MINNESOTA
PUBLIC UTILITIES COMMISSION

# Staff Briefing Papers

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| Meeting Date | February 20, 2020 | Agenda Item 5 ** |
| Company | Minnesota Power | |
| Docket No. | **E-015/D-19-534** | |
| | **In the Matter of Minnesota Power's 2019 Remaining Life Depreciation Petition** | |

Issues

1. Should the Commission approve Minnesota Power's 2019 remaining lives annual depreciation petition?
2. Should the Commission accept Minnesota Power's proposal to separately depreciate certain Account 390.0 buildings?
3. Should the Commission authorize Minnesota Power's request to transfer an asset (a loader) from regulated operations (Laskin Energy Center) to non-regulated operations (Rapids Energy Center) and its associated accounting treatment?
4. Should the Commission authorize Minnesota Power's request for an offsetting transfer of an asset (a bulldozer) from non-regulated operations (Rapids Energy Center) to regulated operations (Taconite Harbor Energy Center) and its associated accounting treatment?


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| **Relevant Documents** | **Date** |
|---|---|
| Minnesota Power – Petition | August 22, 2019 |
| Minnesota Department of Commerce – Comments | October 22, 2019 |
| Minnesota Power – Reply Comments | November 14, 2019 |
| Department of Commerce – Response Comments | November 26, 2019 |

## Table of Contents

# I. Statement of the Issues

1. Should the Commission approve Minnesota Power's 2019 remaining lives annual depreciation petition?

2. Should the Commission accept Minnesota Power's proposal to separately depreciate certain Account 390.0 buildings?

3. Should the Commission authorize Minnesota Power's request to transfer an asset (a loader) from regulated operations (Laskin Energy Center) to non-regulated operations (Rapids Energy Center) and its associated accounting treatment?

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# II. Relevant Statutes, Rules and Practice

**Minn. Stat. § 216B.11. Depreciation Rates and Practices**.

The Commission shall fix proper and adequate rates and methods of depreciation, amortization, or depletion in respect of utility property, and every public utility shall conform its depreciation, amortization or depletion accounts to the rates and methods fixed by the commission.

**Minn. Rules, pts. 7825.0500 – 7825.0900. Depreciation Certification.**

Minn. Rules, pt. 7825.0600, subp. 1. Depreciation Certification.

Depreciation practices applicable to all utilities. All electric and gas utilities shall maintain, and have available for inspection by the commission upon request, adequate accounts and records related to depreciation practices as defined herein. Each utility has the prime responsibility for proposing the depreciation rates and methods that will be used. The commission shall certify by order to the utility the depreciation rates and methods which it considers reasonable and proper. Any allocation or adjustment of the depreciation reserve will require specific justification and certification by the commission.

Either the utility may submit or the commission may request a petition for depreciation certification because of unusual circumstances or unique situations.

Minn. Rules, pt. 7825.0600, subp. 2 & 3. Depreciation Certification.

… All utilities shall review their depreciation rates annually to determine if they are still generally appropriate. Depreciation certification studies shall be made so that all primary accounts (class A & B utilities) or all functional groups of plant accounts (class C & D utilities) have been analyzed at least every five years. ..

Minn. Rules, pt. 7825.0900. Petition for Certification Procedure.

… Depreciation rates and methods, once certified by order, are binding on all future rate proceedings and will remain in effect until the next certification or until the commission shall determine otherwise. …

**Commission Practice**

Depreciation methods, practices and rates are evaluated in depth once every five years in a depreciation study provided by the utility and then reviewed annually, usually in a request for certification of the remaining lives of the utility's assets. The depreciation rates established in these proceedings are incorporated into the Company's revenue requirement and rates in a general rate proceeding. These stand-alone depreciation filings allow for a thorough examination of the Company's depreciation methods, practices and rates independent of the other issues examined and analyzed within a rate case. This is one of the main reasons for having separate depreciation filings.

## III. Background

On August 22, 2019, in its initial filing, Minnesota Power (the Company) requested an adjustment for one year's passage of time for the remaining lives of all of its production plant assets with the exception of general plant account 390.0, and proposed no changes to salvage rates. Further, Minnesota Power pointed out that the Commission, in its January 14, 2019 Order in Docket No. E-015/D-18-544 required Minnesota Power to propose to depreciate the largest structures in the 390.0 Structures and Improvement account individually, while continuing to apply group depreciation to the smaller structures.

On October 22, 2019, the Minnesota Commerce Department, Division of Energy Resources (the Department or DOC) submitted its comments. The Department reviewed Minnesota Power's petition to determine whether the Company's proposals complied with all applicable statutes, rules, and Commission orders; to evaluate the reasonableness of the Company's depreciation-related proposals; and to review the 2018 depreciation expense accruals and capital account activities.

On November 14, 2019, Minnesota Power submitted its reply to the Department in which MP addressed both the proposed accounting treatment for the asset transfers and that Rapids Energy Center[1] is a non-regulated asset that is not subject to affiliate interest filing requirements under Minn. Stat. § 216B.48.

On November 26, 2019, the Department submitted its response and recommended the Commission approve MP's Petition with modification.

[1] The Rapids Energy Center is a non-regulated co-generation facility owned by Minnesota Power, located at the paper mill in Grand Rapids.

(Separately, in its September 4, 2018 Order, in Docket No. E-015/D-18-226, the Commission reviewed MP's five-year depreciation study for its transmission and distribution plant accounts and certified MP's depreciation rates for these assets. On March 27, 2019, MP submitted its 2019 annual update of transmission and distribution depreciation rates, in Docket 18-226.)

## IV. Minnesota Power - Initial Petition

Minnesota Power is requesting the Commission's approval of its 2019 Remaining Life Depreciation Petition which adjusts the remaining lives of all production facilities for one year's passage of time, except for account 390.0 structures and improvements, and proposed no changes to salvage rates.

The changes proposed would result in an estimated $64,000 decrease to 2019 annual depreciation expense when compared to 2018 rates and lives.

### A. Remaining Life Adjustments

Minnesota Power reviewed the remaining lives and salvage values for thermal, hydroelectric, wind and solar production facilities; and determined that the remaining lives should be adjusted for one year's passage of time and that salvage rates should remain unchanged. The Company also noted that, in this petition, it is using the information and forecast periods from its 2015 Integrated Resource Plan (2015 IRP Plan).[2] Minnesota Power will file its next integrated resource plan by October 1, 2020. The table below shows the proposed remaining lives, salvage rates, end of lives and the 2015 IRP Plan end of lives for production facilities.

