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October 17, 2008

PUBLIC SERVICE COMMISSION

Jerry Lein, Public Utility Analyst
North Dakota Public Service Commission
State Capitol Building, Dept. 408
600 East Boulevard
Bismarck, ND 58505-0480

SUBJECT: Xcel Energy Demand Side Management Proposal (Case No. PU-08-627)
Response to Commissioner Questions 08-171

Dear Mr. Lein:

With this letter Northern States Power Company, a Minnesota corporation (“Xcel Energy” or the “Company”) submits its response to a specific request and comments to other inquiries raised the Public Service Commission (the “Commission”) during its October 13, 2008 work session on the Demand Side Management (“DSM”) Proposal filed on April 18, 2008 in this proceeding.

Question: What are the financial implications of: (1) the proposed DSM tracker accounting and recovery mechanisms; and (2) deferring the costs of DSM for consideration in a future rate case?

The Company’s proposed DSM tracker accounting and recovery mechanism provides for better matching and more concurrent recovery of program costs than traditional, base rate recovery. Since the DSM recovery factor is adjusted annually, recoveries can be adjusted to reflect lower or higher program costs.

Under the tracker methodology, program costs recorded in tracker accounts are expensed in a manner equal to the amount of program revenues realized through the recovery mechanism (i.e., the DSM Rider). This one-to-one matching of DSM revenues and expense results in our customers only paying the actual cost of the program, and a net zero impact on earnings. The proposed recording and recovery of lost margins through the DSM Tracker would offset the financial consequences of lower electric sales due to DSM. Customers would pay the same rates as would be required if there had been a rate case reflecting the lower sales volumes, while avoiding the need for rate case expenses and again, the earnings impact would be immaterial. In its entirety, the package of proposed DSM programs proposed in this proceeding is neither designed nor expected to affect, much less enhance, Xcel Energy’s regulated electric earnings in North Dakota.

Should the Commission decide to approve only the deferral of DSM program costs for later consideration in a future rate case proceeding, this too would not impact regulated operating income during the interim period, because there would be no DSM revenues or recognized

expenses for the costs themselves. Instead, the deferral would build until the time of the next rate case, and would be subject to appropriate carrying charges.

Under the deferred accounting model, the Company would file in its next rate case a proposal to amortize the balance in the deferred accounts over a multi-year period. The resulting annual amortization included in the test year would be approved, presumably, for recovery in base rates along with the annual DSM costs being incurred on an ongoing basis. The amortization period is typically a function of the expected frequency of general rate cases, or a determination of the benefit life span of the DSM program costs.

There are two important differences between these approaches. Current recovery utilizing a tracker mechanism allows better matching between costs and benefits.

Deferral imposes current costs on future ratepayers. Deferral also increases the revenue requirement in a future rate case, as both the then current DSM costs and the amortization of the deferred amount would need to be recovered. If a carrying charge is permitted on the deferred amount, the cost to future customers is further increased.

Therefore, the Company encourages the Commission's approval of current cost recovery utilizing the proposed DSM tracker accounting. However, if current cost recovery is not authorized, it is important that the Commission authorize deferred accounting. While the Company, under deferred accounting, would still need to prove the reasonableness of its expenditures in a future rate case, authorizing deferred accounting allows the Company to create a regulatory asset and would be entitled, absent future imprudent behavior, to future cost recovery. That minimum assurance would be an important consideration for the Company incurring the cost of proceeding with this new program.

Question: Why didn't Xcel Energy include its proposed DSM Programs and forecasted costs in its pending general rate case application in Case No. PU-07-776?

During both of the Commission's October 8, 2008 Informal Hearing and the October 13th Work Session, the Commissioners and Staff raised questions about the Company's decision to file its DSM proposal as a self-contained petition distinct from the general rate case it had filed in December 2007(Case No. PU-07-776).

The Company's primary intent in filing the DSM proposal separately was to provide more time and focus for assessing the various types of programs, their cost-effectiveness, and the unique cost recovery mechanism proposed. Because the Company was proposing to recover *all* DSM costs through a separate rate factor and not through base rates, the Company removed any costs specific to existing DSM from the general rate case test year and included them in the independent DSM filing along with all newly proposed programs costs. The objective was twofold: consistent accounting and regulatory treatment for all DSM programs, and proper matching of program costs and rate recovery.

In addition, the Company believed that by filing its DSM proposal independent from the general rate case, the Commission could exercise its options to either proceed with the DSM Proposal under a separate docket, or fold it into the pending general rate case.

