MINNESOTA
PUBLIC UTILITIES COMMISSION

Staff Briefing Papers

Meeting Date	September 30, 2021		Agenda Item #: 2*
Company	Minnesota Energy Resources Corporation (MERC)		
Docket No.	**G004/D-20-515**		
	In the Matter of Minnesota Energy Resources Corporation Petition for Approval for its Annual Review of Depreciation Rates for 2020.		
Issues	Should the Commission approve MERC's Annual Review of its Depreciation Rates for 2020 effective January 1, 2020?		
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✓ Relevant Documents	Date
Minnesota Energy Resources – Initial Filing	June 1, 2020
Department of Commerce – Comments	June 7, 2021
MERC's Reply Comments	June 17, 2021

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.

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I. Statement of the Issues

Should the Commission approve MERC's Annual Review of its Depreciation Rates for 2020 effective January 1, 2020?

MERC agreed with the Department's June 7, 2021 recommendations, and therefore there are now no disputed issues in this docket.

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. 7825.0600, subp. 2 & 3. Depreciation Certification (in part)

[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.

3. Minn. Rules, pt. 7825.0900. Petition for Certification Procedure (in part)

> . . . 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. . .

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 June 1, 2020, MERC submitted a petition for approval of its annual depreciation rates pursuant to Minn. Stat. §216B.11 and Minn. Rules, Parts 7825.0500 to 7825.0900. This submission is also required by the Commission's January 8, 2020 Order, in Docket No. G-004/D-19-377, which required that MERC file its 2020 Annual Review of Depreciation Rates on or before June 1, 2020.

On June 7, 2021 the Department of Commerce submitted its Comments in response to MERC's Petition. The Department recommended that the Commission approve the Petition.

On June 17, 2021, MERC submitted its Reply Comments.

IV. Parties' Comments

A. MERC's Petition

MERC is seeking the Commission's approval of the Company's annual review of its plant in service, depreciation reserve, and depreciation accruals. MERC requests that the depreciation lives and rates be effective January 1, 2020. The current lives and depreciation rates were approved in Docket Nos. G011/D-17-442 and G011/D-19-377.

1. Vintage Amortization Accounting

MERC pointed out that vintage amortization accounting for certain general plant accounts was proposed and approved in Docket No. G007,011/D-08-614. The Company stated that it continues to apply the lives and associated depreciation rates to the general plant accounts listed in the table below.[1] As a result, these general plant accounts are excluded from the Annual Review of Depreciation Rates schedules.

Account Number	Description	Amortizable Life (Years)
391	Office Furniture & Equipment	20
391	Computer Equipment	5
393	Stores Equipment	20
394	Tools, Shop & Garage Equipment	20
395	Laboratory Equipment	20
397	Communication Equipment	12
398	Miscellaneous Equipment	20

2. Remaining Life Report

According to MERC, this report's remaining life calculation uses total future book accruals over the total annual accrual for vintage years not fully accrued. It incorporates additions as well as vintage retirements to calculate a remaining life for each account based upon the approved life and curve from the most recently approved depreciation study filed in Docket No. G011/D-17-442.

3. Minnesota Rule 7825.0700, Subpart 2B

Minnesota Rule 7825.0700, subpart 2B requires a list of any major future additions or retirements to the plant accounts that the utility believes may have a material effect on the current certification results. According to MERC, it has experienced an increased level of investment particularly in distribution mains, services, and station accounts resulting in increased plant additions because of system improvements. MERC further stated that it is experiencing increased investment due to the approval of the Rochester Natural Gas Extension Project under Docket Nos. G011/M-15-895 and G011/M-16-315.

4. Compliance with January 8, 2020 Order (January Order)

The Commission's January Order Approving Depreciation Lives and Rates and Providing Instructions for Future Filings in Docket No. G011/D-19-377, required that MERC individually depreciate the Rosemount, Rochester, Cloquet, and Albert Lea Service Centers in Account 390 Major Group, and depreciate the other buildings in Account 390 as members of the Minor buildings group. Additionally, the Commission's Order Point 4 required that MERC identify new

[1] MERC Petition, June 1, 2020, p. 3.

or existing buildings that exceed a total book value of $1,000,000 in its future depreciation filings.

