MINNESOTA
DEPARTMENT OF
COMMERCE

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October 30, 2007

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

RE: **Reply Comments of the Minnesota Department of Commerce In the Matter of the Commission's Investigation into the Appropriateness of Continuing to Permit Electric Cost Adjustments**
Docket No. E999/CI-03-802

Dear Dr. Haar:

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

> The August 16, 2007 Notice issued by the Minnesota Public Utilities Commission (Commission) soliciting further comments to update the record and to clarify what issues remain relevant to this investigation.

The Department provides its reply comments in response to comments filed by parties on this issue. The Department is available to answer any questions the Commission may have.

Sincerely,

/s/ KATE O'CONNELL
Supervisor, Electric Planning and Advocacy

KO/ja
Attachment

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

REPLY COMMENTS OF THE
MINNESOTA DEPARTMENT OF COMMERCE

DOCKET NO. E999/CI-03-802

I. BACKGROUND

In response to the Commission's August 16, 2007 Notice of Comments, the following parties provided comments on September 28:

- Dakota Electric Association (DEA);
- Office of Attorney General – Residential Utilities Division (OAG-RUD);
- Northern States Power d/b/a/ Xcel Energy (Xcel);
- Minnesota Power (MP);
- Interstate Power and Light (IPL); and
- The Department.

No comments were filed by Otter Tail Power Company (OTP). The Department responds to the filed comments below.

II. DEPARTMENT'S RESPONSE TO COMMENTS

A. DAKOTA ELECTRIC ASSOCIATION

Dakota Electric Association filed comments stating that DEA stands by its previous comments filed in this proceeding, specifically those indicating that DEA is in a different set of circumstances than other vertically integrated utilities. Because DEA takes nearly all of its power from its generation and transmission provider, Great River Energy, DEA has less control over its fuel costs and less ability to take specific steps to manage its fuel costs. For this reason, DEA request that Dakota Electric Association be removed from any further investigation that they Commission may decide to undertake in this docket. In addition, DEA requests that that the Commission find that DEA's continued application of its Resource and Tax Adjustment (RTA) is "appropriate and in the best interest of our member-owners."

The Department agrees that DEA is in a different position than investor-owned utilities since DEA is not the entity bidding in its resources and load to the MISO Day 2 Market on a daily basis. While DEA should theoretically be able to influence GRE's fuel costs indirectly through its influence as a large member of GRE, the issues expected to be involved in the instant proceeding are of a different nature than those DEA would face. As a result, the Department agrees that it would be reasonable not to require DEA to be involved in this matter on an ongoing basis. However, DEA is advised to follow this process as it moves forward. In addition, the Department notes that DEA's RTA has not been called into question in this proceeding. Moreover, since rates are considered to be just and reasonable until changed, the Department concludes that there is no need for the Commission to make a specific finding regarding DEA's RTA. However, the Department would not oppose such a finding if the Commission determines it to be necessary to do so.

B. OAG-RUD

The OAG-RUD filed comments stating that it stood by the comments filed on April 16, 2007. The Department notes that we responded to those comments earlier in this process.

C. XCEL

Xcel filed comments referencing a series of meetings the Department has held with stakeholders and noting Xcel's belief that "the following topics are appropriate for continued discussion and review in this proceeding:

- The need for improved provision of information to stakeholders and customers regarding the level and key drivers of the FCA,
- The need for greater prior review of the expected FCA costs to mitigate burdensome ex-post review of the costs, and
- The value of incentive mechanisms in encouraging enhanced utility performance in managing the costs recovered in the FCA."

Xcel agreed that customers need to be better informed about FCA costs and their energy bills since these costs have become higher and more volatile. Xcel states that:

> This information will help customers with budget planning and will assist them in making informed decisions regarding current and future energy consumption, including potential investments in

> energy-consuming products, energy-saving devices, and potentially planned maintenance on their facilities.

