

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

LeRoy Koppendraye
Marshall Johnson
Ken Nickolai
Thomas Pugh
Phyllis A Reha

Chair
Commissioner
Commissioner
Commissioner
Commissioner

In the Matter of Northern States Power
Company d/b/a Xcel Energy's Application for
Approval of its 2004 Resource Plan

ISSUE DATE: May 31, 2006

DOCKET NO E-002/RP-04-1752

ORDER ESTABLISHING RESOURCE
ACQUISITION PROCESS, ESTABLISHING
BIDDING PROCESS UNDER MINN. STAT
§ 216B.2422, SUBD. 5, AND REQUIRING
COMPLIANCE FILING

PROCEDURAL HISTORY

On November 1, 2004, Northern States Power Company d/b/a Xcel Energy (Xcel) filed its 2004 resource plan, covering the fifteen-year planning period from 2005 through 2019. On November 17, 2005, after several rounds of stakeholder comments and extensive discovery, the Commission issued an interim order seeking more detailed proposals on how to improve the effectiveness of the Company's program for competitive procurement of generation.¹

Specifically, the interim order requested a detailed report from Xcel on how it would select new generation resources from the pool of competing alternatives, a detailed description from the Department of Commerce on its proposal that Xcel use a certificate-of-need-like process to select new baseload resources, and comments from interested persons on both filings.

The Company and the Department of Commerce made the filings required under the November 17, 2005 Order, and the following parties filed comments on those filings:

- Izaak Walton League of America – Midwest Office, Minnesotans for an Energy-Efficient Economy, Union of Concerned Scientists, and Minnesota Center for Environmental Advocacy, filing jointly ("Environmental Intervenors")
- LS Power Associates, L P (LS Power)
- Excelsior Energy Inc.
- Gascoyne Project
- North Dakota Industrial Commission

¹ Order Seeking More Detailed Proposals, this docket

On April 25, 2006, the matter came before the Commission. Having reviewed the entire record and having heard the arguments of the parties, the Commission makes the following findings, conclusion, and order.

FINDINGS AND CONCLUSIONS

I. Introduction

A. The Resource Planning Process

The resource planning statute and rules are detailed, but they basically require utilities to file periodic reports on (1) the projected energy needs of their service areas over the next 15 years; (2) their plans for meeting projected need; (3) the analytical process they used to develop their plans for meeting projected need; and (4) their reasons for adopting the specific resource mix proposed to meet projected need. Minn. Stat. § 216B.2422 and Minn. Rules Chapter 7843.

These requirements are designed to strengthen utilities' long term planning processes by providing input from the public, other regulatory agencies, and the Commission. They are also designed to ensure that utilities give adequate consideration to factors whose public policy importance has grown in recent years, such as the environmental and socioeconomic impact of different resource mixes.

B. The Resource Acquisition Process

Historically, electric utilities have been vertically integrated; that is, they have themselves provided all three of the major services – generation, transmission, and distribution – required to ensure reliable service to retail customers. Over the past fifteen to twenty years, however, state and federal policies have encouraged or permitted utilities to outsource at least some of their generation and transmission functions, on the theory that competition in the generation sector and centralized operations in the transmission sector could result in greater efficiency and lower costs.

Xcel has outsourced many of its transmission functions by joining the Midwest Independent System Operator, Inc. (MISO), a regional transmission organization that serves as a neutral, third-party administrator of member utilities' transmission facilities. The Company has also committed to outsourcing many of its generation functions – at least as to *new* generation – through competitive bidding or other market-based procurement processes.

The Company has been using an "All-Source Bidding" process, in which it does not specify a need for specific increments of generation or, in most cases, for generation from specific technologies. Instead, it uses the resource planning process to determine how much new supply it needs and then invites potential suppliers to submit proposals based on the published results of that process.

Despite this market-based approach to acquiring new generation, the Company is still both the supplier of last resort, since it retains the duty to serve regardless of the outcome of the All-Source Bidding process, and a potential competitor in that process, since it remains engaged in the generation business.

The All-Source Bidding process was approved by the Commission and appeared to hold great promise for attracting innovative and low-cost generation proposals. It fell short of expectations, however, in part because its open-endedness and flexibility tended to undermine the certainty, transparency, and

accountability required in the commercial context. In fact, despite its commitment to using competitive, market-based strategies for securing new generation, Xcel ultimately constructed two peaking plants that the Department and interested stakeholders contended should and would have been secured through competitive bidding, but for deficits in the All-Source Bidding process.

