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VIA ELECTRONIC FILING AND U.S. MAIL

June 16, 2008

Illona A. Jeffcoat-Sacco, Executive Director
North Dakota Public Service Commission
State Capitol Building, Dept. 408
600 East Boulevard
Bismarck, ND 58505-0480

Re: *Application of Northern States Power Company, a Minnesota Corporation for Authority to Increase Rates for Electric Service in North Dakota*
Case No. PU-07-776

Dear Ms. Jeffcoat-Sacco:

The Rebuttal Testimony for the following witness in the above-referenced proceeding was omitted from the submission we made to the North Dakota Public Service Commission on Friday, June 13, 2008. Mr. Watson's Rebuttal Testimony is included with this communication.

- *Dane A. Watson* – Depreciation, Retirement Costs and ARO

As noted in our June 13 cover letter, the Rebuttal Testimony for the witnesses listed below will be sent under separate cover today:

- *Elizabeth M. Engelking*
- *Richard A. Rosvold*

We have served copies of this communication on all parties on the attached service list. Please contact me at (701) 241-8632 if you have any questions.

Sincerely,

MARY A. MARTINKA
REGULATORY CASE SPECIALIST

Enclosure

cc: Service List

In the Matter of the Application by
Northern States Power Company,
a Minnesota corporation
for Authority to Increase Rates for Electric Service in North Dakota
Case No. PU-07-776
OAH File No. 20080012

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Rebuttal Testimony
Dane A. Watson

Before the North Dakota Public Service Commission
State of North Dakota

In the Matter of the Application of
Northern States Power Company, a Minnesota Corporation

For Authority to Increase Rates for
Electric Service in North Dakota

Case No. PU-07-776
Exhibit___

Depreciation
Retirement Costs and ARO

June 13, 2008

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Dane A. Watson. My business address is 1410 Avenue K, Suite 1105B, Plano, Texas 75074.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION?

A. I am a Partner in Alliance Consulting Group. Alliance Consulting Group provides consulting and expert services regarding depreciation, valuation and accounting-related issues to the utility industry.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I hold a Bachelor of Science degree in Electrical Engineering from the University of Arkansas at Fayetteville and a Master's Degree in Business Administration from Amberton University.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. Since graduation from college in 1985, I have worked in the area of depreciation and valuation. I co-founded Alliance Consulting Group in 2004 and am responsible for conducting depreciation, valuation, and certain accounting-related studies for clients in various industries. My duties related to depreciation studies include the assembly and analysis of historical and simulated data, conducting field reviews, determining service life and net salvage estimates, calculating annual depreciation, presenting recommended depreciation rates to utility management for their consideration, and supporting such rates before regulatory bodies.

My prior employment from 1985 to 2004 was with Texas Utilities Electric Company and successor companies ("TXU"). During my tenure with TXU, I was responsible for, among other things, conducting valuation and depreciation studies for the domestic TXU companies. During that time I served as Manager of Property Accounting Services and Records Management in addition to my depreciation responsibilities.

I have twice been Chair of the Edison Electric Institute ("EEI") Property Accounting and Valuation Committee and have also served as Chairman of EEI's Depreciation and Economic Issues Subcommittee. I am a Registered Professional Engineer in the State of Texas and a Certified Depreciation Professional. I am a Senior Member of the Institute of Electrical and Electronics Engineers ("IEEE") and served for several years as an officer of the Executive Board of the Dallas Section of IEEE. I am also currently Past-President of the Society of Depreciation Professionals.

Q. DO YOU HOLD ANY SPECIAL CERTIFICATION AS A DEPRECIATION EXPERT?

A. Yes. The Society of Depreciation Professionals ("SDP") has established national standards for depreciation professionals. The SDP administers an examination and has certain required qualifications to become certified in this field. I have met all of these requirements and hold a Certified Depreciation Professional certification.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY REGULATORY COMMISSION?

A. Yes. I conducted depreciation studies and filed testimony regarding depreciation and valuation issues before the Public Utility Commission of Texas in Docket Nos. 11735, 12160, 15195, 16650, 18490, 20285, 22350,

23640, 24040, 32766, and 34040, before the Railroad Commission of Texas in Gas Utility Docket Nos. 8976, 9145-9148, 9225, 9313, 9400, 9670, and 9762, before the Arkansas Public Service Commission in Docket No. 06-161-U, before the Public Utilities Commission of the State of Colorado in Docket 06S-656G, and before the New Mexico Public Regulation Commission in Case No. 07-00319-UT. I also appeared in Federal Energy Regulatory Commission ("FERC") Docket No. 02-7-00 as an industry panelist on Asset Retirement Obligations ("ARO").

Q. FOR WHOM ARE YOU TESTIFYING?

A. I am testifying on behalf of Northern States Power Company, ("Xcel Energy" or the "Company") a Minnesota corporation operating as a public utility in North Dakota.

Q. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY IN THIS PROCEEDING?

A. No.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS PROCEEDING?

A. The purpose of my Rebuttal Testimony is to respond to statements made by Mr. Charles King and Mr. Michael Majoros in their Direct Testimonies presented on behalf of the Advocacy Staff of the North Dakota Public Service Commission (the "Commission") and related to Xcel Energy's depreciation study and retirement practices. More specifically, I will address Mr. King's proposal for determining retirement costs and Mr. Majoros' proposal for refunding amounts paid by past ratepayers toward future retirement costs. The other depreciation-related issues raised by Mr. King

regarding changes to a remaining life methodology, life extensions, and the development of a North Dakota-specific depreciation study will be addressed by Mr. Jeffrey Robinson.

