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March 31, 2014

Burl W. Haar
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: **Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. E015/M-14-166

Dear Dr. Haar:

Attached are the comments of the Division of Energy Resources of the Minnesota Department of Commerce (Department) in the following matter:

Petition by Minnesota Power for Approval of Modifications to Erie Mine Site Service Schedule.

The petition was filed on February 24, 2014 by:

David R. Moeller
Senior Attorney
Minnesota Power
30 West Superior Street
Duluth, Minnesota 55802

The Department recommends **that Minnesota Power provide additional information in its reply comments** and is available to answer any questions the Commission may have.

Sincerely,

/s/ KATE O'CONNELL
Manager, Energy Regulation and Planning

KO/ja
Attachment



BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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

DOCKET No. E015/M-14-166

I. SUMMARY OF MP PROPOSAL

On February 24, 2014, Minnesota Power (MP or the Company) filed a Petition with the Minnesota Public Utilities Commission (Commission) for Approval of Modifications to Erie Mine Site Service Schedule (proposed EMSS). Given MP's interpretation of the provisions of the EMSS, the only customer eligible to take service under the EMSS is Mesabi Nugget. The Department discusses issues related to Mesabi Nugget in the separate docket filed by Minnesota Power, Docket No. E015/M-14-155.

As discussed further below, given the terms of the tariff and information provided by MP, all service under the current EMSS expired on December 31, 2013. Under MP's proposal, service under the EMSS would be extended only to Mesabi Nugget, and only until Taconite Harbor is expired. The specific change to the availability section that MP proposes is shown in red-line:

To the electric service requirements of any new industrial, mining or manufacturing Customer(s) located at the former Erie Mine Site or, subject to the prior written approval of the Company, at any other location in or around Hoyt Lakes, Minnesota where service can be taken from the Company's 138 kV transmission line. Service hereunder is limited to Customers with total power requirements of at least 2,000 kilowatts (kW) per Customer and not more than 25,000 kW in total for all customers. Customer and Company shall execute an Electric Service Agreement having a minimum term of one (1) year ~~and maximum term of six (6) years~~ (subject to the early termination option of the Company set forth

below). Any service under this Schedule must commence on or before January 1, 2008.

If, at any time after this Rate Schedule becomes effective, Company chooses to retire the Taconite Harbor generating station or convert the Taconite Harbor generating station to a fuel source other than coal, new service under this schedule shall immediately cease to be available, and, commencing on January 1 of the next calendar year after the date of retirement or conversion, any existing service under this rate schedule shall terminate. Company shall, in the event of such a retirement or conversion, provide timely written notice to any existing Customer taking service under this Rate Schedule. Existing Customer(s) shall choose an alternative Rate Schedule or be assigned to an applicable Rate Schedule by the Company.

Since MP filed this petition as a stand-alone petition separate from the proposed electric service agreement with Mesabi Nugget, the Department analyzes the proposed change in the EMSS tariff on its own.

II. BACKGROUND

In 2001, MP and Cleveland-Cliffs worked with the Minnesota Iron Range Resources and Rehabilitation Board, the Minnesota Department of Natural Resources, the Minnesota Department of Revenue and the Minnesota Pollution Control Agency to acquire the northeastern Minnesota assets of LTV Steel Mining Company (LTV).

In October 2001, Rainy River-Taconite Harbor (RRTH), a subsidiary of MP, and Cleveland Cliffs purchased portions of LTV's Minnesota assets through the bankruptcy proceeding of LTV. The Company purchases included the transmission line from Taconite Harbor to Hoyt Lakes and the coal-fired generation units located at Taconite Harbor.

MP agreed to dedicate electric service from the Taconite Harbor units to the former Erie Mine Site (or at MP's consent, elsewhere in Hoyt Lakes where service can be taken from the 138 kV transmission line) at a special rate to facilitate future development in the Hoyt Lakes area.¹

The dedication of up to 25 MW reflected the gap forecasted between the accredited capacity of the Taconite Harbor generating station and the amount of available transmission from the units.

¹ Source: the portion of the State Master Agreement filed by MP in Docket No. E015/M-03-717 included herein as Attachment 1.