**Table 1: Minnesota Power's Proposed Generation Parameters**[3]

| | Proposed Remaining Lives (Years) | Proposed Salvage Rates | Proposed End of Lives | 2015 IRP Plan End of Lives |
|---|---|---|---|---|
| Thermal Production Plants | | | | |
| Hibbard Renewable Energy Center | 11.0 | (2.11%) | 12/2029 | 2029 |
| Laskin Energy Center | 12.0 | (24.12%) | 12/2030 | 2030 |
| Boswell Energy Center | | | | |
| Unit 1 | 4.0 | (16.08%) | **12/2022** | **2024**[4] |
| Unit 2 | 4.0 | (18.06%) | **12/2022** | **2024** |
| Unit 3 | 17.0 | (7.92%) | **12/2035** | **2034** |
| Unit 4 | 17.0 | (7.42%) | 12/2035 | 2035 |
| Common | 17.0 | (3.95%) | **12/2035** | **2030** |
| Taconite Harbor Energy Center | 8.0 | (7.23%) | 12/2026 | 2026 |
| Hydroelectric Production Plants | | | | |

[2] Docket No. E-015/RP-15-690, approved by the Commission on July 18, 2016.

[3] Petition, August 22, 2019, pages 6-7.

[4] Emphasis added to highlight difference between proposed depreciable end of lives and 2015 IRP Plan.

| | Proposed Remaining Lives (Years) | Proposed Salvage Rates | Proposed End of Lives | 2015 IRP Plan End of Lives |
|---|---|---|---|---|
| Prairie River HE Station | 45.0 | 0 | 12/2063 | 2063 |
| Thomson HE Station | 45.0 | 0 | 12/2063 | 2063 |
| Fond du Lac HE Station | 45.0 | 0 | 12/2063 | 2063 |
| Winton HE Station | 45.0 | 0 | 12/2063 | 2063 |
| Knife Falls HE Station | 45.0 | 0 | 12/2063 | 2063 |
| Scanlon HE Station | 45.0 | 0 | 12/2063 | 2063 |
| Blanchard HE Station | 45.0 | 0 | 12/2063 | 2063 |
| Pillager HE Station | 45.0 | 0 | 12/2063 | 2063 |
| Birch Lake HE Station | 45.0 | 0 | 12/2063 | 2063 |
| Boulder Lake Reservoir | 45.0 | 0 | 12/2063 | 2063 |
| Fish Lake Reservoir | 45.0 | 0 | 12/2063 | 2063 |
| Island Lake Reservoir | 45.0 | 0 | 12/2063 | 2063 |
| Rice Lake Reservoir | 45.0 | 0 | 12/2063 | 2063 |
| Whiteface Reservoir | 45.0 | 0 | 12/2063 | 2063 |
| Gauging Stations and White Iron Lake Reservoir | 45.0 | 0 | 12/2063 | 2063 |
| Other Production Plants | | | | |
| Taconite Ridge I Wind | 24.4 | (0.31%) | 5/2043 | 2043 |
| Bison 1 Wind – Phase 1 | 26.9 | (0.95%) | 11/2045 | 2045 |
| Bison 1 Wind – Phase 2 | 28.0 | (0.93%) | 12/2046 | 2046 |
| Bison 2 Wind | 29.0 | (0.35%) | 12/2047 | 2047 |
| Bison 3 Wind | 29.0 | (0.42%) | 12/2047 | 2047 |
| Bison 4 Wind | 31.0 | 0.03% | 12/2049 | 2049 |
| Community Solar Garden | 22.9 | 0 | 11/2041 | 2041 |

The Company noted that, with the exception of the Boswell Energy Center (discussed below), all production plant facilities have estimated remaining lives which agree with the estimated operational lives in the 2015 Plan.

### 1. Boswell Energy Center (BEC) Remaining Lives

In September 2014 Minnesota Power settled with the Environmental Protection Agency and entered into a Consent Decree that required that Boswell Energy Center Units 1 and 2 (BEC1&2) must be retired, refueled, repowered, or emissions rerouted through existing emission controls at BEC, no later than December 31, 2018. The Company's 2015 IRP Plan[5] defined its preferred option to reroute emissions, however, the Commission's Order stated that Minnesota Power's proposed investment in $SO_2$ reduction at BEC1&2 had not been demonstrated to be reasonable at that time. Therefore, the Commission ordered the Company to retire BEC1&2 when sufficient energy and capacity became available, but not later than 2022.

[5] Docket No. E-015/RP-15-690.

In Minnesota Power's 2018 Remaining Life Depreciation docket,[6] the Commission Order[7] approved remaining lives of five years as of January 1, 2018 for BEC1&2, based on a retirement year of 2022. Since Minnesota Power retired BEC1&2 in December 2018 based on the consent decree, the remaining balances were transferred to regulated assets that are being amortized through 2022.

The Company noted that, as ordered by the Commission in the 2018 Remaining Life Depreciation docket,[8] it recorded supplemental depreciation expense of $0.9 million of the $2.8 million total, to reflect one year of amortization for Boswell Unit 3 (BEC 3) and Boswell Common.

In summary, BEC1&2 regulated assets are being amortized through 2022, two years less than the 2015 IRP Plan's estimated operational life end of 2024. BEC3, BEC4, and BEC Common all have proposed remaining lives of 2035, which are equal to or greater than the estimated lives in the Company's 2015 IRP Plan.

Minnesota Power stated that it will continue to act on reconciling differences between remaining lives and the latest approved integrated resource plan in a reasonable and timely manner.

### 2. General Plant Account 390.0

Ordering point 6 of the Commission's January 14, 2019 Order[9] required the Company to include a proposal to depreciate the largest structures in account 390 Structures and Improvements individually and to continue to apply group accounting to the smaller structures. MP is required to explain how it proposes to:

A. determine which structures should be removed from the group to be depreciated separately, and which should remain in the group;
B. allocate the existing depreciation reserve among structures that should be removed from the larger group and those that remain in the group; and
C. determine the remaining lives for structures that should be removed from the group and the remaining life for the group.

In response, the Company is proposing to individually depreciate the largest structures using the following proposed end of lives (note that the current end of life is 12/2036) and no change in salvage rates.

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[6] Docket No. E-015/D-18-544.

[7] Ibid, Order, January 14, 2019.

[8] Ibid, Order, Point 3.

