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STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE 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

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

XCEL ENERGY'S REPLY BRIEF

January 19, 2007

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INTRODUCTION

Northern States Power Company d/b/a Xcel Energy ("Xcel Energy"), respectfully submits this Reply Brief responding to the arguments of Excelsior Energy, Inc. and Mesaba I LLC (collectively, "Mesaba 1 LLC").[1] In sum, Mesaba 1 LLC has not established that its proposed power purchase agreement (the "Mesaba 1 PPA") is in the public interest or satisfies the Innovative Energy Project and Clean Energy Technology statutes.

- Mesaba 1 LLC's legal arguments regarding the statutes are not supported by the rules of statutory interpretation and therefore do not support the Petition.
- The Mesaba 1 PPA remains the central focus of the record as it is the vehicle for passing the costs of Mesaba Unit 1 to ratepayers and as a result it must satisfy the public interest tests of the two statutes.
- Mesaba 1 LLC's submissions do not satisfy the public interest tests because (i) the cost of power is unknown and uncapped, (ii) substantial operating and financial risks are shifted to ratepayers, (iii) substantial indirect costs will occur, and (iv) the plant will not sequester carbon.

[1] In addition to submissions from Xcel Energy and Mesaba 1 LLC, initial briefs were submitted by the Minnesota Department of Commerce ("Department"), a group of environmental organizations ("Environmental Intervenors"), mncoalgasplant.com ("MCGP"), the Minnesota Chamber of Commerce ("Chamber"), Minnesota Power, Manitoba Hydro, the co-owners of Big Stone II, and Xcel Large Industrial Intervenors.

The remainder of this Reply expands upon these and other relevant issues addressed in Mesaba 1 LLC's brief and is structured in the following sections:

I. Addressing the scope of Mesaba 1 LLC's initial brief and proposed findings and the scope of this Reply;

II. Responding to the legal issues raised by Mesaba 1 LLC;

III. Responding to Mesaba 1 LLC's description of the record; and

IV. Commenting on Deputy Commissioner Garvey's Policy Statement.

REPLY

I. SCOPE

Mesaba 1 LLC's Findings of Fact, Conclusions of Law and Recommendation ("Mesaba 1 Proposed Findings") substantially restate large portions of the Petition and Mesaba 1 LLC's testimony. Xcel Energy will not engage in a point-by-point response to the 836 paragraphs contained in the Mesaba 1 Proposed Findings. As with our testimony (*see, e.g.*, XE-2002 at 7), Xcel Energy will focus on the key issues, the relevant statutory requirements, and whether Mesaba 1 LLC has satisfied its burden of proof. The lack of a specific response to a particular proposed finding or line of argument does not mean Xcel Energy agrees with that finding or argument.

In addition to restating significant portions of its previous submissions, the Mesaba 1 Proposed Findings include a number of inaccurate and unsupported assertions and assumptions that go beyond the record and the briefs. For example:

- Mesaba 1 Proposed Findings at 43-44, ¶ 97 (stating without support or citation that "Big Stone II…falls at the clean end of the pulverized coal technology spectrum, <u>and may not even constitute a 'traditional' technology within the meaning of the Statutes</u>");
- *id.* at 54-56, ¶¶ 141-146 (asserting without support that production of syngas is an additional economic benefit that should be considered in favor of the project when Mesaba 1 LLC has affirmatively stated that it will not produce excess syngas for resale (XE-2002 at Schedule 1));
- *id.* at 83, ¶ 253 (incorrectly stating that "Mesaba One will generally reduce emissions by 60%" when Mesaba 1 LLC's own witness testified that emission

levels for NO_X and particulate matter are reduced by only 15% & 30% respectively (EE-1084 at 3-4));

- *id.* at 90, ¶ 274 (incorrectly stating that "Xcel witness Clarke, MP witness Cashin, and MPCA witness Jackson provide direct evidence that the Mesaba Project's emissions profile is superior to every other traditional solid fuel baseload technology identified in this proceeding" despite (1) Mr. Clarke testifying to "insufficient information to determine that the Mesaba Unit 1 will significantly reduce emissions" (XE-2023 at 3); (2) Mr. Cashin testifying only that "IGCC is potentially slightly favorable to modern PC in terms of reductions of mercury, SO^2 and NO_x" (MP-4004 at 4); and (3) Ms. Jackson's testimony that the emission profile is comparable to traditional technologies and NO_x emission for the plant will be higher (MPCA 8000 and 8001);
- *id.* at 90-103, ¶¶ 273-290 (repeatedly presenting Mesaba Unit 1's emission profile as only "superior" to other technologies and asserting that "superior" is sufficient to meet the significant reduction burden for each of the criteria pollutants (sulfur dioxide, nitrogen oxide, particulate, and mercury emissions);[2]
- *id.* at 57, 75, 80, 81, 278, 291, ¶¶ 149, 218, 241, 246, 796, 824 (asserting that Xcel Energy will rely on natural gas to meet increased baseload needs despite (1) Xcel Energy's Resource Plan and November 1, 2006 filing in the Docket E002/CN-06-1518 (EE-1268) proposing a hydro/wind combination to satisfy the 375 MW of baseload need in 2015 found by the Commission, and (2) the January 2, 2007 filing in Docket No. E002/M-07-02 (EE-1220) demonstrating baseload need prior to 2015 will be met with 390 MW of upgrades to the Sherco coal units, and Prairie Island and Monticello nuclear units)).

The above list is not exhaustive but this case should remain focused on the Mesaba 1 PPA and whether this "Petition for Approval of a Power Purchase Agreement" should be granted where:

- Ratepayer costs are unknown and uncapped, contrary to the public interest and the requirement of a hedged, predictable price.

[2] Mesaba 1 LLC's word choice appears to dilute the statutory requirement that all listed criteria pollutants be significantly reduced. *E.g.,* Minn. Stat. § 216B.1693(c). As pointed out by the MPCA, "EPA estimates that future performance of supercritical and ultra supercritical units will emit less NO_x than Mesaba Energy for every megawatt generated." MPCA-8000 at 4; *see also* Minnesota Power Br. at 21. Mesaba 1 LLC's claim of being "superior" does not satisfy the statutory burden that the plant significantly reduce all criteria pollutants.

- The Mesaba 1 PPA is not likely to be a least cost resource for Xcel Energy, resulting in approximately $1.5 billion in excess costs.
- The Mesaba 1 PPA would result in serious financial consequences, including: imputed debt of $1.9 billion (XE-2011 at 23), likely credit rating downgrades (*id.* at 14-15), adverse accounting treatment (XE-2014 at 2), and a $950 million increase to Xcel Energy's capital structure (XE-2011 at 23).
- The Mesaba 1 PPA shifts significant financial and operational risks to Xcel Energy and its ratepayers beyond those which are consistent with industry norms for power purchase agreements, or prudent under a commercially reasonable PPA. XE-2019 at 2-3.
- The project does not take advantage of IGCC technology. The Mesaba 1 PPA contains no requirement to sequester carbon, produce hydrogen, or even install the equipment needed to do so.

Xcel Energy, therefore, continues to recommend that the ALJs find that Mesaba 1 LLC has not satisfied its burden of proof. With minor refinements described in this Reply, Xcel Energy's January 5, 2007 Proposed Findings of Fact, Conclusions of Law and Recommendation ("Xcel Energy Findings") should be adopted by the ALJs as the best statement of the overall record in this matter.

II. RESPONSE TO LEGAL ISSUES

A. The Statutes Control

Xcel Energy agrees that the Clean Energy Technology and Innovative Energy Project statutes control the determinations to be made in this case. Neither Xcel Energy nor Mesaba 1 LLC has the "authority to determine what the law shall be or to supply a substantive provision of the law which he thinks the legislature should have included in the first place."[3] Mesaba 1 Br. at 7. Thus, arguments about what a particular party thinks the law should be or what they think was intended are not relevant to the determination of what the statutes actually provide.[4] *See* Mesaba 1 Br.

[3] Quoting *Wallace v. Comm'r of Taxation*, 184 N.W.2d 588, 594 (Minn. 1971).

[4] Courts will not consider the post-enactment opinions of participants or observers of the legislative process to determine what the Legislature intended in enacting a statute. *In re State Farm Mut. Auto.*

at 5-9; Mesaba 1 Proposed Findings at 13-18. The Legislature has specifically provided that when interpreting statutes, "the letter of the law shall not be disregarded under the pretext of pursuing the spirit." Minn. Stat. § 645.16. Hence, courts "will not supply words that the legislature either purposely omitted or inadvertently left out. Instead we apply the plain meaning of the words of the statute."[5]

Xcel Energy accepts these principles of statutory interpretation and they preclude the expansive construction of the Clean Energy Technology and Innovative Energy Project statutes advanced by Mesaba 1 LLC. Instead, these principles require that the ALJs interpret the words of the statutes and make a determination whether the Mesaba 1 PPA is in the public interest considering all of the circumstances.

