


## Staff Briefing Papers

Meeting Date	January 9, 2019	Agenda Item *4
Company	Minnesota Power	
Docket No.	<b>E-015/D-18-544</b>	
	<b>In the Matter of Minnesota Power's 2018 Remaining Life Depreciation Petition</b>	
Issues	Should the Commission approve Minnesota Power's 2018 remaining lives annual depreciation petition?	
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 Relevant Documents	Date
Minnesota Power – Initial Filing	August 21, 2018
Minnesota Department of Commerce – Comments	November 5, 2018
Minnesota Power – Reply Comments	November 15, 2018
Department of Commerce – Letter in Lieu of Response Comments	November 19, 2018

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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.

## I. Statement of the Issues

Should the Commission approve Minnesota Power's 2018 remaining lives annual depreciation petition?

## II. Relevant Statutes, Rules and Procedures

### A. Minn. Stat. § 216B.11. Depreciation Rates and Practices.

The commission shall fix proper and adequate rates and methods of depreciation, amortization, or depletion in respect of utility property, and every public utility shall conform its depreciation, amortization or depletion accounts to the rates and methods fixed by the commission.

### B. Minn. Rules, pts. 7825.0500 – 7825.0900. Depreciation Certification.

#### 1. Minn. Rules, pt. 7825.0600, subp. 1. Depreciation Certification.

Depreciation practices applicable to all utilities. All electric and gas utilities shall maintain, and have available for inspection by the commission upon request, adequate accounts and records related to depreciation practices as defined herein. Each utility has the prime responsibility for proposing the depreciation rates and methods that will be used. The commission shall certify by order to the utility the depreciation rates and methods which it considers reasonable and proper. Any allocation or adjustment of the depreciation reserve will require specific justification and certification by the commission.

Either the utility may submit or the commission may request a petition for depreciation certification because of unusual circumstances or unique situations.

#### 2. Minn. Rules, pt. 7825.0900. Petition for Certification Procedure

... Depreciation rates and methods, once certified by order, are binding on all future rate proceedings and will remain in effect until the next certification or until the commission shall determine otherwise. ...

#### 3. Minn. Rules, pt. 7825.0600, subp. 2 & 3. Depreciation Certification.

... All utilities shall review their depreciation rates annually to determine if they are still generally appropriate. Depreciation certification studies shall be made so that all primary accounts (class A & B utilities) or all functional groups of plant accounts (class C & D utilities) have been analyzed at least every five years. ...

### C. Commission Practice

Depreciation methods, practices and rates are evaluated in depth once every five years in a depreciation study provided by the utility and then reviewed annually, usually in a request for certification of the remaining lives of the utility's assets. The depreciation rates established in

these proceedings are incorporated into the Company's revenue requirement and rates in a general rate proceeding. These stand-alone depreciation filings allow for a thorough examination of the Company's depreciation methods, practices and rates independent of the other issues examined and analyzed within a rate case. This is one of the main reasons for having separate depreciation filings.

### III. Background

On August 21, 2018, in its initial filing, Minnesota Power (MP) requested an adjustment for one year's passage of time for the remaining lives of all facilities, except for the Boswell Energy Center ("BEC") Units 3, 4, and Common; as well as proposing salvage rate changes to reflect updated plant in-service balances. Further, Minnesota Power points out that the Commission, in its May 29, 2018 Order in Docket No. E-015/GR-16-664 ordered Minnesota Power to set the lives of BEC Units 3, 4, and Common to end in 2035, effective January 1, 2018.

On November 5, 2018, in its comments, the Minnesota Department of Commerce (the Department) recommended approval of Minnesota Powers' proposed one-year passage-of-time adjustments to the remaining lives of all its facilities with the exception of BEC3, BEC4, and BEC Common and general plant account 390 Structures and Improvements. The Department proposed modifications for the latter production facilities and general plant account 390. The Department also discovered that, due to uncertainty as to the appropriate remaining lives in its BEC Common facility, it had recorded a decrease in depreciation expense that was \$2.0 million less than it should have been. Similarly, the depreciation expense booked for BEC3 was \$0.8 million less than it should have been. The Department proposed correcting this in 2018.

On November 15, 2018, Minnesota Power filed its reply comments, and agreed with all of the Department's recommendation, except for its' recommendation that MP record \$2.8 million in depreciation expense in 2018. Minnesota Power argues that booking the whole correction in 2018 will result in significant out-of-period adjustments which will negatively affect the Company and ratepayers. Instead, MP is seeking approval to amortize the supplemental depreciation over a period of 60 months. Minnesota Power will commit to excluding the amortization from any request for cost recovery in a future rate case that would be filed during this 60 month period.

