

STATE OF MINNESOTA
BEFORE THE PUBLIC UTILITIES COMMISSION

LeRoy Koppendraye
Marshall Johnson
Tom Pugh
Phyllis Reha

Chair
Commissioner
Commissioner
Commissioner

In the Matter of the Commission's
Investigation into the Appropriateness of
Continuing to Permit Electric Cost
Adjustments

Docket No. E999/CI-03-802

**COMMENTS OF
THE OFFICE OF THE ATTORNEY
GENERAL - RESIDENTIAL AND SMALL
BUSINESS UTILITIES DIVISION**

I. INTRODUCTION.

The Office of the Attorney General ("OAG") files these Comments in response to the Commission's March 30, 2007 Notice for Comments ("Notice") in the above-referenced docket. In its Notice, the Commission notes that comments and reply comments on the purpose, structure, and rationale of the Fuel Clause Adjustment¹ ("FCA") were last filed in 2004. The Commission now offers parties an opportunity to update the record, and requests comments on whether the investigation should be continued and, if so, what issues it should pursue.

¹ Minn. Stat. § 216B.16, subd. 7 states:

Energy cost adjustment. Notwithstanding any other provision of this chapter, the commission may permit a public utility to file rate schedules containing provisions for the automatic adjustment of charges for public utility service in direct relation to changes in:

- (1) federally regulated wholesale rates for energy delivered through interstate facilities;
- (2) direct costs for natural gas delivered; or
- (3) costs for fuel used in generation of electricity or the manufacture of gas.

The FCA is discretionary. It states that the Commission *may* allow a public utility to recover through automatic adjustments in customers' bill the fluctuations in the cost of wholesale energy it purchases, the cost of fuel used to generate electricity, and the wholesale cost of natural gas it supplies to its customers. The FCA is contained in the comprehensive rate case statute, Minn. Stat. § 216B.16, and is intended as an exception to rate case review of costs. It was not meant to address what have traditionally been base rate issues, such as capacity costs and long-term fuel contracts.

While the use of the FCA has expanded dramatically to cover costs other than those involving fuel or purchased power, the statute has not been modified to accommodate the uses to which it is now put. The OAG maintains that continued expansion of the use of the FCA for items that have little to do with the cost of fuel or purchased power in contravention of the limited terms of the statute is bad public policy, and is most likely unlawful. The OAG recommends that the Commission either terminate the use of the FCA or restrict the use of the FCA to the purposes for which it was enacted.

II. BACKGROUND

On June 4, 2003, the Commission opened an investigation into whether the FCA continues to be a useful regulatory tool. On December 19, 2003, the Commission issued an *Order Determining Scope and Setting Procedural Framework (Order)* and *Notice of Comment Periods*. The Order indicated that the investigation would begin with written analyses by the utilities of the original purpose, structure, and rationale of the FCA, current operation of the FCA, and relevance to the current regulatory environment. The Department of Commerce ("DOC" or "Department"), in its 2004 filings, raised numerous concerns about the expanded use

of the FCA and recommended alternatives.² The last set of comments in this proceeding was Supplemental Reply Comments filed by Minnesota Power on June 14, 2004.

In its March 30, 2007 Notice, the Commission states that several concerns initially raised have been addressed through various modifications or variances in the application of the FCA. These include the recovery of MISO charges through the FCA,³ Otter Tail Power's FCA true-up,⁴ Xcel separately showing the cost of energy on customer bills, and the recovery of certain renewable costs pursuant to statutory changes. The Notice also specifically identified the following as additional issues raised in comments to date:

- Incentives for controlling costs passed through the FCA;
- Price signals;
- Potential for fuel price manipulation;
- Alternative FCA mechanisms such as Wisconsin's banding approach;
- Data reporting, including what is reported and how frequently;
- Regulatory oversight of FCA data reporting;
- Changes required in the FCA enabling statute: Minn. State. 216B.16, subd. 7; and

² See *Reply Comments of the Minnesota Department of Commerce in the Matter of an Investigation into the Appropriateness of Continuing to Permit Electric Energy Cost Adjustments*, Docket No. E999/CI-03-802 (April 5, 2004); *Addendum and Revised Pages to Reply Comments of the Minnesota Department of Commerce in the Matter of an Investigation into the Appropriateness of Continuing to Permit Electric Energy Cost Adjustments*, Docket No. E999/CI-03-802 (April 16, 2004).

