

No. A07-1957

STATE OF MINNESOTA
IN COURT OF APPEALS

In the Matter of the Application of the City of Redwood Falls to Extend Its Assigned
Service Area Into the Area Presently Assigned to Redwood Electric Cooperative,

City of Redwood Falls,

Relator,

vs.

Minnesota Public Utilities Commission and Redwood Electric Cooperative,
Respondents.

**BRIEF AND ADDENDUM OF RESPONDENT MINNESOTA PUBLIC
UTILITIES COMMISSION**

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

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I. IS THE DECISION OF THE MINNESOTA PUBLIC UTILITIES COMMISSION SUPPORTED BY SUBSTANTIAL EVIDENCE IN THE RECORD?

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STATEMENT OF THE CASE

Minnesota Statutes section 216B.44(a) (2006) allows a municipal utility that either extends its corporate boundaries through annexation or consolidation, or that determines to extend its service territory within its existing corporate boundaries, to petition the Minnesota Public Utilities Commission (“Commission”) to furnish electric service to the area. If the municipal utility and displaced utility are unable to agree as to the terms of payment or exchange, either party may petition the Commission to determine the appropriate compensation. Minn. Stat. § 216B.44(b) (2006). In determining appropriate compensation, the Commission is to consider the original cost of the property, less depreciation, loss of revenue to the utility formerly serving the area, expenses resulting from integration of facilities, and other appropriate factors. Minn. Stat. § 216B.44(b) (2006).

Pursuant to this statute, Relator City of Redwood Falls (“City”) petitioned the Commission to transfer service territory from Respondent Redwood Electric Cooperative (“Cooperative”) and determine compensation. Additionally, the City indicated that the Cooperative had been serving the City’s Wastewater Treatment Ponds (“Ponds”) within the City’s assigned service area without the City’s consent and asked that the Commission order the Cooperative to remove its facilities and confirm that the City had authority to serve the Ponds.

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The Commission referred the matter of compensation to the Office of Administrative Hearings (“OAH”) for contested case proceedings, including the issue of service rights to the Ponds. The primary issues in dispute that are continued in this

appeal are whether the Cooperative is entitled to compensation for loss of service rights to the Ponds and what is the appropriate Power Cost Adjustment ("PCA") figure to be used in calculating compensation to the Cooperative.

The record demonstrates that the Ponds were located within the service territory of Northern States Power Company ("NSP") when the Ponds were initially constructed in 1996. The uncontested evidence in the record shows that the City requested the Cooperative serve the Ponds and that NSP consented to the Cooperative serving the Ponds. The City has offered no evidence to rebut the testimony of the Cooperative's witnesses or an alternative explanation for the Cooperative's service to the Ponds. The Cooperative has served the City without objection for nine years.

In 1998, the City acquired the service territory surrounding the Ponds from NSP. The agreement between the City and NSP did not include service rights to the Ponds or the Cooperative's facilities used to serve the Ponds. At the time the City acquired service rights to the surrounding areas, NSP did not possess service rights to the Ponds and could not have transferred service rights to the City. The Administrative Law Judge ("ALJ"), however, found that there was insufficient evidence that NSP entered into a binding contract with the Cooperative regarding service to the Ponds, that the informal arrangement between NSP and the Cooperative did not bind the City, and that the Cooperative was not entitled to compensation for loss of service rights to the Ponds.

The Commission disagreed. While the statute states that consent must be in writing, there is no requirement that a transfer of service rights be preceded by a binding contract. The statute does not impose the penalty of invalidity for failing to meet the

writing requirement and a service by exception agreement has never been invalidated on that basis. Prior Commission orders and decisions from this Court support a finding that, while such a writing is preferred, a party's consent will not be invalidated where the purposes of the Public Utilities Act are met.

Accordingly, the Commission determined that compensation was due to the Cooperative for loss of service rights to the Ponds. Due to the lack of identifiable terms, however, the Commission reduced the period of compensation by half, finding that the reduction reasonably balanced the Cooperative's interest in recovering its ongoing investment, the City's interest in limiting the expenditures necessary to accomplish its mission, and was the most reasonable resolution based on the facts in the case.

In awarding compensation to the displaced utility, the Commission attempts to put the displaced utility in the same position it would have been but for the acquisition. Because the loss of service area to the displaced utility does not result in an immediate and corresponding reduction in the utility's cost of service, the Commission attempts to protect the displaced utility's remaining customers from paying higher rates to recover fixed costs that would have been recovered through charges to customers in the lost areas. Overhead and administrative expenses, as well as taxes, depreciation and maintenance, among others, are all costs that continue to be incurred. The loss of sales to the annexed areas means there are fewer customers left to share the burden of these fixed costs.

The Commission applies a four-step net revenue loss method to determine compensation due the displaced utility. The first step of the calculation, determining

It is hereby declared to be in the public interest that, in order to encourage the development of coordinated statewide electric service at retail, to eliminate or avoid unnecessary duplication of electric utility facilities, and to promote economical, efficient, and adequate electric service to the public, the state of Minnesota shall be divided into geographic service areas within which a specified electric utility shall provide electric service to customers on an exclusive basis.

Minn. Stat. § 216B.37 (2006). The Legislature further provided that “each electric utility shall have the exclusive right to provide electric service at retail to each and every present and future customer in its assigned service area. . . .” Minn. Stat. § 216B.40 (2006).

In recognition that service areas may require adjustment over time, however, the Legislature established a procedure to allow municipal utilities to acquire parts of another utility’s service territory. Minn. Stat. § 216B.44 (2006). Section 216B.44(a) (2006) provides, in part:

whenever a municipality which owns and operates an electric utility (1) extends its corporate boundaries through annexation or consolidation, or (2) determines to extend its service territory within its existing corporate boundaries, the municipality shall thereafter furnish electric service to these areas unless the area is already receiving electric service from an electric utility, in which event, the municipality may purchase the facilities of the electric utility serving the area.

The Legislature clearly established that after April 12, 1974, unless a municipality which owns and operates an electric utility elects to purchase the facilities and property of the other electric utility as provided in section 216B.44, “the inclusion by incorporation, consolidation, or annexation of any part of the assigned service area of an electric utility within the boundaries of any municipality shall not in any respect impair or affect the rights of the electric utility to continue and extend electric service at retail throughout any part of its assigned service area.” Minn. Stat. § 216B.41 (2006).

When a municipality which owns and operates an electric utility intends to acquire another utility's service territory, Minn. Stat. § 216B.44 (2006) outlines the procedure to transfer the service area and what factors the Commission must consider in making its determination of appropriate compensation. Section 216B.44(b) provides that if a municipality seeks to extend its service area and the parties cannot agree as to the terms of payment, the parties may request that the Commission determine the appropriate terms for exchange or sale. The Commission is to consider "the original cost of the property, less depreciation, loss of revenue to the utility formerly serving the area, expenses resulting from integration of facilities, and other appropriate factors." Minn. Stat. § 216B.44(b) (2006).

Minnesota statutes also carve out four narrow exceptions to the general rule prohibiting utilities from providing service outside of their assigned service areas. These exceptions include: (1) where the other utility consents in writing;¹ (2) when service is to the utility's own utility property or facilities;² (3) when service is to a building on homestead property partially within the utility's assigned service area and the building had been under construction as of April 11, 1974;³ and (4) when service is to a customer two megawatts or larger located outside a municipality and the Commission has found

¹ Minn. Stat. § 216B.40 (2006).

² Minn. Stat. § 216B.42, subd. 2 (2006).

³ Minn. Stat. § 216B.421 (2006).

service to be in the public interest after notice and hearing and consideration of several factors.⁴

The City filed its Petition for Approval of Transfer and Determination of Compensation with the Commission in August, 2005. City's App. 1.⁵ The City indicated that the former City of North Redwood Falls ("North Redwood") was consolidated with the City effective December 31, 1996. RA1. The City indicated that a portion of North Redwood was located within the Cooperative's service territory. RA2. The City stated that it had annexed several additional parcels into the City's corporate boundaries and that the City intended to acquire service rights to the annexed parcels. RA2-RA3. The City also indicated that the Cooperative was serving its Ponds and that the Ponds were within the service territory acquired by the City from NSP in 1998. RA2.

In its initial petition, the City asked the Commission to refer the matter to the OAH for contested case proceedings. RA4. The City also requested that the Commission order the Cooperative to remove its facilities from the Ponds without payment of any kind and confirm the City's authority to serve the Ponds. RA4. The City asked that the Commission transfer service rights to the other areas to the City and that the Commission determine appropriate compensation to the Cooperative. RA4. The City also requested that the Commission grant the City the right to serve new points of delivery within one of the annexed areas, the Prairie Knoll Addition, while compensation was being determined. RA4.

