

Minnesota Public Utilities Commission
Staff Briefing Papers

Meeting Date: September 28, 2017 **Agenda Item #** 3 **

Company: Minnesota Power

Docket No. E-015/M-14-962
In the Matter of Minnesota Power’s 2015 Renewable Resources Rider and
Renewable Factor

Issue: Should the Commission reaffirm, modify, or clarify its November 30, 2016
*Order Determining Treatment of North Dakota Investment Tax Credits for
Bison Wind Projects?*

Staff: Sundra Bender 651-201-2247

Relevant Documents

PUC

Staff Briefing Papers - October 18, 2016 Commission Meeting October 6, 2016
*Order Determining Treatment of North Dakota Investment Tax Credits for
Bison Wind Projects* November 30, 2016
Staff Briefing Papers – February 2, 2017 Commission Meeting January 25, 2017
*Order Denying Minnesota Power’s Petition for Reconsideration and
Granting Reconsideration for Further Proceedings* February 14, 2017

Comments

Minnesota Power May 30, 2017
Edison Electric Institute May 30, 2017
Department of Commerce May 30, 2017
Office of the Attorney General May 30, 2017

Reply Comments

Minnesota Power June 30, 2017
Department of Commerce June 30, 2017
Office of the Attorney General June 20, 2017

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September 20, 2017

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Statement of the Issue

Should the Commission reaffirm, or modify, its November 30, 2016 Order Determining Treatment of North Dakota Investment Tax Credits for Bison Wind Projects (November 30 Order)?

Introduction

Minnesota Power (Minnesota Power, MP, or the Company) built four Bison Wind electric generation facilities in North Dakota. MP will earn approximately \$113 million in North Dakota Investment Tax Credits (ND ITCs) based on the amount expended to construct these plants. ND ITCs are not transferable or refundable, however, ND state income tax law allows ND ITCs to be applied against the aggregate income tax liability of all corporations included in a consolidated state tax return filing.

Over the life of the ND ITCs, MP projected that ALLETE, Inc. and its affiliated consolidated group of companies will use approximately \$22 million of the available tax credits and that the rest will expire unused.

MP argued that only the amount of ND ITCs that would have been realized (used) had MP filed a separate return should be reflected in MP's revenue requirements, estimated to be about \$10.7 million. The remaining \$11.3 million, estimated to be used on the consolidated returns, would be credited to a consolidation company (shareholders) under MP's proposal.

The Department of Commerce (Department) argued that the higher of the amount of ND ITCs that would have been realized had MP filed a separate return, or the amount of ND ITCs actually used on the consolidated return should be reflected in MP's revenue requirements.

In its November 30 Order, the Commission decided that all of the ND ITCs actually realized in tax-return filings, or monetized through other permissible means, shall be reflected in MP's revenue requirements. This amount could potentially be higher, or lower, than the amount that MP would use if it filed a separate return.

On February 14, 2017, the Commission granted reconsideration on its own motion to consider the merits of its November 30 Order for purposes of determining whether any changes should be made to the November 30 Order.

On May 30, 2017, MP, the Department, the Office of the Attorney General (OAG), and Edison Electric Institute (EEI) filed comments.

On June 20, 2017, OAG filed its reply, and on June 30, 2017, MP and the Department filed their replies.

MP's position is that the Commission should modify its November 30 Order to allow MP to reflect in MP's revenue requirements only those ND ITCs that would have been used by MP if it had filed separate returns.

