Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: January 28, 2016 .... * Agenda Item # 3

Company: Minnesota Power ("MP" or the "Company")

Docket No. E-015/M-15-699
In the Matter of Minnesota Power's Petition for Approval of an Electric Service Agreement between Magnetation, LLC and Minnesota Power

Issues: **Should the Commission approve Minnesota Power's Electric Service Agreement with Magnetation?**

Staff: Clark Kaml 651-201-2246
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Relevant Documents

Minnesota Power Initial Filing .... July 24, 2015
Fresh Energy Comments .... August 24, 2015
Department of Commerce Comments .... September 23, 2015
Fresh Energy Reply Comments .... October 5, 2015
Minnesota Power Reply Comments .... November 9, 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 otherwise noted.

January 20, 2016

Statement of the Issue

> Should the Commission approve Minnesota Power's Electric Service Agreement ("ESA") with Magnetation LLC ("Magnetation")?

Introduction

Minnesota Power requests approval of its Amended and Restated Electric Service Agreement ("Agreement") with Magnetation, LLC ("Magnetation"). The Agreement, if approved, requires Magnetation to purchase all of its electric service from Minnesota Power through at least 2025 under the Minnesota Power Large Power Service Schedule. The Agreement also allows Magnetation's Plant 2 to receive electric service under MP's Large Power [rate] Schedule.

The Department of Commerce ("Department") and Fresh Energy raised various concerns about MP's proposed Agreement which have been addressed by MP. Staff believes the issue the Commission needs to decide is whether it agrees with the Department's conclusion that MP's ratepayers will clearly not be worse off for the duration of the Agreement as a result of the proposed rates and terms and conditions of service in the proposed ESA.

Background

On July 24, 2015, Minnesota Power filed a petition requesting Commission approval of an ESA between MP and Magnetation.

On August 24, 2015, Fresh Energy filed comments recommending that the Commission amend the proposed ESA to better align with the Commission's order in Minnesota Power's previous Integrated Resource Plan.

On September 23, 2015, the Department of Commerce filed comments recommending approval of the Electric Service Agreement.

On October 5, 2015, Fresh Energy filed reply comments stating that it supports both of the recommendations on page 7 of the Department's September 23, 2015, comments.

On November 9, 2015, Minnesota Power filed reply comments responding to the comments of the Department and Fresh Energy.

(According to newspaper accounts, Magnetation filed for Chapter 11 bankruptcy protection in May 2015. In December 2015, a federal judge sided with Grand Rapids-based Magnetation ordering that a contract between the iron ore supplier and AK Steel must be honored which requires AK to continue to purchase Magnetation's pelletized iron ore processed in Magnetation's Plant 4. In January 2016, Magnetation announced that in addition to closing it Keewatin plant last April, it was also closing its Bovey plant in January 2016.)

Electric Service Agreement. Minn. Stat. § 216B.1621 (2015)

Subdivision 1. Agreement.

When a retail customer of a public utility proposes to acquire power from or construct a new electric power generation facility in the assigned service area of the utility serving the retail customer to provide all or part of the customer's electric service needs, the public utility may negotiate with and enter into an agreement with the customer to supply electric power to the customer in order to defer construction of the facility until the utility has need of power generated by the proposed facility, if the Public Utilities Commission approves the agreement under subdivision 2.

Subd. 2. Commission approval.

(a) The commission shall approve an agreement under this section upon finding that:

(1) the proposed electric service power generation facility could reasonably be expected to qualify for a market value exclusion under section 272.0211;
(2) the public utility has a contractual option to purchase electric power from the proposed facility; and
(3) the public utility can use the output from the proposed facility to meet its future need for power as demonstrated in the most recent resource plan filed with and approved by the commission under section 216B.2422.

(b) Sections 216B.03, 216B.05, 216B.06, 216B.07, 216B.16, 216B.162, and 216B.23 do not apply to an agreement under this section.

