

Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: July 30, 2015 **Agenda Item #4

Company: Xcel Energy (Xcel or the Company)

Docket No. **E-002/M-15-401**

**In the Matter of the Petition of Northern States Power Company, d/b/a
Xcel Energy, for Approval of the Acquisition of the 200 MW Courtenay
Wind Farm**

Issue: Should the Commission approve Xcel's proposal to acquire Courtenay Wind,
with or without conditions, pursuant to Minn. Stat. § 216B.1645, subd. 2a?

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Relevant Documents

Xcel Energy, Petition (public and non-public) April 30, 2015
Department of Commerce, Initial Comments (public and non-public) June 1, 2015
Xcel Energy, Reply Comments June 11, 2015
Department of Commerce, Response to Reply Comments June 22, 2015
Xcel Energy, Additional Reply Comments July 14, 2015
Department of Commerce, Letter July 17, 2015

The attached materials are workpapers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless noted otherwise.

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I. BACKGROUND

Courtenay Wind is a 200-megawatt (MW) wind power purchase agreement (PPA) that Xcel signed in 2013. The facility is located in east-central North Dakota in Stutsman County. For various reasons,¹ the developer, Geronimo Energy, has decided to exit the project, providing an opportunity for Xcel to pursue ownership. In the instant docket (the Courtenay Petition), Xcel is seeking Commission approval to acquire this project from Geronimo.

Courtenay Wind has an estimated project cost of approximately \$300 million, and it must be in-service by the end of 2016 to be eligible for the federal wind production tax credit (PTC). Due to new and/or renegotiated vendor and landowner agreements, internal fees, and the costs to “cure” certain transmission and interconnection risks, the updated levelized cost of the Courtenay project has increased slightly; however, the new levelized cost estimate remains well below the \$29 per MWh price threshold Xcel used to evaluate bids in its 2013 wind RFP.

Based on the revised economic analysis, Xcel still projects the Courtenay project will have a significant net benefit to the NSP system. In levelized cost terms, Xcel estimates a total net benefit of \$24.24 per MWh. According to Xcel’s Strategist analysis, the addition of Courtenay will save \$222 million over the project’s economic life (in Present Value of Societal Costs, or PVSC, terms), when compared to abandoning the project altogether.²

Xcel’s Courtenay Petition and the Department of Commerce (the Department) comments each provide a comprehensive description of the Courtenay facility, including further detail on the economic analysis and the project’s regulatory history in the Company’s Minnesota and North Dakota jurisdictions. Therefore, these staff briefing papers are intentionally limited to a discussion of the reasonableness of Xcel’s decision to acquire Courtenay, and to the ratemaking issues which remain or have emerged since 2013. Additionally, staff discusses the Department’s recommendations, provides alternate wording of the Department’s recommendations for the Commission’s consideration, and introduces new decision options regarding cost recovery.

II. DISPUTED ISSUES

Xcel and the Department are in near-complete agreement that the Commission should approve Xcel’s acquisition of Courtenay Wind. However, the disputed item which remains appears to be a threshold issue, as the Department recommends “conditional approval” of the Courtenay Petition. Some questions, then, are whether Xcel would terminate the PPA with the Department’s condition attached, or whether the Department would still recommend approval with their condition rejected or tabled for a future proceeding.

¹ Staff note: Xcel discusses these reasons throughout its Petition, specifically on page 8.

² Staff note: Xcel ran its Strategist model using the Commission’s approved CO₂ values, which the Company is required to do under Minn. Stat. § 216H.06. In North Dakota, though, Xcel is prohibited from incorporating CO₂ values into its modeling. Thus, a comparison of the two Petitions yields different values of total net benefits. However, in reviewing Xcel’s modeling in this docket and in its North Dakota Advance Determination of Prudence Petition, filed with the North Dakota PSC on May 6, 2015, Staff notes that the two models do not yield different economic *conclusions*. In Xcel’s North Dakota ADP filing, Xcel found that the Courtenay acquisition creates system net benefits under all scenarios.

