STATE OF MINNESOTA
IN COURT OF APPEALS
A17-1300

In the Matter of the Application of Otter Tail Power Company
for Authority to Increase Rates for Electric Service in Minnesota.

Filed June 11, 2018
Reversed
Halbrooks, Judge

Public Utilities Commission
File No. E017/GR-15-1033

Bruce Gerhardson, Otter Tail Power Company, Fergus Falls, Minnesota; and

Richard J. Johnson, Patrick T. Zomer, Kelly C. McGinty, Moss & Barnett, P.A., Minneapolis, Minnesota (for relator Otter Tail Power Company)

Lori Swanson, Attorney General, Kathryn A. Fodness, Lisa Crum, Assistant Attorneys General, St. Paul, Minnesota (for respondent Minnesota Public Utilities Commission)

Considered and decided by Halbrooks, Presiding Judge; Worke, Judge; and Connolly, Judge.

U N P U B L I S H E D O P I N I O N

HALBROOKS, Judge

On certiorari appeal from a rate-case order, relator power company challenges respondent commission's decision to include costs and revenues for two of relator's multi-value transmission-grid projects when setting the retail electric rates charged to relator's Minnesota customers. Relator contends that 16 U.S.C. § 824s (2016) of the Federal Power

Act preempts respondent from doing so. Relator also argues that respondent overstepped its authority under Minn. Stat. § 216B.16, subd. 7b (2016), by directing relator to put those projects' costs and revenues into a transmission-cost recovery rider. Because we conclude that 16 U.S.C. § 824s of the Federal Power Act preempts respondent from trapping federally approved interstate-wholesale revenues, we reverse.

FACTS

Relator Otter Tail Power Company, headquartered in Minnesota, provides retail electric service to 161,000 customers in Minnesota, North Dakota, and South Dakota. It is the second smallest investor-owned utility company in the United States. Otter Tail projects that it will invest $858 million between 2016 and 2020, representing its "largest capital expenditure program in its history."

To offset those expenditures, Otter Tail filed a general rate case with respondent Minnesota Public Utilities Commission (MPUC) seeking to increase its annual retail electric rates. In its rate-case filing, Otter Tail proposed to exclude costs and revenues for two multi-value transmission-grid projects. Otter Tail reasoned that those projects are not subject to MPUC's intrastate retail ratemaking authority because they are instead subject to the Federal Energy Regulatory Commission's (FERC) interstate wholesale ratemaking authority, and FERC has authorized Otter Tail through a federal tariff to recover a fixed rate of return on its investments in those multi-value transmission-grid projects.

MPUC referred the case to the Office of Administrative Hearings, and an administrative law judge (ALJ) held four public hearings and three evidentiary hearings. Otter Tail, the Minnesota Department of Commerce, the Minnesota Chamber of

Commerce, the Office of the Minnesota Attorney General, and two other companies appeared.

During the contested-case proceedings, the attorney general's office supported Otter Tail's treatment of the projects' costs and revenues, explaining that such treatment "would be most consistent with traditional principles of cost allocation and separation." The commerce department and the chamber, however, opposed Otter Tail's treatment, pointing to three other projects in Otter Tail's portfolio—subject to the same federal tariff—that Otter Tail had not excluded before. The commerce department and the chamber argued that Otter Tail should treat all projects the same and put the costs and revenues into a transmission-cost recovery rider under Minn. Stat. § 216B.16, subd. 7b.

Following the proceedings, the ALJ issued an order recommending that MPUC not include the projects' costs and revenues because it was preempted by the Federal Power Act. The ALJ explained that, under the commerce department and chamber's approach, Otter Tail would not recover $13.8 million in revenues that have already been approved by FERC under a federal tariff. The ALJ also recommended that MPUC not direct Otter Tail to include the costs and revenues in a transmission-cost recovery rider, reasoning that Minn. Stat. § 216B.16, subd. 7b, did not authorize MPUC to do so.

MPUC adopted most of the ALJ's findings and conclusions, but declined to adopt the ALJ's recommendation that it exclude the multi-value transmission-grid projects' costs and revenues, reasoning that the Federal Power Act reserves for state ratemaking commissions the authority to control intrastate retail rates. Under a theory of ratemaking policy referred to by MPUC as "all-in allocation," MPUC ordered Otter Tail to amend its

petition "to incorporate into its filing the costs and revenues related to [those projects]." This appeal follows.

