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Minnesota Department of Commerce

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July 31, 2013

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/D-13-252

Dear Dr. Haar:

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

In the Matter of Minnesota Power's 2013 Average Service Life Petition.

The petition was filed on April 1, 2013 by:

Debbra A. Davey
Supervisor, Accounting
Minnesota Power
30 West Superior Street
Duluth, MN 55802

The Department recommends **approval** and is available to answer any questions the Minnesota Public Utilities Commission may have.

Sincerely,

/s/ CRAIG ADDONIZIO
Financial Analyst

CA/ja
Attachment

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

COMMENTS OF THE
MINNESOTA DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

DOCKET NO. E015/D-13-252

I. INTRODUCTION

On April 1, 2013, Minnesota Power (MP or the Company) submitted its 2013 Average Service Life Depreciation Petition (Petition) to the Minnesota Public Utilities Commission (Commission). The Company has reviewed the current depreciation parameters and rates for its transmission and distribution plant accounts, for which the Company uses an average service life (ASL) depreciation procedure. In its Petition, MP proposes changes to the ASLs and salvage rates of a number of accounts. When applied to plant balances on December 31, 2012, the proposed parameters result in an increase in depreciation expense of $342,000 per year, or 1.26 percent, relative to the currently approved parameters.

II. DEPARTMENT ANALYSIS

The Department examined MP's Petition for compliance with filing requirements and previous Commission Orders, and for the reasonableness of the proposed depreciation parameters.

A. DEPRECIATION RULES AND PREVIOUS COMMISSION ORDERS

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

MP filed its last ASL petition on April 9, 2008 in Docket No. E015/D-08-422 (2008 ASL Docket), and in that Docket the Commission ordered the Company to file its next ASL petition no later than April 1, 2013. MP met this requirement by filing its Petition on April 1, 2013. As required, the Company uses a straight-line depreciation method, and the depreciation rates approved in Docket No. E015/D-08-422 have remained in effect in each year since the Commission approved them.

The Commission's Order in the 2008 ASL Docket also required the Company to include an update on its Financial Accounting Standard 143 (FAS 143) accounting and reporting in its next ASL depreciation petition. FAS 143 addresses financial accounting for obligations associated with the retirement of tangible long-lived assets and the associated retirement costs. MP met this requirement with a discussion of its asset retirement obligations on pages 3-4 of its Petition.

The Department concludes that the Company has complied with all applicable filing requirements and previous Commission Orders.

B. REASONABLENESS OF PROPOSED DEPRECIATION PARAMETERS

As noted above, the Company has proposed changes to the ASLs and salvage rates of a number of plant accounts. MP has proposed an effective date of January 1, 2013 for these changes. The Department concludes that the proposed effective date is reasonable. The Department discusses the reasonableness of the proposed service lives and salvage rates below.

1. Average Service Lives

As in past filings, the Company used Simulated Plant Record (SPR) analysis to estimate average service lives for most of the electric utility property accounts included in the Petition. SPR analysis is a method of estimating the ASL of a type of property and the dispersion, or variance, around that ASL, used when data on plant additions and retirements by year is available, but data on the age of property at retirement is not. SPR analysis uses actual plant additions and an assumed average service life and dispersion (represented by an Iowa Curve) to simulate annual plant balances for each property account. Those *simulated* plant balances are then compared to *actual* plant balances. A number of average service lives and dispersion patterns are tested for each account, and the retirement characteristics that produce simulated annual property balances that most closely match actual property balances are selected as an account's depreciation parameters and used to calculate the account's depreciation expense.

The Department concludes that the Company has supported all of its proposed ASL adjustments, and that all proposed ASL's are reasonable. The Department discusses two notable accounts below.

a. Account 3580, Transmission Underground Conductor

On page 27 of Appendix II to its Petition, the Company stated that Account 3580 was not included in the Company's last depreciation study, and in its response to Department Information Request No. 7, the Company stated that it had no property in Account 3580 prior to 2009.[1] However, in the same response, MP stated that in 2000 it input a depreciation rate into its system reflective of a 50-year-ASL, which was the then-current salvage rate for Account 356, Transmission Overhead Conductor.

On page 27 of Appendix II to its Petition, the Company stated that, because there have been no retirements in this account, the Company is able to use neither SPR nor actuarial analysis to examine the account's ASL. MP explained that it relied on judgment to determine an appropriate ASL for the account. In its response to Department Information Request No. 7, the Company further stated:

> For account 3580, there is no Company history to analyze for this account. To determine a life parameter for this account, Mr. Watson relied on his professional judgment, 28 years of experience in performing depreciation studies, and knowledge of general trends across the utility industry. Mr. Watson's judgment is this account would follow trends similar to other utilities.

