

December 14, 2015

Daniel P. Wolf  
Executive Secretary  
Minnesota Public Utilities Commission  
121 7th Place East, Suite 350  
St. Paul, Minnesota 55101-2147

RE: **Response Comments of the Minnesota Department of Commerce,  
Division of Energy Resources**  
Docket No. E015/AI-15-712

Dear Mr. Wolf:

Attached are the Response Comments of the Minnesota Department of Commerce, Division of Energy Resources (DOC or Department) to the November 11, 2015 Reply Comments of Minnesota Power (MP).

The Department appreciates MP providing additional information in its reply comments, which is discussed below. The Department again requests MP to provide all important information in its initial filing, rather than relying on the Department or any other agency to flesh out the foundation to support the proposal through information requests and examination of additional information provided in reply comments that should have been provided in the Company's initial filing. As noted on page 13 of our initial comments:

Finally, the Department recommends that MP include important information in initial filings to show how MP is treating affiliates and non-affiliates in the future if competitive bidding does not occur, to help support any decision not to use competitive bidding and to help show that the affiliate is not being subsidized. Such information would avoid either a recommendation that the Commission deny MP's petition or the need for several information requests from the Department or the need for several rounds of comments. As noted above, the burden of proof to show that the proposal is reasonable is on the utility, not the Department or Commission.

Based on the additional information provided by MP via information requests and in reply comments, the Department now largely recommends **approval with modifications** of the proposed affiliated interest agreement between ALLETE, Inc./MP and ALLETE Clean Energy (ACE) for the New Lease Agreement. However, as discussed below, the Department has two remaining areas of concerns regarding inconsistent application between affiliates and non-affiliates on notice of termination of lease agreements and MP's "Corporate Equity" allocator.

First, in response to the Department's question regarding penalties in our initial comments, MP indicated in its reply comments that ACE (MP's affiliate) was not charged a penalty or fee as a result of early termination of their prior lease with ALLETE, Inc./MP, since ACE provided the required 6 months' notice of termination of the prior lease. MP noted that their other tenant, Minnesota Power Employees Credit Union (MPECU), (not an MP affiliate) requires a 12 months' notice of termination for their lease. MP indicated that the size of the MPECU office lease, the non-affiliated tenant, is significantly more space (7,002 square feet in three locations) than the ACE office lease.

The Department notes that ACE's previous office space was 1,780 square feet;<sup>1</sup> however, the current office lease space is 5,540 square feet<sup>2</sup> and has the same 6 month's prior written notice.<sup>3</sup> As a result of the information that MP provided in its reply comments, the Department agrees that MPECU's lease space of 7,002 square feet is significantly more space than ACE's prior lease of 1,780 square feet. However, the MPECU's lease space of 7,002 square feet is not significantly more space than ACE's new lease with office space of 5,540 square feet, which still has the same 6 months' notice rather than the 12 months' notice required for MPECU.

Thus, the Department recommends that the Commission require MP to use consistent terms for its affiliated and non-affiliated leases when circumstances are similar. As a result, MP should require either a 6-month or 12-month termination notice for all tenants, including revising either the MPECU or ACE's lease agreements to make them consistent.

Second, in response to the Department's question regarding consistent application of annual increases in rent, MP noted in its reply comments that acting through its contracted property management company, MP will calculate the Consumer Price Index (CPI-U) for the year ending December 2015. MP will then increase rent for the upcoming year on July 1 2016 by notifying tenants in May of 2016 of the increase; MP stated that this process will be repeated each year. MP also stated that their application of this lease increase is consistent with the way other non-affiliate entities are treated. The Department considers MP's response regarding application of annual increase in rent expense to be reasonable, with the understanding that affiliated and non-affiliated tenants will be treated equitably.

Third, the Department asked MP to reconcile the apparent inconsistency in MP's responses to the Department's Information Request Nos. 6 and 9, which appear to indicate that there both are and are not shared employees in MP/ALLETE, Inc. and ACE. MP stated the following in their reply comments:

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<sup>1</sup> See MP's initial filing dated August 26, 2011, attached Lease Agreement, in Docket No. E015/AI-11-868.

