

NO. A11-352

State of Minnesota  
In Court of Appeals

ALLETE, Inc., d/b/a Minnesota Power,

*Relator,*

v.

Minnesota Public Utilities Commission

*Respondent.*


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**BRIEF AND APPENDIX OF RELATOR**

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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).

## TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES .....	iii
STATEMENT OF ISSUES .....	1
STATEMENT OF CASE .....	4
STATEMENT OF FACTS .....	8
A.    Minnesota's Statutory Regime for Interim Rates .....	8
B.    Commission Staff's Analysis of Minnesota Power's Proposed Interim Rate Increase.....	11
C.    Commission Staff's Analysis of Other Interim Rate Proposals.....	12
1.    Interim Rate Proposals of LPI, Boise, and OAG .....	13
2.    Commission Staff's Analysis of LPI, Boise, and the OAG's Interim Rate Proposals .....	14
D.    Commission Decision to Limit Minnesota Power's Interim Rate Increase.....	16
E.    Impact of Commission's Decision to Limit Minnesota Power's Interim Rate Request .....	18
ARGUMENT .....	20
I.    INTRODUCTION .....	20
II.   STANDARD OF REVIEW .....	21
III.  THE COMMISSION'S USE OF EXIGENT CIRCUMSTANCES TO REDUCE INTERIM RATES WITHOUT REGARD TO THE ELEMENTS OF THE INTERIM RATEMAKING FORMULA EXCEEDED ITS STATUTORY AUTHORITY .....	22
A.    For Final Rates, Utilities are Entitled to a Reasonable Rate of Return on Investments Made to Serve Customers .....	22
B.    For Interim Rates, Minnesota Statutes Prescribe the Limited Factors that can be Considered.....	24
C.    The Exception for "Exigent Circumstances" is Narrow and Does Not Override the Other Limitations of the Interim Rate Statute .....	25
1.    The plain meaning of the statutory phrase "except that it shall include" mandates a formula for interim rates even when exigent circumstances exist.....	26

**TABLE OF CONTENTS**  
(continued)

	<b>Page</b>
2. Even if ambiguous, the context of the "exigent circumstances" language limits its application only to the elements of the interim rate formula .....	27
D. The Commission's Interim Rate Order Relied on Circumstances That Do Not Qualify as "Exigent" Under the Statute .....	30
1. The Size of the Company's Rate Request Reflects its Costs of Service and By Law Cannot Constitute Exigent Circumstances .....	30
2. The Timing of the Company's Rate Filing Was Expressly Permitted by Statute and Therefore, as a Matter of Law, Could Not Constitute "Exigent Circumstances." .....	32
3. The Economy and its Impact on Ratepayers are Not Relevant to a Determination of the Cost of Service and Therefore By Law Could Not Constitute Exigent Circumstances .....	33
IV. THE COMMISSION'S PROCESS FOR REDUCING MINNESOTA POWER'S INTERIM RATE RECOVERY EXCEEDED ITS STATUTORY AND CONSTITUTIONAL AUTHORITY .....	35
A. The Commission Arbitrarily Prejudiced the Company's Rate Request by Reducing the Interim Rate Recovery to 60% of Final Rates .....	35
B. The Commission Violated the Statutory Requirement That Interim Rate Schedules "Shall" be Set Ex Parte Without a Public Hearing .....	38
V. THE APPROPRIATE REMEDY IS A REMAND ORDER REQUIRING THE COMMISSION TO ESTABLISH A METHOD FOR RECOUPMENT OF LOST REVENUES AS A RESULT OF THE COMMISSION'S ERROR.....	39
CONCLUSION.....	44

## TABLE OF AUTHORITIES

### CASES

<i>Bluefield Waterworks &amp; Improvement Co. v. Pub. Serv. Comm'n of W. Va.</i> , 262 U.S. 679 (1923) (" <i>Bluefield</i> ").....	22, 34
<i>Great Northern Ry. Co. v. Public Serv. Comm'n of Minn.</i> , 284 Minn. 217, 169 N.W.2d 732 (1969).....	21
<i>Hibbing Taconite Co. v. Minn. Pub. Serv. Comm'n</i> , 302 N.W.2d 5 (Minn. 1980).....	23
<i>In the Matter of the Application of Minnegasco, a Div. of Arkla, Inc., for Auth. to Increase Its Rates for Natural Gas Serv. in the State of Minn.</i> , 565 N.W.2d 706 (Minn. 1997) (" <i>Minnegasco</i> ") .....	Passim
<i>In the Matter of Qwest's Wholesale Serv. Quality Standards</i> , 702 N.W.2d 246 (Minn. 2005).....	3, 42
<i>In the Matter of Request of Interstate Power Co. for Auth. to Change its Rates for Gas Serv. in Minn.</i> , 559 N.W.2d 130, 133 (Minn. Ct. App. 1997), <i>aff'd</i> , 574 N.W.2d 408 (Minn. 1998).....	23
<i>In re the Application of Peoples Natural Gas Co. for Auth. to Increase Rates for Gas Util. Serv. in Minn.</i> , 389 N.W.2d 903 (Minn. 1986).....	Passim
<i>In re Petition of Inter-City Gas Corp. for Auth. to Change its Schedule of Rates for Gas Serv. in Minn.</i> , 389 N.W.2d 897, 902 (Minn. 1986).....	1-2, 25, 31
<i>In re Petition of Minn. Power &amp; Light Co.</i> , 435 N.W.2d 550 (Minn. Ct. App. 1989) .....	11, 24-25
<i>Minn. Power &amp; Light Co. v. MPUC</i> , 342 N.W.2d 324 (Minn. 1983).....	23
<i>Nw. Bell Tel. Co. v. State</i> , 299 Minn. 1, 216 N.W.2d 841 (1974).....	3, 42
<i>Otter Tail Power Co. v. MPUC</i> , 417 N.W.2d 677, 679 (Minn. Ct. App. 1988) .....	28
<i>Peoples Natural Gas Co. v. Minn. Pub. Util. Comm'n ("MPUC")</i> , 369 N.W.2d 530 (Minn. 1985).....	21

