Surrebuttal Testimony
Mark A. Hervey

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

Rate Impacts

October 31, 2006

Table of Contents

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME.

A. My name is Mark A. Hervey.

Q. HAVE YOU PROVIDED DIRECT TESTIMONY IN THIS CASE?

A. Yes. I provided Direct Testimony regarding the incremental impact on Minnesota electric rates if Xcel Energy entered into the 603 MW power purchase agreement ("Mesaba 1 PPA") proposed in this proceeding.

II. PURPOSE

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

A. I respond to the Rebuttal Testimony of Mesaba 1 LLC's witness Joseph Cavicchi. Specifically, I discuss:

- development of a rate impact analysis,
- inclusion of capital structure and transmission costs, and
- the difference between the Strategist present value revenue requirements ("PVRR") analysis and an annual revenue requirements analysis.

Q. HAS MR. CAVICCHI'S REBUTTAL TESTIMONY CAUSED YOU TO CHANGE THE RATE IMPACT ANALYSIS YOU PROVIDED IN YOUR DIRECT TESTIMONY?

A. No. As explained in my Direct Testimony, to determine the incremental rate impact of the Mesaba 1 PPA, I compared the generation revenue requirements associated with our approved Resource Plan to the generation revenue requirements associated with the Mesaba 1 PPA. I included the impact that the Mesaba 1 PPA would have on Xcel Energy's capital structure and the transmission revenue requirements associated with delivery of Mesaba Unit 1's output to Xcel Energy's system. My analysis is consistent with the way the Minnesota Public Utilities Commission (the "Commission") sets rates. I continue to estimate that in the first full year under the Mesaba 1 PPA, rates would be between 8 and 12 percent higher than under our approved Resource Plan.

III. ASSESSMENT

A. Rate Impact Analysis

Q. DO YOU AGREE WITH MR. CAVICCHI THAT HIS ALTERNATIVE CALCULATION RESULTING IN A ONE-HALF PERCENT RATE IMPACT FROM THE MESABA 1 PPA IS "MORE APPROPRIATE, LOGICAL, AND STRAIGHTFORWARD?"

A. No. First, Mr. Cavicchi's analysis is based on a number of significant cost adjustments that reduce the incremental cost of the Mesaba 1 PPA. For example, Mr. Cavicchi's analysis does not include the transmission-related costs and the costs related to capital structure impacts that were included in my analysis. I explain why these adjustments are inappropriate later in my Surrebuttal Testimony. In addition, his analysis reflects adjustments that Maria Scheller made to the fuel costs and capital costs used in the Strategist modeling of the cost impact of the Mesaba 1 PPA. The Surrebuttal Testimony of Ms. Elizabeth Engelking addresses these adjustments.

Second, Mr. Cavicchi disregards how rates are set by the Commission. He fails to follow the "test year" method of isolating the cost of an element of service in a given year, in this case the Mesaba 1 PPA, and then determining the rate increase required to recover the revenue requirements for that cost.

Q. WHAT IS THE "TEST YEAR" APPROACH YOU FOLLOWED IN YOUR RATE IMPACT ANALYSIS?

A. The Commission employs the "test year" approach to setting rates. Under this approach, all the costs of service a utility will incur within a one year period are identified, along with the return allowed on those costs, to determine the revenue requirement necessary to recover the utility's costs and allowed return. The test year can be a calendar year or a non-calendar 12-month period. In either event, the costs included are only those that are expected to occur within the chosen test year. Individual costs from past years are not moved forward into the test year, nor are costs from future years included in the test year. To do so would violate the test year concept. The test year approach is also used to isolate the rate impact of adding a particular cost item that is not currently recovered in a utility's rates. The revenue required in a particular year to recover the added costs is determined and then converted to the percent increase in current customer rates necessary to recover the revenue requirement.

Q. HOW DOES MR. CAVICCHI'S RATE IMPACT ANALYSIS VIOLATE THE TEST YEAR CONCEPT?

A. He reduces the PPA's total twenty-year cost difference over our Resource Plan to its net present value, and then annualizes the recovery as an annuity (a levelized amount) over twenty years to arrive at his estimated rate impact for the Mesaba 1 PPA. Mr. Cavicchi's analysis is not a rate impact analysis. It is an analysis that is often used to determine how to understand the cost of a particular item, particularly in relation to another item, but it is not used to determine how that item's cost would be recovered from customers in a utility's rates.

Q. HAS XCEL ENERGY PROVIDED THE COMMISSION RATE IMPACT ANALYSES IN OTHER DOCKETS THAT ARE CONSISTENT WITH THE ANALYSIS YOU PROVIDED FOR THE MESABA 1 PPA?

