

Minnesota Public Utilities Commission
Staff Briefing Papers

Meeting Date: May 12, 2011 ****Agenda Item # _15_**

Company: Minnesota Power

Docket No. E-015/GR-09-1151
In the Matter of the Application of Minnesota Power for Authority to Increase Rates for Electric Service in Minnesota

Issues: 2009 Rate Case Compliance Filing

1. Should the Commission authorize Minnesota Power (MP) to implement new rates on customer bills on a prorated basis for services rendered on and after June 1, 2011?
2. Should the Commission authorize an effective date of November 2, 2010 or June 1, 2011 for the class revenue apportionment, rate design, and/or class rate structure decisions in the Commission's November 2 Order?
3. If the Commission makes a decision about the effective date of the new class revenue apportionment, should the Commission also approve (a) MP's interim rate under-collection plan, (b) OAG-RUD's request for an interim rate refund plan for MP's residential and small commercial customers, or (c) defer making a decision?
4. Should the Commission clarify its November 2 Order as requested by OAG-RUD?

Staff: Robert C. Harding 651-201-2237

Relevant Documents

Minnesota Power - Interim Rate Under-Collection Plan and Compliance Filing Mar. 7, 2011
OES - Comments Apr. 6, 2011
OAG-RUD - Request for Interim Refund Plan for Residential & Small Commercial Customers Apr. 6, 2011
OAG-RUD - Request for Clarification of November 2 Order Apr. 21, 2011
Minnesota Citizens Federation-Northeast – Public/Reply Comment Apr. 21, 2011
Minnesota Power - Reply Comment Apr. 26, 2011

Large Power Intervenors - Reply Comment Apr. 26, 2011
Minnesota Chamber of Commerce - Reply Comment Apr. 26, 2011

Relevant Commission Orders

Minnesota Power 1994 Rate Case - Docket No. E-015/GR-94-001
Order Setting Final Rates, Requiring Refund, And Requiring Report May 31, 1995

The attached materials are workpapers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless otherwise noted.

This document can be made available in alternative formats (i.e., large print or audio) by calling (651) 296-0406 (voice). Persons with hearing or speech disabilities may call us through Minnesota Relay at 1-800-627-3529 or by dialing 711.

May 4, 2011

Statement of the Issues

2009 Rate Case Compliance Filing

1. Should the Commission authorize Minnesota Power (MP) to implement new rates on customer bills on a prorated basis for services rendered on and after June 1, 2011?
2. Should the Commission authorize an effective date of November 2, 2010 or June 1, 2011 for the class revenue apportionment, rate design, and/or class rate structure decisions in the Commission's November 2 Order?
3. If the Commission makes a decision about the effective date of the new class revenue apportionment, should the Commission also approve (a) MP's interim rate under-collection plan, (b) OAG-RUD's request for an interim rate refund plan for MP's residential and small commercial customers, or (c) defer making a decision?
4. Should the Commission clarify its November 2 Order as requested by OAG-RUD?

Introduction

The interim rate statute, Minn. Stat. § 216B.16, subd. 3(c), requires that in a rate case when interim rates are higher than final rates, the utility must refund the difference between interim and final rates, plus interest, from the effective date of interim rates forward. However, if interim rates are lower than final rates, then the Commission must prescribe a method for the utility to recover the difference between interim and final rates, but only from the date of the final determination forward. In this instance, final determination means the date of the Commission's initial decision on the merits of the case, i.e. the Findings of Fact, Conclusions of Law, and Order.

In this case, the Commission authorized MP to put an interim rate increase of approximately \$48.5 million per year into effect on January 1, 2010. In its November 2 Order (final determination) the Commission authorized Minnesota Power to increase final rates by approximately \$53.5 million per year. On an annualized (twelve-month, test-year) basis, the difference between interim and final rates is approximately \$5 million.

In its plan, MP asked to recover the difference between interim and final rates from the date of the final determination forward, i.e. from November 2, 2010 through May 31, 2011. The amount of MP's request is approximately \$3.25 million (or \$3,251,479) in under-collected revenue.¹

There is no dispute amongst the parties that MP is entitled to recover the \$3.25 million difference between interim and final rates for the seven-month period between November 2 and May 31

¹ MP's initial request was for approximately \$3.3 million (or \$3,282,784) in total. This initial request consisted of approximately \$3.25 million (or \$3,251,479) in under-collected revenue plus \$31,305 in interest. MP subsequently withdrew its request for interest.

following the Commission's final determination.²

However, there is a dispute over MP's plan to surcharge its customers to recover this \$3.25 million difference and the effective date of the class revenue apportionment decision in the Commission's November 2 Order.

The two main issues that need to be resolved at the Commission's May 12 meeting are: (1) the effective date for the class revenue apportionment decision in the Commission's November 2 Order, and (2) approval of MP's, OAG-RUD's, or some other method of reconciling this \$3.25 million (approximate) difference between final rates and the amount of interim rates collected between November 2, 2010 and May 31, 2011.

MP proposed a June 1 effective date. Because interim rates overall were lower than final rates, MP asked to surcharge its customers for the revenue it did not collect between November 30 and May 31. MP proposed a uniform, across-the-board surcharge consistent with the way interim rates were assessed.

OAG-RUD proposed a November 2 effective date. OAG-RUD asked the Commission to order interim refunds for the residential and small commercial customers because final rates for these two customer classes will be lower than the increase that was set for interim rates. OAG-RUD did not make a specific recommendation for how MP should recover the difference between interim and final rates from its other customers but implied that it could be done on a class-by-class basis and that it could be left to MP's discretion to actually impose the surcharges.

Class revenue apportionment was one of the most contentious issues in MP's 2008 rate case and in this rate case. This dispute continues here over the effective date of final rates, i.e. as of the date of the Commission's final determination on November 2, or as of the Commission's post-compliance order effective June 1.

