division of energy resources
Minnesota Department of Commerce

85 7th Place East, Suite 500, St. Paul, MN 55101-2198
Main: 651.539.1500
Fax: 651.539.1549

mn.gov/commerce/energy

November 20, 2013

Burl W. Haar
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: **Response Comments of the Minnesota Department of Commerce**
Division of Energy Resources
Docket No. E002/M-00-1583

Dear Dr. Haar:

Attached are the response comments of the Minnesota Department of Commerce, Division of Energy Resources (Department) in response to Xcel Energy's November 8, 2013 reply comments in the following matter:

Xcel Energy's Request for Approval of a Renewable Development Fund Oversight Process

Xcel Energy's November 8, 2013 reply comments were submitted, in response to the Department's October 2, 2013 comments, in this matter by:

Paul J. Lehman
Manager, Regulatory Compliance and Filings
Northern States Power Company d/b/a Xcel Energy
414 Nicollet Mall
Minneapolis, Minnesota 55401-1993

The Department recommends that the Commission **require Xcel Energy to return $1.1 million to the Renewable Development Fund, pertaining to AnAerobics**. The Department is available to answer any questions the Commission may have.

Sincerely,

/s/ SAMIR OUANES
Rates Analyst

SO/lt
Attachment

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

COMMENTS OF THE
MINNESOTA DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

DOCKET NO. E002/M-00-1583

I. SUMMARY

On August 8, 2013, Northern States Power Company d/b/a Xcel Energy (Xcel or the Company) filed a Status Update on the development of replacement projects for the AnAerobics Renewable Development Fund (RDF) project (Project) equipment pursuant to the August 17, 2004 *Order Deferring Decision, Allowing Time to Develop Alternative Uses, and Requiring Consultation and Report* (2004 Order) in Docket E002/M-00-1583.

On October 2, 2013, the Minnesota Department of Commerce, Division of Energy Resources (Department) recommended that the Minnesota Public Utilities Commission (Commission) find that the RDF grant amount of $1.1 million of ratepayer fund expended by Xcel was not shown to be prudently incurred for the following documented reasons:

- The Project failed not because of the type of risks associated with "emerging technologies," such as equipment costs or risks of performance failure associated with new technologies, but because of unreasonably loose contract management.

- Contract performance risks associated with unreasonable contract management are avoidable risks and should be covered by the party that has the specific knowledge, responsibility and control to execute the contract; such risk should not be shifted to ratepayers.

- Commission approval of a grant contract cannot be interpreted as evidence in favor of the contract's prudency and reasonableness as discussed in the August 5, 2004 Staff Briefing Papers at 12.

- Xcel chose to not review or even request a copy of any agreement between AnAerobics and Seneca Foods regarding the availability of onsite waste processing and conversion before executing the grant contract, even though the Project's success depended on this availability. As a result, Seneca Foods was left free to potentially discontinue AnAerobics' onsite waste processing and conversion, which it did.

- A prudent and reasonable person investing his or her own money would not have executed such a contract without at least ensuring that all third parties involved would be bound by a reasonable contract. At a minimum, a reasonable person would have wanted to understand performance and breach provisions in the third parties' contract(s) before committing to investing such funds.

- Problems due to Xcel's unreasonable contract management were compounded by the Company's lack of transparency and selective treatment of the Commission-approved grant contract provisions as discussed further in sections III.B and III.C of the Department's October 2, 2013 comments.

- Xcel unreasonably executed two amendments *without Commission review or approval*, and without first assessing the continued viability of the Project. Thus, the record does not support a Commission determination that Xcel provided reasonable protections for ratepayers in its contractual dealings with AnAerobics.

- Xcel may have been "legally obligated to pay the funds to AnAerobics." However, this obligation, if it existed, is not under the Commission-approved contract, but may be under the Company's unilateral choice to bind itself with respect to changes to the Commission-approved contract.

- Forcing AnAerobics to file a legal action to receive the milestones payments may have provided better results for Xcel's ratepayers than Xcel's reliance on AnAerobics' May 22, 2003 commitment to "mitigate expenses and obligations incurred." It may have at least allowed Xcel to understand performance and breach provisions of any relevant agreement between AnAerobics and Seneca Foods, albeit after-the-fact. In any event, the Company has not demonstrated the reasonableness of its actions or inactions in this regard on behalf of ratepayers.

If the Commission agrees with the Department's conclusion that the RDF grant amount of $1.1 million of ratepayer fund expended by Xcel was not shown to be prudently incurred, the Department recommended that the Commission require Xcel to return the expended amount of $1.1 million to the RDF fund for use in future funding cycles. Any funds obtained through the sale of AnAerobics' equipment, including the $50,000 discussed by the Company, should be retained by Xcel.

