

May 29, 2014

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

RE: **Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. E002/M-14-364

Dear Dr. Haar:

Attached are the comments of the Division of Energy Resources of the Minnesota Department of Commerce (DOC or the Department) in the following matter:

A Petition by Northern States Power Company d/b/a Xcel Energy for Renewal of Variances to the Fuel Clause Adjustment Rules.

The Petition was filed on April 30, 2014 by:

Paul J Lehman
Manager, Compliance and Filings
Xcel Energy
414 Nicollet Mall
Minneapolis, Minnesota 55401

The Department recommends that the Minnesota Public Utilities Commission (Commission) **approve** the Petition, and is available to answer any questions the Commission may have.

Sincerely,

/s/MICHAEL N. ZAJICEK
Rates Analyst

MNZ/ja
Attachment



BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

COMMENTS OF THE MINNESOTA DEPARTMENT OF COMMERCE DIVISION OF ENERGY RESOURCES

DOCKET No. E002/M-14-364

I. SUMMARY

On April 30, 2014, Northern States Power Company d/b/a Xcel Energy (Xcel or the Company) requested renewal of variances to the Fuel Clause Rules (Petition) for an additional three years, through July 16, 2017. Specifically, Xcel requested that the Minnesota Public Utilities Commission (Commission) grant a variance to Minnesota Rules, Part 7825.2600, subpart 2, and 7825.2400, subpart 13 to allow the monthly Fuel Clause adjustment (FCA) to be based on the use of a month-ahead forecast of energy costs. Xcel also filed a Forecasted FCA Compliance Report (Report) in response to requirements ordered in Docket No. E002/M-11-452 (2012 Order).

II. BACKGROUND

On April 4, 2000, in Docket No. E002/M-00-420, Xcel petitioned the Commission for a revision to its Fuel Clause Adjustment Rider. In the petition, Xcel proposed to:

- Calculate the FCA based on a one-month-ahead forecast of sales and energy costs, rather than a forecast based on a rolling average of actual sales and energy costs;
- Include a rolling FCA true-up factor in each monthly FCA filing; and
- Prorate the FCA based on the number of days in each billing cycle.

The Company requested a one-year variance to Minnesota Rules parts 7825.2600, subpart. 2 and 7825.2400, subpart 13 to implement these changes. Xcel proposed to file a report on the performance and impact of the forecasted FCA (Forecasted FCA Compliance Report) by April 1, 2001. The Company also requested to defer for one year, without carrying

charges, the unrecovered balance resulting from the change from the previous lagged method to the new forecasted method.

On May 4, 2000, the Minnesota Department of Commerce (DOC or the Department) recommended approval of Xcel's Petition, without transition period cost recovery and with additional reporting requirements.

In its June 27, 2000 Order (2000 Order), the Commission approved Xcel's petition as modified to include the Department's recommended reporting requirements. The Commission also granted deferred accounting for certain transition period costs, indicating that the Company would need to support any claim for rate recovery in a future filing. In addition, the Commission ordered the Company to develop a way to communicate forecasted pricing to customers in advance.

On September 12, 2000, the Company submitted a filing calculating the amount of the claimed transition cost obligation, described the options for transition cost recovery, and recommended the adoption of the netting approach to transition cost recovery.

In its November 1, 2000 Order, the Commission approved Xcel's proposed transition cost recovery.

In its July 27, 2001 Order in Docket No. E002/M-01-477 (2001 Order), the Commission extended the variances previously granted to Xcel in the June 27, 2000 Order in Docket No. E002/M-00-420 for an additional year. The 2001 Order required Xcel to abide by the requirements of the 2000 Order with one additional requirement: that the Company analyze the merits of three true-up methods (monthly, moving-average, and annual) and file them with the Annual Automatic Adjustment (AAA) report, Docket No. G,E999/AA-01-838.

