

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

LeRoy Koppendraye	Chair
David C. Boyd	Commissioner
Marshall Johnson	Commissioner
Thomas Pugh	Commissioner
Phyllis A. Reha	Commissioner

In the Matter of the Application of Northern States Power Company, a Minnesota Corporation and Wholly Owned Subsidiary of Xcel Energy Inc., for Authority to Increase Rates for Natural Gas Service in Minnesota

ISSUE DATE: September 10, 2007

DOCKET NO. G-002/GR-06-1429

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER

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PROCEDURAL HISTORY

I. Initial Filings

On November 9, 2006, Northern States Power Company, a Minnesota corporation and wholly owned subsidiary of Xcel Energy Inc. (Xcel or the Company), filed a request for a general increase in its natural gas rates. Xcel requested an increase of \$18,542,000, or approximately 2.41 percent, over existing rates, based on a rate of return on common equity of 11.0 percent. Xcel proposed a forecasted test year ending on December 31, 2007. In its proposed test year, Xcel has approximately 427,000 customers and throughput of approximately 76.3 Bcf/gas.

On January 4, 2007, the Commission issued Orders in which it accepted Xcel's filing as being in proper form and substantially complete, suspended Xcel's proposed final rates until the end of this case, and referred this matter to the Office of Administrative Hearings for a contested case proceeding. The Commission also approved Xcel's request for interim rates, and authorized Xcel to increase its revenues by \$15,900,000 annually, or approximately 2.05 percent, subject to refund, beginning with service provided on and after January 8, 2007.

II. The Parties and their Representatives

The parties and their representatives are set forth below.

Megan J. Hertzler, Assistant General Counsel, Xcel Energy, 414 Nicollet Mall, Fifth Floor, Minneapolis, MN 55402, and Michael J. Bradley and Richard J. Johnson, Attorneys at Law, Moss & Barnett, 4800 Wells Fargo Center, 90 South Seventh Street, Minneapolis, MN 55402, appeared on behalf of Northern States Power Company (NSP) and Xcel Energy, Inc. (Xcel).

Karen F. Hammell and Valerie M. Means, Assistant Attorneys General, 1400 Bremer Tower, 445 Minnesota Street, St. Paul, MN 55101, appeared on behalf of the Minnesota Department of Commerce (the Department).

Steven H. Alpert and Ronald M. Giteck, Assistant Attorneys General, 900 Bremer Tower, 445 Minnesota Street, St. Paul, MN 55101, appeared on behalf of the Office of Attorney General, Residential and Small Business Utilities Division (RUD-OAG).

Chris Duffrin and Pam Marshall, 823 Seventh Street East, St. Paul, MN 55106, appeared on behalf of the Energy CENTS Coalition (Energy Cents).

James M. Strommen and Peter G. Mikhail, Attorneys at Law, Kennedy & Graven, Chartered, 470 U.S. Bank Plaza, 200 South Sixth Street, Minneapolis, MN 55402, appeared on behalf of the Suburban Rate Authority (SRA).

Robert S. Lee and Andrew P. Moratzka, Attorneys at Law, Mackall, Crouse & Moore, PLC, 1400 AT&T Tower, 901 Marquette Avenue, Minneapolis, MN 55402, appeared on behalf of Gerdau Ameristeel US, Inc., and Marathon Petroleum Company, LLC (Xcel Large Industrials).

Christopher D. Anderson and James C. Erickson, Attorneys at Law, 30 West Superior Street, Duluth, MN 55802, appeared on behalf of Minnesota Power.

Robert Harding, Rates Analyst, Jerry Dasinger, Financial Analyst, and Stuart Mitchell, Rates Analyst, 121 Seventh Place East, Suite 350, St. Paul, Minnesota 55101, attended the hearings on behalf of the Staff of the Minnesota Public Utilities Commission (Commission).

III. Proceedings Before the Administrative Law Judge (ALJ)

The Office of Administrative Hearings (OAH) assigned Administrative Law Judge Beverly Jones Heydinger (ALJ Heydinger or the ALJ) to hear the case.

On March 9, 2007, the Department, the RUD-OAG, and the ECC submitted pre-filed direct testimony. The Department was the only party to submit testimony on all issues and to propose an alternative to the revenue requirement proposed by Xcel. On April 10, 2007, Xcel submitted pre-filed rebuttal testimony. On April 24, 2007, the Department, and OAG submitted pre-filed surrebuttal testimony.

On March 12, 14, and 15, 2007, ALJ Heydinger conducted public hearings in Oakdale, St. Cloud, and St. Paul. In addition to the public testimony at these hearings, the ALJ accepted written public comments until April 10, 2007. The public testimony and comments are summarized in the ALJ's Report.

On May 1 and 2, 2007, ALJ Heydinger conducted technical/evidentiary hearings at the offices of the Commission in St. Paul, Minnesota. A briefing schedule was established at the conclusion of the evidentiary hearings. The evidentiary hearing record closed on June 20, 2007.

On May 30, 2007, Xcel, the Department, OAG, ECC, and SRA submitted initial briefs, on June 8, Xcel Large Industrials submitted its post-hearing brief, and on June 20, Xcel, the Department, and RUD- OAG submitted reply briefs.

IV. Proceedings Before the Commission

On July 26, 2007, the ALJ issued Findings of Fact, Conclusions, and Recommended Order (the ALJ's Report). In her Report, the ALJ recommended a rate increase of approximately \$10.8 million, or approximately 1.46 percent, based on a recommend rate of return on common equity of 9.4 percent. The recommended \$10.8 million increase does not include the \$2.5 million recommended for the affordability plan.

On August 6, 2007, Xcel, the Department, and RUD-OAG filed exceptions to the ALJ's Report. Replies to these exceptions were not permitted, pursuant to Minn. Rules, part 7829.2700, subpart 2.

Also on August 6, 2007, at the request of the Commission, Xcel filed preliminary financial and rate design schedules that Xcel believes reflect the ALJ's recommended revenue requirement and rate design.

On August 9, 2007, the Department filed its financial and rate design schedules that it believes correctly interpret and apply the ALJ's recommendation in this case.

On August 14, 2007, the Commission held oral argument and the record closed under Minn. Stat. § 14.61, subd. 2.

On August 16, 2007, the Commission met to consider this matter.

Having examined the entire record herein and having heard the arguments of the parties, the Commission makes the following findings, conclusions, and Order.

FINDINGS AND CONCLUSIONS

I. The Company

Xcel Energy Inc., a Minnesota corporation, is a public utility holding company. Its continuing operations include four utility subsidiaries that serve electric and natural gas customers in 10 states. Northern States Power Company d/b/a Xcel Energy, a Minnesota Corporation, referred to in this proceeding as NSP, Xcel or the Company, is one of those subsidiaries.

Currently, NSP serves approximately 462,000 natural gas customers. Approximately 419,000 of the customers reside in Minnesota and 43,000 in North Dakota. The Minnesota customer count is approximately 24,000 higher than that in NSP's last natural gas rate case. Ninety percent of NSP's customers are in the Residential class, and ten percent are in the Commercial and Industrial classes. NSP's gas service territory includes portions of the Twin Cities metropolitan area and communities throughout southern and western Minnesota.

NSP's last natural gas rate increase was granted by the Commission, effective on December 1, 2005.¹ The Commission authorized an increase in gross revenues of \$5,793,000 in that proceeding.²

II. Jurisdiction

The Commission has general jurisdiction over the Company under Minn. Stat. §§ 216B.01 and 216B.02. The Commission has specific jurisdiction over the rate changes requested by the Company under Minn. Stat. § 216B.16.

The case was properly referred to the Office of Administrative Hearings under Minn. Stat. §§ 14.48-14.62 and Minn. Rules, part 1400.0200 *et seq.*

III. The Legal Standard - Burden of Proof

Under the Public Utilities Act, utilities seeking a rate increase have the burden of proof to show that the proposed rate change is just and reasonable. Minn. Stat. § 216B.16, subd. 4. Any doubt as to reasonableness is to be resolved in favor of the consumer. Minn. Stat. § 216B.03.

The Minnesota Supreme Court has articulated standards for the burden of proof in rate cases. See *In the Matter of the Petition of Northern States Power Company for Authority to Change Its Schedule of Rates for Electric Service in Minnesota*, 416 N.W.2d 719 (Minn. 1987). In the *Northern States Power* case the Court divided the ratemaking function of the Commission into quasi-judicial and legislative aspects. The Commission acts in a quasi-judicial mode when it determines the validity of facts presented. Just as in a civil case, the burden of proof is on the utility to prove the facts by a fair preponderance of the evidence. Such items as claimed costs or other financial data are facts which the utility must prove by a fair preponderance of the evidence.

The Commission acts in a legislative mode when it weighs the facts presented and determines if proposed rates are just and reasonable. Acting legislatively, the Commission draws inferences and conclusions from proven facts to determine if the conclusion sought by the utility is justified. The Commission weighs the facts in light of its statutory responsibility to enforce the state's public policy that retail consumers of utility services shall be furnished such service at reasonable rates. In its legislative capacity, the Commission forms determinations such as the usefulness of a claimed item, the prudence of company decisions, and the overall reasonableness of proposed rates.

¹ *In the Matter of an Application by Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Natural Gas Service in the State of Minnesota*, Docket No. G-002/GR-04-1511, ORDER (November 22, 2005).

² *In the Matter of an Application by Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Natural Gas Service in the State of Minnesota*, Docket No. G-002/GR-04-1511, ORDER ACCEPTING AND MODIFYING SETTLEMENT AND REQUIRING COMPLIANCE FILINGS (August 11, 2005).

The utility therefore faces a two-part burden of proof in a rate case. When presenting its case in the rate case proceeding, the utility has the burden to prove its facts by a fair preponderance of the evidence. The utility also has the burden to prove, by means of a process in which the Commission uses its judgment to draw inferences and conclusions from proven facts, that the proposed rates are just and reasonable.

IV. Statement of the Issues

Xcel stated that it was requesting an overall rate increase in order to return its gas operations to a reasonable and fair rate of return, based on its 2007 test year. The Company has cited a few key factors that it contends are driving its need for a rate increase. First, Xcel stated that it has experienced a decline in its use per customer. The Company cited records showing that projected 2007 residential use per customer has declined by 10 percent since 2004 and its sales volumes are below those experienced in 2004, even though the number of customers has grown. In addition, while prices were rising, Xcel accelerated its conservation spending. For these reasons, the Company stated, its revenues have not met its projections.

The key issues whose resolution determines the final outcome on the docket's ultimate questions are the following:

- Is the revenue increase sought by Xcel reasonable or will it provide the Company with unreasonable or excessive earnings?
- Is the rate design proposed by Xcel reasonable?

In its January 4, 2006 Order referring the Company's rate case to the Office of Administrative Hearings (OAH) for a contested case proceeding, the Commission identified a number of issues to be developed in the record.

- (1) Is the test year revenue increase sought by the Company reasonable or will it result in unreasonable and excessive earnings by the Company?
- (2) Is the rate design proposed by the Company, including proposed revisions to customer charges, reasonable?
- (3) Are the Company's proposed capital structure, cost of capital, and return on equity reasonable?
- (4) Are the Company's sales forecast, its calculation methodology and the underlying assumptions and inputs used in that calculation reasonable?
- (5) Is the Company's proposal for a residential revenue decoupling mechanism reasonable?
- (6) Is the Company's proposal for a residential low-income discount rate program reasonable?

- (7) Are the Company's treatment of costs to support service to electric generation customers in its class cost of service study reasonable?
- (8) Should a stand alone tariff for electric generation service be established?

V. The Administrative Law Judge's Report

On July 26, 2007, the ALJ issued Findings of Fact, Conclusions, and Recommended Order (ALJ's Report). In her report, the ALJ recommended a rate increase of approximately \$10.8 million, or approximately 1.46 percent, based on a recommend rate of return on common equity of 9.4 percent. The \$10.8 million increase does not include the \$2.5 million recommended for the affordability plan.

The Commission finds that the ALJ's report is thoughtful, comprehensive, and thorough. She made 272 findings of fact, which served as the basis for 19 conclusions and her principal recommendation, i.e., that the Commission issue an Order finding that the Company is entitled to increase gross annual revenues in the manner and in the amount consistent with the terms of her Report.

