Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: April 23, 2014 .... ** Agenda Item # **4**

Company: Minnesota Power

Docket No. E-015/D-13-275

In the Matter of Minnesota Power's 2013 Remaining Life Petition

Issues: Should the Commission approve Minnesota Power's 2013 Proposed Remaining Lives?

What salvage rates should be used to calculate the depreciation expense?

Staff: Ann Schwieger...(651) 201-2238
Jerry Dasinger ....(651) 201-2235

Relevant Documents

Minnesota Power-Initial Filing .... April 4, 2013
Minnesota Power-Supplemental Information (3 parts) .... July 30, 2013
Minnesota Power-Supplemental Information (2 parts) .... September 4, 2013
Department of Commerce-Comments.. October 11, 2013
Minnesota Power-Reply Comments.. January 10, 2014
Department of Commerce-Response to Reply Comments .... February 25, 2014

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April 17, 2014

Statement of the Issue

Should the Commission approve Minnesota Power's 2013 Remaining Life Petition?

What salvage rates should be used to calculate the depreciation expense?

Background

April 12, 2013: Minnesota Power (Company) submitted its 2013 Remaining Life Depreciation Petition requesting approval of the proposed 2013 remaining lives and salvage rates for all of Minnesota Power's production plant assets and certain general plant accounts. The Company requested an effective date of January 1, 2013.

July 30, 2013: Minnesota Power filed Supplemental Information explaining how the Company uses decommissioning probabilities to calculate its salvage rates. The schedules provided a comparison of depreciation expense as currently calculated by the Company to the effect of using a 100% decommissioning probability. If the Company were to use a 100% decommissioning probability, depreciation expense would increase annually by approximately $1.3 million.

September 4, 2013: Minnesota Power filed an amendment to its 2013 Remaining Life Petition as required in the Commission's July 31, 2013 Order in Docket No. E-015/D-12-378. The Order required the Company to adjust its 2008-2012 depreciation reserve prospectively to correct an error in the formula used to calculate salvage rates. The increase to annual depreciation expense due to the correction is approximately $1.3 million. The total increase to depreciation expense is approximately $4.47 million and will be amortized over 36 months at $124,200 per month.

October 11, 2013: The Department submitted comments and recommended the Commission approve Minnesota Power's proposed remaining lives. The Department recommended the Commission deny the Company's proposed salvage rates in this Petition and approve the salvage rates the Department calculated with estimates from the Company's 2011 Decommissioning Study.

January 10, 2014: The Company submitted reply comments and disagreed with the Department's recommendation to use the salvage rates calculated with estimates from the Company's 2011 Decommissioning Study. The Company stated that it is currently in the process of completing an updated Decommissioning Study, as required every five years, which will be finalized and incorporated into Minnesota Power's 2014 Remaining Life Depreciation Petition and Production Plant Depreciation Study.

February 25, 2014: The Department submitted response comments and continued to recommend the Commission order the Company to use the salvage rates calculated with the estimates from the Company's 2011 Decommissioning Study.

Introduction

Minnesota Statute §216B.11 and Minnesota Rules, parts 7825.0500 to 7825.0900 require public utilities to seek Commission certification of their depreciation rates and methods. Utilities must use straight line depreciation unless the utility can justify a different method. Utilities must review their depreciation parameters and rates annually to determine if they are appropriate. The utility must file a depreciation study to support the parameters at least once every five years. Once the parameters are certified by order, they remain in effect until the next certification.

The outstanding issue in this docket is what salvage rates should the Company use when calculating its depreciation expense. The Company proposed use of the salvage rates which were approved in its 2009 five-year study. The Department is recommending the Commission require the Company to use the salvage rates with estimates from the Company's 2011 Decommissioning Study. In between the initial filing and the final round of comments, the Company completed an additional decommissioning study that it plans to use to support the proposed salvage rates in its 2014 Five-year Depreciation study. A comparison of the proposed salvage rates is shown in the table below.

