

BEFORE THE MINNESOTA OFFICE OF ADMINISTRATIVE HEARINGS
600 North Robert Street
St. Paul MN 55101

FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION
121 7th Place East, Suite 350
St Paul MN 55101-2147

IN THE MATTER OF THE REQUEST OF
MINNESOTA POWER FOR A CERTIFICATE
OF NEED FOR THE GREAT NORTHERN
TRANSMISSION LINE PROJECT

Docket No. E015/CN-12-1163
OAH Docket No. 65-2500-31196

SURREBUTTAL TESTIMONY OF MARK A. JOHNSON

ON BEHALF OF

**THE MINNESOTA DEPARTMENT OF COMMERCE,
DIVISION OF ENERGY RESOURCES**

NOVEMBER 7, 2014

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TABLE OF CONTENTS

Section	Page
I. INTRODUCTION.....	1
II. PURPOSE	3
III. RESPONSE TO MP’S REBUTTAL TESTIMONY.	4
A. Allowance for Funds Used During Construction (AFUDC).....	4
B. Rider Recovery Timeframe	9
C. Cost Allocations and Rate Design.....	11
IV. SUMMARY OF RECOMMENDATIONS	14

1 I. INTRODUCTION

2 Q. Would you state your name, occupation and business address?

3 A. My name is Mark A. Johnson. I am employed as a Public Utilities Financial Analyst by
4 the Minnesota Department of Commerce, Division of Energy Resources (DOC or
5 Department). My business address is 85 7th Place East, Suite 500, St. Paul,
6 Minnesota 55101-2198.

7
8 Q. What is your educational and professional background?

9 A. I received a Bachelor of Science degree in accounting in 1988 from the University of
10 Minnesota. In 1992, I received an M.B.A. degree from the University of St. Thomas
11 with an emphasis in management. I also maintain an active Certified Public
12 Accountant (CPA) License in the state of Minnesota.

13
14 Q. What is your business experience?

15 A. My business background includes over three years of experience with the Minnesota
16 Office of the State Auditor performing audits of local governments. I also have two
17 years of experience as a staff accountant with a CPA firm conducting audits of
18 businesses, preparing financial statements, and preparing corporate and individual
19 tax returns.

20 Since accepting the position of Financial Analyst at the DOC over seven years
21 ago, I have worked on numerous issues pertaining to regulatory finances and
22 ratemaking, including depreciation matters, surcharges to underground distribution
23 utility lines, ratemaking treatment of sulfur dioxide allowances, ratemaking treatment
24 of mercury costs, purchased acquisition (PA) petitions related to spare transformers,

1 aircraft equipment, transmission lines, generator facilities and numerous other
2 financial matters. In addition, I have filed direct testimony in the following matters:

- 3 • Interstate Power and Light Company's *Joint Petition for Approval of*
4 *Transfer of Transmission Assets to ITC Midwest LLC* (Docket No. E001/PA-
5 07-540),
- 6 • Otter Tail Power Company's *Application for Authority to Increase Electric*
7 *Rates in Minnesota* (Docket No. E017/GR-07-1178),
- 8 • Minnesota Power Company's *Application for Authority to Increase Electric*
9 *Rates in Minnesota* (Docket No. E015/GR-08-415),
- 10 • Minnesota Energy Resources Corporation's *Application for Authority to*
11 *Increase Natural Gas Rates in Minnesota* (Docket No. G007,011/GR-08-
12 835),
- 13 • CenterPoint Energy Resources Corporation, d/b/a CenterPoint Energy
14 Minnesota Gas' *Application for Authority to Increase Natural Gas Rates in*
15 *Minnesota* (Docket No. G008/GR-08-1075),
- 16 • Northern States Power Company's *Application for Authority to Increase*
17 *Natural Gas Rates in Minnesota* (Docket No. G002/GR-09-1153),
- 18 • Interstate Power and Light Company's *Application for Authority to Increase*
19 *Electric Rates in Minnesota* (Docket No. E001/GR-10-276),
- 20 • Minnesota Energy Resources Corporation's *Application for Authority to*
21 *Increase Natural Gas Rates in Minnesota* (Docket No. G007,011/GR-10-
22 977),

- 1 • Interstate Power and Light Company's *Petition for Approval of Eligibility for*
2 *Investment in Whispering Willow-East, Renewable Energy Recovery*
3 *Adjustment, and 2010 Rate* (Docket No. E001/M-10-312),
- 4 • CenterPoint Energy Resources Corporation, d/b/a CenterPoint Energy
5 Minnesota Gas' *Application for Authority to Increase Natural Gas Rates in*
6 *Minnesota* (Docket No. G008/GR-13-316),
- 7 • ITC Midwest LLC's *Application for a Certificate of Need for the Minnesota-*
8 *lowa 345 KV Transmission Line Project in Jackson, Martin, and Faribault*
9 *Counties, Minnesota* (Docket No. ET6675/CN-12-1053), and
- 10 • Dakota Electric Association's *Applications for Authority to Increase Rates*
11 *for Electric Service in Minnesota* (Docket No. E111/GR-14-482).

