

Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Dates: February 2, 2017.....**Agenda Item # 8

Company: Minnesota Power (“MP” or the “Company”)

Docket No. **E-015/AI-16-454**

In the Matter of Petition for Approval of Affiliated Interests Between ALLETE, Inc. and U.S. Water Services, Inc.

Issue: Should the Commission approve the Alliance Agreement between ALLETE, Inc. and U.S. Water Services, Inc.?

Staff: Clark Kaml.....(651) 201-2246
Sundra Bender.....(651) 201-2247

Relevant Documents

Minnesota Power - Initial Filing (TS) May 5, 2016
Department of Commerce (“Department”) – Comments August 23, 2016
Minnesota Power - Reply Comments October 7, 2016
Department of Commerce - Reply Comments..... November 10, 2016

The attached materials are workpapers 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.

This document can be made available in alternative formats (i.e., large print or audio) by calling (651) 296-0406 (voice). Persons with hearing loss or speech disabilities may call us through their preferred Telecommunications Relay Service.

Statement of the Issue

Should the Commission approve the Alliance Agreement (“Agreement”) between ALLETE, Inc. and U.S. Water Services, Inc. (“USWS” or “U.S. Water Services”)?

Background

On May 25, 2016, Minnesota Power filed a Petition requesting approval of an Alliance Agreement with U.S. Water Services Inc., an affiliate of Minnesota Power (“Petition”).

On August 23, 2016, the Department of Commerce (“Department”) filed comments recommending the Commission deny the Petition and require reports from the Company.

On October 7, 2016, Minnesota Power filed reply comments.

On November 10, 2016, the Department filed comments affirming its initial recommendation that the Commission deny the request and require reports from the Company.

Relevant Statutes, Rules, and Commission Order

Minn. Stat. 216B.48 defines “affiliated interests” with a public utility, and states that any affiliated interest, or any arrangement between a public utility and an affiliated interest, is not valid or effective unless and until the contract or arrangement has received the written approval of the commission.

Minnesota Rules 7825.1900 through 7825.2300 provide Commission Rules addressing affiliated interests. These include definitions, filing requirements, and procedures for regulation of an affiliated interest.

On September 14, 1998, the Commission issued an Order Initiating Repeal of Rule, Granting Generic Variance, and Clarifying Internal Operating Procedures (Docket No. E,G-999/CI-98-651). In that Order, the Commission provided guidance for future affiliate interest filings, including interpretation of Minn. Stat. § 216B.48, and a list of minimum filing requirements. The minimum filing requirements are discussed later in these papers.

Minnesota Power’s Petition

On May 25, 2016, Minnesota Power submitted a Petition requesting that the Commission approve “the Alliance Agreement, along with the current and future purchase orders entered into under the authority thereof” between U.S. Water Services, Inc. (USWS) and the Company.

U.S. Water Services

USWS was purchased by Allete, Inc. (“Allete”) on February 10, 2015. Allete is organized such that Minnesota Power is an operating division of Allete. USWS appears to be a subsidiary of

Global Water Services Holdings, Inc., a third or fourth tier subsidiary of Allete according to the organization chart(s) provided in Attachment A to the Petition. Prior to the purchase, USWS had been an existing vendor supplying commodity services to Minnesota Power generating facilities.

Minnesota Power explained that USWS (founded in 1997) is a nationwide company providing integrated water management solutions. It combines engineering, equipment, chemicals, and services to discover and apply optimal solutions for water, energy, process, and compliance issues faced by its industrial customers. The primary industries served by USWS include agriculture; biofuels; commercial facilities and data centers; education and higher learning; food and beverage; healthcare; oil and gas; and the power and utility sector.

Minnesota Power stated USWS has been a service provider to Minnesota Power prior to ALLETE's acquisition of USWS's parent company in early 2015. Minnesota Power stated that its diversification strategy into complementary energy-centric businesses has been consistently communicated in capital structure filings since the spin-off of the ADESA auto auction in 2004. The USWS acquisition, along with the development and growth of ALLETE Clean Energy, are the results of that diversification effort. Minnesota Power argued that with respect to the requirements of Minnesota Statute Sections 216B.48, 216B.49 and 216B.50:

The USWS acquisition was compliant with the Company's capital structure requirements;

No new affiliate or administrative services requirements resulted from the transaction; and

The USWS operations in the state consisted of neither utility plant nor operating unit under Commission precedent or statute, or rules and regulations.