A. Yes. My rate impact analysis here is consistent with the analysis done in the Metropolitan Emissions Reduction Project ("MERP") docket, where the Commission asked Xcel Energy to provide for its review the cost increase that ratepayers would see on their monthly bills if the MERP Project were approved.

B. Capital Structure and Transmission Costs

Q. WHY WERE THE TRANSMISSION AND CAPITAL STRUCTURE COSTS XCEL ENERGY WOULD INCUR IF IT ENTERED INTO THE MESABA 1 PPA INCLUDED IN YOUR RATE IMPACT ANALYSIS?

A. The Clean Energy Technology statute, Minn. Stat. § 216B.1693, specifically states that in determining whether a clean energy technology is least-cost, one must include the costs for transmission and other ancillary services. In addition, at its July 27, 2006 hearing on transmission and other issues in this proceeding, the Commission asked that the record include information on the total costs that will be borne by Xcel Energy ratepayers for energy to be delivered from the Mesaba plant to Xcel Energy's load. Thus, I included the transmission and capital structure costs Xcel Energy would incur – and ratepayers would pay for – if it were ordered to enter into the Mesaba 1 PPA. As I explained in my Direct Testimony, I received the capital structure costs from Mr. George Tyson, and the transmission costs from Mr. Richard Gonzalez and Mr. Dean Schiro.

C. Strategist PVRR vs. Annual Revenue Requirements Analysis

Q. MR. CAVICCHI'S EXHIBIT___(AJC-6) SHOWS THAT FOR THE "BASE CASE," HIS NET PRESENT VALUE CONVERSION OF YOUR REVENUE REQUIREMENTS DATA FROM STRATEGIST DOES NOT MATCH THE STRATEGIST NET PRESENT VALUE OF SYSTEM GENERATION COSTS PROVIDED BY MS. ENGELKING. PLEASE EXPLAIN THIS.

A. When evaluating the total cost impact of different resource expansion plans, Strategist calculates the *present value* revenue requirements for each plan. In the PVRR analysis, Strategist calculates the *economic carrying charge* ("ECC") for new units added in the expansion plan. The ECC has the same present value as the unit's conventional revenue requirements but the ECC increases over time whereas revenue requirements tend to decrease. This methodology removes the bias against adding large capital-intensive projects by redistributing the timing of costs. For the analysis of the rate impact of different plans, Strategist follows the cost recovery methodology that is used in setting rates in Minnesota. Because these are different calculations, the Strategist annual revenue requirement value that I use to calculate a rate impact on customers for a particular expansion plan would not likely match the Strategist present value revenue requirement that Ms. Engelking uses to assess the relative costs between expansion plans.

Q. DO YOU AGREE WITH MR. CAVICCHI THAT THERE ARE INCONSISTENCIES BETWEEN THE STRATEGIST REVENUE REQUIREMENT DATA YOU RELIED ON TO SUPPORT YOUR RATE IMPACT ANALYSIS AND THE STRATEGIST REVENUE

REQUIREMENT OUTPUTS PROVIDED TO MESABA 1 LLC BY MS. ELIZABETH ENGELKING?

A. No. A review of Mr. Cavicchi's Exhibit___(AJC-6) detailing the supposed inconsistencies shows that on each line in the Exhibit labeled "Hervey Testimony," Mr. Cavicchi has reported a revenue requirement that I did not provide to Mesaba 1 LLC in support of my rate impact analysis. Rather, it reports a net present value Mr. Cavicchi developed from the revenue requirements data I provided. The immediately adjacent line in the Exhibit labeled "Strategist Output" then reports Mr. Cavicchi's calculation of the net present value he developed from the Strategist revenue requirements provided by Ms. Engelking. In all instances, Mr. Cavicchi's calculations of the net present value of the data I provided match the data provided by Ms. Engelking.

IV. CONCLUSION

Q. PLEASE SUMMARIZE YOUR SURREBUTTAL TESTIMONY.

A. Mr. Cavicchi's estimated rate impact of the Mesaba 1 PPA is based on a present value analysis, which is not used by the Commission to determine an item's rate impact. Thus, the estimated rate impact provided in Mr. Cavicchi's Rebuttal Testimony is incorrect. My rate impact analysis for the Mesaba 1 PPA: (1) correctly follows the test year approach used by the Commission to set rates, (2) appropriately includes the transmission and capital structure costs associated with the Mesaba 1 PPA, and (3) is consistent with the Strategist data used by Ms. Engelking in this proceeding. Thus, I continue to estimate that in the first full year under the Mesaba 1 PPA, rates would be between 8 and 12 percent higher than under our approved Resource Plan.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.