David R. Moeller
Senior Attorney
218-723-3963
dmoeller@allete.com

May 30, 2017

VIA ELECTRONIC FILING

Mr. Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
350 Metro Square Building
121 Seventh Place East
St. Paul, MN 55101

Re: Minnesota Power's Comments
In the Matter of Minnesota Power's Renewable Resources Rider and 2015 Renewable Factors
MPUC Docket No. E015/M-14-962

Dear Mr. Wolf:

Enclosed for filing with the Minnesota Public Utilities Commission ("Commission"), please find Minnesota Power's Comments in Response to the Commission's March 24, 2017 Notice.

By copy of this letter, I am providing service to those listed on the service list on file with the Commission.

If you have any questions, please feel free to contact me.

Yours truly,

David R. Moeller

DRM:kjv
Enclosure
cc: Service List

STATE OF MINNESOTA
BEFORE THE
MINNESOTA PUBLIC UTILITIES COMMISSION

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In the Matter of Minnesota Power's Renewable Resources Rider and 2015 Renewable Factor

Docket No. E015/M-14-962

Minnesota Power's Comments in Response to the Commission's March 24, 2017 Notice

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I. INTRODUCTION

Minnesota Power appreciates that the Minnesota Public Utilities Commission ("Commission") reconsidered its November 30, 2016 Order ("November 30 Order") and concluded that the potential implications resulting from that order required additional evaluation. Minnesota Power respectfully requests that the Commission modify its November 30 Order to continue its longstanding policy of shielding utility customers by separating both the benefits and risks of non-regulated affiliate business operations. In short, the Commission's November 30 Order incorrectly assigns tax credits utilized because of non-regulated ALLETE, Inc. ("ALLETE") income to ALLETE's regulated operations. The November 30 Order results in the Commission adopting a policy of imbalanced sharing of risks and benefits between regulated and non-regulated operations of ALLETE, in contravention of regulatory policy intended to insulate ratepayers from non-regulated business operations.

On March 24, 2017, the Commission issued a Notice of Comment Period in Docket No. E015/M-14-962 ("March Notice") on the regulatory treatment of investment tax credits ("ITC") and on applicable accounting policies related thereto. In its March Notice, the Commission identified five topics for which it sought comments. Minnesota Power (or the "Company") provides these comments in response to the March Notice to address the five topics identified by

the Commission. Minnesota Power appreciates the opportunity to address these issues, and its comments are focused primarily on regulatory policy and the paramount need to shield the regulated utility ratepayer from unintended consequences that lead to the potential exposure of Minnesota Power's customers to risks associated with non-regulated business operations.

II. COMMENTS

A. Commission Questions

1. Does the Commission's November 30, 2016 *Order Determining Treatment of North Dakota Investment Tax Credits (ND ITCs) for Bison Wind Projects* (the "November 30 Order") which assigns Bison ND ITCs actually realized by ALLETE, Inc. ("ALLETE") to its regulated operations result in the sharing of risks and benefits between ALLETE's regulated and non-regulated operations? Please explain in detail the mechanics of such sharing.

The Commission's November 30 Order does result in the sharing of benefits and ***some*** risks between ALLETE's regulated and non-regulated business operations. Assigning tax benefits to a regulated utility based on the results of a consolidated (unitary) tax return will result in a sharing of benefits between the regulated utility and the non-regulated affiliate businesses, which opens the door to the sharing of risks, as the ratepayer, under the November 30 Order, will receive a different amount (more benefit or less benefit) than the regulated utility alone would utilize. As a result of the November 30 Order, utility customers receive a benefit from additional tax credits utilized as a result of investments made by shareholders in non-regulated business affiliates. This imbalanced treatment is contrary to settled regulatory policy.

The November 30 Order does provide for a limited sharing of "risks", in that if ***less*** tax credits are utilized due to non-regulated affiliate operations, the ratepayers will receive the lesser amount. This is not really a sharing of "risks" but rather shares the benefits of the availability of the ND ITC to the extent it can be monetized by ratepayers. In any case, this "sharing" , is limited to sharing only in the value of state tax credits available; ratepayers do not share fully in

the risks associated with the creation of non-regulated operations, nor the funding of any losses in excess of revenues at the non-regulated operation. Under the November 30 Order, ratepayers only share in the benefit of the non-regulated business operations generating more or less taxable income.

