MINNESOTA PUBLIC UTILITIES COMMISSION

Staff Briefing Papers

Meeting Date	October 25, 2018		Agenda Item 6**
Company	Minnesota Power		
Docket No.	**E-015/M-18-375**		
	In the Matter of Minnesota Power's Renewable Resources Rider and 2018 Renewable Rider Factors		
Issues	1. Should the Commission approve Minnesota Power's Petition to implement its updated Renewable Resources Rider factor coincident with the implementation of final rates in Minnesota Power's general rate case?		
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✓ **Relevant Documents**	**Date**
Minnesota Power - Petition	June 5, 2018
Department of Commerce - Comments	June 26, 2018
Department of Commerce - Letter	June 29, 2018
Minnesota Power Comments - Letter	June 29, 2018
Commission - Order	July 30, 2018

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	August 3, 2018
Minnesota Power - Reply Comments	August 16, 2018
Department of Commerce- Response Comments	September 5, 2018
Minnesota Power - Reply Comments Letter	September 13, 2018

I. Statement of the Issues

- Should the Commission approve Minnesota Power's Petition to implement its updated Renewable Resources Rider factor coincident with the implementation of final rates in Minnesota Power's general rate case?

II. Introduction

On June 5, 2018, Minnesota Power (MP) filed a petition seeking approval to implement the updated Renewable Resources Rider (RRR) factor coincident with the implementation on **December 1, 2018** of final rates in MP's current general rate case.

On August 3, 2018, the Department filed comments recommending the Commission approve MP's petition for approval of its Renewable Resources Rider and 2018 Renewable Factors, subject to modifications.

On August 16, 2018, MP filed reply comments. The Company is open to many of the modifications presented by the Department should the Commission decide the materiality of the recommendations warrants the change.

The Department responded to MP on September 5, 2018, reiterating its modifications.

MP responded to the Department on September 13, 2018, again questioning materiality. Specifically, MP opposes the Department's recommendation to delay implementation until **January 1, 2019** to resolve any issues related to ADIT proration. MP argues that the Department's recommendation is unreasonable given that the financial impact of the ADIT proration is $299.

III. Background

A. Minnesota Power's Renewable Resource Rider

On May 11, 2007, the Commission established MP's RRR through an order to allow recovery of investments and expenditures related to transmission upgrades for the Oliver Wind II power purchase agreement with FPL Energy under Minn. Stat. §216B.1645.

Beginning in 2010, MP also utilized its RRR to recover costs related to the Bison Wind Energy Center. MP started cost recovery for Bison 1 in 2010 and subsequently began recovering costs for the remaining Bison facilities in 2013 and 2015. Additionally, MP used the RRR to recover costs for Thomson [Dam – Hydro restoration] Projects beginning in 2016.

B. Provisional approval granted to MP to implement proposed RRR sub-factors effective August 1, 2018

MP also requested provisional approval to zero out the rider sub-factor for the Large Power class effective July 1, 2018, and requested that the Commission waive the requirements of

Minn. Rule 7825.3200 which requires that utilities serve notice to the Commission at least 90 days prior to the proposed effective date of modified rates. MP will continue to bill the Large Power customers the base rate sub-factor and credit that revenue to base rate revenue until implementation of final rates in the rate case.

On June 26, 2018, the Minnesota Department of Commerce, Division of Energy Resources (Department) filed comments recommending approval of provisional billing factors, which included the current base rate sub-factors and proposed final rider rate sub-factors, for all customers rather than zeroing out the Large Power class' rider sub-factors. The Department recommended that the Commission set the provisional rate factors effective July 1, 2018 or as soon as the Commission issues an Order on this issue, whichever is earliest. Given that this timing may violate Minn. Rules part 7825.3200, the Commission would need to vary this rule. The Department concluded "that enforcement of the rule would impose an excessive burden on customers by forcing them to, in effect, make a temporary loan to the Company." The Department also concluded "that granting the variance would not adversely affect the public interest and the Department is not aware of any conflict with standards imposed by law." The Department will file additional comments and provide additional analysis on MP's final rates at a later date.

On June 29, 2018, MP filed a letter generally agreeing with the Department's comments and recommendations, but stated there are two implementation details which the Company believes must be incorporated into the Commission's decision in this matter as follows.

Rider sub-factors – MP's current billing factors are split into two sub-factors – a rider sub-factor and a base rate sub-factor. The Department's recommendation discussed the overall total factors rather than just the rider sub-factor.

> Minnesota Power does not object to the Department's recommended billing factor in total. However, the Company believes that only the rider subfactors may be altered in the current docket, since the base rate subfactors are used for revenue purposes in the general rate case. Therefore, if the Commission accepts the Department's recommendation, this must be accomplished by altering only the rider subfactors.

