

## Staff Briefing Papers

Meeting Date December 21, 2017

Agenda Item \*\*2

Company Minnesota Power (MP)

Docket No. **E-015/PA-17-457**

In the Matter of the Petition of Minnesota Power for Approval of a Purchase Agreement for the Sale of the Aurora Service Center to Lakehead Constructors, Inc.

**E-015/PA-17-459**

In the Matter of the Petition of Minnesota Power for Approval of a Purchase Agreement for the Sale of the Chisolm Service Center to United Way of Northeastern Minnesota, Inc.

**E-015/PA-17-460**

In the Matter of the Petition of Minnesota Power for Approval of a Purchase Agreement for the Sale of Land and Buildings near the Boswell Energy Center to Airmark, Inc. d/b/a Nelson Wood Shims

**E-015/PA-17-461**

In the Matter of the Petition of Minnesota Power for Approval of a Purchase Agreement for the Purchase of the Long Prairie Service Center from the State of Minnesota-Department of Military Affairs

- Issues
1. Should the Commission approve the proposed property transactions?
  2. If approved, should the Commission require Minnesota Power to establish a regulatory liability account to track

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collected revenues and costs that the Company is no longer incurring associated with the proposed property transactions?

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 **Relevant Documents**

**Date**

Minnesota Power - Initial Filing (E015/PA-17-457)	June 1, 2017
Minnesota Power - Initial Filing (E015/PA-17-459)	June 1, 2017
Minnesota Power - Initial Filing (E015/PA-17-460)	June 1, 2017
Minnesota Power - Initial Filing (E015/PA-17-461)	June 1, 2017
Department of Commerce - Comments (All Dockets)	September 18, 2017
Minnesota Power - Reply to Department Comments (All Dockets)	September 28, 2017
Department of Commerce – Response to Reply Comments (All Dockets)	November 30, 2017

## **I. Statement of the Issues**

- Should the Commission approve the proposed property transactions?
- If approved, should the Commission require Minnesota Power to establish a regulatory liability account to track collected revenues and costs that the Company is no longer incurring associated with the proposed property transactions?

## **II. Background**

In its June 1, 2017 filings, Minnesota Power (MP) has requested that the Commission approve the sale of three properties:

- Aurora Service Center (E-015/PA-17-457), resulting in a book loss,
- Chisolm Service Center (E-015/PA-17-459), resulting in a book loss, and
- Land, including cold storage buildings, located near the Boswell Energy Center (E-015/PA-17-460) in Cohasset, MN, resulting in a book gain.

In addition to the property sales, MP is also seeking the approval of the Commission to reacquire the Long Prairie Service Center (E-015/PA-17-461) in Long Prairie, MN.

MP requested a variance on the filing requirements established by Minnesota Rules, part 7825.1400 as it pertains to capital structure filings and the issuance of securities. MP feels a variance is justified since these requirements are relevant only when securities are issued and the Company's capital structure is changing rather than to small property transfers.

The Department of Commerce (Department), noting that the properties and related expenses have all been included in the rate base and the revenue requirement in MP's current rate case,<sup>1</sup> recommended approval of the property transactions with modifications. As they relate to these transactions, the Department recommended that deferred accounting be utilized and that a regulatory liability account be established so that collected revenues and costs that the Company is no longer incurring can be tracked. Amounts in the regulatory liability account may then be netted against MP's revenue requirement in a subsequent rate case. The Department agreed with MP that a variance to Minnesota Rules, part 7825.1400 as it pertains to capital structure filings and the issuance of securities should be granted and noted that, since the information is not directly relevant to assessing the reasonableness of these property transactions, requiring the information would prove to be an excessive burden to the utility.

## **III. Relevant Statutes**

### **MINN. STAT. § 216B.50, RESTRICTIONS ON PROPERTY TRANSFER AND MERGER**

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<sup>1</sup> Minnesota Power General Rate Case Docket No. E-015/GR-16-664

Minn. Stat. § 216B.50 requires a public utility to obtain Commission approval prior to selling, acquiring, leasing, or renting any plant as an operating unit or system in this state for a total consideration in excess of \$100,000, or merge or consolidate with another public utility or transmission company operating in this state, without first being authorized so to do by the commission...If the commission finds that the proposed action is consistent with the public interest, it shall give its consent and approval by order in writing. In reaching its determination, the commission shall take into consideration the reasonable value of the property, plant, or securities to be acquired or disposed of, or merged and consolidated.