D E C I S I O N

On appeal from a contested-case proceeding, we may affirm or remand MPUC's decision; or we may reverse or modify the decision if the substantial rights of Otter Tail have been prejudiced because MPUC's decision violates a constitutional provision, exceeds its statutory authority or jurisdiction, is made upon unlawful procedure, is affected by other error of law, is unsupported by substantial evidence in view of the record as a whole, or is arbitrary or capricious. Minn. Stat. § 14.69 (2016); *see N. States Power Co. v. Minn. Pub. Utils. Comm'n*, 344 N.W.2d 374, 377 (Minn. 1984). Statutory interpretation and federal preemption are questions of law, which we review de novo. *Gretsch v. Vantium Capital, Inc.*, 846 N.W.2d 424, 428 (Minn. 2014).

I.

The Supremacy Clause provides that the laws of the United States are "the supreme Law of the Land; . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const., art. VI, cl. 2. A state law or regulatory scheme is preempted if, under the circumstances presented, "the challenged state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hughes v. Talen Energy Mktg., LLC*, 136 S. Ct. 1288, 1297 (2016). Congress's purpose "is the ultimate touchstone of any preemption inquiry." *Id.*; *accord Gretsch*, 846 N.W.2d at 432-33.

A. Federal Law—the Federal Power Act

The Federal Power Act, 16 U.S.C. §§ 791a-828c (2016), grants FERC the exclusive authority to regulate "the transmission of electric energy in interstate commerce" and "the sale of electric energy at wholesale in interstate commerce." 16 U.S.C. § 824(b)(1); *F.E.R.C. v. Elec. Power Supply Ass'n*, 136 S. Ct. 760, 767 (2016). The Federal Power Act provides FERC jurisdiction "over all facilities for such transmission or sale of electric energy" and charges FERC with ensuring that "all rates and charges" as well as "all rules and regulations affecting or pertaining to such rates or charges" are just and reasonable. 16 U.S.C. §§ 824(b)(1), 824d(a).

At the same time, the Federal Power Act maintains a regulatory zone in which the states enjoy exclusive jurisdiction. 16 U.S.C. § 824(a), (b); *Elec. Power Supply Ass'n*, 136 S. Ct. at 767. The Federal Power Act provides states with the exclusive authority to regulate intrastate retail sales of electricity. 16 U.S.C. § 824(b); *Elec. Power Supply Ass'n*, 136 S. Ct. at 768.

1. Regional Transmission Organizations

In response to industry restructuring, FERC authorized seven non-profit associations known as "regional transmission organizations" to take control of large-scale transmission grids that distribute power across a wide geographic footprint. *Reg'l Transmission Orgs.*, 89 FERC ¶ 61285, 1999 WL 33505505, at *10-11 (Dec. 20, 1999). Regional transmission organizations are operated by an independent system operator. *Cent. Iowa Power Co-op. v. Midwest Indep. Transmission Sys. Operator, Inc.*, 561 F.3d 904, 907 (8th Cir. 2009). The Midcontinent Independent System Operator, Inc. (MISO) is

a FERC-approved public utility that is both a regional transmission organization and an independent system operator.[1] *Id.* at 908. MISO's footprint covers 15 states, including Minnesota, and one Canadian province. Otter Tail is a member of MISO.

2. Section 219—Incentive-Based Rules to Attract Transmission Investment

In 2005, Congress enacted section 1241 of the Energy Policy Act of 2005, which added section 219 to the Federal Power Act, in order to encourage investment in interstate transmission-grid infrastructure. Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594, 961-62 (2005) (codified at 16 U.S.C. § 824s (2016)). Section 219 charged FERC with establishing rules for "incentive-based . . . rate treatments for the transmission of electric energy in interstate commerce by public utilities." 16 U.S.C. § 824s(a). The rules must (1) "promote reliable and economically efficient transmission and generation of electricity by promoting capital investment in the enlargement, improvement, maintenance, and operation of all facilities for the transmission of electric energy in interstate commerce"; (2) "provide a return on equity that attracts new investment in transmission facilities"; (3) "encourage deployment of transmission technologies . . . to increase the capacity and efficiency of existing transmission facilities and improve the operation of the facilities"; and (4) allow recovery of "all prudently incurred costs necessary to comply with mandatory reliability standards . . . [and] all prudently incurred costs related to transmission infrastructure development." 16 U.S.C. § 824s(b).

[1] MISO changed its name from Midwest Independent Transmission System Operator, Inc. to Midcontinent Independent System Operator, Inc. *Ass'n of Buss. Advocating Tariff Equity Coal. of MISO Transmission Customers v. Midcontinent Indep. Sys. Operator, Inc.*, 156 FERC ¶ 61234, 2016 WL 5799957, at *1 (Sept. 28, 2016).

