

Staff Briefing Papers

Meeting Date May 13, 2021 Agenda Item 7*

Company Minnesota Power

Docket No. **E-015/M-19-440**

**In the Matter of Minnesota Power’s Request for Approval of its 2019
Transmission Factors under its Transmission Cost Recovery Rider**

Issues Should the Commission accept Minnesota Power’s transmission cost recovery rider compliance filing and its comments in response to the Federal Energy Regulatory Commission’s (FERC’s) December 4, 2020 Audit Report and Order, in FERC Docket No. FA20-2-000?

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Relevant Documents

Date

PUC – Order Approving Transmission Cost Recovery, Clarifying Prior Order, and Requiring Filings	December 3, 2020
Minnesota Power – Compliance Filing on Order Points 3, 4, and 6	December 10, 2020
Minnesota Power – Compliance Filing, Copy of Federal Energy Regulatory Commission (FERC) Audit Report	December 10, 2020
PUC – Notice of Comment Period	December 21, 2020
Minnesota Power – Supplemental Filing on Status of FERC Audit Report	February 9, 2021

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The attached materials are work papers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless noted otherwise.

 **Relevant Documents**

Date

Department of Commerce – Comments

February 19, 2021

Minnesota Power – Reply Comments

March 5, 2021

Department of Commerce – Response Comments

March 22, 2021

Minnesota Power – Letter

March 30, 2021

Table of Contents

I.	Statement of the Issues.....	1
II.	Background	1
III.	Parties’ Positions.....	2
	A. Minnesota Power’s (MP’s) December 10, 2020 compliance filing	2
	B. Resolution of compliance issues from the December 3, 2020 Order	2
	1. Net Credits received from MISO for Dog Lake and Great Northern Transmission Line .	2
	2. FERC’s audit report.....	3
	3. Compliance tariffs	3
	C. FERC audit report	3
	D. Impact of the FERC audit findings	4
	1. Calculation of Pre-funded AFUDC.....	4
	2. Environmental mitigation project costs	5
	3. Distribution assets recorded as transmission plant and transmission assets recorded as distribution plant	6
	4. Recording of proceeds from long-term debt instruments and associated interest expense	6
	5. Administrative & General expenses	7
	6. Depreciation rates.....	7
	7. FERC Form No. 1 reporting errors	8
	E. Should the Commission take any action with respect to the FERC audit report?.....	8
	F. Are there other issues or concerns related to this matter?.....	9
IV.	Staff Comments.....	9
V.	Decision Alternatives.....	9

I. Statement of the Issues

Should the Commission accept Minnesota Power's transmission cost recovery rider compliance filing and its comments in response to the Federal Energy Regulatory Commission's (FERC's) December 4, 2020 Audit Report and Order, in FERC Docket No. FA20-2-000?

II. Background

On December 3, 2020, the Commission issued its ORDER APPROVING TRANSMISSION COST RECOVERY, CLARIFYING PRIOR ORDER, AND REQUIRING FILINGS.

On December 10, 2020, MP submitted a compliance filing addressing the requirements of Order Points 3, 4, and 6 of the December 3, 2020 Order which included:

- Reporting the net credits it receives from MISO under Schedule 9 for Dog Lake and Great Northern Transmission Line;
- Submitting a copy of FERC's (Federal Energy Regulatory Commission) audit report regarding Minnesota Power's transmission formula rates in this proceeding when it becomes available; and
- Compliance tariff language reflecting the modifications adopted in this order.

On December 21, 2020 the Commission issued a Notice of Comment Period seeking comments on seven topics regarding Minnesota Power's compliance filing. These topics related to the Commission's Ordering Points #3, 4 and 6 of the December 3, 2020 Order and, more specifically, the Federal Energy Regulatory Commission's (FERC) Audit Report.

On February 19, 2021, the Department of Commerce submitted its comments on MP's December 10, 2020 compliance filing. The DOC recommended accepting the compliance filing pending MP's providing additional information requested in the DOC's comments.

On March 5, 2021, Minnesota Power filed reply comments to the PUC Notice and, provided answers to the DOC's questions posed in its February 19, 2021 initial comments.