According to the Department, Xcel should credit its Minnesota ratepayers with a share of income tax benefits Xcel may receive from the State of North Dakota for Courtenay Wind. The Department states their overall position in their June 22, 2015 Response comments:

The DOC recommends **conditional approval** as set forth in the attached Response Comments [cover page] ...

III. DOC RECOMMENDATIONS

The Department recommend[s] that the Commission approve Xcel's proposal to purchase and develop the Courtenay Project along with Xcel's proposal to forgo capital costs that exceed their estimates in this proceeding. In addition, the Department recommends that the Commission require Xcel to credit its Minnesota ratepayers for their proportionate share of utilized [North Dakota Income Tax Credits] associated with the Courtney Project, based on the pro-rata share of the costs of the Courtenay project that is charged to Minnesota ratepayers. [p. 6]

Xcel refers to the North Dakota Income Tax Credit (the ND ITC) as "negligible" and discusses in its Reply comments and Additional comments the applicability of the ND ITC to the Courtenay Project. In short, Xcel believes that (1) since the economic analyses of Courtenay did not include the effects of the ND ITC and (2) since the Department supports approval of the Project based on the levelized cost analysis, Xcel does not believe any additional conditions related to ND ITC are necessary. The Department filed a Response to Reply comments and a Letter refuting Xcel's arguments. In short, the Department believes it would be reasonable, fair, and consistent with the Commission's treatment of ND ITCs in past dockets to require Xcel to credit its Minnesota ratepayers for their proportionate share of utilized ND ITCs.

Arguments regarding the utilization of the ND ITC are volleyed back and forth in the record, through letters and comments submitted before and after the comment deadline. The Department and Xcel appear to be at a standstill on this issue. However, while additional oral comments could help build some consensus, and they could certainly be instructive to the Commission's decision, staff does not believe that the ND ITC issue needs to be resolved as a condition for the Commission's determination of the reasonableness of the Courtenay acquisition. Thus, the Commission could address the approval of the acquisition with or apart from the ND ITC issue. As such, staff split apart the Department recommendations and included them as separate issues in the decision options section of this briefing paper (with some alternatives, which are staff variations of the Department's proposed language).

III. NORTH DAKOTA INCOME TAX CREDIT

Xcel direct assigns state-level taxes to the respective states. Given this method, Xcel reasons that the ND ITC is not available to offset the cost of service for the remaining four jurisdictions (Michigan, Minnesota, South Dakota and Wisconsin). In other words, ND ITCs, which offset North Dakota income taxes, are considered a cost of service savings to only its North Dakota customers.

ND ITCs from wind energy projects installed after 2011 have a ten-year carry-forward life, and Xcel expects these tax credits will more than offset its North Dakota income tax liability over this same span. Under Xcel's current allocation, its North Dakota customers will have no state income tax costs for this period of time due to the building of the Borders Wind farm. The Courtenay Wind Project would extend the ND state income tax elimination period by one year.

To further explore the fairness of Xcel's cost of service assignment of ND ITCs and other state tax credits, the Commission could adopt Xcel's position to defer the ND ITC issue in this docket and require Xcel to address and include a discussion of this matter in its next rate case.³ As Xcel contends in its July 14, 2015 Additional Reply comments, it could be unnecessarily problematic to isolate such small potential benefits into a decision for this docket, when such a decision could have unintended consequences. Xcel then provides three justifications for its position that a deferral is more reasonable than a decision now:

- Very little of the ND ITC will be attributable to the Courtenay Project;
- Because the ND ITC can only offset Xcel's cost of service in North Dakota, implementing something other than stand-alone tax treatment would require approval from the North Dakota PSC; and
- Final resolution of the issue at a later time can be based on a complete record, which would include ND ITC treatment of the Borders Wind Project.

Xcel suggests the Commission address the treatment of the ND ITC in proceedings relating to the Borders Wind Project, either in Xcel's 2016 rate case or in the 2015 capital true-up arising out of the Company's 2014 rate case.

The Department counters there is already clear precedent demonstrating that the Commission has addressed the treatment of the ND ITC, and the Department cites three dockets in its July 17, 2015 Letter pertaining to this statement.⁴ According to the Department, Xcel should apply the same methodology to the Courtenay Project as it has for these other projects, by using Xcel's previously defined energy allocators for each state.

