

April 24, 1995

DOCKET NO. E-002/M-95-54

ORDER APPROVING PROPOSAL WITH MODIFICATIONS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Joel Jacobs	Commissioner
Marshall Johnson	Commissioner
Dee Knaak	Commissioner

In the Matter of the Petition of
Northern States Power Company for Approval
of a Request for Proposals for Approximately
50 MW of Biomass Generation

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PROCEDURAL HISTORY

On August 18, 1994, the Commission issued its ORDER ACCEPTING COMPANY'S PROPOSAL WITH MODIFICATIONS AND REQUIRING FURTHER FILINGS in Docket No. E-002/RP-93-630; E-002/CI-93-6 (the bidding docket). In that Order the Commission approved most aspects of a supply-side bidding program proposed by Northern States Power Company (NSP or the Company). The bidding program would be used to select the Company's new capacity.

Most of the critical elements of the bidding program were referenced in a generic Request for Proposal (RFP) filed with the bidding proposal. In the August 18, 1994, Order in the bidding docket the Commission stated that the generic RFP was sufficiently developed to allow the Company to proceed with bidding. The Commission noted that parties, including NSP, agreed that some RFP issues remained outstanding and that further development of the generic RFP would be necessary.

In 1994 the Minnesota legislature passed Minn. Stat. § 216B.2424 (1994). This statute requires NSP to construct and operate, or purchase, 50 MW of installed capacity generated by farm-grown, closed loop biomass by December 31, 1998.

On January 18, 1995, NSP submitted a petition for approval of an RFP for the statutorily-mandated 50 MW of biomass-generated capacity.

Comments and responsive comments were filed by the Department of Public Service (the Department), the Residential Utilities Division of the Office of the Attorney General (RUD-OAG), the Izaak Walton League of America, and NSP.

On March 23, 1995, the Company's proposed biomass generation RFP came before the Commission for consideration.

FINDINGS AND CONCLUSIONS

I. THE COMPANY'S FILING

NSP's proposed biomass RFP consists of four main sections and five appendices. The body's four sections include: Introduction and Overview; Scope of Work; Instructions to Bidders; and Proposal Threshold Requirements. Among the appendices is a proposed standard form contract entitled Proposed Biomass Generation Purchase Agreement.

NSP's proposed biomass RFP is patterned after the generic RFP included with NSP's bidding proposal in the bidding docket.

II. COMMENTS OF THE PARTIES

A. The Department

The Department recommended that the Commission approve NSP's proposed biomass RFP with some modifications. The Department stated that the filing followed the procedures of NSP's approved bidding process. The Department also recommended approval of the standard contract included with the proposed RFP.

The Department recommended modifications to the Company's proposed use of environmental costs in its bid evaluations. The Department disagreed with the Company's view that zero environmental cost is a viable option for the evaluation process. The Department recommended that the Company use the Commission's minimum interim environmental values in its selection of the short list of bidders.

The Department did not believe that inclusion of the regulatory out clause in the proposed standard contract would result in an unacceptable allocation of regulatory risk.

B. The RUD-OAG

The RUD-OAG pointed out a number of editorial and typographical errors in the proposed RFP.

The RUD-OAG stated that there were three problem areas in the proposed RFP: the definition of biomass; NSP's proposed treatment of environmental costs; and the allocation of regulatory risk in the proposed standard contract.

The RUD-OAG recommended against Commission approval of the standard form contract as part of this proposal.

C. The IWLA

The IWLA recommended that the high value of interim environmental costs be used to select the short list of bidders.

III. COMMISSION ACTION

A. Summary of Commission Action

The Commission finds that NSP's proposed biomass RFP, with modifications, fulfills the bidding requirements previously established by the Commission.

The Commission will not approve the standard form contract included as an appendix to the RFP.

The Commission will require NSP to file a complete and corrected copy of the RFP, consistent with the findings of this Order, for Commission review.

A discussion of the major issues follows.

B. Definition of Biomass

The proposed RFP refers to the legal definition of "farm-grown, closed loop biomass," when in fact no clear statutory definition exists. The Commission agrees with the RUD-OAG that it would avoid confusion and unnecessary legal research on the part of bidders if NSP explained in the RFP that the definition of "farm-grown, closed loop biomass" is not clear. NSP concurred that the meaning was not clear and agreed to clarify this fact in the RFP.

The proposed RFP also states that NSP will accept bids for projects using fuels that do not meet the legal definition of "farm-grown, closed loop biomass." The RFP states that it will be the responsibility of the bidder to demonstrate that its proposed fuel meets the definition of biomass fuels allowed under the statute at the time bids are evaluated. The provision allowing proposals outside the legal definition of biomass was inserted due to a belief that legislation would be passed which would modify the 50 MW biomass requirement. At the time of the Commission meeting, no such legislation had been introduced. The Commission therefore finds that the provision allowing proposals outside the definition of "farm-grown, closed loop biomass" should be deleted. The Company has agreed that this is appropriate.

