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February 11, 2015

VIA ELECTRONIC FILING

Mr. Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, MN 55101-2147

**RE: Reply Comments of Minnesota Power to the Division of Energy Resources of the Minnesota Department of Commerce's (DOC or the Department) Response Comments
Docket No. E-999/AA-13-599**

Dear Mr. Wolf:

Minnesota Power hereby electronically submits its Reply Comments in the above-referenced Docket.

Please contact me at the number above should you have any questions related to this request.

Yours truly,

Christopher D. Anderson

CDA:jn
Attachment
cc: Service List



**STATE OF MINNESOTA
BEFORE THE
MINNESOTA PUBLIC UTILITIES COMMISSION**

In the Matter of 2014 Electric Company's
Annual Automatic Adjustment Reports

Docket No. E-999/AA-13-599

REPLY COMMENTS

Minnesota Power provides Reply Comments in the above-referenced Docket in response to the Minnesota Department of Commerce comments dated December 31, 2014.

Minnesota Power addresses the Department's recommendations regarding recovery of replacement power costs, where the Department recommends that the Commission require the following for Minnesota Power and the other utilities:

- 1) Utilities seeking to recover replacement power costs due to a forced outage must provide:
 - a. Information showing the causes of forced outages;
 - b. Efforts the utility took to prevent the forced outage;
 - c. Efforts the utility took to minimize the length of the forced outage;
 - d. Efforts the utility took to protect the ratepayers from having to pay for the costs of the forced outage;
 - e. Efforts the utility took to recover replacement power costs from all potential sources; and
 - f. The amount by which the replacement power costs exceed the power costs the utility would otherwise have charged ratepayers.
- 2) IOUs must develop a searchable database application to non-nuclear facilities that shares the attributes of the SEE-IN program and provides for a systematic gathering, review, and analysis of operating experiences at (Minnesota) IOUs-owned non-nuclear facilities.
- 3) Utilities should adopt Xcel's program, identified in more detail in Attachment D of its November 10 comments, to hold contractors more accountable for replacement power costs, to the extent those practices are not already in place.

- 4) Xcel and other utilities should add language to the “Supplier Warranties” section of the contracts as discussed above to indicate that contractors may be liable for a limited amount of replacement power costs.

Minnesota Power Responses:

Item 1 a and f:

Minnesota Power currently includes information related to items 1.a. and 1.f above in our AAA filings.

Item 1 b:

Minnesota Power inherently takes action to minimize the financial impact of replacement energy costs for our customers. Minnesota Power would be able to provide the above information for forced outages.

Item 1 c:

Minnesota Power will continue to take a variety of actions to minimize the financial impact of replacement energy costs for our customers, as we have described in great detail in past AAA dockets. Minnesota Power’s Energy Supply Department works closely with the Generation Operations and Transmission groups in an effort to minimize customer costs. Energy Supply is constantly monitoring current and forward energy markets to ensure least cost supply for all Minnesota Power ratepayers. Upon notification of a generation event that may lead to a forced outage, Energy Supply evaluates the market to determine the best time to take the unit offline to minimize customer costs. Market drivers that are evaluated include:

- Weather
- Load
- Generation Outages (planned and existing, at both MP and other utilities/marketers).
- Transmission Outages/Constraints
- Wind Forecasts
- MISO Imports and Exports

Upon the market evaluation, Energy Supply develops price forecasts to determine the expected market costs to ratepayers for multiple scenarios. The market costs of the scenarios are then weighed against plant personnel safety, environmental compliance, resource availability and potential risk of equipment damage due to delaying the forced outage. Following this evaluation, the optimal time to take the outage is determined.

Minnesota Power will continue to be able to provide the above information for forced outages.

Item 1 d:

Minnesota Power will continue contractual negotiation as well as post-event warranty claims in effort to ensure that responsible parties (such as vendors, contractors, etc.) pay costs that cause fuel clause impacts on customers.

Item 1 e:

One of Energy Supply's objectives is to provide least cost supply to Minnesota Power customers. During a forced outage this is done by ensuring that all potential sources of replacement power have been evaluated. Sources of replacement power include:

- Additional generation that can be dispatched from other Minnesota Power Generators
- Additional generation that can be dispatched from generators owned by Minnesota Power Customers
- Demand side management
- Dual Fuel
- Critical Peak Period declaration
- Demand Response
- Price Recall
- Bilateral purchases from neighboring utilities or power marketers
- Physical purchases from neighboring ISO's
- MISO market purchases

The need for replacement power during forced outages varies depending on the size of the generator that was forced offline and MP system load during the expected outage period. Upon acting on the afore mentioned sources of replacement power, the Energy Supply group constantly monitors the overall energy position of Minnesota Power to determine the amount of replacement power that needs to be procured in order to assure least cost supply for Minnesota Power Ratepayers.

