

Staff Briefing Papers

Meeting Date May 13, 2021 Agenda Item [8**](#)

Company Minnesota Power (or the Company)

Docket No. **E-015/PA-20-675**

In the Matter of the Petition by Minnesota Power for Approval of Land Sales

- Issues
1. Should the Commission approve Minnesota Power’s request to sell certain residential lease lots for which Company ownership is no longer required to continue operating its hydropower reservoirs?
 2. Should the Commission allow Minnesota Power to set the baseline value of each lot on the county’s Estimated Market Value (“EMV”) methodology?
 3. Should the Commission authorize Minnesota Power to defer all proceeds from the land sales into a regulatory liability that would be refunded to customers in either a future rate case or through the Renewable Resources Rider?

Staff Godwin Ubani godwin.ubani@state.mn.us 651-201-2191

✓ Relevant Documents

Date

Minnesota Power – Petition	August 31, 2020
Department of Commerce – Comments	January 15, 2021
Minnesota Power – Reply Comments	January 25, 2021
Department of Commerce – Supplemental Response Comments	March 25, 2021

To request this document in another format such as large print or audio, call 651.296.0406 (voice). Persons with a hearing or speech impairment may call using their preferred Telecommunications Relay Service or email consumer.puc@state.mn.us for assistance.

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

Table of Contents

I.	Statement of the Issues.....	1
II.	Introduction	1
III.	Background	1
IV.	Relevant Statutes	3
V.	Parties’ Comments	5
	A. Minnesota Power	5
	B. Department.....	5
VI.	Staff Analysis	6
	A. Should the Commission approve Minnesota Power’s request to sell certain residential lease lots for which Company ownership is no longer required to continue operating its hydropower reservoirs?	6
	1. FERC Project Boundary Change	7
	B. Should the Commission allow Minnesota Power to set the baseline value of each lot on the county’s Estimated Market Value (“EMV”) methodology?	7
	1. Sale Price based EMV	7
	2. Counter Offers from Leaseholders	10
	C. Should the Commission authorize Minnesota Power to defer all proceeds from the land sales into a regulatory liability that would be refunded to customers in either a future rate case or through the Renewable Resources Rider?	11
	1. Proposed lot sales Accounting - Costs deductions from Sales Proceeds	11
	2. Proposed Land Sales Accounting - Journal Entries	12
	3. Application of taxes to these land sales	13
	4. Proposed Land Sales - Benefits Allocation.....	14
	5. Will the sale of these lands benefit the Company’s nonregulated affiliates?	14
	D. Department - Overall Recommendation	14
VII.	Concluding Comment.....	15
VIII.	Decision Alternatives.....	16

I. Statement of the Issues

- Should the Commission approve Minnesota Power's request to sell certain residential lease lots for which Company ownership is no longer required to continue operating its hydropower reservoirs?
- Should the Commission allow Minnesota Power to set the baseline value of each lot on the county's Estimated Market Value ("EMV") methodology?
- Should the Commission authorize Minnesota Power to defer all proceeds from the land sales into a regulatory liability that would be refunded to customers in either a future rate case or through the Renewable Resources Rider?

II. Introduction

Minnesota Power in this filing is seeking approval from the Minnesota Public Utilities Commission (Commission) to sell residential leased lots surrounding several reservoirs in its hydroelectric (HE) system, for which ownership is no longer required to maintain operations.¹ The proposed lots for sale have an estimated value of approximately \$101 million.² The Company proposes to credit ratepayers with the net proceeds from the sales in a future rate case or through the Renewable Resources Rider to mitigate against future rate increases.

These lands that Minnesota Power is proposing to sell were acquired about a hundred years ago, specifically most of the lots were purchased in 1923.³ At the time of purchase this land was remote, rural and undeveloped with an overall book value of about \$1 million.⁴ The land now has an estimated market value of over \$100 million.

III. Background

Minnesota Power in its pursuit to mitigate rate increases for all customers especially in this period in which all classes of customers are struggling to recover from the economic effects of COVID-19, proposes to begin selling unneeded land holdings along its hydro reservoirs. Along with the request to sell some lands, the Company is requesting guidance on the lands valuation and requests to be allowed to defer proceeds from the sale to a regulatory liability, that would be credited to customers in the future. Thus, the Company submits this petition pursuant to Minn. Stat. §§ 216B.16, 216B.1696 and 216B.50.