Xcel noted that there was discussion of the possibility in the future that there would be periodic meetings with interested stakeholders, including customers, to gain better understanding of these costs and find out what the utility is doing to mitigate FCA costs. There would be separate meetings for each utility, wherein the utility would present demand and energy cost forecasts, expected trends in costs, key factors affecting costs, and other relevant information. Xcel states that "This information would provide a framework for reviewing and tracking actual FCAs over the course of the year, and would help highlight any deviations from forecast that occur." Under this approach, significant increases in costs could lead to more stakeholder meetings, as needed. Xcel states that this approach would give customers better information about upcoming energy costs and help them understand the key factors affecting energy costs. Xcel notes that it would be important in this proceeding to reach "consensus regarding further definition of the substance for these meetings and reporting in monthly FCA filings to allow tracking of deviations from forecast to actual" costs.

Regarding the issue of prior review of FCAs, Xcel agreed that there would be value in getting input, when possible, prior to when utilities make significant decisions affecting energy costs. Xcel states that "[t]his type of review will facilitate greater understanding of utility procurement practices and decision-making and the potential risks and rewards associated with alternative procurement strategies." Xcel noted that this kind of review is new and thus it may be better to use a less formal approach via meetings rather than a formal approach, at least initially, to try this approach.

Regarding incentives, Xcel noted that the Department has been recommending use of incentives in the stakeholder meetings. Xcel is not opposed to the use of incentives, but states that regulation should continue with the thorough review of utility actions which currently takes place. Xcel states that incentives can work with such comprehensive reviews to minimize fuel costs. Xcel states that "[t]he Company's experience in other jurisdictions has been that effective and balanced mechanisms take some time to develop and cannot be done without in depth knowledge by stakeholders of the key drivers of FCA costs."

Finally, Xcel states:

> The recommended stakeholder meetings discussed above would provide a valuable starting point for understanding the key drivers of FCA costs and identification of potential areas where incentive mechanisms can effectively align shareholder and ratepayer interests. Some discussion has already taken place at recent stakeholder meetings organized by the Department. While this process may require more time than immediate development of incentive mechanisms, the Company believes that more effective

> and enduring incentive mechanisms are appropriate for further consideration and development through this investigation process.

Xcel recommends that the Commission "keep the existing docket open and direct parties to develop more detailed recommendations addressing three issues:

- Improved provision of FCA information to stakeholders;
- Increased focus on before-the-fact review of forecasted FCA costs and utility actions to mitigate these costs; and
- Development of FCA incentive mechanisms to better align ratepayer and shareholder interests.

The Department appreciates Xcel's articulation of the issues and agrees that the recommendation above is reasonable. The Department further notes that, in the time since these comments were filed, parties met to discuss how such a process would move forward regarding information in annual meetings and filings. The utilities have agreed to provide information in early November which parties will subsequently meet to discuss. The willingness of parties to develop resolutions to these issues points to the importance for ratepayers to keep FCA costs as low and reasonable as possible, along with the utilities willingness to move forward on this matter. The Department appreciates the movement utilities have made over time to address the concerns of customers.

D. MP

MP filed a proposed change in the fuel clause review process that MP states would provide:

> …the Commission, the Department and other stakeholders greater information regarding how the utilities each prepare their annual fuel clause budget forecast. The intent of this proposal is to get more information to stakeholders upfront, so they have the opportunity to question individual utilities in advance of each utility implementing fuel clause related activities for a given year.

In addition, MP provided information on outages, which have been a key topic of conversation both in the stakeholder meetings and in various filings before the Commission. MP also agrees that it is important to provide information in a timely manner to its ratepayers about electricity prices expected to occur over the year due to the operation of the FCA. Minnesota Power identifies its understanding of the issues in this proceeding to be:

- Stakeholders want to know that utilities aggressively manage FCA costs to keep them reasonable and as low as possible using good business practices.

- There should be measurable performance targets for the FCA to which the utilities are or can be held accountable.

- Timely, useful energy pricing notification should be provided to customers so they can make informed energy usage choices.

- Utilities should follow maintenance practices and outage management procedures that minimize FCA costs.

- Small- to moderate-sized business customers and residential customers should receive information on FCA performance that they would find useful, in addition to the reports currently provided to mostly larger customers.