In its July 17, 2002 Order in Docket No. E002/M-02-645 (2002 Order), the Commission again extended the variances for an additional year. The 2002 Order required that Xcel file, in its 2003 Forecasted FCA Compliance Report, a report of the alternative methods for true-up, similar to the report required in the 2001 Order. In addition, the 2002 Order required that the Company make its best efforts to improve its forecasting.

In its July 10, 2003 Order in Docket No. E002/M-03-585 (2003 Order), the Commission extended the variances for one year or until the Commission takes other action pursuant to the investigation into the fuel clause adjustment (Docket No. E999/CI-03-802), whichever comes first. The 2003 Order also required that Xcel continue to comply with all of the requirements of the 2000, 2001, and 2002 Orders and file any request to extend the variances by April 15, 2004.

In its August 13, 2004 Order in Docket No. E002/M-04-595 (2004 Order), the Commission extended the variances for an additional year. Similar to the 2003 Order, the 2004 Order required that the Company continue to comply with all the requirements of the 2000, 2001, and 2002 Orders. In addition, the 2004 Order required that in its next Forecasted FCA Compliance Report, Xcel describe and explain the performance of the forecast in predicting fossil fuel costs, purchased energy costs, nuclear fuel costs, system MWh sales, and net system costs.

In its July 27, 2005 Order in Docket No. E002/M-05-613 (2005 Order), the Commission extended the variances for an additional year and required additional reports.

In its July 17, 2006 Order in Docket No. E002/M-06-589 (2006 Order), the Commission extended the variances for an additional year and required additional reports.

In its July 6, 2007 Order in Docket No. E002/M-07-484 (2007 Order), the Commission extended the variances for an additional year and required additional reports.

In its July 16, 2008 Order in Docket No. E002/M-08-451 (2008 Order), the Commission extended the variances for an additional three years and required additional reports.

In its May 4, 2012 Order in Docket No. E002/M-11-452 (2012 Order), the Commission extended the variances for an additional three years and required additional reports.

III. DEPARTMENT ANALYSIS

In analyzing the Company's Petition, the Department identified the following issues for discussion:

- Does the Report address the reporting requirements of Commission Orders?
- Should the Commission approve Xcel's request to extend the variances for an additional three years?
- Does the current design of the fuel cost recovery mechanism encourage the minimization of overall costs of providing energy?

These issues are discussed below.

A. COMPLIANCE WITH THE 2008 ORDER

In its 2011 Order, the Commission required the Company to:

- a) Provide a calculation of what the monthly FCA would have been absent this change;
- b) Provide a calculation of what the monthly FCAs were under the pilot;
- c) Describe how closely the FCA under the pilot program mirrors actual costs;
- d) Discuss alternative true-up methods;
- e) Include the Company's recommendations for the future of the pilot; and
- f) Describe and explain the performance of the forecast in predicting fossil fuel costs, purchased energy costs, nuclear fuel costs, system MWh sales, net system costs, and MISO Day 2 Costs.

In addition, the Commission required Xcel to clearly identify and justify any changes or corrections made to historical data. Finally, the Commission required the Company to:

- a) Report in its monthly AA filings whether MISO Day 2 costs are included in its forecasted costs; and
- b) If so, report on the effect of MISO Day 2 costs on the forecast.

In Ordering Paragraph 4 of its 2006 Order, the Commission required Xcel to report in its monthly AA filing two months later if its forecast deviates from actual fuel costs per kWh by 20 percent or more.

The Department notes that, pursuant to the December 20, 2006 MISO Day 2 Order, the Company has lowered the deviation explanation threshold from 20 percent to 15 percent.

Over the last 12 months reported (March 2013-February 2014), the largest under-forecasted deviation (where actual costs were more than forecast) occurred in January 2014 (13.9 percent) where the system cost of 3.397¢ was 13.9% higher than the 2.924¢ forecasted for January two months ago. The deviation is mainly due extreme cold weather and an outage at the Monticello in the month of January. The deviation does not exceed the 15% limit.

