

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

Beverly Jones Heydinger	Chair
David C. Boyd	Commissioner
Nancy Lange	Commissioner
J. Dennis O'Brien	Commissioner
Betsy Wergin	Commissioner

Docket Nos. E999/AA-12-757
E-999/AA-11-792

In the Matter of the Review of 2011-2012
Annual Automatic Adjustment Reports

**REPLY COMMENTS OF THE
OFFICE OF THE ATTORNEY GENERAL –
ANTITRUST AND UTILITIES DIVISION**

I. INTRODUCTION

The Office of the Attorney General - Antitrust and Utilities Division (“OAG”) submits the following Reply Comments regarding the Automatic Adjustment Reports of Utilities for the period of July 2011 through June 2012, and the comments filed by other parties.

The Department of Commerce (“DOC”) submitted comments discussing the Fuel Clause Adjustment (“FCA”) and providing historical background of the use of the FCA by utilities to automatically recover their fuel and purchased power costs. While the OAG agrees with the DOC’s overall assessment that the current automatic recovery mechanism for fuel and purchased power costs fail to provide the proper incentive to control these significant costs, it disagrees that the best method to fix the current problem is to eliminate the FCA. Moreover, the OAG is concerned that convening additional meetings, as suggested by the DOC,¹ will not provide progress toward a resolution. Accordingly, the OAG continues to recommend that the Commission adopt the FCA incentive mechanism, described below, that it has recommended in

¹ The DOC made its suggestion to conduct an additional meeting on utilities’ FCAs in Docket No. E-999/AA-11-792. Accordingly, these comments apply equally to that docket.

past rate cases. In the alternative, the OAG recommends the Commission solicit specific proposals for an FCA incentive mechanism from parties for comment.

II. THE CURRENT FCA IS AN OUTDATED TOOL THAT SHOULD BE CHANGED.

A. The Current FCA Model Has Been Questioned for Years.

For ten years, the Commission and parties have discussed the appropriateness of utilities' current FCA. Despite these discussions on whether the FCA continues to be appropriate, Minnesota utilities still pass through actual costs of fuel and purchased power costs and adjust their recovery monthly. The Commission has discretion to allow fuel and purchased power cost recovery automatically and may discontinue or modify an automatic adjustment provision for an individual utility.² Because many of the reasons for adopting the FCA no longer apply, the Commission should modify the FCA to conform with current conditions.

As the DOC explained: "the FCA was originally designed to allow the utility to recover, outside of rate cases, costs that were largely outside the control of the utility."³ Moreover, "[t]he FCA also provided a way to pass savings to ratepayers if the actual cost of fuel dipped below the base cost included in rates."⁴ Based on concerns that utilities' automatic recovery of fuel and purchased power may not be in the best interests of ratepayers, however, the Commission opened an investigation on June 4, 2003, to investigate the propriety of continuing the automatic adjustment of charges by utilities.⁵ In opening the investigation, the Commission stated:

² Minn. Rule 7825.2920, subp. 3.

³ *Comments of DOC IN THE MATTER OF THE REVIEW OF THE 2011-2012 ANNUAL AUTOMATIC ADJUSTMENT REPORTS*, Dkt. No. E999-AA-12-757 (June 5, 2013) at 16.

⁴ *Id.*

⁵ *IN THE MATTER OF THE COMMISSION'S INVESTIGATION INTO THE APPROPRIATENESS OF CONTINUING TO PERMIT ELECTRIC COST ADJUSTMENTS*, Dkt. No. E999/CI-03-802 (June 4, 2003) at 5.

V. Investigation Opened

Finally, as noted above, the Commission concurs with the Department that this is an appropriate time to open a proceeding to explore the continuing usefulness of the fuel clause adjustment as a regulatory tool. The Commission also concurs with Xcel that this proceeding should be industry-wide, not company-specific.

While the advantages of permitting fuel clause adjustments are widely understood and have come to be taken for granted, their disadvantages have not been carefully examined since their initial adoption. Furthermore, since that time, the kinds of costs recovered through the fuel clause have significantly changed.

Purchased power costs and the costs associated with the practice of “hedging,” for example, are very different from the straightforward fuel costs the fuel clause was originally designed to recover. As the Department notes in its comments, these new costs may pose different issues in terms of risk management, price signals, and oversight and accountability.

The Commission’s investigation has never concluded and the question of whether the FCA is an appropriate tool for cost recovery remains today. As explained by the Chamber of Commerce, in its comments dated October 30, 2007, automatic cost recovery fails to provide incentives for a utility to manage its costs:

To us, however, ensuring proper management of FCA’s by the utility might mean giving utilities appropriate incentives to optimize maintenance of existing resources, plan for outages, hedge fuel purchases, and respond to external factors (e.g, weather, unplanned outages) without a guarantee that customers will foot the bill under any circumstance.⁶

Since October 2007, no party has made a filing in the Commission’s docket that began in 2003. Throughout that docket, however, the parties conducted extensive meetings to address the various ancillary issues surrounding an incentive mechanism to control fuel and purchase power costs. Despite the numerous meetings that have been held over the years, utilities continue to collect their fuel and purchased power costs through the FCA.

⁶ Chamber Comments – October 30, 2007 in the 03-802 Docket. The OAG notes that the Commission would still maintain authority to review the specific methods used by utilities to control fuel costs.

B. Adopting an Incentive Mechanism is Appropriate at this Time Due to Utilities' Expanded Influence over their Fuel Costs.

