BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Beverly Jones Heydinger	Chair
Nancy Lange	Commissioner
Dan Lipschultz	Commissioner
Matthew Schuerger	Commissioner
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In the Matter of Minnesota Power's 2015 Renewable Resources Rider and Renewable Factor

ISSUE DATE: November 30, 2016

DOCKET NO. E-015/M-14-962

ORDER DETERMINING TREATMENT OF NORTH DAKOTA INVESTMENT TAX CREDITS FOR BISON WIND PROJECTS

PROCEDURAL HISTORY

I. Introduction

Minnesota Power (the Company), a part of ALLETE, Inc.,[1] built the Bison Wind 1, 2, 3, and 4 electric generation facilities (Bison Projects) in North Dakota. The Bison Projects will earn approximately $113 million in North Dakota Investment Tax Credits (tax credits, or credits) based on the amount spent to construct the projects. These credits are not refundable or transferable, and Minnesota Power will not have enough taxable income in North Dakota to be able to use all the tax credits it expects to generate.

Minnesota Power does not anticipate using any of these credits until at least 2020. Minnesota Power projected that ALLETE, Inc. and its affiliated consolidated group will use approximately $22 million of the available tax credits over the respective carryforward periods of the credits.

North Dakota state income tax law allows Minnesota Power's investment tax credits to be applied against the aggregate income tax liability of all corporations included in its consolidated state tax return filing. The Bison Projects' costs, however, are wholly assigned to Minnesota Power's regulated operations.

The primary issue the Commission is asked to decide in this case is the proper treatment of the tax credits in calculating Minnesota Power's revenue requirement. Using a separate-return methodology of tax allocation, Minnesota Power argued that only $10.7 million of the tax credits should be applied to Minnesota Power's revenue requirements, with the remaining $11.3 million of tax credits going to reduce the tax liability of ALLETE's non-utility affiliates.

[1] Minnesota Power is a part of ALLETE, Inc. (ALLETE). ALLETE files a consolidated federal tax return and a unitary (consolidated) North Dakota tax return with its tax-jurisdictional affiliates.

The Department of Commerce, Division of Energy Resources (the Department) argued that the entire $22 million of useful tax credit benefits should be allocated to Minnesota Power when determining its revenue requirements, not just the $10.7 million useable by the Company on a separate return basis.

II. Filings in this Case

On November 10, 2014, Minnesota Power filed a petition requesting approval of its 2015 Renewable Resources Rider. On February 13, 2015, the Company filed a supplement to its petition (not relevant to the issues raised herein).

After several rounds of comments and reply comments were filed by the Company and the Department, the Commission issued an order on March 9, 2016. The Commission resolved all issues raised in the rider filing, except for the treatment of the Company's North Dakota investment tax credits for the Bison Wind Projects.

The March 9 order permitted the Company to file additional information or arguments as to why it accounts for the tax credits as it does, and why it believes that that treatment is consistent with relevant accounting rules and prior decisions of the Commission.

On April 8, 2016, Minnesota Power filed comments. The Company continued to argue that its ratepayers should be credited with only a portion of the tax credits ($10.7 million). The Company proposed to credit the remaining $11.3 million to ALLETE's consolidation company, rather than Minnesota Power's ratepayers.

On April 22, 2016, the Department filed comments disagreeing with the Company's proposed allocation of the credits. The Department argued that the full $22 million of credit benefit should be allocated to the regulated utility's revenue requirements.

On October 5, 2016, Minnesota Power filed a letter reiterating its position that the tax credit issue would best be handled in the Company's anticipated general rate case.[2] As it has previously argued, Minnesota Power asserted that a decision made on the use of the tax credits will have no impact on the current docket, as neither the Company nor any non-regulated subsidiary has used any of the tax credits in dispute.

On October 18, 2016, the Commission met to consider the matter.

FINDINGS AND CONCLUSIONS

I. Summary of Commission Action

In this matter, the Commission takes the following actions:

[2] Minnesota Power filed its general rate case on November 2, 2016. *In the Matter of Minnesota Power's Application for Authority to Increase Electric Service Rates in Minnesota*, Docket No. E015/GR-16-664).