On March 22, 2021, the Department of Commerce submitted response comments recommending that the Commission accept Minnesota Power's December 10, 2020 compliance filing, and require additional testimony from MP in its next rate case addressing how the company has ensured that the overall classification of expenses is appropriate and consistent with FERC requirements.

On March 30, 2021, Minnesota Power sent a letter expressing agreement with the DOC's recommendations.

III. Parties' Positions

A. Minnesota Power's (MP's) December 10, 2020 compliance filing

Issue: Should the Commission accept Minnesota Power's (MP's) December 10, 2020 compliance filing, in this docket?

In its initial comments, the Department of Commerce stated that it "expects to recommend that the Commission accept Minnesota Power's December 10, 2020 compliance filing, and we will provide our final recommendation after reviewing the information requested from the Company in the instant comments".¹

In its reply comments, Minnesota Power provided additional information that answered the Department's questions, which are individually discussed below.

In its response comments the Department issued its final recommendations that the Commission:

- Accept Minnesota Power's December 10, 2020 compliance filing.
- Require Minnesota Power to provide testimony in its next rate case addressing how the Company has ensured that the overall classification of expenses is appropriate and consistent with FERC requirements, which Minnesota has adopted.

B. Resolution of compliance issues from the December 3, 2020 Order

Issue: Does Minnesota Power's December 10, 2020 compliance filing fully resolve Ordering Points #3, 4, and 6 of the Commission's December 3, 2020 ORDER APPROVING TRANSMISSION COST RECOVERY, CLARIFYING PRIOR ORDER, AND REQUIRING FILINGS? If not, what are the deficiencies in MP's compliance filing?

1. Net Credits received from MISO for Dog Lake and Great Northern Transmission Line

Ordering Point #3: Minnesota Power shall include in this proceeding the net credits it receives from MISO under Schedule 9 for Dog Lake and Great Northern Transmission Line.

In its compliance filing, Minnesota Power reported the net credits it received from the Midcontinent Independent System Operator (MISO) for other utilities' use of the Dog Lake and GNTL facilities in 2019.²

¹ Department of Commerce Comments, February 19, 2021, p. 8.

² MP Compliance Filing, December 10, 2020, Revised Exhibit B-1, P. 3 and B-2, p. 2 in Attachment A.

The Department, in its February 19, 2021 comments, observed that the 2019 credits for Dog Lake and GNTL facilities fell entirely in the month of December and asked that MP submit a supplemental filing to include:

- A clarification as to whether the GNTL and Dog Lake credits shown in Minnesota Power's Revised Exhibit B-2 represent the total credit amount for the whole year of 2019 or solely for the month of December.
- Supporting calculations that demonstrate how the Company arrived at the GNTL and Dog Lake credit amounts shown in Minnesota Power's Revised Exhibit B-2.

Minnesota Power responded with the explanation that the credits represented the total credit amount for the whole year of 2019, but that it was expedient to drop the whole amount in the last month of the year. MP also supplied two tables with supporting calculations for the credits.

In response, the Department said that it concluded the Company appropriately adjusted the TCR Rider billing factors for the Dog Lake and GNTL credits, satisfying Ordering Point #3.

2. FERC's audit report

Ordering Point #4: Minnesota Power shall file a copy of FERC's audit report regarding Minnesota Power's transmission formula rates in this proceeding when it becomes available.

Minnesota Power, in compliance with Ordering Point #4, submitted a copy of FERC's audit report as part of its December 10, 2020 compliance filing. Issues related to timeliness and the audit report findings are discussed below.

3. Compliance tariffs

Ordering Point #6: Minnesota Power shall file compliance tariffs reflecting the modifications adopted in this order.

Minnesota Power submitted revised tariff sheets in compliance with Ordering Point #6 on December 10, 2020. The Department confirmed that the TCR Rider tariff sheets reflected the billing factors adjusted to incorporate the GNTL and Dog Lake revenue credits.

In its March 22, 2021 response comments, the Department recommended that the Commission accept Minnesota Power's December 10, 2020 compliance filing.

C. FERC audit report

Issue: Was the FERC audit report contained in the compliance filing submitted in a timely manner?

In its comments³, the Department concluded that since the Company submitted the FERC Audit Report just six days after FERC issuance, it was submitted in a reasonable timely manner.