The Company stated that the Alliance Agreement has become the first Commission-jurisdictional activity of USWS and Minnesota Power.

Alliance Agreement

Minnesota Power and USWS have entered into a series of purchase orders since February 10, 2015, the date ALLETE acquired the USWS parent company. In a parallel negotiation, Minnesota Power and USWS representatives met to negotiate an Alliance Agreement. Minnesota Power stated that an Alliance Agreement is a special agreement Minnesota Power enters into with vendors that signifies an agreement to work together on a specific project or series of projects of a similar kind or nature. The Alliance Agreement removes the need to negotiate terms and conditions of service contracts on a project by project (or purchase order by purchase order) basis. Instead, those terms are negotiated upfront and become part of the Alliance Agreement and govern the series of work performed by the vendor. In Exhibit C to its filing, Minnesota Power provided a listing of current Alliance Agreements in effect.

From the vendor's perspective, the Alliance Agreement means that Minnesota Power looks to the vendor to perform work in certain circumstances. An example is the alliance that Minnesota Power has with Lakehead Construction, which has employees available and onsite for Minnesota Power to supplement staff in extreme workload conditions in the event of outages or other projects at Minnesota Power generating units. The vendor has an idea of upcoming work that will require dedicated staff.

Minnesota Power stated that it has as comfort that the vendor can be called upon to perform work in situations where the need may develop on a short-term or rush basis. In addition, efficiencies are realized since the vendor is familiar with and knowledgeable about Minnesota Power operations and facilities.

Minnesota Power argued that in this case, pricing terms have been developed to capture cost savings that will benefit Minnesota Power and not be retained by USWS. MP stated that this helps address the Commission's concern that the work scope of the USWS Alliance is not being competitively bid. The unique nature of USWS' integrated approach to water system needs makes competitive bidding difficult, if not impossible, because the work is neither strictly commodity or service based.

The Minnesota Power / USWS Alliance Agreement (attached to the Petition as Exhibit D) features a series of contract documents entered into and agreed upfront including:

- Overall terms and conditions governing work performed by USWS.
- General conditions governing any major supply agreement issued by Minnesota Power.
- Chemical services terms and conditions to address commodity provision, pricing and responsibilities.
- Engineering services terms and conditions since standard or specialized equipment may be installed at Minnesota Power by USWS engineers.
- A specific statement of work for water treatment equipment, specialty chemicals, and engineering services.
- All purchase orders are intended to serve as attachments to and part of the Alliance Agreement.
- The USWS business continuity plan is included to assure Minnesota Power of how emergency events would affect USWS' ongoing provision of services.

The remainder of the terms and conditions of the Alliance Agreement include the following highlights:

- The initial term is through September 30, 2018, with allowance for two 1-year extensions at Minnesota Power’s option.
- Minnesota Power has the right to terminate the Alliance Agreement both for its unilateral convenience or if USWS defaults. (Minnesota Power may terminate any individual purchase order without affecting other purchase orders or the Alliance Agreement itself.)
- Pricing is set forth in Section 6 of the Alliance Agreement. (This section of the Alliance Agreement has been designated as Trade Secret.)
 - Pricing will be reviewed on an annual basis; a price index will be followed for specialty chemicals and consumable equipment after joint review and mutual agreement (with price reductions via the formula passed back to Minnesota Power annually without further review); USWS will absorb the first 3% in price increases occurring outside the annual pricing review process; all costs will be transparent and auditable on a quarterly or annual basis; incentives and rebates from USWS suppliers will be passed on to Minnesota Power; and any service or commodity subject to bidding may have its margin adjusted.
 - Price escalations will be managed, monitored, and substantiated by USWS and shall be annually reviewed to ensure that pricing is competitive.
 - Pricing is subject to a “most favored nations” clause in that Minnesota Power will not incur prices less favorable than any other contractor for the same or similar goods in the same or similar geography and of similar size.
- Minnesota Power purchase orders govern the acquisition of any good or service from USWS.
- Exhibit A-1 to the Alliance Agreement is the General Terms and Conditions for a major supply agreement (for work requiring installation services) which comprise more thorough contract terms similar to standard contract terms like those found in AIA forms (or other standard agreements).
- Exhibit A-2 contains detailed terms governing the supply of chemicals.
- Exhibit A-3 provides contract terms governing engineering services.
- Exhibit B is the Statement of Work specifically addressing water treatment equipment, specialty chemicals and engineering services provided by USWS.

