

STATE OF NORTH DAKOTA
BEFORE THE
PUBLIC SERVICE COMMISSION

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

REPLY BRIEF OF XCEL ENERGY

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This Reply Brief is submitted to the North Dakota Public Service Commission (the “Commission”) in support of the December 7, 2007, Application by Northern States Power Company, a Minnesota corporation (“Xcel Energy” or the “Company”), for authority to increase its base rates for electric service in North Dakota. This reply is limited to responding to new arguments that were not fully addressed in the Company’s Initial Brief, and clarifying or correcting information contained in the Advocacy Staff’s Initial Brief.

In addition to addressing those new arguments, we renew our proposal for additional dialog with the Commission regarding how to amend the process to obtain greater Commission input into that process. We also appreciate the opportunity for an evaluation of whether the existing process for Commission involvement in depreciation studies should be changed. We are committed to developing both a resource planning process and depreciation rate process that addresses the

Commission's interests and concerns. But it is essential to distinguish such forward-looking steps from the recommendations by Advocacy Staff to look backward and withhold essential revenue needed to provide service to our North Dakota customers. Improvements in the regulatory processes are in the public interest and benefit everyone. In sharp contrast, disallowing our cost of providing electric service would be confiscatory and not further anyone's interests.

I. PROPER CONSIDERATION OF THE BURDEN OF PROOF STANDARDS AND THE USED AND USEFUL STANDARD SUPPORTS COST RECOVERY.

The Advocacy Staff's Initial Brief asserts that, with regard to the Commission's review of the record in this proceeding, the Company did not satisfy its burden of proof with respect to any of Staff's proposed adjustments. To the contrary, we responded to proposed adjustments with substantial Rebuttal Testimony demonstrating that, with respect to each issue, our expenses, investments and actions have been in the best interest of all of our customers. The Consultants who assisted Advocacy Staff did not challenge the Company's evidence, and instead relied heavily on the argument that the Company has the burden of proving its case.¹ We agree that we have that burden to prove the reasonableness of our request. However, having fairly and fully addressed each proposed adjustment by providing unrefuted testimony, we have met that burden.

¹ *E.g.*, Evidentiary Hearings Vol. II at 553 (Majoros); and Vol. III at 722 (King).

During a rate hearing: “the burden to show that the increased rate is just and reasonable is upon the public utility applying for the increase.”² However, that responsibility does not mean that the Advocacy Staff is exempt from presenting evidence to support the reasonableness of their adjustments.

The burden of proof is made up of two separate parts: “the burden of going forward with the evidence and the burden of persuasion.”³ The second component of the burden of proof, the burden of persuasion, never shifts: “it remains with the party having the burden of proof.”⁴ This means that the burden of proving the reasonableness of its proposed rates stays with the Company throughout the proceedings. However, the first component, the burden of going forward with evidence: “may rest ... at one time upon the [utility] and at another time upon the [Advocacy Staff].”⁵

If the party bearing the burden of proof presents evidence strong enough, if uncontradicted, to support a finding in her favor, that party has made a prima facie case. When the party with the burden of proof establishes a prima facie case, “the burden of going forward with the evidence ... shifts to the [other party]. If the [other party] can impair the prima facie quality of [*i.e.*, rebut] the case against him, the burden [of going forward] returns to the party having the burden of proof.” If the party having the burden of proof establishes a prima facie case, this party will prevail unless the opposing party offers “proof to the contrary.”⁶

² N.D. Cent. Code § 49-05-06.

³ *Helbling v. Helbling*, 541 N.W.2d 443, 445 (N.D. 1995).

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* at 445-446 (citations omitted).

Once the Company provided sufficient evidence disproving a concern or claim by the Advocacy Staff's Consultants, it became the responsibility of the Consultants to provide affirmative evidence disputing the Company's evidence in order to defeat the Company's prima facie case. In this case, the Company's Rebuttal Testimony is both adequate and unrefuted by relevant, reliable evidence and, consequently, the Company has met its burden of proof.

Advocacy Staff also generically argues that expenditures complying with Minnesota law are not used and useful.⁷ However, our Rebuttal Testimony demonstrates that our expenditures and investments are used and useful in providing utility service. For example, the Metro Emission Reduction Project ("MERP") projects provide capacity and energy needed by our customers.⁸ Further, to the extent we have been required to comply with Minnesota requirements, *e.g.*, mercury control monitoring equipment and renewable development fund payments, we have demonstrated that such programs benefit all of our customers.⁹ Moreover, expenditures required as a condition of being able to continue operating a plant are, as a matter of law, used and useful in providing service. *See e.g., Senior Citizens Coalition v. Minn. Pub. Util.*, (holding that recreational facilities (including picnic tables) that were required by FERC as a condition of obtaining a permit to operate hydroelectric

⁷ *E.g.*, Advocacy Staff Initial Brief at 12.

⁸ This issue is addressed further in our Initial Brief at 16- 20.

⁹ This issue is addressed further in our Initial Brief at 25-26.

facilities are used and useful in the generation of electricity).¹⁰ The Court in *Senior Citizens* relied on a long line of cases finding pollution control equipment to be used and useful, and found that:

Where, as here, the utility has incurred costs in providing an item which is required for continued operation of a plant pursuant to valid federal licensing standards That item is “used and useful,” and, hence, the utility’s costs in providing that item must be included in the rate base.¹¹

The record in this current case reflects that each of the expenditures made by the Company provide real benefits to all of our customers, either directly by providing low-cost generation resources, or indirectly by reducing the future cost of environmental compliance, or by investing in research to improve the efficiency of generation using renewable resources. But even if there were no such direct customers benefits, the fact remains that a cost required for continued operation of a plant is used and useful and recoverable in rates as a matter of law.

When properly applied, the burden of proof standards and the used and useful standards support the Company’s request for cost recovery.

II. THE COMPANY’S DECISIONS HAVE BEEN PRUDENT AND THE COMPANY SHOULD BE ALLOWED TO RECOVER COSTS ALLOCATED TO NORTH DAKOTA.

A. The King and High Bridge Projects Were Prudent and Used And Useful.

The need for and reasonableness of the investments made in the rehabilitation of the King Plant and the conversion of the High Bridge Plant are described in detail

¹⁰ 355 N.W.2d 295, 301 (Minn. 1984).