<i>Qwest Corp. v. MPUC</i> , 427 F.3d 1061 (8th Cir. 2005) .....	42
<i>Schmidgall v. FilmTec Corp.</i> , 644 N.W.2d 801 (Minn. 2002) .....	21
<i>St. Paul Area Chamber of Commerce v. Minn. Pub. Serv. Comm'n</i> , 312 Minn. 250, 251 N.W.2d 350 (1977) .....	1, 34-35
<i>State v. Tri-State Tel. &amp; Tele. Co.</i> , 204 Minn. 516, 284 N.W. 294 (1939) .....	37
<i>Waller v. Powers Dep't Store</i> , 343 N.W.2d 655 (Minn. 1984) .....	21

**STATUTES**

Minn. Stat. Ch. 14 (2008) .....	36
Minn. Stat. § 14.69 .....	21
Minn. Stat § 216.27 (2008) .....	2, 21, 40-41
Minn. Stat. § 216B.03 (2008) .....	23
Minn. Stat. § 216B.16 .....	4, 23
Minn. Stat. §216B.16, subd. 1 .....	9
Minn. Stat. § 216B.16, subd. 2 .....	23
Minn. Stat. § 216B.16, subd. 2(a) and (b) (2008) .....	9
Minn. Stat. § 216B.16, subd. 2(g) .....	2, 40
Minn. Stat. § 216B.16, subd. 3 (2008) .....	Passim
Minn. Stat § 216B.16, subd. 3(a) (2008) .....	Passim
Minn. Stat. § 216B.16, subd. 3(b) .....	1, 15, 24, 33
Minn. Stat. §216B.16, subd. 3(c) .....	18, 25
Minn. Stat. § 216B.16, subd. 3(e) .....	32
Minn. Stat. § 216B.16, subd. 3(e) and (e)(2) .....	32

Minn. Stat. § 216B.16, subd. 4 .....	38
Minn. Stat. § 216B.16, subd. 6 .....	23, 33
Minn. Stat. § 216B.16, subds. 2, 5, 6 (2008).....	2, 36
Minn. Stat § 216B.16, subds. 3(b) and 6 .....	35
Minn. Stat. § 216B.16, subds. 5 and 6.....	37
Minn. Stat. § 216B.27 .....	2
Minn. Stat. § 216B.27, subd. 1 (2008).....	1
Minnesota Statutes § 216B.16, subdivision 3(b).....	25, 30
Subdivision 3(a) of Minn. Stat. § 216B.16.....	38

**OTHER AUTHORITIES**

<i>In the Matter of the Application of CenterPoint Energy Minn. Gas, A Div. of CenterPoint Energy Resources Corp., for Auth. to Increase Natural Gas Rates in Minn.,</i> Order Setting Interim Rates at 2, Docket No. G-008/GR-05-1380 (Dec. 21, 2005).....	38
<i>In the Matter of the Application of Midwest Gas, a Div. of Iowa Pub. Serv. Co., for Auth. to Increase its Rates for Gas Serv. in the State of Minn.,</i> Order Approving Increased Participation and Modifying Tariff at 3, Docket No. G-010/GR-90-678 (Nov. 9, 1990).....	29
<i>In the Matter of the Petition of N. States Power Co. for Auth. to Increase Rates for Elec. Serv. In Minn.,</i> Order Setting Interim Rates at 3, Docket No. E-002/GR-92-1185 (Dec. 31, 1992).....	29
<i>In re the Application of Minnegasco, a Div. of NorAm Energy Co., for Auth. to Increase Natural Gas Rates in Minn.,</i> Order Setting Interim Rates at 4, Docket No. G-008/GR-95-700 (Oct. 10, 1995).....	28, 40, 42-43
<i>In re the Application of Peoples Natural Gas Co., a Div. of UtiliCorp United, Inc., for Auth. to Increase Its Rates for Natural Gas Serv. in the State of Minn.,</i> Order Setting Interim Rates at 3, Docket No. G-011/GR-92-132 (May 29, 1992).....	29

Minn. R. 7825.3100 .....	23
Minn. R. 7825.3100-7825.4400 .....	4
Minn. R. 7825.3200 .....	9
Minn. R. 7825.3900 .....	9
Minn. R. 7829.1000 (2009) .....	23
United States Constitution .....	22

## STATEMENT OF ISSUES

1. **Did the Commission exceed its statutory authority when it used "exigent circumstances" to reduce Minnesota Power's proposed interim rate increase without regard to the requirements of the interim ratemaking formula in Minn. Stat. § 216B.16, subd. 3(b)?**