On May 9, 2003, MP filed a petition for approval of the EMSS.

The Commission approved the EMSS in its Order issued August 20, 2003. According to MP, part of the rationale for the EMSS was to encourage the development of the former Erie Mine Site near Hoyt Lakes, Minnesota, by providing a special rate on power from the Taconite Harbor units for development at the site. The available transmission from the Taconite Harbor units is not enough to support all of the generation units' accredited capacity. The corresponding excess capacity of 25 MW is, therefore, available for local load only. The EMSS has a maximum of 25,000 kW available to all customers, corresponding to the excess capacity of the Taconite Harbor units, and any eligible customer must take at least 2,000 kW of service from MP's 138 kV transmission line by January 1, 2008.

Service under the current EMSS expired on December 31, 2013.² Under the current EMSS, service was required to start on or before January 1, 2008, and the maximum term agreed upon with the state agencies described above was six years.

III. DEPARTMENT ANALYSIS

In the 2003 docket, MP filed portions of the State Master Agreement, identified as Exhibit 8.3(a) and filed as Exhibit C in that proceeding. Provision 10 on page 6 of the excerpt that MP provided in that docket refers to a limitation of five years regarding activities on that site. The initial limit of six years in the availability section of the EMSS tariff that MP proposes to eliminate in the instant docket may or may not be related to that agreement. Neither the Department nor the Commission were parties to the proceeding that gave rise to the State Master Agreement. However, since the original purpose of the EMSS tariff stems from the State Master Agreement, changes to the EMSS should be understood in light of the entire State Master Agreement; further parties to the State Master Agreement should be allowed to weigh in on the proposed change.

Thus, the Department recommends that MP provide the following in its reply comments:

- The entire original State Master Agreement and any modifications made to the State Master Agreement over time, and
- Confirmation by the parties to the State Master Agreement that MP's proposal to eliminate the six-year maximum term to the availability section of the EMSS tariff is acceptable.

In addition, in accordance with its review of this type of filing, the Department evaluates whether the proposed EMSS would result in rates that are unreasonably preferential, prejudicial, or discriminatory.³

² Source: MP's response to the Department's Information Request No. 1, Attachment 2.

The Department appreciates that MP's EMSS tariff retains the language indicating that service under the EMSS Tariff ceases once MP retires Taconite Harbor. However, it is unclear to the Department why only Mesabi Nugget is eligible to take service under the EMSS tariff since MP provided service to both Mesabi Nugget and PolyMet Mining Corporation (PolyMet).⁴ MP stated that "the only other potentially eligible customer," Polymet, "is not eligible to restart EMSS Schedule service."⁵ It is not clear from MP's petition: 1) what the basis is for MP's conclusion that Polymet is ineligible for service under the EMSS Tariff and 2) whether that basis would hold true if the six-year maximum term is removed as MP proposes. In response to discovery from the Department on this issue, MP stated:

Minnesota Power is not aware of any other customer except Mesabi Nugget with electric service requirements of at least 2,000 kW that is or will be located in the applicable area in 2014 when the EMSS Schedule would again be made available. PolyMet, the only other potentially eligible customer, voluntarily discontinued EMSS service (as Minnesota Power stated in the Petition) and has not expressed interest in restarting service under the EMSS Schedule. Also, since the start date requirement has not been modified, no other customers would be eligible.

The Department agrees with MP that "no other customers would be eligible" as a result of "the start date requirement [of January 1, 2008]." However, MP has not shown that the Company made Polymet aware that service under the EMSS would continue to be available to Polymet under MP's proposal. Thus, the Department recommends that MP provide: 1) the basis for MP's conclusion that Polymet is no longer eligible for service under the EMSS and 2) documentation that Polymet continues to decline service under the EMSS, given MP's proposal to extend service until MP retires Taconite Harbor. The Department will review MP's responses to this information and provide responses in subsequent comments.

³ As required by Minnesota Statute Section 216B.03.

