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Memorandum

To: Transition Team Energy & Environment Policy Group

From: Benjamin G. S. Fowke III, Chief Financial Officer, Xcel Energy Inc.

Subject: Renewable and Clean Energy Incentives

Date: December 16, 2008

Xcel Energy Inc. appreciates the opportunity to provide the following suggestions to President-Elect Obama's Transition Team, Energy & Environment Policy Group regarding incentives for the development of renewable and clean energy in the United States. We reviewed these concepts in our December 11th meeting and indicated at that time that we would follow-up in writing.

Xcel Energy and its Environmental Leadership. Xcel Energy is a major U.S. electricity and natural gas company with regulated operations in eight Western and Midwestern states (Minnesota, Wisconsin, North Dakota, South Dakota, Michigan, Colorado, Texas and New Mexico). We provide a comprehensive portfolio of energy-related products and services to 3.3 million electricity customers and 1.8 million natural gas customers through our regulated operating companies. Our headquarters are located in Minneapolis, Minnesota, and we serve the cities of Minneapolis-St. Paul, Denver, Amarillo and Eau Claire, along with numerous other cities and towns throughout our service territory.

Xcel Energy is committed to renewable and other clean energy technologies and is developing business strategies that position the company for the regulation of greenhouse gases. Our clean energy leadership is reflected in our programs and accomplishments:

- The American Wind Energy Association has certified that Xcel Energy is the nation's number one utility wind provider;
- We are also the nation's fifth largest utility solar energy provider and are planning to grow our fleet of solar resources dramatically in the years ahead;
- We have announced plans for the construction of the largest biomass generating plant in the Midwest;
- We are a leader in energy efficiency and conservation, with some of the largest demand side management programs outside of California;
- We are developing the nation's first "Smart Grid City" in Boulder, Colorado, which will allow us to demonstrate how advanced information technologies can promote a more efficient, reliable and cleaner energy system; and

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- We are repowering aging coal plants with clean natural gas and taking other steps to reduce carbon dioxide emissions across our system by 15% by 2020.

We are proud of our environmental leadership and believe that our clean energy initiatives are consistent with the policies of our states and have created value for our customers. Our strategy has reduced our carbon emissions while promoting a more reliable electric system and maintaining a reasonable electricity price. Xcel Energy's approach can serve as a model for the kind of policy that will allow the U.S. energy industry to meet the challenges of a clean energy future.

Based on our experience, Xcel Energy is a strong advocate of renewable energy. However, we have also learned that sound public policy is vital to the financing and successful development of renewable energy resources. Often, public policy to encourage renewable energy is disjointed and inconsistent. Moreover, renewable energy public policy on both the state and federal level often fails to recognize the important role that utilities play as agents for the public in the acquisition of clean energy resources. We believe that the nation would benefit from a consistent and comprehensive renewable energy policy that addresses concerns of all market participants, including utilities, as each has a role in bringing renewable energy to the marketplace.

We recommend that the transition team consider the following clean energy policy enhancements:

1. Provide continued and expanded federal support for electricity from renewable resources. Additional incentives will encourage greater renewable energy development and reduce the cost of financing it. Tax incentives such as wind production tax credit and the solar investment tax credit are critical in encouraging the development of renewable energy.

We strongly support a long-term extension of the wind production tax credit ("PTC"). The on-again, off-again PTC of the last several years has caused dramatic swings in the wind market place as manufacturers and developers scramble to build wind farms based on the latest PTC deadline. We encourage Congress and the Obama Administration to enact a five-year PTC extension in the stimulus package that will be under consideration early next year. This will provide an immediate boost to the economy as entities will begin to make turbine purchases and other needed commitments for 2010 projects in 2009 when the PTC is currently set to expire.

In addition, the Administration and Congress must look seriously at providing an immediate remedy to the erosion in the incentive value of the PTC and other energy tax credits caused by the financial crisis. Simply put, many traditional investors in renewable generation projects – due to substantial losses

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stemming from the financial crisis – no longer have sufficient taxable income against which to apply the tax credits, so the value of these credits is negated. In addition to considering the possibility of making the PTC refundable or tradable, a simple way to restore the value of the PTC for many new renewable generation facilities, would be for Congress to allow the tax credit to be utilized by *either* the seller of electricity from the renewable resource, *or* the buyer of such electricity. In this way, because most investor-owned utilities still have "tax appetite," new renewable generation projects that would not benefit under current law from the associated PTC could do so by having the utility (or other load serving purchaser) – as the buyer – claim the PTC for the electricity generated from the seller's facility.

Moreover, it must be recognized that integrating a significant increase in renewable generation into the grid imposes significant burdens on the utilities that transmit and distribute the electricity from such resources to customers. Substantial expenditures are necessary to accommodate these resources while maintaining system reliability. For example, to account for the impacts of intermittent renewable energy, utilities are often required to make investments in new quick-start natural gas generating facilities and supporting natural gas infrastructure, storage and fuel. They also incur increased maintenance costs resulting from rapid changes in the operating rates of coal and gas plants used to balance renewable generation. It is also likely that utilities will have to expend increasing resources to develop and manage energy storage facilities.

To encourage utilities to make necessary system upgrades and ongoing expenditures in support of widespread deployment of intermittent renewable resources, we support the creation of a "Renewable Integration Credit" in addition to the existing PTC. The integration credit should be designed on a sliding scale based on the amount of renewable energy on a utility system. The credit should hit a target of at least 0.5 cents per kWh of electricity from renewable electricity generators with solar and wind penetration equal to or greater than 15%. For lower levels of penetration the credit would be lower and for higher levels of penetration the credit would be higher. We have derived this proposed integration credit by examining the costs of integration from studies across our system.

