Minnesota Energy Resources Corporation
2685 145th Street West
Rosemount, MN 55068
www.minnesotaenergyresources.com

October 11, 2019

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 Seventh Place East, Suite 350
St. Paul, MN 55101

VIA ELECTRONIC FILING

Re: In the Matter of the Petition of Minnesota Energy Resources Corporation for its Annual Review of Depreciation Rates for 2019
Docket No. G011/D-19-377

Additional Reply Comments of Minnesota Energy Resources Corporation

Dear Mr. Wolf:

Minnesota Energy Resources Corporation ("MERC" or the "Company") submits these Additional Reply Comments in response to the October 4, 2019, Response Comments filed by the Minnesota Department of Commerce, Division of Energy Resources (the "Department") in the above-referenced docket. In its Response Comments, the Department reiterates many of its positions and recommendations from its August 9, 2019 Comments, to which MERC responded on August 28, 2019. The Department also provides additional and revised recommendations based on the Company's August 28, 2019 Reply Comment filing. In particular, the Department recommends that the Commission:

1. Not approve MERC's proposed criteria for the separate depreciation of future building locations and instead require the Company to evaluate any building additions on a case-by-case basis;

2. Approve MERC's proposed depreciation rates and parameters for all plant accounts other than Account 390 Structures and Improvements;

3. Require MERC to depreciate its Rochester, Rosemount, Cloquet, and Albert Lea Service Centers individually, and to depreciate the remaining 18 buildings in Account 390 using group depreciation, using the following depreciation parameters and rates as presented in the Company's response to OAG IR 11;

4. Deny MERC's request for deferred accounting;

5. Require MERC to include in its next depreciation filing a summary of the largest individual assets booked to each of its plant accounts and an explanation of why group accounting is or is not appropriate for those assets;

6. Require MERC to file its next annual depreciation study by June 1, 2020; and

7. Require MERC to file its next five-year study by June 1, 2022.

MERC thanks the Department for its additional review and comments but continues to advocate that its proposal as set forth in its May 31, 2019 Petition, to separate the Rochester and Rosemount buildings and to separate new buildings only when they are newly acquired or constructed and will constitute at least one percent of the Company's total depreciable net plant is the most reasonable alternative for the Commission to approve. MERC's proposal recognizes the unique attributes of the Rochester and Rosemount buildings and establishes an objective standard for the evaluation of future building attributes to ensure consistent treatment of any new building additions. As discussed in MERC's August 28, 2019, Reply Comments, and in more detail below, all other asset accounts are properly accounted for utilizing group or composite accounting.

The Department's recommended modifications to MERC's proposal are based on the premise that each of the identified buildings is itself an "asset" where in reality, each building location is made up of numerous assets including roofs, HVAC equipment, siding, plumbing, fire protection, doors, windows, etc. The application of the composite method of depreciation to larger facilities containing numerous components and parts is well recognized in regulated utility accounting is a reasonable and appropriate methodology. Indeed, the Department and the Commission have recently recognized the appropriateness of such depreciation treatment in Docket No.E017/D-18-568.[1] As discussed in that proceeding, group or composite accounting practices yield the same results as individual depreciation so long as the correct remaining life is estimated, because the utility is able to separately identify all applicable assets along with their historic costs and accumulated depreciation balances.

Further, the Department's recommendation to allow ad hoc case-by-case review of the application of group or composite depreciation invites opportunistic proposals that could result in MERC being disallowed the ability to fully recover the costs of its reasonable, prudent, and necessary investments in utility plant. Such proposal is at odds with Minn. Stat. §216B.16, subd. 6, which requires the Commission to give due consideration to the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing the service, including adequate provision for depreciation if its utility property used and useful in rendering service to the public. MERC's proposed objective standard would ensure a consistent evaluation based upon a reasonable materiality standard that reflects changes over time.

MERC's recording and reporting of depreciation accruals and reserves is consistent with the explicit provisions of the Commission's regulations. Minn. R. 7825.0600 provides that Class A and B utilities (1) maintain continuing property records; (2) record depreciation accruals and reserves *by functional group of plant accounts* (e.g., distribution property) or on an optional basis, by primary plant account (e.g., meters) for corporate ledger and balance sheet supporting schedule purposes; (3) retain data in sufficient detail to conduct depreciation certification studies for the purpose of determining depreciation accruals and reserves by primary plant account; and (4) review their depreciation rates annually to determine if they are still generally appropriate. Attempting to allocate depreciation accruals and reserves to each particular asset is inconsistent with the nature of group or composite accounting and at odds with the specific requirements set forth in applicable Minnesota rules. The entire basis of group and composite

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[1] *In the Matter of Otter Tail Power Company's Petition for Approval of its 2018 Five-Year Review of Depreciation Certification*, Docket No. E017/D-18-568, Order Approving Petition and Setting Additional Requirements (July 17, 2019).

accounting is to address those situations where it is impractical to separately track each individual asset or component and part.