Minnesota Power's hydropower reservoir system's surrounding leased lots include twenty-one (21) lots on Fall and Garden Lake in Lake County, as well as approximately one thousand (1,000) lots within the St. Louis River Project ("SLRP"). The majority of the residential leased lots in SLRP are on Island, Fish and Whiteface Reservoirs, and these lots are currently

¹ Minnesota Power's Petition, p. 2.

² Id., at p. 6.

³ Id., at p. 9.

⁴ Id.

undergoing significant refinement, including surveying, platting and potential adjustment of the Federal Energy Regulatory Commission (“FERC”) project boundary.⁵

The Company reviewed the SLRP’s Project Boundary and determined that it includes land that is not needed to operate and maintain its HE system and does not serve any other project purpose. Therefore, prior to offering the lots for sale, Minnesota Power plans to submit a petition to FERC to revise the Project Boundary to include only the first 3 feet of land in from the shoreline, rather than the first 25 feet in from the shoreline. The Company will retain ownership of the portion of the land that is within the project boundary (i.e. classified as utility property), and sell only the land that is outside of the boundary (i.e. classified as non-utility property). The Company would provide a riparian easement to allow the new landowners to access and use the lake.

In its August 31, 2020 Petition Minnesota Power requested Commission approval to sell land holdings surrounding many of its hydropower reservoirs worth approximately \$101 million, including permission to set baseline value of each lot on the basis of the county’s estimated market value (EMV) and defer sale proceeds into regulatory liability⁶ to be returned to customers in future rate case or via renewable resources rider.

Minnesota Power in its petition also requested a variance on filing requirements set forth by Minnesota Rules, part 7825.1400 that pertains to capital structure and the issuance of securities. Regarding this Rule, the Company believes a variance is appropriate since the Rules requirements are relevant only to investigating the issuance of securities that result in changes in a Company’s capital structure, which is not the case in this filing. The Company believes the public interest will not be adversely affected and that no other applicable law or statute will be violated by granting the variance.

On January 15, 2021, the Department filed Comments indicating general support for the Company’s proposal, including support for the Commission to grant the requested variance Minnesota Rule, part 7825.1400, but requesting additional information from Minnesota Power, before it would make its final recommendations.

On January 25, 2021, Minnesota Power filed Reply Comments addressing the issues raised in the Department’s Comments.

The Department on March 25, 2021, submitted supplementary reply comments and recommended the Commission approve the Petition, with reporting requirements as listed in the supplementary comments.

⁵ Minnesota Power’s Petition, p. 5.

⁶ The Commission approved, and the Department supported, the creation of a regulatory liability for the sale of Minnesota Power’s service centers on February 8, 2018 in dockets E015/PA-17-457, E-105/PA-17-459, E-015/PA17-460. E-105/PA-17-461.

IV. Relevant Statutes

Filing Requirement for Property Transfers

Minn. Stat. § 216B.50 states:

A public utility shall not sell, acquire, lease, or rent 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. 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. 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.

In view of the above statutes, MP has to prove the reasonableness of proposed land sale and for the Commission to approve the transaction, it must find that the transaction is reasonable and consistent with public interest. The Department in its Comments stated that the proposed land sale and ratepayer credit fall under the Commission's purview and as such should approve the sale, if it finds the transaction is consistent with the public interest.

Filing Requirements, Minnesota Rules 7825.1800 and 7825.1400

Minnesota Rule 7825.1800 contains the filing requirements for property acquisition petitions. Specifically, the rule states:

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:

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.

Minnesota Rule 7825.1400 contains the filing requirements for capital structure approvals: property acquisition petitions. Specifically, the rule states:

- A. A descriptive title.
- B. A table of contents
- C. The exact name of the petitioner and address of its principal business office.
- D. Name, address, and telephone number of the person authorized to receive notices and communications with respect to the petition.
- E. A verified statement by a responsible officer of the petitioner attesting to the accuracy and completeness of the enclosed information.
- F. The purpose for which the securities are to be issued
- G. Copies of resolutions by the directors authorizing the petition for the issue or assumption of liability in respect to which the petition is made; and if approval of stockholders have been obtained, copies of the resolution of the stockholders shall be furnished.
- H. A statement as to whether, at the time of filing of the petition, the petitioner knows of any person who is an "affiliated interest" within the meaning of Minnesota Statutes, section 216B.48, subdivision 1, who has received or is entitled to receive a fee for services in connection with the negotiations or consummation of the issuance of the securities, or for services in securing underwriters, sellers, or purchasers of the securities
- I. A signed copy of the opinion of counsel in respect to the legality of the issue or assumption of liability.
- J. A balance sheet dated no earlier than six months prior to the date of the petition together with an income statement and statement of changes in financial position covering the 12 months then ended. When the petitions include long-term securities, such statements shall show the effects of the issuance on such balance sheet and income statement.