The largest over-forecasted deviation (where actual costs were less than forecast) occurred in February 2014 (2.2 percent). The actual February 2014 system cost of 2.811¢ was 2.2% lower than the 2.874¢ forecasted for March two months ago. This deviation does not exceed the 15% limit.

Over the previous 36 months the forecasted method has deviated 4.4% from actual costs, well within the 15% limit. The Department also notes that over the last 12 months reported, Xcel under-forecasted actual costs by 5.66 percent on average.¹

Based on its review of the Report and Xcel's monthly AA filings, the Department concludes that the Company is in compliance with the 2012 Order.

B. REQUEST FOR VARIANCES

In its Petition (page 5), Xcel requested renewed three-year variances from Minnesota Rules parts 7825.2600, subpart 2 and 7825.2400, subpart 13 to allow the Company to continue to:

- Calculate the monthly FCA based on a one-month-ahead forecast of energy costs, rather than a forecast based on a rolling average of actual energy costs;
- Include a monthly true-up factor in each monthly FCA filing; and
- Prorate the monthly FCA based on the number of days in each billing cycle.

Minnesota Rules 7829.3200 states that the Commission shall grant a variance to its rules when it determines that the following requirements are met:

- A. enforcement of the rule would impose an excessive burden upon the applicant or others affected by the rule;
- B. granting the variance would not adversely affect the public interest; and
- C. granting the variance would not conflict with standards imposed by law.

In its 2000, 2001, and 2002 Orders, the Commission identified several reasons why Xcel's previous requests to implement a forecasted FCA method met the above requirements. These reasons are summarized below.

- A. Excessive Burden:** Previous analysis indicated that the monthly true-up method estimated the current period cost of energy more accurately than the forecast based on a two-month average FCA calculation method (historical method) required by Minnesota Rules parts 7825.2600, subpart 2 and 7825.2400, subpart 13. Based on this result, enforcement of these rules would impose an excessive burden on Xcel and its ratepayers through distorted price signals. The Department notes that the customers facing the largest burden under the two-month lagged approach were interruptible customers who interrupted load in a high-use month such as July, only to pay high rates several months later, when the high July rates were used to calculate the lagged FCA rate.

¹ The Department used the data provided under Attachment A, Exhibit 5 (lines 1-2, p. 14) of the Report to calculate this number: $(3.081-2.916)/2.916 * 100 = 5.66$. The Company shows a different number under line 4, 5.3 percent.

- B. Public Interest:** The monthly true-up method was expected to promote the public interest by improving price signals.
- C. Standards Imposed by Law:** Granting the variances would not violate any standards imposed by statute.

On page 6 of the Petition, Xcel uses similar reasoning to justify its request for renewed variances. Based on the information included in its Report, Xcel concludes that its monthly true-up method provides more accurate price signals than the forecast based on a two-month historical method required by Rules. Xcel also notes that granting the variances would not conflict with any standards imposed by law. Finally, Xcel notes that enforcement of Minnesota Rules parts 7825.2600, subpart 2 and 7825.2400, subpart 13 would burden both the Company and ratepayers with the transition costs of a return to the forecast based on a two-month historical FCA method, and would result in distorted price signals.

The Department agrees with Xcel that the variances would not conflict with standards imposed by law. The Department also agrees with Xcel that enforcement of the Rules cited above could burden the Company and/or ratepayers as a result of distorted price signals. Therefore, the Department focuses our analysis on whether the variances would promote the public interest by improving price signals.

The Department clarifies that Xcel has not met its burden to support its claim that a return to the forecast based on a two-month historical FCA method would result in transition costs. The Company has not explained and/or provided any analysis in support of this claim. Nonetheless, if there were any such costs, there would be an additional burden, at least for Xcel.

