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MPUC Docket No. E-6472-/M-05-1993
OAH Docket No. 12-2500-17260-2

BEFORE THE
MINNESOTA OFFICE OF ADMINISTRATIVE HEARINGS
100 Washington Square, Suite 1700
Minneapolis, Minnesota 55401-2138

FOR THE
MINNESOTA PUBLIC UTILITIES COMMISSION
127 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

In the Matter of the Petition of Excelsior Energy Inc. and Its Wholly-Owned Subsidiary MEP-I, LLC For Approval of Terms and Conditions For The Sale of Power From Its Innovative Energy Project Using Clean Energy Technology Under Minn. Stat. § 216B.1694 and a Determination That the Clean Energy Technology Is Or Is Likely To Be a Least-Cost Alternative Under Minn. Stat. § 216B.1693

PREPARED REBUTTAL TESTIMONY AND EXHIBITS OF EXCELSIOR ENERGY INC. AND MEP-I LLC

RENEE J. SASS

OCTOBER 10, 2006

EXCELSIOR ENERGY, INC.

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

PREPARED REBUTTAL TESTIMONY OF

RENEE J. SASS

Q Please state your name, current employment position and business address.

A Renee J. Sass. I am a Senior Vice President and Chief Financial Officer for Excelsior Energy Inc. My business address is Excelsior Energy Inc., Crescent Ridge Corporate Center, 11100 Wayzata Boulevard, Suite 305, Minnetonka, Minnesota 55305.

Q On whose behalf are you testifying?

A I am testifying on behalf of MEP-I LLC and Excelsior Energy Inc. (collectively "Excelsior"), the developers of the Mesaba Energy Project (the "Project").

Q Have you previously provided testimony in this proceeding?

A Yes. I submitted testimony on June 19, 2006 and on September 5, 2006 on behalf of Excelsior.

Scope and Summary

Q What is the purpose of your rebuttal testimony in this proceeding?

A Part I of my testimony responds to the suggestion of Mr. George E. Tyson II, witness for Northern States Power Company ("NSP") d/b/a Xcel Energy, that "advisory credit ratings" should be obtained to assess the impacts of the Mesaba I Power Purchase Agreement ("PPA") on NSP and its parent, Xcel Energy, Inc. ("XEI"), noting that Mr. Tyson's testimony lacks enough detail on the specifics of his proposal to know whether or not it would yield any meaningful, informative or helpful information as the Commission considers the issues presented in this proceeding. Part II addresses

comments made by Mr. Timothy J. Sheesley on behalf of NSP and Mr. Ronald R. Rich on behalf of the website, mncoalgasplant.com, relating to the University of Minnesota Duluth's Labovitz School of Business Economic Benefits Report. Part III of my testimony addresses the impact of natural gas price forecasts on NSP's Strategist model runs used in its integrated resource planning ("IRP") process.

Advisory Credit Ratings

Q Have you read the testimony of George E. Tyson II, and in particular his suggestion that advisory credit ratings be obtained in connection with the Mesaba I PPA?

A Yes.

Q What is your reaction to that suggestion?

A Excelsior has reviewed Mr. Tyson's suggestion regarding advisory credit ratings and has determined that not enough information has been provided to meaningfully evaluate the suggestion. Mr. Tyson's testimony only states that NSP should seek and consider an advisory credit rating, but is vague as to what options will be evaluated and how any results would be applied. As a result, Excelsior defers comment at this time pending further details and clarification from NSP as to how the process would be conducted and how the results would be used or applied in this proceeding. Since NSP as the bond issuer being rated would have much more influence than any other party involved in such an advisory credit rating process, the Commission as a threshold matter would need to find some way to ensure impartiality on behalf of the NSP representatives involved in the process. In light of the testimony filed on September 5 by NSP, it seems unlikely that NSP could render an impartial assessment of the actual terms and conditions of the Mesaba I PPA to the rating agencies in such a process. Even if the Commission

could somehow get comfortable that such a process could ever be conducted impartially, at a minimum details concerning the following questions would need to be presented:

- How would the process be conducted?
- How would the parties to this proceeding be involved, both in terms of advisory opinion options considered and evaluation of results?
- How would any results be applied or used in this proceeding?
- Which rating agencies would participate (presumably advisory ratings would be obtained from all three major agencies), and how would differences in results be reconciled?
- Would the agencies also be asked to give advisory ratings for the situation where NSP would be building its own baseload plant in Minnesota, or relying upon its base case plan to meet growing power needs with significant increases in consumption of natural gas?
- How would the advisory rating be influenced by other factors affecting NSP and XEI's credit, such as recently announced capital plans?
- What assurances would the Commission have regarding the transparency of the process to assure that ratepayer interests (and not just bond issuer and bondholder interests) are represented?
- Would the rating agency representatives be available to testify in hearings in this proceeding?

Q Do you have any other observations about the advisory credit rating suggestion?

A Yes. Excelsior notes that until the terms and conditions of the Mesaba I PPA have been finalized, the rating agencies will likely have trouble offering a meaningful

assessment of the potential ratings impacts of the Mesaba I PPA. If asked for an advisory opinion, the rating agencies will err on the side of caution, so the opinion by nature will be of limited value. The issue in this proceeding is whether the Mesaba I PPA is in the public interest, and not whether the Mesaba I PPA is in the interest of bondholders of NSP and XEI, as represented by the rating agencies. Bondholder and credit quality concerns generally are certainly a factor that utility commissions must be aware of as one of many important factors to be considered in regulating utilities. But those factors are not paramount to all others. All else being equal, bondholders will always favor lower leverage, higher allowed costs of debt and equity, higher revenue requirements and higher bond ratings. These objectives often run directly against what is in the best interests of ratepayers. Because of these considerations, the advisory ratings process should only be pursued if the concerns addressed above can be resolved and the Commission has assurances that in the process, that ratepayer interests (and not just bond issuer and bondholder interests) are represented.

Economic Benefits Report

Q Have you read the testimony of Timothy J. Sheesley and Ronald R. Rich concerning the University of Minnesota Duluth Labovitz School's economic benefit report ("Economic Development Report") about the Mesaba Project?

A Yes.

Q Was the scope of the Economic Development Report proper?

A Under the Innovative Energy Project Statute ("IEP Statute"), Minn. Stat. § 216B.1694, subd. 2(a)(7), when making its public interest determination prior to approving a PPA, the Public Utilities Commission should take into account (among other

things) "the project's economic development benefits to the state." The scope of the Economic Development Report closely matches this statutory language: "This economic analysis from the UMD Labovitz School's research bureau quantifies both the Mesaba Energy project's direct effects, and its secondary effects on increased spending in the greater economy of the Arrowhead Region and the State of Minnesota." (Economic Development Report, p. vii).

Q Is there any basis for the claim that the Economic Development Report should have compared the economic impacts of alternative energy resources?

A No. The Economic Development Report establishes that the economic benefits to the State are substantial.

Q Is there any basis for the claim that the Economic Development Report is incomplete due to negative impacts associated with higher electricity prices?

A No. Excelsior's filings in this proceeding establish that the Mesaba Project is or is likely to be a least-cost resource for NSP ratepayers. Therefore, if electricity prices do increase as a result of the Mesaba Project, the increase will not be as large as it would be if the Mesaba Project were not providing electricity to NSP's customers, especially given NSP's need for base load generation capacity and its increasing reliance on natural gas-fired generation. It is misleading to attribute negative economic impacts associated with higher electricity prices to the Mesaba Project, when the Mesaba Project will help limit price increases and the risks associated with gas-fired generation for ratepayers.

Q Is there any basis for the claim that the Economic Development Report is incomplete because it could result in job losses in other regions?

A No. First, the Economic Development Report clearly establishes that while the primary benefits of the project accrue to the region near the site, there will be economic development benefits that accrue to the State outside the Arrowhead/Iron Range region. Second, the Mesaba Project is a response to growing energy needs and NSP has not indicated that it will decommission any power generation plants elsewhere in the State, so the Mesaba Project will not simply be transferring economic benefits from one region to another.