D. Impact of the FERC audit findings

Issue: Did any of the FERC audit findings have an impact on either the test year in Minnesota Power's 2016 rate case or any of the calculations in the 2019 Transmission Cost Recovery Rider? If so, what were those impacts and how do they affect rates?

The FERC Audit Report contained seven audit findings. The Department concluded that none of the FERC audit findings had any impact on the TCR Rider nor the 2016 rate case.

1. Calculation of Pre-funded AFUDC

FERC Finding 1: "ALLETE's method for computing Pre-funded AFUDC⁴ for its transmission incentive projects was contrary to the [FERC's] orders. As a result, ALLETE overstated the transmission plant balances used to compute its annual transmission revenue requirements, which led to overbillings to wholesale transmission customers."⁵

In Minnesota Power's reply comments,⁶ the Company said that the AFUDC included in the rider calculation was correct. The Company supplemented its response via an e-mail to the Department, adding:

Contra/Prefunded AFUDC included in the Company's 2017 test year in its 2016 rate case was also correct and offset all AFUDC on retail rider recoverable projects except AFUDC prior to retail recovery, AFUDC on internal costs, and any AFUDC after a project was capped.

The Department said that it concluded that FERC Finding 1 did not impact MP's 2016 rate case or the 2019 TCR Rider calculations.⁷

³ DOC Comments, February 19, 2021, p. 3.

⁴ Allowance for Funds Used During Construction.

⁵ FERC Audit Report, p. 19.

⁶ MP Reply Comments to Notice, March 5, 2021, p. 3.

⁷ DOC Response Comments, March 22, 2021, p. 4.

2. Environmental mitigation project costs

FERC Finding 2: “ALLETE improperly recorded environmental mitigation project costs of \$4.2 million in Account 930.2, Miscellaneous General Expenses. As a result, ALLETE overstated its annual transmission revenue requirement and overbilled wholesale transmission customers.”⁸

The Department initially concluded that, while this finding had no impact on MP’s TCR Rider, depending on the timing of the expenditures, it may have had some impact on the 2017 test year. As a result, the Department requested that MP submit a supplemental filing that included:

An explanation and supporting information/calculations addressing whether and to what extent (in dollar terms) the FERC’s Finding 2 impacted the Company’s 2017 test year in its 2016 rate case. Please provide the amount of Account 930.2 - Miscellaneous General Expenses approved in the 2016 rate case, including a breakout of these expenses and identifying any amount of donation costs that were incorrectly included

Minnesota Power⁹ responded with the following:

The entire \$4.2 million of costs noted in Finding 2 were incurred in 2014, so there was no impact on the 2017 test year in Minnesota Power’s 2016 rate case. The amount approved for Account 930.2 - Miscellaneous General Expenses in the 2016 rate case was \$1,542,320 as broken out below in Table 3. No donation costs were identified as being incorrectly included in these amounts.

MP Table 3: Account 390.2 – Miscellaneous General Expense in 2016 Rate Case

Labor and Overheads	\$ 229,966
Meals, Travel, and Lodging	\$ 194,501
Board of Directors Compensation	\$ 891,791
Contractors, Professional Services, and Materials	\$ 528,871
Lease and Rental Expense	\$ 111,453
Office Supplies and Postage	\$ 54,790
Dues, Licenses, and Miscellaneous Expenses	\$ 7,042
Test Year Adjustments	\$ (476,095)
Total 930.2 Expense (excludes impact of Deferred Fuel Adjustment Clause activity which was disallowed for recovery)	\$ 1,542,320

The Department said that it concluded that FERC Finding 2 did not impact MP’s 2016 rate case or the 2019 TCR Rider calculations.¹⁰

⁸ FERC Audit Report, p. 23.

⁹ MP Reply Comments to Notice, March 5, 2021, p. 4.

¹⁰ DOC Response Comments, March 22, 2021, p. 5.