Overall, staff agrees with Xcel that Courtenay Wind appears to be an economic resource regardless of the availability and utilization of the ND ITC. However, Staff agrees with the Department that, to the extent benefits exist and are available to Minnesota ratepayers, Xcel's Minnesota ratepayers should receive those benefits. In staff's view, it should not matter whether the Strategist modeling incorporates the tax benefits or not; the result showing that Courtenay is economic without them should not preclude the Commission from exploring additional ratepayer benefits. Doing so would simply make the project a more economic resource for Minnesota ratepayers. Staff also sees merit to the Department's argument (made in their July 17 Letter) that a decision on the ND ITC dispute in this docket could be preferable, if only to save regulatory resources from having to address this issue again in a future proceeding.

³ This proposal is outlined in Xcel's July 14, 2015 Additional Reply Comments.

⁴ On pp. 1-2, the Department cites the following three dockets in which the ND ITC issue has previously been resolved: Merricourt Wind (Docket No. 08-1437); Xcel's 2009 RES Rider (Docket No. 09-1083); and Xcel's 2010 RES Rider (Docket No. 10-1066).

With any path the Commission chooses, based on the economic analysis alone, the Courtenay acquisition could be approved with or without a decision on the utilization of the ND ITC, which is why staff includes them as separate options. While staff's position is that Minnesota ratepayers should receive its proportionate, fair share of available benefits, it does not seem to be the case that the cost-effectiveness of Courtenay Wind is dependent on Minnesota ratepayers receiving these benefits.

IV. CONSTRUCTION AND CAPITAL RISKS

In its July 16, 2013 Petition for Approval of 600 MW of Wind Generation (which included Courtenay), Xcel stated, "By contracting only for the output of the Courtenay and Odell projects, the Company has fully-shifted the risks of development and construction to Geronimo Energy."⁵ Also, Xcel provided in its timeline an expectation that "[t]he bulk of construction of the Courtenay project is expected to begin in the spring of 2014."⁶ As it stands now, acquiring the project means assuming these risks previously borne by Geronimo. While the economic viability may not rest on the ND ITC, there is urgency and an economic necessity for Xcel to capture the benefits of the federal wind PTC, which requires the Courtenay Project to be placed in service no later than December 31, 2016. To meet this deadline, construction needs to begin in 2015, but construction cannot start until the North Dakota Public Service Commission (ND PSC) issues a Certificate of Public Convenience and Necessity (CPCN).⁷

In addition, there is an absorbed risk with regard to the actual cost of development and construction itself. Rather than basing Courtenay's investment recovery on actual costs, Xcel has proposed to recover a return of and a return on the Project's estimated cost amount. Xcel characterized its proposal as risk mitigation for customers. Xcel calculated the overall Project capital expenditures to be approximately \$300 million, plus an Allowance for Funds Used During Construction (AFUDC) estimate of \$12.2 million.⁸ Under its proposal, Xcel would forgo recovery of any costs that exceed its estimate, but would be permitted rate recovery based upon the estimated project cost, even if the actual cost of the project is less.⁹

Xcel likened its proposal to the capital recovery approach used to establish Black Dog 6's pricing terms in its recent competitive resource acquisition proceeding.¹⁰ Staff notes that the resource acquisition docket may not be the most appropriate example to establish precedence. First, it should be noted that that bidding docket was a unique circumstance in which Xcel was both bidder and buyer; and in that docket, the Commission established uniform rules under which bidders would be held to the prices and terms used for each bid. Thus, in an effort to hold bidders to their terms, including Xcel, bidders could keep their savings if actual costs turned out

⁵ Xcel Petition for Approval of 600 MW of Wind Generation, July 16, 2013, p. 21.

⁶ *Ibid*, p. 17.

⁷ Footnote 20 on Page 17 of Xcel's Courtenay Petition states, "Under North Dakota requirements, Geronimo was not required to obtain a Certificate of Public Convenience and Necessity because it is not a public utility. As a public utility acquiring the Project, the Company will need to obtain a CPCN prior to formal project construction."