Shielding customers from non-regulated business activities requires that the "ring-fence" around non-regulated business activities be maintained. "Ring-fencing" is a mechanism by which the regulated utility and its customers are protected against risks internal to the affiliate non-regulated businesses and risks external to the non-regulated businesses, to continue to provide the public with essential services.[1] Ring-fencing is "the legal walling off of certain assets or liabilities within a corporation."[2] The fact that a regulated utility in Minnesota has a set electric service area for which it is the solely responsible source of critical electricity delivery to its customers creates a structural mandate for ring-fencing as the utility and its customers must be protected from risk as it is the only entity in this service area able to provide the essential service.[3]

Minnesota Power acknowledges that the tax credits utilized on the unitary North Dakota State tax return exist because of the Bison Wind Projects, the cost of development for which is currently included in the Renewable Resources Rider. Minnesota Power has a limited amount of North Dakota income, but that income is estimated to utilize approximately $10.7 million[4] of the ND ITCs. The value of this utilization will flow to Minnesota Power's customers via the

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[1] Steven L. Schwarcz, *Ring-Fencing*, 87 S. CAL. L. REV 69, 105 (2014).

[2] Steve Fetter, *Don't Fence Me Out*, PUB. UTILS. FORTNIGHTLY, October 2004, at 20.

[3] Schwarcz, *supra* note 1, at 105.

[4] Note that all dollar values currently assigned for purposes of this regulatory proceeding are estimates only and subject to change based on actual circumstances during future tax years. This means that Minnesota Power's or its non-regulated affiliate's income could increase and utilize more of the ND ITCs or could decrease and utilize fewer of the ND ITCs.

Renewable Resources Rider. ALLETE's non-regulated affiliates, which participate in the unitary North Dakota State tax return are estimated to have sufficient taxable North Dakota income to utilize an additional $11.3 million of ND ITCs (the "Credits at Issue"). The income of the ALLETE non-regulated affiliates is attributable, entirely, to investments made by ALLETE shareholders.

This creates a situation where Minnesota Power customers made the investment that created the available Credits at Issue, but ALLETE's non-regulated affiliates created the income that will utilize the Credits at Issue. Allowing ALLETE to retain the value of the Credits at Issue poses no <u>risk</u> to Minnesota Power's customers. Allowing Minnesota Power's customers to receive the value of the Credits at Issue, however, gives them a direct <u>benefit</u> from non-regulated business activities, removing the ring-fence between regulated and non-regulated business activities put in place to insulate customers from operations of the non-regulated affiliates.

In 2002, the Commission opened a Docket to investigate the operations and corporate governance of Xcel Energy Inc. as it related to the affiliate relationship between Northern States Power Company ("NSP") and NRG Energy, Inc. ("NRG").[5] At that time, the regulated utility (NSP) affiliate, NRG, was facing financial difficulties and the Commission was concerned about what impact those difficulties may have on NSP ratepayers.[6] NSP affirmed to the Commission that despite the financial difficulties NRG was facing at the time, there was no risk to the regulated utility ratepayers and NSP made several firm commitments to provide adequate service at reasonable cost and to shield utility ratepayers from any direct or indirect effect of NRG's

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[5] *In the Matter of an Inquiry into Possible Effects of Fin. Difficulties at NRG and Xcel on NSP and its Customers and Potential Mitigation Measures*, Docket No. E,G002/CI-02-1346, ORDER REQUIRING ADDITIONAL INFORMATION AND AUDIT (Oct. 22, 2002) [hereinafter NRG Docket].

[6] *Id.* at 1.

investments, consistent with Minnesota law and Commission precedent.[7] Those commitments included ensuring that utility assets were properly ring-fenced on a going-forward basis and to commit to insulate ratepayers to the extent that past activities created a risk to ratepayers.

At the time, rates were required to remain at prior levels set until 2006 unless certain conditions had been met, when NSP was permitted to file its next rate case.[8] The Commission and NSP affirmed the commitments to protect NSP ratepayers from any detrimental effects realized by NRG and that any detrimental effects would be borne solely by shareholders, ring-fencing the utility operations and the non-regulated energy operations to ensure no direct or indirect cost impacts would be borne by NSP ratepayers. By affirming this separation, the Commission reaffirmed the principles and policies set forth in 1994: utility ratepayers should bear no risk (and therefore reap no benefit) from non-regulated utility business operations. This focus on shielding the ratepayer has guided Minnesota Power's position in the present case.

2. If the November 30 Order's assignment of Bison ND ITCs results in a sharing of risks and benefits, please explain how such sharing is or is not justified in light of the Commission's cost-and-benefit-allocation principles as set forth on pages 22-24 of the Commission's September 1, 2006 Order ("2006 NSP Order") in *In the Matter of the Application of N. States Power Co. d/b/a Xcel Energy for Auth. to Increase Rates for Elec. Serv. in Minn.*, Docket No. E002/GR-05-1428.

