Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: February 2, 2017 ..... Agenda Item # 9**

Company: Minnesota Power

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

Issue: Should the Commission grant the petition for reconsideration of its November 30, 2016 *Order Determining Treatment of North Dakota Investment Tax Credits for Bison Wind Projects* as requested by Minnesota Power?

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Relevant Documents

Commission's Order .....November 30, 2016
Minnesota Power - Petition for Reconsideration .....December 20, 2016
Department of Commerce - Answer to the Petition for Reconsideration .....December 30, 2016

The attached materials are workpapers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless otherwise noted.

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January 25, 2017

Statement of the Issue

Should the Commission grant the petition for reconsideration of its November 30, 2016 *Order Determining Treatment of North Dakota Investment Tax Credits for Bison Wind Projects* as requested by Minnesota Power?

Minnesota Statutes and Commission Rules

Petitions for reconsideration are subject to Minn. Stat. § 216B.27, and Minn. Rules, Part 7829.3000.

Petitions for reconsideration are denied by operation of law unless the Commission takes action within sixty days of the request. If the Commission takes no action on Minnesota Power's ("MP" or the Company) petition, the request is considered denied as of February 21, 2017[1].

The Commission may also take specific action to either grant or deny the petition. If the Commission takes up MP's request for reconsideration, the Commission may: (1) reconsider, and then (a) reverse, (b) modify or (c) affirm its initial decision, or (2) deny the petition for reconsideration and thereby affirm the initial decision.

The Commission may also reconsider or clarify its Order on its own motion.

Background

On November 30, 2016, the Commission issued its *Order Determining Treatment of North Dakota Investment Tax Credits for Bison Wind Projects* ("November Order"). In its November Order, the Commission decided that all Bison Wind Project North Dakota Investment Tax Credits (ND ITCs) actually realized (or monetized) shall be reflected in 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 of Commerce ("Department" or "DOC") answered the Company's Petition and requested the Commission to deny reconsideration.

[1] February 18 is 60 calendar days from MP's petition filing date, however this date falls on a Saturday, and a holiday weekend, in 2017.

Commission Decision

Oral argument and deliberations were held on October 18, 2016. The motion deciding, "all Bison Wind Projects' North Dakota Investment Tax Credits actually realized in tax return filings, or monetized through other permissible means shall be reflected in Minnesota Power's revenue requirements" passed on a vote 4-1, with Commissioner Tuma opposing.

Reconsideration Item

Treatment of North Dakota Investment Tax Credits

Minnesota Power

In its December 20, 2016, Petition for Reconsideration, the Company stated that,

> "The net effect of the November Order deprives the ALLETE companies of approximately $11.3 million, resulting in an impermissible confiscation of nonregulated ALLETE company assets from ALLETE shareholders in contravention of the basic principles of financial separation between regulated and nonregulated activities of settled regulatory principles.
> …
> [T]he November Order does not comport with the settled standards for administrative agency decisions articulated in each of Minnesota Statutes Sections 14.69(a) – (f).
> …
> The Commission's decision results in the income of the nonregulated ALLETE companies, for which neither Minnesota Power nor its customers bear any risk in operations, being used for the benefit of Minnesota Power's customers, creating an unlawful asymmetrical allocation of risks and benefits."[2]

It is MP's view that by requiring ND ITCs used by the nonregulated ALLETE companies to be passed through to Minnesota Power's customers, the Commission engages in cross-subsidization, and takes the benefit of the nonregulated businesses without exposing ratepayers to potential future risks of nonregulated operations of affiliates.

ALLETE established a tax consolidation company to provide an accounting mechanism to absorb the differences between the separate tax liability of Minnesota Power (an operating division of ALLETE) and the nonregulated ALLETE affiliates. MP attested that the tax consolidation company provides added protection in maintaining separation of utility and nonregulated business operations.