II. SUMMARY AND ORGANIZATION

Q. PLEASE PROVIDE A SUMMARY OF YOUR REBUTTAL TESTIMONY.

A. To summarize where the issues are, the main difference between the Company's recommendations regarding depreciation and Mr. King's recommendations are the choice of the depreciable life (which is addressed by Mr. Robinson in his Rebuttal Testimony), and the amount of retirement costs to be included in rates. The other major adjustment presented by Mr. Majoros relates to the treatment of "non-legal asset retirement obligations" ("non-legal cost of removal" or "non-legal ARO"). Both Mr. King and Mr. Majoros' retirement cost proposals cause significant intergenerational inequities and are not in the ratepayers' interest. In the case of Mr. King's proposal, retirement costs would be based on <u>current</u> costs, when it is beyond debate that future actual retirement costs will be substantially higher. Current ratepayers should be required to pay their proportionate share of the costs related to the assets used to provide them with utility service, rather than shifting those costs to future ratepayers. Similarly, under Mr. Majoros' proposal, amounts paid by past ratepayers would be refunded to current ratepayers, only to be recollected from future ratepayers, creating yet another intergenerational disparity. I will also explain the inappropriateness of using the accounting pronouncements that Mr. Majoros relies upon to support his ARO adjustment and show the lack of relevance they have on utility ratemaking in general, and on and this case in particular.

III. NET SALVAGE

Q. WHAT IS NET SALVAGE?

A. Net salvage is the difference between the gross salvage (the value of a unit retired from service resulting from its sale for scrap or reuse) and the removal cost (the expense incurred to remove the unit from service including expenses necessary to return the environment to an acceptable condition, as well as disposal of the unit). Net salvage is expressed as a percentage of plant retired. That percentage is determined by dividing the net salvage by the original cost of the retired plant.[1] Some plant assets can experience significant negative removal cost percentages.

Q. PLEASE PROVIDE AN EXAMPLE.

A. Assume for example, a Distribution asset in FERC Account 364 with a removal cost of $50 and a current installed cost of $500 (the cost if the asset were installed in 2008). Further assume that this asset had an actual installed cost of $63 in 1969. If one were to calculate removal cost as simply a percentage of the current installation cost, a removal cost of $50 for the asset would only have a negative ten percent removal cost ($50/$500). This result would be incorrect. The correct removal cost calculation would show approximately negative 80 percent removal cost for that asset ($50/$63).

Q. WHY IS IT APPROPRIATE TO CALCULATE THE PERCENTAGE BASED ON INITIAL INSTALLATION COST?

A. This is because the depreciation rate, which includes the removal cost percentage, will be applied to the original installed cost of assets. The

[1] NARUC Public Utilities Depreciation Practices, August 1996, Page 18.

purpose of including the life-cycle net salvage in the depreciation calculation is to fully recover the cost of removing an asset (minus any salvage) by the end of the life of the asset. If inflation in removal costs from the time of installation of the asset until the time of its removal were ignored during the life of the asset, the higher removal costs would not be recovered during the life of the asset and would become a cost unfairly imposed on future customers.

Q. WHAT DO MR. KING AND MR. MAJOROS RECOMMEND WITH REGARD TO NET SALVAGE?

A. Mr. King and Mr. Majoros recommend moving away from accrual accounting and the normal and accepted method of calculating net salvage, which is used in all but a few states, in favor of a form of "pay-as-you-go", cash-basis removal cost recovery with a refund of all accrued removal cost. Mr. King recommends allowing in the cost of service only the average of the last five years of cost actually incurred to remove assets. Thus, instead of rates reflecting cost which will necessarily be higher in the future, he proposes using a below-cost historical average or, in the alternative, a below-cost current value. Mr. Majoros recommends refunding all historically-accrued non-legal cost of removal.

Q. PLEASE SUMMARIZE HOW THE COMPANY'S NET SALVAGE METHOD IS DIFFERENT FROM WHAT MR. KING REQUESTS?

A. Consistent with how depreciation expense is determined, the Company is requesting a straight-line accrual, over the life of the assets, of the cost to remove the assets at the end of their useful lives. This accrual method is used by this Commission and nearly all Commissions in the country for a good

reason. It ensures that customers who are provided service from an asset pay equally the full cost of the asset (installation cost and removal cost). The method used by the Company is supported by 73 years[2] of traditional and accepted depreciation theory.

On the other hand, Mr. King recommends moving away from accrual accounting, preferring that removal cost instead be paid by customers after it is incurred. Mr. King's method is simply a variation of the "pay-as-you-go" methodology (using a 5-year average instead of a single year). Mr. King's alternative method would use the present value of future retirement costs (that is, the projected future retirement with the cost of inflation removed).

Whereas the accrual method recovers the cost of removal equally from all of the customers who benefit from use of the asset over the life of the asset, the pay-as-you go/present value methods forces future customers to be burdened with most of the cost associated with removing assets used by past customers. The effect of Mr. King's method is to defer, or "back-load", the payment of removal cost from current customers to future customers, and this would require future customers to pay not only their portion of the removal costs but also the portion of the removal costs that was not recovered from prior customers. Mr. King's backend loaded method would create intergenerational inequities, while the Company's method does not.

[2] Bulletin 125 by Robley Winfrey from the Engineering Research Institute of Iowa State University, titled "Statistical Analyses of Industrial Property Retirements", originally published in 1935 is the original basis for modern depreciation theory.

Q. ARE THE COMPANY'S NET SALVAGE RATES "EXCESSIVE"?

A. No. The methodology used by the Company for estimating the percentage of inflation for retirement costs, which I discussed earlier, is the accepted industry standard. Further, compared to the industry, Xcel Energy's net salvage request is well within the norm of other utilities and is, in fact, significantly less in many accounts than the average across the Country.