³ The OAG opposes this application of the FCA and has filed an appeal at the Minnesota Court of Appeals of the Commission's decision to allow MISO charges to be passed on to ratepayers through the FCA. See Minnesota Court of Appeals Case Number A07-730 filed April 9, 2007.

⁴ The OAG requested the Commission to immediately require Otter Tail Power to begin sharing its wholesale revenue profits with ratepayers through the automatic adjustment mechanism of the monthly Fuel Clause Adjustment. See *Reply Comments of the Office of the Attorney General in the Matter of Otter Tail Corporation d/b/a Otter Tail Power Company's August Fuel Clause Adjustment in Docket No. E017/AA-05-1228* (March 16, 2007).

- Emission allowances and other environmental credits.

III. THE COMMISSION HAS ALLOWED THE FCA TO EXPAND BEYOND ITS INTENDED PURPOSE.

A. The FCA Passes Many Costs Through to Ratepayers Other Than Fuel and Purchased Power Costs.

The Commission has granted the public utilities' requests to use the FCA to pass along many costs to ratepayers that are neither fuel costs, nor costs for wholesale energy purchases.

The utilization of the FCA as a vehicle for extra-statutory items includes the following:

- Wind curtailment payments;⁵
- Capacity costs;⁶
- MISO Day 2 Charges;⁷
- Hedging;⁸ and
- Renewable development fund ("RDF") costs.⁹

These costs have been accorded FCA treatment even after the Department expressed its misgivings about the expanded use of the FCA in 2004.

⁵ See *Xcel Energy's Wind Projections Compliance Report*, Docket No. E,G999-AA-04-1279 (March 19, 2006).

⁶ See *In the Matter of Northern States Power d/b/a Xcel Energy Request for Approval of a Renewable Energy Purchase Agreement with Velva Windfarm LLC*, Docket No. E-002/M-04-864; see also ORDER GRANTING EXTENSION OF RECOVERY MECHANISM AND DIRECTING THAT REO ELIGIBILITY DETERMINATION BE MADE IN RESOURCE PLAN PROCEEDING *In the Matter of the Petition of Otter Tail Power Company to Revise its Cost of Energy Adjustment Tariff to Accommodate Purchased Energy from Renewable Resources*, Docket No. E-017/M-03-970 (July 12, 2006).

⁷ See *Order Establishing Accounting Treatment For MISO Day 2 Costs*, Docket Nos. E-002/M-04-1970 / E-015/M-05-277 / E-017/M-05-284 / E-001/M-05-406 (December 20, 2006).

⁸ See *In the Matter of Interstate Power and Light's request for approval of a Variance to the Fuel Clause Adjustment Rules for Financial Hedging*, Docket No. E-001/M-05-542 (September 5, 2005).

⁹ See *In the Matter of the Petition of Northern States Power Company d/b/a Xcel Energy for Approval to Separate the RDF Cost Recovery from the FCA, Establish an RDF Rate Rider, and Request Deferred Accounting Treatment*, Docket No. E-002/M-03-2018.