Having examined the record and carefully considered the ALJ's Report, together with the parties' exceptions to the ALJ's Report, their oral arguments on August 14, 2007, and their clarifications on August 16, 2007, the Commission accepts, adopts, and incorporates herein nearly all of her findings and conclusions of law. At a few points, however, the Commission has reached different conclusions, in whole or in part, as delineated and explained below in the text of this Order.

In addition to discussing the issues on which the Commission did not adopt the ALJ's recommendations, in whole or in part, the Order also addresses issues on which a party filed exceptions to the ALJ's recommendation unless the party subsequently abandoned its objection. In discussing those issues, the Order explains why the Commission has rejected the position taken in the party's exceptions and adopted the ALJ's recommendation.

Financial Issues

VI. Establishment of Test Year Expenses

Setting just and reasonable rates involves establishing the utility's expenses during a test year and the revenues it projects for that test year based on current rates, projected sales, and rate structure. The Company's revenue deficiency is then calculated as the difference between a utility's test year costs, including the need to pay a fair return to investors, and its test year revenues.

Xcel selected calendar year 2007 as its test year. It began with the actual financial information for its most recent fiscal year, calendar year 2005, and the projected fiscal year, calendar year 2006, with adjustments to eliminate out-of-period expenses from the calculation.

No party challenged the Company's proposed test year but there were objections to several expenses included in that test year, as discussed below.

VII. Rate Case Expense

A. Xcel's Position

In its initial filing, Xcel proposed including \$1,200,000 of projected direct expenses associated with this rate case and the unamortized balance of the rate case costs from its last natural gas rate case, \$480,000. The Company contended that the expenses were prudently incurred and therefore should be recovered. The Company proposed to recover that amount in three years, arguing that this period would promote recovery of the current rate case expenses within the recovery period.

At the oral argument on this matter, the Company requested that it be allowed to offset the unamortized rate case costs against the refund, but also stated that it would not object to the disallowance of the \$480,000 unamortized balance of the rate case costs from its last natural gas rate case if a three-year recovery period was approved.

B. The Department and the RUD-OAG

The Department and the RUD-OAG opposed recovery of the unamortized rate case expenses. The Department noted that the Company over-recovered in each of its three previous natural gas rate cases because the utility chose to file its rate cases with longer intervening times than the amortization periods. The public agencies stated that if costs are carried forward into subsequent cases, they will be repaid indefinitely. They also noted that in the recent Great Plains natural gas rate case³ the Commission disallowed recovery of unamortized rate case expenses from a prior case.

The Department and the RUD-OAG also favored a five-year amortization period, basing their recommendation on the fact that NSP's average period of time between rate cases is 5 years.

C. The ALJ's Report

The ALJ agreed with the Department and the RUD-OAG that the unamortized rate case expenses should not be recovered in this case and that the amortization period should be five years.

D. Commission Analysis and Action

For the reasons advanced by the Department and the RUD-OAG, the Commission will disallow recovery of the unamortized balance of rate case expenses from Xcel's previous rate case, as recommended by the ALJ.

Regarding the recovery period for the current rate case expenses, the Commission will set a three year period, as proposed by Xcel, rather than the five year period recommended by the ALJ. The

³ *In the Matter of a Petition by Great Plains Natural Gas Company, a Division of MDU Resources /Group, Inc., for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-004/GR-04-1487 (May 1, 2006).

Commission agrees with the ALJ that it is appropriate to look at a reasonable historical average since it is difficult to predict the future frequency of rate case filings, but disagrees with her conclusion that five years is the appropriate amortization period in this case.

First, the Company stated that it expects to file its next gas rate case in three years and cites several reasons for that expectation: the Company's plans for significant future investment, expected usage patterns, and inflation.

Second, in determining a reasonable interval between rate cases, it is also important to note that intervals between rate cases appear to be cyclical, with periods of frequent rate cases and periods of less frequent rate cases, as well as other factors affecting the interval, such as Xcel's commitment as a result of the Merger Settlements not to file a rate case for natural gas service for the period between 2000 and 2004.

Third, only two years have passed since Xcel's last rate case and since 2004, CenterPoint Energy, Great Plains Energy and Greater Minnesota Gas have all filed gas rate cases within one or two years of their previous rate case filings, suggesting, as Xcel has argued, that this may be a period of more frequent filings.

Taking all these factors into consideration, the Commission finds it more reasonable to establish a three year amortization period for the Company's rate case expenses.

VIII. New Area Surcharge

A. Xcel's Position

Initially, Xcel made no adjustment to investment for costs related to areas to which a new area surcharge (NAS) applies. In responding to an Information Request from the Department, the Company stated that it had discovered a flaw in the forecast system logic that required an adjustment to conform to the cost of service procedure. Specifically, the Company stated, the average rate base was understated by \$231,009 and depreciation expense was overestimated by \$359,432. The Company stated that adjustments should be made to correct these errors.

B. The Department's Recommendation

The Department recommended that it was appropriate and necessary to make the adjustments identified by the Company.

C. The ALJ's Report

The ALJ supported the Department's proposal to increase the test-year rate base by \$231,000 and to decrease the test year depreciation expense by \$359,000 to correct the error identified by the Company. The Commission will so Order.

D. Commission Analysis and Action

The Commission determines that the average rate base should be increased by \$231,009 and depreciation expense should be decreased by \$359,432 related to New Area Surcharge (NAS) projects, as recommended by the ALJ.

IX. Cash Working Capital

The Department reviewed the lead/lag study factors applied by the Company to its test-year operating and maintenance (O&M) expenses to determine its cash working capital requirement. The Department determined the factors were reasonable except for the following four factors: revenue lag days applicable to Transportation Revenue; revenue lag days applicable to Late Payment Revenue; revenue lag days applicable to the contribution in aid of construction (CIAC) related adjustment from the 2004 gas rate case; and revenue lag days applicable to Other Gas Revenue.

The Department proposed changes to those four factors, calculating that the effect of these adjustments decreases the test-year Cash Working Capital by \$136,000. The Company agreed to make the proposed changes.

X. Vehicle Fuel Expense

A. Xcel's Position

Xcel used a \$2.80 per gallon price for both gasoline and diesel to develop the budgeted 2007 expenses used in the test year. The Company stated that gasoline and diesel costs were not isolated as an individual expense in the 2007 budgeting process. The Company explained that vehicle rates applicable to the entire NSP fleet for the 2007 budget were based on a flat-line estimate of 2,250,000 gallons including not only gasoline but also diesel fuel, depreciation and lease expense, garage operations expenses, vended cost, and licensing.

Xcel objected to the Department's recommendation that the fuel cost be set at \$2.30, based on data from the Energy Information Administration (EIA). The Company argued that it is inappropriate to isolate one cost input of an estimated operating budget for the Company's Minnesota gas business while ignoring all other cost changes that have occurred.

B. The Department's Position

The Department initially opposed the Company's \$2.80 per gallon proposal, noting that this was 22 percent greater than the EIA's forecast. The Department stated that the Company's budgeted gasoline rate, \$2.80 per gallon, did not appear to be reasonable for test year revenue requirement purposes since the EIA's forecasted average price for 2007 is \$2.30.

Following the ALJ's Report adopting the Company's \$2.80 figure, the Department stated at the oral argument on this matter that it did not oppose the Company's figure.

C. The ALJ's Report

The ALJ stated that although Xcel may not have fully itemized its vehicle fuel expense, the Department did not take into account the several components to this category identified by the Company. The ALJ concluded that since the Company has demonstrated that this category includes several components and reached a figure not far from the Department's calculation for gasoline only, the Company's proposed expense should be allowed.

D. The Commission's Analysis and Action

The Commission agrees with the ALJ that the Xcel's reasoning is sound and that the \$2.80 per gallon figure is reasonable. The Commission will approve it and allow its use in calculating test year expense.

XI. Late Payment Revenue - Historical Period

A. The Department's Objections to Xcel's Proposed Historical Period

Xcel based its calculation of test year late payment revenue on 28 months of data, January 2004 through April 2006. The Department objected that this period was insufficient. The Department stated that since the data is available for a longer period, there is no reason not to use a longer period than the allegedly arbitrary 28-month period used by the Company.

In addition, the Department stated that the Company's 28-month historical period contained two abnormal months during which the Company had decided not to charge late payments while it was converting to a new billing system. The Department stated that including those months skews the results. The Department recommended that the available five years of data should be used to evaluate late payment revenue. Based on that average, the Department recommended that the test year late Payment revenue be increased by \$318,540.

B. Xcel's Proposed Revised Historical Period

Xcel acknowledged that February and March 2006 were abnormal months. The Company recommended removing this period from the sample, annualizing the revenues collected to a 365-day period, and restating the test year Late Payment Revenues accordingly. The Company stated that there was no need to use a five-year average to correct for the two months of poor data. Based on its recalculation, the Company recommended to increase late payment revenue by \$37,000.

C. The ALJ's Report

The ALJ concluded that Xcel did not show that its 28 month historic period minus the two abnormal months would produce results more representative of business going forward than increasing the sample period as advocated by the Department. The ALJ also concluded, however, that other than its statement that five years is a longer period, the Department failed to show why including five years of information was more likely to provide a better method of calculating test year revenue.

The ALJ found that the late revenue figures for 2002 through 2006, including the Department's adjustment for 2005, show a marked increase between 2002 and 2003 and a significant increase for 2006. The ALJ stated that neither the Company nor the Department attempted to explain the increase, or offer an opinion about whether the 2006 figure was an anomaly. The ALJ concluded that it would be most appropriate to calculate a representative test-year figure for Late Payment Revenues by averaging the figures from 2003 through 2006. The ALJ explained that this would better represent the past experience and moderate the 2006 increase.

D. Commission Analysis and Action

The Commission finds that the ALJ's four year historical period is reasonable and will approve it. The ALJ has provided a sound basis to conclude that projecting the level of late payment revenue on a four year historical period is preferable to the periods proposed by Xcel and the Department.

XII. Late Payment Revenue - Methodology to Calculate Late Payment Revenues

A. Xcel's Methodology

Xcel took the actual late payment revenues for its proposed 28 month period, calculated a monthly average, and multiplied that amount by 12 to determine the test year late payment revenues.

B. The Department's Methodology

The Department linked the late payment revenue to the level of retail sales the Company included in the test year revenue requirement. The Department argued that if the sales (monthly customer bills) increase due to increased gas costs or colder than normal weather, the incidence of late payments and hence late payment revenues associated with those sales should also increase because customers will have trouble paying their bill. The Department objected that the Company's use of a simple average did not reflect the increase in sales shown by Xcel for the test year.

To correct this deficiency, the Department proposed an alternative methodology for projecting test-year late payment revenue: for each year of the historical period, find the percentage that late payments constitute of retail revenues for each year of the historical period, find the average of those percentages, and multiply that average percentage times the projected test-year revenues.

C. The ALJ's Report

The ALJ did not specifically address the competing methodologies proposed by Xcel and the Department but indirectly adopted the Company's method (a simple average of actual late payment revenues during the historic period) stating: ". . . to calculate a representative test-year figure for Late Payment Revenues, it would be most appropriate to average the figures from 2003 through 2006."

D. The Commission's Analysis and Action

The Commission is persuaded that the Department's method of projecting a representative test-year figure for Late Payment Revenues is preferable to the Company's. Setting aside the length of the historical period (since that aspect of the methodology was decided in the previous section), the Commission finds that the Department's methodology appropriately takes into consideration the increase in test year revenues projected by the Company and approved by the Commission in this Order. As such, it is a more reasonable method for projecting the level of late payment revenue that the Company is likely to recover during the test-year.

Reviewing the ALJ's findings regarding Late Payment Revenue, it is unclear that the ALJ made a conscious decision to adopt the Company's method. The ALJ's Finding 129 appears focused on defining the historic period rather than on choosing between the parties' competing methodologies. The ALJ explains in detail her reasons for choosing a four year historic period but does not specifically address the methodology issue. However, to the extent that the ALJ's Report can be viewed as adopting and recommending the Company's method, the Commission declines to adopt that recommendation for reasons stated in the foregoing paragraph.

