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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. E999/AA-12-757

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	)	AFFIDAVIT OF SERVICE VIA
	) ss	ELECTRONIC FILING
COUNTY OF ST. LOUIS	)	

Jodi Nash of the City of Duluth, County of St. Louis, State of Minnesota, says that on the 11th day of February, 2015, she served Minnesota Power's Reply Comments in Docket No. E999/AA-12-757 to the Minnesota Public Utilities Commission and the Energy Resources Division of the Minnesota Department of Commerce via electronic filing. The remaining parties on the attached service list were served as so indicated on the list.

/s/ Jodi Nash

Subscribed and sworn to before
me this 11th day of February, 2015.

/s/ Dawn LaPointe

Notary Public - Minnesota
My Commission Expires Jan. 31, 2020

Last Name	First Name	Email	Company Name	Delivery Method	View Trade Secret
Anderson	Julia	Julia.Anderson@ag.state.mn.us	Office of the Attorney General-DOC	Electronic Service	Yes
Ferguson	Sharon	sharon.ferguson@state.mn.us	Department of Commerce	Electronic Service	No
Greiveldinger	Michael	michaelgreiveldinger@alliantenergy.com	Interstate Power and Light Company	Electronic Service	No
Hughes	Tiffany	Regulatory.Records@xcelenergy.com	Xcel Energy	Electronic Service	No
Lindell	John	agorud.ecf@ag.state.mn.us	Office of the Attorney General-RUD	Electronic Service	Yes
Moratzka	Andrew	apmoratzka@stoel.com	Stoel Rives LLP	Electronic Service	No
Oehlerking Boes	Leann	lboes@mnpower.com	Minnesota Power	Electronic Service	No
Olson	Randy	rolson@dakotaelectric.com	Dakota Electric Association	Electronic Service	No
Savelkoul	Richard	rsavelkoul@martinsquires.com	Martin & Squires, P.A.	Electronic Service	No
Tommerdahl	Stuart	stommerdahl@otpco.com	Otter Tail Power Company	Electronic Service	No
Wolf	Daniel P	dan.wolf@state.mn.us	Public Utilities Commission	Electronic Service	Yes

STATE OF MINNESOTA
BEFORE THE
MINNESOTA PUBLIC UTILITIES COMMISSION

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In the Matter of 2012 Electric Company's Annual Automatic Adjustment Reports	Docket No. E999/AA-12-757 REPLY COMMENTS

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The Department's FCA Mechanism

The Department notes in its response comments to the AA-12-757 Docket that the current FCA mechanism has several advantages including allowing the utilities to address fuel price volatility with filing expensive rate cases, addressing costs beyond the utility's control, reducing business risk, improving the utility's credit rating and a mechanism to pass savings on to the ratepayers when actual costs are below the base cost of fuel included in rates.

The Department also notes a drawback to the current FCA mechanism with the idea that utilities treat costs recovered through trackers differently than costs recovered in base rates.

The Department also described difficulties they believe they have encountered during the review of the AAA filings, including extensive time and resources needed to assess the reasonableness of the rates, difficulty in assessing whether FCA costs are minimized, difficulty by utilities to explain why unplanned outages occurred and how they minimized costs, and inherent difficulties the Commission faces in addressing issues after the fact. The Department goes on to "suggest" that the utilities are in effect, putting the burden of proof of reasonable rates and prudent costs back on the Department, Commission and ratepayers.

The Department suggests several alternative FCA recovery mechanisms and further recommends that the Commission consider asking the parties to file comments on the options, bring the parties together to talk about the options or both.

Minnesota Power's Response

The Department has been focused on creating an incentive FCA since the closure of the 11-792 Docket. In discussing its goal of reforming the FCA, the Department appropriately cites that the utility should have a reasonable opportunity to recover their costs of providing service. While current ratemaking structures encourage utilities to minimize O&M costs and provide little to no incentive to minimize replacement power costs, utilities still have an inherent obligation and incentive to minimize customer cost overall – an FCA incentive is not a prerequisite to the utilities fulfilling this obligation.

While alternatives to an incentive FCA were not on the table for discussion in the Department-led review in the aftermath of the 11-792 Docket, it was a good opportunity for the stakeholders to gather to discuss the FCA. As noted by the Department, various alternatives were considered but the issues were certainly not resolved in the stakeholder meetings. It is clear that there are many complex and nuanced issues involved – often with many differing perspectives and opinions.

The Department recommends an alternative ratemaking approach holding utilities accountable for replacement power costs. The Department does not define what "accountability" means or how it would be applied. In any event, the Department believes this would encourage utilities to consider all costs of providing service, including replacement power costs, short-term and long-term planning. However, Minnesota Power already considers replacement power costs in both short-term and long-term planning, and also considers replacement power costs if the unit is operating in such a fashion that is forced outage should be taken in the near-term in order to protect the asset on a long-term basis. This least-cost planning approach was explained in detail in Docket No. E-999/CI/03-802.

