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December 22, 2014

VIA E-FILING AND EMAIL

The Honorable Judge Ann O'Reilly (ann.oreilly@state.mn.us)
Office of Administrative Hearing
600 North Robert Street
P.O. Box 64620
St. Paul, MN 55164-0620

**Re: In the Matter of the Request of Minnesota Power for a Certificate of Need for the Great Northern Transmission Line Project
Docket No. E-015/CN-12-1163
OAH Docket No. 65-2500-31196**

Dear Judge O'Reilly:

On behalf of the Large Power Intervenors, attached for filing in the above docket please find the following documents:

1. Post Hearing Brief - Public version;
2. Post Hearing Brief - Trade secret version; and
3. Certificate of Service.

Very truly yours,

STOEL RIVES LLP

/s/ Andrew P. Moratzka

Andrew P. Moratzka

APM
Enclosure

Alaska California Idaho
Minnesota Oregon Utah Washington
and Washington, D.C.

PUBLIC DOCUMENT
TRADE SECRET DATA HAS BEEN EXCISED

BEFORE THE MINNESOTA OFFICE OF ADMINISTRATIVE HEARINGS
100 Washington Square, Suite 1700
Minneapolis, MN 55401-2138

FOR THE PUBLIC UTILITIES COMMISSION OF THE STATE OF MINNESOTA
121 Seventh Plaza East, Suite 350
St. Paul, MN 55101-2147

In the Matter of the Request by Minnesota Power for a Certificate of Need for the Great Northern Transmission Line	PUC Docket No. E-015/CN-12-1163 OAH Docket No. 65-2500-31196

POST-HEARING BRIEF OF THE LARGE POWER INTERVENORS

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Over the last decade, rates charged by Minnesota Power have increased dramatically for all ratepayers. The Large Power Intervenors ("LPI")[1] is a consortium of large industrial customers receiving electric service from Minnesota Power that has been directly impacted by these recent and significant rate increases. LPI has been an active participant in this proceeding since filing its Petition to Intervene on January 16, 2014. LPI provided Direct Testimony on September 19, 2014, and Surrebuttal Testimony on November 7, 2014, and provided testimony in person at the Commission's hearing in this docket on November 14, 2014. LPI now submits this brief to suggest means of ensuring that Minnesota Power's investments in the Great Northern Transmission Line project (the "Project") are prudent and recovered from customers in a fair manner.

I. INTRODUCTION

Under Minnesota law, Minnesota Power bears the burden of demonstrating that its certificate of need application (the "Application") satisfies the criteria set forth in section 216B.243 of the Minnesota Statutes ("Minn. Stat.") and Chapter 7849 of the Minnesota Rules ("Minn. R."). In its order accepting the Application for filing and referring it to the Office of Administrative Hearings ("OAH"), the Minnesota Public Utilities Commission (the "Commission") expanded the scope of analysis beyond those threshold criteria by expressly permitting parties to "raise and address other issues relevant to the [A]pplication."[2] LPI's testimony and advocacy in this proceeding has therefore been separated into two categories: (1) recommendations to ensure the need criteria in Minn. Stat. 216B.243 and Minn. R. 7849 are satisfied and (2) additional recommendations relevant to the Commission's consideration of the Application. With respect to the former, LPI's position is that the Administrative Law Judge ("ALJ") should recommend to the Commission that it impose a cap on the amount Minnesota Power can recover from its customers for costs associated with the Project. With respect to the latter, LPI's position is that the ALJ should recommend to the Commission that it: (1) condition

[1] ArcelorMittal USA (Minorca Mine); UPM-Blandin Paper Company; Boise Paper (Boise), a Packaging Corporation of America company, formerly known as Boise, Inc.; Enbridge Energy, Limited Partnership; Hibbing Taconite Company; Mesabi Nugget Delaware, LLC; NewPage Corporation; PolyMet Mining, Inc.; Sappi Cloquet, LLC; USG Interiors, LLC; United States Steel Corporation (Keetac and Minntac Mines); and United Taconite, LLC.