A finding of exigent circumstances was first proposed in letters to the Commission submitted by certain utility customers and the Office of Attorney General-Residential Utilities Division. In its December 30, 2009 Order Setting Interim Rates, the Commission said that "exigent circumstances" existed due to: (i) the size of Minnesota Power's request for a rate increase; (ii) the timing of Minnesota Power's rate case filing; and (iii) the state of the economy and its impact on ratepayers. Add. 1.<sup>1</sup>

Minnesota Power was prevented by statute from seeking reconsideration until after the Commission's final determination was issued. Minnesota Power asked the Commission to reconsider the matter of its own accord (App. 53), and then formally sought reconsideration following the Commission's November 2, 2010 final determination. See Minn. Stat. § 216B.27, subd. 1 (2008); Minn. Stat. § 216B.16, subd. 3(a) (2008). On January 20, 2011, the Commission denied reconsideration without discussion. Add. 6. A petition for a writ of certiorari followed on February 22, 2011. App. 146.

### **Apposite Statutes and Cases:**

Minn. Stat. § 216B.16, subd. 3 (2008).

*In re Petition of Inter-City Gas Corp. for Auth. to Change its Schedule of Rates for Gas Serv. in Minn.*, 389 N.W.2d 897, 902 (Minn. 1986).

*In re the Application of Peoples Natural Gas Co. for Auth. to Increase Rates for Gas Util. Serv. in Minn.*, 389 N.W.2d 903, 908 (Minn. 1986).

*St. Paul Area Chamber of Commerce v. Minn. Pub. Serv. Comm'n*, 312 Minn. 250, 255, 251 N.W.2d 350, 354 (1977).

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<sup>1</sup> Hereafter, "Add.\_" refers to the Addendum to this brief. "App.\_\_\_\_" refers to the Appendix.

2. **Was the Commission's (i) prejudgment of the merits of Minnesota Power's final rate request and (ii) reduction of Minnesota Power's proposed interim rates to 60% of its proposed final rates, in violation of the statutory requirements for interim rates and due process, unsupported by substantial evidence, or arbitrary and capricious?**

Third party intervenors in the Company's rate case submitted requests that the Commission limit the Company's interim rate increase from 0% to 5%. App. 7, 9 and 11. Commission Staff speculated that the Commission could decrease the Company's interim rate request based on the average ratio of approved final rates to requested final rates in the Company's three most recent rate cases. App. 44. The Commission did so by order dated December 30, 2009, with the same subsequent procedural history as for Issue 1 above.

**Apposite Statutes and Cases:**

Minn. Stat. § 216B.16, subs. 2, 5, 6 (2008).

Minn. Stat. § 216B.16, subd. 3(a) (2008).

*In re Petition of Inter-City Gas Corp. for Auth. to Change its Schedule of Rates for Gas Serv. in Minn.*, 389 N.W.2d 897, 902 (Minn. 1986).

*In re the Application of Peoples Natural Gas Co. for Auth. to Increase Rates for Gas Util. Serv. in Minn.*, 389 N.W.2d 903, 908 (Minn. 1986).

3. **Must the Commission provide a remedy to recoup revenues lost as a result of the unlawful reduction in interim rates?**

Minnesota Power asked the Commission to "spell out how the Company can recover the lost interim rate revenue" in the event the Order either set final rates higher than interim rates or was deemed to be issued in error. App. 54. The Commission did not respond. Pursuant to Minn. Stat. § 216B.27 and Minn. Stat. § 216B.16, subd. 2(g), Minnesota Power reiterated this request in its Request for Reconsideration of the Commission's November 2, 2010 "final determination" of rates. App. 141. Rehearing was denied without discussion. Add. 6.

**Apposite Statutes and Cases:**

Minn. Stat § 216.27 (2008).

Minn. Stat. § 216B.27 (2008).

*In the Matter of the Application of Minnegasco, a Div. of Arkla, Inc., for Auth. to Increase its Rates for Natural Gas Serv. in the State of Minn.*, 565 N.W.2d 706 (Minn. 1997).

*In the Matter of Qwest's Wholesale Serv. Quality Standards*, 702 N.W.2d 246, 259-60 (Minn. 2005).

*Nw. Bell Tel. Co. v. State*, 299 Minn. 1, 28-30, 216 N.W.2d 841, 858-59 (1974).

## STATEMENT OF CASE

This case involves an unprecedented decision by the Minnesota Public Utilities Commission ("Commission") that "exigent circumstances" justified the reduction of Minnesota Power's (or "the Company's") "interim" rates without reference to Minnesota's statutory interim rate formula. Because Minnesota's investor-owned utilities must file a request with the Commission any time they need to increase rates, and because final resolution of that request often consumes ten months or more, utilities uniformly request interim rate increases pursuant to the formula and procedure set forth in Minn. Stat. § 216B.16, subd. 3 (2008) (the "interim rate statute"). The Commission's departure from precedent and the statutory formula in Minnesota Power's rate case created significant uncertainty among Minnesota utilities. This appeal seeks to clarify the authority of the Commission and the operation of the interim rate statute.