Party Positions

Minnesota Power

Minnesota Power's Petition requests Minnesota Public Utilities Commission approval of an Amended and Restated Electric Service Agreement between Minnesota Power and Magnetation, LLC. The Agreement requires Magnetation to purchase its electric service from Minnesota Power through at least 2025 at both Plant 2 and Plant 4 facilities located near Taconite, Minnesota and Coleraine, Minnesota. The Petition proposes to combine two previously-approved service agreements relating to Magnetation under the Minnesota Power Large Power Service Schedule.[1]

The proposed ESA is similar to ESAs between MP and Magnetation approved in Docket Nos. E015/M-11-823, E015/M-13-93, and E015/M-14-130. However, under this proposed ESA, all of Magnetation's electric service requirements will be provided under MP's Large Power ("LP")

[1] The Commission has previously approved separate electric service agreements and subsequent amendments between Minnesota Power and Magnetation in Docket Nos. E015/M-11-823, E015/M-13-93 and E015/M-14-130.

Service Schedule rather than under MP's Large Power [rate] schedule. Under the existing arrangement, Magnetation's Plant 2 receives electric service under MP's Large Light and Power (LLP) Service Schedule. This Agreement, if approved, would apply Minnesota Power's Large Power ("LP Schedule") on a combined basis to Points of Delivery serving both Plant 2 and Plant 4.

Plant 4 has the capacity to produce nearly twice the iron concentrate (with corresponding higher electric usage) compared to Plant 2. MP stated that combined contracts are not unusual on Minnesota Power's system, and a combined Agreement provides benefits both to the customer and to Minnesota Power and its ratepayers.

MP contends that Magnetation can utilize the combined agreement to operate its two facilities on a complementary basis, utilizing the Large Power Electric Service terms to effectively manage electric use at both facilities to optimize production thresholds, maintenance outages, nomination terms and other provisions across a greater plant production landscape.

Fresh Energy Comments

Fresh Energy takes exception to the provision in the proposed ESA which "precludes any right to construct, operate or utilize self-generating or cogenerating capacity, or for Customer to purchase electric service from any other person or party to meet" Magnetation's demand and energy needs during the term of the ESA. Fresh Energy contends that this ESA provision is not consistent with the public interest, inhibits progress on the Commission's Order in Minnesota Power's last Integrated Resource Plan, and is inconsistent with the public interest regarding the system benefits of on-site generation.

Fresh Energy advocates that the Commission order deletion of the following language in the ESA:

> Unless the Parties otherwise agree in a written amendment to this Agreement, Customer agrees that the entire electric service requirement commitment provided in this Paragraph precludes any right to construct, operate or utilize self-generating or cogenerating capacity, or for Customer to purchase electric service from any other person or party to meet the Power and Energy requirement of the Plant 2 Facilities, Plant 4 Facilities and Jesse Loadout Facilities during the term of this Agreement regardless of any changes in applicable law.

and replace it with the following language:

> Both parties agree to identify and analyze energy savings opportunities, including but not limited to, self-generating and cogeneration capacity at the Plant 2 Facilities, Plant 4 Facilities, and the Jesse Loadout Facilities during the term of this Agreement, and pursue these opportunities to the extent they benefit the Customer's long-term operations and expenses and the Company's long-term system-wide resource portfolio.

Department of Commerce Comments

Necessary Conditions

The Department noted that in past dockets, it has identified conditions necessary for the Department to recommend approval of a proposed ESA. The proposed ESA should be approved only if it is in the public interest. For the ESA to be in the public interest, it must meet the following conditions:

1. No party affected by the proposed ESA should be worse off as a result of the amendment.

2. The rates and terms of the ESA must not be discriminatory, the terms of the agreement must be consistent with MP's approved tariffs and available to any other similarly situated large power customer.