- Requires that all Bison Wind Project North Dakota Investment Tax Credits actually realized in tax-return filings, or monetized through other permissible means, be reflected in the Company's revenue requirements;

- Requires Minnesota Power to amortize the actual North Dakota Investment Tax Credits realized over the remaining life of the Bison Wind Projects; and

- Requires Minnesota Power to file supplemental compliance filings if there are: 1) material changes (greater than ten percent or $2.2 million) to the estimated North Dakota Investment Tax Credit utilization on a consolidated/unitary tax return; and/or 2) legislative changes that allow additional means to monetize these credits.

These actions are explained below.

II. North Dakota Investment Tax Credits to be Included in Revenue Requirements

A. Introduction

Minnesota Power proposed to credit its future renewable-energy-rider revenue requirements with the tax credits used by Minnesota Power operations. According to the Company, this would be equal to the amount used by the Company if it were to file a separate North Dakota tax return ($10.7 million).

The Company explained that ALLETE allocates tax expense among its subsidiaries based on a "separate-return calculation." According to the Company, each ALLETE subsidiary determines its tax liability as if it filed a separate return, and pays its respective tax liability to a consolidation company, also under ALLETE. Should the sum of tax liabilities determined by the affiliates differ from the actual, collective tax liability that resulted from the filing of a consolidated return, the consolidation company keeps, or pays for, the net difference (whether positive or negative).

Minnesota Power argues that its use of the separate-return tax calculation is consistent with the Commission's long-standing use of the "stand-alone" method of tax calculation for corporate subsidiaries. And, throughout these proceedings, the Company has referred to ALLETE's method of allocating tax liability to subsidiaries as the stand-alone method. The Company also argues that its methodology is consistent with prior Commission decisions, Generally Accepted Accounting Principles (GAAP), and Federal Energy Regulatory Commission (FERC) policy.

The Department also urged use of the stand-alone method of allocation, but argues that the Company has improperly defined its method of allocation as the stand-alone method, when, in fact, it is a separate-return method. The Department argued that under the stand-alone methodology, there would be no leftover amounts to be assigned to a consolidation company. All of an entity's consolidated tax expense would be allocated to individual members of the group, and accordingly, the sum of the amounts of income tax allocated to each member of the group would equal the consolidated amount.[3]

[3] The difference between a separate-return calculation and a stand-alone calculation methodology is the treatment of the difference between the total of all separate return tax liability calculations and the total tax liability on the consolidated tax return. The stand-alone method allocates tax expense to individual members through recognition of the benefits/burdens contributed by each member of the group to the consolidated return.

The FERC has explained the difference between a separate-return methodology and the stand-alone methodology as follows:

> The FERC has issued several decisions rejecting the use of the separate return method for determining income tax expense when an entity files as part of a consolidated group. Instead, the FERC relies on the stand-alone method of allocating income taxes between the members of a consolidated group.
>
> Under the stand-alone method of tax calculation, the consolidated tax expense is allocated to individual members through recognition of the benefits/burdens contributed by each member of the consolidated group to the consolidated return. Under the stand-alone method, the sum of amounts allocated to individual members equals the consolidated amount. [4]

B. Minnesota Power's Position

The Company stated that, currently, no North Dakota income taxes are being charged to its revenue requirements. To the extent the Company generates taxable income in North Dakota in the future, any resulting income taxes would be offset by use of the non-refundable tax credits. Based on the Company's estimates of corporate North Dakota income taxes, it does not anticipate that it will be able to fully use the available $113 million of North Dakota investment tax credits, but expects to use approximately $22 million.

To reflect this tax benefit in jurisdictional rates, Minnesota Power proposed to credit its future renewable rider revenue requirement with the amount of tax credits equal to what the Company would consume if it were to file a separate return. This approach would credit Minnesota ratepayers with only a portion of the $22 million in tax credits expected to be applied to ALLETE's North Dakota consolidated tax return, or $10.7 million. The Company stated that the remainder ($11.3 million) will be credited to reduce the tax liability of ALLETE's non-utility affiliates. The Company concluded that the $11.3 million remainder in tax credits is a benefit associated with filing on a unitary basis.

