

Staff Briefing Papers

Meeting Date	December 21, 2017	Agenda Item **3
Company	Minnesota Power (MP)	
Docket No.	E-015/PA-17-400 In the Matter of the Petition of Minnesota Power for Approval of the Purchase of Transmission Assets and Approval of a Substation Access Easement Agreement with United Taconite, LLC	
Issues	<ol style="list-style-type: none">1. Should the Commission approve the Transmission Asset and Substation Access Agreement between United Taconite, LLC and Minnesota Power?2. Should the Commission accept MP's explanation of the actual revenue requirement impact on the rate case of the purchase of the United Taconite Transmission Assets and MP's explanation of why this is reasonable?	
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 **Relevant Documents**

Date

Minnesota Power - Initial Filing	May 18, 2017
Department of Commerce -Comments	September 18, 2017
Minnesota Power - Reply Comments	September 25, 2017
Department of Commerce - Response to Reply Comments	September 29, 2017
Minnesota Power - Response to DOC	October 6, 2017
Minnesota Power – Copy of FERC Approval	November 28, 2017

I. Statement of the Issues

- Should the Commission approve the Transmission Asset and Substation Access Agreement between United Taconite, LLC and Minnesota Power?
- Should the Commission accept MP's explanation of the actual revenue requirement impact on the rate case of the purchase of the United Taconite Transmission Assets and MP's explanation of why this is reasonable?

II. Background

On May 18, 2017, Minnesota Power (MP) filed a petition requesting Commission approval to purchase transmission assets from United Taconite, LLC, a subsidiary of Cliffs Natural Resources (Cliffs). Historically, both MP and United Taconite have maintained transmission assets at the Eveleth Taconite Company (ETCO) Substation but, according to MP, "it is mutually beneficial for Minnesota Power, an experienced transmission owner and utility, to assume responsibility to operate, maintain and report on the bulk electric system and relieve United Taconite, an experienced iron ore mining and processing company, of that responsibility." This would allow MP "to realize better coordination, planning, and efficiency of operation, maintenance, construction, and necessary upgrading of the overall transmission system than can be realized as compared to when parts of the system are owned and operated by different parties." Included in this agreement is a substation access agreement that formally authorizes MP access to and egress from land owned by United Taconite for the purposes of operating and maintaining MP's transmission assets. The sales price is \$422,921, equal to the net book value.¹

III. Relevant Statutes

MINN. STAT. § 216B.50, RESTRICTIONS ON PROPERTY TRANSFER AND MERGER

Minn. Stat. § 216B.50 requires a public utility to obtain Commission approval prior to selling, acquiring, leasing, or renting any plant as an operating unit or system in this state for a total consideration in excess of \$100,000, or merge or consolidate with another public utility or transmission company operating in this state, without first being authorized so to do by the commission...If the commission finds that the proposed action is consistent with the public interest, it shall give its consent and approval by order in writing. In reaching its determination, the commission shall take into consideration the reasonable value of the property, plant, or securities to be acquired or disposed of, or merged and consolidated.

MINN RULE 7825.1800, FILING REQUIREMENTS FOR PETITIONS TO ACQUIRE PROPERTY.

Petitions for approval to acquire property shall contain one original and three copies of the following information, either in the petition or as exhibits attached thereto:

¹ Minnesota Power – Reply Comments, Attachment A

A. Petitions for approval of a merger or of a consolidation shall be accompanied by the following: the petition signed by all parties; all information, for each public utility, as required in parts 7825.1400 and 7825.1500; the detailed reasons of the petitions and each party for entering into the proposed transaction, and all facts warranting the same; the full terms and conditions of the proposed merger or consolidation.

B. Petitions for approval of a transfer of property shall be accompanied by the following: all information as required in part 7825.1400, items A to J; the agreed upon purchase price and the terms for payment and other considerations.

C. A description of the property involved in the transaction including any franchises, permits, or operative rights, and the original cost of such property, individually or by class, the depreciation and amortization reserves applicable to such property, individually or by class. If the original cost is unknown, an estimate shall be made of such cost. A detailed description of the method and all supporting documents used in such estimate shall be submitted.

