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May 14, 2018

—Via Electronic Filing—

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

RE: REPLY COMMENTS
STATE ENERGY POLICY RIDER
DOCKET NO. G002/M-18-184

Dear Mr. Wolf:

Northern States Power Company, doing business as Xcel Energy, submits this Reply to the April 2, 2018 Comments of the Minnesota Department of Commerce, Division of Energy Resources in the above-referenced docket.

We have electronically filed this document with the Minnesota Public Utilities Commission, and copies have been served on the parties on the attached service list.

If you have any questions regarding this filing please contact Rebecca Eilers at rebecca.d.eilers@xcelenergy.com or (612) 330-5570, or me at (612) 330-7681 or lisa.r.peterson@xcelenergy.com

Sincerely,

/s/

LISA R. PETERSON
MANAGER, REGULATORY ANALYSIS

Enclosures
c: Service List

STATE OF MINNESOTA
BEFORE THE
MINNESOTA PUBLIC UTILITIES COMMISSION

Nancy Lange	Chair
Dan Lipschultz	Commissioner
Matthew Schuerger	Commissioner
Katie J. Sieben	Commissioner
John A. Tuma	Commissioner

IN THE MATTER OF THE PETITION OF
NORTHERN STATES POWER COMPANY
FOR APPROVAL OF A MODIFICATION TO
OUR NATURAL GAS SEP TARIFF, 2018
SEP RATE FACTOR, AND 2017 SEP
COMPLIANCE FILING

DOCKET NO. G002/M-18-184

REPLY COMMENTS

INTRODUCTION

Northern States Power Company, doing business as Xcel Energy, submits to the Minnesota Public Utilities Commission this Reply to the April 2, 2018 Comments of the Minnesota Department of Commerce – Division of Energy Resources regarding our State Energy Policy (SEP) Rider filing.

REPLY COMMENTS

The SEP Rider recovers the annual revenue requirement associated with the cast iron pipe replacement project that went into service in 2012 and the costs associated with the Assessment for Department Regional and National Duties (ADRND). The Company approached the annual SEP Rider Petition this year much as we have in the past. Though we had not yet implemented a rate for the 2017-2018 SEP Period, we provided the 2017 compliance report updating the tracker with known 2017 actuals, and we also presented our 2018-2019 SEP Period forecast. Our proposed rate combined the 2017 tracker carryover balance with the 2018 forecasted rate, as we have done in our past SEP Rider petitions.

The Company and the Department agree on the reasonableness of the costs going through the SEP Rider. The only issues of disagreement relate to (1) the proration of accumulated deferred income taxes (ADIT) and (2) the natural gas sales period used

to calculate the rider rate. Our Reply discusses why we believe it is appropriate to resume recovery of SEP Rider revenue requirements using a forward-looking test year and forecasted sales.

A. ADIT

1. 2017 SEP Proceeding

The Department argues that the Company's proposal in this proceeding is a request for rehearing of the Commission's Order in Docket No. G002/M-17-174. The Company does not agree given the nature of the discussion and the fact that a permanent move to a historical test year was not an issue fully addressed in the written record.

In the Commission's August 24, 2017 ORDER CONTINUING RECOVERY OF COSTS THROUGH THE STATE ENERGY POLICY RIDER AND OTHER ACTION in Docket No. G002/M-17-174, the Commission recounted how it arrived at Order Point 3 (which provides "Xcel Gas shall not prorate its accumulated deferred income taxes in the SEP Rider") and Order Point 4 (which provides "The effective date of the SEP rider shall not be before July 1, 2018.")

1. Xcel Gas

Xcel Gas stated that it planned on requesting a Private Letter Ruling (PLR) from the Internal Revenue Service to resolve the issue of proper ADIT treatment in riders. The Company prepared a draft request for a PLR, which it shared with the Department. At the Commission meeting, the Company stated that it hoped to reach a compromise with the Department regarding the treatment of ADIT, to avoid the need to obtain a PLR in light of another PLR recently issued.

2. Department

At the hearing, however, the Department amended its initial recommendation, and requested that the Commission not allow Xcel to prorate its accumulated deferred income taxes in the SEP Rider, and require the effective date of the SEP Rider to be July 1, 2018.

3. Commission Action

The Commission agrees that the Department's approach is more reasonable, *particularly in lieu of waiting for a PLR that the Company has not yet*

formalized or submitted. As the Department explained, there will be no proration effect of ADIT on the SEP Rider if the rate has been put into effect at the conclusion of the test year (June 30, 2018).

Accordingly, the Commission will adopt the Department's recommendation to not allow Xcel Gas to prorate its accumulated deferred income taxes in the SEP Rider, and to set the effective date of the SEP Rider to be on or after July 1, 2018.

