

E-999/CI-93-207 ORDER AFTER CONSIDERATION OF EVALUATIVE ISSUES IN  
SECTION 712 OF THE ENERGY POLICY ACT OF 1992

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair  
Commissioner  
Commissioner  
Commissioner  
Commissioner

In the Matter of an  
Investigation into Standards  
Regarding Long-term Wholesale  
Purchased Power Under Section  
712 of the Energy Policy Act of  
1992

ISSUE DATE: October 25, 1993

DOCKET NO. E-999/CI-93-207

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EVALUATIVE ISSUES IN SECTION 712  
OF THE ENERGY POLICY ACT OF 1992

**PROCEDURAL HISTORY**

On October 24, 1992, the federal Energy Policy Act of 1992 (the Energy Act) was signed into law. Section 712 of the Energy Act requires state public utility commissions to consider a standard which incorporates four evaluative issues related to long-term wholesale purchased power. By October 23, 1993,<sup>1</sup> each regulatory commission must determine whether it is appropriate to implement the standard in its respective state. The standard containing the four evaluative issues is set out in amended Section 111 of the Public Utility Regulatory Policies Act (PURPA).

On June 17, 1993, the Commission issued its ORDER ESTABLISHING COMMENT PERIOD in the above-entitled docket. In that Order the Commission allowed parties who wished to file comments regarding the proposed standard to submit those comments on or before July 30, 1993. Parties filing reply comments were given a deadline of August 31, 1993. Commenting parties were encouraged to address an attached list of questions concerning the evaluative issues.

Between July 28, 1993, and August 31, 1993, the following parties submitted written comments: the Department of Public Service (the Department); the Residential Utilities Division of the Office of the Attorney General (RUD-OAG); Northern States Power Company (NSP); Otter Tail Power Company (Otter Tail); Minnesota Power; Minnesota Rural Electric Association (MREA); Utilicorp United, Inc. (Utilicorp); Minnesotans for an Energy-Efficient Economy

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<sup>1</sup> Since October 23, 1993, falls on a Saturday, the deadline will be understood to be the next business day, which is Monday, October 25, 1993.

(ME3); Enron Power Corporation (Enron); and the Electric Generation Association (EGA).

On October 13, 1993, the Commission met to consider the parties' comments and to determine if the Section 712 standard should be implemented.

## FINDINGS AND CONCLUSIONS

### **I. Factual Background**

In 1935 the Public Utilities Holding Company Act (PUHCA) was enacted. This federal law empowered the Securities Exchange Commission (SEC) to break up large interstate utility holding companies, thus limiting the provision of electric service to local geographic areas. Since the passage of PUHCA, the electric power industry has been for the most part vertically integrated, from generation through transmission to distribution. Regulation of the industry has been largely in the hands of state commissions.

In recent years there has been a movement in the electric industry which advocates a reversal of the PUHCA "divide and regulate" philosophy. Proponents of this movement predict that a more freely competitive, nationally coordinated electric industry will bring benefits to consumers and the industry as a whole.

The 1992 Energy Act is a product of this movement toward a more freely competitive environment. The Energy Act creates a new class of wholesale power producers, Exempt Wholesale Generators (EWGs), which may be horizontally integrated across state lines. EWGs are exempt from most SEC regulation.

During congressional debate over the 1992 Energy Act, there was recognition that its passage might create competitive, financial and reliability issues. One answer to concerns raised was Section 712 of the Energy Act, which requires state commissions to address certain issues arising from the new competitive environment.

Section 712 of the Federal Energy Act, which amends Section 111 of PURPA, requires state regulatory commissions to consider the following four evaluative issues:

1. The potential for increases or decreases in the cost of capital for utilities, and any related effects on retail rates, that may result from the utility purchasing long-term wholesale power supplies instead of constructing new generating facilities;

2. Whether the use by EWGs of capital structures which employ a higher proportion of debt than the capital structures of utilities threatens reliability or gives EWGs an unfair competitive advantage over utilities;
3. Whether to implement procedures for the advance approval or disapproval of utility purchases of particular long-term wholesale power supplies; and
4. Whether to require as a condition for approval of utility purchases of power reasonable assurances of fuel supply adequacy.

