to help clarify the issue.

Use of Historical Costs in Future Cost Recovery Filings

Department Position

The Department recommended that the Commission consider denying rider recovery or limiting rider recovery based on historical costs. Both approaches would eliminate the need to prorate ADIT balances.

The Department argued that requiring Xcel's TCR Rider (and other riders) to be based solely on historical costs would fully address the ADIT issue, as described in the Private Letter Ruling of the IRS:

Congress was explicit: normalization "in no way diminishes whatever power the [utility regulatory] agency may have to require that the deferred taxes reserve be excluded from the base upon which the utility's permitted rate of return is calculated." H.R. Rep. No. 413, 91st Cong., 1st Sess. 133 (1969).

...

[T]he second interpretation of section 1.167(l)-1(h)(6)(ii) of the regulations [that "the historical period is that portion of the test period before rates go into effect, while the portion of the test period after the effective date of the rate order is the future period"] is consistent with the purpose of normalization, which is to preserve for regulated utilities the benefits of accelerated depreciation as a source of cost-free capital. The availability of this capital is ensured by prohibiting flow-through. But whether or not flow-through can even be accomplished by means of rate base exclusions depends primarily on whether, at the time rates become effective, the amounts originally projected to accrue to the deferred tax reserve have actually accrued.

If rates go into effect before the end of the test period, and the rate base reduction is not prorated, the utility commission is denying a current return for accelerated depreciation

benefits the utility is only projected to have. This procedure is a form of flow-through, for current rates are reduced to reflect the capital cost savings of accelerated depreciation deductions not yet claimed or accrued by the utility. Yet projected data is often necessary in determining rates, since historical data by itself is rarely an accurate indication of future utility operating results. Thus, the regulations provide that as long as the portion of the deferred tax reserve based on projected (future estimated) data is prorated according to the formula in section 1.167(l)- 1(h)(6)(ii), a regulator may deduct this reserve from rate base in determining a utility's allowable return. In other words, a utility regulator using projected data in computing ratemaking tax expense and rate base exclusion must account for the passage of time if it is to avoid flow-through.

But if rates go into effect after the end of the test period, the opportunity to flow through the benefits of future accelerated depreciation to current ratepayers is gone, and so too is the need to apply the proration formula. In this situation, the only question that is important for the purpose of rate base exclusion is the amount in the deferred tax reserve, whether actual or estimated. Once the future period, the period over which accruals to the reserve were projected, is no longer future, the question of when the amounts in the reserve accrued is no longer relevant (at the time the new rate order takes effect, the projected increases have accrued, and the amounts to be excluded from rate base are no longer projected but historical, even though based on estimates). (Emphasis added).²⁷

Xcel Position

Xcel stated it disagrees with the Department's alternative solution to use historical test years for riders, and noted 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 and a historical test year creates a whole host of new issues as well.

Xcel stated that 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 the customers.

Xcel noted that there are customer benefits associated with the use of accelerated tax methods in the forecast period that would disappear with the use of a historical test year. The Company stated that if the Commission wishes to explore the use of historical test years for riders, it believes there should be additional record development, including input from interested parties.

Other Minnesota Utilities Approaches

Xcel stated that other Minnesota utilities, like Otter Tail Power (OTP), agree with the

²⁷ <https://www.irs.gov/pub/irs-wd/201541010.pdf> pages 6-8.

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." Failure to use ADIT proration is non-compliance with the IRS normalization requirements which could result in losing the ability to take accelerated depreciation.

Regarding the ADIT true-up, some Minnesota utilities are approaching treatment of the true-up differently than Xcel Energy, though the Company stated it does not know what information the companies have based their decisions on. The Company stated it has reason to believe the approach to the ADIT true-up is outdated due to the earlier timing of their filings that addressed the issue. The Company stated its 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 the Company's approach to maintaining ADIT proration in the true-up is consistent with the most recent guidance available. The Company stated it does not believe it has a choice of not maintaining ADIT proration in a true-up calculation if it is to remain in compliance with the Tax Normalization Rules.

Summary of Party Positions – ADIT Proration

Xcel Recommendations

The Company provided three Commission options, listed in order of Xcel Energy's preference, as well as the outcome associated with each option:

Option 1:

Approve the Company's RES Rider rate factor for 2016, confirm ADIT proration is required, and defer proration of ADIT at true-up decision to a later proceeding.

