
STAFF MEMORANDUM SUPPORTING SETTLEMENT STIPULATION

TO: COMMISSIONERS AND ADVISORS
FROM: KRISTEN EDWARDS, JON THURBER, AND BRITTANY MEHLHAFF
RE: DOCKET EL16-037 – IN THE MATTER OF COMMISSION STAFF’S REQUEST TO INVESTIGATE NORTHERN STATES POWER COMPANY D/B/A XCEL ENERGY’S PROPOSED FUEL CLAUSE RIDER
DATE: AUGUST 28, 2017

Commission Staff (Staff) submits this Memorandum in support of the Settlement Stipulation (Stipulation) in the above-captioned matters.

BACKGROUND

On November 30, 2016, Northern States Power Company doing business as Xcel Energy (Xcel Energy or Company) filed with the Public Utilities Commission (Commission) its monthly fuel clause rider (FCR) filing to be effective December 1, 2016. On November 30, 2016, Staff filed a petition to suspend the FCR for one hundred eighty (180) days to allow adequate time for Staff to evaluate whether certain power purchase agreements (PPAs) requested by the Company for cost recovery through the FCR are reasonable and cost effective. On December 1, 2016, the Commission electronically transmitted notice of the filing and the intervention deadline of December 16, 2016, to interested individuals and entities on the Commission’s PUC Weekly filings listserv. No petitions to intervene or comments were filed. By Order dated December 12, 2016, the Commission suspended the Company’s proposed FCR for one hundred eighty (180) days after November 30, 2016 (the Suspension Date) while retaining in effect the FCR rate filed on October 31, 2016. The Company chose not to place the FCR rates into effect subject to refund at the conclusion of the 180 day suspension period.

On May 8, 2017, Staff filed a Motion and Brief for Order to Show Cause Why Certain Costs Included in Proposed Fuel Clause Rider Should not be Disallowed (Motion). In its Motion, Staff identified a number of resources that should be evaluated which are: The Renewable Development Fund (RDF) PPAs; the Community-Based Energy Development (C-BED) PPAs; the Natural Gas Generation Capacity PPAs; the Biomass PPAs; the 187 MW Solar PPAs; and the Aurora Solar PPA (the RDF PPAs, the C-BED PPAs, the Natural Gas Generation Capacity PPAs, the Biomass PPAs, the 187 MW Solar PPAs, and the Aurora Solar PPA are collectively referred to as the “Identified PPAs”). By Order dated May 25, 2017 in the above captioned proceeding (the May 25 Order), the Commission required the Company to appear and show cause as to why costs associated with the Identified PPAs should be passed on to South Dakota customers through the FCR. On the same date, the Commission issued a Procedural Order in the instant proceeding.

On June 30, 2017, the Company filed Direct Testimony in the instant proceeding supporting the recovery of the Identified PPAs through the FCR. On July 28, 2017, Staff filed its Direct Testimony arguing that the costs of the Identified PPAs, except for the Natural Gas Generation Capacity PPAs, should not be recovered. Staff also identified that certain additional resources related to the State of Minnesota’s legislative Made in Minnesota program, as well as certain net metered resources, need to be evaluated for cost recovery. On

August 8, 2017, the Company filed its rebuttal testimony proposing an alternative path to resolution of this Docket.

On August 18, 2017, Staff filed a letter requesting that the procedural schedule be suspended as the parties reached a settlement agreement in principle. On August 22, 2017, Staff and Xcel filed a Joint Motion for Approval of the Settlement Stipulation.

STAFF'S ANALYSIS AND SETTLEMENT RESOLUTIONS

Staff conducted a review of Xcel Energy's FCR and identified certain PPAs that appeared uneconomic and needed to be evaluated for prudence. While Staff evaluated twenty-nine resources that were part of the Identified PPAs, Staff did not review the economic analysis associated with each and every PPA that Xcel Energy requested for recovery through the FCR. Staff focused its review on the resources that appeared to be above-market at the time the resource was acquired, or were acquired primarily to comply with another state's laws and initiatives.

While the Commission can approve cost recovery of generation resources that are not least cost, the Commission is required to evaluate reasonableness and need. The fundamental question in this docket is whether there is adequate support to deviate from a strict least cost plus need paradigm for resources that were primarily acquired to comply with another state's laws and initiatives. Staff believed the challenged resources were not least cost, and the qualitative factors were not sufficient to justify the resource decision. Staff recommended that the cost of the challenged resources be either directly assigned to the customers in the state where these resources were required, or adjusted to reflect a fair and reasonable price for electricity.