The Commission has authority to grant rule variances under Minnesota Rule 7829.3200 when the following criteria are met:

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

V. Parties' Comments

A. Minnesota Power

Minnesota Power in its petition proposed to sell the majority of its residential lease lots with EMV of over \$101 million with a book value of under \$1 million over the next few years, and credit the difference between the book value of the land and the sale price to ratepayers. The Company, for sale purposes relied on the assessed EMV, as determined by county assessors for tax purposes, as a reasonable estimate of the value of the lots to offer for sale.

Minnesota Power proposed to offer each lot to its current leaseholders using the lot's current assessed EMV as the offer price. If a leaseholder initially chooses not to purchase the lot, the Company will fully honor the lease through its current term, and the leaseholder will have a second chance to purchase the lot when the lease expires. However, leaseholders that choose not to purchase their lots by the end of their current lease will be required to sell the structures on their lots, and the purchasers of the structures will then be required to also purchase the lot from Minnesota Power.⁷ Further, for sale of unoccupied lots it would use a standard, competitive bidding process and list the lots for sale using the EMV as the list price and will secure the best price possible for each lot.⁸

Further, Minnesota Power requested approval of a variance to Minnesota Rules 7825.1800 and 7825.1400, which are only relevant for capital structures filings for the purpose of investigating the issuance of securities and not applicable for this Petition.

B. Department

Department in its comments stated that the proposed land sale and ratepayer credit fall under the Commission's purview and, as such, the Commission should approve the sale, if it is in public interest.

Thus, Department commented that Subpart A of Rule 7825.1800, specifically refers to mergers and consolidation and not applicable to land sale, subpart B refers to Rule 7825.1400, item A to J for which MP offered partial information, on subpart C, MP included information on description of property and estimate of property's original cost and offered no depreciation information, since land does not depreciate but instead appreciates. Finally, for subpart D, no information was necessary. Accordingly, the Department held that the Petition meets all the relevant reporting requirements except for the requirements of Minnesota Rule 7825.1400.

As for Minnesota Power's request for a variance to Rule 7825.1400, the Department recommended the Commission grant the variance request and noted thus:

The Department agrees that requiring Minnesota Power to provide the information required for Minnesota Rule 7825.1400 would constitute an excessive burden on the

⁷ Minnesota Power's Petition, p. 7.

⁸ Id.

Company, because this information relates to specific types of transactions (securities issuances) that are inapplicable to the transaction proposed in this docket. Further, the Department sees no reason why granting a variance to these filing requirements would adversely affect the public interest and is not aware of any laws that would be violated as a result of granting the variance. Therefore, the Department recommends that the Commission grant Minnesota Power a variance to Minnesota Rule 7825.1400.⁹

Further, the Department in its January 15, 2021 comments reviewed the reasonableness of the Minnesota Power's proposed land sale and concluded that the proposal is reasonable, so long as the sale price is appropriate and thus, requested additional information related to the sales price, journal entries to record sale of the lots, federal and state capital gains tax treatment for the land sales, and any direct or indirect benefits that inure to any non-regulated affiliates. These are discussed in detail in the following section of the briefing papers.

VI. Staff Analysis

A. Should the Commission approve Minnesota Power's request to sell certain residential lease lots for which Company ownership is no longer required to continue operating its hydropower reservoirs?

Minnesota Power stated that in preparation for the proposed land sale, it reviewed the FERC boundary of the St Louis River Project (SLRP) in order to make sure the lots can be sold without jeopardizing compliance with FERC'S requirements for land within the project boundary, or the Company's ability to operate and maintain downstream hydroelectric generation reservoirs and including other SLRP uses like recreation, cultural and environmental protection. By virtue of the said review Minnesota power determined that it could adjust the FERC Project Boundary back to include only three (3) feet of land from the shoreline, instead of the first twenty (25) feet in from shoreline and still remain compliant with FERC's requirement and able to maintain and operate its reservoirs.¹⁰

The Company also noted by the review of the SLRP Project boundary that it would be able to include additional tracts of land to this transaction. The Company also opined that it knows of no significant potential costs or investments related to the lands that it hopes to add to regulated rate base that would be above minimal (less than \$10,000 annually) monitoring and maintenance expense.