3. Multi-Value Transmission-Grid Projects

In 2010, MISO sought and received FERC approval to fund and construct multi-value transmission-grid projects. *Ill. Commerce Comm'n v. F.E.R.C.*, 721 F.3d 764, 771 (7th Cir. 2013). A multi-value project is a high-voltage transmission-grid project that must have "an expected cost of at least $20 million, must consist of high-voltage transmission lines (at least 100kV), and must help MISO members meet state renewable energy requirements, fix reliability problems, or provide economic benefits in multiple pricing zones." *Id.* at 774. MISO has 17 multi-value projects in its portfolio.

Otter Tail owns 50% of two MISO multi-value projects. The Brookings project is a transmission line extending approximately 70 miles between two substations in South Dakota. The Ellendale project is a transmission line extending 160 to 170 miles between a substation in South Dakota and a substation in North Dakota. Otter Tail is investing approximately $134.5 million in the Brookings project and $182.5 million in the Ellendale project—a total of $317 million. The projects together are referred to as the Big Stone Area Transmission projects, or the BSAT Lines.

Otter Tail is also a part-owner of a third multi-value project known as the Hampton Line, which is located in Minnesota. In addition, Otter Tail owns two other transmission lines located in Minnesota—the Fargo Line and the Bemidji Line—that are not multi-value projects.

4. MISO Tariff—Cost Allocation and Return on Equity

MISO imposes on its members an open-access transmission tariff (MISO tariff) that dictates how multi-value-project costs are allocated. Multi-value projects have such

significant costs and system-wide benefits that "MISO provides for their costs to be recovered from all of MISO's load-serving entities . . . based on each entity's share of energy consumed within the MISO footprint." Because Otter Tail's retail customers in Minnesota, North Dakota, and South Dakota collectively consume 0.98% of all the energy consumed in the MISO region, the MISO tariff allocates 0.98% of all multi-value project costs to Otter Tail's retail customers.

The MISO tariff also sets out FERC-approved wholesale rates for electricity delivered through MISO's transmission grid, including electricity generated by and purchased from Otter Tail's multi-value projects. *Id.* at 771-72. Based on its 50% ownership in the BSAT Lines, Otter Tail receives wholesale revenues at fixed interstate wholesale rates approved under the MISO tariff, which in turn guarantees Otter Tail a fair and reasonable level of return on equity in its investment and ownership in the BSAT Lines. *Midcontinent Indep. Sys. Operator, Inc.*, 156 FERC ¶ 61234, 2016 WL 5799957, at *3.

B. State Law—Minnesota's Retail-Ratemaking Authority

MPUC has the authority to regulate Minnesota public utilities. Minn. Stat. § 216B.08 (2016). If a public utility wants to increase Minnesota retail rates, the utility must file the proposed rate change with MPUC for approval. *See* Minn. Stat. § 216B.16, subd. 1 (2016). MPUC determines if the new rates are just and reasonable, giving due consideration to "the public need for adequate, efficient, and reasonable service and to the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing the service, . . . and to earn a fair and reasonable return upon the investment in such property." Minn. Stat. § 216B.16, subd. 6 (2016).

C. MPUC's Decision—All-in Allocation

MPUC, under a theory of ratemaking policy called "all-in allocation," included the FERC-approved MISO-tariff wholesale revenues for the BSAT Lines in determining whether Otter Tail's proposed rate change was just and reasonable. MPUC explained that Otter Tail's proposal to exclude the revenues would have financial consequences for Otter Tail's shareholders and Minnesota ratepayers; it would benefit shareholders "by permitting them to retain earnings calculated on the basis of MISO's higher return on equity, rather than having those revenues assigned to the state jurisdictions in which Otter Tail operates to offset the utility's other costs." In effect, MPUC used the FERC-approved MISO-tariff wholesale revenues for the BSAT Lines to reduce the retail rates paid by Otter Tail's Minnesota customers.

II.

Otter Tail contends that MPUC's decision to include the BSAT Lines FERC-approved wholesale revenues in setting Minnesota intrastate retail rates is preempted by section 219 because Congress has expressly mandated that FERC establish rule-based incentives for investing in the interstate power grid, including multi-value projects like the BSAT Lines. We agree.

Congress's intent under section 219 is clear: FERC must create incentive-based wholesale rate treatments that attract capital investments in regional transmission-grid projects, like the BSAT Lines. 16 U.S.C. § 824s(b); *see Promoting Transmission Inv. Through Pricing Reform*, 117 FERC ¶ 61345, 2006 WL 3792941, at *4 (Dec. 22, 2006) ("Section 219 does not simply 'codify' [FERC's] legal authority; it requires [FERC] to

take affirmative action to promote new investment."). Section 219 authorizes Otter Tail to recover, through mechanisms such as the MISO tariff, fixed interstate wholesale returns on their investments in the BSAT Lines. 16 U.S.C. § 824s(b).