The Company's rebuttal testimony submitted on August 8, 2017, indicated an interest in exploring an alternative pricing methodology for generation resources to the contracted price. This testimony represented a significant change from Xcel Energy's direct testimony position, and encouraged settlement discussions as a possible path to achieve Staff's main objective of a fair and reasonable price for electricity. The amount of time between the August 8th rebuttal testimony submission and the August 29th hearing did not allow adequate time for the Staff to evaluate potential proxy price methods for certain challenged resources or provide staff a reasonable opportunity to provide written testimony in response to Xcel Energy's alternative path for resolution. As a result, Staff explored a path of resolving the cost recovery of certain resources where the record was sufficient and agreement could be achieved, and deferred the decision of specific resources to a separate proceeding where additional information on different proxy pricing options was needed. To protect customers, any decision associated with the generation resources in the additional proceeding needed to be retroactive to the December 1, 2016, suspension date, subject to refund.

Company and Staff (jointly the Parties) positions were discussed thoroughly at several settlement discussions. As a result, some Party positions were modified and others were accepted where consensus was found. This Memorandum will explain why Staff modified certain positions from its direct testimony, and support each position based on sound regulatory principles. A summary of the major elements of the Settlement Stipulation is as follows:

- **Aurora Solar PPA** – The actual costs of the Aurora Solar PPA contract will not be recovered from South Dakota customers. The Company will be allowed to recover through the FCR a credit equal to the Company's system average cost of fuel and purchased power per kWh for the South Dakota

share of the output of the Aurora Solar PPA. The Company will not recover a capacity credit associated with the Aurora Solar project for the term of the PPA.

- **187 MW Solar PPAs** – The recovery of the actual 187 MW Solar PPAs contract costs through the FCR will be replaced with an energy and capacity proxy price. The energy proxy price applicable to the 187 MW Solar PPAs will be established in the Proxy Pricing Proceeding and be applied retroactive to December 1, 2016, subject to refund. The capacity proxy price applicable to the 187 MW Solar PPA is based on MISO’s 2014 Cost of New Entry (CONE) escalated on an annual basis at 2% until 2024 and applied to the MISO accredited capacity of these resources. However, no capacity proxy will be applicable to the 187 MW Solar PPAs until 2024.
- **C-BED and RDF PPAs** – The recovery of the actual RDF and C-BED PPA contract costs through the FCR will be replaced with an energy and capacity proxy price. The appropriate energy and proxy price will be established in the Proxy Pricing Proceeding and be applied retroactive to December 1, 2016, subject to refund.
- **Biomass PPAs** – The Company may recover the costs of the Biomass PPAs in the FCR for their term.
- **Natural Gas Generation Capacity PPAs** – No disallowance was reflected in the settlement.¹
- **Proxy Pricing Proceeding** – An additional proceeding is necessary to determine the energy proxy price applicable to the 187 MW Solar PPAs, and the energy and capacity proxy prices applicable to the RDF and C-BED PPAs. The Company will make its initial filing to commence the proceeding no later than 120 days following the Commission’s adoption of the Stipulation. The application of the proxy energy and capacity pricing will be retroactive to December 1, 2016, upon completion of the proxy pricing proceeding.
- **FCR Filing Reforms** – For any new PPA with a term of one year or more which is requested for recovery through the FCR, the Company will include the information requested by Staff beginning with the monthly FCR filing immediately following the Commission’s adoption of the Stipulation. Xcel Energy will disclose any new resource or cost recovered through the FCR that is acquired pursuant to another states’ laws and initiatives in each monthly filing.²
- **Net Metered Resources** – The actual costs associated with Minnesota net metering resources currently in the FCR will not be recovered from South Dakota customers.

AURORA SOLAR PPA³

Staff believes the Company’s own analytical findings concluded that the Aurora Solar resource was (1) not needed to fill a capacity need, (2) not the least cost resource to fill a capacity need, and (3) was not the least cost solar project. Based on Staff’s analysis, the decision to acquire the Aurora Solar resource was clearly erroneous, and the contracted cost should not be recovered from South Dakota customers. The Stipulation allows the output of the Aurora Solar PPA to be recovered through the FCR at a rate equal to the Company’s system average cost of fuel and purchased power per kWh. The Company will not recover a capacity credit associated with the Aurora Solar project for the term of the PPA. In 2016, the system average cost of fuel and purchased power was approximately \$22 per MWh. Even with normal fuel and power market price inflation, the system average cost will be substantially less than the Aurora Solar resource’s contracted levelized cost of energy of **[Begin Confidential] [End Confidential]** per MWh over a 20-year term. Staff believes this proxy pricing method is fair given the unique circumstances surrounding this resource, and may not be applicable to the Proxy Pricing Proceeding.