[9] Docket No. E-015/D-18-544

**Table 2: Account 390.0 – Structures and Improvements Proposed Depreciation Parameters**[10]

| Location | Proposed Remaining Life (Years) | Proposed Salvage Rates | Proposed End of Life |
|---|---|---|---|
| General Office Building | 32 | 0% | 12/2050 |
| Rowe Energy Control Center | 32 | 0% | 12/2050 |
| Little Falls Service Center and DC Line Material Storage Facility | 32 | 0% | 12/2050 |
| *The long range plan for these facilities is significant planned future investment.* | | | |
| Herbert Service Center | 22 | 0% | 12/2040 |
| Eveleth Service Center | 22 | 0% | 12/2040 |
| Sandstone Service Center | 22 | 0% | 12/2040 |
| Pine River Service Center | 22 | 0% | 12/2040 |
| Miscellaneous Structures & Improvements | 22 | 0% | 12/2040 |
| *The long range plan for these facilities is continued operation and upgrades.* | | | |
| International Falls Service Center | 12 | 0% | 12/2030 |
| Cloquet Service Center | 12 | 0% | 12/2030 |
| *The long range plan for these facilities is minimal planned future investment* | | | |
| Coleraine Service Center | 7 | 0% | 12/2025 |
| The long range plan for this facility is little to no planned future investment | | | |
| Crosby Service Center | 3 | 0% | 12/2021 |
| Park Rapids Service Center | 3 | 0% | 12/2021 |

Minnesota Power also stated that it is interpreting the word "individually" in order point 6 to mean separately, since individually depreciating individual assets that make up a facility would be "daunting".[11] The facilities proposed to be separately depreciated all have an investment of $1 million or more. Account 390.0 facilities with investment of $1 million or less have been combined as a group asset, will have the same life, and will be depreciated as miscellaneous structures and improvements.

### B. Future Additions or Retirements Affecting Current Certification

Minnesota Power stated that it has no major future additions or retirements to plant accounts that would materially impact the 2019 depreciation accruals. The Company noted its plan to end coal operations at the Taconite Harbor Energy Center (THEC) Units 1 and 2 in 2020 and economically idled them in the fall of 2016. Minnesota Power requested that the remaining balances of all THEC units be recovered over the current remaining life of the plant through 2026.

[10] Petition, August 22, 2019, pages 12-13.

[11] Instant Docket, Petition, Appendix B, July 21, 2019, page 1 of 2.

In conclusion, Minnesota Power reiterated its request that the remaining lives of all facilities, with the exception of account 390.0 structures and improvements, be adjusted for one year's passage of time. The Company proposed no changes to salvage rates. The Company stated that the changes proposed in its petition will result in an estimated 2019 annual depreciation decrease of about $64,000 when compared to 2018 rates and lives.

## V. Minnesota Department of Commerce – Comments

### A. Introduction

The Department stated that Minnesota Power's 2019 Remaining Life Depreciation Petition includes MP's request for an update to depreciation rates to reflect the passage of one year's time, 2018 plant-related activities, and approval for 2019 depreciation parameter. More specifically:

- Adjust the remaining lives of the Company's generation facilities and Federal Energy Regulatory Commission (FERC) Account 390.0 assets downward by one year, to reflect a one-year passage of time.
- Extend or reduce, by varying lengths, the remaining lives of all Account 390.0 assets for factors other than the passage of one year's time.
- Separate and independently depreciate twelve buildings included in Account 390.0, while continuing to apply a group depreciation methodology to the remaining assets in Account 390.0.
- Continue using the previously approved salvage rates for all assets included in the instant filing.

The Department stated that Minnesota Power is requesting a January 1, 2019 effective date for its depreciation parameters, asserting that its proposals would result in an approximate $64,000 overall net decrease, or about a 0.006 percent reduction, in annual depreciation expense.[12]

### B. Compliance Review

The Department stated that, under Minnesota Statutes § 216B.11 and Minnesota Rules, parts 7825.0500-7825.0900, utilities are required to use Straight Line depreciation (unless the utility can justify a different method), and found that Minnesota Power continues to use the Straight

[12] Per the Department: the Commission most recently approved depreciation and salvage rates in Docket No. E015/D-18-544; these rates were effective January 1, 2018. In Petition Appendix A-1, Minnesota Power provides a comparison of the total depreciation expense accrual that would result under the currently approved and proposed depreciation rates. For this comparison, Minnesota Power applied the current and proposed depreciation rates to the Company's plant balances as of December 31, 2018, which means that these depreciation expense accruals are theoretical estimates and do not reflect the actual depreciation expense that Minnesota Power will book. Calculation of 0.006 percent is as follows: ($99,114,886 depreciation expense using current rates - $99,050,843 depreciation expense using proposed rates) / ($99,114,886) = 0.0006.

Line Method. The Department noted that under a remaining life methodology, depreciation rates must be updated each year to both reflect the passage of time and the impact of plant activities (i.e. asset additions, retirements, transfers, and adjustments). Based on its review, the Department found that Minnesota Power has complied with applicable statutes and rules.

### C. Compliance with Commission Orders

The Department found that, in compliance with the Commission's last order,[13] Minnesota Power included a comparison of the remaining depreciable lives proposed to the remaining lives in the Company's most recent Integrated Resource Plan (IRP). The Department determined that, aside from some minor differences, Minnesota Power's proposed lives align with the most recent IRP. The Department recommended that the Commission continue to require this remaining lives comparison in future depreciation studies.

As required by the Commission's order in Minnesota Power's last depreciation review,[14] the Company has proposed a plan to separate and individually depreciate the largest structures in Account 390.0 Structures and Improvements as follows:

- Determine which structures should be removed from the group to be depreciated separately, and which should remain in the group.[15]
- Allocate the existing depreciation reserve among structures that should be removed from the larger group and those that remain in the group.[16]
- Determine the remaining lives for structures that should be removed from the group and the remaining life for the group.[17]

The Department also confirmed that, in response to the Commission's order,[18] the Company recorded depreciation expense amounts of $671,889 and $266,702 in Account 312.1 Boiler Plant Equipment, Pollution for BEC Common and Unit 3, respectively. These amounts reflect 12 months' worth of the $2.8 million supplemental depreciation required to be distributed over a 36 month period.[19]

In conclusion, the Department found that Minnesota Power has demonstrated in its petition that it has complied with Commission orders as required.

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[13] Docket E-015//D-17-118, Order, March 21, 2018.

[14] Docket No. E-015/D-18-544, Order, January 14, 2019.

[15] Petition, Appendix B.

[16] Petition, pages 2 and 3.

[17] Petition, Appendix B.

[18] Docket No. E-015/D-18-544, Order, January 14, 2019.

[19] Department Attachment 9.

### D. Depreciation Methodology

Depreciation is a cost allocation method that allows an entity to approximately match the cost of an asset over its useful life to the revenue generated by the use of that asset. Minnesota Power individually depreciates its generation facilities using a straight line, remaining life depreciation methodology. Using this methodology, the remaining lives are adjusted annually to reflect a one-year passage of time. Asset lives may also be adjusted due to other factors (e.g. a change in useful life, policy or capital changes, etc.).

Regarding the Company's Account 390.0 Structures and Improvements, Minnesota Power historically used a straight line, remaining life methodology applied at a group level.[20] Unlike most of the Company's group depreciation accounts, Minnesota Power does not assign a statistical retirement curve or average service life to its assets in Account 390. Rather, the group remaining life is adjusted downward by one year, each year.

Minnesota Power proposed to separate significant buildings from Account 390.0 and to depreciate these buildings individually, using the same depreciation methodology applied to the Company's generation facilities.