⁴ On February 15, 2007, MP petitioned the Commission for approval of an Electric Service Agreement (ESA or Agreement) between MP and PolyMet. Under the proposed ESA, MP will provide power for PolyMet's NorthMet project, which will be located near Hoyt Lakes, Minnesota. On April 25, 2007, the Commission issued an Order approving MP's first electric service agreement (Polymet ESA) using in part the EMSS Schedule, In the Matter of a Request by Minnesota Power for Approval of an Electric Service Agreement with Polymet Mining Corporation, Docket No. E015/M-07-221.

On November 20, 2007, MP filed its request for approval of an electric service agreement (Mesabi ESA) between itself and Mesabi Nugget. On February 20, 2008, the Commission issued an Order approving MP's second electric service agreement (Mesabi ESA) using in part the EMSS Schedule, Commission's February 20, 2008 Order Approving Electric Service Agreement as Conditioned and Clarified, Docket No. E015/M-07-1456.

⁵ Source: Page 6 of the instant filing.

This information, in addition to the State Master Agreement and information described above will be helpful to ensure that MP is not unduly discriminating against other customers. This information is particularly important in this proceeding since, contrary to the schedule MP provided for approval of the initial EMSS filing which allowed time for customers to express an interest in the Commission-approved EMSS before entering into an ESA negotiation, MP filed for Commission approval of the proposed ESA on February 20, 2014 to allow only Mesabi Nugget to use the total amount of excess capacity, a few days before filing for Commission approval of the proposed EMSS.

To assess whether or not the proposed EMSS would result in rates that are unreasonably prejudicial, the Department asked MP to provide its analysis showing that approval of the proposed EMSS will not negatively affect MP's other ratepayers until and after MP files its next rate case.

The Department notes that the distinction between the period until and after the filing of a rate case stems from the fact that between rate cases, capacity cost recovery is determined during a rate case proceeding and does not change between rate cases. However, energy costs are automatically recovered through the fuel clause adjustment. As a result, MP's other ratepayers may only be affected by changes in capacity costs after MP files its next rate case, while MP's other ratepayers may be affected by changes in energy costs between rate cases.

In response to the Department's discovery regarding the impact of the proposed EMSS on MP's other ratepayers until MP's next rate case, MP stated:⁶

The EMSS Schedule Energy Charge is based on actual Taconite Harbor energy production costs, including fuel and O&M expenses, when the Taconite Harbor units are the source for the energy. Taconite Harbor generation fuel costs associated with EMSS energy sales are (and would continue to be under the proposed EMSS Schedule) excluded from Minnesota Power's fuel clause adjustment. When fewer than two Taconite Harbor units are operating, the energy supply under the EMSS Schedule comes from a combination of MP's system (depending upon availability) and market purchases. Lower-cost energy from MP's system is first used to supply firm and interruptible load requirements, and the next-highest-cost energy is then used as the basis for MP's incremental costs under the EMSS Schedule. The blend of Taconite Harbor monthly average fuel cost and non-Taconite Harbor hourly incremental energy cost used for the EMSS Schedule is subtracted from the fuel clause cost of fuel as "fuel

⁶ Source: MP's response to the Department's Information Request No. 4, Attachment 3.

cost recovered through inter-system sales” in the calculation of the monthly fuel adjustment rate. Therefore, MP’s other ratepayers are protected from paying for this higher-cost energy.

The Department agrees with MP that “other ratepayers are protected from paying for this higher-cost energy.” Therefore, the Department concludes that the proposed EMSS would not result in rates that are unreasonably prejudicial, until MP’s filing of its next rate case.

In response to the Department’s discovery regarding the impact of the proposed EMSS on MP’s other ratepayers after MP files its next rate case, MP stated:⁷

The same ratepayer protections related to energy costs discussed in MP’s response to DOC IR 4 would continue to apply after MP files its next rate case. In addition, when MP files its next rate case, capacity revenue associated with Mesabi Nugget load will be applied to the recovery of MP’s fixed costs and thereby benefit other ratepayers. The EMSS Schedule, which was created to spur economic development in the region, has helped enable Mesabi Nugget to remain in business during its ongoing development phase. Given the continued experimental nature of Mesabi Nugget’s process, it has not been profitable and is struggling to become so. The recent boom in natural gas supplies, as well as a declining pig iron market, has exacerbated the project’s cost structure when compared to other iron sources. The use of the EMSS Schedule has allowed Mesabi Nugget to mitigate this cost disparity and to continue process and technology development. Denial of the proposed EMSS Schedule would force Mesabi Nugget onto a more costly electric rate option. These higher costs would negatively impact the project’s economic viability and long term prospects, and may jeopardize its continued operation. If the project is viewed as too costly to continue and terminated, the fixed costs recovered from this existing customer would burden other ratepayers.