The Department identifies the following issues for analysis:

1. Historically, has Xcel's forecast been biased or unbiased?
2. How has Xcel's forecasted FCA performed historically, relative to alternative FCA calculation methods?
3. Would the variance promote the public interest by improving price signals?
4. How is the Midcontinent Independent System Operator (MISO) Day 2 market expected to affect the performance of Xcel's forecasted FCA?

These issues are discussed below.

1. Biased or Unbiased Forecast

From a public interest perspective, it is important to verify that Xcel's forecast is not biased. This issue arises because in theory an upwardly biased forecast could be used to increase working capital at the expense of ratepayers. The true-up mechanism mitigates this problem partially, but not completely; for example, even with a true-up mechanism in place, an upwardly biased and rising forecast would lead to constant over-recoveries.

The Department took this issue into account in our review of the Company's Petition. However, our examination of Xcel's forecast versus actual costs does not yield evidence of an upwardly biased forecast. As noted previously, the Company under-forecasted actual costs by 5.66 percent on average over the last 12 months reported (March 2010-February 2011). Over the life of the pilot, Xcel under-forecasted actual costs by 1.6 percent on average for the months reported (July 2000-February 2014).²

Therefore, the Department concludes that the Company's forecast does not show a tendency to overestimate actual fuel costs.

The Department notes that this analysis does not address the issue of whether actual fuel costs are larger than necessary due to Xcel's assurance of recovery through the true-up mechanism. However, such an issue pertains to the FCA in general and not to this method in particular.

2. Actual Performance of Forecasted FCA versus Other FCA Calculation Methods

Xcel's Compliance Report provides extensive data on the performance of the Company's FCA calculation method over the period July 2000-February 2014. In addition, the Report shows how alternative FCA calculation methods would have performed over the same period. In the sections below, the Department discusses the relative accuracy of the two-month historical method, the Company's forecast (with and without a monthly true-up), and alternative true-up methods.

(a) Two-Month Historical Method versus the Company's Forecast (Without a True-up)

The Department examined the price signaling accuracy of the two-month historical method in Minnesota Rules versus the Company's forecast (without a true-up) in tracking actual fuel

² The Department used the data provided under Attachment A, Exhibit 5 (lines 1-2, p. 14) of the Report to calculate this number: $(2.303-2.267)/2.267*100 = 1.6$ percent.

and purchased power costs. Examination of the forecast without a true-up sheds light on the Company's ability to accurately forecast costs.

The Company's forecast provided a greater price signaling accuracy than the two-month historical method required by Rules over the July 2000-February 2014 reporting period. Xcel's forecast was more accurate in absolute value than the two-month historical method in 96 out of the 164 months, or 58.5 percent of the time.³

(b) *Two-Month Historical Method versus the Company's Forecast (With Monthly True-up)*

In this section, the Department analyzes the price signaling and recovery accuracy of the two-month historical method versus the Company's forecast after the monthly true-up is applied. This issue is important from the perspective of giving Xcel's ratepayers reasonable information about the cost of energy, since the monthly true-up is included in the monthly fuel clause adjustment factor that customers see. While the Commission has already allowed Xcel to have a true-up, this analysis is intended to monitor the performance of the true-up in practice over time.

Moreover, the Department notes that one of the reasons the Company proposed using a forecasted FCA was to address the concerns of large interruptible customers who saw their rates increase in September and October even when these customers had their electric service interrupted in July and August and thus did not contribute to increased costs during these peak months in the ways other customers had. It's important to assess whether the true-up would result in the same rate increases that Xcel was trying to avoid.

The two-month historical method required by Rules appears now to have a better price signaling accuracy than the monthly true-up method. Over the July 2000-February 2014 reporting period, the monthly true-up method was more accurate in absolute value in 78 of the 164 months and the two-month historical method was more accurate in 86 out of the 164 months.⁴

Over the last year reported (March 2013-February 2014), the Company's forecast with monthly true-up was more accurate (in absolute value) than the two-month historical method in 6 of the 12 months (April, July, August, November, December 2013, and January 2014).⁵ In other words, the two-month historical method was more accurate in absolute value than Xcel's forecast in 6 of the 12 months. The two-month historical method was also more accurate in absolute value than Xcel's forecast in 20 of the last 36 months reported

³ Department's calculations based on Attachment A, Exhibit 4 (lines 6 and 16, pp. 1-14).