⁴ Minn. Stat. § 216B.42, subd. 1 (2006).

⁵ Items from the City's Appendix will hereafter be referred to as "RA ____."

The Commission referred the matter for contested case proceedings in its *Notice and Order for Hearing* dated November 10, 2005. RA26. The Commission directed that, if the parties were unable to resolve the issues regarding the Cooperative's service to the Ponds, the parties were to address whether the service is authorized, whether the City must pay compensation to acquire the service rights to the Ponds, and the amount of any compensation required. RA26. The Commission also directed the parties to address the factors outlined under Minn. Stat. § 216B.44 regarding the determination of appropriate compensation. RA26. In its November 14, 2005, *Order Granting Interim Service Rights*, the Commission granted the City's request to serve new points of delivery within the Prairie Knoll Addition, subject to several conditions. Administrative Record Item No.10 at 5.⁶

Although numerous issues were argued and briefed, only two issues remain subject to dispute in this case. The first issue is whether the Cooperative is entitled to lost revenues for the transfer of service rights to the Ponds. The second issue is whether the PCA factor included in gross revenues should reflect revenues associated with the loss of service rights to these customers, or whether the PCA should be a composite of the Cooperative's existing PCA that does not reflect revenues directly associated with the loss of these customers.

⁶ Items from the Administrative Record will hereafter be referenced as "R. ___."

II. SERVICE TO THE PONDS

In the course of the contested case proceedings, the City and the Cooperative were unable to resolve the issues surrounding service to the Ponds. The Ponds were built in 1996 to handle the expansion of the City's sewer system to serve the needs of North Redwood. RA492. The Ponds were within NSP's service area at the time the Cooperative extended service to the Ponds. RA494 ¶ 18. There is no written agreement between NSP and the Cooperative memorializing the service by exception. The City did not have the right to serve the area when electricity service was initially requested. RA495 ¶ 19.

The Cooperative submitted, and the ALJ accepted, the testimony from Ron Horman, the Cooperative's lineman in charge of constructing the facilities to extend service to the Ponds. RA211; R. 36 at 1.⁷ Mr. Horman testified that the City had requested that the Cooperative provide service and that NSP agreed to the service extension. RA495 ¶ 21 (citing RA224-RA226); R. 36 at 1-3. Mr. Horman testified that the City's Director of Public Utilities, Mr. Curt Weber, contacted the Cooperative's Manager of Operations, Mr. Dennis Trom, and requested that the Cooperative provide service to the Ponds.⁸ R. 36 at 2. Mr. Horman explained that he was not directly involved in the discussions between Mr. Weber and Mr. Trom, but that Mr. Trom described his conversations with Mr. Weber to Mr. Horman on several different occasions. RA227. Mr. Horman explained that he was working with Mr. Trom on the

⁷ The City did not object to the admission of Mr. Horman's testimony. RA211.

⁸ Mr. Weber is now deceased.

project because Mr. Horman was the foreman for the job at the time. RA226-RA227. Mr. Horman further testified that Mr. Weber contacted the Cooperative about setting up an account for the Ponds and included with his testimony a copy of the Cooperative's records for setting up the account. R. 36 at 2 and Ex. RH-3; RA226-RA227.

The Cooperative installed a three-phase cable from its existing three-phase line to provide electric service to the Ponds. RA493 ¶ 12 (citing R. 36 at 2). Mr. Horman testified that the Cooperative's facilities capable of providing service to the Ponds were closer than those of NSP. RA229. Mr. Horman explained that the Cooperative's facilities used to serve the Ponds were within 1,300 feet of the Ponds. RA229. NSP's facilities were approximately one-half to three-quarters of a mile away. RA229. NSP did not have any suitable facilities in the area from which to extend service. R. 36 at 2; RA228. Mr. Horman indicated that Mr. Trom had contacted NSP and that NSP did not object to the Cooperative providing service to the Ponds. RA228.

Mr. Horman also testified that he spoke with the representative from the Cooperative's outside engineering firm, MEI Engineering ("MEI"), about the service extension at issue here. RA231. The MEI representative relayed that NSP agreed that the Cooperative could extend service to the Ponds and that the City had requested the service extension. RA232.

The City and NSP began negotiating for an amendment of their adjoining service areas soon after the Cooperative began service to the Ponds. RA495 ¶ 22. The agreement between NSP and the City transferred service rights to the area around the Ponds to the City. R. 50. The agreement between NSP and the City did not mention

service to the Ponds or include the facilities constructed to serve the Ponds. R. 50. Although the Cooperative participated in the hearings transferring service rights from NSP to the City, the Cooperative's participation was limited to addressing coordinated distribution service between the parties. R. 50, Order Accepting Settlement at 2.

The City claimed and the ALJ agreed that the City learned that the Ponds were within the service area the City obtained from NSP when it began to review the service maps in its contemplated acquisition of the Cooperative's service territory. RA496 ¶ 25. The ALJ determined that there was no evidence to show that the City had prior knowledge the Ponds were within the City's service territory. RA496 ¶ 25. The ALJ determined that NSP and the Cooperative had an informal arrangement regarding service to the Ponds and the evidence did not support a conclusion that NSP entered into any formal agreement regarding a change to the service area boundary with the Cooperative. RA495 ¶ 24. The ALJ found that the informal arrangement between NSP and the Cooperative did not bind a successor in interest regarding service to the Ponds. RA495-RA495 ¶ 24. The ALJ recommended that no lost revenue be awarded for the transfer of service rights to the Ponds. RA498 ¶ 35.

It is uncontested that the agreement between NSP and the Cooperative was never reduced to writing, that the purchase agreement between NSP and the City did not mention service rights to the Ponds, and that the Cooperative served the Ponds with no objection from the City from the summer of 1996 until the beginning of this proceeding. RA666. The Commission found that the lack of a writing, however, does not invalidate the service by exception here.

The Commission found that, while the City argued that it did not have documentation that it asked the Cooperative to serve the Ponds, the City did not offer an alternative explanation for how the Cooperative's service to the Ponds was initiated in 1996 and continued without objection through the time the City made its filing here. RA665. The Cooperative agreed that its exception agreement with NSP should have been reduced to writing pursuant to Minn. Stat. § 216B.40, but indicated that failure to do so did not invalidate the agreement or the Cooperative's right to compensation for service rights to the customer. RA262; RA666.⁹

The Commission found that total denial of compensation for service rights to the Ponds was not required by Minn. Stat. ch. 216B ("Public Utilities Act"), was inconsistent with past Commission practice, would not serve the policy goals of the assigned service area statutes, and was not required to ensure fair treatment to the City. RA667. The Commission recognized that informal exception agreements are commonplace and are essential tools for achieving the goals of the assigned service area statutes. RA668. The goals of the statutes are to ensure coordinated, statewide electric service, to avoid unnecessary duplication of facilities, and to promote economical, efficient and adequate electric service throughout the State. Minn. Stat. § 216B.37 (2006). The assigned service area statutes give the utilities the flexibility to meet these goals and avoid making

⁹ The City states that there was no filing at the Commission, City Br. 11, but fails to indicate that service by exception agreements are not required to be filed at the Commission. Minn. Stat. § 216B.40.

expensive and duplicative investments to serve customers whose needs may be met more economically by a non-assigned provider. RA668.

Further, the statute requiring a writing does not impose the penalty of invalidity and the Commission has never invalidated an exception agreement on that basis. RA669. The Commission has recognized and enforced unwritten exception agreements on several occasions, each time noting the importance of exceptions to the efficient and economical provision of electric service. RA669, n.21.

Moreover, the Commission disagreed with the ALJ's conclusion that the City did not know that the Cooperative had been serving the Ponds since 1996 until it began preparing its application in this proceeding. RA669. The Commission found the City clearly did have notice. The record supports that the City requested service from the Cooperative when the Ponds were constructed and the City has been paying the monthly bills for service since 1996. RA224-RA226; RA670. Further, the Commission recognized that the City is itself an electric utility under the assigned service area provisions of the Public Utilities Act, and is presumed to know the boundaries of its service area. RA670.