The Department agrees with MP that “[t]he same ratepayer protections related to energy costs discussed in MP’s response to DOC IR 4 would continue to apply after MP files its next rate case.” However, MP’s claim that “capacity revenue associated with Mesabi Nugget load will be applied to the recovery of MP’s fixed costs and thereby benefit other ratepayers” is based on the assumption that Mesabi Nugget’s operations will cease prior to when MP retires Taconite

⁷ Source: MP’s response to the Department’s Information Request No. 5, Attachment 4.

Harbor. The Department requests that MP provide documentation of this assumption in its reply comments.

IV. DEPARTMENT RECOMMENDATION

The Department recommends that MP provide the following information in its reply comments:

- The entire original State Master Agreement and any modifications made to the State Master Agreement over time,
- Confirmation by the parties to the State Master Agreement that MP's proposal to eliminate the six-year maximum term to the availability section of the EMSS tariff is acceptable,
- The basis for MP's conclusion that Polymet is no longer eligible for service under the EMSS, and
- Documentation that Polymet continues to decline service under the EMSS, given MP's proposal to extend service until MP retires Taconite Harbor.

The Department intends to file further comments subsequent to reviewing MP's responses.

/ja

Attachment 1

**STATE
MASTER AGREEMENT**

This State Master Agreement (the "Agreement") is made and entered into between the STATE OF MINNESOTA (the "State"), MINNESOTA IRON RANGE RESOURCES AND REHABILITATION ("IRRR"), MINNESOTA DEPARTMENT OF NATURAL RESOURCES ("DNR"), MINNESOTA POLLUTION CONTROL AGENCY ("PCA") AND MINNESOTA DEPARTMENT OF REVENUE ("Revenue Department") (IRRR, DNR, PCA and Revenue Department, are collectively referred to herein as the "Departments"), CLIFFS ERIE, LLC ("CE"), CLEVELAND-CLIFFS INC ("CCI"), MINNESOTA POWER, an operating division of ALLETE, Inc. ("MP"), RAINY RIVER ENERGY CORPORATION - TACONITE HARBOR ("RRTH", which term shall include any RRTH Assignee¹), LTV STEEL MINING COMPANY ("LTVSMC") and LTV STEEL COMPANY, INC. ("LTV Steel").

Recitals

A. CE, RRTH, LTVSMC and other affiliated entities have entered into, contemporaneously with the execution and delivery of this Agreement, a certain Asset Purchase Agreement dated as of October 8, 2001 (the "Asset Purchase Agreement") to which this Agreement is attached as Exhibit 8.3(a) and pursuant to which LTVSMC and other affiliated entities, have agreed to sell, and CE and RRTH agree to acquire, respectively, the Cliffs Acquired Assets and the RRTH Acquired Assets. In conjunction with effecting the transactions contemplated by the Asset Purchase Agreement, CE and RRTH desire to obtain certain of the permits, licenses and leases identified in Schedule 5(b) (the "Permits"), currently held by LTVSMC with respect to the Acquired Assets and which Permits are less than all the permits currently held by LTVSMC. "Permits" means the permits, licenses and leases identified in Schedule 5(b), and any amendments, modifications, supplements, extensions, reissuances or replacements thereto and any necessary or new additional permits, easements, licenses and leases and any amendments, modifications, supplements, extensions, reissuances or replacements thereto.