Staff believes the only time the Commission has directly addressed a dispute over the effective date of final rates was in MP's 1994 rate case, in docket 94-001, when the Commission approved a prospective, post-compliance effective date. A copy of the Commission's May 31, 1995 Order is included in the relevant documents for this meeting.

Background

On November 2, 2009, Allete, Inc. d/b/a Minnesota Power (Minnesota Power, MP or the Company) submitted its request for a general increase in rates of approximately \$80.9 million (or approximately 18.9%) per year over existing rates.

² There is, however, a separate dispute pending in the Court of Appeals, involving interim rates collected prior to the Commission's final determination (i.e. from January 1 through November 1, 2010), and whether the Commission exceeded its authority in finding exigent circumstances and setting interim rates below the amount requested by Minnesota Power and below the amount that was ultimately determined to be reasonable for final rates.

On December 30, 2009, the Commission issued orders³ accepting MP's request as substantially complete, suspending MP's proposed final rates until the end of this case, setting this matter for contested case hearing, and authorizing an interim rate increase of approximately \$48.5 million (or approximately 11.34%) per year into effect on January 1, 2010. The authorized amount of this interim rate increase was approximately sixty percent of MP's request for a \$80.9 million increase in final rates. For interim rates, MP had requested an increase of approximately \$73.3 million per year.

On November 2, 2010, the Commission issued its *Findings Of Fact, Conclusions, And Order* (November 2 Order), which authorized Minnesota Power to increase its Minnesota jurisdictional revenues by approximately \$53.5 million to produce jurisdictional total retail related revenue of approximately \$662 million, based on a rate of return on equity of 10.38%, for the test year ending December 31, 2010. In two subsequent orders⁴ the Commission denied requests for reconsideration and clarified its November 2 decision.

Position of the Parties

Minnesota Power - Interim Rate Under-Collection Plan ("MP plan") and Compliance Filing

On March 7, 2011, MP submitted its interim rate under-collection plan ("MP plan") and compliance filing. MP requested permission to implement final rates (i.e. the new class revenue apportionment and rate design, including the expansion of the residential inclining block rate structure) on customer bills effective June 1, 2011. MP also proposed a plan ("MP plan") designed to collect the difference between authorized final rates and interim rates for the time period between the Commission's final determination, in its November 2 Order, and June 1, the date MP proposes to implement the Commission's rate design decisions. In its plan, MP proposes to surcharge all of its customers who were charged an interim rate adjustment for a proportionate share of the total (\$3.25 million) under-collected amount.

MP also included in its compliance filing the following items that were required by the Commission's November 2 Order

- Customer notice of new electric rate
- Financial schedules ... including support for Minnesota Power's base cost of energy (which was not changed as a result of this proceeding) and the revised fuel adjustment tariff
- Rate design schedules
- Comparison of operating revenues under present and proposed rates, including schedules of billing determinants and updated customer bill comparisons
- Revised tariff sheets and a summary of rate riders and associated charges currently in effect

³ *Order Accepting Filing And Suspending Rates, Notice And Order For Hearing, and Order Setting Interim Rates*, this docket.

⁴ *Order Denying Petitions For Reconsideration And Extending Reconsideration Period To Permit Clarification* (January 20, 2011), and *Order Clarifying Order Of November 2, 2010* (February 4, 2011), this docket.

- Conservation improvement plan tracker account summary
- Boswell 3 environmental tracker account summary
- Cost of service study with updated Minnesota jurisdiction and total company numbers. [Please see MP's compliance filing transmittal letter, pp. 1-2, and MP's compliance filing.]

Office of Energy Security⁵

On April 6, 2011, the Office of Energy Security of the Minnesota Department of Commerce (OES) submitted comments. OES recommended the Commission approve Minnesota Power's compliance filing with one exception. OES recommended the Commission not approve MP's request to apply interest to under-collected revenue in the Company's plan.

Office of the Attorney General - Requests for Interim Refund Plan ("OAG-RUD plan") & Correction

On April 6, 2011, the Residential and Small Business Utilities Division of the Office of the Minnesota Attorney General (OAG-RUD) submitted its request for an interim refund plan for Minnesota Power's residential and small commercial customers ("OAG-RUD plan"). OAG-RUD asked the Commission to require this refund by issuing

... an order that Minnesota Power's new rates become effective November 2, 2010, the date of the Commission's Order approving the rates. The OAG-RUD further requests that the Commission refund to residential and small commercial ratepayers the difference paid between the higher interim rates charged and the final rate increase, pursuant to Minn. Stat. § 216B.16, subd. 3. [OAG-RUD, request, p. 1]

According to OAG-RUD

... residential and small commercial customers will receive a refund of \$4,454,268 and \$1,789,104, respectively. Since the final increase for the residential and small commercial customers is less than interim rates, a refund will be issued to residential and small commercial customers. Minnesota Power can then determine whether, and in what manner, it collects a surcharge from the other customer classes. [OAG-RUD, request, p. 9, emphasis added]

On April 21, 2011, OAG-RUD asked the Commission to correct its November 2 Order by means of a clarification to the November 2 Order. This correction, if approved, would put MP on notice that more detailed test-year budget information (for calculating rate base and operating income) would be needed in future cases if MP continues to propose projected test-years.

Minnesota Citizens Federation-Northeast - Public/Reply Comment

On April 21, 2011, Minnesota Citizens Federation-Northeast,⁶ a member of the Energy Cents Coalition, asked the Commission to approve OAG-RUD's plan. The Minnesota Citizens

⁵ The name of the Office of Energy Security changed to the Department of Energy Resources after these comments were filed.

Federation-Northeast (MCF-N)⁷ is not an intervenor (or party) in this case but may be considered a participant and provide written comments, pursuant to Minn. Rules, part 7829.0900. The MCF-N asked the Commission to approve OAG-RUD's plan.