	Salvage Rates Proposed by MP in 2013 Depreciation Petition as Approved in 2009 Petition	**Salvage Rates Proposed by Department from 2011 Decommissioning Study**	**Salvage Rates with Estimates from MP's Updated Decommissioning Study To Be Proposed in 2014 Petition**	**Actual Salvage Rates Proposed in MP's 2014 Petition[1]**
Boswell				
Unit 1	-1.82%	-6.92%	-6.23%	-6.09%
Unit 2	-2.27%	-9.13%	-8.06%	-7.90%
Unit 3	-4.19%	-4.93%	-4.50%	-4.50%
Unit 4	-3.84%	-4.88%	-4.65%	-4.62%
Common	-1.77%	-2.89%	-2.11%	-2.06%
Laskin	-10.87%	-33.95%	-14.66%	-14.50%
Taconite Harbor	-3.60%	-5.91%	-4.36%	-4.16%

Party Positions

Minnesota Power filed its 2013 Depreciation petition on April 12, 2013. In the petition Minnesota Power stated it is requesting the remaining lives of all facilities be adjusted for one

[1] Minnesota Power filed its five-year 2014 Remaining Life Depreciation Petition on April 15, 2014 in Docket No. E-015/D-14-318.

year's passage of time. The Company stated that it has incorporated the Department's recommended method of calculating salvage rates in this petition. This method complies with the Commission's Order in MP's 2012 Annual Remaining Lives Depreciation Petition, (Docket No. E-015/D-12-378) issued on July 31, 2013.

Minnesota Power stated that its basis for preparing this Petition is the following:

> "On October 5, 2009 Minnesota Power submitted its 2010 Integrated Resource Plan ("2010 Resource Plan") for the 2010-2024 forecast period in Docket No. E-015/RP-09-1088. The Commission approved the 2010 Integrated Resource Plan in an order dated May 6, 2011. Historically the regulatory precedent has been to compare remaining life depreciation petitions to the latest approved Integrated Resource Plan. This 2013 Remaining Life Depreciation Petition makes comparison to the 2010 Resource Plan, which is the latest approved plan. On March 1, 2013, Minnesota Power filed its 2013 Integrated Resource Plan ("2013 Resource Plan" or "2013 IRP") which recommends the conversion of the Laskin Energy Center to natural gas, and the retirement of one of three units at Taconite Harbor Energy Center. Minnesota Power expects Commission action on the 2013 IRP by the end of 2013. The Commission's decision on the 2013 IRP will be the basis for preparing the 2014 Remaining Life Depreciation Petition. Accordingly, this 2013 Remaining Life Depreciation Petition does not reflect the recommendations proposed in the 2013 IRP."

Minnesota Power submitted Supplemental information on July 30, 2013 to comply with the Commission's Order dated July 31, 2013 in Docket No. 12-378. Because the Company uses decommissioning probabilities in the calculation of its salvage rates, the Commission ordered the Company to provide a comparison of its depreciation expense as currently calculated and the expense assuming a decommissioning probability of 100%. The Company estimated that using 100% decommissioning probability would result in an approximately $1.3 million increase in annual depreciation expense.

In the same docket, Minnesota Power requested the Commission open a broader generic docket to provide guidance and clarification regarding decommissioning studies and the use of probabilities to eliminate confusion and issues going forward. Additionally, the Company would like the Commission to address the frequency and adequacy with which companies should file and update decommissioning studies, including any correlation with integrated resource plans.[2]

On September 4, 2013 the Company submitted additional information in response to the Commission's Order in Docket No. 12-378 dated July 31, 2013. In the Order, the Commission directed Minnesota Power to alter the way it calculates decommissioning costs to correct an error in the formula and to make conforming adjustments prospectively and retrospectively. The

[2] Initial comments have been received from interested parties in the generic docket (Docket No. E,G-999/CI-13-626) with response comments due in May of 2014.

Company stated that the total estimated impact from 2008 to 2012 is $4,471,200. Minnesota Power began amortization of the expense in October of 2013 and will record a monthly expense of $124,200 over 36 months. The estimated impact to the current annual depreciation expense for 2013 will be $1,317,500 using the Department's method.