With the Alliance Agreement and its attachments, Minnesota Power has entered into a series of purchase orders or project proposals with USWS governing specific work projects. The listings of those twelve (12) purchase orders and eleven (11) project proposals are attached as Exhibit E

to the Petition, and the actual executed Purchase Orders and project proposals are attached as Exhibit F to the Petition.

Minnesota Power stated that the Commission can expect that each project proposal that will ultimately result in a purchase order that will outline an issue that Minnesota Power and USWS have jointly agreed requires attention, will identify the proposed steps to address the issue and the objectives the work scope seeks to achieve, and outline the estimated price such steps will incur to achieve the objective. At the conclusion of each project a similar written report will analyze the action steps taken and whether the objective was achieved.

Minnesota Power proposed that an annual compliance filing will provide the information necessary for the Commission to review any projects and purchase orders entered into during the prior calendar year. Such a report would create a written record of the projects and their supporting documentation for use in future rate proceedings. Any material changes to the Alliance Agreement and its supporting documents, such as price adjustments, will be tracked and provided to the Commission in the annual compliance filing.

Procedural

In a section titled “IV. Procedural Matters”, Minnesota Power provided a list of filing requirements under Minnesota Rules 7829.1300, and the information necessary to meet those requirements.

Affiliate Interest Requirements

In a section titled “V. Affiliate Interest Requirements”, Minnesota Power provided the information required by the Commission’s September 14, 1998 Order Initiating Repeal of Rule, Granting Generic Variance, and Clarifying Internal Operating Procedures, in Docket Number E, G-999/CI-98-651 (“98 Order”). The requirements under the 98 Order, and the Company’s responses are:

1. A heading that identifies the type of transaction.

The transaction is an Alliance Agreement and a series of purchase orders entered into between Minnesota Power and USWS.

2. The identity of the affiliated parties in the first sentence.

The affiliated parties under this Petition are Minnesota Power (a Minnesota utility and an operating division of ALLETE, Inc.) and U.S. Water Services, Inc., a wholly owned subsidiary of ALLETE, Inc. (See Exhibit A for a corporate organizational chart of ALLETE, Inc.)

3. A general description of the nature and terms of the agreement, including the effective date of the contract or arrangement and the length of the contract or arrangement.

Please refer to Section III of this Petition for the general description of the nature and terms of the Alliance Agreement. The Alliance Agreement was entered into on April 25, 2016 with an initial term through September 30, 2018. Individual purchase orders for projects will be entered into during the term of the Alliance Agreement, and Minnesota Power proposes an annual compliance filing process to update the Commission on the new purchase orders entered into between the parties not otherwise listed in this Petition.

4. A list and the past history of all current contracts or agreements between the utility and the affiliate, the consideration received by the affiliate for such contracts or agreements, and a summary of the relevant cost records related to these ongoing transactions.

Prior to the February 10, 2015 acquisition of USWS by ALLETE, Inc., USWS had been an existing vendor supplying commodity services to Minnesota Power generating facilities. A list of purchase orders Minnesota Power entered into from January, 2012 through December, 2015 with USWS is attached as Exhibit B to show the nature of the relationship prior to the acquisition of USWS. The spreadsheet provides the consideration or amount of each purchase order. Further information regarding these cost records, the purchase orders, or any other supporting documentation can be obtained upon request.