XIII. Incentive Compensation

A. Xcel's Positions

Xcel included \$655,426 in incentive compensation in its test year revenue requirement, i.e., \$1,170,405, reduced by \$514,979 to exclude the long-term part of the officer's incentive compensation, to remove non-corporate incentive plan costs, and to remove all incentive plan costs above twenty-five percent of base pay.

Xcel also requested that the Commission discontinue the requirement that the company refund to its customers incentive compensation that is included in rates but not paid. The Company argued that under the Incentive Compensation plan proposed in this case there is little risk of over-recovering and that the limited risk did not justify imposing this requirement. At the hearing for oral argument, however, Xcel agreed to the continuation of that requirement.

B. The Department and the RUD-OAG's Recommendation

The Department agreed that the Company's proposed level of incentive compensation in this proceeding is reasonable since the Company's proposed figure excludes long-term incentive compensation, excludes an incentive compensation award that exceeds 25 percent of their base salary, and includes only 55 percent of the targeted incentive compensation level.

The Department and the RUD-OAG opposed discontinuing the refund requirement for any unpaid incentive compensation. The public agencies maintained that only the refund requirement would protect against the possibility that the incentive compensation will not be actually paid by the Company. They noted that although the Company may fully intend to make incentive payments in excess of 55 percent of the targeted incentive compensation in 2007, it is not clear how market conditions may change and whether the Company will routinely pay out in excess of that level in the future.

C. The ALJ's Report

The ALJ found no reason to deviate from the prior decisions in Xcel rate cases and relieve the Company of the obligation to refund amounts included in the test year for incentive compensation that were not actually paid.

D. The Commission's Analysis and Action

The Commission finds that the Company's proposed level of incentive compensation in this proceeding is reasonable and will approve it. The Commission also adopts the ALJ's finding and will require Xcel to refund amounts included in the test year for incentive compensation that were not actually paid.

XIV. Bad Debt Expense

Xcel initially proposed that \$3,193,887 be included in the test year for bad debt expense. Subsequently, the Department and the Company agreed that this amount should be reduced by \$43,546 to correct for the fact that the initial figure included bad debt related to energy markets that should have been attributed to the electric utility. Correcting that error reduced the bad debt expense for the gas utility budget from \$3,193,887 to \$3,150,341.

The ALJ agreed that this reduction was appropriate.

The Commission finds that the resulting figure for test year bad debt in this matter, \$3,150,341, is reasonable and will approve it.

XV. Main and Service Extension

A. Background

In its March 31, 1995 Order in Docket No G-999/CI-90-563, the Commission stated:

Finally, the Commission has concern about the impact of service extension-related additions (projects involving multiple customers) on the company's rate base. In future rate cases, the Commission will request the Department to investigate the company's service extension-related additions to rate base to make sure:

1. that LDCs are applying their tariffs correctly and consistently,
2. that they are appropriately cost and load justified, and
3. that wasteful additions to plant and facilities are not allowed into rate base.

The purpose of the three requirements was to assure that for all extensions made by a utility that require a Contribution in Aid of Construction (CIAC), the calculation of the CIAC is correct and that the CIAC is collected from the persons whose service extensions occasioned these additional costs.

B. Xcel's Position

Xcel reported that a review of its service extensions showed that the CIAC amount not collected was \$1,406 or 1.37 percent of the total cost of the service extensions in the sample and that a review of its main extensions showed that the uncollected amount of CIAC was \$2,250 or 0.39 percent of the total sample cost. The Company stated that according to general auditing practices, a margin of error of less than two percent is considered immaterial. The Company concluded that since the amounts of CIAC not recovered fall within a reasonable margin of error (less than two percent), its service and main extension tariffs were appropriately applied resulting in no wasteful additions being allowed into rate base.

C. The Department's Recommendation

The Department stated that although it had concerns about the number of errors in the application of its services extensions tariff, it acknowledged that both the unrecovered CIAC amount and the over recovered CIAC amount associated with these errors are each less than 2 percent of the overall cost associated with the services sample identified by the Company. In addition, the Department stated, the Company refunded all CIAC charges to six customers where joint trenching may have occurred. The Department did not challenge the Company's conclusion that it has, within a reasonable margin of error, correctly and consistently applied its extensions tariff since its 2004 natural gas rate case. The Department did not propose any financial adjustment for errors identified in the application of the Company's services extensions tariff but did state that it expected to continue to see improvements in the Company's application of its extensions tariff.

D. The Commission's Analysis and Action

In its review, Xcel's method understated the significance of the uncollected CIAC by calculating the percentage that the uncollected amount bears to the total cost of the extensions. A more meaningful assessment of the level of uncollected CIAC is gained by viewing the amount of uncollected CIAC as a percentage of the CIAC that should have been collected.

Applying this more meaningful method, the percentage not collected for main extensions remains relatively low (0.85 percent as compared with the 0.39 percent figure used by Xcel) but the percentage not collected for service connections rises substantially: 8.25 percent rather than the 1.37 percent figure used by Xcel.

Assuming for this case a significance factor of two percent and that anything higher than two percent warrants an adjustment, the Commission finds that the 8.25 percent uncollected CIAC for service extensions is significant and requires an adjustment.

Applying this method, which all parties ultimately agreed was appropriate, the proper amount of that adjustment, including related accumulated depreciation and depreciation expense, is \$82,485. The Commission will so order.

XVI. Main and Service Extension Tariff

A. Xcel's Positions

Xcel initially proposed to continue the following approved tariff provision in the present docket:

Once the Company waives any contribution by new customers for main and service extension costs, the Company cannot at any time recover these costs from existing ratepayers. (2nd Revised Sheet No. 17, Section No. 6, Subsection 5.1 General Extension Policy)

After the Department proposed adding the phrase “in situations where the Company is competing for new customers with another gas utility or other energy provider” at the end of the introductory clause, Xcel agreed to that language but proposed adding the following sentence: “The Company shall waive any CIAC of \$5.00 or less.”

At the oral argument, the Company agreed to accept the tariff language proposed by the Department, minus the phrase “in situations where the Company is competing for new customers with another gas utility or other energy provider.” See below.

B. The Department's Recommendations

In response to the Company's initially proposed tariff language quoted above, the Department proposed that the tariff be amended to read as follows:

Once the Company waives any contribution by new customers for main and service extension costs in situations where the Company is competing for new customers with another gas utility or other energy provider, the Company cannot at any time recover these costs from existing ratepayers. (2nd Revised Sheet No. 17, Section No. 6, Subsection 5.1 General Extension Policy)

The Department later clarified in testimony that the Department did not intend this language to limit the situations where recovery of waived CIAC costs is denied the Company.

In response to the Company's subsequent proposal to add a sentence exempting the Company from tracking, reporting, or otherwise explaining CIAC waivers of \$5.00 or less, the Department opposed that proposal, arguing that the Company has not shown that it is reasonable to have existing ratepayers pay for the CIAC charges (\$5.00 or less) waived under the Company's proposal. The Department also stated that it will be the Company's burden to show, in the Company's next natural gas rate case, that the amount of CIAC waived under this policy is not included in rate base. To provide additional clarity on that point, the Department recommended that the Commission include in the tariff the following additional sentence: “The Company cannot at any time recover these cost from existing ratepayers.”

C. The Commission's Analysis and Action

At the hearing for oral argument, all parties agreed upon the following tariff language:

The Company shall waive any CIAC of \$5.00 or less. The Company cannot at any time recover these cost from existing ratepayers.

Once the Company waives any contribution by new customers for main and service extension costs, the Company cannot at any time recover these cost from existing ratepayers.

The Commission finds that this language is reasonable and will approve it. In so doing, the Commission essentially adopts the tariff changes proposed by the Department for the reasons stated by the Department. However, to clarify that the denial of recovery of waived CIAC is not limited to situations where the Company is competing for new customers with another gas utility or other energy provider, the Commission is not approving the earlier proposed phrase "in situations where the Company is competing for new customers with another gas utility or other energy provider."

XVII. Sales Forecast

A. Xcel's Position

Xcel initially advocated for its sales forecast, asserting that the reasonableness of its forecasting methodology is undisputed, that it has used its forecasting methodology for fifteen years for internal budgeting and planning, and it more accurately reflects short-run changes in the economy and demographics. The Company acknowledged that despite the differences in methodology, the Department's forecasting methodology and the Company's reached virtually identical results in this case. The Company recommended that the Commission consider the results of both forecasts since the Department's forecast provides an excellent tool for testing the accuracy of the Company's forecast.

At the oral argument, the Company did not oppose use of the Department's sales forecast for setting rates in this case, provided it is clarified that the approval of the Department's methodology in this case is limited to this case.

B. The Department

The Department noted that sales volumes are important factors in calculating a utility's revenue requirement because sales levels affect both revenues and expenses. The Department recognized that the difference between the Department's and the Company's aggregate forecasts are small in this case (.26 percent, with Xcel's method having a rate impact of + .25 cents annually for residential ratepayers compared with the Department's). The Department argued, however, that the Department's forecast should be adopted because the Commission has used the Department's sales forecasting methodology in numerous previous natural gas rate cases and any doubt as to reasonableness should be decided in favor of the ratepayer.

C. The ALJ's Report

The ALJ decided to approve use of the Department's methodology. The ALJ reviewed the arguments for and against the proposed methodologies. The ALJ stated that in light of the reasonably close results of the analysis done by the Company and the Department, the choice of one over the other will have little effect on the ratepayer.

The ALJ stated, however, that the Department's methodology has been accepted by the Commission in several prior rate proceedings while the Company's has not. In addition, the ALJ found, the greater change in the Company's results compared to the Department's when additional months of data were added lends credence to the Department's position that the Company's methodology may be less reliable.

D. The Commission's Analysis and Action

As ultimately agreed by the parties, the Commission will adopt the Department's sales forecast for setting rates in this case, clarifying that this decision is limited to this case. The Commission makes no determination as to which methodology should be used in the Company's next rate case, leaving that open for the parties and the Commission to address at that time.

As additionally agreed between the parties, the Commission will also require Xcel to provide the Department with the two Negotiated Transportation Service customer contracts that the Department requested in its Reply Brief to resolve the sales forecasts and class designation for these two customers.

XVIII. Commodity Cost of Gas

A. The Department's Basic Recommendation

Several items in this rate case such as cash working capital, debt interest expense, and taxes, are calculated based on firm revenue, which contains the price of natural gas paid by Xcel. As a consequence, the Department stated, evaluation of the price of natural gas and its ultimate impact on overall revenue requirements is warranted.

Illustrating the impact of the decreasing price of natural gas on Xcel's revenue requirement, the Department stated that a \$0.10 decrease in the commodity cost of natural gas will result, all else being equal, in a reduction in the overall revenue requirement of approximately \$16,000 and that a \$1.00 decrease in the commodity cost, all else being equal, would result in a decrease of approximately \$149,000.

B. Xcel's Position

Xcel stated its willingness to re-examine the base cost of gas throughout the general rate case proceeding and work with the parties to reflect current market data for the base cost included in final rates. The Company submitted testimony stating that using the sales forecast originally filed

and updating the purchased gas expense budget with current market indices resulted in a decrease in Minnesota jurisdictional commodity costs of \$48.9 million. The Company requested that this amount of commodity costs be used to determine the revenue requirement.

C. The ALJ's Report

The ALJ found, as stated by the Department, that some expenses are calculated based on firm revenue, which includes the price of gas. The ALJ noted that the Commission has directed Xcel to update the commodity cost of gas to reflect current market data every two months starting in January 2007 including, at a minimum, the NYMEX futures contract prices as of October 6, 2006, which were used for this base cost of gas filing and, cumulatively, the NYMEX contract futures for the first Friday of the reporting months: January, March, May and July 2007.

The ALJ found that the revenue requirement should be adjusted to meet the most recently filed commodity price available and that no party objected to this approach.

D. The Commission's Analysis and Action

In assessing the impact of the price of natural gas on overall revenue requirements, it is appropriate to use updated commodity cost of gas figures because the price of gas has decreased significantly from the time this rate case was filed. Since the record evidence of this proceeding did not include current price information, the Commission directed Xcel in the New Base Cost of Gas Docket (G-002/MR-06-1578) to file periodic updated commodity gas cost information every two months starting in January 2007. In its petition in that docket, Xcel had expressed willingness to re-examine the base cost of gas throughout the general rate case proceeding and to work with the parties to reflect current market data in the base cost of gas included in final rates. The Commission's intent in approving the Company's petition in that docket and ordering the bi-monthly filings was to include this updated information in the rate case record.⁴

Accordingly, the Commission will direct that the cost of gas initially filed by Xcel be adjusted based on the most recently filed commodity price available, i.e., the cost as of July 6, 2007, which was included in the Company's July 12, 2007 filing in Docket No. G-002/MR-06-1578. No party disagreed with this approach.