<sup>2</sup> See MP's initial filing dated July 30, 2015, attached Lease Agreement Section 1 paragraph 1, in Docket No. E015/AI-15-712.

<sup>3</sup> See MP's initial filing dated July 30, 2015, attached Lease Agreement Section 1 paragraph 2, in Docket No. E015/AI-15-712.

There is an inconsistency in the answer, which can be rectified as follows: the response to IR 9 governs and is accurate – there are no “shared employees” per se such that list could be created of individuals who work for both entities. As IR 9 indicated, an individual is either an ACE employee or an ALLETE/MP employee. In either case, the employee charges their time in providing any work product to the other via direct charging – and the vast majority of the time the charges run from ALLETE/MP to ACE. The response to IR 6 inartfully used the “shared service” language to identify those employees of ALLETE/MP who may work on an ACE project or matter (for example, someone in Legal, Tax, Human Resources or Accounting). The direct charging of time (as well as the general allocation of time that cannot be direct charged) ensures that ACE pays its share of employees’ time, and has the added benefit of reducing overall costs for Minnesota Power ratepayers.

The Department appreciates MP’s clarification regarding shared employees. However, from an accounting perspective, the Department concludes that employees (usually in Legal, Tax, Human Resources, Accounting, etc. as noted by MP) who perform work for ALLETE/MP and other subsidiaries such as ACE are shared employees. While the Department appreciates that legally these employees work for only one employer as noted by MP, the salaries and benefits are shared through direct assignment and allocations across all entities for which they perform work.

The Department was attempting to identify and quantify the level of shared employees and ensure direct assignments of costs and allocation of indirect costs are occurring especially between MP and ACE. Based on our limited review of MP’s compliances in Docket Nos. E015/M-01-1416 and E015/AI-11-868 and information requests in this proceeding, the Department identified only one concern at this time regarding MP’s “Corporate Equity” Allocator, as discussed below. However, future dockets and rate cases should review and consider MP’s assignments and allocations, if additional information supports a change in direct assignment, cost-causative allocation or use of general allocator for non-cost-causative type costs and revenues. Minnesota Statute section 216B.48, subd. 6 states:

**Commission retains continuing authority over contract.**

The commission shall have continuing supervisory control over the terms and conditions of the contracts and arrangements as are herein described so far as necessary to protect and promote the public interest. The commission shall have the same jurisdiction over the modifications or amendment of contracts or arrangements as are herein described as it has over such original contracts or arrangements. The fact that the commission shall have approved entry into such contracts or arrangements as described herein shall not preclude

disallowance or disapproval of payments made pursuant thereto, if upon actual experience under such contract or arrangement it appears that the payments provided for or made were or are unreasonable.

Thus, there is a continuing requirement to ensure that ratepayers are not subsidizing other entities, especially non-regulated and affiliated interest entities.

Fourth, the Department asked MP to explain how MP's "Corporate Equity" allocator is a cost causative allocator, why it is superior to the Commission's "Expenses less purchase goods sold" allocator consistent with the Commission's March 7, 1995 and September 28, 1994 Orders in Docket No. G,E999/CI-90-1008 (1008 Docket), and how the "Corporate Equity" allocator does not harm ratepayers. MP in its reply comments referred to MP's October 15, 2002 compliance filing in Docket No. E015/M-01-1416, where MP addressed the use of MP's "Corporate Equity" allocator in lieu of the "Expenses less purchase goods sold" Commission allocator. MP indicated that it addressed the Department's concern at that time by providing evidence of the "Corporate Equity" allocator would have a very limited scope and MP would further limit by use of direct charging and alternative allocators. MP also cited OES (now Department) IR 134 as follows:

Corporate Equity is calculated utilizing the amount of equity investment in various entities - ALLETE/MP, MP Lines of Business and ALLETE Subsidiaries. It is not the intent to claim equity as a causative factor of increased activity, however, it is an available "number" that often can be equated with the value of an entity and as such it is often interpreted that the activity support of an entity increases with its' value. Minimal use of the method is desired. The intent is to utilize this solely for those costs that are associated with investors or shareholders where the concept of "value" = "equity" may be valued.

