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July 16, 2007

The Honorable Steve M. Mihalchick  
The Honorable Bruce H. Johnson  
Administrative Law Judges  
Office of Administrative Hearings  
100 Washington Square, Ste 1700  
Minneapolis, MN 55401-2138

RE: 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. 12-2500-17260-02**

Dear Judges Mihalchick and Johnson:

Enclosed for filing in the above referenced docket, please find the Phase 2 Reply Brief of the Minnesota Department of Commerce.

The Department is also filing a copy of this document electronically. Also enclosed is an affidavit of service.

Very truly yours,

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Enc.  
c(w/enc.): All Parties of Record



**E6472/M-05-1993**

**In the Matter of a Petition by Excelsior Energy, Inc., ...  
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**MPUC Docket No. E6472/M-05-1993  
OAH Docket No. 12-2500-17260-2**

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**FOR THE**

**MINNESOTA PUBLIC UTILITIES COMMISSION  
Suite 350, 121 Seventh Place East  
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**In the Matter of the Petition of 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 - Phase 2**

**PHASE 2  
RELY BRIEF OF THE  
MINNESOTA DEPARTMENT OF COMMERCE**

Dated: June 22, 2007

Respectfully submitted,

**MINNESOTA DEPARTMENT OF  
COMMERCE**

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Minn. Stat. §216B.1693**

**PHASE 2  
RELY BRIEF OF THE  
MINNESOTA DEPARTMENT OF COMMERCE**

The Minnesota Department of Commerce (“Department”) respectfully submits this *Reply Brief* to respond to the *Initial Briefs* filed by the parties in this proceeding. Given its already extensive briefing, the Department will not repeat its analyses but offers targeted clarification and response with respect to key issues. On June 22, 2007, the following parties filed *Initial Briefs* in the instant proceeding:

- Excelsior Energy (“Excelsior” or “The Company”);
- The Department;
- Minnesota Power;
- Northern States Power d/b/a Xcel Energy (“Xcel”); and
- Mncoalgasplant.com (“MCGP”).

The Department’s Reply Brief focuses on response to Excelsior’s *Initial Brief*.

## I. THE SCOPE OF PHASE 2

The scope of Phase 2 was defined by the Administrative Law Judge (ALJ) Bruce Johnson's May 10 Order (ALJ May 10 Order) which stated:

Four key issues of law and fact that bear on Phase 2 proceedings were addressed by the ALJs in the Phase 1 report and have been presented to the Commission for adjudication: (1) whether the Project qualifies as "clean energy technology"; (2) whether the Project "is or is likely to be a least cost resource"; (3) whether the Project qualifies as a "innovative energy project"; and (4) if all of that is so, whether having the Project supply at least two percent of the electric energy provided to Xcel's retail customers would be contrary to the public interest. **The only question remaining for Phase 2 is very narrow:** If the Commission's final decision is that Excelsior's Project meets all four of those criteria, whether the Commission should direct that the Project provide thirteen percent, rather than two percent, of the electric energy provided to Xcel's retail customers. (Emphasis added.)

The issue to be decided in the Phase 2 proceeding as indicated by the ALJ May 10 Order is, if the Commission's final decision in Phase 1 of the proceeding is that Excelsior's Project meets all four of the criteria noted above, whether the Commission should direct that the Project provide 13 percent, rather than 2 percent, of the electric energy provided to Xcel's retail customers. This issue is now before the ALJ for recommended decision based on the evidentiary record.

The Department notes that on May 2, 2007, Excelsior filed two new sets of testimony and an Offer of Proof that, along with certain portions of Excelsior's *Initial Brief*, do not appear to speak to the specific question set forth by the ALJ in his May 10 Order. It is the Department's understanding that such testimony, being outside the ALJ's scope of the Phase II proceeding, is not considered to be evidence in the Phase 2 record unless the Commission allows the testimony to be offered into the record.



For efficiency in this record development, the Department provides a response to the new testimony in the separate section below, entitled “IV. Offer of Proof Testimony.” Thus, if this new testimony is allowed into the Phase 2 record at a later time, the Department offers that this section of our *Reply Brief* be allowed in the record as well, in response to this testimony, to provide the Commission with a full record upon which to make a decision in the proceeding.

