

BEFORE THE MINNESOTA OFFICE OF ADMINISTRATIVE HEARINGS
600 North Robert Street
St. Paul, Minnesota 55101

FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION
121 Seventh Place East, Suite 350
St. Paul, Minnesota 55101-2147

In the Matter of the Application of
DAKOTA ELECTRIC ASSOCIATION,
for Authority to Increase Rates
for Electric Service in Minnesota

MPUC Docket No. E-111/GR-14-482
OAH Docket No. 80-2500-31796

SETTLEMENT AGREEMENT

BETWEEN

DAKOTA ELECTRIC ASSOCIATION

AND

MINNESOTA DEPARTMENT OF COMMERCE -
DIVISION OF ENERGY RESOURCES

I. INTRODUCTION

Dakota Electric Association (Dakota Electric, DEA or the Cooperative) is a cooperative association organized under Minn. Stat. § 308.05 for the purpose of supplying electric service to approximately 103,000 customers in Dakota County and portions of Scott, Rice and Goodhue Counties in Minnesota. The Cooperative's principal office is in Farmington, Minnesota. DEA purchases its electric requirements from Great River Energy of Maple Grove, Minnesota.



On July 2, 2014, the Cooperative filed a petition for a general increase in electric rates. The Cooperative requested a rate increase of about \$4,189,000, or about 2.1% over existing rates. For the test year, the Cooperative proposed to use actual historical operations for 2013, adjusted for known and measurable changes.

On August 29, 2014, the Commission issued three Orders in this matter. The first Order accepted the filing and suspended the proposed rates. The second Order set interim rates and required certain notices. The third Order referred the case to the Office of Administrative Hearings for contested case proceedings. In its third Order, the Commission directed parties to address the following issues in the course of the contested case proceedings ordered therein:

1. Is the test year revenue increase sought by the Association reasonable or will it result in unreasonable and excessive earnings by the Association?
2. Is the rate design proposed by the Association reasonable?
3. Is the Association's proposed capital structure, cost of capital, and return on equity reasonable?

The Commission's third Order also asks the parties to address and provide schedules and supporting documentation in the development of the record in this matter, that show the matching of power cost revenue to power cost expense in the pro forma test year financial schedules.

The Office of Administrative Hearings assigned the case to Judge LauraSue Schlatter. A prehearing conference was held before Judge Schlatter on September 9, 2014, in the Large Hearing Room of the Minnesota Public Utilities Commission, 121 Seventh Place East, Suite 350,

St. Paul, Minnesota. Judge Schlatter issued an Amended Prehearing Order on September 16, 2014 providing procedural direction for this case. In addition to the Cooperative, parties to this proceeding include the Minnesota Department of Commerce – Division of Energy Resources (Department or DOC) and the Minnesota Office of the Attorney General – Antitrust and Utilities Division (OAG).

Judge Schlatter presided at two public hearings to receive comments and questions from non-intervening ratepayers. The first hearing was held in Apple Valley, Minnesota, on the afternoon of December 2, 2014. The other public hearing was held in Farmington, Minnesota, on the evening of December 2, 2014. Five members of the public appeared at the afternoon public hearing and no members of the public appeared at the evening public hearing. Four members of the public spoke at the afternoon public hearing. Three expressed concerns about overall increases in costs, including electric rates. One person indicated that they receive very good service from Dakota Electric and people should expect prices to increase. Representatives of the Commission staff, Office of the Attorney General, Department of Commerce, and the Cooperative attended both hearings.

II. APPLICABLE STATUTES; JURISDICTION.

The Commission has general jurisdiction over DEA under Minn. Stat. §§ 216B.01 and 216B.026. These statutes provide for Commission regulation of cooperative electric associations if the members elect to become subject to rate regulation by the Commission. In 1980, a majority of DEA members made such an election and the Cooperative has been regulated by the Commission since 1981.

The matter was properly referred to the Office of Administrative Hearings under Minn. Stat. §§ 14.57 - 14.62 (1990) and Minn. Rules, parts 1400.0200 et seq.

III. SUMMARY OF ISSUES

The positions of parties to this proceeding were included in a number of prefiled documents. Dakota Electric's initial petition; including testimony, exhibits, and workpapers; was filed on July 2, 2014. The Department of Commerce and Office of the Attorney General submitted prefiled direct testimony on October 30, 2014. All parties submitted prefiled rebuttal testimony on November 20, 2014, and prefiled surrebuttal testimony on December 8, 2014. During this process, the DOC and OAG also submitted numerous information requests to Dakota Electric. Through this process, Dakota Electric and the Department of Commerce have narrowed the contested issues between them. This agreement resolves any remaining contested issues between the Cooperative and Department. Following is an identification of issues addressed by these two parties, along with a description of the agreement on these issues reached between these two parties.