[2] *In the Matter of the Request of Minnesota Power for a Certificate of Need for the Great Northern Transmission Line Project*, Docket No. E-015/CN-12-1163, ORDER ACCEPTING FILING, VARYING TIME LINES, AND NOTICE AND ORDER FOR HEARING at 4 (Jan. 8, 2014) (the "Referral Order").

any grant of the Application upon approval of Minnesota Power's 133 MW Renewable Optimization Agreements ("ROAs"); (2) direct Minnesota Power to accrue allowance for funds used during construction ("AFUDC") rather than permit it to seek current recovery of carrying charges during the construction period; (3) authorize ratemaking recovery through a rider as opposed to base rates; and (4) allocate the increase to customer classes based on base revenues excluding fuel and other riders.

II. ANALYSIS

A. The Referral Order Sets forth the Issues to be Addressed in the Proceeding

In its order accepting Minnesota Power's Application and referring the matter to the OAH, the Commission stated:

> The ultimate issue in this case is whether the Applicant's proposed transmission line project meets the need criteria set forth in Minn. Stat. § 216B.243 and Minn. Rules Chapter 7849. This issue turns on numerous factors that are best developed in formal evidentiary proceedings. The parties to this proceeding should address whether the proposed project meets these criteria and address these factors. The parties may also raise and address other issues relevant to the application.[3]

Thus, contrary to the assertions of both Minnesota Power and the Department of Commerce – Division of Energy Resources (the "Department"), cost recovery issues that are relevant to the Commission's consideration of the Application such as a cost cap, AFUDC, rider recovery, and revenue allocation are well within the purview of the ALJ and the Commission in this proceeding. This brief tracks the issues set forth in the Referral Order and breaks the analysis into two parts. First, this brief examines the need criteria, particularly the reasonableness of alternatives to the Project. Second, this brief raises and proposes resolutions to other issues, including cost recovery issues, that are relevant to the Application.

[3] *Id.*.

B. Costs of the Project Energy to be Supplied by the Project are Important Considerations in Evaluating the Application

Section 216B.243 specifically places the burden of demonstrating need upon the applicant, which in this case is Minnesota Power. In assessing the need for a large energy facility such as the Project, the Commission is to evaluate, *inter alia*, "possible alternatives for satisfying the energy demand or transmission needs…"[4] Parties to any certificate of need proceeding are free to submit alternatives to the project. As quoted by LPI witness Mr. Lane Kollen in his surrebuttal testimony, the relevant portion of Minn. R. 7849.0120 states as follows:

> A certificate of need must be granted to the applicant on determining that: … B. a more reasonable and prudent alternative to the proposed facility has not been demonstrated by a preponderance of the evidence on the record, considering: … (2) *the cost of the proposed facility and the cost of energy to be supplied by the proposed facility compared to the costs of reasonable alternatives and the cost of energy that would be supplied by reasonable alternatives.*[5]

In other words, one set of factors that should be considered is a comparison of both the cost of the proposed facility and cost of energy supplied by the proposed facility to the cost of a reasonable alternative and the cost of energy that would be supplied by that reasonable alternative.

1. Minnesota Power's Evaluation of Alternatives Contains Minimal Analysis, Relying Instead on Analysis from Other Commission Dockets

In his direct testimony, Minnesota Power witness Mr. David J. McMillan alleges "Minnesota Power examined a number of alternatives, discussed in further detail by Mr. Rudeck and Mr. Winter, including: generation alternatives; various transmission solutions, including upgrading existing facilities, and using different voltage levels and different endpoints; and a 'no-build alternative.'"[6] Minnesota Power witness Mr. Allen S. Rudeck, Jr., briefly addressed generation alternatives. Minnesota Power witness Mr. Christian Winter only addressed transmission alternatives. And for his part, Mr. Rudeck's direct testimony contains no analysis,

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[4] MINN. STAT. § 216B.243 subd. 3(6).
[5] Ex. 50, *Surrebuttal Testimony of Lane Kollen*, 5:19-25 (quoting MINN. R. 7849.0120).
[6] Ex. 34, *Direct Testimony of David J. McMillan*, 19:18-20:1,