**MINN RULE 7825.1800, FILING REQUIREMENTS FOR PETITIONS TO ACQUIRE PROPERTY.**

Petitions for approval to acquire property shall contain one original and three copies of the following information, either in the petition or as exhibits attached thereto:

A. Petitions for approval of a merger or of a consolidation shall be accompanied by the following: the petition signed by all parties; all information, for each public utility, as required in parts 7825.1400 and 7825.1500; the detailed reasons of the petitions and each party for entering into the proposed transaction, and all facts warranting the same; the full terms and conditions of the proposed merger or consolidation.

B. Petitions for approval of a transfer of property shall be accompanied by the following: all information as required in part 7825.1400, items A to J; the agreed upon purchase price and the terms for payment and other considerations.

C. A description of the property involved in the transaction including any franchises, permits, or operative rights, and the original cost of such property, individually or by class, the depreciation and amortization reserves applicable to such property, individually or by class. If the original cost is unknown, an estimate shall be made of such cost. A detailed description of the method and all supporting documents used in such estimate shall be submitted.

D. Other pertinent facts or additional information that the commission may require.

(A complete copy of Minnesota § 216B.50 and Minnesota Rules, parts 7825.1400 through 7825.1800 are attached)

**IV. Parties' Comments**

**A. E-015/PA-17-457 – Sale of the Aurora Service Center (ASC) to Lakehead Constructors, Inc.**

**1. Minnesota Power**

Contingent upon Commission approval, MP entered into an agreement to sell the Aurora Service Center (ASC) to Lakehead Constructors, Inc. for \$375,000. The book value of the

property, net of accumulated depreciation, is \$482,146.79.<sup>2</sup> The ASC is currently generating annual revenues of \$24,000 due to a lease agreement with Embarrass Vermillion Credit Union. These revenues help offset the O&M costs but MP states that the sale is in the public interest because it will help reduce long-term real estate costs and provides a space for a key local employer. MP noted that the Company does not intend to recover the book loss from ratepayers.

## **2. Department of Commerce**

The Department recommends that the Commission approve the sale of the ASC with modifications. The Department noted that the asset, revenues, and expenses associated with the ASC are all included in MP's current rate case<sup>3</sup> and that the inclusion of these amounts in MP's 2017 test year will require ratepayers to pay for a building MP will no longer own. Specifically, the Department identified the following amounts that are included in the current rate case:<sup>4</sup>

- The average annual accumulated depreciated balance for the asset in 2017 of \$473,847,
- \$27,000 in annual operation and maintenance expenses, and
- \$18,000 in annual property taxes.

This transaction, if approved, would therefore contravene public interest. The Department recommended the use of deferred accounting to create a regulatory liability account that could be netted against the revenue requirement of a subsequent rate case. The regulatory liability account would consist of other revenues, operations and maintenance expenses, depreciation expense, property taxes and return on rate base grossed up for income taxes (all revenue requirements) for the transaction identified in this docket, as well as the proceeds of the sale.

(Please see Attachment B of the Department's Comments for the schedule that supports the Department's incremental cost analysis.)

### **B. E-015/PA-17-459 – Sale of the Chisolm Service Center (CSC) to the United Way of Northeastern Minnesota, Inc. (United Way)**

#### **1. Minnesota Power**

Contingent upon Commission approval, MP entered into an agreement to sell the Chisolm Service Center (CSC) to the United Way for \$300,000. The book value of the property, net of accumulated depreciation, is \$726,819.89. MP provided an informal market analysis that places

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<sup>2</sup> Minnesota Power – Initial Filing, section I, paragraph B. *The Purchase Agreement is in the Public Interest* states the book value to be \$482,146.79, however, Exhibit B, *Summary of Estimated Entries* shows a book value of \$468,295.40. The Department based its analysis off of the book value of \$468,295.40.