B. The DOC's Original Is Still Correct.

The OAG generally supports the DOC's April 5, 2004 and April 16, 2004 Reply Comments in this docket. The Department concluded that

more investigation is necessary to assess certain factors in the context of current conditions. These factors include:

- Incentive effects,
- Control over fuel cost volatility; and
- Risk allocation.¹⁰

As noted by the Department:

- The FCA was intended to allow utilities to address fuel price volatility without filing frequent, expensive rate cases.
- The FCA addresses costs that were presumed to be beyond the utility's control.
- The FCA was intended to reduce a utility's business risk and thereby improve the utility's credit ratings.
- Federal regulations for purchased energy provided an example for cost flow-through and further regulatory oversight.
- The FCA provided a way to pass savings to ratepayers if the actual cost of fuel dipped below the base cost included in rates.

The Department's April 5, 2005 Reply Comments discussed four potential concerns over the use of the FCA:

- Apparent inconsistencies between the FCA policy and the wholesale revenue policy.

¹⁰ See *Reply Comments of the Minnesota Department of Commerce in the Matter of an Investigation into the Appropriateness of Continuing to Permit Electric Energy Cost Adjustments*, Docket No. E999/CI-03-802 (April 5, 2004) at 11.

- Price signals.
- Data reporting procedures.
- Potential for fuel price manipulation.

As noted by the Department, at the time the FCA was first implemented in Minnesota, the Federal Energy Regulatory Commission (“FERC”) used a relatively rigid approach to regulating prices paid in the wholesale market for purchases of energy. FERC’s increasing reliance on market forces to determine prices, however, have amplified the concerns and at the same time call into question the original purpose and justification for the FCA. The reliance on the market to set prices is not an adequate substitute for setting just and reasonable rates. As examples, the Department noted:

- In the last several years, there has been an increase in the volatility in the prices paid by Minnesota consumers for electricity through the operation of the FCA.
- There have been increased concerns about the use of natural gas to generate electricity and the impact it is having on both electric rates and natural gas rates, in general.

The OAG believes the DOC’s concerns remain well-founded. In addition, the OAG believes that a host of other issues should also be addressed, including inconsistencies in the treatment of wholesale revenues, the lack of proper price signals, the lack of control over fuel cost volatility, and the shift of risk allocation to ratepayers.

C. The FCA Leads to Inconsistencies in the Treatment of Wholesale Revenues.

The language of the FCA does not contemplate ratepayers recovering increases in a utility’s wholesale revenue from the amount that was computed in the utility’s most recent rate case. In recent years annual wholesale revenues have typically been greater than the amount set

in the rate cases. See the table below derived from Commission Staff Briefing Papers for Docket No. E,G-999/AA-04-1279 on October 20, 2005 at 6 (emphases in original):

Comparison of Wholesale Revenues Built into Rates and Wholesale Revenues for Calendar Years 2001, 2002, and 2003 for Investor-Owned Utilities Serving Minnesota (Table E3, DOC Review, Vol. I, p. 19)							
Utility	Wholesale Revenues Built into Rates in Last General Rate Case (in millions)	2001 Wholesale Revenue (in millions)	Percent that 2001 Wholesale Revenues Exceed Amount Built into Rates	2002 Wholesale Revenue (in millions)	Percent that 2002 Wholesale Revenues Exceed Amount Built into Rates	2003 Wholesale Revenue (in millions)	Percent that 2003 Wholesale Revenues Exceed Amount Built into Rates
Interstate	\$ 0.74	\$ 9.04	1117%	\$ 5.46	635%	\$ 37.55	4955%
Mn. Pwr.	\$ 16.35	\$ 33.77	107%	\$ 19.18	17%	\$ 33.76	106%
Otter Tail	\$ 6.43	\$ 98.20	1427%	\$ 81.83	1173%	\$ 153.52	2288%
Xcel ¹⁷	\$ 34.20	\$ 51.98	51%	\$ 29.27	-14%	\$ 59.65	74%

¹⁷ Dollar values for Xcel Electric represent margins on wholesale sales.

More recent wholesale revenues are found in Exhibit E of the Joint Report and Recommendation of the MISO Day 2 Stakeholder Group to Recover MISO Day 2 Charges, Docket Nos.: E-002/M-04-1970, E-015/M-05-277, E-017/M-05-284, E-001/M-05-406, attached here as Appendix A.