Minnesota Power

On April 26, 2011, Minnesota Power recommended the Commission reject OAG-RUD's plan. However, MP indicated it would accept the OES recommendation that it not collect interest on under-collected revenues and withdrew its request to apply interest (or a carrying charge) to the under-collected interim rate revenue.

Large Power Intervenors

On April 26, 2011, the Large Power Intervenors (LPI)⁸ recommended the Commission reject OAG-RUD's plan.

Minnesota Chamber of Commerce

On April 26, 2011, the Minnesota Chamber of Commerce (Chamber) also asked the Commission to reject the OAG-RUD's plan.

Minnesota Statutes, Case Law, and Commission Precedent

Interim Rate. Minn. Stat. § 216B.16, subd. 3(c)

... If, at the time of its final determination, the commission finds that the interim rates are less than the rates in the final determination, the commission shall prescribe a method by which the utility will recover the difference in revenues between the date of the final determination and the date the new rate schedules are put into effect. ... [emphasis added]

Definition of Final Determination. Minn. Stat. § 216B.16, subd. 2(g)

For the purposes of this section, "final determination" means the initial decision of the commission and not any order which may be entered by the commission in response to a petition for rehearing or other further relief. The commission may further suspend rates until it determines all those petitions.

⁶ The Minnesota Citizens Federation-Northeast is not an intervenor in this case but may be considered a participant and provide written comments, pursuant to Minn. Rules, part 7829.0900.

⁷ MCF-N is a member of and was represented by the Energy Cents Coalition in this case. MCF-N has approximately 1,300 low- and moderate income members, primarily in the Duluth area. Prior to 2004, MCF-N was known as the Minnesota Senior Federation-Northeast.

⁸ The members of the LPI in this case are: AreclorMittal USA (Minorca Mine); Blandin Paper Company; Boise, Inc.; Hibbing Taconite Company; Mesabi Nugget Delaware, LLC; NewPage Corporation; PolyMet Mining, Inc.; Sappi Cloquet, LLC; USG Interiors, Inc.; United States Steel Corporation (Keewatin Taconite and Minntac Mine); and United Taconite, LLC.

Determination After Finding Rate Unacceptable. Minn. Stat. § 216B.16, subd. 5

If, after the hearing, the commission finds the rates to be unjust or unreasonable or discriminatory, the commission shall determine the rates to be charged or applied by the utility for the service in question and shall fix them by order to be served upon the utility. The rates shall thereafter be observed until changed, as provided by this chapter. In no event shall the rates exceed the level of rates requested by the public utility, except that individual rates may be adjusted upward or downward. Rate design changes shall be prospective from the effective date of the new rate schedules approved by the commission.

Inter-City Gas [358 N.W.2d 692]

The 1984 Inter-City Gas (“Inter-City”) rate case was one of the earliest challenges to the interim rate statute. In that case, the interim rate increase was set at \$2,737,100 and the final rate increase was \$2,787,288, approximately \$50,000 higher. In its decision, the Court said:

... The Commission ordered no refunds since the revenues authorized by the final order exceeded the revenues collected under the interim rates. The final order made several changes in the rate design. It called for no rate increase for the large volume class. This effected a decrease from the interim rate and the previous rate design.

Conwed (a large volume customer) petitioned for amendment or reconsideration for the final order. It contended that the Commission should order a refund for large volume customers since their final rates were below their interim rates. The Commission denied Conwed’s petition, finding no refund was required since overall final rates exceeded the overall interim rates. [358 N.W.2d 693]

The main issue in dispute in that case was the Commission’s interpretation of the statutory requirement that there not be any change in rate design while interim rates are in effect, and the Commission’s interpretation of the statute such that interim rate refunds are required only if overall final rates are lower than interim rates. This decision did not, however, reach or make any distinction between interim rates collected before the Commission’s final determination and rates collected after the final determination, when, arguably, interim rates are no longer in effect.

In its decision, the Court of Appeals upheld the Commission’s refund policy and the Commission’s ruling that, in this case, no refund of interim rates would be awarded when the final revenue requirement was higher than the interim revenue requirement even though one class of customers, the large volume customers, received no increase in final rates. The Court also upheld the Commission’s argument with respect to refunding one class of customers and surcharging another. The Court, in its analysis, stated that

... refunds, if necessary, [are] to be made across the board to all customers such that the final rates are prospective only. [358 N.W.2d 694]

If interim rates were altered on the basis of final rate determination, either Inter-

City must make refunds from revenues to which it is entitled, or other classes of ratepayers must pay a surcharge to repay the overpaying class. This violated the clear language of subdivision 5 that rate changes shall be prospective only. Nor is it keeping with the subdivision 3 mandate that interim rates contain no change in rate design.

Only if the Commission found that the overall final revenue increase for Inter-City was less than the interim increase, would Conwed and other customer classes be entitled to an across-the-board refund. (Not every customer who paid excessive rates pending appeal is entitled to a full or even a partial refund). We believe the Commission's refund policy is both reasonable and consistent with § 216B.16, subds. 3 and 5. [358 N.W.2d 695]

Peoples Natural Gas [358 N.W.2d 684]

The 1984 Peoples Natural Gas Company rate case is another example of the Court upholding the Commission's interpretation of the interim rates statute. In the Peoples case, the Court again did not make a distinction between interim rates collected before the Commission's final determination, and rates collected after the Commission's final determination. Nevertheless, the Court upheld the Commission's authority to set interim rates in keeping with the no changes in rate design provision of the interim rates statute, and found reasonable the Commission's decision

to impose the interim rate increase proportionately to all customer classes even though Peoples had requested that the entire amount of the proposed rate increase be assigned to general service class members only. [358 N.W.2d 690, 691]

The Court also upheld the Commission's decision that "an across-the-board refund of excess revenues collected during the interim rate period is reasonable" and that a refund for one class versus another would not be appropriate or reasonable even if one rate class received no increase in final rates while another did.

