

Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: May 1, 2014*Agenda Item #5

Company: Minnesota Power

Docket No. **E-015/M-14-130**
In the Matter of Minnesota Power's Petition for Approval of an Electric Service Agreement Between Magnetation, LLC and Minnesota Power

Issue(s): Should the Commission approve Minnesota Power's proposed Electric Service Agreement (ESA) with Magnetation, LLC?

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Relevant Documents

Prior Dockets

PUC Staff Briefing Papers Docket No. E015/M-12-1025November 27, 2012
Commission Order Docket No. E015/M-12-1025 December 10, 2012
Commission Order Docket No. E015/M-13-93 April 15, 2013
Commission Order Docket No. E015/M-13-354 June 21, 2013
Commissioner Order Docket No. E015/M-13-1084 January 31, 2014

Current Docket: E-015/M-14-130

Minnesota Power Initial Filing-Electric Service Agreement
Between Magnetation, LLC and Minnesota Power February 10, 2014
Comments of the Department of Commerce, Division of Energy Resources February 20, 2014
Magnetation, LLC Reply Comments February 26, 2014
Minnesota Power Reply Comments February 28, 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 Minnesota Power's proposed Electric Service Agreement (ESA) with Magnetation, LLC?

II. Relevant Statute

Minn. Stat. § 216.05, subd. 2a. Electric service contract:

A contract for electric service entered into between a public utility and one of its customers, in which the public utility and the customer agree to customer-specific rates, terms, or service conditions not already contained in the approved schedules, tariffs, or rules of the utility, must be filed for approval by the commission pursuant to the commission's rules of practice. Contracts between public utilities and customers that are necessitated by specific statutes in this chapter must be filed for approval under those statutes and any rules adopted by the commission pursuant to those statutes.

Docket No. E015/M-08-1344 addressed issues related to the Commission's authority over rates for Large Light and Power (LLP) and Large Power (LP) customers. The Commission's February 26, 2009 Order in that docket emphasized that fact that the Commission has continuing jurisdiction over and the right to review the LLP and LP contracts at any time and established protocols for future filings seeking approval of LLP of LP electric service agreements.

The Order also required Minnesota Power to add a provision to its LP Service Schedule stating:

No Public Utilities Commission approval of any of the large power customer electric service agreements required by this Schedule shall act to prevent the Commission from later increasing or decreasing any of the rates or charges contained in this Schedule or shall exempt any customer from the applicability of such increased or decreased charges.

III. Background

The Commission has previously approved two electric service agreements between Minnesota Power (MP) and Magnetation, LLC (Magnetation): an initial agreement in Docket E-015/M-11-823 and a subsequent amendment in Docket E-015/M-13-93. These agreements were for facilities at Plant 2. The agreement in question in the instant petition is for facilities at Plant 4.

On February 10, 2014, MP petitioned the Commission for approval of a second amended Electric Service Agreement (ESA or Agreement) between MP and Magnetation. Under the proposed ESA, MP would provide power initially under its LLP rate schedule and later under its LP rate schedule for Magnetation's iron ore concentrate facility, which will recover and produce iron ore concentrates from waste ore stockpiles near Coleraine, Minnesota. Magnetation is in the process

of locating and constructing its processing plant. Under the proposed ESA, Magnetation would purchase its total electric service requirements from Minnesota Power through at least 2025.

On February 10, 2014, the Department of Commerce, Division of Energy Resources (Department) filed comments recommending approval.

On February 26, 2014, Magnetation filed reply comments in this matter.

On February 28, 2014, Minnesota Power filed reply comments agreeing with the Department's comments.

IV. Parties' Comments

MP: The Agreement contains several key provisions of benefit to Magnetation and Minnesota Power. First, and critically important to Minnesota Power and its other ratepayers, is Magnetation's agreement to purchase its electric service requirements for its Plant 4 Facility from Minnesota Power through at least 2025. Second, the Agreement provides Magnetation with start-up operating flexibility under the LLP Schedule as it develops another facility to recover iron ore from waste ore stockpiles in Northeastern Minnesota, while providing Minnesota Power protection on transmission and distribution capital expenditures in the event the Plant 4 Facility project does not proceed. Finally, the Agreement assists Minnesota Power in growing a new customer segment (iron ore recovery) to its existing industrial customer base.