Q. DO YOU BELIEVE MR. KING'S RECOMMENDED METHODOLOGY IS AN APPROPRIATE METHOD TO USE IN DETERMINING NET SALVAGE RATES?

A. No. There are a number of problems with his method. First, it contradicts the recognized authoritative texts on net salvage analysis. Second, it creates tremendous intergenerational inequities. Third, it contradicts the straight-line depreciation methodology that this Commission has historically followed. Fourth, it creates different recovery methods within a single depreciation rate (the asset depreciation is recovered using a straight-line method and the net salvage cost is recovered under a deferral mechanism). Fifth, using this deferral mechanism will have a detrimental effect on the total cost customers will pay for use of the assets over the lives of the assets.

Q. PLEASE GIVE EXAMPLES OF HOW USING A 5-YEAR HISTORICAL AVERAGE (PAY-AS-YOU-GO) NET SALVAGE CONTRADICTS AUTHORITATIVE GUIDANCE.

A. All authoritative utility depreciation sources agree that projecting the cost to remove assets at the end of their lives is a necessary factor in establishing net salvage rates. The National Association of Regulatory Utility Commissioners ("NARUC") "Public Utility Depreciation Practices" supports the use of estimated future salvage and removal cost as part of the depreciation

calculation. The publication, "Public Utility Depreciation Practices" (1996 Edition) published by NARUC states:

> Under presently accepted concepts, the amount of depreciation to be accrued over the life of an asset is its original cost less net salvage. **Net salvage is the difference between the gross salvage that will be realized when the asset is disposed of and the cost of retiring it.** Positive net salvage occurs when gross salvage exceeds cost of retirement, and negative net salvage occurs when cost of retirement exceeds gross salvage. **Net salvage is expressed as a percentage of plant retired by dividing the dollars of net salvage by the dollars of original cost of plant retired.** The goal of accounting for net salvage is to allocate the net cost of an asset to accounting periods, making due allowance for the net salvage, positive or negative. This concept carries with it the premise that property ownership includes the responsibility for the property's ultimate abandonment or removal. Hence, **if current users benefit from its use, they should pay their pro rata share of the costs involved in the abandonment or removal of the property** and also receive their pro rata share of the benefits of the proceeds realized.
>
> **This treatment of net salvage is in harmony with generally accepted accounting principles** and tends to remove from the income statement any fluctuations caused by erratic, although necessary, abandonment and removal operations. It also has the advantage that **current customers pay or receive a fair share of cost associated with the property devoted to their service, even though the costs may be estimated.**[3]

Also, two of the most widely regarded experts on depreciation, Frank Wolf and Chester Fitch, state in their 1994 treatise Depreciation Systems:

> Effect of Inflation on the Salvage Ratio: One inherent characteristic of the salvage ratios is that the numerator and

[3] NARUC *Public Utility Depreciation Practices*, Page 18 (emphasis added).

> denominator are measured in different units; the numerator is measured in dollars **at the time of retirement** while the denominator is measured in dollars at the time of installation.[4]

Drs. Wolf and Fitch further explain the importance of recognizing the future cost to retire current assets as follows:

> Negative salvage is a common occurrence. With inflation, the cost of retiring long-lived property, such as a water main, may exceed the original installed cost. Decommissioning cost of nuclear power plants is an example of large negative salvage. The matching principle specifies that all costs incurred to produce a service should be matched against the revenue produced. **Estimated future costs of retiring of an asset currently in service must be accrued and allocated as part of the current expenses. ... The accounting treatment of these future costs is clear. They are part of the current cost of using the asset and must be matched against revenue. While the current consumers would say they should not pay for future costs, it would be unfair to the future users if these costs were postponed.** Some say that although the current consumers should pay for the future cost, that the future value of the payments, calculated at some reasonable interest rate, should equal the retirement cost. Studies show that the salvage is often "more negative" than forecasters had predicted.[5]

Q. HOW DOES ONLY ALLOWING A HISTORICAL 5-YEAR AVERAGE AMOUNT, INSTEAD OF CONDUCTING A NET SALVAGE ANALYSIS, SHIFT THE BURDEN OF REMOVING ASSETS TO FUTURE CUSTOMERS?

A. The Commission has a long history of using straight-line depreciation for recovering the cost of assets and their associated net salvage cost. Using a

[4] *See* Depreciation Systems, page 53 (emphasis added).

[5] *See* Depreciation Systems, pages 7 and 8 (emphasis added).

5-year historical average cost as a substitute for net salvage analysis will no longer allow the recovery of removal cost on a straight-line basis. In reality, Mr. King's method is extremely back-end loaded.

Q. WOULD YOU DEMONSTRATE HOW MR. KING'S METHOD SHIFTS THE BURDEN OF REMOVING ASSETS TO FUTURE CUSTOMERS?

A. Yes. Assume a distribution asset account was placed in service ten years ago with a $1,000 investment. Each year for the next nine years the same investment is made in the class (increased at a three percent inflation rate) so that you have the following ten years of investment in the account.