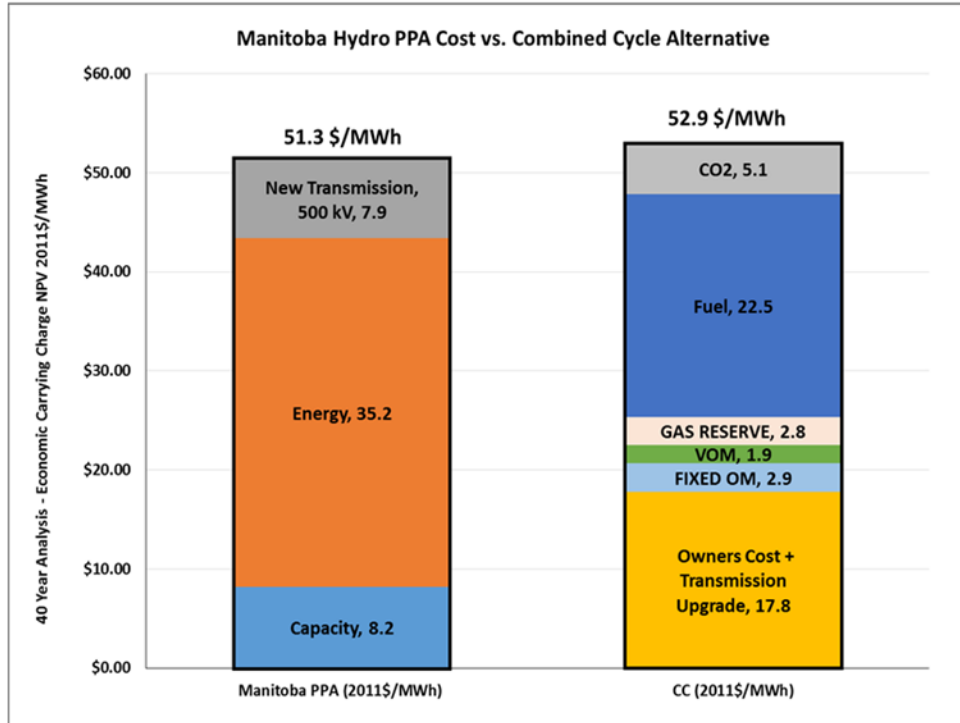
only the bald assertion that Minnesota Power entered into electric service agreements with Manitoba Hydro,

> [b]ut only after conducting analyses that also considered market purchases; advanced coal-fired generation, combustion gas turbines and combined cycle gas turbines; other renewable generation; and incorporating demand side management and conservation across a wide range of future energy industry assumptions and sensitivities. *As discussed in the 938 Docket approving the 250 MW Agreements, using its strategist model for screening reasonable alternatives, the Company concluded that a combined cycle unit may be the only reasonable alternative to the 250 MW Agreements.*[7]

2. LPI's Analysis Demonstrates the Reasonable Combined-Cycle Alternative is on Cost Parity with the Cost of Energy to be Delivered under the Project

It is difficult to understand how a blanket reference to modeling work done in a separate docket is sufficient to serve as Minnesota Power's justification of need. Nevertheless, Minnesota Power's concession that "a combined cycle unit may be the only reasonable alternative to the 250 MW Agreements" (and therefore the only reasonable alternative to the Project, which is designed to deliver power under those agreements) prompted LPI to further evaluate the option. LPI submitted discovery requests to better understand the modeling assumptions and results regarding the combined cycle alternative. Minnesota Power's responses, which are responses to LPI Information Request Nos. 14 and 17, are attached to Mr. Kollen's direct testimony. Extrapolating from these responses, Mr. Kollen demonstrated in his direct testimony that the difference in projected costs between the Project and a combined-cycle alternative is small, making the Commission's decision on cost effectiveness a very close call.[8] The results are demonstrated graphically in the table below.[9]

[7] Ex. 43, *Direct Testimony of Allen S. Rudeck, Jr.*, 29:18-30:5 (emphasis added).
[8] Ex. 49, *Direct Testimony of Lane Kollen*, 7:5.
[9] *Id*. at 8.