## **II. EXCELSIOR’S PROPOSED IGCC FACILITIES (MESABA I) IS NOT AND IS NOT LIKELY TO BE A LEAST COST RESOURCE**

### **A. THE APPROPRIATE RESOURCE**

On page 3 of its *Initial Brief*, Excelsior claims that IGCC technology is likely to be a least cost resource. The Department notes that the appropriate resource to be analyzed is Excelsior’s proposed IGCC facility, not, as claimed by Excelsior, a generic IGCC resource.

Minn. Stat. §216B.1693 states:

216B.1693 Clean energy technology.

(a) if the commission finds that a clean energy technology is or is likely to be a least cost resource, including the costs of ancillary services and other generation and transmission upgrades necessary, the utility that owns a nuclear generating facility shall supply at least two percent of the electric energy provided to retail customers from clean energy technology.

(b) Electric energy required by this section shall be supplied by the innovative energy project defined in section 216B.1694, subdivision 1, unless the commission finds doing so contrary to the public interest.

(c) For purposes of this section, “clean energy technology” means a technology utilizing coal as a primary fuel in a highly efficient combined-cycle configuration with significantly reduced sulfur dioxide, nitrogen oxide, particulate, and mercury emissions from those of traditional technologies.

(d) This section expires January 1, 2012.

First, from Part (a) a clean energy technology is entitled to sell at least 2 percent of the electric energy to Xcel if it is or is likely to be a least cost resource including the costs of ancillary services and other generation and transmission upgrades necessary.

Therefore, to analyze the least cost requirement, it is necessary to know the costs of all necessary ancillary services and other generation and transmission upgrades. Clearly such an analysis must be performed on a specific facility, not on IGCC technology in general as claimed by Excelsior.

Second, from Part (b), the electric energy required to be acquired by Xcel (at least 2 percent) must be supplied by the innovative energy project defined in Section 216B.1964, subdivision 1.

Minn. Stat. §216B.1694, subdivision 1 states:

Subdivision 1. **Definition.** For the purposes of this section, the term “innovative energy project” means a proposed energy-generation facility or group of facilities which may be located on up to three sites:

(1) that makes use of an innovative generation technology utilizing coal as a primary fuel in a highly efficient combined-cycle configuration with significantly reduced sulfur dioxide, nitrogen oxide, particulate, and mercury emissions from those of traditional technologies;

(2) that the project developer or owner certifies is a project capable of offering a long-term supply contract at a hedged, predictable costs; and

(3) that is designated by the commission of the Iron Range Resources and Rehabilitation Board as a project that is located in the taconite tax relief area on a site that has substantial real property with adequate infrastructure to support new or expanded development and that has received prior financial and other support from the board.

Clearly the provisions in Minn. Stat. §216B.1693 together with the provisions in Minn. Stat. §216B.1694 provide for the clear conclusion that Phase 2 must deal with specific, not general, ICGG facilities. Part (b) of Minn. Stat. §216B.1694, subd. 1 defines an innovative energy project as one that must meet at least the following requirements:

1. A proposed energy-generation facility or group of facilities which may be located on up to three sites.
2. The project developer or owner certifies that the project is capable of offering a long-term supply contract at hedged, predictable costs.
3. The project is designated by the Commissioner of the Iron Range Resources and Rehabilitation Board as a project that is located in the taconite tax relief area on a state that has substantial real property with adequate infrastructure to support new or expanded development and that has received prior financial and other support from the board.

It is clear from the above discussion that Minn. Stat. §216B.1693 and Minn. Stat. §216B.1694 require that specific, not generic, IGCC facilities must meet the conditions set in those two statutes in order to have the right to supply at least 2 percent of Xcel's retail energy needs. Moreover, while Excelsior's proposed Mesaba I facility may meet some conditions required by Minn. Stat. §216B.1693 and Minn. Stat. §216B.1694, no other proposed IGCC facility meets conditions 1 through 3 above. Thus, the proposed Mesaba 1 unit is the only facility that could be considered in the determination before the Commission. The above conclusion is also supported by Section II of the Commission's April 26, 2006 Order that states that the issues to be addressed in this proceeding are:

- (1) approve, disapprove, amend, or modify the terms and conditions of a proposed power purchase agreement that Excelsior has submitted to Xcel Energy under Minn. Stat. §216B.1694; and
- (2) determine that the coal-fueled Integrated Gasification Combined Cycle (IGCC) power plant that Excelsior plans to construct in northern Minnesota is, or is likely to be, a least cost resource, obligating Xcel to use the plant's generation for at least two percent of the energy supplied to its retail customers, under Minn. Stat. §216B.1693.

