

Public Version

MESABA ENERGY PROJECT

REPORT TO THE MINNESOTA PUBLIC UTILITIES COMMISSION

SECTION VI

SUMMARY OF KEY PPA TERMS AND CONDITIONS

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SUMMARY OF KEY PPA TERMS AND CONDITIONS

BACKGROUND

Because NSP does not have a standard form power purchase agreement for a base load power plant, Excelsior has developed a base load contract that takes into account both the base load nature of Unit One of the Mesaba Project (“Unit One”) as well as the operational issues required by IGCC technology (such as its fuel flexibility).

The starting point for the Base Load Power Purchase Agreement submitted for approval in this docket (the “Mesaba PPA”) is NSP’s Model Dispatchable Power Purchase Agreement from July, 2004 (the “Model PPA”). Excelsior then worked with a team of internal and external experts, including Credit Suisse First Boston (financial advisor) and outside counsel to modify the Model PPA appropriately to allow Mesaba One to be financed in a way that will yield the lowest cost of energy. Many of the terms and conditions in the Model PPA have therefore been rewritten to apply in this context.

The key risk-shifting provisions of the Model PPA remain. The Mesaba PPA transfers all development, construction and significant operating performance risk to the project owner and lenders and away from the ratepayers who would bear those risks in a rate-based, utility self-build project. The Mesaba PPA retains the key feature of the Model PPA that no payments will be made to the project owner until the commercial operation date of the facility. This is in contrast to a self-build project where utilities recover all development, feasibility analysis and planning costs for new units from ratepayers on a current basis, and where utilities are increasingly requesting current recovery of costs relating to design engineering and construction costs and expenses before a facility is used and useful in the sense that it is producing power.

In addition, all risks of cost overruns during the construction phase of the Project are borne under the terms of the Mesaba PPA by the project owners. Again, this contrasts with the traditional cost-of-service model that would require the ratepayers to incur the overrun costs, unless it could be demonstrated that such costs were not prudently incurred. The Mesaba Project sponsors also bear the risk that the Project does not perform as expected. In such event, the ratepayers pay only for capacity and energy that is actually delivered. In contrast, once a utility plant is approved, the ratepayers bear the risk that plant performance is substandard, unless imprudent practices can be proven.

Mesaba One will be financed based upon a traditional, limited recourse project finance model, as outlined in detail in the Financing Plan in Section IV of this Report. The foundation for any large infrastructure project financing is a set of separate yet integrated commercial agreements among the various parties needed to build and

operate a project.¹ In order to minimize the risk-adjusted cost of electricity provided to NSP's customers, each project agreement places risks associated with the project on the party in the best position to mitigate the identified risk. This summary describes the principal changes to the Model PPA that were made in drafting the Mesaba PPA and where appropriate explains why the specific terms and conditions in the Mesaba PPA allocate risks appropriately to achieve the lowest cost, risk-adjusted cost of power for NSP's customers.

ARTICLE 1 - DEFINITIONS

[Trade Secret Data Begins]

[Trade Secret Data Ends]

As the name integrated gasification combined cycle clearly indicates, Mesaba One combines two facilities to produce power from a combined cycle power plant using synthesis gas from a gasification island as a primary fuel source. Therefore the Mesaba PPA defines both the "Gasification Island" and the "Power Island" for ease of reference throughout the agreement. This distinction is particularly important since, unlike a conventional coal-fired power plant, the Power Island of Mesaba One can operate using natural gas as a back-up fuel if for any reason there is an outage of the Gasification Island.

ARTICLE II – TERM

The term of the Mesaba PPA is 25 years from the Commercial Operation Date, allowing Mesaba One to maximize the use of long term debt, thereby providing a lower tariff. Such term is consistent with the language of the IEP Statute which states that the capacity and energy shall be sold under a long-term contract.

¹ In the case of a power plant project, the typical project agreements would include a power purchase agreement with the off-take provider, an engineering, procurement and construction ("EPC") contract with the construction contractor, an operations and maintenance ("O&M") contract with the O&M provider, fuel supply and transportation agreements with fuel suppliers and the appropriate railroads, and an interconnection agreement with the transmission interconnect provider and system operator.

