

E-002/C-92-899 ORDER REQUIRING NEGOTIATIONS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner

In the Matter of the Complaint
of LS Power Corporation Against
Northern States Power Company

ISSUE DATE: April 12, 1993

DOCKET NO. E-002/C-92-899

ORDER REQUIRING NEGOTIATIONS

PROCEDURAL HISTORY

On August 7, 1992 the Commission received a complaint from LS Power Corporation (LS Power or Complainant) against Northern States Power Company (NSP or Company). The complaint alleged that NSP refused to negotiate in good faith or enter into a contract for the purchase of power from LS Power's proposed cogeneration facility in Cottage Grove, Minnesota. The proposed development is a natural gas fired, combined cycle cogeneration facility, with 3M's Chemolite Plant serving as the steam host. The facility would have a capacity of approximately 220 megawatts.

NSP notified LS Power on or near the date the complaint was filed of the Company's intent to develop a competitive negotiation or bidding process to use in filling the capacity need that LS Power and other developers were seeking to meet. NSP subsequently filed its answer to the complaint on August 27, 1992. The Commission received comments on September 8, 1992 from LS Power; AES Plover, Inc. (AES); Rainy River Energy Corp. (Rainy River); the Department of Public Service (Department); the Residential Utilities Division of the Office of the Attorney General (RUD-OAG); and 3M. The University of Minnesota (University) and Izaak Walton League filed comments on September 9, 1992.

The Commission initially met to resolve the complaint on November 23, 1992. The Commission continued the proceeding pending further written briefing on the issue of LS Power's status vis-a-vis other qualifying facilities seeking to sell power to NSP. Initial briefs were filed on December 14, 1992, from LS Power, NSP, Rainy River, AES, the University, and the Department. The Commission also received a joint brief on that date from the OAG-RUD and the Izaak Walton League. Reply briefs were filed on December 21, 1992 from all the parties except the

University. The Commission received a letter from Project Environment Foundation on December 22, 1992. This letter supported the joint reply brief of the RUD-OAG and Izaak Walton League.

On January 12, 1993, the Commission issued an Order initiating an investigation into the possibility of establishing a competitive bidding process to meet the future capacity needs of NSP. In the Matter of an Investigation into Establishing a Bidding Process to Select Resources to Meet the Future Capacity Needs of Northern States Power Company, Docket No. E-002/CI-93-6, ORDER REQUIRING BIDDING PROPOSAL (January 12, 1993). This Order severed the consideration of bidding from LS Power's complaint.

The Commission met on February 25, 1993 to consider this matter in light of the briefs received in response to the Commission's request at its meeting on November 26, 1992. The Commission met again on March 11, 1993 for final deliberations on this matter.

FINDINGS AND CONCLUSIONS

The complaint in this case alleges that NSP has failed to negotiate or enter into a contract, based upon LS Power's proposal, in violation of NSP's obligations under state and federal law. NSP has responded by expressing its desire to use a formal competitive negotiation or bidding process to select from among the competing developers, which include LS Power. NSP informed LS Power of this intent by letter dated August 6, 1992.

This complaint presents three issues: (1) whether NSP is obligated to enter into a contract with LS Power, or provide LS Power with the right of first refusal with respect to competing proposals, for the purchase of the electric output of LS Power's proposed cogeneration facility; (2) whether NSP has failed to negotiate in good faith with LS Power in violation of its legal obligation under Minnesota law; and (3) whether NSP should negotiate exclusively with LS Power or collectively with all appropriate developers who have offered proposals. Each issue will be addressed in turn.

I. OBLIGATION TO ENTER INTO CONTRACT

LS Power asserts that NSP is obligated to enter into a contract to purchase power from its proposed cogeneration facility. In the alternative, LS Power maintains that NSP should offer it the right of first refusal, requiring NSP to award the power purchase contract to LS Power if it can meet or beat the terms offered by other developers.

LS Power offers two theories to support its claims against NSP. First, LS Power argues that it is entitled under Minnesota law to a contract or right of first refusal as against other developers because LS Power's cogeneration proposal was "first in line" ahead of the proposals of other developers. Second, LS Power argues that it has a legally enforceable obligation (LEO) to provide power to NSP, which under federal law requires NSP to enter into a contract for the purchase of that power. The Commission rejects both arguments and finds that LS Power does not have a legally enforceable obligation or any special right of priority based on the timing of its proposal relative to other developers.