(emphasis added.) In light of the fact the decision alternatives the Commission ultimately adopted were raised orally at hearing and the language in the order tied Commission action to facts specifically tied the 2017 SEP Rider filing, the Company does not believe the Commission decided to permanently change the SEP Rider into a historical recovery mechanism. Such a marked change to the regulatory compact requires notice and full written record upon which the Commission can rely. As such, the Company disagrees with the characterization that this is a request for rehearing of the Commission's decision in Docket No. G002/M-17-174. Rather, the issue is evolving, as evident in other active dockets, and merits the Commission's consideration based on the current state of affairs.

To that end, and as the Commission is aware, since the IRS clarified its normalization regulations, the utility industry has sought additional guidance from the IRS, in the form of PLRs, to understand how the IRS' interpretation would apply to a variety of different scenarios. The Company made its proposal in the SEP Rider filing because it believes the IRS' more recent and specific PLR issuances should be incorporated into Commission decisions.

In acknowledgement of the Department's position that our initial proposal unduly harms customers because it "would not give back to the ratepayers the income taxes they prepaid on the original prorated ADIT, and would not credit ratepayers for the difference between prorated and un-prorated ADIT," we offer a revised ADIT proration proposal that addresses this concern while avoiding a violation of IRS normalization rules.

2. Response to the Department Across Rider Proceedings

We acknowledge that the ADIT Proration requirements from the IRS are cumbersome. We took steps to evaluate this topic in significant depth and explore what alternative treatments could be applied across all of the Company's open rider proceedings so as to minimize the customer impact while still maintaining the

significant deferred tax benefits provided to our customers. Below we provide a discussion of the Department's proposed resolution of the issue and discuss the additional work we have done as well to bring constructive closure to this issue.

In the Department's Comments in other concurrent rider dockets,¹ the Department compares the Company's position to the resolution in the Otter Tail Power TCRR proceeding, Docket No. E017/M-16-374, noting:

As the tracker is updated with actual results, the effect of proration is eliminated and the actual, non-prorated ADIT amounts are reflected in the TCRR.

We note that the Otter Tail docket is now two years old, and did not have the benefit of the clarifying guidance from the IRS. Otter Tail has not filed subsequent riders in Minnesota, but it has filed subsequent riders in other jurisdictions. For example, in their January 29, 2018 supplement to a rider in South Dakota, Docket No. EL17-048, Otter Tail writes:

Proration of Federal Accumulated Deferred Income Taxes (ADIT): Based on further research and analysis of United States Internal Revenue Service (IRS) rules related to proration, including recently issued IRS private letter rulings, Otter Tail identified revisions needed to its Accumulated Deferred Income Tax (ADIT) balances to preserve the effect of the application of the proration methodology for the true-up period. This calculation methodology is necessary in order to comply with Section 1.167(l)-l(h)(6)(ii) of the IRS regulations and to avoid a tax normalization violation.

The Department also notes that Private Letter Rulings (PLRs) are not the same as IRS Regulations and every PLR is only for the entity requesting the PLR. The Company notes that nonetheless, PLRs represent the IRS' view of the application of the law to a specific set of facts. Thus, the IRS makes their PLR findings public so that parties with similar fact patterns can learn from the circumstances addressed in the PLR.

The Department notes that by implementing the ADIT prorate, debits and credits would no longer be equal in the ratemaking calculation. It also notes that ADIT would be treated differently from the rest of rate base, which follows a BOY/EOY average without a proration effect. The Company notes that tax normalization is required in order to use accelerated depreciation, and Treasury Regulation

¹ April 2, 2018 Comments in Docket No. E002/M-17-797 (Transmission Cost Recovery Rider) and March 26, 2018 Comments in Docket No. E002/M-17-818 (Renewable Energy Standard Rider).

§1.167(l)(h)(6) requires a proration of forecasted ADIT to comply. Without changing the law or the regulation, the Company sees no way to avoid this circumstance.

The Department notes that the Company is not incurring any additional costs to warrant such a change in long-standing ratemaking policy. While Treasury Regulation §1.167(l)(h)(6) has been in place since the 1970s, through a series of PLRs over the past few years, the IRS highlighted that many utilities and regulators had not been complying with this provision in their ratemaking practices. The Company has no particular interest in the provision other than it is required in order to preserve the significant deferred tax benefits for our customers and the IRS has communicated to the industry the ways in which it should be implemented.