Year 1	$1,000
Year 2	$1,030
Year 3	$1,061
Year 4	$1,093
Year 5	$1,126
Year 6	$1,159
Year 7	$1,194
Year 8	$1,230
Year 9	$1,267
Year 10	$1,305
Total	$11,465

The retirement pattern for each vintage (year of investment) is a 60 R2 mortality curve. This means that the assets will retire, on average, at 60 years (with some assets retiring earlier than 60 years and some retiring older than 60 years). In this example, which reasonably mimics real life, we have just closed Year 10 and are calculating removal cost for use in a depreciation

study. At Year 10, we know that it costs 50 percent of the original cost of the assets that are retiring to remove them. Using normal straight-line depreciation, each asset's removal cost will be depreciated over the life of that asset (e.g. an asset that will last 5 years will have its removal cost spread over its five-year life and an asset that will live 100 years will have its removal cost spread over 100 years). As shown in Chart 1 below, the traditional method creates a recovery pattern where smaller and smaller accruals occur each year as fewer and fewer assets remain in service (i.e. customers only pay for the portion of the assets they are receiving benefit from). Under the normal straight-line removal cost accrual, in Year 10 (when all assets are still in service), the accrual would be approximately $95. As assets are retired, the accrual decreases until at Year 85 (when 80 percent of the assets are retired), the accrual is only $25. In contrast, under Mr. King's method, customers would be charged $2.69 in Year 10 for removal cost (when all assets are being used by customers). In Year 85 (when only 20 percent of the assets remain), Mr. King's method would require the Company to charge $100. Customers under Mr. King's method will pay 37 times as much in Year 85 in removal cost while having use of only 20 percent of the assets as customers in Year 10 and customers in Year 85 will be paying for the removal of assets that are not providing service to them.

Chart 1

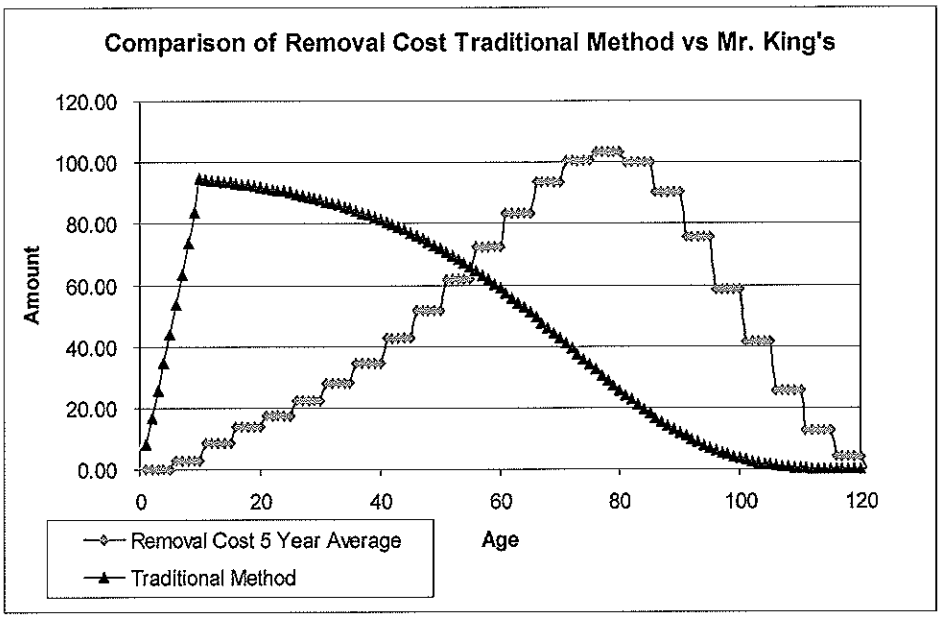


Chart 2 below shows the surviving asset balance over the lives of the assets. This pattern matches very closely the pattern of the recovery of removal cost under the traditional method. In other words, customers contribute toward the removal of assets in the same pattern as their usage of the assets.

Chart 2

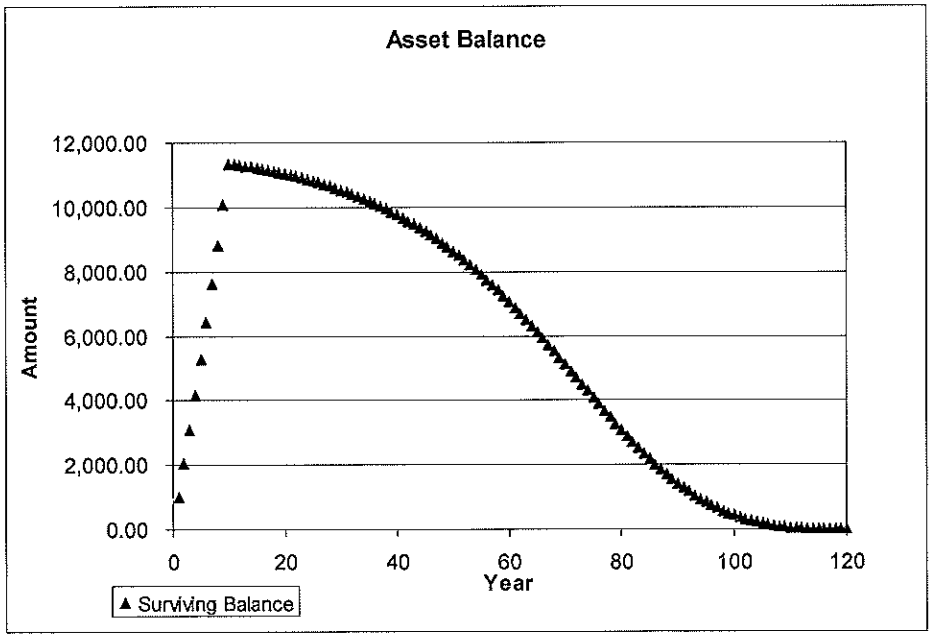
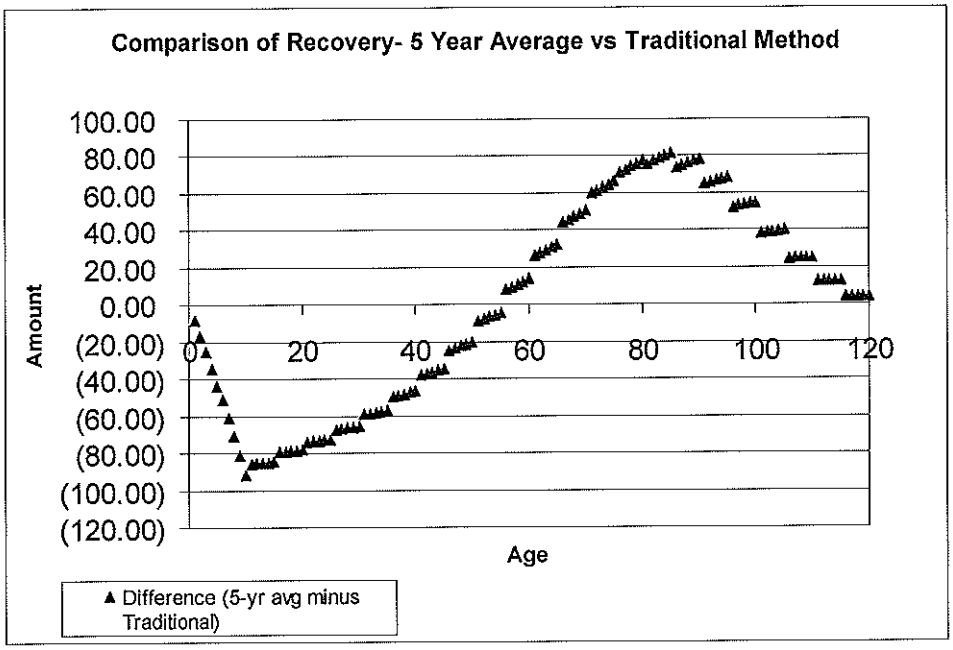