The Department's position is that "if any change were made to the Commission's November 30 Order, it should be not only to require that all monetized ND ITCs must be assigned to MP's ratepayers, but also to protect MP's ratepayers from the loss of ND ITCs due to any losses incurred by ALLETE's affiliates[.]"¹

EEI's position is that "Allocating ND ITC benefits--realized in part by non-regulated operations--to the regulated electric company creates a situation of regulatory uncertainty for investors that could have negative consequences for the creditworthiness of ALLETE, which could directly increase ALLETE's cost of capital with potentially negative impacts on rates for electricity customers." The Commission should "reconsider its decision regarding the allocation of the benefits of the ND ITCs."²

The OAG's position is that the "Commission should preserve its Order to the extent that it attributes any tax benefits from the Bison ITCs to the Company's revenue requirement."³ "The Commission should reserve the issue of what to do in the event the consolidated tax return reduces the amount of tax credits that can be used for a situation where those specific facts actually exist and can be explored through discovery and comments."⁴

Background

MP's Renewable Resources Rider (RRR) was first established in Docket No. E-015/M-07-216 to allow for recovery of costs associated with future renewable resource contracts, investments and expenditures, as allowed under Minn. Stat. §216B.1645, subd. 2.

The issue of the appropriate treatment of ND ITCs in determining MP's RRR revenue requirements was first discussed in a prior MP RRR docket, Docket No. E-015/M-14-349. It was continued into the instant docket.

On March 9, 2016, the Commission issued an Order resolving all issues in this Docket except for the appropriate treatment of the ND ITCs. In the March 9, 2016 Order, the Commission deferred action on the issue of the ND ITCs and permitted MP 30 days to file any additional information or argument it wished to offer in support of its recommendation. The same Order also required responsive filings to be submitted 14 days thereafter.

On April 8, 2016, MP filed comments.

On April 22, 2016, the Department filed a response.

On November 30, 2016, the Commission issued its Order Determining Treatment of North Dakota Investment Tax Credits for Bison Wind Projects (November 30 Order). In its November 30 Order, the Commission decided that all Bison Wind Project North Dakota Investment Tax

¹ Department June 30, 2017 *Reply Comments* at 7.

² EEI May 30, 2017 *Comments* at 4.

³ OAG May 30, 2017 *Comments* at 7.

⁴ *Id.* at 3.

Credits (ND ITCs) actually realized in tax-return filings, or monetized through other permissible means, shall be reflected in MP's revenue requirements. The Commission also decided to amortize realized credits over the remaining life of these projects; and directed MP to inform the Commission if there are material changes to the estimated utilization of the ND ITCs.

On December 20, 2016, the Company filed a Petition for Reconsideration. MP requested that the Commission reconsider its decision requiring the Company to reflect all Bison Wind Project North Dakota Investment Tax Credits actually realized in tax-return filings, or monetized through other permissible means, in the Company's revenue requirements.

On December 30, 2016, the Department answered the Company's Petition and requested the Commission deny reconsideration.

In its February 14, 2017 Order Denying Minnesota Power's Petition for Reconsideration and Granting Reconsideration for Further Proceedings, the Commission decided on its own motion to reconsider the merits of its November 30 Order and whether any changes should be made to the order.

On March 24, 2017, the Commission issued a Notice of Comment Period requesting comments and replies on the following questions:

- 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 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 any such sharing.
- 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 at pages 22-24 of the Commission's September 1, 2006 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. E-002/GR-05-1428 (2006 NSP Order).
- 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.
- 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?

On May 30, 2017, MP, the Department, the OAG, and EEI filed comments.

On June 20, 2017, the OAG filed reply comments.

On June 30, 2017, MP and the Department filed reply comments.

Summary of Parties' Positions

Minnesota Power

Minnesota Power maintains its request “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.” MP further stated:

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.^[5]

In its March 24, 2017 Notice of Comment Period, the Commission identified five topics for comment. MP responded to all five topics primarily focusing “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.”

MP’s position is that ratepayers bore none of the risks of creating the non-regulated taxable income that allowed the Credits at Issue to be utilized, therefore, ratepayers should receive none of the benefit that resulted from utilization of the Credits at Issue. To do so removes the ring-fence around non-regulated operations and violates the cost separation principles the Commission has had in place for decades.

According to MP,

... 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 risk to Minnesota Power’s customers. Allowing Minnesota Power’s customers to receive the value of the Credits at Issue, however, gives them a direct benefit 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.^[6]

...