On November 2, 2009, Minnesota Power filed a general rate case with the Commission seeking a rate increase of \$81 million. Add. 1. In compliance with the interim rate statute, the Company included a proposed schedule for \$73.3 million in interim rates, to be collected during the year-long process required for the Commission to evaluate the Company's rate request and determine final rates. App. 3.

The Commission sought comments on whether Minnesota Power's rate case filing was complete in accordance with Minn. Stat. § 216B.16, Minn. R. 7825.3100-7825.4400, and prior Commission Orders. App. 23. The Commission also sought comments on whether the case should be referred to the Office of Administrative Hearings ("OAH") for a contested case proceeding. *Id.*

The Office of Energy Security of the Minnesota Department of Commerce ("OES"),<sup>2</sup> which is statutorily charged with reviewing the completeness of a rate case filing, advised the Commission that Minnesota Power's rate case was complete. *Id.* OES also advised that the case raised issues of material fact, and therefore should be sent to OAH for a contested case proceeding. *Id.* OES did not comment on Minnesota Power's proposed interim rates.

Certain subsequent intervenors in the rate case – the Large Power Intervenors ("LPI"), Boise, Inc., and the Office of Attorney General-Residential Utilities Division ("OAG") – filed separate comments requesting that the Commission deny or reduce the interim rates Minnesota Power proposed, based on factors extraneous to the statutory formula for interim rates. App. 7, 9 and 13. These comments were submitted in violation of the statutory requirement that the Commission "shall" set interim rates *ex parte* with no public input or hearing. Minn. Stat. § 216B.16, subd. 3(a). Minnesota Power filed reply comments noting that the Commission was barred from entertaining third-party interim rate proposals and that the proposals violated the interim rate statute's requirements. App. 17.

Commission staff prepared briefing papers<sup>3</sup> on completeness of the filing, referral to the OAH, and interim rates. App. 21. Staff agreed that Minnesota Power's interim rate

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<sup>2</sup> By Executive Order dated April 8, 2011, OES has been renamed the Division of Energy Resources. For the sake of continuity, this brief continues to refer to the OES.

<sup>3</sup> "Briefing papers" are akin to a public bench memo from Commission staff to the Commission, typically addressing each issue raised by the parties and providing staff's perspective on those issues. Staff also provides decision options and may provide staff's

request was complete and generally complied with statutes, rules, Commission policy statements, and prior Commission Orders on interim rates. App. 31. Staff accepted Minnesota Power's explanation of the differences between the proposed interim rates and final rates, concluding that any disagreements it might have with the Company would overall increase interim rates and the Company had agreed to forgo that increase. App. 34-35. Despite the statutory "ex parte" requirement, staff addressed the interim rate proposals advanced by the three parties, asking "Should Exigent Circumstances be Found on a Broad or Global Basis, Limiting the Requirement for an Interim Increase?" App. 36.

The Commission ordered a public hearing (transcript of interim rate hearing ("T." at 12-13), at which it voted to reduce Minnesota Power's interim rate increase on the grounds that "exigent circumstances" warranted modification to the statutory interim rate formula. Add. 3-4. Finding that approved final rate increases in Minnesota Power's last three cases (1987, 1994, and 2008) were each lower than requested final rates, the Commission reduced interim rates to 60% of the proposed final rates. *Id.*

The Commission issued its Order Setting Interim Rates ("Interim Rate Order") on December 30, 2009. Add. 1. The Commission reduced the increase by \$24.8 million, to \$48.5 million. Add. 4 and App. 55. Final rates were ultimately set at \$53.5 million; therefore, the reduction in interim rates resulted in an under collection of interim rate revenue of \$5 million on an annual basis. App. 127.

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recommended resolution of each issue. Briefing papers are publicly filed on the Commission's e-dockets system and made available to the parties prior to Commission deliberations.

Because the interim rate statute prevented Minnesota Power from seeking reconsideration until after the Commission's decision on final rates (Minn. Stat. § 216B.16, subd. 3(a)), Minnesota Power could only file a letter with the Commission noting the errors of law underlying the interim rate decision. App. 53.

The Commission determined Minnesota Power's final rates on November 2, 2010. App. 59. On November 22, 2010, the Company petitioned for reconsideration of the Commission's interim rate order (among other things). App. 131. The Commission denied the petition on January 20, 2011, and this writ of certiorari followed. Add. 6 and App. 146.

## STATEMENT OF FACTS

On November 2, 2009, Minnesota Power filed a general rate case with the Commission, seeking an increase in final rates of \$80,885,213. Add. 1. This increase was due largely to increases in capital investments necessary to meet statutory environmental mandates and to improve system reliability. App. 53-54 and 150. A portion of the increase was also due to the loss of revenue from large industrial customers as a result of the economic downturn. App. 149. The rate increase request was based on a test year of January 1, 2010 through December 31, 2010. App. 3.<sup>4</sup>

Minnesota Power's filing set in motion a year-long process to determine final rates. During that year long process, the statute requires the Commission to allow the recovery of the Company's proposed interim rates, subject to refund if final rates are less than interim rates. Minn. Stat. § 216B.16, subd. 3. The timing of the Company's filing was designed so that the interim rates would reflect the increase in costs for the same period during which interim rates would be charged. App. 2.

Minnesota Power proposed an increase in interim rates of \$73.3 million. App. 3.