Regarding the issue of harm to ratepayers, MP indicated that information request no. 15 in this proceeding (which is attached to MP's reply comments) requested that MP recalculate regulated and non-regulated percentages using the "Expense less purchase goods sold" allocator - and the results of that methodology are consistent with the "Corporate Equity" allocator currently in use. MP noted that the "Corporate Equity" allocator, which is used for allocating costs for the Board of Directors and Investor Relations, more directly aligns such expenses with the actual value of each entity.

Based on our review of the "Corporate Equity" allocator, the Department concludes the following:

- The Department had prior concerns with MP's "Corporate Equity" allocator in the E015/M-01-1416 and that is why this allocator was to be used in a very limited basis.

- As noted in the Department's initial comments at page 11, the Commission's 1008 docket discussed the importance of direct assigning costs first, then second using an indirect assignment/allocation by costs causation, and finally a general allocator for costs that cannot be direct assigned or indirectly allocated, therefore MP's "Corporate Equity" allocator is a general allocator.
- The Department has used the standard that if a Company chooses to use a general allocator different than the Commission's 1008 docket general allocator of "Expenses less purchased goods sold" the Company must show it to be a superior allocator and show that ratepayers are not harmed. The Department notes that both Xcel Energy and CenterPoint Energy have a different general allocator than the Commission's general allocator, but have shown their allocator to be superior and to allocate fewer costs to ratepayers in their rate cases. MP has not shown its "Corporate Equity" allocator to be superior; further, MP's allocator for Investor Relations and Board of Directors assigns 2.2% more costs to regulated, specifically 73.4% to regulated (0.0% to non-regulated plus various % to other ALLETE subsidiaries including 0.2% to ACE) compared to the Commission's allocator, which assigns 71.2% to regulated (6.2% to non-regulated plus various % to other ALLETE subsidiaries including 2.4% to ACE).
- The Department notes that in the past two Xcel Energy rate cases (Docket Nos. E002/GR-13-868 and E002/GR-12-961) the Commission approved recovery of only 50% of Investor relations costs to ratepayers and 50% to shareholders. Additionally, in CenterPoint Energy's last rate case G008/GR-13-316 the Commission approved 50% of Investor relations costs to ratepayers and 50% to shareholders. This issue is also being addressed in the current CenterPoint Energy rate case in Docket No. G008/GR-15-424. The Department considers Board of Directors costs to be similar to Investor Relations costs.

Based on our review of the Company's "Corporate Equity" allocator, the Department continues to recommend that MP address in its next rate case:

- Background on Investor Relations and Board of Directors costs, including categories of types of costs, basis for the categories of costs, amounts of costs by category, how costs are allocated between shareholders and ratepayers, and why the allocation is reasonable.
- For any costs (besides Investor Relations and Board of Directors) that MP continues to allocate using its "Corporate Equity" allocator, MP should provide support that these costs cannot be direct assigned and cannot be allocated using an indirect cost causative allocator. Additionally, MP should explain and support why the Commission's general allocator of "Expenses less purchased goods sold" is not being used, including why the Company's "Corporate Equity" allocator is a superior allocator and does not harm ratepayers.

In summary, the Department recommends that MP's New Lease Agreement between ALLETE Inc./MP and ACE be approved, with the requirement that MP use consistent terms for its affiliated and non-affiliated leases when similarly situated. As a result, MP should either require a 6 month or 12 month termination notice requirement for all tenants, including revising either the MPECU or ACE's lease agreement to make them consistent. The Department also recommends that the Commission require MP to provide the following in MP's next rate case:

- Background on Investor Relations and Board of Directors costs, including categories of types of costs, basis for the categories of costs, amounts of costs by category, how costs are allocated between shareholders and ratepayers, and why the allocation is reasonable.
- For any costs (besides Investor Relations and Board of Directors) that MP continues to allocate using its "Corporate Equity" allocator, MP should provide support that these costs cannot be direct assigned and cannot be allocated using an indirect cost causative allocator. Additionally, MP should explain and support why the Commission's general allocator of "Expenses less purchased goods sold" is not be used, including why the Company's "Corporate Equity" allocator is a superior allocator and does not harm ratepayers.