1. Financial Issues

Dakota Electric Association proposed Total Test Year Operating Expenses (excluding interest) of about \$192,961,000, reflecting a Total Revenue Requirement (including margin) of about \$203,753,000. (Larson prefiled Direct Testimony at Page 6.) Dakota Electric proposed a revenue increase of about \$4,189,000 or 2.1% based on a comparison of proposed Test Year Total Revenue Requirements and Total Revenue. (Larson prefiled Direct Testimony at Page 6.)

Department witness Mr. Johnson performed the Department's financial review and sponsored specific financial adjustments including other non-operating income, accumulated depreciation expense, capitalized payroll expense, cash working capital, and rate base and overall rate of return.

a) Other Non-Operating Income

Dakota Electric reduced its required net operating income and resulting test year revenue deficiency by including about \$399,000 of non-operating income. (Larson prefiled Direct Testimony at Page 6.) This non-operating income consists of 1) interest on non-operating margins, 2) subsidiary net income, and 3) other revenue from non-operating margins. (Johnson prefiled Direct Testimony at Page 6.)

In prefiled Direct Testimony, Mr. Johnson noted that, normally, rate-regulated utilities calculate net operating income and the resulting test year revenue deficiency on a stand-alone basis, which does not include non-utility businesses. (Johnson prefiled Direct Testimony at Page 7.) Accordingly, Mr. Johnson recommended that Dakota Electric's non-operating income of \$399,147 be reduced by \$272,889 to \$116,258. (Johnson prefiled Direct Testimony at Page 9 and prefiled Surrebuttal Testimony at Page 10.)

Dakota Electric concurred with the Department's non-operating income recommendation in rebuttal testimony. (Larson prefiled Rebuttal Testimony at Page 5.)

b) Accumulated Depreciation Expense

Dakota Electric proposed an adjustment to normalize its December 2013 depreciation expense for the test year. DEA's proposed adjustment increased test year

depreciation expense by \$78,749. (Larson prefiled Direct Testimony at Exhibit DEA-1 at Page 2.)

The Department accepted this adjustment and recommended a corresponding increase in test year accumulated depreciation of \$78,749 to reflect the increase in depreciation expense. (Johnson prefiled Direct Testimony at Page 9.)

Dakota Electric concurred with the Department's accumulated depreciation recommendation in rebuttal testimony. (Larson prefiled Rebuttal Testimony at Page 5.)

c) Capitalized Payroll Expense

DEA proposed an adjustment to normalize the percentage of payroll that is expensed (as opposed to capitalized) in the test year. (Larson prefiled Direct Testimony Exhibit DEA-1 at Page 2.)

Mr. Johnson did not oppose the adjustment to normalize payroll expense. However, Mr. Johnson recommended that DEA record an offsetting entry to rate base for the portion of test-year payroll that was normalized and expensed on the income statement. He recommended that DEA's test year rate base be reduced by \$228,590. (Johnson prefiled Direct Testimony at Page 10.)

Dakota Electric concurred with the Department's recommended adjustment to rate base to reflect the normalization of payroll in rebuttal testimony. (Larson prefiled Rebuttal Testimony at Page 5.)

d) Cash Working Capital

Dakota Electric incurs costs before consumers pay bills. Cash working capital is the amount of money that DEA needs to have on hand to pay for the costs it incurs to

serve its members. The Cooperative applied lead/lag study factors to its test year cash operating expenses to determine its cash working capital requirement of \$6,987,282, which was added to its test year rate base. (Larson prefiled Direct Testimony Exhibit DEA-2 at Page 2.)

Mr. Johnson noted that DEA's calculation of cash working capital included test year interest expense, which is included in overall rate of return calculations and not in cash working capital. (Johnson prefiled Direct Testimony at Page 11.) Mr. Johnson recommended that the test year cash working capital be reduced by \$125,290 for the lead/lag study due to various DOC adjustments including the removal of interest expense. (Johnson prefiled Direct Testimony at Page 11 and Attachment (MAJ-4))

Dakota Electric concurred with the Department's recommended adjustment to cash working capital in rebuttal testimony. (Larson prefiled Rebuttal Testimony at Page 5.)

e) Rate Base and Overall Rate of Return

In prefiled Direct Testimony, Dakota Electric proposed a Test Year rate base level of \$171,613,635. (Larson prefiled Direct Testimony Exhibit DEA-2 at Page 2.)