The Department could be more proactive in their review of outage data and costs by spending more time with the monthly filings. It appears through a review of utility regulatory costs that this is now occurring, and Minnesota Power welcomes a more "real-time" review of the fuel clause on a monthly basis (as we have advocated previously). A more timely review would enable the utilities to provide more current responses with having to try to recover information from months or years ago. Also, in the event that costs were deemed imprudent, this would provide for more timely return of funds to the ratepayers who paid for these costs.

Minnesota Power believes that taking this discussion out of the context of reviewing each company's annual AAA filing – and instead making it an overall Commission investigation or workgroup process – would be the most beneficial way to address the wide array of issues at play if the entire fuel adjustment clause mechanism is reviewed. That is one reason why Minnesota Power reminded the Commission of the open Investigation in Docket E999/CI-03-802 during the recent deliberations of the 11-792 Docket. Opening a dialogue would allow the Commission to shape the scope of inquiry and provide direction to the parties as to the information the Commission will need in its decision making process, and allow more time for information gathering, inquiry and reflection.

At present, the perceived "problems" and how to address them are a moving target. For example, the Department's comments in the 11-792 Docket focused on forced outage costs and whether some replacement energy costs were prudently incurred, with the disallowance of certain costs as the proposed resolution. However, the Department comments in the AA-12-757 Docket abandoned the forced outage cost inquiry completely and instead substitutes a menu of options for consideration – options that have not been fully vetted by all stakeholders. Obviously the Department is continuing to seek a replacement of the current fuel clause mechanism and appears intent on advocating to do so until the current system is changed, despite the Commission's clear rejection of the Department's advocacy in the Order in 11-792. The Department recommends various options to the current fuel class mechanism, including a rolling average FCA, fuel costs set in a rate case, fuel costs set in a rate case with index adjustments, and fuel costs set in a rate case with band adjustments. After listing numerous "advantages" to these recommendations, the Department identifies two potential disadvantages, with one being that reduce costs me not before future repairs quickly enough.

But any changes to the fuel clause could have far reaching impacts that the Commission should carefully consider. The Department's recommendations of an incentive fuel clause did not take into consideration the changing nature of each utility's generation portfolio; the nature of commodity price fluctuations and changing fuel transportation costs; the impact of renewable energy mandates; or changing emission regulations and enforcement actions. The Department's comment regarding utilities being accountable for replacement power costs would presumably shift these costs from ratepayers to the utility for the provision of electric service to utility customers. This would be a significant change in the rate-making equation, and without an overall, holistic approach to resource planning and generation supplied decision-making a targeted modification to the FCA that shifts replacement power costs from ratepayers to utilities would be problematic. Until the Commission initiates an overall review of the fuel clause, the fuel clause role in overall utility service (including resource planning), the operation of the MISO market, the impact of transportation costs and fuel costs on both the wholesale and commodity level, these recommendations have no context and no value. These impacts need to be explored and understood in the context of the entire fuel clause operation and application before the Commission can even determine if there is in fact a "problem" that must then be addressed in a balanced way.

The Department's recommendations do not take into consideration the changing nature of each utility's generation portfolio: the nature of commodity price fluctuations and changing fuel transportation costs; the impact of renewable energy mandates; or changing emission regulations and enforcement actions. Any change must consider the utility's five-year fuel clause projection and must assure complete and timely recovery of a utility's fuel costs recovery. Minnesota Power projects total fuel and purchase energy costs (FPE) to increase from 2015-2018. The projected cost increases are not the anticipated outcome of poor planning or imprudency; they are due to increasing costs beyond the direct control of Minnesota Power, including increased fuel and transportation costs, market prices, load additions, and bridging purchase costs that have increased FCA costs but have delayed generation-related capital investment costs. For example, our use of bridging purchases provides the overall least cost to our customers even though they do increase FCA costs.

Further, the Department's recommendation also does not take into consideration two of the most significant issues that have faced Minnesota Power in recent years regarding fuel clause impacting events: the loss of the Thompson Hydro system for almost 2 years due to a significant weather event, and the effect that the BNSF Railway Co. has had in shifting its coal delivery schedule and choking fuel necessary for generation supply. Without a discussion of these two significant events, is unclear how an “improved FCA incentive" mechanism could even adequately address fuel clause operation.

The Department continues to emphasize that the utilities do not have an incentive to lower fuel clause costs. The Department cites a National Regulatory Research Institute paper that is filled with suppositions but is short on specific facts or examples, and is not focused on Minnesota. Most remarkably is the sentence that states “By contrast, minimizing costs recovered in the FCA has no effect on utilities profits." As Minnesota Power has stated repeatedly, if the Company does not manage its fuel clause costs to minimize the impact of the FCA on its energy prices, then its customer base is not profitable and the customers themselves are exposed to temporary or permanent shutdown, severely impacting not Minnesota Power's other ratepayers and out overall business interests as a whole. As a result, the FCA is one of the areas of Minnesota Power's greatest focal points for reducing minimizing and managing customer costs: our globally-competitive large power customers require the lowest energy prices available in order to compete in the world market – otherwise they face idled or shuttered operations. The reduced energy sales that would result would directly and immediately affect Minnesota Power’s annual revenue and severely impact the company financially. These customers provide 60% of our revenue and the FCA accounts for approximately 40% of their monthly energy bill. These customers materially affect the company in many ways and we take all of their costs and all other customer costs into consideration as we procure energy supply and manage generation availability, so for the Department to suggest we simply pass these costs through with no regard is not merely misguided but also not true.