⁴ *In the Matter of the Application of Northern States Power Company, a Minnesota Corporation and Wholly Owned Subsidiary of Xcel Energy Inc., for Approval of a New Base Cost of Gas for Interim Rates*, Docket No. G-002/MR-06-1578, ORDER SETTING NEW BASE COST OF GAS (January 4, 2007), page 2.

XIX. Federal and State Income Taxes

A. Background

In Xcel's 2005 electric rate case, the Commission decided that Xcel should recover, on a stand alone basis, its federal and state income tax liability in rates. In doing so, the Commission rejected the position, renewed by the RUD-OAG in this rate case, that Xcel should not recover in rates any amount of tax liability that was not ultimately paid to state or federal tax authorities. In rejecting the RUD-OAG's position, the Commission reviewed and adopted the extensive findings and rationale of the ALJ in that case. In addition to incorporating the ALJ's sound analysis, the Commission's Order explained in detail the importance of the Commission's long-established rate-making principles that supported its decision.⁵

B. The RUD-OAG's Position

In this docket, the RUD-OAG restated its opposition to Xcel's rate recovery of its tax liability on a stand alone basis and again requested that the Commission limit the income tax component of the rates to the amounts actually paid by the Company.

In its exceptions to the ALJ's Report, the RUD-OAG stated that the ALJ had accurately summarized the RUD-OAG's position but had provided no reason for departing from the regulatory principle that rates should recover only costs actually incurred. The RUD-OAG urged the Commission to adopt the actual taxes paid approach and stated that the fact that the Commission had not adopted that approach in Xcel's electric rate case did not justify not doing so in this case.

C. The ALJ's Report

The ALJ summarized the RUD-OAG's position opposing Xcel's proposal to recover \$14.164 million state and federal income taxes in its rates. The ALJ then referenced the Commission's Order rejecting the RUD-OAG's position on that issue in Xcel's 2005 Electric Rate Case and concluded that there was no need to revisit the issue in this proceeding.

D. The Commission's Analysis and Action

The ALJ's Report essentially incorporated the Commission's decision and rationale on this issue in Xcel's 2005 Electric Rate Case. The Commission has reviewed that decision and finds its approach and rationale in deciding the income tax issue is thorough and appropriate.

⁵ *In the Matter of the Application of Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Electric Service in Minnesota*, Docket No. E-002/GR-05-1428, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER; ORDER OPENING INVESTIGATION (September 1, 2006), pages 21-24.

In that Order, the Commission stated, among other things, as follows:

While the challenge to rate recovery of the income tax expense may have superficial appeal, disallowing rate recovery in this case would be both result-driven and inconsistent with the cost- and benefit-allocation principles the Commission has applied to all Minnesota gas and electric utilities over the past twelve years.
[footnote omitted]

These allocation principles, modeled after the cost separations procedures of the Federal Communications Commission, were developed and adopted after a lengthy, industry-wide proceeding to determine how to protect ratepayers from the potentially adverse consequences of utility diversification into unregulated enterprises. They have proven clear and effective and have become an essential regulatory tool.

.....

It is far more important to protect ratepayers from loss than to give them opportunities for windfalls. While ratepayers will not be harmed by missing a chance for a tax break they had nothing to do with creating, they would be harmed by paying higher rates to cover losses from unregulated investments they had nothing to do with making.

It would be imprudent to throw off the protections that have shielded ratepayers from the adverse impacts of twelve turbulent years of unregulated utility investments, in order to claim a tax refund that might not exist, had those protections not spared ratepayers the consequences of a catastrophic unregulated investment.⁶

The RUD-OAG has identified no weakness in the Commission's analysis of the income tax issue provided in the September 1, 2006 Order in Docket No. E-002/GR-05-1428. Nor has it shown any reason why that Order should not provide appropriate precedent on that issue for this case. Accordingly, the Commission will adopt the ALJ's recommendation and not revisit this issue.

XX. NSP Loaned Executive

A. The RUD-OAG's Position

In its Initial Brief filed May 30, 2007 after the close of evidentiary hearings, the RUD-OAG stated that in light of Xcel's donation of the services of Cynthia Leshner, president and CEO of Northern States Power Company-Minnesota, to serve as president of the Minnesota Host Committee for the Republican National Convention, the Commission should disallow rate recovery of Ms. Leshner's

⁶ Id. At pages 22-23.

compensation. The RUD-OAG characterized Xcel's loan of Ms. Lesher's services as a monetary contribution to the Host Committee in the amount of Ms. Lesher's compensation as President and CEO of NSP and argued that this contribution did not qualify for recovery as a prudent charitable contribution under Minn. Stat. § 216B16, subd 9.

The RUD-OAG also argued that in these circumstances the amount of Ms. Lesher's compensation was comparable to expenditures for political advertising designed to influence or having the effect of influencing public attitudes towards legislation or proposed legislation. The RUD-OAG argued that rate recovery of expenditures for such political advertising (the provision of executive services in this case) was prohibited by Minn. Stat. § 2176B.16, subd. 8(a).

Finally, the RUD-OAG stated that the statute authorizing the rate recovery of expenses incurred in economic and community development applied only if ratepayer benefit from such expenses could be shown. The RUD-OAG indicated that Xcel had not show the ratepayer benefit resulting from the identified expense.

The RUD-OAG concluded that the expenses associated with the donation of Ms. Lesher's services to the Republican National Convention host committee should be disallowed as a "known and measurable change" in test year expenses. The RUD-OAG estimated the amount of Ms. Lesher's compensation and, hence, the amount included in the 2007 test year due to her employment and being donated by Xcel to the Republican National Convention host committee, to be approximately \$2,000,000.

B. Xcel's Position

In its Reply Brief, Xcel stated that it had announced the loan of Ms. Lesher in a press release on January 16, 2007 and that if the RUD-OAG had raised its objection regarding Ms. Lesher's compensation in its Direct Testimony, the Company would have filed testimony addressing the issue in its Rebuttal Testimony.

The Company made an offer of proof, stating that it would have filed testimony making the following points:

- Like the fuel cost adjustment proposed by the Department, it is inappropriate to consider isolated changes to the overall 2007 budget. As Mr. Jeffery Robinson testified: "I am sure that there are other deviations in both directions that exist for other cost components as well."
- The change in expense related to the loan of Ms. Lesher is not the only change that resulted from this event. Her position was filled, as was her replacement's position. There are normal changes of budgeted staffing levels, both up and down, in any test year and these are not reasons to seek a test-year adjustment, particularly when the Company is not eliminating the position. In the end, the total compensation expenses from these changes are not likely to be appreciably different from those contained in the 2007 budget.

- If an adjustment were made, it would not be anything close to the magnitude implied by the OAG in its Initial Brief. The OAG speculated on the amount of Ms. Lesher's compensation based on a proxy statement that did not include specific information on Ms. Lesher's compensation. In addition, the compensation listed in that proxy statement for other executives does not reflect the fact that the rate increase request: (i) eliminated all executive long-term compensation; and (ii) capped the amount of requested incentive compensation to 25 percent of base salary for all employees. Further, the portion of Ms. Lesher's recoverable compensation allocable to the Minnesota jurisdiction for gas operations would be relatively small.
- If an adjustment was appropriate, after making the proper disallowances, jurisdictional allocations and offsetting changes in the compensation for other employees, the adjustment would be \$8,457.

C. The ALJ's Report

The ALJ noted the RUD-OAG's objection and Xcel's responses and concluded that because Xcel had no opportunity to address the issue prior to or at the evidentiary hearing and had cast significant doubt on the RUD-OAG's claim, the record failed to support an adjustment to the Company's 2007 test year expenses to reflect Ms. Lesher's loaned executive status.

D. The RUD-OAG's Exception to the ALJ's Conclusion

Regarding the ALJ's finding that Xcel had no opportunity to address the issue prior to or at the evidentiary hearing, the RUD-OAG stated that it had brought the rate case implications of the loan to the attention of the ALJ as soon as it became aware of the loan, which was subsequent to the filing of its testimony but in time for inclusion in its Initial Brief. More fundamentally, the RUD-OAG argued that the Company had the burden of proof with respect to the expense in question and that it had the obligation to report in its Rebuttal Testimony the loan of Ms. Lesher to the Republican National Convention Host Committee and to adjust its revenue requirement accordingly. In light of this burden of proof, the RUD-OAG argued, the fact that the Company issued a news release announcing the loan of Ms. Lesher in January 2007 was irrelevant to the fact that the Company had not adjusted its requested revenue requirement to reflect the loan.

Regarding the ALJ's substantive finding that the record regarding the loaned executive did not support an adjustment to the revenue requirement, the RUD-OAG continued to maintain that recovery of the loaned executive's compensation should be disallowed because it is inappropriate and contrary to Minnesota law and precedent. The RUD-OAG again cited the charitable contribution statute, the political advertising statute, and the community development expense statute and argued that they mandate disallowance of the expenses in question. The RUD-OAG concluded that the donation of Ms. Lesher's services is a "known and measurable change" which occurred in the test year and that because it does not provide ratepayer benefit, expenses associated with it should be disallowed.

E. The Commission's Analysis and Action

The RUD-OAG faulted Xcel for not filing, as part of its Rebuttal Testimony, an adjustment to its revenue requirement reflecting the fact asserted by the RUD-OAG, that the loaned executive's compensation continues to be included in the Company's test year expenses. The RUD-OAG's assertion appears to rest on the premise that the Company will not incur equivalent expenses employing personnel to replace the utility-related services she had been expected to provide during the test year.

Based on the information provided by the Company, the Commission concludes that Ms. Lesher's compensation during the time she is loaned to the Republican National Convention Host Committee will not be paid from rates and that the amount of compensation paid to secure replacement personnel due to Ms. Lesher's absence essentially substitutes for the compensation required prior to Ms. Lesher's departure. Specifically, the Company stated that Ms. Lesher's position was filled, as was her replacement's position, so that the total decrease in actual employee compensation attributable to Xcel's gas utility due to Ms. Lesher's departure is \$8,457. Calculation of this amount, the Company explained, takes in to consideration the facts 1) that the Company's rate request eliminated all executive long-term compensation and capped the amount of requested incentive compensation to 25 percent of base salary for all employees and 2) that the portion of Ms. Lesher's recoverable compensation allocable to the Minnesota jurisdiction for gas operations would be relatively small.

Xcel stated that there are always changes in budgeted staffing levels, both up and down, in any test year. The Company argued that such changes are no reason to require a test-year adjustment, particularly when the Company is not eliminating the position and the total compensation expenses from these changes are not likely to be appreciably different from those contained in the 2007 budget. At the oral argument, however, the Company stated that it did not oppose reducing the revenue deficiency by \$8,457, the amount it had calculated as the total decrease in actual employee compensation attributable to Xcel's gas utility due to Ms. Lesher's departure.

Taking into consideration the ALJ's findings and the unique circumstances of this case, the Commission finds that Xcel's agreement to adjust the revenue requirement downward by \$8,457 to reflect the actual decrease in recoverable compensation allocable to the Minnesota jurisdiction for gas operations produces a reasonable result and will accept it.

To conclude, the Commission emphasizes that the Company has affirmed and the record substantiates that no portion of Ms. Lesher's compensation while on loan to the Republican National Convention Host Committee is to be paid from rates.