¹¹ *Id.* at 301.

in our Initial Brief at 10-20, and we rely primarily on referring to that discussion for our reply to Advocacy Staff. We strenuously disagree with Advocacy Staff's assertion that these projects were undertaken: "not because they were useful for the service and convenience of the North Dakota public, but because of policy decisions made by the Minnesota legislature."¹² To the contrary, the unrefuted evidence is that both plants were at the end of their useful lives, and the rehabilitation of the King plant and the conversion of the High Bridge plant were cost effective in meeting our customers' resource needs.

The King Plant was no longer reliable; components of the boiler were failing on a regular basis; and without intervention, the plant would have ceased operations in 2005.¹³ Rehabilitating the King Plant allowed a 25-year life extension; reclaimed 60 MW of capacity; improved the plant's capacity factor from 74 percent to 82 percent; and significantly improved the emission levels in our Twin Cities Metropolitan service area.¹⁴ Rehabilitation was accomplished at approximately one-third the cost of constructing a new coal-fired facility.¹⁵ Advocacy Staff provided **no** evidence that the King Plant could have continued operating through the 2008 test year (three years after the planned shutdown of the plant), much less evidence that it could have continued in operation without rehabilitation through 2011 (the end of the three-year period the

¹² Advocacy Staff Initial Brief at 13.

¹³ Ex. 10, Engelking Rebuttal at 7.

¹⁴ Ex. 3, Larson, Direct at 17.

¹⁵ *Id.*

rates from this case are expected to remain in effect). The Company's Rebuttal Evidence on the need for and timing of the rehabilitation is unrefuted. Therefore, the Company has met its burden of proof, and there is not substantial evidence to support disallowing the King rehabilitation costs.

The High Bridge conversion increased capacity by 276.4 MW; provided needed operational flexibility; allowed the Company to defer investment in a new, green-field plant for several years; avoided delay in bringing the needed capacity on line; maintained transmission reliability; provided transmission congestion cost savings, all while improving the emission levels in our Twin Cities Metropolitan service area.¹⁶ The project was accomplished at a significant cost saving (33 percent) compared to the construction of a new combined-cycle generating plant.¹⁷

Advocacy Staff has refuted none of these facts. Instead of evidence that the Company acted imprudently or that the changes are not used and useful, Advocacy Staff selectively quotes a portion of Mr. Kent Larson's testimony, where he stated that: "absent MERP, Xcel Energy does not know if it would have done what it did."

However, Mr. Larson's full statement was:

We had to refurbish them, we had to repower them. I don't think that we can say as a company that if that statute had not passed, we would have done exactly what we did. **I can't also tell you what else we would have done** because certainly the statute was passed and that's all in the past and, you know, we did what we did. **But absent that**

¹⁶ Ex. 10, Engelking Rebuttal at 10-15.

¹⁷ *Id.*

legislation, we still had to do something to those plants. They were at the end of their life.¹⁸

Advocacy Staff has provided no evidence that the plants were not at the end of their lives. All of the evidence demonstrates that the rehabilitation of King and the conversion of High Bridge were the least-cost method for meeting our customers demand for safe, reliable and adequate energy. There is no evidence in the record to the contrary.

Advocacy Staff asserts that the Minnesota Pollution Control Agency (“MPCA”), which evaluated the Company’s MERP projects before they were submitted for review to the Minnesota Public Utilities Commission (“MPUC”) was concerned with air quality, not costs. In evaluating the environmental impact of the various alternatives, the MPCA did consider cost/benefits. As explained by Ms. Elizabeth Engelking:

In sum, the MPCA concluded that the cost and benefit of the proposed coal High Bridge Plant alternative was inadequate and that this alternative should be rejected. The MPCA continued to study the High Bridge alternative. Its subsequent report concluded that the coal alternative was not a cost-effective way to proceed. While the MPCA modified its position on whether the coal alternative would satisfy the relevant EPA and MPCA pollution requirements, it concluded that keeping the plant on coal was not the most cost-effective approach.¹⁹

No evidence was presented that the MPCA was wrong in finding that keeping High Bridge on coal was not the most cost-effective approach.

¹⁸ Evidentiary Hearing, Vol. 1 at 245 (Larson) (emphasis added).

¹⁹ Ex. 10, Engelking Rebuttal at 12.

The Advocacy Staff's assertion that the MPCA did not consider cost effectiveness is also irrelevant because cost was a primary driver for the Company in making its recommendation to convert the High Bridge plant. As the Company stated in its May 3, 2002 MERP Proposal:

[W]e balanced the interests of State energy security, our customers, communities and shareholders, and our desire to maximize the efficiency of existing plant sites and transmission infrastructure. *** Each of Xcel Energy's three proposed projects: ... Creates energy supply benefits, plant reliability, system capacity and system reliability at reasonable cost.²⁰

In addition, the MPUC, not the MPCA, determined which projects to approve and, in our opinion, the MPUC was very concerned that the MERP projects were cost effective.

Most important, however, is the unrefuted evidence in this proceeding that both projects were a cost-effective means of addressing the end of life circumstances for these two plants.²¹

Advocacy Staff also argues that neither the King rehabilitation nor the High Bridge Projects are used and useful, asserting that the projects were undertaken, not for system needs, but to further Minnesota environmental policies.²² Advocacy Staff admits that this allegation would be fully refuted if these projects are consistent with the Company's integrated resource plans. As explained in our Initial Brief, both the

²⁰ *Xcel Energy's Proposal Under The Emission Reduction Rider Statute* at 3-1 - 3-2, <https://www.edockets.state.mn.us/EFiling/ShowFile.do?DocNumber=434630>.

²¹ This issue is addressed at length in our Initial Brief at 11-15.

²² Advocacy Staff Initial Brief at 15-17.

Company's 2000 and 2002 Integrated Resource Plan filings identify the need to rehabilitate King (assumed in the 2000 Integrated Resource Plan filing as part of the base case, and specifically identified in the 2002 Integrated Resource Plan filing) and both filings provided detail support for the need for the additional capacity provided by the King rehabilitation and the High Bridge conversion.²³ This was not, as Advocacy Staff argues, a "twelfth hour attempt to justify the more expensive project."²⁴

The evidence will not support even the suspicion, much less the conclusion that the Company proposed, and the MPUC approved, an unnecessary rehabilitation of the King plant and 334 MW of excess capacity at a cost to Xcel Energy customers of more than \$1 billion.

