

ECONOMICS OF THE MESABA ENERGY PROJECT

Prepared by Citizens Against the Mesaba Project

Introduction

The Itasca Economic Development Corporation, relying on two studies by the UMD Labovitz School of Business and Development, recently announced its support for the Mesaba Energy Project. The initial Arrowhead Region study, commissioned by Excelsior Energy, was published in 2005; a second study, commissioned by the IEDC and focussing on Itasca County, was published in April 2006. These studies are seriously flawed and misleading, and the disclaimers given by the authors have been ignored. The authors have cautioned that these studies are not cost-benefit analyses and should not be used to determine policy or make decisions. The Minnesota Chamber of Commerce has concluded that the net economic impact of the Mesaba Energy Project to the state is likely to be negative.* If all costs were properly analyzed the net impact to Itasca County would likely also be negative.

**Testimony of William Blazar, Sr. V.P., Public Affairs and Business Development, before the Minnesota Public Utilities Commission (MPUC), 10/10/06*

Qualifications of Developer

The experience of the developer of the Mesaba Project ought to be considered in evaluating its financial viability and potential economic benefits. Excelsior Energy was incorporated in 2001 for the purpose of building coal gasification plants to produce energy for the wholesale market; Mesaba I is its first project. Excelsior's website lists nine top executives, eight of whom previously held positions at NRG Energy, Inc.:

- Tom Micheletti and Julie Jorgensen, Co-Presidents and Co-CEOs of Excelsior both served as V.P. and General Counsel at NRG during the 1990s;
- Thomas Osteraas, Sr. V.P. and General Counsel, worked as Sr. Counsel at NRG;
- Renee Sass, Sr. V.P. and Chief Financial Officer, worked at NRG from 1991 until at least 2002 when she was V.P., Strategic Planning and Portfolio Assessment;
- Robert Evans, V.P., Environmental Affairs, worked at NRG as Exec. Dir. and Manager, Environmental Services;
- Jim Milkovich, V.P., Technical Services and Fuel, previously held various positions with NRG;
- William Ryzinski, V.P. Development and Mary Day, Controller also held positions at NRG.

According to the Minneapolis/St. Paul Business Journal, NRG was founded in 1989 as a subsidiary of Northern States Power Company and it operated as an independent power producer. During the go-go days of industry deregulation NRG grew rapidly, becoming the 7th largest power generator in the world by 1999. In 2002 California sued NRG for violating its Unfair Competition Act, and the California Systems Operator fined an NRG joint venture (Electric Clearinghouse) \$25 million for failing to make capacity available between June 1999 and April 2002. NRG developed a significant debt problem and by March 2003 NSP was trying to settle with NRG's creditors for \$752 million. In May 2003 NRG filed Chapter 11 bankruptcy and was reorganized to operate independently of NSP, which continued in its traditional business as a regulated utility serving customers.

Financing and Costs

Despite no performance history, Excelsior Energy successfully lobbied the Minnesota legislature in 2003 for regulatory exemptions and \$10 million to build a project on the Iron Range. It also has been funded with \$9.5 million from Iron Range Resources and \$36 million from the federal Department of Energy, which has recently estimated the total cost for Phase I (the first 606 MW) at \$2.156 billion. This does not include the \$55 million estimated cost of infrastructure requested from Itasca County or the hundreds of millions of dollars for transmission lines to deliver the power to Xcel's territory. Nor does it include the costs of capture and sequestration of carbon dioxide, which is the main advantage claimed for the gasification technology. The cost of capture equipment and a pipeline to move the CO₂ to a sequestration site could be \$1.077 billion in 2011; the cost of sequestration could vary from \$9/MWh to \$12/MWh.*

**MPUC testimony of Dr. Eilon Amit, Minnesota Department of Commerce, 10/10/06*

Itasca County Economics

The IEDC claims that the construction and operation of the Mesaba Energy Project will have an enormous positive economic impact in Itasca County. Using unverified input data provided by Excelsior Energy, the UMD study projects \$242.2 million in “value added spending” in the county each year. However, the authors state that any “policy recommendations should be made in regard to the ‘big picture’ of total impact”, and “a cost-benefit analysis would be needed to assess the environmental, social and governmental impacts”. The IEDC’s misplaced reliance on this study leads to an erroneous conclusion about the economic benefit the Project would have in Itasca County. Others have concluded that the economic impact is likely to be far less than projected in these studies. Burton Abrams, Ph.D., Professor and Acting Chair of the Department of Economics, University of Delaware, estimates the economic impact to be \$15-25 million before factoring in the costs of lost tourism, decreased real estate values, public health expenses and environmental impacts.