### E. Proposed Depreciation Parameters

Minnesota Power's Petition Appendix A-1 details its proposed adjustments to the remaining lives of generation facilities and Account 390.0 Structures and Improvements. The Company requested an effective date of January 1, 2019 for its depreciation parameters and did not request any changes to its approved net salvage rates. The regulated asset amortization parameters for the retired BEC Units 1 and 2 are detailed in Petition Appendix A-5. The table below shows the net annual depreciation impact of the Company's proposals:

**Table 3: Impact of Minnesota Power's Proposals on Theoretical Estimate of 2019 Depreciation Expense[21]**

| | Annual Depreciation Expense Increase/(Decrease) |
|---|---|
| Total Generation Assets | 0 |
| Total Account 390.0 Assets | (64,043) |
| **Net Estimated Impact** | **(64,043)** |

As shown in MP's Petition Appendix A-1, using currently approved depreciation parameters would result in a theoretical depreciation expense of $99,114,886 while using the proposed parameters results in a theoretical expense of $99,050,843, resulting in a difference of $64,043. Note that these are theoretical estimates because the actual depreciation will be applied to account balances that will be impacted by annual account activities (e.g. additions, retirements, etc.) and will also be calculated and booked on a monthly basis.

[20] In 2018, Minnesota Power retired the entire property balance in the Company's general plant FERC Account 398.2 –Aircraft Fixed Wing. Petition Appendix A-2.

[21] Department Comments, page 4.

In addition to the typical one year passage of time, the Company is proposing to alter the remaining live of all the assets in Account 390.0 Structures and Improvements and to individually depreciate 12 buildings that have capitalized values of $1 million or more, while applying a group depreciation methodology to the remaining collection of buildings. Minnesota Power, in response to a Department information request, stated that it determined the remaining lives of the 12 individually depreciated buildings through a combination of walk-around building inspections, as well as routine inspections performed by contractors. The proposed remaining lives for assets in Account 390.0 are shown in the table below:

**Table 4: Minnesota Power's Proposed Remaining Lives for Account 390.0 – Structures & Improvements[22]**

| Building | Current Remaining Life (Years) | Proposed Remaining Life (Years) | Proposed Total Depreciable Life (Years) |
|---|---|---|---|
| 1. General Office Building | 18 | 32 | 88 |
| 2. Rowe Energy Control Center | 18 | 32 | 72 |
| 3. Little Falls Service Center/DC Line Material Storage Facility | 18 | 32 | 72/39[23] |
| 4. Herbert Service Center | 18 | 22 | 62 |
| 5. Eveleth Service Center | 18 | 22 | 56 |
| 6. Sandstone Service Center | 18 | 22 | 52 |
| 7. Pine River Service Center | 18 | 22 | 54 |
| 8. International Falls Service Center | 18 | 12 | 50 |
| 9. Cloquet Service Center | 18 | 12 | 48 |
| 10. Coleraine Service Center | 18 | 7 | 43 |
| 11. Crosby Service Center | 18 | 3 | 36 |
| 12. Park Rapids Service Center | 18 | 3 | 35 |
| 13. Miscellaneous (Grouped Structures) | 18 | 22 | N/A[24] |

The Department noted that the first twelve building listed in the above table reflect $59,882,678 or about 85 percent of Account 390.0's current depreciable balance.

Consequently, the Miscellaneous (Grouped Structures) category amounts to $10,862,193 or about 15 percent of the balance.

The Company also indicated that its long term plan for some buildings includes future investments and upgrades, which may be significant. The table below shows the Account 390.0

[22] Department Comments, page 5. Data in Table 4 was retrieved from Petition Appendix A-1, unless otherwise noted.

[23] Little Falls Service Center, 72 years; DC Line Material Storage Center, 39 years.

[24] Because the Miscellaneous building category contains multiple structures with initial capitalization that occurred at different points in time, a single total depreciable life cannot be assigned to this grouped category.

building investment and retirement data provided in response to a Department information request:

**Table 6: Minnesota Power's Estimated 2019 and 2020 Capital Investments and Retirements for Select Buildings in Account 390.0 – Structures & Improvements**[25]

| Building | 2019 ($ in Millions) | | 2020 ($ in Millions | |
|---|---|---|---|---|
| | Capital Investment | Retirements | Capital Investment | Retirements |
| General Office Building | 1.3 | (0.5) | 6.0 | (1.1) |
| Rowe Energy Control Center | 1.0 | (0.2) | 0.2 | 0.0 |
| Little Falls Service Center/DC Line Material Storage Facility | 0.3 | 0.0 | 0.0 | 0.0 |
| Herbert Service Center | 0.5 | (0.2) | 1.3 | (0.3) |
| Eveleth Service Center | 0.3 | 0.0 | 0.0 | 0.0 |
| Sandstone Service Center | 0.1 | (0.1) | 0.0 | 0.0 |
| Pine River Service Center | 0.0 | 0.0 | 0.3 | 0.0 |
| Miscellaneous Grouped Structures | 0.7 | (0.1) | 0.7 | (0.1) |
| **Totals** | **4.2** | **(1.1)** | **8.5** | **(1.5)** |

The Department concluded that Minnesota Power's proposed depreciation parameters, both for Account 390.0 and its generation facilities, are reasonable and recommended Commission approval. The Department also recommended approval of the Company's request for a January 1, 2019 effective date.

i. Corrections to 2019 Theoretical Estimates of Depreciation Expense

The Department reported that Minnesota Power, in response to an information request, made two minor mathematical corrections and submitted a revised version of Petition Appendix A-1.[26] The Department indicated that it appreciated the Company's response and considers these mathematical errors resolved.

### F. Major Future Additions and Retirements

Minnesota Power reported that it "does not have any major future additions or retirements to plant accounts that would materially impact the 2019 depreciation accruals."[27]

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[25] Department Comments, page 6. Data in Table 3 retrieved from Department Attachment 7.

[26] Minnesota Power confirmed that the original Petition Appendix A-1 contained formula errors that resulted in a miscalculation of the 2019 theoretical estimates of depreciation expense for THEC and Total Steam Generation (see Department Attachments 2 and 3). As a part of its response to the relevant Department information requests, the Company submitted a revised Petition Appendix A-1, with corrected formulas (see Excel workbook filed with the instant Comments and titled "DOC IR 02 3 4 Revised Appendices").

[27] Petition page 13.

## G. Annual Depreciation Expense Accruals

The table below shows a summary of select plant-in-service activity and depreciation provisions from 2015 through 2018.