3. Additional Work and Interpretation

The Company has reviewed recently-released IRS guidance and engaged Deloitte Tax Services to evaluate our rider calculations and propose further optimizations that could be applied to reduce or effectively eliminate the impact to customers. Through this process we identified a possible modification, which is to treat each forecast month as a test period since the revenue requirements in these riders are calculated monthly. This allows the monthly ADIT balance to be reset to its un-prorated beginning balance and only the monthly activity receives the proration. This treatment reduces the impact to the ratepayers in these rider mechanisms significantly. This treatment will require the ADIT prorate to be embedded in the rate base calculation rather than separated as a line item. However, we will provide a supporting schedule to identify the revenue requirement impact of that item individually. We are still finalizing these calculations and will provide a supplement to this Reply to provide the detailed schedules and impacts of this methodology.

At this level we feel we have taken as many steps as possible to minimize the issue. We ask that the Commission allow current recovery using this treatment rather than waiting to set the rate after the test period as that is punitive to the Company and potentially volatile for customer rates.

Even without this potential optimization, we believe our position on true-up treatment is in fact quite close to the Department's. In their April 2, 2018 TCR Rider Comments and March 26, 2018 RES Rider Comments, the Department restated their position from our last Transmission Cost Recovery (TCR) proceeding, Docket No. E002/M-15-891:

Based on our review of IRS Section 1.167(l)(b)(6), the Department concludes that the ADIT issue is simply a timing issue. Once actual non-prorated ADIT balances are known in the following year, they should replace the forecasted prorated ADIT balances in the beginning-of-year and end-of-year average ADIT balance calculations for true-up purposes.

We note that the proposal provided in our SEP Rider Petition is a slight modification to the Department's position above, and is based on the most recent and relevant guidance from the IRS. Our proposed treatment also uses actuals to replace the forecasted prorated ADIT balances in the beginning-of-[period] and end-of-[period] average ADIT balance calculations for true-up purposes. The only difference is the clarification that neither the original forecast nor the actual results are prorated for the purposes of the comparison used in the true-up.

The Department goes on to say, again quoting from the TCR docket:

Alternatively, the Commission could require Xcel's riders to be based solely on historical costs, as Xcel acknowledges that the issue applies only in cases with forward-looking rates.

We continue to believe this purely historical method, while definitive, provides significant drawbacks to our customers. The revenue requirements value of the prorate is quite small; however postponing the rate implementation past the test year, would create a large carryover balance to be recovered in the next rate. This creates significant volatility in the rider rates year-to-year, causing confusion for customers.

We appreciate the input and discussion the Department has provided thus far in what we acknowledge to be a complex topic. Given the minimal difference that now exists between the parties' interpretations, the Company would be interested in follow-up discussions to determine if any additional adjustments can result in a satisfactory outcome for all parties. Additionally, we believe that, given the additional guidance received from recent IRS rulings and work with Deloitte Tax Services, it is no longer necessary for the Company to submit its own PLR. We look forward to resolving remaining differences with parties.

4. Updated Rate Calculation

When we supplement this Reply to support our updated ADIT proration methodology, we will provide updated rate calculations to reflect the ADIT proration changes.

B. Sales Used in the Rate Calculation

In the Department's comments, they also note that the Company's therm sales "appear to be too low" and thus recommends setting rates effective July 1, 2018 based on 2016 sales. While the Company appreciates the Department's concern, we believe the use of forecasted sales provides the best opportunity for a matching of costs and revenues. It is well established that the SEP Riders use forecasted sales and any necessary true-up will be handled in future filings. As the Department itself explained in its July 2, 2010 Comments in the 2010 SEP Rider in Docket No. E,G002/M-10-210:

[S]ince Xcel Energy's forecasted sales are used to set rates in the present docket, any changes arising from the difference in revenue between forecasted sales and actual sales and differences in costs due to the rate of return determination in the ongoing gas rate case will be reflected in future SEP Rider filings, beginning with the filing to be submitted by March 1, 2011.

The Company's 2018 forecast is based not only on a review of past actuals sales, but detailed analysis of what the Company expects gas sales to be in the future (e.g., whether it will lose or gain customers, whether it expects gas use to increase or decrease, etc.). The goal in setting the rate is to collect as close to the approved revenue requirement as possible without over- or under-collecting significantly. The best way to achieve this goal is to use the appropriate sales forecast for the period over which that revenue requirement will be collected. Using the corresponding forecast will allow for a more consistent match in costs and recovery timeframes and should result in less of a true-up amount. Based on an appropriate match between cost and recovery, as well as the long understood practice that actual gas sales will be trued up in subsequent SEP Rider filings, the Commission should use 2018 forecasted sales as proposed by the Company in its initial petition.

CONCLUSION

We respectfully request that the Commission approve our SEP Petition as supplemented by these Reply Comments.

Dated: May 14, 2018

Northern States Power Company

CERTIFICATE OF SERVICE

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

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

xx electronic filing

DOCKET No. G002/M-18-184

Dated this 14th day of May 2018

/s/

Carl Cronin

[illegible]

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