The Company stated this RES proceeding does not include a true-up of the ADIT balance, and the 2016 revenue requirements can be approved as proposed even if the Commission defers a decision on the treatment of the true-up balance. If additional guidance from the IRS, the FERC, or other proceedings shows our ADIT proration treatment to be unsupported, the Company stated it would credit to customers any difference through the RES tracker.

Option 2:

Defer the entire ADIT proration decision as well as approval of the Company's RES Rider rate factors for 2016.

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.

Option 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.

Department Summary & Recommendations

The Department provided the following reasons for the Commission to consider while making a decision on the issue of proration its ADIT credits:

- First, Private Letter Rulings (PLRs) are not the same as Internal Revenue Service (IRS) Regulations and every PLR states that they are only allowed to be used by the entity requesting the PLR and may not be used or cited as precedent.
- Second, providing ratepayers with an ADIT credit for rate base equal to the deferred tax expense that ratepayers are prepaying is a long-standing ratemaking policy.
- Third, under Xcel's proposal, debits and credits would no longer be equal which violates a fundamental accounting rule. The debit is to deferred tax income tax expense, which the Company still plans to fully charge customers, yet the ADIT credit would be reduced because of the proration.
- Fourth, Xcel is not incurring any additional costs to warrant such a change in this long-standing ratemaking policy; in fact, utilities are paying less income tax than ever due to bonus tax legislation. Thus, increasing costs to ratepayers is unsupported. (Note providing an ADIT credit equal to the deferred tax expense is no different than ratepayers paying depreciation expense and then getting the same amount as a reduction to rate base through accumulated depreciation.)
- Fifth, all components of forecasted rate base are calculated using an average of non-prorated beginning and end-of-year balances (average rate base). Thus, allowing the ADIT credit to be calculated on a prorated basis would result in an inconsistent treatment of rate base calculations and therefore would not be reasonable without adequate support for such a difference in accounting and ratemaking.

The Department provided three Commission options for the Commission to consider, listed in order of the Department's preference:

Option 1:

The Department recommended the Commission deny the Company's request for the proration of ADIT.

Option 2:

For purposes of resolving this issue and not using limited state resources, the Department's

alternative recommendation is to:

- 1) allow the prorated ADIT only for recovery of forecasted costs (costs that are not historical, actual costs at the time the rates go into effect) and,
- 2) require a true-up in the following year (once all amounts are historical/actual) by using actual non-prorated ADIT amounts.

Option 3:

Finally, if Xcel continues to pursue this issue to the detriment of ratepayers, the Department recommends that the Commission consider either denying rider recovery or limiting rider recovery to historical costs, as both of these approaches would eliminate the need to prorate ADIT balances.

Staff Analysis

The Department's position is that ADIT issue in the TCR rider is a timing issue. In the rider, the issue is resolved by trueing up to actual costs once the cost become known, not prorated costs. The Department's main concern is how the issue would be handled in a rate case because in the rate case, there is no true-up of prorated ADIT and this results in a permanent rather than temporary difference between prorated ADIT and the offsetting ADIT credit to rate base.

In previous rate cases, the Company has included non-prorated ADIT balances in its forecasted test-year rate base. In its current rate case, the Company is proposing proration of the ADIT balances in its forecasted test-year rate base. The Company does not agree an ADIT true-up in the following year is required when the amounts become actual.

Straight Line Depreciation

Straight line depreciation allows the utility to recover the cost of an asset in equal amounts each year over the assets productive life. In setting rates for Minnesota ratepayers the Commission allows the Company to charge ratepayers for a tax expense based on the assumption of straight line depreciation. Because straight line depreciation expense is lower than an accelerated amount of depreciation when a Company is investing in its business, tax expense using the straight line method will be higher than it would be using one of the accelerated methods allowed for tax reporting purposes. The depreciation parameters and resulting rates are reviewed periodically and set by the Commission.

Bonus Tax Depreciation

Bonus tax depreciation is a depreciation method used for income tax purposes that reflects more depreciation in the early years of an asset's useful life compared to straight-line depreciation and most other forms of accelerated depreciation. Straight-line depreciation is used for financial accounting and regulatory purposes and is the method on which gas and electric utility rates are set. Bonus depreciation is used for federal tax accounting purposes and defers income taxes by reducing taxable income in the early years of an asset's life and increasing taxable income in the latter years. The difference between straight-line depreciation (constant through an asset's life) and bonus depreciation is a matter of timing, which in turn generates a deferred tax liability.