<sup>3</sup> Department of Commerce – Comments, Attachment A, Docket No. E-015/PA-17-457, IR 4 and 5

<sup>4</sup> Department of Commerce – Comments, Attachment A, Docket No. E-015/PA-17-457, IR 5-8

the reasonable market value of the property at \$285,000.<sup>5</sup> MP is willing to sell the property at a reduced book value as part of its United Way support. MP stated that CSC is too large and expensive to maintain for its current minimal needs and that the sale of the property is in the public interest because it reduces real estate costs and provides space for a local charity. MP noted that the Company does not intend to recover the book loss from ratepayers.

## **2. Department of Commerce**

The Department's comments regarding the sale of the CSC reflected the same concerns and recommendations noted above with the sale of the ASC. The Department has identified that the asset and the following expenses are included in the current rate case:<sup>6</sup>

- The average annual depreciated balance for the asset in 2017 of \$712,809,
- \$15,000 in annual operations, and maintenance expenses, and
- \$16,700 in annual property taxes.

The Department recommended the use of deferred accounting in order to track other revenues, operations and maintenance expenses, depreciation expense, property taxes and return on rate base grossed up for income taxes (all revenue requirements) for the transaction identified in this docket as well as the proceeds of the sale.

(Please see Attachment B of the Department's Comments for the schedule that supports the Department's incremental cost analysis.)

### **C. E-015/PA-17-460 – Sale of Land, Including Cold Storage Buildings, Near Boswell Energy Center**

#### **1. Minnesota Power**

Contingent upon Commission approval, MP entered into an agreement to sell land, including cold storage buildings, located near Boswell Energy Center in Cohasset, MN (Cohasset Land), to Airmark, Inc. dba Nelson Wood Shims (Airmark) for \$247,000. Airmark is located adjacent to the Cohasset Land and initially approached MP about purchasing two full parcels<sup>7</sup>. MP commissioned the Wellson Group, Inc. to conduct a market price analysis on the property, resulting in a fair market price estimated at \$331,000.<sup>8</sup> MP's property accountants determined the book value of the Cohasset Land to be \$224,451.82. This land has historically been used to

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<sup>5</sup> Minnesota Power – Initial Filing, June 1, 2017, Exhibit B

<sup>6</sup> Department of Commerce – Comments, Attachment A, Docket No. E-015/PA-17-459, IR 2-7

<sup>7</sup> The Cohasset Land, as identified in the purchase agreement, consists of only one of the parcels and a part of the second; Airmark modified its offer after the market price analysis had been completed.

<sup>8</sup> Minnesota Power – Initial Filing, Exhibit B

<sup>9</sup> MP addresses the difference between market value and sales price as being the result of Airmark reducing the amount of land to be purchased after the analysis was complete - Department of Commerce – Comments, Attachment A, Docket No. E-015/PA-17-460, IR 7

host various unrelated business ventures that benefit from the infrastructure to the site, but MP stated that this sale is in the public interest because it reduces real estate costs and provides a local employer an opportunity to expand and create jobs, which aligns with MP's core objective of fostering economic development in its service territory. MP noted that the Company intends to credit the book gain on the sale to ratepayers.

## **2. Department of Commerce**

The Department's comments regarding the sale of the Cohasset Land reflected the same concerns and recommendations noted above with the sale of the ASC and CSC. The Department has identified that the asset and the following expenses are included in the current rate case:<sup>10</sup>

- The average annual depreciated balance for the asset in 2017 of \$219,168, and
- \$4,300 in annual property taxes.

The Department recommended the use of deferred accounting in order to track depreciation expense, property tax expense and return on rate base (all revenue requirements) for the transaction identified in Docket No. E-015/PA-17-460 as well as the proceeds of the sale.

(Please see Attachment B of the Department's Comments for the schedule that supports the Department's incremental cost analysis.)