The Commission's cost-and-benefit-allocation principles set forth on pages 22-24 of the Commission's 2006 NSP Order summarize the principles the Commission set forth over a decade prior to that order. In 1994, the Commission developed, through an industry-wide cost-allocation proceeding that spanned over four years, cost-allocation principles that were intended to prevent regulated utility and non-regulated businesses from co-mingling the risks and benefits

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[7] *Id.* at 1-3.

[8] The 2006 NSP Order cited by the Commission in its March Notice is a result of that rate case and included both a recitation and reaffirmation of the 1994 cost-allocation proceedings requiring separation of regulated and non-regulated affiliate business in both the report of the Administrative Law Judge and the Commission's order.

of these business activities.[9] Minnesota utilities have operated under these principles since that time and with a reliance on the Commission's decisions as a result of that lengthy, all-utilities, contested process.

As a result of the 1994 proceeding, the Commission developed allocation principles to ensure that ratepayers would be no worse off or no better off with or without any non-regulated business activity. Specifically, the principles ensure that utility property is not encumbered for the benefit of the non-regulated businesses, that the regulated utility will not seek rate recovery for costs associated with non-regulated businesses, and that the regulated utility cost of debt or equity is not negatively impacted by non-regulated business activities. These are all in place to insulate ratepayers from the risks of non-regulated business operations.

For example, in the NRG Docket, the Commission addressed in detail the importance of insulating utility ratepayers from the risks of non-regulated business operations. In that case, NRG, a non-regulated affiliate of the public utility NSP, encountered the presence of loan agreements to NRG that contained "cross-default" provisions that could ultimately have operated to the detriment of NSP's utility customers. The presence of such "cross-default" provisions did not serve the principal of ring-fencing ratepayers from both the risk and benefits of non-utility operations.

Based on a combination of commitments made by the utility, plus recommendations from the Department of Commerce ("Department") and other stakeholders, the Commission issued an order requiring strict separation of the utility operations from non-regulated business risks. Fundamentally the Commission required the utility to ensure that "any direct or indirect cost

[9] 2006 NSP Order at 23.

impacts from . . . [non-regulated] investments . . . will not be borne by ratepayers."[10] The Commission specifically precluded the utility from encumbering utility property for any non-utility purpose and precluded inter-company loans.[11] In short, the Commission decided to impose and enforce strict ring-fencing, further enforcing its 1994 policies.

The NRG Docket highlights the importance of maintaining strict separation between the utility and any non-regulated activities engaged in by the Company. That proceeding shows that the protection of ratepayer interests is the paramount concern, necessitating strict separation of regulated and non-regulated business activities. To achieve this protection, ratepayers must not only be insulated from non-regulated business activity disappointments but must also be insulated from receiving non-regulated business activity windfalls.

In the NRG Docket, the "risk" was simple to grasp – the non-regulated activities created a risk of loss for utility ratepayers. The Commission correctly affirmed the cost-allocation principles to ensure that ratepayers be insulated from those risks and that shareholders, who bore the risk of those activities, also bear the responsibility for the outcome of those activities. In other words, the "risk" of non-regulated activities translates into shareholders accepting both the downside and the upside of the non-regulated activity. If there are losses to be incurred by non-regulated businesses, only shareholders should bear that risk and the regulated utility and its customers should be protected. And, conversely, if there are returns to be made from a non-regulated investment, only shareholders should reap that reward because structures had been implemented to ensure ratepayers have been insulated from the non-regulated investment.

ALLETE's non-regulated operations are also a classic example of separating these activities. While both Minnesota Power and the non-regulated ALLETE affiliates have business

[10] NRG Docket at 6 and Order Point 1(d).

[11] NRG Docket at Order Points 1(c) and 1(g).

assets in North Dakota, ALLETE has taken great care to keep those business operations separate. Minnesota Power does not share in the risk of business decisions made regarding the non-regulated ALLETE affiliates. Further, the entities maintain separate income statements and record tax expense on a separate return basis, with any unallocated taxes residing with the consolidation company.