D. Other pertinent facts or additional information that the commission may require.

(A complete copy of Minnesota §216B.50 and Minnesota Rules Chapter 7825, parts 1400-1800 are attached)

IV. Parties' Comments

A. Minnesota Power Initial Filing

1. Minnesota Power's request for variance on the filing requirements established by Minnesota Rule 7825.1400 as it pertains to capital structure and the issuance of securities

Minnesota Power (MP), in their initial filing, requested a variance to Minnesota Rules 7825.1400 as it relates to capital structure and the issuance of securities and 7825.1800(A). The Department of Commerce (Department) noted, in its response comments, that a variance to Minnesota Rule 7825.1800(A) is not needed because subpart 1800(A) specifically addresses mergers and is not applicable to this docket. MP subsequently withdrew the request for the variance to Minnesota Rule 7825.1800(A) so long as it doesn't create a completeness issue.

MP requests a variance to Minnesota Rules 7825.1400 as it relates to capital structure and the issuance of securities. MP justifies this request by noting that these requirements do not have any direct relevance to small property transfers, such as the agreement in this docket. Furthermore, MP states that the public interest will not be adversely affected and no other law of statute would be violated if the variance is granted.

2. The Agreement is in the Public Interest

As previously discussed, MP and United Taconite have jointly owned and operated transmission assets located at the ETCO Substation. The transmission assets owned by United Taconite often

are required to be part of MP's network transmission system, with power serving both the customer load at the site but also flowing through the substation and to other parts of MP's transmission grid. Having ownership and control of these assets allows MP to more effectively "realize better coordination, planning, and efficiency of operation, maintenance, construction, and necessary upgrading of the overall transmission system than can be realized as compared to when parts of the system are owned and operated by different parties." Also, MP noted that the utility is better suited to ensure these assets remain compliant with the North American Electric Reliability Corporation (NERC) standards. This results in a more efficient, more reliable transmission network.

B. Department of Commerce Comments

1. Recommendation for Approval of Variance

The Department agrees with MP that a variance to Minnesota Rule 7825.1400 should be granted, as enforcement of the rule would impose an excessive burden to the applicant in relation to the usefulness of the information. The Department agrees that granting a variance would not adversely affect the public interest and is unaware of any legal standards that would be violated if a waiver was granted.

2. The Agreement is in the Public Interest

The Department agrees with MP that the agreement would likely facilitate operation and maintenance of transmission assets and that MP's request is reasonable.

3. Requests for Additional Information

The Department expressed concern with the accounting for the transaction. Specifically, MP shows the transmission assets original installed cost (OIC) of \$447,902, the accumulated depreciation of \$24,981, and the book value (and purchase price) to be \$422,921.² Since the amount appears to be lower than anticipated, the Department requested that MP provide additional support for the accumulated depreciation amount. The Department acknowledged that the final valuation of the transmission assets will be determined on the effective date of the sale.

Also, the Department asked for additional information on how the transaction would impact MP's pending rate case and proposed revenue requirement, and to explain why MP considers the impact to be reasonable.

...MP noted that an estimated price of the transaction was included in 2016 year-end Construction Work in Progress (CWIP) amount, but since MP does not receive a return on CWIP in the rate case, the 2017 Test Year would not include any related revenue requirements. The Department does not agree with MP that its rate of return is not applied to CWIP in the rate case. As shown on MP's Rate Base Summary in Docket No. E015/GR-16-664, in Volume IV, Informational

² Department of Commerce – Comments Part (D) 3 Accounting and Ratemaking for Transmission Assets to be Purchased. DOC used information obtained from Minnesota Power – Initial Filing, p. 7

Requirements, on Direct Schedule A-5, line 26, Construction Work In Progress, MP does include CWIP in its average rate base calculation and therefore does propose to earn a return on CWIP. The Department also notes that since the transmission assets being purchased appear to be in-service during 2013 to 2016, it is not logical that these transmission assets would still be recorded in CWIP...³

Finally, the Department recommended that final journal entries be submitted as a compliance filing 60 days after completion of the sale.

C. Minnesota Power - Reply Comments & Response to Department of Commerce Comments

1. Additional Support for Accumulated Depreciation

MP addressed the accumulated depreciation concerns by explaining that the equipment was originally installed in 1965 and is largely considered to be completely depreciated, carrying a book value of \$0. The OIC, accumulated depreciation, and resulting book value are related to newer components installed from 2013-2016. MP provided a spreadsheet⁴ in its reply comments that shows the newer equipment being purchased, the OIC, accumulated depreciation, and remaining book value for each component.