Although the City argued that service rights to the Ponds were transferred to the City when it acquired the surrounding service area in 1998 from NSP, the City, like a buyer in any transaction, is bound by what the seller can actually convey. RA669. At the time NSP transferred service rights to the surrounding areas, NSP did not have service rights to the Ponds. RA669. Accordingly, NSP was unable to convey service rights to the Ponds to the City. RA669. The agreement between the City and NSP transferred

NSP's equipment, facilities and service rights within the specified area. RA670; R. 50. It did not transfer service rights or facilities that belonged to other utilities.

The Commission found that the existence of an exception agreement here is clear, but the terms of that agreement are less so. RA671. The absence of a writing and the passage of time made it impossible to reconstruct the terms of the agreement between the Cooperative and NSP. RA667. Accordingly, the Commission found that the record did not support a full ten-year compensation award and reduced the award to five years of lost revenues. RA667-RA668. The Commission found that to deny any compensation would deny the Cooperative's ratepayers of the opportunity to recoup investments and the cost of financial commitments entered into to serve the Ponds and would otherwise provide a windfall to the City. RA671. Accordingly, the Commission exercised its expertise in determining compensation to find that an award of 50 percent of the normal compensation award reasonably balanced the Cooperative's interest in recovering its ongoing investment and the City's interest in limiting its expenditures. RA671.

III. CALCULATION OF LOST REVENUE

The Commission applies a four-step method to determine lost revenues for a displaced utility. RA671. The Commission:

1. determines annual gross revenues;
2. determines annual avoided costs;
3. subtracts avoided costs from gross revenues for each year of the ten-year compensation period; and
4. reduces to present value the total amount calculated in the first three steps.

RA671. The Commission then converts the total compensation award to a per-kilowatt-hour mill rate to protect against the possibility of inaccuracies in the forecast. RA671.

The City and the Cooperative both used the net revenue loss method to calculate compensation. However, the City and the Cooperative disputed what PCA should be used in the first step of the analysis, calculation of the gross revenues.¹⁰ RA671.

Both parties agree that the Cooperative buys wholesale power from the Western Area Power Administration (“WAPA”) and Great River Energy (“GRE”) and that WAPA power is significantly cheaper than that of GRE. RA671. WAPA power is allocated among eligible customers and the Cooperative’s allocation of WAPA power is less than its total requirements. The Cooperative buys all power for which it is eligible from WAPA and purchases the remainder of its power from GRE. RA671. Because the Cooperative would continue to purchase all of its WAPA allocations after the City’s acquisition, the reductions in purchased power expense would come from reduced purchases from GRE. Accordingly, both the Cooperative and the City used GRE’s wholesale rates to calculate the Cooperative’s avoided purchased power costs.

Although the City used GRE’s wholesale rates to calculate the Cooperative’s avoided purchased power costs, the City argued that the PCA component of the gross revenues calculation should be a *composite* figure reflecting the purchased power costs of WAPA and GRE power. RA672; R. 56, DAB-1 rev. 1 at 5; R. 57 at 7-8. The ALJ recommended the Commission adopt the City’s proposed method of determining the PCA component of the gross revenues calculation. RA504 ¶ 60.

¹⁰ The PCA is an automatic adjustment mechanism through which the Cooperative recovers costs, including purchased power costs, that the Cooperative incurs that exceed the costs included in base rates.

In contrast, the Cooperative applied a PCA figure reflecting the actual impact on the Cooperative's system of the City's acquisition. RA93; R. 27 at 13-14, Table 6. The Cooperative's PCA included the reduction to the PCA that would result from the Cooperative purchasing less power from GRE, and therefore reducing the amount of revenue needed to be recovered via the PCA. RA93-RA94. The Cooperative used GRE's wholesale rates to calculate both its avoided purchased power costs and the PCA included in gross revenues, since all reductions in the amount of power purchased would come from the Cooperative's GRE purchases. RA93; RA671. The Cooperative calculated, "[w]hat the PCA would be applying just to the sales in the area to exactly match the purchased power costs." RA93; R. 27 at 13-14.

The purpose of the PCA is to recover actual costs of service. If the Cooperative no longer serves the areas, the Cooperative will no longer need to purchase wholesale power from GRE to serve the load associated with the lost customers. R. 26 at 27. The amount of power purchased from WAPA is not affected by the City's acquisition. RA93-RA94; R. 27 at 13. Accordingly, because the Commission includes in its compensation determination actual costs and revenues that result from the City's acquisition, the Commission rejected the City's proposed PCA and adopted the Cooperative's PCA. RA672.

The Commission explained that the issue is not how the Cooperative allocates and reflects purchased power costs in its rate schedules, but how the loss of actual customers will affect the Cooperative's purchased power costs. RA672. When an increase in customer numbers forces a utility to purchase higher-priced wholesale supplies, the

higher costs are generally passed through to customers in the form of a higher power rate adjustment. RA672. If the new customers disappeared, however, the power rate adjustment would decrease by the amount of the additional, higher-priced power the utility had been buying to serve them. RA672.

The objective of the net revenue loss formula is to put the displaced utility in the same position it would have occupied but for the loss of service rights to the area for which compensation is being determined. RA672; RA147; *In re Complaint Regarding the Annexation of a Portion of the Serv. Territory of People's Coop Power Ass'n by the City of Rochester (North Park Additions)*, 470 N.W.2d 525, 528 (Minn. Ct. App. 1991).

To put the displaced utility in the same position it would have otherwise occupied requires that both the PCA component of gross revenues and the avoided cost calculation reflect the costs the Cooperative will actually shed and those that remain. RA672. Accordingly, the Commission found that the PCA of the gross revenues calculation should be set to achieve symmetry with the avoided purchased power costs, and that both calculations should be based on GRE's wholesale rates. RA673.

The Commission determined that the appropriate compensation due to the Cooperative for loss of service rights was 32.9 mills per kilowatt hour for five years for the Ponds and 29.7 mills per kilowatt hour for all other present and future customers for a period of ten years. RA674; RA714.

SCOPE OF REVIEW

An appeal from a decision and order of the Commission may be commenced in accordance with Minn. Stat. ch. 14. Minn. Stat. § 216B.52, subd. 1 (2006). In a judicial review of an agency decision:

the court may affirm the decision of the agency or remand the case for further proceedings; or it may reverse or modify the decision if the substantial rights of the petitioners may have been prejudiced because the administrative finding, inferences, conclusion, or decisions are:

- (a) in violation of constitutional provisions; or
- (b) in excess of the statutory authority or jurisdiction of the agency; or
- (c) made upon unlawful procedure; or
- (d) affected by other error of law; or
- (e) unsupported by substantial evidence in view of the entire record as submitted; or
- (f) arbitrary or capricious.

Minn. Stat. § 14.69 (2006). The party seeking review bears the burden of proving that the agency's conclusions violate one or more provisions of Minn. Stat. § 14.69. *Markwardt v. State Water Resources Bd.*, 254 N.W.2d 371, 374 (Minn. 1977).

The court reviews the Commission's factual findings to determine whether they are supported by substantial evidence or whether its conclusions are arbitrary and capricious. *In re Excess Surplus Status of Blue Cross & Blue Shield of Minn.*, 624 N.W.2d 264, 277-279 (Minn. 2001) ("*Blue Cross & Blue Shield*"). Substantial evidence for purposes of appellate review of an administrative agency's decision is: (1) such evidence as a reasonable mind might accept as adequate to support a conclusion; (2) more

than a scintilla of evidence; (3) more than some evidence; (4) more than any evidence; and (5) evidence considered in its entirety. *Cable Communications Bd. v. Nor-West Cable Communications P'ship*, 356 N.W.2d 658, 668 (Minn. 1984) (citations omitted).

A reviewing court may not substitute its own judgment for that of an administrative agency when the finding is properly supported by the evidence. *Vicker v. Starkey*, 265 Minn. 464, 470, 122 N.W.2d 169, 173 (1963). This Court defers to the agency's conclusions regarding conflicts in testimony, the weight given to expert testimony and the inferences to be drawn from testimony. *Blue Cross & Blue Shield*, 624 N.W.2d at 278 (citing *Quinn Distrib. Co. v. Quast Transfer, Inc.*, 288 Minn. 442, 448, 181 N.W.2d 696, 700 (1970) ("*Quinn*")). Courts defer to the agency's fact-finding process and it is the challenger's burden to establish that the findings are not supported by the evidence. *Id.*

A decision may be deemed arbitrary and capricious if the decision reflects the agency's will and not its judgment. *Id.* at 277. To satisfy the arbitrary and capricious test, the agency must explain the connection between the facts found and choices made. *Id.* An agency decision is not arbitrary and capricious if the agency, presented with opposing points of view, reaches a reasoned decision that rejects one point of view. *In re Detailing Criteria and Standards for Measuring an Electric Utility's Good Faith Efforts in Meeting the Renewable Energy Objectives Under Minn. Stat. § 216B.1691*, 700 N.W.2d 533, 539 (Minn. Ct. App. 2005) (citation omitted), *aff'd*, 714 N.W.2d 426 (Minn. 2006). A reviewing court will affirm the agency's decision if it was not arbitrary or capricious "even though [the court] may have reached a different conclusion had it been

the fact-finder.” *White v. Minnesota Dep't of Natural Resources*, 567 N.W.2d 724, 730 (Minn. Ct. App. 1997).