As explained by the DOC, the conditions that existed when the FCA was first implemented have changed, rendering an incentive mechanism for the FCA even more important than it was previously. As noted above, when initially implemented, the FCA was seen as having an equal potential to benefit both utilities and ratepayers. Because fuel costs were considered to be outside the control of utilities, the FCA protected utilities from unavoidable increasing costs. On the other hand, ratepayers benefitted from an immediate reduction to their bills when fuel costs declined. Even with the potential to balance both the interests of utilities and ratepayers, parties recognized the many drawbacks of automatic pass-through of fuel costs and the potential to distort market incentives.⁷ Despite these drawbacks, the FCA was adopted as the method to balance utility and ratepayer interests.

Any balance that may have existed in the potential benefits to ratepayers and utilities when the FCA was adopted no longer exists. As noted by the DOC, “[w]hile utilities are not in complete control of energy costs, utilities’ choices have far more influence on FCA costs than has been the case previously.”⁸ Ratepayers, however, continue to have no control over their utilities’ fuel costs. It is unfair, therefore, for ratepayers to bear an equal risk for changes in fuel costs for which utilities have considerable influence. Instead, the Commission should incentivize utilities to manage their fuel costs for all parties’ benefit.

⁷ See *Comments of DOC IN THE MATTER OF THE REVIEW OF THE 2011-2012 ANNUAL AUTOMATIC ADJUSTMENT REPORTS*, Dkt. No. E999-AA-12-757 (June 5, 2013) at 16-17.

⁸ *Id.* at 17.

C. Parties Should Provide Specific Proposals to Amend the FCA.

While the OAG agrees with the DOC's statement that many nuances exist in the FCA,⁹ it is not convinced that convening a workgroup or conducting further meetings will spur meaningful progress to resolve these nuances. As noted above, the parties have conducted various meetings and discussions for ten years. The issue has spanned six different dockets – three rate cases in which the OAG recommended an incentive mechanism, two Annual Automatic Adjustment proceedings, and the initial investigation initiated by the Commission. Until the DOC's recent proposal to eliminate the FCA, no party had provided a specific alternative to the OAG's proposed FCA incentive mechanism. The lack of progress to-date means that utilities continue to recover their costs of fuel without any incentive to mitigate these costs. Additional open-ended discussion, without specific proposals or directives, will likely lead to further delays.

For its part, the OAG continues to recommend the proposal it made in each of NSP's 2008, 2010, and 2012 rate cases. While the OAG understands the administrative benefits of eliminating the FCA altogether—as suggested by the DOC—it is not convinced that eliminating the FCA is the optimal solution in light of utilities' greater control of their fuel costs. In other words, since utilities have greater control of fuel costs, they have the ability to minimize their risks for changes to these costs. The DOC proposal, however, places an equal risk on ratepayers for decreases in fuel costs as it does on utilities for increases in fuel costs.

The OAG proposal would cap utilities' cost recovery for fuel and purchased power and thereby provide an incentive to utilities to control their fuel and purchased power costs. The OAG's proposed cap is generous, at three percent above the authorized base cost in a utility's

⁹ See *Comments of the DOC IN THE MATTER OF THE REVIEW OF THE 2010-2011 ANNUAL AUTOMATIC ADJUSTMENT REPORTS FOR ALL UTILITIES*, Dkt. No. E999/AA-11-792 (Sept. 5, 2013) at 2.

rate case. Accordingly, utilities would be able to recover three percent *more* than that approved in their base rates without filing a new rate case. This proposal recognizes the increased control that utilities have over their overall fuel costs and retains the principle that utilities should not receive a windfall simply because the cost of fuel declined. Therefore, the Commission should adopt the OAG's proposal.

If the Commission believes that additional discussion on the FCA incentive is warranted, then the OAG urges the Commission to establish deadlines for any party that supports an incentive mechanism to submit a proposal and to provide substantive comments on other proposals. Certainly, if parties want to meet informally to help develop an incentive mechanism proposal, the OAG has no objection. However, the OAG requests that the Commission not establish a formal workgroup or conduct additional Commission meetings, as these processes will likely lead to further delays.

III. OAG'S RECOMMENDATIONS.

For the reasons set forth above, the OAG does not support eliminating or freezing the FCA as recommended by DOC in Docket 12-757, nor does it support further meetings as recommended by DOC in Docket 11-792. Past meetings have not produced viable consideration of any incentive mechanism, including the proposal offered by the OAG. Accordingly, the OAG recommends adopting its proposed three percent cap on fuel costs above a utility's base cost.

In the alternative, the OAG recommends that the Commission: (1) establish principles for the design of an incentive mechanism to control costs; and (2) solicit additional rounds of comments to consider the OAG's proposed incentive mechanism, or alternatively allow other parties to recommend a different incentive mechanism which would be subject to critique by other parties.

The OAG has recommended and continues to recommend the following principles for an incentive mechanism:

- that the incentive mechanism be simple to administer and not require extensive analysis and debate about whether the utility has justified full recovery of its fuel and purchased power costs each year; and
- that the incentive mechanism does not incorporate the potential that the utility profit from reduced costs that should be passed on to ratepayers.

The OAG appreciates that there is agreement that the FCA fails to provide proper incentives to control fuel and purchased power costs as indicated by the DOC and the Chamber of Commerce. However, the OAG cannot support the DOC's proposal because it could result in higher costs to ratepayers despite increased control of these costs by utilities. Also, as more renewable resources such as wind and solar, with no fuel costs, are included in the generation resource mix, it is possible that fuel and purchased power costs will decline. Thus, the OAG does not support elimination of the FCA but instead encourages the Commission to establish an incentive mechanism so that utilities will internalize the need to control fuel and purchased power costs.

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Respectfully submitted,

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