1994 Minnesota Power Rate Case

The 1994 Minnesota Power rate case appears to be the only case in which the effective date of final rates was disputed. In that case, the Commission agreed with the state agencies (the Department and OAG) over the objections of Minnesota Power and the Company's Large Power customers and decided that given the large rate increase (over 20%) authorized for the residential rate class, the new rate design should go into effect prospectively. However, the Commission also found that

... the Public Utilities Act does not specify when new general rate schedules should take effect -- the Commission must designate a date in each case. ...⁹

⁹ ORDER SETTING FINAL RATES, REQUIRING REFUND, AND REQUIRING REPORT, In the Matter of the Petition of Minnesota Power for Authority to Change Its Schedule of Rates for Retail Electric Service in the State of Minnesota, Docket No. E-015/GR-94-001 (May 31, 1995) p. 6

A copy of the Commission's May 31, 1995 Order that explains this decision is included in the relevant documents for this meeting.

1987 Minnesota Power Rate Case

The Commission described its decision in the 1987 rate case, in Docket No. E-015/GR-87-223, in its May 31, 1995 Order, in Docket No. E-015/GR-94-001, as follows

... The case demonstrates that the Commission has long believed it has the flexibility to set the effective date of final rates in light of the public interest.

The 1987 case was unique in that the Company was found to be over-earning and received an overall rate reduction.

It is worth noting that the Company's 1987 effective date proposal was unopposed by any party and overshadowed by an issue that went on to the Court of Appeals - whether, since the Company had been over-earning, it could be required to make interim rate refunds below the level of its pre-rate case rates. For these reasons, the effective date issue did not receive the close scrutiny it is receiving in this case.

Finally, as noted before, the 1987 Minnesota Power rate case is the only case in which the Commission has made new rate structures effective on the date of the original Order on the merits. The weight of precedent clearly favors a post-compliance filing effective date.¹⁰

Staff Comment

In most respects, staff believes MP's compliance filing can be approved, as recommended by the OES. However, the Commission will need to resolve at its May 12 meeting or a future meeting, the dispute over the effective date of the class revenue apportionment decision in the Commission's November 2 Order. How the effective date issue is resolved affects the customer surcharge proposal in the MP plan, and the refund proposal for residential and small commercial customers and surcharge for all others in the OAG-RUD plan. Regardless of how the Commission decides the effective date issue, staff recommends the Commission require MP to apply new rates on customer bills on June 1st as MP requested.

Staff also recommends the Commission take no action on MP's proposed customer notice as explained later in the briefing papers and defer that until after the Commission makes its decision on the effective date issue and MP has revised its notice to reflect the commission's decision.

Staff also recommends the Commission approve the clarification of its November 2 Order requested by OAG-RUD.

¹⁰ Ibid., p. 9

- **MP's request to implement the new class revenue apportionment and rate design on customer bills on June 1st**

There are at least two different time periods at issue in this rate case. Staff believes the Commission will need to keep the distinctions between these time periods in mind in making its decision.

January 1, 2010 – November 1, 2010

This is the time period between the date interim rates went into effect and the day before the Commission made its final determination and issued its November 2 Order. Because the authorized interim rate increase of \$48.5 million was less than the \$73.3 million per year MP requested for interim rates, and less than the \$54.5 million the Commission authorized for final rates, MP has asked the Court of Appeals to review whether the Commission exceeded its authority when it found exigent circumstances and set interim rates below the amount MP requested and below the amount ultimately determined to be reasonable for final rates. MP's appeal is pending.

November 2, 2010 – May 31, 2011

This is the time period that is at issue for this meeting on May 12. MP proposes to implement and make effective the rate design decisions in the Commission's November 2 Order on June 1, 2011 at the end of this time period. The OAG-RUD's plan, if adopted, would make the Commission's class revenue apportionment (rate design) decision effective November 2, 2010.

June 1, 2011 →

There does not appear to be any dispute regarding MP's request to apply its new class revenue apportionment and rate design on customer bill on June 1. Staff believes the Commission should authorize MP to apply new rates on customer bills on June 1 as requested.

However, the application of the new class revenue apportionment (and rate design) on customer bills on June 1 is a different issue from the effective date issue. Regardless of how that issue is decided, staff recommends the Commission authorize MP to apply new rates on customer bills on June 1st as requested by MP. If the Commission does not make a decision on the merits of MP's plan or OAG-RUD's plan on May 12, the effective date issue could be deferred until that decision is made.

- **MP's request to recover the difference between interim and final rates from November 2, 2010 through May 31, 2011**

The Commission authorized MP to put an interim rate increase of approximately \$48.5 million (or \$48,531,128) per year on an annualized basis into effect on January 1, 2010. In its November 2 Order the Commission authorized Minnesota Power to increase its Minnesota jurisdictional revenues by approximately \$53.5 million (or \$53,530,424) per year. On an annualized (twelve-month, test-year) basis, the difference between interim rates and final rates is approximately \$5 million (or \$4,999,206).

In its plan, MP asked to recover the difference between interim and final rates. The amount of

MP's initial request was approximately \$3.3 million (or \$3,282,784) in total. MP's request consisted of approximately \$3.25 million (or \$3,251,479) in under-collected interim rate revenue plus \$31,305 in interest.

There is no dispute amongst any of the parties that MP is entitled to recover the \$3.25 million difference between interim and final rates for the seven-month period between November 2 and May 31 following the Commission's final determination.