As a result of various Department adjustments, the DOC recommended a rate base of \$171,181,006 (equal to DEA's \$171,613,635 minus \$432,629 of DOC rate base adjustments). (Johnson prefiled Direct Testimony at Page 12 and prefiled Surrebuttal Testimony at Page 11.) The resulting overall rate of return, based on calculations and recommendations contained in the prefiled Direct Testimony of Dr. Amit, is 6.53 percent. (Johnson prefiled Direct Testimony at Page 12 and Johnson prefiled Surrebuttal Testimony at Page 11 and MAJ-S-6.)

Dakota Electric concurred with the Department's recommended adjustment to rate base and overall rate of return in rebuttal testimony. (Larson prefiled Rebuttal Testimony at Page 5.)

f) Summary of Financial Issues

After reflecting all adjustments summarized in the prefiled testimony of Mr. Johnson, the Department recommended a revenue deficiency for the Cooperative of \$4,454,787. (Johnson prefiled Surrebuttal Testimony at Page 12.) The Department also stated that Minnesota Statute §216B.16, subd. 5 does not allow the revenue requirement to exceed the level of rate increase requested by the public utility. "Thus, since the total revenue requirement that the Department recommended for DEA exceeds the Cooperative's requested increase in rates, the Department concluded that DEA supported its proposed overall rate increase." (Johnson prefiled Direct Testimony at erratum, Page 1, Surrebuttal Testimony at Pages 12-13.)

Dakota Electric concurred with the Department's recommended revenue requirement in rebuttal testimony. (Larson prefiled Rebuttal Testimony at Page 5.) The Cooperative acknowledges through this Settlement Agreement that the annual revenue increase in this proceeding is limited to the amount requested in its initial filing.

2. Rate of Return

DEA proposed a total Test Year rate base of \$171,613,635 (Larson prefiled Direct Testimony Exhibit DEA-2 at Page 2.). DEA proposed an overall rate of return of 6.52 percent (Larson prefiled Direct Testimony Exhibit DEA-2 at Page 8.) Dakota Electric's calculation of

overall rate of return is based on the testimony and recommendation of Department witness Dr. Amit in the Cooperative's 2009 general rate case, which was approved by the Commission.

Department witness Dr. Amit determined a fair rate of return on common equity capital and a fair overall rate of return for Dakota Electric on behalf of the Department. Dr. Amit determined that, since the overall rate of return is applied to the rate base to produce the appropriate level of net income, the overall rate of return must be adjusted to allow DEA to earn the same amount on its rate base as it would on its total capitalization. (Amit prefiled Direct Testimony at Page 19.) Dr. Amit's analysis resulted in a recommended overall rate of return of 6.51 percent, which is based on a rate of return on equity for DEA of 4.35 percent, a cost of debt of 5.31 percent, and an overall return on total capital of 4.75 percent. (Amit prefiled Direct Testimony at Page 19.)

Dr. Amit noted that his recommended return on equity, cost of debt, and the resulting overall rate of return (ROR) are based on DEA's initially filed test year rate base of \$171,613,635. Dr. Amit testified that, if the Commission approves a rate base different from \$171,613,635, then the return should be adjusted as reflected in Dr. Amit's Direct Testimony, where he stated that:

...every member of DEA must invest in DEA in order to receive any electric service. In contrast, any investors in an IOU make their decisions based on the merit of this investment relative to many other investment opportunities.

As a result, the required rate of return on DEA's equity is not determined by the opportunity cost of investing capital somewhere else; rather, it is determined by the need to finance the growth of DEA's rate base and maintain a sound capital structure. (Amit prefiled Direct Testimony at Page 6.) The calculation of the adjustment to DEA's ROR due to changes in rate base is as follows:

Overall return on rate (ROR) base = 4.75 x Total Capitalization/Approved Rate Base.

(Amit prefiled Direct Testimony at Page 19.)

As included in the direct and surrebuttal testimony of Department witness Mr. Johnson and agreed to in DEA's Rebuttal Testimony, DEA's Test Year rate base in this proceeding is \$171,181,006. Because the agreed-upon rate base was different from the amount used in Dr. Amit's prefiled Direct Testimony, Mr. Johnson in Surrebuttal Testimony performed the calculations as required, resulting in the following:

Cost of Debt 5.31 %

Return on Equity 4.35%

Overall Rate of Return 6.53%

(Johnson prefiled Surrebuttal Testimony, DOC Attachment MAJ-S-6.)