The Company argued against including the remaining $11.3 million tax credits in its revenue requirements, arguing that the tax credit used as a result of the income from the non-regulated operations cannot be used to reduce rates, as regulated rates should not be based on the financial information of non-regulated subsidiaries. Further, the Company argued that ratepayers have no financial interest in or operational risk for the non-regulated affiliates that allow the additional credits to be monetized. The Company claimed that this approach is consistent with the stand-alone accounting method approved by the Commission, and is consistent with GAAP.

The Company asserted that using its described methodology and applying only $10.7 million to the Company's revenue requirements will nonetheless provide a benefit to Minnesota Power, as the remaining $11.3 million will provide more cash to the Company, and potentially reduce its borrowings when doing construction and other activities.

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[4] *See* FERC Accounting for Income Taxes, AI-93-5-000 (April 23, 1993).

1. Analysis of Prior Commission Decisions

The Company's filings analyzed several prior Commission decisions it argued support its position on the proposed allocation of the credits. The Company argued that the Commission's decision in the 2005 Northern States Power rate case[5] supports its position that tax credits used to offset income from non-regulated operations should not be used to reduce ratepayer rates. The Company argued that in the Northern States Power case, the Commission found that the stand-alone tax allocation methodology prevents ratepayers from benefitting from or subsidizing a utility's non-regulated activities.

The Company asserted that the Commission has not previously decided that it must offset rider revenue requirements with North Dakota investment tax credits, pointing to an earlier Commission decision in the Bison 1 Wind Project. The Company read the Bison Wind 1 case as limiting the Commission's discretion to return all the tax credits to ratepayers.[6]

The Company pointed out that the Commission's foundational order setting cost-separation requirements for utilities with unregulated affiliates did not explicitly require the accounting treatment recommended by the Department in this case.[7]

The Company also argued that this situation was analogous to a case in which the Minnesota Supreme Court reversed a Commission decision to reflect in rates the "good will" value that the Company's unregulated appliance-repair business derived from using the Minnegasco name.[8]

Finally, the Company cited the so-called Lost Margins case[9] as an example of a case in which the proper allocation of tax liability resulted in tax consequences accruing to the benefit of the utility rather than its ratepayers. The Company argued that in the Lost Margins case, shareholders of the involved utilities were permitted to earn amounts in excess of their allowed returns in connection with the recovery of profits lost by the utilities due to the implementation of conservation programs in 1998.

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[5] *In the Matter of the Application of Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Electric Service in Minnesota*, Docket No. E-002/GR-05-1428, Findings of Fact, Conclusions of Law, and Recommendation, at 33-34 (July 6, 2006).

[6] *In the Matter of Minnesota Power's Petition for Approval of Its Renewable Resources Rider and 2011 Renewable Factor*, Docket No. E-015/M-11-274, Order Approving Cost Recovery Proposal, at Order Point 2 (November 15, 2011).

[7] *In the Matter of an Investigation into the Competitive Impact of Appliance Sales and Service Practices of Minnesota Gas and Electric Utilities*, Docket No. G,E-999/CI-90-1008, Order Setting Filing Requirements at 6-7 (September 28, 1994).

[8] *See, Minnegasco v. Minnesota Public Utilities Commission*, 549 N.W.2d 904 (Minn. 1996).

[9] *In the Matter of a Request by Minnesota Power for Approval of Its 1998 CIP Tracker Activity Report, Demand Side Management Financial Incentives Report, and Annual Conservation Program Adjustment,* and *In the Matter of a Request by Northern States Power Company for Approval of Its 1999/2000 Proposed CIP Adjustment, 1998 Demand Side Management Incentives, and 1998 CIP Status Report*, Nos. C2-00-456, C4-00-457, 2000 WL 1847621 (Minn. App. Dec. 19, 2000).