⁵ MP’s May 30, 2017 *Comments* at p. 1.

⁶ *Id.* at 4.

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 of these business activities. [2006 NSP Order at 23.] 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.^[7]

...

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." [2006 NSP Order at 23]^[8]

MP states that regulatory policy requires symmetrical treatment. "The November 30 Order results in asymmetrical treatment of the ND ITCs."⁹

"If the Commission's longstanding policy of ring-fencing is abandoned, utility customers are exposed to costs and risks of non-regulated business operations."¹⁰

"...[T]he 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."¹¹

"Minnesota Power continues to request that 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."¹²

⁷ Id. at 5-6.

⁸ Id. at 8.

⁹ Id. at 9.

¹⁰ Id. at 12.

¹¹ Id. at 17.

¹² Minnesota Power June 30, 2017 *Reply Comments* at p. 7.

Edison Electric Institute (EEI)

According to EEI:

The asymmetric treatment of ALLETE's subsidiaries as a result of the assignment of any and all ND ITC benefits realized by non-regulated activities to ALLETE's regulated operations not only inaccurately reflects the cost of providing electric service, it also undermines the legal and financial separation between ALLETE's affiliated subsidiaries and the regulatory certainty that is important to investors. This action could be viewed negatively by Wall Street analysts, which would erode their confidence in the regulatory environment in Minnesota. In turn, this can negatively impact not only the company's cost of capital, but also access to capital markets, which is especially burdensome for a small-to-mid cap company such as ALLETE, Inc. (see Figure 1, below) that has less analyst coverage and lower visibility among investors.^[13]

...

... EEI encourages the Commission to reconsider its decision regarding the allocation of the benefits of the ND ITCs. Allocating ND ITC benefits—realized in part by non-regulated operations—to the regulated electric company creates a situation of regulatory uncertainty for investors that could have negative consequences for the creditworthiness of ALLETE, which could directly increase ALLETE's cost of capital with potentially negative impacts on rates for electricity customers.^[14]

Department of Commerce (Department)

According to the Department, the sharing of risk in the unlikely event that MP's participation in ALLETE's unitary North Dakota tax return results in fewer ND ITCs being consumed than MP would consume on a separate return basis "is not justified in light of the Commission's cost and benefit allocation principles as set forth at pages 22-24 of the Commission's September 1, 2006 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.*," (2006 NSP Order), Docket No. E002/GR-05-1428. This is because it leaves open the possibility of ratepayers being harmed by tax consequences arising from ALLETE's non-regulated operations. [This is explained at pages 4-9 of the Department's comments.]

The Department stated, "By requiring MP to reflect in revenue requirements only the value of ND ITCs actually realized, the Commission's November 30 Order potentially exposes ratepayers to an 'adverse consequence of utility diversification into unregulated enterprises,' ... contrary to the Commission's cost-and-benefit principles as described in the 2006 [NSP] Order."¹⁵

¹³ EEI May 30, 2017 *Comments* at 2.

¹⁴ *Id.* at 4.

¹⁵ Department May 30, 2017 *Comments* at 8.

If MP's participation in ALLETE's unitary North Dakota tax return results in the consumption of more ND ITCs than MP would consume on a separate return basis, the allocation of benefits required by the Commission's November 30 Order is justified, according to the Department.¹⁶ This is because it prevents ratepayers from subsidizing unregulated operations or shareholders.

The Department stated:

As noted above, in the 2006 [NSP] Order, the Commission stated that one intention behind its cost-and-benefit allocation principals is "to keep utilities from subsidizing unregulated affiliates." If more ND ITCs are actually realized than would be on MP's separate tax returns, the November 30 Order prevents an unreasonable sharing of benefits from ratepayers to non-regulated operations (i.e. a subsidy of unregulated affiliates by the utility).