**Table 7: Minnesota Power's Plant-in-Service and Depreciation Provision Summary for Year 2015-2018[28]**

| Year | Plant-in-Service Balance at December 31 ($)[29] | Change in Plant Balance ($) | Annual Depreciation Expense Booked ($) | Depreciation Reserve Balance at December 31 ($) | Change in Depreciation Reserve Balance ($) | Depreciation Reserve Ratio |
|---|---|---|---|---|---|---|
| 2018 | 2,629,646,206 | (104,528,187) | 103,122,345 | 855,857,353 | (5,321,912) | 33% |
| 2017 | 2,737,174,393 | 15,194,534 | 77,022,723 | 861,179,265 | 54,352,675 | 31% |
| 2016 | 2,718,979,859 | 4,904,657 | 100,427,012 | 806,826,590 | 57,165,091 | 30% |
| 2015 | 2,714,075,202 | N/A | 83,189,427 | 749,661,499 | N/A | 28% |

The Department stated that the plant-in-service balances have been relatively stable during this period, with a decrease in 2018 that can largely be attributed to the retirement of BEC Units 1 and 2.[30] DOC associated the fluctuations in booked depreciation expense to a change in plant balances combined with previously approved remaining life extensions and reductions for BEC Common and Units 3 and 4.[31]

i. Evaluation of MP's 2018 Depreciation Expense Accruals by Facility and FERC Account

The Department performed a high-level analysis of the Company's 2018 depreciation expense accruals by facility and FERC account and concluded that the accruals seem to be consistent with the depreciation rates that were approved for 2018.[32]

## H. 2018 Capital Asset Activities (Additions, Retirements, Transfers, and Adjustments)

Table 8 (below) shows that 2018 retirements and downward adjustments outweighed additions and upwards adjustments resulting in lower ending balances for Steam, Wind and Account

[28] Department Comments, page 8. Figures documented in Table 7 were retrieved from Docket Nos. E015/D-19-534, E015/D-18-544, E015/D-17-118, and E015/D-16-797.

[29] Plant balances exclude non-depreciable land.

[30] Petition Appendix A-2.

[31] In its March 12, 2018 Order in Docket No. E015/GR-16-664, the Commission approved a remaining life extension through 2050 for BEC Common and Units 3 and 4, effective January 1, 2017; a combined depreciation expense of approximately $23.7 million was recorded for BEC Common and Units 3 and 4 in 2017. In its March 29, 2018 Order in Docket No. E015/GR-16-664, the Commission set a retirement date of 2035 for BEC Common and Units 3 and 4, effective January 1, 2018; a combined depreciation expense of approximately $49.8 million was recorded for Boswell Common and Units 3 and 4 in 2018.

[32] Department Comments, page 9.

390.0. In contrast, Hydro showed an increase due to additions, while Solar remained unchanged.

**Table 8: Changes in Minnesota Power's Plant Balances for 2018**[33]

| *Plant Asset Categories* | *Plant Balance 1/1/2018* | *Additions* | *Retirements* | *Transfers* | *Plant Balance 12/31/2018* |
|---|---|---|---|---|---|
| **Generation Type** | | | | | |
| Steam | 1,639,411,311 | 7,254,069 | (113,892,017) | (532,490) | 1,532,240,873 |
| Hydro | 197,366,547 | 6,172,980 | (133,796) | - | 203,405,731 |
| Wind | 823,242,874 | 394,474 | (585,894) | - | 823,051,454 |
| Solar | 203,277 | - | - | - | 203,277 |
| *Total Generation* | 2,660,224,009 | 13,821,523 | (114,611,707) | (532,490) | 2,558,901,335 |
| **General FERC Account** | | | | | |
| 390.0 - Structures & Improvements | 73,626,835 | (26,760) | (2,855,205) | - | 70,744,870 |
| 392.8 - Aircraft, Fixed Wing | 3,034,143 | | (3,034,143) | - | 0 |
| *Total General Account* | 76,660,978 | (26,760) | (5,889,348) | - | 70,744,870 |

i. 2018 Negative Capital Additions

In response to a Department information request, Minnesota Power explained that the $3.2 million in negative capital additions[34] were either due to differences between estimates and actuals for allocations among FERC accounts, or due to sales taxes and other refunds for projects placed in-service in a prior year. The Department concluded that the Company's explanations were reasonable.

ii. 2018 Capital Transfers Reducing Plant Balances

The Department stated that Minnesota Power explained various capital transfers that impacted plant balances in 2018. In a separate information request,[35] the Department asked the Company to explain whether negative transfer values included assets that are part of Minnesota Power's current rate base. The Company explained that it had transferred a loader from the regulated operations of Laskin Energy Center to the non-regulated operations of Rapids Energy Center. The total value of the asset transferred was $267,787 and the Company also transferred the related asset depreciation reserve of $128,170.

The Department explained that ratepayers pay the depreciation expense of a utility's capital assets, as well as a return of investment on those capital assets. So, if a capital asset is used by the regulated operations of the company and is part of rate base, then it needs to remain in the regulated rate base. Otherwise ratepayers are paying for an asset that is no longer "used or useful" and shareholders of non-regulated operations receive an unpaid benefit.

[33] Department Comments, page 9.

[34] Department Comments, Attachment 4.

[35] Department Comments, Attachment 5.

The Department pointed out that this transfer was made without Commission approval and has not been authorized pursuant to Minnesota Statute §216B.48, subd. 3, which states in part:

> Subd. 3. Contract between utility and affiliated interest**. No contract or arrangement,** including any general or continuing arrangement, providing for the furnishing of management, supervisory, construction, engineering, accounting, legal, financial, or similar services, and no contract or arrangement for the purchase, sale, lease, or exchange of any property, right, or thing, or for the furnishing of any service, property, right, or thing, other than those above enumerated, made or entered into after January 1, 1975 between a public utility and any affiliated interest as defined in subdivision 1, clauses (1) to (8), or any arrangement between a public utility and an affiliated interest as defined in subdivision 1, clause (9), made or entered into after August 1, 1993**, is valid or effective unless and until the contract or arrangement has received the written approval of the commission.** (Emphasis added)

As a remedy, the Department recommended that the Commission require Minnesota Power to establish a regulatory liability for the amount of depreciation expense that was charged to ratepayers from the time of the unauthorized transfer until the Company files its next rate case, at which time the regulatory liability should be addressed.

The Department concluded that, with the exception of the Laskin loader transfer, transfers that reduced plant balances during 2018 were appropriate.

iii. Retirement of Boswell Energy Center Units 1 and 2

Minnesota Power retired Boswell Units 1 and 2 in December, 2018 and transferred remaining balances to regulated assets. The Company will amortize these regulated asset through 2022[36] and booked an amortization expense of $7,323,188 for 2019.[37] Further, as requested, Minnesota Power provided a reconciliation of minor discrepancies between asset and depreciation reserve balances, revealing that it booked an additional $144,877 of depreciation expense in December, 2018 after finding that its accounting software had mistakenly recorded too little depreciation. This accounted for the discrepancies observed by the Department.[38]

As requested by the Department, Minnesota Power agreed to add amortization impacts of Boswell Units 1 and 2 to its Appendices A-1 through A-4 in future depreciation updates. These updates would include the regulated asset balance, accumulated amortization, and

[36] In its March 12, 2018 Findings of Fact, Conclusions, and Order, order point 3, Docket No. E015/GR-16-664, the Commission approved remaining accounting lives through 2022 for BEC Units 1 and 2.