⁴ Department's calculations based on Attachment A, Exhibit 4 (lines 12 and 16, pp. 1-14).

⁵ Department's calculations based on Attachment A, Exhibit 3 (lines 5 and 7, pp. 13-14) of the Report.

(March 2011-February 2014).⁶ The Department notes that this number may be inflated due to the historical method performing extremely well during the 2011 calendar year. In the last 24 months the forecast method and the historical Method have each been more accurate an equal number of times.

These results show similar trends as those observed by the Department in the previous variance extension request, Docket No. E002/M-11-452. At that time the Company stated that while a new trend might appear to be developing, recent results are due to stable fuel costs during the recent period. Xcel believes that since the historical method has no way to adjust for even known volatilities, the forecast method will be more accurate in the long run, and indeed it has been.⁷

The Department notes that the forecast method with monthly true-up outperformed the two-month historical method in the high-cost summer months. In its Petition, Xcel stated that “[t]he lagged cost recovery of the historical method means it is slow to reflect higher summer peaking costs, and moves recovery of these costs to September and October.”⁸

Data in the Report supports Xcel’s assertion. With only eight exceptions (June 2001, August 2005, July 2010, June 2011, August 2011, August 2012, July 2013, and August 2013), the two-month historical method understated actual costs in the months of June, July, and August for each of the years reported and would have overstated actual costs in September and October of those years (with four exceptions, in September 2004, October 2005, September 2009, and October 2013).⁹ The forecast with monthly true-up outperformed the two-month historical method in terms of matching costs with cost recovery in a majority of the summer months reported (24 out of 41 months).¹⁰ More importantly, under the monthly true-up method, FCA charges in the fall months have tended to be closer to actual costs (15 out of 28 months).¹¹ This may be changing, however, as the two-month historical method outperformed the forecast with monthly true-up method in the summer and fall months for the last 3 years (5 out of 6 months each year).¹²

Finally, the Department notes that over the period of July 2000-February 2014, Xcel over-recovered on average 0.001 cents per kWh with its forecast method with true-up, compared to an under-recovery of 0.023 cents per kWh with the two-month historical method (without true-up).¹³ The Department concludes that the Company’s forecast with true-up matched

⁶ Department’s calculations based on Attachment A, Exhibit 3 (lines 5 and 7, pp. 11-14) of the Report.

⁷ As shown on Attachment A, Page 5, of the Company’s Report.

⁸ Source: Attachment A, page 6 of 9.

⁹ Source: Attachment A, Exhibit 3 (line 5, pp. 1-14) of the Report.

¹⁰ Source: Attachment A, Exhibit 3 (lines 5 and 7, pp. 1-14) of the Report.

¹¹ Source: Attachment A, Exhibit 3 (lines 5 and 7, pp. 1-14) of the Report.

¹² Source: Attachment A, Exhibit 3 (lines 5 and 7, pp. 1-14) of the Report.

¹³ Source: Attachment A, Exhibit 3 (lines 5 and 7, p. 14) of the Report.

costs with cost recovery more closely over time than the two-month historical method without a true-up.

In summary, the Department notes that, overall, the forecast method with true-up appears to be a more accurate method of calculating Xcel's FCA; however in recent years, the two-month historical method has been equally, if not more, accurate.

(c) *Monthly True-up vs. Alternative True-up Methods*

(i) *Overview*

In addition to the current (monthly) true-up mechanism, the Petition includes an analysis of two alternative true-ups that could be applied to the Company's forecast: the annual true-up and the moving-average true-up. The monthly, annual, and moving average true-ups result in a two-month, thirteen-month, and two-and-one-half-month delay in cost recovery respectively.