Advocacy Staff argues that added capacity was not needed because the Company submitted an alternative plan that did not significantly increase the capacity of the High Bridge plant.²⁵ This argument ignores Ms. Engelking's unrefuted testimony that if the coal alternative had been selected, the Company would have needed to build new green-field generation, with the attendant higher cost of acquiring land, developing the infrastructure and building transmission.²⁶ Ms. Engelking's testimony is supported by the Company's 2000 and 2002 IRP filings,

²³ Xcel Energy Initial Brief at 16-20.

²⁴ Advocacy Staff Initial Brief at 17.

²⁵ *Id.*

²⁶ Ex. 10, Engelking Rebuttal at 14.

which clearly demonstrate that the Company needed the additional capacity provided by the High Bridge conversion.

All of the evidence in the record supports the Company's position that these MERP projects were prudent and are used and useful. That evidence has not been refuted. Based on the record in this proceeding, the Company has satisfied its burden of proof.

B. The Mercury Control Programs Are Used And Useful For The Service And Convenience Of Our Customers.

We addressed the Advocacy Staff's opposition to recovering mercury control costs in our Initial Brief, and we rely primarily on that discussion for our reply.²⁷

Advocacy Staff, however, make a new argument in its Initial Brief that: "to the extent the [mercury] program is anticipating future federal requirements, North Dakota law prohibits NSP's recovery of those costs."²⁸ That interpretation of North Dakota statutes is incorrect.

Neither N.D.C.C. § 49-02-23 nor § 49-06-24 even address, much less preclude, cost recovery for prudently incurred environmental control costs that lower the cost of complying with future environmental requirements.²⁹ Rather, both Section 49-02-

²⁷ See Xcel Energy Initial Brief at 22-28.

²⁸ Advocacy Staff Initial Brief at 18.

²⁹ Section 49-02-23 provides:

The commission may not use, require the use of, or allow electric utilities to use environmental externality values in the planning, selection, or acquisition of electric resources or the setting of rates for providing electric service. Environmental externality values are numerical costs or quantified values that are assigned to represent either:

03 and Section 49-06-24 only address the use of environmental externality values. More specifically, they prevent the consideration of environmental externality values in resource planning, and they also disallow cost recovery for higher cost resources selected because of externality values. However, the role of externality values is not relevant to this proceeding. Xcel Energy has not changed any resource selection because of externality values.

In addition, the test year expenses associated with complying with Minnesota mercury control requirements was approximately \$12,000, not the \$438,427 asserted by Advocacy Staff.³⁰ Mr. Richard Rosvold testified that the \$12,000 was for monitoring mercury emissions, a necessary compliance cost, and that the information provided through monitoring mercury emissions is useful to the Company in designing and managing future state and Federal mercury compliance efforts.³¹ This testimony was not refuted.

Included within the \$438,427 is approximately \$200,000 for oxidizing nitrogen equipment at the Sherco Plant (units 1 and 2), approximately \$1,000 in engineering

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1. Environmental costs that are not internalized in the cost of production or the market price of electricity from a particular electric resource; or
 2. The alleged costs of complying with future environmental laws or regulations that have not yet been enacted.

Section 49-06-24 provides:

The commission may not increase electric rates as a result of actions taken by other states requiring higher cost resources to be built, purchased, or otherwise acquired as a result of the application of quantified environmental externality values, as defined in section 49-02-23, as part of any resource selection process.

³⁰ Advocacy Staff Initial Brief at 18.

³¹ Ex. 10, Rosvold Rebuttal at 10-11.

work for mercury sorbent injection systems for Sherco unit 3 and the King Plant, and an additional \$225,000 in chemical sorbents or reagents to be used at the King Plant for removing sulfur dioxide and reducing oxidizing nitrogen. These were all current 2008 costs, not costs for rehabilitation of King or a future program.³² No evidence was submitted that these expenditures were not prudent and used and useful.

Advocacy Staff asserts that the Company is preparing to comply with a Minnesota mercury emission standard that exceeds the now vacated Federal Clean Air Mercury Rule.³³ However, the Company's preparations are not in excess of the federal standard that is expected to apply going forward.³⁴

Advocacy Staff asserts that the Company has not demonstrated that the mercury control plan would have been adopted absent MERP.³⁵ To the contrary, Mr. Rosvold testified that we adopted "the lowest-cost control option available to us, given the cost of mercury emission controls at these facilities and our estimates of future emission allowance prices."³⁶ There is no evidence in the record that the Company's control efforts were not the least-cost approach. In addition, any rehabilitation of King would have required the Company to install adequate controls,³⁷ and the King Plant needed to be rehabilitated, with or without MERP.³⁸

³² Evidentiary Hearing, Vol. I at 291-292 (Rosvold).

³³ Advocacy Staff Initial Brief at 14.

³⁴ Ex. 11, Rosvold Rebuttal at 8.

³⁵ Advocacy Staff Initial Brief at 15.

³⁶ Ex 11, Rosvold Rebuttal at 5.

³⁷ Evidentiary Hearing, Vol. I at 293-294 (Rosvold).

³⁸ *Id.* at 245 (Larson).

Advocacy Staff has provided no evidence that the Company acted imprudently. In addition, a long line of cases have held that emission control costs qualify as a used and useful expense,³⁹ and there is no statutory prohibition against their recovery in rates. The Company has satisfied its burden of proof on this issue.

C. The Company’s Renewable Energy Expenditures Have Been Prudent And Used And Useful.

1. The Renewable Development Fund Is Used And Useful.

The Company addresses this issue in its Initial Brief at 35-36, and that discussion serves as our primary reply on this issue. Advocacy Staff argues that: “Minnesota ratepayers, who use and get the benefit of the annual \$16 million RDF payment, should pay for the benefit.”⁴⁰ To the contrary, all customers use and get the same benefit from the annual \$16 million renewable development fund (“RDF”) payment.

The RDF payments support research to improve the efficiency of renewable generation. All customers benefit from improved generation. The Commission previously recognized this when it allowed cost recovery for research and development expenses that had the goal of developing new generation technology.⁴¹

³⁹ Validly required pollution control facilities are routinely considered “used and useful” and, thus, included in a utility’s rate base, even though such facilities do not produce or distribute electricity, or aid in doing so. See *Green v. Pennsylvania Public Utility Commission*, 473 A.2d 209, 214 (Pa. Commw. 1984); *Commonwealth Edison Co. v. Department of Local Government Affairs*, 408 N.E.2d 263, 266 (1980), *aff’d.*; *AFL-CIO, Central Labor Council of Vanderburgh, Posey and Warrick Counties v. Southern Indiana Gas and Electric Co.*, 443 N.E.2d 1243, 1247-48 (Ind.App. 1983).