Further, Minnesota Power indicated that if there were a flood or the occurrence of some other event that affected the lots, the Company would not be subject to additional liability because of the sale of these lots. The Company is not aware of any other potential legal, or operational harm of financial concern regarding the proposed land sales.¹¹

⁹ The Department's Comments, p. 6.

¹⁰ Minnesota Power's Petition, p. 6.

¹¹ The Department's Comments, p. 6.

The Department held that the sale of land is reasonable since the land MP is proposing to sell is not required for operational purposes and the sale will not expose the Company and its ratepayers to any additional financial or operational risks.

Staff supports the Department's recommendation since there seem to be no discernable potential legal or operational risk that may result in material financial harm from the proposed land sales.

1. FERC Project Boundary Change

Minnesota Power, on December 22, 2020 in docket 2360-000 submitted a non-capacity license amendment application to the Federal Energy Regulatory Commission ("FERC") to adjust the Project Boundary for specific sections of Island, Fish, and Whiteface Reservoirs in the St. Louis River Hydroelectric Project ("SLRP") to first 3 ft in from shoreline instead of from the first 25 ft in from shoreline. Also, the Company noted if FERC approves its request, this would increase the Project Boundary by 423 acres or by about 10% and if it adds this new land to rate base, it would be at book value for about \$500,000 (\$0.5 million).¹²

The Department in its comments opined that should FERC deny MP's application to change Project Boundary, MP would be unable to sell the lots as planned. However, Minnesota Power on the other hand stated should FERC deny its request, then it would have to conduct a re-evaluation of the value of leased lots, since the EMV would be inapplicable to the new lots.

Minnesota Power in its January 25, 2021 reply comments disclosed that its request was granted by FERC on January 21, 2021 under Docket P-2360-272.¹³

In any case, the Department in its comments recommended that in the event of FERC approval of the request, MP should be required to make a compliance filing in this Docket within 10 days after FERC issues its Order on the proposed Project Boundary changes describing the FERC's decision, as well as, any impacts the decision may have on the proposed sales.¹⁴

B. Should the Commission allow Minnesota Power to set the baseline value of each lot on the county's Estimated Market Value ("EMV") methodology?

1. Sale Price based EMV

Minnesota Power proposed to maximize lease lot sale values by setting the baseline value of each lot based on the respective county's assessed Estimated Market Value (EMV), which is a well-established Minnesota state processes.¹⁵ The Company indicated that it conducted a survey in which over ninety (90) percent leaseholders expressed average to above average interest in acquiring their lease lot, this invariably meant that most of the lots will be sold to existing leaseholders, instead of through competitive, open-market listings.

¹² Id., at p. 2 and Attachment 6, p. 2 of 2.

¹³ Minnesota Power's Reply Comments, p. 2.

¹⁴ The Department's Comments, p. 10.

¹⁵ Minnesota Power's Petition, p. 6.

The Department in its comments expressed some concerns on the Company's proposed reliance on county assessed EMV as opposed competitive sales processes. However the Department noted that Minnesota Power defended the use of EMVs as a reasonable offer price for the lots, since by statute, Minnesota Department of Revenue's (DOR) Board of Appeals and Equalization Handbook, sales ratio for EMVs are targeted to be between 90-105 percent of actual sale prices.¹⁶ Further, the Company held that EMVs are subjected to vetting and appeals processes, which afford them a level of credibility and acceptance not attainable via traditional one-off real estate appraisals. The Department also noted that the Company performed no analysis as to verify the accuracy of EMVs in counties where the lease lots located, but merely presumed DOR's verification process of actual sales compared to EMVs to be accurate.

Further, the Department expressed concern with Minnesota Power's reliance on EMVs relating to attribution of total EMV of a lot to its land against the structures and improvements on the land and requested an explanation in Information Request No. 2 from the Company. Minnesota Power in response provided recent assessment reports, showing total EMV for each property and separate EMVs for the leased land, and the structures and buildings or improvements on the leased land, thus the total EMV equals the sum of the EMVs for the land and buildings.

