

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

REC
DEC

Attachment A
Docket Nos. 03I-134E & 04I-098E
Decision No. C04-1566
December 30, 2004
Page 1 Of 15

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IN THE MATTER OF THE EARNINGS TEST)
FOR PUBLIC SERVICE COMPANY OF) DOCKET NO. 03I-134E
COLORADO FOR CALENDAR YEAR 2002)

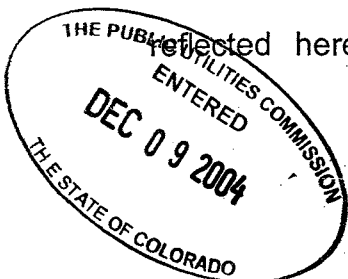
REGARDING THE INVESTIGATION INTO)
THE RELIABILITY OF THE ELECTRIC) DOCKET NO. 04I-098E
DISTRIBUTION SYSTEM OF PUBLIC)
SERVICE COMPANY OF COLORADO)

STIPULATION AND SETTLEMENT AGREEMENT

I. INTRODUCTION

Public Service Company of Colorado ("Public Service" or "the Company"), the Staff of the Colorado Public Utilities Commission ("Staff"), and the Colorado Office of Consumer Counsel ("OCC"), collectively referred to as the "Parties" hereby enter into this Stipulation and Settlement Agreement ("Agreement") resolving all issues that have been raised or could have been raised in the 2002 Electric Earnings Test and Reliability Investigation proceedings. This Agreement sets forth all the terms and conditions of such settlement.

The Parties to this Agreement state that the results of the compromises reflected herein are a just and reasonable resolution of the issues that have been raised in the 2002 Earnings Test and Reliability Investigation proceedings, and that reaching agreement as set forth herein by means of a negotiated settlement is in the public interest. Each Party hereto pledges its support of this Agreement and states that each will defend the settlement reached and the principles reflected herein. The Parties respectfully request that the Public Utilities



Commission of the State of Colorado ("Commission" or "CPUC") approve this Agreement.

II. BACKGROUND

2002 Annual Electric Earnings Test

On May 2, 2003, Public Service filed with the Commission its Electric Department Performance-Based Regulatory ("PBR") Earnings Report for 2002. Based on the Company's calculations, Public Service did not have sufficient earnings to reach the sharing threshold that was established in the PBR section of the Stipulation and Agreement approved by the Commission in Decision C00-393, page 10 of Docket No. 99A-377EG.

On July 15, 2003, the OCC filed a Protest and Request for Hearing. The OCC was concerned that Public Service had improperly stated its average cost of debt in its 2002 Earnings Test. The OCC believed that the Company's higher than market average cost of debt was most likely related to the bankruptcy of Xcel Energy's subsidiary NRG Energy, Inc. ("NRG"). Even though the OCC stated that it was unlikely that a recalculation and restatement of the Company's average cost of debt would result in Public Service having earnings subject to savings, ratepayers may still be harmed.

On July 16, 2003 the Staff submitted its analysis of the Company's May 2003 Earnings Sharing Report (for calendar year 2002 operations). In the Staff's response to the Report, it stated that it believed that PSCo has been indirectly affected by the financial difficulties of its non-regulated wholesale-power generating sister subsidiary, NRG. Staff expressed concerns about the

Company's ability to secure financing at reasonable rates even prior to the actual bankruptcy filing by NRG. As a result of its review, Staff concluded that investor concerns about NRG did have a direct impact on investors' risk perceptions of PSCo and other Xcel Energy subsidiaries and that the uncertainty resulted in a higher rate for PSCo debt securities.

On August 21, 2003 the Commission issued Decision No. C03-0955 setting the 2002 Earnings Test for hearing. On May 28, 2004, witnesses representing the Staff and the OCC pre-filed testimony concerning the cost of the September 2002 debt issuance. Both Staff and OCC alleged that Public Service paid a coupon rate associated with the 10-year note that was higher than it otherwise would have been because of a negative influence arising from the financial difficulties of Public Service's then-affiliate NRG. At the time of the subject debt issuance NRG was suffering from the collapse of the independent power market and was on the verge of filing for bankruptcy protection.