Item 2:

Minnesota Power's understanding of the key attributes of a SEE-IN type program include dedicated departments/resources on a full time basis to administer the program, common equipment and nomenclature and a procedure intense operation (all common of a Nuclear Regulated industry). It would be possible to implement such a program among Minnesota IOU's; however it would be very difficult, and of limited value, given the differences in

generating unit characteristics. A more in-depth analysis should be performed to determine the prudence of implementation of such a program.

Minnesota Power is a paying member for FOMIS (Fossil Operations & Maintenance Information Service), EPRI and EEI among others. These forums provide Minnesota Power a mechanism to learn from other utilities along with the additional ability to access emergency spare parts to prevent forced outages at our plants.

Item 3:

While MP has not adopted a centralized approach to a formal quality management plan as illustrated by the Xcel program cited by the Department, operational divisions within MP have implemented standard practices which are designed to achieve a similar result.

The MP Engineering Services group utilizes a standard Project Procedures Manual. In developing project specifications and engaging contractors, quality management is a primary focus and concern. In addition, certain areas of operations require adoption of specific quality standards, such as the Dam Safety QCIP program; State Building Code compliance for structural engineering; and FERC requirements for hydro generation facilities. The MP Generation Reliability group has developed standard scope of work documents for complex, operation critical activities, such as the overhaul of a boiler feed pump.

Contracting with suppliers who have rigorous quality standards is a priority for MP. Many of MP's alliance partners have ISO 9001 Quality Management Systems Certification.

In addition, quality management considerations are incorporated into MP's contracting processes. MP engineers and project managers develop clear and thorough contract specifications and scopes of work. The commercial terms included in MP's contracts contain warranty rights and active project management provisions.

MP does not anticipate any impediment to adopting a centralized, standard approach to contractor quality management as long as that approach contains the flexibility needed to manage individual projects.

Item 4:

MP uses two standard form agreements that are relevant to this discussion: (1) purchase order terms and conditions; and (2) major supply agreement conditions of contract. The standard warranty provisions in MP's contracts provide for the recovery of replacement power costs to the

extent that such costs are caused by a supplier default, but note that sophisticated vendors will negotiate these provisions out of their contracts because the scope of risk is too great for them to bear in performing the work.

The warranty provisions of these agreements provide:

Purchase Order Terms and Conditions:

Seller warrants that: (a) all the goods, work and services furnished under this Purchase Order shall be produced and furnished in compliance with all applicable federal, state and local laws, rules, orders and regulations; (b) all goods supplied will be: (i) of good quality and in accordance with the standards of Seller's industry (including the North American Electric Reliability Corporation); (ii) new unless otherwise required or permitted by this Purchase Order; (iii) of the kind, make, and quality specified in this Purchase Order; (iv) free from errors, omissions, faults and defects in design, workmanship, and materials; and (v) in full conformity with this Purchase Order and performing as required by this Purchase Order; and (c) all services provided by Seller will be: (i) performed in a professional, prudent and workmanlike manner that is free from defects, errors and omissions and with the highest degree of skill and care that is utilized by nationally-recognized professionals in the same field under the same or similar circumstances; (ii) strictly in accordance with this Purchase Order and all applicable laws, and (iii) performed in accordance with all applicable engineering, environmental, construction, safety, and electrical generation codes and standards, as such codes and standards exist on the date of delivery of the goods and/or performance of the work. If Seller, after notice, fails to proceed promptly to remedy any failure to comply with any of the warranties set forth herein, Purchaser may remedy such failure of deficiency or have such failure or deficiency remedied by a third party, and Seller will be liable for all costs and expenses so incurred. Compliance with or conformance to a quality assurance, quality control or similar program will not relieve Seller of its warranty obligations hereunder. In addition to its warranty obligations set forth herein, Seller will be fully responsible to Purchaser for the cost of repair or replacement of property of Purchaser that is damaged as a result of goods or services provided by Seller that are faulty or defective, or otherwise fail to conform to the warranties provided herein. Unless otherwise specified herein, Seller shall obtain all permits necessary for performance under this Purchase Order.

Further, the purchase order terms and conditions contain a broad indemnification clause (including first party indemnity) that provides, in pertinent part: "Seller shall, at its own cost and

expense, completely indemnify, defend, and hold Purchaser, its officers, agents and representatives (“Indemnitees”) harmless from and against all claims for personal injury, property damage, wrongful death or other damages, losses, and expenses, including attorneys’ fees (“Claims”), arising out of, or resulting from, defective goods or the performance of work or services for Purchaser.”