The Department in its comments noted that the MN DOR uses sales ratios that merely compare total EMVs to actual sale prices and without providing adequate information regarding the accuracy of the separate land and building EMVs. According to the Department this meant Minnesota Power did not evaluate the accuracy of the land EMVs it proposed to rely on and as such asked the Company in Information Request (IR) No. 24 to explain the process involved when a structure on a lot owned by Minnesota Power is sold.

Minnesota Power responded and provided data relating to 40 recent sales of structures on its lots during the past two years, including the EMV of the land, the value of the structures and improvements, and the purchase price. In each transaction, Minnesota Power retained ownership of the land, and the transaction involved only the structures on the lots. The Department compared the reported EMVs of the structures involved in each transaction to the purchase prices as depicted by the Department in figure 1 below.

**Figure 1: Summary of Structures EMV/Purchase Price Ratios
Recent Lot Transactions¹⁷**

Minimum Ratio	3.7%
Average Ratio	44.1%
Maximum Ratio	68.9%

¹⁶ Id., at p. 7.

¹⁷ The Department's Comments, p. 9.

Cumulative Transactions

Range	No. of Transactions	No. of Cumulative Transactions	Percentage
0 %– 10%	1	1	2.5%
10% – 20%	2	3	7.5%
20% – 30%	3	6	15.0%
30% - 40%	8	14	35.0%
40 %- 50%	9	23	57.5%
50% - 60%	12	35	87.5%
60% - 70%	5	40	100.0%

The Department noted that in the above figure, the average ratio of structure EMV to purchase price in the forty (40) transactions was 44.1% and the highest ratio in any individual transaction was merely 68.9%, while 23 of the 40 transactions had below 50% ratios.¹⁸ As a result of the low ratios for structures (buildings) in figure 1 above, the Department became concerned that the land EMVs MP has proposed to rely on for setting the purchase price of most of the lots are not correct and probably underestimate the value of the lots.

In this vein, Department argued that selling the lots based on land EMVs that under-estimate their value will result in an unreasonable transfer of wealth from Minnesota Power and invariably its ratepayers to buyers of these lots. Thus, the Department asked the Company the following questions:

1. whether it considered using competitive [bidding] processes for more (or all) of its lots?
2. whether it considered using any other methods of determining the offer price for each lot other than assessed EMV?

On the first question above, the Department noted:

Minnesota Power stated that listing the lots for competitive sale on the real estate market was considered but dismissed as unviable. The Company stated that competitively bidding out land on which personal property exists would be highly detrimental to current leaseholders, and would likely increase the risks of damage claims and other issues that would slow, complicate, and/or increase the expenses of the proposed divestiture. Additionally, the Company would not be able to list the lots for sale until the current leases expire, which would further delay the sale process.

Regarding the second question above, the Department noted:

The Company also considered having each lot appraised and using the appraised value as the price offered to current leaseholders. The Company stated however, that because the current land EMV is used to determine annual rent, using an

¹⁸ Id.

alternative valuation at the time of sale may create confusion and dissuade some leaseholders from participating, in which case the lots could not be listed for sale until the current lease expires. Additionally, the Company was concerned that it would be obligated to perform multiple appraisals in many cases, and the resulting fees and time needed for the extra process would negatively impact the timing and net proceeds received.

The Department considered Minnesota Power's responses and in reply comments said that under the circumstance Minnesota Power's proposal is not unreasonable. The Department stated that despite its apprehensions regarding MP's reliance on EMVs as estimates of sale prices, in view of the difficulties associated with other alternatives or methods (such as competitive sales and appraisals for all the lots) that were considered by MP, Minnesota Power's proposal seemed reasonable.¹⁹

Staff agrees with the Department that there exist no better alternatives to MP's proposed use of county assessed EMV for setting sale price for the lots offered to leaseholders for purchase. Besides, the process used to calculate EMV is purported to rely on well-established MN state processes.

2. Counter Offers from Leaseholders

As was discussed in section V of the Briefing Papers, Minnesota Power proposed to offer each lot to its current leaseholder using the lot's current assessed EMV as the offer price. If a leaseholder initially chooses not to purchase the lot, the Company will fully honor the lease through its current term, and the leaseholder will have a second chance to purchase the lot when the lease expires.