3. Distribution assets recorded as transmission plant and transmission assets recorded as distribution plant

FERC Finding 3: “ALLETE improperly recorded distribution assets in transmission plant accounts and transmission assets in distribution plant accounts. As a result of the transmission and distribution asset misclassification, ALLETE overstated its annual transmission revenue requirement which led to overbillings to wholesale transmission customers.”¹¹

In its initial comments,¹² the Department said that it believed that Finding 3 would likely impact the Company’s wholesale customers more than its Minnesota jurisdictional retail customers. Further, based on the amounts (\$497,264 of distribution assets out of transmission accounts, partially offset by \$278,330 of transmission assets out of distribution accounts between 2016 and 2019), the Department concluded, both in initial comments and its response comments, that the offset makes the impact of these errors de minimis in both the TCR Rider and the 2016 rate case.

4. Recording of proceeds from long-term debt instruments and associated interest expense

FERC Finding 4: “ALLETE improperly recorded proceeds from long-term debt instruments in Account 186, Miscellaneous Deferred Debits. In addition, ALLETE improperly recorded interest expense associated with the debt instruments in Account 920, Administrative and General Salaries. As a result, ALLETE overstated its annual transmission revenue requirement and overbilled wholesale transmission customers.”¹³

The Department point out in its comments¹⁴ that the long-term debt proceeds and interest payments in FERC’s Finding 4 are from life insurance policies associated with ALLETE’s Executive Investment Plan. Minnesota Power explained¹⁵ that Executive Plan Expenses were not allowed for recovery in MP’s 2016 rate case and this finding had no impact on the 2017 test year.

The Department concluded¹⁶ that FERC Finding 4 would not have impacted the 2019 TCR Rider calculations, nor the 2017 test year in the 2016 rate case.

¹¹ FERC Audit Report, p. 25.

¹² DOC Comments, February 19, 2021, p. 5.

¹³ FERC Audit Report, p. 27.

¹⁴ DOC Comments, February 19, 2021, p. 5.

¹⁵ MP Reply Comments to Notice, March 5, 2021, p. 4.

¹⁶ DOC Response Comments, March 22, 2021, p. 6.

5. Administrative & General expenses

FERC Finding 5: “ALLETE improperly recorded various Administrative & General (A&G) expenses in a manner contrary to the FERC’s accounting regulations. As a result of the improper accounting for certain A&G expenses, ALLETE overstated its annual transmission revenue requirement and overbilled wholesale transmission customers.”¹⁷

The Department explained¹⁸ that one of the specific issues in FERC Finding 5 that had the possibility of impacting the 2016 rate case was ALLETE’s erroneous recording of 2016 and 2017 lobbying costs of approximately \$26,000 in Account 921 – Office Supplies and Expenses, rather than the correct booking to Account 426.4 – Expenditures for Certain Civic, Political, and Related Activities.

In response to a Department request, Minnesota Power responded:¹⁹

The lobbying expense misclassification described in FERC’s Finding 5 did not have an impact on the Company’s 2017 test year in its 2016 rate case. The lobbying expense item was properly budgeted, and therefore included in the test year, to FERC account 426.4 as below the line expense. Additionally, as documented in rate case testimony and in Rebuttal and Surrebuttal schedules, adjustments to Operating Income were made to exclude all lobbying expenses found in the review of employee expenses.

As a result, the Department continued to conclude²⁰ that FERC Finding 5 did not have an effect on either the 2019 TCR Rider filing or the 2016 rate case.

6. Depreciation rates

FERC Finding 6: “ALLETE applied state-approved depreciation rates to assets included in its wholesale transmission formula rate determination but had not previously filed these depreciation rates with the [FERC] and obtained [FERC] approval. In addition, ALLETE improperly recorded depreciation expenses associated with plant held for future use in Account 403, Depreciation Expense, instead of Account 421, Miscellaneous Nonoperating Income. As a result of ALLETE’s improper accounting for depreciation expenses associated with plant held for future use, ALLETE overstated its annual transmission revenue requirement which led to overbillings to wholesale transmission customers.”²¹

¹⁷ FERC Audit Report, p. 30.

¹⁸ DOC Response Comments, March 22, 2021, p. 6.

¹⁹ MP Reply Comments to Notice, March 5, 2021, p. 5.

²⁰ DOC Response Comments, March 22, 2021, p. 6.

²¹ FERC Audit Report, p. 34.