The Department notes that each of these true-up methods has advantages and disadvantages. First, the annual true-up would allow the Company to provide advance notice to customers of the levels of fuel-related charges each month over the course of the year. This type of long-term price information cannot be provided if the Company uses the monthly or moving-average true-up methods, because these methods require that true-ups be incorporated into fuel-related charges over the course of the year.

Second, the various true-up methods impact the Company's cost recovery and price signaling accuracy in different ways. The Department notes that theoretically the monthly true-up method is expected to result in the lowest over- or under-recovery of costs at any given time, because this method allows the Company to recover its over- or under-collected costs closest to the time they are incurred.¹⁴ The moving-average and annual true-up methods are expected to result in the least price distortion from true-ups, because these methods allow the Company to average the true-up over two or twelve months respectively, thereby helping to smooth out any anomalous spikes that may occur in the monthly true-up. Price signals are particularly important for interruptible customers who need to stop taking electric service when requested by Xcel, and may choose to switch to alternatives if such switches are economical.

In the sections below, the Department discusses whether the performances of the various true-up methods are consistent with these expectations.

¹⁴ However, the Department notes that for the annual or moving-average true-up methods, the problem of over- or under-recovery may be mitigated somewhat if the forecast is highly accurate or if over-estimates of costs are cancelled out by under-estimates of costs in subsequent months.

(ii) Over/under Recovery of Costs

Consistent with expectations, the monthly true-up method resulted in the smallest combined over- under-recovery of the three methods over the entire period July 2000-February 2014. The monthly true-up method resulted in a 0.09 percent under-recovery of actual costs, whereas the annual true-up method resulted in a 2.0 percent over-recovery of actual costs and the moving-average true-up method resulted in a 0.11 percent under-recovery of costs.¹⁵

During the most recent 12-month period of March 2013 through February 2014, the monthly true-up method resulted in the smallest combined over- under-recovery of the three methods. The monthly true-up method resulted in a 0.96 percent under-recovery of costs, whereas the moving-average true-up method resulted in a 1.12 percent under-recovery of actual costs and the annual true-up method resulted in a 2.60 percent under-recovery of actual costs.

During the most recent 36-month period of March 2011 through February 2014, the monthly true-up method resulted in the smallest combined over- under-recovery of the three methods. The monthly true-up method resulted in a 0.34 percent under-recovery of actual costs, whereas the moving-average true-up method resulted in a 0.57 percent under-recovery of actual costs and the annual true-up method resulted in a 2.80 percent under-recovery of costs.

The Department notes that the monthly true-up method has been the top performer over the last three years. The Company noted during the 2011 variance renewal that the monthly true-up method is also better able to react to volatility in energy costs.

(iii) Closer to Cost

Data in Attachment A, Exhibit 9 (lines 8, 13, and 18, pp. 1-11) of the Company's filing indicates that the annual true-up method was accurate in more individual months during the July 2000- February 2014 reporting period than either of the other two true-up methods (68 months for the annual true-up method, 45 for the moving average and 48 months for the monthly true-up method). The annual true-up, however, was not the most accurate overall when the entire period, the last 36 months, or the last 12 months are considered as a group. Overall, the monthly true-up method is superior, suggesting that while it has more variation than the annual method, the monthly true-up method recovers from errors or unexpected price volatility more quickly when that volatility occurs. The Department notes that all three methods result in very accurate total recovery of fuel costs.

¹⁵ Department's calculations based on Attachment A, Exhibit 6 (lines 17 and 21, p. 28) and Exhibits 7-8 (lines 17 and 21, p. 14) of the Report.

The Company noted during the 2011 variance renewal that the purpose of a true-up is not to improve price signal accuracy, but to instead ensure that the recovery is as close to real costs as possible.

