MINNESOTA DEPARTMENT OF COMMERCE

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August 31, 2016

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: **Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. G011/D-16-490

Dear Mr. Wolf:

Attached are the Comments of the Minnesota Department of Commerce, Division of Energy Resources (Department), in the following matter:

Petition of Minnesota Energy Resources Corporation for its Annual Review of Depreciation Rates for 2016.

The petition was filed on June 1, 2016 by:

Tina E. Wuyts
Senior Accountant
WEC Energy Group – Business Services
PO Box 19001
Green Bay, WI 54307-9001

The Department recommends **approval** and is available to answer any questions the Minnesota Public Utilities Commission may have.

Sincerely,

/s/ CRAIG ADDONIZIO
Financial Analyst

CA/lt
Attachment

MINNESOTA DEPARTMENT OF COMMERCE

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

COMMENTS OF THE MINNESOTA DEPARTMENT OF COMMERCE DIVISION OF ENERGY RESOURCES

DOCKET NO. G011/D-16-490

I. SUMMARY OF MERC'S PETITION

On June 1, 2016, Minnesota Energy Resources Corporation (MERC or the Company) filed a petition (Petition) with the Minnesota Public Utilities Commission (Commission) requesting approval of the Company's proposed depreciation parameters and rates effective January 1, 2016. MERC's Petition is the fourth update to its most recent comprehensive five-year depreciation study, filed in Docket No. G007,011/D-12-533 (2012 Depreciation Docket). With two exceptions, described in greater detail below, the average service lives and salvage rates proposed in the Petition are unchanged from those approved in the 2012 Depreciation Docket, and remaining lives have been updated to reflect the passage of time and plant activity (i.e. additions, retirements, transfers, etc.). As indicated in Attachment 1 to MERC's Petition, the application of the proposed lives and salvage rates to December 31, 2015 plant and reserve balances results in 2016 depreciation expense of $10,977,280, or $126,844 higher than depreciation expense would be under current depreciation rates. The proposed depreciation parameters yield a composite depreciation rate of 2.54 percent for 2016, or 0.03 of a percentage point higher than the composite depreciation rate yielded by currently approved depreciation parameters (2.51 percent).

II. DEPARTMENT ANALYSIS

The Minnesota Department of Commerce, Division of Energy Resources (Department) examined MERC's Petition for compliance with filing requirements and previous Commission Orders, and for the reasonableness of the proposed remaining lives, salvage rates, and depreciation rates.

A. COMPLIANCE WITH FILING REQUIREMENTS AND COMMISSION ORDERS

Minnesota Statutes Section 216B.11 and Minnesota Rules, parts 7825.0500-7825.0900 require public utilities to seek Commission certification of their depreciation rates and methods. Utilities must use straight-line depreciation unless the utility can justify a different method. Additionally, utilities must review their depreciation rates annually to determine if they are generally appropriate and must file depreciation studies at least once every five years. Once certified by order, depreciation rates remain in effect until the next certification. MERC employs a straight-line depreciation method and files annual depreciation studies with the Commission. Additionally, in 2015, MERC used the most recently approved depreciation rates to calculate depreciation expense, which were approved by the Commission in Docket No. G004/D-15-534 (2015 Depreciation Docket). The Department concludes that MERC's Petition meets all relevant filing requirements.

B. REASONABLENESS OF PROPOSED REMAINING LIVES, SALVAGE RATES, AND IMPACT OF RESULTING DEPRECIATION RATES

1. Proposed Lives and Salvage Rates

All of the average service lives, survivor curves, and salvage rates that MERC used in its Petition were established in prior MERC depreciation dockets. As noted above, most were established in the 2012 Depreciation Docket. The depreciation parameters for account 381.2 Automated Meter Reading Devices were established in Docket No. G011/D-14-455, and the parameters for account 392.1 Transportation Equipment were established Docket No. G011/D-15-534. Because MERC's proposed average service lives, survivor curves, and salvage rates conform to those established in previous proceedings, the Department concludes that they are reasonable.