5. A descriptive summary of the pertinent facts and reasons why such contract or agreement is in the public interest.

The Alliance Agreement signifies a business arrangement with upfront negotiated terms and conditions, paving the way for the actual work of addressing Minnesota Power's unique industrial water needs quickly and efficiently. Minnesota Power has negotiated a favorable contract in terms of pricing over the term, and retains the right to both obtain the benefit of price reductions or rebates and/or exit the Alliance upon notice. USWS and Minnesota Power are committed to working together to justify the scope and cost of potential projects upfront through an agreed-upon scope of work, with the estimated cost and the criteria to determine and measure success established upfront and measured after the fact. Minnesota Power's ratepayers are protected because the purchase orders under the Alliance will be documented and reported to the Commission annually, with an established record measuring projected and actual costs.

6. The amount of compensation and, if applicable, a brief description of the cost allocation methodology or market information used to determine cost or price.

The amount of compensation of each purchase order will be agreed to upfront by Minnesota Power and USWS, and will be submitted and available to the Commission for review during the annual compliance process.

With respect to pricing in general, Minnesota Power believes the terms of pricing under the Alliance Agreement are very favorable in terms of protection from cost increases and

capturing of cost reductions in the raw materials and services provided by USWS. The terms of Section 6.1 – 6.3 of the Alliance document show how pricing is determined and how it will be adjusted to account for the changes.

7. If the service or good acquired from an affiliate is competitively available, an explanation must be included stating whether competitive bidding was used and, if it was used, a copy of the proposal or a summary must be included. If it is not competitively bid, an explanation must be included stating why bidding was not used.

The purchase orders entered into with USWS under the Alliance Agreement have not been subject to competitive bidding, and future work made pursuant to project proposals will also not be subject to competitive bid. The primary reason is that the work represented by the purchase orders and proposals have been the result of comprehensive analysis performed by USWS to address specific process improvements that have been identified and brought forward to Minnesota Power.

8. If the arrangement is in writing, a copy of that document must be attached.

A copy of the Alliance Agreement with USWS is attached as Exhibit D, as are the current purchase orders and project proposals included in Exhibit F.

9. Whether, as a result of the affiliate transaction, the affiliate would have access to customer information, such as customer name, address, usage or demographic information.

USWS has not and will not have any access to Minnesota Power's customer information or demographic information as a result of these agreements. Such information is not required in the course of performance under the Alliance Agreement or the individual purchase orders.

10. The filing must be verified.

A verification of this Petition is attached hereto as Exhibit H.

Minnesota Power claimed that the Alliance Agreement and the underlying purchase orders are in the public interest because of upfront negotiated contract terms and conditions, enabling Minnesota Power's unique industrial water needs to be addressed quickly and efficiently. Minnesota Power claimed that it has negotiated a favorable contract in terms of pricing over the term of the arrangement, and retains the right to both obtain the benefit of price reductions or rebates and/or exit the Alliance upon notice. MP stated that most importantly, Minnesota Power's ratepayers are protected because the purchase orders under the Alliance will be documented and reported to the Commission annually, with an established record measuring projected and actual costs.

Minnesota Power Reply Comments

In its reply comments, Minnesota Power addressed the discrepancy between Exhibits E and F, the Alliance Agreement effective date, competitive bidding, and rate case impact.

Discrepancy Between Exhibits E and F

MP explained the discrepancy between Exhibits E and F stating that Exhibit F is correct and the March 17, 2016 purchase order was canceled due to an error in its issuance. No activity occurred under this purchase order and no payment for US Water products or services was made; this purchase order was subsequently reissued on May 12, 2016.

Effective Date of the Alliance Agreement

Minnesota Power agreed that the Alliance Agreement Effective Date pursuant to Item 3 of the 98 Order's requirements was missing from Minnesota Power's initial filing. In addressing Item 3 in the Petition, Minnesota Power inadvertently referenced the date the Agreement was entered into rather than the execution date of the Agreement itself.