In view of the above discussion, the Department in reply comments asked Minnesota Power to explain: Whether Minnesota Power will consider counteroffers from current leaseholders after the Company offers to sell their lots at current EMV, or whether those offers will be non-negotiable.

Minnesota Power stated that it will not consider counteroffers from current leaseholders after the Company offered to sell their lots at current EMV.²⁰ In addition, MP stated leaseholders will be availed the option to delay the purchase of the lot, to the extent that their lease term allows, however the methodology for calculating the purchase price will remain the same. Delayed purchases will be based on the most current EMV available from the county.²¹

Accordingly, the Department in its March 25, 2021 supplemental reply comment accepted Minnesota Power's response and concluded that the Company's proposed plan to offer the lots to existing leaseholders at current EMV seemed reasonable.

¹⁹ The Department's Supplementary Comments, p. 10.

²⁰ Minnesota Power's Reply Comments, p. 2.

²¹ Id.

C. Should the Commission authorize Minnesota Power to defer all proceeds from the land sales into a regulatory liability that would be refunded to customers in either a future rate case or through the Renewable Resources Rider?

1. Proposed lot sales Accounting - Costs deductions from Sales Proceeds

Minnesota Power proposed to defer all proceeds derived from the sale of the lots into a regulatory liability, which at future dates would be credited back to ratepayers. The Company initially indicated that ratepayers would be credited with the difference between sale price of the lots and their book value, but later amended this statement. Thus, the Company instead meant that the net sales amount would be returned to customers after deducting certain related costs/expenses from the gross sales proceeds. In fact, the Company provided a list that included the following costs for deduction from the gross amount of lot sales:

- prorated county taxes
- title charges and escrow/settlement charges (disbursement fee/courier fee, title exam - title company, document preparation – title company, closing fee – title company)
- government recording and transfer charges
- deed registration tax
- project management

The above list from MP emanated from the Department’s Information request (IR) No. 28, asking that MP provide detailed list of expenses, including taxes that would be deducted from the land sale proceeds to arrive at final credit to ratepayers. Minnesota Power described the list as not exhaustive since total costs cannot be predicted precisely until after final sales.

The Department in its comments expressed concern about the cost item listed as “project management” and requested for explanation from Minnesota Power. Thus, the Department noted the following:

In its IR response, Minnesota Power estimated that project costs would be equal to 7.5 percent of the sale price of the lots, but provided no information related to the nature of the costs included in that 7.5 percent beyond stating that they will be “variable” and “commensurate with hours required to oversee tasks and transactions.” In a subsequent IR response, the Company stated that the cost of the surveying and platting process it is currently undertaking, expected to be approximately \$2 million, is included in this item. However, given that potential sale proceeds could be \$101 million, project management costs of 7.5 percent would equate to \$7.5 million, meaning Minnesota Power appears to be expecting to incur roughly \$5 million in additional expenses.

Further, the Department requested for an explanation for the reason Minnesota Power did not include income taxes to be charged against gains expected to be realized from the sale when it

explained the expected costs that would be deducted from gross land sales amount. Accordingly, the MP offered its response and which the Department noted as thus:

In its response to Department IR No. 41, Minnesota Power clarified that there will be an income tax impact from the gain on sale, and that the Company is proposing to deduct this tax expense from the gross sale proceeds. The Company stated that the income tax gain on the land sales will be equal to the book gain (i.e. sale price less original cost of the land), and the Company will incur federal and state tax expense on that gain. In the example calculations provided in its IR response, the Company used its composite state and federal income tax rate of 28.742 percent to illustrate the tax expense expected to be triggered by the gain.

Further, the Department in its comments stated that there exist a high level of uncertainty surrounding the types and amounts of costs expected to be deducted from the gross proceeds from the land sales, and as such it recommended the Commission require Minnesota Power to file detailed cost and revenue information on a regular basis until all of the lots are sold.²²

On that point, Minnesota Power in its Petition indicated that it would provide annual updates on the number of sales, the purchase prices, and the amount (balance) in the tracker account. The Department agreed with the need for annual compliance filings as reasonable but recommended the Commission require Minnesota Power track and report on all additions to (i.e. sales revenue) and deductions from (i.e. expenses) from the tracker account at the most granular level possible.

