

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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In the Matter of Minnesota Power's 2012
Remaining Life Depreciation Petition

ISSUE DATE: July 31, 2013

In the Matter of a Commission Inquiry into
Decommissioning Policies Related to
Depreciation

DOCKET NO. E-015/D-12-378

DOCKET NO. E,G-999/CI-13-626

ORDER APPROVING REMAINING
LIVES, REQUIRING COST
ADJUSTMENTS, AND INITIATING
DECOMMISSIONING COST
INVESTIGATION

PROCEDURAL HISTORY

On April 16, 2012, Minnesota Power filed a petition seeking authorization to retain its current estimate of decommissioning costs for certain assets, to adjust the service lives of production plant and certain general plant assets, and to make these changes effective as of January 1, 2012. The company uses these estimates for calculating depreciation expense, and for calculating the amount of net capital assets the utility has.

From July 2012 until March 2013, Minnesota Power and the Minnesota Department of Commerce (the Department) filed responsive comments.

The matter came before the Commission on May 30, 2013.

FINDINGS AND CONCLUSIONS

I. Summary

In this order the Commission will do the following:

- Approve Minnesota Power's remaining life calculations and the utility's use of probabilities in calculating the cost of decommissioning plants.

- Direct Minnesota Power to alter the way it calculates decommissioning costs, and to make conforming adjustments prospectively and retrospectively.
- Provide direction for Minnesota Power's 2013 depreciation filing.
- Open an industry-wide docket to review decommissioning policies related to depreciation expense, including the calculation of decommissioning costs.

II. Background

Depreciation refers to the loss of an asset's service value due to consumption or prospective retirement, other than losses that can be restored through routine maintenance or paid for by insurance.¹ Assets may depreciate due to wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, and changes in demand and requirements of public authorities, among other causes.²

Depreciation accounting permits a utility to recover the cost of tangible capital assets plus the cost of decommissioning the asset over the asset's useful life.³ Decommissioning costs refer to the anticipated cost of removing an asset at the end of its useful life, offset by the asset's anticipated salvage value; the opposite of this number – salvage value minus cost of removal – is called *net salvage*.⁴

The Commission sets a utility's rates with the goal of providing the utility a reasonable opportunity to recover its operating costs plus a fair return on its assets. Depreciation influences this calculation because depreciation represents a form of operating cost, and because depreciation reduces the amount of assets upon which the utility earns a return. If a utility understates its depreciation, this error will result in lower operating costs, a higher asset balance over time, and assets that reach the end of their useful lives before the utility has fully recovered its investment in them.

To promote appropriate depreciation practices, each energy utility must obtain Commission certification of the utility's depreciation rates.⁵ A utility may depreciate a capital asset using either the *average service life* technique or the *remaining life* technique. Because the remaining life technique requires annual adjustments to a utility's depreciation rates, utilities using this technique must obtain approval of new depreciation rates annually. But regardless of technique used, a utility must use straight-line depreciation – depreciating an equal amount of an asset's cost plus decommissioning costs in each year of the asset's probable service life -- unless the Commission authorizes an exception.⁶

Minnesota Power petitioned to use the average service life technique for certain assets, and the remaining life technique for others. The Commission granted the petition regarding the utility's use of

¹ Minn. R. 7825.0500, subp. 6.

² *Id.*

³ *Id.* at subp. 7.

⁴ *Id.* at subp. 8.

⁵ Minn. R. 7825.0700, subp. 1.

⁶ Minn. R. 7825.0500, subp. 14; 7825.0800.

the average service life technique.⁷ This order addresses Minnesota Power’s petition regarding its use of the remaining life technique.

III. Positions of the Parties

A. Remaining lives as reported in depreciation studies and resource plans

Minnesota Power proposes to leave decommissioning rates unchanged from the company’s last depreciation filing, and proposes to reduce the remaining lives of all facilities to reflect one year’s passage of time.

The Department has reviewed the proposed remaining lives and concludes that they are reasonable for purposes of the current docket. The Department and Minnesota Power disagree about the merits of continuing to operate certain generators, and thus disagree about the appropriate remaining lives for those plants. But the parties agree that it would be more appropriate to address these disagreements in other dockets – such as Minnesota Power’s resource planning docket, in which the utility will propose how it intends to secure a sufficient supply of electricity to meet its customers’ needs.⁸

While Minnesota Power does not propose any alterations to the remaining life estimates proposed in its petition, the utility proposes in its next depreciation filing to compare the remaining lives used for depreciation and the remaining lives used in its then-current resource plan, and to explain any differences.

B. Remaining lives and decommissioning uncertainty

The Department argues that Minnesota Power’s method of calculating decommissioning costs violates the requirement to use straight-line depreciation.