### **D. E-015/PA-17-461 – Purchase of Long Prairie Service Center (LPSC) from the State of Minnesota – Department of Military Affairs**

#### **1. Minnesota Power**

Contingent upon Commission approval, MP entered into an agreement to purchase the Long Prairie Service Center (LPSC), from the State of Minnesota – Department of Military Affairs (State) for \$270,000. The building was originally constructed by MP in 1981 and was sold to the State in 1998.<sup>11</sup> MP never left the facility and the Company leases a portion of the facility at a current cost of \$57,540 annually. The Company also maintains a lease for pole storage at LPSC for \$3,000 annually. Following the sale of the LPSC, MP leased a former Ford dealership that is no longer adequate for the Company's operational needs. It is not convenient to get the large line trucks and trailers to the current building, the garage and office space is too small, and the parking is inadequate. Additionally, the building is in need of major repairs including electrical, plumbing, and roofing. The walls need painting and the flooring needs to be replaced due to moisture intrusion and the space smells musty. The landlord has made it apparent to MP that the necessary repairs will not be done. Therefore, MP feels that reacquiring the LPSC will better serve the utility as well as guard against future lease rate increases. The State will continue to lease a portion of the building from the Company, offsetting some of the O&M costs. For these reasons, MP considers this purchase to be in the public interest.

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<sup>10</sup> Department of Commerce – Comments, Attachment A, Docket No. E-015/PA-17-460, IR 1-6

<sup>11</sup> Sale of Long Prairie Service Center, Docket No. E-015/M-98-442

## **2. Department of Commerce**

The Department recommended that the Commission approve the purchase of the LPSC with modifications. The Department noted that, unlike the sales transactions listed above, MP prematurely recorded the purchase of the asset and the related renovation costs into their current rate base and revenue requirement prior to the purchase closing. The Department recognized that MP may have believed this transaction would be completed by the end of 2016<sup>12</sup>, but the Department is troubled that MP failed to exclude from the rate base and revenue requirement or disclose in the rate case any of the property sales (harming ratepayers) while concurrently including the purchase of the LPSC in their rate base and revenue requirement (also harming ratepayers). The Department feels that the lack of consistency in the treatment of these transactions and the cumulative impact on the ratepayers is not in the public interest and warrants the use of deferred accounting in which a regulatory liability is created and could be netted against the revenue requirement of a subsequent rate case. The Department recommended that the depreciation expense and one half of the cost of purchasing and remodeling the LPSC be included in the regulatory liability account.

(Please see Attachment C of the Department's Comments for the schedule that supports the Department's incremental cost analysis for the purchase of the LPSC.)

## **V. Staff Analysis**

### **A. Are the proposed transactions in the public interest?**

In each of its filings, MP recorded the following passage regarding public interest:

In prior cases, the MPUC established that this standard 'does not require an affirmative finding of public benefit, just a finding that the transaction is compatible with the public interest.' In the Matter of the Proposed Merger of Minnegasco, Inc. With and Into ARKLA, Inc., Order Approving Merger, Docket No. G-008/PA-90-604 (1990). As recently as February 24, 1997, the Commission reconfirmed this standard in its approval of the merger In the Matter of the Proposed Merger of Minnegasco, Inc. With and Into Houston Industries, Inc. and

Houston Lighting and Power Co., Docket No. G-008/PA-96-950. In that matter, the MPUC approved a merger that had no rate reductions or freezes. The statute does not require that proposed transactions affirmatively benefit ratepayers or the public or that they otherwise promote the public interest. They cannot, however, contravene the public interest and must be shown to be compatible with it.

While the Department does not dispute that selling the Aurora Service Center (ASC), Chisolm Service Center (CSC), and the land near Boswell Energy Center (Cohasset Land) would result in lower real estate costs, the Department is concerned as to how the public would benefit from the transactions. MP noted that the Company would not seek rate recovery on the book losses resulting from the sales of the ASC and CSC and, despite not explaining how, it would credit

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<sup>12</sup> The purchase agreement is dated June 5-6, 2016



ratepayers for the Cohasset Land's sale gain. Also, as the Department pointed out, MP does not address how the cash flow resulting from the sales of assets would benefit ratepayers. Furthermore, because the assets are included in rate base and the incremental costs are included in the revenue requirement of MP's current rate case, MP's ratepayers would be paying for three properties MP does not own. MP also included the LPSC and its renovation costs in the current rate case even though the building is not owned by MP and the costs have not yet been incurred. This contravenes public interest.

The Commission has historically used four criteria when evaluating a utility's request for deferred accounting:<sup>13</sup>

1. Related to utility operations for which ratepayers have incurred costs or received benefits;
2. Significant in amount;
3. Unusual or extraordinary items;
4. Subject to review for reasonableness and prudence.