B. As a material inducement for each of the parties to the Asset Purchase Agreement to enter into and perform their obligations under the Asset Purchase Agreement and this Agreement, the State and the Departments have agreed to enter into this Agreement in order to evidence the State's and the Departments' binding commitment to: (i) promptly transfer or cause the transfer of the Permits; (ii) support the transfer of permits not within its control; and (iii) support approvals necessary and related to the transactions contemplated by the Asset Purchase Agreement.

¹ Terms used herein and not otherwise defined shall have the meanings ascribed to them in the Asset Purchase Agreement.

(e) Provide the State and the Departments with a certificate of authority in the form attached as **Exhibit 7(e)** confirming RRTH's authority to enter into this Agreement and all of the other agreements to which RRTH is a party which are Exhibits to this Agreement or the Asset Purchase Agreement.

8. Subsequent to the closing of the transactions contemplated by the Asset Purchase Agreement, MP shall:

(a) Proceed with the construction of an electric service substation at Laskin Energy Park to further economic development objectives; and

(b) File by January 1, 2002 for Minnesota Public Utilities Commission approval of a rate schedule effectuating MP's commitment to provide up to 25 MW of the accredited capacity of the Generation Facilities, at such facilities' cost based rate (including future capital additions) pursuant to a power purchase agreement between MP and RRTH. Availability of the rate is subject to the continuing operation of the Generation Facilities in their present coal fired configuration. The rate under such schedule shall be in effect for a six-year period from the date of CE's eligibility for this rate. Any party's eligibility for this rate shall be conditioned upon such party operating an industrial facility on the premises of the current LTVSMC mining site prior to January 1, 2008.

9. At and concurrently upon Principal Closing under the Asset Purchase Agreement, MP shall provide the State and the Departments with a certificate of authority in the form attached as **Exhibit 9** confirming MP's authority to enter into this Agreement and all of the other agreements to which MP is a party which are Exhibits to this Agreement or the Asset Purchase Agreement.

10. CE and RRTH further collectively agree that, effective upon the Principal Closing under the Asset Purchase Agreement and, unless otherwise agreed to by the parties, for five (5) years from the date of this Agreement, no development will take place on lands within the following areas, except for mining and mining-related activities (including, without limitation, all CE actions pursuant to or in connection with performance of the Closure Plan Obligations, such as the planning, engineering and construction of a proposed watercourse from the Dunka Mine Pit to Birch Lake, and the creation or maintenance of wetlands), timber management, surveying, road development and any other activities approved in writing by the DNR:

West 1/2 of Section 25, East 1/2 of Section 26, East 1/2 of Section 35 and West 1/2 of Section 36, Township 61 N., Range 12 W.

At the conclusion of this five (5) year period, the DNR will meet with CE and RRTH to discuss the status of non-ferrous metallic mining projects in this area and ways to mitigate any development plans that would interfere with non-ferrous metallic minerals mining.

Attachment 2

State of Minnesota
DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

Utility Information Request

Docket Number: E015/M-14-166

Date of Request: February 28, 2014

Requested From: Minnesota Power

Response Due: March 12, 2014

Analyst Requesting Information: Samir Ouanes

Type of Inquiry: Financial Rate of Return Rate Design
 Engineering Forecasting Conservation
 Cost of Service CIP Other:

If you feel your responses are trade secret or privileged, please indicate this on your response.

Request No.	
1	<p>Reference: MP's February 24, 2014 petition for approval of the Erie Mine Site Service Schedule (proposed Schedule).</p> <ol style="list-style-type: none">1. Please state whether any service can be provided under the Commission-approved Erie Mine Site Service Schedule (Schedule) on or after January 1, 2014.2. If so, fully explain which service(s) can be provided under the Schedule and fully justify your answer.

Response:

1. No, service cannot be provided under the existing Commission-approved EMSS Schedule on or after January 1, 2014, unless the Schedule is modified. Under the existing Schedule, service was required to commence on or before January 1, 2008, and the maximum term was six years, which is through December 31, 2013.
2. N/A

Response by: Marcia Podratz

List sources of information: _____

Title: Director - Rates

Department: Rate Department

Telephone: 218-355-3570

Attachment 3

EMSS Schedule is subtracted from the fuel clause cost of fuel as “fuel cost recovered through inter-system sales” in the calculation of the monthly fuel adjustment rate. Therefore, MP’s other ratepayers are protected from paying for this higher-cost energy.