This separation of regulated and non-regulated business operations assigns all the risks of non-regulated business operations and business decisions to shareholders. The effect of this separation, however, is that it prevents ratepayers from receiving windfalls when they are experienced by non-regulated business operations. Obtaining a tax break that is available, or a tax credit that is only utilized, because of an investment or income that the ratepayer had nothing to do with creating would result in the ratepayer receiving a benefit to which it was not entitled. Allowing this would vitiate the separation of regulated utility and non-regulated businesses that the Commission and Minnesota utilities have maintained for decades. The Commission has consistently concluded that for ratepayers to share in any "benefits is inevitably accompanied by the sharing of risks."[12]

If the Commission seeks to change this policy, the Commission itself has acknowledged that "any reevaluation those protections might merit should take place only in another lengthy, carefully considered, industry-wide proceeding."[13] This has been affirmed by the Minnesota Court of Appeals where the Commission sought to change policy in response to a utility's annual accounting filing instead of in a dedicated proceeding to the specific issue presented.[14] At this

[12] 2006 NSP Order at 23.

[13] 2006 NSP Order at 23 (emphasis added).

[14] *In re a Request by Minn. Power for Approval of its 1998 CIP Tracker Activity Report, Demand Side Mgmt. Fin. Incentives Report, and Annual Conservation Program Adjustment*, Nos. C2-00-456, C4-00-457, 2000 WL 1847621 (Minn. App. Dec. 19, 2000).

time, the Commission's consideration of this issue, while lengthy in time, has been isolated to the Docket of one utility and has not been subject to the same investigatory procedures as the Commission's policy development over two decades ago.

The cost-and-benefit-allocation principle described herein is more than looking at who paid for the cost of a regulated asset, and then claiming that all benefits potentially related to that asset belong to the ratepayer. The ND ITC issue has primarily been portrayed strictly on the cost side – regulated utility customers paying the cost of the wind investment should be entitled to all credits utilized. Proper application of the cost-and-benefit-allocation principle, however, must also look to the non-regulated operations side and ask if ratepayers bore the cost to create the non-regulated income, which in turn created tax expense and additional tax credit utilization.

3. Does the November 30 Order's assignment of ND ITCs result in a symmetrical sharing of benefits and risks between Minnesota Power ratepayers and ALLETE shareholders? Please provide a clear description and explanation of "symmetrical sharing," "benefits," and "risks" in your response. Please explain whether or not it matters that the benefits and risks are shared symmetrically.

a. <u>Regulatory Policy Requires Symmetrical Treatment</u>

The November 30 Order results in asymmetrical treatment of the ND ITCs. Symmetry indicates balance, and the application of correct proportions, or appropriate sharing. Symmetrical treatment, for tax purposes, requires application of the matching principle to achieve this balance. The benefits and the risks should be shared symmetrically. This principle dictates that costs and revenues must be matched such that ratepayers receiving the benefit of service should also pay for the service. This principle also ensures that utility operations are properly insulated from the company's non-regulated operations. Utility regulation is properly concerned with insulting utility ratepayers from the business risks that may be undertaken by the Company's non-regulated operations, as described in the NRG Docket.

Two decades ago, "the Commission adopted explicit and specific cost separation requirements to prevent cross subsidization between regulated and [non-regulated] operations."[15] A regulated utility's revenue requirement should be based solely on regulated revenues and expenses.[16] The Commission's responsibility is to "balance the needs of the customers and the shareholders."[17] But in making its decisions, the Commission may not simply focus on ratepayer interests.[18]

Symmetrical treatment requires the application of a balanced approach, with both parties having an equal opportunity for benefit or risk. However, as described in the 1994 Docket, utility ratepayers should bear no risk from non-regulated operations. If regulatory policy does not isolate the costs and risks of non-regulated affiliate businesses, a utility's credit rating, cost of capital, access to capital markets, and cost and tax liabilities could all be negatively impacted to the detriment of utility customers.

The Commission's November 30 Order requiring that all ND ITCs actually realized in a unitary tax return filing be reflected in revenue requirements is in contravention of the Commission's longstanding and carefully considered policy that requires the symmetrical

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[15] *In the Matter of the Application of N. States Power Co. d/b/a Xcel Energy for Auth. to Increase Rates for Elec. Serv. in Minn.*, Docket No. E002/GR-05-1428, ADMINISTRATIVE LAW JUDGE'S FINDINGS OF FACT, CONCLUSIONS, AND RECOMMENDATION at Finding 140 (July 6, 2006) (citing *In the Matter of an Investigation into the Competitive Impact of Appliance Sales and Serv. Practices of Minn. Gas and Elec. Utils.*, Docket No. GE999/CI-90-1008, ORDER SETTING FILING REQUIREMENTS (Sept. 28, 1994)).

[16] *See In the Matter of the Application of N. States Power Co. d/b/a Xcel Energy for Auth. to Increase Rates for Elec. Serv. in Minn.*, Docket No. E002/GR-05-1428, ADMINISTRATIVE LAW JUDGE'S FINDINGS OF FACT, CONCLUSIONS, AND RECOMMENDATION at Finding 141 (July 6, 2006).