Although ratepayers do not pay for fuel costs incurred for intersystem sales, they have paid for generating capacity and possibly the transmission lines used to carry out these sales. The OAG agrees with the DOC that if variations in fuel costs are passed to ratepayers, then variations in wholesale revenue should be passed to ratepayers as well.¹¹

¹¹ See Reply Comments of the Office of the Attorney General in the Matter of Otter Tail Corporation d/b/a Otter Tail Power Company's August Fuel Clause Adjustment in Docket No. E017/AA-05-1228 (March 16, 2007); see also Comments of the Department of Commerce in the Matter of Otter Tail Corporation d/b/a Otter Tail Power Company's August Fuel Clause Adjustment in Docket No. E017/AA-05-1228 (March 5, 2007)

D. Ratepayers Do Not Receive Proper Price Signals.

Even when the FCA is being used to pass on energy costs that are properly within its scope, because FERC is no longer regulating these rates to reflect actual costs, ratepayers are no longer protected through regulatory oversight. In addition the FCA, as applied today, essentially represents a rolling average of past costs because most utilities use a rolling average of previous costs to calculate the FCA. This practice dilutes price signals in two ways: (1) customers do not know the cost of energy prior to consumption, and (2) by averaging over a time-period, the rate fails to reflect the cost of energy at the time of consumption. Even when projected costs are included in the FCA: (1) the customer still does not know what the costs are prior to consumption, and (2) the FCA is adjusted for the difference between actual and projected costs. In addition, these average costs charged through the FCA subject ratepayers to market volatility and premiums without allowing them to “benefit” from the market. The wholesale market subject to FERC jurisdiction remains a supply market, without the ultimate consumer, *i.e.*, captive ratepayers, being able to participate or benefit from that market.

E. The Current Application of the FCA Results in Little Control Over Fuel Cost Volatility.

The Department notes that, in the long term, a utility can take steps to limit fuel cost volatility through actions such as long-term fuel contracts, diversifying fuel use, selecting less volatile fuels to power new resource additions, and using less costly generation alternatives. Under the current policy of unbridled use of the FCA, however, utilities do not bear any of the rate risk such as the cost of natural gas price increases due to supply shortages.

F. The Risk Allocation Burden Has Shifted to Ratepayers.

Rating agencies have indicated that the stability of cash flows and the relative certainty of full recovery of fuel and purchased power costs are important issues affecting the level of

business risk of a utility. The result has been that ratepayers, not shareholders, now bear the burden of any risk associated with escalation in the costs of fuel and or purchased power. It is appropriate to reassess the tradeoff between the positive risk effects and the negative incentive effects of unchecked FCA recovery of all fuel and purchased power costs.

G. The Commission Cannot Lawfully Create Trackers To Permit Automatic Recovery of Items Now Improperly Passed Through the FCA.

If the Commission restricts the FCA to fuel and purchased power costs, the Commission should not alternatively establish trackers for the automatic recovery of costs now improperly being passed through the FCA. As a threshold matter, the Commission has no statutory authority to establish such trackers:

The MPUC, as a creature of statute, only has the authority given it by the legislature. The legislature states what the agency is to do and how it is to do it. While express statutory authority need not be given a cramped reading, any enlargement of express powers by implication must be fairly drawn and fairly evident from the agency objectives and powers expressly given by the legislature.