The Company offers no other support for its proposal to retain the current 50-year ASL, nor does it provide any qualitative or quantitative descriptions of general trends across the utility industry related to this type of property.

Nonetheless, as shown in Table 1 below, the Department confirms that MP's proposed ASL falls within the range of ASL's used by Minnesota's other investor-owned utilities (IOUs).

Table 1
Summary of Investor-Owned Utilities'
ASLs for Account 358

	ASL		Source Docket
Interstate Power & Light Company	50		E,G001/D-12-680
Northern States Power Company	55	1/	E,G002/D-12-858
Otter Tail Power Company	35		E017/D-12-933

1/ Northern States Power Company's current ASL for Account 358 is 40 years. In the Docket referenced above, the Company has requested, and the Department has recommended approval of, a 55-year ASL, although the Docket is still pending before the Commission.

[1] MP's response to Department Information request No. 7 is included with these Comments as Attachment 1.

Because MP's proposed ASL for Account 3580 is comparable to the ASLs of the other IOUs in Minnesota, the Department concludes that it is reasonable.

b. Account 370, Distribution Meters

In the 2008 ASL Docket, MP stated that its SPR analysis of Account 370 indicated a 24 year ASL. However, the Company proposed an ASL of 20 years for the account, based on the expected life of its electronic meters. The Department disagreed with MP's proposed life largely due to the fact that only 20 percent of its meters at that time were electronic, and the Department concluded that it would have been unreasonable to allow the ASL for the entire account to be determined by such a small portion of the property in the account. The Department proposed, and the Commission ultimately approved, an ASL of 24 years as indicated by the SPR analysis which reflected all property included in the account.[2]

In its Petition in the instant Docket, the Company stated that its SPR analysis of Account 370 indicates an ASL of 22 years, but MP proposed to retain a 24-year ASL for the account in compliance with the Commission's Order in the 2008 ASL Docket. The Department notes that the Commission's Order in the 2008 ASL Docket did not bar MP from proposing an adjustment to this account's ASL in future filings if facts would justify such a change. Had the Company proposed a 22-year ASL for the account, the Department would not have disagreed. However, given the imprecise nature of SPR analysis and the small impact the two-year difference in ASL would have on the account's annual depreciation expense, the Department concludes that the proposed 24-year ASL is reasonable.

2. Salvage Rates

The Company studied its salvage experience for each account over the last 25 years by analyzing trends in average salvage rates over time. The Company studied moving one- to ten-year average salvage rates over the 25 year period. One-year salvage rates can fluctuate significantly, and the Company's analysis tended to rely more on the five and ten-year rolling average salvage rates, which smooth out some of the annual variance. Generally, the Company was conservative in proposing changes to salvage rates; if an account's recent salvage experience differed significantly from the currently approved salvage rate, the Company proposed to adjust the salvage rate in the direction of trend, but not close the entire gap. The Department supports this approach as even the ten-year moving averages can be imprecise.

The Department concludes that the Company has supported all of its proposed salvage rate changes, and that the proposed salvage rates are reasonable. The Department discusses four notable changes below.

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[2] June 11, 2008 Comments of the Office of Energy Security of the Minnesota Department of Commerce in Docket No. E015/D-08-422.

a. Account 3550, Transmission Poles and Fixtures; and Account 3560, Transmission Overhead Conductor

In the 2008 ASL Docket, the Company combined the salvage data for Account 3550 with the salvage data for Account 3560 and analyzed the two accounts as a single group. Pursuant to that analysis, the Company proposed a negative 23 percent salvage rate for both accounts. In its Petition in the instant Docket, the Company analyzed the two accounts separately, and proposed salvage rates of negative 35 percent and negative 30 percent for Account 3550 and Account 3560, respectively.

In response to Department Information request No. 15, the Company explained that in the 2008 ASL Docket, the salvage analysis for Account 3560 produced results that were contrary to the expectations of the Company and its depreciation consultant.[3] Because no explanation could be found for the unexpected results, the Company combined Accounts 3550 and 3560, which, the Company stated, generally show similar salvage values.