This Court accords deference to an agency’s expertise that is exercised within the scope of its authority. *Blue Cross & Blue Shield*, 624 N.W.2d at 278. Agency decisions are presumed correct and deference should be shown to agency expertise and special knowledge. *Id.*

This Court retains the authority to review de novo errors of law which arise when an agency decision is based on the meaning of words in a statute. *In re Denial of Eller Media Co.’s Application for Outdoor Advertising Permits*, 664 N.W.2d 1, 7 (Minn. 2003). However, “an agency’s interpretation of the statutes it administers is entitled to deference and should be upheld, absent a finding that it is in conflict with the express purpose of the Act and the intention of the legislature.” *Geo. A. Hormel & Co. v. Asper*, 428 N.W.2d 47-48, 50 (Minn. 1988) (citations omitted).

ARGUMENT

I. THE RECORD SUPPORTS THE COMMISSION’S DETERMINATION THAT COMPENSATION IS DUE TO THE COOPERATIVE FOR SERVICE RIGHTS TO THE PONDS.

Substantial evidence in the record supports the Commission’s determination that the City requested service from the Cooperative, the Cooperative was serving the Ponds pursuant to an informal agreement with NSP, and that the City never acquired service rights to the Ponds. Nothing in the City’s agreement with NSP indicates that NSP transferred service rights to the Ponds. In fact, NSP no longer held service rights to the

Ponds at the time of its agreement with the City and NSP could not, therefore, have transferred service rights to the City. The Commission is expressly charged by the Legislature with the authority to determine compensation for loss of service rights and the Commission has acted pursuant to that authority here.

A. Standard Of Law

The question for this court is whether, on the basis of the record, the Commission could reasonably reach the conclusion it did. *See Hagen v. Civil Serv. Bd.*, 282 Minn. 296, 299, 164 N.W.2d 629, 632 (1969). “The agency’s factual findings must be viewed in the light most favorable to the agency’s decision and shall not be reversed if the evidence reasonably sustains them.” *Bd. Order, Kells (BWSR) v. City of Rochester*, 597 N.W.2d 332, 336 (Minn. Ct. App. 1999); *see also Otter Tail Power Co. v. MacKichan*, 270 Minn. 262, 133 N.W.2d 511 (Minn. 1965) (this Court considers testimony in the light most favorable to the party who prevailed below). The weight and credibility of evidence are matters within the exclusive province of the ALJ and the Commission. *Quinn* 288 Minn. at 449, 181 N.W.2d at 699. Unless there is manifest injustice, the Court must refrain from substituting its judgment concerning the inferences to be drawn from evidence for that of the agency, even where it might appear that contrary inferences might be drawn. *Id.*

B. Substantial Evidence In The Record Supports The Determination That The Cooperative Was Serving The Ponds Pursuant To A Service By Exception Agreement With NSP.

1. The Evidence In The Record Regarding The Cooperative's Service To The Ponds Is Uncontested.

The uncontroverted evidence in the record supports the finding that the Cooperative and NSP agreed to the service by exception. *See In re Request of Interstate Power Co. for Authority to Change its Rates for Gas Serv.*, 574 N.W.2d 408, 415 (Minn. 1998) (finding substantial evidence to support the Commission's decision where the evidence in the record was uncontradicted). The ALJ and the Commission agreed that the Cooperative and NSP had an agreement allowing the Cooperative to extend and provide service to the Ponds. RA495-RA496 ¶ 24; RA667. Although the City argues at length that there is no evidence of a written agreement between NSP and the Cooperative transferring the service rights to the Ponds to the Cooperative, Relator fails to acknowledge that no party has asserted that such a writing ever existed. The Cooperative admits that the agreement between the Cooperative and NSP was not reduced to writing.

The City alleges that the evidence on which the agreement between NSP and the Cooperative is based is hearsay evidence, City Br. 24, but offers no alternative explanation for how the Cooperative came to serve the Ponds.¹¹ The City did not offer

¹¹ The City fails to acknowledge that the evidentiary rules for administrative proceedings differ from the evidentiary rules in district court proceedings. Minn. R. 1400.7300, subp. 1 states as follows:

The judge may admit all evidence which possesses probative value, including hearsay, if it is the type of evidence on which reasonable,
(Footnote Continued on Next Page)

any evidence to contradict the evidence in the record that supports the service by extension of the Cooperative. Although the City called as a witness its City Attorney, Mr. Stephen Thies, who was also the City Attorney in 1996 and 1998, Mr. Thies did not have information to contest the Cooperative's claims. RA342-RA343.

As noted above, Mr. Horman did not directly participate in the discussions about extending service between the Cooperative's Dennis Trom and the City's Curt Weber. Mr. Horman testified as to the content of his discussions with his supervisor at the time, Mr. Trom, and with MEI. The City does not dispute the facts presented in the testimony of Mr. Horman and the statements conveyed to him by Mr. Trom or MEI, and the City offered no testimony or other evidence to rebut Mr. Horman's statements. *See Citizens Nat'l Bank of Madelia v. Mankato Implement, Inc.*, 441 N.W.2d 483, 485 (Minn. 1989) (party's failure to provide rebuttal evidence only increases the extent to which the court must rely on the trial court's assessment of the credibility of the witnesses presented).

The City argues that Cooperative did not provide testimony from its representatives or employees that had direct communications with NSP or the City in 1996. City Br. 24. The City is correct that the primary testimony in support of the existence of the service by exception agreement between the Cooperative and NSP was

(Footnote Continued From Previous Page)

prudent persons are accustomed to rely in the conduct of their serious affairs. The judge shall give effect to the rules of privilege recognized by law. Evidence which is incompetent, irrelevant, immaterial, or unduly repetitious shall be excluded.

that of Mr. Horman. The City fails to acknowledge, however, that Mr. Horman's testimony was uncontested.¹²

The City did not object to the admission of Mr. Horman's pre-filed testimony and did not challenge Mr. Horman's testimony in the evidentiary hearings.¹³ The ALJ in this case specifically admitted the testimony and exhibits of Mr. Horman and the other Cooperative witnesses. Further, although the ALJ agreed that Mr. Horman's testimony included hearsay, the ALJ did not challenge the credibility of Mr. Horman as a witness. RA495 ¶ 21 (finding that Mr. Horman did have personal knowledge that Mr. Weber was involved in the installation work to provide electric service to the Ponds).

In this case, the City fails to acknowledge that Mr. Horman was the line foreman and was involved in the actual construction of the facilities used to serve the Ponds. The City ignores that the Cooperative had been serving the Ponds for over a year at the time

¹² The City cites to an excerpt of Mr. Horman's testimony included in the ALJ's Report and argues that, "[o]n this point, the Commission Order failed to provide a 'reasonable explanation' for departing from ALJ findings grounded in the record." City Br. 24, n.5. However, the City does not cite an ALJ finding or indicate how the Commission has departed from it. Further, as discussed throughout this brief, the Commission has clearly explained its reasoning in this case.

¹³ The City appears to contest the admission of Mr. Horman's exhibits. City Br. 7, n.4. As indicated, however, the City did not object to the admission of Mr. Horman's pre-filed testimony, including the attached exhibits. The City cannot allege here there is inadequate foundation for the exhibits. Such statements are improper where the ALJ has admitted these documents into the record and the City has not challenged the admission either before the ALJ or before the Commission. Whether or not the City believes any part of the record in this case has been properly admitted is not before this Court. See *Kenney v. Chicago Great W. Ry. Co.*, 245 Minn. 284, 289, 71 N.W.2d 669, 673 (1955) (a party who fails to raise an objection at trial is precluded from raising the question on appeal).

service rights to the surrounding area were transferred to the City from NSP, that Cooperative continued to serve the Ponds for approximately nine years without objection, and that the City paid all the bills for service, also without objection, until this proceeding was initiated. Thus, not only does the record contain the *uncontested* testimony of Mr. Horman of matters in which he was directly involved, and of those of which he was informed, but these additional *uncontested* facts support the existence of the exception agreement.