1. Least-Cost Resource Analysis

Mesaba 1 LLC argues that the ALJs must accept their studies comparing the generic costs of IGCC technology to those of other coal technologies as sufficient to show that Mesaba Unit 1 is or is likely to be a least cost resource. *See, e.g.*, Mesaba 1 Br. at 9, 20, and 43. Minn. Stat. § 216B.1693, however, places no such "hypothetical facility" restriction on the ALJs' least-cost analysis. Since Mesaba 1 LLC requests approval of a particular contract, which captures all of the costs of a specific IGCC plant (XE-2016, -2017 and -2018), the least-cost analysis must include consideration of those costs, not hypothetical costs.[6]

Ins. Co., 392 N.W.2d 558, 568-69 (Minn. Ct. App. 1986) (testimony after enactment of a statute is not competent, admissible evidence of legislative intent); *see TVA v. Hill*, 437 U.S. 153, 193 (1978).

[5] *Vlahos v. R&I Constr. of Bloomington, Inc.*, 676 N.W.2d 672, 681 (Minn. 2004).

[6] The Commission expects the record to contain the total cost of the actual proposed facility and the actual impact on ratepayers of this plant. *See* Transcript of July 27, 2006 Commission Hearing, at 18-19. At that hearing, responding to a Commissioner request to provide the total cost of electricity from the project, (*id.* at 18, lines 20-23), Mesaba 1 LLC's representative stated:

> We've made a proposal in the power purchase agreement, and we're working with Xcel to make sure we all understand what our proposal is. And I will commit to you that by the time it comes back from the contested case proceeding, that issue will be fleshed out and there will be, I'm very hopeful, agreed-upon scenarios where we will say if X happens, here's

This is plain from the statute's requirement that any least-cost analysis of IGCC technology must include the costs of ancillary services, generation, and transmission necessary for the operation of the proposed facility. Minn. Stat. § 216B.1693(a). None of the generic studies or other estimates of generic IGCC plant costs advanced by Mesaba 1 LLC include these plant-specific costs. Nor do these studies include the costs arising from the specific terms and conditions of the Mesaba 1 PPA. Therefore these studies and estimates cannot be a sufficient basis upon which to make the least-cost resource determination required under the statute.[7]

In addition, the statute requires IGCC technology to be compared to "other traditional technologies," not just coal technologies. Minn. Stat. § 216B.1693(c). Comparisons to the actual costs of other technologies such as nuclear and hydro power, as well as to SCPC, Ultra SCPC,[8] Circulating Fluidized Bed, and other coal power, are appropriate in making the least-cost resource determination under the statute.[9] XE-2023 at 8-9, 12. Thus, Mesaba 1 LLC's reliance only on generic studies of hypothetical IGCC and SCPC costs does not satisfy the burden of proof.

> what the cost of power will be; if Y happens, here's what the cost of power will be, because obviously you need to know that.

Id. at 19, lines 11-20.

[7] Mesaba 1 LLC relies extensively on the generic comparisons of its choice. Yet when generic comparisons are not to its advantage, Mesaba 1 LLC agrees that comparisons to generic facilities are not relevant to the ALJs' determination in this case. *E.g.*, Mesaba 1 Proposed Findings at ¶ 288 (discussing comparisons of Mesaba Unit 1 to the Environmental Protection Agency's generic facilities data and stating "[q]uite simply, the 'generic' facilities are conceptual ideas that may or may not ever exist."); *see also id.* at ¶ 97 (for the first time suggesting that Big Stone II may not even be a "traditional technology" for comparison purposes).

[8] MPCA-8000, Attached Report at 1 ("Supercritical and ultra-supercritical PC represents the latest versions of traditional coal-fired electric generating technologies."(Emphasis added).).

[9] Mesaba 1 LLC has objected to comparing the costs of its greenfield IGCC plant to the actual costs of adding a comparable coal plant at a brownfield site. EE-1122 at 41-42. Mr. Bodmer testified that "[t]aken to the extreme, the comparison of expansion sites to first units would lead to every new plant being built at the same site- ultimately there would be twenty plants at Big Stone and fifteen at

2. *No Presumption That Statute Has Been Satisfied*

Mesaba 1 LLC claims that whether it is an innovative energy project is not at issue in this case. According to Mesaba 1 LLC, this was decided by the Commission in Docket No. E002/M-03-1883, where it was determined that Mesaba 1 LLC was eligible for a $10,000,000 grant from the Renewable Development Fund because "there was little doubt that the Mesaba project meets the statutory definition of an innovative energy project." Mesaba 1 Br. at 10. The Commission recognized, however, that the burden always remains on Mesaba 1 LLC to establish that it has maintained the required statutory status.[10] The Commission Order recognizes that while an entity could initially satisfy the definition, circumstances could change and therefore Mesaba 1 LLC must show it continues to meet the criteria.

Thus, it is appropriate for the ALJs to determine whether Mesaba 1 LLC satisfies all of the requirements of an innovative energy project. If the record shows, for example, that Mesaba Unit 1 does <u>not</u> significantly reduce each of the emissions (*e.g.*, MPCA 8001) or does not satisfy an essential element, the Commission retains authority to determine that Mesaba 1 LLC is not now an innovative energy project.

Mesaba 1 LLC also contends that the question of whether its project is capable of offering a long-term supply contract at a hedged, predictable price should not be considered. Mesaba 1 LLC argues that its self-certification to that effect is all that is required under the statute, thus ending the matter. Mesaba 1 Proposed Findings at

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Sherco."). This position ignores the "likely" cost of alternatives by both creating an unreal comparison to a coal plant and ignoring Xcel Energy's actual alternatives. *See* DOC-3018 at 20-21.

[10] Before ordering that the grant be made, the Commission required Mesaba 1 LLC to submit "evidence that [it] continues to meet the criteria set forth in Minn. Stat. § 216B.1694, subd. 1, [defining an innovative energy project]." *In the Matter of the Request of Northern States Power Company d/b/a Xcel Energy for Approval of Selected Projects for the Second Funding Cycle of the Renewable Development Fund*, Docket No. E002/M-03-1883, Order Approving and Directing Fund Expenditures, Giving Guidance on the Treatment of Innovative Energy Project, Requiring Consultative Process, and Requiring Compliance Filings at Ordering ¶ 1(d) (Feb. 23, 2005).

44-45, ¶¶ 100-02. Mesaba 1 LLC claims this outcome is similar to the ALJs' interpretation of another provision of the Innovative Energy Project statute, dealing with the designation of an innovative energy project by the Iron Range Resources and Rehabilitation Board ("IRRRB"). *See id.* at ¶¶ 100-01.

The two provisions present very different issues. With respect to the IRRRB's designation, the ALJs concluded they lacked jurisdiction to adjudicate the validity of the IRRRB designation or to collaterally attack the findings of another State actor. Order on [MCGP's] Motion for Summary Disposition, Memorandum at 4-5 (Oct. 25, 2006). As such, the ALJs found that without specific legislation they lacked the authority to second-guess or collaterally attack that administrative decision.

Mesaba 1 LLC, on the other hand, is a private party that has petitioned the Commission for review and approval of its proposed PPA as specifically provided by statute, and bears the burden of proving the claims in its Petition in all respects. The Commission has referred this matter to the ALJs to develop the record for the Commission's adjudication of whether the proposed PPA meets the statutory requirements. The ALJs therefore have specific authority to adjudicate Mesaba 1 LLC's claim that it is an innovative energy project, including the claim that the project provides power at a hedged and predictable price.[11] Unlike with the IRRRB, the ALJs have plenary jurisdiction over Mesaba 1 LLC to assess the validity and accuracy of its claims.[12] To suggest that the ALJs are foreclosed from examining the validity of Mesaba 1 LLC's self-certification of a hedged, predictable price is tantamount to

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[11] As was discussed in our initial brief, Mesaba 1 LLC is incapable of providing a hedged, predictable price. Xcel Energy Br. at 22-25.