Using different methods, both Staff and OCC imputed a lower coupon rate to the September 2002 debt issuance and argued that the Company should use the lower cost debt in calculating its weighted average cost of capital in future earnings test and general rate case proceedings. Neither the Staff's nor the OCC's lower imputed debt cost would have resulted in earnings sharing for 2002. The Company was not required to file an earnings test in 2003. The earliest possible actual impact on customer bills of using an imputed lower cost of debt would be in the 2004 earnings test.

On August 24, 2004, Public Service pre-filed Answer testimony contending that the cost of the September 2002 debt issuance reflected generally unstable market conditions that could not be specifically attributed to the difficulties of NRG. Public Service also explained the steps that Xcel Energy Inc had taken to protect ("ring fence") each of its operating utility companies from the financial difficulties of NRG. The Company argued that the Staff's and OCC's recommended disallowance of debt expense was inappropriate in light of the reasonableness of its weighted average cost of capital overall, the inability to isolate and identify the effect that NRG's financial difficulties may have had on the actual cost Public Service paid for debt it issued in September 2002, and the lack of evidence of any imprudence on the part of the Company.

Electric System Reliability

On January 14, 2004, the Staff and the OCC issued an Initial Report regarding their informal investigation of the reliability of Public Service's electric distribution system. The Initial Report was the result of an informal inquiry concerning the performance of Public Service's distribution system that began in August 2003. The Staff and OCC's inquiry focused on six specific areas:

1. The high rate of failure of distribution transformers and whether Public Service is taking adequate measures to address the problem;
2. Whether the Company's systems and engineering practices are adequate to identify inadequacies in its distribution infrastructure, particularly in older neighborhoods;

3. How Public Service communicates with customers during outages and whether customers are receiving current and adequate information;
4. How Public Service dispatches and communicates with its repair crews;
5. Whether the resources dedicated to the operation and maintenance of the distribution system appear adequate; and
6. Whether adequate capital dollars are dedicated by Public Service to maintain its distribution infrastructure and to refurbish this infrastructure.

The Commission established Docket No. 04I-098E as a repository docket for the data and information gathered concerning the investigation of electric reliability.

Public Service filed a written response to the Staff and OCC Electric Distribution Reliability Initial Report on February 17, 2004. The Company also made an oral presentation to the Commission on February 25, 2004 of its response to the Initial Report including the Company's 2004 Action Plan directed at improving electric system reliability. On June 17, 2004 the OCC submitted its supplemental report regarding the reliability of the Company's electric distribution system authored by Liberty Consulting Group. The Liberty Consulting report alleged that several measures of plant investment, maintenance expenses and system reliability showed downward trends and recommended that the Commission initiate a detailed audit of the Company's electric distribution system operations. The PUC Staff issued its Final Report regarding its reliability

investigation on July 9, 2004. In the Final Report, the Staff expressed its concern that the Company's 2004 "Action Plan, as provided to the Commission [on February 25th], does not ensure that problems will be sufficiently mitigated by infusions of capital or personnel to return reliability to acceptable performance levels." The Final Report went on to say, "While the Company is clearly adding resources to improve the operation and maintenance of its system and is focusing on fixing feeder cable problems, it is not clear that the Company is setting its performance goals or deploying resources sufficient to return to service levels equivalent to or better than 2001 results in the near term."

On August 6, 2004, Public Service filed its "Verified Response to the Final Reports of the Staff and OCC Regarding the investigation into the Reliability of Public Service Company of Colorado's Electric Distribution System." In its Verified Response, Public Service addressed each of the issues raised by the Staff and the OCC. In addition, the Company presented the results, to date, of its 2004 Action Plan as well as a response to the Liberty Consulting's trend analysis that was prepared for the Company by PA Consulting. One of the specific issues affecting reliability discussed in the Company's Verified Response was distribution cable failure. The Verified Response stated:

Separately, within the last few years the Company has begun to experience a number of premature failures of its late 70's and 80's vintage main feeder cable. The Company's distribution system includes approximately 3000 segments of main feeder cable that was installed in the late 70's and 80's. This older type cable used a plastic insulation material, prevalent in the industry at that time, some of which is degrading more quickly than expected due to microscopic "treeing" of the insulation. As the problem with this cable has manifested at Xcel Energy and throughout the industry, the Company has worked responsibly to replace problem segments

as they have come to light and to proactively identify and refurbish or replace such cable segments before they experience additional faults. The Company's main feeder replacement program that was begun in 1999 focused on this problem. In 2003, the Company devoted \$4.4 million to proactive replacement and \$2.1 million on reactive replacement of such cable. In 2004, as set forth in the Company's Action Plan, Public Service expects to spend \$7.5 million and \$2.5 million, respectively, on proactive and reactive replacement of such segments. The premature failure of 70's and 80's vintage main feeder cable is not a problem with overloading or with the Company's maintenance practices. This cable is failing significantly before the end of its expected useful life and the Company is systematically addressing the problem.

