

Surrebuttal Testimony
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State of Minnesota
Before the Office of Administrative Hearings
For the Minnesota Public Utilities Commission

*In the Matter of a Petition by Excelsior Energy Inc. for Approval of a Power
Purchase Agreement Under Minn. Stat. § 216B.1694, Determination of Least
Cost Technology, and Establishment of a Clean Energy Technology Minimum
Under Minn. Stat. § 216B.1693*

OAH Docket No. 12-2500-17260-2
PUC Docket No. E6472/M-05-1993

PPA Risks and Financial Impacts

October 31, 2006

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1 **I. INTRODUCTION**

2
3 Q. PLEASE STATE YOUR NAME.

4 A. My name is John J. Reed.

5
6 Q. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY IN THIS CASE?

7 A. Yes. I provided Direct Testimony and Rebuttal testimony on behalf of
8 Northern States Power Company d/b/a Xcel Energy (“Xcel Energy”)
9 regarding the Mesaba 1 PPA.

10
11 **II. PURPOSE**

12
13 Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY IN THIS
14 PROCEEDING?

15 A. I respond to the Rebuttal Testimony of Roger Gale, Edward Bodmer,
16 Margaret Meal, Thomas Osteraas, and Renee Sass regarding PPA risks and
17 financial impacts of the Mesaba 1 PPA.

18
19 Q. WHAT IS YOUR OVERALL ASSESSMENT OF THE REBUTTAL TESTIMONY FILED
20 BY MESABA 1 LLC?

21 A. The Mesaba 1 LLC Rebuttal Testimony attempts to equate the Mesaba 1 PPA
22 with PPAs in general, but does not address the effects of the *specific terms* of
23 the Mesaba 1 PPA, which differ substantially from typical industry PPAs.
24 The Mesaba 1 PPA (including the changes proposed by Mr. Osteraas) do not
25 resolve the issues raised in my Direct Testimony regarding the transfer of risk
26 from the project developers to Xcel Energy and its customers in key contract
27 areas including: (i) Engineering, Procurement and Construction (“EPC”)

1 costs; (ii) interconnection and fixed fuel costs; (iii) Operation and
2 Maintenance (“O&M”) costs; and (iv) timing of supply. As a result, my
3 conclusions remain unchanged that the Mesaba 1 PPA would:

- 4 • impose excessive costs and risks on Xcel Energy and its customers;
- 5 • be very likely to adversely affect the credit rating of Xcel Energy; and
- 6 • be contrary to the public interest.

7
8 Q. PLEASE EXPLAIN HOW YOUR TESTIMONY IS ORGANIZED.

9 A. My Surrebuttal Testimony is presented in three additional sections:

- 10 • *Risk Allocation*, where I discuss why the Mesaba 1 PPA, even as
11 amended by Mr. Osteraas, does not address the significant concerns
12 regarding unacceptable risk transfers from the project developer to
13 Xcel Energy and its customers.
- 14 • *Comparison to Self-Generation*, where I present how, contrary to
15 Mesaba 1 LLC’s assertions, the PPA imposes far more risk for Xcel
16 Energy’s customers than a self-build option poses.
- 17 • *Credit Rating Impacts*, where I describe the very real concerns about
18 credit rating implications, contrary to Mesaba 1 LLC’s assertions that
19 they are exaggerated.

20
21 **III. ASSESSMENT**

22
23 **A. Risk Allocation.**

24 Q. DO YOU AGREE THAT THERE ARE NO APPLICABLE STANDARDS BY WHICH TO
25 EVALUATE THE MESABA 1 PPA?

1 A. No. Mr. Gale states that Mesaba 1 LLC's needs are unique and outside the
2 norm for "peaking and gas-fired intermediate plants" (page 3) and that the
3 Mesaba 1 PPA should reflect those unique needs. While there are certain
4 differences in terms that one would expect in a PPA for peaking plant versus
5 a PPA for baseload generation, those differences do not justify the terms
6 offered in the Mesaba 1 PPA or make the terms of typical PPAs irrelevant.