In its initial comments,²² the Department stated that MP's application of state-approved depreciation rates would not have had any adverse impact of the Company's 2019 TCR Rider filing or the 2016 rate case. However, the Department was concerned that depreciation expense for plant held for future use could have impacted the 2016 rate case. The Department requested further information from Minnesota Power.

In response, Minnesota Power explained that:²³

The improperly recorded depreciation expense associated with plant held for future use, as described in FERC Finding 6, had no impact on the Company's 2017 test year in its 2016 rate case. The Company excludes the held for future use depreciation expense that is in account 40300 (\$407.00 2017 expense) from the amount provided in the rate case for transmission depreciation and amortization expense. The company also excludes account 10500 plant held for future use (\$19,426.00 in 2017 plant) from the amounts provided in the rate case for transmission plant in-service.

As a result of this explanation, the Department continued to conclude²⁴ that this finding would not have impacted the 2019 TCR Rider filing nor the 2016 rate case.

7. FERC Form No. 1 reporting errors

Finding 7: "ALLETE did not properly follow the FERC Form No. 1 instructions and, therefore, did not report all required information in its FERC Form No. 1 filings."²⁵

The Department concluded²⁶ that FERC Form No. 1 reporting errors would not have impacted either MP's 2019 TCR Rider nor the 2016 rate case.

E. Should the Commission take any action with respect to the FERC audit report?

Based on its review of the seven FERC Audit Report findings, the Department does not recommend any action for the Commission to take on the audit report at this time.²⁷

²² DOC Comments, February 19, 2021, p. 7.

²³ MP Reply Comments to Notice, March 5, 2021, p. 5.

²⁴ DOC Response Comments, March 22, 2021, p. 7.

²⁵ FERC Audit Report, p. 38.

²⁶ DOC Response Comments, March 22, 2021, p. 7.

²⁷ Ibid.

F. Are there other issues or concerns related to this matter?

In its March 22, 2021 response comments, the Department stated that the FERC Audit Report reinforced the need for the Department to perform a targeted review of the Company's general/administrative expense accounts and below-the-line expenses in MP's next rate case.

The Department recommended that the Commission:

- Accept Minnesota Power's December 10, 2020 compliance filing.
- Require Minnesota Power to provide testimony in its next rate case addressing how the Company has ensured that the overall classification of expenses is appropriate and consistent with FERC requirements, which Minnesota has adopted.

IV. Staff Comments

Staff appreciates the analysis performed by the Department to ascertain the impacts of FERC's Audit Report on both Minnesota Power's 2019 TCR Rider and the 2016 general rate case. Staff also appreciates the openness of Minnesota Power in responding to the Department's requests for information. Staff concurs with the Department's recommendations.

V. Decision Alternatives

Compliance Filing

1. Accept Minnesota Power's December 10, 2020 compliance filing (DOC, MP)
- or
2. Do not accept Minnesota Power's December 10, 2020 compliance filing

Minnesota Power's Next Rate Case

3. Require Minnesota Power to provide testimony in its next rate case addressing how the Company has ensured that the overall classification of expenses is appropriate and consistent with FERC requirements, which Minnesota has adopted. (DOC, MP)
- or
4. Make other rate case testimony requirements of Minnesota Power that the Commission deems necessary.

FERC Audit Report – Executive Summary (Partial)

Federal Energy Regulatory Commission

Office of Enforcement, Division of Audits and Accounting

Audit Report

Audit of ALLETE, Inc.'s Compliance with:

- Tariff requirements governing its FERC jurisdictional rates;
- Conditions included in the Commission's orders granting transmission incentives;
- Accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees;
- Reporting requirements of the FERC Form No. 1; and
- Requirements in Preservation of Records of Public Utilities and Licensees, 18 C.F.R. Part 125.

FERC Docket No. FA20-2-000
December 4, 2020

ALLETE, Inc.