If MP were to reflect only the ND ITCs it would consume on a separate return basis, and keep any "extra" ND ITCs for shareholders, its shareholders would receive the opportunity to earn a fair rate of return AND the value of the "extra" ND ITCs. That value, above and beyond the opportunity to earn a fair rate of return, would be a subsidy.^[17]

Further, the Department stated:

The Commission's November 30 Order does, in a sense, result in a symmetrical sharing of risks and benefits between MP ratepayers and ALLETE shareholders. However, it does not matter that the benefits and risks are shared symmetrically, and in fact a degree of asymmetry is reasonable and appropriate.^[18]

The Department concluded its May 30, 2017 Comments as follows:¹⁹

Given that MP currently expects to [sic] ALLETE to use more ND ITCs than MP would be able to use on a separate return basis, the Department concludes that the November 30 Order will achieve a reasonable result. Because MP's non-regulated affiliates will bear none of the costs of Bison Wind Facilities giving rise to the ND ITCs in question, they should be allocated none of the benefits. Similarly, because MP's ratepayers will bear their jurisdictional share of the full cost of the Bison Wind Facilities, all of the ND ITCs should be reflected in MP's revenue requirements.

In the unlikely event that ALLETE uses fewer ND ITCs than MP would use on a separate return basis, the Department concludes that the November 30 Order imposes an unreasonable sharing of risks from ALLETE's non-regulated operations onto MP and its ratepayers. The cost-and-benefit allocation principles described by the Commission in its 2006 Order in the 2005 NSP-MN Rate Case are

¹⁶ Id. at 9.

¹⁷ Ibid.

¹⁸ Id. at 10.

¹⁹ Id. at 12.

in part intended to protect ratepayers from adverse consequence of utility diversification into unregulated enterprises.

The Department is not aware of any contract, state law, or federal law that the November 30 Order may violate, nor is the Department aware of any way in which the November 30 Order is confiscatory.

Office of the Attorney General (OAG)

The OAG stated that the purpose of its comments “is to demonstrate that the Commission’s November 30, 2016 Order “assigns both risks and benefits to Minnesota ratepayers, is consistent with Commission and Supreme Court precedent, and, when read in conjunction with that precedent, results in symmetrical treatment of tax benefits for ratepayers and utility companies.”

That said, the OAG’s position is that:

The Commission should preserve its Order to the extent that it attributes any tax benefits from the Bison ITCs to the Company’s revenue requirement. The Commission should also exercise caution before it establishes a policy broader than is necessary to resolve the question before it.^[20]

Specifically with respect to exercising caution, the OAG stated:

The Commission should reserve the issue of what to do in the event the consolidated tax return reduces the amount of tax credits that can be used for a situation where those specific facts actually exist and can be explored through discovery and comments. Alternatively, the Commission should adopt the Department’s original recommendation that the Company would credit ratepayers with the higher of the Bison ITCs that would be realized on a stand-alone basis and the value of the Bison ITCs actually utilized. [Footnote omitted.] Such a result would ensure that ratepayers receive the full benefit of tax credits created by ratepayers, while removing the incentive for the Company to take actions that would increase its unregulated profits while diminishing the value of the Bison ITCs.^[21]

The OAG also recommended that the Commission “find that its Order was not confiscatory.”²²

²⁰ OAG May 30, 2017 *Comments* at 7-8.

²¹ *Id.* at 3-4.

²² OAG June 20, 2017 *Reply Comments* at 4.

Summary of the Parties' Responses to the Questions in the Commission's Notice

MP responded to each of the five Commission questions at pages 2-18 of its May 30, 2017 comments.

The Department responded to each of the five Commission questions at pages 4-12 of its May 30, 2017 comments and to MP's response to the five questions at pages 2-12 of its June 30, 2017 reply comments.

The OAG responded to the Commission questions at pages 2-7 of its May 30, 2017 comments and MP's argument that the November 30 Order is confiscatory in its June 20 reply comments at pages 1-4.

EEI did not organize its comments around the Commission questions, but has some general responses to some of the questions.