⁸ Xcel Petition, Public and Non-Public Versions, p. 11.

⁹ Xcel proposal is a return on and of the estimated Project cost. Docket E-002/M-15-401 Initial Petition Filing, pp. 12-13 (April 30, 2015)

¹⁰ Docket 12-1240, Commission Order, Issued April 16, 2015

to be lower.¹¹ Second, staff notes that in the resource acquisition docket, Xcel's bid initially included a different cost-recovery approach for Black Dog 6 than what was ultimately used. The initial bid offered a MERP-style rate recovery mechanism,¹² which was later modified to conform to the Commission's Order establishing uniform rules.¹³

Commission approval of the Courtenay Petition's cost recovery proposal would be a move away from traditional cost-based rate setting. The merits of this proposal may be better addressed in performance-based rates discussions. Permitting recovery of capital additions based upon estimated costs may alleviate future prudence challenges and uncertainties, but may also lead to excessive padding of estimates. Staff believes that such a shift in rate-setting may require additional oversight upfront to review Xcel's project cost estimates.

In the Company's pending multi-year rate case, the Commission approved use of a capital true-up.¹⁴ Given the Company's intention to file another electric rate case later this year, the Courtenay Wind Project would likely be reflected in a 2016 test year or subsequent step year. Should the Commission prefer to apply traditional cost-based rate setting with this project, a capital true-up feature in the upcoming rate case could again be used.

Alternatively, Xcel's proposal could be modified. For example, in theory and if permitted under statute, the Commission could allow Xcel an earnings or a shared savings incentive, yet confine recovery of project costs to actual costs. Specifically, if actual project costs are lower than the \$312 million estimate (with AFUDC), the Company could be allowed to earn a 'return on' \$312 million, but return of the project cost would be based on the lower actual cost amount. Likewise, if actual costs exceed the estimate, the Company may recover the excess project cost (return of), but is limited to a return on the \$312 estimated cost. This modification retains some incentives, may still increase upfront oversight requirements, yet simulates some past Commission rate treatment of costs above estimates deemed reasonable. For example, for Xcel's Nobles Wind project, costs in excess of estimates were disputed in both the 2010 and 2012 Xcel rate cases.¹⁵ The Commission resolution allowed Xcel to recover project costs that exceeded its competitive bid amount, but did not allow the Company to earn a return on those excess (and arguably imprudent or unreasonable) costs.¹⁶

The Department accepted Xcel's Project rate base proposal in part because it was balanced and because the pricing outcome would be similar to a PPA.¹⁷ Although Xcel is stepping in for a failed PPA, staff does not agree that Xcel's capital recovery proposal is equivalent to a PPA outcome because several rate/costs risks associated with this resource remain with customers. For example, the risks associated with output performance, storm damage/repair costs, outages,

¹¹ Docket 12-1240, Commission Order, Issued May 23, 2014

¹² *Staff note:* A "MERP-style" cost-recovery approach refers to the cost recovery mechanism developed for the Metropolitan Emissions Reduction Project (MERP), whereby the ROE could be adjusted up or down when placed in service to reflect any difference between the estimated capital cost and the actual capital cost.

¹³ Docket 12-1240, Xcel Petition Seeking Approval for a Competitive Resource Acquisition, April 15, 2013.

¹⁴ Docket No. E-002/GR-13-868.

¹⁵ Dockets E-002/ GR-10-971 and E-002/GR-12-961.

¹⁶ Commission Order (September 3, 2013), Docket E-002/GR-12-961, *In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota*.

