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December 22, 2014

Darrell Nitschke  
Executive Secretary  
North Dakota Public Service Commission  
600 East Boulevard Avenue  
Department 408  
Bismarck, ND 58505

—Via Electronic Mail—

Re: Compliance Report on Potential Framework to Enable Interjurisdictional  
Renewable Energy Credit Sales  
Case No. PU-12-813

Dear Mr. Nitschke:

Northern States Power Company, doing business as Xcel Energy, submits the enclosed report regarding the Company's investigation into the development of a framework for transacting interjurisdictional renewable energy credit sales. This report is submitted pursuant to the *Order Adopting Settlement* issued by the North Dakota Public Service Commission on February 26, 2014 in the above-referenced case.

We look forward to further discussions with the NDPSC regarding its consideration of the information offered in this filing and our recommendation. Please contact me at (701) 241-8632 or [dave.sederquist@xcelenergy.com](mailto:dave.sederquist@xcelenergy.com) if you have questions regarding this submission.

Sincerely,

A handwritten signature in black ink that reads 'David H. Sederquist'.

DAVID H. SEDERQUIST  
SR. REGULATORY/FINANCIAL CONSULTANT  
NORTHERN STATES POWER COMPANY

Enclosure



## **Compliance Report on Potential Framework to Enable Interjurisdictional Renewable Energy Credit Sales**

**Case No. PU-12-813**

Northern States Power Company, doing business as Xcel Energy (NSP or the Company), submits this report regarding the Company's investigation of a framework for transacting interjurisdictional renewable energy credit (REC) sales. This report is submitted pursuant to the *Order Adopting Settlement* (Order) issued by the North Dakota Public Service Commission (Commission) on February 26, 2014 in Case No. PU-12-813.

The Company recommends that we do not move forward with interjurisdictional REC sales at this time. While such a framework might enable non-marketable RECs allocated to our North Dakota electric jurisdiction to be transferred or sold to the Company's REC portfolio for purposes of meeting renewable energy standards or objectives in other NSP jurisdictions, subject to approval of those jurisdictions, the Company currently maintains a sufficient number of banked RECs for future compliance. More specifically, the Company can comply with the 2016 and 2020 milestones of the Minnesota Renewable Energy Standard (RES) without securing additional renewable resources to comply. Additionally, with the uncertainty surrounding EPA's 111(d) Rule and the pending Restack Agreement currently being negotiated by Commission Staff and the Company, it may be premature to design and implement such a framework at this time.

### **Introduction**

The Commission Advocacy Staff and Xcel Energy entered into a Revised Second Amended Settlement Agreement (Agreement) on February 25, 2014 resolving all issues in the Company's December 2012 electric rate case filing. Parties determined that the Agreement would "...(a) result in just and reasonable rates for the Company's retail electric operations in North Dakota for a four-year period beginning January 1, 2013 and ending December 31, 2016 and (b) implement a framework to reflect North

Dakota's energy policy priorities as expressed by the Commission."<sup>1</sup> The Commission approved the Agreement as memorialized in the above-noted Order.

One condition of that Agreement related to promoting North Dakota's energy policies (and benefiting North Dakota ratepayers) is the requirement for the Company to pass 100 percent of the net proceeds for all North Dakota REC sales on and after January 1, 2014 to the state's customers.<sup>2</sup> Previously, the Company had been allowed to retain 10 percent of the net proceeds as an incentive to maximize the value of any REC sales in an immature market, in accordance with the Commission's Order in Case No. PU-10-19.<sup>3</sup>

Further, the Commission has previously expressed its intention for the Company to sell all North Dakota-allocated RECs not needed to meet the 2015 renewable objective of 10 percent. Thus, another condition of the Agreement is that the Company file a report no later than December 31, 2014 discussing the potential for establishing a process for transferring (i.e., "selling") to other NSPM jurisdictions North Dakota-owned RECs that are not viable for sale in the national REC market.

While North Dakota customers will now receive 100 percent of the net proceeds from RECs sales, we are currently experiencing a low demand for RECs both from our other jurisdictions and from the secondary market due to various evolving compliance scenarios across the utility industry. Among them, we observe that:

- 1) potential buyers are meeting their renewable generation obligations without needing to purchase RECs,
- 2) in some states buyers are restricted by legislation and/or regulation from purchasing RECs to meet those obligations, and
- 3) buyers are not seeking RECs with less popular environmental attributes such as hydro or biomass sourcing.

The following report provides a brief review of the development of the North Dakota Renewable Energy Objective (REO), an update on the status of North Dakota RECs, a current market conditions update, discussion of the REC interjurisdictional transfer

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<sup>1</sup> See page 2 of the Revised Second Amended Comprehensive Settlement Agreement (Agreement), as attached to NDPSC Order dated February 26, 2014 resolving Case No. PU-12-813, among others. <http://www.psc.nd.gov/database/documents/12-0813/200-010.pdf>.