2. Proposed Land Sales Accounting - Journal Entries

Minnesota Power provided journal entries in response to the Department's IR that asked for example of its proposed journal entries for recording lot sales. The Department, however noted that the journal entries provided by MP did not involve or create a regulatory liability, contrary to its Petition, in which MP proposed to defer all proceeds from land sales into a regulatory liability that would be returned to ratepayers in a future rate case or Renewable Resources Rider. According to the Department, the information provided by MP instead showed that the journal entries record the gain on sale as income on Minnesota Power's income statement in FERC Account 421.1 Gain on Disposition of Property.²³

The Department viewed many aspects of Minnesota Power's proposal and related explanations as reasonable, but before making its final recommendations requested that the Company provide additional information on the following:

Department requests that the Company provide additional information regarding its proposed journal entries to record the sale of these lots. As described above, the Company stated that it would defer all proceeds from the lot sales into a

²² The Department's Comments, p. 12

²³ The Department's Comments, p. 13., and Attachment 21, p. 2 of 2.

regulatory liability, but the proposed journal entries do not create or involve a regulatory liability.

Minnesota Power in reply comments stated “Minnesota Power intends to defer all proceeds from the land sales, net of tax into a regulatory liability. Once all proceeds are distributed to customers the regulatory liability would terminate. The Company will pay tax on the gain at the time of the sale”.²⁴

Also, the Company stated that the benefits of the full gain would inure to the customer because the net liability amount will be grossed up for taxes since the customer distributions will reduce the Company’s tax liability. For context the Company presented the below illustrative example:²⁵

Gain on land Sales	\$100	
Corporate Tax	<u>(28)</u>	
Regulatory Liability	\$ 72	
Distribution Gross-up	/ (1.40)	
Customer Revenue Impact		\$(100)
Corporate Tax		28
Regulatory Liability		\$ (72)

The Department in its supplemental comments held that Minnesota Power did not provide in its reply comments updated journal entries that demonstrated the creation of a regulatory liability. However, the Department noted that the Company subsequently provided updated journal entries showing the creation of the regulatory liability as proposed in the Petition.²⁶

Thus, the Department reviewed the updated proposed accounting treatment of land sales and found it reasonable.

3. Application of taxes to these land sales

The Department asked Minnesota Power to clarify whether the federal and state corporate income tax rates, or lower capital gains tax rates, will apply to these land sales.²⁷

In Reply Comments, the Minnesota Power stated that Federal and state corporate income tax rates will apply to land sales, and that business capital gain is taxed at the same rate as ordinary income for companies.²⁸

²⁴ Minnesota Power’s Reply Comments, p. 2.

²⁵ Id., at p. 3.

²⁶ The Department’s Supplementary Comments, p. 2.

²⁷ The Department’s Comments, p. 15.

²⁸ Minnesota Power’s Reply Comments, p. 3.

The Department in its supplementary comments concluded that based on the Company's response, the proposal to use Federal and state corporate income tax rates to calculate the tax expense to be deducted (among other expenses) from the gross proceeds of the sales in determining the final credit for ratepayers should be considered reasonable.

4. Proposed Land Sales - Benefits Allocation

The Department expressed concern in its comments that Minnesota Power did not speak to what specific mechanism it would use to distribute net proceeds from the land sales to ratepayers nor the manner in which it would allocate the net proceeds across customer classes. Nevertheless, both parties agreed to address this issue in the future.

Though, the Department in the discussion above had agreed to leave the benefit allocation issue to a future filing, it observed on review of the Petition's summary page the following:

Minnesota Power stated that it submitted the Petition pursuant to Minn. Stats. § 216B.16, 216B.1696, and 216B.50. Minn. Stat. § 216B.1696 permits utilities to establish separate rates for energy-intensive, trade exposed (EITE) customers, as defined in the Statute.

The Department requested in its IR No.21 for clarification from Minnesota Power. In response, the Company stated that its reference to Minn. Stat. § 216B.1696 was inadvertent, and that it is not proposing to distribute the net proceeds only to EITE customers.²⁹

5. Will the sale of these lands benefit the Company's nonregulated affiliates?

Further, the Department requested Minnesota Power to explain in Reply Comments whether any of the tax liability generated by the sale of these lands will be used in any way to benefit the Company's nonregulated affiliates, for example by being used to consume nonregulated deferred tax assets or otherwise monetize tax benefits generated by ALLETE Inc.'s nonregulated lines of business.

