

Minnesota Public Utilities Commission
Staff Briefing Papers

Meeting Date: August 21, 2014**Agenda Item # 6

Company: Minnesota Power

Docket Nos. **E-015/M-14-155**
In the Matter of a Petition for Approval of an Electric Service Agreement
Between Mesabi Nugget and Minnesota Power

E-015/M-14-166
In the Matter of Minnesota Power’s Erie Mine Site Service Schedule

- Issue(s):
1. Should the Commission approve the Electric service Agreement Between Mesabi Nugget and Minnesota Power?
 2. Should the Commission approve the modifications to its Erie Mine Site Service (EMSS) Schedule after December 31, 2013?
 3. Should the Commission grant Minnesota Power’s request for a variance to Minn. Rule 7825.3200?

Staff: Marc Fournier651-201-2214

Relevant Documents

Docket E015/M-14-155 Documents:

Minnesota Power Initial Filing
Petition for Approval of Electric Service Agreement..... February 20, 2014

Comments of the Minnesota Department of Commerce March 31, 2014

Docket E015/M-14-166 Documents:

Minnesota Power Initial Filing-Petition for Approval
of Modification to Erie Mine Site Service Schedule February 24, 2014

Comments of the Department of Commerce,
Division of Energy Resources March 31, 2014

Common Documents:

Reply Comments Mesabi Nugget April 15, 2014

Minnesota Power Reply Comments..... April 28, 2014

Iron Range Resources & Rehabilitation Board
(IRRRB) Reply Comments June 2, 2014

Minnesota Department of Commerce Reply Comments
Include Attachment 1 (6/19/2014) June 18, 2014

Reply Comments Mesabi Nugget July 7, 2014

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.

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I. Statement of the Issues

Should the Commission approve the Electric service Agreement between Mesabi Nugget and Minnesota Power?

Should the Commission approve the modifications to its Erie Mine Site Service (EMSS) Schedule after December 31, 2013?

Should the Commission grant Minnesota Power's request for a variance to Minn. Rule 7825.3200?

II. Background

On February 20, 2014, Minnesota Power (MP or the Company) filed a Petition with the Minnesota Public Utilities Commission (Commission) for Approval of an Amended and Restated Electric Service Agreement between Mesabi Nugget and Minnesota Power (Amended ESA). The Amended ESA provides for Mesabi Nugget to modify its commitment to provide electric service.

On February 24, 2014, the Company filed a Petition with the Commission for Approval of Modifications to Erie Mine Site Service Schedule (proposed EMSS). MP stated that Mesabi Nugget was the only customer eligible to take service under the EMSS. The current filing allows Mesabi Nugget to continue to take service under the EMSS Schedule after December 31, 2013.

On March 31, 2014, the Division of Energy Resources of the Minnesota Department of Commerce (DOC) filed comments in Docket Nos. E015/M-14-155 and E015/M-14-166.

On April 15, 2014, Mesabi Nugget filed reply comments addressing both Dockets.

On April 28, 2014, Minnesota Power filed reply comments addressing both dockets.

On June 2, 2014, the Iron Range Resources & Rehabilitation Board (IRRRB) filed reply comments addressing both Dockets.

On June 18, 2014, the Division of Energy Resources of the Minnesota Department of Commerce (DOC) filed reply comments addressing both Dockets.

On July 7, 2014, Mesabi Nugget filed further reply comments addressing both Dockets.

On July 9, 2014, Minnesota Power filed further reply comments addressing both dockets.

III. Party Positions

MP: In Docket 14-155, Minnesota Power requests that the Agreement be effective January 1, 2014 and requests a variance from the 90-day notification requirement under Minn. Rules 7825.3200. Minnesota Power will continue to bill Mesabi Nugget in accordance with the current electric service agreement, recognizing that any rate change is not effective until Commission approval. If the Commission grants the variance, Minnesota Power will rebill Mesabi Nugget retroactive to January 1, 2014 and implement the remainder of the Agreement beginning on the first day of the calendar month following receipt of a written Commission Order approving the Agreement.

In Docket 14-166, Minnesota Power proposes to eliminate the maximum contractual term of six years in order to allow the one existing customer, Mesabi Nugget, to continue taking service on the EMSS Schedule under the currently applicable conditions. The original intent of the EMSS Schedule was to facilitate and encourage economic development at the Erie Mine Site and in the Hoyt Lakes area. Minnesota Power believes that continuing to offer this rate will benefit Mesabi Nugget by providing a more competitive electric price while it is in a continuing development mode, as well as Minnesota Power and its other customers by providing continued revenue and fixed cost contributions.

