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December 31, 2014

VIA E-FILING

Dr. Burl W. Haar
Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, MN 55101

Re: In the Matter of the Review of 2011-2012 Annual Automatic Adjustment Reports
Docket No. E999/AA-12-757

Dear Dr. Haar:

The Minnesota Large Industrial Group ("MLIG") has previously commented in this docket about the importance of reforming electric utilities' fuel clause adjustment mechanisms and appreciates the Minnesota Department of Commerce's efforts to facilitate stakeholder discussions about this topic last winter. As part of that stakeholder process, MLIG submitted the enclosed comment letter to the Department, which includes our analysis of the proposals made by various stakeholders and MLIG's recommendations.

MLIG looks forward to renewing the discussion in this docket and moving toward implementation of modifications to fuel clause adjustment mechanisms.

Very truly yours,

/s/ Sarah Johnson Phillips

Sarah Johnson Phillips

Enclosure

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February 14, 2014

VIA E-MAIL

Kate O'Connell
Minnesota Department of Commerce, Division of Energy Resources
85 7th Place East, Suite 500
St. Paul, MN 55101-2198

Re: Comments on Proposals to Improve or Replace the Fuel Clause Adjustment

Dear Kate:

Thank you for the opportunity to comment on the proposals for updating Minnesota's fuel and purchased energy cost recovery mechanism, generally known as the fuel clause adjustment, or "FCA." The Minnesota Large Industrial Group ("MLIG"), which is an ad hoc association of industrial consumers of electricity consuming more than 6.5 billion kWh annually, appreciates the Department's efforts to convene stakeholders and develop ideas to improve or replace the FCA.

The Department has requested comments on four proposals offered by (1) Northern States Power Company d/b/a Xcel Energy ("Xcel"), the (2) Minnesota Chamber of Commerce (the "Chamber"), (3) the Office of the Attorney General - Antitrust and Utilities Division ("OAG") and (4) the Department itself. Each of these proposals addresses different aspects of the current FCA and therefore potentially offers a range of advantages and disadvantages. Below we provide MLIG's evaluation of the pros and cons of each proposal and a recommendation.

I. Overview of FCA Proposals.

In general, each of the proposals to update or replace the FCA include methodologies to set a benchmark for the amount of recovery of fuel and purchased energy costs and approaches to determine actual recovery of fuel and purchased energy costs relative to the benchmark.

- **Summary of Recommended Benchmarks**. Three of the four proposals recommend setting fuel costs in base rates (Department, Chamber, and the OAG). In setting that base rate, the Department recommends using a historic average of fuel and purchased energy costs, while the Chamber recommends incorporating certain forward-looking

factors such as market indices. The OAG does not elaborate on how fuel and purchased energy costs should be calculated for inclusion in base rates. Xcel recommends using a historic performance measure (the Equivalent Availability Factor or Equivalent Unplanned Outage Rate) to set a benchmark for future performance.

- **Summary of Recommended Recovery Mechanisms**. Each of the proposals provides a mechanism for cost recovery relative to the benchmark. The Department recommends that there be no adjustments to recovery amounts between rate cases. The Chamber recommends that there be no adjustment to recovery amounts so long as actual costs fall within a 2% band above or below the base level. The OAG recommends implementing a cap on fuel and purchased energy cost recovery at 3% above the base level. Xcel recommends a set dollar amount of over- or under-recovery based its performance relative to a generating unit availability metric.

As described further below, there are pros and cons to each of these proposals, but there may also be some common ground**.**

II. Evaluation of FCA Proposals.

A. Statutory Background. Minnesota law permits the automatic adjustment of rates for energy and emission control costs. Specifically, Minnesota law states:

> 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;
> (3) costs for fuel used in generation of electricity or the manufacture of gas; or
> (4) prudent costs incurred by a public utility for sorbents, reagents, or chemicals used to control emissions from an electric generation facility, provided that these costs are not recovered elsewhere in rates. The utility must track and report annually the volumes and

costs of sorbents, reagents, or chemicals using separate accounts by generating plants.[1]

Commission rules spell out the purpose of the fuel adjustment clause and govern application of this statutory provision. The purpose of the rules are "to enable regulated gas and electric utilities to adjust rates to reflect changes in the cost of energy delivered to customers from those costs authorized by the commission in the utility's most recent general rate case."[2] The rules state that "The adjustment per kWh is the sum of the current period cost of energy purchased and cost of fuel consumed per kWh less the base electric cost per kWh."[3] The term "current period" is defined as "the most recent two-month moving average used by electric utilities in computing an automatic adjustment of charges."[4] Also, "The amount of the billing period adjustment to charges must be determined by extending kilowatt-hour sales in the billing period by an adjustment per kWh."[5] Given the method of calculation, utilities are not entitled to recover actual fuel and related variable costs. Instead, the method provides a means for utilities to recover certain fuel and related variable costs, which should approach actual costs over time (though there may be over-collection and under-collection). Further, the statutory language states that the Commission "may permit" automatic adjustments, which implies appropriate limitations can be set. One such limitation that must govern recovery is that rates remain just and reasonable, with any doubt resolved in favor of the consumer.[6]