Staff will not repeat all of the parties' comments here, but summarizes their positions as follows:

1. Does the November 30 Order which assigns Bison ND ITCs actually realized by ALLETE to its regulated operations result in the sharing of risks and benefits between ALLETE's regulated and non-regulated operations?

MP states that the "November 30 Order does result in the sharing of benefits and *some* risks between ALLETE's regulated and non-regulated business operations." MP stated that this "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."²³

The Department states that:

In the unlikely event that MP's participation in ALLETE's unitary North Dakota tax return results in fewer ND ITCs being consumed than MP would consume on a separate return basis, the November 30 Order would result in a sharing of risks between ALLETE's regulated and non-regulated operations.²⁴

In the event that MP's participation in ALLETE's unitary North Dakota tax return results in more ND ITCs being consumed than MP would consume on a separate return basis, the November 30 Order would not result in a sharing of risks or benefits between ALLETE's regulated and non-regulated operations.²⁵

²³ MP May 30, 2017 *Comments* at 2-3.

²⁴ This is because "The November 30 Order leaves open the possibility of ratepayers being harmed by tax consequences arising from ALLETE's non-regulated operations." Department May 30, 2017 *Comments* at 4-5.

²⁵ Department May 30, 2017 *Comments* at 4.

The OAG stated that the Commission's Order assigns ratepayers both risks and benefits associated with the ND ITCs.

Under the Commission's ruling, ratepayers are reaping the tax benefits that exist only because of investments made by MP's regulated operations. Conversely, the Commission's order dictates that ratepayers would face higher rates in the event that the consolidated tax return caused a reduction in the amount of tax benefit available due to the Bison ITCs. [Footnotes omitted.]

- 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 at pages 22-24 of the Commission's September 1, 2006 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. E-002/GR-05-1428.**

MP responds to this question at pages 5-9 of its May 30, 2017 comments. MP stated that 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. MP further stated, "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." MP also stated, "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."

EEI stated that, "The asymmetric treatment of ALLETE's subsidiaries as a result of the assignment of any and all ND ITC benefits realized by non-regulated activities to ALLETE's regulated operations not only inaccurately reflects the cost of providing electric service, it also undermines the legal and financial separation between ALLETE's affiliated subsidiaries and the regulatory certainty that is important to investors."

According to the Department, the sharing of risk of fewer tax credits being utilized on the consolidated return than would be utilized on a separate return of MP is not justified in light of the Commission's cost and benefit allocation principles.²⁶ If the consolidated return resulted in fewer tax credits being utilized it would harm ratepayers causing them to pay higher rates to cover losses from unregulated investments they had nothing to do with making, contrary to the Commission's cost and benefit allocation principles.

However, the Department also states that the allocation of benefits required by the November 30 Order is justified if MP's participation in ALLETE's unitary North Dakota tax return would result in more NDI ITCs being consumed than MP would utilize on a separate return basis.²⁷ This is because allocating all of the benefits to ratepayers prevents ratepayers from subsidizing

²⁶ Department May 30, 2017 *Comments* at 7.

²⁷ *Id.* at 9.

the non-regulated activities or shareholders, something the Commission's cost-and-benefit-allocation principles were designed to do.

According to the OAG, allowing the benefits of the tax credits to flow to the ratepayers that created them is consistent with Commission precedent. The OAG stated²⁸ in the 2005 Xcel Energy Electric Rate Case:

the Commission found that the tax benefit from the loss sustained by the unregulated affiliate should remain with that affiliate. Ratepayers were not allowed to reap the benefit of a tax deduction that "they had nothing to do with creating." The Commission's Order in the instant proceeding reaches precisely the same outcome: an affiliated entity should not receive a windfall from tax benefits stemming from investments made by a different affiliate simply because they share a consolidated tax return. [Footnotes omitted.]

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.

According to MP, the November 30 Order results in asymmetrical treatment of the ND ITCs. Without the proper sharing of non-regulated risks along with non-regulated benefits, asymmetrical treatment will occur.²⁹ MP stated in part that:

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 ringfence 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.³⁰

MP also stated that "The Commission's November 30 Order may have far-reaching implications for any regulated utility with non-regulated affiliates."³¹

²⁸ OAG May 30, 2017 *Comments* at 4.