According to MERC, it started depreciating the Rosemount, Rochester, Cloquet, and Albert Lea Service Centers individually effective 2019. These four buildings are using parameters from MERC's response to OAG information request (IR) number 11 as approved in Docket No. G011/D-19-377. As described in OAG information request number 11, the approved parameters utilize a life span method coupled with an interim retirement curve.

Additionally, MERC received approval to use the North Central Region Gas Utility Index to annually adjust the $1,000,000 threshold. The January 2019 baseline index was 585 and the January 2020 index was 584, resulting in a decrease of the threshold amount from $1,000,000 to $998,291 for 2020. The Company stated that it reviewed the structures and improvements account as of December 31, 2019 and did not identify additional building locations which meet the requirements set forth by the Commission for its 2020 depreciation filing.

B. Department's Comments and Analysis

1. Compliance with Minnesota Rules

The Department made the following statement:

> 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 an 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.[2]

The Department stated that MERC employs a straight-line depreciation method and files annual depreciation studies with the Commission, and thus complies with those requirements.

However, the Department said that during its review, it observed that the depreciation rates implied by the 2019 depreciation accruals and plant balances for accounts 381 and 383 differed from those approved in the 2019 Depreciation Docket.[3] In MERC's response to Department's

[2] Department Comments, June 7, 2021, P. 2.

[3] Ibid, Department's Footnote 1: "During its review, the Department also noted that the depreciation rates reported in the Petition as being applied during 2019 to the subaccounts of Plant Account 390, Structures and Improvements, differed significantly from the depreciation rates approved in the 2019 Depreciation Docket. However, the Company explained the differences between the approved and actual depreciation rates in its response to Department IR No. 3. Based on the Company's explanation, the Department concludes that MERC's 2019 deprecation accruals for Plant Account 390 were reasonable. See Dept. Attachment 1."

Information Request (IR) No. 2, it provided a schedule that shows that it effectively calculates two separate depreciation rates for its plant accounts.[4] The first depreciation rate specifically accounts for the portion or depreciation expense associated with the original cost of the plant in the account. MERC refers to this rate as the "life depreciation rate." The second depreciation rate reflects the cost of removal component of depreciation expense. MERC refers to this rate as the "cost of removal rate." The sum of the life and cost of removal rates equals the depreciation rate approved by the Commission for each account in the 2019 Depreciation Docket.

According to the Department, MERC explained that in its depreciation petitions, it calculates a single depreciation rate for each plant account that reflects both life depreciation and cost of removal. In its actual monthly depreciation calculations, however, it reportedly separates life depreciation from cost of removal, and calculates separate depreciation rates and accrues separate reserve balances for each component of depreciation expense. As a result, in its actual monthly depreciation calculations, MERC made the adjustments referenced above intentionally to zero out the cost of removal component of depreciation expense.

The Department asserted that it has concerns with this apparent mismatch between the Company's depreciation rate calculations as presented in its depreciation petitions, and the calculations MERC uses to calculate and accrue its actual depreciation expense. Per the Department's analysis, the difference resulted in MERC not applying approved depreciation rates for accounts 381 and 383 in 2019. The impact on depreciation expense was relatively small, $30,000, across both accounts.

The Department concluded that, due to the small dollar amounts involved in 2019 and the likelihood that any impacts in 2020 and 2021 will be similarly small, no correction or specific action by the Commission is necessary at this time. The Department, however, recommended that the Commission require MERC, in its next depreciation filing, to provide a discussion of the difference between the way it calculates depreciation rates in its depreciation petitions and how it applies those rates in calculating its actual depreciation expense, and whether those practices result in reasonable and correct depreciation accruals.

2. Compliance with Prior Commission Orders

In the January Order, in Docket No. G011/D-19-377 (the 2019 Depreciation Docket), the Commission required MERC to file its next annual depreciation petition by June 1, 2020, and its next five-year study by June 1, 2022. The Department concluded that MERC complied with this requirement.