Effective date – MP clarified that:

> While Minnesota Power is eager to implement the rates as soon as possible, it is unable to do so without a Commission Order. Further, the Company requires a modicum of notice in order to update its billing system with the new tariffs. The Company proposes to update tariffs on the first day of the month following a Commission Order on the issue. The earliest foreseeable date for implementation would be August 1, 2018, subject to prior Commission approval.

MP requested "the Commission approve MP's request for a waiver of the 90-day requirement under Minn. Rule 7825.3200, and grant approval of the modified provisional rate request, effective on the first day of the month following a Commission Order."

On June 29, 2018, the Department filed a letter supporting the proposals in MP's June 29, 2018 letter. The Department recommended that the Commission approve the Department's original recommendation as modified by MP's June 29, 2018 letter.

The Commission met on July 26, 2018 to consider MP's proposal to provisionally zero-out the Renewable Resource Rider billing factor. The Commission granted MP's modified request, issuing the order on July 30, 2018.

IV. Parties' Comments

A. Minnesota Power

In MP's rate case, Docket E-015/GR-16-664, all of the Bison projects and most of the costs associated with the Thomson Project were rolled into base rates. The only items remaining in the RRR include:

- Updated tracker balance,
- Investments and Expenditures related to two remaining projects associated with the Thomson Project,
- True-up of actual production tax credits as reflected in Order Point 37 in MP's recent rate case,[1]
- Reimbursements of sums related to the Bison 6 Large Generator Interconnection Agreement (LGIA) as ordered in the Commission's March 16, 2018 Order.[2]

Overall, MP proposed a total recoverable retail revenue requirement for the 2018 RRR of -$7.6 million.[3]

> The total recoverable retail revenue requirements for the 2018 Renewable Resources Rider is -$7.6 million, consisting of a -$4 million 2017 tracker balance, $0.8 million in projected revenue requirements for 2018 for the Thomson Projects, a revenue credit of $1.5 million for the 2018 Bison LGIA reimbursement, and a revenue credit of $2.9 million for the 2017 PTC true-up.

MP utilized assumptions approved in its previous rate case.[4]

> Minnesota Power has utilized the appropriate authorized rates of return, the jurisdictional Power Supply Production Demand allocators, and the jurisdictional Power Supply Transmission Demand allocators, based on those approved by the

[1] Docket No. E-015/GR-16-664

[2] Docket No. E-015/AI-17-304

[3] Minnesota Power, Initial Filing, Page 14

[4] Minnesota Power, Initial Filing, Page 24

Commission in Minnesota Power's last retail rate case[5] and as approved in previous Renewable Resources Rider Factor filings.

B. Department of Commerce

The Department reviewed each component of MP's proposed revenue requirement and identified the following issues.

1. Return on Investment

The Department summarized MP's methodology:[6]

> MP has proposed to calculate both the return on equity and return on debt (interest expense) components of the RRR revenue requirement using the capital structure and rate of return from the Company's 2009 rate case, Docket No. E015/GR-09-1151.

The Department concluded[7]

> …it would be more appropriate to instead use the capital structure and rate of return recently approved in the March 12, 2018 Order in the Company's most recent rate case, Docket No. E015/GR-16-664. The rate of return and capital structure approved in MP's general rate case earlier this year are more recent and therefore more accurately reflect MP's cost of service.

2. Impact of the Tax Cuts and Jobs Act of 2017

MP has proposed to incorporate the impacts of the Tax Cuts and Jobs Act of 2017 (TCJA) as follows:[8]

> The 2018 revenue requirements do not reflect any changes due to the 2017 Federal Tax Act. Once determinations have been made in the Commission's Investigation Regarding the Tax Cuts and Jobs Act of 2017, [Docket No. E,G-999/CI-17-895] the Company will update the RRR tracker and incorporate the impacts in the subsequent factor filing. The anticipated updates are the removal of 40 percent bonus tax depreciation on projects placed in service, and the reduction in the federal tax rate from 35 percent to 21 percent.

The Department concluded[9]

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[5] Docket No. E-015/GR-09-1151

[6] Department Comments, filed 8/3/2018, Page 8

[7] Id.

[8] MP Initial Filing, filed 6/5/2018, Page 22-23

[9] Department Comments, filed 8/3/2018, Page 9

> …it would be more appropriate to update the RRR revenue requirements to include the tax changes, since the tax changes are already in effect and therefore are more representative of the cost of service.

3. Accumulated Deferred Income Taxes

The Department discussed Accumulated Deferred Income Taxes (ADIT):[10]

> Regarding accumulated deferred income taxes (ADIT), MP has proposed to include "the prorata deferred tax calculation … for one month, resulting in a minimal impact on the deferred tax liability." The Department concluded "that this proposal is reasonable as long as MP trues up the ADIT figures to actual not prorated ADITs in their true-up calculation, as such treatment would negate any positive or negative impacts from MP's proposal." The Department initially requested that MP confirm that it plans to true-up ADIT figures as such. MP did not so confirm. Ultimately the Department recommended that the Commission require MP to implement the 2018 RRR factor no sooner than January 1, 2019 to eliminate the forecasted costs and the need for proration. "This would result in the $299 in proration being removed for December 2018."