7

8 I also disagree with Mr. Osteraas statement that "there is no norm for large
9 baseload solid fuel facilities" (page 17). To the contrary: (i) the size of a
10 facility does not affect PPA fundamentals; (ii) there are relevant examples of
11 power contracts for base load facilities; and (iii) while the facility's fuel may
12 drive unique pricing terms specific to the fuel, this fact does not make
13 acceptable the degree of project development and operational risk that Xcel
14 Energy and its customers would be faced with under the Mesaba 1 PPA.

15

16 As discussed below, and more specifically in the testimony of Karen Hyde,
17 EPC cost risk, heat rate risk, transmission costs, O&M costs, fuel cost risk
18 and delay costs are all examples where the Mesaba 1 PPA imposes far more
19 risk on Xcel Energy and its customers than typical PPAs.

20

21 Q. HAVE YOU PERFORMED AN INDEPENDENT ANALYSIS OF THE MESABA 1 PPA
22 AND MESABA 1 LLC'S REBUTTAL TESTIMONY?

23 A. Yes. Mr. Osteraas' Rebuttal Testimony seems to suggest that my Direct
24 Testimony was based on the analysis of the Mesaba 1 PPA performed by Ms.
25 Hyde. To the contrary, both my Direct Testimony and this Surrebuttal
26 Testimony are based on my independent analysis.

27

1 Q. HAS MESABA 1 LLC PROVIDED AN ADEQUATE RESPONSE TO CONCERNS
2 ABOUT EPC COST CHANGES?

3 A. No. Mr. Gale points out that, under the Mesaba 1 PPA, construction cost
4 risk is “only for a short period of time” (page 14), while Mr. Osteraas states
5 that “it is a one time adjustment” (page 14), which he says is appropriate
6 because “[n]o one can know today what the final construction cost for the
7 facility itself will be” (page 15). However, it is not helpful that the risk is only
8 for a short period of time or that there is only a one time adjustment because
9 Mesaba 1 LLC is requesting approval *now, before* the time period runs and
10 *before* the adjustment occurs.

11

12 Q. IS IT REASONABLE FOR XCEL ENERGY TO BEAR THE RISK OF INCREASES IN
13 THE EPC CONTRACT COSTS UNTIL THE FINANCIAL CLOSE?

14 A. No. Messrs. Gale and Osteraas have missed the key point: it is premature to
15 approve a PPA where the EPC costs are as lacking in certainty as in the
16 Mesaba 1 PPA. The risk of EPC price changes is certainly not a risk that Xcel
17 Energy should bear without strict limitations on those cost changes. Mr. Gale
18 takes the opposite view on this issue (page 14) and offered Merrimack Energy
19 Group’s report to PacifiCorp from August 2006 as support for his position.
20 Mr. Gale quotes from the report (page 15) regarding the suggestion by
21 Merrimack that bidders in a competitive process be “allowed to bid capital
22 cost components which include some indexing options,” and Mr. Gale then
23 asserts that “[t]his is precisely what Excelsior has done” (page 15). To the
24 contrary, this is not what the Mesaba 1 PPA has done, and my review of the
25 Merrimack report and discussion with its author show that Merrimack, in
26 PacificCorp and other Requests For Proposals (“RFPs”), has been clear that

1 capacity prices need to be clearly specified, and offer the buyer significant
2 price certainty.

3
4 Q. PLEASE ELABORATE.

5 For example, in a more recent Merrimack report on RFP standards to the
6 Delaware Public Service Commission the recommendation is “that a portion
7 of capacity price (no more than 15%) could be indexed to a steel index from
8 the time of bid submission until the bidder executes its EPC contract but no
9 later than two years after contract signing..., subject to a cap, and another
10 portion could be indexed to general inflation or for labor costs to recover
11 fixed operations and maintenance costs.”¹ This approach, which has limited
12 and capped escalation factors for both EPC costs and fixed O&M costs is far
13 more predicable and appropriate than, and not at all similar to, the structure
14 of the Mesaba 1 PPA.

15
16 Q. IS IT REASONABLE TO COMPARE THE EPC COST RISK IN THE MESABA 1 PPA
17 TO THIS RISK IN A SITUATION WHERE XCEL ENERGY BUILDS ITS OWN PLANT?

18 A. Such a comparison is both complex and of little value. Messrs. Gale and
19 Osteraas rely on the assertion that the EPC cost changes would be borne by
20 Xcel Energy in a self-build option, but as discussed in Section B, the controls,
21 oversight and alignment of interests are so fundamentally different in a self-
22 build option as compared to a PPA structure that their assertion is invalid
23 with regard to the risks customers ultimately bear.