Minnesota Power's contractual arrangements with its LP and LLP customers have always created significant fixed cost recovery assurances upon which Minnesota Power and its ratepayers could depend. This Agreement continues and extends these fixed cost recovery assurances to a growing customer segment (iron ore recovery) while also providing Magnetation with competitive electric service and operational flexibility under the LLP and LP Schedules. In addition, Magnetation's take-or-pay commitments represent a new contribution toward fixed cost recovery on Minnesota Power's system.

When Magnetation's commitments are coupled with Magnetation's obligation to purchase its electric service needs from Minnesota Power through at least December 31, 2025, as provided in the Agreement, all of Minnesota Power's other ratepayers will find themselves in a better situation than they would otherwise be without this Agreement. No one knows what events await Minnesota Power's other large power industrial customers who play such a critical role in Minnesota Power's financial well-being. As occurred just a few years ago, if Minnesota Power were to face the shutdown of any industrial customer, even on a temporary basis, the scenario for all customers would look bleaker without this Agreement and the corresponding revenue assurances it provides.

In addition to benefits to Minnesota Power and its other customers, the Agreement will benefit Magnetation in a variety of ways. It will stabilize Magnetation's production costs by keeping the cost of electric service competitive and by matching Magnetation's operational requirements, especially during the Start-up Period. The positive impacts that this Agreement will bring to all

interested parties are significant and far-reaching. Minnesota Power and its ratepayers stand to benefit from the sweeping, long-term commitments that Magnetation has provided regarding its new electric service needs. In addition to the parties directly affected, this Agreement is supportive of the regional economy in that it is beneficial to a new major regional industrial operation and employer, especially around Coleraine, Minnesota.

The benefits mentioned in the preceding paragraphs will be realized without any changes to rates provided in Minnesota Power's approved tariffs. The terms of this Agreement are appropriate given Minnesota Power's and Magnetation's needs and unique circumstances. In accordance with the requirements of Minn. Stat. §§ 216B.03, .06, and .07, Minnesota Power has always applied the LLP Schedule and the service agreements it enters into thereunder in a fair and equitable manner between and among eligible LLP customers. Minnesota Power intends to continue this practice by making similar terms and conditions available to eligible LLP customers who make similar commitments to Minnesota Power. Accordingly, the Agreement meets the public interest requirements of the Minnesota Public Utilities Act.

DOC: The Department reviewed the ESA, stating it should be approved only if it is in the public interest. The Department said it would be in the public interest if it met two conditions:

1. MP's other ratepayers must not be negatively affected by the Amended Agreement.
2. The rates under the Amended Agreement must not be discriminatory, namely the rate would be available to any other large power customer of MP facing similar circumstances to those of Magnetation.

The parties that may be affected under the proposed ESA are the Company, Magnetation, and MP's ratepayers. Since MP and Magnetation agreed on the proposed ESA and since they are both assumed to act in their own best interest, clearly neither the Company nor Magnetation are worse off as a result of the proposed ESA. Therefore, it only remains to show that MP's ratepayers are not worse off as a result of the proposed ESA. First, the Department notes that the proposed ESA does not have any impact on MP's rates from the time the proposed ESA is in effect until MP's next rate case.

Under both the LLP and LP rates, Magnetation would provide additional contribution to MP's system fixed cost, thus benefiting the remaining MP ratepayers. Therefore, the proposed ESA would result in higher contribution from Magnetation to the Company's total fixed costs. Such higher contributions would not affect MP's remaining ratepayers until MP files a rate case. However, if MP files a rate case prior to 2025, then all other things remaining the same, the amendment would result in lower overall revenue requirements for MP and therefore, lower rates for MP's other ratepayers than would be the case absent the proposed ESA.

In conclusion, the new electric service provided to Magnetation first under that LLP tariff and second under the LP tariff would reduce MP's future revenue requirements, thus benefiting MP's other ratepayers. As such, no party affected by the proposed ESA should be worse off as a result of the amendment.

The rates under the proposed ESA are offered to Magnetation under the LLP tariff for the startup period and under the LP tariff after the ending of the start-up period. Clearly, such rates are available to any other customer meeting the requirements of either the LP or the LLP tariff. Therefore, they are clearly not discriminatory. Moreover, any specific terms of the contract are similar to the specific terms in the previous ESA and Amended ESA between MP and Magnetation which were approved by the Commission (Docket Nos. E-15/M-11-823 and E015/M-13-93, respectively) and would be available to any other large customer of MP facing similar circumstances to those of Magnetation. Therefore, the DOC concludes that the proposed ESA is not discriminatory, and the rate is available to any other large power customer of MP facing similar circumstances to those of Magnetation.