MP stated that the proposed effective date is not a material issue as the Commission reviews this Docket. The requirement of the 98 Order was for Minnesota Power to file the petition within 30 days of the Agreement execution; the 98 Order was silent as to effective date. Each of the proposed projects under the umbrella of the Alliance Agreement is proposed to be analyzed and justified on a case-by-case basis; the effective date of the Alliance Agreement has no relevance to that review. MP added that affiliate filings, by their nature, are retroactive since they must be filed within 30 days after their execution.

The October 1, 2015, effective date was chosen because it was the beginning date of the three-year pricing period proposed by US Water Service as the two companies negotiated the terms of the Alliance Agreement. The effective date that Minnesota Power proposes has no force or effect on the ultimate issue regarding the Alliance Agreement.

MP summarized that the effective date of the Alliance Agreement is a nonissue in the overall analysis of each of the specific projects proposed to be undertaken in the Minnesota Power/US Water Alliance. The Department did not address Minnesota Power's proposal for regulatory review of each work project in any detail, so there is nothing further in the record other than Minnesota Power's proposal regarding that review process.

Competitive Bidding

MP stated that the Department failed to recognize the distinction between the Alliance Agreement and the individual project proposals that are entered into under its umbrella. It is correct that the Alliance Agreement was entered into after US Water became an affiliate. As noted in Minnesota Power's Petition at Exhibit C, Minnesota Power has entered into a variety of Alliance Agreements with various vendors in order to achieve beneficial business arrangements.

As Minnesota Power has learned more about US Water through its affiliation after being acquired by ALLETE, it became clear that there were numerous benefits that US Water's process could bring to Minnesota Power generation facilities. In exploring those opportunities, it became clear that the established process by which utilities seek low-cost products or services through a bidding process did not allow for the overall benefits of the US Water relationship with its customers to be realized by Minnesota Power through that "normal" bid-process mechanism.

As noted above, US Water is not a straight commodity or equipment provider; it instead establishes a relationship with its customer base and provides in-depth analysis of chemicals and processes in order to identify cost and operational improvements. The US Water approach cannot be easily replicated or measured through a simple competitive bid process.

Minnesota Power stated that it believes its annual review process is the best method to allow the Commission to validate the benefits achieved in using US Water, and MP is open to suggestions for improvement from the Commission and Department on that proposed process.

Rate Case Impact

Minnesota Power stated that if it uses a 2016 test year then a review of US Water related purchase orders is prudent. Minnesota Power indicated that it would justify any US Water related costs, and while the Department may wish for it to occur within the context of a rate case, Minnesota Power proposes that this Docket would be the better vehicle for that review because it would address ongoing purchase orders beyond the test year.

Minnesota Power Conclusion

Minnesota Power requested Commission approval of the Alliance Agreement, along with the current and future purchase orders entered into under the authority thereof. The terms of the Alliance Agreement and the proposed compliance protocol are beneficial to Minnesota Power ratepayers and satisfy the Commission's public interest standard.

Department Comment

Filing Requirements

The Department noted that the 98 Order requires that, within 30 days of executing a contract or arrangement with an affiliate, the Company file for Commission approval. The Department noted that on pages 10 to 14 of the Petition, MP provided the affiliated-interest requirements pursuant to the 98 Order, with the information for each requirement in one location, along with a brief explanation of how the Company believes it has satisfied each requirement. The Department concluded that MP has substantially complied with the filing requirements under the 98 Order, with the exception of the effective date of the contract or arrangement.

The Alliance Agreement was entered into on April 25, 2016. MP filed for approval on May 25, 2016, however, MP proposed that the Alliance Agreement have an Effective Date of October 1,

2015, more than six months prior to when the Alliance Agreement was entered into. Minnesota Power: 1) proposed to file a general rate case before the end of 2016; and 2) implicitly requested a retroactive approval (going back to October 1, 2015) of “the Alliance Agreement, along with the current and future purchase orders entered into under the authority thereof.”