### **A. Minnesota's Statutory Regime for Interim Rates**

Under Minnesota's utility rate setting regime, a utility may increase its rates only by filing a notice that includes all the financial information necessary to support the

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<sup>4</sup> "Test year" refers to the one-year time period that the utility chooses as a basis for estimating its revenues from electric service sales and its expenses to provide that service, along with a rate of return on investments made to serve the public. Taken together, these elements identify the rate increase needed for test year revenues to cover both test year expenses and a reasonable rate of return

requested increase. Minn. Stat. §216B.16, subd. 1. This is commonly referred to as a general rate case filing.

A general rate case filing is very comprehensive, including dozens of required financial schedules, as well as the utility's direct testimony in written question and answer format. Minn. Stat. § 216B.16, subd. 1; Minn. R. 7825.3200 and 7825.3700 to 7825.4400 (2009). The filing must support the need for a rate increase based on the standard ratemaking formula that rates must allow the utility to recover sufficient revenues from the sales of electricity to cover operating expenses plus a reasonable rate of return on its investments in rate base. Minn. Stat. § 216B.16, subd. 1; Minn. R. 7825.3900.

Upon determining that the filing is complete, the Commission has 60 days to accept the rate increase as proposed or to suspend the increased rates and refer the matter to the OAH for a contested case proceeding. Minn. Stat. § 216B.16, subd. 2(a) and (b) (2008). The contested case process, including the Commission's determination of the final rate increase, is limited to ten months (*id.*, subd. 2(a)), but may be extended another three months (*id.*, subd. 2(f)).

During the 10- to 13-month period of suspension, the utility has a right to collect interim rates that it proposes subject to extremely limited review and modification by the Commission. Minnesota's interim rate statute provides in relevant part:

- (a) Notwithstanding any order of suspension of a proposed increase in rates, the commission shall order an interim rate schedule into effect not later than 60 days after the initial filing date. The commission shall order the interim rate schedule *ex parte* without a public hearing. \* \* \*

[N]o interim rate schedule ordered by the commission pursuant to this subdivision shall be subject to an application for a rehearing or an appeal to a court until the commission has rendered its final determination.

- (b) Unless the commission finds that exigent circumstances exist, the interim rate schedule shall be calculated using the proposed test year cost of capital, rate base, and expenses, except that it shall include: (1) a rate of return on common equity for the utility equal to that authorized by the commission in the utility's most recent rate proceeding; (2) rate base or expense items the same in nature and kind as those allowed by a currently effective order of the commission in the utility's most recent rate proceeding; and (3) no change in the existing rate design.

\* \* \*

Minn. Stat. § 216B.16, subd. 3.

The legislative policy choices reflected in the interim rate statute achieve a balancing of interests and an efficiency of process. The interests of the utility are served by allowing interim rates to be summarily approved. The interests of rate payers are served by requiring the utility to propose an interim rate increase in compliance with the statutory formula, i.e., based on the Company's proposed test year cost of capital, rate base, revenues, and expenses, with refunds plus interest on any excess in interim rates over the final rates. The Commission is to determine interim rates *ex parte*, and no party may seek judicial review of an interim rate decision until the Commission determines final rates.

The Minnesota Supreme Court has recognized this balancing of interests rationale and the statute's limitation of Commission authority to modify the utility's proposed interim rates:

The thrust of the statute is a balancing of interests. The statute provides for interim rates geared to permit the utility to maintain its current rate of return but not to improve it pending consideration of its request to increase its rates. . . . [T]he consumers maintain their relative position while paying higher interim rates; each class of consumers continues to pay its proportionate share of revenues collectible by the utility under the interim rates. Refunds of excess revenues generated by interim revenues are returned to the consumers in the same proportions. Thus, the statutory plan is constructed to meet the public need for adequate, safe, and reasonable service during the pendency of the ratemaking proceeding while at the same time holding the utility and the several consumer classes in the same relative positions.

*In re the Application of Peoples Natural Gas Co. for Auth. to Increase Rates for Gas Util. Serv. in Minn. ("Peoples Natural Gas")*, 389 N.W.2d 903, 908 (Minn. 1986). The Minnesota Court of Appeals has further cautioned, "the purpose of the interim [rate] period is to prevent the 'potentially confiscatory effect of regulatory delay'" associated with conducting a 10-13 month process before the utility may realize its currently authorized rate of return on new rate base items and recover the increased expenses. *In re Petition of Minn. Power & Light Co.*, 435 N.W.2d 550, 556 (Minn. Ct. App. 1989). Accordingly, the requirement that the Commission act summarily and apply the ratemaking formula in a near ministerial manner is a crucial aspect of this balancing of interests.

**B. Commission Staff's Analysis of Minnesota Power's Proposed Interim Rate Increase**

Consistent with the interim rate statute, Commission staff communicated *ex parte* with the Company's rate case personnel to address questions about the proposed interim rate of return, rate base, revenues, expenses, or rate design. App. 32-35. Staff identified

six items that deviated from the statutory formula: overall rate of return ("ROR"), depreciation expense, asset-based wholesale margins, rate case expenses, MISO 16 and 17 costs, and the Conservation Program Adjustment ("CPA"). *Id.*

Staff noted that while the ROR, depreciation expense, and wholesale margins were lower than what would be allowed under the interim rate statute, these were conscious choices made by Minnesota Power because the Company believed that its accounting was ultimately more accurate. App. 32-34. Staff therefore recommended to the Commission that "exigent circumstances" supported the Company's decision to waive recovery of these items. *Id.* The Company, of course, had no objection to this targeted use of exigent circumstances.