III. TERMS OF SETTLEMENT

Over the last few months, the Company, Staff and OCC have engaged in broad discussions regarding the issues raised in both the 2002 Earnings Test proceeding and in the Reliability Investigation. These discussions have focused on resolving the Parties' concerns as raised in each proceeding in a constructive manner consistent with the public interest. Specifically, with the financial difficulties at NRG now behind Xcel Energy and Public Service, and in recognition of Xcel Energy's and Public Service's renewed focus on its core utility businesses, the Parties have attempted to reach a settlement that best serves the interests of Public Service's customers going forward.

Public Service, the Staff and the OCC hereby stipulate and agree as follows:

1. Investment in Electric Distribution Reliability.

Public Service agrees to accelerate its feeder and URD cable repair and replacement programs that were initiated by the Company in 1999. The Company shall invest an additional \$12 million in 2005 and \$13 million per year

in 2006 and 2007 for repair and replacement of underground and URD 500 kcmil feeder cable above the \$13 million annual investment currently budgeted for 2005 and expected to be included as part of the 2006 and 2007 capital budgets for the Company's feeder and URD cable repair and replacement programs. The Parties agree that this accelerated investment program is in the public interest and that the facilities installed through this program are properly recoverable through the Company's utility rates.

Public Service shall supply the Commission an annual report detailing its implementation of its distribution cable replacement program. The annual report will be filed on or about April 1st of each year for the immediately preceding calendar year.

2. Treatment of Prematurely Retired Electric Distribution Plant for Depreciation Purposes.

Public Service represents that the cable being replaced as a result of this Agreement is part of a continuous property group, meaning that many vintage groups are combined to form a common group. Each year assets are removed from service for many reasons and, at the same time, new assets are added to replace those that are retired and to meet growth in the Company's service territory. For depreciation purposes, the capital investment in the continuous property group is recovered over the average service life of the group. Retirement patterns for assets are spread out over a dispersion curve resulting in a statistical average life for the group. The cable segments that will be replaced under this Agreement provided 20 to 30 years of service, which is less than the

average life for the group. If the levels of such "non-normal" retirements are significant enough there may be a statistical downward push on the average life of the group over time. However the original cost of the assets being retired is not statistically large in comparison to the value of the entire continuous property group. As such, the normal calculation and recording of depreciation expense on an annual basis should not vary significantly because of the replacement of the cable feeder segments. Accordingly, the Company agrees that no change to depreciation accounting methods for these accounts is necessary at this time, the retired segments will be removed at a fully depreciated status and no loss will be recognized.

3. Cost of Debt

The Parties acknowledge that the coupon rate of the PSCo debt security at issue here may have been impacted by the financial difficulties of its non-regulated wholesale-power generating sister subsidiary, NRG. The Parties agree that, in light of the other features of this agreement the Company shall be allowed to include the actual cost of the September 2002 \$600 million First Collateral Trust bonds in the calculation of its weighed average cost of capital for purposes of the 2002 Earnings Test and all future earnings tests or rate proceedings in which the Company's cost of capital is at issue.

4. Contribution to Energy Outreach Colorado

Public Service agrees to contribute \$2 million to the Energy Outreach Colorado in 2004 for the purpose of assisting clients served by that agency with

the payment of heating bills. This contribution shall not be recoverable in rates and shall not be included as part of the earnings sharing calculation for 2004.

5. Request to Close the Reliability Investigation

The Parties agree to request the Commission to close the Reliability Investigation. Public Service agrees to file a proceeding on or about July 1, 2005 addressing needed modifications to the current Quality of Service Plan (QSP) and the future of the plan after January 1, 2007. Beginning in April 2005, the Company agrees to work collaboratively with Staff and the OCC to identify, collect, and provide data that may assist Staff and the OCC in proposing alternative QSP measures.