[12] A certification, like an affidavit, must still accurately state the facts and it is appropriate to review the certification to determine whether it is supported by the underlying facts. *See Conlin v. City of St. Paul*, 605 N.W.2d 396, 402-03 (Minn. 2000) (affidavits that lack a factual basis and are conclusory in nature may not be considered); *see also In re Mack*, 519 N.W.2d 900 (Minn. 1994) (attorney's false self-certification of books and records was subject to review and sanction).

eliminating the Commission's public interest authority, contrary to Section 216B.1694, subd. 2(a)(7). This interpretation cannot be sustained.

B. Public Interest Test

Mesaba 1 LLC argues that the public interest test is limited exclusively to the five factors listed in subdivision 2(a)(7) of the Innovative Energy Project statute. Mesaba 1 Br. at 11-12. As already discussed in our initial brief, that statute states only that the Commission make its public interest determination "taking into consideration" the five statutory factors. It does not limit consideration to those factors alone. Without limiting language, other factors may be considered.[13]

This statutory language identifying the five factors to be included in the Commission's consideration is nearly identical to the language the Legislature used to identify the factors it wanted to be considered in the Commission's public interest determination under Minn. Stat. § 216B.50 (regulated property transfers). *See* Manitoba Hydro Br. at 8 n.14. Section 216B.50 provides that "the commission shall take into consideration the reasonable value of the property, plant, or securities to be acquired or disposed of, or merged and consolidated" when making its public interest determination. (Emphasis added.) This standard is, likewise, not exclusive and the Commission routinely makes public interest determinations under Minn. Stat. § 216B.50 that involve factors beyond the statutorily-identified "value of property" factor. *Id.* In fact, under Section 216B.50, the Commission retains broad authority to ensure that the requested action satisfies the public interest standard.[14]

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[13] *Vlahos*, 676 N.W.2d at 681 (courts may not insert into a statute words that were purposely or inadvertently left out).

[14] *In the Matter of the Joint Application for Approval and Consent of Interstate Power and Light Company et al.*, MPUC Docket No. E-001/PA-05-1272, Order Approving Sale and Transfer of Ownership Interest in the Duane Arnold Energy Center with Conditions (January 25, 2006) ("*Duane Arnold Energy Center Order*") (finding that utility's initial proposal to sell a baseload generation plant was not consistent with the public interest because it exposed ratepayers to the risk that replacement energy would be more expensive and subject to price volatility, and therefore imposing conditions on the utility's base

Thus, the Commission's long-established public interest criteria for analyzing power purchase agreements is not replaced or overridden by the five statutory factors that are to be "taken into consideration."[15] Rather, the Commission's broad public interest inquiry is merely supplemented by additional considerations. That test involves determining whether: (1) operational risks; (2) financial risks; and (3) the purchase price; are reasonable when considered in combination with other socioeconomic factors (such as the five statutory considerations). *See* DOC-3000 at 8.

In its proposed conclusions of law, Mesaba 1 LLC also asserts that it bears no burden to show that requiring Xcel Energy to take a minimum of two-percent of its Minnesota retail energy needs under the Mesaba 1 PPA is in the public interest. Mesaba 1 Proposed Findings at 305, ¶ 6. To the extent Mesaba 1 LLC is claiming the burden is on some other party, this is an incorrect reading of the applicable law. *See* Minn. R. 1400.7300, subp. 5. To the extent it is asserting that the "not contrary to the public interest" burden of the Clean Energy Technology statute is different than the Innovative Energy Project statute's "in the public interest" burden, Mesaba 1 LLC is incorrect. *See* Xcel Energy Statement of the Case at 1 n.2 (observing there is no practical difference in these two standards). Both of these statutes require the

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rates and fuel recovery to make the sale meet the public interest test). The Commission's consideration here went far beyond only consideration of the value of property to be transferred.

[15] It is not uncommon for a regulatory agency to look beyond specific statutes while performing its duty to protect the public's interest. *See, e.g., St. Joseph's Hosp. v. Commissioner of Health et al.*, 379 A.2d 467, 471-72 (N.J. 1977)(statute governing issuance of certificates of need for cardiac surgery programs must be administered by Agency consistent with its charge to protect the public interest); *see also American Pilots' Ass'n v. Gracey*, 631 F. Supp. 827, 831 (D. D.C. 1986)(in maritime context court determined Coast Guard has plenary authority to "properly consider goals other than those specified in [the statute]" including a cost/benefit analysis to determine whether its action will promote the public's interest); *Pacific Shrimp Co. v. U.S. Dept. of Trans.*, 375 F Supp. 1036, 1042 (D. Wash. 1042)("[a]n administrative agency charged with protecting the public interest, is not precluded from taking appropriate action" even when the agency had not previously acted); *Cf.* William N. Eskridge, NO FRILLS TEXTUALISM, 119 Harv. L. Rev. 2041 (2006)(discussing different views of statutory interpretation and stating "[i]f agencies are captured by special interests, agency interpretations are unlikely to reflect the larger public interest upon which regulatory statutes are grounded.") As in these other contexts, the Commission has broad authority to consider all factors relevant to the public interest.

Commission to make an affirmative finding about the public interest of the proposed contract. As the proponent, Mesaba 1 LLC has the burden to prove its case to obtain such a finding. Thus while the language of the two statutes differ, their legal effect is substantially similar and it remains Mesaba 1 LLC's obligation to prove its case.

The Commission has significant experience with applying standards of this type. For example under Minn. Stat. § 216B.50, the Commission is charged with determining whether specified property transfers are "consistent" with the public interest. The Commission has found that this closely analogous standard still requires that the proponent affirmatively prove that the standard is satisfied.[16]

C. No Mandate

1. *Xcel Energy's Need for Power vs. Certificate of Need for Facility*

Mesaba 1 LLC argues that an innovative energy project's exemption under Minn. Stat. § 216B.1694, subd. 2(a)(1) from the certificate of need requirement for the construction of its plant somehow precludes consideration of Xcel Energy's need for the power from that plant. Mesaba 1 Br. at 41-45 (citing Minn. Stat. §216B.1694, subd. 2(a)(1)). This claim was already addressed in Xcel Energy's initial brief.[17] The statute exempts an innovative energy project from obtaining a certificate of need prior to construction of the plant. That exemption does not address whether a utility can be compelled to buy the output if it has no need for the power. The statute does not preclude consideration of whether the power to be purchased is actually needed.

In fact, pursuant to Minn. Stat. § 216B.1694, subd. 2(a)(5), Mesaba 1 LLC is free to sell its power to any utility. Thus the exemption from the certificate of need requirement provides an innovative energy project with the broad advantage of being

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[16] *Duane Arnold Energy Center Order, supra* n.12, at 4 (noting that utility had failed in its initial filing "to meet its burden to demonstrate that the proposed [sale of a baseload generation plant] is consistent with the public interest").

[17] Xcel Energy Br. at 22; *see also* Environmental Intervenors Br. at 6; Manitoba Hydro Br. at 8; and Chamber Br. at 3.

able to build a plant and sell the output potentially to many buyers without first establishing need for the plant. (In other words, Mesaba 1 LLC is able to avoid a proceeding like the currently pending Big Stone II Certificate of Need proceeding.) But this statutory exemption cannot be read as permitting Mesaba 1 LLC to compel a utility to purchase from such a facility. If the ALJs were to take Mesaba 1 LLC's interpretation to its limit, the statute would allow utilities unrestrained ability to purchase as much Mesaba 1 LLC power as they want without regard to whether the Commission has determined they actually need the power. This would not be in the public interest. Certainly, if the Legislature had intended this result it would have said so rather than rely on the circuitous arguments presented in Mesaba 1 LLC's brief.

Indeed the Innovative Energy Project statute specifically requires a broad public interest inquiry, which necessarily involves considering the cost to be incurred under the power purchase agreement. Consideration of the cost incurred correspondingly requires analysis of whether that cost is reasonable in light of the ratepayers' need (or lack of need) for the power purchased. *See also* Minn. Stat. § 216B.1693 (explicitly requiring the resource – here, the Mesaba 1 PPA – to be or likely be a "least-cost" resource). Obviously, a facility whose power is unneeded by the purchasing utility cannot be a 'least-cost' resource. Xcel Energy's need for the power it would be required to take under the Mesaba 1 PPA is central to the public interest and least-cost determinations that are required by statute.

2. *Requirement of a Voluntary "Contract"*

Mesaba 1 LLC treats as undisputed its assertion that Xcel Energy is mandated to acquiesce to the Mesaba 1 PPA. *See* Mesaba 1 Br. at 1, 7, 8, 29, 33, and 35. As already pointed out in Xcel Energy's initial brief, this argument misreads the statutes; the two statutes preclude a finding that a statutory mandate exists.