[37] Petition Appendix A-5.

[38] Department Attachment 6. The details of the reconciliation provided by Minnesota Power are contained in the Excel file submitted in response the relevant Department IR. The Company notes the provision of this Excel file to the Department in the response documented in Department Attachment 6.

amortization expense.[39] The Department recommended that the Commission incorporate this agreement in its current docket order.

### I. Department Conclusions and Recommendations

The Department recommended that the Commission:

- Require Minnesota Power to continue to provide in future depreciation filings a comparison of the remaining depreciable lives proposed in its depreciation filing and the remaining operating lives approved in the Company's most recent integrated resource plan, with an explanation of any differences.
- Approve Minnesota Power's proposed salvage rates for all assets included in the instant filing, as outlined in Petition Appendix A-1 and A-5.
- Approve Minnesota Power's proposal to adjust the remaining lives of the Company's generation facilities and the assets in Account 390.0 – Structures & Improvements downward by one year, to reflect a one-year passage of time.
- Approve Minnesota Power' proposals to extend or reduce, by varying lengths, the remaining lives of all Account 390.0 assets for factors other than the passage of one year's time, as outlined in Petition Appendix B.
- Approve Minnesota Power's proposal to separate and independently depreciate twelve buildings in Account 390.0, while continuing to apply a group depreciation methodology to the remaining assets in Account 390.0, as outlined in Petition Appendix B.
- Approve Minnesota Power's proposed effective date of January 1, 2019 for the Company's proposed depreciation parameters.
- Require Minnesota Power to (1) establish a regulatory liability for the amount of depreciation expense charged to ratepayers for the transferred Laskin Energy Center assets, from the time of the unauthorized transfer up until the Company files its next rate case and (2) address the resulting regulatory liability in its next rate case.

## VI. Minnesota Power - Reply Comments

In its reply comments, Minnesota Power asserted that its Rapids Energy Center is a "non-regulated asset that is not subject to affiliate requirements under Minn. Stat. § 216B.48."[40]

Regarding the Department's recommendations that Minnesota Power be required to establish a regulatory liability for the depreciation expense charged to ratepayers for the asset transferred to the non-regulated Rapids Energy Center and address that liability in its next rate case: the Company stated that it can accept the recommendation "so long as the Company is allowed to use the same calculation [methodology] that was ordered by the Minnesota Public

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[39] Department Attachment 1. In response to the relevant Department information request, Minnesota Power also submitted a revised version of Petition Appendices A-1 through A-4 that includes the amortization impacts of Boswell Units 1 and 2 (see Excel workbook filed with the instant Comments and titled "DOC IR 02 3 4 Revised Appendices").

[40] Minnesota Power Reply Comments, November 14, 2019.

Utilities Commission (Commission) to record the regulatory liability for the sale of the Aurora and Chisolm service centers in Docket Nos. E015/PA-17-457 and E015/PA-17-459".

Minnesota Power also proposed to offset the recommended regulatory liability by creating a regulatory asset that is a result of the transfer of a dozer from non-regulated Rapids Energy Center to regulated Taconite Harbor Energy Center, noting that both transfers occurred in August, 2018. The Company would make an entry for 17 months (August 2018 through December 2019) at which point the entry would stop, since MP's rate case was filed November 1, 2019 and interim rates are expected to go into effect as of January 1, 2020. After the proposed offset, the regulatory liability would be $7,395.[41]

Minnesota Power's explanation for why the Laskin Energy Center transfer to Rapids Energy Center is not covered under Minn. Stat. §216B.48 "Relations with Affiliated Interest" and Minn Stat. §216B.50 "Restrictions on Property Transfer and Merger" is that "[a] transfer from Laskin Energy Center to Rapids Energy Center is not an affiliate transfer because both facilities are owned by Minnesota Power and therefore no contract or other arrangement was done between the public utility (Minnesota Power) and an affiliated interest as defined under Minn. Stat. § 216B.48, subd. 1". Minnesota Power also claims that Minn. Stat. § 216B.50 is not applicable because it only applies when public utilities "sell, acquire, lease, or rent any plant as an operating unit or system" and that this did not occur since Rapids Energy Center is owned and operated by Minnesota Power, the public utility.

## VII. Minnesota Department of Commerce - Response Comments

The Department addressed Minnesota Power's Reply Comments regarding the issues surrounding the capital asset transfer between the Company's regulated and non-regulated operations.

The Department stated that it believes that, by executing the transfer ($267,787 plant balance and $128,170 depreciation reserve) Minnesota Power violated Minn. Stat. § 216B.48, which regulates transactions between utilities and their affiliated interests.[42]

The Department pointed out that utility customers pay depreciation and property tax expense for capital assets that are used and useful in providing service, as well as paying the utility a return on the capital assets that are in rate base. If an asset is transferred from regulated operations to non-regulated operations, without a corresponding removal from rate base, then customers continue to pay the expenses associated with owning the asset without receiving the benefit from the capital asset, at least until new rates are set in a general rate case. The Department believes "[t]his circumstance is not just and reasonable for Minnesota Power's ratepayers".

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[41] Minnesota Power Reply Comments – Attachment, November 14, 2019 (Excel file).

[42] Department's October 22, 2019 Comments in Docket No. E015/D-19-534, pages 10 and 11 and Department Attachment 5.

The Department acknowledged that both Laskin and Rapids energy centers are wholly owned by the Company. However, the Department said that:

1. Rapids meets the definition of an affiliated interest per § 216B.48, subd. 1, clause (9), which states that an affiliated interest of a public utility includes "every part of a corporation in which an operating division is a public utility." Under the current circumstances, Rapids is a part of a corporation (ALLETE, Inc.) in which an operating division is a public utility (the regulated operations of Minnesota Power).

2. The statute uses the word "contracts" and the broader term "arrangements" and the Department believes that Minnesota Power's voluntary capital asset transfer from regulated to non-regulated had to result from some "arrangement".

3. Lastly, the asset transferred exceeded the $50,000 threshold under the statute.

The Department stated that its recommended remedy for this transfer is to book a regulatory liability which would then be addressed in the Company's next rate case. Minnesota Power conditionally accepted this recommendation provided it be permitted to calculate the liability by using a methodology that was approved by the Commission for the sale of its Chisolm and Aurora Service Centers.[43] The Company also proposed creating an offsetting regulatory asset to reflect its historical transfer of a different capital asset, but from the unregulated Rapids to the regulated facility at Taconite Harbor Energy Center.