MP stated its financial separation accounting has been entirely consistent with the practices of other utilities and that it follows the Commission's directive to assure ratepayers are no better or

[2] Minnesota Power Reconsideration Petition, pp. 1-2 (December 20, 2016)

worse off with or without nonregulated business activity. "This financial separation was re-emphasized with the Commission's order in Xcel Energy's 2005 rate case."[3,4]

The Company stated that the Commission's November Order fails to account for the notion that the ND ITCs could not be accounted for [assigned to] the benefit of MP because MP lacks the tax appetite to absorb the full $22 million in utilized ND ITCs. Rather, $11.3 million of this $22 million in ND ITCs are only available for use because of the income of ALLETE's North Dakota nonregulated companies. As a result, MP argued that under acceptable standard principles of tax accounting and financial separation of regulated and nonregulated activities, those tax credits must be allowed to be realized by the ALLETE companies that utilized the credits.

The Company stated that the Commission's decision also fails to allow application of a full tax allocation, as explained by FERC's accounting principles, which describes methods on how the tax liability on the consolidated filing is allocated. The Company also stated that the Commission's decision is at odds with the tax allocation agreements approved for Minnesota Energy Resource Corporation, which would produce a tax allocation result precisely requested by MP regarding the ND ITCs.[5]

The Company emphasized the FERC accounting for income taxes principle: that the tax expense must be allocated in such a way that the *benefits and burdens* contributed by *each member* of the consolidated group are *recognized* in the allocation.[6] MP suggested that each members' contributions of *benefits* to the consolidated/unitary tax return is "income"; therefore, MP concluded that the Commission decision directs unequal treatment of these benefits. MP emphasized that the *risk* associated with the generation of the income that allows the estimated $11.3 million of the ND ITCs to be realized resides solely with the nonregulated ALLETE companies and their shareholders. MP concluded that the Commission's November Order has granted ratepayers the right to share in the nonregulated ALLETE companies' profits without requiring they bear any of the risk of the nonregulated ALLETE company operations. MP stated that if the Commission has concluded that ratepayers should be the sole beneficiary of nonregulated ALLETE companies' income, then ratepayers should also bear at least some of the risk associated with this income in the future.

MP argued that even if the Commission concludes that its November Order does not violate the principles of financial separation, the Order results in an impermissible confiscation, or taking, from ALLETE shareholders. MP stated it is well settled that the imposition of confiscatory rate regulation is a taking of property in violation of the due process clause of both the federal and state constitutions.[7] The Company quoted from well-known utility cases heard at the U.S. Supreme Court level:

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[3] 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, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER; ORDER

[4] MP Reconsideration Petition, p. 4 (December 20, 2016)

[5] *In the Matter of a Request by Minn. Energy Res. Corp. (MERC) for Approval of the Tax Allocation Affiliated Interest Agreement between WEC Energy Group, Inc. (WEC) and its Regulated and Non-Regulated Subsidiaries,* Docket No. G011/AI-15-705, ORDER (Oct. 6, 2015).

[6] FERC Docket No. AI93-5-000, ACCOUNTING FOR INCOME TAXES at 13 (Apr. 23, 1993) [emphasis added].

[7] *See* Hibbing *Taconite Co. v. Minn. Pub. Serv. Comm'n*, 302 N.W.2d 5, 10 (Dec. 12, 1980) (citing *Bluefield Waterworks and Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679 (1923)).

> "Rates which are not sufficient to yield a reasonable return on the value of the property used, at the time it is being used to render the service, are unjust, unreasonable, and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment."[8]
>
> "The guiding principle has been that the Constitution protects utilities from being limited to a charge for their property serving the public which is so 'unjust' as to be confiscatory."[9]
>
> "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."[10]

MP claimed that the ND ITC tax benefit belongs to those that pay for the acquisition or creation of the unregulated assets that generate the tax benefit. MP argued that benefit is the generation of the income of the ALLETE companies necessary to utilize the $11.3 million of ND ITCs. The ALLETE shareholders, wholly, pay for the creation of the unregulated assets that generate the income of the ALLETE companies, and sufficient compensation for that support is not afforded when the ND ITCs are diverted to customers who have no interest in those assets. Therefore, MP concluded that the Commission's November Order effectuates a taking of the nonregulated assets of shareholders.