<sup>2</sup> See page 28 of Settlement Agreement.

<sup>3</sup> Order point 3 of NDPSC's September 8, 2010 Order in Case No. PU-10-19. <http://www.psc.nd.gov/database/documents/10-0019/019-010.pdf>.

concept, and other considerations in evaluating potential transactions for interjurisdictional REC sales.

Even though the Company does not recommend moving forward with an interjurisdictional REC sales framework at this time, we describe in this report our recommended accounting process for such an interjurisdictional transfer.

## **North Dakota REO**

North Dakota's renewable energy and recycled energy objective took effect August 1, 2007 as N.D.C.C. § 49-02-28. The objective is voluntary. Utilities may count all electricity sourced by solar, wind, hydroelectric<sup>4</sup>, biomass, geothermal, hydrogen and recycled energy systems<sup>5</sup> generators towards meeting the objective if so desired.

NSP includes renewable-based generation in its fleet of facilities serving all customers in its five-state NSP-System (Minnesota, North Dakota, South Dakota, Wisconsin and Michigan). The states in the system have adopted varying energy policies, including standards and objectives, over the past several years that are intended to advance the development of renewable energy generation. We strive to manage our generation resources and plan acquisitions so as to meet all of these requirements and goals.

Towards establishing a structure to meet the North Dakota REO, the Company submitted our first annual REO compliance report for calendar year 2008 on June 29, 2009 pursuant to N.D.C.C. § 49-02-34. This report included information regarding qualifying electricity delivered and RECs purchased and retired as a percentage of annual retail sales, a brief narrative describing steps taken to meet the REO over time, and a discussion of related challenges and/or barriers.

We have since made similar annual filings with the Commission. On October 16, 2009, we provided a progress report on a REC management plan and subsequently discussed components with NDPSC Advocacy Staff. The Company requested approval in a December 31, 2009 application to implement a pilot program to sell excess North Dakota RECs. Therein, we proposed crediting net proceeds back to

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<sup>4</sup> Hydroelectric facilities must have in-service dates of January 2007 or later or repowering or efficiency improvements implemented August 2007 or later.

<sup>5</sup> N.D.C.C. § 49-02-25. Recycled energy systems are those producing electricity from currently unused waste heat resulting from combustion or other processes into electricity and which do not use an additional combustion process. The term does not include any system whose primary purpose is the generation of electricity unless the generation system consumes wellhead gas that would otherwise be flared, vented, or wasted.

customers via the Fuel Cost Rider (FCR) in the Company's electric tariff pursuant to the Commission's automatic adjustment clause rules. The Commission approved the pilot program in its Order dated September 8, 2010 in Case No. PU-10-19.

Since 2009, the Company has sold approximately 971,000 RECs for North Dakota, flowing approximately \$2,094,500 back to the state's ratepayers through the FCR as a credit on their bills.

### **North Dakota RECs**

We maintain our REC inventory in the regional Midwest Renewable Energy Tracking System (M-RETS), which was established for compliance tracking relative to state renewable energy standards. In M-RETS, one MWh of generation from a renewable source equates to one REC. In recognition of the principle that RECs remain with the associated energy until retired or sold, the Company has set-up separate state jurisdictional "holding" accounts in M-RETS and allocated RECs to each jurisdictional account in proportion to jurisdictional energy cost allocations.

We plan and operate our generation and transmission facilities as an integrated system in the most cost-effective way possible to the benefit of all customers across the five state jurisdictions served by the Company and Northern States Power Company, a Wisconsin Corporation (NSPW). The costs of this integrated system are spread across our entire customer base. As a result, North Dakota customers pay approximately 5 percent of the Company's integrated generation system including renewable based generation. Thus, a similar percentage of the corresponding earned RECs is assigned to the North Dakota jurisdiction.

The Company's early actions to cost effectively add renewable resources to our portfolio have positioned us well to comply with the renewable energy goals of each state and have produced other important benefits, including reduced regulatory risk and hedging against volatility in fuel markets. Perhaps most importantly to our ratepayers, we added many of these generation resources using a rigorous competitive bidding process to ensure the best selection was made relative to other alternatives. Using the flexibility provided by our early renewable energy acquisitions and a robust REC inventory will allow us to leverage the greatest value renewable energy projects at the lowest cost to our customers.

In its September 8, 2010 Order issued in Case No. PU-10-19, the Commission confirmed that the Company is not required to retire RECs prior to 2015. North

Dakota RECs do not have a prescribed “shelf life,” or set period of time that a REC can be used for compliance.<sup>6</sup> Thus, they have been banked from year to year in M-RETs, and some have been sold on the national market to take advantage of some very good prices.