C. Final Proposal Evaluation

The Company's proposed RFP indicates that the evaluator's initial and final reports are filed with the Commission only if NSP's subsidiary NRG Energy Inc. (NRG) or another NSP affiliate is a short-listed bidder.

The Commission's August 18, 1994, bidding Order made it clear that the evaluator's initial and final reports are always filed with the Commission:

The evaluator's initial report and short list will be filed with the Commission, the Department, and the RUD-OAG at the same time it is served on the Company. ***** NSP will file the evaluator's final report and selection with the Commission, the Department, and the RUD-OAG at the time it announces its selection. Order at p. 3.

NSP must clarify this issue in its RFP. The Commission will require the Company to submit clarifying language in a compliance filing.

Parties also differed as to the Company's interpretation of the final selection process if NRG or another NSP affiliate is a short-listed bidder. At the March 23 meeting the parties agreed to defer discussion of this issue to a later time. Because the interpretation of this final selection scenario is currently being discussed by the parties, the Commission will require NSP to remove from the RFP the language interpreting this part of the selection process.

D. Approval of the Standard Form Contract

NSP's proposed RFP includes a standard form biomass generation purchase agreement.

The Department recommended approval of the standard form contract along with the rest of the proposed RFP.

On two previous occasions, the Commission has declined to approve or disapprove standard form generation contracts included with wind generation RFPs filed by NSP.¹ In those Orders the Commission reasoned that power purchase agreements are fact-intensive and usually require analysis and determination based upon their individual terms and parties' comments. In the second of the Orders the Commission allowed the Company to include the standard form contract with the RFP, with the explicit wording that the proposed contract had not been approved by the Commission.

The Commission sees no reason to depart from its prior reasoning in this case. At the March 23 meeting the Company stated that it did not object to receiving the same treatment from the Commission that it had received in the previous wind dockets. The Commission will not approve or disapprove the standard form contract submitted with NSP's RFP, and will require the Company to specifically note on the contract that it has not been approved by the Commission.

E. "Regulatory Out" Language

1. Introduction

Section 10.1.1 of the proposed standard form contract caused particular concern to the parties. This section provides that if any portion of the payments under the contract is disallowed by rate regulators, NSP can either terminate the purchase agreement or reduce the payments under the contract to the level for which recovery is allowed. In addition, the Company can deduct earlier payments over the allowed recovery level from subsequent payments.

The RUD-OAG recommended that the Commission remove the regulatory out language from the standard form contract. The RUD-OAG argued that this language would result in an inappropriate allocation of risk to the bidder.

The Department agreed with the Company that the regulatory out language did not on its face create an unacceptable risk allocation between the Company and potential bidders. According to the Department, the parties should be allowed to negotiate based on this standard term in the contract; the Commission has the opportunity to decide if the final terms are equitable.

The IWLA argued that regulatory out language would discourage small bidders, who would be unable to find financing because of their burden of risk.

¹ In the Matter of the Petition of Northern States Power Company for Approval of Its 1991 Resource Plan, Docket No. E-002/RP-91-682, ORDER DECLINING TO APPROVE OR DISAPPROVE STANDARD CONTRACT (August 17, 1993); In the Matter of a Request by Northern States Power Company for Approval of a Request for Proposal to Supply 100 Megawatts of Wind Generation Resources, Docket No. E-002/M-94-730, ORDER APPROVING REQUEST FOR PROPOSAL, AS MODIFIED (October 21, 1994).

2. Commission Decision

The Commission agrees with the RUD-OAG that the regulatory out language should be removed from the standard form contract included with NSP's biomass RFP. Although the Commission is not approving the terms of the contract, and language will be inserted to that effect, the Commission also finds that the language should be deleted from the contract.

The Commission finds that the regulatory out language could result in an inappropriate shift of risk to the bidder, who has no control over the Company's business decisions or regulatory behavior. The allocation of risk, especially the risk of contract termination, would be likely to cause bidders to factor higher costs into their bids. This would be particularly hard on smaller, potentially more diverse, entrepreneurs. Contract language placing risk of contract termination or payment reduction on the bidder could also result in uncertainty in the small generation projects contemplated.

The Commission will require NSP to remove the regulatory out language from the standard form purchase agreement.

F. Environmental Costs

1. Introduction

Under NSP's RFP proposal, bids would be evaluated using the three scenarios from the Commission's environmental cost docket²: no environmental costs, the low end of the interim range of costs, and the high end of the interim range. If the three short lists corresponding to the zero, minimum, and maximum externalities values were not identical, NSP's evaluator would use the no-cost scenario to determine the short list. NSP stated that this environmental cost treatment reflects its position in the ongoing environmental cost contested case proceedings, in which the Company is arguing that it is inappropriate to value externalities in bidding processes.