*B. CONCLUSIONS*

Based on its analysis of Minn. Stat. §216B.1693, Minn. Stat. §216B.1694, the Commission's April 26, 2006 Order and the ALJ's June 2, 2006 Order, the Department concludes that:

1. Phase 2 of these proceedings must determine whether or not the specific IGCC facilities proposed by Excelsior meet the requirements of Minn. Stat. §216B.1693.
2. Since the only plant proposed by Excelsior in the record is Mesaba I, this is the only plant that could and should be analyzed in Phase 2.
3. Any analysis of generic or hypothetical IGCC facilities and any testimony regarding generic or hypothetical IGCC facilities are irrelevant to the Phase 2 proceedings.

*C. EXCELSIOR'S SPECIFIC ARGUMENTS REGARDING THE ISSUE OF LEAST COST RESOURCE*

1. *Excelsior Argues that Under Minnesota Law IGCC Technology is the Only Economically Viable Coal-Fueled Generation Resource Available.*

The Department concludes that the evidence in the record does not support this conclusion. Even with capture and sequestration of CO<sub>2</sub>, the Mesaba I IGCC (the only relevant IGCC to be considered in this proceeding) is not economically viable (Exhibit DOC 3023 Amit Surrebuttal Testimony, non-public).

In addition, Minnesota law does not exclude the use of coal-based resources. Moreover, proposals for baseload technologies should be based on the least cost baseload resource, not the least cost coal plant. Thus, other baseload facilities may be more economically viable than the proposed Mesaba I facility.

2. *Excelsior Argues that IGCC Technology will Protect Xcel's Ratepayers from Planned Unsustainable Increases in Natural Gas Consumption.*

This argument presumes a great deal of evidence not in the record. First, it is not clear in the record how much natural gas Xcel needs on its system. Such determinations are best made in resource planning dockets or other venues where it is possible to look at the effect on the system of factors such as increased demand for electricity and increased requirements for renewable and possibly intermittent power.

Moreover, since the issue before the Commission does not pertain to a generic IGCC, the pertinent question is whether the Mesaba I IGCC facility is a reasonable addition to Xcel's system. As indicated by the ALJs in Conclusion 11 of their April 12, 2007 *Finding of Fact, Conclusion of Law, and Recommendation* (April 12 Findings), "The Project and its technology do not satisfy the requirements of Minn. Stat. §216B.1693(a) because the Final PPA is not, and is not likely to be, a least cost resource including the costs of ancillary services and other necessary generation and transmission upgrades." Since Mesaba I is not a least cost resource, substituting Mesaba I for other resources will significantly increase Xcel's ratepayers' costs.

3. *Excelsior Argues that in Accounting for Fine Particulate Emissions, IGCC Technology is Likely to be a Least Cost Resource.*

Regarding emissions, the Minnesota Pollution Control Agency indicated the following as identified by the ALJs at 70 and 72 of their April 12 Findings:

70. With regard to reducing SO<sub>2</sub>, the Project is expected to underperform what the EPA estimates will be the future emission reduction performance of IGCC technology, while the Project is expected to significantly outperform EPA's estimates of what will be the future SO<sub>2</sub> emission reduction performance of SC and USC technologies with regard to SO<sub>2</sub>. However, the Project is expected to only slightly outperform those technologies in terms of reducing PM emissions, and slightly underperform them in terms of reducing NO<sub>x</sub> emissions.

72. The particulate matter emissions of other traditional solid fuel baseload technologies (ranging from 18% to 73%) are generally higher than the Project's estimated particulate emissions.

However, even when accounting for emission costs including the emission costs of particulate matter and other pollutants using the externality values set by the Commission, the proposed IGCC is not a least cost resource (Exhibit DOC 3017 and Exhibit DOC 3023). Finally, the emission costs of fine particulate matter (PM<sub>2.5</sub>) unlike the costs of other emissions, has not been yet established under the Commission's environmental externality proceedings and, therefore, its impact is, at this point, uncertain.

