Memo

To: Commissioners, Public Utility Division, Illona

From: Mike Diller Mike Diller

Date: January 25, 2013

Re: NSP's Interim Electric Rate Increase Request (PU-12-813)

NSP filed for a rate increase on December 18, 2012. The Company uses a 2013 projected test year to calculate its interim rate relief request of $14.7 million in increased revenue collections or an overall increase in revenue collections of 8.05%. Staff recommends that the commission approve NSP's interim rate request. Following is staff's analysis.

Staff reviewed the commission's last rate case order (PU-10-657 and PU-11-55) and the Company's immediate interim rate request for compliance with the laws and rules governing interim rate increases. The applicable section of law reads:

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

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terms of the bond, including the amount and surety, are subject to the commission's approval.

4. **As ordered by the commission, the utility shall promptly refund to persons entitled thereto all interim rate amounts collected by the public utility in excess of the final rates approved by the commission plus reasonable interest at a rate to be determined by the commission.**

According to the law, NSP interim rates are calculated using the Company's last authorized return on equity of 10.4%.

Determining whether or not the rate base and expenses included in the interim rate request are the "same in nature and kind" as allowed by the commission in NSP's last rate order is more difficult to determine given the last rate case was settled. The Settlement Agreement approved by the commission did not specify which rate case issues were agreed to or disallowed for rate recovery. Instead, the parties agreed to settle on a mutually agreeable rate increase amount.

Therefore, it is necessary to determine in a more general sense whether or not the interim rate increase request is reasonable. NSP's interim request removes $2.196 million (13%) in revenue requirements from its final rate increase request to comply with the spirit of the law. The specific adjustments are shown in Schedule 2, Page 1 of the Interim Rate Petition application and include removal of charitable donations, incentive compensation above 15% of base pay and changes in depreciation methods. The largest of these adjustments pertain to depreciation changes. It is at least arguable that depreciation expense is the same in nature and kind regardless of changes in current estimates of remaining lives and end of life salvage values. However, staff is not opposed to the Company's adjustments.

I also reviewed staff's proposed adjustments in NSP's last rate case noting total expense adjustments of $1.7 million and rate base adjustments impacting revenue requirements by $.177 million. A number of staff's adjustments were not really positions of disallowance but instead expense adjustments to reflect more current or company updated information which is not applicable here. The largest and more contentious adjustment by staff included a disallowance of Mercury sorbent costs required by the state of Minnesota but not federally mandated or required by North Dakota standards. Since the plants are located in Minnesota, staff's position was not indisputable.

Another of staff's larger adjustments reduced bad debt expense as proposed by NSP. The adjustment was based on historical trends rather than the more studied and perhaps convoluted method employed by NSP. Arguments can be made for either method but neither approach was agreed to in the Settlement Agreement and therefore not included as an adjustment for purposes of determining interim rates.

While I could go on for some time discussing adjustments made by staff in the last rate case and the perceived strength of those arguments, my overall conclusion is that the interim rate increase amount of $14.7 million is reasonable given the legal requirements and the fact that the case was settled without specific guidance on recoverability of certain kinds of expenses. Please note that the law provides a backstop by requiring a refund of any interim rate amounts collected in excess of the final rates approved by the commission.

While the overall rate increase to customers' bills is 8.05%, the interim tariff increase is only applied to non-gas rates. Therefore, a 12.17% increase to the non-gas rates is necessary to generate an overall increase in revenues of $14.7 million or 8.05%. As a result, the interim tariff increase will be applied across-the-board to all non-gas rates of all customer classes resulting in no change to rate design and an overall increase in total revenue collections of 8.05%.

Even though the commission may require a bond to ensure a refund in the event that the commission does not find in NSP's favor, staff believes the financial security of NSP is sufficient so as to not require a bond.

In summary, staff believes that NSP's interim rate request is reasonable and should be approved for use on or after February 16, 2013. A Motion and Order has been prepared for the January 30, 2013 commission meeting.