As to the other items, staff concluded that rate case expenses were overstated by approximately \$13,500, MISO expense was overstated by \$40,200, but CPA revenues were understated by nearly \$450,000. App. 34-35. Minnesota Power reported that it would forego the additional interim rate recovery associated with reducing CPA revenues by \$450,000, and staff recommended the Commission not adjust the other items. App. 35. The Commission accepted these recommendations. Add. 2.

### **C. Commission Staff's Analysis of Other Interim Rate Proposals**

Despite the statutory directive that interim rates be determined *ex parte*, separate interim rate proposals were filed by a group of Minnesota Power's Large Power customers (including paper mills and taconite plants), referred to as the Large Power Intervenors ("LPI"); one other Large Power customer, Boise Inc. ("Boise"); and the Office of the Attorney General-Residential Utilities Division ("OAG"). App. 7, 9 and 11.

Each asked the Commission to reduce Minnesota Power's interim rate request or deny it altogether. App. 7, 9 and 13.

1. Interim Rate Proposals of LPI, Boise, and OAG

LPI argued that the Commission should find exigent circumstances existed because Minnesota Power had increased its rates by \$20 million effective November 1, 2009, the day before it filed its current rate case on November 2, 2009, and no customer should be forced to bear a 17% increase of its rates on the heels of a \$20 million rate increase during an economic downturn. App. 7. LPI recommended an interim rate increase of no more than 5%. *Id.*

Boise argued that because its business was suffering as a result of the economic downturn, the Commission should find "exigent circumstances" and exempt Boise and other Large Power customers from paying any interim rate increase. App. 13. Boise proposed a rate increase of up to 5% for all other customers classes. *Id.*

The OAG also argued that no interim rate increase should be allowed because of "exigent circumstances." App. 9. According to the OAG, exigent circumstances existed because Minnesota Power's final rates from its last rate case had just gone into effect, there was "near-record unemployment" in the Company's service territory, and Minnesota Power customers were entering the heating season. *Id.*

None of these intervenor groups provided evidence in support of their proposals, nor justified their request to depart from the interim rate statute requirements that Minnesota Power must be able to earn its authorized rate of return on new rate base items and recover expenses of the same kind and nature as those allowed in its most recent rate

proceeding, with no change in rate design. Further, none recognized the irony that the same economic downturn had produced a dramatic decrease in Minnesota Power's revenues under current rates, one of the major factors producing the need for a rate increase. See App. 7-13 and 151. The direct testimony of Company witness David McMillan, provided with the rate case filing, was that the six taconite plants that provided just over 35% of Minnesota Power's system load had halted production for several weeks in 2009 and were expected to be at no more than 60% production during the test year, meaning that electric revenues from those customers significantly declined. App. 152-54. In fact, Mr. McMillan testified that as a result of these declines, Minnesota Power's rate of return on equity, approved in the last rate case at 10.74%, fell to 5.29% in 2009 and was projected to be only 7.06% in 2010. App. 161.

Minnesota Power objected to the Commission considering any interim rate proposals other than the one it filed, citing the statutory requirement that interim rates be determined *ex parte* without a public hearing on the basis of the utility's proposal, and Commission precedent specifically stating that handling interim rates *ex parte* is a statutory requirement with which it must comply. App. 17. The Company also pointed out that a finding of exigent circumstances does not allow the Commission to establish below-cost rates for the interim period. App. 18-19.

2. Commission Staff's Analysis of LPI, Boise, and the OAG's Interim Rate Proposals

Commission staff analyzed the alternative interim rate proposals of LPI, Boise, and the OAG, correctly describing them as asking that exigent circumstances "be found

on a broad or global basis" to limit Minnesota Power's interim rate increase – i.e., without reference to the requirements enumerated in Minn. Stat. § 216B.16, subd. 3(b). App. 36-44. Staff specifically noted that its review of Minnesota Power's rate case filing did not reveal anything inconsistent with the interim rate statute. App. 31 and 39. Staff also noted that the proposals to increase rates for some classes but not others plainly violated the "no change in rate design" provision of the interim rate statute. App. 31. Staff explained that it was not correct to claim that Minnesota Power customers had experienced a \$20 million increase in their rates just one day before the Company filed its current rate case. App. 42. Rather, the \$35.5 million interim rate increase in the Company's 2008 rate case had become effective August 1, 2008, such that the \$20 million final rate increase effective on November 1, 2009 represented a reduction from the interim rates that customers had been paying for over a year. *Id.*

Staff further acknowledged that the purpose of the interim rate statute was to balance the impacts of a bad economy on both customers and the utility:

Conceptually, the interim rate statute has been considered a "make whole" statute. In other words, interim rates allow the utility to recover certain increased costs of providing service, but to not increase its return on equity, thereby attempting to maintain the position the utility would be in under its existing rate [o]rder. The "no change in rate design" provision maintains the relative position of customer classes.

App. 41. Staff concluded:

while staff recognizes that the refund provision of the interim rate statute does not relieve the economic pressures [identified by LPI, Boise, and OAG], it does appear to protect customers from ultimately paying rates in excess of those determined to be just and reasonable.