On November 8, 2013, the Company filed reply comments (Reply Comments) in response to the Department's October 2, 2013 comments. Xcel still believes that "no disallowance of costs from this past RDF project is necessary."[1]

II. DEPARTMENT ANALYSIS

The Department notes that Xcel's arguments in Reply Comments appear to fit under the following three broad categories: accountability lag, contract mismanagement and RDF process improvements. The Department addresses each of these issues in the next three sections.

1. Accountability Lag

On page 2 of Xcel's Reply Comments, the Company states that "[t]his AnAerobics project was selected and approved during our first RDF cycle, over <u>11 years ago</u>." (emphasis added)

The Department notes that Xcel filed a letter on August 4, 2004 requesting that the Commission allow the Company time to pursue applications of the bio-digester in an effort to obtain results for ratepayers similar to that anticipated in the original AnAerobics proposal. The 2004 Order granted the Company's request and deferred decision on the issue of disallowance of project costs to a later date. Thus, this issue was raised as soon as Xcel's actions were known and the Commission gave Xcel time to work out a reasonable solution since the Company claimed at that time that such a solution was possible.

The Commission provided Xcel with ample time to pursue applications of the bio-digester in an effort to obtain results for ratepayers similar to that anticipated in the original AnAerobics proposal. After several unsuccessful attempts over the last ten years to obtain such results, the Company finally decided to request the Commission to make a determination regarding the issue of disallowance of AnAerobics costs.

The Department is certainly aware that Xcel has taken a considerably long time to try to resolve this issue and was unsuccessful in doing so. However, Xcel's lag should not result in punishment of Xcel's ratepayers.

2. Contract Mismanagement

On page 3 of Xcel's Reply Comments, the Company states that "this project did not succeed because of the technology and methods our vendor employed, not because of contract mismanagement."

The record does not include any evidence in support of Xcel's claim. In fact, as fully discussed and supported in the Department's October 2, 2013 comments and summarized in Section I above, unreasonably loose contract management is the reason why the Project failed. As noted above, a prudent and reasonable person investing his or her own money would not have executed

[1] Source: page 2 of Xcel's Reply Comments.

such a contract without at least ensuring that all third parties involved would be bound by a reasonable contract. At a minimum, a reasonable person would have wanted to understand performance and breach provisions in the third parties' contract(s) before committing to investing such funds.

On page 5 of Xcel's Reply Comments, the Company stated that "[t]he [2004] Order language recognizes the inherent risk of project failure when dealing with emerging technologies."

The Department also recognizes the inherent risk of project failure when dealing with emerging technologies. For example, the Department did not raise objections to the failure of the Biomass Demonstration Plant at Central Minnesota Ethanol Cooperative (EP44) as a result of "refractory problems."[2]

However, the Project did not fail due to the "emerging technologies" nature of the Project, such as equipment costs or risks of performance failure associated with new technologies, but because of unreasonable contract management as fully discussed and supported in the Department's October 2, 2013 comments and summarized in Section I above.

3. RDF Process Improvements

The Department agrees that "RDF administrative and contractual improvements were put into effect" by Xcel as the result of "stakeholder meetings with Department of Commerce, Commission staff, and representatives of the RDF Board."[3]

The Department commends Xcel for implementing these improvements. However, the Department notes that these improvements were not added until after the Department raised concerns about Xcel's unreasonable contract management. Further, the Department believes that there is still room for improvement of the RDF administrative and contractual processes by Xcel. In particular, the Department notes that Xcel's April 6, 2007 proposed RDF grant contract with RCM Digesters, Inc. and Xcel's November 6, 2012 filing requesting approval of an assignment of the RDF grant contract from RCM Digesters, Inc. to Diamond K Feeds, LLP missed at least one red flag – the availability (at the time of the execution of the grant contract and at the time of the proposed assignment) of the needed fuel supply at a reasonable cost - a reasonable project management process would have identified.[4]

Given the absence of a market mechanism to provide the right incentives, accountability is key to ensuring that appropriate procedures are updated, put in place and implemented under the current regulatory framework.

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[2] A discussion of the issues surrounding the failure of EP44 is provided in the "Lessons Learned" section (pp. 14-16) of the Department's November 1, 2012 Comments and Xcel's November 13, 2012 Reply Comments (pp. 3-6) in Docket No. E002/M-12-1062.

[3] Source: page 3 of Xcel's Reply Comments.

[4] See issues raised by the Department in its December 6, 2012 comments at pages 4-5 out of 30 and at page 11 out of 30 in Docket No. E002/M-03-1883.

III. DEPARTMENT RECOMMENDATIONS

Based on Xcel's failure to demonstrate the reasonableness of its actions, the Department continues to recommend that the Commission find that the RDF grant amount of $1.1 million of ratepayer funds expended by Xcel was not shown to be prudently incurred.