The petition to modify the EMSS tariff was filed on February 24, 2014. Minnesota Power requests that the modifications to the EMSS Schedule be effective January 1, 2014 and requests a variance from the 90-day notification requirement under Minn. Rules 7825.3200. Recognizing that any rate change is not effective until Commission approval, Minnesota Power has been billing and will continue to bill Mesabi Nugget under the Large Power (“LP”) Service Schedule, the alternative standard applicable rate schedule, for all of its electric service effective January 1, 2014. If the Commission grants the variance, Minnesota Power will rebill Mesabi Nugget under the EMSS Schedule retroactive to January 1, 2014.

At a minimum Minnesota Power appreciates the June 18, 2014 DOC recommendation supporting approval of the new ESA and the proposed EMSS as written at least until there are “material changes to the Taconite Harbor generation facilities.” This will allow Mesabi Nugget to garner the certainty of the new ESA as of January 1, 2014, as well as additional service under the EMSS for the near term. Minnesota Power does accept Mesabi Nugget’s statement that the certainty and stability of the new long-term contract structure will be impacted through a conditional approval of the ESA and the EMSS tariff, arguably providing a material modification of the terms and conditions of the ESA as negotiated, and for that reason Minnesota Power does support approval of the ESA and the EMSS tariff as submitted to the Commission.

Minnesota Power does not believe that closure of Taconite Harbor Unit 3 will result in a significant change in EMSS rates to make them unreasonably preferential or discriminatory to customers located outside of the EMSS area, such that changes are required to either the ESA or the EMSS tariff as filed. Both Minnesota Power and Nugget recognized the need for evaluation

and consideration of changes in either customer operation or tariff features over time and built flexibility into the ESA to allow for adjustments during the contract term while still retaining the overall ESA structure. Specifically, Paragraph 3(B) of the new ESA requires Minnesota Power to conduct an annual rate analysis and to recommend the most appropriate Commission approved rate to Mesabi Nugget. This feature, common to customers in other rate classes, will provide Mesabi Nugget rate optionality if closure of Taconite Harbor Unit 3 or some other material change to the Taconite Harbor Generating Station results in the EMSS becoming an uneconomic rate. In addition, Paragraph 4(D) provides Minnesota Power the ability to offer rate incentives or other modifications to encourage efficiency improvements outside of the EMSS tariff, subject to Commission approval. Should Minnesota Power and Mesabi Nugget agree upon such changes, and should the Commission approve those changes, Minnesota Power would offer those new products or features to all other similarly situated customers to avoid preferential or discriminatory treatment. The Company has no objections to the Commission assessing whether Minnesota Power's rates are unreasonably preferential or discriminatory to customers located outside of the applicable area as stated in its June 18, 2014 reply comments, but proposes that such assessment be contained within a compliance filing request at the time of a material change to the Taconite Harbor Generating Station as opposed to a partial or conditional approval of the ESA or the EMSS tariff as filed.

Minnesota Power does agree with the DOC that trapped capacity from Taconite Harbor generation initially drove the development of the rate components contained in the EMSS. That notwithstanding, Minnesota Power agrees with the Mesabi Nugget reply comments in that the main reason for the EMSS itself was for regional economic development. It is certain that the EMSS would not have occurred but for the devastation to the Eastern Mesabi Iron Range resulting from the closure of LTV, driving the State of Minnesota to encourage stakeholders to look at all available means to get economic development at this site. The EMSS was then conceived as an economic development tool to encourage new industry to develop in this region, re-using existing infrastructure and facilities, including but not limited to the Taconite Harbor Energy Center, to provide the regional economic benefits. Mesabi Nugget is a critical economic engine for the Eastern Iron Range, providing both direct and indirect economic impact to the region, and any future analysis of impact on Mesabi Nugget and other customers should include other factors such as the negative impact to the region resulting from Mesabi Nugget not operating may have on other Minnesota Power customers. Mesabi Nugget has satisfied the requirements of the EMSS, and they are currently striving to meet the economic development goals established after the LTV closure as they continue to invest and to optimize in their new iron nugget manufacturing technology. Minnesota Power believes that Commission approval of the new ESA and revised EMSS tariff will allow Mesabi Nugget to continue to meet the economic development challenges and to provide value to the region.