2. Financial Reporting

The Company also raised a concern with respect to its financial reporting requirements, and how the Commission decision on the tax credits could impact those obligations. The Company explained that accounting rules differ for regulated and non-regulated businesses.

The Company stated that the credits that ALLETE assigned to Minnesota Power regulated operations have been recorded in a deferred regulatory liability account, and are benefits yet to be included in rates; the tax credits that ALLETE assigned to its non-regulated operations are required to be recognized as income at the time the benefit is earned. ALLETE has already reflected in its financials the earned benefits it apportioned to non-regulated operations.

The Company cautioned that if the Commission decides that the full $22 million in credits is to be reflected in Minnesota Power's rates, ALLETE would be required to reverse the benefit it has previously assigned to its non-regulated operations, which it claimed would increase non-regulated tax expense by up to $10 million.

C. The Department's Position

The Department argued that the Commission should require the Company to reflect *all* tax credits used in ALLETE's consolidated North Dakota tax returns when determining revenue requirements, and not just the portion of the tax credits that are used by the Company on a separate return basis. The Department asserted that the benefit of the tax credit should be assigned to the creator of the tax credit, and not, as the Company claimed, to the creator of the tax liability that consumes the credit.

The Department made a distinction between the Company's method of allocating tax expenses and the stand-alone method. The Department claimed that the Company's tax allocation method differs from the stand-alone method as articulated by FERC, and espoused by the Commission for many years. Under FERC guidance, there would be no leftover amounts of credits to be assigned to a consolidation company. The test considered by the FERC is as follows:

> . . . whether the expenses are included in the relevant cost of service. If they are, the associated deductions and their tax reducing benefits will be taken into account in calculating the tax allowance for that cost of service.[10]

The Department argued that the Company inappropriately defined the stand-alone method as one that calculates tax expense based on a separate-return calculation. The Department argued that the Company should apply the stand-alone method as articulated by FERC as the appropriate means of allocating income tax expense.

1. Analysis of Prior Commission Decisions

The Department argued that the cases cited by Minnesota Power are not directly relevant and do not support the Company's request to allocate only $10.7 million in credits to ratepayers.

[10] *FERC*, *supra*, at note 4.

For example, the Department explained that some of the confusion surrounding the difference between the two tax-allocation methods may stem from the Commission's 2005 Northern States Power rate case. In that matter the parties tended to use the terms separate-return method and stand-alone method interchangeably. But in fact, in that case, the separate-return and stand-alone methods would have produced the same result, and it was not necessary to distinguish between the two methods.

The Department also argued that the Company misinterpreted the Minnesota Supreme Court's decision in the Minnegasco case. Good will is generally not considered to be a "cost" of rendering utility service, but an inchoate property interest. Further, the costs of creating the good will were not borne by ratepayers. Here, the Commission must decide who is entitled to the value of actual tax credits.

Finally, the Department also distinguished the Company's reference to the Lost Margins case, arguing that it related to retroactive ratemaking, which is not an issue in this matter.

The Department responded to each case relied upon by the Company and explained why it concluded that each decision does not support the Company's position in this case.

2. Financial Reporting

The Department explained the financial reporting rules applicable to the Company should the Commission require it to assign all tax credits to ratepayers. The Department discounted the Company's claim of corporate harm, asserting that any negative financial impacts to ALLETE would be the direct result of its erroneous interpretation of the Commission's stand-alone methodology.

The Department argued that had the Company correctly and reasonably proposed to credit ratepayers with all the tax credits useable on ALLETE's North Dakota tax returns, the deferred tax asset and the regulatory liability created would have been the same size. ALLETE would have recorded no net income pursuant to the credits, and no reversal would be necessary.

D. Commission Action

Both Minnesota Power and the Department have completed comprehensive analyses of the Bison Wind Projects' North Dakota Investment Tax Credit issue, and how the tax credits should be allocated. The core dispute between the Department and the Company is whether the benefit of the tax credit should be assigned to the creator of the tax credit—Minnesota Power—or whether the benefit of the tax credit should be assigned to the creator of the tax liability that consumes the credit—any member/subsidiary of ALLETE participating in the consolidated tax return.