On a $/MWh basis, the two alternatives are very close, which raises two significant concerns. The first concern is whether the agreements with Manitoba Hydro, combined with the cost of the Project, remain the least cost option for Minnesota Power's capacity and energy needs.[10] The second concern is the rate impact on customers – i.e., the greater the cost of the Project, the greater the rate impact on customers.[11]

3. An Administratively Efficient Way to Ensure There is Not A More Reasonable, Prudent, and Cost Effective Alternative to the Project is to Impose a Cost Cap

To address the concern that the Project is, in fact, the least cost option that will have the smallest rate impact on customers, LPI suggests that the ALJ recommend a hard cap on Minnesota Power's recoverable Project costs to the Commission, specifically limiting Minnesota Power's recovery to **[TRADE SECRET DATA BEGINS… …TRADE SECRET DATA ENDS]** million in as-spent dollars, or $676.243 million in 2013 dollars.[12] LPI believes that such a cap is reasonable for multiple reasons. First, the estimate in 2013 dollars was used by

[10] *Id*. at 6:15-7:2.
[11] *Id*. at 8:2-3.
[12] *Id*. at 11:19-22.

Minnesota Power in the facilities construction agreement and cited by Minnesota Power to quantify the revenue requirement in response to discovery.[13] Second, the Commission has recent experience with cost-caps.[14] Specifically, the Commission recently imposed a cost cap on the environmental upgrades on the Boswell 4 generating unit. Third, a cost cap will ensure that Minnesota Power is accountable for the cost of the Project and properly incentivized to control costs.[15] Ratepayers have already seen five separate cost estimates in this docket, each of which is understated, and should be protected against continually escalating costs.[16] Fourth, there is limited downside risk to Minnesota Power because it has already budgeted for over $34 million in construction plan contingencies and over $57 million in project contingencies- a total of more than $92 million in contingencies.[17] These contingencies should be interpreted by the Commission for exactly what they are – i.e., Minnesota Power's best estimate of potential cost overruns. By setting a hard cap at the outset, the Commission would be (a) acknowledging the very small difference in projected costs between the Project and a combined cycle alternative, (b) approving shareholder protections for cost overruns in the form of contingencies built into the budget, and (c) limiting ratepayer liability for cost overruns in excess of those contingencies.

Finally, as described in Mr. Kollen's surrebuttal testimony, there are two policy reasons for addressing the issue of a cost cap in this proceeding: (1) administrative efficiency and (2) timing. Not only is it more efficient to address the cost cap issue while the record is open in this proceeding to do so, but ratepayers may be disadvantaged in subsequent proceedings if the Commission defers the issue for later determination.[18]

C. Conditions Should Accompany any Grant of the Application to Protect Ratepayers and Keep Costs Reasonable

As set forth in detail above, the cost of the Project is a key consideration in reviewing the Application. Equally important, however, is how Minnesota Power should be able to recover that cost from ratepayers. The Referral Order explicitly allows parties to raise issues relevant to

[13] *Id*. at 11:22-12:1.
[14] *Id*. at 12:5-10.
[15] *Id*. at 12:11-13.
[16] *Id*. at 5:23-6:11. In addition to identifying the five cost estimates, Mr. Kollen notes at 9:1-5, that "the cost estimates are understated because they do not include the financing costs that the Company will incur during construction," and recommends at 10:10-16, that those financing costs should be included in the cost estimates.
[17] Ex. 59.
[18] Ex. 50, *Surrebuttal Testimony of Lane Kollen*, 6: 3-13.

the Application that are not addressed by the need criteria set forth in Minn. Stat. 216B.243 and Minn. R. 7849. Therefore, LPI's position is that the ALJ should recommend to the Commission that it: (1) condition any grant of the Application upon approval of the ROAs to ensure cost recovery from Minnesota Power's ratepayers is limited to the 28.3% of projected Project costs as promised by Minnesota Power; (2) direct Minnesota Power to use AFUDC rather than permit it to seek current recovery of carrying charges during the construction period; (3) authorize ratemaking recovery through a rider as opposed to base rates; and (4) allocate the increase to customer classes based on base revenues excluding fuel and other riders. LPI understands that Minnesota Power and the Department accept the first recommended condition on cost recovery.[19] The parties' positions on the three remaining conditions are set forth below.