The Commission therefore required the Company to enter into discussions with the Department and interested stakeholders on how to improve its competitive procurement process,² which produced the filings under consideration today.

II. Positions of the Parties

A. Xcel and the Department

1. Xcel

Both Xcel and the Department proposed separate processes for procuring baseload generation and procuring other generation.

In its initial filing Xcel proposed that it use a formal, competitive bidding process to acquire peaking, intermediate, and renewable generation resources. It proposed to identify the size, type, and in-service date for each facility required in these categories and to include this information in each Request for Proposals issued under the formal bidding process.

To acquire baseload generation, the Company proposed to use a less structured, more complex, and more evaluative approach. Baseload needs would be determined in the public, resource-planning process, which would alert potential baseload providers of the need. The Company would then examine all reasonable baseload options, weighing the myriad factors that determine baseload choices, which include but are not limited to construction time lines and costs, fuel costs, reliability, environmental and socioeconomic impacts, transmission interfacing, and adaptability to future changes in load characteristics and service area demographics.

Once the Company selected an option and submitted it for Commission approval, supporters of competing options could intervene, challenge the Company's choice, and urge the Commission to order negotiations with the challenger.

2. The Department

In its initial filing the Department concurred in the use of a formal, competitive bidding process for peaking, intermediate, and renewable generation, but recommended specific refinements to the Company's proposal. These included requiring an independent auditor's report each time the bidding process was used, using a standard contract as the starting point in each bidding process, and disclosing the Company's contingency plan for a failed bidding process at the start of each bidding process.

² In the *Matter of the Application of Northern States Power Company (d/b/a Xcel Energy) for a Certificate of Need for a Large Electric Generating Facility*, Docket No. E-002/CN-04-76, ORDER GRANTING CERTIFICATE OF NEED AND REQUIRING DISCUSSION WITH THE DEPARTMENT (June 25, 2004); ORDER SEEKING MORE DETAILED PROPOSALS, this docket (November 17, 2005).

For baseload procurement, the Department recommended conducting a contested case proceeding on any Company request for approval or certification of new baseload resources and to use that proceeding to fully develop baseload alternatives not chosen by the Company. If the Commission found an alternative to be superior to the baseload resource chosen by the Company, the Commission would deny the request for approval or certification and the Company would enter into good-faith negotiations to obtain its baseload needs from the superior alternative.

3. The Convergence of the Two Positions

The Company initially opposed the Department's proposal for baseload acquisitions, citing legal concerns about issuing certificates of need for alternative projects that were not the applicants in certificate of need proceedings. The Company also had reservations about the Department's refinements to the bidding process for non-baseload generation, citing concerns about the time and expense required to use independent auditors and about the loss of flexibility that might result from introducing standard contracts early in the bidding process.

After further discussion, however, the Company's and the Department's positions essentially converged.

The Department revised its baseload procurement process to require certificate of need applications from competing baseload suppliers, to be consolidated with the Company's filing in a single contested case proceeding. And the Company stated its willingness to incorporate into the structured, bidding process the refinements proposed by the Department, including the use of independent auditors, standard contracts, and contingency plans.

Both parties supported or acceded to Commission approval of the Department's revised resource acquisition process.

B. The Environmental Intervenors

The Environmental Intervenors opposed categorizing new generation needs into peaking needs, intermediate needs, and baseload needs, arguing that the regional electricity markets resulting from MISO's centralized transmission operations made these distinctions obsolete. They argued that resource acquisition should begin with an analysis of what is available in the market and should avoid using these arguably outmoded categories.

They also argued that the procedural framework for baseload acquisition recommended by the Company and the Department would favor self-build options, especially if the Commission, in acting on the resource plan proper, adopted the Company's time frame for baseload acquisition.

C. LS Power

LS Power, a non-utility company engaged in the production and wholesale provision of electricity, emphasized that its effective participation in the competitive procurement process required "a fair, transparent, well-defined competitive bidding process featuring independent oversight for the procurement of all generation."³ It stated at hearing that it considered the process proposed by the Company and the Department workable and would participate in such a process, other things being equal.

³ January 13, 2006 Comments of LS Power, page 5

D. Excelsior Energy Inc.

Excelsior argued that the Company's proposed resource acquisition process, even as modified by the Department, failed to adequately factor in the special status of the Mesaba Project, a coal-fueled Integrated Gasification Combined Cycle power plant it is developing in northern Minnesota.