[17] *In re the Request of Interstate Power Co. for Auth. to Change its Rates for Gas Serv. in Minn.*, 574 N.W.2d 408 (Minn. 1998).

[18] *See generally In re Review of 2005 Annual Automatic Adjustment of Charges for All Elec. and Gas Utils.*, 768 N.W.2d 112, 119 (Minn. 2009) ("[T]he Commission had to consider the policy mandate to balance the interest of the public utility . . . with the interests of the public."); *N. States Power Co. v. Minn. Pub. Utils. Comm'n*, 344 N.W.2d 374, 378 (Minn. 1984), *cert. denied*, 467 U.S. 1256 (1984) ("[T]he MPUC must consider the right of the utility and its investors to a reasonable return, while at the same time establishing a rate for consumers which reflects the cost of service rendered plus a 'reasonable' profit for the utility." (citation omitted)).

treatment and the application of the "stand-alone" tax methodology. The Department acknowledged that its recommendation resulted in a change in policy and in asymmetrical treatment of the ND ITCs:

> While this appears to result in asymmetrical treatment, as ALLETE bears all the risks associated with foregone tax benefits resulting from consolidation, but only reaps benefits associated with "extra" tax credits generated by non-regulated operations, the Department concludes that this asymmetry is appropriate . . . .[19]

The Department justified its position, in part, by referencing the Federal Energy Regulatory Commission ("FERC") definition of "stand-alone" from its guidance on Accounting for Income Taxes.[20] This FERC definition is an accounting allocation method, and has not previously been utilized by the Commission for determining tax expense.

Cost allocation principles require that regulated costs of service are systematically separated from non-regulated costs and results in symmetrical sharing. They are used to ring-fence the utility operations from any direct or indirect benefits or risks from non-regulated business operations. The stand-alone tax method does not result in asymmetrical sharing just because a portion of the credits utilized on a consolidated (unitary) tax return does not benefit the ratepayer. The ratepayers are receiving the tax benefit commensurate with the regulated income generated, and are indifferent to the non-regulated income generated on the consolidated (unitary) tax return. The credits utilized on a consolidated (unitary) tax return are not being "taken" from the ratepayer as, without the consolidated (unitary) return, they would merely go unused, at no detriment to the ratepayer or the regulated utility.

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[19] *In the Matter of Minn. Power's Renewable Res. Rider and 2015 Renewable Factor*, Docket No. E015/M-14-962, RESPONSE COMMENTS OF THE MINN. DEP'T OF COMMERCE at 7-8 (Dec. 16, 2015).

[20] *Id.* at 8-10.

If two utilities had similar operations and credits from North Dakota, with similar capitalization and cost structures, under the stand-alone method of accounting they should have similar customer rates. If one of those utilities, however, has no affiliates while the second utility has affiliates (and was able to utilize more credits strictly due to non-regulated business operations) abandonment of the stand-alone method of accounting could result in tax savings and a reduction in rates for the second utility each time the consolidated entity's shareholders fund new, profitable, non-regulated business operations with which the ratepayers had no involvement. While the potential for lower rates is appealing, without the proper sharing of non-regulated risks along with non-regulated benefits, asymmetrical treatment will occur.

If the Commission's longstanding policy of ring-fencing is abandoned, utility customers are exposed to costs and risks of non-regulated business operations. In addition to these complications, the November 30 Order raises further regulatory policy concerns such as:

- How federal credits, such as production tax credits, that would be utilized by a "regulated utility income only" calculation but would be less on a consolidated basis would be accounted for to the benefit of customers; and when the results of federal consolidated or state unitary return allocations should be utilized to determine tax expense;
- In the absence of federal or state tax credits, is there an allocation of tax expense, rather than tax expense calculated based upon the revenues and expenses included in a rate proceeding?
- If there is an allocation of tax expense, the utility must now forecast non-regulated business activity and the corresponding impact on the regulated utility's tax attributes, bringing a large amount of non-regulated operations information into the rate process which has not been necessary in the past for the purpose of computing the revenue requirement related to state tax credits.
- How a utility with electric, gas, and multiple state jurisdictions would allocate tax expense from a consolidated (unitary) return to the jurisdictional level.

b. The November 30 Order Exposes Ratepayers to Non-Regulated Business Risks

A core principle of ratemaking is to ensure that the rates paid by customers accurately reflect the cost of providing utility service from both a regulatory and a financial perspective.[21] As part of this calculation, the Commission must ensure that regulated utility operations are separated entirely and clearly from non-regulated operations. The Commission has stated its commitment to protecting the regulated utility customer: "It is far more important to protect ratepayers from loss than to give them opportunities for windfalls."[22]