⁴⁰ Advocacy Staff Initial Brief at 22.

⁴¹ See *Re Otter Tail Power Co.*, Case No. 9996 (April 22, 1980) (approving expenses allocated to the Electric Power Research Institute, for research and development of a fast breeder nuclear reactor).

Second, the grants were not earmarked for Minnesota and a substantial portion of the funds have been awarded to North Dakota organizations.⁴² Therefore, Minnesota customers did not “get the benefit” from this expenditure. The Company did not include a request to recover the proportionate share of the \$10.9 million in production incentives, which were Minnesota specific, referenced by Advocacy Staff.⁴³

Third, the grants are a condition on the ability to install the dry casks needed to keep the Prairie Island Nuclear Facility operating. Advocacy Staff admits that North Dakota customers benefit from the continued operation of Prairie Island.⁴⁴ The RDF expenditures are a cost of continuing to operate the Prairie Island nuclear plant and are, therefore, used and useful. *See, Senior Citizens Coalition v. Minn. Pub. Util.*, holding that recreational facilities (including picnic tables) required by FERC as a condition of obtaining a permit to operate hydroelectric facilities are used and useful in the generation of electricity.⁴⁵

Contrary to Advocacy Staff’s assertion, research costs into improving renewable resource generation is not precluded from cost recovery by North Dakota statutes.⁴⁶ The referenced statutory provisions prohibit certain uses of externality values, a wholly unrelated issue.

⁴² Ex. 21A, Heuer Rebuttal at 14.

⁴³ Advocacy Staff Initial Brief at 19; Ex. 21A , Heuer Rebuttal at 14.

⁴⁴ Advocacy Staff Initial Brief at 22.

⁴⁵ 355 N.W.2d 295 (Minn. 1984).

⁴⁶ Advocacy Staff Initial Brief at 20.

The RDF is a cost of doing business that allows the continued operation of a nuclear facility that benefits all customers equally. The cost is used and useful, and a proportionate share of those costs is recoverable, as a matter of law, from our North Dakota customers.

2. Our Wind Generation Is Not Suboptimal.

Advocacy Staff agrees that North Dakota customers benefit from our wind generation but argues that the location of that generation was suboptimal.⁴⁷ Advocacy Staff further argues that there is no evidence comparing North Dakota and Minnesota wind resources. To the contrary, there is substantial, uncontested evidence that Grand Meadow and other exiting Minnesota wind generation is optimally located. As explained in our Initial Brief at 28 through 34:

- While North Dakota's wind resources are spread over a larger area, Minnesota has wind resources with equivalent quality that have been adequate for our prior needs.⁴⁸
- Minnesota capacity factors equal those in North Dakota.⁴⁹
- Minnesota's wind resources are closer to Xcel Energy's primary load, giving Minnesota locations a significant advantage.⁵⁰
- It is not possible to install generation dedicated to serving only North Dakota load.⁵¹

⁴⁷ *Id.* at 22.

⁴⁸ Evidentiary Hearing, Vol. III at 660 (King).

⁴⁹ Evidentiary Hearing, Vol. I at 117 (Larson) and 217-218 (Engelking).

⁵⁰ Evidentiary Hearing, Vol. III at 661 (King).

⁵¹ *Id.* at 661 (King).

- Grand Meadow was able to meet our needs on a timely manner because it already had MISO approval to access the transmission network, and no new North Dakota project could have met our timelines.⁵²
- Grand Meadow could be brought on line in time to qualify for tax credits worth \$20.00 per MWH for the first ten years, or more than 16 percent of the cost of the Grand Meadow project.⁵³ No new North Dakota project could have qualified for these savings.
- The cost of transmission to the Buffalo Ridge is significantly less than the cost of transmission to deliver wind generation in North Dakota to Xcel Energy's load.⁵⁴

All of the evidence demonstrates that the existing wind generation is producing the lowest-cost wind generation. There is no evidence in the record demonstrating that the existing wind generation is in a suboptimal location. The Company has satisfied its burden of proof.

D. Conclusion.

The Advocacy Staff, in response to perceived requirements by the Minnesota legislature and the MPCA, has proposed disallowances that are factually unsupported by the record. The MERP projects were necessary; we have prudently controlled emissions; and we acquired efficient wind generation. With respect to the Renewable Development Fund, such research efforts benefit all customers and have routinely been recovered in rates. We respectfully request that the Commission evaluate these projects based on their need and cost effectiveness. There have been no expenditures

⁵² Ex. 10, Engelking Rebuttal at 18-19.

⁵³ *Id.* at 19.

⁵⁴ Evidentiary Hearing, Vol. 1 at 320-321 and 329 (Grivna); and Ex. 31.

that were not in the best interest of our customers, or which were not used and useful in providing service. For this reason, the record will only support full cost recovery.

III. THE COMPANY'S DEPRECIATION EXPENSE IS REASONABLE.

A. Rates Should Be Determined Based On The Existing Integrated Depreciation Study.

In its Initial Brief, Advocacy Staff argued, for the first time, that the rate case should be dismissed because the Company did not perform a North Dakota specific depreciation study.⁵⁵ This suggestion is fatally flawed both factually and legally:

- It is inconsistent with the integrated system used to serve North Dakota customers.
- It is based on the unsupported assumption that North Dakota would have a lower depreciation expense than Minnesota; and ignores the real potential for shorter North Dakota useful lives for distribution facilities as a result of the harsher North Dakota winters and periodic flooding of the Red River Valley, where much of the Company's system resides.
- Contrary to the assertions by the Advocacy Staff's Consultants, they were provided all of the information they requested, except for limited proprietary information, which they could have obtained had they pursued the necessary procedures (either by entering into a separate protective agreement with the Company or by obtaining a protective order).
- It is inconsistent with long-standing Commission practice of using an integrated depreciation study;⁵⁶ and, consequently, dismissal of the rate case because the Company did not foresee this change in policy would be prohibited retroactive ratemaking.

For all of these reasons, the Commission should decide this case based on the Company's integrated depreciation studies.