4. *Excelsior Argues that, Including the Carbon Dioxide Emission Mitigation Impacts, IGCC is a Least Cost Resource.*

Again, the issue before the Commission is not regarding a generic IGCC technology but the proposed Mesaba I IGCC Facility. Since Excelsior does not propose to capture and sequester CO<sub>2</sub>, it has no advantage over a supercritical pulverized coal power plant (SCPC) regarding the issue of CO<sub>2</sub> emission mitigation. This issue is summarized in Finding 152 of the April 12

Findings:

Excelsior Energy does not plan to install the technology on the Project until it is required by law to do so. If and when it is, Excelsior Energy plans to install a system that removes 30% of the CO<sub>2</sub>, and, if it is ever feasible, one that removes 90%. It is not known how those reduction levels will compare to retrofitted or other new coal-fired plants. Thus, the Project has little or no quantifiable advantage at this time over other coal burning plants and no advantage over baseload generators operating on renewables.

5. *Conclusion*

Based on its analyses and the records in these proceedings, the Department concludes that Excelsior's proposed Mesaba I facility (the only non-generic IGCC facility analyzed in these proceedings) is not, and is not likely to be, a least cost resource.

**III. THE TWO PERCENT LEVEL WOULD BE XCEL'S ONLY REQUIRED ENERGY PURCHASE AMOUNT SHOULD THE COMMISSION DECIDE THAT EXCELSIOR HAS FAVORABLY MET ALL CRITERIA AS OUTLINED IN PHASE 1**

A. *DISCUSSION*

Excelsior argues that, at a minimum, Xcel should be required to purchase 13 percent of its retail energy from Excelsior. Excelsior argues that this 13 percent minimum would protect Xcel's ratepayers from over exposure to natural gas volatility, price and supply risks.

To support its 13 percent claim, Excelsior points to the new Renewable Energy Standard law (RES) (S.F.4, 85<sup>th</sup> Leg. Reg. Session) which requires Xcel to generate 30 percent of its energy from renewable sources by 2020. Additionally, Excelsior points to the testimony of its Witness whose testimony is subject to the Commission's decision on Excelsior's Offer of Proof, Mr. Andrew Weissman, regarding the negative impacts of relying on energy supplied from natural gas power plants. Mr. Weissman's testimony is discussed in Section IV below; the following addresses the RES.

It is expected that the RES will have a large impact on Xcel's system and resource needs, particularly energy needs, but the specific impacts are not known at this time or sufficiently developed in this record. As far as the arguments about natural gas, the Department addresses that issue elsewhere in this *Reply Brief*. However, as to the least-cost arguments by Excelsior, arguments about natural gas costs would need to be balanced against the effects of requiring Xcel to purchase at least 13 percent of its retail load from Excelsior if such requirement would substitute more expensive energy from Mesaba I for lower cost energy from renewable sources. In its Phase 1 testimony Xcel demonstrated that substituting Mesaba 1 for other resources, including natural gas resources, would increase Xcel's cost of energy significantly (Exhibits XE – 2034, XE – 2035, XE – 2036 and XE – 2037).

## B. *CONCLUSIONS*

Based on its analyses and review of Excelsior's *Initial Brief*, the Department concludes that there is neither legal justification nor a public interest justification to require Xcel to purchase more than 2 percent of its retail energy load from Excelsior.

## IV. **OFFER OF PROOF TESTIMONIES**

### A. *INTRODUCTION*

Excelsior submitted two new testimonies as "Offer of Proof." The purpose of this discussion is not the legal standing of this "Offer of Proof." Rather, as indicated above, the Department provides a short analysis of the two new testimonies to be used in the event the decision is made to allow the testimonies into the Phase 2 record. The first testimony is provided by Douglas H. Cortez and is an update of his testimonies in Phase 1, comparing the costs of IGCC resources to the cost of conventional coal resources. The second testimony is provided by Andrew D. Weisman and is an update in his testimony in Phase 1, arguing that the minimum of Xcel's retail energy load to be purchased from Excelsior should be no less than 13 percent of Xcel's retail load.