## **II. Comments of the Parties**

### **A. The Department**

The Department stated that it is difficult to predict the effect of long-term purchased power on utilities' cost of capital or to determine the competitive advantage, if any, of EWGs' higher debt loads. Many of the increased financial risks associated with purchased power will be offset by other advantages. Parties can and should face issues of risk and competitive advantage and use the terms of their individual contracts to divide risk fairly.

The Department stated that the Integrated Resource Planning (IRP) process and competitive bidding procedures are adequate regulatory means of overseeing utility resource decisions. Because these measures exist, it is unnecessary to implement new regulatory methods for advance approval of purchased power contracts.

According to the Department, the reliability of fuel supply is just one risk factor which may be addressed and dealt with in purchased power contracts.

### **B. The RUD-OAG**

The RUD-OAG stated that the IRP process and individual rate cases are the proper forums for consideration of the four evaluative issues. The RUD-OAG recommended a preliminary investigation, in which the Commission would develop filing guidelines and practical evaluative standards for the IRP process. These guidelines would assist the Commission's consideration of long-term purchased power in the IRP context.

The RUD-OAG stated that the IRP process is an adequate means of providing what is in effect advance approval of purchased power contracts. According to the agency, a contract approved in an IRP as an appropriate resource choice, which performs as predicted, would be difficult to challenge in a rate case.

The RUD-OAG believed that fuel supply adequacy and reliability can be addressed in IRP and competitive bidding processes.

### **C. NSP**

NSP stated that its position is unique in at least two ways. It is the only Minnesota utility which has fully committed to a competitive bidding process, including power purchases. It would be uniquely harmed if the Commission's decision resulted in evaluative standards being developed in the context of the IRP process, because the timing of its own IRP cycle would mean that those standards could not be considered in NSP's IRP for more than three years.

NSP supported the general idea of long-term purchased power contracts, although the company stated that such contracts brought increased risk for utilities. NSP stated that the Commission should implement the four evaluative issues on a case-by-case basis for each utility. In NSP's case, the issues should be incorporated into its ongoing competitive bidding process.

### **D. Minnesota Power**

Minnesota Power advocated adoption of the four evaluative issues, and implementation of the issues on a utility-by-utility basis. Utilities differ from each other in important ways; Minnesota Power, for instance, is unlike NSP in its load characteristics and in many other features. The Commission's current proceedings, such as the IRP process, can be used to implement the Section 712 standard.

### **E. Utilicorp**

Utilicorp stated that the Commission should refrain from setting standards for the use of purchased power contracts at this time. Rather, the Commission should address the issues on a case-by-case basis, as part of the IRP process, in competitive bidding proceedings, in rate cases, and in any proceeding seeking prior approval of a power contract.

### **F. Otter Tail Power**

Otter Tail recommended that the Commission choose not to establish specific standards at this time. The Commission should let general standards evolve, based on developments in regions with significant EWG activity, and on a case-by-case experience.

### **G. Other Comments**

ME3 recommended that no adjustment be made under Section 712 which would adversely affect the economics of high efficiency cogeneration and renewable energy production by independent producers in Minnesota.

Enron, a non-utility power generator, stated that regulatory policy should reflect the new role of competition in this market and should provide an environment in which competition can work to meet the needs of electrical power customers. Enron recommended that the evaluative issues be developed on a case-by-case basis rather than by setting inflexible generic guidelines.

EGA, a national trade association representing independent power producers, argued that any increased risks of long-term power purchases must be balanced on a case-by-case basis against projected benefits. EGA suggested that the Commission hold full evidentiary hearings if it is inclined to reject preapproval or to entertain other arguments raised by utilities.

MREA, an association of electric cooperatives, stated that issues of preapproval and the Commission's review of long-term purchased power contracts are ratemaking issues between the Commission and regulated utilities. MREA stated that issues associated with EWGs, such as financial and performance reliability, are best addressed in long-term power contracts between the parties.