24

¹ Final Report Regarding Delmarva Power & Light Company’s Proposed RFP, October 12, 2006, Page 42.

1 Q. HAVE THE MESABA 1 LLC WITNESSES PROVIDED AN ADEQUATE RESPONSE TO
2 CONCERNS ABOUT THE RISKS ASSOCIATED WITH OTHER CAPITAL COSTS?

3 A. No. Mr. Gale states that after financial close “all capital construction” costs
4 are borne by Mesaba 1 LLC (page 14). However, for an undefined period of
5 time thereafter, Xcel Energy will still be open to the risks stemming from
6 transmission system upgrades and fixed fuel costs.

7

8 Q. HAVE THE MESABA 1 LLC WITNESSES PROVIDED AN ADEQUATE RESPONSE TO
9 CONCERNS ABOUT O&M COSTS?

10 A. No. Although Mr. Gale claims that the Mesaba 1 PPA transfers all O&M
11 cost risks to Mesaba 1 LLC, Mr. Osteraas acknowledges that both fixed and
12 variable O&M costs are subject to change (page 28). This cost component
13 remains open-ended and uncapped throughout the entire 25-year term of the
14 Mesaba 1 PPA (reopening costs at five-year intervals throughout the term).

15

16 Q. HAVE THE MESABA 1 LLC WITNESSES PROVIDED AN ADEQUATE RESPONSE TO
17 CONCERNS ABOUT FUEL MIX AND HEAT RATE?

18 A. No. The Mesaba 1 PPA offers no guaranty of the percent of time the Mesaba
19 Unit 1 plant will run on solid fuel vs. natural gas, nor has Mesaba 1 PPA
20 accepted Dr. Amit’s proposal to allow operational flexibility to Mesaba but
21 give economic assurance to Xcel Energy. Further, the Mesaba 1 PPA
22 provides insufficient capacity payment credits when the plant is operated on
23 natural gas, and provides no guaranty of the plant’s heat rate. Since all fuel
24 costs are passed-through on a dollar-for-dollar basis, there is no incentive for
25 Mesaba 1 LLC to undertake the maintenance and on-going capital expenses
26 to maintain a reasonable heat rate, or to control fuel costs.

27

1 Mr. Osteraas claims that Xcel Energy's customers have in the past assumed
2 "unprecedented and extreme natural gas price volatility" and goes on to argue
3 that those customers "should have no more or less fuel risk from the Mesaba
4 1 PPA" (page 26). I agree that the appropriate standard should be that
5 customers should have no more risk than they would typically bear.
6 However, in addition to imposing commodity price risk, the Mesaba 1 PPA
7 does not guaranty the type of fuel that will be burned, the amount of fuel that
8 will be burned (through a heat rate guarantee), nor does it sufficiently
9 compensate Xcel Energy or its ratepayers for the lost value if what the
10 customers are paying for (a state-of-the-art coal plant) is devalued because gas
11 is substituted for coal.

12
13 In this regard, it is noteworthy that Mesaba 1 LLC did not respond to Dr.
14 Eilon Amit's suggestion that the fuel cost be determined on the basis of a
15 fixed mix of fuels as opposed to the plant's actual fuel mix.

16
17 Q. HAVE THE MESABA 1 LLC WITNESSES PROVIDED AN ADEQUATE RESPONSE TO
18 CONCERNS ABOUT TIMING?

19 A. No. The timing of the Mesaba Unit 1 project is determined without regard or
20 compensation for the impact on Xcel Energy or its customers. If Mesaba
21 Unit 1 were to come on-line when projected, it would be well in advance of
22 the Xcel Energy's need (as addressed by Xcel Energy witnesses Judy Pofert
23 and Elizabeth Engelking). If Xcel Energy rebalances its portfolio in
24 anticipation of the Mesaba 1 PPA deliveries, but the project is late, Xcel
25 Energy and its ratepayers bear the burden with no compensation.