On November 30, 2017, the Department filed supplemental comments<sup>14</sup> with a comparative analysis of its deferred accounting recommendation in these property transaction dockets to the Commission's decision denying MP's request for deferred accounting for storm response and recovery costs, in Docket E-015/M-16-648. The Department believes these dockets are significantly different with different facts and should be reviewed independently.

These criteria are examined below.

### **Related to utility operations for which ratepayers have incurred costs or received benefits**

Since MP included costs associated with the assets it is proposing to sell in the test year revenue requirement of its pending rate case,<sup>15</sup> all of those costs would be included in the Commission-approved revenue requirement and corresponding rates. Therefore, MP's ratepayers would be paying for costs MP will not be incurring after the transactions are completed.

### **Significant in amount**

In previous orders, the Commission has maintained a high bar for utilities seeking deferred accounting. The Department agrees with the Commission in maintaining this high bar which acts as a disincentive to utilities that, in order to shift operational and financial risks on to the ratepayers, would otherwise request deferred accounting frequently as a risk management tool. The Department recommended lowering the "significant in amount" interpretation for instances when a ratepayer advocate requests deferred accounting.

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<sup>13</sup> Recently, these four criteria were used to consider Minnesota Power's request for deferred accounting after incurring significant costs related to severe storms in 2016. Docket No. E-015/M-16-648

<sup>14</sup> See Department of Commerce, Response to Reply Comments, for additional comparative analysis

<sup>15</sup> Minnesota Power, General Rate Case, Docket No. E-015/GR-16-664

While Staff concurs with the Department’s recommendations, Staff does not consider this to be a lowering of the bar or a lowering of the “significant in amount” interpretation of the standard for authorizing deferred accounting. Staff does not believe this is appropriate or necessary. The “significant in amount” requirement for evaluating deferred accounting requests gives the Commission ample latitude to determine what that amount should be. To lower the standard for ratepayer advocates only could not only be perceived as inequitable to the utilities but could also lead some advocates to recommend the use of deferred accounting unnecessarily but with more frequency. Staff considers the Department’s financial analysis to be strong enough to withstand application of the current standard without requiring a “lowering of the bar”.

### **Unusual or extraordinary items**

While the Department recognized that the individual property transfers are not “unusual or extraordinary,” proposing to do so during a rate case is unusual, especially given the fact that MP typically has gone years between filing rate cases. Additionally, the timing of the filings (controlled by the utility) could be considered unusual since the purchase agreement for the Long Prairie Service Center is dated in June 2016, the three sales are dated in January-March 2017 and MP’s petitions were filed in June 2017.

### **Subject to review for reasonableness and prudence**

The Department would review the amounts included in the proposed regulatory liability account in the subsequent rate case to determine if they are appropriate and reasonable given the information in these dockets.

In its response,<sup>16</sup> MP noted that the Department recently recommended against deferred accounting in Docket E-015/M-16-648 (2016 Storm).<sup>17</sup> MP stated the petition was denied in part because the amount requested (\$2.9 million) was not significant enough to warrant the creation of the account. MP quoted from the Commission’s order:<sup>18</sup>

Deferred accounting is a valuable regulatory tool used primarily to hold utilities harmless when they incur out-of-test-year expenses that, because of their nature or size, should be eligible for possible rate recovery as a matter of public policy. Traditionally, deferred accounting has been reserved for costs that are unforeseeable, unusual, and large enough to have a significant impact on the utility’s financial condition. Deferred accounting has also sometimes been

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<sup>16</sup> Minnesota Power – Response to Department Comments

<sup>17</sup> Minnesota Power referenced the docket in which they were denied the request to create a storm recovery account after incurring significant costs resulting from a 2016 storm that caused power outages for 46,000 customers

<sup>18</sup> Commission Order – Denying Petition for Deferred Accounting Treatment, Docket No. E-015/M-16-648

permitted when utilities have incurred sizeable expense to meet important public policy mandates. Deferred accounting, however, is not used to remedy ordinary fluctuation in costs between rate cases.