The project has received a \$36,000,000 start-up grant from the United States Department of Energy, \$9,500,000 in loans from the Minnesota Iron Range Resources and Rehabilitation Board, and a five-year, \$10,000,000 engineering and development grant from the Renewable Development Fund⁴ More directly relevant for current purposes, the project also has a statutory entitlement to special consideration as a potential baseload resource for Xcel.⁵

E. Gascoyne Project

The Gascoyne Project is a 500-megawatt coal-fired facility being developed in North Dakota by Westmoreland Power, Inc., a wholly owned subsidiary of Westmoreland Coal Company. The Project argued that the Company's original proposal for baseload acquisition was structured in a manner that would inevitably and consistently result in choosing the self-build option.

Gascoyne recommended a traditional bidding process for baseload acquisition. In the alternative, it recommended the Company's process as modified by the Department, which it believed would "ensure fairness and transparency and guarantee that Minnesota ratepayers receive the most reliable, lowest cost option."⁶

F. North Dakota Industrial Commission

The North Dakota Industrial Commission was established by the North Dakota Legislature to promote North Dakota industries, utilities, enterprises, and business projects, including the State's lignite industry. The North Dakota Industrial Commission filed comments to support careful consideration of lignite-based generation technologies and projects, including the Gascoyne and Great Northern projects, to meet future Minnesota baseload needs.

⁴ *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. E-002/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 (February 23, 2005).

⁵ Minn. Stat. §§ 216B.1693 and 216B.1694.

⁶ January 13, 2006 Comments of the Gascoyne Project, page. 9

III. Commission Action

A. New Competitive Procurement Process Required

The Commission concurs with stakeholders that Xcel's resource procurement process must be overhauled if the Company is to continue using a competitive process to acquire new generation

The purpose of the competitive process – getting the best overall price for ratepayers – cannot be achieved without robust competition. And robust competition cannot be achieved without two things: (1) a fair, predictable, and transparent competitive process; and (2) widespread agreement that the process is fair, predictable, and transparent.

Potential suppliers will not commit the resources necessary to compete effectively, and will not disclose the sensitive information often required to evaluate their competitive proposals, unless they have confidence in the objectivity, good faith, and predictability of the competitive process. In fact, to attract competitive proposals, it may matter less what the rules are – assuming fundamental rationality and basic fairness – than whether all potential players know the rules and know that they will be enforced evenhandedly.

The Commission finds that the two-track, competitive procurement process described in the Department's comments of January 30, 2006, acceded to by the Company, provides much more certainty, predictability, and accountability than the current process. It will be instituted, as adapted below to require certificate-of-need-like proceedings whenever Xcel participates in the competitive procurement process as a bidder.

Finally, the Commission notes that Excelsior's statutory right to special consideration as a potential baseload resource is being examined in a separate, contested-case proceeding, making it unnecessary to examine those issues here.⁷

B. Certificate of Need Framework Applied to all Competitive Procurement Processes in which Xcel Submits a Proposal

The Department and the Company recommended using the framework of the certificate of need process to procure baseload generation. The Environmental Intervenors argued that distinctions between baseload, peaking, intermediate, and renewable resources were increasingly outdated and arbitrary, and that using these categories tended to divert analysis away from new possibilities created by emerging regional energy markets.

The Commission concurs with the Company and the Department on the value of using a certificate-of-need-like process to compare competing resource options. Certificate of need filing requirements

⁷ 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, Docket No. E-6472/M-05-1993, NOTICE AND ORDER FOR HEARING AND ORDER GRANTING INTERVENTION PETITION (April 25, 2006)

and decision criteria are clear, comprehensive, directly relevant to resource procurement, and easily transferrable to the resource procurement process.⁸

Further, the process is familiar and credible to stakeholders. It has the proven ability to produce an intelligible and trustworthy record from the examination of voluminous, complex, and contested facts. In short, the process is substantively, procedurally, and pragmatically well suited for adaptation to competitive resource procurement.

For all these reasons, the Commission concurs with the Company, the Department, and other stakeholders on the value of the certificate of need framework for evaluating competing resources. At the same time, however, the Commission shares the Environmental Intervenors' discomfort at the prospect of reserving that process for baseload generation alone.