App. 43. While Commission staff did not undertake a separate balancing of interests, staff questioned whether "the fact that the economy is down and customers are experiencing serious financial stress" constituted exigent circumstances that would justify a Commission decision to reduce the Company's proposed interim rate increase. App. 44.

**D. Commission Decision to Limit Minnesota Power's Interim Rate Increase**

Commission staff noted that it would be desirable if "interim rates [could] be set at a level that reasonably approximates the final outcome," but observed that there "is no way to determine the final outcome until the Commission meets for the final deliberation." App. 44. Staff then asked whether, to reach that outcome:

Would there be a basis to find exigent circumstances based on the actual experience with MP rate filings, coupled with the state of the economy, and limit the interim rate increase to approximately 60% of MP's \$81 million request for final rate increase?

App. 44.

The Commission did exactly that. Without reference to any evidence or to the interim rate statute, the Commission declared that the state of the economy was an exigent circumstance justifying a reduction of the Company's interim rate request.<sup>5</sup> T. 52 and 55-56; Add. 3. While the Commission further noted the short time between rate cases, one Commissioner observed that filing rate cases each year or every other year as authorized by law was a common practice in the past. T. 46-47. Likewise,

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<sup>5</sup> Minnesota Power recognizes that the Commission formally speaks through its Orders, while its public deliberations provide insight into the bases for its written orders.

Commissioners recognized that rate cases are being filed as a result of environmental mandates that utilities are required to meet. T. 49, 53 and 59.

The Commission then considered the ratios of the Company's proposed final rates versus approved final rates in its three last rate cases and decided to set interim rates at 60% of the Company's final rate request. T. 44 and 58-59; Add. 4. There was no discussion of the Company's proposed level of interim rates in this case, nor any discussion of how that proposal could be adjusted in accordance with the requirements of the interim rate statutes. *See generally* T. 42-66; Add. 1-5.

The Commission's Interim Rate Order did not rectify these errors of law, but magnified them. The Interim Rate Order identified three factors that, in combination, were found to constitute "exigent circumstances": 1) that Minnesota Power filed this rate case only one day after final rates from its last rate case had gone into effect; 2) that this was the largest rate increase request the Company had ever filed; and 3) that the economy was in an unprecedented economic downturn. Add. 3. Based on the combination of these three factors, the Order concluded that there is "serious potential for rate shock – and even outright hardship – for MP's customers," which justified an overall reduction in the interim rate request. Add. 3.

Minnesota Power notified the Commission of the legal errors underlying the decision. App. 53. The Commission's process was deficient and the three factors cited could not constitute exigent circumstances because the timing of the rate case was expressly allowed by statute, the size of the rate case was dictated by the costs of service that were authorized for inclusion in the Company's proposed interim rate schedule, and

the interim rate statute did not permit the reflection of non-cost factors, such as the impact on ratepayers' ability to pay. App. 56-57. These same factors were incorporated into the Company's request for reconsideration and notice of appeal. See App. 131 and 146.

**E. Impact of Commission's Decision to Limit Minnesota Power's Interim Rate Request**

As a result of the Commission's procedural and substantive violations of the interim rate statute, Minnesota Power's interim rate increase was reduced by \$24.8 million, to \$48.5 million. Add. 4; App. 55. In determining final rates, the Commission concluded that the Company should be allowed a \$53.5 million rate increase. App. 129. This translates to a loss of \$5 million per year over the approximately 17-month period that interim rates are to be in effect.<sup>6</sup> Although the Company can recover a portion of this shortfall for the period beginning with the Commission's November 2010 "final determination" (Minn. Stat. §216B.16, subd. 3(c)), there is no mechanism to recover for the period from the effective date of interim rates (January 1, 2010) until the November 2, 2010 final determination, resulting in a decrease in revenue to the Company of about \$4.4 million.<sup>7</sup>

The prejudice to the Company was not only the shortfall in interim rate revenues. Company witness Julie Cannell filed testimony in the contested case proceeding noting

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<sup>6</sup> Implementation of final rates in this rate case is expected on or about June 1, 2011, but the date has not been finally established as of this writing.

<sup>7</sup> The precise amount of the Company's under recovery is determined through compliance filings. No party has taken exception to Minnesota Power's calculations of the monthly difference between interim rate recovery and final rates.

that several institutional investors issued public commentary regarding the Commission's interim rate decision, and highlighted its significant detrimental impact on investor confidence in the utility and in public utility regulation:

CJS Securities, Inc. noted the uncertainty the PUC's ruling introduced to the Company's outlook:

MPUC's decision to grant \$48mm of the expected \$73mm interim rates overturned the state of Minnesota statute as implementation is historically based on completeness of the filing without discussion of the merits of the case. ... MPUC cited 'exigent' circumstances based on the economy and took an arbitrary 60% of the finalized request ... [I]t remains unclear if the company will be able to recover higher potential final rates through a 'surcharge' to cover the potential shortfall during the interim period.

CJS Securities also issued an update on the decision.... [T]he concern was apparent:

- Decision expected to create share volatility as market appears to have priced full interim rates.
- Overturns statute as implementation of interim rates historically based on 'completeness' of filing w/o discussion of case...