The Department notes generally that a plant account's remaining life is a function of its average service life, assumed survivor curve, and the age of property in the account, which is tracked by vintage. Thus, even when an account's assumed average service life does not change, plant additions can lengthen the account's remaining life, as the new property will be expected to survive longer than older property in the account. Similarly, retirements of older property in an account can also lengthen the account's remaining life, as the weighted average age of the property in the account would decrease. Barring a change the age-makeup of property in an account, its remaining life would be expected to decrease by approximately one year from one depreciation study to the next if the account's average service life does not change.[1]

In its Petition, MERC proposed updated remaining lives that reflect the passage of time as well as plant activity (additions and retirements) in its accounts. The Department reviewed MERC's proposed remaining lives and concludes that they are reasonable.

2. Depreciation Rates

For each plant account other than Account 390.0 Structures and Improvements, MERC's proposed depreciation rate is a function of the account's current plant and reserve balances, remaining life, and salvage rate. The Department concludes that all are reasonable.

[1] Due to the probabilistic nature of the remaining life calculation, the remaining life of an account that has had no additions, retirements, transfers, etc., would actually be expected to decline by slightly less than one year.

For Account 390.0, however, the proposed depreciation rate is not a function of the account's current plant and reserve balances and depreciation parameters. Rather, MERC has proposed to leave the account unchanged from the rate approved in the 2012 Depreciation Docket. In the 2012 Depreciation Docket, MERC separated the property in Account 390.0 into two groups with different remaining lives. MERC calculated a separate depreciation rate for each group and then used those two depreciation rates to calculate a single composite depreciation rate to be applied to the account's plant balance. Rather than redoing this exercise each year, MERC proposed in the 2012 Depreciation Docket to leave the resulting composite depreciation rate of 2.37 percent unchanged until it files its next comprehensive five-year depreciation study. The Department concludes that this treatment is reasonable.

The Department also notes that in MERC's prior depreciation proceeding, Docket No. G011/D-15-534, the property in Account 392.2 Trailers was fully depreciated, and thus it was not possible to calculate a meaningful depreciation rate for the account using the account's plant and reserve balances. Instead, the Commission ordered the Company to apply the General Plant composite depreciation rate to any new investments booked to the account. During 2015, the Company booked new property to the account, which means that the account is no longer fully depreciated. MERC was able to calculate and propose a meaningful depreciation rate for the account, and it is no longer necessary to apply the General Plant composite rate. The Department concludes that MERC's proposed depreciation rate for Account 392.2 Trailers is reasonable.

C. PLANT AND RESERVE ACTIVITY AND BALANCES

1. Interstate Power & Light Assets Acquired by MERC

MERC's Petition marks the Company's first depreciation filing in which the assets purchased from Interstate Power & Light (IPL) were fully incorporated in the Company's plant and reserve balances.[2] The Department notes that MERC's current depreciation parameters were determined pursuant to an analysis of MERC's plant prior to the IPL purchase, and are likely to change as a result of the addition of IPL's gas assets. The Commission's Order in the 2015 Depreciation Docket required MERC to file a comprehensive 5-year depreciation study by June 1, 2017, and the depreciation parameters determined in that analysis will reflect the IPL property acquisition.

2. Historical Plant Activity, Accrual Rates, and Reserve Ratios

MERC's plant activity, accrual rates, and reserve ratios for all of its plant accounts for the last five years are presented below:

[2] See Docket No. G001,011/PA-14-107.

MERC
Reserve Ratio Summary
2011-2015
($ Millions)

Year	Gross Depreciable Plant Balance	Increase in Plant Balance	Reserve Balance	Reserve Ratio	Annual Depreciation Provision	Accrual Rate
2015	432.8	45.4	179.9	41.57%	10.3	2.37%
2014	387.4	23.0	163.9	42.32%	9.3	2.39%
2013	364.5	16.3	157.7	43.26%	6.4	1.77%
2012	348.1	17.1	154.4	44.36%	10.4	2.98%
2011	331.0	7.5	147.5	44.55%	9.9	2.98%

Source: MERC Depreciation Petitions

MERC's reserve ratio has been decreasing since 2011, which indicates that its plant additions have been outpacing its depreciation and retirements.

III. CONCLUSION AND RECOMMENDATIONS

After review, the Department concludes that the depreciation parameters and rates proposed in MERC's Petition are reasonable. The Department recommends that the Commission:

1. approve the depreciation parameters and depreciation rates proposed in MERC's Petition effective January 1, 2016; and
2. require MERC to file a five-year depreciation study by June 1, 2017.

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