26

1 Q. DO YOU AGREE THAT THE USE OF NEW IGCC TECHNOLOGY MAKES TYPICAL
2 PPA TERMS IRRELEVANT TO THE MESABA 1 PPA?

3 A. No. A change in technology may require some refinements to typical PPA
4 terms but not an abandonment of risk allocation and cost responsibility
5 fundamentals. As discussed in my Direct Testimony, there are good examples
6 in the industry of managing risks for new technologies and executing PPAs
7 (such as Ocean State Power when gas-fired combined cycle power was a new
8 technology) that don't unduly burden utility customers. In addition, the
9 contracting objectives of parties, such as UniStar Nuclear LLC, that are
10 currently marketing new nuclear plants acknowledge the need for developers
11 to manage the risks that buyers cannot, and should not, be expected to take,
12 such as EPC cost risk and delay risks. These are real world examples of base
13 load plants using new technology and managing costs and risks for buyers.
14 Further, Wisconsin Energy's Power the Future Project ("Power the Future")
15 shows that large (1230 MW) base load solid fuel facilities can be developed
16 outside of a traditional utility rate base project on terms that don't subject
17 customers to extreme risks.

18

19 Q. DID MR. GALE CORRECTLY CHARACTERIZE YOUR POSITION IN TESTIMONY
20 BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION AND THE IOWA
21 UTILITIES BOARD?

22 A. Yes. Mr. Gale extracted my comments on the two PPAs at issue in those
23 proceedings as effectively shifting "to the maximum extent
24 possible...operating risk, financial risk...industry risk...[and] potentially
25 significant future capital expenditures," (page 12) to the power seller. He also
26 pointed out my statements that fixed capacity and energy pricing for delivered

1 energy provides customers with a high-degree of certainty and very low
2 exposure to operating risk (page 22).

3
4 Q. IS MR. GALE CORRECT IN CLAIMING THAT THE MESABA 1 PPA HAS SIMILAR
5 CHARACTERISTICS?

6 A. No. Mr. Gale is completely wrong when he states that “[s]imilar terms in the
7 Mesaba 1 PPA likewise offer the significant value of shifting risks away from
8 Xcel Energy and its ratepayers” (page 22). The Mesaba 1 PPA is
9 fundamentally different in structure and pricing than the Palisades and Duane
10 Arnold Energy Center (“DAEC”) PPAs that Mr. Gale refers to.

11
12 Q. PLEASE EXPLAIN HOW THE MESABA 1 PPA DIFFERS FROM THE DAEC AND
13 PALISADES PPAs.

14 A. Since both DAEC and Palisades are operating nuclear units, I will focus on
15 the differences that apply during the operating period. Fundamentally, the
16 DAEC and Palisades PPAs are “pay for performance” contracts.² In any
17 given month, if power is not delivered, the plant owner is paid nothing. All
18 costs, including fixed costs are recovered by the owner on the basis of
19 delivered energy. The Mesaba 1 PPA is fundamentally different from either
20 of these PPAs.

21
22 Under the DAEC and Palisades PPAs, the owner is responsible for all capital,
23 operating and fuel costs of the plant. Like the Mesaba Unit 1 project, the
24 exact magnitude and timing of these costs is unknown and unknowable at this
25 time. However, all of the capital costs will be borne by the new owner under

² The Palisades PPA is available in an unredacted form in the CMS Energy 10-Q filing dated August 4, 2006.

1 the DAEC and Palisades PPAs. None of them are passed onto the power
2 purchaser, and the price per MWh delivered for all energy is fully specified in
3 the PPA.

4
5 Additionally, the owner takes all responsibility for operating and maintaining
6 the plant and purchasing fuel, with no “pass-through” mechanisms or
7 reopeners. Both of these PPAs are for large, base load, solid fuel facilities.
8 Each of them is an excellent example of risk shifting but bears no
9 resemblance to the Mesaba 1 PPA.

10
11 Q. DO YOU BELIEVE THAT THE CONTRACT TERMS MR. OSTERAAS NOW PROPOSES
12 TO CHANGE RESOLVE ANY OF THE KEY PROBLEMS WITH THE PPA?

13 A. No. The key flaws in the Mesaba 1 PPA boil down to an unspecified cost
14 with no ceiling, no guaranteed performance level, and an all-in cost that is
15 likely to be far above market. Mr. Osteraas’ proposed changes do nothing to
16 resolve these fundamental problems.