Below are two hypothetical examples. The first example compares straight line depreciation to bonus depreciation. The second example illustrates the effect that using straight line depreciation vs. bonus depreciation has on the calculation of operating income in Year 1.

Straight Line vs. Bonus Depreciation

Year	Straight Line (MN)	Bonus Depreciation (Tax)
1	\$100,000	\$200,000
2	\$100,000	\$320,000
3	\$100,000	\$192,000
4	\$100,000	\$115,200
5	\$100,000	\$115,200
6	\$100,000	\$57,600
7	\$100,000	\$0
8	\$100,000	\$0
9	\$100,000	\$0
10	\$100,000	\$0
Total	\$1,000,000	\$1,000,000

Operating Income Year 1

	Regulatory Basis (MN)	Tax Basis
Revenue	\$1,000,000	\$1,000,000
Expenses	(700,000)	(700,000)
Depreciation	(100,000)	(200,000)
Taxable Income	200,000	100,000
Income Tax Expense @ 35%	(70,000)	(35,000)
Operating Income	130,000	65,000

Accumulated Deferred Income Taxes

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.

The revenue requirement is impacted by bonus depreciation as a decrease to rate base when the bonus depreciation is factored into the ADIT calculation. The revenue requirement is impacted because this reduces the value of the assets on which the Company is authorized to earn a rate of return. Depreciation expense, on the other hand, is included in the revenue requirement calculations, as part of the Company's expenses that are included in the cost of service. Under normalized accounting for income taxes, ADIT signifies amounts paid by customers for current

taxes that the utility will not have to pay the government until a later period.

Normalization

Deferred taxes are a result of an accounting process called “normalization”, which is the timing difference between book and tax accounting. The difference is then multiplied at the current tax rate to determine the current deferred tax. This amount in turn is added to the Accumulated Deferred Income Tax (ADIT) balance. Deferred taxes derive from tax depreciation being greater than book depreciation (in the early years of an assets life.) The Company’s ADIT balance has been growing in large part due to bonus tax depreciation as well as increased spending on capital projects. The Company strives to maximize the tax benefits by using accelerated methods to depreciate its assets, which are often taken in the early years of an asset’s life. Deferred taxes, from a rate making perspective, allow the Company to share some of the early tax benefits with customers over the asset’s straight line book life. An illustration of the computation of deferred taxes is provided below.

(The alternative to the “normalization” method is the “flow-through” method. “When a utility is required...to flow through the tax savings which the utility enjoys with the use of accelerated depreciation, the financial statements of the utility reflect straight-line depreciation and actual taxes paid. The result is an increase in net income after taxes. In a rate making situation this will mean a higher rate of return. The flow-through concept not only advocates flowing through the actual tax savings and subsequently, higher income on the income statement, but also anticipates a flowing onward to the rate payer in the form of lower rates since the rate of return has now increased and the savings, in fact, belong to the rate payer.”²⁸

Accumulated Deferred Income Taxes

Year	Book Depreciation	Tax Depreciation	Timing Difference	Deferred Tax @ 35%	ADIT
1	\$100,000	\$200,000	(\$100,000)	(\$35,000)	(\$35,000)
2	\$100,000	\$320,000	(\$220,000)	(\$77,000)	(\$112,000)
3	\$100,000	\$192,000	(\$92,000)	(\$32,200)	(\$144,200)
4	\$100,000	\$115,200	(\$15,200)	(\$5,320)	(\$149,520)
5	\$100,000	\$115,200	(\$15,200)	(\$5,320)	(\$154,840)
6	\$100,000	\$57,600	\$42,400	\$14,840	(\$140,000)
7	\$100,000	\$0	\$100,000	\$35,000	(\$105,000)
8	\$100,000	\$0	\$100,000	\$35,000	(\$70,000)
9	\$100,000	\$0	\$100,000	\$35,000	(\$35,000)
10	\$100,000	\$0	\$100,000	\$35,000	\$0
Total	\$1,000,000	\$1,000,000			

The deferred tax liability is a different sort of liability because the tax is not really owed to the government. As far as the IRS is concerned, the only tax due is the current portion of the tax

²⁸ Public Utility Accounting, Theory and Application, James Suelflow, pp. 116-117.

expense that is calculated on the current year's tax return. However, it is an expense that the Company has included in income tax expense for ratemaking purposes.