Duration of the Agreement

Under paragraph 2 of the proposed ESA, Magnetation would take service from MP through at least 2025, without any prior right of termination. Consistent with the terms of the LP Service Schedule, the ESA may be terminated after 2025 with a written notice four years in advance of cancellation.

Service Requirement

The Service Requirement is provided under "take-or-pay" conditions requiring a Minimum Billing Requirement in monthly bills. Under Paragraph 5 of the proposed ESA, Magnetation is obligated to purchase all its power and energy requirements from MP.

The Department noted that there are additional provisions which include Incremental Production Service, Allowance for Scheduled Maintenance and Increases and Decreases in Service Requirements. These provisions generally allow the customer more flexibility regarding its electric requirement while providing MP with appropriate compensation.

Guaranteed Annual Revenue

The proposed ESA provides for a Guaranteed Annual Revenue requirement that carries forward the amount from the existing Plant 4 ESA to ensure that sufficient revenues from Magnetation are recovered to support the service extension and other costs required to provide service.

Public Interest Determination

1. No party affected by the proposed Amendment should be worse off as a result of the ESA

The Department noted that the parties that may be affected under the proposed ESA are the Company, Magnetation, and MP's ratepayers. Since MP and Magnetation agreed on the proposed ESA and since they are both assumed to act in their own best interests, clearly neither the Company nor Magnetation are worse off as a result of the proposed ESA.

Regarding MP's ratepayers, the Department noted that the proposed ESA does not have any impact on MP's base rates from the time the proposed ESA is in effect until MP's next rate case. Under the proposed ESA, Magnetation would take service under the approved LP tariff, which the Commission has found to be just and reasonable. Further, under the proposed ESA, Magnetation would provide additional contribution to MP's system fixed costs, thus benefiting the remaining MP ratepayers.

The Department concluded that: 1) no party affected by the proposed Amendment should be worse off as a result of the ESA and 2) MP's other ratepayers may potentially benefit in the future from Magnetation's increased contribution to MP's system fixed costs. MP stated that the Company and its ratepayers have suffered a pre-petition bankruptcy debt loss of approximately $650,000 as a result of Magnetation's May 5 Chapter 11 bankruptcy filing. Upon Commission approval of the proposed ESA, Magnetation will make a motion in U.S. Bankruptcy Court to assume the ESA, and that Magnetation will then be required to pay its pre-petition debt of $650,000 to MP. Rates, including recovery for bad debt expense, were set in MP's last rate case; thus, it is unclear how ratepayers would be affected by Magnetation's pre-petition bankruptcy debt. The Department requested that MP explain in reply comments how ratepayers would benefit. Guaranteed Annual Revenues include all revenues under the LP tariff.

2. Non-Discriminatory Rates under the proposed ESA

The Department noted that the rates under the proposed ESA are offered to Magnetation under the LP tariff. These tariffed rates are available to any customer meeting the requirements of the LP tariff. Therefore, they are not discriminatory.

Department Response to Fresh Energy

The Department stated that Fresh Energy's proposed amendment could harm MP's other ratepayers. As a result, the Department cannot support this amendment to the proposed ESA with Magnetation or other ESAs. Under the Fresh Energy's proposed amendment, Magnetation would be allowed to construct generation capacity to offset its load without consulting MP. Allowing Magnetation to offset its load could adversely affect other ratepayers by reducing Magnetation's contribution toward MP's costs, thus imposing a greater burden on MP's other ratepayers. This result would be especially true if MP acquires additional resources (including contracts or investments in facilities to serve a large customer) in order to meet load that does not materialize due to a customer's decision to self-generate.

The Department added that amending the ESA to allow Magnetation to self-generate without consulting MP would also create additional uncertainty in the resource planning process. As Fresh Energy requested that its proposed amendment be applied to future ESAs, and MP offers similar terms to similarly situated customers, the added uncertainty would apply to most of MP's load.