The issue has been complicated by the parties' differing definitions of the stand-alone allocation mechanism, long used by the Commission to allocate consolidated income tax responsibility among corporate subsidiaries. The Company in fact has proposed use of a separate-return mechanism, as defined by FERC, but asserts that it is a stand-alone mechanism.

The separate-return mechanism, however, ignores the consolidated tax return and reflects in the tax allowance none of the tax-reducing benefits the group realizes from filing a consolidated return. The stand-alone method, as described by FERC, does not ignore the consolidated return or the tax-reducing benefits the group realizes, but allocates the consolidated tax liability to the members under a single tax return.

As explained by the Company, ALLETE's practice assigns to a consolidation company the difference between the unified group's consolidated tax burden and the aggregated outcomes of the separate-return method. This is not consistent with what the Commission has long accepted as the FERC-approved stand-alone method, but is, in fact, the separate-return mechanism.

The Bison Wind Projects are generating the tax credits. There is no dispute that Minnesota Power's regulated operations bear all the costs and expenses of the Projects. The Commission is persuaded by the Department's analysis that to the extent there is a benefit generated by the credits, that full benefit should flow back to the ratepayers who paid for it, to help offset the cost of the Bison Wind investment.

Thus, the Commission will align the tax credits with the cost responsibility. The Commission agrees that the stand-alone method as described by FERC should be used, and that Minnesota Power's ratepayers should receive the full $22 million in tax-credit benefits in the Company's renewable resource rider revenue requirements. This method of tax-credit assignment is also consistent with other Minnesota utilities' treatment of North Dakota tax credits.[11]

The Commission finds that none of the cases relied on by the Company as support for why it accounts for these tax credits in the way it does are directly relevant to the Commission's decision in this matter. For example, in the Northern States Power 2005 rate case, the separate-return and stand-alone methods would have produced the same result, and it was not necessary for the Commission to distinguish between the two methods.

In Dakota Electric's most recent rate case, the reason subsidiary net income was excluded from ratemaking was that ratepayers bore none of the costs or risks associated with generating that net income. Thus, any benefits were appropriately excluded from rates.

Further, the Lost Margins case referenced by the Company dealt with retroactive ratemaking issues not relevant to this decision. And, it is an unpublished decision with no precedential value under Minn. Stat. § 480A.08, subd. 3. Finally, the Minnesota Supreme Court's decision in Minnegasco is inapposite, as it dealt with the value of good will used, but not paid for. Here, the Commission is faced with a corporate tax issue not comparable to good will.

Finally, the concerns raised by the Company regarding its financial reporting are of its own making. Any impacts are the result of the Company's misinterpretation of the Commission and FERC's stand-alone tax methodology. Had the Company correctly and reasonably planned to credit ratepayers with all the credits used on ALLETE's North Dakota tax return, ALLETE would not face the financial implications of a reversal in its financial statements.

Accordingly, the Commission finds that all Bison Wind Projects' tax credits actually realized in tax return filings, or monetized through other permissible means, are to be reflected in the Company's revenue requirements.

[11] Xcel Energy and Otter Tail Power both make use of North Dakota tax credits in their Renewable Resource filings. *See, e.g.* Docket Nos. E-002/GR-05-1428 (Xcel Energy); and E-017/M-09-1484 and E-017/GR-10-239 (Otter Tail Power).

III. Timing and Method of Incorporating Tax Credits into Rates

Having decided that ratepayers should receive the full value of all tax credits utilized, the Commission must also address how and when to recognize the credits in rates. Minnesota Power has not yet reflected any tax-credit benefits in its revenue requirements. The Company does not expect to use any tax credits until 2020. The Company has stated that it intends to reflect the credits in revenue requirements when they are used, explaining that ordinarily, tax credits reflected in rates are credits for which the utility has already received a benefit. Further, the Company asserted that the quantity of tax credits the Company expects to use is currently merely an estimate, and not a specifically calculated amount.