Xcel Energy apologizes if the separate application has inconvenienced the Commission, or made it difficult for the Commission to adequately review its DSM Proposal. The Company

is certainly willing to waive the suspension deadline in this case and allow the Commission additional time to develop its overall DSM policy and/or assess forthcoming proposals from the other electric utilities before making a decision on these programs.

Question: How would the proposed DSM Program budgets be affected if only certain programs were approved?

During the October 13th Work Session there was some discussion regarding the budgeted amounts for individual programs. The staff memo you prepared indicated that a simple summation of the Residential Saver Switch, Business Saver Switch, and Peak and Energy Controlled Rate programs budgets yielded a total cost of \$206,904. However, as you also pointed out in your memo and at the October 13th Work Session, all of the proposed business DSM program budgets reflect an allocation of labor costs including, in particular, an additional full-time employee to be located in North Dakota and focused only on administration of the North Dakota DSM programs.

Should the Commission decide to select only two of the eight proposed business programs, we would need to adjust labor costs. We had included \$136,100 in direct labor to promote and support all of our proposed business programs. If the Commission authorizes just the Load Management programs, we would propose that an additional \$60,000 of labor and other expenses be included for the time and resources an additional North Dakota sales representative would need to work with commercial customers to inform them about the Peak and Energy Controlled rates and the Business Saver Switch program. This representative would help them determine if they would be good candidates for these programs, assist in their implementation, and serve as an on-going resource.

Question: What would the Company's approach be if the Commission failed to approve any cost recovery at this time?

If the Commission declined to approve recovery the Company would not implement the new DSM initiatives in North Dakota and would discontinue those programs that it currently performs on a limited scale that are currently not included in the test year for the pending electric rate case. The Company would continue to work with the Commission and Staff to develop other potential approaches that may be more acceptable to the Commission, for example, through the possible rulemaking or workshop on DSM.

While there are system-wide benefits to pursuing DSM as a resource option, there is a cost for achieving the energy efficiency and peak reductions needed to achieve those benefits. In addition to those costs, efforts to promote lower or off-peak energy use also decrease Company sales and margins. Xcel Energy's proposed package is a measured but comprehensive first step in promoting wise energy use in North Dakota. Should the Commission decide that the DSM Proposal is worth pursuing, we request that the corresponding cost recovery be approved.

Question: Should the Commission initiate a rulemaking case to establish general policies and goals for a DSM program?

As was correctly recognized, in addition to the DSM Program proposed by Xcel Energy, the Commission recently ordered both Otter Tail Power Company (“OTP”) and Montana Dakota Utilities Co (“MDU”) to file their own DSM/Conservation programs, in Case Nos. PU-06-481 and PU-06-482. Rulemaking may be beneficial if the Commission intends for the three utilities to establish programs using the same benefits tests and cost recovery mechanisms.

Xcel Energy would support the Commission conducting further assessment of DSM programs to ensure they accomplish the state’s objectives. We would be pleased to work with the Commission and its Staff to develop appropriate rules for evaluating DSM programs and compensating utilities for those programs.

We note, however, that the Commission may also conclude that the OTP and MDU DSM programs, which are mandated programs, should be evaluated using a different benefits test from that used by Xcel Energy in its voluntary program. More specifically, the required OTP and MDU programs are those programs that have been identified as “more economic resources than Big Stone II in [the OTP and MDU] integrated resource plan.” In contrast, Xcel Energy’s DSM Program includes a potentially broader array of DSM programs that have been selected based on whether they are beneficial using a Total Resource Cost Test (described in detail at pages 6-7 of our April 18, 2008 Application). This test compares the avoided revenue requirements on the system (generation, transmission and distribution, and marginal energy costs) over the lifetime of the DSM equipment installed to the costs of the installed equipment plus utility costs to administer the DSM Program. This process yields a benefit-cost ratio, where a program is determined cost-effective if the benefit-cost ratio exceeds 1.0.

Thus, it is possible that the three utilities’ DSM programs will be different, in which case rulemaking may not be appropriate. Whether the Commission elects to proceed through rulemaking or by individual order, we look forward to working with the Commission to implement a DSM program that is in the best interest of our customers.

The Company welcomes any additional questions you may have regarding this response or the application in general. Thank you.

Sincerely,



David H. Sederquist
Sr. Consultant, Regulation & Finance
Xcel Energy