Nevertheless, MP's request to recover the difference between interim and final rates is unusual. There have not been many cases in which final rates were higher than interim rates, perhaps as many four over the last thirty years. Staff believes there may be only one case in which the Company has elected to surcharge its customers for the difference between interim and final rates in addition to applying the final authorized rate increase to customer bills. What happens more often than not is that the Company elects to forego making the surcharge because it is getting a permanent increase in final rates, there is a risk of adverse publicity, and surcharges are often offensive to consumers that do not appreciate or understand the rate making process.

Staff believes the Commission is required by statute to authorize the Company to collect the difference between interim and final rates from the date of the final determination forward. However, staff does not believe the Company is absolutely required to collect (or surcharge) for this difference and may forgo collecting this surcharge as long as it does so in a non-discriminatory manner.

- **MP's request for interest on the uncollected difference between interim and final rates from November 2, 2010 through May 31, 2011**

Initially there was a disagreement regarding MP's request for interest (or a carrying charge) on the uncollected difference.

OES specifically objected to MP's request to apply interest to the under-collected balance. OES argued that because the interim rate statute, Minn. Stat. § 216B16, subd. 3(c) does not require or authorize interest when interim rates are under-collected in the same way the statute requires the payment of interest on refunds, statute prohibits the Commission from authorizing MP to collect interest on the under-collected balance of interim rates.

OAG-RUD's proposed refund/surcharge plan did not include interest.

In its reply, MP stated that it agrees with and accepts the Department's position that no interest should be applied to the under-collected interim rates. MP agreed that in the final implementation of rates from this case it will not apply interest to the under-collected amount.

Staff agrees with most of the OES analysis of the interim rate statute, Minn. Stat. § 216B.16, subd. 3(c). This section of the statute specifically requires interest on refunds but is silent with respect to interest on under-collections. Staff believes this silence was intentional. If the legislature wanted the interest requirement to be applied to both, the statute would have been written that way. However, staff does not believe the statute precludes the Commission from

granting MP's request for interest. Nevertheless, staff agrees that applying interest to the under-collected balance would not be in the public interest. MP (and utilities in general) already have procedural advantages in the rate-making process because of their control of the timing and content of filings, and the size of requested rate increases for final and interim rates. Staff does not believe MP and the other utilities need the same protections, i.e. in this instance, the application of interest on under-collections, that is afforded to consumers.

- **Effective date for the class revenue apportionment and rate design decisions in the November 2 Order**

The primary dispute in this matter is whether the Commission should approve

- June 1, 2011 as the effective date and MP's plan. If approved, this would authorize MP to surcharge all of its customers for the under-collected interim rates. **or**
- November 2, 2010 as the effective date and OAG-RUD's plan. If approved, MP would be required to make refunds to its residential and small commercial customers. OAG-RUD does not specify where this refund money would come from but suggested the Commission could authorize MP to determine whether, and in what manner, to collect surcharges from its other customers.

The Commission's November 2 Order allocated the \$53.5 million rate increase and apportioned responsibility for MP's \$543.5 million revenue requirement so that the Large Power customers received a larger share of the rate increase than the Residential and Small Commercial customers. The issue in dispute in this compliance filing is whether the new apportionment of revenue responsibility amongst the customer classes should become effective as of the date of the Commission's November 2 Order or whether this part of the Commission's rate design decision should become effective June 1 when the Company starts billing customers under its new rate structure.

Class	Final Rate Increase (1)	Final Revenue Requirement - includes rate increase (1)	MP - under-collection adjustment/plan (2)	OAG-RUD interim refund (& surcharge) plan
Residential	\$ 3,200,000	\$ 90,300,000	\$ 590,000	\$ (4,450,000)
General Service	\$ 2,700,000	\$ 52,400,000	\$ 340,000	\$ (1,790,000)
Large Light and Power	\$ 8,100,000	\$ 88,500,000	\$ 540,000	\$ 140,000
Large Power	\$ 37,800,000	\$ 295,100,000	\$ 1,680,000	\$ 9,170,000
Municipal Pumping	\$ 500,000	\$ 4,700,000	\$ 20,000	\$ 30,000
Lighting	\$ 400,000	\$ 3,100,000	\$ 20,000	\$ 60,000
Dual Fuel (Res)	\$ 700,000	\$ 7,200,000	\$ 50,000	\$ 80,000
Dual Fuel (C/I)	\$ 200,000	\$ 2,100,000	\$ 10,000	\$ 20,000
Total	\$ 53,500,000	\$ 543,500,000	\$ 3,250,000	\$ 3,250,000

(1) Taken from 3/7/2011 E-015/GR-09-1151 Compliance Filing Schedule 12, Page 2 of 49.

- (2) Does not include \$31,305 in interest initially requested by MP
- (3) Numbers in this table are rounded.

In its plan, MP proposed to recover approximately \$3.25 million by surcharging its customers that were charged an interim rate adjustment for a proportionate share of the under-collected amount. The surcharge factor of approximately 10.3% (10.3012 percent) represents the difference between authorized interim and final revenue. This is the same general approach that is used for refunding over-collected interim rate adjustments.

According to MP

The under-collection amount for existing customers will be in the form of a bill surcharge. A typical residential customer using 771 kWh per month would have a total surcharge of approximately \$5.40 for the seven-month period from November 2010 through May 2011. [MP, plan, p. 2]

OAG-RUD argued that it would be unfair and unjust for the Commission to allow MP to collect an additional surcharge for under-collected interim rates from its residential and small commercial customers because these customer are currently being charged an 11.34% interim rate adjustment, and were assigned much lower rate increases, 3.9% and 5.4% respectively, for final rates. OAG-RUD believes charging the difference between interim and final rates has been so burdensome for these customers that it would be inequitable for them not to receive refunds.