In response, the Department first stated that it believes the calculation methodology requested by Minnesota Power is reasonable, particularly since it aligns with the 2017 test year[44] revenue requirements associated with the transferred capital asset. However, the Department disagrees with the proposal to establish an offsetting regulatory asset by transferring from a non-regulated facility to a regulated one. That proposal would leave the Company's ratepayers paying for the costs of an asset that the Commission did not consider and approve.

The Department pointed out that Minnesota Power could have addressed cost recovery for the asset transferred from the Rapids Energy Center to Taconite Harbor Energy Center in a timely manner, but chose to wait for more than a year to address that issue. The Department suggested that if the Company wants cost recovery on a going-forward basis then it should seek recovery through its current rate case proceeding.[45]

Finally, the Department does not believe that establishing the proposed offsetting regulatory asset would be reasonable or fair to ratepayers and also appears to be another violation of Minn. Stat. § 216B.48

[43] Docket Nos. E015/PA-17-457 and E015/PA-17-459.

[44] Minnesota Power used a 2017 Test Year in its prior rate case, Docket No. E015/GR-16-664.

[45] Docket No. E-015/GR-19-442.

**Department Conclusion and Recommendations**

The Department pointed out that the Company has not raised any objections to the Department's initial recommendation. However, in its response comments, the Department amended the last bullet point in its initial recommendation, i.e.

- Require Minnesota Power to (1) establish a regulatory liability for the amount of depreciation expense charged to ratepayers for the transferred Laskin Energy Center assets, from the time of the unauthorized transfer up until the Company files its next rate case and (2) address the resulting regulatory liability in its next rate case.

To the following:

- For the capital asset transferred from the Laskin Energy Center (regulated operations) to the Rapids Energy Center (non-regulated operations), require Minnesota Power to (1) establish a regulatory liability, using the calculation methodology submitted by the Company in its Reply Comments Attachment on November 14, 2019 and (2) address the resulting regulatory liability in its current rate case, Docket No. E-015/GR-19-442.

- If the Commission directs Minnesota Power to establish the Department-recommended regulatory liability, require Minnesota Power to submit a compliance filing, within 10 days of the Commission's order in this matter, showing the Company's finalized calculation of and journal entries for the relevant regulatory liability.

- Deny Minnesota Power's proposal to establish a regulatory asset for the capital asset transfer from the Rapids Energy Center (non-regulated operations) to the Taconite Harbor Energy Center (regulated operations).

## VIII. Staff Analysis

Staff notes that, with the exception of the issue of the Laskin asset transfer (a loader from regulated operations transferred to non-regulated operations) and the Rapids asset transfer (a bulldozer from non-regulated operations transferred to regulated operations), there are no other areas of disagreement between Minnesota Power and the Department of Commerce.

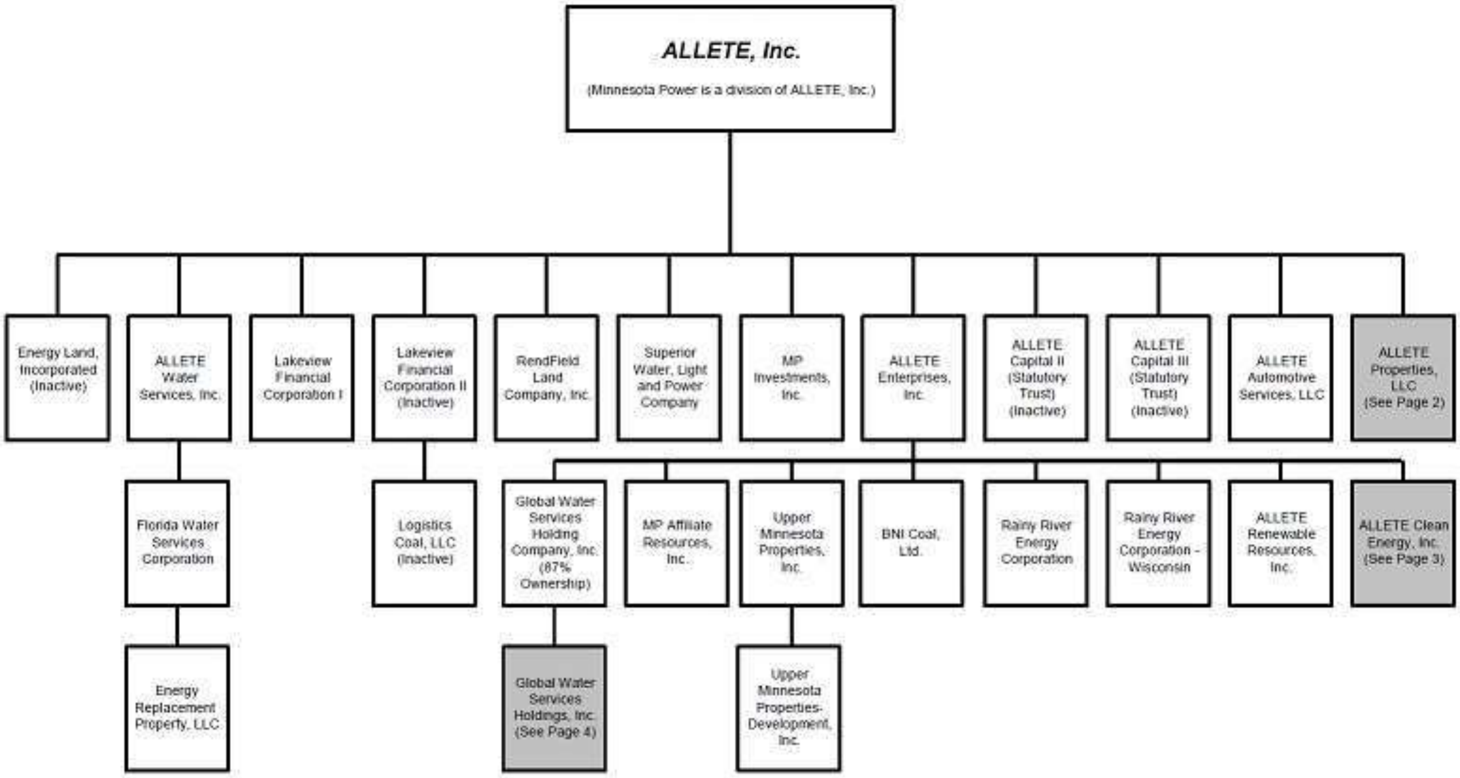
The two issues that remain unresolved are: 1) the nature of these asset transfers and 2) their proper accounting treatment.

**The Nature of the Asset Transfers**
The Department contends that the asset transfers are to an affiliate and should be considered under Minnesota Statute. §216B.48 "Relations with Affiliate Interest". This statute, under subdivision 1 "Definition of affiliated interests" says, in part, that an affiliate is:

> (9) every part of a corporation in which an operating division is a public utility.