The Department filed comments on October 11, 2013. The Department stated that it agrees with the Company's proposal, but has a concern with the Company's proposed salvage rates. The Department agreed with the Company's decision to use the life assumptions from its 2010 Resource Plan, but disagreed with the Company's decision not to use the decommissioning estimates from the 2011 Decommissioning Study.

In Docket No. E-015/D-10-223, the Company's 2010 Depreciation Petition, the Commission ordered the Company to conduct an external decommissioning study to be submitted within 90 days of the Company's next resource plan filing. The 2011 Decommissioning Study was submitted to the Commission on March 29, 2013 in conjunction with the Company's 2013 Resource Plan.[3]

The Department stated that while a generating asset's estimated remaining life is a function of many factors, a utility's resource planning process plays a large and important role in the determination of the remaining lives of its plants for both resource planning purposes and depreciation purposes. The Department agreed with Minnesota Power's decision to use the life assumptions from its prior resource plan rather than the life assumptions from the then-unapproved 2013 Resource Plan. The resource planning process does not, however, play the same role in the determination of decommissioning costs and salvage rates, and the Department disagrees with MP's decision to use its old estimates of decommissioning costs as the basis for its salvage rates in its 2013 Depreciation Petition.

The Department concluded that the 2011 Decommissioning Study contains estimates of the costs to decommission the Boswell Energy Center, the Laskin Energy Center, the Taconite Harbor Energy Center, and the Hibbard Renewable Energy Center as those plants exist today. The assumed retirement dates of the plants do not affect the decommissioning estimates, and the estimates do not reflect costs Minnesota Power expects to incur pursuant to future regulations which are not currently in effect. The decommissioning estimates derived in the 2011 Decommissioning Study are in no way dependent on the Commission's approval of MP's 2013 Resource Plan. The decommissioning estimates produced in the 2011 Decommissioning Study represent the most current and best estimates of Minnesota Power's anticipated decommissioning costs, and the estimates should be used as the basis for determining the Company's salvage rates.

The Department estimated that the use of these newer salvage rates, instead of Minnesota Power's proposed salvage rates, would result in an increase in annual depreciation expense of approximately $2.6 million, or 4.2 percent. The Department noted that the majority of the $2.6 million increase is attributable to the decrease in the salvage rate of the Laskin Energy Center,

[3] The Commission's Order approving the 2013-2027 Resource Plan was issued on November 12, 2013.

from negative 10.87 percent to negative 33.95 percent. The Department recommended that the Commission require Minnesota Power to use the salvage rates based on the 2011 Decommissioning Study in its depreciation calculations.

Minnesota Power responded to the Department's recommendation on January 10, 2014. The Company stated it intentionally did not incorporate the 2011 Decommissioning Study into its petition because it was a planning tool used to support Minnesota Power's 2013 Resource Plan and was not completed for the 2013 Remaining Life Depreciation Petition. In 2011, Minnesota Power prepared a special decommissioning study for use in the February 2012 Baseload Diversification Study. The Company stated that it is in the process of completing an updated Decommissioning Study which will be finalized and incorporated into Minnesota Power's 2014 Remaining Life Depreciation Petition and Production Plant Depreciation Study as is required every five years.

The Company stated that the major assumption changes between the five-year required Decommissioning Study update that will be used to support the 2014 Remaining Life and Production Plant Depreciation Petition and the 2011 Decommissioning Study are as follows:

1.) All structures will be demolished to grade versus four feet below grade.
2.) Coal pile restoration will be six inches below grade versus a foot below grade.
3.) Ten percent contingency versus a twenty percent contingency.
4.) Laskin Energy Center ponds will be capped versus relocating all ash.
5.) Deposit concrete at Laskin on-site versus off-site.
6.) Lower scrap values based on actual scrap values.