If the Commission agrees with this conclusion, the Department recommends that the Commission require Xcel to return the expended amount of $1.1 million to the RDF fund for use in future funding cycles. Any funds obtained through the sale of AnAerobics' equipment, including the $50,000 discussed by the Company, should be retained by Xcel.

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CERTIFICATE OF SERVICE

I, Sharon Ferguson, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, e-mail, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

Minnesota Department of Commerce
Response Comments

Docket No. E002/M-00-1583

Dated this **20th** day of **November, 2013**

/s/Sharon Ferguson

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Steven J.	Almos	salmos.wn@bsm.com	Bay State Milling Company	55 Franklin Street Winona, MN 55987	Paper Service	No	OFF_SL_0-1583_1
Julia	Anderson	Julia.Anderson@ag.state.mn.us	Office of the Attorney General-DOC	1800 BRM Tower 445 Minnesota St St. Paul, MN 551012134	Electronic Service	Yes	OFF_SL_0-1583_1
Janet	Anderson	jainstp@q.com	-	1799 Sargent St. Paul, MN 55105	Electronic Service	No	OFF_SL_0-1583_1
Karen	Anderson		American Sustainable Energy Council	80 South 8th Street, #900 Minneapolis, MN 55402	Paper Service	No	OFF_SL_0-1583_1
John	Bailey	bailey@ilsr.org	Institute For Local Self-Reliance	1313 5th St SE Ste 303 Minneapolis, MN 55414	Electronic Service	No	OFF_SL_0-1583_1
Jim	Boerboom	jim.boerboom@state.mn.us	MN Department of Agriculture	625 North Robert Street St. Paul, MN 551552538	Electronic Service	No	OFF_SL_0-1583_1
Edna C.	Brazaitis		Friends of the Riverfront	PO Box 580545 Minneapolis, MN 554580545	Paper Service	No	OFF_SL_0-1583_1
George	Crocker	gwillc@nawo.org	North American Water Office	PO Box 174 Lake Elmo, MN 55042	Paper Service	No	OFF_SL_0-1583_1
Lisa	Daniels	lisadaniels@windustry.org	Windustry	201 Ridgewood Avenue Minneapolis, MN 55403	Paper Service	No	OFF_SL_0-1583_1
Executive	Director		Onanegozie RC&D	2008 Mahogany Street, #3 Mora, MN 550517164	Paper Service	No	OFF_SL_0-1583_1

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Ian	Dobson	ian.dobson@ag.state.mn.us	Office of the Attorney General-RUD	Antitrust and Utilities Division 445 Minnesota Street, 1400 BRM Tower St. Paul, MN 55101	Electronic Service	No	OFF_SL_0-1583_1
John R.	Dunlop, P.E.	JRDunlop@igc.org	American Wind Energy Association	Suite 300 448 Morgan Ave. S. Minneapolis, MN 554052030	Paper Service	No	OFF_SL_0-1583_1
Sharon	Ferguson	sharon.ferguson@state.mn.us	Department of Commerce	85 7th Place E Ste 500 Saint Paul, MN 551012198	Electronic Service	Yes	OFF_SL_0-1583_1
Doug	Fredrickson			400 County Road 50 Avon, MN 56310	Paper Service	No	OFF_SL_0-1583_1
Gary	Gillet		University Of Minnesota	Suite 450 200 Oak Street SE Minneapolis, MN 554552070	Paper Service	No	OFF_SL_0-1583_1
Elizabeth	Goodpaster	bgoodpaster@mncenter.org	MN Center for Environmental Advocacy	Suite 206 26 East Exchange Street St. Paul, MN 551011667	Electronic Service	No	OFF_SL_0-1583_1
Larry	Greden		Greden Dairy	RR 1, Box 13 Altura, MN 55910	Paper Service	No	OFF_SL_0-1583_1
Burl W.	Haar	burl.haar@state.mn.us	Public Utilities Commission	Suite 350 121 7th Place East St. Paul, MN 551012147	Electronic Service	Yes	OFF_SL_0-1583_1
Andy	Herring		Colorado School Of Mines	1500 Illinois Street Golden, CO 80401	Paper Service	No	OFF_SL_0-1583_1
Jerry	Horgan		Pipestone-Jasper Public Sch Dist #2689	1401 Seventh Street SW Pipestone, MN 561641877	Paper Service	No	OFF_SL_0-1583_1