IV. GENERAL PROVISIONS

Public Service, the Staff and the OCC agree to submit this Agreement to the Commission for approval at the earliest opportunity. The Parties stipulate that all pre-filed testimony shall be entered into evidence in Docket No. 03I-134E and that no cross-examination on the prefiled testimony shall be conducted. Instead, each of the Parties shall join in a motion that requests the Commission to approve this Agreement and to testify in support of this Agreement.

This Agreement is a negotiated compromise of issues raised in the 2002 Earnings Test and Reliability Investigation proceedings. Nothing contained herein shall be deemed to constitute an admission or an acceptance by any party of any fact, principle, or position contained herein. Notwithstanding the foregoing, the Parties, by signing this Agreement and by joining the motion to adopt the Agreement filed with the Commission, acknowledge that they pledge

support for Commission approval and subsequent implementation of these provisions.

This Agreement shall not become effective until the issuance of a final Commission Order approving the Agreement, which Order does not contain any modification of its terms and conditions that is unacceptable to any of the Parties. In the event the Commission modifies this Agreement in a manner unacceptable to any Party, that Party shall have the right to withdraw from this agreement and proceed to hearing on the issues that may be appropriately raised by that Party in Docket No. 03I-134E and to take any action that Party deems appropriate with respect to Docket No. 04I-098E. The withdrawing Party shall notify the Commission and the Parties to this Agreement by e-mail within three business days of the Commission modification that the Party is withdrawing from the Agreement and that the Party is ready to proceed to hearing; the e-mail notice shall designate the precise issue or issues on which the Party desires to proceed to hearing (the "Hearing Notice").

The withdrawal of a Party shall not automatically terminate this Agreement as to the withdrawing Party or any other Party. However, within three business days of the date of the Hearing Notice from the first withdrawing Party, all Parties shall confer to arrive at a comprehensive list of issues that shall proceed to hearing and a list of issues that remain settled as a result of the first Party's withdrawal from this Agreement. Within five business days of the date of the Hearing Notice, the Parties shall file with the Commission a formal notice containing the list of issues that shall proceed to hearing and the list of issues

that remain settled. The Parties who proceed to hearing shall have and be entitled to exercise all rights with respect to the issues that are heard that they would have had in the absence of this Agreement. Hearing shall be scheduled on all of the issues designated in the formal notice filed with the Commission as soon as practicable.

In the event that this Agreement is not approved, or is approved with conditions that are unacceptable to any Party who subsequently withdraws, the negotiations or discussions undertaken in conjunction with the agreement shall not be admissible into evidence in this or any other proceeding, except as may be necessary in any proceeding to enforce this Agreement.

Approval by the Commission of this Agreement shall constitute a determination that the Agreement represents a just, equitable and reasonable resolution of all issues that were or could have been contested among the Parties in this proceeding. The Parties state that reaching agreement in this docket by means of a negotiated settlement is in the public interest and that the results of the compromises and settlements reflected by this Agreement are just, reasonable and in the public interest.

All Parties to this Agreement have had the opportunity to participate in the drafting of this agreement. There shall be no legal presumption that any specific Party was the drafter of this Agreement.


If the Commission approves this Agreement, and at some later date interprets this Agreement in a manner harmful to the interests of one of the Parties, but not advocated by any of the other Parties, all Parties agree to

support the original intent of this Agreement with appropriate pleadings before the Commission.

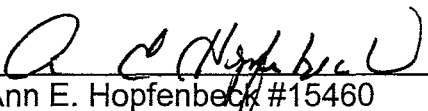
This Agreement may be executed in counterparts, all of which when taken together shall constitute the entire Agreement with respect to the issues addressed by this Agreement.

Dated this 8th day of December, 2004.

PUBLIC SERVICE COMPANY OF
COLORADO

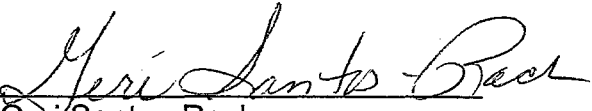
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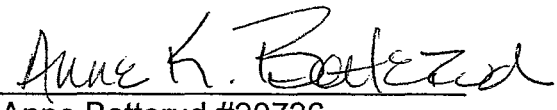
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