XXI. Financial Schedules

A. Gross Revenue Deficiency

The above Commission findings and conclusions result in a Minnesota jurisdictional gross revenue deficiency of \$11,938,000 plus \$2,500,000 for the affordability program for an overall revenue deficiency of \$14,438,000 as shown below:

Revenue Requirements Summary
Test Year Ending December 31, 2007
(Dollars in Thousands (\$,000))

Average Rate Base	\$438,319
Rate of Return	8.37%
Required Operating Income	<u>\$36,687</u>
Operating Income	<u>\$29,688</u>
Income Deficiency	\$6,999
Gross Revenue Conversion Factor	<u>1.705611</u>
Gross Revenue Deficiency	\$11,938
Affordability Program	<u>\$2,500</u>
Total Revenue Deficiency	<u><u>\$14,438</u></u>

B. Rate Base Summary

Based on the above findings, the Commission concludes that the appropriate rate base for the test year is \$438,319,000, as shown below:

Rate Base Summary
Test Year Ending December 31, 2007
(Dollars in Thousands (\$,000))

PLANT IN SERVICE	
Production	\$13,953
Storage	\$30,731
Transmission	\$48,809
Distribution	\$686,392
General	\$14,928
Common	\$58,271
TBT Investment	\$0
Total plant in Service	<u>\$853,084</u>
RESERVE FOR DEPRECIATION	
Production	\$10,974
Storage	\$21,642
Transmission	\$19,248
Distribution	\$294,532
General	\$7,283
Common	\$36,003
Total Reserve for Depreciation	<u>\$389,682</u>
NET PLANT IN SERVICE	\$463,402
Construction Work in Progress	\$12,432
Less: Accumulated Deferred Income Taxes	\$69,632
Cash Working Capital	(\$2,807)
Other Rate Base Items:	
Materials and Supplies	\$1,641
Gas in Storage	\$47,387
Non-plant Assets & Liabilities	(\$17,980)
Prepayments	\$7,731
Customer Advances	(\$1,410)
Other Working Capital	(\$2,445)
Total Other Rate Base Items	<u>\$34,924</u>
TOTAL AVERAGE RATE BASE	<u><u>\$438,319</u></u>

C. Operating Income Summary

Based on the above findings, the Commission concludes that the appropriate Minnesota jurisdictional operating income for the test year under present rates is \$29,688,000 as shown below:

Operating Income Summary
Test Year Ending December 31, 2007
(Dollars in Thousands (\$,000))

OPERATING REVENUES

Retail	\$679,504
Weather Impact Net Margin Adjustment	\$0
Interdepartmental & Transportation	\$17,157
Other Operating	\$5,692
Gross Earnings Tax	\$0
Total Operating Revenue	<u>\$702,353</u>

UTILITY OPERATING EXPENSES

Purchased Gas	\$558,139
Other Production	\$3,206
Transmission	\$1,066
Distribution	\$22,736
Customer Accounting	\$13,135
Customer Service & Information	\$5,457
Administrative & General	\$16,184
Amortization	\$450
Sales, Econ Dvlp & Other	\$78
Total Operating Expenses	<u>\$620,451</u>

Depreciation \$28,369

Taxes

Property	\$14,014
Gross Earnings	\$0
Deferred Income Tax & ITC	\$2,142
Federal & State Income Tax	\$6,958
Payroll & Other	\$2,156
Total Taxes	<u>\$25,270</u>

Total Expenses \$674,090

Allowance for Funds Used During Construction \$1,425

Utility Operating Income \$29,688

XXII. Rate of Return

A. Background

In any rate case, the Commission needs to determine the appropriate overall rate of return, which is then applied to the rate base — the investment needed to provide service — to help determine the revenue requirement.

The overall rate of return reflects the relative proportions of securities comprising the capitalization of the Company, and their respective costs. As a general rule, the cost rates of long- and short-term debt may be directly observed, and are not always a matter of controversy. In this case, all parties agreed on these costs.

In addition, the parties in this case agreed on the capital ratios. The results of these agreements are shown below:

Type of Capital	Capital Ratio	Cost (%)	Weighted Cost (%)
Long-Term Debt	45.76%	6.97%	3.19%
Short-Term Debt	2.26%	5.81%	0.13%
Common Equity	51.98%		

The positions of these parties on the cost of common equity and resultant overall rate of return are summarized as follows:

Party	Cost of Common Equity	Weighted Cost	Overall ROR
Xcel Energy	10.75%	5.59%	8.91%
Department	9.50%	4.94%	8.26%
RUD-OAG	9.26%	4.81%	8.13%

B. The ALJ's Report

At the outset, the ALJ cited the Commission's statutory responsibility to set rates that are just and reasonable and to balance consumer and utility interests. The ALJ noted that this balance includes setting rates that allow a utility to earn an appropriate return, a return that will allow the utility to compete for funds in capital markets. Return on equity (ROE), the ALJ stated, is a market-based

concept but since NSP is a wholly owned subsidiary of Xcel Energy and, as such, has no publicly traded stock, it is necessary to establish the Company's appropriate level of ROE through use of a group of publicly-traded companies similar in risk to NSP. In this case, witnesses for all parties advocating a rate of return using groups consisting of stand-alone natural gas distribution utilities.

As the ALJ stated, the Commission has historically relied upon the Discounted Cash Flow (DCF) analysis to derive ROE for rate cases.⁷ The ALJ stated that the DCF analysis is the most widely accepted model and one that has been used consistently as a starting point for establishing the cost of equity in public utility cases before the Commission.

The ALJ reviewed in detail the DCF analyses sponsored by the Company, the Department, and the RUD-OAG, carefully examining the components of each party's proposed Comparison Group and evaluating their rationales for adjusting the results. The ALJ noted that although each party proposing an ROE figure began its analysis with the DCF analysis, they all reached different results due to differences in 1) the groups of companies selected for comparison (Comparison Groups), 2) the length of time included in the determination of average stock price, and 3) other variables.

1. Comparison Group Issues

Regarding Comparison Group differences, the ALJ, after detailed analysis, rejected the Company's major challenge to the Department's Comparison Group, concluding that the Company had not provided convincing evidence that four companies (AGL, Laclede, New Jersey Resources and Piedmont) should be dropped from the Comparison Group. The ALJ found that the appropriate Comparison Group should include AGL, Laclede, New Jersey Resources, Piedmont, Atmos, Cascade, Northwest, and South Jersey Industries.

2. Length of Trading Period

Regarding the length of time used in determining the average stock price, the ALJ assessed the Company's proposed 360-day trading period and the Department's proposed 20 -day trading period. The ALJ concluded that the Department's use of a 20 trading-day period is a reasonable means of mitigating possible anomalies of any one trading day. Moreover, the ALJ reasoned, the Department's approach is consistent with DCF theory that the most current day of equity prices best reflects the views of investors, weighing the most current information. The ALJ concluded

⁷ The DCF analysis assumes that the price an investor is willing to pay for a given stock is based on the expected cash flow from future dividends from that investment. In simple terms, the DCF analysis adds the stock's projected growth rate to the current dividend yield of the stock.

that the appropriate return on equity should be determined on the basis of the Department's twenty-day trading average for the Comparison Group because a twenty trading-day period is more consistent with the model than the Company's proposed 360-day period, which places undue weight on historical events.

3. Other Considerations

The ALJ addressed several Company arguments that the DCF results must be adjusted upward to yield reasonable results.

First, the ALJ noted the Company's contention that the DCF results are skewed because stocks are overpriced due to merger and acquisition speculation. The ALJ found no evidence in the record to support the Company's claim that such speculation influenced the higher stock prices rather than lower interest rates, strong, overall performance by the utility sector, or other factors. The ALJ further noted that both the Company and the Department included in their Comparison Groups a company with a known pending merger (Cascade) because both concluded that its stock price was not significantly affected by the pending merger.

Second, the ALJ assessed the Company's claim that the cost of debt and the cost of capital have increased since the prior natural gas rate cases. The ALJ found that the Company's claim is not supported in the record, noting that a comparison of the cost of debt used in prior cases and in this case does not support NSP's claim. In addition, the ALJ found, the RUD-OAG offered additional evidence to explain why the cost of equity for utility companies has stayed low, and with a low premium above short-term and long-term bonds.

Third, the ALJ cited with apparent approval the Department's rebuttal of the Company's claim that its DCF-derived ROE figure should be raised because it faces higher risk than other companies in the Comparison Group. The Department objected that the Company adds a risk premium, the Company's subjective perception of forward-looking risk. The Department argued that since the DCF model already includes investor risk analysis in the analysis, the Company's addition of a risk premium is double counting the effect of risk on ROE.

The ALJ concluded that the Department's proposed ROE of 9.50 percent is reasonable. The ALJ found that the Company's use of multiple forecasting tools, the selective rejection of results, and the additional consideration of risk are all indicative of efforts to substitute judgment for analysis. The ALJ stated that the Company's final proposed ROE, 10.75 percent, exceeds even the range of results achieved by the weighted DCF analysis relied upon by NSP's expert. By contrast, the ALJ stated, the Department witness's use of the previously accepted methodology is strong evidence that his results reflect an appropriate range of returns that are sufficient to attract investment

capital. The ALJ found that due to the Capital Asset Pricing Model (CAPM) analysis,⁸ applying the highpoint of the range for the Department's range for ROE (9.50 percent) is a reasonable means of assuring that the interests of shareholders and ratepayers are balanced.

Further, the ALJ indicated that the data provided by the Company regarding ROE awards in other jurisdictions and its argument based on that data that the Department's and the RUD-OAG's recommended ROEs are out of line with ROEs approved in other jurisdictions was insufficient to render the ALJ's selection of the Department's proposed ROE unreasonable. The ALJ found that both the Department and the RUD-OAG had raised legitimate questions about the Company's data.

Specifically, the ALJ noted the Department rejected the Company's data regarding ROEs authorized in other jurisdictions because, among other reasons cited, the Company had not separated combination electric and gas utilities from stand-alone gas distribution utilities and there was no way to tell whether the Company's provided chart of 2006 awards is representative of stand-alone natural gas distribution companies and that the chart of 2007 awards was incomplete. The ALJ also noted the Department's argument that an ROE below the mean of those cited from other states does not show that an ROE below that mean is unreasonable since awards will naturally fall on both sides of the mean and its proposed ROE (9.50 percent) did fall within the range of ROE awards cited by the Company.

The ALJ also noted the RUD-OAG's argument that although investors and rating agencies have had, in general, a favorable impression of the Minnesota regulatory environment, many factors influence this impression and there is no evidence that recent awards to CenterPoint of an ROE of 9.71 percent and to Great Plains of an ROE of 9.72 percent had an appreciable effect on that overall impression.

⁸ See ALJ Finding of Fact 67: "In order to test the validity of his predicted DCF analysis, Mr. Reed evaluated three Capital Asset Pricing Model (CAPM) scenarios. The CAPM approach looks at the likely risk-free rate of return and then applies a risk premium appropriate to the industry. The mean result of Mr. Reed's CAPM analysis was 10.73 percent. Based on his review of the data, analyst estimates, and his view that a premium should be applied because NSP does not have a weather-normalization component to its rate, Mr. Reed's recommended ROE was 10.75 percent." See also ALJ Findings of Fact 81 and 82: "Dr. Griffing also applied a CAPM analysis, based on the intermediate-term government bond rate of 5.4 percent. The outcome was 10.41 percent, outside the high end of Dr. Griffing's DCF ROE results." "As he did in his direct testimony, Dr. Griffing adopted the high end of his DCF ROE results because of the CAPM analysis. . . ."

See also ALJ Finding of Fact 95 regarding the ALJ's view of the relative usefulness of CAPM: ". . .reliance on DCF analysis is generally considered a better measure of future ROE than the more historically oriented CAPM results."

In final comments on the issue, the ALJ raised the possibility that updated information for 2007 awards in other jurisdictions might require an adjustment in the 9.50 percent figure to remain in line with the approved awards in other jurisdictions for 2006 and 2007.

C. Xcel's Exceptions to the ALJ's Findings Regarding Return on Common Equity

Xcel did not identify particular findings of the ALJ to which it took exception, but instead excepted generally to the ALJ's recommendation regarding ROE. The key points of the Company's argument in its exceptions to the ALJ's Report are summarized in the following paragraphs.

Xcel stated that the record on this matter demonstrates the accuracy of the Commission's prior observations that "setting the rate of return on equity is not like solving an equation -- there is no right answer," and that "empirical models are decision-making tools whose usefulness does not extend to dictating outcomes."⁹ The Company argued that fairness and reasonableness of the ROE must be judged on the result reached, not the basis of the theory applied or the inputs used in a particular model. Accordingly, to ensure that the ROE in this proceeding is fair and reasonable, the Company stated, the Commission must also consider the practical impacts of its ROE decision and reconcile the results of the empirical models (not merely the inputs to those models) to other factors within its expertise. As a result, the determination of the appropriate ROE in this case is a matter for the Commission's informed judgment.