The only evidence in the record supports an agreement between NSP and the Cooperative to allow the Cooperative to serve the Ponds. The City offered no evidence to the contrary. The Commission makes its decisions based on the best evidence available. *See Qwest Corp. v. Koppendraye, et al.*, 436 F.3d 859, 868 (8th Cir. 2005) (citation omitted) (noting that pursuant to 47 U.S.C. § 252(b)(4), the Commission was required to make its decision based on the best information available where one party provided no evidence to the contrary); *see also In re Petition of Northern States Power Gas Util. for Auth. to Change its Schedule of Gas Rates for Retail Customers Within the State of Minn.*, 519 N.W.2d 921, 926 (Minn. Ct. App. 1994) (“an agency decision may be upheld where each witness testified that a different calculation was reasonable even though no witness gave testimony supporting the figure chosen by the Commission”). Finding substantial evidence to support the existence of the agreement and no evidence to the contrary, the Commission appropriately found that NSP agreed that the Cooperative would serve the Ponds. *See Blue Cross & Blue Shield*, 624 N.W.2d at 278 (this Court

defers to, “the agency’s conclusions regarding conflicts in testimony, the weight given to expert testimony and the inferences to be drawn from testimony”).

Further, although the ALJ found that the evidence did not demonstrate that the City actively requested service from the Cooperative with any intent to bind the City regarding any future service area issues, RA495 ¶ 21, evidence of the City’s intent regarding service territory is immaterial. At the time the City requested service, the Ponds were within the service territory of NSP. NSP agreed that the Cooperative could serve the Ponds. The Cooperative thereafter held service rights to the Ponds and the City did not acquire those service rights when it purchased the service rights to the surrounding areas from NSP. There is no requirement, in statute or caselaw, that evidence must support the City’s intent to bind itself regarding service territory issues to support an award of compensation for lost revenues to the displaced utility.

2. The Lack Of A Writing Between NSP And The Cooperative Does Not Invalidate The Agreement.

a. Precedent From The Commission And This Court Supports Giving Effect To An Unwritten Exception Agreement Where The Purposes Of The Public Utilities Act Are Met.

The City relies on Minn. Stat. § 216B.40 to support its argument that the failure by the Cooperative and NSP to reduce their agreement to writing invalidates the Cooperative’s service to the Ponds by exception. Minn. Stat. § 216B.40 states, in part, that except as provided in Minn. Stat. §§ 216B.42 and 216B.421, “each electric utility shall have the exclusive right to provide electric service at retail to each and every present

and future customer in its assigned service area and no electric utility shall render or extend electric service at retail within the assigned service area of another electric utility unless the electric utility *consents thereto in writing[.]*” (emphasis added). However, the statute requiring written consent does not impose the penalty of invalidity and the Commission has *never* invalidated an exception agreement on that basis.

The Commission has repeatedly admonished utilities for failing to reduce their agreements to writing, but has recognized on several occasions that these agreements satisfy the purposes of the Public Utilities Act and the Commission has given effect to these agreements on that basis. The standard in reviewing these agreements is whether the extension serves the purposes of the Public Utilities Act and is in the public interest. *In re City of White Bear Lake’s Request for an Elec. Util. Serv. Area Change*, 443 N.W.2d 204, 207-208 (Minn. Ct. App. 1989) (“*White Bear*”) (the Commission may alter the service area boundaries of public utilities providing electric service within a municipality if doing so would provide more efficient, reliable and cost-effective service or would otherwise serve the public interest”). The Commission has not invalidated an unwritten exception agreement where to do so would clearly be contrary to the intent of the Legislature.

Although the City and ALJ emphasized one case in which the Commission stated utilities must put exception agreements in writing, the City and ALJ fail to recognize that the Commission enforced the unwritten agreement in that case. RA496 ¶ 27 (citing *In re Petition by Northern States Power Co. for an Exchange of Serv. Area with Dakota Elec. Ass’n*, MPUC Docket No. E002/SA-89-1040, Order Approving Changes in Assigned

Service Areas (June 15, 1990) ("*NSP/Dakota Exchange*"). Further, in addition to *NSP/Dakota Exchange*, the Commission recognized and gave effect to unwritten service by exception agreements in several other cases.¹⁴ The Commission found that recognizing and enforcing those agreements was important in meeting the purposes of the service territory provisions under the Public Utilities Act.

For example, in its December 26, 1989, Order Denying Change in Service Area Arrangements, the Commission specifically gave effect to a service by exception agreement not reduced to writing. *In re Petition by Mr. L.D. Wright to be Released as a Customer of Meeker Coop. Light & Power Ass'n and Served by Litchfield Pub Util.*, MPUC Docket No. E-121, 267/SA-88-899, MPUC Add. 15. In that case, a restaurant located in the service territory of Litchfield Public Utilities ("LPU") was receiving service from Meeker Cooperative Light and Power Association ("Meeker"). *Id.* Meeker

¹⁴ See also *In re Petition by Northern States Power Co. for an Exchange of Service Area with Anoka Elec. Coop.*, Order Approving Changes in Assigned Service Areas (June 15, 1990), MPUC Docket No. E-101, 002/SA-89-1103, MPUC Add. 21 (recognizing that the service arrangement fulfilled the purposes of the Act but reminding the utilities to reduce service by exception agreements to writing); *In re Petition from N. Star Elec. Coop. to Change a Portion of its Service Territory Boundary with Roseau Elec. Coop. near the City of Warroad*, Order Approving Changes in Assigned Service Areas (Dec. 12, 1990), MPUC Docket No. E-129, 136/SA-90-641, MPUC Add. 18 (approving changes in service boundaries where one utility had begun serving customers in another utility's service territory pursuant to an unwritten agreement and noting that service by exception should be preceded by a written agreement); *In re Petition from Tri-County Elec. Coop. and Interstate Power Co. to Change a Portion of their Mutual Serv. Territory Boundary Near the City of St. Charles*, Order Approving Changes in Assigned Service Areas (March 22, 1991), MPUC Docket No. E-001, 145/SA-90-1156, MPUC Add. 23 (approving service area change where cooperative had been mistakenly serving two customers within adjacent utility's service territory where continuing the existing arrangement was in the public interest).

had served the restaurant since its construction in 1973. The service area maps agreed to between LPU and Meeker in 1974 failed to identify in sufficient detail “islands” of service such as that provided to the restaurant by Meeker, and the area was included in the area identified as LPU’s service territory. *Id.* The restaurant’s owner petitioned the Commission to grant the restaurant the right to receive service from LPU. *Id.* The Commission denied the restaurant’s request. *Id.*

In that case, the Commission found that the maps at issue failed to identify the restaurant as an “island” within LPU’s service territory. *Id.* However, the Commission recognized that the utilities had been living in harmony with that arrangement and that neither utility asked the Commission to amend the service area arrangement. *Id.* The Commission found that the statutory goals of coordination, stability, economy and avoiding the unnecessary duplication of facilities supported the Commission’s denial of the petition. *Id.* The Commission found that despite the fact that there had been no memorialized consent, the utilities agreed there was actual consent and consistently conducted themselves in accordance with that understanding. *Id.* The Commission noted the decision in *White Bear*, where the Minnesota Court of Appeals “reaffirmed the service area goals of stability, coordination of service, economy, and avoidance of duplication, all to be fit within the framework of **broad public interest.**” MPUC Add. 17 (citing 443 N.W.2d 204).

Similarly, in *In re Petition by Northern States Power Company for an Exchange of Service Area with Anoka Electric Cooperative*, the Commission approved changes in the utilities’ proposed assigned service area boundaries to allow the utility with closer

facilities to serve the areas at issue. Order Approving Changes in Assigned Service Areas (June 15, 1990), MPUC Docket No. E-101, 002/SA-89-213, City Add. 5-6. The Commission found that to do so was consistent with the goals of the assigned service area statutes. *Id.* The Commission admonished the utilities for serving outside of their service territories without the written consent of the other utility, but the Commission nonetheless accepted the proposed changes as consistent with the statutes. *Id.*

In the instant matter, the Commission specifically addressed the purposes of the Public Utilities Act outlined under Minn. Stat. § 216B.37. RA663; RA668. As the Commission explained,

[e]xception agreements are essential tools for achieving the three goals of the assigned service area statutes--ensuring coordinated, statewide electric service; avoiding the unnecessary duplication of facilities; and promoting economical, efficient, and adequate statewide service throughout the state--because they grant utilities the flexibility necessary to avoid making expensive and duplicative investments to serve customers whose needs could be met more economically by a non-assigned provider.