¹ The Stipulation reflects Staff’s position on Capacity PPAs as explained in Thurber Direct Testimony, pgs. 10 – 11.

² The Stipulation reflects Staff’s position on FCR Filing Changes as explained in Thurber Direct Testimony, pgs. 20 – 22.

³ See Maini Direct Testimony, pg. 7 - pg. 16, for Staff’s filed position on the Aurora resource.

187 MW SOLAR PPAs⁴

Staff concluded that the 187 MW Solar PPAs were acquired to comply with the Minnesota Solar Energy Standard (SES) and there was no evidence to support these resources as cost effective compared to other resource alternatives. Absent the Minnesota SES, there was no capacity need for the 187 MW Solar resources when the Company entered into these contracts until 2024. While these resources may provide environmental benefits and serve as a hedge against natural gas volatility, the Company provided no support suggesting that the 187 MW Solar PPAs were the most cost effective resources to provide these benefits.

The Stipulation reflects that the actual 187 MW Solar PPAs contract costs should be replaced with an energy and capacity proxy price. To address Staff's concerns regarding need, no capacity proxy will be applicable to these resources until 2024. The Parties agreed that the capacity proxy should be based off from MISO's 2014 CONE, escalated on an annual basis at the estimated rate of inflation of 2% until 2024, and applied to the MISO accredited capacity of these resources. The MISO CONE capacity proxy price provides an independent and verifiable price that represents the current capital cost of constructing a power plant. The energy proxy price will be established in the Proxy Pricing Proceeding.

C-BED AND RDF PPAs⁵

Staff believes the RDF and C-BED resources were acquired to promote uneconomic and inefficient energy policy goals of another state. The Stipulation reflects that the actual RDF and C-BED PPA contract costs should be replaced with an energy and capacity proxy price. While Staff argued disallowance or direct assignment of the resource to the mandating jurisdiction, a proxy price could serve as a reasonable method to achieve a fair price and retain aspects of the integrated system. Although these resources will be included with the 187 MW Solar PPAs as part of the Proxy Pricing Proceeding, the RDF and C-BED resources may ultimately have a different proxy price method applied than the 187 MW Solar PPAs.

BIOMASS PPAs⁶

Staff is concerned with generation resources that are acquired to comply with another states' law that requires specific fuel types without regard to economics. Xcel Energy's primary argument is the resources were necessary for the continued operation of its nuclear fleet. While Staff has supported the Company's nuclear fleet as a low cost generation resource, this support has limits. The requirements put on the Company by the state and communities where the facilities are located need evaluation for reasonableness before the associated costs are recovered from South Dakota customers.

Staff does recognize that the Biomass resources have been recovered from South Dakota customers for a long period of time, and Staff believes the Commission was generally aware that the Biomass resources were being recovered. No Staff member currently employed worked for the Commission in 1994 when the legislation was enacted or the early 2000s when the recovery began from South Dakota customers, so Staff cannot opine on the support provided by the Commission and Staff at the time. In addition, Staff and the

⁴ See Maini Direct Testimony, pg. 17 - pg. 28, for Staff's filed position on the 187 MW Solar PPA resources.

⁵ See Thurber Direct Testimony, pg. 6 lns 4 – 13, pg. 7 lns 31 - 34, pg. 12 ln 8 – pg. 16 ln 15, for Staff's filed position on C-BED and RDF resources.

⁶ See Thurber Direct Testimony, pg. 5 ln 34 – pg. 6 ln 4, pg. 7 lns 17 – 29, pg. 16 ln 17 – pg. 17 ln 26, for Staff's filed position on Biomass resources.

Company could not find any Orders from the Commission associated with these resources. Given the long-standing recovery of the costs of these resources and the Company's initiative to terminate these PPAs, Staff supports the recovery of costs associated with the Biomass resources through the term of the contract in consideration of the Company's acceptance of other contested items.

NET METERED RESOURCES

In direct testimony, Staff requested more information on Net Metering and Made in Minnesota resources. It was unclear what costs, if any, associated with the Made in Minnesota and Net Metering resources are being recovered from South Dakota customers through the FCR or base rates. The Company provided the information requested by Staff in response to Staff Data Request 7-6, which is provided in Exhibit A to this Memorandum. Made in Minnesota resources are very similar to Net Metering resources, and are treated comparably in this settlement.