17
18 Q. DO YOU CONCUR WITH MR. BODMER THAT DR. AMIT HAS INCORRECTLY
19 CALCULATED THE RELATIVE COSTS OF MESABA 1 PPA AS COMPARED TO
20 OTHER ALTERNATIVES?

21 A. No. Dr. Amit’s analytical framework is generally appropriate. While there
22 may be certain data or assumptions that should be refined, Dr. Amit’s use of
23 Mesaba 1 LLC’s model outputs as the basis of his analysis significantly favors
24 the Mesaba 1 PPA. The understatement of the Mesaba 1 PPA costs that
25 results from Dr. Amit’s use of Mesaba 1 LLC model outputs far outweighs
26 the impact of any adjustments that one might make to the economics of other
27 resources.

1

2 Q. CAN YOU PROVIDE AN EXAMPLE OF THE MESABA 1 PPA COSTS THAT ARE
3 UNDERSTATED IN THE DATA DR. AMIT USED?

4 A. Yes, as mentioned in my Direct Testimony, the economics of the Mesaba 1
5 PPA, as claimed by Mesaba 1 LLC, consistently exclude significant capital
6 costs (the uncapped EPC contract adjustment, transmission costs, fixed fuel
7 costs, etc.) and assume on-going performance that has no basis. These costs,
8 which even Mr. Osteraas calls “significant” (page 15), are assumed to be zero
9 in the analysis performed by Mesaba 1 LLC. Dr. Amit’s analysis used the
10 only information that was available to him, and demonstrates that even when
11 the Mesaba 1 PPA is viewed in this most favorable light, it is grossly
12 uneconomic.

13

14 **B. Comparison to Self Build**

15 Q. WHAT IS MESABA 1 LLC’S POSITION REGARDING THE RISK OF PPAS VS.
16 UTILITY SELF BUILD?

17 A. Mr. Osteraas claims that “any power purchase agreement...contractually
18 transfers risk *away* from the utility and its customers” (page 8). Mr. Gale
19 refers to PPAs as being “inherently” less risky than utility ownership (see
20 pages 2, 8, 10 and 24).

21

22 Q. DO YOU AGREE?

23 A. No. Any such “inherent” characteristic can clearly be undone by using non-
24 standard terms in a PPA, as Mesaba 1 LLC does. In addition, such a risk
25 assessment needs to consider that virtually all PPAs *create* some risks that are
26 not present in a self-build option. For example, counter-party credit concerns
27 and the loss of optionality are risks created by a PPA structure. The relative

1 risk to ratepayers depends on the specific terms of the PPA. As noted above
2 and as demonstrated by the DAEC and Palisades PPAs, the economic
3 exposure under the Mesaba 1 PPA is orders of magnitude greater than the
4 risks in either of those PPAs. Accordingly, it is not meaningful to judge the
5 appropriateness of Mesaba 1 LLC's proposed terms by simply looking at
6 generic attributes of PPAs.

7
8 Q. WHAT ARE THE KEY DIFFERENCES BETWEEN THE UTILITY SELF-BUILD OPTION
9 AND TYPICAL PPA STRUCTURES?

10 A. I would generally describe the key differences as: (i) a change in the alignment
11 of interests; (ii) a change in the role of regulatory oversight; and (iii) the
12 creation of counter-party and contractual risks. Once a PPA is signed, the
13 power seller typically has little or no need to be concerned about the costs
14 and risks that are imposed on the buyer's customers. A seller under a PPA is
15 only required to meet the terms of the contract, not a broader standard of
16 charging just and reasonable rates or providing customer benefits, subject to
17 regulatory oversight.

18
19 Q. CAN YOU OFFER SOME EXAMPLES OF HOW THESE DIFFERENCES AFFECT RISKS?

20 A. Yes. Mr. Osteraas claims that the EPC cost risk in the Mesaba 1 PPA is lower
21 than the risk of self-build because, once the EPC cost is fixed in the Mesaba 1
22 PPA, Xcel Energy is no longer subjected to cost overrun risk. However, the
23 total level of the EPC cost and the amount of contingency that will be
24 included in the lump-sum turn-key price are outside of Xcel Energy's and the
25 Commission's control. Once the Mesaba 1 PPA is executed and approved,
26 there is no motivation for Mesaba 1 LLC to control EPC costs or limit the
27 contingencies that the EPC contractor will include, and neither Xcel Energy

1 nor the Commission have any control or review authority over Mesaba 1
2 LLC's actual costs. Conversely, in a self-build scenario, Xcel Energy remains
3 subject to on-going prudence reviews of all costs and is subject to
4 disallowances if its decisions are imprudent, unreasonable or wasteful.