Department Analysis of Proposal

The Department noted that when a transaction does not involve an affiliate, the public utility often has the right incentives to keep its O&M costs as low as possible since its recovery of these costs is already included and fixed in base rates until its next rate case. However, the fact that MP waited until USWS became an affiliate to execute such an Arrangement, and then executed the arrangement without competitive bidding, raises serious concerns. The Department quoted the following concern from page 8 of the July 31, 2008 Staff Briefing Papers in Docket No. E-017/M-08-119:

In staff’s opinion, transactions between a public utility and its affiliates lend to the possibility for mischief, should be viewed with a suspicious eye, and should be subjected to extra controls. The earnings of the regulated utility are subject to the limits of the reasonable rates established in rate proceedings. However, if excess costs can be shifted to the utility by an affiliate, or revenues shifted to the affiliate from the utility, it may be possible for the overall corporation to maximize earnings at the expense of the captive ratepayers. Minn. Stat. 216B.48 exists for the purpose of protecting ratepayers from such potentially unreasonable transactions. It should be kept in mind that there may be benefits to the utility by entering into reasonable transactions with affiliates.

The Department stated that these comments articulate the Department’s support for a competitive bidding process as the preferred standard to ensure a reasonable fair market value and arms-length transaction. The Department noted that the preference for a competitive bidding process is reflected in the Commission’s Rule 7825.2200.

The Department noted that the purchase orders entered into with USWS under the Alliance Agreement have not been subject to competitive bidding, and future work made pursuant to project proposals will also not be subject to competitive bidding. The Department stated that:

MP did not claim in response to item 7 of the 98 Order that “the service or good acquired from an affiliate is [not] competitively available.” A Google research showed that there was at least one other company that may be able and willing to provide similar services and goods, Fremont Water Solutions, based on the information provided in its website. Other companies are likely available as well. Only a competitive bidding process would identify the companies that may be able and willing to provide the needed services and goods.

The Company’s justification for not using competitive bidding is that “the work represented by the purchase orders and proposals have been the result of comprehensive analysis performed by USWS to address specific process improvements that have been

identified and brought forward to Minnesota Power.” As a result, MP cannot bid such work out “due to its comprehensive and proprietary nature unique to that specific vendor.” MP appears to be saying that it cannot use competitive bidding because it already worked with USWS and, as a result, USWS identified process improvements that would be at the basis of current and future purchase orders and proposals that are of a “comprehensive and proprietary nature unique to that specific vendor.” Department noted that the Company chose to commit to and work with USWS while knowing in advance that “competitive bidding is the [Commission’s] preferred standard by which to determine reasonableness.”

It disagrees with MP’s representation that “the protections and incentives of the competitive bid process have been captured by the terms of the Alliance Agreement and the annual compliance process.” Nothing in the record shows that the proposed pricing terms would achieve a reasonable fair market value and be consistent with an arms-length transaction for any of the services or goods to be acquired from USWS. This includes but is not limited to a level of profit margin, pricing of services and price adjustments that may or may not reflect market prices faced or to be faced by MP.

The Department concluded that MP did not meet its burden of proof to show that the Alliance Agreement is both reasonable and consistent with the public interest.

Department Reply Comments

The Department stated that Minnesota Power’s Reply Comments did not provide any new information in the record that would change its initial recommendations.

The Department noted that Minnesota Power’s Reply Comments at page 4 repeat MP’s proposal that the Department/Commission perform an after-the-fact review of individual projects to assess whether the “project was beneficial and actually realized the savings identified up-front prior to the work beginning.” MP proposed this as an alternative to competitive bidding or other up-front methods for ensuring least cost pricing.

The Department notes that MP’s statement at page 4 that the Company’s proposed “annual review process is the best method to allow the Commission to validate the benefits achieved in using US Water:”

- Translates into the Department and the Commission micromanaging these projects without having MP’s specific knowledge of the Company’s operations, and
- Relies on MP’s representation, with which the Department disagreed “the protections and incentives of the competitive bid process have been captured by the terms of the Alliance Agreement and the annual compliance process.”

The Department restated its conclusion that MP did not meet its burden of proof to show that the Alliance Agreement is both reasonable and consistent with the public interest.

Department Recommendation

The Department does not recommend approval of the Petition. Since some of the costs related to the Alliance Agreement (including but not limited to “current” and/or future purchase orders) may be part of MP’s next rate case, depending on the test year chosen by MP, the Department recommended that the Commission require the Company to identify any such costs and support the reasonableness of these costs in its next initial rate case filing.