On November 19, 2018, in its letter, the Department stated that it does not object to Minnesota Power's request to be allowed to amortize the \$2.8 million of supplemental depreciation over a period up to 60 months, since doing so would protect ratepayers from out-of-period adjustments. However, the Department pointed out that in order to have no impact on current ratepayers, MP would have to remove the supplemental depreciation expense from rate base, in addition to removing it from revenue requirements in any rate case during the amortization period.

## IV. Parties' Comments

### A. Minnesota Power - Initial Petition

Minnesota Power is requesting the Commission's approval of its 2018 Remaining Life Depreciation Petition which adjusts the remaining lives of all facilities for one year's passage of time. The Company is also proposing salvage rate changes due to updating plant in-service balances. However, since the Department objected to salvage rate changes outside of a Five-Year Depreciation Study, the Company agreed to withdraw its proposed salvage rate changes.

Regarding BEC Units 3, 4, and Common: the Commission's May 29, 2018 Order<sup>1</sup> directed the Company to set these facilities to end in 2035 effective January 1, 2018, and MP proposes this in the instant petition. Since these facilities previously were set to end in 2050, the change in remaining lives will result in increased depreciation expense of \$22,190,092 when compared to 2017 rates and lives

The petition also includes a comparison of remaining lives and salvage rates in this docket to the forecast remaining life of MP's generation resources in Minnesota Power's 2015 Integrated Resource Plan (IRP).<sup>2</sup> These will be updated by October 1, 2019 in MP's next IRP. The Company states that it will continue to reconcile remaining lives and the latest approved integrated resource plan in a timely manner. Additionally, the petition includes a discussion of the Company's production facilities and their proposed remaining lives.

Minnesota Power states that it does not have any major future additions or retirements that would materially impact the 2018 depreciation accruals. Finally, the petition includes a compliance filing regarding the disposition of its aircraft,<sup>3</sup> which was fully depreciated as of December 31, 2017 and donated to Lake Superior College Aviation Maintenance Technology Program.

### B. Minnesota Department of Commerce - Comments

#### 1. Compliance Review

The Department found that Minnesota Power uses a straight-line depreciation method, and files annual depreciation studies for its generation assets. However, there were errors in the 2017 depreciation accruals recorded for BEC Unit 3 and BEC Common (discussed further below). The Department found that MP complied with the Commission's Order<sup>4</sup> in providing a comparison between the Company's most recent integrated resource plan and this depreciation filing: ". . . aside from some minor differences for Boswell Units 1,2, and 3, the

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<sup>1</sup> Docket No. E-015/GR-16-664, "Order Granting Reconsideration in Part, Revising March 12 2018 Order, and Otherwise Denying Reconsideration Petitions", filed May 29, 2018.

<sup>2</sup> Docket No. E-015/RP-15-690, filed September 1, 2015

<sup>3</sup> Commission Order in Docket No. E-015/D-17-118, filed March 21, 2018

<sup>4</sup> Docket No. E-015/D-17-118, filed March 21, 2018

remaining lives assumed in MP's Petition align with the operational lives assumed in MP's most recent IRP". In addition, MP complied with the Commission's reporting requirement regarding the disposal of its aircraft; because the aircraft was fully depreciated and donated, there was no gain or loss on this transaction.

## 2. Review of Depreciation Parameters – Remaining Lives

### a. BEC3, BEC4, and BEC Common

In MP's 2016 rate case, the Commission approved a retirement year of 2050 for BEC3, BEC4, and BEC Common, which was a significant extension over the previous retirement years (BEC3 at 2034, BEC4 at 2035, and BEC Common at 2030). The Commission considered that a variance to its depreciation-accounting rules by separating the accounting lives from the operational lives was reasonably justified as a means to mitigate the proposed rate increase<sup>5</sup>.

Subsequently, the 2017 federal Tax Cuts and Jobs Act removed the need for mitigation of the rate increase and the Commission reconsidered its remaining life extension and ordered that the lives be set to 2035.<sup>6</sup> Therefore, the Department finds MP's proposal to shorten the remaining life of these facilities from 33 years to 18 years to be reasonable.

### b. General Plant Account 390 Structures and Improvements

As discussed in the Minnesota Energy Resource Corporation's ("MERC") 2017 rate case<sup>7</sup>, MERC was using group depreciation for high value building structures. The Department believes group accounting is usually used for property accounts that consist of large numbers of similar items – e.g. poles, meters, etc., that are too numerous to account for individually. Group accounting may not be appropriate for large value items like an office building, and may be tracked separately. In Information Request No. 6, MP provided a list of assets in account 390 and the Department notes that the four largest structures have a combined value of \$45.3 million and account for 62% of the account total.