The Innovative Energy Project statute provides that an innovative energy project "shall be <u>entitled to enter into a contract</u> with a public utility …." Minn. Stat.

§ 216B.1694(2)(7) (emphasis added). By its plain terms, this provision states what Mesaba 1 LLC is "entitled" to do: enter into a contract. It does not place any reciprocal obligation on Xcel Energy to acquiesce to any proposal regardless of the circumstances. In other words, an innovative energy project's entitlement to enter into a contract does not mean that the counterparty is mandated or compelled to accept any proposal advanced against it and its customers' interests. This statutory language means, rather, that upon the parties mutually agreeing to a contract, Mesaba 1 LLC is entitled to approval of the contract if it satisfies the public interest test.

"Entitling" Mesaba 1 LLC to "enter into a contract" does not remove the essential elements of offer, acceptance and consideration that underlie any voluntary agreement, which is generally achieved through commercial negotiation.[18] Indeed, by this statutory language the Legislature was merely expediting a consensual project by eliminating any other regulatory requirements that could impede or delay implementation of a "contract," such as the Commission's competitive bidding requirements, consistent with the Legislature's elimination of the certificate of need requirement. This language cannot be interpreted to create a mandate.

The statutory language specifically provides that the Commission has authority to review and then approve, disapprove, amend, or modify "the contract," which perforce means that the Legislature contemplated that a contract exists for the Commission to consider. Here there is no "contract" between two mutually agreeing parties, but rather a unilateral proposal being forwarded by one party to be imposed on the other.[19] Absent language that plainly mandates that Xcel Energy enter into a

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[18] Prior to the commencement of this proceeding, Xcel Energy and Mesaba 1 LLC engaged in exploratory negotiations for a contract. All aspects of those negotiations (other than the fact that the negotiations occurred) are subject to a separate confidentiality agreement; it would be a violation of that agreement for either party to disclose the substance or characterize the extent or outcome of those negotiations.

[19] *See Bowie v. La. Pub. Serv. Comm'n*, 627 So.2d 164, 169 (La. 1993) (where state regulations infringed on utility stock holders' rights to contract, the regulations had to be strictly construed to apply only

unilaterally proposed "contract" against its will, there is no statutory authority to compel Xcel Energy to enter into a contract involuntarily with Mesaba 1 LLC.

3. PURPA Analysis Supports Xcel Energy

Mesaba 1 LLC relies on the Public Utility Regulatory Policy Act ("PURPA") in asserting that the Minnesota statutes create a mandate for Xcel Energy. *See* Mesaba 1 Br. at 8, n. 20; Mesaba 1 Proposed Findings at ¶ 58. PURPA is readily distinguishable and actually supports finding no mandate under the Minnesota statutes.

First, PURPA uses the phrase "legally enforceable obligation" when it describes the utility's obligation to purchase. This statutory obligation directed toward the purchasing utility creates a far stronger standard than the "entitled to enter into a contract" language directed toward the power seller in Section 216B.1694, subd. 2(a)(7).[20] No obligation to purchase is found under the Innovative Energy Technology statute.[21]

Second, while the legally enforceable obligation language under PURPA specifically creates obligations on the purchasing utility, even that statute has not been treated as a blanket federal mandate or an unlimited right to force utilities to buy

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where warranted by the regulations' language); *see, e.g., In re Minnegasco*, 556 N.W.2d 607, 609 (Minn. Ct. App. 1996), *rev'd on other grounds*, 565 N.W.2d 706 (Minn. 1997) (finding Commission lacked authority to require utility to dedicate utility property to benefit of ratepayers); *Peoples Natural Gas Co. v. Minn. Pub. Utils. Comm'n*, 369 N.W.2d 530, 535 (Minn. 1985) (finding that where there was no express authority for the MPUC to order a regulated utility to refund monies, "[it] is not the kind of agency authority that can or should be implied in the absence of more explicit legislative action.").

[20] *Compare* Minn. Stat. §§ 216B.2423 and 216B.2424 (mandates specifically detailing Xcel Energy's obligation to purchase biomass and wind power).

[21] Even under PURPA, it cannot be assumed that any proposal triggers a legally enforceable obligation to purchase, or that a generator may compel unacceptable contract terms. *Smith Cogeneration Management, Inc. v. Corp. Comm'n,* 863 P.2d 1227, 1232 (Okla. 1993)(confirming that the purchasing utility is not compelled to pay for capacity it does not need and stating "we find nothing in PURPA which entitled Smith to have avoided costs fixed for the life of the proposed power sales agreement" where no need for the capacity was shown.)

power at excessive prices or on unacceptable terms.[22] Protracted Texas litigation (in both state and federal court[23]) on the scope of PURPA's legally enforceable obligation language is instructive.[24] In these cases, the plaintiff, who was proposing a qualifying facility or "QF," under PURPA sought a power purchase agreement and demanded specific terms that would make it easier to finance the facility.[25] The state court held that the utility was not required to acquiesce to the proposed terms and rather held the parties to the requirements of the PURPA statutes.[26] In federal court the generator argued that a legally enforceable obligation meant that it was entitled to the contract of its choice on terms of its choosing and an outcome that assured success.[27] This second attempt was equally unsuccessful; a legally enforceable obligation does

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[22] In *Public Service Co. of Ok v. State ex rel. Oklahoma,* 115 P.3d 861 (Okla. 2005) the Court observed under PURPA that "the creation of a legally enforceable obligation is not governed by the common law of contracts. It is a concept created by federal and state statutes, regulations and administrative rules. It is clear from these sources that electric utilities need not be willing participants in the creation of a legally enforceable obligation. Rather, a utility's obligation to purchase power is imposed by law." *Id.* at 872-73 (citing *Snow Mountain Pine Co. v. Maudlin*, 734 P.2d 1366, 1370 (1987)); *See* 45 Fed.Reg. 12215 (1980).

[23] *See Power Res. Group Inc. v. Pub. Util. Comm'n of Tex.*, 73 S.W.3d 354, 358-59 (Tex Ct. App. 2002) (finding that Congress did not intend PURPA to create a risk-free environment that "requires" a utility to contract regardless of circumstances); *Power Resource Group, Inc. v. Public Utility Comm'n of Texas,* 422 F.3d 231, 238 (5th Cir. 2005) (analyzing PURPA's legally enforceable obligation language and finding that states have broad latitude to implement that requirement).

[24] *See e.g., Smith Cogeneration Mgmt., Inc. v. Corp. Comm'n*, 863 P.2d 1227, 1232 (Okla. 2005)(recognizing that only a viable project can incur a legally enforceable obligation).

[25] *Power Res. Group Inc.*, 73 S.W.3d at 357; *Power Resource Group, Inc.,* 422 F.3d at 232-33. In between stops at the state and federal courts, Power Resource Group also filed an action with the Federal Energy Regulatory Commission (FERC), but the agency did not respond. *Power Resource Group, Inc.,* 422 F.3d at 234.

[26] *See Power Res. Group Inc.*, 73 S.W.3d at 358-59 (finding that Congress did not intend PURPA to create a risk-free environment that "requires" a utility to contract regardless of circumstances).

[27] *Power Resource Group, Inc.,* 422 F.3d at 233-34.

not mandate a contract at any cost and on any terms.[28] Thus, Mesaba 1 LLC's reliance on PURPA is misplaced. No comparable language or "legally enforceable obligation" exists under either Minn. Stat. §§ 216B.1694 or 216B.1693 and the Commission retains broad latitude in implementing these statutes.

III. RESPONSE TO FACTUAL DISCUSSION

Mesaba 1 LLC devotes a considerable portion of its brief comparing the generic costs of a hypothetical IGCC plant to those of a hypothetical SCPC plant. Mesaba 1 Br. at 12-29. This discussion concludes that IGCC technology may someday ultimately be lower cost than SCPC technology. *Id.* This argument misses the fundamental point of this proceeding: this case is not about a hypothetical IGCC plant and it is not about a hypothetical, comparable SCPC plant. The focus of this case remains on the 603-MW Mesaba 1 PPA and whether it is in the public interest.