When the end of an asset’s useful life is many years into the future, a utility may lack confidence about the precise length of that life. Minnesota Power argues that it is appropriate to adjust the amortization of decommissioning costs to reflect this uncertainty. When an asset has a long remaining life, Minnesota Power may reduce its amortization of decommissioning costs by up to 50%. As the date for retiring the asset grows closer and Minnesota Power grows more confident in its assessment of the asset’s remaining life, Minnesota Power begins amortizing the full amount of the decommissioning costs over the asset’s then-remaining life.

The Department argues, however, that when Minnesota Power accrues only 50% of a year’s worth of decommissioning costs during the early years of an asset’s life, this leaves an inappropriately large balance to be recovered during the later years of the asset’s life. According to the Department, this practice violates the Commission’s rule requiring straight-line depreciation. The Department does not ask the Commission to order changes in the current docket to correct this problem. But the Department recommends that the Commission direct Minnesota Power to include in its next depreciation filing information comparing the utility’s depreciation calculations under Minnesota

⁷ *In the Matter of Minnesota Power’s (MP) General Plant Depreciation Petition*, Docket No. E-015/D-12-379, Order (May 31, 2013).

⁸ See Minn. Stat. § 216B.2422 and *In the Matter of Minnesota Power’s 2013 – 2028 Integrated Resource Plan*, Docket No. E-015/RP-13-53.

Power's current formula to the depreciation calculations that would result if the utility excluded consideration of decommissioning uncertainties from the analysis.

While Minnesota Power supports the Department's recommendation to accept the utility's analysis for purposes of the current docket, it opposes the Department's rationale. Minnesota Power argues that the rule prescribing straight-line depreciation is not intended to prohibit a utility from adjusting rates to reflect new information. And Minnesota Power argues that its increasing confidence about the eventual retirement date for an asset reflects new information, which justifies a change in depreciation rates. Moreover, Minnesota Power argues that its depreciation policy conforms to Commission-approved practices. If the Commission proposes to alter these practices, Minnesota Power recommends that the Commission explore that course of action in an industry-wide docket.

C. Decommissioning costs calculations

Separate from the issue noted above, the Minnesota Power and the Department now agree that Minnesota Power's method of calculating depreciation has under-recovered decommissioning costs and warrants a change. But the parties disagree about whether to make adjustments to past depreciation amounts, or merely to apply the change prospectively.

Briefly, an asset's *adjusted plant in service* reflects the cost a utility incurred for the asset plus its decommissioning costs – in sum, the cost needed to be recouped to compensate the utility for its known and anticipated investment. Ideally this figure remains constant throughout the asset's service life and serves as a basis for calculating depreciation. But Minnesota Power's depreciation formula caused its adjusted plant in service to decline over time. This anomaly distorted other aspects of Minnesota Power's depreciation analysis, resulting in the under-recovery of decommissioning costs.

According to the Department, this anomaly simply reflects an error on Minnesota Power's part. Consequently the Department recommends that the Commission direct the utility to adjust its books as far back as practicable – perhaps as far back as 2008. This adjustment would have the effect of treating Minnesota Power as if it had employed the correct depreciation formula, and thus, as if the utility had already recovered the appropriate depreciation costs.

Minnesota Power opposes the Department's proposal, arguing that it should have the opportunity to recover these forgone depreciation costs. According to the utility, the needed adjustment reflects a change in estimates, and that accounting rules provide for implementing changes to estimates solely on a prospective basis. Moreover, Minnesota Power argues that ratepayers have benefited from the anomaly in its depreciation formula, and thus there is no inequity in ratepayers bearing the cost of adjusting depreciation schedules prospectively. Consequently, if the Commission decides to require retrospective adjustments to Minnesota Power's books, the company would propose amortizing the unrecovered decommissioning costs over the next 36 months. This would permit Minnesota Power, in a future rate case, to seek to recover at least part of these costs from ratepayers.

IV. Commission Action

A. Remaining lives as reported in depreciation studies and resource plans

In its 2011 Depreciation Study Order, the Commission directed Minnesota Power to “continue to provide in future depreciation studies an explanation and schedule of the differences between the depreciation remaining lives and ... planning lives of electric generation plant [reported in the

utility's resource plan]."⁹ Minnesota Power and the Department continue to disagree about the appropriate time to retire certain generating plants, but acknowledge that this matter may be addressed in other dockets, including Minnesota Power's resource plan docket.

The Commission concurs in this conclusion and will not pursue the matter further in this context. But for purposes of Minnesota Power's 2013 depreciation filing, the Commission will again direct Minnesota Power to address any differences between the remaining lives the utility uses in its depreciation studies and the remaining lives it uses in its resource plan.

B. Remaining lives and decommissioning uncertainty

Having reviewed Minnesota Power's proposed remaining lives and the Department's analysis thereof, the Commission finds that these remaining lives are reasonable and proper. Consequently the Commission will approve them.