Nevertheless, in recognition of the unique characteristics of the Rochester and Rosemount buildings as well as the interest of the Department, OAG, and Commission in obtaining more detailed data and analysis regarding such buildings, MERC proposed to separate the Rochester and Rosemount buildings for depreciation purposes. MERC continues to believe that proposal most reasonably addresses the concerns raised in Docket No. G011/GR-17-563 while also recognizing the reasonableness and appropriateness of composite depreciation in general in the case of buildings and similar facilities. MERC responds briefly to the Department's October 4 Response Comments and additional recommendations below.

Test to Determine Depreciation Method for New Buildings

First, with respect to the standard to be applied to determining whether a building should be separated for depreciation purposes, MERC proposed to establish an objective materiality threshold to separate any future new buildings.

In its Response Comments, the Department states that while it "understands MERC's concern, the Department maintains its position that a strict test would be unnecessarily limiting and that building additions are rare enough that reviewing them on a case-by-case basis will not be overly burdensome."

Given that the OAG recommended review for incremental investments to existing building locations and the Department is now advocating additional review of assets outside of Account 390 Structures and Improvements, MERC believes its concerns regarding the potential burden of an open-ended case-by-case evaluation are legitimate and supported. The Company believes the establishment of a clear, bright line, objective standard, is necessary and appropriate to avoid the substantial expenditure of resources that would occur through a case-by-case assessment. Further, a clear standard ensures MERC is provided with the opportunity to recover its actual reasonable and prudent depreciation expense for utility investment by treating assets consistently throughout their lives and at retirement.

Separation of Cloquet and Albert Lea Service Centers

While MERC continues to advocate that separation of only the Rochester and Rosemount buildings is reasonable and appropriate, if the Commission requires the Company to separate the Cloquet and Albert Lea Service Centers as recommended by the Department, the depreciation parameters to be applied to the separated Service Centers must be reasonable and appropriate in consideration of the characteristics of those buildings.

In its Response Comments, the Department concluded that MERC's proposed parameters as set forth in response to OAG Information Request No. 11, including use of 2035 as a probable retirement year for the Cloquet Service Center, are reasonable. MERC agrees that the depreciation parameters and rates as set forth in MERC's response to OAG Information Request No. 11 and summarized in the Department's response comments are reasonable and appropriate if the Commission determines the Cloquet and Albert Lea Service Centers should be separated along with Rochester and Rosemount.

Evaluation of Assets Other than Buildings

Finally, the Department notes that while it generally agrees with MERC that it is likely that group depreciation is the appropriate depreciation methodology for the majority of its plant, the Department recommends that the Commission require MERC to include in its next depreciation filing a summary of the largest individual assets booked to each of its plant accounts and an explanation of why group accounting is or is not appropriate for those assets.

As explained in the Company's May 31, 2019 Petition and August 28, 2019, Reply Comments, in the context of utility accounting there are two independent justifications for the application of group accounting for utility assets: (1) with respect to certain fixed assets such as utility poles and other components of the transmission and distribution system, the components are too numerous to practically track on an individual basis given the small relative value of each individual asset; and (2) with respect to larger assets like buildings that are comprised of numerous components and parts, it is impractical to separately track all components, especially when the components are typically inseparable from the building (e.g., a roof or HVAC system).

As MERC is a gas distribution company, its distribution and transmission property includes many dispersed but interrelated assets. These assets, numbering in the tens of thousands, are recorded at a vintage year, size, material type, and municipal tax reporting level. As such, these assets represent a large number of similar assets for which additions and retirements occur continually and systematically over time and the life of any one unit is not dependent on the life of any of the other units. As a result, the assets are widely dispersed and have a variety of costs which are not conducive to individual depreciation.

As noted above, the Department generally agreed with MERC stating that group depreciation is likely the appropriate method for the majority of MERC's plant. However, the Department now questions whether group depreciation remains appropriate for other accounts, such as Account 378 Measuring & Regulating Station Equipment and Account 379 City Gate Stations. MERC has previously reviewed assets in Accounts 378 and 379 and notes that there are approximately 1,200 assets recorded in these accounts (exclusive of projects not yet broken into their lower level detail assets). These plant accounts are comprised of numerous assets with an average cost of approximately $13,000. Additionally, there are no assets which currently exceed $250,000 and only four assets with a cost greater than $200,000.

MERC continues to support that assets in plant accounts outside of Account 390 are not conducive to individual depreciation. As such, MERC proposes that the Commission deny the Department's recommendation to require MERC to include in its next depreciation filing a summary of the largest individual assets booked to each of its plant accounts and an explanation of why group accounting is or is not appropriate for those assets.