Minnesota Power has stated that it would be willing to depreciate larger buildings separately. In its response to Information Request No. 12, MP estimated that three of its four largest buildings lives could be extended from 19 to 33 years (from a retirement year of 2036 to retirement in 2050). Further, MP estimates that this would result in a depreciation expense decrease of \$0.5 million per year.

Since this issue is not urgent, the Department recommended that MP include a proposal in its next depreciation filing to:

- determine which buildings should be removed and which should stay in the group

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<sup>5</sup> Docket No. E-015/GR-16-664, Commission Order issued March 12, 2018, pages 11-15 and ordering points 3-6

<sup>6</sup> Docket No. E-015/GR-16-664, Commission Order issued May 29, 2018

<sup>7</sup> Docket No. G-011/GR-17-563

- develop the method to reasonably allocate the depreciation reserves between the buildings and the remaining group
- determine the remaining lives for the individual buildings and the group

c. Review of Depreciation Parameters – Salvage Values

The Company proposed updating the salvage rates of its production facilities. However, the Department notes that salvage rates are usually only updated after the completion of a new decommissioning study, which has not been performed. The Company indicates that the result of updating the salvage rates with more current gross plant balances is a small increase in depreciation expense of \$0.2 million. Although the difference is small, the Department prefers to refrain from updating salvage rates until a new decommissioning study is done and, therefore, recommends that the Commission deny MP's proposed updated salvage rates.

d. 2017 Depreciation Accruals for BEC3 and BEC Common

At the start of 2017 MP was accruing depreciation on BEC Common using a retirement year of 2029. In the Company's 2016 rate case, MP proposed a retirement year of 2050 for BEC Common, while the Administrative Law Judge recommended a retirement year of 2035. Based on this, the Company made an initial depreciation accrual adjustment to extend the life from 2029 to 2035. Subsequently, the Commission orally approved a retirement year of 2050 and MP booked a second adjustment in 2017 to recognize an extension from 2029 to 2050. However, the second adjustment should have been from 2035 to 2050. The result was that BEC Common's 2017 depreciation expense was \$2.0 million lower than it should have been. A similar set of adjustments was also made for the BEC3 facility with a 2017 depreciation expense understatement of \$0.8 million. Without adjustment, the impact will be that BEC Common's and BEC3's depreciation expense will be slightly higher over their remaining lives. Therefore, the Department recommends that the Commission requires MP to record supplemental depreciation expense of \$2.0 million for BEC Common and \$0.8 million for BEC3.

e. Department Recommendation

1. approve Minnesota Power's proposed remaining lives;
2. deny MP's request to update its salvage rates;
3. require MP to record, during 2018, supplemental depreciation expense of \$2.0 million for BEC Common and \$0.8 million for BEC3;
4. require MP to include, in future depreciation filings, a comparison between its depreciation remaining lives and its integrated resource plan remaining lives and to explain the differences;
5. require MP to file its next Remaining Life Depreciation Petition by September 2, 2019 to be effective January 1, 2019.

### C. Minnesota Power - Reply Comments

In its reply comments, Minnesota Power stated that it agrees with all of the Departments recommendations, except for number 3 to record \$2.8 million of supplemental depreciation

expense in 2018. The Company points out that the depreciation adjustment error occurred in the middle of significant debate over Boswell life assumptions and notes that its ratepayers have not been impacted by this error. Although MP agrees with the Department's calculations and amounts, it requests to be allowed to amortize this significant out-of-period depreciation expense adjustment over a period of 60 months. These amortizations would be excluded from any future rate cases during the amortization period. The Company notes that if Minnesota Power "were required to record the entire \$2.8 million of supplemental depreciation expense in 2018, it would further challenge its financial health by further reducing its projected return on common equity." MP pointed out that it faced a similar situation in its 2012 Remaining Life Depreciation Petition<sup>8</sup> and the Commission allowed the Company to amortize a supplemental depreciation expense adjustment related to decommissioning over 36 months.

#### D. Minnesota Department of Commerce - Letter in Lieu of Response Comments

Minnesota Power in its reply comments of November 15, 2018, agreed with the Department's recommendation to correct \$2.8 million of supplemental depreciation expense. However, MP requested that it be allowed to amortize this amount over five years. MP states that it wants to ensure that ratepayers bear no additional expense due to any recording errors. The Department notes that, should MP file a rate case during the amortization period, it would not only need to remove the amortization expense from its revenue requirement, but would also need to adjust its rate base to set it at the level it would have been had the errors not taken place.