### B. *DOUGLAS H. CORTEZ TESTIMONY*

#### 1. *Summary of Mr. Cortez's Testimony*

In Phase 1 of these proceedings Mr. Cortez provided testimonies on behalf of Excelsior comparing the cost of IGCC and SCPC with and without capturing and sequestering CO<sub>2</sub>. In the instant testimony Mr. Cortez updates his cost comparisons between IGCC and SCPC. His main conclusions from his Phase 1 analyses and from his newly submitted testimony is that IGCC resources are significantly less costly than SCPC resources when capture and sequestration of CO<sub>2</sub> are included.



2. *Discussion of Mr. Cortez's Testimony*

Mr. Cortez's new Testimony compares generic IGCC and SCPC plants. As noted above, such a generic comparison is not germane to the issue of determining the appropriate percentage of energy to be sold by Excelsior to Xcel from the Mesaba I plant. As the Department demonstrated earlier in this *Reply Brief*, the statutes require specific Excelsior-owned IGCC facilities, not a generic IGCC resource, to be a least cost resource.

Second, Excelsior's proposed PPA and proposed Mesaba I IGCC facilities do not include capture and sequestration of CO<sub>2</sub> nor the costs needed to capture and sequester CO<sub>2</sub>. Therefore, the cost information provided by Mr. Cortez is not applicable to the issue to be determined in Phase 2.

Finally, as shown in Phase 1 (Exhibit DOC 2023 – Eilon Amit, Non-Public Surrebuttal Testimony and Exhibits XE-2035, and XE-2037) and as confirmed by Conclusion of Law No. 11 noted above in the April 12 Finding, Excelsior's proposed IGCC Mesaba I facility is not a least cost resource.

C. *ANDREW D. WEISSMAN TESTIMONY*

1. *Summary of Mr. Weissman's Testimony*

In Phase 1 of these proceedings, Mr. Weissman provided testimony supporting a 13 percent minimum (Exhibit (p2) EE 1005). In the instant testimony, Mr. Weissman updates his Phase 1 testimony on the 13 percent minimum issue. Mr. Weissman's updated testimony offered into the record under the "Offer of Proof" does not add any new analysis. It simply updates his testimonies in Phase 1 of these proceedings. His Phase 1 testimony argued for 13 percent minimum because Xcel needs significant baseload electric power and thus, without the 13 percent minimum, Xcel's ratepayers would be over exposed to significantly higher future natural gas prices and significantly higher volatility of future natural gas prices. In his instant testimony,

Mr. Weissman argues that his initial concerns about over exposing Xcel's ratepayers to the risk of significant dependence on natural gas are reinforced by higher demand and reduced supply of natural gas and fewer options available to Xcel to meet its baseload needs.

2. *Discussion of Mr. Weissman's Testimony*

None of the arguments in Mr. Weissman's Phase 2 testimony are new. First, to support his argument Mr. Weissman simply substitutes his natural gas forecast for various natural gas forecasts provided by institutions that provide such forecasts on a regular basis.

Second, as was shown in the record in this proceeding (Exhibit XE 2035 and XE 2037), substituting Mesaba 1 for other available resources including natural gas, would significantly increase, not reduce, the cost of electricity to Xcel's ratepayers due to the comparative price of Mesaba's proposed energy. This conclusion was reinforced by Conclusion of Law No. 11 noted above of the April 12 Finding.

Finally, based on the information in this record, Xcel does not need baseload capacity at least until the year 2015. Moreover, with the new RES (S.F.4 85<sup>th</sup> Leg. Reg. Sess) which is cited in Excelsior's *Initial Brief*, the need for baseload capacity may be deferred beyond the year 2015.

## **V. CONCLUSION**

As indicated in Phase 1 of this proceeding, the Department's Direct Policy Testimony indicated support for the concept of this project. That conceptual support has not changed or diminished. However, the issue in Phase 2 is whether the Commission should direct that the Project provide 13 percent, rather than 2 percent, of the electric energy provided to Xcel's retail customers. The Department sees no basis in the record to interpret the statute beyond its plain reading as 2 percent, rather than 13 percent, being Xcel's only obligated energy purchase amount should the Commission decide that Excelsior has met the requirements of Phase 1 favorably

including the least cost requirement. Also noting the public policies reasons discussed above, the Department respectfully requests a recommendation from the Administrative Law Judge and an Order from the Commission consistent with recommendations herein.

Dated: June 22, 2007

MINNESOTA DEPARTMENT OF COMMERCE

By: \_\_\_\_\_

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