The Department stated that it is also possible that, if considered in the larger context of MP's resource plan and overall system needs, self-generation or co-generation could be part of a cost-effective plan to reliably and efficiently serve MP's customers. The Department noted that MP considered numerous resource options in its recently filed IRP, some of which could represent customer-sited generation. In addition, MP should also ensure these resources are fully and fairly considered when MP actually acquires additional resources, such as through a request for proposal (RFP). The Department requested that MP explain in reply comments how customer-sited and distributed generation resource could participate in its resource acquisition process.

The Department noted that the Commission could also consider requiring MP to provide notice to existing customers of any resource acquisition process to ensure those customers are able to participate. MP currently has significant amounts of small-scale and distributed generation facilities on its system. These include numerous wind and photovoltaic qualifying facilities that receive a net-metered rate, projects developed under MP's Renewable Energy Program and Community Wind Power Project. MP indicated that additional customers, including Magnetation, have not indicated a desire to pursue on-site generation.

The Department stated that Fresh Energy's request that Magnetation be required to complete a study as a condition of receiving service on the proposed ESA, may run afoul of Minn. Stat. § 216B.03 which requires that, "Rates shall not be unreasonably preferential, unreasonably prejudicial, or discriminatory, but shall be sufficient, equitable, and consistent in application to a class of consumers." As a public utility, Minnesota Power is obligated to serve customers in its exclusive service territory under the tariffed rates approved by the Commission. A requirement that Magnetation complete a study prior to obtaining service is both inconsistent with the terms of the LP Tariff and inconsistent with terms offered to other similarly situated customers and thus would be discriminatory. In summary, MP currently has significant amounts of small-scale, distributed, and customer owned generation facilities on its system. Additional self-generation or co-generation at Magnetation could be part of a cost-effective plan to reliably and efficiently serve MP's customers, however, adding Fresh Energy's proposed amendments to the ESA is not the way to achieve that outcome because allowing Magnetation to offset its load without joint planning with MP may harm MP's other ratepayers and would be considered discriminatory.

Customer-Sited Resources

The Department emphasized that the proposed ESA allows Magnetation to construct, operate, or utilize self-generation or cogeneration if MP agrees in a written amendment to the ESA.

The Department concluded that this provision is reasonable as it protects existing ratepayers while also allowing self-generation or cogeneration if in the best interest of MP's system. As an alternative to the recommendation by Fresh Energy, the Department recommended that the Commission require MP to work with any customer who is interested in self-generation or cogeneration, to determine how those generation additions may be incorporated into MP's resource planning decisions. Further, if tariff revisions or ESA modifications are necessary to allow customers to pursue cost-effective self-generation or cogeneration, or to be able to fully participate as a demand-side resource in the MISO market, MP should propose appropriate tariff and/or ESA modifications to the Commission. MP has agreed to a similar proposal regarding demand response in the past.

Department Conclusion

The Department concluded that the ESA between MP and Magnetation is in the public interest. As Magnetation would take service using the Company's existing LP tariff, the Company's other ratepayers should experience no significant negative impacts from the proposed ESA. Magnetation's commitments would contribute toward fixed cost recovery on MP's system. The Department notes that this agreement is similar to other ESAs between MP and its large power customers. Further, the Company stated that it intends to continue its practice of "making similar terms and conditions available to eligible LP customers in similar situations."

Department Recommendation

The Department:

Recommended that the Commission approve the petition for an Electric Service Agreement between Minnesota Power and Magnetation.

Requested the MP explain in reply comments how ratepayers would benefit from the payment of the pre-petition debt and how customer-sited and distributed generation resource could participate in its resource acquisition processes.

Recommended that the Commission:

Direct MP to work with any large power customer who is interested in self-generation or cogeneration, to determine how those generation additions may be incorporated into MP's resource planning decisions. If tariff revisions or ESA modifications are necessary to allow customers to pursue cost-effective self-generation or cogeneration, or to be able to fully participate as a demand-side resource in the MISO market, MP should propose appropriate tariff and/or ESA modifications to the Commission.