The Department raises important questions about whether the Commission's rule prescribing straight-line depreciation is consistent with the practice of adjusting a utility's decommissioning accruals based on the utility's confidence in its remaining life calculations. But the Commission is not persuaded that this issue is sufficiently developed to permit the Commission to rule on the matter. As Minnesota Power observes, the Commission has had more experience with new construction than with plant retirements and decommissioning; the Commission may benefit from a more thorough analysis of decommissioning policies. Moreover, comments from other utilities that employ this depreciation practice may be helpful.

Consequently the Commission will adopt the recommendations of both parties. For the present, the Commission will adopt the Department's recommendation to accept Minnesota Power's calculations based on the use of decommissioning uncertainties. But to facilitate analysis of this matter in the context of Minnesota Power's 2013 depreciation filing, the Commission will direct Minnesota Power to include information comparing the utility's depreciation calculations under Minnesota Power's current formula to the depreciation calculations that would result if the utility excluded consideration of decommissioning uncertainties from its analysis.

In the meantime, the Commission will adopt Minnesota Power's recommendation to initiate an industry-wide investigation reviewing decommissioning policies, including policies governing the salvage portion of depreciation expense. To ensure informed decision-making, these complex issues require the comprehensive development and stakeholder participation available only in an industry-wide proceeding.

C. Decommissioning cost calculations

While the parties agree about the need to alter Minnesota Power's depreciation calculations, and about the new calculation to apply, they disagree about whether the utility should apply this change to its past depreciation records or merely to prospective ones. The Commission concludes that the parties have identified an error in the manner in which Minnesota Power has calculated its decommissioning costs, that the past errors should be corrected, and that future errors should be avoided.

⁹ *In the Matter of Minnesota Power's Request for Approval of its 2011 Remaining Life Depreciation Petition and Production Plant Depreciation Study*, Docket No. E-015/D-11-327, Order (August 22, 2011).

Minnesota Power offers no serious justification for using a calculation that systematically under-recovered the utility's decommissioning costs. While Minnesota Power correctly observes that its formula involves estimated variables, and that financial standards provide for recording changes to estimates on a prospective basis, this argument does not justify applying the remedy to its depreciation practices solely on a prospective basis. The correction proposed by the Department does not involve changes to any estimated variables; rather, it involves a change to the formula itself – a change needed to eliminate an error. Because Minnesota Power had applied its erroneous formula to its past depreciation reserves, it is appropriate to correct these errors as far back as is practicable. For purposes of this docket, the Commission will accept 2008-2012 as the appropriate period for making the relevant adjustment.

That said, there is no evidence that Minnesota Power implemented its faulty decommissioning cost practices to secure an inappropriate advantage, or that the error harmed any customer. Consequently, as the Commission directs Minnesota Power to correct its depreciation cost calculations prospectively, the Commission will also authorize the company to amortize its foregone decommissioning costs over a 36-month period. To implement these changes the Commission will direct Minnesota Power to incorporate the adjustments, and the calculations supporting the adjustments, into its 2013 depreciation filing and all subsequent depreciation filings until the balance is fully amortized.

The Commission will so order.

ORDER

1. For purposes of this docket the Commission approves Minnesota Power's proposed remaining lives and accepts Minnesota Power's use of decommissioning uncertainties.
2. Regarding the manner in which Minnesota Power calculates its decommissioning costs:
 - A. Prospectively, Minnesota Power shall correct the way it calculates decommissioning costs in the manner described by the Department.
 - B. Minnesota Power shall adjust its accumulated depreciation reserve for the period 2008 to 2012 to the level it would have been had the company used the Department's decommissioning cost calculation.
 - C. Within 60 days of this order, Minnesota Power shall begin amortizing the cost of this adjustment for the following 36 months as a supplemental depreciation expense.
 - D. Minnesota Power shall file an amendment to its 2013 Remaining Life petition to include this supplemental depreciation.
 - E. In all remaining life depreciation cases in which Minnesota Power records this amortization, beginning with the 2013 case, the company shall provide the detailed calculations supporting the adjustment and amortization.

3. The Commission opens Docket No. E,G-999/CI-13-626, *In the Matter of a Commission Inquiry into Decommissioning Policies Related to Depreciation*, a generic docket to review decommissioning policies related to depreciation expense, including the calculation of the salvage portion of depreciation expense.
4. In its 2013 depreciation filings, Minnesota Power shall provide the following:
 - A. An analysis comparing its depreciation expense calculated using its current method to its depreciation expense calculated without decommissioning uncertainties.
 - B. A comparison of the remaining lives used in its depreciation filing and in the utility's then-current resource plan, and an explanation of any differences.
5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary



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