V. Staff Discussion

Staff agrees with the Department that the ESA between MP and Magnetation should be approved. However, some of the conclusions stated by the Department are broader than are necessary to support approval and could be problematic in the future if adopted as part of the Commission's Order. Specifically, the DOC language that causes the greatest concern is:

“Magnetation would provide additional contribution to MP's system fixed cost, thus benefiting the remaining MP ratepayers. Therefore, the proposed ESA would result in higher contribution from Magnetation to the Company's total fixed costs. Such higher contributions would not affect MP's remaining ratepayers until MP files a rate case. However, if MP files a rate case prior to 2025, then all other things remaining the same, the amendment would result in lower overall revenue requirements for MP and therefore, lower rates for MP's other ratepayers than would be the case absent the proposed ESA.”
(February 20, 2014 DOC Comments at page 3 in docket no. E015/M-14-130)

In a similar docket, **Docket No. E-015/M-12-1025**, the Commission approved an Amendment to an Electric Service agreement which extended the term of Minnesota Power's existing ESA with NewPage Wisconsin System, Inc. through at least 2022 and modifies other provisions related to NewPage's Chapter 11 bankruptcy filing. The Amendment provides NewPage with additional flexibility and cost reduction potential, while protecting Minnesota Power's other customers through an extended full requirements contract and full recovery of pre-petition electric service debt. The Amendment also supports the business strategy of an important regional industrial employer. The petition filed described the amendment and summarized the benefits to both parties.

The Commission Staff in its briefing document dated December 6, 2012 (filed November 27, 2012) provided the following analysis:

Staff generally agrees with the Department's analysis and is not going to repeat specifics in this briefing paper. However, staff is concerned with the DOC statement that “[s]ince NewPage's rates include contribution to MP's fixed costs,

MP's ratepayers benefit from such contribution that would otherwise have to be collected from them."

The addition of a new large customer or the retention of one that might otherwise leave the system is not necessarily beneficial to other customers.

Whether other ratepayers would pay more without the contract with NewPage is dependent on the existence of surplus capacity and the market for that capacity and on supply of energy and demand for the energy.

The Amendment extends the duration of the Electric Service Agreement to December 31, 2022. A review of current forecasts indicates that there may be a need for additional capacity during that period. According to Minnesota Power's most recent resource plan, Docket No. E015/RP-09-1088, the Utility's expected forecast shows resource deficits for both summer and winter beginning in 2016. At this point, if Minnesota Power needs to pay more for the additional capacity and energy than the rates being paid by NewPage, other customers would be harmed by the contract.

Minnesota Power also has the option of selling surplus power and energy. If the Company is able to sell that power or energy at rates higher than what is being paid by NewPage, other customers will not be benefiting from the contract. According to the Midwest ISO's September 2012 study, 6 gigawatts of capacity may be needed by 2015 to maintain an appropriate planning reserve margin. This would indicate that there will be a market for capacity in the near future.

The rates for NewPage are tariffed under the Large Power Service schedule and are subject to future Commission review, as a result, the Commission does not need to make a specific finding regarding the benefits to other customers.

In the Commission's December 10, 2012 Order approving Minnesota Power's ESA with NewPage, the Commission agreed with and adopted the recommendations of the DOC. However, in its Order, the Commission noted that it makes no specific findings regarding the benefits of the agreement to other customers.

Since the Commission's December 10, 2012 Order the Commission has issued orders in several dockets that are similar in nature. A description of these dockets are as follows:

Docket No. E015/M-13-93 The Commission approved an amendment to the existing electric service agreement between Minnesota Power and Magnetation for Plant 2. The amendment modified a paragraph in the agreement related to the guaranteed annual revenue designated in the agreement.

In Commission's April 15, 2013 Order, the Commission approved Minnesota Power's proposed Amendment to the Company's ESA with Magnetation. In the Order, the Commission agreed

with and adopted the recommendations of the Department of Commerce, which were attached and incorporated into the Order.