The Company stated that it does not agree with the Department's recommendation to use the salvage rates based on the 2011 Decommissioning Study for any of its units, especially for Laskin at a negative 33.95%. The Department Comments noted that much of the $2.6 million increase in depreciation expense would be due to the decrease in the salvage rate for Laskin. The proposed salvage rate for Laskin in this petition is a negative 10.87%. The estimated salvage rate in the updated Decommissioning Study is negative 14.66% which the Company plans to propose in its 2014 depreciation filing.

The Company argued that decommissioning rates affect the utility's annual earning level through the annual depreciation rate setting mechanism established through the Commission's accounting review process. In the past, Minnesota Power has reviewed decommissioning estimates every five years with the current update due with the 2014 depreciation filing. Minnesota Power stated that it plans to adjust the salvage rates in its 2014 Depreciation filing. As a publicly traded company, Minnesota Power provides earnings guidance, relying in part on precedence for items such as decommissioning studies and rates. Requiring an updated decommissioning study and updated decommissioning rates under currently unestablished guidelines or precedence results in uncertainty which is problematic.

Minnesota Power stated that if the Company had planned on incorporating the 2011 Decommissioning Study in the 2013 Remaining Life Petition it would have requested other changes as well. For example, the Company would have requested life extensions for its hydraulic generating units.

Minnesota Power is requesting Commission approval of the rates proposed in the Petition. The Company stated that it will incorporate the five year required Decommissioning Study update into its 2014 Remaining Life and Production Plant Depreciation Petition.

The Department responded to the Company's comments on February 25, 2014. The Department noted that Minnesota Rule 7825.0600, subp. 2, part D requires the Company to:

> Review their depreciation rates annually to determine if they are still generally appropriate. Depreciation certification studies shall be made so that all primary accounts shall have been analyzed at least every five years.

Based on its analysis, the Department agreed with the Company that it is reasonable for the Company to update its decommissioning estimates at a minimum, once every five years. The Department argued that if the Company updates its decommissioning estimates outside of the five year schedule the Commission should require the Company to incorporate those estimates into its depreciation calculations. The Company conducted the 2011 Decommissioning Study to comply with the Commission's requirement and used the study to support both its Baseload Diversification Study (Docket No. E-015/RP-09-1088) and its 2013 Integrated Resource Plan (Docket No. E-015/RP-13-53). The Department concluded that unless there is a specific reason why the estimates from the 2011 Decommissioning Study are inappropriate for depreciation purposes, they should be used as the basis for Minnesota Power's salvage rates.

The Department asked the Company to explain why the assumptions used to develop the 2011 Decommissioning Study were appropriate for use in the resource planning process, but not appropriate for depreciation purposes. Based on the Company's response, the Department concluded that the Company did not use the 2011 Decommissioning Study in its 2013 Depreciation Petition only because the timing did not match the Company's five-year schedule for updating its decommissioning estimates. The Department recommended that because the Company has updated its decommissioning estimates, those estimates should be reflected in its depreciation calculations.

The Department stated that it understands the Company is likely to propose new salvage rates in its 2014 Depreciation Petition. The Department also understands its recommendation to use the salvage rates from the 2011 Decommissioning Study would result in unusual volatility in the Company's depreciation expense. The new salvage rates have not been proposed and may or may not be determined to be reasonable. The Department recommended use of the salvage rates as developed in the 2011 Decommissioning Study because they represent the most current and best estimates of Minnesota Power's decommissioning costs. The estimates produced in the 2011 Study represent the costs to decommission Minnesota Power's plants as those plants exist today and measured in today's dollars and should be used to in the calculation of the Company's salvage rates.

Staff Analysis

A depreciation certification study, supported by a decommissioning study, is normally done so that all primary accounts have been analyzed at least once every five years per Minnesota Rule 7825.0600. Having two decommissioning studies completed within the five year cycle is unusual. The question of which Decommissioning Study to use in the development of Minnesota Power's 2013 Remaining Lives Depreciation parameters is unique in this instance because two studies have been completed. The precedent has been for the Company to use its most current Decommissioning Study to support its depreciation parameters. Minnesota Power is proposing use of the parameters from its 2009 Decommissioning Study in support of its 2013 Remaining Lives Depreciation Petition. The Department has recommended the Commission require the Company to use its 2011 Decommissioning Study to develop the depreciation parameters in this filing because the 2011 Decommissioning Study was ordered by the Commission.