First Come, First Served

LS Power maintains that Commission precedent entitles it to a contract or right of first refusal based on the timing of its proposal relative to other developers. LS Power appears to have been the first developer to provide NSP with a proposal to meet most of its projected need for up to 300 megawatts of intermediate capacity the year 2000.¹ LS Power argues that the Commission's 1989 decision in In re County of Dakota, 104 P.U.R. 4th 224, established a policy that gives priority in awarding power purchase contracts to the developer who first proposes a facility. The Commission disagrees.

The Dakota case provided that the avoided costs used in negotiations would be available on a "first come first served basis;" it did not establish a basis for selecting from among competing suppliers seeking to meet the same capacity requirement. The Dakota case involved two small projects with a combined capacity far less than the utility's capacity need. The facts of that case simply did not raise the issue presented here, where multiple suppliers are offering capacity that exceeds the need identified by NSP. The issue in this proceeding, therefore, is one of first impression.

The first come, first served approach has been used in some jurisdictions. The Commission, however, does not believe this is the appropriate standard in this case. A first come, first served rule would give undue weight to the relative timing of the proposals and not enough consideration to the relative merits of the projects. The interests of ratepayers and QF developers are

¹ AES Plover, Inc. filed its proposal to provide NSP's capacity need for 1997 within 2 weeks of LS Power's proposal. The University of Minnesota's discussions with NSP regarding the sale of power from its planned cogeneration facility began as early as 1990. A construction contract for the University's project has been awarded, and both fuel and financing commitments have been secured.

best served by careful consideration of and good faith bargaining with all developers, so long as the negotiations with one developer do not unduly delay agreement with any others. These negotiations should focus on the broad array of factors that go into selecting a power supplier. NSP can and should negotiate with any or all developers who have submitted proposals. This will ensure the protection of ratepayers consistent with NSP's obligation to deal with QFs under federal and state law.

Legally Enforceable Obligation

The Public Utility Regulatory Policies Act of 1978 (PURPA or the Act) requires a public utility to purchase electricity that a qualifying facility (QF) makes available to it, at full "avoided cost." 16 U.S.C. § 824a-3. Avoided cost is the incremental cost a utility would incur to generate or purchase energy if it did not purchase the energy from a qualifying facility. 18 C.F.R. § 292.101 (b) (6). The mandatory purchase provision of PURPA is intended to encourage the development of cogeneration and renewable energy facilities. Limiting QF rates to the utility's avoided costs protects ratepayers from paying more than they would otherwise pay for power absent the utility's purchase from a QF.

A qualifying facility can provide energy to a utility when the energy becomes available or pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term. 18 C.F.R. § 292.304 (d). If energy is provided under a legally enforceable obligation, the QF may elect to receive payment based on the avoided costs at the time of delivery or at the time the obligation is incurred. LS Power argues that it had a legally enforceable obligation to provide energy from its proposed facility as of March 4, 1992, when it submitted its proposal to NSP. The Commission disagrees.

The issue of whether a QF has a LEO has not been addressed previously in Minnesota. Commissions and courts in other jurisdictions have generally found a LEO to exist when a QF has done everything within its power to create an enforceable obligation such that only an act of acceptance by the utility or approval by the state regulatory authority remains to establish the existence of a contract. This inquiry is very fact-specific and involves the consideration of a number of factors, including but not limited to (1) price; (2) site and design details of the proposed QF; (3) interconnection plans; (4) financing for the project; and (5) fuel supply.

The Commission finds that LS Power's proposal was not sufficiently complete in these areas to give rise to a LEO as of March 4, 1992. The proposal submitted on that date was a "term sheet" which did not show the required commitment to provide energy or capacity. It had no signature page and lacked detail

in a number of fundamental areas such that it could not have been intended as more than a basis for future negotiations.

LS Power submitted a contract to the Commission on August 6, 1992 as part of its complaint. This contract, however, was not submitted to the Company for negotiations prior to the filing of the complaint. Moreover, although the contract provided more detail than the March 4 term sheet, it still lacked the breadth of detail necessary to establish a LEO. It identified the site and the steam host (3M), but did not include a letter of intent or memorandum of understanding to show that 3M would purchase the steam. It did not include details on interconnection, which may be important if there are transmission problems in connecting LS Power's proposed QF to NSP's system. The contract proposal lacked important agreements related to financing and gas supply. It also failed to include an appendix to which it referred that would have explained important details of the available capacity and capacity audit procedures.