Chart 3 below shows the difference between the accrual pattern of the traditional approach and Mr. King's "pay-as-you-go" method.

Chart 3



Clearly, this pattern created by Mr. King's pay-as-you-go method shifts the removal cost and creates a burden to future customers who do not have use of the assets or, in regulatory parlance, creates an impermissible intergenerational inequity.

Q. PLEASE EXPLAIN THE INTERGENERATIONAL EQUITY PROBLEM CAUSED BY MR. KING'S PROPOSAL.

A. A good analogy for Mr. King's removal cost proposal, as compared to Commission precedent (and the Company's practice), is a balloon mortgage as opposed to a fixed rate mortgage for a homeowner. Under the existing removal cost paradigm of the Commission and the Company, the recovery of

removal costs could be viewed as a fixed rate mortgage. In a fixed rate mortgage, the total future cost of the mortgage is paid evenly over the life of the loan. The current paradigm is that the estimated amount of removal cost required to remove assets at the end of their lives (parallel to the total mortgage cost) is accrued evenly, or on a straight-line basis, over the expected life of the assets (parallel to the loan period). The effect on ratepayers of adopting Mr. King's paradigm is to, in effect, move from a fixed rate mortgage to a balloon mortgage. Under a balloon mortgage, a small payment sufficient to cover interest is paid each year until the balloon payment for the actual loaned amount is required. Paying this balloon payment will be a significant problem, unless the holder of the mortgage has been saving during the life of the loan for the eventual balloon payment. Mr. King's plan would have the Company accrue a small amount each year that would only cover the normalized average of the last five year's removal cost. Unfortunately, as with the balloon mortgage, this does not allow the Company to "save" for the dramatically higher cost to remove assets at future costs. The customers paying these "balloon payment removal costs" will be those customers who are using the asset at the end of or after its useful life. The effect that this proposal has on future ratepayers is clear. Future customers will be forced to pay a disproportional share of the removal costs of assets that current customers are using.

Q. IS DEFERRING DEPRECIATION EXPENSE GOOD FOR CUSTOMERS?

A. No. The deferral of depreciation expense will cost customers more over the life of an asset than contributing depreciation expense on a straight-line basis. In the same way that a home buyer will pay more over the life of a loan making lower principal payments (due to higher interest payments on the

outstanding balance), the deferral of depreciation expense increases rate base (retirement payments are an offset to rate base), which causes customers to pay more in return on investment. Using a 10 percent rate of return with the earlier example, customers would pay approximately $4,600 more (or an additional 40 percent of the original asset cost) in return on investment over the life of the asset using the deferral approach. During the first few years, the pay–as-you-go approach would artificially lower rates. As seen in Chart 3 above, the pay-as-you-go approach is significantly more costly later in the life of the asset. Deferring depreciation expense is not good for customers.

IV. ASSET RETIREMENT OBLIGATIONS

Q. PLEASE DESCRIBE MR. MAJOROS' TESTIMONY RELATED TO DEPRECIATION IN THIS PROCEEDING.

A. Mr. Majoros believes that the Securities and Exchange Commission ("SEC") pronouncement accepting the Statement of Financial Accounting Standards No. 143 ("FAS 143") provides new information that should cause the Commission to reconsider the normal accounting for retirement costs that it has used for many years.[6] He further recommends that because this pronouncement recognizes that, for regulated utilities, retirement costs have been accrued for the future removal of assets where there is no legal obligation to remove the assets, this accrued removal cost should be transferred to a regulatory liability for ratemaking purposes.[7] Finally, he recommends that the accrued removal costs where there is no legal obligation should then be returned to the customers over a 10-year period.[8]

[6] Direct Testimony of Mr. Majoros, page 9.
[7] Direct Testimony of Mr. Majoros, page 12, lines 11-12.