2. Impact of Purchase on the Revenue Requirement

Initially, MP stated that this transaction was not included in the plant (rate base) of the 2017 test year and that the asset would only be included in the rate base of a subsequent rate case, however, in preparing reply comments, MP noticed that no AFUDC offset associated with this transaction was recorded as an offset to CWIP which would have reduced the impact of this transaction on rate base in the pending rate case. In response comments, MP calculated the impact on the revenue requirement in the rate case as:⁵

Average CWIP balance \$250,000 x Proposed ROR 7.548% x Gross revenue conversion factor 1.705611 x DTran Jurisdictional allocator 82.713% = \$26,621 revenue requirements.

According to MP:

The Department is correct that CWIP is included in rate base and earns a return. However, typically most projects in CWIP have AFUDC that is included as an offset to expense, which largely nets out the return on rate base. In Reply Comments the Company believed that the amount in CWIP would be offset by AFUDC, for no net revenue requirement impact. In preparing these Response Comments, however, the Company notes that there is no AFUDC offset associated with this CWIP estimate, and therefore the revenue requirement impact in the rate case is \$26,621 as shown above...

³ Department of Commerce – Response to Reply Comments, p. 2

⁴ Minnesota Power – Reply Comments, Attachment A

⁵ Minnesota Power – Response to DOC, p. 1

MP also states that “it is not unreasonable to include this amount in the rate case as it is significantly lower than the amount recently determined.”

3. Minnesota Power Agrees to File Journal Entries in a Compliance Filing

MP agreed to file journal entries in a compliance filing within 60 days following the completion of the sale.

V. Staff Analysis

A. Minnesota Power’s request for variance on the filing requirements established by Minnesota Rule 7825.1400 as it pertains to capital structure and the issuance of securities

MP has requested a variance on the filing requirements established by Minnesota Rule 7825.1400 as it pertains to capital structure and the issuance of securities. The Commission uses the following criteria, in Minnesota Rule 7829.3200 (Other Variances), to evaluate requests for rule variances.

1. Enforcement of the rule would impose an excessive burden upon the applicant or others affected by the rule.
2. Granting the variance would not adversely affect the public interest.
3. Granting the variance would not conflict with standards imposed by law.

Staff agrees with the Department and MP that a variance should be granted on Minnesota Rule 7825.1400. The filing requirements in Minnesota Rule 7825.1400 do not apply to this transaction and are unnecessary to ascertain the reasonableness of the transaction described in this docket. Requiring information that is not needed would prove to be an excessive burden to the applicant. Granting a variance on Minnesota Rule 7825.1400 does not adversely impact the public interest nor does it violate any other law, rule, or legal standard.

B. The Agreement is in the Public Interest

MP cited, in their initial filing, the following excerpt from Minnesota Statute §216B.50

Upon the filing of an application for the approval and consent of the commission, the commission shall investigate, with or without public hearing. The commission shall hold a public hearing, upon such notice as the commission may require. If the commission finds that the proposed action is consistent with the public interest, it shall give its consent and approval by order in writing.

Also, in prior cases, MP noted that the Commission has established that this standard "does not require an affirmative finding of public benefit, just a finding that the transaction is compatible with the public interest."⁶

⁶ Docket No. G-008/PA-90-604 – PUC Order approving merger between Minnegasco, Inc. and ARKLA, Inc.

MP and the Department agree that this transaction would have the potential to result in a more efficient and reliable system. Therefore, the transaction would be in the public interest.

C. Impact of Purchase on Revenue Requirement

After initially confirming that the transaction was not included in the 2017 test year, MP conceded that this transaction has an impact in the current rate case. MP considers the use of the CWIP account to be in error and acknowledged that the company should have used account number 10200, Utility Plant Purchased and Sold. When MP realized there was no AFUDC offset for the transaction recorded in CWIP, it determined the revenue requirement impact to be \$26,621,⁷ an amount MP considers to be reasonable. Because MP corrected the error, the Company is not in violation of Minn. Stat. §216B.10, Accounting, or Minnesota Rules, parts 7825.0200 through 7825.0400, Uniform System of Accounts, which require public utilities to maintain their accounts in accordance with the uniform system of accounts (USOA) prescribed by the Federal Energy Regulatory Commission (FERC) unless authorized by the Minnesota PUC to do otherwise.