A. Mesaba 1 PPA Terms are Critical

What is determinative here is the cost of power under the Mesaba 1 PPA, the risks that ratepayers bear, and the ramifications of the contract. As described throughout this proceeding, the cost of the Mesaba 1 PPA is currently unknown and uncapped and many of those costs will be incurred without prudence review or

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[28] *Power Resource Group, Inc.*, 422 F.3d at 238. Here, the Fifth Circuit analyzed PURPA's legally enforceable obligation language and found that states have broad latitude to implement that requirement. This court recognized that even under this language, qualifying facilities are not entitled to impose unacceptable terms on an unwilling utility. *Compare Armco Advanced Materials Corp. v. Pa. Pub. Util. Comm'n*, 135 Pa.Cmwlth. 15, 579 A.2d 1337 (1990) (holding that a Legally Enforceable Obligation arises under Pennsylvania law when the QF commits to delivering energy, not at the time of "serious negotiations"), *Snow Mountain Pine Co. v. Maudlin*, 734 P.2d 1366, 1371 (Or. 1987) (applying Oregon law), A.*W. Brown Co., Inc. v. Idaho Power Co.*, 121 Idaho 812, 828 P.2d 841 (1992) (applying Idaho law), and N.*H. Pub. Util. Comm'n*, 130 N.H. 285, 539 A.2d 275 (1988) (applying New Hampshire law), *with Mid-South Cogeneration, Inc. v. Tenn. Valley Auth.*, 926 F.Supp. 1327 (E.D.Tenn.1996) (finding no legally enforceable obligation arose under Tennessee law), and *S. River Power Partners, L.P. v. Pa. Pub. Util. Comm'n*, 696 A.2d 926, 932 (Pa. Cmwlth. 1997) (holding no legally enforceable obligation arose under liberal Pennsylvania standard).

meaningful contractual penalties. What is known is that whatever the costs of Mesaba Unit 1 prove to be, all of them will be passed through to Xcel Energy's ratepayers.[29]

Mesaba 1 LLC claims that its cost analysis prior to entering into an EPC contract will be an "open-book exercise," and that all substantial components of the plant construction will be put out for bid to subcontractors allowing "the Department, Xcel Energy, and the Commission to have detailed oversight over the final costs of the Project." Mesaba 1 Br. at 32. However there are no terms in the Mesaba 1 PPA providing for any "oversight" (much less prescriptive control or prudence review) of the plant's construction costs by anyone other than Mesaba 1 LLC and its chosen contractor. *See* EE-1039 at 21-22. ("The contract itself essentially sets the prudency standard," thereby precluding prescriptive regulatory oversight).

1. *Commercially Unreasonable Costs and Risks.*

The Mesaba 1 PPA contains numerous terms that shift financial and operational risks to Xcel Energy's ratepayers that are not in the public interest:

- There is no fixed Capacity Price prior to Commission approval of the Mesaba 1 PPA, and the contract may incorporate whatever costs Mesaba 1 LLC certifies as included regardless of level or prudence. Mesaba 1 Br. at 32; EE-1024, Schedule 1. The contract does not limit cost categories.

- The Mesaba 1 PPA costs are not subject to competitive bidding, cost caps, or prudence review under the PPA. Once the PPA is approved, the Commission will lack jurisdiction over Mesaba 1 LLC and the prudence of its implementation of the contract. EE-1039 at 21-22.

- Transmission costs and increases in the cost of capital will also be incorporated into the Capacity Price without risk to the project owners. Mesaba 1 Br. at 32; EE-1024, Schedule I.

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[29] As described in Mesaba 1 LLC's own financial review document (XE 2003, Schedule 2 at 9 of 24) the Mesaba 1 PPA provides substantial assurances that mitigate the risk of the project owners, shifting them to Xcel Energy and ratepayers. The relevant quote from this exhibit is set forth in Trade Secret Reply Attachment 1.

- Both fixed and variable O&M costs are subject to upward adjustment for inflation throughout the plant construction period and the life of the Mesaba 1 PPA thereafter. EE-1024 at 30 (Articles 8.2) and 31 (Article 8.4).[30] In addition, Mesaba 1 LLC may require Xcel Energy to renegotiate those costs after the first five years of Mesaba Unit 1's operation. EE-1024 at 38 (Article 10.9) and at 46 (Article 12.9).

- Xcel Energy and its ratepayers bear all the risk of Mesaba 1 LLC's fuel purchases. EE-1024 at 31 (Article 8.3); *Id.* at 37 (Article 10.5(C)). Even if these costs flow through the fuel clause and are subject to prudence review, Xcel Energy must reimburse Mesaba 1 LLC even for imprudent costs. EE-1024 at 31 (Article 8.3).

- Mesaba 1 LLC has assumed a fuel mix for Mesaba Unit 1 of 75% coal and 25% petroleum coke. EE-1020 at 117. There is no commitment or obligation in the Mesaba 1 PPA, however, that any particular mix will be used. EE-1024 at 26 (Article 5.5) and 37 (Article 10.5(C)). There are also no limits in the Mesaba 1 PPA on the cost of the fuel mix.

- The Mesaba 1 PPA provides no efficiency commitments (e.g., heat rate guarantees) to ensure that Mesaba Unit 1 runs at maximum efficiency on each type of fuel. XE-2005 at 20; XE-2009 at 12; XE-2016 at 16. This means that the risk that the fuel mix may result in plant inefficiency is borne by Xcel Energy and its ratepayers. *Id.*

- Running Mesaba Unit 1 on natural gas will result in the plant's capacity being reduced by 17%, from 603 MW to 503 MW. XE-2019 at 13-14 & n.3; EE-1024, Exhibit G at 3 (net capacity on natural gas is 503,000 kW versus 603,000 kW on coal). The Mesaba 1 PPA makes no adjustment in the Capacity Price to reflect this lost capacity. XE-2019 at 13-14.

- Mesaba 1 LLC does not have any fuel or fuel delivery contracts in place, nor does it intend to negotiate fuel arrangements until 2009-2010. EE-1208. Any risks associated with fuel pricing and unavailability is shifted to Xcel Energy.

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[30] This inflation adjustment is discussed in Xcel Energy Findings at ¶¶ 26 and 56. Those proposed findings correctly stated that all O&M costs are adjusted each year until the plant begins commercial operation, but then state that the inflation adjustment continues for each of the next five years. *Id.* In fact, all O&M costs continue to be adjusted each year thereafter for the duration of the PPA, as noted above. Xcel Energy suggests that the ALJs clarify these paragraphs to reflect that the inflation adjustment continues through the term of the contract.

- Mesaba 1 LLC can run on natural gas for up to four hours without notice. EE-1024 at 27 (Article 6.1). Thus the costs associated with the risk that Mesaba Unit 1 will not perform on solid fuel as advertised, and be uneconomic to dispatch, are shifted to ratepayers.

- Allowing Mesaba 1 LLC to switch to natural gas without notice will create problems and costs for managing fuel supply. XE-2006 at 21.

- Mesaba 1 LLC has proposed a revised adjustment to the Capacity Price formula when Mesaba Unit 1 runs on natural gas. Mesaba 1 Br. at 31; Mesaba 1 Proposed Findings at ¶ 584; EE-1062 at 4-7; Xcel Energy Findings at ¶ 25. But even with this revised formula, Mesaba Unit 1 can be run nearly 50% of the time on gas and Xcel Energy is still required to pay 70% of the Capacity Price.[31] EE-1062 at 6-7; Xcel Energy Findings at ¶ 55.

- In the event that Mesaba Unit 1's commercial operation date is delayed, the Mesaba 1 PPA specifically provides that Mesaba 1 LLC is not responsible for Xcel Energy's replacement power costs. EE-1024 at 44 (Article 11.10).

- In the event that Mesaba 1 LLC runs into financial difficulties, the Mesaba 1 PPA does not have the provisions found in other power purchase agreements to protect the buyer in these circumstances, such as a security fund, a subordinated lien, or step-in rights. XE-2006 at 28; DOC-3010 at 17-18; EE-1024 at 43 (Article 11.6).