Also, the Department discovered that, in its November 5, 2018 comments, it had omitted its recommendation regarding depreciating general plant account 390 *Structures and Improvements*. Additionally, the Department proposed other changes to its original recommendation as shown below, with edits underlined:

1. approve Minnesota Power's proposed remaining lives;
2. deny Minnesota Power's request to update its salvage rates and approve the salvage rates approved Docket No. E015/D-17-118, as shown in Appendix A-1 to the Company's Petition;
3. require Minnesota Power to record, either during 2018 or over a period of time that the Commission determines to be reasonable, supplemental depreciation expense of \$2.0 million for the Boswell Common Facilities, and \$0.8 million for Boswell Unit 3;
4. require Minnesota Power to include in any future request for cost recovery all adjustments necessary to ensure that ratepayers bear no additional expense as a result of the errors in the 2017 depreciation accruals for Boswell Unit 3 and the Boswell Common Facilities;

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<sup>8</sup> Docket No. E-015/D-12-378

5. require MP to include in future depreciation filings a comparison of the remaining lives used in its depreciation filing to the operating lives used in the Company's most recent integrated resource plan and explain any differences;
6. require Minnesota Power to include in its next depreciation petition a proposal to depreciate the largest structures included in plant account 390 Structures and Improvements individually, while continuing to apply group depreciation to the smaller structures in the account, that explains how Minnesota Power will:
  - determine which structures should be removed from the group to be depreciated separately, and which should remain in the group;
  - allocate the existing depreciation reserve among structures that should be removed from the larger group and those that remain in the group;
  - determine the remaining lives for structures that should be removed from the group and the remaining life for the group;
7. require MP to make its next depreciation filing on or before September 2, 2019 to establish depreciation parameters and rates to be effective January 1, 2019.

## V. Staff Analysis

Staff notes that there are essentially no areas of disagreement between Minnesota Power and the Department of Commerce. The Department indicated that it has no strong objection to allowing MP to amortize the recommended depreciation expense adjustments over a period of time that the Commission deems appropriate. However, at its meeting on January 9, 2019, the Commission may want to ask MP to confirm on the record that it agrees with the Department's November 15 modifications to its recommendation.

## VI. Decision Options

### 2018 Remaining Life Depreciation

1. Approve Minnesota Power's proposed remaining lives, [MP, DOC] **OR**
2. Require Minnesota Power to continue to use the depreciation parameters and rates approved in the 2017 filing,

**AND**

3. Deny Minnesota Power's request to update its salvage rates and approve the salvage rates approved previously in Docket No. E-015/D-17-118, [DOC, MP does not object] **OR**
4. Allow Minnesota Power to update its generating facility salvage rates.



### Depreciation Adjustments

5. Require Minnesota Power to record supplemental depreciation expense of \$2.0 million for the Boswell Common Facilities, and \$0.8 million for Boswell Unit 3 over a period of time that the Commission determines to be reasonable, [MP, DOC] **AND**
6. Require Minnesota Power to include in any future request for cost recovery all adjustments necessary to ensure that ratepayers bear no additional expense as a result of the errors in the 2017 depreciation accruals for Boswell Unit 3 and the Boswell Common Facilities. [DOC]

### Reconciling to IRP

7. Require Minnesota Power to include in future depreciation filings a comparison of the remaining lives used in its depreciation filing to the operating lives used in the Company's most recent integrated resource plan and explain any differences. [MP, DOC]

### Account 390 Structures and Improvements

8. Require Minnesota Power to include in its next depreciation petition a proposal to depreciate the largest structures included in plant account 390 Structures and Improvements individually, while continuing to apply group depreciation to the smaller structures in the account, that explains how Minnesota Power will:
  - determine which structures should be removed from the group to be depreciated separately, and which should remain in the group;
  - allocate the existing depreciation reserve among structures that should be removed from the larger group and those that remain in the group;
  - determine the remaining lives for structures that should be removed from the group and the remaining life for the group. [DOC] **OR**
9. Allow Minnesota Power to continue use of group depreciation in Account 390.

### Filing Date

10. Require MP to make its next depreciation filing on or before September 2, 2019 to establish depreciation parameters and rates to be effective January 1, 2019. [DOC, MP] **OR**
11. Assign a different filing and effective date as deemed appropriate by the Commission.

### **Staff Recommendation**

Staff recommends 1, 3, 5, 6, 7, 8, and 10