The South Dakota legislature has considered mandatory net metering policies on multiple occasions and has concluded net metering is not in the public interest. Staff believes South Dakota customers should not subsidize Minnesota's net metering policies. Generally, net metering forces Xcel Energy to pay the generator above market cost for its electricity, and results in increased electric costs for all customers. The Stipulation removes the costs associated with Minnesota net metering resources currently in the FCR, resulting in an annual disallowance of approximately \$11,000.

PROXY PRICING PROCEEDING

Within 120 days following the Commission's adoption of the Stipulation, the Company will initiate another proceeding to propose a proxy price for the unresolved energy and/or capacity prices applicable to the 187 MW Solar PPAs, the RDF PPAs, and the C-BED PPAs. The application of the proxy energy and capacity pricing will be retroactive to December 1, 2016, upon completion of the proceeding.

Staff commends Xcel Energy for initiating the request for another proceeding through rebuttal testimony. The Company's proposal alleviates the statutory time constraint associated with the FCR suspension and will allow interested parties adequate time to evaluate proxy pricing concepts. At the same time, South Dakota customers are protected by the agreement to retroactively apply any proxy price to the FCR suspension date.

While the proxy pricing proceeding only applies to the resources listed above, the framework established in this proceeding may serve as an indication of how the Commission will treat future resource decisions driven primarily by state policies. Staff is committed to explore all possible proxy price methods as a way to determine a fair and reasonable price for electricity, but reserves the right to recommend disallowance of resources if the Parties cannot agree to a proxy price.

FCR BALANCING ACCOUNT AND RATE VOLATILITY

The proposed FCR to be effective December 1, 2016, was suspended for 180 days. As Staff explained at the December 6, 2016 Commission meeting, by suspending the FCR, the FCR rates effective November 1, 2016, as filed on October 31, 2016, would remain in effect through the suspension period. However, the Company implemented the proposed FCR rates on December 1, 2016, and these rates have remained in effect to date. Xcel elected to not put interim rates into effect subject to refund once the 180 day period concluded and instead kept the FCR frozen at the December 1, 2016 rates. Although the Company's

implementation of the proposed December 2016 FCR rates violates the Commission's Order Suspending Fuel Clause Rider for 180 days, as long as all outcomes of this proceeding are retroactive back to December 1, 2016, any over or under recovery in the FCR balancing account as a result of a different rate being implemented will ultimately be charged or refunded to customers. Since interest is applied to the balancing account, customers are relatively indifferent to this error and the FCR rate can be adjusted to fix this oversight.

Xcel submitted monthly informational reports detailing the FCR balance throughout the suspension period in order to allow Staff and Xcel to monitor the balancing account level. Most recently, the Company provided to Staff that the total balance of unrecovered expenses as of July 2017 is \$3,230,889. Such a balance is reaching a level that is fairly significant to pass on to customers all in one month and would cause FCR rate volatility for customers. Therefore, Staff recommends the Company smooth out the balance over a number of months. Xcel will provide Staff a specific proposal to smooth out the balance and will file for Commission approval of such a plan prior to implementing the FCR rates to be effective October 1, 2017.

Staff notes this balance assumes Xcel should have received full recovery of all Identified PPAs during the suspension period. The balance will need to be adjusted based on the proxy pricing agreed to in this proceeding prior to new FCR rates going into effect. Staff has requested the Company make a compliance filing on or before October 1, 2017, detailing the amount that customers will be refunded associated with the Aurora project proxy pricing back to December 1, 2016.

The Parties agree that upon approval of this Stipulation, Xcel will calculate the refund associated with the Aurora project and will include this refund, with interest, in the calculation of the FCR rates to be effective October 1, 2017. Customers will continue to be billed the FCR rates effective as of December 1, 2016, until October 1, 2017.

Although new FCR rates will be in effect as of October 1, 2017, the FCR will be subject to refund based on the results of the proxy pricing proceeding. The application of the proxy energy and capacity pricing determined in the proxy pricing proceeding will be retroactive to December 1, 2016.

RECOMMENDATION

Staff recommends the Commission grant the Joint Motion for Approval of Settlement Stipulation and adopt the Stipulation without modification, with an FCR effective date of October 1, 2017. Prior to October 1, Staff recommends the Company file:

- (1) A compliance filing that provides the amount that customers will be refunded associated with the Aurora project proxy pricing back to December 1, 2016; and
- (2) A docket with a proposal to mitigate the potential FCR rate volatility associated with the unrecovered amount in the balancing account.