Minnesota Power in its reply comments stated that there exist no direct or indirect benefits to any non-regulated affiliate from the land sales.³⁰

D. Department - Overall Recommendation

The Department after detailed review and analysis of Minnesota Power's Petition and related information made the following recommendations:

1. Approve Minnesota Power's Petition.
2. Require Minnesota Power to provide annual compliance filings that include:
 - a. data regarding lot sale transactions, including:

²⁹ The Department's Comments, p. 14, and Attachment 22, p. 1 of 1.

³⁰ Minnesota Power's Reply, p. 3.

- i. the number of offers to current leaseholders made to date as of the time of the compliance filing
 - ii. the number of offers to current leaseholders accepted
 - iii. the number of offers to current leaseholders rejected
 - iv. the number of lots listed on the open real estate market
 - v. the number of lots sold via the open real estate market
- b. the tracker balance, including:
 - i. all additions to the tracker
 - ii. all deductions from the tracker
- c. an estimate of anticipated customer benefits
- d. updates on the status of Minnesota Power's non-capacity license amendment application at the Federal Energy Regulatory Commission;
3. Require Minnesota Power to provide timely updates to the Commission via compliance filings in this Docket regarding important developments related to its non-capacity license amendment application at the Federal Energy Regulatory Commission;
4. Require Minnesota Power to track, at the most granular level possible, information on the costs and revenues associated with the lot sales, including:
 - a. for individual lot sales:
 - i. sale price
 - ii. list price (if different from sale price)
 - iii. EMV of land at the time of the sale
 - iv. EMV of buildings/structures at time of sale
 - v. all fees and expenses (e.g. title fees), itemized by type
 - vi. whether the lot was sold to the current leaseholder
 - b. for costs deducted from the tracker that are not attributable to individual lots sales, sufficient detail to determine whether they are internal costs included in base rates, or external costs.

VII. Concluding Comment

PUC Staff generally supports the Department's overall recommendations and appreciated the detailed review and analysis of Minnesota Power's Petition.

Further, staff notes the potential benefits to ratepayers via net proceeds credit that would inure to them, increase in economic activities via constructions and related jobs and likely increases in county tax base³¹ for the local economy that would assist funding of education and community projects.

³¹ Minnesota Power's Petition, p. 12.

VIII. Decision Alternatives

1. Approve Minnesota Power's Petition to sell residential land lots surrounding its hydropower reservoirs to customers. (MP, Department)
2. Allow Minnesota Power to set the baseline value for each lot for sale on the county's Estimated Market Value (EMV) methodology. (MP, Department)
3. Authorize Minnesota Power to defer all proceeds from the land sales into a regulatory liability that would be refunded (credited) to customers in either a future rate case or through the Renewable Resources Rider. (MP, Department)
4. Require Minnesota Power to provide annual compliance filings with verifiable data regarding lot sale transactions, including:
 - i. the number of offers to current leaseholders made to date as of the time of the compliance filing
 - ii. the number of offers accepted by current leaseholders
 - iii. the number of offers rejected by current leaseholders
 - iv. the number of lots listed on the open real estate market
 - v. the number of lots sold via the open real estate market
(Department, MP)
5. Direct Minnesota Power to track, at the most granular level possible, information on the costs and revenues associated with the lot sales, including
 - a) for individual lot sales:
 - i. Sale price
 - ii. List price, if different from sale price
 - iii. Estimated Market Value (EMV) of the land at the time of sale
 - iv. EMV of buildings/structures at the time of sale
 - v. All fees and expenses, (e.g. Title fees) and itemized by type
 - vi. Whether lot was purchased by current leaseholder
(Department, MP)
6. Require Minnesota Power to provide in an annual compliance filing, its land sales tracker balance, including:
 - a) All additions to the tracker
 - b) All deductions to the tracker (Department, MP)
7. Require Minnesota Power to provide in an annual compliance filing an estimate of anticipated amount of customer benefits (Department, MP)



8. Direct Minnesota Power to disclose all costs deducted from the tracker that are not attributable to individual lots sales, in sufficient detail to determine whether they are internal costs included in base rates, or external costs. (Department, MP)
9. Require Minnesota Power to provide timely and annual updates to the Commission in compliance filings in this Docket regarding important developments related to its non-capacity license amendment application at the Federal Energy Regulatory Commission. (Department, MP)