MP's comments speak at length about the beneficial effects of the FCA on the utility and suggests that the current focus on the FCA at this time is due to greater understanding of the FCA. For clarity, the Department points out that the greater focus on the FCA is due to the significant effects of the rate impacts of the FCA on Minnesota ratepayers and the need to help protect Minnesota's economy from negative effects of large and volatile rate effects stemming from the costs being charged to industrial, business and residential customers through the FCA. Since the Commission does not see FCA rates until long after the rates have been charged, it is critical for the Commission to be aware of the sharp rate increases that have resulted from the operation of the FCA. Moreover, since circumstances have changed significantly from what existed decades ago when the FCA was established, it is important to ensure that rates charged through the FCA are in fact reasonable.

The Department notes that former Commissioner Ken Nickolai clearly articulated the current issues regarding the FCA in his concurring opinion in the Commission's December 20, 2006 Order I*n the Matter of the Petitions for Approval of Revisions to Rider for Fuel Adjustment to Recovery Costs and Pass-Through Related to MISO Day 2* (Docket No. E015/M-05-277). First, he noted that utility operations under the MISO Day 2 Market changed the responsibilities of utilities. Second, he pointed out that oversight of FCAs also needs to change. Since former Commissioner Nickolai explained the matter so well, the Department provides the relevant portion of his concurring opinion below:

> Originally the fuel clause permitted electric utilities to recover the cost of wholesale power purchases made at rates that the Federal Energy Regulatory Commission (FERC) had found to be reasonable. Today, rates established through FERC's reasonableness review have largely been replaced by rates established in MISO's evolving energy market. It is too early to tell whether the results of this FERC-driven change will be beneficial to consumers, or whether automatic wholesale cost recovery will need to be revisited in the future.

I am persuaded by the authors of the Joint Report and Recommendation that the costs utilities now recover through the fuel clause are of the same type that utilities recovered through the fuel clause prior to the emergence of the MISO market. But that assurance does not address whether utilities retain adequate incentives to push back on MISO to keep the costs within reason – costs that previously were more under the control of each individual utility.

However, I am also convinced that to not allow the cost of wholesale energy through the fuel clause at this time would not be prudent. Barring the recovery of these costs through the fuel clause could affect the utilities' financial ratings and ultimately their cost of debt and equity capital -potentially substantial consequences for utilities and their customers that have not yet been addressed in this record. Further examination of those issues would be necessary before taking any steps to disallow automatic recovery of these costs.

I am very pleased that my colleagues have reaffirmed the need to investigate ways of ensuring low-cost electricity for Minnesota. The risks to Minnesota electric consumers arising from the MISO market as currently structured are substantial. Issues needing careful examination include the following:

- The means of ensuring adequate generating capacity within the boundaries of MISO's operations. To date, electricity markets have proven to be effective at pricing scarcity, but not at bringing new generation to the market. Planning reserve margins, which are an essential component of reliability and stable market prices, are no longer enforceable.

- Risk of bidding strategies. Each day utilities make decisions on their strategies for offering energy into the markets and purchasing energy from the markets. Use of the fuel clause allows the risk of those decisions to be automatically passed from the utilities to their consumers. Careful review is necessary to ensure that retail customers are being adequately protected from any adverse consequences of a utility's bidding strategy.

> - Allocation of Financial Transmission Rights (FTRs). As discussed briefly in the Order, FTRs are the means by which Minnesota retail customers are protected from "congestion pricing" and resulting cost increases. To ensure protection of native load customers, MISO must provide utilities with a full allocation of FTRs. MISO has not always provided such allocations in the past. This allocation should be carefully watched in the future.
>
> - Risk of cost shifting. The mechanisms by which costs incurred by MISO are allocated back to the customers of their member utilities needs to be carefully scrutinized. If programs undertaken by Minnesota utilities and consumers help reduce demand during times of peak demand, those utilities and customers should not have to bear the costs of acquiring expensive power to serve those who do not reduce their demand.
>
> This list is not intended to be exhaustive, but to be indicative of the types of inquiry that are needed as we proceed to investigate how to enure the supply of least-cost electric energy for Minnesota customers.
>
> In conclusion, while I concur in the decision, I urge my colleagues on the Commission and the representatives of the public at the Department of Commerce and the Residential and Small Business Utilities Division of the Office of the Attorney General to continue to provide active oversight for MISO's operations. We must carefully consider both whether the existing structure of the market is working as hoped for the Minnesota retail consumer, and to thoughtfully revisit the use of the fuel clause in the broader context of its potential financial consequences after there has been more experience with the MISO market.