Minnesota Power is an operating division of Allete, Inc. Laskin, Rapids and Taconite Harbor are all held within the Minnesota Power operating division of Allete, Inc.

Allete (Minnesota Power) Current Corporate Structure 2016[46]




The Department, in its October 22, 2019 comments contended that Minnesota Power made this transfer without Commission approval, which the Department believes is a violation of Minnesota Statute §216B. 48, subd. 3, which states in part:

> No contract or arrangement, . . . is valid or effective unless and until the contract or arrangement has received the written approval of the commission."

In its November 14, 2019 reply comments, Minnesota Power stated:

> A transfer from Laskin Energy Center to Rapids Energy Center is not an affiliate transfer because both facilities are owned by Minnesota Power and therefore no contract or other arrangement was done between the public utility (Minnesota Power) and an affiliated interest as defined under Minn. Stat. § 216B.48, subd. 1.

Further, in discussions, the Department had requested MP to address the applicability of Minn. Stat. §216B.50 Restrictions on Property Transfer and Merger. Minnesota Power asserted that:

> Because Minnesota Power was doing a transfer between its own utility facilities, the restrictions on property transfers under Minn. Stat. § 216B.50 is not applicable. The statute applies when public utilities "sell, acquire, lease, or rent any plant as an operating unit or system". That did not occur in this instance since Rapids Energy Center is owned and operated by Minnesota Power, the public utility.

46 https://www.oasis.oati.com/woa/docs/MP/MPdocs/legal_organizational_chart_11112016.pdf

The Department, in its November 26, 2019 response comments said that it believes that §216B.48 applied because:

1. Rapids Energy Center (recipient of the asset transfer) meets the definition of an affiliated interest according to subdivision 1, clause 9 – an affiliated interest includes "every part of a corporation in which an operating division is a public utility".
2. The Department noted that subdivision 3 uses that words "contracts" and "arrangements" in describing prohibited transactions between public utilities and affiliated interests and that the "intentional and voluntary transfer" of the loader had to be done through some form of arrangement.
3. The asset transferred exceeded the $50,000 threshold specified in subdivision 5: the original cost of the loader was $267,787 and had a depreciation reserve of $128,170 at the time of the transfer.

If the Commission determines that the asset transfer meets the definition of an affiliated interest transaction or a property transfer, then the transfer would require Commission approval (as would MP's proposed offsetting transfer of a bulldozer from Rapids Energy Center to Taconite Harbor Energy Center). However, neither party has explicitly recommended denial or approval of either asset transfer, but they do make specific recommendations regarding regulatory accounting treatment.

**Accounting Treatment of the Transfer**

The Department recommended that the Commission require Minnesota Power to remedy the transfer by establishing a regulatory liability for the amount of depreciation expense charged to ratepayers for the loader from the time of the transfer up to the time the Company files its next rate case. (MP filed its rate case on November 1, 2019, Docket No. E-015/GR-19-442.)

In response, Minnesota Power said it "can accept this recommendation to record a regulatory liability so long as the Company is allowed to use the same calculation [methodology] that was ordered by the Minnesota Public Utilities Commission to record the regulatory liability for the sale of the Aurora and Chisolm service centers in Docket Nos. E-015/PA-17-457 and E-015/PA-17-459". The Department had no objection to the calculation methodology.

Minnesota Power also proposed "to offset the recommended regulatory liability with the regulatory asset that would result from the transfer of a dozer from Rapids Energy Center (non-regulated) to Taconite Harbor Energy Center (regulated)". Note that both of these transfers occurred in August 2018. The net result of establishing the proposed offsetting regulatory asset would be to reduce the net amount of the regulatory liability to $7,395 which MP would be required to refund (or credit rate base) in its rate case.

The Department contended that MP's proposed offsetting transfer would not meet the requirement needed to establish a regulatory asset and "would result in Minnesota Power's ratepayers paying for the costs of an asset that the Commission did not have an opportunity to consider and did not approve, since the Company chose not to file for approval of the transfer".

Staff believes that whether the non-regulated parts of MP meet the definition of an affiliated interest is a legal question. In either case, staff believes some compensation to regulated operations is due for the transfer of the loader from regulated to non-regulated operations.

# IX. Decision Alternatives

**2019 Remaining Life Depreciation**

1. Approve Minnesota Power's proposal to adjust the remaining lives of the Company's generation facilities and the assets in Account 390.0 – Structures & Improvements downward by one year, to reflect a one year passage of time. [MP, DOC]

2. Approve Minnesota Power's proposed salvage rates for all assets included in the instant filing, as outlined in revised Petition Appendix A-1 and A-5[47]. [MP, DOC]

3. Approve Minnesota Power's proposed effective date of January 1, 2019 for the Company's proposed depreciation parameters. [MP, DOC]

**Reconciling to IRP**

4. Require Minnesota Power to continue to provide in future depreciation filings a comparison of the remaining depreciable lives proposed in its depreciation filing and the remaining operating lives approved in the Company's most recent integrated resource plan, with an explanation of any differences. [MP, DOC]

**Account 390 Structures and Improvements**

5. Approve Minnesota Power' proposals to extend or reduce, by varying lengths, the remaining lives of all Account 390.0 assets for factors other than the passage of one year's time, as outlined in Petition Appendix B. [MP, DOC]

6. Approve Minnesota Power's proposal to separate and independently depreciate twelve buildings in Account 390.0, while continuing to apply a group depreciation methodology to the remaining assets in Account 390.0, as outlined in Petition Appendix B. [MP, DOC]

**Accounting Treatment of Asset Transfers**

7. Require Minnesota Power to (a) establish a regulatory liability for the loader transfer from Laskin to Rapids, using the calculation methodology submitted by the Company in its Reply Comments Attachment on November 14, 2019 and (b) address the resulting regulatory liability in its current rate case, in Docket No. E-015/GR-19-442. [MP, DOC]

[47] Department of Commerce, Information Request 02, 03, 04 Revised Appendices, October 22, 2019.

8. Approve Minnesota Power's proposal to a) establish an offsetting regulatory asset for the 2018 capital asset transfer of a bulldozer from the Rapids Energy Center (non-regulated) to the Taconite Harbor Energy Center (regulated) and b) address the resulting regulatory liability in its current rate case, in Docket No. E-015/GR-19-442. [MP]

**OR**

9. Deny Minnesota Power's proposal to establish a regulatory asset for the 2018 capital asset transfer of a bulldozer from the Rapids Energy Center (non-regulated operations) to the Taconite Harbor Energy Center (regulated operations). [DOC]

**Compliance Filing**

10. If the Commission directs Minnesota Power to establish the Department-recommended regulatory liability or Minnesota Power's proposed offsetting regulatory asset, require the Company to submit a compliance filing, within 10 days of the Commission's order in this matter, showing the Company's finalized calculation of any journal entries for the relevant regulatory accounts. [MP, DOC]