RA668. The Commission recognized that while the statute requires that utilities reduce their exception agreements to writing, the statute does not impose the penalty of invalidity for failure to do so. Further, there is no requirement that the exception agreements be approved by the Commission or recorded on the official service area maps kept on file by the Department of Commerce. RA670.

The Legislature has charged the Commission with enforcing the provisions of the Public Utilities Act and determining under what circumstances the public interest is met. Minn. Stat. §§ 216B.37-216B.465. Consistent with its previous decisions, the

Commission gave effect to the unwritten service by exception agreement here. *See People's Natural Gas Co. v. Minnesota Pub. Util. Comm'n*, 342 N.W.2d 348 (Minn. Ct. App. 1983), *review denied* (April 24, 1984) (an agency must either conform to its prior norms and decisions or explain the reason for its departure from such precedent). This Court has recognized that the Public Utilities Act allows for flexibility in the reassignment of electric service areas to accomplish the goals of the Act and the evidence in the record supports that the extension of service to the Ponds by the Cooperative was the more efficient and cost-effective option at the time. RA229; *see White Bear*, 443 N.W.2d at 207-208.

b. The Contract Law Cited By The City Does Not Apply In This Case.

The City cites general principles of contract law to argue that the agreement between NSP and the Cooperative is unenforceable. While the City argues that the record does not support that a contract existed between NSP and the Cooperative, the City never establishes that a contract is required. Nothing in the statute, prior Commission orders, or case law requires that the consent of the utility in whose service territory the extension is made must meet the elements of a contract, and such a requirement is not supported by the purposes of the Public Utilities Act. Minn. Stat. § 216B.37 (2006).

Further, contrary to the City's argument, the Commission did not find that the City was a "legally-bound successor" to a "contract" between NSP and the Cooperative. City Br. 23. Neither did the Commission find that the Cooperative proved all elements of a

contract. City Br. 26. Rather, the Commission found that NSP and the Cooperative had agreed that the Cooperative would serve the Ponds when the Ponds were constructed in 1996, and that the City did not acquire the service rights to the Ponds when NSP transferred service rights to the surrounding areas in 1998. NSP did not have service rights to the Ponds in 1998 and accordingly could not transfer rights to serve the Ponds to the City.

The City's assertion that the lack of identifiable terms equates to the lack of a contract again ignores that a contract is not required. City Br. 21. The lack of identifiable terms goes to what compensation is due, not whether compensation is due, when the evidence supports that NSP consented to the Cooperative serving the Ponds. *See also Citizens Nat'l Bank of Madelia v. Mankato Implement, Inc.*, 441 N.W.2d 483, 485-486 (Minn. 1989) (evidence presented in piecemeal fashion and that was general rather than specific was sufficient when considered as a whole to support trial court's finding that oral consent was given, and oral consent was effective despite agreement requiring consent in writing).

C. The Lack Of A Writing Affects The Amount Of Compensation Due.

The Commission acts in its legislative capacity when determining the appropriate period for compensation. *In re Application by the City of Rochester for an Adjustment of its Serv. Area Boundaries*, 556 N.W.2d 611, 613 (Minn. Ct. App. 1996), *review denied* (Feb. 26, 1997) ("*Rochester*") (citing *St. Paul Area Chamber of Commerce v. Minnesota Pub. Serv. Comm'n*, 313 Minn. 250, 262, 251 N.W.2d 350, 358 (1977)). When the Commission issues a decision that is legislative in nature, balancing public policies and

private needs and making choices among public policy alternatives, this Court will affirm, unless there is clear and convincing evidence that the Commission's decision exceeds its statutory authority, or is unjust, unreasonable, or discriminatory. *Id.*

The Commission determined that the substantial evidence in the record supported an informal agreement between NSP and the Cooperative granting the Cooperative service rights to the Ponds. The Commission recognized that the Cooperative's account of the discussions surrounding the initial extension of service was uncontested, credible, consistent with industry practice and corroborated by nine years of service to the Ponds. RA670. The Commission found that the agreement for service by exception was supported by substantial evidence, but that the terms of that agreement were not. RA671.

While the Commission found that it could not grant compensation for the full ten years without substantial evidence demonstrating that the transfer of service rights was intended to be permanent, the Commission also recognized that to deny compensation would inappropriately deny the Cooperative and its ratepayers of the opportunity to recoup investments and irrevocable financial commitments and otherwise provide a windfall to the City. RA671. After consideration of the purposes of the statutes and the interests of the parties, the Commission reduced the award by 50 percent.

In addressing that informal exception agreements are common, the Commission noted that often the terms of these exception agreements are simple and one utility authorizes another to serve a customer and effectively transfers service rights to that customer permanently. RA668. The Commission recognized, however, that some service by exception agreements are more limited. RA668.

For example, in a 1989 case involving a cooperative and municipal utility, the Commission enforced an exception agreement that authorized one utility to serve the existing load and another to serve any new load. RA668 (citing *In re Petition of Kandiyohi Coop. Elec. Power Ass'n Regarding Elec. Serv. to Farm Serv. Elevator by Willmar Municipal Util. Comm'n*, Order Requiring Compensation (July 11, 1989), MPUC Docket No. E-118, 329/SA-88-379, MPUC Add. 7). In that case, the cooperative filed a petition alleging that the municipal utility had extended service to a cooperative customer in violation of the assigned service area statutes. MPUC Add. 7. The customer was located within the municipal utility's assigned service area, but had received service from the cooperative until the dispute arose. *Id.*

In its orders approving the service area boundaries between the utilities at issue, the Commission provided that the cooperative would continue to serve its customers within the municipal utility's assigned service area until the two utilities had agreed to terms for the municipal utility's purchase of the cooperative's facilities used to serve those customers. *Id.* Both utilities interpreted the existing exception agreement to apply only to existing loads and that new loads resulting from customer expansion would be served by the utility with the assigned service area that included the customer's location. *Id.* The issue in dispute involved whether the old load would transfer to the municipal utility when new load was added. *Id.*

The Commission found that its earlier orders outlining service rights between the parties clearly indicated that the cooperative held service rights to the old load of its existing customers. MPUC Add. 10. The Commission found the assigned service areas

and exceptions were set for the benefit of the public, to prevent the disruption of existing service arrangements, to control load loss during the transition period, and to minimize the duplication of facilities. MPUC Add. 12.

In another case, the exception agreement between the cooperative and municipal utility was reflected in service maps agreed to by the parties and approved by the Commission. *In re Complaint by Kandiyohi Cooperative Electric Power Association Against Willmar Municipal Utilities Commission for Extending Electric Facility into Part of Section 26, Township 119, Range 35, Order Requiring Cessation of Provision of Elec. Serv. and Removal of Facilities* (October 23, 1989), MPUC Docket No. E-118, 329/SA-89-817, MPUC Add. 1. The agreement allowed the municipal utility to serve a residential customer located within the cooperative's service territory. *Id.* The service area maps identified the exception customer as "MUC Serves 1 Residential." *Id.*

The property was subsequently developed into a paint shop and a proposed Wal-Mart store. *Id.* The dispute in that case concerned service to the store. *Id.* Because the store was located on the property previously occupied by the residential customer, the municipal utility argued that the service by exception agreement allowed the municipal utility to serve the store and that the owners of the property were successors in interest to the former residential customers. *Id.* The Commission disagreed.

The Commission found that the approved service area map allowed the municipal utility to serve one residential customer in the area identified in the map. MPUC Add. 3. The Commission found that neither the construction site for the store nor the store itself was either a residential customer or in the blocked area and, accordingly, neither

qualified to receive service from the municipal utility. *Id.* The Commission determined that, “[t]he exception does not entitle the owner of the property to add additional residential customers, to receive commercial service from the City, or to extend commercial service to other portions of the property, whether the owner is the original owner or a successor in interest.” MPUC Add. 4.