Minnegasco, a Div. of NorAm Energy Corp. v. Minnesota Public Utilities Com'n, 549 N.W.2d 904, 907 (Minn. 1996). All automatic adjustments and trackers that flow through costs to ratepayers have been implemented pursuant to legislative authority. For example, the FCA itself is authorized by Minn. Stat. § 216B.16, subd. 7. Similarly, the CIP Tracker is allowed under Minn. Stat. § 216B.16, subd. 6b(c). Other automatic adjustment mechanisms permitted by law are set forth in Minn. Stat. § 216B.16, subds. 6d(3) (wind energy property tax adjustment), 7a (performance-based gas purchasing adjustment), and 7b (transmission cost adjustment), as well as Minn. Stats. §§ 216B.1645, subd. 2 (wind and biomass purchase power contract adjustment), 216B.1635, subd. 2 (gas utility infrastructure costs recovery), 216B.1692, subd. 3 (emissions

reduction rider), and 216B.241, subd 2b (energy conservation improvement costs recovery).

None of these statutes authorize *ad hoc* trackers.¹²

IV. OAG RECOMMENDATIONS.

The FCA, as currently applied in Minnesota, suffers from numerous problems and unfairly subjects Minnesota ratepayers to undue risks solely to the benefit of the utility suppliers.

If FCA is to continue to be used, the risks and rewards must be brought back into balance. The

OAG recommends that the Commission:

1. Immediately cease all further applications of the FCA to utility costs that do not directly pertain to the purposes to which the FCA was enacted as set forth in the statute's express language.

2. Reevaluate the various purposes to which the FCA is now applied to determine whether they conform to the language of the statute.

3. Determine how the FCA can be applied such that utilities contain the costs of fuel and purchased power passed on to ratepayers.

¹² CenterPoint Energy's Environmental Cost Recovery Charge ("ECRC") tracker is an anomaly and cannot be used to provide a basis for the establishment of extra-statutory trackers. See FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER, MINNEGASCO, Docket No. G-008/GR-95-700 (June 10, 1996) at 22 et seq. In any case, the environmental cleanup costs being tracked were in response to exigent circumstances and highly volatile costs. Indeed, the Commission may have exceeded its statutory authority in establishing the ECRC tracker, and the fact that no other such mechanisms appear to have been approved without statutory authority buttresses this position.

4. In the alternative, use its discretion to terminate the FCA.

Dated: April 30, 2007

/s Ronald M. Giteck
RONALD M. GITECK
Assistant Attorney General
Atty. Reg. No. 0289747
445 Minnesota Street, Suite 900
St. Paul, Minnesota 55101-2130
(651) 284-4066 (Voice)
(651) 296-1410 (TTY)

**ATTACHED HERETO
IS
EXHIBIT E**

MISO Day 2 Joint Report
Wholesale Margins
Otter Tail Power Company

- A. How wholesale margins are generated and what utility resources are used to generate them.

Otter Tail Power Company's wholesale margins are derived from two main sources: asset based transactions and non-asset based transactions. Asset based transactions sell excess energy available from Otter Tail's generation resources to buyers. The utility resources can be any of Otter Tail Power's generating resources, depending upon retail requirements and the markets.

Non-asset based transactions use energy purchased from entities other than Otter Tail Power Company and sold to third parties. This includes bi-lateral transactions and transactions occurring within the MISO Market.

- B. The level of wholesale revenues and related expenses for 2005.

	<u>System</u>	<u>Minnesota</u>
<u>Asset-based</u>		
Revenue	\$25,748,110	\$13,246,357
Expense	<u>\$14,176,694</u>	<u>\$7,293,333</u>
Margins	\$11,571,416	\$5,953,024
<u>Non-asset based (virtuals at net)</u>		
Revenue	\$138,365,136	\$69,633,994
Expense	<u>\$120,011,760</u>	<u>\$60,397,427</u>
Margins	\$ 18,353,376	\$ 9,236,567
<u>Total</u>		
Revenue	\$164,113,246	\$82,880,351
Expense	<u>\$134,188,454</u>	<u>\$67,690,760</u>
Margins	\$ 29,924,792	\$15,189,591

It should be noted that a large portion of the margins were from virtual transactions, which may be subject to RSG pending the outcome of FERC's final disposition of Docket ER04-691-065.