⁵⁵ Advocacy Staff Initial Brief at 4-6.

⁵⁶ *See id.* at 5.

The Company did not file a North Dakota specific depreciation study because it operates an integrated system. As such, there is not a separate North Dakota system to separately study for depreciation purposes. Our generation and transmission facilities benefit all of our customers. The only facilities that could be separated on a jurisdictional basis are our distribution facilities. We have, however, always treated the distribution facilities as part of the overall integrated system. Consequently, we do not even have the necessary property records that could be used to support a standalone North Dakota and Minnesota distribution depreciation rates.

Advocacy Staff's consultant, Mr. King, initially argued for a longer five-year life for overhead conductors based on the assumption that the Company's improved vegetation management program justified such an extension. When the Company proved that its vegetation management program would not materially increase the useful life of these assets, Mr. King, on the stand, changed the basis for his adjustment and asserted that lower rainfall occurs west of the Mississippi and justifies using longer lives in North Dakota than in Minnesota.⁵⁷ Mr. King's argument, however, was not based on any evidence that overhead conductors located in North Dakota actually have longer useful lives than overhead conductors located in Minnesota.⁵⁸

Because this claim that North Dakota distribution facilities have a different useful life than Minnesota distribution facilities was raised for the first time on the

⁵⁷ Evidentiary Hearing, Vol. III at 703 (King).

⁵⁸ *Id.* at 701 (King) (confirming no studies had been performed).

stand, the Company did not have an opportunity to file expert testimony refuting this unsupported and speculative assumption by Mr. King. Had we had the opportunity, we would have pointed out that North Dakota's much harsher winters, ice storms, and periodic flooding in the Red River Valley (*e.g.*, the 2005 ice storm and the extensive winter storms that preceded the great flood in the Red River Valley in 1997) make adopting Mr. King's proposal a gamble that would likely result in higher costs for our North Dakota customers.

It is important to note that we are not arguing the Commission must accept the results of the Minnesota approved depreciation study. Obviously, the Commission may make adjustments to the integrated study, if supported by the record. But the adjustments should be made to the integrated study rather than require a separate standalone North Dakota study.

The Advocacy Staff Initial Brief asserts that the Company did not provide the information the Consultants needed to perform their analysis.⁵⁹ This is not true. The Company provided all of the studies and supporting information necessary to support the depreciation costs used in this filing. When asked for additional information, we identified where within the studies and supporting documentation the information had already been provided to Advocacy Staff's Consultants. The only information not provided was limited proprietary information and no effort was made by Advocacy Staff or its Consultants to either obtain an order protecting that

⁵⁹ Advocacy Staff Initial Brief at 4.

information or to have the Consultants obtain the information directly from the Company under a protective agreement. In addition, none of the proprietary information would have resulted in a substantive change in the Consultants' recommendations concerning: (i) depreciation methodologies; (ii) the use of average lives to justify life extensions; (iii) the use of artificial historical costs rather than future actual costs for retirement cost recovery; and (iv) the proposal to refund prior amounts collected for retirements (all of which are stock proposals by Mr. King and Mr. Majoros in the other rate cases in which they have testified).

The Company believes that the existing Commission approved procedure of using the depreciation rates accepted in Minnesota, subject to adjustment in a rate case proceeding, has resulted in fair rates and an appropriate use of the Commission's limited regulatory resources. There is, however, nothing preventing the Commission from changing, on a prospective basis, that practice. The Company has, in the past, submitted the depreciation studies it filed in Minnesota to the Commission, and the Commission, if it so desires, may elect to conduct its own review of those studies.

The Commission may not, however, decide to impose that new policy retroactively and dismiss this rate case proceeding. It is undisputed that the Commission has, as a matter of formal policy, elected not to independently study depreciation rates for utilities operating in both North Dakota and Minnesota for nearly two decades. In *Otter Tail Power Company Settlement Agreement*, in Docket PU-401-88-374, the Commission's December 20, 1988 *Order* formally established the

practice of developing a single depreciation study for use in both North Dakota and Minnesota, but subject to separate review by this Commission (after the Minnesota rates were established). In 1992, the Commission expressly eliminated its separate review of the Minnesota approved depreciation rates stating:

The intent of the 1988 Order was that the same depreciation parameters approved by the Minnesota Public Utilities Commission be used in both North Dakota and Minnesota. The purpose was to reduce Otter Tail Power Company's regulatory and accounting burden, not add to it. Accordingly, the requirements of the previous order requiring this Commission to review and approve the Minnesota rates are redundant and unnecessary.⁶⁰

Consequently, the Commission vacated that requirement. The identical practice has been in place with respect to Xcel Energy.

In reliance on that long-established Commission policy, we filed our rate case using the depreciation rates previously approved by the MPUC and filed with the Commission. The Company was entitled to reasonably rely on that decades old policy.

We do not question the Commission's authority to change that policy prospectively. If, however, the rate case were dismissed, it would deny the Company the right to retain the interim rates it was entitled to receive under the Commission's depreciation policies in effect at the time we filed the rate case and interim rates went into effect. That would be a prohibited retroactive application of the new policy requiring a North Dakota specific depreciation study.

⁶⁰ *Amended Order*, Case No. PU-401-88-374 (June 23, 1992).

The ratemaking process must operate prospectively. *See Board of Public Utility Commissioners v. New York Telephone Company*,⁶¹ *Montana-Dakota Utilities v. Public Service Commission*,⁶² *Quad County Community Action Agency v. Elkin*,⁶³ and *Transcontinental & Western Air v. Civil Aeronautics Board*.⁶⁴

While the prohibition against retroactive ratemaking has its genesis in constitutional principles, it is also embodied in North Dakota statutes. N.D.C.C. § 49-02-03, provides.

Whenever the commission, after hearing, shall find any existing rates, tariffs, joint rates, or schedules unjust, unreasonable, insufficient, unjustly discriminatory, or otherwise in violation of any of the provisions of this title, the commission by order shall fix reasonable rates, joint rates, charges, or schedules to be **followed in the future** in lieu of those found to be unjust, unreasonable, insufficient, unjustly discriminatory, or otherwise in violation of any provision of law.

(Emphasis added.)