OAG-RUD based its recommendation on the number of customers that have complained about MP's interim rates. These customers believe they are being over-charged while interim rates remain in effect. OAG-RUD also reported receiving complaints about MP's surcharge proposal. MP believes that given the extremely troubled economic conditions MP's residential and small commercial customers must deal with and the hardship caused by MP's rate increases, in this and the 2008 rate case, the Commission should exercise its discretion and prescribe refunds for these customers. (Please see pp. 5-7 of the OAG-RUD's April 6 filing for a description of the customer comments and complaints.)

The Minnesota Citizens Federation-Northeast (MCF-N) agreed with OAG-RUD. MCF-N also argued that the 11.3% across-the-board interim rate increase and the absence of a refund for residential and small commercial customers is causing economic hardship and rate shock for these customers. MCF-N believes the interim rate increase and the proposed surcharge are unfair coming right after the rate increases in the 2008 rate case which fell disproportionately on MP's smaller customers. MCF-N believes the Commission's decision in this case reversed the inequitable rate increases in the 2008 case and it is the industrial customers turn to pay for MP's rate increase. MCF-N believes the Commission's decision in this case should become effective as soon as possible. MCF-N also noted that poverty levels and unemployment increased in 2009 and are expected to increase again in 2010.

In contrast, the Large Power Intervenor (LPI) believe it would be unfair for the Commission change its practice and prior interpretations of the interim rate statute to approve the OAG-RUD plan. LPI (and MP) note that when final rates are lower than interim rates it is usually the residential class that benefits from the Commission's across-the-board refund policy, and they

did benefit from this policy in MP's 2008 rate case.

The Minnesota Chamber of Commerce (Chamber) argued that because it believes the Commission's decision in this case was unfair to the Chamber's members, due to differences in class cost of service and apportionment of class revenue responsibility, it would be unjust and unreasonable for the Commission to make the Large Power class responsible for a larger share of MP's under-collected interim rates any earlier than June 1.

Staff believes these arguments about the burden of interim rates on ratepayers and the impact of a surcharge compared to a refund are a continuation of the rate design arguments previously considered in the rate case. The Commission needs to decide whether the difference between a \$6 (estimated) surcharge and a \$45 or \$50 (estimated) refund for an average residential customers is so substantial that it should vary the normal rate case practice of an across-the-board reconciliation (i.e. refund or surcharge).

Neither the OAG-RUD or the MCF-N address the impact of their proposal on MP's non-residential and non-small commercial customers. The OAG-RUD plan would, in effect, require the Commission to authorize MP to surcharge all of its non-residential and non-small commercial customers to collect all of the \$3.25 million under-collected revenue plus the additional refund monies for over-charges going back to November 2.

No party has provided an estimate of what these surcharges would be on a per customer basis for non-residential and non-small commercial customers. OAG-RUD states that "Minnesota Power can determine whether, and in what manner, it collects a surcharge from" its other customers. Even without calculations or estimates, under the MP plan, the surcharges for individual Large Power customers could be fairly large. Staff believes they would amount to approximately \$9.2 million divided among a dozen or more customers. If the Commission is inclined to approve the OAG-RUD plan, it needs to carefully consider whether and how the OAG-RUD plan balances the interests of MP's various customer classes and the interests of MP.

Staff believes the plain language in the interim rate statute (section 16 of Ch. 216B) suggests the Commission's class revenue apportionment could become effective as of the date of Commission's final determination if the Commission believes the circumstances of this case warrant a November 2 effective date.

... If, at the time of its final determination, the commission finds that the interim rates are less than the rates in the final determination, the commission shall prescribe a method by which the utility will recover the difference in revenues between the date of the final determination and the date the new rate schedules are put into effect. ... [Minn. Stat. § 216B.16, subd. 3(c), emphasis added]

However, the Commission would have to specifically require (prescribe) the November 2 date and a method for recovering the difference in revenues. The Commission's normal practice has been to use a later, post-compliance filing, effective date for rate design decisions, and there are Commission decisions and case law that suggests across-the-board refunds of interim rate over-collections are the Commission's prescribed method of reconciling differences between interim

and final rates.

Usually, the changes in class revenue apportionment and class rate structure are fairly modest and the benefit of making the new rate design effective as of the date of the Commission's final determination does not outweigh the administrative cost of making it effective before it can be applied on customer bills. In these cases the rate design changes have been judged, either explicitly or implicitly, to be not so great that a delay in the effective date of the new rate design would cause terrible inequities.

Generally, the effective date is the date the Commission issues its order approving the Company's rate case compliance filing unless the Commission specifically authorizes a different effective date. When a specific effective date is authorized that is different from the issue date of the order, it is usually done to accommodate the Company so that the Company has a specific date to work with for applying final rates to customer bills and providing new billing information to customers. This coincides with the requirement that the Company provide its customers with a notice or bill insert that explains final rates.

Staff also believes the Commission has generally tried to follow Minn. Stat. § 216B.16, subd. 5, which states that

Rate design changes shall be prospective from the effective date of the new rate schedules approved by the commission.

However, staff would note that the language in subdivision 5 of section 16 that proceeds the above sentence that discusses finding rates unjust, unreasonable or discriminatory, more accurately describes a complaint or investigation proceeding than a rate case. Staff does not necessarily agree that subdivision 5 applies to a general rate proceeding. There is extensive notice and due process afforded to all parties in a general rate case, and a case could be made that rate case are excepted from subdivision 5. The Commission may at some point have to decide whether this language applies specifically to the rate design decision in a rate case.

In the 1994 MP rate case, the Commission acknowledged but did not completely reach this issue about retroactive versus prospective changes in rates in a general rate case proceeding.

The Department and the RUD-OAG read the statutory requirement for rate design changes to be prospective from the effective date of new rate schedules to mean that the effective date of new rate schedules must always be after Commission approval of the rate case compliance filing. While this reading comports with most Commission precedent on the issue, the Commission does not necessarily read the statute that narrowly.