The main issue being discussed in this case is whether the ADIT balances should be prorated or not prorated when the Company forecasts its test year for rate base. And, if the Commission agrees with Xcel that proration of the ADIT balances is required because of the federal tax code, must the true-up also be calculated using the proration method when adjusting for actual ADIT.

Xcel provided the following data in its TCR filing which illustrates the effect proration will have on ratepayers. A simple comparison of the Company's January forecasted monthly deferred tax expense to the Company's prorated deferred tax expense would produce the following results:

Month	Proration Factor	Forecasted Monthly Deferred Tax Expense	Prorated Deferred Tax Expense	Difference
Jan	0.917808	\$815,944	\$748,880	\$67,064

Under the Company's proposal to use proration of the forecasted monthly deferred tax expense, ratepayers would pay \$815,944 in tax expense and receive an ADIT offset of \$748,880. As can be seen from this example, if this data were turned into a journal entry for accounting purposes, the debits and credits would not be in balance. The remaining \$67,604 would be a permanent difference. The permanent differences could be a substantial burden on ratepayers especially in the context of the rate case.

It is Staff's opinion that the ADIT proration issue requires further development before the Commission makes a decision on this issue. As of the date of the Commission meeting there are several proceedings in progress that seek to address the ADIT issue and arrive at a definitive answer as to how proration of ADIT and proration of the ADIT true-up should be treated.

Xcel Settlement in Rate Case

The Department and Xcel reached a settlement on all of the financial issues in the rate case and that is why the issue is being discussed in this proceeding. Because Staff is not privy to the terms of the black box settlement, some of the questions the Commission may want to ask Xcel at its agenda meeting in regards to the rate case settlement:

- Does the settlement change the way ADIT has been treated in the past?
- An explanation as to what would have been the financial effect if its proposal was approved in the rate case.
- What would be the effect of the Company prorating its forecasted ADIT balances while maintaining proration in the true-up?
- How much would benefit Xcel and its shareholders vs. the benefit to its ratepayers?

The Commission may also want to ask Xcel to address these issues in its next TCR filing.

Xcel PLR

In an e-mail dated November 29, 2016 Xcel stated its intention to seek guidance from the IRS regarding the correct interpretation of their requirement to prorate the accumulation of current year ADIT in rate base when implementing a projected test year rate as well as a true-up of that rate. Xcel stated its goal is for the IRS response to clarify the interpretation and ensure that customers continue to benefit from the reduction in rate base provided by income tax normalization. It is anticipated the PLR request would be done in consultation with PUC staff and the Department, much like OTP's proposal. However, staff does not believe formal written authorization from the Commission in the form of an order is necessary for Xcel (or OTP) to submit its request for a PLR from the IRS. Staff believes it would be sufficient for the parties to the proceeding to stipulate to the request for the PLR and PUC staff may only need to be consulted.

Historical Costs

Staff would like to note that the Department's recommendation to allow rider recovery based on historical costs is appealing. It is staff's experience that Xcel's rider filings usually turn into a small rate case. As shown in this briefing paper regarding the ADIT issue, the issues Xcel tends to raise in its riders are complex and time consuming for both the Department and PUC staff to deal with. In Xcel's last TCR rider filing²⁹ the Company asked the Commission for "guidance" as to when to recover the revenue requirements associated with two TCR eligible projects located out of state, the Couderay to Osprey project located in Wisconsin and the Big Stone to Brookings project located in South Dakota. This guidance was requested after the Company had made a written commitment in its most recent rate case to not seek rider recovery for any new projects through the TCR rider during the duration of its Multi-Year Rate Plan (MYRP).³⁰

Decision Alternatives

ADIT Proration

1. Confirm proration is required in the RES rider and defer the decision of proration at true-up to a later proceeding. (Xcel preferred)
2. Defer the entire ADIT proration decision. (Xcel second preference)
3. Order the Company to not prorate ADIT in general or at true-up. (Xcel third preference, Department preferred)
4. Allow the Company to prorate ADIT only for recovery of forecasted costs (costs that are not historical, actual costs at the time the rates go into effect) and, require a true-up in the

²⁹ Docket No. E-002/M-14-852.