The Commission's November 30 Order may have far-reaching implications for any regulated utility with non-regulated affiliates. Unlike the last time the Commission set broad tax allocation policy, in which all electric and gas utilities were involved through contested case proceedings, the Commission's November 30 Order sets policy that may result in unintended consequences for all public utilities. Specifically, the Commission has now supplanted on ratepayers the risk of rate volatility, rather than predictable rates, due to non-regulated business operation variability. If non-regulated operations are performing well, presumably additional taxable income will be generated, additional state tax credits will be utilized, and rates will go down. However, if non-regulated operations are creating losses, rates could presumably rise due to less credits benefiting ratepayers than on a separate return basis. Prudent tax planning could result in the implementation of tax planning decisions that create tax losses at the non-regulated business, or new tax laws could impact the non-regulated businesses. The potential rate impact of the taxable income or loss from non-regulated operations is exacerbated if federal tax credits

[21] *See In the Matter of the Application of N. States Power Co. d/b/a Xcel Energy for Auth. to Increase Rates for Elec. Serv. in Minn.*, Docket No. E002/GR-05-1428, ADMINISTRATIVE LAW JUDGE'S FINDINGS OF FACT, CONCLUSIONS AND RECOMMENDATION at Finding 139 (July 6, 2006).

[22] NSP 2006 Order at 23.

are similarly assigned to ratepayers. If ratepayers are no longer insulated from non-regulated operational results, year-to-year rate variability could result, which would be very difficult for ratepayers to understand.

B. Federal and State Law Support the Avoidance of Comingling of Non-regulated Business Income to Regulated Utility Rate Revenue

In its final questions, the Commission asks for an analysis of the legal issues surrounding its November order. Specifically, the Commission asks:

> **Is the November 30 Order's assignment of all Bison ND ITCs actually realized to ALLETE's regulated operations prohibited by contract or state tax law?**
> **Is the result of the Commission's November 30 Order confiscatory or in any other way in violation of state or federal law?**

This final section of the Company's Comments addresses these legal issues.

1. Federal and State Law or Contract Law

A tax allocation agreement is a contract that allocates the consolidated income tax liabilities between members of a consolidated filing group. This tax allocation is reflected in the separate company financial statements of each member company. Assignment of tax attributes contrary to an approved federal or state tax allocation agreement are not prohibited by contract or state tax law, but do not make good regulatory policy. ALLETE, Northern States Power Company d/b/a Xcel Energy, Minnesota Energy Resources Corporation, and Otter Tail Power Company all file unitary tax returns. All have allocation methods approved by the Commission.[23] Tax allocation agreements, however, have not dictated how tax expense is

[23] *See, e.g.*, *In the Matter of a Request by Minn. Energy Res. Corp. for Approval of the Tax Allocation Affiliated Interest Agreement between WEC Energy Grp. and its Regulated and Non-Regulated Subsidiaries*, Docket No. G011/AI-15-705, ORDER (Oct. 6, 2015); *In the Matter of Otter Tail Power Co.'s Petition for Approval of an Admin. Servs. Agreement, Cash Mgmt. Agreement, and Tax-Sharing Agreement with Otter Tail Corp.*, Docket No. E017/AI-09-899, ORDER (Nov. 6, 2009); *In the Matter of a Request by N. States Power Co. d/b/a Xcel Energy, Inc. for Approval of the Tax Allocation Agreement Between Xcel Energy Inc. and N. States Power Co.*, E,G002/AI-01-124,

computed for rate purposes. Under prior Commission policy, tax expense has been computed under the "stand-alone" accounting method, utilizing only the items of income and expense included in the test year jurisdictional revenue requirement calculation.[24] This methodology has been adhered to for other utilities. Consistency and predictability in regulatory policy is essential.

In addition, Congress has instituted federal normalization requirements to ensure that the tax system is not used to subsidize reductions in regulated rates. Regulatory policy needs to be consistent and balanced to determine just and reasonable rates. If ring-fencing is abandoned for the calculation of tax expense, then that decision should also be applied to other areas of cost allocation as well.