Q Are there any other observations you care to make regarding Mr. Sheesley's or Mr. Rich's testimony?

A Yes. While the Economic Development Report contains solid analysis based on industry-accepted methodologies, Mr. Sheesley's and Mr. Rich's observations only make unsubstantiated claims that lack any quantitative support.

Natural Gas Price Data

Q How did Excelsior review the integrated resource planning process of NSP?

A As part of its review of the Strategist modeling data being used by NSP to analyze the Mesaba PPA, Excelsior felt it was prudent to request the underlying Strategist modeling data for NSP's 2002 integrated resource plan ("IRP") and initial 2004 IRP to review for consistency in inputs, which could bias generation selection outcomes. Strategist files for the 2005 update to the 2004 IRP were not provided by NSP.

Key inputs that Excelsior examined were natural gas price and plant costs. Excelsior does not have access to the quantitative tools necessary to do a thorough job of analyzing and replicating the various Strategist runs. To supports internal efforts, Excelsior engaged the reputable firms of ICF Consulting Group, Inc. ("ICF") and FTI

Consulting, Inc. ("FTI") in its review of the Strategist model. ICF and FTI were also solicited in the effort to understand the impacts of the primary modeling inputs and to provide Excelsior with similar modeling capability in order to examine alternative fuel price cases to the Strategist runs which were all done at the same fuel price—and the manual adjustments to those runs—upon which all of NSP's testimony is based.

Q Were ICF and FTI able to review all data provided by NSP?

A No. NSP does not have an independent forecast of natural gas prices. NSP simply accepts the natural gas forecasts of a single outside consultant as the basis for all of its resource planning efforts. ICF and FTI were therefore not allowed to review the natural gas price data, since it was deemed by PIRA Energy Group, NSP's consultant, as proprietary.

Q Did Excelsior review the gas price data?

A Yes. While Excelsior has a team with significant experience in the power industry, our core expertise is not in the forecasting of natural gas prices. That is why we have relied on FTI to provide expert testimony on the topic of future gas prices. However, since NSP did not allow us to have our experts view and comment on its gas price assumptions, we did some basic analysis of those assumptions.

Q Can you summarize the gas price assumptions from the 2002 and 2004 Strategist models?

A The natural gas price assumptions that NSP used to create its 2002 and 2004 Strategist models was available. The 2002 gas forecast appears to represent a general increasing natural gas price in line with a traditional fundamental analysis, as was typical of long-term forecasts during that period and the short-term strips that were being traded

for the first few years of the forecast. In 2004, the gas forecast seems to reflect at least a portion of the cost increases that were experienced in the market. After the initial years of the forecast being based on the strip prices, the forecast then reverted to what again appears to be a traditional fundamental forecast.

Q Can you comment on the gas forecast that was used in the Strategist model run that analyzed the Mesaba project?

A Yes. The Strategist model run used in this proceeding and provided to us utilized a gas forecast that is based on market data in the short term, and a traditional fundamental forecast in the long run. This was similar to the types of information used in the previous 2004 data, using short term market indications of price and a fundamental forecast in the longer term; however, as we know, natural gas prices experienced a great deal of volatility and increase in the time period since the 2002 and 2004 IRP processes. Prices are at a higher level and this is consistent with what we saw in the Strategist detail. For the period from August 2006 to December 2008, the gas prices used by NSP are based on **[TRADE SECRETE BEGINS**

TRADE SECRET ENDS]—so that NSP is using actual market forward prices for the early years and then switching to a fundamental analysis approach for the model inputs in the later years. However, what is evident when looking at a graph of these gas price forecasts is the fact that the PIRA forecast for gas prices is **[TRADE SECRET BEGINS**

