BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE PETITION FILED BY NORTHERN STATES POWER COMPANY FOR APPROVAL OF THE INCLUSION OF FINANCIAL INCENTIVES IN ITS FUEL CLAUSE	))))	ORDER APPROVING PETITION EL99-021

On December 23, 1999, the Public Utilities Commission (Commission) received a Petition for Approval of the Inclusion of Financial Incentives in its Fuel Clause from Northern States Power Company (NSP). In the petition, NAP requested approval of the use of financial instruments and linked transactions to be considered as part of its Fuel Adjustment Clause pursuant to SDCL 49-34A-25.

In its petition, NSP requested that it be allowed to use financial instruments such as futures contracts, option contracts, and linked transactions to help reduce price and volatility for its customers. The first type of instrument proposed to be used by NSP is a futures contract. A futures contract is similar to a forward contract in that it locks in the price of electricity. The difference is that with a futures contract NSP will typically close out the futures contract and then purchase energy at the market price. NSP would then reflect the locked-in price through the recognition on NSP's books of a gain or loss on the transaction and apply the gains and losses to the fuel clause.

The second type of instrument is an option contract. An option contract will give NSP the choice to elect delivery at a fixed price, by paying an option premium, without any obligation to actually take the energy. NSP stated that it may utilize options with power-producing entities or with futures contracts. NSP stated that the costs and revenues of options contracts should be allowed to flow through the fuel clause because those costs and revenues reflect the actual costs and benefits of securing optimally priced power.

The third type of instrument is a "linked" or transmission sensitive forward contract. This type of instrument would allow NSP to create linked forward transactions based upon transmission price differentials in order to lower costs. NSP stated that opportunities to link transactions exist because of regional market price differences and that linked transactions can result in lower overall total cost of energy to customers. NSP stated that without fuel clause recovery, it would take a loss on this transaction.

On December 30, 1999, the Commission received a Motion to Disallow Petition and to Compel Posting of Bond from Commission Staff. In its motion, Staff requested that a hearing date be set to determine an appropriate bond in the event NSP implements its proposals in accordance with its proposed effective date of January 1, 2000, and Staff further requested that the Commission disallow the petition.

At its January 18, 2000, meeting, the Commission considered this matter. NSP represented that it would not include the use of financial instruments and linked transactions in its fuel clause prior to Commission approval. Based on that representation, Staff withdrew its request for a hearing concerning the posting of a bond. On January 27, 2000, NSP filed a response to Staff's motion and requested that the Commission deny Staff's motion to disallow the petition.

On March 16, 2000, the Commission received a Stipulation of Facts entered into by NSP and Staff. Under the stipulation, NSP and Staff agreed to certain conditions under which NSP will operate if the Commission approves NSP's petition. NSP and Staff also agreed to a briefing schedule to address whether the petition is legally permissible. Briefs were filed as scheduled and on April 13, 2000, the Commission heard oral arguments from NSP and Staff concerning the petition.

The legal issue presented to the Commission is whether SDCL 49-34A-25 allows the recovery of gains, losses, and costs associated with the financial instruments to be flowed through the fuel clause as automatic adjustments of charges for service. SDCL 49-34A-25 provides as follows:

> The commission shall permit a public utility to file rate schedules containing provisions for the automatic adjustment of charges for public utility service in direct relation to changes in wholesale rates for energy delivered, the delivered costs of fuel used in generation of electricity, the delivered cost of gas, ad valorem taxes paid, or commission approved fuel incentives. The amended rate schedules shall be filed with the commission on or before the effective date of the change in costs, and if the commission determines that the revised rate schedule is in error, the commission may within ten days of receipt thereof require by order the public utility to file a bond or other security upon such terms and conditions as the commission may require and for such purposes as contained in §§ 49-34A-17 and 49-34A-22. Such rates may go into effect on the date of the change in costs subject to the above refund provisions. Failure of the commission to enter an order in regard thereto shall be deemed approval. The public utility may appeal such order pursuant to and in accordance with § 49-34A-62.