5
6 In the portion of the Merrimack report provided by Mr. Gale, Merrimack
7 states that passed-through price changes “[i]deally...would be controlled by
8 performance incentives” (RWG-6, page 38). These protections are not
9 included in the Mesaba 1 PPA.

10
11 Another example Mr. Osteraas uses is the fuel risk (page 26) that he considers
12 to be the same under the Mesaba 1 PPA and an Xcel Energy-build option.
13 However, with the Mesaba 1 PPA's: (i) absolute pass-through of costs, (ii) no
14 guarantee of heat rate, and (iii) limited capacity charge relief if Mesaba Unit 1
15 ends up burning natural gas, the Mesaba 1 PPA offers no protection to Xcel
16 Energy or its customers, and no risk to Mesaba 1 LLC. Further, under an
17 Xcel Energy-build option, fuel costs and use are subject to an ongoing
18 regulatory review.

19
20 Mr. Gale states that the Mesaba 1 PPA protects ratepayers because “payments
21 are only made under the Mesaba 1 PPA for capacity actually available” (page
22 21). In fact, the PPA requires Xcel Energy to make capacity payments on the
23 basis of Net Capability at Reference Conditions (Mesaba 1 PPA page 12,
24 definition of Net Capability). Depending on the ambient conditions, the
25 operations and maintenance of the plant over 25 years and the fuel Mesaba 1
26 LLC chooses, the actual available capacity could be 17% less than the amount

1 the capacity on which the payment is based.³ The Mesaba 1 PPA again
2 insulates Mesaba 1 LLC from any cost consequences of the Mesaba Unit 1
3 project not performing well under real operating conditions, since the
4 capacity payment does not change based on actual generating capability.
5 Conversely, under the self-build option, Xcel Energy would expect that on-
6 going prudence reviews by the Commission would protect customers if poor
7 decisions by Xcel Energy were to lead to the plant performing poorly.

8
9 These same basic principles of economic immunity under the Mesaba 1 PPA
10 vs. on-going cost responsibility under the self-build option apply to O&M
11 costs, transmission costs, and fixed fuel costs, among others.

12 13 **C. Credit Rating Implications**

14 Q. HOW DO YOU RESPOND TO MR. GALE'S ASSERTION THAT YOUR CONCERNS
15 ABOUT IMPUTED DEBT ARE "EXTREME AND MISLEADING" (PAGE 9)?

16 A. I disagree. These risks are very real and have been convincingly demonstrated
17 by a number of companies. The negative effect on a company of poor credit
18 ratings can and has led to an inability to raise capital, inability to perform and
19 in some cases bankruptcy. The best approach to these risks is to not try to
20 compensate a company for these risks, but to avoid them.

21
22 Q. DO YOU AGREE WITH MR. GALE'S ASSERTION THAT RATING AGENCIES'
23 CONCERNS WILL BE FULLY RESOLVED IF THE COMMISSION INDICATES IT WILL
24 APPROVE XCEL ENERGY'S COST RECOVERY FOR THE MESABA 1 PPA COSTS?

³ See Mesaba 1 PPA, Exhibit G, page 3, noting that Mesaba Unit 1 will provide 503 MW (natural gas) vs. 603 MW at Reference Conditions.

1 A. No. Rating agencies are keenly aware that decisions of one commission are
2 not binding on future commissions. Accordingly, the rating agencies look
3 beyond an initial regulatory approval of cost pass-through to customers and
4 review the fundamental economics in order to determine the risk level
5 associated with any particular contract. To the extent that a PPA is above
6 market or provides pricing that is outside of market projections, rating
7 agencies consider the risks associated with that PPA to be increased. In part
8 this is because of the increased likelihood of such a PPA later being rejected
9 by a commission or becoming the subject of litigation between the parties.
10 Rating agencies also carefully evaluate the risk allocation in a PPA, and
11 whether the power is needed when they consider the rating impacts. The
12 Mesaba 1 PPA fares very badly on both of these points.