13 II. PURPOSE

14 Q. What is the purpose of your testimony?

15 A. The purpose of my testimony is to assist the Minnesota Public Utilities Commission
16 (Commission) in evaluating the financial impacts of the application by Minnesota
17 Power's, an operating division of ALLETE, Inc. (MP or the Company), for a Certificate
18 of Need (Petition) to construct the Minnesota/Manitoba border—Blackberry 500 kV
19 transmission line and associated facilities, referred to as the Great Northern
20 Transmission Line (GNTL or the Project). More specifically, the purpose of my
21 testimony is to respond to the Rebuttal Testimony of MP Witness Mr. David J.
22 McMillan regarding the following accounting issues raised by the Large Power
23 Intervenor Group (LPI) in direct testimony:

- LPI's proposed accounting treatment of Allowance for Funds Used During Construction (AFUDC);
- LPI's proposal to keep GNTL in a rider permanently; and
- Cost allocations and rate design.

III. RESPONSE TO MINNESOTA POWER'S REBUTTAL TESTIMONY

A. ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC)

Q. What did LPI recommend in direct testimony regarding the treatment of AFUDC costs associated with GNTL?

A. Mr. Kollen testified that the Commission should direct the Company to accrue AFUDC on its balance of construction work in progress (CWIP) rather than seek current recovery of a return on CWIP (carrying charges) during the construction period. Mr. Kollen stated that the Commission should do so in this proceeding to pre-empt any subsequent request by the Company to obtain current recovery of carrying charges in its annual Transmission Cost Recovery Rider (TCR Rider). LPI Ex. __ at 4 (Kollen Direct).

Q. Did MP agree with LPI's recommendation?

A. No. Mr. McMillan stated that Mr. Kollen's recommendation had several flaws. Mr. McMillan stated that:

First, while Minnesota Power has worked to be transparent about cost recovery matters, cost recovery treatment is not an issue that needs to be decided in the Certificate of Need docket. Indeed, it would be premature and inappropriate to do so at this time.

1 Second, under Minnesota Statutes Section 216B.16,
2 subd. 7b, high voltage transmission projects that receive
3 a Certificate of Need are specifically eligible for current
4 cost recovery during construction. The Minnesota
5 Legislature granted utilities this authority to incentivize
6 new transmission construction, such as the Project, in
7 lieu of the old paradigm that prohibited recovery of the
8 costs of a new asset until it was “used and useful” and
9 placed into rate base.

10
11 Third, a current return on CWIP provides customers a
12 lower overall capital cost. As shown in Ex. __ (DJM-R),
13 Schedule 1, Minnesota Power estimates the overall
14 capital savings of CWIP treatment to be approximately
15 \$55 million in nominal dollars compared to recording
16 AFUDC. Precluding a current return on CWIP simply
17 delays cost recovery until the Project is in-service. This
18 delay will increase total overall revenue requirements for
19 Minnesota Power’s customers.

20
21 Fourth, Minnesota Power disagrees with Mr. Kollen’s
22 statement that the Project “has value only after it is
23 constructed and placed in-service.” Given the
24 contractual requirements in the Power Purchase
25 Agreements with Manitoba Hydro and the certainty that
26 those requirements are met, the long lead time it takes
27 to permit and construct a project and the significant
28 capital cost outlay required to construct a 500 kV line,
29 Minnesota Power sees significant value to the Company
30 and its ratepayers prior to the date when the Project is
31 placed in-service. Other benefits from a return on CWIP
32 include reduced rate shock for customers because rate
33 increases are gradually phased in during construction,
34 and improved cash flow for the utility which will in turn
35 support stronger financial ratings and lower capital costs
36 for this Project and all other capital projects.

37
38 MP Ex. __ at 12-13 (McMillan Rebuttal) (emphasis in original).

39
40 **Q. How do you respond to Mr. McMillan’s first point regarding when the method of cost**
41 **recovery should be decided?**

1 A. I agree that cost recovery issues are not usually addressed in Certificate of Need
2 proceedings. Instead, these issues are generally addressed in cost recovery
3 proceedings, such as riders and rate cases. However, to the extent that the
4 Commission may find this information helpful, I provide a response to the cost
5 recovery issues addressed by MP in rebuttal testimony.