DOC: The DOC notes that the proposed EMSS is applicable to any new industrial, mining or manufacturing customers located at the former Erie Mine Site or, subject to the prior written approval of the Company, at any location in or around Hoyt Lakes, Minnesota where service can be taken from MP's 138 kV transmission line. As discussed in MP's response to discovery from the DOC, the rationale for this restricted application of the proposed EMSS is that the available

transmission from the Taconite Harbor units would not be enough to support all of the units installed generating capacity. The corresponding excess capacity of 25 MW would be available for local load only. Therefore, the DOC concludes that the proposed EMSS and the Amended ESA would not result in rates that are unreasonably preferential, or discriminatory to customers located outside of the applicable area until the elimination of the current Taconite Harbor excess capacity of 25 MW that is available for local load only, including but not limited to MPs' proposed closure of Taconite Harbor Unit 3 by the end of 2015. The DOC believes that it is clear from the record that it is reasonable to continue to offer the EMSS rate under the current configuration of the Taconite Harbor generation facilities.

Based on the development of facts in this proceeding, the DOC concludes that provision of service to Mesabi Nugget under the proposed EMSS and/or the Amended ESA is reasonable until there are material changes to the Taconite Harbor generation facilities (such as Taconite Harbor 3 being retired). However, as approved by the Commission in Minnesota Power's 2013 resource plan, Taconite Harbor unit 3 is to be removed from MP's system by the end of 2015, which would eliminate the excess capacity that would be available for local load only. Thus, at that time, it will be necessary to assess whether MP's rates are unreasonably preferential or discriminatory to customers located outside of the applicable area.

The DOC recommends approval of the proposed EMSS and the Amended ESA until the earlier of the following two events: 1) the end date of the proposed ESA and 2) any circumstance that would eliminate the current Taconite Harbor excess capacity of 25 MW that is available for local load only, including but not limited to MPs' proposed closure of Taconite Harbor Unit 3 by the end of 2015.¹

IRRB: The State Master Agreement required the Erie Mine Site Service Schedule (EMSS) Tariff "be in effect for a six year period." The six year period is not listed as a maximum in the State Master Agreement. The Petition by Minnesota Power for Approval of Modifications to EMSS will extend that period beyond 6 years. The original intent of the EMSS provision of the State Master Agreement was to encourage and support development at the former LTV Steel Mining Company (LTVSMC) site.

The signatory agencies support the Petition by Minnesota Power for Approval of Modifications to EMSS and an effective date of January 1, 2014, since both are consistent with the original intent of the EMSS provision of the State Master Agreement. Under item I. of the March 31, 2014, Comments of the Minnesota Department of Commerce, Division of Energy Resources, it states", Under MP's proposal, service under the EMSS would be extended only to Mesabi Nugget, and only until Taconite Harbor is expired," Our support is also based on this understanding.

¹ Paragraph 3(B) of the new ESA requires Minnesota Power to conduct an annual rate analysis and to recommend the most appropriate Commission approved rate to Mesabi Nugget. This feature, common to customers in other rate classes, will provide Mesabi Nugget rate optionality if closure of Taconite Harbor Unit 3 or some other material change to the Taconite Harbor Generating Station results in the EMSS becoming an uneconomic rate.

Mesabi: Section 216B.03 states: Every rate made, demanded, or received by any public utility...shall be just and reasonable. Rates shall not be unreasonably preferential, unreasonably prejudicial, or discriminatory, but shall be sufficient, equitable, and consistent in application to a class of consumers.” In its 2003 comments on the EMSS, the DOC applied this statute and concluded that rates were not unreasonably preferential or discriminatory to customers located outside of the EMSS service area because of a claimed 25 MW of trapped capacity. The DOC’s June Comment makes the jump that the elimination of the alleged 25 MW of trapped capacity results in unreasonably preferential or discriminatory rates to customers located outside of the EMSS Tariff service area.

The DOC introduces uncertainty to the Amended ESA by concluding it will be necessary to assess whether Minnesota Power’s rates are unreasonably preferential or discriminatory upon the closure of Taconite Harbor Unit 3. Mesabi believes this unprecedented review structure unfairly elevates a benefit of initially approving the EMSS Tariff to a requirement for approval of the revised EMSS Tariff. The DOC’s proposal should be rejected for four reasons.

The fundamental purpose of the EMSS Tariff was (and remains) to stimulate economic development on the former LTV Steel Mining Company mining site, not to find a taker for claimed stranded capacity. The EMSS Tariff was originally designed to incent and enable economic development.² That same level of stranded capacity could be taken by one or more customers was simply an added benefit. The EMSS Tariff and Amended ESA, which continue the focus on economic development, reflect this interpretation. As the DOC concedes, Minnesota Power’s and Mesabi’s interpretation was recently supported by the State parties to the State Master Agreement. On June 2, 2014, the Minnesota Department of Revenue, Minnesota Pollution Control Agency, Minnesota Department of Natural Resources, and IRRRB filed with the Commission a letter stating that the amended EMSS Tariff and Amended ESA “are consistent with the original intent of the EMSS provision of the State Master Agreement.” Therefore, the DOC’s attempt to add a requirement that the EMSS should only be available under certain operational characteristics of Minnesota Power’s system should be rejected.