In Docket No. E-015/D-10-223, Minnesota Power agreed with the Department's recommendation that the Company should perform a specific study to support various assertions with respect to depreciation related items such as unit decommissioning probabilities. The Company proposed completing the study to coincide with the submission of the Company's next IRP. According to the Company, "This plan will provide strategic context for developing the assertions and assumptions for the useful lives, decommissioning probabilities and salvage rates used in completing a meaningful study". The Commission ordered the Company to, "Conduct an external study for decommissioning to be submitted within 90 days of Minnesota Power's next resource plan filing pursuant to Minn. Stat. §216B.2422." This is the 2011 Decommissioning Study.

According to Minnesota Power in the Company's 2013 Integrated Resource Plan (Docket No. E-015/RP-13-53) filed on March 1, 2013. In Appendix L: Accounting for Proposed Retirements and Decommissioning Study Discussion:

> "Minnesota Power submitted its last decommissioning study to the Commission on April 22, 2009, in Docket No. E-015/D-09-407. That 2009 study has been used in subsequent remaining life depreciation petitions.
>
> Minnesota Power's Commission Order from its 2010 Remaining Life Depreciation Petition (Docket No. E-015/D-10-223) requires an updated Decommissioning Study due within 90 days of this Resource Plan filing. As required, the Decommissioning Study is being provided in Appendix H, Assumptions and Outlooks.
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> As a part of the review process for the last integrated resource plan ("IRP"), the Commission accepted Minnesota Power's 2010-2024 IRP and ordered a Baseload Diversification Study ("BDS") to be conducted, with several conditions. One of the conditions was that the BDS incorporate all potential EPA regulations relevant to fossil fuel generation which affect the Company's operations.

> To comply with the BDS Order, in 2011 Minnesota Power requested a special decommissioning study be prepared for use in the February 2012 BDS. The decommissioning study was prepared to incorporate all potential EPA regulations to support the environmental assumptions for the long-range planning scenarios as ordered. These environmental assumptions included, among others, the use of the coal combustion residual proposed regulations. Minnesota Power used the decommissioning estimated costs in the environmental scenarios ranging from less stringent, to stringent, to more stringent. The environmental cases demonstrate the potential impact of the EPA regulations on the long-range planning scenarios in the BDS.
>
> This same 2011 decommissioning study has been used in this 2013 Plan for analyzing the base case compared to the other cases presented, and is attached in Appendix H. The base case incorporates the most probable EPA outcomes, includes only a portion of the currently proposed coal combustion regulations, and excludes other proposed regulations.
>
> The 2011 Decommissioning Study was not incorporated into the 2012 Remaining Life depreciation petition and will not be incorporated into the 2013 Remaining Life Depreciation petition. As the 2011 Decommissioning Study included all *potential* EPA regulations as required to comply with the BDS Order, Minnesota Power intentionally did not incorporate that study into those remaining life depreciation filing. Upon Commission approval of this 2013 Plan filing, Minnesota Power will complete an updated Decommissioning Study utilizing the final approved plan and a range of probable EPA regulations, and file that Decommissioning Study by April 15, 2014, as required by the Commission's order in Docket No. E-015/D-09-407.

The Department disagreed with Minnesota Power's decision to use the 2009 Decommissioning Study estimates of decommissioning cost as the basis for its salvage rates in its 2013 petition. The Department stated that the 2011 Decommissioning Study contains estimates of the costs to decommission Boswell, Laskin, Taconite Harbor and Hibbard as those plants exist today. The Department stated, "The estimates from the 2011 study do not reflect costs Minnesota Power expects to incur pursuant to future regulations which are not currently in effect".