Xcel further advised that the substantial evidence rule authorizes the Commission to make appropriate adjustments and to select an ROE that is different from the recommendations of any particular witness. The Company noted that the testimony of its witness provided substantial evidence justifying an ROE of 10.50 percent to 10.75 percent. The Company asserted that the record clearly establishes that the ROE should be not lower than 10.25 percent.

Xcel stated that the Commission's ROE determination will have an impact on the Company that greatly exceeds the revenues that directly flow from that ROE determination. The Company stated that this impact merits serious consideration. The Company stated that the heightened impact of the ROE decision results from the facts that Minnesota is its primary jurisdiction and the Company has very extensive investment plans that include not only its natural gas operations, but

⁹ *In the Matter of a Petition by Interstate Power and Light Company for Authority to Increase Electric Rates in Minnesota*, Docket No. E-001/GR-03-767, ORDER AFTER RECONSIDERATION AND AMENDING MODIFICATION TO SETTLEMENT (July 1, 2004) at page 4.

also its far more extensive electric operations. The Company asserted that investors are likely to draw inferences concerning prospects for the Company's electric service operations from the Commission's decision in this proceeding. As a result, the Company cautioned, a very low ROE award for the Company could have an adverse impact on both the cost of the Company's investment plans and its ability to complete those plans.

Xcel stated that the ALJ invited the Commission to consider the gap between the 9.5 percent ROE recommended by the Department and the mainstream of ROEs awarded by other state utility commissions, along with the results of further decisions occurring in 2007. The Company stated that the gap remains very wide.

Xcel stated that the Department's recommendation of 9.5 percent would be one of the lowest ROE awards in the nation within the last three years, and the Commission would be one of only two states with three (or more) ROE awards below 10.00 percent much less below 9.75 percent. The Company stated that the ALJ's alternative recommendation (to add to the comparable group) would result in a 9.4 percent ROE, which would be the lowest ROE awarded in the nation in the last three years.

Xcel stated that the Commission's decision on this issue will have very significant policy implications. The Company stated that Commission has had a longstanding practice of awarding moderate ROEs that are neither at the top, nor at the bottom, of the ROE awards. The Company stated that making another ROE determination that was at the bottom of the nationwide average would signal a radical change from the Commission's past practice. Such a change, the Company asserted, would be clearly recognized because investors and debt rating agencies are keenly aware of regulatory trends, and ROE decisions are readily and easily compared. The Company requested that the Commission should not change its policy of moderation since there is substantial evidence in the record that would support a ROE that would continue its traditional practice of moderation.

D. The Department's Exceptions to the ALJ's Report

The Department took exception to the ALJ's Finding 106 in which the ALJ suggests that the Commission consider updated information on the 2007 ROE awards in other jurisdictions prior to reaching its decision on the ROE issue. The Department argued that the ALJ had properly found that the Department's methodology to compute ROE was better justified than the Company's and should be adopted. The ALJ also properly found, according to the Department, that the Company had not demonstrated that its proposed ROE strikes an appropriate balance between the interests of shareholders and the interests of ratepayers. Having made these appropriate findings, the Department argued, the ALJ erred in suggesting that the Commission substitute judgement for

analysis by comparing ROE awards in other jurisdictions to the Department's DCF results and then adjusting the recommended ROE (9.50 percent) to come in line with the approved awards in other jurisdictions for 2006 and 2007.

The Department also asserted that the record is insufficient to establish whether the information from other jurisdictions is, in fact, truly comparable to the Company's particular set of circumstances in Minnesota.

The Department concluded that using ROE results in other jurisdictions to increase or decrease DCF ROE results would establish a new standard impacting all regulated electric and natural gas utilities in Minnesota. If the Commission wishes to consider its use, the Department argued, the Commission begin a separate all-utility proceeding and give all interested parties an opportunity to comment.

The Department also took exception to the ALJ's Finding 93 in which the ALJ included Northwest and excluded Southwest Gas from the ALJ's approved Comparison Group.

The Department argued that Northwest should be excluded because it was outside of the bond rating screen. The Department noted that it had a higher rating than the range centering on NSP's A-/BBB+ bond rating, and that its exclusion was justified because it was sufficiently less risky than Xcel. In addition, the Department said that the eight members of its Comparison Group make up a large enough group that it is unnecessary to tweak the bond rating criterion in order to add one company, Northwest, to the group.

The Department requested the Commission to adopt its surrebuttal analysis that yielded a Comparison Group of AGL Resources, Atmos Energy, Cascade Natural Gas, Laclede Group, New Jersey Resources, Piedmont Natural Gas, South Jersey Industries, and Southwest Gas (with Southwest's individual ROE results being dropped from the analysis because they were too low to be consistent with other group members' results).

E. The RUD-OAG's Position Regarding the ALJ's Findings Regarding Return on Common Equity

The RUD-OAG did not take exception to the ALJ's findings and conclusions regarding return on equity.

F. The Commission's Analysis and Action

1. Summary

Having reviewed the record including the oral arguments provided by the parties, the Commission finds that a 9.71 percent cost of equity is reasonable for the Company, is in the public interest, and is supported by substantial evidence in the record. The Commission will therefore approve an overall rate of return and rates using that figure for the cost of equity. The Commission's reasoning in reaching that figure is as follows.

2. Selection of the RUD-OAG's Analysis

First, while the results of DCF analysis are not determinative of an exact figure for the cost of equity, the Commission has traditionally used DCF analysis as a sound starting point in determining a reasonable return on equity. In this case, the Commission's selected cost of equity figure (9.71 percent) is supported by a reasonable application of the DCF analysis. Specifically, the figure is at the high end of the reasonableness range identified by the RUD-OAG's DCF analysis, which the Commission has examined and found to be sound. In its review of the parties' various DCF analyses, the ALJ preferred the Department's DCF analysis, but made detailed findings regarding the RUD-OAG's analysis that demonstrate its reasonableness as well. The RUD-OAG's DCF analysis is described as follows:

a. Comparison Group

For its Comparison Group, the RUD-OAG eliminated two companies that Xcel and the Department included. The RUD-OAG eliminated Cascade from its group because it was in the process of merging and because its dividend payments had not increased in ten years. Although these factors were considered by the Company and the Department, they determined that Cascade met their criteria for inclusion. The RUD-OAG also eliminated Southwest Gas because it had no dividend growth for the last 10 years and is not expected to increase payments, and because Southwest has a high, long-term debt ratio and negative earnings growth per share from 1999 through 2003.¹⁰ In addition, Zacks did not provide an earnings growth estimate for Southwest, and, as the Department determined, the Yahoo! Finance estimate dropped to 3.0 percent as of

¹⁰ The RUD-OAG also challenged Company's use of the April 2, 2007 Yahoo! Finance analyst estimate of 12 percent for Southwest's earnings growth in light of the reported decline to 2.16 percent shortly thereafter on April 19, 2007.

April 11, 2007.¹¹ Given the significant variation in results caused by the inclusion of Southwest, and disparate growth estimates for that company, it is appropriate, as the RUD-OAG recommended, to drop it from the Comparison Group.

The RUD-OAG, like the Company, included Northwest in its Comparison Group.

Although NSP eliminated AGL, Laclede and Piedmont, the RUD-OAG did not agree that they should be excluded. AGL should not be excluded, the RUD-OAG argued, because contrary to the Company's assertion, AGL is not sufficiently different from other natural gas distribution companies to warrant elimination from the sample group. Regarding Laclede and Piedmont, the RUD-OAG argued that the comparatively small spread between their mean DCF results and current corporate long-term bond yield did not warrant their exclusion.

In sum, the RUD-OAG included Atmos Energy, AGL Resources, Laclede Group, New Jersey Resources, Northwest, Piedmont and South Jersey Industries in its Proxy Group. Based on the RUD-OAG's explanations for the composition of its Comparison Group, the Commission finds that its group is reasonably representative.

b. Length of Trading Period

In estimating the dividend yield for the Comparison Group, the RUD-OAG took the average of the stock prices for the Comparison Group for two different lengths of time: (1) three months; and (2) one year, making an adjustment for dividend growth in the first year. The RUD-OAG explained that the time period for estimated dividend yield in regulatory proceedings should be current but of sufficient length to mitigate short term aberrations in the market. The Commission finds that the RUD-OAG's method reasonably meets those two goals.

c. Growth Rates

The RUD-OAG used an estimate for growth rates based on the average of expected growth from Value Line and Zacks. The RUD-OAG did not use information taken from Yahoo! Finance, but accepted that its use was appropriate and that its growth rates were consistent with other estimates, except for the growth rate estimate for Southwest Gas, as indicated above. The RUD-OAG used an earnings growth rate of 5.59 percent, the same as the maximum growth rate established by the Department.

¹¹ The ALJ noted that if the Value Line growth estimate of 8 percent is used for Southwest the Company's DCF ROE estimate declines to approximately 9.64 percent.

d. RUD-OAG's Range

Based on its DCF formula, the RUD-OAG found an equity range of 8.58 percent to 9.52 percent with an average of 9.08 percent based on the average stock prices for the last three months of 2006, and using stock prices for the full 2006 calendar year, it found an equity ranges of 8.85 percent to 9.71 percent.

3. Commission's Selection of the ROE

Having considered the testimony and arguments of all parties, the Commission concludes that 9.71 percent is an appropriate rate of return on equity for Xcel in this case. While this decision departs from the precise number recommended by the ALJ (9.50 percent), the Commission notes that the ALJ's comments in her Report make her recommendation of that specific figure somewhat provisional. In fact, the Commission believes its selection of 9.71 percent is consistent with her approach in that it slightly adjusts her number upward, as she suggested the Commission may find appropriate. In light of the entire record and applying the Commission's considered judgement, the Commission finds that it is appropriate to adjust the ALJ's recommended figure slightly upward to 9.71 percent for several reasons.

First, the Commission notes that the 9.71 percent figure is only slightly above the Department's recommendation and is within the DCF ranges established by both the Company and the RUD-OAG. To illustrate, the Company's DCF analysis established a range of 8.68 percent to 10.52 percent, with a mid-point (9.60 percent) slightly below the Commission's selection, 9.71 percent. The 9.71 percent figure is at the high point on the RUD-OAG's scale of reasonable ROEs, but is fully supported by its DCF analysis, which the Commission has reviewed carefully (see discussion in preceding sections) and found reasonable in all respects.

Second, as the ALJ noted, the Department pointed out that an ROE in the 9 percent range is consistent with statements from investors and advisors that the required return on stock is 500 basis points or less above the long-term Treasury bond. The ALJ found that with current bond yields below five percent, this would suggest that the required ROE for typical stock would be about 10 percent, with a lower return for a utility stock. This analysis supports the reasonableness of the Commission's selection of a 9.71 percent ROE.

Third, as the ALJ herself suggested, the Commission has taken administrative notice of a list of updated ROE decisions from other jurisdictions provided by the Company. The ALJ suggested that updated information on those decisions might support adjusting her 9.5 percent ROE recommendation upward. While the probative value of ROEs set in other jurisdictions is limited because the record does not allow the Commission to assess the differing regulatory circumstances

affecting those awards, they do provide some window to national context and, as such, can serve a limited function as a check on reasonableness. The Commission's upward adjustment from 9.50 percent to 9.71 percent is not inconsistent with those decisions.

Fourth, much more probative of the reasonableness of an ROE for the Company are the ROEs that the Commission has recently granted gas utilities in Minnesota: CenterPoint Energy (9.71 percent)¹² and Great Plains (9.72 percent)¹³. Granting Xcel a rate of return on common equity 9.71 percent in this case is very consistent with those returns.

In these circumstances, therefore, the Commission concludes that a 9.71 percent ROE for Xcel is consistent with the ALJ's recommendation, is manifestly reasonable on this record, and will result in rates that allow Xcel to earn an appropriate return, a return that will allow the utility to compete for funds in capital markets.

4. Reasons for Rejecting Xcel's Proposed ROE

By contrast, Xcel has not shown that its proposed ROE is reasonable or that a 9.71 percent ROE is unreasonable. The Company's proposed ROE (10.75 percent) exceeded the range of results achieved by the weighted DCF analysis of its expert witness. As the ALJ found, the Company's use of multiple forecasting tools, the selective rejection of results, and the excessive consideration of risk suggest efforts to substitute judgement for analysis.