Dakota Electric concurred with the Department's recommended adjustment to rate base and overall rate of return of 6.53 % in rebuttal testimony. (Larson prefiled Rebuttal Testimony at Page 5.)

3. Energy Sales

Dakota Electric's filing included a weather-normalized energy sales forecast. (Larson prefiled Direct Testimony at Workpaper 13.)

Mr. Zajicek analyzed Dakota Electric's calculations of test year energy sales volumes and customer counts on behalf of the Department. Mr. Zajicek recommended that the Commission approve Dakota Electric's energy sales volumes and budgeted customer counts in this proceeding. (Zajicek prefiled Direct Testimony at Page 8.)

Dakota Electric concurred with the Department's recommendation regarding energy sales volumes and customer counts. (Larson prefiled Rebuttal Testimony at Page 5.)

4. Class Cost of Service Study

Dakota Electric's filing included a cost of service study that uses the same model approved by the Commission in the Cooperative's 2009 general rate case (Docket No. E-111/GR-09-175), with two modifications. (Larson prefiled Direct Testimony at Page 20 and Exhibit DEA-3.) The first modification is use of the minimum-size method to determine the relative amount of specified distribution accounts to classify as "consumer" costs. (Larson prefiled Direct Testimony at Page 21 and Workpaper 21.) The second modification was the inclusion of a new wholesale power energy charge. (Larson prefiled Direct Testimony at Page 21.)

Mr. Ruzycki evaluated Dakota Electric's class cost of service study (CCOSS) on behalf of the Department. Mr. Ruzycki concluded that Dakota Electric's proposed CCOSS is reasonable. DEA used the same methodology that was approved by the Commission in its last rate case with the exception of the two changes noted. The classification and allocation of the functionalized accounts are generally consistent with the 1992 Electric Utility Cost Allocation Manual by the National Association of Regulatory Utility Commissioners (NARUC), and Dakota Electric has made relevant updates to its input data. (Ruzycki prefiled Direct Testimony at Page 14.) Based on these conclusions, Mr. Ruzycki recommended that the Commission adopt Dakota Electric's proposed class cost of service study. (Ruzycki prefiled Direct Testimony at Page 15, prefiled Rebuttal Testimony at Page 7, and prefiled Surrebuttal Testimony at Page 8.)

Dakota Electric concurred with the Department's recommendation to adopt the CCOSS. (Larson prefiled Rebuttal Testimony at Page 6 and prefiled Surrebuttal Testimony at Page 20.)

5. Revenue Apportionment and Rate Design

Dakota Electric proposed many rate design changes as described in the prefiled Direct Testimony of Mr. Larson at Pages 38 through 58.

Department witness Ms. Peirce reviewed the revenue apportionment and rate design recommendations proposed by Dakota Electric.

a) Apportionment of Revenue Responsibility to Customer Classes

Regarding apportionment of revenue responsibility to customer classes, in prefiled Direct Testimony Ms. Peirce recommended more modest increases in annual revenue from Small General Service (Schedule 41) by increasing the revenue responsibility from General Service (Schedule 46) slightly more than proposed by Dakota Electric. Specifically, in prefiled Direct Testimony, the DOC recommended a 3 percent annual increase in revenue for Small General Service compared to the 5.15 percent increase proposed by Dakota Electric. To offset the revenue responsibility from this more modest increase to Small General Service, the DOC recommended a slightly larger revenue increase of 0.34 percent to General Service compared to the 0.04 percent revenue increase proposed by Dakota Electric. (Peirce prefiled Direct Testimony at Page 7.)

In prefiled Rebuttal Testimony, Dakota Electric presented cost and revenue comparison information for the Small General Service rate schedule and indicated that the Cooperative would welcome further testimony from the DOC to explore a compromise position between our revenue apportionment positions. (Larson prefiled Rebuttal Testimony at Page 8.)

In prefiled Surrebuttal Testimony, the Department recommended a 3.5 percent annual increase in revenue for Small General Service compared to the 5.15 percent

increase proposed in Dakota Electric's initial filing. To offset the revenue responsibility from this modest increase to Small General Service, the DOC recommended a revenue responsibility increase of 0.27 percent to General Service compared to the 0.04 percent increase in revenue responsibility proposed in Dakota Electric's initial filing. (Peirce prefiled Surrebuttal Testimony at Page 3.)