6
7 **Q. How do you respond to Mr. McMillan’s second point regarding authorization in**
8 **Minnesota statutes regarding earning a current return on CWIP?**

9 A. I agree that Minnesota’s Transmission Cost Recovery Statute, Minn. Stat. § 216B.16,
10 subd 7b, allows utilities to seek current recovery of a return on CWIP during the
11 construction period, which is prior to when a project is placed in-service. Specifically,
12 Minn. Stat. § 216B.16, subd 7b(b) and 7b(b)(5) state that:

13 (b) Upon filing by a public utility or utilities providing
14 transmission service, the commission may approve,
15 reject, or modify, after notice and comment, a tariff that:

16 . . .

17 (5) provides a current return on construction work
18 in progress, provided that recovery from Minnesota
19 retail customers for the allowance for funds used
20 during construction is not sought through any other
21 mechanism
22

23 **Q. Are you aware of any instances where the Commission has denied current recovery**
24 **of a return on CWIP in a utility’s TCR Rider because the project was under**
25 **construction?**

26 A. No. In fact, if the Commission denied a request by MP for current recovery of a
27 return on CWIP in a future TCR Rider, the Commission would be making a significant
28 departure from past precedent.

1 Q. **How do you respond to Mr. McMillan's third point that allowing a current return on**
2 **CWIP during the construction period would result in lower overall capital costs?**

3 A. I agree with Mr. McMillan that earning a current return on CWIP would result in lower
4 overall capital costs to be recovered in rates over the life of the GNTL facility, if GNTL
5 is approved. This result occurs because the utility is provided a current return on
6 CWIP in lieu of capitalizing more AFUDC costs during the construction phase of the
7 project. However, this fact does not necessarily result in a benefit to ratepayers.

8
9 Q. **Please explain why lower overall capital costs may not necessarily result in a benefit**
10 **to ratepayers.**

11 A. While Mr. McMillan is correct that a current return on CWIP would result in a lower
12 level of overall capital costs for GNTL, he failed to note that the annual revenue
13 requirements would be significantly higher during the construction phase of the
14 Project due to the current return on CWIP. In other words, the \$55 million in AFUDC
15 savings would be offset by the current return on CWIP that MP is allowed to collect
16 during the construction phase of the Project.

17
18 Q. **Do you agree with Mr. McMillan's statements that precluding a current return on**
19 **CWIP simply delays cost recovery until the Project is in-service, and that this delay will**
20 **increase total overall revenue requirements for Minnesota Power's customers?**

21 A. I agree that precluding a current return on CWIP would delay cost recovery until a
22 project is in service, and that this delay would increase total overall revenue
23 requirements. However, such a delay would not necessarily result in a detriment to
24 ratepayers.

1 **Q. Please explain why this delay would not necessarily result in a detriment to**
2 **ratepayers.**

3 A. In exchange for recovery of a current return on CWIP during the construction phase of
4 the facility, MP is forgoing additional AFUDC costs that would otherwise be capitalized
5 and charged to ratepayers over the life of the asset. Therefore, in order to determine
6 whether this different rate treatment represents an overall cost or benefit for
7 ratepayers, it would be necessary to calculate the present value of total annual
8 revenue requirements over the life of the project under both methods: 1) allowing
9 MP to earn a return on CWIP during the construction period, and 2) allowing MP to
10 incur higher AFUDC costs and earn a current return on the higher capitalized amount
11 over the life of a facility.

12 Given that these calculations would need to include numerous assumptions
13 on future rates of return, AFUDC rates (costs), discount rates, depreciable lives, etc., I
14 am unable to precisely determine which method results in the lowest real-dollar¹
15 costs for ratepayers.

16
17 **Q. How do you respond to Mr. McMillan's fourth point that the project provides value to**
18 **ratepayers before it is placed in service?**

19 A. I agree that there would be value for MP associated with allowing MP to begin
20 recovery of a project's costs before it is placed in-service, including improved cash
21 flow and better financial ratings. There may arguably be benefits to ratepayers of
22 reduced rate shock, assuming that the project is eventually placed in service, and

¹ Nominal dollar costs adjusted for inflation.