Department of Commerce

In its December 30, 2016, Answer, the Department provided a brief response to some of the issues raised in MP's petition, specifically on the topics of asymmetrical treatment of risks and benefits [11], and the driver behind the realizable consolidated tax savings[12]. These are thoroughly discussed on pages 1 – 5 of the Department's Answer and will not be repeated here.

The Department concluded that the November Order fully considered the facts of this Docket and the relevance of prior Commission Orders; that the Company's assertions are without merit; therefore, MP's request of reconsideration should not be granted.

[8] Bluefield, 262 U.S. at 690.
[9] Duquesne *Light Co. v. Barasch*, 488 U.S. 299, 307 (1989).
[10] *Id.* at 308.
[11] Department of Commerce Comments, pp. 1-2 (December 30, 2016)
[12] Department of Commerce Comments, pp. 2-5 (December 30, 2016)

Staff Comments

It is important to recognize that Minnesota Power has a tax agreement filed and approved by the Commission, therefore it would be that agreement to reference for tax allocation purposes. MP's state tax agreement was included in the record[13] of this docket and for convenience is included as an attachment to these briefing papers.

MP's state tax agreement has a provision on how to address the use of tax benefits (i.e., net operating losses or unused tax credits) beyond what the individual subsidiary could use on a separate return basis. The tax agreement directs that the subsidiary shall be paid the amount by which taxes of the group are less by reason of including the subsidiary in the group.[14] Though the Company has argued that MP is an operating division, not a subsidiary, staff believes the Commission's decision captured the essence of this tax allocation agreement's recognition that tax credits are associated with the operation that created them, not the other subsidiary group members that produce a tax liability that allows additional credits to be utilized.

MP's arguments are based upon its position that "income" is the "benefit" contributed to the unitary tax return. This appears not only contrary to the provisions within its own tax agreement, but differs from the context of FERC discussions on the application of the stand-alone concept in consolidated tax returns. The FERC opinion stated:

> "[The] stand-alone method […] does not ignore the consolidated return or the tax reducing benefits the group realizes by filing such a return…[O]ur stand-alone policy … requires the answer to only one question: have the expenses that generated the tax deduction been included in the cost of service?"[15]

The FERC opinion indicates the "benefit" contributed to the unitary tax return are those elements that lower taxes.

The Commission's decision recognizes that the investment tax credit essentially reduces the cost of the investment in the Bison Wind facilities. Rates were designed to provide MP a return of the full cost of the Bison Wind facilities which includes a return on the cost of these investments. As the earned investment tax credits are realized, the cost of the Bison Wind facilities are reduced, therefore, the Bison Winds' cost-of-service to ratepayers will be lower. The Commission's decision to reflect the lower cost of service when developing rates is reasonable.

Staff believes the Commission carefully considered this matter and reached a reasonable decision. However, if the Commission would like to hear further legal arguments on the legal issues raised by Minnesota Power, it may want to toll the time period on MP's request for reconsideration and ask parties for oral argument at hearing or briefs.

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[13] State Tax Agreement included as Attachment 4 to Department Comments (December 16, 2015)

[14] See Articles 4.B & 4.C of the State Tax Agreement.

[15] FERC Opinion No. 173: Opinion and Order Establishing Proper Cost of Service Treatment of Tax Liability Arising from the Filing of a Consolidated Tax Return (June 22, 1983). 23 FERC 61,852; 61,860 (1983)

Decision Options

A. Rehearing and Reconsideration of the November 30, 2016 Order

1. Grant Minnesota Power's petition for reconsideration, or

2. On its own motion, reconsider the November Order, or

3. Deny Minnesota Power's request for reconsideration, or

4. Take no action and allow Minnesota Power's petition for reconsideration to be denied by operation of law.

B. If the Commission grants Minnesota Power's petition (Alternative A-1), or, on its own motion reconsiders the November 30, 2016 Order (Alternative A-2), it may

1. Affirm the initial decision in the November 30, 2016 Order.

Or

2. Modify the Order and grant Minnesota Power's request to reverse its decision, and/or

3. Make any other changes to amend or clarify the decision the Commission deems appropriate or necessary.

Or

4. Toll the time period for Minnesota Power's request for reconsideration and request oral argument at hearing or in briefs on the legal issues raised by Minnesota Power.