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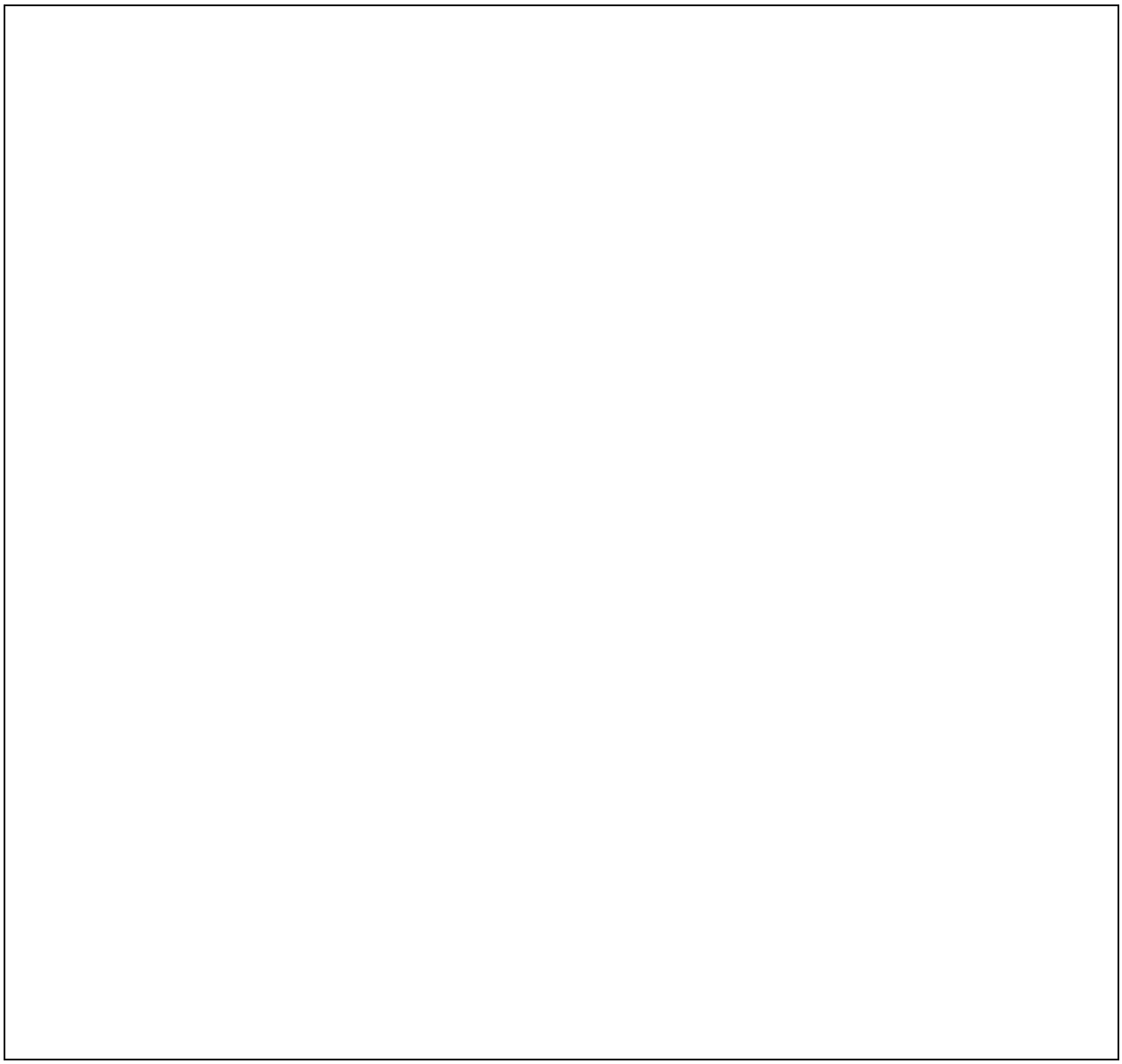

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Q How could this impact resource planning decisions?