13

14 Additionally, the Mesaba 1 PPA does not meet the thresholds Mr. Gale sets
15 out in his testimony. He states that rating agencies are not concerned if “the
16 PPA assures that the project failure risk is largely held by the developer” (page
17 11). Mr. Gale does not define “project failure” but total cost, capacity factor,
18 fuel choice, heat rate, and on-line date are all factors that can contribute to
19 economic project failure. Those risks are not borne by Mesaba 1 LLC, as a
20 developer, but rather, are largely borne by Xcel Energy and its customers
21 under the Mesaba 1 PPA.

22

23 Q. DO YOU HAVE OTHER CONCERNS WITH MR. GALE’S POSITION?

24 A. Yes. His statement that Xcel Energy “has no grounds for opposing the
25 Mesaba 1 PPA” if there is an assurance of full pass through of costs to
26 ratepayers ignores the fundamental duty of a public utility, i.e., to provide
27 service at just and reasonable rates.

1

2 Q. DO THE SOURCES THAT MS. MEAL CITES SUPPORT HER CONCLUSION THAT
3 RATING AGENCIES WILL RESPOND FAVORABLY TO THE MESABA 1 PPA?

4 A. No. To the contrary, her testimony underscores the concerns that rating
5 agencies will have concerning the Mesaba 1 PPA. Throughout her testimony
6 Ms. Meal cites rating agency publications about PPAs, based on generic PPA
7 structures. Such a general discussion does not resolve the issue in this case,
8 which will be based on the specific terms of the Mesaba 1 PPA. My Direct
9 Testimony and the Direct Testimony of Ms. Hyde demonstrate the numerous
10 ways in which the Mesaba 1 PPA diverges from typical PPA terms.

11

12 Q. MS. MEAL ALSO CITES TWO STUDIES FROM 1994 CONCLUDING THAT PPAs
13 HAVE NOT BEEN SHOWN TO ADVERSELY AFFECT A UTILITY'S DEBT COST.
14 (PAGES 38-39) HOW DO YOU RESPOND TO THESE STUDIES?

15 A. The importance of PPAs to a utility's debt rating has changed dramatically
16 since 1994, which was before rating agencies developed a specific focus on
17 the debt equivalence of PPAs. Rating agency statements also have an effect
18 on the cost of equity, so those studies are not representative of current
19 conditions.

20

21 Q. MS. MEAL ALSO CITES FROM FOUR UTILITY COMMISSION ORDERS THAT SHE
22 CLAIMS SHOWS THAT OTHER COMMISSIONS HAVE REJECTED THE STANDARD &
23 POORS DEBT IMPUTATION METHODOLOGY WHEN CONSIDERING THE EFFECTS
24 OF PPAs (PAGES 61-63). HOW DO YOU RESPOND TO THESE STATEMENTS?

25 A. Three of the four commissions that Ms. Meal cites have affirmed that they *do*
26 include imputed debt as one of the considerations in evaluating the costs
27 imposed by PPAs. In a more recent document, the Utah Division of Public

1 Utilities has called for PacifiCorp to secure an advisory ratings opinion so that
2 these impacts can be included in the final RFP evaluation. Florida and
3 California, two other states cited by Ms. Meal, specifically have acknowledged
4 the importance of considering the debt equivalence issue in RFP evaluations.
5 In addition, there are several other Commissions that she does not cite that
6 also support the approach I have recommended. There is no question that,
7 taken as a whole, utility regulators clearly understand the importance of
8 imputed debt in evaluating PPAs.

9
10 Q. ARE THERE SPECIFIC PROVISIONS THAT RATING AGENCIES LOOK FOR IN PPAs
11 WHICH MESABA 1 PPA DOES NOT PROVIDE?