1. The ALJ Should Recommend that the Commission Direct Minnesota Power to Use AFUDC Rather Than Seek Current Recovery of Carrying Charges Before the Project is In-Service and Useful to Customers

Costs have increased dramatically for Minnesota Power's ratepayers over the last 7 years. For example, rates for residential and small commercial customers have increased by about 47% and 50% respectively since 2007.[20] Rates for Minnesota Power's large power class, the class from which Minnesota Power receives a majority of its revenue, have increased by more than 60%.[21] To help alleviate these dramatic increases, LPI believes it is appropriate for Minnesota Power to capitalize the financing costs and add them to the other costs included in construction work in progress ("CWIP"). Mr. Kollen explained the difference between this approach, which defers cost recovery during construction, and the current recovery approach in his direct testimony. There, he testified:

> Under the AFUDC approach, the financing costs are capitalized and added to the other costs included in CWIP. There is no current recovery of financing costs during the construction period. When the project is completed and placed in-service, all of the construction costs, including the AFUDC that was capitalized, are removed from CWIP and added to plant-in-service. The Company then recovers a "return of" and "return on" the plant-in-service, including the AFUDC that was capitalized, over the lives of the

[19] Ex. 35, *Rebuttal Testimony of David J. McMillan*, at 10:1-3; Ex. 55, *Rebuttal Testimony of Steve Rakow*, at 2:1.
[20] *See* Ex. 60 and 61.
[21] *Id*.

> assets. *In this manner, the Company is fully compensated for the financing costs incurred during construction, but these costs are recovered in the same manner as all other components of the construction cost.*
>
> Under the current recovery approach, the financing costs are not capitalized and are not added to the other costs included in CWIP. Instead, they are recovered as incurred, generally through a rider. *In this manner, the Company is fully compensated for the financing costs incurred during construction, but these costs are recovered on a compressed or accelerated basis over the construction period and they are recovered before the project is completed rather than after it is completed and providing service.*[22]

As is evident from the emphasized text, Minnesota Power is fully compensated under either the AFUDC or current recovery approach. The issue can therefore be simplified to a question of whether ratepayers should be required to "pay Minnesota Power now" (i.e., *before* the Project is placed in service and providing value to ratepayers) or "pay Minnesota Power later" (i.e., *after* the Project is placed in service and providing value to ratepayers)?

Mr. Kollen set forth seven reasons in his direct testimony why ratepayers should be allowed to pay Minnesota Power later. First, the AFUDC approach is consistent with Generally Accepted Accounting Principles ("GAAP").[23] Second, it is consistent with the regulatory notion that ratepayers should not be responsible to bear a utility's costs until and asset is used and useful in providing service.[24] Third, it is consistent with the regulatory concept of generational equity - that is, that customers who use or benefit from an asset should be responsible for paying for that asset.[25] Fourth, costs of construction do not have a large immediate impact on customers rates.[26] Fifth, accrual of AFUDC on the 28.3% would match Minnesota Power's accrual of the 17.7% under its 133 MW Energy Sale Agreement with Manitoba Hydro.[27] Stated differently, if Minnesota Power uses the current recovery method, it discriminates against its own ratepayers by allowing Manitoba Hydro to "pay later" while requiring its own ratepayers to pay for current recovery. Sixth, there is no evidence in the record to demonstrate that a current return is

[22] Ex. 49, *Kollen Direct*, 19:19-20:12 (emphasis added).
[23] *Id*. at 21:6-14.
[24] *Id*. at 21:15-18
[25] *Id*. at 21:19-22.
[26] *Id*. at 21:23-22:1.
[27] *Id*. at 22:3-7.

necessary for Minnesota Power to bolster or retain its financial health.[28] Finally, the Commission is not obligated to allow for current recovery under any State law, including section 216B.16 of the Minnesota Statutes. LPI believes this evidence supports its position that the ALJ should recommend that the Commission direct Minnesota Power to use the AFUDC approach.