The January Order also required the Company to depreciate its Rosemount, Rochester, Cloquet, and Albert Lee Service Centers individually within account 390, and depreciate the other 18 buildings in account 390 as members of the minor buildings subaccount, using the depreciation

[4] Docket No. G011/D-20-515, Department Attachment 2

parameters set forth in the 2019 Depreciation Docket. Upon review of MERC's Petition, the Department concluded that the Company complied with this requirement.

Additionally, the Commission's January Order required MERC in future depreciation filings, to identify new or existing buildings that exceed a threshold total book value so that those buildings can be considered for individual depreciation, rather than being included in the Minor buildings group subaccount of Plant Account 390. In its Petition, the Company stated that it did not identify any buildings that meet this requirement. Consequently, the Department concluded that the Company complied with this requirement.

3. Reasonableness of Proposed Lives and Salvage Rates for all Property Accounts

MERC's average service lives, survivor curves, and salvage rates used in its Petition to develop its proposed depreciation rates were established in the 2017 or 2019 Depreciation Dockets. The Department concluded that those depreciation parameters continue to be reasonable.

The Department observed 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, according to the Department, 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. Without a change in 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.[5]

The Company proposed updated remaining lives that reflect the passage of time as well as plant activity (additions and retirements) in its account. The Department stated that it reviewed MERC's proposed remaining lives and concluded that all property accounts are reasonable.

4. Proposal to Skip 2021 Depreciation Study

The Department noted that, in April 2021, MERC informally proposed that due to the amount of time that has elapsed since it filed its Petition in this docket, it be allowed to skip its planned 2021 depreciation filing. The Company said that due to the limited amount of time between the date of the Commission's order in this Docket and the due date of its 2022 five-year depreciation study, a 2021 depreciation filing will have limited value. After an analysis and discussion of the proposal, the Department recommended that the Commission approve

[5] Department Comments, June 7, 2021, P. 4.

MERC's request to skip its 2021 depreciation filing, and instead let the Company's next five-year study, due by June 1, 2022, be its next depreciation filing.[6]

The Department noted that, in response to Information Request No. 1[7], MERC provided updated schedules showing 2020 additions of $95.8 million and retirements of $3.8 million. The Department observed that net increases in additions would lengthen the remaining lives which, in turn, would result in lower depreciation rates and expense for the affected accounts. Therefore, the Department concluded that, if the Commission allowed MERC to skip its 2021 filing, the impact would not harm ratepayers. As a result, the Department recommended that the Commission approve MERC's request to skip its 2021 depreciation filing, and instead let the Company's next five-year study, due by June 1, 2022, be its next depreciation filing.

5. Department's Conclusion and Recommendations

The Department recommended that the Commission:

1. Approve the depreciation parameters and rates proposed in MERC's Petition, effective January 1, 2020;

2. Allow MERC to use the depreciation rates proposed in its Petition for 2020 in 2020 and 2021;

3. Require MERC to file its next five-year depreciation study by June 1, 2022.

4. Require MERC, in its next depreciation filing, to provide a discussion of the difference between the way it calculates depreciation rates in its depreciation petitions and how it applies those rates in calculating its actual depreciation expense, and whether these practices result in reasonable and correct depreciation accruals.

V. MERC's Reply Comments

MERC stated that it agreed with the Department's recommendations.

VI. Staff Comments

This docket contains no disputed items between the Department and the Company. As such, staff concurs with the Department that the Commission approve MERC's Petition and accept the Department's recommendations.

[6] Ibid, p. 5.

[7] Ibid, Department Attachment 3.

VII. Decision Alternatives

1. Approve the depreciation parameters and rates proposed in MERC's Petition, effective January 1, 2020. (Department, MERC)

2. Allow MERC to use the depreciation rates proposed in its Petition for 2020 in 2020 and 2021. (Department, MERC)

3. Require MERC to file its next five-year depreciation study by June 1, 2022. (Department, MERC)

4. Require MERC, in its next depreciation filing, to provide a discussion of the difference between the way it calculates depreciation rates in its depreciation petitions and how it applies those rates in calculating its actual depreciation expense, and whether these practices result in reasonable and correct depreciation accruals. (Department, MERC)

Staff recommends adopting Alternatives 1, 2, 3, and 4.