²⁹ See MP's May 30, 2017 *Comments* at 9-14.

³⁰ MP May 30, 2017 *Comments* at 11.

³¹ *Id.* at 13.

EEI believes the November 30 Order results in the “asymmetric treatment of ALLETE’s subsidiaries as a result of the assignment of any and all ND ITC benefits realized by non-regulated activities to ALLETE’s regulated operations...”³²

The Department responded to this 3rd question at pages 10-11 of its May 30, 2017 comments. The Department stated in part:³³

The Commission’s November 30 Order does, in a sense, result in a symmetrical sharing of risks and benefits between MP ratepayers and ALLETE shareholders. However, it does not matter that the benefits and risks are shared symmetrically, and in fact a degree of asymmetry is reasonable and appropriate.

The OAG stated that:³⁴

The Commission’s Order seems to treat the risks and benefits of the consolidated tax return’s impact on tax credits symmetrically. Ratepayers receive an added benefit of the consolidated return enhancing the value of their tax credits, and also bear the risk of that return diminishing the value of those credits.

The OAG also stated that to the extent that “symmetry” is relevant to the Commission’s decision,³⁵

... the Company is the party advocating for the most asymmetrical treatment of tax benefits in this proceeding. As shown earlier in these Comments, the Commission has found that it is inappropriate to reward ratepayers for tax benefits created by unregulated affiliates. In light of that doctrine, it would be asymmetrical for the Commission to now turn around and allow the Company’s parent company to enjoy windfall profits from tax credits created entirely by ratepayers and the Company’s regulated operations.

4. 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?

According to MP,

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... 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

³² EEI May 30, 2017 *Comments* at 2.

³³ Department May 30, 2017 *Comments* at 10.

³⁴ OAG May 30, 2017 *Comments* at 6-7.

³⁵ *Id.* at 6.

calculation.³⁶ This methodology has been adhered to for other utilities. Consistency and predictability in regulatory policy is essential.³⁷

... 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.³⁸

The Department stated that it “is not aware of any contract or state tax law that prohibits the assignment of ND ITCs in the manner required by the November 30 Order,....”³⁹

According to the OAG, Minnesota Supreme Court precedent does not mandate giving MP the benefits of tax credits created by its regulated activities. The OAG stated that:⁴⁰

On the contrary, the Supreme Court found that “[t]he cost of furnishing utility service typically includes: labor, materials and supplies, *taxes*, insurance, and depreciation.”⁴¹ That list explicitly includes taxes. As taxes are a cost of utility service, it would be appropriate for the Commission to consider both tax liabilities and tax benefits created by the Company’s regulated operations when setting its revenue requirement, and the Company is wrong to state that the Supreme Court has held otherwise.

5. Is the result of the Commission’s November 30 Order confiscatory or in any other way in violation of state or federal law?

MP states that “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.”⁴² Further, MP states that:⁴³

The utilization of the Credits at Issue, realized because of the income of ALLETE nonregulated 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 achieve this subsidization. Further, this decision deprives the shareholders of income properly allocated to the non-regulated ALLETE affiliates.

In its June 30, 2017 reply comments, MP responded to the OAG’s June 20, 2017 reply comments. MP stated in part:

³⁶See *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).

³⁷ MP May 30, 2017 *Comments* at 14-15.

³⁸ *Id.* at 15.

³⁹ Department May 30, 2017 *Comments* at 12.

⁴⁰ OAG May 30, 2017 *Comments* at 5-6.

⁴¹ *Minnegasco*, 549 N.W.2d at 909 (internal quotations omitted) (emphasis added).

⁴² MP May 30, 2017 *Comments* at 17.

⁴³ *Id.* at 17-18.