1 possibly benefits of MP's improved cash flow and better financial ratings. However,
2 these values or benefits are difficult to measure and may or may not come to fruition.
3

4 **Q. Given your responses above, what do you recommend?**

5 A. Due to the provision discussed above in statutes and Commission precedent, I agree
6 with MP's recommendation that the Commission deny LPI's request to require MP to
7 accrue AFUDC on its CWIP balance rather than seek current recovery of a return on
8 CWIP during the construction period in a future TCR Rider.

9
10 **B. RIDER RECOVERY TIMEFRAME**

11 **Q. What did LPI recommend in direct testimony regarding future rider recovery of GNTL?**

12 A. Mr. Kollen recommended that the Commission allow recovery of GNTL costs only
13 through MP's TCR Rider, or another rider, rather than through base rates. LPI Ex. __
14 at 4 and 23-26 (Kollen Direct).

15
16 **Q. Did MP agree with LPI's recommendation?**

17 A. No. Mr. McMillan stated that:

18 Minnesota Power agrees that the Project will be eligible
19 under Minnesota Statute Section 216B.16, subd. 7b for
20 the Transmission Cost Recovery Rider if the Commission
21 approves the Certificate of Need. Minnesota Power also
22 agrees that the benefits from the Monthly Must Take Fee
23 and other revenues Minnesota Power receives should be
24 credited to ratepayers. However, once the Project is
25 built and in service, better ratemaking outcomes may
26 well be achieved for customers by addressing this major
27 new asset addition through a traditional general rate
28 case. For example, a rate case would re-examine the
29 issue of wholesale/retail allocation and may provide
30 benefits to retail customers. Further, the transmission
31 rider would use Minnesota Power's last approved return

1 on equity (“ROE”) rather than re-examining and resetting
2 the appropriate ROE going forward. In addition, from the
3 Company’s perspective, under current Commission
4 precedent, utilities are not allowed to recover internal
5 capital costs through rider mechanisms. If the Project
6 must stay in Minnesota Power’s transmission rider, there
7 will not be an opportunity to recover these internal costs.
8 Also, if the Commission limits current cost recovery to a
9 set capital range, then Minnesota Power will not have
10 the opportunity to recover any future capital costs.

11
12 MP Ex. __ at 14 (McMillan Rebuttal) (emphasis in original).
13

14 **Q. How do you respond?**

15 A. First, I agree that the Project will likely be eligible for recovery under the TCR Statute
16 if the Commission approves the Certificate of Need in this proceeding. Second, I
17 agree that better ratemaking outcomes may be achieved for customers through a
18 general rate case; however, the opposite also holds true depending upon
19 Commission decisions in a future rate case. Third, I agree that under current
20 Commission precedent MP would not be allowed to recover any of its internal
21 capitalized costs if the Project were required to permanently stay in a rider. Fourth,
22 under current Commission precedent, I agree that MP would not be allowed to
23 recover any additional capital costs in a rider that are over and above the estimates
24 used in this proceeding. Finally, if the Commission were to require MP to keep the
25 Project permanently in a rider, I note that the Commission would essentially be pre-
26 determining rate recovery of the Project over the next 55 years.²

27
28 **Q. Are you aware of any instances where the Commission has required a utility to**
29 **permanently keep a project in a rider?**

² Expected service life of the Project is 55 years per MP Ex. __ at 27 (Initial Petition).
Johnson Surrebuttal / 10

1 A. No. Furthermore, the TCR Statute clearly contemplates that rider projects can be
2 moved into base rates in a general rate case proceeding. Minn. Stat. § 216B.16,
3 subd 7b(b) and 7b(b)(9) state that:

4 (b) Upon filing by a public utility or utilities providing
5 transmission service, the commission may approve,
6 reject, or modify, after notice and comment, a tariff that:

7 . . .

8 (9) terminates recovery once costs have been fully
9 recovered or have otherwise been reflected in the
10 utility's general rates. (emphasis added).
11

12 **Q. What do you recommend?**

13 A. Based on the above, I conclude that the Commission should not determine at this
14 time whether the costs of GNTL would be recovered in a rider or base rates in the
15 future. Thus, I agree with MP's recommendation that the Commission deny LPI's
16 request to only allow recovery of GNTL costs through MP's TCR Rider, or another
17 rider, rather than through base rates.