In this case, the Commission found that the existence of the service by exception award justifies compensation for the loss of service rights, but that substantial evidence in the record could not support a compensation award for ten years based on loss of permanent service rights. Based on the record in this case, the Commission found that the most reasonable and equitable approach, considering the interests of the parties and the purpose of the statute, was to reduce the award by half. RA671.¹⁵

D. The City Had Actual Notice It Was Receiving Service From The Cooperative.

The City argues that it first became aware of the Cooperative’s service to the Ponds when it initiated this proceeding and that it should not be bound by the terms of an exception agreement to which it was not a party and of which it had no notice. RA1. The Commission specifically rejected this argument, noting that the City had actual notice that the Cooperative was serving the Ponds. RA669. As noted throughout this

¹⁵ The City mistakenly alleges that the Commission sat as a court in equity by basing its decision on equitable considerations. City. Br. 30. The City fails to acknowledge that the Commission has determined compensation for loss of service rights pursuant to its statutory authority under Minn. Stat. § 216B.44. Clearly, the Commission is authorized by statute to consider the evidence in the record to determine a reasonable and equitable award that takes into account the purposes of the statutes and the interests of the parties.

proceeding, the Cooperative has been serving and billing the City for electric service to the Ponds since the Ponds were constructed. The City has taken service from the Cooperative without objection for nine years. As the Commission noted, there is nothing surreptitious about the Cooperative's service to the Ponds.

The Commission recognized that not only was there actual notice, but the City is itself an electric utility under the assigned service territory provisions of the Public Utilities Act. RA670. The Commission appropriately found that the City has its assigned service area and is presumed to know its boundaries and its customers. RA670. The City is not naïve about service territory issues. The City's alleged failure to note the Cooperative's service to the Ponds is no basis for the Commission to refuse to recognize the exception agreement between NSP and the Cooperative.¹⁶

E. The City Did Not Acquire Service Rights To The Ponds From NSP.

The City argues that it should not be bound by the agreement between NSP and the Cooperative. In fact, however, the City is bound by *its own agreement* with NSP. NSP could not and did not convey service rights to the Ponds. NSP would have had to reacquire the service rights from the Cooperative in order to effectuate a transfer to the City. The record does not indicate that NSP ever re-acquired service rights to the Ponds.

¹⁶ The City argues that the Cooperative was a sophisticated party and should have known how to accomplish a permanent transfer of service rights. City Br. 30. The City cannot argue that the Cooperative, as an electric utility, is a sophisticated party regarding service territory matters that should have recognized a problem, but the City, itself an electric utility, is not sufficiently sophisticated to take notice of the issue of the Ponds for a period of nine years.

Further, under the City's analysis, the City could acquire for free what it would otherwise have to pay the displaced utility for.¹⁷ As the Commission noted, such a determination would result in a windfall to the City and would not serve the public purpose outlined by the Legislature. RA671.

Nothing in the settlement agreement between the City and NSP indicates that the agreement includes service rights to the Ponds. The City introduced into the record the documents supporting the transfer of the service rights to the surrounding areas from NSP to the City. R. 50; see *In re Application of the Redwood Falls Pub. Util. Comm'n to Extend its Assigned Serv. Area into the Area Presently Served by Northern States Power Co.*, MPUC Docket No. E-002, 198/SA-96-869, Order Accepting Settlement (Feb. 4, 1998). As indicated in the Order Accepting Settlement, the City and NSP agreed to a total purchase price of \$340,104. R. 50 (Order Accepting Settlement at 2). The price paid included, "electric operating facilities, easements, service rights, lost revenues, and all expenses associated with the transfer of service rights." *Id.* The settlement also revised a distribution agreement between NSP and the Cooperative, and included a new distribution agreement between the City and the Cooperative. *Id.* The Commission approved the settlement and the revision to the service area boundaries as reflected in the maps submitted by the City and NSP. *Id.*

¹⁷ The City's interpretation would allow a utility that has agreed to an exception arrangement to unilaterally extinguish another utility's rights to serve and is contrary to the purposes of the Public Utilities Act.

The Commission noted and the City did not contest that the agreement under which the City purchased NSP's service rights to the area surrounding the Ponds did not claim to transfer service rights to the Ponds or expressly include compensation for service rights to the Ponds. RA 670. The agreement transferred NSP's equipment, facilities and service rights.¹⁸ As the Commission explained, "[s]ervice rights within the area that might belong to other utilities were not transferred, any more than equipment or facilities that might belong to other utilities were transferred. Any confusion or ambiguity about what was transferred raises issues to be resolved between NSP and the City, not the City and the Cooperative." RA670; cf. *Levin v. Twin City Red Barn No. 2, Inc.*, 296 Minn. 260, 264, 207 N.W.2d 739, 742 (1973) ("[i]t has long been recognized in Minnesota that a person who purchases land with knowledge or with actual, constructive, or implied notice that it is burdened with an easement in favor of other property ordinarily takes the estate subject to the easement").

The City's agreement with NSP did not include facilities to serve the Ponds or service rights to the Ponds. In its Order Accepting Settlement, the Commission specifically approved the transaction between the City and NSP under Minn. Stat. § 216B.50, the statute which, in part, prohibits a public utility (here NSP) from selling

¹⁸ The City references its Exhibit 25 (R. 50) to support its argument that the City's agreement with NSP transferred service rights to the Ponds. City Br. 6, n.2. The City indicates that, "NSP was obliged to set forth any liens or encumbrances associated with the complete service territory rights transfer, and no issue related to the Ponds was disclosed." City Br. 6, n.2. However, the issue the City has with its agreement with NSP is an issue to be resolved between the City and NSP, not between the City and the Cooperative.

any plant or operating system for more than \$100,000 without Commission authorization. *Id.* The Commission specified that, “NSP may transfer to the City the electric service area and electric operating properties identified in the purchase agreement on the date of closing under the terms of the purchase agreement” *Id.* at 3. The Cooperative’s properties required to serve the Ponds were clearly not included.

The Commission notes that the Cooperative participated in the Commission’s docket addressing the transfer of service rights from NSP to the City but did not raise the issues related to the Ponds. The record demonstrates that the Cooperative’s participation was limited to addressing ongoing distribution issues between the utilities and that no party addressed service rights to the Ponds. R. 52 at 8.

Based on the evidence in the record, the Commission appropriately determined that the City never acquired service rights to the Ponds when it acquired service rights to the surrounding areas. The Cooperative held the service rights to the Ponds and the City never acquired those service rights from the Cooperative.

F. The Commission Has The Authority To Determine Compensation For Loss of Service Rights To The Ponds.

The Legislature has explicitly granted the Commission broad authority to set assigned service areas for all electric utilities within the state, to resolve disputes regarding assigned service areas, and to set compensation when one utility exercises its right to expand its assigned service area at the expense of another. Minn. Stat. §§ 216B.37-216B.465 (2006); *see also City of Willmar Municipal Util. Comm’n v. Kandiyohi Coop. Elec. Power Ass’n*, 452 N.W.2d 699, 702-703 (Minn. Ct. App. 1990)

(noting that the statutes governing assigned service areas consistently refer to the jurisdiction of the Commission and that the Public Utilities Act gives the Commission authority to adjudicate conflicts within its jurisdiction). The Commission has acted within its statutory authority in this case.

The record supports the Commission's finding that the Cooperative is serving the Ponds pursuant to its agreement with NSP and that the City has never acquired service rights to the Ponds. Further, Minn. Stat. § 216B.44(b) expressly provides that the Commission may determine compensation in transfers of service territory.¹⁹

The statutes provide for the Commission to determine compensation, the Commission has determined compensation based on the statutory factors, and the Commission has clearly stated the evidence in the record supporting the facts found and choices made. The Commission's decision is consistent with the Commission's own prior precedent, as well as decisions from this Court.

¹⁹ Additionally, the City argues that laches and equitable estoppel do not apply against the City in this case. City Br. 31-33. The Commission's decision, however, is based neither on laches nor on equitable estoppel. The Commission's decision is based on the evidence in the record and its statutory authority to determine compensation to a displaced utility for loss of service rights. The City also states that the Commission's decision violates the constitutional requirement of separation of powers, but fails to indicate how such a violation occurs or cite to any support for its proposition. City Br. 29. Accordingly, the Court should disregard the City's allegation.

III. THE COMMISSION APPROPRIATELY CALCULATED THE PURCHASED POWER COST ADJUSTMENT IN ITS DETERMINATION OF LOST REVENUES.

A. Standard Of Law

“When determining compensation for an electric utility’s loss of service rights in an annexed area, the Commission must consider the utility’s expected revenue losses.” *Rochester*, 556 N.W.2d at 614 (citing Minn. Stat. § 216B.44). The purpose of the statute is to put the displaced utility in the same position it would have been but for the City’s acquisition. *See North Park*, 470 N.W.2d at 528 (in addressing the issue of whether compensation was due for service rights to areas where there were no existing customers, finding that that compensation is needed to protect member customers, lenders and investors whose prior investments are rendered less usable and more expensive because of the city’s acquisition).²⁰ When the displaced utility loses customers, the customers remaining on the displaced utility’s system pay more of the fixed costs of providing service. The compensation award avoids the result of the Cooperative’s customers paying more as a result of the City’s acquisition.