With a 10 percent REO objective in 2015, the Company is forecasting an obligation of 223,000 RECs needed for compliance in North Dakota. With the current REC bank balance of approximately 423,000 RECs, NSP is well positioned to meet that 2015 objective and beyond.

### **Current Market Conditions**

The current market conditions are challenging for selling RECs. According to the United States Department of Energy,<sup>7</sup> current national REC pricing in the voluntary market for RECs unbundled from energy sales is approximately \$1 per REC. Older RECs generally hold less value in the market than RECs generated more recently; thus, vintage impacts the price and liquidity of REC transactions. National voluntary market REC prices have been relatively stable since 2010, but individual state REC prices vary greatly depending on the attributes of the REC, location of the generation, and renewable resource type (wind, solar, biomass).

In general, prices are lower in states with a surplus of RECs compared to states with a deficit. Since North Dakota maintains a REC surplus, current REC prices for M-RETs RECs are around the national average, currently \$1/REC. Liquidity in the market is also uncertain, and it may be difficult to find buyers for large quantities of RECs in certain areas. There is potential for increased demand in the voluntary and compliance markets as renewable portfolio requirements increase, but that remains to be seen.

### **REC Interjurisdictional Transfer Concept**

We first discussed the concept of interjurisdictional REC transfers (or sales) in our *2009 Report on Progress Towards Meeting the Renewable Energy and Recycled Energy Objective* submitted June 29, 2009. At the time, we envisioned that, to minimize overall costs, it

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<sup>6</sup> Other jurisdictions have set periods of time during which a REC can be used for compliance. For example, a REC can be used in Wisconsin for compliance with the RPS in the year that it is generated or in any of the four subsequent years. Thus, in Wisconsin, a REC generated in 2008 can be used to comply with Wisconsin’s requirements any time through 2012.

<sup>7</sup> See <http://apps3.eere.energy.gov/greenpower/markets/certificates.shtml?page=5>.

may become necessary in the future for states with lower renewable energy goals to be able to sell system generated RECs to states with higher requirements. Such a transfer approach could, theoretically, facilitate a more efficient level of renewables on our NSP integrated system. A “transfer pricing” model would need to be developed to take into account both the value of the energy resource to the NSP System and the value of the REC.

Because these transfers were not anticipated to be needed for several years, we did not actively pursue this idea. More recently, dropping wind energy prices and the Company’s efforts to take advantage of those lower prices by accelerating its additions of wind to the system have significantly reduced the need for and viability of an interjurisdictional REC transfer process. However, as a provision of the Settlement in the Company’s most recent electric rate case (PU-12-813), the Company agreed to further investigate the concept.

As discussed previously, the Company has actively worked towards REC compliance for 2015 and beyond. With banked RECs we have accumulated due to our early actions to add renewable generation to our portfolio, we are ahead of all of our state renewable energy targets and expect to generate a sufficient amount of RECs over the next several years to satisfy those obligations.

While our other jurisdictions are not in need of additional RECs, in response to the Commission's request for an interjurisdictional transfer plan, we have investigated what kind of mechanism would be needed to accomplish such transfers.<sup>8</sup> If necessary, we could liquidate North Dakota RECs through premium bilateral or brokered transactions. Any ND RECs inventory available in December from the prior year could be sold to Minnesota or another jurisdiction using third-party indicative pricing from broker sheets. For example, in December 2015, all vintage 2014 RECs remaining in North Dakota’s REC inventory could be sold. To eliminate older inventory, it may be necessary to exchange older North Dakota RECs with other jurisdictions' RECs, so that other jurisdictions can meet compliance. This would require implementation of a market-to-market valuation and a determination of which state takes the potential gain or loss.

With the described transfer mechanisms, North Dakota could benefit if the REC purchase is from RECs earned in the prior year based on the broker sheet price.

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<sup>8</sup> The Company has not, however, discussed the concept of interjurisdictional REC sales with other state regulators.

Other jurisdictions could benefit if they purchase RECs just prior to expiration at a discounted price. Regardless, any transfer agreed to would not occur for prices higher than market. But again, based on the Company's early action in renewable generation, other NSPM jurisdictions have sufficient REC balances for 2015 and beyond. Therefore the other jurisdictions do not need to acquire additional RECs.

## **Other Considerations**

### *1. Uncertainty of Environmental Protection Agency's 111(d) Rule*

In light of the uncertainty around the Environmental Protection Agency's (EPA) Section 111(d) Proposed Rules, it may be prudent to maintain a North Dakota REC inventory exceeding the amount needed to meet the state's 10 percent objective so as to be prepared for potential compliance implications of the pending federal regulations. As stated in the Commission's October 2014 press release, the Proposed Rules would "...decide how much coal, natural gas, nuclear and renewable energy North Dakota and each other state should use and how much less electricity North Dakota consumers should use. If finalized unchanged, EPA's proposed rule would require at least a 30 percent reduction in CO<sub>2</sub> emissions from existing power plants in the United States by 2030." As such, the Proposed Rules could dictate more aggressive emission control standards for the state, possibly requiring an increased use of RECs. This would decrease the surplus volume available to liquidate for interjurisdictional and/or general market sales. The rule could also create a more active market through which the Company could sell excess RECs for the benefit of North Dakota ratepayers.