Under United States Supreme Court and Minnesota Supreme Court caselaw, MPUC must give effect to FERC-approved wholesale rates. *Hughes*, 136 S. Ct. at 1297; *see Miss. Power & Light Co. v. Miss. ex rel. Moore*, 487 U.S. 354, 371, 108 S. Ct. 2428, 2439 (1988) ("FERC has exclusive authority to determine the reasonableness of wholesale rates."); *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966, 106 S. Ct. 2349, 2357 (1986) ("Once FERC sets [an interstate wholesale rate], a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable."); *N. States Power*, 344 N.W.2d at 381 (determining that the reasonableness of a FERC-approved wholesale rate cannot "be relitigated in a retail rate proceeding before [MPUC]").

Here, the ALJ found that under "the FERC-authorized cost recovery mechanism, Otter Tail estimate[d] that it would recover approximately $67.8 million" between 2016 and 2020. But under MPUC's "all-in allocation" scheme, the ALJ found that Otter Tail would recover only $54 million, thereby preventing Otter Tail from recovering $13.8 million that has already been approved by FERC under the MISO tariff. As the ALJ explained, applying "all-in allocation" traps $13.8 million in FERC-approved wholesale revenues. MPUC cannot use its state retail-ratemaking authority to trap FERC-approved costs and revenues. *Nantahala*, 476 U.S. at 971, 106 S. Ct. at 2359. By applying "all-in allocation," MPUC has, in effect, "chose[n] an allocation . . . that differs from the

allocation . . . adopted by [FERC] in a wholesale ratemaking proceeding." *Id.* at 955, 106 S. Ct. at 2351.

MPUC argues that using all-in allocation is not preempted because under what is known as the "*Narragansett* principle," MPUC can investigate Otter Tail's financial structure to see if Otter Tail will experience savings in other areas that would justify lowering retail rates paid by customers in Minnesota. *Narragansett Elec. Co. v. Burke*, 381 A.2d 1358, 1363 (R.I. 1977). In *Narragansett*, the Rhode Island Supreme Court determined that the Rhode Island state utilities commission was required to treat a power company's purchased power costs as an actual operating expense. *Id.* at 1362. In doing so, the Rhode Island Supreme Court concluded that the state utilities commission "may treat [a] proposed rate increase as it treats other filings for charged rates under [Rhode Island's public utilities statute] and investigate the overall financial structure of [the power company] to determine whether the company has experienced savings in other areas which might offset the increased price for power." *Id.*

The Eighth Circuit applied *Narragansett* in *Arkansas Power & Light Co. v. Missouri Pub. Serv. Comm'n*, 829 F.2d 1444, 1451 (8th Cir. 1987). In *Arkansas Power*, a power company filed to increase interim electric rates charged to its Missouri retail customers after FERC had approved a cost-allocation system between multiple power companies. 829 F.2d at 1446-47. The state commission suspended the requested rate increase proceedings, advising that it needed time to "study the effect of the proposed tariffs and to determine if they are just, reasonable and in the interest of the public." *Id.* at 1447. This narrow question was presented: whether the Missouri commission was "obliged, by the

preemptive force of the Federal Power Act, to allow an immediate pass-through of these costs, without regard to the ordinary process of suspension and investigation provided by state law." *Id.* at 1450. The *Arkansas Power* court agreed with the state commission, explaining that "[a]lthough the FERC order clearly contemplates that costs will have to be passed on to retail customers, it also clearly recognize[s] the role of the States in regulating retail electric rates and the need to balance overlapping State and Federal electric rate jurisdiction." *Id.* (alteration in original) (quotation omitted).

MPUC maintains that *Narragansett* and *Arkansas Power* authorize it to use FERC-approved wholesale revenues to reduce Minnesota retail rates. We are not persuaded. Even if a state commission can investigate a power company's financial structure to see if it has experienced savings in other areas, under binding Supreme Court caselaw, a state commission must nevertheless give effect to FERC-approved wholesale revenues and cost allocations. *See Hughes*, 136 S. Ct. at 1297; *Miss. Power*, 487 U.S. at 371, 108 S. Ct. at 2439; *Nantahala*, 476 U.S. at 972, 106 S. Ct. at 2359. State commissions cannot use their state retail-ratemaking authority to trap FERC-approved wholesale revenues, like MPUC has done here. *Nantahala*, 476 U.S. at 971, 106 S. Ct. at 2359.