STATE TAX AGREEMENT

This Agreement, effective this 5th day of October, 1993, is entered into between and among Minnesota Power Enterprises, Inc. ("MPE") and each subsidiary corporation of MPE executing a Signature Page in the form attached (referred to herein as a "Subsidiary" or the "Subsidiaries").

WITNESSETH:

WHEREAS, MPE is a member of the unitary group which includes the Subsidiaries (the "Group"); and

WHEREAS, ALLETE, Inc. is required to file state unitary income tax returns and MPE wishes to make provisions therefor;

NOW, THEREFORE, in consideration of the premises and of the agreements herein set forth, MPE and the Subsidiaries hereby agree as follows:

1. Each Subsidiary shall join in the unitary return to be filed by MPE for the first taxable year ending after the effective date of this Agreement with respect to such Subsidiary, as set forth in Paragraph 10 of this Agreement, and shall continue to join in the unitary return until this Agreement is terminated with respect to the Subsidiary as set forth in Paragraph 7.

2. Each Subsidiary hereby irrevocably designates MPE as its agent for the purpose of taking any and all action necessary or incidental to the filing of unitary returns, and to furnish MPE with any and all information requested by MPE in order to carry out the provisions of this Agreement. Each Subsidiary acknowledges and agrees that MPE shall have exclusive power and authority to make any and all state income tax elections which could effect the unitary group or separate state income tax liability of MPE or any Subsidiary in the Group.

3. Each Subsidiary will cooperate with MPE in filing any return or consent contemplated by this Agreement and agrees to take such action as MPE may request, including but not limited to the filing of requests for the extension of time within which to file tax returns, and to cooperate in connection with any refund claim with respect to any year for which it has filed or will file a unitary return with MPE.

4. For any year or partial year in which a Subsidiary is a party to this Agreement, the Subsidiary shall pay to MPE, or receive from MPE, the following amounts in connection with the state income tax liability of MPE and the Subsidiaries subject to this Agreement:

A. On or before the prescribed due date for each estimated payment and extension payment of state income tax; MPE shall at its sole option: (i) compute the estimated payment that would be required to be made by Subsidiary if it filed a separate return, subject to the provisions of Paragraph 5 hereof; and (ii) each Subsidiary shall pay

such amount to MPE. MPE shall provide to each Subsidiary documentation supporting its computation. In the event Subsidiary disagrees with MPE's computations, the parties shall make a good-faith effort to resolve their differences within 45 days after the documentation is provided by MPE. In the event the parties cannot agree, they shall submit the issue to the certified public accounting firm" then utilized by MPE for federal income tax matters for a final and binding determination to be made within 30 days after submission.

B. On or before the prescribed due date (including extensions) of the state unitary income tax return for the Group: (i) MPE shall compute the amount of state income tax the Subsidiary would be required to pay for the immediately preceding fiscal year if the Subsidiary had filed a separate return, subject to the provisions of Paragraph 5 hereof; (ii) MPE shall determine the amount of the total tax liability of the unitary group and apportion it among the members of the Group in proportion to their respective separate tax liabilities, and (iii) MPE shall notify each Subsidiary of its share of the unitary tax liability no later than 60 days after completing the state unitary income tax return of the Group, taking into account any prior estimated tax payments. Each Subsidiary shall make payments to MPE within 30 business days of such notification. MPE shall provide to each Subsidiary documentation supporting its computation. In the event Subsidiary disagrees with MPE's computation, the parties shall make a good-faith effort to resolve their differences within 45 days after the documents are provided by MPE. In the event the parties cannot agree, they shall submit the issue to the certified public accounting firm then utilized by MPE for income tax matters for a final and binding determination to be made within 30 days after submission.