Docket No. FA20-2-000

I. Executive Summary

- **Overview**

The Division of Audits and Accounting (DAA) within the Office of Enforcement of the Federal Energy Regulatory Commission (Commission or FERC) has completed an audit of ALLETE, Inc. (ALLETE or the Company). The audit evaluated ALLETE's compliance with: (1) approved terms, rates, and conditions of its transmission formula rate mechanism as provided in Attachment O of The Midcontinent Independent System Operator, Inc.'s (MISO) Open Access Transmission, Energy and Operating Reserve Markets Tariff (MISO's FERC Electric Tariff); (2) conditions included in the Commission's orders granting ALLETE transmission incentives; (3) accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101; (4) reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others, under 18 C.F.R. § 141.1; and (5) the requirements in Preservation of Records of Public Utilities and Licensees under 18 C.F.R. Part 125. The audit covered the period from January 1, 2016 through September 3, 2020.

- **ALLETE, Inc.**

ALLETE is an energy services company headquartered in Duluth, Minnesota. Through its operating division, Minnesota Power, ALLETE generates, transmits, and distributes electricity in a 26,000-square-mile service territory in northern Minnesota. ALLETE's business operations include both regulated and non-regulated activities. The regulated operations include ALLETE's regulated utilities – Minnesota Power and Superior Water, Light and Power Company (SWL&P), and its investment in American Transmission Company, LLC (ATC), a Wisconsin-based regulated utility that owns and maintains electric transmission assets.

ALLETE, doing business as Minnesota Power, provides regulated utility electric service in northeastern Minnesota to approximately 145,000 retail customers and electric generation and transmission service to 15 non-affiliated municipal customers as well as to SWL&P. Through Minnesota Power, ALLETE owns approximately 8,752 miles of electric transmission and distribution lines and 169 substations with a total capacity of 9,525 megavolt amperes. In 2019, ALLETE reported approximately \$1.004 billion in total revenue from its electric operations. Of the \$1.004 billion, \$104.8 million was associated with its wholesale transmission operations.

- **Summary of Compliance Findings**

Audit staff's compliance findings are summarized below. Details of these findings are in section IV. Audit staff found the following seven areas of noncompliance:

- *Transmission Incentives* – ALLETE's method for computing Pre-funded Allowance for Funds Used During Construction (AFUDC) for its transmission incentive projects was contrary to the Commission's orders. As a result, ALLETE overstated the transmission plant balances used to compute its annual transmission revenue requirements, which led to overbillings to wholesale transmission customers.
- *Accounting for Environmental Costs* – ALLETE improperly recorded environmental mitigation project costs of \$4.2 million in Account 930.2, Miscellaneous General Expenses. As a result, ALLETE overstated its annual transmission revenue requirement and overbilled wholesale transmission customers.
- *Transmission and Distribution Plant Accounting* – ALLETE improperly recorded distribution assets in transmission plant accounts and transmission assets in distribution plant accounts. As a result of the transmission and distribution asset misclassification, ALLETE overstated its annual transmission revenue requirement which led to overbillings to wholesale transmission customers.
- *Accounting for Long-Term Debt and Interest Expense* – ALLETE improperly recorded proceeds from long-term debt instruments in Account 186, Miscellaneous Deferred Debits. In addition, ALLETE improperly recorded interest expense associated with the debt instruments in Account 920, Administrative and General Salaries. As a result, ALLETE overstated its annual transmission revenue requirement and overbilled wholesale transmission customers.
- *Accounting Misclassifications* – ALLETE improperly recorded various administrative and general (A&G) expenses in a manner contrary to the Commission's accounting regulations. As a result of the improper accounting for certain A&G expenses, ALLETE overstated its annual transmission revenue requirement and overbilled wholesale transmission customers.
- *Application of Nonapproved Depreciation Rates* – ALLETE applied state- approved depreciation rates to assets included in its wholesale transmission formula rate determination but had not previously filed these depreciation rates with the Commission and obtained Commission approval. In addition, ALLETE improperly recorded depreciation expenses associated with plant held for future use in Account 403, Depreciation Expense, instead of Account 421, Miscellaneous Nonoperating

Income. As a result of ALLETE's improper accounting for depreciation expenses associated with plant held for future use, ALLETE overstated its annual transmission revenue requirement which led to overbillings to wholesale transmission customers.

- *FERC Form No. 1 Reporting* – ALLETE did not properly follow the FERC Form No. 1 instructions and, therefore, did not report all required information in its FERC Form No. 1 filings.