2. Confiscatory Decision by the Commission

Under the confiscatory rates doctrine, "the constitution protects utilities from being limited to a charge for their property serving the public which is so 'unjust' as to be confiscatory."[25] A rate is confiscatory if the rate is "not sufficient to yield a reasonable return on the value of property used at the time it is being used to render the service," or if the rate is "so unjust as to destroy the value of the property for all the purposes for which it was acquired."[26] "If the rate does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation and so violated the Fifth and Fourteenth Amendments."[27]

ORDER (June 8, 2001); *In the Matter of Minn. Power & Light Co.'s Petition for Approval of its Tax Agreement with its Subsidiaries*, Docket No. E015/AI-93-1326, ORDER (Apr. 29, 1994).

[24] *See In the Matter of the Application of N. States Power Co. d/b/a Xcel Energy for Auth. to Increase Rates for Elec. Serv. in Minn.*, Docket No. E002/GR-05-1428, ADMINISTRATIVE LAW JUDGE'S FINDINGS OF FACT, CONCLUSIONS AND RECOMMENDATION at Finding 139 (July 6, 2006).

[25] *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307 (1989).

[26] *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 690 (1923); *Covington & Lexington Pk. Rd. Co. v. Sandford*, 164 U.S. 578, 597 (1896).

[27] *Duquesne*, 488 U.S. at 308.

The Minnesota Supreme Court has also recognized that rates insufficient to allow a utility to collect enough revenue "to meet the cost of providing service and to earn a fair and reasonable return upon its investment" are "unjust, unreasonable and confiscatory."[28]

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as those that are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[29]

As noted by the Minnesota Supreme Court and the United States Supreme Court, the utility has no constitutional right to profits of non-regulated business operations, such as those in highly profitable enterprises or speculative ventures. The Fifth Amendment of the Constitution states that "private property" shall not "be taken for public use, without just compensation."[30] A valid claim for a compensable taking requires that (1) there is a specific property interest at issue; and (2) the government has appropriated that interest, leaving the property holder without the use or benefit of that interest.[31] While a taking is often the result of a physical invasion or confiscation, the Supreme Court has long recognized that "if regulation goes too far it will be recognized as a taking."[32] While the Constitution does not create or define the scope of property

[28] *N. States Power Co. v. Minn. Pub. Utils. Comm'n*, 414 N.W.2d 383 (Minn. 1987).

[29] *Minn. Power & Light Co. v. Minn. Pub. Serv. Comm'n*, 310 N.W.2d 686, 690 (Minn. 1981) (emphasis added) (citing *Bluefield*, 262 U.S. at 692-93).

[30] U.S. Const. amend. V.

[31] *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1027-29 (1992).

[32] *See Conti v. U.S.*, 291 F.3d 1334, 1338 (Fed. Cir. 2002).

interests compensable under the Fifth Amendment, "existing rules and understandings" and "background principles", such as state, federal, or common law, define the dimensions of property rights for purposes of establishing a cognizable taking.[33]

Private citizens have a legally-cognizable property interest in money for purposes of takings.[34] Further, "[a]n assessment, fee, or tax may be a taking if 'the exaction is a flagrant abuse, and by reason of its arbitrary character is mere confiscation of particular property.'"[35] Under these policies and principles, the Commission's November 30 Order has taken, or confiscated, money from ALLETE shareholders and created an imbalance between ratepayers and shareholders and takes money for ratepayers without compensating shareholders. For example, in this situation, if the non-regulated subsidiary has taxable income it would be liable to pay North Dakota income tax, but for the availability of the ND ITC. With the Commission's confiscation of the tax credit, that payment now goes to the ratepayers, and not to North Dakota. However, the subsidiary is still subject to the North Dakota tax and will be out the money. Under consistent regulatory policy and application of the relevant legal principles, the non-regulated subsidiary should have the right to retain the benefit of the credits, and it is not appropriate to divert that benefit to ratepayers.

The utilization of the Credits at Issue, realized because of the income of ALLETE non-regulated subsidiaries, will be applied (as a result of the November 30 Order) to the rates of Minnesota Power customers, resulting in the rate paid by Minnesota Power being less than what it costs the regulated utility to provide that service. Shareholder investments are being used to

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[33] *Lucas*, 505 U.S. at 1030 (1992); *Bd. of Regents of State Colls. v. Roth*, 408 U.S. 564 (1972).

[34] *See Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980) (holding that the court clerk's appropriation of the interest on funds held by the court in an interpleader action was an unconstitutional taking because the funds were held for the benefit of creditors and the amount withheld was not reasonably related to services rendered by the court).

[35] *Houck v. Little River Drainage Dist.*, 239 U.S. 254 (1915).

achieve this subsidization. Further, this decision deprives the shareholders of income properly allocated to the non-regulated ALLETE affiliates.