2. *Inconsistent Arguments*

Mesaba 1 LLC simultaneously argues that (i) the newness of the technology justifies these open-ended contract terms (EE-1039 at 5; EE-1138 at 2-3; Mesaba 1 Proposed Findings at ¶ 522, 532); and (ii) these terms are comparable to other Xcel Energy power purchase agreements like Calpine Mankato (EE-1147 at 8-11). These inconsistent positions underscore major concerns about the Mesaba 1 PPA – that it is

[31] This revised formula highlights that Mesaba 1 LLC's attempts to "negotiate" problematic terms in this contested case do not provide a "sound basis for the ALJs' recommendations and Commission's actions in this matter." Mesaba 1 Br. at 29-30. To the contrary, negotiation through litigation is inefficient and ineffective. XE-2008 at 9; Xcel Energy Br. at 11-12.

inconsistent with industry norms for power purchase agreements and that it is not an appropriate allocation of risks for a new technology.

a. Comparison with other Contracts

First, it is incorrect for Mesaba 1 LLC to suggest that the terms of the Mesaba 1 PPA are comparable to those of other Xcel Energy contracts. As depicted in the charts reproduced in Trade Secret Reply Attachment 1, numerous material differences exist. XE-2006, Schedule 3 at 1 of 1; XE-2008 at 12 (comparing Mesaba 1 PPA to Calpine/Mankato); *see also* XE-2006 at 23 and Schedule 3 (comparing Mesaba 1 PPA to biomass PPAs and concluding that "Mesaba 1 PPA's [pass-through clause] is the most inclusive to date"). The record supports a finding that the terms and conditions of the Mesaba 1 PPA are materially different than those of other power purchase agreements and that those differences shift material, additional risks to ratepayers.

b. New Technology Underscores Risks

Second, the newness of the IGCC technology does not justify ignoring material ratepayer protections. XE-2017 at 17-19. As Mr. Reed testified, it is not "appropriate from either a power supply perspective or a public policy perspective to promote one particular project through a PPA that provides out-of-market subsidies to the seller and imposes extraordinary costs and risks on a single utility and its customers." *Id.* at 17. Instead, ratepayers have traditionally been protected from the risks associated with new technology by developers partnering with other project participants to assume the associated developmental risk. *Id.* at 18-19.[32]

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[32] Mesaba 1 LLC asserts that "[t]he fact that IGCC is at the beginning of a long road of continuous improvement through learning curve improvements provide [sic] ratepayers with value not offered by boiler technologies such as SCPC, which is a mature technology that has limited ability to adapt to ever-tightening emission limits." Mesaba 1 Br. at 18. The "learning curve" required for a 603 MW IGCC baseload plant to succeed presents significant risks for Xcel Energy and its ratepayers that must be accounted for in the contract in order to ensure adequate protection.

These risks are meaningful. The coal feed system and gasifier of Mesaba Unit 1 are going to be scaled up about 50% from current IGCC facilities, and in contrast to the two existing IGCC units in the U.S. with established performance profiles, Mesaba Unit 1 is to run on sub-bituminous rather than bituminous coal. There is no question that scale up of the new technology creates an element of operating risk. Minnesota Power Br. at 9. Indeed, the EPA reported recently "that little research or commercial work has been done to investigate the gasification of low rank coals, including subbituminous" coal, and the public utility AEP (who has committed to two IGCC plants using bituminous coal) has stated that it is not comfortable building an IGCC plant the size of Mesaba Unit 1 using sub-bituminous coal. *Id.* at 10.

Given these performance concerns over Mesaba Unit 1's proposed use of sub-bituminous coal, the fuel mix and fuel cost risks borne by Xcel Energy and its ratepayers under the Mesaba 1 PPA are inappropriate. These risks should more appropriately be borne by their developers and promoters, who have the incentive and the ability to aggressively manage them. *See* XE-2016 at 17-19; XE-2019 at 8-10.

c. Importance of Contract Oversight

Since the Commission will not have prescriptive regulatory jurisdiction over the power seller under this contract, it is important that the Commission be satisfied that the Mesaba 1 PPA provides adequate contractual protections. As described in the record, the risk shifts found throughout Mesaba 1 PPA provide only a weak link between project performance and contractual remedies. XE-2005 at 3.

Stated good intentions to properly undertake the project development do not resolve these concerns. Rather this is an issue of prudent contract implementation and administration for Xcel Energy and the Commission. The Mesaba 1 PPA does not provide meaningful remedies if Mesaba 1 LLC or any subsequent owner fails to perform properly. The Mesaba 1 PPA does not limit the types and extent of costs

that can be included in the EPC Contract. The Mesaba 1 PPA does not provide for Commission oversight if the plant does not perform as described by Mesaba 1 LLC.

This absence of contract covenants is problematic since the Mesaba 1 PPA provides extensive rights allowing the current owners to sell their interest in the plant. EE-1024 at 55-56 (Article 18.3). In fact, Mesaba 1 LLC has signaled its intent to sell a large equity stake in this project. XE-2055. Thus it is important that the contract contain safeguards that will allow the proper administration of the relationship even when new owners have been substituted who have no tie to this proceeding.[33]

3. Transmission Costs

Mesaba 1 LLC recently added three MISO reports as exhibits. *See* EE-1301, -1302, -1303. Exhibits EE-1302 and -1303 indicate MISO's findings that the interconnection requests for the West site (600 MW) and East site (531 MW) passed the new deliverability study which MISO recently instituted. *Id.*; XE-2027 at 3 ("MISO recently implemented new procedures for conducting the 'deliverability study' which focus more on localized issues").[34]

While MISO's revised deliverability study results appear to be a positive development, it does not eliminate concerns over the cost of the project.[35] The

[33] If the plant does not perform as petitioners expect, or encounters "scale up" problems, a contract like the one presented would lead to multiple and ongoing disputes, which would be costly and counterproductive. EE-1024 at 46-47 (Article 12.9) (dispute resolution).

[34] MISO had initially found that the interconnection requests made by Mesaba 1 LLC failed the deliverability study requirements in place at the time. XE-2025 at 6. As a result, the only way for NSP to obtain MAPP accreditation for the Mesaba 1 LLC resource was as a "Local Capacity Resource." See XE-2026 at 15. Subsequently, MISO changed the deliverability study procedures. XE-2027 at 3. Interconnection requests that had previously failed the deliverability study were allowed to request MISO to restudy their requests under the new revised deliverability study. Mesaba 1 LLC requested MISO to perform such a restudy and the results are that both sites passed at the MW indicated. *See* Exhibit EE-1302 and -1303.

[35] Mr. Sherner acknowledged: "[a]s Dr. Amit had pointed out earlier in his Direct Testimony at page 32, 'the overall cost of the project may not be significantly impacted by the inclusion or exclusion of transmission costs.' I agree with this assessment." EE-1081 at 12. In fact, by reducing the

upgrades referenced in these studies must be completed as a condition of granting the facility the right to deliver energy to the MISO system. *Id.* Thus if those upgrades are not completed or are delayed, the same delivery issues would be present. Additionally, this MISO finding is applicable only to the capacity levels studied. XE-2026 at 2-3. Only 531 MW has been studied for the East Range site, not the 598 MW proposed by Mesaba 1 LLC if Mesaba Unit 1 is located at that site. EE-1050 at 3. A new request and potentially new upgrades would be required to account for the additional 67 MW.[36] Finally, the projects continue to be subject to the substantial transmission upgrade costs to interconnect the facility. For the East Range site that is $73M (EE-1070 at 12) and for the West Range site the cost is $70M (EE-1070 at 12). Thus the ALJs should issue findings that the cost of transmission remain significant and will be borne by Xcel Energy's ratepayers under the Mesaba 1 PPA.

B. Lack of Carbon Sequestration

Mesaba 1 LLC concedes that the cost of IGCC technology is higher than other technologies. *See generally* Mesaba 1 Br. at 19-20; EE-1091 at 5-6. In fact, it is clear that the costs associated with the Mesaba 1 PPA are significantly higher than costs associated with comparable alternatives. Xcel Energy Br. at 15-20; Department Br. at 44 ("the costs of the PPA for all proposed sites and all considered load are much higher than the costs of Comparable Alternatives").

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transmission costs by $100 million "the PPA cost would change [by] less than 1% based upon Dr. Amit's calculation methodology." EE-1081 at 12.

[36] MISO's preliminary findings indicate that the estimated $233 million cost for transmission that both Xcel Energy and Mesaba 1 LLC agreed was reasonable may be too high. *See* Xcel Energy Findings at ¶¶ 35 and 63. Nevertheless, the cost premium for the Mesaba 1 PPA without accounting for transmission costs is still roughly $1.5 billion more than for our approved Resource Plan. *See id.* at ¶¶33-36. The Department calculates the cost premium for Mesaba Unit 1 without including the cost of transmission to be 31% to 44% over alternative coal resources. *See* DOC-3025 at 1, Table 1 (price for Mesaba Unit 1 without transmission ranges from $96 to $105 per MWh versus $73 per MWh for alternative SCPC resources (Big Stone and Sherco 4)). This calculation by the Department should replace that found in Xcel Energy Finding ¶ 40.

Deputy Commissioner Garvey, in his January 5, 2007 Policy Statement, suggested that the higher costs proposed in the Mesaba 1 PPA may be justified if Mesaba Unit 1 included technology to capture and sequester carbon. Garvey Policy Statement at 2-3. However, despite Mesaba 1 LLC's acknowledging that the "Enabling Legislation represents a statutory determination that in-state IGCC power generation" is necessary "to prepare the State for . . . new requirements relating to control of carbon dioxide emissions," Mesaba 1 LLC concedes that Mesaba Unit 1 will not include carbon sequestration equipment.[37] XE-2032 at 21-23; EE-1067 at 2. Absent sequestration, the high costs of the Mesaba 1 PPA are not justified. EE-1268.