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Ralph	Jacobson	N/A	Innovative Power Systems, Inc.	1413 Hunting Valley Rd Ste 1 Saint Paul, MN 55109-1555	Paper Service	No	OFF_SL_0-1583_1
Eric	Jensen	ejensen@iwla.org	Izaak Walton League of America	Suite 202 1619 Dayton Avenue St. Paul, MN 55104	Electronic Service	No	OFF_SL_0-1583_1
Cindy	Jepsen		Capitol Resources	Box 254 Marine On St. Croix, MN 55047	Paper Service	No	OFF_SL_0-1583_1
John	Johnson		Stewart Energy Products	22739 Highway 212 E. P.O. Box 219 Stewart, MN 55385	Paper Service	No	OFF_SL_0-1583_1
Timothy M.	Kelley		Leonard, Street & Deinard	Suite 2300 150 South Fifth Street Minneapolis, MN 55402	Paper Service	No	OFF_SL_0-1583_1
Nancy	Kelly	bademailnancyk@eurekarecycling.org	Eureka Recycling	2828 Kennedy Street NE Minneapolis, MN 55413	Paper Service	No	OFF_SL_0-1583_1
Michael	Krikava	mkrikava@briggs.com	Briggs And Morgan, P.A.	2200 IDS Center 80 S 8th St Minneapolis, MN 55402	Electronic Service	No	OFF_SL_0-1583_1
Sheryl	Landis		Energy & Environmental Research Center	PO Box 9018 15 North 23RD Street Grand Forks, ND 582029018	Paper Service	No	OFF_SL_0-1583_1
John	Lindell	agorud.ecf@ag.state.mn.us	Office of the Attorney General-RUD	1400 BRM Tower 445 Minnesota St St. Paul, MN 551012130	Electronic Service	Yes	OFF_SL_0-1583_1
Michael	Loeffler	mike.loeffler@nngco.com	Northern Natural Gas Co.	CORP HQ, 714 1111 So. 103rd Street Omaha, NE 681241000	Electronic Service	No	OFF_SL_0-1583_1

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Gary C.	Lundeen C.P.A.		Crown Hydro LLC	1040 Sixth Street South Hopkins, MN 55343	Paper Service	No	OFF_SL_0-1583_1
Pam	Marshall	pam@energycents.org	Energy CENTS Coalition	823 7th St E St. Paul, MN 55106	Electronic Service	No	OFF_SL_0-1583_1
Richard	Mattocks		Environomics	2517 Rte. 44, 11-221 Salt Point, NY 12578	Paper Service	No	OFF_SL_0-1583_1
Clark	McDonald			504 - 20Th Street North Benson, MN 56215	Paper Service	No	OFF_SL_0-1583_1
Diana	McKeown		Clean Water Action Alliance Of MN	326 Hennepin Avenue East Minneapolis, MN 55414	Paper Service	No	OFF_SL_0-1583_1
David	Ostlie		Energy Performance Systems, Inc.	Suite K 12510 Fletcher Lane Rogers, MN 55374	Paper Service	No	OFF_SL_0-1583_1
David	Planting		Archer Daniels Midland	400 West Erie Rd. Marshall, MN 56258	Paper Service	No	OFF_SL_0-1583_1
Kellye	Rose	kellye@roseconserve.com	Rose Consulting Service, Inc.	10915 Pioneer Drive Burnsville, MN 55337	Paper Service	No	OFF_SL_0-1583_1
Richard	Savelkoul	rsavelkoul@martinsquires.com	Martin & Squires, P.A.	332 Minnesota Street Ste W2750 St. Paul, MN 55101	Electronic Service	No	OFF_SL_0-1583_1
Dean	Sedgwick	N/A	Itasca Power Company	PO Box 457 Bigfork, MN 56628-0457	Paper Service	No	OFF_SL_0-1583_1

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Don	Selmarten			1617 Cole Blvd. Golden, CO 80401	Paper Service	No	OFF_SL_0-1583_1
Sheldon	Strom		Center For Energy And Environment	212 3rd Ave N Ste 560 Minneapolis, MN 554011459	Paper Service	No	OFF_SL_0-1583_1
SaGonna	Thompson	Regulatory.Records@xcelenergy.com	Xcel Energy	414 Nicollet Mall FL 7 Minneapolis, MN 554011993	Electronic Service	No	OFF_SL_0-1583_1
Steven W.	Tyacke	styacke@briggs.com	Briggs And Morgan	2200 IDS Center 80 South Eighth Street Minneapolis, MN 55402	Electronic Service	No	OFF_SL_0-1583_1
Scott	Vreeland		Seward Neighborhood Group	2437 - 33Rd Avenue South Minneapolis, MN 55406	Paper Service	No	OFF_SL_0-1583_1
Heather	Westra		Prairie Island Indian Community	5636 Sturgeon Lake Road Welch, MN 55089	Paper Service	No	OFF_SL_0-1583_1
Paul	White	paul.white@prcwind.com	Project Resources Corp./Tamarac Line LLC/Ridgewind	618 2nd Ave SE Minneapolis, MN 55414	Electronic Service	No	OFF_SL_0-1583_1
Robyn	Woeste	robynwoeste@alliantenergy.com	Interstate Power and Light Company	200 First St SE Cedar Rapids, IA 52401	Electronic Service	No	OFF_SL_0-1583_1