C. If any Subsidiary shall have a net operating loss or unused tax credits on a separate return basis, which losses or unused tax credits are used on the unitary return, MPE shall pay to such Subsidiary the amount by which the taxes of the Group are less by reason of including the Subsidiary in the Group. In the event MPE owes an amount to a Subsidiary, MPE shall pay such amount to the Subsidiary not later than 60 days after filing of the state unitary income tax return of the Group, including proper extensions.

5. In the computation of the amounts to be paid under Paragraph 4, the following rules shall apply:

A. Except as otherwise provided below, all applicable rules of state income tax law shall be applied as if each Subsidiary filed a separate return.

B. The alternative minimum tax liability each member of the Group shall be taken into account.

C. MPE's determination of the amount due from or payable to a Subsidiary shall be controlling, notwithstanding the dispute resolution provisions of Paragraph 4, unless there are shareholders of a Subsidiary that are not members of the Group.

D. Gain or loss from "deferred intercompany transactions" pursuant to the Treasury Regulations promulgated under Section 1502 of the Code shall be recognized at the same time as on the unitary return of the Group.

E. In determining the separate return income tax liability of a Subsidiary, MPE will equitably resolve the treatment of elections and tax computations, such as surtax exemptions, which may have been different from the unitary treatment if separate returns were filed.

F. Payments made under Paragraph 4 to the Subsidiaries shall be computed on a with and without method, which determines the change in tax if the Subsidiary is excluded from the unitary filing.

G. The foregoing rules shall be applied on a consistent basis from one year to the next. If a Subsidiary desires to change the basis on which it applies any rule of state income tax law, it shall first obtain MPE's approval.

6. The computation of the amount of the separate return state income tax of Subsidiary as determined in Paragraphs 4 and 5 above for any period in which Subsidiary joined a state unitary income tax return of MPE shall be adjusted consistent with any adjustment by the Minnesota Department of Revenue or tax refund obtained by MPE. The computation of a Subsidiary's obligation to pay (or right to receive payment) with respect to any such Minnesota Department of Revenue adjustment or tax refund shall be made under Paragraph 4 by giving effect to the portion of such adjustment or tax refund which is attributable to such Subsidiary as if it had been made a part of the original computation of tax liability hereunder. Such recomputation and any adjusting payment required as a result shall be made forthwith upon the final administrative or judicial determination of such adjustment or refund claim. Adjusting payments shall include that portion of the interest payable to (or receivable from) Minnesota which is attributable to the Subsidiary's adjusting payment to (or from) MPE.

Any income tax deficiencies which arise with respect to the state unitary income tax of the MPE affiliated group and which are attributable to Subsidiary shall be promptly and diligently defended by MPE with counsel and accountants of its own selection. Subsidiary will pay the expenses of counsel and accountants which are attributable to Subsidiary. Subsidiary shall cooperate with and assist MPE as required in any such proceeding and Subsidiary agrees not to accept any overassessment or deficiency of state income tax which is attributable to Subsidiary without the written consent of MPE. Subsidiary further agrees to execute and file such waivers, consents, other forms, Tax Court or other petitions, powers of attorneys and other document as MPE requests from time to time in order to defend income tax deficiencies attributable to Subsidiary.

7. This Agreement shall not apply to a Subsidiary for any unitary return tax year beginning on or after the date the Subsidiary ceases to be a member of the Group; provided that following termination, the Subsidiary shall be bound by the terms of this Agreement, and shall be entitled to receive payments attributable to any period during which it was a party to this

Agreement, and shall be obligated to make payments attributable to any period during which it was a party to this Agreement.

8. This Agreement shall be governed by the law of the State of Minnesota and shall be binding on the successors and assigns of the parties hereto.

9. This Agreement may be executed in two or more counterparts, each of which will constitute an original.

10. This Agreement shall be effective with respect to a Subsidiary for all taxable years of the Group ending after the date specified in the Signature Page attached to this Agreement, and shall supercede any prior tax sharing agreement between MPE and the Subsidiary.

MINNESOTA POWER ENTERPRISES, INC.

By _____

Its Chairman, President & CEO