The Department notes that former Commissioner Nickolai's concurring opinion provides a clear and reasonable basis for the discussions that are beginning to take place among stakeholders to accomplish the goals set out by Xcel and MP in the lists provided in their comments and reproduced above.

MP proposes to provide more information to its customers on expected fuel costs for an upcoming year. As indicated above in response to Xcel, stakeholders have begun to talk about what would be involved and included in such a process. Thus, it is expected that this discussion will be on-going at least in the near term. The Department would welcome any input the

Commission would like to provide at this time regarding any expectations the Commission would have about such a proposal. It is expected that the stakeholders would return to the Commission with a more fleshed-out proposal.

E. IPL

IPL noted that the utilities acknowledged "that the monthly rates filed under the FCA process are provisional, are subject to retroactive revision upon further investigation, and are reviewed in the utility's AAA filings." The Department notes that the Department included a copy of the letter from utilities on this point in our September 28, 2007 letter in this proceeding. IPL then concludes that "the AAA proceeding provides an opportunity to determine that the fuel and purchased power costs were prudently incurred, and should be eligible for recovery from customers." IPL requests that "the Commission find that the FCA is an appropriate tool in the current regulatory environment."

The Department notes that the question in this proceeding has been whether the current operation of the FCA provides adequate oversight of costs flowing through the FCA. As IPL stated so well, '[t]o say the least, the Day 2 market is complicated, and provides the utilities with many more decision points and choices than they had before." Former Commissioner Nickolai's concurring opinion provided above raises important questions that the Department hopes stakeholders will be able to address in a reasonable and timely manner.

III. RECOMMENDATIONS

Based on the information available at this time, the Department notes the following:

It is reasonable for the Commission not to require DEA to be actively involved in this matter at this time. However, DEA may certainly choose to monitor the development of issues in this proceeding.

It is not necessary for the Commission to find that DEA's RTA is reasonable since the RTA has not been called into question at this time.

Stakeholders are meeting on an ongoing basis to develop ways to discuss objectives such as the following (the following lists all of the objectives identified in Xcel's and MP's comments):

- Improved provision of FCA information to stakeholders;

- Increased focus on before-the-fact review of forecasted FCA costs and utility actions to mitigate these costs; and

- Development of FCA incentive mechanisms to better align ratepayer and shareholder interests.

- Ensure that stakeholders know that utilities aggressively manage FCA costs to keep them reasonable and as low as possible using good business practices.

- Develop measurable performance targets for the FCA to which the utilities are or can be held accountable.

- Provide timely, useful energy pricing notification to customers so they can make informed energy usage choices.

- Ensure that utilities follow maintenance practices and outage management procedures that minimize FCA costs.

- Provide small- to moderate-sized business customers and residential customers with information on FCA performance that they would find useful, in addition to the reports currently provided to mostly larger customers.

The expectation is that when reasonable progress is made on these goals, stakeholders will provide updated information to the Commission. In any case, stakeholders expect to update the Commission on progress made prior to the end of the year.

/ja

STATE OF MINNESOTA)
) ss
COUNTY OF RAMSEY)

AFFIDAVIT OF SERVICE

I, **Sharon Ferguson**, being first duly sworn, deposes and says: that on the **30th** day of **October, 2007**, served the **Minnesota Department of Commerce Reply Comments**

MN DOC DOCKET NUMBER: E999/CI-03-802

XX by depositing in the United States Mail at the City of St. Paul, a true and correct copy thereof, properly enveloped with postage prepaid

XX electronic filing

/s/Sharon Ferguson

Subscribed and sworn to before me

this 30th day of October, 2007

/s/ Clodetta I. Jenson
Notary Public-Minnesota
Commission Expires 1/31/2009

E999/CI-03-802

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