- C. The level of wholesale revenue or margin approved in the utility's most recently approved rate case and how these amounts were calculated in that case.

Otter Tail Power Company's last rate case was in Docket E-017/GR-86-380. The following amounts are from the compliance filing approved June 26, 1987. The total revenue and expense were allocated to Minnesota using an energy factor (E2) for base energy and a demand factor for purchased energy (D2).

	<u>System</u>	<u>Minnesota</u>
Revenue	\$13,064,652	\$6,429,200
Expense	\$11,562,400	\$5,689,921
Margin	\$ 1,502,252	\$ 739,280

MISO Day 2 Joint Report
Wholesale Margins
Northern States Power Company d/b/a Xcel Energy

- A. How wholesale margins are generated and what utility resources are used to generate them.

The Company's trading operation generates revenue from Asset based and Non-Asset based transactions. Asset based transactions are sales to other utilities using Company owned generation resources and long term purchases acquired to serve native load customers. Asset based transactions existed at the time of the Company's most recent completed electric rate case in 1993.

Non-asset based transactions are sales made that are not made from Company owned generation and long term purchased resources but rather through short term trading arrangements. The resources used for non-asset based transactions involves the time of the traders and certain information systems. Non-asset based transactions did not exist at the time of the Company's 1993 rate case, but are discussed in the Company's pending electric case (Docket No. E002/GR-05-1428).

Finally, the Company has certain wholesale municipal customers that receive what is essentially a cost of service rate (as the price is indexed to Minnesota retail rates). Costs are assigned to this FERC jurisdiction and these native customers are served through the same resources as retail customers. Since system costs are allocated to these transactions in a manner similar to allocations to the North Dakota and South Dakota retail jurisdictions, they do not generate wholesale margins subject to revenue crediting.

- B. The level of wholesale revenues and related expenses for 2005.

Xcel Energy had \$74 million in total company Asset based margins in 2005, which equates to roughly \$55 million on a Minnesota jurisdictional basis. It had Non-Asset based margins of \$2.8 million on a total company basis after accounting for the effect of the Joint Operating Agreement (a FERC-jurisdictional agreement providing for certain margin sharing among Xcel Energy, Public Service Company of Colorado and Southwestern Public Service Company), and approximately \$2.4 million on a Minnesota jurisdictional basis.

- C. The level of wholesale revenue or margin approved in the utilities most recently approved rate case and how these amounts were calculated in that case.

The Company had a credit to base rates of \$34 million in asset based margins on a total company basis, or \$26 million on a Minnesota jurisdictional basis, included in its 1993 Minnesota rate case. In the pending 2005 electric rate case, the Company has reached a settlement agreement on the treatment of Asset based and Non-asset based margins that was not opposed by any party and that settlement agreement currently pending before the Commission. In addition, concerns regarding the treatment of certain charges to native load municipal customers raised by the Department of Commerce were resolved by the close of the hearing.

MISO Day 2 Joint Report
Wholesale Margins
Minnesota Power

How wholesale margins are generated and what utility resources are used to generate them.

The majority of Minnesota Power wholesale margins (capacity and energy) are currently produced off of a long-term participation power sale sourced from Boswell Units 1 & 2 and Taconite Harbor. Other wholesale margins are produced when power supply exceeds requirements.

- A. The level of wholesale revenues and related expenses for 2005.

Minnesota Power's 2005 Regulated Wholesale Power Marketing revenues were \$53.5M with power supply costs of \$32.3M.

- B. The level of wholesale revenue or margin approved in the utilities most recently approved rate case and how these amounts were calculated in that case.

Minnesota Power's most recent Minnesota Retail Rate Case (Docket No. E-015/GR-94-001) was based on a 1994 test year. Final rates reflect \$30.2M in wholesale revenues with \$16.7M of expenses producing a margin of \$13.5M. The amounts were calculated based on the expected sales in 1994.