Therefore, if the Commission elects to implement Advocacy Staff's recommendation, the Commission will need to do so without dismissing this proceeding. Under an analogous circumstance, where, based on evidence in a rate case, the Commission determined that Montana Dakota Utilities ("MDU") should be required to file a new depreciation study (the prior depreciation study was 11 years old), the Commission used the depreciation rates developed in the old depreciation

⁶¹ 271 U.S. 23, 30-31, 46 S. Ct. 363, 366 (1926).

⁶² 431 N.W. 2d 276, 280-281 (N.D. S. Ct. 1988).

⁶³ 315 N.W.2d 665 (N.D. 1982).

⁶⁴ 336 U.S. 601, 604, 69 S. Ct. 756, 758 (1949).

study to set rates, and also required MDU to file a new depreciation study within 13 months. The Commission stated in its order:

The Commission anticipates that this review should take no longer than six months from the date MDU files its new depreciation study. In the interim the Commission will allow MDU to implement rates reflecting the findings and conclusions in the instant order together with MDU's current depreciation rates. The Commission recognizes that the instant decision is a final decision as to all issues except for the depreciation issue, which is continued pending the filing and review of the new study.⁶⁵

Subsequently, the new depreciation rates, approved as a result of the new depreciation study, were implemented on a prospective basis effective September 1, 2003, approximately 21 months after the rate case order.⁶⁶

If we are required to develop a North Dakota depreciation study for distribution facilities, we would likewise need 13 months to prepare such a study. That is because we do not have property records for our distribution facilities on a state jurisdictional basis (because there has never been a need to record such investments on a jurisdictional basis), and it would be necessary to create such records from scratch to prepare a new depreciation study. It would also require that we conduct North Dakota specific vintage life studies. We ask the Commission to carefully consider whether such an effort will be valuable for customers, as there is nothing in the record to support that the cost and effort of preparing such property

⁶⁵ *Re Montana-Dakota Utilities Company*, Case No. PU-399-02-183, *Order* (December 18, 2002).

⁶⁶ Case No. PU-399-02-183 *Order Approving Settlement Agreement* (July 31, 2003).

records and analysis would, in the end, result in lower North Dakota depreciation rates.

B. The Service Lives Used In The Company’s Depreciation Study Were Reasonable.

The Company relies primarily on its Initial Brief, at 42-52, for its reply to the Advocacy Staff’s position. Advocacy Staff is proposing to increase the lives of our generation assets in advance of the investments being made that would support an extension. In that manner, the depreciation expense associated with current investments is shifted to future customers long after that the useful life of the current investments has expired. This shift of current costs to future customers is a recurring theme in Advocacy Staff’s recommendations.

Advocacy Staff states that: “by understating service life, a public utility can over-accrue depreciation.”⁶⁷ This is not true. Once the initial investment has been recovered, the depreciation expense becomes zero. It is never “over-accrued.”

Advocacy Staff next argues that the Company did not provide a “factual basis to support its assumption that the Sherco units would have a shorter than average life.” To the contrary, the Company fully explained why the life of the Sherco Units should only be extended three years for Units 1 & 2, and two years for Unit 3, as the Company proposed in its most recent depreciation study (which has been approved

⁶⁷ Advocacy Staff Initial Brief at 8.

by the MPUC).⁶⁸ More specifically, the remaining lives of the Sherco Units were based on a carefully conducted engineering study, and the current **investment** in the Sherco units would expire before the Sherco units reached an average life. The purpose of depreciation is to return investment over the life of that investment. While the Sherco units may eventually have longer than average lives as a result of being refurbished, that will occur only after the substantial new investment identified by the Company is made.⁶⁹ When that new investment is made, that investment will be depreciated over the useful life of the investment.

Advocacy Staff argues that relicensure of the Prairie Island nuclear plant is a virtual certainty. Xcel Energy does not agree, but more importantly, Prairie Island will not have a longer life until after the Company spends approximately \$18,000,000 to make that life extension possible.

Advocacy Staff's mistaken belief that additional vegetation control justifies extending the life of overhead conductors has been fully addressed in our Initial Brief at 50-52. As we explained, additional vegetation control will not extend the life of overhead conductors.

⁶⁸ Xcel Energy Initial Brief at 45.

⁶⁹ See Xcel Energy Initial Brief at 46.

C. The Company Is Properly Recovering Retirement Costs.

The Company relies primarily on its Initial Brief, at pages 53-60, for its reply to Advocacy Staff's argument that retirement costs should be determined based on historical costs rather than actual future costs.

Advocacy Staff argues that the current methodology, which is the widely accepted and traditional method, and which has been used for depreciation purposes for more than 73 years,⁷⁰ front loads future inflation.⁷¹ We disagree. The current and well accepted methodology reflects actual future costs that should be recovered from all customers who benefit from the use of an asset. Further, **Advocacy Staff admit that under their proposal the unrecovered higher future cost will need to be recovered from future customers.**⁷² By shifting those costs to future customers, they have not reduced the overall cost or avoided the need to eventually pay those costs; rather they have artificially lowered the cost of service for current customers.

In an effort to make the current well-accepted methodology appear unfair, Advocacy Staff argues that the: "average accrual rate for transmission plant has been twice the actual net removal cost experience. The average accrual rate for distribution plant has been 25 times the actual average net removal rate."⁷³ This argument implies that the retirement costs being recovered are artificially high. They are not, and Advocacy Staff is not disputing that those are the **actual** future cost of replacement.

⁷⁰ Xcel Energy Initial Brief at 53.

⁷¹ Advocacy Staff Initial Brief at 6-7.

⁷² See *id.* at 7.

⁷³ *Id.*

Rather, Advocacy Staff has improperly looked backward to historical costs (claimed “actual costs”) when the **actual** costs are much higher forward looking costs. Using backward-looking costs artificially lowers the current cost of service to the detriment of future customers and is poor public policy.

Advocacy Staff’s statement that we have over-collected \$342 million in retirement costs is based on the same unfounded argument. The Company has recovered the **actual** cost of retirements rather than a backward-looking artificially low historical cost of retirement. With respect to the argument that the \$342 million should be flowed back to customers in the form of a credit to depreciation costs over a 10-year period, we rely on the discussion contained our Initial Brief, at 64-67, for our reply.

With respect to the Advocacy Staff request that the Commission officially recognize non-legal asset retirement obligations as a regulatory liability, we rely on our Initial Brief, at 60-64, for our reply.

D. Conclusion.

Our North Dakota customers have been well served by the practice of using an integrated depreciation study in setting rates. If the Commission elects to abandon this decades-long practice, it must do so prospectively.