C. Impacts to Xcel Energy's Credit and Other Indirect Impacts

Mesaba 1 LLC argues that indirect costs, such as those associated with the credit impact of the Mesaba 1 PPA, may not be considered in the Commission's public interest analysis. Mesaba 1 Br. at 33-40. To the contrary, the appropriate public interest analysis includes consideration of not only the Mesaba 1 PPA's direct costs but also its indirect costs such as the financial implications for Xcel Energy and its ratepayers as a result of negative impact on Xcel Energy's position in the financial market. Xcel Energy Br. at 35-36; Department's Br. at 36-37 (concluding the negative impact on Xcel Energy's financial health is a properly considered indirect cost).

Mesaba 1 LLC's argument that these factors be ignored directly contravenes Minnesota law. The range of factors to be considered by the Commission in a public interest analysis is very broad, and includes ratepayer impacts and the fiscal integrity of the utility.[38] *See also* Minn. Stat. §§ 216B.03 and 216B.16, subd. 6.

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[37] Mesaba 1 LLC does not plan to sequester carbon unless the Mesaba 1 PPA is modified to provide it additional compensation for the associated costs. EE-1068 at 2 (Mesaba 1 LLC must be "compensated a reasonable cost of capital for the necessary capital investments, and to be made whole on the other costs" of sequestration).

[38] The Minnesota Supreme Court has recognized that it is the Commission's responsibility "to balance the needs of the customers and the shareholders, the risk to the fiscal integrity of the utility ... [and] the prudence and reasonableness of the utility's actions" in making determinations under

Mesaba 1 LLC next argues that "in order for Xcel's argument about credit to have merit, Xcel would have to establish that the PPA negatively impacts its credit situation." Mesaba 1 Br. at 33. Xcel Energy did so, as discussed below. In addition, Xcel Energy specifically proposed a collaborative process to obtain a direct response from the credit rating agencies themselves by seeking (and submitting to the Commission) an advisory credit rating impact analysis from S&P and Moody's Investor Services. XE-2011 at 24-26; XE-2012 at 15-17. As described in Mr. Tyson's Surrebuttal testimony, XE-2012 at 15-17, the advisory credit rating process would have provided precisely the type of affirmative demonstration Mesaba 1 LLC points to in its brief. However, Mesaba 1 LLC declined that offer. EE-1059 at 2-4. Even after Mesaba 1 LLC's concerns were addressed (XE-2012 at 15-17), Mesaba 1 LLC has ignored that superior approach to assessing credit rating impacts.

As a result of the financial risk-shifting structure of the Mesaba 1 PPA, significant debt will be imputed to Xcel Energy, which will adversely affect its credit rating. Xcel Energy Br. at 19, 35-36; Department Br. at 36-37 (concluding that the PPA would harm ratepayers by a significant increase in Xcel Energy's cost of debt, cost of common equity and overall cost of capital).[39] Xcel Energy's Treasurer, George Tyson testified that "dealing with credit rating agencies and managing credit rating represents a substantial part of [his] responsibilities for Xcel Energy and its affiliates." XE-2012 at 15. He analyzed the Mesaba 1 PPA prices and terms and concluded that approval of "Mesaba Unit 1 PPA would cause Standard & Poor's ("S&P") to impute approximately $1.9 billion of additional debt into Xcel Energy's balance sheet" which "would be likely to cause significant credit rating downgrades-

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the provisions of the Public Utilities Act. *Matter of Request of Interstate Power Co.*, 574 N.W.2d 408, 413 (Minn. 1998).

[39] *Compare* EE-1147 at 11 (wherein Mr. Hamilton testifies that the Mesaba 1 PPA is consistent with other Xcel Energy PPAs that did not require consolidation, but then concedes that "if necessary, the Mesaba 1 PPA could be amended in a manner to ensure it would not [have to] be consolidated...").

possibly below investment grade- and the loss of market value of Xcel Energy's bonds and of the stock and bonds of XEI [Xcel Energy Inc.] without substantial additional equity investments and increased current revenue requirements." XE-2010 at 2, 26. As a result, a substantial infusion of nearly $1 billion of new equity would be required to maintain Xcel Energy's existing debt to total capital ratios. *Id.* at 23-24. John Reed, who also has extensive and recent experience in dealing with credit rating agencies in relation to large PPAs, confirmed that the Mesaba 1 PPA would cause a significant adverse reactions by credit rating agencies. XE-2018 at 21-28; XE-2019 at 14-18.

In contrast, Mesaba 1 LLC's witnesses lack a substantial foundation for their assertions. Ms. Meal's testimony is based solely on her interpretations of credit rating agency publications, and Mr. Gale's testimony is limited to discussion of PPAs in general, lacking any discussion of the specific terms of the Mesaba 1 PPA. Ms. Meal has not spoken with any credit rating agency during the past five years (XE-2068), and Mr. Gale's only conversations consisted of two one-hour meetings, which did not include Mesaba 1 PPA terms or prices.[40] XE-2064. Ms. Meal's and Mr. Gale's lack of meaningful experience with credit rating agencies illustrate that they lack the necessary expertise to opine on how credit agencies assess the financial risks that a singularly large power purchase agreement presents for a public utility.

Mesaba 1 LLC also argues that Xcel Energy has impeached its own witnesses because it has not yet disclosed these potential financial risks to investors in its SEC filings. Mesaba 1 Br. at 39-41. Xcel Energy has disclosed in its SEC filings that this proceeding is ongoing and that "NSP-Minnesota presented its assessment that the proposal…would impose substantial risks and costs for both customers and NSP-Minnesota." EE-1291. In the event that the Commission approves the Mesaba 1 PPA, Xcel Energy will assess whether the particular terms of the approval constitute a

[40] The venue and other factors suggest these were cursory discussions. (XE-2064).

material adverse event that would have to be reported by Xcel Energy in additional SEC filings.

D. Xcel Energy's Resource Plan

Mesaba 1 LLC's brief continues to challenge the Commission's finding that Xcel Energy has a baseload need of 375 MW in 2015, while also arguing that Xcel Energy artificially reduced its need for power. Mesaba 1 Br. at 41-55. Xcel Energy previously discussed that Mesaba 1 LLC is prohibited from collaterally attacking the Commission's need determination in our Resource Plan, and will not repeat it here.[41] *See* Xcel Energy Br. at 16-17. Likewise, Xcel Energy will not repeat that the utility's need for power (as established in the Resource Plan) is highly relevant to the Commission's public interest determination.

Given that Xcel Energy's need for base load power (375 MW in 2015) has already been established, the Strategist modeling proffered in this case was not a "need analysis" as Mesaba 1 LLC contends, let alone a need analysis that was precluded by the Clean Energy Technology statute. *See* Mesaba 1 Br. at 43-44. Rather, the Strategist modeling was an analysis undertaken to determine whether the Mesaba 1 PPA is a least-cost resource relative to other resource options as required under the Clean Energy Technology statute, and whether its cost is reasonable and as such in the public interest as required under the Innovative Energy Project statute. The modeling showed that the Mesaba 1 PPA did not meet either statutory requirement. Xcel Energy Br. at 14-18, 36-37 (detailing that Xcel Energy system generation costs had a net present revenue requirement that was $1.5 billion higher

[41] Mesaba 1 LLC's suggestion that changes in Xcel Energy's need analyses indicate that those analyses are flawed has been specifically rejected by the Commission. *See* XE-2076 (finding that "analyzing future energy needs and preparing to meet them is not a static process; strategies for meeting future needs are always evolving in response to changes in actual conditions in the service area. When demographics, economics, or technologies change, so do resource needs ….")

with the Mesaba 1 PPA as a resource than our approved Resource Plan, even with environmental costs and high gas prices taken into consideration).