Q. ARE MR. MAJOROS' RECOMMENDATIONS REASONABLE OR APPROPRIATE?

A No. The Commission's current process, which is used by nearly every state in the country, is appropriate. As I will demonstrate, the concepts and broad assumptions underlying Mr. Majoros' proposal are incorrect. Additionally, the Company is not aware of any Commission that has ordered utilities to refund their accumulated removal costs based on FAS 143, as proposed by Mr. Majoros.

Q. WHAT IS THE STATED BASIS FOR MR. MAJOROS' RECOMMENDATION TO REFUND ALL ACCRUED REMOVAL COST?

A Mr. Majoros states two primary reasons for this recommendation. The first is that "[he] do[es] not believe NSP will ever spend all of this money on future cost of removal."[9] Secondly, he states that, "as long as the money remains in the Company's hands, it will do whatever it can to convert the regulatory liability to income."[10] Neither of these assumptions is correct.

Q. DOES XCEL ENERGY HAVE A HISTORY OF USING ITS ACCRUED REMOVAL COST?

A. Yes. Although Mr. Majoros states that "my experience shows that it is unlikely that all of the amounts collected will be spent for future cost of removal",[11] the reality is that Xcel Energy has a strong record of removing assets and, in a number of instances, has not accrued sufficient removal cost to cover the removal of those assets. Mr. Majoros has provided no evidence that the amounts held for future retirement are excessive, while the Company has shown that its retirement percentages are conservative. In addition, under

[8] Direct Testimony of Mr. Majoros, page 21, lines 9-14.
[9] Direct Testimony of Mr. Majoros, page 21, lines 4-8.
[10] Direct Testimony of Mr. Majoros, page 21, lines 4-8.

established depreciation principals, any excess retirement amounts would automatically be used to reduce the depreciation expense. It is only under his extreme assumption of deregulation that the Company could even possibly recognize the difference as income. Even if that were plausible, which it is not, any mismatch can hardly justify eliminating all of the accumulated retirement amounts.

Q. PLEASE DESCRIBE AN EXAMPLE CURRENTLY TAKING PLACE AT THE COMPANY THAT DEMONSTRATES THE COMPANY NOT ONLY USES ACCRUED REMOVAL COSTS BUT ALSO HAS IN SOME CASES UNDER ACCRUED FOR REMOVAL COST.

A. Xcel Energy is currently in the process of completely demolishing the High Bridge Steam Plant, a multiple unit coal-burning facility. The portion of the plant site containing the former coal-burning facility is being brought to green-field conditions. A new natural gas fired combined-cycle unit is being constructed on a separate portion of the original plant site.

Q. WHAT NET SALVAGE RATE WAS USED FOR THE HIGH BRIDGE GENERATING PLANT?

A. In the early 1980s, the Minnesota Public Utilities Commission ("MPUC") approved the use of an average net salvage percentage of approximately negative 5 percent for High Bridge. (If the cost of removal exceeds the salvage value of the retired plant components, then the net salvage value will be negative.)

Q. IS THE NEGATIVE 5 PERCENT ESTIMATED NET SALVAGE SUFFICIENT TO REMOVE THE HIGH BRIDGE PLANT?

[11] Direct Testimony of Mr. Majoros, Page 13, lines 13-14.

A. No. The historical use of approximately negative 5 percent net salvage for High Bridge has resulted in $5.2 million in removal costs being accrued at the end of the plant's operational life. The most recent estimate of removal and remediation costs for the High Bridge Steam Plant (which currently is being dismantled) is $35.9 million. The actual cost that will be incurred equates to a negative 32 percent net salvage value. Future customers who did not benefit from the use of the original High Bridge generating facility will now be burdened with paying this cost. This is the same type of intergenerational inequity that will happen to Xcel Energy's customers for all assets, if the Commission accepts Mr. Majoros' recommendation. Under Mr. Morojors' recommended method, the shortfall would have been $35.9 million, since his approach refunds all historically-accrued net salvage.

Q. PLEASE PROVIDE ANOTHER EXAMPLE THAT FURTHER ILLUSTRATES THE COST OF REMOVAL ISSUE AND THE PRACTICE OF THE COMPANY TO REMOVE ASSETS.

A. The Minnesota Valley Generating Plant is owned by Xcel Energy and was retired in 2004. While in-service, approximately $906,000 in removal costs was recorded. In a 2004 demolition study (conducted immediately before dismantling the plant) performed by Utility Engineering and Veit Companies the estimated demolition costs were $10.1 million. This estimate equates to a negative 72 percent net salvage rate. Under Mr. Majoros' recommended methodology, there would have been a $10.1 million shortfall.

Q. HOW IS THE UNDER-RECOVERY OF DEMOLITION COST FOR THE MINNESOTA VALLEY GENERATING PLANT BEING ADDRESSED?

A. In a recent decision in Docket No. E, G002/D-05-288, the MPUC provided a 12.5-year time period for NSP-Minnesota to record additional cost of

removal dollars through the monthly depreciation accrual process. Given that the Minnesota Valley facility is not in-service, current ratepayers receive no benefit in the form of generated electricity during the 12.5 years while these additional costs are being recorded, and the ratepayers who received the actual benefit of the generation from the plant did not pay for the full cost of the generation. Accepting Mr. King's recommendation would result in a similar mismatch in revenues versus expenses and intergeneration inequities for all non-legal asset obligations.

Q. DOES THE COMPANY INTEND TO "TRANSFER THE REGULATORY LIABILITY (I.E. ACCRUED REMOVAL COST) INTO GAAP INCOME"?

A. No. Mr. Majoros based his supposition on a statement in the Company's SEC Form 10-K. These financial statements are conservative in nature, and the statement Mr. Majoros refers to is for the entire section on regulatory assets and liabilities, not just the non-legal cost of removal. Mr. Majoros' supposition is further premised on a claim that future deregulation would allow the Company to transfer the regulatory liability to the income statement. Whereas, in reality, if deregulation were to occur (which there is no indication of happening), the Company, the North Dakota legislature, and the Commission could deal with all regulatory assets and liabilities as deregulation was put in place.