4. Application of Jurisdictional and Class Allocators

The Department noted:[11]

> MP has proposed to defer use of the Company's most recently approved jurisdictional and class allocators (in Docket No. E015/GR-16-664) until December 1, 2018, since that is when the Company anticipates implementing final rates in Docket No. E015/GR-16-664. Since the Commission has already approved the updated jurisdictional and class allocators, the Department views the updated allocators as the most reflective of MP's cost characteristics.

5. Energy Production at the Bison Projects

The Department has expressed concerns about the level of underproduction of the Bison projects relative to the production MP cited to demonstrate the projects were cost-effective in their respective eligibility (i.e. pre-approval) for cost recovery filings. Despite these projects being rolled into base rates, the Department requests that MP provide actual production for the Bison projects over the prior year, explaining underperformance, and to continue to provide this information in all future RRR filings.

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[10] Id.

[11] Id.

6. Summarized Recommendations

The Department recommended that the Commission require MP to use the following in its 2018 RRR revenue requirement calculations and to file the updated rate factors in a compliance filing before implementation:

- the rate of return, capital structure, jurisdictional allocators, and class allocators approved in the March 12, 2018 Order in Docket No. E015/GR-16-664; and
- the tax rates as updated in the Tax Cuts and Jobs Act of 2017.

The Department also recommended the Commission require MP to implement the 2018 RRR factors no sooner than January 1, 2019 to eliminate the inclusion of forecasted costs and the resulting need for ADIT proration.

In addition, the Department recommended the Commission require that, in all future RRR filings, MP provide the actual production for the Bison projects over the prior year and explain any underperformance compared to the 1,888,000 MWh per year assumed in the eligibility filings.

C. Minnesota Power Response

1. Assumptions Used

MP responded to the Department, arguing that the Department appears to be inconsistent in recommendations regarding tariff calculations. MP states that it used the rate of return, capital structure, jurisdictional allocators, and class allocators approved in its 2009 general rate case (Docket No. E015/GR-09-1151) in the rider docket for the recovery of MP's Boswell Unit 4 Emission Reduction Rider (BEC4 Rider) and the Department did not take exception to the Company's assumptions in that docket.

MP is open to using the Department's recommendations should the Commission determine that the materiality of these recommendations warrants the change, however, the Company also believes consistency is important in evaluating assumptions for current cost recovery riders. MP provided updated revenue requirement calculations for using the assumptions in the current rate case.[12]

> Using the Department's proposed assumptions for rate of return and capital structure would decrease revenue requirements for the 2018 RRR rates by $60,731. Using the Department's proposed assumption for jurisdictional and class allocators would increase revenue requirements by $17,917. The net effect of updating these assumptions as recommended by the Department is a decrease to revenue requirements of $42,813.

[12] MP Reply Comments, filed 8/16/2018, page 3

2. Impact of the Tax Cuts and Jobs Act of 2017

MP notes that the impacts of the TCJA had not yet been decided when this petition was filed. Any tax differences resulting from the TCJA will be minimal and will be included in the RRR tracker.

Additionally, MP did not object to the Department's recommendation, which will result in a decrease to the revenue requirement of $29,104.

3. Combined Impact of Assumptions and TCJA

MP states that[13] "incorporating the Department's recommendations results in a reduction to revenue requirements of $71,917. This change would have no impact on the originally proposed Large Power rates and would change the rate for other classes by one thousandth of a cent ($0.00001). While Minnesota Power is not opposed to the Department's recommendation, it believes the impact is immaterial to the current RRR tariff and should instead be considered in the RRR tracker."

4. Accumulated Deferred Income Taxes

MP confirmed that it intends to true-up the forecasted prorata ADIT amount of $299 utilizing the method prescribed by the IRS. The Company recommends to implement the rider sub-factor coincident with the implementation of final rates and therefore is opposed to the Department's recommendation to postpone implementation until January 1, 2019.

[13] MP Reply Comments, Filed 8/16/2018, page 7.