Minnesota Power has the 4th lowest rates in the country and has always had to be especially mindful of rate impacts in resource decisions. It is ironic that Minnesota Power’s low energy cost makes it a target for outage cost examination in part due to the marked difference between its generation supply cost and replacement energy costs purchased in the wholesale market – and that is true even in the depressed wholesale market prices we see today. Minnesota Power understands the concerns of the Department regarding increased energy costs and the impacts of increasing fuel and purchased energy costs have on our customers. Minnesota Power believes it does a good job in controlling FCA costs and does not believe change in the FCA is required to ensure least cost supply because providing the all-in lowest cost alternative is already a strong and well established process at Minnesota Power. The financial impact of fuel clause operations on ratepayers is indirect but always prevalent – so much so that Minnesota Power annually budgets its anticipated fuel clause costs and reviews those costs with its large power customers so they are aware of their cost impacts. Minnesota Power implemented this close working relationship with its customer base long before the Commission ever became interested in these issues related to fuel clause operation. These annual updates became the model for updating the Department of Commerce monthly fuel clause projections that we use today.

The Department's recommendation of changing the basis of fuel and purchase energy recovery could fundamentally change the business model that Minnesota Power is currently working under and has used to make long-term supply decisions. Resource decisions need to be made by considering all aspect of costs, including capital investment, fuel cost and deliverability. Minnesota Power has worked hard to minimize all energy and capacity costs through a robust Integrated Resource Plan, as well as competitive fuel, rail and purchase power contracts over the last twenty and thirty years. Energy procurement and commodity costs are increasing. The favorable long-term fuel and transportation agreements negotiated in the past (whose benefits have already been passed on to ratepayers) are expiring, being replaced by shorter-term fuel contracts that contain cost escalators.

In addition, Minnesota Power's Energy Forward Strategy (as reflected in our Integrated Resource Plan) could be impacted by changes to the fuel adjustment process. Specifically, as Minnesota Power moves toward less carbon-intensive generating resources as required by the State's renewable energy standards as well as federal generator emission regulations, we introduce more variability to fuel costs. For example, the additions of the Bison wind assets have led to lower fuel costs when the wind is blowing but require dispatchable or intermediate resources when the wind generation is not available. This energy can come in the form of low priced MISO market purchases or through the addition of natural gas generation. Either element adds additional fuel cost variability when compared to the Company's current baseload coal resources. If the fuel adjustment were to be fixed or capped at a certain level, it may change the Company's operating philosophy or future resource additions.

In describing difficulties in the current operation of the fuel adjustment class, the Department has again cited the fact that it took several rounds of discovery lengthy time periods for utility responses in the 11–7 92 docket. The Department cited this is utility resistance to inquiry and difficulty by the utilities to show the cost to recover to the fuel clause are reasonable. As for the difficulties the Department believes they have encountered during the review of the AAA filings, not all of these difficulties are utility-created. The Department explicitly noted the rounds of discovery needed to review reasons for forced outages. We disagree with the contention that the utilities were being difficult and uncooperative; the initial information requests were vague and confusing; requested information not normally kept for long periods of time; was requested in a format that was not compatible with our reports created at the time. In fact, the Department's level of inquiry was unprecedented, and was requesting information that utilities had not previously been required to assemble and provide the Department. Further, difficulty interpreting Department financial analysts' request by the engineering staff on site at the various generators lead to additional rounds of discussions in order to clarify the exact nature of information the Department was requesting. The Commission rejected the Department's recommendations in that Docket because the Department was attempting to apply standards after the fact, and holding the utilities to those standards that it created through its inquiry process. It is disingenuous for the Department to now claim that the difficulties it faced in undertaking that inquiry should now be used as a basis to attribute reluctance to regulatory review by the utilities.

Finally, in providing its overview of the FCA mechanism, the Department is an error in stating that the FERC formerly regulated purchased power costs but now does not with the advent of the MISO energy market. In fact, prior to the creation of MISO (first as a transmission management entity and then later as an energy market manager), the cost of replacement energy was not regulated any differently and was in fact much less transparent than it is today. The advent of the MISO market has increased transmission reliability and has allowed a more open and transparent energy market so that regulators utilities and customers can monitor energy prices. Prior to MISO, utilities could manipulate the availability of transmission, and could use that transmission market power to drive up market energy prices. The resulting energy market replacement costs were not as visible as they are today, even though the resulting prices impacted utility customers in the same exact way as they do today.

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

Dated: September 20, 2013

Respectfully submitted,

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