The Commission should accept the Company’s proposed useful lives for the production plants and overhead conductors. Those lives reflect the engineering

analysis of the useful lives of the investment that is being recovered by the depreciation expense.

The Commission should not replace the existing flat rate, future retirement cost recovery with a present value/pay-as-you-go methodology. While the present value method would reduce costs for current customers, the amounts not collected would have to be collected from future customers. Refunding amounts previously collected to pay future retirement costs would severely exacerbate that intergenerational cost shift.

IV. OTHER FINANCIAL ISSUES.

As explained in our Initial Brief, at 72-84, and below, the Company's proposals regarding the remaining contested financial issues should be accepted:

A. The Company's Proposed Sharing Of Wholesale Asset-Based And Non-Asset Based Margins Should Be Approved.

We propose passing to customers 85 percent of our asset-based margins through the fuel clause adjustment, but we are also willing to accept Advocacy Staff's proposal to pay 100 percent of those margins through the fuel clause adjustment if the Commission is not interested in authorizing an incentive to maximize the Company's performance in obtaining asset-based margins. We also propose passing to customers 15 percent of the non-asset based margins through the fuel clause adjustment. Advocacy Staff requests that we pay 100 percent of our non-asset based margins to our customers, asserting that other utilities do not differentiate between

asset-based and non-asset based margin payments.⁷⁴ Asset-based margins, however, are new, and it does not appear that an appropriate level of payments associated with those margins has been previously addressed by the Commission.

In addition, Advocacy Staff's argument ignores the critical differences between the two types of margins. Asset-based margins occur as a result of selling unused capacity or energy from generation assets included in rates. Consequently, it is appropriate to pass the revenues from those margins (less a 15 percent incentive) to our customers.

In contrast, non-asset based trading is the practice of purchasing energy in the wholesale market (other than for retail purposes) and attempting to sell the energy for a profit. This is a non-utility activity with very few customer-supplied costs.⁷⁵ Advocacy Staff's recommendation to pay 100 percent of the profit from this voluntary, unregulated, risky activity would eliminate the reason for the Company continuing the business. If the business is discontinued, so too would the benefit for our customers.

B. The Company's Proposal For Its Pole Inspection And Replacement And Cable Replacement Programs Is Reasonable.

Advocacy Staff proposes taking money paid by past customers for the purpose of retiring assets and diverting those funds to instead pay for new poles and cable.⁷⁶

⁷⁴ Advocacy Staff Initial Brief at 25.

⁷⁵ Evidentiary Hearing, Vol. II at 589 (Heuer).

⁷⁶ Advocacy Staff Initial Brief at 8.

Acceptance of that proposal would result in a misuse of the purpose for which the funds were collected, a violation of accounting principles, and would lead to future shortfalls in retirement costs, as explained in our Initial Brief at 75-80.

C. The Company's Proposed Nuclear Refueling Outage Costs Are Reasonable.

Advocacy Staff argues that it is reasonable to limit the costs of nuclear fuel outage expense to \$811,935 because the Company picked the test year, and those were the actual accounting expenses during the test year.⁷⁷ As explained in our Initial Brief, at 77-80, it is well established regulatory practice to normalize a test year expense (whether it is too high or too low) for rate setting purposes so that the test year will better reflect the cost of providing service during the period rates are in effect. The Consultant, Mr. Majoros, admitted that under his proposal to use 2008 accounting costs the Company would under-collect its actual cost by \$1,500,000 per year starting in 2009.⁷⁸ It would be inappropriate to select an unrepresentative cost for nuclear outage refueling that is clearly below actual future costs. For additional discussion of this issue, see our Initial Brief at 77-80.

D. Private Nuclear Fuel Storage Costs Are Prudent And Should Be Allowed.

Advocacy Staff merely restates its incorrect argument that the private nuclear fuel storage facility project is stalled.⁷⁹ To the contrary, the project has proceeded as far as is appropriate at this time. The necessary Nuclear Regulatory Commission

⁷⁷ *Id.* at 25.

⁷⁸ Evidentiary Hearing, Vol. III at 558 (Majoros).

⁷⁹ Advocacy Staff Initial Brief at 25.

(“NRC”) license has been obtained, allowing the project to proceed further when appropriate. For additional discussion of this issue, see our Initial Brief at 80-81.

E. Charitable Contributions Serve Customers’ Best Interest.

Advocacy Staff merely repeats its position that charitable contributions have not historically been approved for inclusion in rates by electric utilities.⁸⁰ This argument ignores the key fact that the charitable contributions made by the Company are a form of local economic development. For example, \$127,567 of the \$165,686 included in the test year is for focus area and community grants. The Commission has been a strong supporter of economic development and has allowed recovery of economic development costs in rates. For additional discussion of this issue see our Initial Brief at 82.

F. The Company’s Incentive Compensation Proposal Is Reasonably Designed To Provide Market Competitive Compensation.

Advocacy Staff provides no justification for its proposal to limit incentive compensation to 15 percent of an individual’s base pay.⁸¹ As explained in our Initial Brief, at 83-84, Mr. Majoros admitted he had no evidence that the Company’s incentive compensation levels are inappropriate, and he offered no criticism of the Company’s incentive compensation levels.⁸²

⁸⁰ *Id.* at 24.

⁸¹ *See id.* at 25.

⁸² Evidentiary Hearing, Vol. II at 562-563 (Majoros).

G. The Company Accepts The Recommendation To Recover MISO Schedule 16 And 17 Costs Through The Fuel Clause.

Advocacy Staff recommends that MISO Schedule 16 and 17 costs be recovered through the fuel clause rather than in base rates.⁸³ We accept that recommendation on a prospective basis, which has the effect of lowering the base rate revenue requirement for final rates by approximately \$532,000 per year. Instead, those costs would be recovered through the fuel clause adjustment; thus, recovering actual future MISO Schedule 16 and 17 charges. It is important, however, that this change occur on a prospective basis as otherwise it would be very difficult to determine the appropriate amount to recover in interim rates.