Major Supply Agreement Conditions of Contract:

Supplier warrants that all Work, including without limitation, the Goods, will conform to the kind, quality and capability designated or described by the Agreement. Supplier shall perform the Work with due care, skill and diligence, in accordance with Applicable Law and applicable professional standards, industry procedures (including NERC CIP) and construction practices. Unless a greater period of time is specified in the Agreement, Supplier shall warrant the Work and all Goods, including parts, equipment, materials and labor furnished under the Agreement to be as specified herein and free from defects in (i) title (including any liens, encumbrances or other third party interests) at all times after passage to Company, and (ii) Design, material and workmanship for the longer period of (A) twelve (12) months after Final Acceptance or the period of any manufacturer’s warranty, or (B) with respect to warranty work performed by Supplier, for an additional period of one (1) year following such warranty work. Any and all manufacturer warranties shall be and hereby are transferred to Company pursuant to the provisions and operation of the Agreement. After delivery of conforming Goods to the Site, Company shall store, maintain and install the Goods consistent with Supplier’s written instructions or, in the absence of such instructions, in accordance with prudent industry practices.

Upon receipt of notice from Company of any failure to comply with the terms of the Agreement including these General Conditions, including without limitation any defect with respect to the Work, either prior to or after Final Acceptance, Supplier shall without additional compensation correct any such defects within a time acceptable to Company and reimburse Company for any resulting costs, expenses or damages suffered by Company, including but not limited to costs of removal, reinstallation, re-procurement and any other third party costs, damages and losses incurred by Company. If Supplier fails to timely replace any such defective Work, Company may cause such defective Work to be replaced by another and all expenses thereof shall be the responsibility of Supplier. Company shall be entitled to deduct such expense and any resulting damages from amounts otherwise due to Supplier.

As provided above, the warranty rights of these agreements provide the ability to recover replacement power costs from a supplier when the supplier's performance falls short of that required by the warranty.

The Department recommended that utilities consider including a specific statement in their warranty language that addresses replacement power costs. Specifically, MP has been asked to add: "...a portion of replacement power costs not otherwise secured by the Company."

Such language would be unnecessarily limiting. As provided above, MP's standard language is quite inclusive and would include a claim for replacement power costs. Expressly providing recovery for "a portion of replacement power costs not otherwise secured by the Company" introduces ambiguous language that may not be enforceable. If the agreement is not clear on what "a portion" means, there would likely be no recovery unless the language was found ambiguous. If it were deemed ambiguous, then the burden would be on the parties to demonstrate what they understood "a portion" would mean. If MP is willing to agree to less than all (i.e., "a portion"), in order to enforce such a provision, the parties would likely need to reach agreement on a specific percentage of replacement power costs. From a negotiation standpoint, if MP will accept a portion of replacement power costs, why wouldn't MP also accept a portion of property damage costs?

In addition, the phrase "not otherwise secured by the Company" creates a difficult standard and burden for the utility. MP does not believe that a supplier would agree to such language without understanding how MP would "otherwise secure" replacement power costs and to what extent MP can and will do so. Contracting parties weigh risk exposure in their agreements and decisions to undertake work, and the risk presented by the proposed language is indeterminate.

Adding the recommended language may also have an unintended negative impact on the contractual remedies available to MP. Pursuant to a maxim of contract construction - *expressio unius est exclusio alterius* (meaning, the failure to include something in a laundry list may exclude it) – such an addition may have the consequence of foreclosing other types of remedies that are not specifically stated. While MP's standard language may mention a particular remedy, it carefully preserves all or any costs and expenses and includes an illustrative item only when industry practice has identified that type of damage to be the subject of misunderstanding or frequent negotiation.

The Commission should be aware that overall Minnesota Power engages in rigorous and disciplined contract negotiation and contractor management activities. With regard to contractor selection, Minnesota Power is often limited by the number of qualified contractors who have the expertise and knowledge needed to provide equipment and services for our plants.

In contract negotiations, Minnesota Power balances operational considerations and risk transfer and mitigation measures to reach a commercially reasonable agreement. Primary among our operational considerations are clear and thorough contract specifications, warranty provisions, performance guarantees (as appropriate) and active project management provisions (such as subcontractor and change management control).

With regard to work conducted during planned outages, Minnesota Power is careful to include a realistic schedule for all work conducted during planned outages. Minnesota Power's schedules include critical milestone dates and an active project management role for Minnesota Power to mitigate the risk of scheduled work prolonging an outage. Minnesota Power may also include liquidated damages in these contracts to ensure that contractors are on schedule and paying attention to the milestones.

In our industry, major contractors are able to require limitation of liability provisions that may impact Minnesota Power's ability to hold a contractor accountable for all losses that could be caused by that contractor. In Minnesota Power's experience, many contractors will refuse to provide equipment or services if they cannot also limit their potential liability and financial exposure in the contract. Minnesota Power does not specifically include a contract provision that requires a contractor to pay replacement power costs; however, the specific clause is not necessary because contract remedies would allow for recovery of those costs if Minnesota Power could prove that the contractor caused the loss and there was nothing in the contract to limit or waive that recovery. In situations where a contract would allow for recovery of replacement power costs and a contractor would be responsible for those costs, Minnesota Power would actively pursue recovery from the contractor.

Minnesota Power appreciates the opportunity to provide the Reply Comments in this Docket.

Dated: February 11, 2015

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'C. Anderson', written in a cursive style.

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