That limitation not only carries the risk of implying, falsely, that selecting non-baseload generation is less complex or important than selecting baseload, but it jeopardizes accountability, fairness, and credibility in procurement processes in which Xcel is a bidder. While an independent auditor's report might minimize or neutralize the first concern through careful explication, it is unlikely to minimize or neutralize the second.

The Commission is convinced that the heightened scrutiny and rigorous factual development of the certificate of need process are required whenever Xcel competes in its own competitive procurement process. The Commission will therefore require the use of the certificate of need procedural framework whenever Xcel proposes a self-build option in the competitive resource procurement process.

The Company simply – and necessarily – has too much control over resource selection to use the standard process when it is a bidder. It has much more reliable and complete information about its needs than its competitors. It also has superior information about its existing generation portfolio, the configuration of its transmission system, and any synergies that would result from adding different resources to the mix.

All these advantages, combined with a clear and unavoidable conflict of interest, point to a need to use the more stringent, certificate-of-need-like process whenever the Company submits its own proposal in the competitive resource procurement process.

C. Refinements to Formal Bidding Process Adopted

The Department recommended refining the formal bidding process, which will be used for competitive procurement when Xcel does not submit a proposal, to improve its effectiveness, transparency, and accountability. Its three main recommendations – ultimately acceded to by the Company – were requiring an independent auditor's report on every bidding process, using a standard contract as the starting point in every bidding process, and preparing a contingency plan for a failed bidding process at the start of every bidding process.

⁸ The Department and the Company noted that some filing requirements in the certificate of need rules are not directly applicable to non-utility entities. They recommended exempting non-utilities from those requirements, delineated in the Department's January 30, 2006 comments. The Commission has exempted non-utility entities from these requirements in the past and will adopt the recommendation of the Company and the Department.

The Commission agrees that these are valuable improvements. Whether or not they affect the outcome of any given bidding process, they add clarity and accountability to every bidding process and to the competitive procurement enterprise as a whole

Using an independent auditor saves time in after-the-fact challenges to bidding processes. It also adds credibility to the process by assuring potential and actual bidders that Xcel is accountable for the choices it makes and that it must demonstrate defensible factual bases for those choices as they are made

Using a standard contract is an effective tool for clarifying, at the beginning of the process, what the Company actually wants, and at the end of the process, what the bidders actually are offering. While standard contracts are adaptable, with explanation, to the specific circumstances of specific bidders, the use of a uniform starting point helps ensure meaningful comparison of competing proposals

Finally, preparing and disclosing a contingency plan early in the bidding process – at least before the opening of the bids – works to ensure and demonstrate precision and good faith in the Company's articulation of what is minimally required of each bidding process

None of the stakeholders opposed the competitive bidding process on which the Department and Company agreed, and the Commission concurs that it holds every appearance and promise of fairness, transparency, accountability, and efficiency. It will be approved

D. Two-Track Process Approved or Established Under Minn. Stat. § 216B.2422, subd. 5

Under Minn. Stat. § 216B.2422, subd. 5, utilities are authorized to select resources to meet needs identified in their resource plans, or to satisfy certain wind power and biomass mandates, through a bidding process approved or established by the Commission. Generating facilities chosen under these circumstances are exempt from certificate of need requirements

The Commission hereby clarifies that the two-track competitive resource acquisition process approved in this order – using the framework of the certificate of need process when Xcel submits a self-build proposal and using a formal, competitive bidding process when Xcel does not – is a bidding process approved or established by the Commission under Minn. Stat. § 216B.2422, subd. 5. The operational details of both tracks of this process, which are too voluminous to set forth here, are set forth in the comments of the Department of Commerce dated January 30, 2006, which are hereby approved, adopted in their entirety, and incorporated by reference.

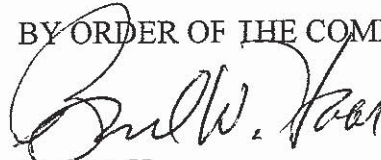
The Commission will so order

ORDER

1. The Commission hereby approves and establishes under Minn. Stat. § 216B.2422, subd. 5, the two-track competitive resource procurement process described above
2. Within 30 days of the date of the Order acting on the merits of the resource plan, Northern States Power Company d/b/a Xcel Energy shall make a compliance filing implementing the decisions set forth above, including a proposed standard contract for the formal, competitive bidding process

3. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

A handwritten signature in dark ink, appearing to read "Burl W. Haar", is written over the printed name.

Burl W Haar
Executive Secretary

(S E A L)

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