The Company recommended that the Commission wait and allow it to reflect in rates the exact, rather than estimated, amount of tax-credit benefit, after the benefits are realized, on a year-to-year basis. The Department did not oppose this approach.

Commission staff observed that the tax credits could be amortized in the same manner that was used in Otter Tail Power Company's 2010 Resource Rider docket, and the Department did not disagree.[12] Otter Tail had sought cost recovery of three company-owned wind projects, all located in North Dakota, through its 2010 Renewable Resources Cost Rider. All three projects qualified for the North Dakota Investment Tax Credit.

In that case, the Commission approved Otter Tail's proposal to amortize the tax credits over the life of the projects. In this way, intergenerational equity for the tax benefits was achieved consistent with traditional investment tax credits. The Commission reasoned that this was appropriate, as the project cost was recovered from ratepayers over its life, and to be consistent, the Commission ordered that the credit be amortized over the plant life.

Here, the Commission has considered all alternatives discussed by the parties, as well as the option to amortize the credit benefits. The Commission finds that the amortization approach is preferable. With amortization, there will be a better alignment of the cost-recovery and benefit-flow periods; there will be a minimization of potential rate fluctuation; and, there will be ease in incorporating a level credit amount into base rates.

The Commission recognizes that there is some uncertainty as to the amount of credits that can be used, due to the long useful period of some credits, the complexity of estimating state taxes, and the impact from potential future changes in state tax laws. Thus, the current $22 million estimated value of the credits is subject to change.

Therefore, the Commission will require rates to reflect the actual, and not estimated, benefits realized, and will require amortization of the benefits to mitigate potential rate variability and will spread the benefits to be realized by ratepayers paying these project costs over the Bison Wind Projects' useful life.

Accordingly, the Commission will require the Company to amortize the actual tax-credit benefit realized over the remaining life of the Bison Wind Projects. At the onset of the actual realization of the benefit, the Commission will require the Company to commence amortization and inclusion of

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[12] *In the Matter of the Application of Otter Tail Power Company's Request for Approval of Its 2010 Renewable Resource Cost Recovery Adjustment Factor*, Docket No. E-017/M-09-1484.

the tax credit in revenue requirement. Further, any credits realized from year to year will be added to the amortizable balance. Further, the Commission will allow an appropriate adjustment to rate base to account for the unamortized balance of the actual credits realized.

IV. Future Reporting Requirements

Finally, the Commission would like to be informed should the estimated North Dakota Investment Tax Credit benefits materially change or should other monetization opportunities arise. The Commission will therefore require the Company to submit supplemental compliance filings if there are 1) material changes (greater than ten percent or $2.2 million) to the estimated North Dakota Investment Tax Credit utilization on a consolidated/unitary tax return; and/or 2) legislative changes that allow additional means to monetize these credits.

ORDER

1. All Bison Wind Project North Dakota Investment Tax Credits actually realized in tax-return filings, or monetized through other permissible means, shall be reflected in the Company's revenue requirements.

2. Minnesota Power shall amortize the actual North Dakota Investment Tax Credit realized over the remaining life of Bison Wind Projects. At the onset of the actual realization of the benefit, Minnesota Power shall commence amortization and tax credit inclusion in revenue requirements in its next renewable resource rider filing. Credits realized from year-to-year shall be added to the amortizable balance. The Commission will permit the appropriate adjustment to rate base to account for the unamortized balance of the actual North Dakota Investment Tax Credit realized.

3. Minnesota Power shall file supplemental compliance filings if there are: 1) material changes (greater than ten percent or $2.2 million) to the estimated North Dakota Investment Tax Credit utilization on a consolidated/unitary tax return; and/or 2) legislative changes that allow additional means to monetize these credits.

4. This order shall become effective immediately.

BY ORDER OF THE COMMISSION

Daniel P. Wolf

Daniel P. Wolf
Executive Secretary

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