For example, the Company contended that the DCF results are skewed because stocks are overpriced due to merger and acquisition (M&A) speculation. But, the ALJ found, there was no evidence in the record to support the claim that M&A speculation influenced the higher stock prices rather than lower interest rates, strong overall performance by the utility sector, or other factors. Further, both the Company and the Department included the one company with a known pending merger, Cascade, in its comparison groups because both concluded that its stock price was not significantly affected.

¹² *In the Matter of the Application of CenterPoint Energy Minnesota Gas, a Division of CenterPoint Energy Resources Corp., for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-008/GR-05-1380, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER (November 2, 2006) at page 37.

¹³ *In the Matter of a Petition by Great Plains Natural Gas Company, a Division of MDU Resources Group, Inc., for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-004/GR-04-1487, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER (May 1, 2006) at page 8.

In addition, the record does not support the significant risk premium advocated by the Company. As the Department argued, the DCF model already includes investor risk in the analysis, so that by including a subjective perception of forward-looking risk, the Company's risk premium model double counted the effect of risk on ROE. In addition, as the RUD-OAG noted and the ALJ found, the Company introduced no evidence to show that recent comparable awards to CenterPoint (9.71 percent) and to Great Plains (9.72 percent) have had an appreciable effect on investors' favorable impression of the Minnesota regulatory environment.

It is understandable that the Company would wish to secure an ROE award at the high end of the reasonableness range since, as it has stated, it has plans to make significant infrastructure investments in the near future. However, the Company has not shown that its proposed ROE is necessary to attract the capital investment it desires. Instead, as the foregoing analysis has shown, it is the Commission's selected ROE (9.71 percent) that is based upon informed judgement, properly balancing the interests of ratepayers and shareholders.

Rate Design

XXIII. Class Cost of Service Study

A. Background

The Commission considers many factors in setting rates, including the cost of providing service. The cost of serving one customer will differ from the cost of serving another. But because similar types of customers impose similar types of costs on a utility, utilities find it useful to group customers into classes for purpose of analysis. Utilities learn about how the cost of serving one class of customer differs from another by conducting a fully distributed, embedded class cost of service study (CCOSS).¹⁴

B. The Parties' Recommendations

Xcel conducted a CCOSS that analyzed its proposed operating costs and return on rate base, and attempted to associate those costs and returns with the particular class of customer responsible for those costs and returns. Xcel's CCOSS is a fully distributed, embedded (or, historical) study. This study is an updated version of what it utilized in its 2004 gas rate case, and is similar to the one

¹⁴ Minn. Rules Part 7825.4300, subp. C.

included in the settlement of the 2004 rate case.¹⁵ Xcel urged the Commission to accept its CCOSS in this rate case, and asserts that this study supports its proposed class revenue apportionment.

The Department reviewed Xcel's CCOSS and generally accepted the methodology as filed. The Department, however, identified an error in the CCOSS study, which did not have an effect on Xcel's proposed rate design. Xcel corrected the error, and the Department submitted Xcel's revised CCOSS.¹⁶ The Department recommended that the Commission accept Xcel's CCOSS with the revision.

The RUD-OAG did not challenge the allocation of costs in the CCOSS for the purpose of allocating joint and common costs; however, RUD-OAG questioned the usefulness of the CCOSS in determining whether each rate class appropriately bears its proportionate share of costs, and whether the design of the rates for each rate class is based on sound economic principles.

C. The ALJ's Recommendation

The ALJ reported that Xcel submitted a corrected CCOSS which the Department did not challenge. The ALJ also noted that the RUD-OAG did not challenge Xcel's allocation of joint and shared costs.

D. Commission Analysis and Action

The Commission accepts the corrected CCOSS, as recommended by the Department. The fully distributed, embedded CCOSS Xcel submitted is generally consistent with what the Company submitted in its last gas rate case in 2005.

The Commission will, however, require Xcel, in its next rate case, to file a CCOSS that separately breaks out its embedded cost for its electric generation and transportation customers by customer class. The Commission will also require Xcel to provide this information for its flexible rate and negotiated transportation service (NTS) customers, by customer class. Finally, the Commission

¹⁵ In the Matter of an Application by Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Natural Gas Service in the State of Minnesota, G-002/GR-04-1511, Order Accepting and Modifying Settlement and Requiring Compliance Filings (August 11, 2005).

¹⁶ Exhibit 6 to Department witness Bonnett's pre-filed direct testimony.

will require Xcel to submit corresponding information in its present and proposed revenue schedules that shows how Xcel proposes to treat these customers for rate making purposes.

XXIV. Class Revenue Apportionment

In the initial stages of the rate case, the issue of how best to allocate the rate increase was hotly contested.

A. Xcel's Recommendation

In developing its initial proposal for class revenue apportionment, Xcel determined the revenue responsibility for the interruptible classes based on the market prices of the customers' typical competitive alternatives. Xcel then apportioned the remaining revenue requirement among the firm classes, attempting to recover as closely as possible the embedded costs allocated to each customer class in the CCOSS while avoiding unacceptably high billing impacts. Xcel argued that its proposal would result in moderate increases for all customer classes, a moderate movement of rates closer to the cost of service, and maintenance of long-standing inter-class rate relationships.

B. The Department and RUD-OAG's Proposals

After review of Xcel's embedded CCOSS, and application of its own competitive value of service analysis, the Department recommended no change in the class revenue apportionment utilized in Xcel's 2004 gas rate case.¹⁷

The RUD-OAG recommended that any rate increase be calculated with gas costs included and that the increase be applied uniformly to all customer classes, to minimize the impact on residential customers.

C. The ALJ's Recommendation

The ALJ recommended that the Commission adopt the Department's recommendation, and apportion the rate increase uniformly across all customer classes, using the same percentage increase for each customer class.

D. Xcel's Exceptions

¹⁷ G-002/GR-04-1511.

Xcel asserted that the proposed across-the-board rate increase on total revenue for all customers would have a disproportionate impact on customer classes with higher per customer gas cost revenues, and transportation customers with no gas cost revenues, who would incur disproportionately large increases in their non-gas rates.

E. Commission Analysis and Action

At oral argument, Xcel presented a modified proposal with respect to class revenue apportionment. Xcel proposed that the Commission authorize a uniform, across-the-board increase for all customer classes, except Xcel's interruptible, transportation, flexible rate and negotiated transportation service customers, based on total class revenue. Xcel further proposed that the Commission authorize a lower increase (50% of overall level) for the interruptible and transportation classes, and no increase for Xcel's flexible rate and negotiated transportation service customers. Finally, Xcel proposed that to the extent possible, existing inter-class rate relationships be maintained.

After discussion, all parties accepted Xcel's modified proposal, and the Commission will adopt it. The proposal is reasonable and has the agreement of all parties hereto.

XXV. Residential Customer Charge

A. Positions of the Parties

Xcel's current residential monthly customer charge is \$8.00. Xcel initially proposed to increase the monthly residential customer charge to \$9.00, arguing this would be an incremental step towards cost.

All other parties opposed Xcel's proposal to increase the residential customer charge, on the bases that: 1) the charge was increased only two years ago from \$6.50 to \$8.00; 2) Xcel's residential customer charge is currently the highest approved by the Commission for any natural gas public utility in Minnesota; and 3) the residential customer charge may also include a new increase to fund the Affordability Program mandated by the Legislature.

B. The ALJ's Recommendation

The ALJ found that Xcel had not shown that an increase in the residential basic charge from \$8.00 to \$9.00 per month was an appropriate adjustment to balance the need to recoup the costs of serving the residential class of customers with the need to encourage conservation, avoid rate shock, and account for other factors between rate classes.

C. Commission Analysis and Action

At the oral argument before the Commission, Xcel announced that it would not pursue the requested increase to the residential customer charge at this time. The Commission will therefore set the residential customer charge at \$8.00 per month.

XXVI. Other Customer Charges

A. Positions of the Parties and ALJ

Xcel initially proposed increasing its basic monthly charge for Small Commercial Firm Service customers from \$20.00 to \$24.00. Xcel also proposed leaving the basic monthly charge the same for all other customer classes (aside from the increase to support the Affordability Program, which will be addressed separately herein).

The Department objected to the proposed increase, because, according to Xcel's CCOSS, the Company's embedded customer costs for the Small Commercial Firm Service customers is \$23.16 per month. Xcel agreed to set the monthly charge at \$23.25 per month. No party opposed that increase.

The ALJ found that it was reasonable to increase the basic charge to the Small Commercial Firm Service customers from \$20.00 to \$23.25.

B. Commission Analysis and Action

Based on changes to the rate structure adopted herein, certain customer charges will require minor modifications. In an attempt to equalize the rate increase impact on a percentage basis for Small and Large commercial customers, the Commission will direct Xcel to make a compliance filing including a revised Small Commercial Firm Service customer charge. The Commission will further direct Xcel to show how that charge maintains existing rate relationships between classes of customers.

Finally, the Commission also requests the Department to assess whether the revised Small Commercial Firm Service customer charge maintains the relationships established herein.

The Commission approves all other customer charges, as agreed to by the parties.

XXVII. Affordability Program

A. Background

In its November 9, 2006 petition, Xcel proposed a \$2.5 million per year low-income affordability and arrearage forgiveness program. Xcel proposed that eligibility be limited to residential customers who receive grants from the Low Income Home Energy Assistance Program (LIHEAP), on a first-come, first-served basis, up to its annual budget.

Subsequently, during the 2007 legislative session, the Minnesota Legislature amended Minn. Stat. § 216B.16, subd. 15, to require public utilities that provide service to low-income customers who use natural gas for home heating to offer a program aimed at assisting low income customers to pay their bills. Natural gas utilities in Minnesota were required to file affordability programs with the Commission no later than September 1, 2007.

Pursuant to the legislative requirement, the parties resolved all issues with respect to Xcel's program, save for the means by which to recover the costs of the program. The Commission therefore approves the Affordability Program, as agreed to by the parties.

B. The Parties' Recommendations Regarding Cost Recovery

Initially, Xcel proposed a \$0.49 per month surcharge assessed to all Xcel customers as the means by which to recover the program's costs. Xcel argued that the Company has operated an electric affordability program since 1994, using the same form of cost recovery. Since Xcel's natural gas customers also take electric service from the Company, which utilizes a combined bill, Xcel argued that using the same methodology for billing would be less confusing.

The RUD-OAG opposed this approach, and argued that the costs of the Affordability Program should be recovered through a volumetric distribution charge rather than a fixed customer charge for all classes of firm customers. RUD-OAG argued that its August 12, 2007 proposal was consistent with the methodology the Commission authorized for CenterPoint Energy's Affordability Program in its 2005 rate case.¹⁸ The Suburban Rate Authority concurred with the RUD-OAG recommendation.

¹⁸ In the Matter of the Application of CenterPoint Energy Minnesota Gas, a Division of CenterPoint Energy Resources Corp., for Authority to Increase Natural Gas Rates in Minnesota, Docket No. G-008/GR-05-1380, Findings of Fact, Conclusions of Law, and Order (November 2, 2006).

At public hearings on the rate case, while many members of the public objected to the Affordability Program, most preferred that, if implemented, the cost of the program should be assessed in proportion to usage (*i.e.*, a volumetric surcharge), and not paid through a flat rate.

C. The ALJ's Recommendation

The ALJ found that Xcel's proposed monthly charge of \$0.49 is not a reasonable mechanism to fund the program. Instead, the ALJ found that an effective monthly charge to the classes of firm sales customers based on a cost per therm conversion was reasonable.

D. Xcel's Exceptions and Recommendation

In its Exceptions, Xcel stated that if a volumetric charge is used, it should be limited to firm customers. Xcel stated that, should the Commission decide that the costs of the Affordability Program be recovered through a per therm rate, it could accept this approach if recovery of Affordability Program expenses excluded Xcel's (firm) flexible rate and negotiated transportation service (NTS) customers.

E. Commission Analysis and Action

1. Affordability Program Surcharge

At oral argument on this matter, after discussion, the parties agreed that assessing costs in proportion to usage, or application of a volumetric surcharge, limited to firm customers and excluding (firm) flexible rate and NTS customers, was reasonable.