Conclusion

In conclusion, MERC respectfully requests that the Commission find the Company has satisfied the requirement in Order Point 15 of the Commission's December 26, 2018, Findings of Fact, Conclusions, and Order and:

1. Approve MERC's proposal to separate the Rochester and Rosemount buildings for depreciation purposes along with the Company's proposed objective criteria for the evaluation of whether any new buildings should be separated in the future; and

2. Approve MERC's proposed depreciation rates and parameters for all plant accounts;

If the Commission determines that separation of the Cloquet and Albert Lea Service Centers, in addition to the Rosemount and Rochester buildings, is necessary, the Commission should:

1. Approve MERC's proposed depreciation rates and parameters for all accounts except Account 390 and for Account 390 approve the depreciation parameters and rates as presented in the Company's response to OAG IR 11;

2. Approve MERC's request for deferred accounting;

Please contact me at (414) 221-2374 if you have any questions regarding the information in this filing. Thank you for your attention to this matter.

Sincerely,

/s/ Mary L. Wolter
Mary L. Wolter
Director – Gas Regulatory Planning & Policy

cc: Service List

In the Matter of the Petition of Minnesota Energy Resources Corporation for its Annual Review of Depreciation Rates for 2019	Docket No. G011/D-19-377

CERTIFICATE OF SERVICE

I, Kristin M. Stastny, hereby certify that on the 11th day of October, 2019, on behalf of Minnesota Energy Resources Corporation (MERC), I electronically filed a true and correct copy of the enclosed Additional Reply Comments on www.edockets.state.mn.us. Said documents were also served via U.S. mail and electronic service as designated on the attached service list.

Dated this 11th day of October, 2019.

/s/ Kristin M. Stastny
Kristin M. Stastny

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Michael	Ahern	ahern.michael@dorsey.com	Dorsey & Whitney, LLP	50 S 6th St Ste 1500 Minneapolis, MN 554021498	Electronic Service	No	OFF_SL_19-377_D-19-377
Generic Notice	Commerce Attorneys	commerce.attorneys@ag.state.mn.us	Office of the Attorney General-DOC	445 Minnesota Street Suite 1800 St. Paul, MN 55101	Electronic Service	Yes	OFF_SL_19-377_D-19-377
Sharon	Ferguson	sharon.ferguson@state.mn.us	Department of Commerce	85 7th Place E Ste 280 Saint Paul, MN 551012198	Electronic Service	No	OFF_SL_19-377_D-19-377
Daryll	Fuentes	dfuentes@usg.com	USG Corporation	550 W Adams St Chicago, IL 60661	Electronic Service	No	OFF_SL_19-377_D-19-377
Brian	Meloy	brian.meloy@stinson.com	STINSON LLP	50 S 6th St Ste 2600 Minneapolis, MN 55402	Electronic Service	No	OFF_SL_19-377_D-19-377
Andrew	Moratzka	andrew.moratzka@stoel.com	Stoel Rives LLP	33 South Sixth St Ste 4200 Minneapolis, MN 55402	Electronic Service	No	OFF_SL_19-377_D-19-377
Catherine	Phillips	catherine.phillips@we-energies.com	We Energies	231 West Michigan St Milwaukee, WI 53203	Electronic Service	No	OFF_SL_19-377_D-19-377
Generic Notice	Residential Utilities Division	residential.utilities@ag.state.mn.us	Office of the Attorney General-RUD	1400 BRM Tower 445 Minnesota St St. Paul, MN 551012131	Electronic Service	Yes	OFF_SL_19-377_D-19-377
Elizabeth	Schmiesing	eschmiesing@winthrop.com	Winthrop & Weinstine, P.A.	225 South Sixth Street Suite 3500 Minneapolis, MN 55402	Electronic Service	No	OFF_SL_19-377_D-19-377
Colleen	Sipiorski	Colleen.Sipiorski@wecenergygroup.com	Minnesota Energy Resources Corporation	700 North Adams St Green Bay, WI 54307	Electronic Service	No	OFF_SL_19-377_D-19-377

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Kristin	Stastny	kstastny@briggs.com	Briggs and Morgan, P.A.	2200 IDS Center 80 South 8th Street Minneapolis, MN 55402	Electronic Service	No	OFF_SL_19-377_D-19-377
Eric	Swanson	eswanson@winthrop.com	Winthrop & Weinstine	225 S 6th St Ste 3500 Capella Tower Minneapolis, MN 554024629	Electronic Service	No	OFF_SL_19-377_D-19-377
Daniel P	Wolf	dan.wolf@state.mn.us	Public Utilities Commission	121 7th Place East Suite 350 St. Paul, MN 551012147	Electronic Service	Yes	OFF_SL_19-377_D-19-377
Mary	Wolter	mary.wolter@wecenergygroup.com	Minnesota Energy Resources Corporation (HOLDING)	231 West Michigan St Milwaukee, WI 53203	Electronic Service	No	OFF_SL_19-377_D-19-377
Tina E	Wuyts	tina.wuyts@wecenergygroup.com	Minnesota Energy Resources Corporation	PO Box 19001 700 N Adams St Green Bay, WI 54307-9001	Electronic Service	No	OFF_SL_19-377_D-19-377