B. **Evaluation Criteria.** Based upon the regulatory framework and policy goals of the FCA, MLIG weighed the following questions in evaluating the pros and cons of the proposals:

i. Does the proposal provide an incentive for utilities to manage fuel and purchased energy costs?

ii. Does the proposal appropriately allocate the burden of proof for cost recovery?

iii. Can the proposal be implemented with reasonable administrative efficiency?

[1] MINN. STAT. § 216B.16 subd. 7.
[2] MINN. R. 7825.2390.
[3] MINN. R. 7825.2600 subp. 2.
[4] MINN. R. 7825.2400 subp. 13.
[5] MINN. R. 7825.2600 subp. 1. Certain utilities have obtained variances from the rules and employ variations on this mechanism.
[6] MINN. STAT. § 216B.03.

C. Evaluation of Proposals.

i. Department Proposal.

1. **Benchmark for Recovery Amounts.** The Department proposes to fix recovery of fuel and purchased energy costs in a rate case at a utility's average energy costs over the previous three years. While the Department's proposal may have the advantage of being administratively efficient, using a historical average may result in chronic under- or over-recovery of costs if long-term trends outside of a utility's control cause fuel costs to consistently rise or fall.

2. **Methodology for Cost Recovery**. The Department's proposal would not provide for any adjustment to recovery amounts between rates cases. As a result, utilities would have an incentive to keep their fuel and purchased energy costs at or below the level set in the rate case. However, as noted above, the historic-looking methodology for setting the rate may result in substantial over- or under-recovery.

ii. Chamber Proposal.

1. **Benchmark for Recovery Amounts.** The Chamber proposes a methodology based on Wisconsin's policy that uses existing contracts, historic averages of outage rates, and market indices to set base rates for fuel and purchased energy costs recovery. The Chamber's methodology for rate setting is more complex than the Department's methodology, but the inclusion of forward-looking components may result in rates that better reflect actual costs. The Chamber also references procedures used in Wisconsin whereby utilities make annual filings to set their base costs. However, an annual process may be burdensome and unnecessary if base costs are established in a rate case.

2. **Methodology for Cost Recovery**. The Chamber proposes to establish a 2% "deadband" around the recovery amount set in the rate case for which there would be no adjustment to recovery relative to actual costs. Like the Department's proposal, this mechanism may provide an incentive for utilities to keep costs at the fixed level or up to 2% below it. Accordingly, and as with the Department's proposal, ratepayers would be insulated

from some of the normal fluctuation in fuel and purchased energy costs. While the plus or minus 2% deadband proposed by the Chamber appears reasonable, it may not be beneficial to establish a fixed deadband. Uncertainty regarding costs may vary over time and among utilities, which may make variations on the range of a deadband appropriate.

The Chamber's proposal does not go into detail regarding what should happen if actual costs deviate more than 2% in either direction. Presumably, ratepayers would receive a refund if actual costs were more than 2% below the set amount. If actual costs are more than 2% higher, MLIG assumes the burden would be on the utility to request additional recovery. MLIG would welcome additional discussion on this issue.

iii. OAG Proposal.

1. **Benchmark for Recovery Amounts.** Like the Department, the OAG recommends setting base costs in a rate case, but does not elaborate on how fuel and purchased energy costs should be calculated for inclusion in base rates.

2. **Methodology for Cost Recovery**. The OAG proposes that automatic recovery of fuel costs continue as under the current FCA, but that cost recovery be capped at 3% above the amount set in a rate case. The advantage of a cap rather than a deadband is that it avoids the possibility of a windfall for the utility if fuel prices decline, while maintaining the benefit of placing the burden on the utility to justify recover of costs above a certain threshold. It also allows for automatic adjustments to continue so long as they are within a set range above base rates. Furthermore, this mechanism allows automatic adjustment to continue for any amount below base rates, which would provide ratepayers the full benefit of any savings. Finally, although a 3% cap does not appear unreasonable, it may be better to set the cap on a case-by-case basis in a rate case in order to account for varying levels of uncertainty and risk over time and across utilities.

iv. Xcel Proposal.