In the course of preparing its Petition in the instant Docket, the Company determined that the unexpected results in the 2008 ASL Docket were attributable to a single anomalous incident in 2004 in which a large amount of wire was left over from a single work order. The excess wire was sold, and the gross salvage amount from the work order, $436,723, was large enough to significantly distort the results of the Account's salvage analysis. In this Petition, that salvage amount has been removed from Account 3560's salvage analysis, and the results of the analysis are in line with the Company's expectations. As a result, in this Petition, the Company has once again proposed separate salvage rates for the two accounts. The Department concludes that the Company's treatment of the two accounts and the proposed salvage rates is reasonable.

b. Account 3580, Transmission Underground Conductor

As noted above, the Company had no property in Account 3580 prior to 2009; thus this account was not included in any prior ASL depreciation studies. On page 50 of Appendix II to its Petition, the Company stated that in 2000, it input a salvage rate of negative 20 percent into its accounting system, which was the then-current salvage rate for Account 356, Transmission Overhead Conductor. That salvage rate has not yet been updated, and has been applied to the property in this account since 2009. The Company stated that underground conductor is typically abandoned in place, and therefore proposed a salvage rate of zero. The Department also notes that the utilities listed in Table 1 above have salvage rates ranging from zero to negative ten percent for Account 3580, which can be found in the Dockets listed in the table. The Department concludes that the salvage rate of zero is reasonable.

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[3] MP's response to Department Information Request No. 15 is included with these Comments as Attachment 2.

c. Account 3680, Line Transformers

In MP's 2008 ASL Docket, the Company proposed to reduce the salvage rate for Account 3680 from 5 percent to negative 20 percent, largely based on the account's then-current five-year average net salvage rate of negative 23 percent. The Department disagreed, noting that the ten-year average net salvage rate was only negative 13 percent, and that the lower five-year salvage rate was driven by only a few years of data and was not a reliable trend. The Commission ultimately approved a net salvage rate of negative 13 percent for the account.

The Department notes that five- and ten-year average net salvage rates for this account have fallen to negative four and negative eight percent, respectively. On page 54 of Appendix II to its Petition, the Company stated that "the net salvage in this account has declined from the ordered net salvage percentage." The Company, however, proposed to retain the currently-approved net salvage rate of negative 13 percent to comply with the Order in the 2008 ASL Docket. The Department notes, again, that the Commission's Order in the 2008 ASL Docket did not bar the Company from proposing a new net salvage rate in the instant Docket. Had the Company proposed to lower the salvage rate for this account slightly, the Department would not have disagreed. However, given the variation in actual salvage experience in this account, the Department concludes that a negative 13 percent net salvage rate is reasonable at this time. Nonetheless, MP should revise the salvage rates in its next filing if the trend continues in this direction.

d. Account 3722, Distribution Installation on Customer Premises

The Company proposed to decrease the salvage rate for Account 3722 from negative 35 percent to negative 60 percent. The account's moving ten-year average salvage rates in 2010, 2011, and 2012 were negative 55 percent, negative 65 percent, and negative 60 percent, respectively, so the Company's proposed adjustment closes the entire gap between the currently effective salvage rate and the salvage rate indicated by recent experience.[4] Generally, the Department prefers more incremental, conservative changes to salvage rates, but in this instance agrees with the Company that the large change is justified. Over the last 15 years, the salvage rate for this account has shown a clear and consistent downward trend, and has not experienced the up-and-down fluctuations observed in other accounts. The Department concludes that the proposed negative 60 percent salvage rate is reasonable.

C. FAS 143, ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS

An asset retirement obligation (ARO) is a legal obligation associated with the retirement of a tangible long-lived asset. The legal obligation may result from an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel. The Financial Accounting Standard Board's Accounting

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[4] See Appendix D to Appendix II of the Company's Petition.

Standard Codification (ASC) 410-20 (formerly FAS 143) establishes the accounting standards for the recognition and measurement of a liability for an ARO.

On page three of its Petition, MP stated that there have been no changes in its accounting for AROs since the 2008 ASL Docket. MP also stated that its entire transmission and distribution network must be viewed as a single asset, which the Company intends to operate indefinitely. According to MP, because no retirement or settlement date can be determined for its transmission and distribution network, the recognition of any obligation shall be deferred until an actual settlement date can be determined, as allowed by ASC 410-20.

The Company also stated that it has no AROs pursuant to either its easement agreements with private landowners or its assets located on public rights-of-way.

The Department recommends that the Commission require the Company to include an update on its reporting and accounting for ASC 410-20 in its next average service life depreciation filing for transmission and distribution plant.