Although the Department did not explicitly file comments disputing the impact on the revenue requirement in this docket, the Department, in concurrent property transfer dockets,⁸ has recommended that annual revenue requirement impacts be deferred and placed in rate base as a regulatory liability to be netted against the revenue requirement in a subsequent rate case. The Commission may want to consider similar treatment in this docket. The Commission may also want to require MP in this docket to, within 60 days of closing, make a compliance filing that provides the final annual revenue requirement impact to be placed in the regulatory liability account.

The Commission has historically used four criteria when evaluating a utility's request for deferred accounting:⁹

1. Related to utility operations for which ratepayers have incurred costs or received benefits;
2. Significant in amount;
3. Unusual or extraordinary items;
4. Subject to review for reasonableness and prudence.

These criteria are examined below.

⁷ Minnesota Power – Response to DOC Page 1

⁸ Dockets E-015/PA-17-457, E-015/PA-17-459, E-015/PA-17-460, and E-015/PA-17-461, also scheduled for December 21, 2017 raise concerns about property transfers and their impact on the revenue requirement. In those dockets, the Department of Commerce recommends the use of deferral accounting. Though the recommendation is not explicitly stated in Department comments in docket E-015/PA-17-400, Staff assumes Department would recommend similar treatment in this docket.

⁹ Recently, these four criteria were used to consider Minnesota Power's request for deferred accounting after incurring significant costs related to severe storms in 2016. Docket No. E-015/M-16-648.

Related to utility operations for which ratepayers have incurred costs or received benefits

With the amount having been recorded in CWIP and subsequently the rate case, ratepayers have incurred costs related to transmission assets MP does not currently own. Additionally, the use of CWIP for this transaction does not make sense as the components of the transmission assets being purchased have been in service during the past several years.

Significant in amount

In previous Orders, the Commission has maintained a high bar for utilities seeking deferral accounting for the creation of regulatory assets. The Department, in concurrent property transfer dockets¹⁰, has argued that the standard for what is considered to be “significant in amount” be lowered in instances that advocates for ratepayers are recommending the use of deferral accounting to create a regulatory liability. The significance of an amount is usually a fact and context specific determination.

Unusual or extraordinary items

Individual property transfers are not “unusual or extraordinary,” however, proposing to do so during a rate case is unusual, especially given the fact that MP typically has gone years between rate case filings. In addition, the timing of the filings (controlled by the utility) could be considered unusual since the date of this agreement is December 9, 2016 but the petition was not filed until May 18, 2017.

Subject to review for reasonableness and prudence

The amount in the regulatory liability would be reviewed for reasonableness and prudence in a subsequent rate case.

¹⁰ The Department of Commerce made this recommendation in dockets E-015/PA-17-457, E-015/PA-17-459, E-015/PA-17-460, and E-015/PA-17-461, also scheduled for December 21, 2017.

VI. Decision Options

1. Transmission Asset and Substation Access Easement Agreement
 - a. Approve Minnesota Power's proposed agreement. (MP, Department)
 - b. Reject Minnesota Power's proposed agreement.
2. Accounting Treatment in the Pending Rate Case and Impact on the Proposed Revenue Requirement
 - a. Approve the accounting treatment as proposed by Minnesota Power, accepting Minnesota Power's explanation of the actual revenue requirement impact on the rate case of the purchase of the United Taconite Transmission Assets and their explanation of why this is reasonable. (MP)
 - b. Approve the accounting treatment proposed by Minnesota Power and require the use of deferral accounting to create a regulatory liability account for the incremental revenue requirement impact of this transaction in the pending rate case to be netted against the revenue requirement in a subsequent rate case. (Staff Alternative)
 - c. Require Minnesota Power to submit a compliance filing within 60 days of closing that provides a detailed explanation and schedule for the regulatory liability established in connection to this transaction (Staff).
3. Approve Minnesota Power's request for variance on the filing requirements established by Minnesota Rule, part 7825.1400 as it pertains to capital structure and the issuance of securities. (MP, Department)
4. Require Minnesota Power to file appropriate journal entries in a compliance filing within 60 days of closing. (MP, Department)