³⁰ Docket No. E-002/GR-13-868.

following year (once all amounts are historical/actual) by using actual non-prorated ADIT amounts. (Department second preference)

5. Either deny rider recovery or limit rider recovery to historical costs, as both of these approaches would eliminate the need to prorate ADIT balances. (Department third preference)

North Dakota Investment Tax Credit

6. Allow the Company to recover the costs of the Courtenay project from Minnesota ratepayers in this rider petition and require Xcel to credit its Minnesota ratepayers for their proportionate share of used NDITCs associated with the Courtney Project, based on the pro-rata share of the costs of the Courtenay project that is charged to Minnesota ratepayers. (Department preferred)
7. Deny Xcel's request to recover the costs of the Courtenay project from Minnesota ratepayers in this rider petition. (Department alternative)
8. Allow the Company to recover the costs of the Courtenay project from Minnesota ratepayers in this rider petition and decide that that no amount of NDITCs should be proportionately shared with Minnesota ratepayers. (Xcel preferred)

2016 Revenue Requirement

9. Approve the 2016 proposed revenue requirement of approximately \$17.3 million for recovery through the RES rider. (The revenue requirement may fluctuate up or down when the Company updates its forecasted numbers with actual numbers.) A large change in the revenue requirement would be brought to the Commission's attention. (Xcel preferred, DOC)
10. Approve the 2016 proposed revenue requirement of approximately \$17.3 million for any decision the Commission makes related to proration of ADIT (in alternatives 1 through 5) for recovery through the RES rider. (The revenue requirement may fluctuate up or down when the Company updates its forecasted numbers with actual numbers.) A large change in the revenue requirement would be brought to the Commission's attention. (Xcel does not prefer #7 if the Commission adopts 2, 3, 4 or 5, DOC alternative)
11. Do not approve the Company's 2016 proposed revenue requirement of approximately \$17.3 million for recovery through the RES rider and allow the Company to continue collecting at its current level of \$0.00. (Xcel second preference)

12. Approve the Company's proposed revenue requirement of approximately \$17.3 million and authorize the recovery of actual 2016 costs through the RES rider. (Staff alternative)

True-up and Tracker

13. Approve the 2015 TCR True-up and Tracker balance report and carryforward of the 2015 tracker balance. (The true-up may fluctuate up or down when the Company updates its forecasted numbers with actual numbers.) A large change in the revenue requirement would be brought to the Commission's attention. (Xcel, DOC)
14. Do not approve the 2015 TCR Tracker True-up and Tracker balance report and carryforward of the 2015 tracker balance.

2016 RES Adjustment Percentage

15. Approve the resulting RES Adjustment percentage to be included in the Resource Adjustment on bills for Minnesota electric customers. (Xcel, DOC)
 - A. Authorize Xcel to recalculate, as needed, the TCR adjustment factors based on a twelve-month period. OR
 - B. Authorize Xcel to recalculate the TCR adjustment factors based on some other length of time.
16. Do not approve the resulting RES Adjustment percentage to be included in the Resource Adjustment on bills for Minnesota electric customers for the 12 months beginning January 1, 2016 and keep the RES Adjustment percentage currently in effect at \$0.00. (Xcel alternative, Department alternative)

Tariff Sheets & Customer Notices

17. Approve the Company's proposed revised tariff sheet and proposed customer notice. (The RES Adjustment percentage in the tariff and proposed customer notice may fluctuate up or down based on the Commission's decisions.) (Xcel, DOC)
18. Do not approve the Company's proposed revised tariff sheet and proposed customer notice.

Compliance Filing

19. Require the Company to submit a compliance filing updated to reflect the Commission's decisions in the Order and updating the forecasted numbers with actual numbers within 10 days from the date the Commission's Order is issued. (Xcel, DOC)

20. Do not require the Company to submit a compliance filing updated to reflect the Commission's decisions in the Order and updating the forecasted numbers with actual numbers within 10 days from the date the Commission's Order is issued.

Recommendation

5, 6, 12, 13, 15 A or B, 17, 19