2. The ALJ Should Recommend to the Commission that Minnesota Power Recover its Costs on the Project Through a Rider Mechanism

Another concern LPI has on cost recovery is the tariff under which the Project costs will be collected. In other words, whether the Project costs will be collected from ratepayers in base rates or through what is known as a rate rider. Base rates are set in conjunction with a utility's general rate case and are not adjusted until a subsequent general rate case is filed. A rate rider, on the other hand, is a mechanism under which a utility can recover costs for certain eligible projects, the recovery of which is generally updated annually. Here, there are a number of factors that weigh in favor of using a rate rider, such as Minnesota Power's Transmission Cost Recovery Rider, to recover costs associated with the Project. First and foremost, rider recovery would ensure that customers pay no more and no less than the actual Project costs.[29] Second, once the Project is in-service, its cost will be depreciated for book and income tax purposes, thereby continually reducing the revenue requirement.[30] Third, the must-take fee revenues can be transparently tracked against the revenue requirement once the Project is in service and providing value to ratepayers.[31] Finally, and related to the previous point, once the Project is in service, Minnesota Power may also have an opportunity to receive revenue credits, which can also be used to reduce the revenue requirement.[32] In light of these ratepayer protections available in a rate rider, LPI respectfully requests that the ALJ recommend that the Commission direct Minnesota Power to utilize rider recovery for the Project costs.

[28] *Id*. at 22:8-9.
[29] Ex. 49, *Kollen Direct*, at 24:15-16.
[30] *Id*. at 24:16-19.
[31] *Id*. at 24:20-21.
[32] *Id*. at 24:21-24:3.

3. The ALJ Should Recommend that the Commission Partially Remedy Existing Interclass Subsidies Currently Provided by the Large Power Class

In its Application, Minnesota Power sets forth an estimate of the rate increases that would result from its recovery of Project costs. Minnesota Power estimated an increase of 3.29% to residential customers, 3.05% to general service customers, 3.46% to large light and power customers, and 4.93% to large power customers.[33] In other words, the class with the smallest increase since 2007 - the residential class at about 47% - would receive the second-smallest rate increase associated with the Project. Meanwhile, the class with the largest increase since 2007 - the large power class at over 60% - would receive the largest rate increase associated with the Project. To partially address this inequity, Mr. Kollen recommended that the Commission should direct Minnesota Power to allocate the rate increases associated with the Project to customer classes based on base revenues, excluding fuel and other riders.[34]

Mr. Kollen went on to request that Minnesota Power respond to this proposal in its rebuttal testimony, including its calculations of the effects of LPI's proposal.[35] Minnesota Power graciously responded to LPI's request, setting forth the calculations in Schedule 2, Table 4, of David J. McMillan's rebuttal testimony.[36] According to Minnesota Power, the varying rate increases associated with the Project that are described above would be uniformly re-set to 3.98%.[37] This marginal benefit, when combined with LPI's other recommendations, would provide much-needed rate mitigation and deferral. LPI therefore respectfully requests that the ALJ recommend that the Commission direct Minnesota Power to allocate the rate increases associated with the Project to customer classes based on base revenues, excluding fuel and other riders.

[33] *Id*. at 25:17-19 (citing *The Application* at 30).
[34] *Id*. at 27:17-18.
[35] *Id*. at 27:19-20.
[36] Ex. 35, *McMillan Rebuttal*, Sched. 2, Table 4.
[37] *Id*.

III. CONCLUSION

Although LPI does not oppose the Application, the group has significant reservations regarding the ever-increasing costs of the Project and recovery of those ever-increasing costs from ratepayers. To address these concerns, LPI submitted a variety of recommendations, most of which should be supported by all ratepayers. LPI respectfully requests the ALJ to recommend that the Commission: (1) impose a hard cap on Project investment; (2) make any granting of the Application contingent upon approval of the ROAs; (3) direct Minnesota Power to use the AFUDC approach; (4) authorize Project cost recovery through a rate rider; and (5) allocate the rate increases associated with the Project to customer classes based on base revenues, excluding fuel and other riders.

Dated: December 22, 2014

Respectfully submitted,

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