Rather than addressing each of the challenges to the validity of the Strategist modeling raised by Mesaba 1 LLC (*see* Mesaba 1 Br. at 46-51), Xcel Energy notes that the resource planning process requires careful analysis and "the kind of careful judgment that sharpens with exposure to the views of engaged and knowledgeable stakeholders." XE-2076 at 7. In the Resource Plan Docket, the Commission fully vetted all of the issues necessary for it to determine what Xcel Energy's resource need is and to provide a plan to satisfy that need. Xcel Energy additionally refers the ALJs to the Direct and Surrebuttal Testimony of Elizabeth Engelking which refutes the claims of modeling error raised by Mesaba 1 LLC.[42]

Mesaba 1 LLC argues the Strategist modeling indicates Xcel Energy has a baseload need from 2011 to 2015 which it plans to meet by increasing its use of natural gas. Mesaba 1 Br. at 33-34, 48, 45-46. Consistent with the Resource Plan Order and as demonstrated by Xcel Energy's January 2, 2007 filing in Docket No. E002/M-07-2, any baseload need that Xcel Energy may have prior to 2015 will be met with 390 MW of baseload power from the upgrades to the Sherco coal units, and Prairie Island and Monticello nuclear units. EE-1220. As the modeling in this proceeding shows, upgrading existing coal and nuclear units in accordance with our approved Resource Plan, rather than purchasing power from gas units or under the Mesaba 1 PPA, is the most cost effective way to increase baseload capacity on the Xcel Energy system. XE-2035 at 5-7.

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[42] Mesaba 1 LLC repeatedly complains that it did not understand how Strategist worked and now asserts it needed more information about Strategist in order to properly analyze it. Mesaba Br. at 48-49. Mesaba 1 LLC's lack of understanding of the modeling program does not mean the program is flawed or unreliable. Mesaba 1 LLC was free to ask for more information in discovery to assist its understanding, and to compel additional responses from the ALJs if it felt the responses were inadequate. It did not do so and discovery is now closed. *Order Denying MCGP'S Motion to Compel and Request for Sanctions*, Memorandum at 2-3 (Jan. 3, 2007).

IV. RESPONSE TO POLICY STATEMENT

The letter from Deputy Commissioner Edward Garvey (included with the Department's initial brief) provided a Policy Statement from the Department and invited parties to work on an alternative contract structure. Xcel Energy is open to pursuing negotiations, but believes they would be most constructive outside the context of litigation. Further, while the Department offers one approach and possible parameters; another approach would be to allow Mesaba 1 LLC to resolve the key uncertainties posed in this case.

Mesaba 1 LLC could complete the Front End Engineering and Design ("FEED") study for its proposed IGCC plant ("Mesaba Unit 1") to determine a fixed capacity price, and correspondingly provide a revised PPA eliminating the provisions that currently cause the proposal to be not in the public interest. EE-1039 at 20. The cost and timing of the FEED study is outlined in Trade Secret Reply Attachment 1 (page 3). At the same time, the Energy & Environmental Research Center ("EERC") could complete its carbon capture and sequestration plan for Mesaba 1 LLC such that carbon sequestration could be built into the proposal, increasing the environmental benefits. EE-1177 at 55-58.

Having specific information and proposals on those issues should allow Mesaba 1 LLC to propose a revised PPA that does not contain the troubling contract provisions discussed in this proceeding and would allow for a more effective weighing of the public interest of the proposal. Xcel Energy is open to pursuing either of these approaches and appreciates the Department's support, but believes that Mesaba 1 LLC would need to initiate these efforts given the status of the current proceeding.

CONCLUSION

For all the foregoing reasons, Xcel Energy respectfully requests that the ALJs find that Mesaba 1 LLC has not satisfied its burden of proving that the Mesaba 1 PPA is a least-cost resource and in the public interest because:

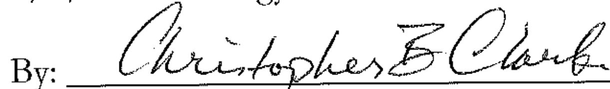
- Ratepayer costs are unknown and unbounded.
- The Mesaba 1 PPA is not and it is not likely to be a least cost resource resulting in approximately $1.5 billion in excess costs.
- The Mesaba 1 PPA would result in serious financial consequences including imputed debt, likely credit rating downgrades, and an increase of $950 million to Xcel Energy's capital structure.
- The Mesaba 1 PPA shifts significant financial and operational risks to Xcel Energy and its ratepayers.
- The Mesaba 1 PPA contains no requirement that Mesaba Unit 1 sequester carbon or install the equipment needed to do so.

Xcel Energy further requests that the ALJs adopt its Proposed Findings of Fact and Conclusions of Law with the minor modifications discussed in this Reply.

Dated: January 19, 2007

Respectfully submitted,

Northern States Power Company,
d/b/a Xcel Energy

By: 

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PUBLIC DOCUMENT
TRADE SECRET DATA EXCISED

Attachment 1

As noted in footnote 29 on page 17 of this Reply, the Pace Global Report states: **[M1 TRADE SECRET BEGINS**

M1 TRADE SECRET ENDS]

On page 29 of this Reply, Xcel Energy cites to the cost and timing of the FEED study.[1] According to the Pace Global report, the FEED study can be completed in only **[M1 TRADE SECRET BEGINS M1 TRADE SECRET ENDS]** months at an estimated cost of **[M1 TRADE SECRET BEGINS M1 TRADE SECRET ENDS]**.

1 **[M1 TRADE SECRET BEGINS**

M1 TRADE SECRET ENDS] XE-2003, Schedule 2 at 10 of 24.

PUBLIC DOCUMENT
TRADE SECRET DATA EXCISED

Attachment 1

As described on page 20 of this Reply, the following charts provide a summary of some of the differences found in the Mesaba 1 PPA:

Risk	**Mankato PPA**	**Mesaba 1 PPA**
Term	20 years	25 years
Conditions to COD	Facility must be commercially operable and available for dispatch	Allows COD to occur if the facility can not operate because the interconnection is not complete
COD	Date certain	Floats up to 4 years
Cure period for missing COD	Total of **[XE TRADE SECRET BEGINS XE TRADE SECRET ENDS]** days	Total of 730 days
Basket of remedies for Seller default	Security Fund, Subordinated Mortgage, **[XE TRADE SECRET BEGINS XE TRADE SECRET ENDS]**, delay damages, replacement power cost liability	None of these
Capacity Payment Rate	Set when PPA is executed for Term	Unknown at this time and subject to change outside of buyer's control
Facility availability for full payment	On-peak months **[XE TRADE SECRET BEGINS XE TRADE SECRET ENDS]** Off-peak months **[XE TRADE SECRET BEGINS XE TRADE SECRET ENDS]**	Year 1 – 65% Year 2 – 75% Year 3 – 85% Year 4 – 96%
Facility Efficiency	Heat Rate Adjustment	No requirements
Seller Force Majeure	No payment	Payments for 30 days
Material Permits	4 including CON	11 excluding CON

XE-2006, Schedule 3 at 1 of 1; XE-2009 at 12.

Attachment 1

	Excelsior/Mesaba	Fibrominn	NGPP (Virginia Hibbing)	St Paul Cogen	Mankato	Cannon Falls
Project Type	+600 MW IGCC	50 MW Biomass (poultry litter)	35 MW Biomass (wood)	**[XE TRADE SECRET BEGINS**	365 MW CC (gas)	357 MW CT (gas)
EPC cost	Full pass-through	No pass-through	No pass-through		No pass-through	No pass-through
Financing	Full pass-through	No pass-through	No pass-through		No pass-through	No pass-through
Ash disposal costs	Full pass-through	No pass-through	No pass-through		N/A	N/A
Byproduct revenues	Full pass-through of byproduct revenue	Share ash sale revenue if above $3.3 million per contract year	No pass-through		N/A	N/A
Emission allowances and credits	Full pass-through of all Environmental Attributes cost including credits, allowances, offsets, etc.	DOE Funding, Section 45 Credits, etc. are assigned to NSP at no additional cost	NO_x, SO_2, CO_2, Hg, and similar credits, allowances, offsets are assigned to NSP at no additional cost		No pass-through or transfer	No pass-through or transfer
Fuel cost	Full pass-through of solid fuel, natural gas and losses	No fuel cost pass-through but pass-through transportation if above $3.70 per ton for poultry litter	Price is capped but share fuel cost savings if legislation reduces amount of required biomass fuel		NSP purchases fuel (tolling)	NSP purchases fuel (tolling)
Equipment sales & use tax	Full pass-through in the EPC cost adjustment	Pass-through above $0.85 million	No pass-through		No pass-through	No pass-through
Taxes & surcharges	Pass-through fuel taxes and environmental Taxes	Pass through new or increased fed, state and local taxes & surcharges	Pass through new or increased fed, state and local taxes & surcharges	**XE TRADE SECRET ENDS]**	**[XE TRADE SECRET BEGINS** **XE TRADE SECRET ENDS]**	**[XE TRADE SECRET BEGINS** **XE TRADE SECRET ENDS]**

XE-2006 at 23 and Schedule 3.