There is no question that the “existing rules or understandings” of how well-settled tax principles are to be applied create a property right that may not be confiscated without compensation.⁴⁴ Under the November 30 Order, the Credits at Issue will be applied to the rates of Minnesota Power customers, resulting in the rate paid by Minnesota Power being less as a result of compelled shareholder subsidization and depriving shareholders of income properly belonging to them – a clear case of unlawful confiscation.

The Commission’s November 30 Order is a sudden change in longstanding policy of separating regulated and non-regulated business operations for the protection of ratepayers.⁴⁵ Further, such change is being done in a single-issue and single-utility docket, without the detailed and contested proceeding previously recognized by the Commission as important in developing or changing the policy.⁴⁶ These two actions, taken together, constitute confiscation of shareholder interests.

The Department stated that it is not “aware of any way in which the November 30 Order could be determined to be confiscatory.”⁴⁷ In its June 30, 2017 reply comments at pages 8-12, the Department responded to MP’s claim that the November 30 Order is confiscatory. The Department stated that:

- MP has not demonstrated that the November 30 Order, by reflecting the value of the ND ITCs in MP’s revenue requirement, would result in confiscatory rates or violate any other state or federal law.
- MP did not show that the overall rate impact of the November 30 Order results in insufficient compensation to the Company.
- MP did not claim or demonstrate that its shareholders have a protectable property interest in the ND ITCs.
- The Commission should be confident that its Order results in just and reasonable rates for MP ratepayers and it need not amend its November 30 Order on these grounds.

As discussed above, the OAG recommended that the Commission find that its November 30 Order was not confiscatory.⁴⁸ The OAG’s June 20, 2017 reply comments respond to MP’s argument that the treatment of the ND ITCs at issue in the November 30 Order is confiscatory.

⁴⁴*Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1030 (1992); *Bd. of Regents of State Colls. v. Roth*, 408 U.S. 564 (1972).

⁴⁵ *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. G,E999/CI-99-1008, ORDER SETTING FILING REQUIREMENTS (Sept. 28, 1994)).

⁴⁶ 2006 NSP Order at 23.

⁴⁷ Department May 30, 2017 *Comments* at 12.

⁴⁸ OAG June 20, 2017 *Reply Comments* at 4.

The OAG stated in part, “The Commission’s Order properly assigned the tax benefits to the entity that created them, and has not improperly deprived the Company of anything it is otherwise entitled to.”⁴⁹

PUC Staff Comment

The Commission on its own motion is reconsidering the merits of its November 30 Order for purposes of determining whether any changes should be made to the order.

As suggested by MP, the Commission could modify its decision and allow MP to reflect in the revenue requirements only those ND ITCs that MP would use on a separate return basis.

Or, as previously recommended by the Department⁵⁰ (and alternatively by the OAG), the Commission could modify its order to remove risk to ratepayers by requiring MP to include in revenue requirements:

- the higher of the ND ITCs used on the consolidated return, or
- the ND ITCs that would be used by MP on a separate return basis.

Alternatively, as suggested by the OAG, the Commission could modify its November 30 Order and leave open to future consideration what happens when the value of tax credits are diminished by a consolidated return.

The Department did not specifically indicate whether it believes the Commission should affirm its November 30 Order, or modify it. However, the Department stated “if any change were made to the Commission’s November 30 Order, it should be not only to require that all monetized ND ITCs must be assigned to MP’s ratepayers, but also to protect MP’s ratepayers from the loss of ND ITCs due to any losses incurred by ALLETE’s affiliates, given the example provided in the Department May 30, 2017 Comments on pages 4-6.”⁵¹

The Commission may wish to ask the Department to clarify its position.

In considering whether to affirm, modify, or clarify its November 30 Order, the Commission may want to consider whether the November 30 Order departs from the Commission’s cost and benefit allocation principles and past practice, and if so, is there good cause. There continues to be controversy on both issues. Staff notes, however, that with respect to whether the

⁴⁹ Id. at 3.