ARTICLE III – FACILITY DESCRIPTION

Construction of Mesaba One cannot begin until a 12-15 month front-end engineering and design (“FEED”) process has been completed by the engineering, procurement and construction contractor (the “EPC Contractor”), and therefore [*Trade Secret Data Begins*]

[*Trade Secret Data Ends*] following completion of the FEED work for the plant.

ARTICLE IV – COMMERCIAL OPERATION

Section 4.9 of the Mesaba PPA recognizes the fact that the Power Island of Mesaba One can operate on natural gas, and likely will be able to produce power using natural gas before construction and testing of the Gasification Island has been completed. Section 4.9 allows NSP the option to purchase energy from the Power Island before the integrated plant has been completed.

Section 4.10 incorporates in one place all of the necessary provisions addressing transmission interconnection for Mesaba One. Excelsior is proceeding diligently through the MISO process and believes if all affected transmission owners (likely including Minnesota Power and Great River Energy) comply with MISO’s recommendations and perform as legally required under MISO’s Large Generator Interconnection Agreement (the “LGIA”), then any necessary transmission upgrades will be completed well in advance of the expected commercial operation date of Mesaba One. However, because MISO has recently proposed to FERC material changes to the cost allocation and recovery mechanisms for large generator interconnection requests², and because neither the project owner nor NSP can legally control whether or not the affected transmission owners will, in fact, enter into the LGIA or perform in a timely way under that agreement, the Mesaba PPA must address the uncertainties existing under the relevant MISO rules.

The Mesaba PPA addresses transmission interconnection issues in light of three principal considerations. First, the goal is to minimize the cost impact of transmission interconnection to NSP’s ratepayers. Second, NSP, as one of the largest transmission owners in the region, is in a better position than the project owner to influence whether or not other affected transmission owners cooperate in entering into the LGIA and perform in a timely way under the LGIA. Third, in any utility self-build project, the utility ratepayers will ultimately be responsible for all related transmission upgrade costs, either through the utility’s electric generation service rates or through the utility’s transmission service rates. [*Trade Secret Data Begins*]

² See the Mesaba Transmission Plan in Section IV of this Report for a detailed discussion of the current status of transmission interconnection for Mesaba One.

[Trade Secret Data Ends].

ARTICLE V – FUEL SUPPLY ISSUES

Mesaba One’s fuel flexibility is a key commercial advantage for NSP’s customers over any other solid fuel power plant since fuel flexibility will allow Mesaba One to minimize its fuel costs over the life of the facility by not being limited to any one grade of fuel *[Trade Secret Data Begins]*

[Trade Secret Data Ends]. In addition to allowing Mesaba One to source the lowest price fuel and/or fuel mix at any time, Mesaba One will also be able to mitigate any supply disruptions (either due to mine production or rail transportation) by using alternative fuels. *[Trade Secret Data Begins]*

[Trade Secret Data Ends].

ARTICLE VI – OBLIGATION TO SELL CAPACITY AND ENERGY

[Trade Secret Data Begins]

[Trade Secret Data Ends]

ARTICLE VIII – PAYMENT CALCULATIONS

[Trade Secret Data Begins]

[Trade Secret Data Ends]

ARTICLE 11 OF THE MESABA PPA – DEFAULTS AND REMEDIES

Because Mesaba One is a large, base load coal-fueled facility with a multi-year construction schedule, the Mesaba PPA builds in appropriate flexibility before events of default can be declared. *[Trade Secret Data Begins]*

[Trade Secret Data Ends]

Exhibit A to PPA Summary

TARIFF DESCRIPTION

The tariff structure in the Mesaba PPA reflects a traditional power purchase agreement tariff, with four components that provide for payment of electric capacity and energy production in a manner that appropriately covers the Seller's cost to provide each service. [*Trade Secret Data Begins*]

[*Trade Secret Data Ends*]

PAYMENTS FOR CAPACITY

[*Trade Secret Data Begins*]

[Trade Secret Data Ends]

PAYMENTS FOR ENERGY PRODUCTION

[Trade Secret Data Begins]

[Trade Secret Data Ends]