In its petition, NSP stated that current fuel clause rules prohibit NSP from passing through a recognized gain through the fuel clause and also referenced a "variance to the fuel clause." However, at oral argument NSP stated that it was not seeking any waivers or variances. NSP explained that the references to waivers or variances in its petition applied to other states where it filed similar petitions and was not applicable to South Dakota. NSP stated that in this case it was seeking an interpretation of SDCL 49-34A-25 and it was NSP's position that this statute allows the recovery of gains, losses, and costs associated with the financial instruments as described in its petition.

In its brief, NSP asserted that its request for fuel clause recovery is allowable as a cost component of "wholesale rates for energy delivered. . . ." NSP stated that the charges are components of market based transactions. NSP also argued that the phrase "in direct relation to changes" allows indirect purchases of energy through financial instruments since those purchases change in direct relation to the cost of wholesale energy purchases. Finally, NSP claimed that the cost recovery of financial instruments is allowable under the clause allowing for recovery of "commission approved fuel incentives." NSP stated that allowing cost recovery of financial instruments gives NSP the incentive to hedge prices for customers in an attempt to lower overall costs.

Staff's position was that these financial instruments are not allowed under SDCL 49-34A-25. Staff stated that the transaction gains and losses which NSP proposes flowing though the fuel clause are not "charges for public utility service in direct relation to changes in wholesale rates for energy delivered. . . ." *See* SDCL 49-34A-25. Staff also stated that these transactions do not fall under the statutory provision which allows "commission approved fuel incentives" to be placed in the fuel clause. Staff asserted that this clause only applies to incentives relating to the purchase of fuel, not the purchase of electric wholesale power.

In the event the Commission approved the use of the financial instruments, NSP and Staff agreed to certain conditions, attached as Exhibit B to the Stipulation of Facts. The conditions imposed reporting requirements; required that the use of the financial instruments would be for a 12 month test period, to be extended an additional 12 months upon Commission approval; changed tariff language (attached as Exhibit 1); capped any losses, premiums and transactions costs at $875,000.00; and allowed the Commission to terminate NSP's authority to use these financial instruments upon three months' notice. The Stipulation also referenced NSP's commodity risk management policy which provides guidelines to its employees pertaining to the use of financial instruments. This document was attached as Exhibit C to the Stipulation and filed as confidential.

The Commission has jurisdiction over this matter pursuant to SDCL Chapter 49-34A, specifically SDCL 49-34A-25. At its April 27, 2000, meeting, the Commission considered this matter. The Commission voted unanimously to approve NSP's petition. The Commission finds that these financial instruments are designed to reduce energy price volatility, lower costs to consumers, and minimize risk. The Commission finds that these financial instruments can be considered as part of the wholesale cost of energy. The Commission adopts the conditions as stated in Exhibit B, which is hereby incorporated by reference. The Commission approves the tariff change to Section No. 5, Original Sheet No. 64 as shown in Exhibit 1 to Exhibit B. The Commission further requires NSP to follow its commodity risk management policy, which is hereby incorporated by reference. Finally, the Commission states that, in future filings, NSP should take the time to make its filing specific to South Dakota, and not file a generic filing that references waivers and variances to nonexistent Commission rules.

It is therefore

ORDERED, that NSP's request to allow the use of the financial instruments as described in its petition is granted subject to the conditions listed in Exhibit B; and it is

FURTHER ORDERED, that NSP's tariff revision is approved as shown in Exhibit 1 to Exhibit B; and it is

FURTHER ORDERED, that NSP shall follow its commodity risk management policy.

Dated at Pierre, South Dakota, this 10th day of May, 2000.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that this document has been served today upon all parties of record in this docket, as listed on the docket service list, by facsimile or by first class mail, in properly addressed envelopes, with charges prepaid thereon.

By: Delaine Kolbo

Date: 5/10/00

(OFFICIAL SEAL)

BY ORDER OF THE COMMISSION:

James A. Burg

JAMES A. BURG, Chairman

Pam Nelson

PAM NELSON, Commissioner

Laska Schoenfelder

LASKA SCHOENFELDER, Commissioner