(iv) Impact on Large Interruptible Customers

In the May 4, 2012 Order for Docket No. E002/M-11-452 the Commission required the Company to provide a comparison of the monthly and annual true-up methods in terms of their impact on large interruptible customers over the reporting period. The Company complied by providing data that shows that under the monthly true-up method the deviation from actual costs was less than what would have occurred under an annual true-up in 27 of 53 months, or 51 percent of the time, during the summer period between June and September over the period from July 2000- February 2014. The Company also noted that when looking only at the months of July and August the monthly true-up method had less deviation from actual prices in 15 of 26 months, or 58 percent of the time.

The Department concludes that the monthly true-up method has a slight advantage over the annual method; however this advantage appears to be minimal.

3. Public Interest

The performance of the various FCA calculation methods has varied over time. However, in general, over the life of the pilot:

- Xcel's monthly true-up method has provided greater price signaling accuracy than the two-month historical method required by Rules (up to the Company's previous petition in the 08-451 filing); however in recent years, the two-month historical method appears now to provide a greater price signaling accuracy. The Company believes, however, that using the forecast method allows for quicker responses to price volatility, and has contributed to the improved performance of the historical method by stabilizing recovery over the past few years
- Xcel's forecast with monthly true-up has more accurately collected total fuel costs than the two-month historical method.
- The annual true-up method resulted in prices that are closer to actual monthly costs than Xcel's monthly true-up method and the moving average true-up method; and
- The monthly true-up method resulted in the lowest under/over-recovery of actual costs than would have been the case under the annual true-up method and the moving average true-up method.

The results indicate that, while the historical method appears to be becoming more accurate, it does not collect total costs as accurately as the forecast method. Further, while the annual true-up has been closer to true costs in more months than the monthly true-up method, the annual true-up method has been worse at collecting total fuel costs during the entire July 2000- February 2014 period. Thus the Department sees no reason at this time to change from using the monthly true-up method to the annual true-up method.

The Department notes that the analysis above is based on the data provided by the Company and that due to recent changes in the electricity market, historical trends may not be indicative of future developments.

4. *Expected Performance of Forecasted FCA under MISO Day 2*

On April 1, 2005, the Midwest Independent System Operator (MISO) launched a new energy market design, commonly referred to as the "MISO Day 2 market." As such, this market has been in operation for nine years. As discussed in the Department's Comments in Docket No. E002/M-04-1970, this market design includes day-ahead and real-time energy trading. Energy prices are calculated based on locational marginal prices and may be hedged with financial transmission rights.

In the Commission's February 24, 2006 Order regarding cost recovery of MISO Day 2 costs (Docket No. E002/M-04-1970, E015/M-05-277, E017/M-05-284 and E001/M-05-406), the Commission required all parties to report back to the Commission on a joint report regarding:

- MISO's 32 charges in FCA or base rates,
- Allocation methods between retail and wholesale operations, and
- Information regarding wholesale margins.

The report to the Commission on these MISO Day 2 issues was filed on June 22, 2006.

On December 20, 2006, the Commission issued its *Order Establishing Accounting Treatment for MISO Day 2 Costs*.

On page 13 of its Petition (Attachment A), Xcel provided the following explanation of MISO Day 2 cost recovery under its current FCA calculation method:

As discussed in previous filings, the Company does not forecast MISO Day 2 and [Ancillary Service Market] ASM costs in terms of charge types as they appear in the accounting records. There are certain costs and revenues related to the MISO Day 2 market, such as congestion, Financial Transmission Rights (FTR), incremental transmission losses, and Revenue

Sufficiency Guarantee (RSG) & Revenue Neutrality Uplift (RNU), which are not explicitly included in the PROSYM forecasting model. Many of these charges and revenues arise out of the MISO settlement process or result from differences between day-ahead and real time market operations nature (costs and revenues). For some of these charges, the net forecast impact in annual dollar amount is relatively small and would not have a significant impact on the Forecasted FCA. The forecasted costs illustrated in Attachment 1, pages 5 and 6 of the monthly FCA filing do not include MISO Day 2 charges explicitly. Monthly MISO Day 2 expenses by charge types are recovered on an actual basis as shown in the fuel cost charges computation in Attachment 1, page 2 of the monthly FCA filing.