Second, the notion of 25 MW of trapped capacity is a regulatory fiction created by the State Master Agreement. 25 MW was chosen because it reflected the gap between the accredited capacity for Taconite Harbor, which consists of three units, each with 75 MW of accredited capacity, and the amount of available transmission from Taconite Harbor. Minnesota Power’s recent resource plan demonstrates that not all units operate at 75 MW all of the time.

² As reflected in the Commission’s August 20, 2003 Order approving the original EMSS tariff, Minnesota Power (at state agencies’ request) agreed to dedicate electric service 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 in order to facilitate future development in the Hoyt Lakes area. The dedication of this 25MW did not affect MP’s marketing plans for Taconite Harbor, because there was a gap forecasted between the accredited capacity of the Taconite Harbor generating station and the amount of available transmission from the units.

Third, the EMSS Tariff contemplates that not all Taconite Harbor units will run all of the time. The EMSS Tariff rate consists of a generation capacity charge, energy charge, transmission service charge, and billing customer charge. The energy charge varies depending on the number of Taconite Harbor units in operation.

Finally, termination of the EMSS Tariff is tied to retirement or refueling of Taconite Harbor in its entirety, not the retirement of one unit. Mesabi acknowledges that Minnesota Power's recent resource plan proposed to retire Taconite Harbor Unit 3 at the end of 2015 and that the Commission accepted that proposal. But retirement of one unit does not result in retirement of Taconite Harbor for purposes of termination of the EMSS Tariff.

Given the stated intent of State agencies (as well as the inherent difficulties referenced above associated with measuring stranded capacity at any given point in time), the EMSS Tariff is an economic development tariff for a very specific region and should be reviewed as such. The issue for the Commission in assessing the amended EMSS Tariff should be whether it provides a platform for economic development in and around Hoyt Lakes. Minnesota Power aptly states "The purpose of extending the EMSS Schedule is to help keep the electric costs affordable as necessary for the long term viability of the Mesabi Nugget facility, which in turn benefits the regional economy and Minnesota Power's other customers." The MN Letter provides additional background and support for Minnesota Power's statement, setting forth the overall planning process, investment levels, tax payments, and operating challenges of MN's operations. The MN Letter ultimately concludes "The Commission's support in this matter is one of the key components toward ensuring that Mesabi Nugget reaches a sustainable economic state." Based on these statements, which were not disputed or refuted by the DOC, Mesabi believes the EMSS Tariff is both in the public interest and consistent with the State agencies' intent, and should be approved.

Conditioning approval of the Amended ESA on a revaluation of circumstances after the retirement of Taconite Harbor Unit 3 would be a material modification and would force Mesabi to evaluate whether to exercise its right to demand renegotiation with Minnesota Power. If such right were exercised, it is possible that the parties would be unable to reach a satisfactory resolution, which could lead to diminished economic development on the Iron Range and a reduction in commitments from Mesabi to Minnesota Power's costs. And any such renegotiation would tax the resources of Minnesota Power, Mesabi, and the DOC, all of whom have expended a significant amount of time negotiating and reviewing the terms contained in the Amended ESA.

IV. Staff Analysis

Staff would like to point out that the EMSS tariff itself is self-adjusting in that the rate is readjusted on an annual basis. The Erie Mine Site Service (EMSS) tariff states Part A Generation Capacity Charge:

The Generation Capacity Charge shall be \$12.14 per kW per month for calendar year 2014. The Generation Capacity Charge for each subsequent year shall be recalculated annually by December 31 using budget data for the subsequent year. The Generation Capacity Charge shall be the sum of Company's budgeted: i) net book value of the Taconite Harbor facilities multiplied by Company's allowed retail pre-tax cost of long term debt, ii) Taconite Harbor depreciation and amortization expense, iii) Taconite Harbor property tax expense, and iv) Taconite Harbor fixed operating and maintenance expense. The capital investment and incremental operating and maintenance costs that are recovered through Company's Rider for Arrowhead Regional Emission Abatement (AREA) shall be excluded from the preceding calculations. The above total shall be increased by the MISO Planning Reserve Margin percentage as incorporated in the Company's most recent Commission approved Resource Plan to account for reserve capacity supply, divided by the Taconite Harbor installed capacity in kW, and averaged over 12 months to result in a monthly Generation Capacity Charge to be applied to each kW of Customer's Billing Demand.