¹⁷ Department Comments (June 1, 2015), page 20, last paragraph.

ongoing O&M and other capital costs, future decommissioning costs, etc., remain with Xcel's customers. The Department also noted the significant ownership-related risks.¹⁸

V. TRANSMISSION RISKS

Courtenay Wind also has a unique operational risk associated with transmitting power over transmission lines not owned by a MISO member. From the facility substation, a 115 kV transmission line will run south from the center of the turbine array to the Otter Tail Power Jamestown 345kV/115kV substation, which is the point of interconnection. While Otter Tail is a MISO member, the transmission lines leaving the Jamestown substation are all owned by Minnkota Power Cooperative, who is not a MISO member. According to Xcel's July 2013 Petition, "There are outstanding disputes over whether the situation requires additional payments to Minnkota. However, we have mitigated the impact of this possibility through the PPA, which requires Geronimo to absorb any such cost risks."¹⁹

Similar to the construction and capital risks identified above, now that Courtenay Wind is an acquisition, not a PPA, these risks shift from Geronimo to the ratepayer. With regard to these risks, according to Xcel, those which would have applied to Geronimo have since been resolved. On June 26, 2015, Minnkota, Geronimo and Xcel all executed a Settlement Agreement that resolves the outstanding transmission delivery issues. This Settlement Agreement will be filed with the Federal Energy Regulatory Commission (FERC), and Xcel believes "the FERC proceeding will be dismissed in the near future."²⁰ Because securing all regulatory filings is a condition for not terminating the PPA with Geronimo, if the outstanding disputes are dismissed at FERC, Xcel can proceed with moving Courtenay Wind forward to meet the December 31, 2016 wind PTC deadline.

VI. JURISDICTIONAL ISSUES

A benefit of the Courtenay Acquisition is the mitigation of multi-jurisdictional issues. Xcel's development of Courtenay is contingent upon several regulatory approvals, which include:

- Approval from the Minnesota Commission;
- Receipt of a Certificate of Public Convenience and Necessity from the ND PSC;
- Transfer of the Certificate of Site Compatibility from Courtenay Wind Farm LLC to Xcel; and
- Receipt of an Advance Determination of Prudence (ADP) from the ND PSC.

If all regulatory approvals are received, construction is expected to begin in 2015, and the project schedule expects commercial operation in late 2016. If all regulatory approvals are not received, Xcel will terminate the Courtenay PPA. Thus, the jurisdictional risk is mitigated because the only way Courtenay Wind will move forward is if Xcel receives regulatory approval at all levels, including at FERC.

¹⁸ See also Department Comments (June 1, 2015), page 22, last paragraph.

¹⁹ Docket No. 13-603, July 16, 2013, Xcel Petition for Approval of 600 MW of Wind Generation, p. 23.

²⁰ Xcel, Additional Reply Comments, p. 2.

The ND PSC will hear the issues related to Courtenay Wind on July 23, 2015. Staff is not certain whether an issue in that case is whether North Dakota's approval of Courtenay Wind is contingent on North Dakota ratepayers receiving all benefits from the ND ITC.

Decision Options

Approval

1. Approve Xcel's proposal to purchase and develop the Courtenay Project.

North Dakota Income Tax Credit

2. Defer making a decision on the disputed North Dakota Investment Tax (ND ITC) allocation issue to Xcel Energy's next electric rate case; **or**
3. Direct Xcel to credit Minnesota ratepayers for their proportionate share of utilized North Dakota Investment Tax Credits associated with the Courtenay Project; (DOC) **or**
4. Approve Xcel's proposal to direct assign all North Dakota Investment Tax Credits to only its North Dakota customers. (Xcel)

AND

5. Require the Company to include in the initial filing in its next rate case both testimony and schedules disclosing, in detail and by project, the ND ITCs and other foreign state tax credits earned, that have resulted from the utility's investments and activity.

Cost Recovery

6. Authorize cost recovery for the Courtenay Project upon completion based on:
 - a. The anticipated \$300 million project cost plus an Allowance for Funds Used During Construction (AFUDC) associated with the \$300 million, (Xcel, DOC) **or**
 - b. The actual, reasonable and prudently incurred project costs plus the associated Allowance for Funds Used During Construction (AFUDC); (Staff Alternative #1) **or**
 - c. A return of the actual, reasonable and prudently incurred project costs plus the associated AFUDC and a return on the approximately \$300 million project cost plus an Allowance for Funds Used During Construction (AFUDC) associated with the \$300 million (net of amortization); **or** (Staff Alternative #2)
7. Defer making a decision on cost recovery for this project to Xcel Energy's next electric rate case.