Based on this explanation, the Department understands that Xcel is not attempting to forecast MISO Day 2 Costs separately, even though they are, in effect, forecasting what Xcel's customers pay for energy through the operation of the MISO market. To the extent that MISO Day 2 Costs result in deviations from the Company's forecast, these costs would be recovered through the true-up mechanism, subject to a two-month lag.

C. FUEL COST RECOVERY MECHANISM DESIGN

The Department raised issues regarding the current FCA recovery mechanism previously, including most recently in Docket No. E999/AA-12-757. In that docket the Department noted that Investor Owned Utilities (IOUs) have little incentive to minimize costs if they are passed through the FCA to rate payers as there is no short-term benefit to shareholders. The Department further noted that:

A well-designed incentive mechanism would encourage IOUs to minimize overall costs of providing energy, including costs that are currently passed through the FCA. To do so, such a mechanism should ensure that IOUs internalize their total cost of doing business, including their fuel and replacement power costs during outages. Under such an incentive mechanism, IOUs would have the appropriate incentives to keep these costs as low as possible because it would be in their own best interest to do so.

Since the issue of the FCA design is still pending, the Department believes that any extension of the variance for the current FCA method should end if the Commission enacts a new FCA mechanism to properly incentives IOUs.

IV. RECOMMENDATION

The Department recommends that the Commission **approve** Xcel's request for a renewal of variances to the Fuel Clause Rules for an additional three years, with the following requirements for its next forecasted FCA compliance report:

- Xcel will continue to comply with all the requirements of the Commission's July 16, 2008 Order in Docket No. E002/M-08-451;
- Xcel will provide a comparison of the monthly and annual true-up methods in terms of their accuracy over the reporting period as discussed above;
- Xcel will provide a comparison of the monthly and annual true-up methods in terms of their impact on large interruptible customers over the reporting period; and
- Any Commission Order enacting a new or revised FCA mechanism would take precedence and end the variance prior to the end of the three year extension.

The Department is available for questions.

/ja

RELEVANT LAWS AND RULES

Minnesota Statutes section 216B.16, subd. 7 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; or (3) costs for fuel used in generation of electricity or the manufacture of gas.”

Minn. Rules 7825.2600, subp. 2 states:

“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.”

Minn. Rule 7825.2400, subp. 13 defines the current period as the “most recent two-month moving average used by electric utilities in computing an automatic adjustment of charges.” The Commission’s rules do not allow a true-up for electric FCAs, but Minn. Rule 7825.2700, subparts 3 and 7 require purchased gas adjustments to include an annual true-up of the differences in costs and recovery of costs in the previous year:

*Subp. 3. **Adjustment per Mcf, Ccf, or Btu.** The adjustment per Mcf, Ccf, or Btu is the sum of the commodity adjustment, demand adjustment, peak shaving gas adjustment, manufactured gas adjustment, and true-up adjustment....*

*Subp. 7. **True-up amount.** The true-up amount is the difference between the commodity and demand gas revenues by class collected by the utility and the actual commodity-delivered gas cost and demand-delivered gas cost by class incurred by the utility during the year. The true-up adjustment must be computed annually for each class by dividing the true-up amount by the forecasted sales volumes and applied to billings during the next 12-month period beginning on September 1 each year, provided that the adjustment has been filed under part [7825.2910](#), subpart 3.*

CERTIFICATE OF SERVICE

I, Linda Chavez, hereby certify that I have this day served copies of the following document on the attached list of persons by electronic filing, 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 - COMMENTS

Docket Nos. **E002/M-14-364**

Dated this **30th** day of **May, 2014**.

/s/Linda Chavez

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