5. Energy Production at the Bison Projects

MP responded to the Department's inquiry regarding production at the Bison facilities.[14]

(MWh)	Estimated*	2014	2015	2016	2017	2017 variance
Bison 1	300,000	266,640	239,519	263,376	271,815	-9.4%
Bison 2	380,000	324,087	294,291	328,831	328,923	-13.4%
Bison 3	365,000	326,727	293,757	326,999	333,816	-8.5%
Bison 4 **	835,000	44,820	712,033	832,159	840,920	0.7%
	1,880,000	962,274	1,539,600	1,751,365	1,775,474	-5.6%

* *Bison 1 - Docket No. E015/M-09-285*

* *Bison 2 - Docket No. E015/M-11-234*

* *Bison 3 - Docket No. E015/M-11-626*

* *Bison 4 - Docket No. E015/M-13-907*

** *Bison 4 was placed in service December, 2014*

MP noted that the Bison facilities did not under-perform for any reliability or curtailment reasons, but rather, due to the relative lack of data and operational experience of the wind industry in the area at the time the estimates were brought before the Commission. Bison 4, as seen in the table above, is closer to its estimates due to the fact that MP was able to apply lessons learned from the previous facilities while developing Bison 4.

[14] MP Reply Comments, Filed 8/16/2018, page 5

V. Staff Analysis

A. ADIT Proration

The Department provided an overview of the ADIT proration issue in Docket G-002/M-18-184.[15]

> Previously, the IRS interpreted this prepayment of income taxes simply as a timing difference: income tax prepayments by ratepayers in one year would simply be returned to ratepayers (reversed) in subsequent years. However, in the past several years, the IRS began interpreting its rules such that ratepayers would not be fully credited for income tax prepayments through the offset provided by ADIT, by prorating (reducing) ADIT if rates are implemented prior to the end of the test period used to set rates.
>
> For example, if rates are based on a test period of July 2017 to June 2018, and if rates were implemented May 1, 2018, the IRS would require proration (reduction) of ADIT for May and June of 2018. As a result, ratepayers would not receive the full credit for income tax prepayments for those two months.

In this docket, the Department argues that MP could simply delay the implementation of the rider until January 1, 2019, thus eliminating concerns about proration. MP argues that it would not only be administratively burdensome, but it would cost ratepayers $600,000 in revenue requirements due to the delay of a significant tariff reduction. MP notes the financial impact of its proposal amounts to a total of $299.

MP also stated that its proposal would not violate any IRS normalization rules. The Department seeks to avoid issues of ADIT proration and potential IRS normalization concerns by delaying the implementation by one month.

The Department is arguing that the Commission has generally required utilities to base rider adjustment factors on known and vetted historical data. MP bases its proposal on a single month of estimated costs and confirmed that it intends to true-up the forecasted prorata ADIT amount of $299 utilizing the method prescribed by the IRS.

The issue of ADIT proration has been argued and will continue to be argued in several rider dockets. Utilities generally request to forecast a portion of their ADIT proration expense to help mitigate the effects of regulatory lag while the Department generally argues that the rider factors should be developed based on historical data in order to produce more accurate results that can be scrutinized. To date, the Commission has decided these ADIT proration issues case-by-case, based on the merits of each individual docket, instead of making a significant general policy finding.

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[15] Docket 18-184, Xcel Energy's State Energy Policy Rider, contemplates the issue of ADIT proration and the timing of implementation similar to this docket.

B. Assumptions Used

The Department is recommending that the Commission require MP to use the rate of return, capital structure, tax rates, jurisdictional allocators, and class allocators that were determined in the Company's most recent rate case (16-664). MP's proposal utilized the assumptions from the Company's previous rate case (09-1151).

MP would be open to the Department's recommendation if the Commission determined that the amount, described above as having a net decrease on Revenue Requirements of $42,813, is significant enough to warrant the change. MP stated that it will use this Department recommendation in future situations when cost recovery riders are calculated before final rates are implemented.

VI. Decision Options

Effective Date

1. Determine that the impact of ADIT proration is de minimus and allow Minnesota Power to implement its 2018 Renewable Resources Rider (RRR) factors concurrent with the anticipated implementation date of final rates in its rate case, Docket No. E-015/GR-16-664. (MP)

2. Require Minnesota Power to implement the 2018 RRR factors no earlier that January 1, 2019 to eliminate the inclusion of forecasted costs and resulting need for ADIT proration. (Department)

2018 RRR factor calculations

3. Approve Minnesota Power's 2018 RRR factor calculations as proposed by MP that utilize assumptions from the Company's previous rate case, E-015/GR-09-1151. (MP)

4. Require Minnesota Power to use the following 2018 RRR revenue requirement calculations as recommended by the Department:

   a. The rate of return, capital structure, jurisdictional allocators, and class allocators approved in the March 12, 2018 Order in Docket No. E015/GR-16-664. (Department; MP is open to this)

   b. The tax rates as updated in the Tax Cuts and Jobs Act of 2017 (Department; MP is open to this)

Compliance filing

5. Require Minnesota Power to file the updated rate factors in a compliance filing before implementation. (Department; MP is open to this)

Future RRR filings

6. Require that, in all future RRR filings, MP provide the actual production for the Bison projects over the prior year and explain any underperformance compared to the 1,888,000 MWh assumed in the eligibility filings. (Department)