The Public Utilities Act is designed to give the Commission the flexibility necessary to deal with situations as they arise, and the Commission is unwilling to rule out the possibility that another situation may arise in which fairness and the public interest require an earlier effective date. Since the Commission's action tracks the recommendations of the two agencies, however, it is unnecessary to

analyze their statutory arguments in greater detail.¹¹

As the parties have pointed out and the Commission explained in its May 31, 1995 Order, staff is only aware of one case (the 1987 Minnesota Power rate case) in which the class revenue apportionment (rate design) decision became effective at the same time as the revenue requirement decision. In that case there was no dispute over the effective date.

Besides the public interest issue involving the burden of MP's rate increases on residential and small commercial rate payers discussed above, parties have raised several legal arguments regarding the Commission's authority to approve OAG-RUD's request.

OAG-RUD argued that

- "... While traditionally new rate schedules are made effective on or immediately after the date of the Order approving the compliance filing containing those schedules, the Commission has previously demonstrated its broad authority to adopt different methods. Specifically, in Minnesota Power's 1987 rate case (Docket No. E-015/GR-87-223), the Commission made the new rate schedules effective as of the date of its original Order on the merits in the rate case." [OAG-RUD, comments, p. 8, footnote omitted]
- The Commission has authority under the interim rate statute (Minn. Stat. § 216B.16, subd. 3(c)) to make the final determination effective as of November 2 and to order refunds for those customers that have paid interim rates in excess of the rate in the final determination, and to prescribe a method by which MP may collect the difference between interim and final revenues for the time period between the date of the final determination and date the new rate schedules are put into effect.
- In Minnesota Power's 1994 rate case, MP and the Large Power Intervenors argued that the Commission has the authority to implement new rate schedules effective as of the date of the Commission's final determination or at any time thereafter based on the merits, e.g. fairness considerations, public policy, and the statutory requirement that rates be just and reasonable.
- The Commission's November 2 Order, even though the Commission did not order a refund plan, states that the Company's compliance plan should include "a plan for refunding the difference between the amounts collected in interim rates and amounts authorized for final rates."

MP, LPI and the Chamber offered arguments and objections in response to OAG-RUD.

- OAG-RUD's interim refund proposal is contrary to case law established in appellate level decisions in the Inter-City Gas and Peoples Natural Company cases. Both cases involved the Commission's authority to order and prescribe certain methodology for

¹¹ Ibid., p. 10. (Reference to Minn. Stat. § 216B.16, subd. 5 omitted.)

interim rate refunds. The methodologies approved in those cases have become standard practice and are similar to surcharge mechanism proposed by MP in this case.

- The interim rate statute, Minn. Stat. § 216B.16, subd. 3(b), that there should be no changes in the existing rate design during the interim rate period, and the rate design changes shall be prospective statute, Minn. Stat. § 216B.16, subd. 5, preclude the Commission from approving OAG-RUD's plan for a November 2 effective date.
- The assessment of interim rates and the reconciliation of interim and final rates at the end of a rate case are not intended to be precise class-by-class or customer-by-customer assessments and reconciliations. The complex and expensive work of setting rates belongs in the main part of the rate case. This does not need to be prejudged in the setting of interim rates or revisited in the reconciliation of those rates after the final determination has been made. While both are important, the process for handling both should be predictable and neither should be an administrative burden.
- MP believes the OAG-RUD's proposal, if adopted, could lead to uncertainty about interim rates and the extent to which they may be retroactively adjusted in future proceedings.
- OAG-RUD's proposal is contrary to the precedent set by Commission order in the 1994 MP rate case.¹²

Staff believes the Commission has the authority to approve OAG-RUD's plan if it believes OAG-RUD's proposal has merit. However, if this is what the Commission decides, it should consider whether it is developing a new policy on final rates effective dates that it expects to be followed in future rate cases and whether it is prescribing a new method, i.e. class-by-class rather than across-the-board, for reconciling interim and final rates.

Staff believes that if the Commission decides the class revenue apportionment decision in its November 2 Order should become effective November 2, there is at least one alternative to OAG-RUD's proposed plan. That alternative would be for MP to calculate a refund or surcharge on a customer-by-customer basis. This would probably be the most accurate and fairest but almost the most expensive to administer approach. This would allow MP to incorporate into the refund and under-collection plan changes in individual revenue responsibility that are due to the expansion of the inclining block rates, as well as changes in class revenue responsibility. However, staff is not aware of any rate cases where the refund has been calculated customer-by-customer using the difference between interim and new rates as the basis for individual refunds.

Staff discussed with MP and OAG-RUD the underlying calculations and methodology in OAG-RUD's proposal and reviewed the results of several alternative calculations that were proposed by staff as possible alternatives. Staff agrees with MP and OAG-RUD that the calculations in

¹² Ibid.

their plans are proxies or estimates and are not intended to precisely match or replicate the kinds of calculations that would be made in the main part of this rate case.

Customer Notice

MP submitted a proposed final rates customer notice in its compliance filing. The OES recommended approval of the notice. However, the notice does not mention MP's plan or its request to surcharge its customers. If MP's plan is approved, this should be explained in the notice as well as the proposed customer surcharges. Alternatively, if the OAG-RUD plan is approved, the interim refunds (and surcharges) should be explained in the notice.

Staff also believes MP should update its "What are these charges on my bill?" brochure and, perhaps, develop a fact sheet that explains the expansion of the residential inverted block rate design and post this on its website. The customer notice can direct customers to the Company's website for this additional information about the new residential class rate structure.

MP suggested that it could develop several different alternatives for the Commission to consider until the Commission makes its determination. Staff suggested MP wait until after the Commission's May 12 meeting before revising the notice and then working on an explanation of the surcharge plan or the refund plan. MP agreed because there will be 2½ weeks between May 12 and June 1 to work on the notice.