Consider requiring MP to provide notice to existing customers prior to any resource acquisition process to ensure those customers are able to participate.

Minnesota Power Reply Comments

Response to Department of Commerce

MP explained that bad debt write-offs suffered by Minnesota Power between rate cases provide a basis for Minnesota Power's request and justification for the level of this expense in the future. Currently Minnesota Power's jurisdictional bad debt expense recovered in rates is $583,673. The exposure to the Magnetation pre-petition debt almost completely subsumes Minnesota Power's annual expense amount. Minnesota Power stated that it can be expected to seek a higher bad debt expense in the future if this amount is not recovered from Magnetation through the bankruptcy process. The Commission's approval of the proposed contract will help keep Minnesota Power's bad debt expense exposure lower for all customers.

Addressing the second issue, how customer-sited and distributed generation resource could participate in Minnesota Power's resource acquisition processes, Minnesota Power explained that it already works with all of its customers to discover energy efficiency and improvement opportunities, as well as co-generation and other generation alternatives to take advantage of power generation options afforded by customers' industrial processes. Minnesota Power is open to customer sited and distributed generation resources participating in resource acquisition processes, however, most customers are not open to developing these resources with the goal of being able to sell surplus energy and possibly under-utilized capacity into the wholesale market; they desire that their capital investment go first toward lowering their cost of energy or increasing the efficiency of their production process. The customer-generation initiatives are generally driven by customer production and budget cycles. Minnesota Power stated that it continuously works to identify energy opportunities for these customers, including on-site generation consistent with provisions in electric service agreements.

Minnesota Power stated that it does not object to the remaining recommendations, with the understanding that the anticipated or expected lack of participation by customers that may be evidence of nothing more than the fact that the process does not fit their own planning or operational requirements.

Response to Fresh Energy

Fresh Energy's August 24, 2015, filing claimed that the standard clause prohibition on customer generation in the proposed ESA is inconsistent with the Commission's November 12, 2013 Order in Minnesota Power's last Integrated Resource Plan. Fresh Energy believes the explicit ban on onsite generation opportunities is at odds with the Commission Order requiring Minnesota Power to evaluate additional conservation scenarios for its CIP exempt customers. Fresh Energy argued that on-site resources should be an option for large customers covered under ESAs as they strive to maintain competitiveness. Fresh Energy recommended that future ESAs modify the restrictions on on-site customer resources in a similar manner.

Minnesota Power claimed that Fresh Energy's comments incorrectly represent the intent of the Commission's November 12, 2013, Order in Minnesota Power's 2013 Integrated Resource Plan (Docket No. E015/RP-13-53). Minnesota Power stated that onsite generation or any new generation is not part of the Commission or the Department's review of Minnesota Power's Conservation Improvement Program ("CIP") and energy efficiency savings goals. Order Point 12 in its November 12, 2013, Order was intended to provide the Commission additional "analysis and aggregated energy savings data for CIP-exempt customers". Minnesota Power indicated that discussion during the Commission September 25, 2013, meeting suggested that the Commission is looking for ways that enable the companies to save energy through energy efficiency.

MP argued that specific customer requirements related to on-site generation was not part of the Commission's deliberations nor reflected in the written order. What the Commission was seeking and what Minnesota Power provided in its pending 2015 Integrated Resource Plan (in Docket #15-690) was additional information on CIP-exempt customer initiatives to save energy.

MP noted that in Reply Comments on October 5, Fresh Energy clarified that it simply intended that the two parties agree to work together within an approved ESA to identify potential savings opportunities and not rule out the possibility of self-generating and cogeneration potential at Magnetation's industrial sites. Minnesota Power has done so, and will continue to do so, as noted in the Department's comments at page 5 and no Commission decision is necessary on that point.