III. CONCLUSION AND RECOMMENDATIONS

After review, the Department concludes that MP's proposed depreciation parameters and the resulting depreciation rates are reasonable. The Department recommends that the Commission:

- Approve the Company's proposed average service lives, salvage rates, and depreciation rates;
- Require the Company to make its next average service life depreciation filing for transmission and distribution plant no later than April 1, 2018; and
- Require the Company to include an update on its accounting and reporting for ASC 410-20 in its next average service life depreciation filing for transmission and distribution assets.

/ja

State of Minnesota
DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

Utility Information Request

Docket Number: E015/D-13-252 | Date of Request: April 29, 2013

Requested From: Debbra A. Davey | Response Due: May 9, 2013

Analyst Requesting Information: Craig Addonizio

Type of Inquiry:

[X] 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.	
7	Reference: FERC Account 3580 – Life Analysis a. Please state the date the Company first began booking property to Account 3580. If this date came after November 6, 2008 (the issue date of the Commission's Order in the Company's last Average Service Life Depreciation Petition, Docket No. E015-D-08-422) please explain why the Company chose to use the life estimate for Account 356 approved in the 2000 Depreciation Study (50 years), rather than the life approved by the Commission in Docket No. E015-D-08-422. b. On the date the Company began using this Account, did the Company transfer any existing property from a different account into Account 3580? Or did the Company begin using this Account when it first started installing underground conductor. c. Please report the portion of Account 3580's $3 million balance attributable to property associated with the Company's wind assets and the portion associated with the Minntac 230/155 kV substation.

Response by: Debbra Davey

List sources of information:

Title: Supervisor - Accounting

Department: Accounting – Property & Construction

Telephone: 218-355-3714

d. The written description of Account 3580 on page 27 of Appendix II states that the Company's wind farms are estimated to have a 35 year life. Please explain whether and how this fact is reflected in the proposed average service life for Account 3580.

Response:

7 a. The account was first used in March of 2009. This account was added to the system in 2000 and the rate was entered at that time, which is why the 2000 approved rate was used. This account rate was not looked at in the 2008 filing since the account was not in use at that time.

7 b. The Company started using this account when installing underground conductors for wind assets.

7 c. The entire balance of $3.0 million in plant account 3580 is attributable to wind assets. The Taconite Ridge Wind Collection Grid location was set up to clearly identify wind assets and the assets in location Minntac 230/155kV substation in account 3580 were transferred to this location.

7 d. For account 3580, there is no Company history to analyze for this account. To determine a life parameter for this account, Mr. Watson relied on his professional judgment, 28 years of experience in performing depreciation studies, and knowledge of general trends across the utility industry. Mr. Watson's judgment is this account would follow trends similar to other utilities.

Response by: Debbra Davey

Title: Supervisor, Accounting

Department: Accounting – Property & Construction

Telephone: 218-355-3714

List sources of information:

State of Minnesota
DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

Utility Information Request

Docket Number: E015/D-13-252 Date of Request: April 29, 2013

Requested From: Debbra A. Davey Response Due: May 9, 2013

Analyst Requesting Information: Craig Addonizio

Type of Inquiry:

[X]...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.	
15	Reference: FERC Accounts 3550 and 3560 - Salvage Analysis a. In Docket No. E015/D-08-422, Accounts 3550 and 3560 were analyzed separately, but given a common net salvage rate. Please explain the Company's rationale for assigning separate net salvage rates to each account in this Docket. b. In 2013 Petition, the gross salvage amount recorded for Account 3560 in 2004 ($11,948) appears to have been revised significantly from the amount recorded in the 2008 Petition ($448,671). Please explain the reason for this revision.

Response by: Debbra Davey

List sources of information:

Title: Supervisor - Accounting

Department: Accounting – Property & Construction

Telephone: 218-355-3714

Response:

15 a. In the last depreciation study, net salvage results for account 3560 were impacted by gross salvage in 2004. Data in that study shows a positive net salvage for account 3560. In Mr. Watson's experience, account 3560 shows negative net salvage. Without an explanation for account 3560 activity in 2004, he combined the results of 3550 and 3560 which generally show similar negative net salvage values. See response to part b for more information that allowed a separate analysis in the current study.

15 b. In performing this depreciation study, Mr. Watson inquired the source of the 2004 gross salvage for account 3560 and was given further information; $436,722.93 of the salvage for account 3560 was from one work order (#1053759). This work order was to upgrade Line #90. Excess wire left from the project was salvaged. Usually such a large amount of wire is not left and is not sold. Engineering personnel confirmed that this event was an anomaly and that amount was removed from the gross salvage for this account in 2004.

Response by: Debbra Davey

List sources of information:

Title: Supervisor, Accounting

Department: Accounting – Property & Construction

Telephone: 218-355-3714