Through this Settlement Agreement, Dakota Electric agrees to the apportionment of revenue responsibility to customer classes offered as a compromise by the Department as contained in the prefiled Surrebuttal Testimony of Department witness Ms. Peirce.

b) Rate Design

Rate design issues evaluated by the DOC included customer charges, residential time-of-day (TOD) tariffs, geothermal heat pump, line extension charges, and service and reconnection charges. Regarding these matters, the DOC summarized its recommendations on Page 23 of Ms. Peirce's prefiled Direct Testimony as follows:

- Approve the following monthly customer charges:
 - Residential - \$9.00
 - Residential (Demand Control) - \$12.00
 - Residential (TOD) - \$12.00
 - Residential (New TOD) - \$12.00
 - Small General Service - \$14.00
 - Irrigation - \$30.00
 - General Service - \$34.00
 - General Service (TOD) - \$36.00
 - Commercial & Industrial Interruptible - \$110.00
- Approve DEA's proposed Schedule 55 Residential Time-of-Day Tariff, and rate changes to its Schedule 53 Residential Time-of-Day Tariff.
- Approve DEA's request to close its Geothermal Heat Pump Service to new customers.
- Approve the proposed Line Extension Charges.
- Approve the proposed Service and Reconnection Charges.

In prefiled Rebuttal and Surrebuttal Testimony, Dakota Electric continued to support a \$2.00 per month increase in residential monthly fixed charges. Dakota Electric

supported all other Department rate design recommendations. (Larson prefiled Rebuttal Testimony at Page 36 and prefiled Surrebuttal Testimony at Page 21.)

Through this Settlement Agreement, in the spirit of compromise, Dakota Electric agrees to the Department's proposed residential monthly fixed charge amounts. This agreement resolves the only rate design matter in dispute between the two parties.

6. Matching Power Cost Revenue and Expense

The Commission's August 29, 2014 Notice and Order for Hearing includes the following language on Page 2:

The Commission also asks the parties to address and provide schedules and supporting documentation in the development of the record in this matter, that show the matching of power cost revenue to power cost expense in the pro forma test year financial schedules.

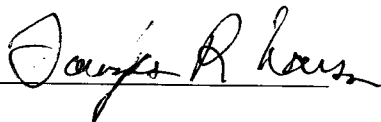
Based on the continuing discussion of this matter through information requests and a meeting with all parties and Commission Staff, Dakota Electric prepared an updated response to Department information request 505 which was included in the evidentiary record as "DEA Surrebuttal Exhibit 3." (Larson prefiled Surrebuttal Testimony at Page 19.) This updated response resolved a few matters. First, Dakota Electric proposed to revise the Power Cost Adjustment (PCA) base that is applied to firm service rate schedules as shown in this exhibit. The net change in the PCA base is an increase from \$0.0899 per kWh to \$0.0903 per kWh. (Larson prefiled Surrebuttal Testimony at Page 19.) Second, the calculation of tariffed revenue under present and proposed rates, and resulting identification of tariffed revenue associated with wholesale power service from GRE and distribution service, includes a component that recognizes about \$285,000 in the current cost of power for various carry-over/true-up amounts in the Cooperative's present Resource and Tax Adjustment (RTA). These amounts will be trued-up as *Dakota Electric's RTA transitions from present rates to proposed rates*. Together, these

updates result in the calculated tariff revenue associated with wholesale power nearly equaling the wholesale power costs included in the test year. (Larson prefiled Surrebuttal Testimony at Page 19.)

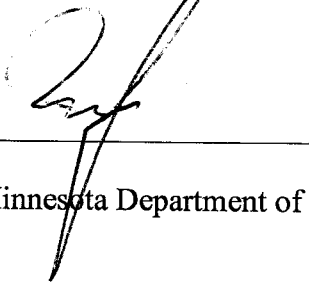
Through this Settlement Agreement, the Department concurs that Dakota Electric has demonstrated the matching of wholesale power cost revenue and expense as presented in the prefiled Surrebuttal Testimony of Mr. Larson.

IV. STATEMENT OF AGREEMENT

Based on the extensive prefiled Testimony submitted in this general rate proceeding, Dakota Electric Association and the Minnesota Department of Commerce believe they have addressed all issues outlined in the Commission's August 29, 2014, Notice and Order for Hearing in this matter. Based on this Testimony and the review of issues above, the Cooperative and Department recommend that the Commission approve the general rate case submitted by Dakota Electric Association in this docket as described in this Settlement Agreement.



Dakota Electric Association



Minnesota Department of Commerce