In its recent natural gas rate case (Case No. PU-06-525), the Company included the following as an Amendment to the Settlement Agreement:

> Should, at any future date, there be change in regulation or other event that would result in a change in the above-described process [for treatment of retirement costs] the Company agrees

to work with the Commission to ensure that any accumulated depreciation amounts for retirement purposes are considered and appropriately addressed as part of that change.

The Company renews that offer in this proceeding.

Mr. Majoros raised these same issues in the most recent gas rate case for Public Service Company of Colorado ("PSCo"), an affiliate of the Company, in Case No 06S-656G. Mr. Majoros' concerns were addressed in a settlement in which PSCo agreed to "include a footnote in its future annual FERC Form 2 filings disclosing the non-legal asset retirement obligation portion of accumulated depreciation for its gas utility operations." The Company is willing to make the same disclosure in its annual North Dakota Public Utilities Commission Annual Report as well.

Q. WHAT IS THE PURPOSE OF FAS 143, ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS?

A. The best response to this question is to refer to the introductory paragraphs provided in the pronouncement itself, which establishes financial reporting obligations related to legal retirement obligations. From FAS 143, page 4,

FAS 143 Summary

This Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This Statement applies to all entities. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and (or) the normal operation of a long-lived asset, except for certain obligations of lessees. **As used in this Statement, a legal obligation is an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal**

construction of a contract under the doctrine of promissory estoppel. (Emphasis supplied)

The Financial Accounting Standards Board ("FASB") chose to standardize the financial reporting process around retirement costs that are directly related to legally required transactions (a "legal ARO"). Accordingly, the main impetus behind the creation of FAS 143 was to increase consistency and comparability in financial reporting to the financial markets and any reader of the financial reports. An example of a legal-ARO is legally required asbestos removal within a building. In contrast, regulatory cost recovery for removal includes both the asbestos removal expense and the expense of removing all other components of the building.

Q. PLEASE SUMMARIZE THE FAS 143 TREATMENT AT XCEL ENERGY FOR FINANCIAL REPORTING PURPOSES.

A. Beginning in 2003, Xcel Energy recognized a mathematical portion of the traditional accumulated depreciation as a regulatory liability (i.e. all non-ARO removal cost) because of the change in financial presentation and reflected this on its financial books. The FASB, in its mission to make the presentation of financial information meaningful and comparable for legal obligations, decided on a common method of recognition of those obligations that should be utilized by all public corporations. Nothing in FAS 143 affected the treatment of non-legal cost of removal, only their recognition in financial reporting.

Thus, FASB touched on the minimum amount Xcel Energy could recognize in its financial reports and statements regarding removal costs. In contrast, state regulatory commissions have historically set rates to recover the

expected total amount needed for the cost of removal, because that approach best protects ratepayer interests and prevents intergenerational inequities. This distinction between the financial and regulatory treatment meant that the difference between the lower financial reporting amount (legal-ARO) and the higher amount actually recovered in rates (non-ARO cost of removal) would accumulate as a regulatory liability. Basically, the change caused by FAS 143 with respect to removal obligations was merely "balance sheet geography", as the cost of removal amount included in accumulated depreciation was reclassified to a regulatory liability at the request of the SEC for financial reporting purposes.

Q. IS IT NECESSARY FOR THE COMMISSION TO CREATE A NEW REGULATORY LIABILITY FOR RATE MAKING PURPOSES?

A. No. The Company and the Commission have long treated the accumulated retirement amounts as comparable to a regulatory liability, using the funds to offset rate base. Mr. Majoros recommends that the Commission require the Company to set up its accumulated depreciation balance for non-legal cost of removal as a regulatory liability. He states,

> "As a result, nothing holds NSP specifically accountable for these excess collections, even though the public accounting profession and the Securities and Exchange Commission recognize that they are regulatory liabilities and that the PSC implicitly holds NSP accountable."[12]

As was demonstrated above, the Company has already done just that for financial reporting purposes for legal and non-legal obligations. For regulatory purposes, removing accumulated retirement amounts from the

accumulated depreciation reserve would provide no additional ratepayer protection.

Q. WHAT IS THE DIFFERENCE BETWEEN THE CURRENT PROCESS AND THE ONE PROPOSED BY MR. MAJOROS?

A. The easiest way to explain the difference is to provide an example using one asset. Assume, for example, that only one asset exists, the original cost of the asset is $100, the asset lasts 25 years, and it has an estimated removal cost of 50 percent. Under the normal ratemaking process, depreciation expense will accumulate until the account is fully depreciated (i.e., the amount accrued equals the sum of the original cost ($100) plus the estimated removal cost ($50)). The Company would split the depreciation expense into two balance sheet accounts for financial reporting purposes with a portion of depreciation expense associated with estimated future removal cost being booked to "other regulatory liabilities." For ratemaking purposes, those two accounts are combined together in the accumulated depreciation account. At the end of the life of the asset (before its retirement), the balance in the other regulatory liability account is $50 – which is the amount needed to remove the asset. At retirement, the asset will be retired and the removal expense incurred will reduce the regulatory liability account to zero.

The main difference under Mr. Majoros' proposed method is that he proposes to return to customers (through an amortization) the other regulatory liability account balance that has accumulated to date. If we assume that we are currently half way through the life of the asset, $25 will be paid to current ratepayers. Current ratepayers, however, did not pay that $25.