Staff recommends the Commission ask the Company and the Department to clarify the agreement made between the two parties in Docket No. E-015/D-10-223 as the written record is limited in that case. On the one hand, the Company stated, "This plan will provide strategic context for developing the assertions and assumptions for the useful lives, decommissioning probabilities and salvage rates used in completing a meaningful study". This statement would lead one to believe the Company had the intention of using the 2011 Decommissioning filing to support the 2013 Depreciation parameters.

Staff recommends the Commission ask the Company to explain the basis of the changed assumptions between the 2009 and 2011 studies?

The Commission may also want to clarify with the Company and the Department what assumptions were made in the 2011 Decommissioning Study. The Department stated, "The estimates from the 2011 study do not reflect costs Minnesota Power expects to incur pursuant to future regulations which are not currently in effect". The Company stated that it purposely did not incorporate the 2011 Decommissioning Study in its 2013 Remaining Life Petition because the study included all *potential* EPA regulations as required to comply with the BDS Order.

If the 2011 Decommissioning Study includes a range of future, unknown regulations included in the assumptions, than it may be that future decommissioning costs are overstated. The 2009 Decommissioning Study may provide a more accurate estimate and be a more likely scenario based on less stringent guidelines. If the Commission adopts the Company's proposal and uses the 2009 Decommissioning Study, depreciation expense would increase by $0.9 million, or approximately 1.5 percent, relative to what the depreciation expense would be if the Company retains its current depreciation rates.

Staff also concludes that use of the 2011 Decommissioning Study would likely overstate the depreciation expense. If the Commission were to adopt the Department's recommendation to use the 2011 Decommissioning Study, the depreciation expense would increase by $2.6 million. This increase would be largely due to the increased salvage rate of Laskin Energy Center. Using the 2011 Decommissioning Study would also decrease the Company's earnings by $2.6 million. Minnesota Power stated, "As a publicly traded company Minnesota Power provides earnings guidance, relying in part on precedence for items such as decommissioning studies and rates. Requiring an updated decommissioning study and updated decommissioning rates under currently unestablished guidelines or precedence results in uncertainty which is problematic."

Decision Alternatives

1. Remaining Lives Effective Date

   a. Approve Minnesota Power's proposed remaining lives with an effective date of January 1, 2013.

   b. Approve Minnesota Power's proposed remaining lives with a different effective date.

2. Salvage Rates

   a. Approve the salvage rates as proposed by the Company in it 2013 Depreciation Petition.

   b. Approve the salvage rates as proposed by the Department based on the 2011 Decommissioning Study.

c. Approve salvage rates as determined by the Commission.

3. Due Date of Next Depreciation Filing

a. Require the Company to file its next five year depreciation study on April 15, 2014.

b. Do not require the Company to file its next five year depreciation study on April 15, 2014.

4. Remaining Life Comparison

a. Require Minnesota Power to continue to provide a comparison of the remaining lives used in its depreciation filing and current resource plan and explain any differences in future remaining lives depreciation filings.

b. Do not require Minnesota Power to continue to provide a comparison of the remaining lives used in its depreciation filing and current resource plan and explain any differences in future remaining lives depreciation filings.

5. Decommissioning Probability Comparison

a. Require Minnesota Power to include an analysis comparing its depreciation expense calculated using its current decommissioning probabilities to depreciation expense calculated using a 100% decommissioning probability.

b. Do not require Minnesota Power to include an analysis comparing its depreciation expense calculated using its current decommissioning probabilities to depreciation expense calculated using a 100% decommissioning probability.

6. Schedule of Supplemental Depreciation Expense

a. Require Minnesota Power to include a schedule of its supplemental depreciation expense recorded in 2013 as ordered by the Commission in the 2012 Depreciation Docket and include a summary of supplemental depreciation expense to be recorded in the future.

b. Do not require Minnesota Power to include a schedule of its supplemental depreciation expense recorded in 2013 as ordered by the Commission in the 2012 Depreciation Docket and include a summary of supplemental depreciation expense to be recorded in the future.

Recommendation

Staff is not making a recommendation at this time.