

Memo

To: Illona Jeffcoat-Sacco
From: Mike Diller
Date: January 16, 2007
Re: NSP Interim Rate Relief (Case No. PU-06-525)

Staff believes that the interim rate increase, effective on or after February 13, 2005, should be \$1.788 million.

In proposing an interim rate increase for its gas operations, NSP begins with its full rate increase request of \$2.801 million using a 2007 test year. NSP then makes two adjustments resulting in an interim rate increase request of \$2.551 million. One adjustment excludes the cost of a new DSM program and the other adjusts the capital structure to give consideration for the low cost of preferred stock which no longer is included in the utility's capital structure. Staff does not object to these adjustments.

However, staff believes additional adjustments are necessary to comply fully with the spirit of the law concerning interim rate increases. The applicable section of the North Dakota Century Code is included at the end of this memo. In addition to the adjustments proposed by NSP, staff believes 3 additional adjustments are in order.

According to the code, rate base items included in the interim rate request must be the same in nature and kind as those allowed by a currently effective commission order in the public utility's most recent rate proceeding. Since the staff and NSP reached a "black box" settlement in the last rate proceeding, the specific agreements were not disclosed to the commission. Still, for purposes of establishing a proper interim increase, some thought must be given to what was agreed to in the last rate proceeding.

The first adjustment staff includes is an adjustment to exclude rate base related to unamortized manufactured gas plant clean-up costs as agreed to in a settlement agreement reached two cases ago, in case No. PU-400-00-521.

In that agreement, the company agreed to an eight year amortization with no rate base treatment. There is no reason to think that this agreement became null and void because a black box settlement was reached in the last rate case proceeding.

The second adjustment proposed by staff has to do with the return on common equity. According to code, the interim rate request should be calculated using the return authorized by the commission in its most recent rate proceeding. Again, the black box settlement did not disclose the specific return on common equity agreed to. In its request, the company suggests using the return on common equity used in the case before the most recent rate proceeding or 11.3%. Out of concession, the staff has included a return on common equity that comports with the return on common equity recently authorized by the Minnesota commission for NSP's electric operations of 10.56%. Staff believes that the black box settlement included a lower return on equity but offers to use 10.56% in the spirit of reasonableness and cooperation.

Last, the interim rate increase amount needs to be adjusted to exclude the impact of NSP changing the way it allocates customer costs. According to its application, NSP implemented a new customer billing system in February, 2005. As a result of its implementation, customer bill counts are recorded differently than was the case for the previous system resulting in allocating additional costs to North Dakota's gas operations of \$363,000. Staff believes that the exclusion of these costs in setting interim rates is necessary to comply with the law that interim rates be based on expenses of the same nature and kind included in the last rate proceeding.

After making these adjustments, the company is entitled to an interim rate increase of \$1.788 million. The rate increase should be applied equally across-the-board to the non-gas portion of the existing tariff rates for all customer classes.

Even though the commission may require a bond to ensure a refund in the event that the commission does not find that the increase is justified, staff believes the financial security of NSP is such that one is not required.

Attached are four worksheets used to calculate staff's supported interim rate increase of \$1.788.

Following are the applicable laws governing the interim gas rate increase requested by NSP:

- 49-05-06. Hearing by commission on proposed change of rates.**
- 2. Notwithstanding that the commission may suspend a filing and order a hearing, a public utility may file for interim rate relief as part of its general rate increase application and filing. If interim rates are requested, the commission shall order that the interim rate schedule take effect no later than sixty days after the initial filing date and without a public hearing. The interim rate schedule must be calculated using the proposed test year cost of capital, rate base, and expenses, except that the schedule must include:
 - a. A rate of return on common equity for the public utility equal to that authorized by the commission in the public utility's most recent rate proceeding;**
 - b. Rate base or expense items the same in nature and kind as those allowed by a currently effective commission order in the public utility's most recent rate proceeding; and**
 - c. No change in existing rate design.****
 - 3. In ordering an interim rate schedule, the commission may require a bond to secure any projected refund required by subsection 4. The terms of the bond, including the amount and surety, are subject to the commission's approval.**
 - 4. As ordered by the commission, the utility shall promptly refund to persons entitled thereto all interim rate amounts collected by the public utility in excess of the final rates approved by the commission plus reasonable interest at a rate to be determined by the commission.**

**Northern States Power Company
Gas Utility - North Dakota
Return Deficiency / Return on Equity
(Dollars In Thousands)**

<u>Line</u>	<u>Return Deficiency</u>	<u>Northern States Power Company</u>					
		<u>Actuals</u>	<u>Test Year</u>	<u>Interim</u>	<u>Interim</u>	<u>Staff</u>	
	<u>2005</u>	<u>2007</u>	<u>Rate Relief</u>	<u>Rate Relief</u>	<u>Staff</u>	<u>Staff</u>	
			<u>Adjustments</u>	<u>Requested</u>	<u>Adjustments</u>	<u>Interim</u>	
						<u>Rate Relief</u>	
1	Rate Base	\$41,245	\$46,631	\$0	\$46,631	(\$721)	\$45,910
2	Rate of Return Required	9.38%	9.23%	-0.09%	9.15%	-0.38%	8.77%
3	Return Required	\$3,870	\$4,305	(\$40)	\$4,265	(\$239)	\$4,026
4	Return Earned	2,636	2,616	110	2,726	219	2,945
5	Return Deficiency/(Excess)	\$1,234	\$1,689	(\$150)	\$1,539	(\$458)	\$1,081
6	Tax Factor	1.656	1.654	1.654	1.654	1.654	1.654
7	Rev. Deficiency/(Excess)	\$2,044	\$2,794	(\$248)	\$2,546	(\$758)	\$1,788
8	Impact of Weather	220	-	-	-	-	-
9	Norm. Deficiency/(Excess)	\$ 1,824	\$ 2,794	\$ (248)	\$ 2,546	\$ (758)	\$ 1,788