Sincerely,

/s/ NANCY A. CAMPBELL  
Financial Analyst

NAC/ja

## **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  
Response to Reply Comments**

**Docket No. E015/AI-15-712**

**Dated this 14<sup>th</sup> day of December 2015**

**/s/Sharon Ferguson**

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Christopher	Anderson	canderson@allete.com	Minnesota Power	30 W Superior St  Duluth, MN 558022191	Electronic Service	No	OFF_SL_15-712_AI-15-712
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_15-712_AI-15-712
Emma	Fazio	emma.fazio@stoel.com	Stoel Rives LLP	33 South Sixth Street Suite 4200 Minneapolis, MN 55402	Electronic Service	No	OFF_SL_15-712_AI-15-712
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_15-712_AI-15-712
Margaret	Hodnik	mhodnik@mnpower.com	Minnesota Power	30 West Superior Street  Duluth, MN 55802	Electronic Service	No	OFF_SL_15-712_AI-15-712
Lori	Hoyum	lhoyum@mnpower.com	Minnesota Power	30 West Superior Street  Duluth, MN 55802	Electronic Service	No	OFF_SL_15-712_AI-15-712
Michael	Krikava	mkrikava@briggs.com	Briggs And Morgan, P.A.	2200 IDS Center 80 S 8th St Minneapolis, MN 55402	Electronic Service	No	OFF_SL_15-712_AI-15-712
Douglas	Larson	dlarson@dakotaelectric.com	Dakota Electric Association	4300 220th St W  Farmington, MN 55024	Electronic Service	No	OFF_SL_15-712_AI-15-712
James D.	Larson	james.larson@avantenergy.com	Avant Energy Services	220 S 6th St Ste 1300  Minneapolis, MN 55402	Electronic Service	No	OFF_SL_15-712_AI-15-712
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_15-712_AI-15-712
Susan	Ludwig	sludwig@mnpower.com	Minnesota Power	30 West Superior Street  Duluth, MN 55802	Electronic Service	No	OFF_SL_15-712_AI-15-712



First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Pam	Marshall	pam@energycents.org	Energy CENTS Coalition	823 7th St E  St. Paul, MN 55106	Electronic Service	No	OFF_SL_15-712_AI-15-712
Herbert	Minke	hminke@allete.com	Minnesota Power	30 W Superior St  Duluth, MN 55802	Electronic Service	No	OFF_SL_15-712_AI-15-712
David	Moeller	dmoeller@allete.com	Minnesota Power	30 W Superior St  Duluth, MN 558022093	Electronic Service	Yes	OFF_SL_15-712_AI-15-712
Andrew	Moratzka	apmoratzka@stoel.com	Stoel Rives LLP	33 South Sixth Street Suite 4200 Minneapolis, MN 55402	Electronic Service	No	OFF_SL_15-712_AI-15-712
Jennifer	Peterson	jjpeterson@mnpower.com	Minnesota Power	30 West Superior Street  Duluth, MN 55802	Electronic Service	No	OFF_SL_15-712_AI-15-712
Susan	Romans	sromans@allete.com	Minnesota Power	30 West Superior Street Legal Dept Duulth, MN 55802	Electronic Service	No	OFF_SL_15-712_AI-15-712
Thomas	Scharff	thomas.scharff@newpagecorp.com	New Page Corporation	P.O. Box 8050 610 High Street Wisconsin Rapids, WI 544958050	Electronic Service	No	OFF_SL_15-712_AI-15-712
Ron	Spangler, Jr.	rlspangler@otpc.com	Otter Tail Power Company	215 So. Cascade St. PO Box 496 Fergus Falls, MN 565380496	Electronic Service	No	OFF_SL_15-712_AI-15-712
Eric	Swanson	eswanson@winthrop.com	Winthrop Weinstine	225 S 6th St Ste 3500 Capella Tower Minneapolis, MN 554024629	Electronic Service	No	OFF_SL_15-712_AI-15-712
Karen	Turnboom	karen.turnboom@newpagecorp.com	NewPage Corporation	100 Central Avenue  Duluth, MN 55807	Electronic Service	No	OFF_SL_15-712_AI-15-712

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Daniel P	Wolf	dan.wolf@state.mn.us	Public Utilities Commission	121 7th Place East Suite 350 St. Paul, MN 551012147	Electronic Service	Yes	OFF_SL_15-712_AI-15-712