### *2. Generation Restack*

As the Commission is aware, the Company and Commission Staff are currently negotiating the generation Restack methodology called for in the Settlement Agreement. If approved by the Commission, as part of the Restack, beginning in 2016 North Dakota customers could be buying their portion of the energy and capacity from certain renewable resources under a system of replacement proxy prices intended to remove the renewable premium value associated with the resource.

Consequently, North Dakota customers will no longer be purchasing their portion of the RECs generated by the restacked resources. The Restack agreement is under negotiation and not final; therefore, the impact on long-term allocation of RECs to North Dakota is unknown.

## **Accounting Considerations**

The accounting for the sale of RECs between regulatory jurisdictions would depend upon the regulatory mechanisms approved by regulators in the jurisdictions involved, as well as the REC transfer price. It is presumed that the REC transfer price would be a fixed dollar amount, specific to each transaction, based on the indicative pricing from broker price quotes (i.e. reflective of current market prices), and that all REC expenses or proceeds would be deferred and shared with the applicable jurisdiction's ratepayers through the corresponding fuel cost rider over 12 months following the period such expenses or revenues would be ordinarily recognized under Generally Accepted Accounting Principles (GAAP).

In accordance with the Company's accounting policy, RECs owned by the Company are recorded in the general ledger following an inventory accounting methodology and industry practice. Individual RECs are grouped with other RECs with similar attributes and are re-priced to the average cost of the group. One of the attributes that distinguish REC groupings is the regulatory jurisdiction where the REC originated (i.e. North Dakota or Minnesota).

Currently, all RECs owned by NSP are recorded in the general ledger at zero cost. Therefore, it is expected that the weighted average inventory value per REC would be lower than the agreed-upon transfer price. When an interjurisdictional sale occurs, REC inventory would be transferred between jurisdictional groups (for example, from North Dakota to Minnesota) at the weighted average REC inventory book value, which is currently zero. Any gains for the transferring jurisdiction (i.e. North Dakota) which result from the transfer price exceeding the book value of inventory would be deferred to a regulatory liability for refund to ratepayers through the FCA. Likewise, the amount by which the purchase price exceeds REC inventory book value would be recorded to a regulatory asset for recovery from ratepayers in the receiving jurisdiction (i.e. Minnesota). This transaction would result in North Dakota ratepayers receiving a refund for the interjurisdictional REC sale amount.

In situations in which the REC inventory identified for an inter-jurisdictional REC sale has a book value, the first step would be to compare the weighted average inventory price per REC with the agreed-upon transfer price to determine whether an inventory impairment is indicated. GAAP inventory accounting literature requires a market-based evaluation of the economic utility of an inventory expenditure to be performed, and an impairment charge would be required if the REC inventory book value exceeds the transfer price. Any impairment charges would be deferred to a

regulatory asset account for future recovery from ratepayers in the transferring jurisdiction (i.e. North Dakota). After impairment, it is anticipated that the relevant REC inventory would be valued at the transfer price, and the interjurisdictional transfer (i.e. from North Dakota to Minnesota) would occur at the new average REC inventory cost.

Overall, the appropriate accounting for the sale of RECs between NSP jurisdictions would be driven by 1) the relative sale price and book value of the RECs to be purchased and sold in such transactions, as well as 2) the regulatory mechanisms approved by the regulators of the involved jurisdictions for the sharing of resulting gains and costs with each jurisdiction's ratepayers. Assuming the fuel cost rider would be the approved mechanism for sharing of the gains and costs of the transactions, and that the REC sale prices would be higher than book value, the receiving jurisdiction would recognize a regulatory asset for its costs, and the transferring jurisdiction would recognize a regulatory liability for its gains at the time of the transaction, to be shared with ratepayers over an approved period of time.

## **Conclusion**

We have explored the current potential for interjurisdictional transfers of North Dakota-owned renewable energy credits. The Company does not believe that interjurisdictional REC sales are a viable option at this time. Other NSP jurisdictions are not in need of additional RECs and therefore, there is no benefit to the NSP system to be able to sell RECs between the jurisdictions. Additionally, there is much uncertainty surrounding the impact of EPA 111(d) rules and the not-yet-finalized Restack Agreement, which would suggest that it would be premature to design, implement, and gain the approvals for an interjurisdictional transfer process. Alternatively, the Commission could direct the Company to sell RECs more aggressively on the open market. However, it would be likely that RECs would be sold at an overall lower price under that scenario.