A The early years of this forecasts, prior to 2015, will have the largest impact on generation selection as it might impact an analysis of the Mesaba plant, or any near-term

coal baseload resource. These are the years when the forecast reverts from being **[TRADE SECRET BEGINS TRADE SECRET ENDS]**. When comparing the gas price forecasts utilized by NSP between the 2004 IRP Strategist runs and the runs done in 2006 for the Mesaba project, I observed, as you can see from the graph above, that in 2007 and 2008, the forecasted gas price for the 2006 Strategist runs is over **[TRADE SECRET BEGINS TRADE SECRET ENDS]** than the forecasted gas price in the 2004 Strategist runs. This price increase appears to be consistent with general market conditions and actual higher prices being realized in the **[TRADE SECRET BEGINS TRADE SECRET ENDS]** market.

In all years past 2020, the forecasted gas price for the 2006 Strategist runs is more than **[TRADE SECRET BEGINS TRADE SECRET ENDS]** than the forecasted gas price for the 2004 Strategist runs. However, during the years, 2009 to 2019, the gas price forecast used by NSP for the 2006 Strategist runs is **[TRADE SECRET BEGINS TRADE SECRET ENDS]** than that forecasted for the 2004 Strategist runs, but significantly less so than what would be warranted by current market conditions, or that which is forecasted post 2020. It is in these key resource planning years that there appears to have been **[TRADE SECRET BEGINS TRADE SECRET ENDS]** in the 2006, versus 2004, forecasts.

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Based solely on the movement of the gas price forecast between the 2004 IRP to the assumptions NSP is making in its 2006 Mesaba analysis, we would have expected that the likelihood that gas generation being selected over coal fired generation would have decreased. This bias against gas fired generation should have been greatest in the 2007 and 2008 time frame and the post 2020 time frame. Because natural gas prices did not **[TRADE SECRET BEGINS TRADE SECRET ENDS]** between the 2004 and the 2006 forecasts for the 2009-2019 time frame, the relative bias against gas and in favor of other forms of generation, such as coal fired generation, is not present during these years. In fact, during some years, the movement of the gas price forecast between 2004 and 2006 was **[TRADE SECRET BEGINS**

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Overall, we question whether this pattern could have biased the Strategist runs to favor the selection of more natural-gas fired generation in greater amounts and sooner in time than it would have had the forecast not contained this pattern.; this effectively delays the addition of coal base load generation for the planning years that fall directly within NSP's five-year action plan, while directly dictating the modeling outcome that in no circumstances would a 2011 coal addition be justified from a timing perspective. Thus, when compared to the Mesaba PPA, natural gas-fired generation appeared more attractive in the short term. If gas prices had been forecasted at the higher level seen throughout the rest of the curve, or if NSP had even averaged the annual gas prices in the forecast, in recognition that the wide swings from year to year simply represented a single gas scenario, rather than being predictive of the actual prices for each year, the model may not have chosen gas and would have been more predisposed to the selection of coal–fired resources. Given that NSP's recommended expansion plan includes more than seven Mesaba-sized units once coal is allowed to enter the mix, and requires that a Mesaba-sized unit be added every two and a half years, on average, allowing the vagaries of one gas forecast, year by year, to delay the coal expansion program is not a sound planning decision.

Clearly, since fuel price is one of the key issues in the resource planning process, a robust plan would take into account the historical volatility of gas prices (as is even reflected in the volatility and increase demonstrated by the gas forecast used in the Strategist runs) and plan for a possible range of different gas price assumptions in making any resource planning decision. While previous resource planning activities of NSP have included a model run at "plus 20%" sensitivities on fuel prices, no such analysis was

done in the analysis concerning Mesaba. Furthermore, without disclosing any trade secrets, it can be said that a "plus 20%" scenario does not represent a meaningful high case scenario in any event. Only one gas price scenario was modeled, which calls into serious question the contention that this plan could be considered robust. Additionally, when looking at any gas price sensitivity, a robust plant would account for the relative movement of gas forecasts, even between the 2004 and 2006 time frame, and would look at sensitivities greater than the 20% range, especially during the key years of resource choice – particularly when gas prices surrounding the years that dictate the choice are at radically higher levels.

In sum, this single case, based upon a gas forecast that dictates the delay of coal by its shape, rather than its absolute level, is not of any value to resource planning decisions.

Q Does this conclude your prepared supplemental testimony?

A Yes.