⁵⁰ The Department did not specifically recommend that the Commission modify its November 30 Order. However, this was the Department’s previous recommendation and the Department did state that “In the unlikely event that ALLETE uses fewer ND ITCs than MP would use on a separate return basis, the Department concludes that the November 30 Order imposes an unreasonable sharing of risks from ALLETE’s non-regulated operations onto MP and its ratepayers.” [Department May 30, 2017 *Comments* at 12.] Further, the Department stated that, “if any change were made to the Commission’s November 30 Order, it should be not only to require that all monetized ND ITCs must be assigned to MP’s ratepayers, but also to protect MP’s ratepayers from the loss of ND ITCs due to any losses incurred by ALLETE’s affiliates[.]” [Department June 30, 2017 *Reply Comments* at 4.]

⁵¹ Department June 30, 2017 *Reply Comments* at 7.

Commission has departed from its cost/benefit allocation principles and past practice, the controversy focuses on the degree to which the Commission has departed from such principles and practices and whether there was good cause to do so, not on whether or not there has been any departure at all.

The Commission may also want to give careful consideration to whether the \$11.3 million tax benefit at issue is properly considered to be created by the ratepayer investment that created the ND ITCs as argued by the Department, or by the non-regulated MP affiliate income that creates the tax liability against which the tax credits would be utilized/realized as argued by the Company. Staff notes that neither of these parties address the issue of whether the tax benefit is properly considered to be created by both the ratepayers' investment creating the credit and unregulated MP affiliate income creating the tax liability that allows the credit to be realized, which could support splitting the credit between ratepayers and shareholders. The Commission may wish to ask the parties to explain the basis for the entire tax benefit flowing only to ratepayers or only to the Company given the facts before the Commission.

MP, the Department, and OAG all appear to agree that the Commission's November 30 Order opens ratepayers to risk in the event that MP's participation in ALLETE's unitary North Dakota tax return results in fewer ND ITCs being consumed than MP would consume on a separate return basis. The Commission's cost separation principles were designed to shield ratepayers, or regulated operations, from the risks of non-regulated operations. No party seemed to think that ratepayers should be placed at risk.

Decision Options

Staff has set forth six decision options below, but recognizes that the Commission may find that other options should be considered. With respect to ratepayer exposure to the risks of non-regulated operations as a result of the November 30 Order, either the second Decision Option below (as suggested by MP), or the third option (as previously recommended by the Department, and alternatively suggested by the OAG), would remove that risk. The fourth Decision Option below (the OAG's preferred option) would leave open the question of what to do when the value of tax credits are diminished by a consolidated return, thus exposing ratepayers to the risks of MP's non-regulated affiliate operations. The fifth Decision Option below would split any of the ND ITC tax benefit realized because of a tax liability created by unregulated MP income equally between ratepayers and the Company.

1. Affirm the initial decision in the November 30, 2016 Order.
2. Modify the initial decision in the November 30, 2016 Order and allow MP to reflect in the Company's revenue requirements only those ND ITCs that MP would realize (use) on a separate return basis. [MP]
3. Modify the initial decision in the November 30, 2016 Order and require MP to credit ratepayers with the higher of the ND ITCs that would be realized on a separate return basis or the value of the ND ITCs actually utilized on the consolidated return.

[Department recommendation before the November 30 Order, OAG Alternative]

4. Modify the initial decision in the November 30, 2016 Order and require MP to credit ratepayers with the full amount of ND ITCs utilized on the consolidated return to the extent the amount utilized on the consolidated return is equal to or higher than the amount that would be realized by MP on a separate return basis. Reserve, for a situation where those specific facts exist, the issue of what to do in the event the consolidated tax return reduces the amount of tax credits than can be used to an amount below that which could be used on a separate return. [OAG]
5. Modify the initial decision to require that any tax benefit realized by the application of ND ITCs to the tax liability of the Company's unregulated ND income be split between MP ratepayers and the Company. [Staff provided option.]
6. Find that the Commission's November 30, 2016 Order was not confiscatory. [OAG]