Staff Analysis

Staff questions the Company’s representation that because of other Commission action, including capital structure approvals, the Alliance Agreement has become the first Commission-jurisdictional activity of USWS and Minnesota Power. Staff reviewed the Company’s capital structure and security issuance petition and the Order in Docket No. E-015/S-14-145. The Commission’s Order approving the capital structure and securities issuance, which was effective until the later of May 1, 2015, or until the Commission issues a new capital structure order, covered the time period in which Allete purchased USWS. The Order does not discuss Minn. Stat. §216B.48, Relations with Affiliated Interest. The only reference to Minn. Stat. §216B.48 in the 14-145 docket is found on page 11 of the Company’s Petition, where it addressed the following filing requirement:

A Statement as to Whether, at the Time of Filing of the Petition, the Petitioner Knows of any Person who is an “Affiliated Interest” Within the Meaning of Minnesota Statutes, Section 216B.48, Subdivision 1, Who has Received or is Entitled to Receive a Fee for Services in Connection with the Negotiations or Consummation of the Issuances of the Securities, or for Services in Securing Underwriters, Sellers, or Purchasers of the Securities.

Minnesota Power’s response to that requirement was:

To the best of the Company’s knowledge, at the time of the filing of this Petition, no person, who is an “affiliated interest” within the meaning of Minn. Stat. § 216B.48 of the Minnesota Public Utilities Act, has received or is entitled to receive a fee for services in connection with the negotiations or consummation of the issuance of the securities, or for services in securing underwriters, sellers or purchasers of the securities herein described, except as may have been reported pursuant to Commission rules or other applicable “affiliated interest” reporting requirements.

This statement does not address the potential purchase of companies that would create an affiliate interest, much less approval of any transactions with those affiliated interests. Staff does not agree with the Company’s representation in footnote one (on page three of its Petition) stating:

Minnesota Power’s diversification strategy into complementary energy-centric businesses has been consistently communicated in capital structure filings since the spin-off of the

ADESA auto auction in 2004; the USWS acquisition, along with the development and growth of ALLETE Clean Energy, are the results of that diversification effort. With respect to the requirements of Minnesota Statute Sections 216B.48, 216B.49 and 216B.50, because the USWS acquisition was compliant with the Company's capital structure requirements, because no new affiliate or administrative services requirements resulted from the transaction, and because the USWS operations in the state consisted of neither utility plant nor operating unit under Commission precedent or statute, or rules and regulations, the Alliance Agreement has become the first Commission-jurisdictional activity of USWS and Minnesota Power.

As noted by the Department, the Petition includes a list of purchase orders ranging from \$1,294 and \$83,193 that MP entered into with USWS between July 22, 2012 and December 11, 2014, before the acquisition of USWS. As noted above, Exhibits E and F identify 12 purchase orders and 11 project proposals.

Minnesota Power's interpretation of the Commission's approval of MP's capital structure securities issuance petitions could undermine the affiliate interest statute and make the property transfer and merger statute unnecessary. Staff suggests that Minnesota Power's interpretation of the Commission's capital structure/security issuance Orders necessitates greater scrutiny and clarification of the limits of what is covered in capital structure and security issuance filings.

In future capital structure and security issuances petitions, the Commission may want to specify that its approval is for the specific transactions and issuances listed by the Company in its petition and is not an approval of any corporate transaction required under any other statute.

The Department's initial comments were submitted before Minnesota Power filed its pending rate case. The Department's reply comments were filed after Minnesota Power filed its rate case. It is not clear if the Department is recommending action in the current, pending rate case, or in future rate cases. The Commission may want to ask the Department to clarify its position at this time.

Decision Options

Some Commission options are:

- A. Approve Minnesota Power's Petition.
- B. Adopt the Department's recommendation and:
 - 1. Do not approve the Petition.
 - 2. Require that Minnesota Power, in its next rate case, identify any costs related to the Alliance Agreement (including but not limited to "current" and/or future purchase orders) and support the reasonableness of the costs.
- C. Reject Minnesota Power's petition.