The Commission concurs with the parties and the ALJ. Based on the agreement of the parties, and for the reasons articulated by the RUD-OAG and the ALJ, the Commission will require Xcel to recover program expenses from all firm classes of customers, except Xcel's (firm) flexible rate and NTS customers, using a volumetric surcharge. The Commission finds this resolution reasonable, equitable, and well supported in the record.

2. Customer Billing

In its proposed tariff language for the Affordability Program, Xcel proposed to recover the costs of the program in the applicable Customer Charge for all customers, rather than as a separate line item on customer bills.

The issue of whether to require Xcel to disclose the Affordability Program surcharge on customer bills as a separate line item, or allow the Company to recover the program costs in the applicable customer charge, was not a contested issue in the rate case.

At oral argument, the parties disagreed as to the best means by which to address the Affordability Program on the customer bill. The Department argued that the program should be a separate line item on the customer bill, akin to the manner in which CenterPoint Energy separately lists its affordability program.¹⁹ The RUD-OAG concurred with Xcel, stating that its preference was for Xcel to include the program surcharge in the generalized customer charge or distribution charge.

After consideration, the Commission will require Xcel to disclose the low-income affordability program surcharge on customer bills as a separate line item. This will help to promote customer awareness of the program, and maintain consistency with the manner in which CenterPoint Energy has billed customers for its affordability program.

XXVIII. Electric Generation Tariff

In its Notice and Order for Hearing, the Commission directed the parties to address whether Xcel's treatment of costs to support service to electric generation customers in its CCOSS is reasonable; and whether a stand-alone tariff for electric generation service should be established.²⁰

Both Xcel and the Department identified issues that would need to be addressed in order to create a stand-alone tariff for this group of customers. The Department recommended that Xcel address the issue of creating a stand-alone electric generation tariff in its next natural gas rate petition and Xcel has agreed to do so. The Commission concurs with this approach, and will so order.

XXIX. Limited Firm Service

In the settlement agreement between Xcel and the Department which resolved Xcel's 2004 rate case, Xcel changed the way gas costs are allocated to the limited firm service²¹ customers in the Company's purchased gas adjustment mechanism and annual true-up filing. Xcel and the

¹⁹ The manner in which to list the program charge was not a contested issue in the 2005 CenterPoint rate case.

²⁰ Docket No. 06-1429, Notice and Order for Hearing (January 4, 2007).

²¹ Limited firm service allows interruptible customers to purchase the right to firm service at interruptible rates for a specified number of days per year.

Department also agreed to develop a permanent limited firm service rate design to include in its next rate case.

According to the Company, it filed its current rate case earlier than originally anticipated, and the parties did not have time to develop a permanent rate design for this service. Xcel and the Department have agreed that it would be reasonable to continue the current rate design, and that a permanent rate design should be submitted in Xcel's next natural gas general rate case petition. The ALJ concurred with this approach.

The Commission finds this approach reasonable, and will so order.

XXX. End User Allocation Service

In 2002, the Commission ordered an end user allocation service pilot program limited to no more than five customers. In 2005, the Commission made this service permanent, limited participation to no more than fifty customers, and established a monthly rate. In Xcel's last gas rate case, the Commission required Xcel to file a separate End User Allocation Service Cost Study²² to determine whether these customers are paying the correct amount to cover the cost of service.

Xcel submitted its Study, which proposed no changes, in its initial filing in this matter. The Department conducted an audit of Xcel's study, and recommended that the program could continue, but asked that Xcel report any ongoing changes in future rate cases and verify that the associated program costs are fully allocated to the customers who participate.

The Commission finds the Department's recommendation on the End User Allocation Service program to be reasonable, and will so order.

XXXI. Miscellaneous Transportation Tariff Charges and Standard Form Contracts

Xcel proposed numerous miscellaneous tariff changes. The Department conducted a thorough review of the proposed changes, including a review of Xcel's standard form contracts. The Department recommended the Commission approve the tariff changes and the standard form contracts. Based on the Department's recommendation, the Commission will approve Xcel's miscellaneous tariff changes. The Commission will also approve the Company's standard form contracts and require Xcel to file each of its customer agreements in its final rates compliance filing in this docket.

²² End User Allocation Service is an information sharing program that allows Xcel, its customers, and upstream pipelines to manage their daily gas flows. The monitoring program requires that participating customers install metering equipment, and allow Xcel to share the customer's usage with the upstream pipeline.

XXXII. Compliance Filings and Comment Period

The Commission will require Xcel to make a compliance filing within 30 days of the date of this Order, revising schedules of rates and charges to reflect the revenue requirements and the rate design decisions herein. The compliance filing will also contain a proposed effective date for the revised rates and charges and a plan for refunding the difference between the amounts it collected in interim rates and the amount it is authorized to collect in final rates. The Compliance filing will also include such additional information as is detailed in Order Paragraph 28, below.

The Commission will establish a brief comment period to give interested persons a chance to review and comment on the Company's filing. See Order Paragraph 29.

ORDER

1. The Commission accepts and adopts the findings, conclusions, and recommendations of the Administrative Law Judge, except as to the length of the rate case expense amortization period, the rate of return on equity, the class revenue apportionment, application of the affordability program surcharge to the firm flexible rate and negotiated transportation service (NTS) customers, and the Small Commercial Firm Service (CSFS) customer charge, as discussed above in the text of this Order.

Financial Issues

2. The Commission finds that the petitioner in this matter, Northern States Power Company, a Minnesota corporation and wholly owned subsidiary of Xcel Energy Inc. (Xcel or the Company), has demonstrated a test-year revenue deficiency of \$14,438,000, based on an overall rate of return of 8.37 percent.
3. The Commission disallows recovery of the uncollected, unamortized rate case expenses from the Company's previous rate case and determines that the appropriate amortization period for the current rate case expenses is three years.
4. The Commission determines that the average rate base should be increased by \$231,009 and depreciation expense should be decreased by \$359,432 related to New Area Surcharge (NAS) projects.

5. The Commission determines that the cost of vehicle fuel should be based on a price of \$2.80 per gallon with no adjustment required.
6. The Commission determines that the Late Payment Revenues shall be based on four years of history, 2003 through 2006 and that the calculation shall be made as a percentage of revenues with the percentage being the average the percentage late payment revenues are of retail revenues calculated annually for the historical period.
7. The Commission retains the requirement that the Company refund to its customers incentive compensation that is included in rates, but not paid.
8. The Commission reduces the test year bad debt expense by \$43,546 to \$3,150,341.
9. The Commission determines that the amount of the required service extension contribution in aid of construction (CIAC) that was not collected was 8.25 percent and disallows recovery of \$82,485 of service extension costs and the related accumulated depreciation and depreciation expense.
10. The Commission approves the tariff changes proposed by the Department (additions underlined) but deletes the language “in situations where the Company is competing for new customers with another gas utility or other energy provider”:

The Company shall waive any CIAC of \$5.00 or less. The Company cannot at any time recover these costs from existing ratepayers.

Once the Company waives any contribution by new customers for main and service extension costs, the Company cannot at any time recover these costs from existing ratepayers.

11. The Commission determines that the cost of gas should be adjusted based on the most recently filed commodity price available which is the cost as of July 6, 2007 which is included in the filing dated July 12, 2007 in Docket No. G-002/MR-06-1578;
12. The Commission affirms the Commission’s decision in NSP's 2005 Electric Rate Case that income taxes should be determined on a stand alone basis for test year purposes.

- 13. The Commission determines that Xcel’s test year compensation should be reduced by \$8,457 to remove the compensation of Cynthia Leshner allocated to NSP- MN Gas.
- 14. The Commission approves the following capital structure and cost rates:

Type of Capital	Capital Ratio	Cost (%)	Weighted Cost (%)
Long-Term Debt	45.76%	6.97%	3.19%
Short-Term Debt	2.26%	5.81%	0.13%
Common Equity	51.98%	9.71%	5.05%
Total	100%		8.37%

Forecasting Issues

- 15. The Commission approves the Department’s sales forecast for setting rates in this case.
- 16. Xcel shall provide the Department with the two Negotiated Transportation Service customer contracts that the Department requested in its Reply Brief to resolve the sales forecasts and class designation for these two customers.

Rate Design Issues

- 17. The Commission accepts Xcel’s corrected Class Cost of Service Study (CCOSS) and directs Xcel, in its next rate case, to file a CCOSS that separately breaks out its embedded cost for its electric generation and transportation customers by customer class.
- 18. In its next rate case, Xcel shall also include in its CCOSS information breaking out its embedded cost for its flexible rate and negotiated transportation service (NTS) customers by customer class.
- 19. Xcel shall provide corresponding information for its flexible rate and negotiated transportation service (NTS) customers in its present and proposed revenues schedules showing how Xcel proposes to treat these customers for ratemaking purposes.
- 20. The Commission hereby 1) authorizes a uniform, across-the-board increase for all customer classes, except Xcel’s interruptible, transportation, flexible rate and negotiated transportation service customers, based on total class revenue, 2) authorizes a lower

increase (50% of overall level) for the interruptible and transportation classes, and 3) authorizes no increase for Xcel's flexible rate and negotiated transportation service customers. To the extent possible, existing rate relationships shall be maintained.

21. The Commission hereby sets the residential customer charge at \$8.00 per month and approves all other customer charges proposed by the Company, except with respect to the Small Commercial Firm Service customer charge addressed below in Order Paragraph 29, a, 5.
22. The Commission approves the low-income affordability pilot program, except for the proposed low-income surcharge.
23. Xcel shall recover, via a volumetric surcharge, program expenses from all firm classes of customers except Xcel's (firm) flexible rate and NTS customers and shall disclose the low-income affordability program surcharge on customer bills as a separate line item.
24. Xcel shall address the issue of creating a stand-alone electric generation rate class and tariff in its next natural gas rate case.
25. The Commission authorizes Xcel to continue using the current Limited Firm Service (LFS) rate design, but requires Xcel and the Department to develop a permanent LFS rate design that can be included in Xcel's next general gas rate case.
26. In future rate cases, Xcel shall (1) report any changes to the End-User Allocation Service program and (2) verify that this program remains a fully allocated cost of service program (meaning those customers who participate in this program are solely responsible for any associated costs).
27. The Commission hereby approves Xcel's standard form contracts and directs Xcel to file each of its customer form agreements in its final rates compliance filing in this docket.
28. The Commission also approves Xcel's proposed miscellaneous transportation tariff changes.

Compliance Filings

29. Within 30 days of the issuance of this Order, Xcel shall make the following compliance filings in this docket:

- a. Revised schedules of rates and charges reflecting the revenue requirement and the rate design decisions herein, along with the proposed effective date, and including the following information:
 1. breakdown of Total Operating Revenues by type;
 2. schedules showing all billing determinants for the retail sales (and sale for resale) of gas. These schedules shall include but not be limited to:
 - (I) Total revenue by customer class;
 - (ii) Total number of customers, the customer charge and total customer charge revenue by customer class; and
 - (iii) For each customer class, the total number of commodity and demand related billing units, the per unit commodity and demand cost of gas, the non-gas unit margin, and the total commodity and demand related sales revenues;
 3. revised tariff sheets incorporating authorized rate design decisions;
 4. proposed customer notices explaining the final rates;
 5. a revised Small Commercial compliance filing including a revised Small Commercial Firm Service customer charge and showing how that charge maintains existing rate relationships between classes of customers; and
 6. each of its customer form agreements; and
- b. A revised base cost of gas and supporting schedules incorporating any changes made as a result of this rate case, and automatic adjustments establishing the proper adjustments to be in effect at the time final rates become effective;
- c. A calculation of the Conservation Improvement program (CIP) conservation cost recovery charges (CCRCs) based on the decisions made herein and schedules detailing the CIP tracker balance at the beginning of interim rates, the revenues (CCRC and CIP Adjustment Factor) and costs recorded during the period of interim rates, and the CIP tracker balance at the time final rates become effective;

- d. A proposal to make refunds of interim rates, including interest calculated at the average prime rate, to affected customers.
- 30. All comments on compliance filings shall be made within 15 days of the date the compliance filings are filed. No comments are necessary on Xcel's proposed customer notice.
- 31. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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