The point is that the tariff is already constructed to adapt to significant changes to the Taconite Harbor facility. Imposing additional conditions will further no cause. There is enough flexibility in the tariff structure where adjustments during the contract period while maintaining the integrity of the ESA. The ESA includes a requirement that Minnesota Power conduct annual rate analysis and to recommend the most appropriate Commission approved rate to Mesabi Nugget. This will allow Mesabi Nugget, as with other customers, to have the option of other rates in the event the closure of Taconite Harbor 3 or some other material event to the entire generating facility results in the EMSS becoming an uneconomic rate. Currently upon Commission approval, Minnesota Power has the ability to offer rate incentives or other modifications to encourage efficiency improvements outside of the EMSS tariff .

With respect to the trapped capacity issue raised by the DOC, the 25 MW reflects the gap between the accredited capacity between Taconite Harbor and the available transmission from the plant. As pointed out by Mesabi, MP's recent resource plan not all units operate at their accredited 75 MW of capacity all of the time. The five year average for all three Taconite Harbor units during the summers of 2006-2010 was 214 MW.

The EMSS tariff anticipates this result. The energy charge varies depending on the number of units in operation. When at least two of the three Taconite Harbor units are available, the energy charge is equal to the average monthly Taconite Harbor energy; when fewer than two units are available, the energy charge is equal to 50% of the average monthly Taconite Harbor energy cost plus 50% of MP's hourly incremental energy cost. This mechanism assures that the rates cover costs and protects against rates that are discriminatory which is the DOC's concern.

Also, Staff would like to reiterate the point made by Mesabi. This is that the termination of the tariff is not tied to the retirement of one of the Taconite Harbor units, but will terminate when the entire facility is retired or refueled. Neither of which is about to occur, or is on the horizon, as defined by the term of the ESA. This is clear from the EMSS tariff language:

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.

As such, the EMSS tariff remains functional with only two of three Taconite Harbor units in Operation.

With respect to the requested variance on effective date (Minn. Rule. 7825.3200), MP and Nugget desire that the modifications be effective January 1, 2014. As such, a variance to Minn. Rule 7825.3200 is required under Commission precedent. Minn. Rule requires that utilities serve notice to the Commission at least 90 days prior to the proposed effective date of modified rates. Under this rule, the Commission shall grant the variance to its rules when it determines that the following requirements are met:

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

Staff agrees with MP and is not aware of any reason why granting the variance in this instance would adversely affect the public interest. Granting of the variance would also not conflict with standards imposed by law or rules governing the Commission's actions.

V. Commission Options

A. Should the Commission approve the Electric service Agreement Between Mesabi Nugget and Minnesota Power?

1. Approve Minnesota Power's Petition for approval of an amended and restated Electric Service Agreement.
2. Approve Minnesota Power's Petition for approval of an amended and restated Electric Service agreement until the earlier of the following two events:
 - a. the end date of the proposed ESA, or

- b. any circumstances that would eliminate the current Taconite Harbor excess capacity of 25 MW that is available for local load only, including but not limited to MP's proposed closure of Taconite Harbor Unit 3 by the end of 2015.
 3. Do not approve Minnesota Power's Petition for approval of an amended and restated Electric Service agreement.
- B. Should the Commission approve the modifications to its Erie Mine Site Service (EMSS) Schedule after December 31, 2013?
1. Approve Minnesota Power's petition for approval of modifications to its Erie Mine Site Service (EMSS) Schedule.
 2. Approve Minnesota Power's petition for approval of modifications to its Erie Mine Site Service (EMSS) Schedule until the earlier of the following two events:
 - a. the end date of the proposed ESA, or
 - b. any circumstances that would eliminate the current Taconite Harbor excess capacity of 25 MW that is available for local load only, including but not limited to MP's proposed closure of Taconite Harbor Unit 3 by the end of 2015.
 3. Do not Approve Minnesota Power's petition for approval of modifications to its Erie Mine Site Service (EMSS) Schedule.
- C. Should the Commission grant Minnesota Power's request for a variance to Minn. Rule 7825.3200?
1. Grant the variance for the EMSS Schedule and the Mesabi Nugget ESA effective dates which will allow Minnesota Power to rebill Mesabi Nugget retroactive to January 1, 2014, under the amended EMSS Schedule.
 2. Do not grant the variance.

VI. Staff Recommendation

Staff recommends items A1, B1, and C1.