MPUC also argues that Otter Tail cannot pick and choose which projects it wants to subject to Minnesota's retail-ratemaking authority, reasoning that it did not exclude the Hampton, Fargo, and Bemidji Lines from state retail-ratemaking authority in prior rate cases. We do not agree that Otter Tail's treatment of those lines dictates its approach here. First, Otter Tail's investment in the BSAT Lines is significantly greater than its investment

in the Hampton line. Second, the Fargo and Bemidji Lines were constructed not to meet the needs of the entire MISO-region power grid but instead for localized Minnesota needs.

MPUC also asserts that allowing Otter Tail to assign the BSAT Lines to FERC jurisdiction will unbundle electric rates in Minnesota. But as Otter Tail argues, "excluding Otter Tail's interstate wholesale earnings from intrastate retail rates will have no effect on the *structure* of the intrastate retail rate, although the *level* of the rate is affected." Just as the Minnesota Supreme Court's decision in *N. States Power* did not unbundle rates, neither will our decision here. 344 N.W.2d at 376.

We acknowledge that "[w]hen FERC sets a wholesale rate, when it changes wholesale market rules, when it allocates electricity as between wholesale purchasers—in short, when it takes virtually any action respecting wholesale transactions—it has some effect, in either the short or the long term, on retail rates." *Elec. Power Supply Ass'n*, 136 S. Ct. at 776. We also recognize that states "may regulate within the domain Congress assigned to them even when their laws incidentally affect areas within FERC's domain." *Hughes*, 136 S. Ct. at 1298. But the Supreme Court has made clear that "States interfere with FERC's authority by disregarding interstate wholesale rates FERC has deemed just and reasonable, even when States exercise their traditional authority over retail rates." *Id.* at 1299. Here, MPUC has invaded FERC's jurisdiction by trapping $13.8 million in FERC-approved MISO-tariff interstate wholesale revenues. We conclude that MPUC's decision is preempted by section 219 of the Federal Power Act because it prevents Otter Tail from recovering $13.8 million in revenues, which in turn prevents it from receiving the FERC-approved and section 219-mandated return on equity for its investment in the BSAT Lines.

III.

Otter Tail argues that MPUC exceeded its statutory authority under Minn. Stat. § 216B.16, subd. 7b, by directing Otter Tail to include the BSAT Lines' costs and revenues in a transmission-cost recovery rider. *See* Minn. Stat. § 14.69(b) (providing that we may reverse or modify decision if agency exceeded its statutory authority).

Upon filing by a public utility, MPUC may approve, reject, or modify a tariff that

> (2) allows the utility to recover charges incurred under a federally approved tariff that accrue from other transmission owners' regionally planned transmission projects that have been determined by the Midcontinent Independent System Operator to benefit the utility or integrated transmission system. . . .
>
> (3) allows the utility to recover on a timely basis the costs net of revenues of facilities approved by the regulatory commission of the state in which the new transmission facilities are to be constructed and determined by the Midcontinent Independent System Operator to benefit the utility or integrated transmission system[.]

Minn. Stat. § 216B.16, subd. 7b(b).

Under the statute's plain language, MPUC cannot direct Otter Tail to file a transmission-cost recovery rider. *Id.* The transmission-cost recovery-rider statute is limited to "Minnesota jurisdictional costs net of associated revenues." Minn. Stat. § 216B.16, subd. 7b(a). As Otter Tail argues, the BSAT Lines "were not designed or approved to meet the local needs of Otter Tail's retail customers" but rather "to meet needs throughout the MISO region." For those reasons, we reverse MPUC's order that directs Otter Tail to file a transmission-cost recovery rider.

IV.

MPUC argues that we should invoke the doctrine of primary jurisdiction and refer this case to FERC to determine the jurisdictional divide between FERC and MPUC. The supreme court has articulated at least two factors in determining whether to invoke the doctrine: "(1) whether the legislature explicitly granted the agency exclusive jurisdiction; and (2) whether the issues raised are 'inherently judicial.'" *Hoffman v. N. States Power Co.*, 764 N.W.2d 34, 49 (Minn. 2009). In deciding whether an issue is inherently judicial, courts look to whether the case "rais[es] issues of fact not within the conventional experience of judges or whether the case require[s] the exercise of administrative discretion." *Id.* (alterations in original) (quotation omitted). Because MPUC has authority to regulate intrastate retail rates, and because the parties are disputing a legal conclusion, we decline to invoke the doctrine of primary jurisdiction.

Reversed.