Fresh Energy Reply Comments

Fresh Energy requested that certain restrictions regarding Magnetation's right to construct, operate, or use self-generating or cogenerating capacity be struck from the proposed ESA. Fresh Energy recommended that the Commission add a term to the ESA that requires both Magnetation and MP to "identify and analyze energy savings opportunities, including, but not limited to, self-generating and cogeneration capacity" at Magnetation's facilities.

In reply comments Fresh Energy stated that in initial comments it also recommended that the ESA language be changed to state that "both parties agree to identify and analyze energy savings opportunities including but not limited to, self-generating and cogeneration capacity at the Plant 2 Facilities, Plant 4 Facilities, and the Jesse Loadout Facilities during the term of this Agreement…"

Fresh Energy noted that the Department interpreted Fresh Energy's comments to mean "that Magnetation be required to complete a study as a condition of receiving service on the proposed ESA…" However, that specific level of detail, action, and requirement was not Fresh Energy's intention in recommending the language change. Fresh Energy intended that the two parties agree to work together within an approved ESA to identify potential savings opportunities and not rule out the possibility of self-generating and cogeneration potential at Magnetation's industrial sites.

Fresh Energy added that it supports both of the Department's recommendations on page 7 of the public comments filed on September 23, 2015.

Staff Analysis

As discussed by the parties, the proposed ESA is consistent with Minnesota Power's tariff provisions. Staff thinks some issues should be clarified.

> Although MP currently has excess power, without additions, it will not have excess power through the term of the agreement and will need to acquire additional resources. Because the Company will need to acquire additional resources, the future cost of energy over the period of the contract is not known. On page 31 of its 2015 resource plan (filed September 1, 2015, in Docket #15-690) Minnesota Power stated that it:
>
> > [H]as positioned its generating resources, and made plans for economic purchases to meet the projected needs of its customers in the near term and create a bridge to long-term additions like the GNTL [Great Northern Transmission Line] and accompanying Manitoba Hydro power purchases. The 2015 Plan evaluation identifies how the Company will implement a power supply strategy to meet any remaining needs after consideration of small thermal coal-fired generation decision making and projected customer growth.
> >
> > The Base Case energy position is shown in Figure 7, and identifies that in the near term, the Company has minimal energy needs and will use the regional wholesale market to optimize its energy supply in keeping with its least-cost, customer focused strategy.
>
> The alternative for excess capacity is not to do nothing. A company can offer its energy into the market.
>
> The Large Power Service specifically allows the Commission to change the rates of the LP Schedule and specifically states that approval of any ESA does not exempt any Customer from the applicability of any change in charges.

None of these factors suggest that the contract is not appropriate or not in the public interest. However, because the Company will be acquiring additional capacity and/or energy in the future at a cost that is uncertain, and the fact that rates are subject to change, such as through a general rate case, through riders, and options such as Minnesota Power's EITE proposal, without additional information, it would seem premature to determine that all of MP's customers will clearly be better off through the term of this proposed contract.

Decision Alternatives

1. Approve the proposed ESA. [MP, DOC, FE]

2. Approve the proposed ESA and note that the Commission is not making any specific findings as to the benefits to other customers.

3. Do not approve the proposed ESA at this time. Find there is not sufficient information in the record to determine that none of MP's customers will be harmed for the duration of this proposed Agreement and require Minnesota Power to provide additional information.

4. Reject the ESA. Determine that some customers will be harmed.

5. Direct MP to work with any large power customer who is interested in self-generation or cogeneration, to determine how those generation additions may be incorporated into MP's resource planning decisions. If tariff revisions or ESA modifications are necessary to allow customers to pursue cost-effective self-generation or cogeneration, or to be able to fully participate as a demand-side resource in the MISO market, MP should propose appropriate tariff and/or ESA modifications to the Commission. [DOC, FE]

6. Require MP to provide notice to existing customers prior to any resource acquisition process to ensure those customers are able to participate. [DOC, FE]