Northern States Power Company
Gas Utility - North Dakota
Rate Base
(Dollars In Thousands)

<u>Line Description</u>	<u>Northern States Power Company</u>					
	<u>Actuals</u> <u>2005</u>	<u>Test Year</u> <u>2007</u>	<u>Interim</u> <u>Rate Relief</u> <u>Adjustments</u>	<u>Interim</u> <u>Rate Relief</u> <u>Requested</u>	<u>Staff</u> <u>Adjustments</u>	<u>Staff</u> <u>Interim</u> <u>Rate Relief</u>
1 Plant in Service	\$ 77,976	\$ 83,952		\$ 83,952		\$ 83,952
2 Accum. Depreciation	34,793	38,495		38,495		38,495
3 Net Plant in Service	\$ 43,183	\$ 45,457		\$ 45,457		\$ 45,457
4 Const. Work in Progress	85	33		33		33
5 Materials and Supplies	151	168		168		168
6 Fuel Stocks	5,621	5,781		5,781		5,781
7 Prepayments	123	2,749		2,749	-721	2,028
8 Customer Deposits	(18)	0		0		0
9 Cash Working Capital	0	456		456		456
10 Other Rate Base ¹	(1,033)	(1,082)		(1,082)		(1,082)
11 Accum. Def. Taxes	(6,867)	(6,931)		(6,931)		(6,931)
12 Average Rate Base	\$ 41,245	\$ 46,631	\$ -	\$ 46,631	\$ (721)	\$ 45,910

Northern States Power Company
Gas Utility - North Dakota
Cost of Capital
(Dollars In Thousands)

<u>Line</u>	<u>Description</u>	<u>Amount</u>	<u>% of Total</u>	<u>Cost</u>	<u>Weighted Cost</u>
<i>2005 (Actuals):</i>					
24	Long-Term Debt	\$ 2,177	51.10%	6.97%	3.56%
25	Short-Term Debt	32	0.75%	5.75%	0.04%
27	Common Equity	2,051	48.15%	12.00%	5.78%
28	Total	<u>\$ 4,260</u>	<u>100.00%</u>		<u>9.38%</u>
<i>2007 (Co. T.Y.):</i>					
29	Long-Term Debt		46.41%	7.08%	3.29%
30	Short-Term Debt		2.00%	5.81%	0.12%
32	Preferred Stock		0.00%	0.00%	
33	Common Equity		51.59%	11.30%	5.83%
34	Total	<u>\$ -</u>	<u>100.00%</u>		<u>9.23%</u>
<i>2007 (Co. Interim Rate Request):</i>					
35	Long-Term Debt		48.45%	7.08%	3.43%
36	Short-Term Debt		2.00%	5.81%	0.12%
37	Preferred Stock			0.00%	0.00%
38	Preferred Stock		0.00%	0.00%	
39	Common Equity		49.55%	11.30%	5.60%
40	Total	<u>\$ -</u>	<u>100.00%</u>		<u>9.15%</u>
<i>2007 (Recommended Staff Interim Rate Relief):</i>					
41	Long-Term Debt		48.45%	7.08%	3.43%
42	Short-Term Debt		2.00%	5.81%	0.12%
43	Preferred Stock			0.00%	0.00%
44	Preferred Stock		0.00%	0.00%	
45	Common Equity		49.55%	10.54%	5.22%
46	Total	<u>\$ -</u>	<u>100.00%</u>		<u>8.77%</u>

**Northern States Power Company
Gas Utility - North Dakota
Net Operating Income
(Dollars In Thousands)**

<u>Line</u>	<u>Operating Revenues</u>	<u>Northern States Power Company</u>					
		<u>Actuals</u> <u>2005</u>	<u>Test Year</u> <u>2007</u>	<u>Interim</u> <u>Rate Relief</u> <u>Adjustments</u>	<u>Interim</u> <u>Rate Relief</u> <u>Requested</u>	<u>Staff</u> <u>Adjustments</u>	<u>Staff</u> <u>Interim</u> <u>Rate Relief</u>
1	Residential	\$ 34,056					
2	Firm C & I	36,071					
3	Interruptible C & I	15,533					
4	Transportation/Other	996					
5	Total Revenues	\$ 86,656	\$ 93,376	\$ -	\$ 93,376	\$ -	\$ 93,376
<u>Operating Expenses</u>							
6	Production	\$ 73,690	\$ 79,619		\$ 79,619		\$ 79,619
7	Transmission	78	132		132		132
8	Distribution	1,953	2,207		2,207		2,207
10	Customer Billing	1,398	1,830		1,830	(363)	1,467
11	Customer Service	177	381	(138)	243		243
12	Amortization		50		50		50
13	Sales & Marketing	35	0		-		-
14	Admin. & General	1,610	1,687		1,687		1,687
16	Depreciation	2,818	2,816		2,816		2,816
17	Property Taxes	1,066	1,158		1,158		1,158
18	Franchise & Payroll Taxes	187	217		217		217
19	Inc. Taxes (Cur. & Def.)	1,008	663	28	691	144	835
20	Total Expenses	\$ 84,020	\$ 90,760	\$ (110)	\$ 90,650	\$ (219)	\$ 90,431
21	Net Operating Income	\$ 2,636	\$ 2,616	\$ 110	\$ 2,726	\$ 219	\$ 2,945