12 A. Yes. For example, Ms. Meal indicates (pages 24 – 25) that Moody’s views
13 PPAs generically as providing a risk reduction if the following features are
14 present:

- 15 • *Outsourcing of operating risk:* While a standard PPA may do this
16 through fixed operating costs and performance guarantees, the Mesaba
17 1 PPA offers no such protections, but rather subjects the buyer to
18 uncapped costs with no performance thresholds.
- 19 • *Certainty of supply:* Again, while this is typical for PPAs, this benefit is
20 not provided in the Mesaba 1 PPA,
- 21 • *Fixing the cost of power:* While price certainty is a valued feature of
22 many PPAs, the Mesaba 1 PPA does not have any certainty at this time
23 or even a ceiling on the capacity, energy, or O&M costs.

24
25 Ms. Meal also points out that Fitch assesses PPAs’ risks based in part on the
26 need for power. Additionally, Fitch adjusts debt if the contract is “for a long
27 term *and* the price is above market” (pages 25-26). Xcel Energy has

1 demonstrated that the Mesaba 1 PPA would provide power in 2011, which is
2 in advance of the need. Further, there is no doubt that 25 years is a long-term
3 contract and that the cost of power from Mesaba Unit 1 (viewed in the most
4 favorable possible light) is well above market. Using the standards that Ms.
5 Meal cites, Xcel Energy is at significant risk of an adverse rating agency
6 response to the Mesaba 1 PPA.

7
8 Q. SHOULD THE COMMISSION DEFER CONSIDERATION OF THESE ISSUES UNTIL A
9 FUTURE RATE CASE?

10 A. No, it would be inappropriate to defer this issue, which is a key element to
11 assessing the overall ratepayer impact of the Mesaba 1 PPA. By the time of
12 the next rate case, the impacts on the cost of capital, credit rating impacts and
13 obligations on Xcel Energy and its ratepayers would have already been
14 incurred. To prevent incurring unknown costs and risks, the expected impact
15 must be reviewed and understood *now, before* the Mesaba 1 PPA costs are
16 imposed on Xcel Energy and its customers. Once the Mesaba 1 PPA is
17 signed, there is no way to undo the risk and the cost of capital impacts.

18
19 Q. DO YOU BELIEVE THAT AN ADVISORY RATING SHOULD BE USED TO CONFIRM
20 THE IMPACT?

21 A. Yes. Ms. Sass' concerns about this approach do not provide any basis not to
22 invoke this valuable tool for development of important information. The
23 rating agency review does not rest on Xcel Energy's assessment of the
24 Mesaba 1 PPA (page 2), but rather on the agencies' assessment of the
25 document itself. Further, Ms. Sass's reluctance to undertake such a review
26 because the terms and conditions of the PPA are not yet finalized (page 3)

1 seems inconsistent with Mesaba 1 LLC's position that the Mesaba 1 PPA, as
2 amended by Mr. Osteraas, is appropriate for adoption by the Commission.

3 4 IV. CONCLUSION

5
6 Q. PLEASE SUMMARIZE YOUR CONCLUSIONS REGARDING THE RISKS AND
7 FINANCIAL IMPACT OF THE MESABA 1 PPA ON XCEL ENERGY AND ITS
8 CUSTOMERS

9 A. The Mesaba 1 PPA, as amended by Mr. Osteraas, is not in the public interest
10 and should not be approved. Contrary to the terms of typical PPAs, the
11 Mesaba 1 PPA, as amended, would continue to impose on Xcel Energy and
12 its customers nearly all of the risks relating to:

- 13 • construction,
- 14 • operations,
- 15 • fuel costs,
- 16 • delivery/transmission capital costs, and
- 17 • performance.

18 In my opinion, these shifts in risk are completely inappropriate and contrary
19 to the public interest.

20
21 The Mesaba 1 PPA, as amended, will be likely to have severe adverse impacts
22 on the credit rating and cost of capital of Xcel Energy. Contrary to the
23 witnesses for Mesaba 1 LLC, assurances of cost recovery will not resolve all
24 concerns of either Xcel Energy or the rating agencies. Waiting until a future
25 rate case to address these impacts is inappropriate because the approval of the

1 Mesaba 1 PPA and resulting damage will have been done by that time, with
2 no possibility of correction.

3

4 Because of the enormity of this commitment, the resulting debt consequences
5 and ratepayer costs should be fully known before the Mesaba 1 PPA is found
6 to be in the public interest. Therefore, before making any final decision to
7 proceed, I continue to recommend that the Commission require that
8 preliminary credit ratings be obtained.

9

10 Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

11 A. Yes, it does.