18
19 C. *COST ALLOCATIONS AND RATE DESIGN*

20 **Q. Did MP respond to LPI's request to provide details on cost allocations, rate design,
21 and rate impacts on customer classes?**

22 A. Yes. Mr. McMillan stated that:

23 However, I must first note that the Company does not
24 agree that cost allocations or rate design matters belong
25 in a Certificate of Need proceeding, as I discuss further,
26 below. Nonetheless, in order to be responsive to Mr.
27 Kollen's request, the Company provides information on
28 two alternative examples of cost allocation. For both
29 examples the Company allocates the revenue
30 requirements to the Minnesota retail jurisdiction using
31 the D-02 transmission demand allocation factor from the
32 Company's last rate case. In the first example, the

1 jurisdictional revenue requirements are allocated to the
2 Large Power (“LP”) Class and all other Non-LP Classes
3 using the D-02 transmission demand class allocation
4 factors. Under this approach, as Mr. Lane correctly
5 states in his testimony, the greatest percentage increase
6 would fall on the LP Class. The allocation of revenue
7 requirements to jurisdiction and to customer classes
8 under this approach is shown in Ex. __ (DJM-R),
9 Schedule 2, Table 1.

10
11 The second example was developed after clarifying the
12 Company’s understanding of Mr. Kollen’s
13 recommendation on allocating revenue requirements.
14 Under this second approach, the jurisdictional revenue
15 requirements are apportioned to customer class on base
16 revenue so that all customer classes have the same
17 average rate increase. The allocation of revenue
18 requirements to jurisdiction and to customer classes for
19 this example is shown in Ex. __ (DJM-R), Schedule 2,
20 Table 2.

21
22 MP Ex. __ at 15-16 (McMillan Rebuttal).
23

24 **Q. How do you respond?**

25 A. I agree that these types of rate design issues are normally addressed in cost recovery
26 proceedings such as riders and rate cases. In fact, the Commission has issued
27 several orders in previous riders addressing cost allocation and rate design issues.

28
29 **Q. What cost allocation and rate design methods did MP use in its most recent
30 Commission-approved TCR Rider?**

31 A. In its 2011 TCR Rider in Docket No. E015/M-11-695, MP allocated its revenue
32 requirements to the Minnesota jurisdiction using the D-02 transmission demand
33 allocator approved in its last rate case (Docket No. E015/GR-09-1151).³ MP also
34 allocated its Minnesota jurisdictional revenue requirements between Large Power

³ See MP’s June 29, 2011 initial filing in Docket No. E015/M-11-695, Exhibit B-2, Footnote 4/
Johnson Surrebuttal / 12

1 and non-Large Power customer classes using the D-02 transmission demand
2 allocators approved in its last rate case.⁴

3 Within the Large Power class, MP incorporated both a demand and energy
4 rate adder by splitting the Large Power customer retail revenue requirement between
5 demand and energy based on the demand and energy revenue split (approximately
6 60% demand/40% energy) in MP's last rate case.⁵ For non-Large Power customers,
7 MP proposed an energy-only rate adder.⁶

8
9 **Q. Is this the same allocation and rate design method proposed by MP in its most**
10 **recent TCR Rider in Docket No. E015/M-14-337, which is currently before the**
11 **Commission?**

12 A. Yes.

13
14 **Q. What do you conclude?**

15 A. Based on my review, I conclude that the rate design method in this proceeding as
16 shown in MP Ex. __ at DJM-R, Schedule 2, Table 1 is similar to the rate design
17 method in MP's most recent Commission-approved TCR Rider in Docket No. E015/M-
18 11-695 and in MP's most recent TCR Rider in Docket No. E015/M-14-337, which is
19 currently before the Commission.

20
21 **Q. What do you recommend regarding cost allocation to customer classes and rate**
22 **design?**

⁴ *Id.*

⁵ See MP's June 29, 2011 initial filing in Docket No. E015/M-11-695, Exhibit B-1, Footnote 4/

⁶ *Id.*

1 A. Based on the above, I agree with MP's recommendation that the Commission take no
2 action in this proceeding regarding future cost allocation and rate design issues that
3 are to be addressed in future riders and general rate case proceedings.
4

5 **IV. SUMMARY OF RECOMMENDATIONS**

6 **Q. Can you please summarize your recommendations for the Commission?**

7 A. Yes. Given statutory language regarding recovery of transmission costs in riders and
8 Commission precedents, I agree with MP's recommendations that the Commission:

- 9 • deny LPI's request to require MP to accrue AFUDC on its CWIP balance
10 rather than seek current recovery of a return on CWIP during the
11 construction period in a future TCR Rider;
- 12 • deny LPI's request to only allow recovery of GNTL costs through MP's TCR
13 Rider, or another rider, rather than through base rates; and
- 14 • take no action in this proceeding regarding future cost allocation and rate
15 design issues that are to be addressed in future riders and general rate
16 case proceedings.

17
18 **Q. Does this conclude your Surrebuttal Testimony?**

19 A. Yes.