### **III. Commission Action**

Many parties who filed comments in these proceedings acknowledged that there is a changing environment in the electric power industry. The industry is moving away from a tightly regulated utility-focused environment toward a more freely competitive setting which will include independent, nonutility power sources. Long-term purchased power contracts with the new category of EWGs will be significant factors in this new power industry pattern. All commenting parties agreed that the issues arising from these purchased power obligations must be dealt with in some manner by state regulators.

While there is general consensus that issues arising from purchased power contracts must be addressed by the Commission, there is little agreement regarding the actual effects of the power contracts. NSP, for instance, predicts that long-term contracts will be perceived as a form of debt obligation and thus as an increased risk for the utility. According to NSP, this perception by rating entities will result in increased capital costs for the utility. The Department, on the other hand, believes that increased financial risk may be offset by such factors as lower risk of construction cost overruns. The financial effect of long-term purchased power contracts on the utility is therefore open to debate.

In the same manner, commenting parties differ in their perception of the competitive nature of EWGs. Some utilities assert that EWGs have the advantage of leveraging their enterprises highly because of the general creditworthiness and reliability of the utilities with whom they contract. Other parties point out that

EWGs' debt obligations may be shorter-term, more costly and more restrictive. In addition, contract provisions such as performance and security clauses can shift risk from the utility to the EWG, reducing the EWG's potential competitive advantage.

In like manner, parties differ on the effects of purchased power contracts on the reliability of fuel supply, and on rating entities' viewpoint of long-term purchased power obligations. These and other issues arising from purchased power contracts continue to be debated among parties.

Utilities differ not only in their perceptions of the effects of purchased power contracts, but also in their own fundamental characteristics. Utilities have different load factors and customer bases. They also differ in their development of regulatory procedures such as competitive bidding processes.

Differences will also be apparent in the contracts entered into by the utilities. Commenting parties have noted that contracts between utilities and wholesale power producers will be highly individual. Issues of risk and possible competitive advantage will be dealt with by the parties through individual terms in their contracts.

Differences of opinion regarding the issues arising from the new competitive environment, individualities of the various utilities, and unique terms in the new contracts all lead the Commission to the conclusion that setting standards to implement the evaluative issues would be inadvisable at this time. When the issues arising from the new electric power environment have been more deeply explored over time, it is possible that standards may emerge and that those standards should be codified. Any movement toward setting standards would be the product of study and dialogue among the Commission, its Staff, other concerned agencies, and industry. Any setting of standards would be premature at this time, however.

While the Commission will not set standards to implement the evaluative issues at this time, the Commission recognizes that the Section 712 evaluative issues represent genuine and well-founded concerns regarding trends in the electric industry. These concerns will arise again and again in the new competitive context; the Commission must and will deal with the issues as they arise.

Fortunately, the Minnesota Public Utilities Commission has well-developed processes which will enable the Commission to address the evaluative concerns as they arise. The IRP process is a logical forum in which the Commission examines utility resource decisions to determine which choices are in the best interests of ratepayers and the general public. Competitive bidding docket and generic Requests for Proposals are other means by which the Commission may examine utility resource choices, including long-

term power purchases. Through these procedures, the Commission can monitor the utility's long-term resource choices, as well as the specific terms of the contracts implementing those choices.

The Commission will therefore consider the four evaluative issues in IRP proceedings, competitive bidding dockets, and any other regulatory procedures in which long-term wholesale purchased power contracts are relevant. By considering these issues in the context of the Commission's ongoing regulatory procedures, the Commission will be able to maintain flexibility in a changing industry environment, while providing protection for ratepayers and the public. The Commission will also be able to ensure that the evaluative issues are implemented in a manner which is consistent with PURPA's goals of encouraging conservation of electric energy, more efficient use of facilities and resources by electric utilities, and equitable rates for electric consumers.

#### **ORDER**

1. Having performed a general evaluation of the four evaluative issues of Section 712 of the Federal Energy Policy Act of 1992, the Commission will henceforth consider the evaluative issues in integrated resource planning proceedings, competitive bidding dockets, and any other regulatory procedures in which long-term wholesale purchased power contracts are relevant.
2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Susan Mackenzie  
Acting Executive Secretary

(S E A L)