In the Briefing Papers,<sup>19</sup> Staff noted that a storm is not considered to be an unusual event. Storm damage is considered in the test year revenue requirement. Furthermore, Staff noted that the length of time without significant storms could be considered the unusual event and that MP has benefited from having little to no storm costs over the past several years. Staff also noted that the O&M expenses calculated were not considered extraordinary as they fell into a similar range as the expenses incurred in 2010-2015. MP does not maintain a separate account or cost center for storm recovery expenses.

Although the Commission ruled against deferred accounting in the 2016 Storm docket, the property transactions proposed should be treated independently from that decision as Staff does not believe the 2016 Storm docket set a binding precedent on future decisions.

**B. Minnesota Power's request for a rule variance from the filing requirements established by Minnesota Rules, part 7825.1400 as it pertains to capital structure and the issuance of securities**

MP requested a variance from the filing requirements established by Minnesota Rules, part 7825.1400 as it pertains to capital structure and the issuance of securities. The Commission uses the criteria in Minnesota Rules, part 7829.3200, to evaluate requests for rule variances:

1. Enforcement of the rule would impose an excessive burden upon the applicant or others affected by the rule
2. Granting the variance would not adversely affect the public interest
3. Granting the variance would not conflict with standards imposed by law

Both parties agree that a variance should be granted, as the information required by Minnesota Rules, part 7825.1400 is not necessary to ascertain the reasonableness of MP's requests in these dockets. Requiring the information when it is not necessary presents an excessive burden to the applicant. The public interest would not be affected by this variance and there would not be any violations of any standards imposed by law.

**C. Require Minnesota Power to file appropriate journal entries for the four transactions in a compliance filing within 60 days of closing**

MP, in its initial filings, included proposed journal entries for each of the four property transactions. The Department does not dispute the proposed journal entries<sup>20</sup> aside from the recommendation for deferred accounting.

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<sup>19</sup> Minnesota Power, Docket No. E-015/M-16-648, Briefing Papers

<sup>20</sup> Department of Commerce – Comments, Attachment A contains replacement journal entries received from MP in response to IRs.

## **VI. Decision Options**

- 1. Approve the following transactions as proposed by Minnesota Power:**
  - a. Sale of the Aurora Service Center to Lakehead Constructors, Inc.**
  - b. Sale of the Chisolm Service Center to the United Way of Northeastern Minnesota, Inc.**
  - c. Sale of land, including cold storage buildings, located near Boswell Energy Center to Airmark Inc. dba Nelson Wood Shims**
  - d. Purchase of the Long Prairie Service Center from the State of Minnesota – Department of Military Affairs**
  
- 2. Approve the following transactions with the modifications proposed by the Department of Commerce to require Minnesota Power to use deferred accounting to create regulatory liabilities for these transactions:**
  - a. Sale of the Aurora Service Center to Lakehead Constructors, Inc.**
  - b. Sale of the Chisolm Service Center to the United Way of Northeastern Minnesota, Inc.**
  - c. Sale of land, including cold storage buildings, located near Boswell Energy Center to Airmark Inc. dba Nelson Wood Shims**
  - d. Purchase of the Long Prairie Service Center from the State of Minnesota – Department of Military Affairs**
  - e. Require Minnesota Power to submit a compliance filing within 60 days of closing that provides a detailed explanation and schedules for the regulatory liabilities established in connection to these four transactions.**
  
- 3. Do not approve the following transactions:**
  - a. Sale of the Aurora Service Center to Lakehead Constructors, Inc.**
  - b. Sale of the Chisolm Service Center to the United Way of Northeastern Minnesota, Inc.**
  - c. Sale of land, including cold storage buildings, located near Boswell Energy Center to Airmark Inc. dba Nelson Wood Shims**
  - d. Purchase of the Long Prairie Service Center from the State of Minnesota – Department of Military Affairs**
  
- 4. Approve Minnesota Power’s request for a variance from the filing requirements established by Minnesota Rule, part 7825.1400 as it pertains to capital structure and the issuance of securities. (MP, Department)**
  
- 5. Do not approve Minnesota Power’s request for a variance from the filing requirements established by Minnesota Rule, part 7825.1400 as it pertains to capital structure and the issuance of securities.**
  
- 6. Require Minnesota Power to file appropriate journal entries for the four transactions in a compliance filing within 60 days of closing (MP, Department)**