H. There Is No Basis To Change How Taxes Are Calculated.

The Advocacy Staff: “recommends the Commission no longer use the stand-alone approach but, instead, in the future look at consolidated taxes.”⁸⁴ Before the this recommendation could be adopted, it would be necessary for the Commission to decide the merits of using the consolidated tax method when setting rates in future rate cases. That is materially different from Mr. Majoros’ recommendation in his testimony that the: “Commission should consider placing NSP on alert in this proceeding that it intends to visit the consolidated tax issue in the next rate case.”⁸⁵

Advocacy Staff’s request to accelerate a decision on the merits of using consolidated

⁸³ Advocacy Staff Initial Brief at 24.

⁸⁴ *Id.* at 28.

⁸⁵ Ex. 24, Majoros Direct at 8.

taxes in the rate setting process is unsupported by any evidence. Therefore, adoption of this recommendation would be arbitrary and would be a denial of due process.

In response to the Mr. Majoros' testimony recommending consideration of this issue in our next rate case, Ms. Heuer filed the following response:

Q DID MR. MAJOROS RECOMMEND ANY ADJUSTMENTS TO THE METHOD USED BY THE COMPANY TO CALCULATE ITS INCOME TAX EXPENSE?

A No. Mr. Majoros did not recommend any adjustment to the method used by the Company to calculate its income tax expense, but he did recommend that the Commission "consider placing NSP on alert" that the Commission may consider "the consolidated tax issue in the next rate case."⁸⁶

Q. WHAT IS THE COMPANY'S RECOMMENDATION?

A Mr. Majoros has provided no basis for the Commission to consider any change in its long-standing practice of using the stand-alone method to determine income taxes, which is part of the fundamental regulatory policy of maintaining separation of regulated and unregulated expenses. Thus, there is no basis to increase the number of issues and complexity of a future rate case.⁸⁷

Advocacy Staff has changed Mr. Majoros' recommendation from requesting possible consideration of the issue in a future rate case to a recommendation in its Initial Brief that the Commission make a determination on the merits of the issue *in this proceeding*. That change, made after the close of the evidentiary hearing, if acted upon, would be arbitrary and a denial of due process.

The proper treatment of the Company's taxes is a complex factual and policy matter that was fully litigated in the Company's 2005 electric rate case in Minnesota

⁸⁶ Ex. 21, Heuer Rebuttal at 17.

⁸⁷ *Id.*

(Docket No. E002/GR-05-1428), where the Company had five witnesses testify on the several related issues. Based that testimony, the cross examination of the witnesses, and the extensive legal briefs on the related issues, the Administrative Law Judge recommended against using consolidated taxes in setting rates.⁸⁸ The MPUC agreed with the Administrative Law Judge,⁸⁹ and the Minnesota Court of Appeals agreed with the MPUC on appeal.⁹⁰ We would require the same opportunity to fully and comprehensively litigate the issue before a decision on the merits could be made by the Commission.

Therefore, the only issue properly before the Commission is whether to alert the Company that it intends to visit the consolidated tax issue in the next rate case. For the reasons set forth in Ms. Heuer's testimony, no evidence was presented by Mr. Majoros supporting even consideration of a change in long-standing regulatory practice. Including this issue in a future rate case would greatly complicate the initial filing and subsequent testimony for that case without any evidence justifying the effort and, consequently, the recommendation should not be accepted.

⁸⁸ ALJ Order (July 6, 2006), <https://www.edockets.state.mn.us/EFiling/ShowFile.do?DocNumber=3176404> at 33-39.

⁸⁹ MPUC Order (September 1, 2006), <https://www.edockets.state.mn.us/EFiling/ShowFile.do?DocNumber=3285507> at 21-24.

⁹⁰ In the Matter of the Application of Northern States Power Co., 2008 WL 131201, Util. L. Rep. P 26,991 (Minn. App. January 15, 2008).

V. A STANDALONE RESOURCE PLAN IS NOT IN NORTH DAKOTA CUSTOMERS' INTEREST.

We are proposing changes to the Integrated Resource Process to improve the process to more fully address the energy policy issues of North Dakota. In contrast, Advocacy Staff proposes a resource plan that “should contain only those resources that are required to meet system load and North Dakota’s -- not Minnesota’s -- environmental and renewable mandates.”⁹¹ Advocacy Staff asserts, however, that it is not: “proposing a stand-alone North Dakota system. Rather, King recommends an Integrated Resource Plan that reflects only North Dakota mandates.” The two statements are not compatible.

It is not possible to serve North Dakota customers using an integrated system while also implementing separate resource plans: one for Minnesota that includes King, High Bridge and wind generation located in Minnesota and another resource plan for North Dakota that excludes these resources. This proposal to develop separate resource plans is the logical consequence of the proposal in the rate case to disallow costs that Advocacy Staff argue are either imprudent or not used and useful. If adopted, we would no longer serve North Dakota and Minnesota using an integrated system.

Under Advocacy Staff’s proposed state-specific resource plan, presumably North Dakota would not approve any resources associated with perceived Minnesota

⁹¹ Advocacy Staff Initial Brief at 27.

requirements (*e.g.*, according to Advocacy Staff, the excluded resources would include King, High Bridge, and wind located in Minnesota). This would result in us having inadequate resources to meet North Dakota's capacity and energy needs. We could not, for example, allocate more of the Sherco units to North Dakota without denying Minnesota its proportionate share of the Sherco units, something that we should assume would be unacceptable to the MPUC. Therefore, we would need to acquire additional standalone resources to serve just the portion of the North Dakota load that the Commission did not want served by our integrated system. The end result is that North Dakota customers would no longer be served by our low-cost integrated network. The end result would be higher cost to serve our North Dakota customers.

Working to improve the resource planning process is an appropriate outcome of this proceeding. Mandating a change in the resource planning process that would eliminate use of our existing integrated network to meet all of our customers' needs in favor of standalone resources designed to meet each state's system load and policies is not in the customers' interest.

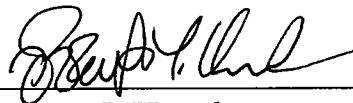
Therefore, Advocacy Staff's recommendation should be denied in favor of working with the Company to improve the resource planning process as more fully described in our Initial Brief, at pages 84-86.

VI. CONCLUSION.

Based on the foregoing and all the facts in the record, Xcel Energy respectfully request that: (i) we be granted an increase in revenues of \$17.95 million; (ii) our depreciation practices, rates and lives be accepted; (iii) our proposed changes in rate design and tariff provisions be approved; and (iv) our proposal for a cooperative multi-jurisdictional approach to resource planning be approved.

Dated: October 1, 2008

Respectfully submitted,

By 

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