The Commission, as the agency with expertise in this matter, has authority to review the evidence in the record to determine the appropriate figure. This Court should not substitute its judgment for that of the Commission. *Reserve Mining Co. v. Herbst*, 256 N.W.2d 808, 825 (Minn. 1977). Agencies may “utilize their experience, technical

²⁰ Although the City alleges the Cooperative has recovered the costs of its facilities, the City fails to acknowledge that the purpose of the Public Utilities Act is to compensate the displaced utility for loss of service rights and such compensation is not limited to recoupment of the costs of facilities. *See* Minn. Stat. § 216B.44 (2006).

competence, and specialized knowledge in the evaluation of the evidence in the hearing record.” Minn. Stat. § 14.60, subd. 4 (2005).

B. The Commission Applied The PCA That Reflected The Actual Impact On The Cooperative To Determine Appropriate Compensation.

The Commission uses the four-step net revenue loss method to determine lost revenues for displaced utilities. RA671. This Court has affirmed the Commission’s use of the net revenue loss method. *See In re Application of the Grand Rapids Pub. Util. Comm’n to Extend its Assigned Serv. Area into the Area Presently Served by Lake Country Power*, 731 N.W.2d 866 (Minn. Ct. App. 2007) (“*Grand Rapids*”).

In this case, both utilities used the net revenue loss method for calculating lost revenue. RA502-RA503 ¶ 55. The difference in the calculations between the parties rested primarily on the different PCA each used in its first step of the method, determining annual gross revenues. In this case, as with most utilities, the Cooperative recovers its costs of service both through base rates and through an automatic adjustment mechanism, here termed the PCA. The PCA is used to recover purchased power costs beyond those recovered through base rates. RA91.

The Cooperative buys both low-priced power from WAPA and higher-priced power from GRE. RA671. Because the Cooperative will continue to purchase all of its WAPA allocations, but will only reduce its GRE purchases as a result of the City’s acquisition, the Commission used the PCA that reflects the amount of revenues associated with GRE purchases. The Commission’s calculation excludes the pass-

through of cheaper WAPA costs to the lost customers because the costs associated with the lost customers do not include the cheaper WAPA costs.

In contrast, the City used a composite PCA, reflecting the revenues recovered from ratepayers to recoup both the GRE and WAPA costs. If these customers were not acquired by the City, these customers would receive both WAPA and GRE power and would pay for both WAPA and GRE power in the PCA. However, when these ratepayers are removed, both parties agree that the costs associated with these ratepayers are only the GRE costs. RA94. The WAPA costs are not avoided, and accordingly, the revenues associated with recouping the WAPA costs would not be recovered from the ratepayers lost. The PCA in gross revenues the Commission uses reflects a direct match with the actual power costs the Cooperative will avoid, reflecting a more accurate impact on the Cooperative of losing service rights to the areas.²¹ RA93.

A simple example may demonstrate the difference between the PCA adopted by the Commission and the PCA proposed by the City. For purposes of this example only, the Cooperative has 100 customers on its system who use 1 kWh each. The Cooperative serves the 100 customers using its full allocation from WAPA of 70 kWh at \$0.01/kWh and with additional purchases from GRE of 30 kWh at \$0.02/kWh. The Cooperative

²¹ Accordingly, these revenues are not “speculative.” City Br. 35.

averages the costs of the WAPA and GRE power and passes those on to its customers. Each customer pays a composite PCA of \$0.013/kWh.²²

When the Cooperative loses 20 customers, however, the Cooperative reduces its GRE purchases to reflect that it no longer must serve those customers. Under the example above, the Cooperative will now have 80 customers and will purchase 70 kWh from WAPA and 10 kWh from GRE. The combined costs of the WAPA and GRE purchases will be passed along to the remaining 80 customers. Accordingly, when calculating the revenues lost with respect to the 20 customers the Cooperative no longer serves, the Cooperative does not apply the PCA reflecting the composite rate applied to all customers, but rather a PCA reflecting only the revenues associated with recovering GRE purchases since it is only the GRE purchases that are associated with serving those customers. Accordingly, the PCA used to determine gross revenues for the lost customers in this example would be the \$0.02/kWh associated with the GRE purchases.

As the Commission explained,

Rates are set to recover costs, but neither individual rates nor individual rate components are set to recover each customer's precise cost of service. Rather, they are set to recover the utility's total, system-wide cost of service on a fair and equitable basis. With very limited exceptions, the costs of serving individual customers within the same customer class are averaged to determine an appropriate per-customer rate.²³ Therefore, when an increase in customer numbers forces a utility to buy additional wholesale supplies at higher prices, the higher costs are generally passed

²²
$$\frac{[(70 \text{ kWh} * \$0.01/\text{kWh}) + (30 \text{ kWh} * \$0.02/\text{kWh})]}{100 \text{ kWh}} = \$0.013/\text{kWh}$$

²³ As the Commission noted, an exception is the customer-specific surcharge that may be applied to recover the costs of extraordinarily long service extensions.

through to all customers in the form of a higher automatic purchased power rate adjustment.

This is appropriate from a ratemaking perspective. Nevertheless, if the new customers disappeared, the utility's costs would drop by the total cost of the additional, higher-priced power it had been buying to serve them, not by the smaller, per-customer purchased power rate adjustment, which reflects the combined cost of both the old and the new wholesale supplies. That is why both parties used GRE's wholesale rates to determine the amount of purchased power costs the Cooperative would avoid as a result of this service area transfer.

Failing to reflect these actual costs in calculating the Power Cost Adjustment component of gross revenues nullifies the effect of reflecting them in the avoided cost calculation. Since the purpose of the compensation award is to put the displaced utility in the same position it would have occupied but for the municipal utility's acquisition, both the Power Cost Adjustment component of gross revenues and the avoided cost calculation should reflect the costs the Cooperative will actually shed and those that will actually remain, not the averaged costs currently allocated among customers through its rate structure.

RA672.

C. The Commission's Decision Is Entitled To Deference.

When reviewing agency decisions, this Court adheres to, "the fundamental concept that decisions of administrative agencies enjoy a presumption of correctness and that deference should therefore be shown by courts to the agency's expertise and its special knowledge in the field." *Grand Rapids*, 731 N.W.2d at 870. The agency decision maker is presumed to have the expertise necessary to decide technical matters within the scope of the agency's authority. *Id.*

The calculation of lost revenues to the displaced utility is a complicated endeavor. The Commission has clearly utilized its extensive experience in determining

compensation in service territory acquisition cases and thoroughly explained its rationale here. When determining lost revenue to the displaced utility, the Commission attempts to put the displaced utility in the same position it would have been but for the acquisition. This determination is based on policy considerations and value judgments. On these matters, this Court defers to the expertise of the agency. *Id.* (citing *Reserve Mining*, 256 N.W.2d at 824). The Commission's decision is based on substantial evidence in the record, the relationship between the facts found and choices made is fully explained, the Commission applied its experience in determining service territory compensation, and the Commission's decision should be affirmed.

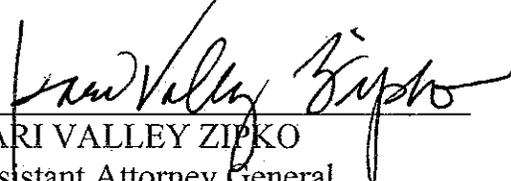
CONCLUSION

Based on the foregoing, the Commission respectfully requests the Court affirm the Commission's order.

Dated: January 14, 2007

Respectfully submitted,

LORI SWANSON
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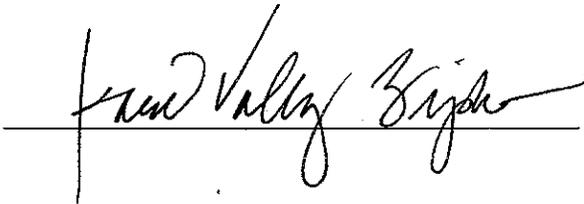
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CERTIFICATE OF COMPLIANCE

WITH MINN. R. APP. P 132.01, Subd. 3

The undersigned certifies that the Brief submitted herein contains 13,918 words and complies with the type/volume limitations of the Minnesota Rules of Appellate Procedure 132. This Brief was prepared using a proportional spaced font size of 13 pt. The word count is stated in reliance on Microsoft Word 2003, the word processing system used to prepare this Brief.

A handwritten signature in cursive script, reading "Fred Valley", is written over a horizontal line.

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