Response by: Marcia Podratz

List sources of information:

Title: Director - Rates

Department: Rate Department

Telephone: 218-355-3570

Attachment 4

State of Minnesota
DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

Utility Information Request

Docket Number: E015/M-14-166

Date of Request: February 28, 2014

Requested From: Minnesota Power

Response Due: March 12, 2014

Analyst Requesting Information: Samir Ouanes

Type of Inquiry: Financial Rate of Return Rate Design
 Engineering Forecasting Conservation
 Cost of Service CIP Other:

If you feel your responses are trade secret or privileged, please indicate this on your response.

Request No.	
5	<p>Reference: MP's February 24, 2014 petition (Petition) for approval of the Erie Mine Site Service Schedule (proposed Schedule)</p> <p>Please provide MP's complete analysis showing that approval of the proposed Schedule will not negatively affect MP's other ratepayers after MP files its next rate case.</p>

Response:

The same ratepayer protections related to energy costs discussed in MP's response to DOC IR 4 would continue to apply after MP files its next rate case. In addition, when MP files its next rate case, capacity revenue associated with Mesabi Nugget load will be applied to the recovery of MP's fixed costs and thereby benefit other ratepayers. The EMSS Schedule, which was created to spur economic development in the region, has helped enable Mesabi Nugget to remain in business during its ongoing development phase. Given the continued experimental nature of Mesabi Nugget's process, it has not been profitable and is struggling to become so. The recent boom in natural gas supplies, as well as a declining pig iron market, has exacerbated the project's cost structure when compared to other iron sources. The use of the EMSS Schedule has allowed Mesabi Nugget to mitigate this cost disparity and to continue process and technology development. Denial of the proposed EMSS Schedule would force Mesabi Nugget onto a more costly electric rate option. These higher costs would negatively impact the project's economic

Response by: Marcia Podratz

List sources of information:

Title: Director - Rates

Department: Rate Department

Telephone: 218-355-3570

viability and long term prospects, and may jeopardize its continued operation. If the project is viewed as too costly to continue and terminated, the fixed costs recovered from this existing customer would burden other ratepayers.

Response by: Marcia Podratz

Title: Director - Rates

Department: Rate Department

Telephone: 218-355-3570

List sources of information:

CERTIFICATE OF SERVICE

I, Sharon Ferguson, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, e-mail, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

**Minnesota Department of Commerce
Comments**

Docket No. E015/M-14-166

Dated this 31st day of **March 2014**

/s/Sharon Ferguson

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Julia	Anderson	Julia.Anderson@ag.state.mn.us	Office of the Attorney General-DOC	1800 BRM Tower 445 Minnesota St St. Paul, MN 551012134	Electronic Service	Yes	OFF_SL_14-166_M-14-166
Christopher	Anderson	canderson@allete.com	Minnesota Power	30 W Superior St Duluth, MN 558022191	Electronic Service	No	OFF_SL_14-166_M-14-166
Sharon	Ferguson	sharon.ferguson@state.mn.us	Department of Commerce	85 7th Place E Ste 500 Saint Paul, MN 551012198	Electronic Service	No	OFF_SL_14-166_M-14-166
Burl W.	Haar	burl.haar@state.mn.us	Public Utilities Commission	Suite 350 121 7th Place East St. Paul, MN 551012147	Electronic Service	Yes	OFF_SL_14-166_M-14-166
John	Lindell	agorud.ecf@ag.state.mn.us	Office of the Attorney General-RUD	1400 BRM Tower 445 Minnesota St St. Paul, MN 551012130	Electronic Service	Yes	OFF_SL_14-166_M-14-166
David	Moeller	dmoeller@allete.com	Minnesota Power	30 W Superior St Duluth, MN 558022093	Electronic Service	No	OFF_SL_14-166_M-14-166
Marcia	Podratz	mpodratz@mnpower.com	Minnesota Power	30 W Superior S Duluth, MN 55802	Electronic Service	No	OFF_SL_14-166_M-14-166