To address timing issues such as this one, the Commission, in its July 21, 2008 *Notice And Order For Hearing* in this docket, delegated to the Executive Secretary the authority to approve customer notices and bill inserts for the duration of this proceeding. As soon after the Commission's May 12 meeting as is practical, and after MP has revised its notice, a Commission notice approving MP's customer notice could be issued.

Clarification of November 2 Order

In the deliberations on this case on September 29, 2010, several decision items were unanimously approved, including an OAG-RUD recommendation regarding the level of detail needed to support requests for projected test-year rate base and operating income budgets in future rate cases.¹³ However, this decision point was not in the Commission's November 2 Order.

In its request for reconsideration, OAG-RUD argued that MP's projected test year was flawed and MP's entire request should be denied. In its request for reconsideration, OAG-RUD argued that the language in the Commission's November 2 Order is not the language unanimously approved on September 29, 2010 when the Commission included decision alternative 67 in the initial block motion for items not in dispute. The OAG requested that, upon reconsideration, the Commission include the same or similar language to that of decision alternative 67 in an amended Order.

In the briefing papers on the parties' requests for reconsideration, staff noted that the Commission approved decision alternative 67, and that if the Commission were to clarify or in any way modify its November 2 Order, the language in decision alternative 67 should be reflected in the Commission's subsequent order. However, in the briefing papers, OAG-RUD's request for clarification was embedded in the decision alternatives involving OAG-RUD's request for reconsideration and that MP's entire request be denied because of flaws in MP's projected test-year. OAG-RUD's request for clarification was not considered as a stand-alone request as were MP's requests for clarification.

On April 21, 2011, OAG-RUD asked the Commission to correct its November 2 Order.

Staff believes the Commission should clarify its November 2 Order to reflect the Commission's deliberations on September 29 and incorporate decision alternative 67 in the Commission's next order in this matter.

¹³ Please see alternative 67 from the September 29, 2010 deliberations outline:

Put MP on notice that if it continues to use a projected test year in future rate cases, the Company must budget in sufficient detail to allow appropriate analysis of its test year rate base and operating income. Failure to do so could result in denial of requested increases in their entirety.

Please also see the minutes from the Commission's September 29, 2010 meeting. Item 25, in the description of the first block motion, which passed 5-0, states the following:

Future Budgeting Detail -- Put the Company on notice that if it continues to use a projected test year in future rate cases, the Company must budget in sufficient detail to allow appropriate analysis of its test year rate base and operating income. Failure to do so could result in denial of requested increases in their entirety.

Decision Alternatives

Approve Minnesota Power's compliance filing with one or more of the following conditions, exceptions or modifications to the Office of Energy Security's April 6, 2011 recommendations.

Implementation Date for Final Rates on Customer Bills

1. Authorize MP to implement its new class revenue apportionment, rate design, and rate structure on customer bills on a prorated basis for services rendered on, and after, June 1, 2011.

Interest on the uncollected difference between interim and final rates from November 2 to May 31

2. Do not allow MP to apply interest to the under-collected difference between interim and final rates.

Effective Date for the Class Revenue Apportionment in the Commission's November 2 Order (i.e. Final Determination)

3. Authorized MP to make its new class revenue apportionment effective June 1, 2011, the implementation date MP requested, for final rates on customer bills, on a prorated basis for services rendered on and after the effective date, or
4. Require MP to make its new class revenue apportionment effective November 2, 2010, the issue date of the Commission's final determination in this matter, on a prorated basis for services rendered on and after the effective date, or
5. Defer making a decision on the effective date of the class revenue apportionment in the Commission's November 2 Order. Direct staff to issue a notice requesting additional comments on MP's and OAG-RUD's proposals, potential modifications and refinements to those proposals, and potential alternatives.

MP's Plan & OAG-RUD's Plan

If the Commission authorizes a June 1, 2011 effective date (alternative 3), then

6. Approve MP's plan (modified to exclude interest) to surcharge all of its customers who were charged an interim rate adjustment for a proportionate share of the total under-collected amount. or
7. Defer taking action on the merits of MP's plan and direct staff to issue a notice requesting additional comments on MP's proposal, potential modifications and refinements, and potential alternatives.

If the Commission authorizes a November 2, 2010 effective date (alternative 4), then

8. Approve OAG-RUD's request for interim rate refunds for MP's residential and small commercial customers, and authorize MP to surcharge its other customers for the under-collected revenue and the refunds to residential and small commercial customers. or
9. Defer taking action on the merits of OAG-RUD's plan and direct staff to issue a notice requesting additional comments on OAG-RUD's proposal, potential modifications and refinements, and potential alternatives.

Compliance Report

If the Commission approves MP's or OAG-RUD's plan with or without modification (i.e. alternative 6 or 8), then

10. Require MP to submit a compliance report within 30 days of completing the approved plan that describes the reconciliation between interim and final rates for the November 2, 2010 to May 31, 2011 time period. This reconciliation shall include the actual surcharges paid by each customer class and include supporting calculations.

Customer Notice

11. Take no action on MP's proposed customer notice. (As soon after the Commission's May 12 meeting as is practical, a Commission notice approving a revised MP customer notice will be issued.)

Clarification: Future Budgeting Detail

12. Clarify and amend the November 2 Order to reflect the Commission's September 29 deliberations approving decision alternative 67 as follows:

Put MP on notice that if it continues to use a projected test year in future rate cases, the Company must budget in sufficient detail to allow appropriate analysis of its test year rate base and operating income. Failure to do so could result in denial of requested increases in their entirety.

13. Do not clarify the November 2 Order.

Staff Recommendation

Staff recommends alternatives 1, 2, 11, and 12. Staff does not believe the application of new rates on customer bills should be delayed beyond June 1. Staff makes no recommendation on the effective date issue or the merits of MP's versus OAG-RUD's plan. However, if the Commission approves either plan, staff recommends alternative 10.