The Department recommended that if the three short lists of bidders differ, the evaluators would select the short list based on the Commission's low value of costs in the environmental cost docket. The Department argued that use of the no-cost scenario is not appropriate because externalities impose a real cost on Minnesota ratepayers. A high cost scenario is unlikely to be the best selection because all projects would be fueled with biomass and the range of costs would be narrow. The use of minimum values would reduce evaluation costs and simplify the RFP.

² In the Matter of the Quantification of Environmental Costs Pursuant to Laws of Minnesota 1993, Chapter 356, Section 3

The Company did not object to the Department's recommendation, as long as the Commission clarifies that its decision will not impact future decision-making in the environmental externalities docket.

The IWLA recommended that NSP be required to use the high value of environmental externalities to select its short list, to ensure that NSP has selected its new resource with the minimum impact on the environment.

2. Commission Decision

The Commission agrees with the Department that NSP should use the low value of environmental costs in selecting its short list of bidders if the short lists based on three environmental scenarios are not identical. Ignoring environmental externalities is not a viable option, because the legislature has specifically mandated consideration of environmental costs in this type of proceeding. Minn. Stat. § 216B.2422, subd. 3 states in relevant part:

A utility shall use the values established by the commission in conjunction with other external factors...when evaluating and selecting resource options in all proceedings before the commission... (Emphasis added.)

Minn. Stat. § 216B.2422, subd. 5 provides:

A utility may select resources to meet its projected energy demand through a bidding process approved or established by the commission. A utility shall use the environmental cost estimates determined under subdivision 3 in evaluating bids submitted in a process established under this subdivision. (Emphasis added.)

Application of the low end of externalities costs properly recognizes the interim nature of the values, while allowing compliance with the statutory mandate.

The Commission will require the Company to use the low value of environmental costs in its selection of a short list of bidders. The Commission clarifies that this decision is not meant to impact any future decisions in the ongoing environmental externalities contested case proceedings. Neither is the Company's agreement to apply the low range of values in this proceeding taken as a waiver of any Company argument in the environmental externalities docket.

G. Environmental Scoring

NSP's proposed method of scoring for bidder selection includes values for environmental impact.

The Department recommended acceptance of the proposed scoring method.

The Commission finds that the Company's proposed scoring for environmental impact is acceptable. The Commission will direct NSP to make the specific range of values more clear, and to submit the clarified version in a compliance filing.

H. NSP's Purchase of Energy

In its proposed standard purchase agreement, NSP refers to the issue of its commitment to purchase energy produced by the generating plant. This issue should be clarified in the body of the RFP.

The Commission will direct NSP to clarify in the RFP the issue of its commitment to purchase energy produced by the generating plant and to submit the clarified language in a compliance filing. The Commission urges the Company to work with the parties to develop the proposed language.

I. Final Version of the RFP

The Commission is requiring several modifications and clarifications to the proposed RFP in this Order. NSP has also recently made changes to the RFP in response to the RUD-OAG's typographical and editorial suggestions. The Commission will therefore require the Company to file a complete and corrected copy of the RFP for Commission review prior to its release.

ORDER

1. The Commission approves NSP's proposed biomass RFP, with the following modifications:
 - a. NSP shall explain in the RFP that the term "farm-grown, closed loop biomass" does not at this time have a clear definition under statute or rule.
 - b. NSP shall delete the provision of its RFP allowing proposals outside the definition of "farm-grown, closed loop biomass."
 - c. NSP shall clarify in the RFP that the evaluator's initial and final reports are always filed with the Commission.
 - d. NSP shall delete from the RFP the language interpreting the final bid selection process when NRG or another NSP affiliate is a short-listed bidder.
 - e. NSP shall clarify in the RFP the language describing the specific range of values for environmental scoring.

- f. NSP shall clarify the issue of its commitment to purchase energy produced by the biomass-fueled generating plant.
 - g. The Commission does not approve or disapprove the standard form purchase agreement submitted as an appendix to the RFP.
 - i. NSP shall so note on the contract.
 - ii. NSP shall remove the "regulatory out" language from the standard form contract.
2. NSP shall use the low value of interim environmental costs in its selection of a short list of bidders if the short lists based on three environmental scenarios are not identical. This decision is not meant to impact any further decisions in the ongoing environmental externalities contested case proceedings. Neither is the Company's agreement to apply the low range of values in this case taken as a waiver of any Company argument in the environmental externalities docket.
 3. Within 60 days of the date of this Order, the Company shall submit a final version of the RFP, incorporating the above modifications.
 4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)