We also encourage policies that will result in additional public and private investments in renewable energy research and development. Xcel Energy works closely with the National Renewable Energy Laboratory in Golden, Colorado on a variety of renewable and clean energy issues and projects. Recently, we joined NREL, Colorado universities and several international solar power manufacturers in the announcement of a solar technology advancement center ('SolarTAC") in Aurora, Colorado. We support increased funding for research and development projects and pilots like SolarTAC through institutions like NREL and partnerships with universities and private industry.

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Finally, as a member of the Edison Electric Institute we are working as an industry to develop a set of recommended tax incentives. We encourage the transition team to consider those recommendations as well.

2. Create a national renewable portfolio standard. Xcel Energy supports the creation of a national renewable portfolio standard. State experience over the last decade has demonstrated that a properly designed RPS can be an effective and low cost method of promoting clean energy markets and attracting capital to renewable energy development and deployment.

As noted, the design of a national RPS is important. A national RPS should be broad-based and flexible. It should provide compliance options to all regions of the country by allowing utilities to comply using many types of clean technologies, including renewables and energy efficiency.

A national RPS should assure that utilities like Xcel Energy that are already leaders in renewable development are awarded credit for existing renewable energy. These utilities have led the nation in bringing renewable energy to customers. This leadership and the leadership of the states that established renewable goals should not be penalized, and early adapters to a renewable framework should receive full credit for their existing system renewable investments.

A national RPS should also create a national renewable energy credit market to ensure low-cost compliance. A national RPS would work more effectively – and encourage more renewable energy development – if it required that all renewable energy credits held by utilities in excess of the federal mandates be either banked for future use or offered for sale to the market. Using a national renewable market as the backstop provision for utilities that may not be positioned or willing to add renewable resources would assure that the entire nation has access to a liquid and least-cost compliance option that is based upon generation of renewable MWHs. Creating a uniform national renewable energy credit market removes obstacles to a currently fragmented market to allow for cost-effective RPS implementation while at the same time assuring continued growth of the nation's supply of renewable energy.

3. Promote transmission development. Transmission is the key link in the development of clean energy technology and delivery of renewable energy to remote markets. We have encouraged public policies that will promote transmission development and reward utilities that participate in efforts to create a more robust national transmission grid.

We support: (1) cost allocation procedures that protect renewable energy-rich regions and provide incentives to local utilities to invest in interstate transmission projects; (2) a shorter depreciable life for transmission assets in

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anticipation of the potential for significant distributed generation deployment in the long run; and (3) appropriate financial incentives such as formula rates, incentives for Regional Transmission Organization participation and higher rates of return to incent significant investments – policies that are currently being implemented by the Federal Energy Regulatory Commission for investments in interstate transmission projects.

4. Electrify the transportation sector. Electric transportation technologies -- plug-in electric hybrid vehicles and electric cars – offer the United States a great opportunity to address several important environmental, economic and security issues at the same time. Widespread deployment of PHEVs and other electric vehicles would reduce the nation's overall greenhouse gas emissions, help promote a profitable and sustainable transformation of the American auto industry, and reduce the nation's dependence on foreign oil.

PHEVs and electric vehicles would complement renewable energy development. These vehicles would serve as consumers of renewable energy generated by the grid while their batteries are charging and simultaneously provide the grid with renewable energy storage. By controlling the time at which the vehicle batteries are charged and discharged, a utility could treat PHEVs and electric vehicles as distributed energy storage resources. . If the grid is modernized to appropriately deal with this level of dispersed generation, the vehicles would enable greater renewable energy penetration. .

We support policies that would facilitate the electrification of light transportation in the United States. We believe that federal research dollars should flow toward improvements in battery technology. As we have previously discussed with the transition team, we support financial and cost recovery incentives for construction of the Smart Grid and onboard vehicle-to-grid technology that will enable efficient integration of PHEVs and electric vehicles. Finally, we encourage the development of federal transportation policies that will provide incentive for automakers to construct PHEVs and other electric vehicles.

5. Encourage capital formation. The utility business is extremely capital intensive. Even without an increased commitment to renewables, which often are more costly than other generation options, the utility industry is facing the need to invest hundreds of billions of dollars over the next decade to maintain reliable electric service to its customers. In order to achieve the desired investments in renewables, it will be important for the Administration to be supportive of policies that make capital investment attractive to private investors. Accordingly, general tax policies will play an important role in determining whether capital will flow into renewables and other areas.

One general tax policy that is particularly important to utilities is the treatment of dividends. Utilities traditionally pay more dividends to their shareholders than other industries, and many utility investors purchase utility

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stocks to obtain dividends. A tax on dividends that is at parity with a tax on capital gains will encourage the formation of the kinds of capital necessary to build utility infrastructure, including renewable energy and related transmission.

6. Encourage state polices that support rapid deployment of renewable energy. Federal policy is important to promotion of renewable energy, but states traditionally have significant control energy development within their borders and thus impact the ability of industry to meet federal policy goals. We encourage federal and state authorities to review clean energy incentives that can facilitate rapid development of renewable energy and associated transmission to bring this clean energy to market. These incentives could include policies similar to FERC incentives for transmission described above, appropriate consideration of the impact of renewable energy power purchase agreements (which today usually do nothing for the utility's finances other than degrade its credit quality), and the use of real time cost recovery for large transmission or renewable energy investments. Many of the states we serve have taken some of these steps to date. Such incentives will help move utilities more rapidly toward investing in newer, often riskier technologies and ensure that there is alignment of utilities' financial interests and the public policy objective of promoting renewable energy resources.

We appreciated the opportunity to meet with you on December 11 and hope that you will consider these ideas as you work with Congress on a stimulus package. We are available to work with the transition staff and the incoming energy policy team to make this a practical, workable framework for moving the nation to a greater level of investment in renewable energy.