The DOC comments stated in part: “Therefore, the proposed Amendment would result in higher contribution from Magnetation to the Company’s total fixed costs. Such higher contributions would not affect MP’s remaining ratepayers until MP files a rate case. However, if MP files a rate case prior to 2018, then, all other things remaining the same, the amendment would result in lower overall revenue requirements for MP and therefore, lower rates for MP’s other ratepayers than would be the case absent the proposed amendment.” (DOC comments, page 3)

Docket No. E015/M-13-354 The Commission approved an ESA between Minnesota Power and Enbridge Energy Limited Partnership. The Agreement provides for Enbridge to continue to purchase all of its electric service requirements for its pipeline facilities under Minnesota Power’s Large Light and Power Service Schedule (the LLP Schedule).

In the Commission’s June 21, 2013 Order, the Commission approved the proposed Agreement between Minnesota Power and Enbridge. In the Order, the Commission agreed with and adopted the recommendations of the Department of Commerce, which attached and incorporated into the Order.

The DOC comments stated in part: “Based on its review and analysis of MP’s petition, the Department concludes that:

1. The Agreement is in the public interest because:
 - a. For each year of the ESA, the revenues received from Enbridge would be higher under the proposed ESA than under the existing ESA.
 - b. The extension of the Agreement to at least December 31, 2020 would benefit MP’s other ratepayers by lowering their share of MP’s total fixed costs. (DOC comments, page 7)

Docket No. E015/M-13-1084 The Commission approved an Amendment to Electric Service Agreement which provides for Boise, Inc. to modify its commitment to purchase electric service requirements from Minnesota Power based on operational changes at its paper mill in International Falls, Minnesota. The Petition describes the Amendment and summarizes the benefits to both parties.

In the Commission’s January 31, 2014 Order, the Commission approved the proposed Agreement between Minnesota Power and Boise, Inc. In the Order, the Commission agreed with and adopted the recommendations of the Department of Commerce, which were attached and incorporated into the Order.

The DOC comments stated in part: “The proposed rates for Boise include a contribution to MP’s fixed costs and thus the Company’s ratepayers would benefit from such a contribution that would otherwise have to be collected from them. The extension would benefit MP by providing it with

additional stability in its revenues by having one of its largest customers under contract through December 31, 2023.” (DOC comments, p. 4) Also, “The agreement allows MP to retain a customer that helps the Company recover its fixed costs, and thus the agreement provides benefits with no harm to MP’s other ratepayers.” (DOC comments, p. 6)

Staff agrees with the parties that the ESA between MP and Magnetation in the instant docket should be approved. However, staff acknowledges the reasoning and concerns expressed in the 12-1025 that it is not appropriate to make findings as to the effect of the agreement on MP customers and future MP revenue requirements.¹

Because MP has an obligation to serve customers in its service territory at Commission-approved rates, and because the rates in these ESA are tariffed, the real issue in the docket is not whether serving this customer per se benefits other ratepayers, but rather whether: 1) the terms and conditions of the ESA are consistent with the public interest (i.e. the specific non-standard terms do not harm other customers) and 2) are not discriminatory with respect to other similarly situated LP and LLP customers. Both of these conditions are met and can be supported by the Department’s analysis without adopting conclusions about future effects. Staff supports this approach. If the Commission agrees with this standard of review, it may wish to inquire whether the Department agrees and will review future ESAs in this manner.

The question before the Commission here is should the Commission agree with, adopt, and incorporate in its Order the DOC analysis regarding the benefits of an ESA or ESA amendment to other customers. One option is to take the approach in the 12-1025 docket. A second approach, as explained above, is to approve the ESA because it meets the two conditions listed above (that is, the terms and conditions are consistent with the public interest, and are not discriminatory). Regardless of the decision the Commission makes, it should signal how it intends to review ESAs going forward, either through an order or verbally at its agenda meeting.

Finally, if the Commission deems that the language has a sound basis and is necessary to support the approval of the Company’s petition, the Commission could approve the current petition without caveats attached.

¹ Staff did not write briefing papers to bring this issue up in some subsequent MP ESAs. Some of the subsequent MP ESAs may have had different circumstances.

VI. Commission Options

1. Approve the proposed Electric Service Agreement.
2. Approve the proposed Electric Service Agreement. However, note that the Commission is not making any specific findings as to the benefits to other customers and declare this as Commission policy on a going forward basis.
3. Find that the terms and conditions of the ESA are consistent with the public interest and are not discriminatory. Approve the proposed Electric Service Agreement and declare this as the standard of review for ESAs on a going forward basis.
4. Do not approve the proposed Electric Service Agreement.