C. Other Issues Based on Commission Deliberations

During its deliberations in February 2017, two questions were raised by the Commission that were not included in the March Notice but merit response. At that time, the Commission asked the following questions during deliberation:

> If ALLETE's subsidiary, and Minnesota Power's affiliate, ALLETE Clean Energy were to have built Bison, would Minnesota Power income have been able to be used to consume ND ITCs? If so, would Minnesota Power have received the value of the ITCs its income consumed on the consolidated tax return?

If ALLETE Clean Energy were to have built Bison, it would have estimated its future costs, including an assumption on the amount of federal income tax expense, Minnesota income tax expense, and North Dakota income tax expense, it needed to recoup in its pricing through a power purchase agreement ("PPA") to Minnesota Power. Taxable income from all members of the consolidated group would be included in the North Dakota unitary income tax return, including Minnesota Power's taxable income. An apportionment rate would be calculated and applied to the unitary state taxable income.

The resulting ALLETE unitary North Dakota State tax liability would be offset by the ND ITCs, reducing the ND tax liability to zero on the unitary return. ALLETE Clean Energy would be paid for the ND ITCs used to offset their own separate pro forma North Dakota State tax liability, which would reduce their North Dakota State income tax to zero. Any difference between the credits utilized by ALLETE Clean Energy on their separate North Dakota State tax return and the credits utilized on the ALLETE unitary return would be recorded on the consolidation company. Therefore, Minnesota Power ratepayers would have zero North Dakota State income tax expense built into the PPA price paid to ALLETE Clean Energy, which is the

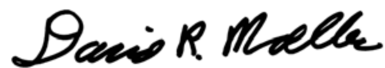
same amount that the ratepayers are being charged under the stand-alone methodology utilized by Minnesota Power in the Renewable Resources Rider. Any difference between the amount of North Dakota State tax expense estimated by ALLETE Clean Energy in the PPA price (estimated at zero) and the amount of North Dakota State tax expense actually owed by ALLETE Clean Energy would be a risk that ALLETE Clean Energy accepted in responding to the request for proposals.

III. CONCLUSION

Minnesota Power respectfully requests that for the present case, the Commission modify its November 30 Order and hold to well-established and well-reasoned accounting principles providing for the separation of regulated utility operations from non-regulated affiliate operations and symmetrical sharing of risks and benefits between these entities. If the Commission seeks to reconsider its prior and longstanding policies, Minnesota Power requests that it does so on a going forward basis, not a retroactive one that would apply to tax credits already generated, in an all-utilities Docket as it did when it established the current policies over two decades ago.

Dated: May 30, 2017

Respectfully submitted,



David R. Moeller
Senior Attorney
Minnesota Power
30 West Superior Street
Duluth, MN 55802
dmoeller@allete.com
(218) 723-3963

IN THE MATTER OF MINNESOTA POWER'S RENEWABLE RESOURCES RIDER AND 2015 RENEWABLE FACTOR

MPUC DOCKET NO. E015/M-14-962

CERTIFICATE OF SERVICE

Theresa Senart certifies that on the 30th day of May 2017, she filed a true and correct copy of **Minnesota Power's Comments in Response to the Commission's March 24, 2017 Notice** by posting the same on eDockets (www.edockets.state.mn.us). Said document is also served via U.S. Mail or email as designated on the attached Service List on file with the Minnesota Public Utilities Commission in the above referenced docket.

/s/ Theresa Senart

Theresa Senart

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Julia	Anderson	Julia.Anderson@ag.state.mn.us	Office of the Attorney General-DOC	1800 BRM Tower 445 Minnesota St St. Paul, MN 551012134	Electronic Service	Yes	OFF_SL_14-962_Official
Ian	Dobson	Residential.Utilities@ag.state.mn.us	Office of the Attorney General-RUD	1400 BRM Tower 445 Minnesota St St. Paul, MN 551012130	Electronic Service	Yes	OFF_SL_14-962_Official
Sharon	Ferguson	sharon.ferguson@state.mn.us	Department of Commerce	85 7th Place E Ste 280 Saint Paul, MN 551012198	Electronic Service	No	OFF_SL_14-962_Official
Susan	Ludwig	sludwig@mnpower.com	Minnesota Power	30 West Superior Street Duluth, MN 55802	Electronic Service	No	OFF_SL_14-962_Official
David	Moeller	dmoeller@allete.com	Minnesota Power	30 W Superior St Duluth, MN 558022093	Electronic Service	No	OFF_SL_14-962_Official
Daniel P	Wolf	dan.wolf@state.mn.us	Public Utilities Commission	121 7th Place East Suite 350 St. Paul, MN 551012147	Electronic Service	Yes	OFF_SL_14-962_Official