1. **Benchmark for Recovery Amounts.** Xcel proposes to establish incentives and penalties based on the Equivalent Availability Factor

("EAF") of selected generation units or, alternatively based on a combination of the EAF and the Equivalent Unplanned Outage Rate ("EUOR"). Xcel's proposal focuses on providing an incentive to control costs associated with unplanned outages and purchased energy. While Xcel's proposal appears to address one of MLIG's primary areas of concern—unplanned outages—it would not resolve issues related to fuel price spikes. Further, Xcel's proposal to measure its performance solely against its own past performance, does not seem adequate. Incorporating a MISO or industry-wide metric would provide a more objective measure of performance. Finally, further discussion is needed regarding other details of Xcel's proposal, including:

a. Whether it is appropriate to exclude nuclear facilities.

b. Whether, to the extent EAF or EUOR is used as a benchmark, it would be based on a rolling average of recent years. A rolling average would ensure that that improvements over time would gradually become a higher standard of performance.

c. Further explanation and analysis of the proposed metrics. The historical EAF and historical EUOR charts provided with Xcel's proposal indicate that they would yield substantially different results, despite being seemingly related metrics.

2. **Methodology for Cost Recovery**. Xcel proposes that cost recovery would continue as normal under the FCA, but that an incentive (in the form of a set dollar amount of over- or under-recovery) based on the company's performance against its historic EAF (or a combination of EAF and EUOR). While Xcel's proposal includes the clearest incentive/disincentive mechanism, it ultimately may not be beneficial to ratepayers to use over-recovery as an incentive. In MLIG's view, the primary goal for updating the FCA is not to create winners or losers, but to establish appropriate presumptions of reasonableness that align the motivations of all parties to control costs.

III. MLIG Recommendations.

The current FCA is outdated for a variety of reasons that have been discussed at length by stakeholders. In recent years, the types of costs that are recovered through the FCA have expanded greatly, which has created an enormous and inappropriate burden on regulators and ratepayers to review the reasonableness of those costs. With all fuel and purchased energy costs automatically passed through under a statutory formula and without an effective means of review, the current system does not encourage utilities to control costs or ensure that rates remain just and reasonable.

Based on our review of the four proposals and analysis of the FCA's policy framework, MLIG believes that a "cap" approach best meets the goals of providing an incentive to control costs, appropriately allocating the burden to establish reasonableness for costs, and reducing administrative burdens. In particular, MLIG recommends that base costs for fuel and purchased energy be established in rate case (incorporating appropriate forecasting factors) and that an appropriate cap on automatic adjustments be set in the same rate case. Below the cap, adjustments would continue as under the current FCA. Above the cap, the burden would be on the utility to seek recovery through a rate case or request deferred accounting. This system would best address the three questions MLIG posed above.

A. Does the proposal provide an incentive for utilities to manage fuel and purchased energy costs? Yes. As noted above, MLIG does not believe the goal of establishing an incentive to control costs is to pit utilities and ratepayers against each other. Rather, the purpose is (or at least should be) to ensure that the parties' interests are aligned to control fuel and purchased energy costs. MLIG believes that utilities are most capable of managing day-to-day fuel and purchased energy costs and that the primary concern is events that cause significant spikes in costs. Establishing a cap allows utilities to continue to manage day-to-day costs, while establishing an incentive to prevent cost spikes.

B. Does the proposal appropriately allocate the burden of proof for cost recovery? Yes. MLIG believes that an appropriate cap can be reasonably established in the context of a rate case. Costs above the cap would require the utility to request cost recovery and to justify those costs. This is a burden MLIG believes is appropriately placed on the utility. And the cap would ensure that resources deployed to review the reasonableness of fuel costs would be best utilized focusing on the events with the largest impact on ratepayers.

C. Can the proposal be implemented with reasonable administrative efficiency? Yes. The cap would arguably establish a presumption that costs below the cap level are reasonable, which would reduce the burden on the Department and ratepayers to scrutinize such costs. Ultimately, however, it would still be the utility's burden to establish that rates are just and reasonable and parties would be free to raise questions when appropriate.[7] This shifting of presumptions regarding reasonableness should reduce the burden on the Department in auditing costs passed through the FCA.

IV. Conclusion

MLIG believes that these FCA stakeholder discussions are addressing an important issue and offers the above comments and recommendations with the objective of furthering the discussion. We remain open to discussing other proposals and finding ways to improve on all of them. A follow-up meeting to further discuss the proposals and next steps likely would be beneficial.

Sincerely,

/s/ Andrew P. Moratzka

Andrew P. Moratzka
Sarah Johnson Phillips
Stoel Rives LLP

[7] *See* MINN. STAT. §§ 216B.03, 216B.16, subd. 4; 216B.17, and 216B.21.