[12] Direct Testimony of Mr. Majoros, Page 13, Lines 4-7.

Prior ratepayers paid it. At the time of retirement of the asset, there would be no accrued Other Regulatory Liability account balance against which to charge the removal cost. That cost would be born completely by future customers who receive service after the asset retires and who did not receive any benefit from using the asset. This would be inconsistent with widely accepted regulatory matching principles. As Xcel Energy will explain in its post-hearing brief in this proceeding, it is also prohibited retroactive ratemaking, because it refunds amounts lawfully recovered under previously approved Commission rates

Q. HOW DOES THE FERC TREAT THE RETIREMENT AMOUNTS THAT ARE COLLECTED WHERE THERE IS NO LEGAL OBLIGATION?

A. The FERC has made no change in the treatment of non-legal cost of removal accruals. In FERC Order 631, Section D: Accounting for Cost of Removal That Does Not Constitute a Legal Obligation, Paragraph 36, the FERC states,

> Under the existing requirements of the Uniform Systems of Accounts removal costs that are not asset retirement obligations are included as a component of the depreciation expense and recorded in accumulated depreciation.[30] The Commission notes that certain jurisdictional entities may have been receiving specific allowances for cost of removal for non-legal retirement obligations as a specific component in their rates approved by their regulators. The Commission did not propose any changes to its existing accounting requirements for cost of removal for non-legal retirement obligations. Accordingly, jurisdictional entities are accounting for such costs consistent with the requirements of the Uniform Systems of Accounts under Part 101 for public utilities and licensees, Part 201 for natural gas companies and Part 352 for oil pipeline companies.

[30] See Definition 10 in 18 CFR Part 101 (Public Utilities and Licensees), Definition 10 in 18 CFR Part 201 (Natural Gas Companies), and Definition 12 in 18 CFR Part 352 (Oil Pipeline Companies).

The FERC did not see a need to change the traditional process. Mr. Majoros was a party to this rulemaking proceeding and participated by providing comments (NASUCA at pp. 15-17), suggesting what he is recommending in this current proceeding to FERC and was rejected by FERC (FERC Order 631 Paragraph 37): "However, this issue is beyond the scope of this rule and we are not convinced that there is a need to fundamentally change accounting concepts at this time."

The Company believes that the FERC was attempting to 1) develop a financial presentation that would be acceptable to the SEC, the FERC, and the financial markets and 2) not to change long-established rate making practices. Simply put, the FERC felt the rules in place were sufficient.

Q. DOES THE FAS 143 PRONOUNCEMENT OR FERC ORDER 631 OFFER "NEW INFORMATION" TO THE COMMISSION AS MR. MAJOROS CLAIMS?

A. No. The fact that there is a regulatory liability embedded in the Accumulated Provision for Depreciation is not a new fact. The SEC merely wanted regulated utilities to recognize regulatory liabilities for financial reporting purposes. FERC simply gave utilities the ability to report without conflicting with the SEC. Mr. Majoros' justification for significantly reducing the Company's depreciation expense because there is "new information" is incorrect.[13]

Q. PLEASE SUMMARIZE THE PROBLEMS WITH MR. MAJOROS' RECOMMENDATION TO REQUIRE THE COMPANY TO REFUND ALL NON-LEGAL REMOVAL COST THAT HAS BEEN ACCRUED FOR FUTURE ASSET REMOVAL.

[13] Direct Testimony of Mr. Majoros, Page 9, lines 2-5.

A. Mr. Majoros' recommendation would require the Company to give back funds previously authorized by this Commission and recollect those same funds in the future. His recommendation is:

- Not required nor even suggested by any authoritative text and was specifically rejected by the FERC, and to the best of our knowledge, it has not been adopted by any State Commission.
- Not based on any "new accounting information."
- Based on unsupported premise that there are "excessive" removal costs in the depreciation reserve, and that a hypothetical transfer of this reserve to income would allow a windfall to the Company.
- Based on the unjustified premise that, if deregulated, utility companies would use removal cost accruals to increase earnings.
- Harms (not protects) future customers.

Therefore, the method used consistently by the Commission should continue to be used, and the Commission should deny Mr. Majoros' recommendation to refund accumulated depreciation.

Q. WHAT IS THE IMPACT OF THESE DEPRECIATION ISSUES?

A. The Company's position is that the Commission has correctly authorized the recovery of expected removal over the useful life of the asset to assure that current customers pay the costs associated with the benefits. Therefore, both the proposed change in determining the amount of retirement expense and the requested amortization of non-legal cost of removal should be denied. The total depreciation adjustment recommended by Mr. King (including those addressed by Mr. Robinson) is over $4.115 million. Mr. Majoros'

adjustment refunding previously collected removal cost over 10 years is $1.837 million

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.

STATE OF NORTH DAKOTA
BEFORE THE
PUBLIC SERVICE COMMISSION

In the Matter of the Application of Northern States Power Company, a Minnesota Corporation For Authority to Increase Rates for Electric Service in North Dakota	Case No. PU-07-776

AFFIDAVIT OF
Dane A. Watson

I, the undersigned, being duly sworn, depose and say that the foregoing is the Rebuttal Testimony of the undersigned, and that such Rebuttal Testimony and the exhibits or schedules sponsored by me to the best of my knowledge, information and belief, are true, correct, accurate and complete, and I hereby adopt said testimony as if given by me in formal hearing, under oath.

Dane A. Watson

Dane A. Watson

Subscribed and sworn to before me, this 12th day of June, 2008.

Karri L. Alba

Notary Public

KARRI L. ALBA
Notary Public
State of Texas
Comm. Expires 11-03-2008