The key question is how much of the value added spending represents a net increase in income for Itasca County residents. The study asserts that “operating expenses” will “generate economic activity across the county”, but this doesn’t equal net economic gain for the county. The study gives only the totals for the gross categories of value added and operating expenses, making it impossible to determine the particulars. The report acknowledges that the IMPLAN modeling used in this study is not suitable to a small geographic area such as a county as there is likely to be significant “leakage”. The following examples show that most of the dollars generated annually by the Mesaba Project will flow out of the county.*

Coal: About \$30/ton for western coal delivered x 2 million tons = \$60 million. Less than 2% of this would stay in NE Minnesota: the cost of coal goes out of state; transportation costs go out of county; fuel costs for delivery go out of state; and most wage earners are outside of Minnesota.
\$1million stays in NE Minnesota; \$59 million leaves the area.

Natural Gas: \$6 per MMBTU average and will increase over time. Amount used depends on how long the plant stays in start-up mode before introducing coal. Natural gas will be used when either gasifier is shut down.
*\$100,000 to \$500,000 per startup and \$1 million to \$4 million backup stays in the area;
\$1.9 million to \$9.5 million per startup and \$19 million to \$76 million backup leaves the area.*

Operating Expenses: Wages (amount unknown), generously assuming \$100,000 per year average with benefits, vacation, health care, overtime for 100 people = \$10,000,000. It is likely that 80% will stay in the area, but 20% is likely to leave the area as the plant will hire people who will commute on weekends and send money home.
\$8 million stays in the area; \$2 million leaves the area.

Maintenance: \$25 million per year for parts, supplies, and contractors. More than 80% will go out of state: most of the specialized contractors are from out of state; very few specialized parts are made in Minnesota. A few local contractors may be used for general repair work. Motels and restaurants will see some of these dollars when specialized contractors are on site.
\$5 million stays in the area; \$20 million leaves the area.

Debt Service: Interest on debt is projected at \$70 million to \$100 million dollars per year. None of this stays in the area.

Profit: If the Mesaba Project is profitable, profits will go to investors.

Real Estate Tax: Will provide some revenue for local government but Excelsior got the legislature to exempt the Mesaba Project from personal property tax, which would likely produce at least four times as much as the real estate tax. Excelsior is obligated to negotiate a “host fee agreement” with the county, Taconite, and Greenway School district in lieu of the personal property tax. The amount of the host fee is unknown but would likely be significantly less than the personal property tax.

**Estimates for a typical year of operation provided by Ross Hammond, P.E., Energy Consultant & former Manager of Xcel’s Riverside Plant*

Concerns of Others re: the Mesaba Project

The MPUC proceeding regarding the proposed Power Purchase Agreement with Xcel Energy has revealed serious concerns that the proposed Mesaba Energy Project is highly risky and may not be economically viable.

Minnesota Department of Commerce: In Dr. Amit's testimony to the MPUC, he concluded that: Xcel's ratepayers are not appropriately protected from the financial and business risks of the proposed PPAs; the PPAs could result in a very significant increase of Xcel's cost of debt, common equity and overall cost of capital; Excelsior does not have a specific plan for the sequestration of CO₂ but based on the information it provided, the cost would be significant; the proposed plant is not likely to be the least-cost resource, as required by Minn. Stat. 216B.1693; and the proposed PPA may not be in the public interest.

Minnesota Chamber of Commerce: In William Blazar's testimony to the MPUC, he stated that: good construction jobs will end and then there will be a modest number of jobs for operations; much of the revenue will be for fuel and will be sent outside of Minnesota; and this Project presents significant risk in terms of technology and as an investment for Xcel's ratepayers. He concluded that the net economic benefits to the state are likely to be negative.

Minnesota Power: In a recent letter to the IEDC, Warren Candy, Sr. V.P. of Utility Operations, explained why Minnesota Power does not agree with the IEDC's support of the Mesaba Energy Project. He stated that the Company has intervened in the MPUC case because it believes that there are significant public policy and business issues that need to be taken into consideration. Among these are concerns about: the lack of fundamentals, such as rail and coal contracts, necessary to ensure an economically successful outcome; using technology unproven in its choice of fuel and on such a large scale, which threatens operating reliability; inappropriately shifting business risks from the developers to Xcel Energy's ratepayers and adding significant financial risk to Xcel; making unrealistic environmental promises; having no realistic plan to capture and store CO₂; needing to import coal to produce power to be used outside of the region; and using up already scarce and valuable air shed needed to meet permit requirements for viable northeastern Minnesota projects based on existing natural resources.

Conclusion

Itasca County and its economic development planners ought to have the same concerns as these three entities. A scheme that is too costly to Xcel Energy, its ratepayers, and the state is too risky for Itasca County. In addition to the risk of operational or financial failure, Itasca County is risking serious detriment to the clean air and water that attract visitors and residents, who also contribute to the economy. Absent a proper cost-benefit analysis using verified data and taking into account the costs to tourism and recreation, land values, public health, and the environment, there is no basis for concluding that the Mesaba Energy Project would benefit Itasca County. To the contrary, evidence is mounting that this Project would be a net loser for the county as well as for the state.