Based on its review of the facts in this case, the Commission finds that LS Power did not have a legally enforceable obligation as of March 4, 1992, or August 6, 1992. Viewing the transaction as a whole, considering all the relevant factors, the Commission is unable to conclude that LS Power has a legally enforceable obligation to sell energy or capacity to NSP. It is clear from the record that further negotiations are required to achieve the completeness and specificity necessary to support a finding that LS Power or any other developer has a LEO.

II. OBLIGATION TO NEGOTIATE

A utility is obligated under both state and federal law to negotiate in good faith with a QF developer. Minn. Stat. § 216B.164; Minn. Rules, part 7835.3200. LS Power asserts that NSP failed to fulfill this obligation when it terminated negotiations in order to implement a competitive negotiation process to address the various proposals it had received.

The Commission agrees that NSP should not have unilaterally suspended negotiations with LS Power without prior Commission approval. However, the Commission does not find that NSP has been unduly recalcitrant or that NSP has been negotiating in bad faith. NSP's actions to date have been based on legitimate questions and confusion regarding the procedures to be followed in selecting from among competing QF developers. This is understandable given the absence of rules or precedent in Minnesota addressing the issue of multiple contemporaneous proposals. Nonetheless, the Commission finds that NSP must resume negotiations with LS Power and any other developers with whom the Company has been negotiating. These negotiations must proceed expeditiously as provided in this Order.

III. NEGOTIATION PROCESS

Simply ordering NSP to negotiate with LS Power would be inadequate in this case given the number of other developers who have come forward with proposals. The involvement of multiple developers has, in fact, been the principal catalyst for the events that lead to this complaint. Therefore, the Commission concludes that NSP must negotiate simultaneously with all the developers who are on record in this case as having submitted proposals to meet all or part of NSP's projected need for intermediate capacity before the end of this decade.

The Commission recognizes the benefits of a competitive process for selecting power supply projects. That is why the Commission initiated an investigation into the possibility of establishing a competitive bidding process to address NSP's future capacity needs. In the Matter of an Investigation into Establishing a Bidding Process to Select Resources to Meet the Future Capacity Needs of Northern States Power Company, Docket No. E-002/CI-93-6, ORDER REQUIRING BIDDING PROPOSAL January 12, 1993). Unfortunately, the competitive negotiations proposed by NSP lack the safeguards necessary to ensure a fair process.

Although adequate safeguards could be developed, there is not enough time to do so and still preserve the rights of the current set of developers to a process which can conclude while they are still viable. Therefore, the Commission rejects the Company's request to engage in competitive negotiations with the developers in this case. The Commission also rejects a sequential process in which negotiations with one party await the conclusion of bargaining with another. Such an approach would also risk unacceptable delay that could jeopardize the rights of the current developers. The Company must negotiate with each developer individually at roughly the same time it negotiates with the others.

The negotiations must proceed expeditiously and be completed no later than 45 days from the date of this Order. The Commission expects the Company to negotiate the best agreement or agreements it can and present the results to the Commission within the 45 day period. The Company's filing with the Commission should include an explanation of its choice of developer(s). Given the substantial work that has already been done, the Commission believes NSP can and should complete its work and submit an agreement in less than the allotted time. The Commission is concerned that any further delay might defeat the statutory directive to encourage cogeneration and small power production consistent with the protection of ratepayers. This would not be acceptable.

The Company is obligated to negotiate in good faith with developers proposing projects that qualify under PURPA and the Commission fully expects it to fulfill this obligation. The negotiations with LS Power are sufficiently advanced that NSP should be in a position to provide a counter offer. This may also be true with respect to other developers. In choosing from among the proposals, NSP should not focus exclusively on cost, but should consider the broad range of relevant factors, including reliability as well as the environmental and socioeconomic benefits of the projects. The Commission expects NSP to select the project or projects that best serve the interests of its ratepayers and the public. This decision should be made promptly, consistent with this Order and the Company's obligations under state and federal law.

ORDER

1. Northern States Power shall negotiate immediately and simultaneously with LS Power and any other developers who are on record in this proceeding as having submitted proposals to meet all or part of NSP's projected need for intermediate capacity before the year 2000.
2. Northern States Power shall conclude and submit the results of its negotiations to the Commission no later than 45 days from the effective date of this Order. This filing shall include an agreement with a developer, or combination of developers, with whom NSP has negotiated pursuant to this Order. The filing shall also include a narrative, setting forth the Company's reasons for its agreement or agreements.
3. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)