App. 163 (internal citations omitted). Moreover, ALLETE stock "had a dramatic reaction to the PUC's December 15 interim rate decision, with the stock price falling almost 12% on the day of the decision alone." App. 164. Given the impact of the Interim Rate Order on Minnesota Power and its broader potential implications for Minnesota utilities, Minnesota Power brings this appeal.

## ARGUMENT

### I. INTRODUCTION

The issues in this case have broad application to each of Minnesota's investor-owned utilities. Minnesota Power's case was the first in which the Commission assumed authority to use the "exigent circumstances" provision to (i) wholly reconstitute a utility's interim rate proposal despite its completeness and conformance to the interim rate statute, and (ii) establish interim rates by pre-judging the possible level of final rates without reference to the statutory formula.

The Commission exceeded its statutory authority by misapplying "exigent circumstances" in this case. To achieve a balancing of interests between utilities and ratepayers and to establish an efficient process, the Minnesota legislature requires interim rate increases be established summarily, and provides for refunds with interest to protect ratepayers if interim rates exceed final rates. To make this process workable, the legislature constrained the discretion of the Commission by specifying what narrow adjustments the Commission could make. The exception for "exigent circumstances" was not intended to permit the Commission to completely override the statutory formula based on subjective social concerns that contradict the policy choices the legislature has already made. Further, the Commission exceeded its statutory and constitutional authority by making an across-the-board reduction in interim rates by prejudging a level of final rates before the ten-month contested case proceeding to determine final rates had even begun.

To correct the Commission's error, Minn. Stat. § 216.27 and Minnesota Supreme Court precedent empower this Court to remand the matter to the Commission to provide a recoupment remedy.

## II. STANDARD OF REVIEW

The Commission is a "creature of statute" and therefore "has only those powers given to it by the legislature." *Peoples Natural Gas Co. v. Minn. Pub. Util. Comm'n ("MPUC")*, 369 N.W.2d 530, 534 (Minn. 1985) (internal quotation omitted). "[A]ny reasonable doubt of the existence of any particular power in the commission should be resolved against the exercise of such power." *Great Northern Ry. Co. v. Public Serv. Comm'n of Minn.*, 284 Minn. 217, 221, 169 N.W.2d 732, 735 (1969).

Further, questions of law, including the proper interpretation of the scope of authority provided by statute, are reviewed *de novo*. *Schmidgall v. FilmTec Corp.*, 644 N.W.2d 801, 804 (Minn. 2002). The Commission's duties are "prescribed by the legislature in considerable detail." *Peoples Natural Gas Co.*, 369 N.W.2d at 535-36. While the Commission has discretion in many areas, "[n]either agencies nor courts may under the guise of statutory interpretation enlarge the agency's powers beyond that which was contemplated by the legislative body." *Waller v. Powers Dep't Store*, 343 N.W.2d 655, 657 (Minn. 1984) (emphasis added).

This Court's scope of review is governed by Minn. Stat. § 14.69, which authorizes reversal of a Commission decision that is:

- (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.

**III. THE COMMISSION'S USE OF EXIGENT CIRCUMSTANCES TO REDUCE INTERIM RATES WITHOUT REGARD TO THE ELEMENTS OF THE INTERIM RATEMAKING FORMULA EXCEEDED ITS STATUTORY AUTHORITY.**

Although the determination of final rates after a due process contested case proceeding is subject to a variety of factors involving some Commission discretion, the determination of interim rates is statutorily prescribed and involves little, if any, discretion.

**A. For Final Rates, Utilities are Entitled to a Reasonable Rate of Return on Investments Made to Serve Customers.**

A utility's right to recover its cost of service, including a reasonable rate of return, is protected by the United States Constitution. *See Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 692 (1923) ("*Bluefield*") (A "public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public."). Final rates that are insufficient to yield a reasonable return on property the utility uses to serve the public are "unjust, unreasonable, and confiscatory," thereby depriving the public utility of its property in violation of the Fourteenth Amendment to the United States Constitution. *Id.* at 690.

The procedure for determining final rates is well defined. The Commission first reviews the utility's petition for compliance with comprehensive regulations governing an initial rate case filing. Minn. Stat. § 216B.16 (2008); Minn. R. 7825.3100 to 7825.4400 (2009). If it finds the filing to be complete, it then refers the petition to the OAH for a contested case proceeding. Minn. Stat. § 216B.16, subd. 2; Minn. R. 7829.1000 (2009). Upon receipt of the recommendation of the administrative law judge regarding each individually contested aspect of the rate case filing, the Commission deliberates on final rates based on the entire record of the contested case proceeding, including pre-filed written testimony, oral testimony at the evidentiary hearing, and briefs. Minn. Stat. § 216B.16, subd. 6.

Although the Commission has discretion in determining final rates, even that discretion is not unfettered. First, the rates must be reasonable as to both the utility and ratepayers. Minn. Stat. § 216B.03 (2008); Minn. Stat. § 216B.16, subd. 6. Second, the rates must be based on cost and the Commission is limited to acting in its quasi-judicial capacity when determining the utility's total cost of service. *Hibbing Taconite Co. v. Minn. Pub. Serv. Comm'n*, 302 N.W.2d 5, 9 (Minn. 1980). The Commission has greater discretion, and acts in a quasi-legislative capacity, only when it establishes general policy or allocates rates among customer classes. *Id.* See also *In the Matter of Request of Interstate Power Co. for Auth. to Change its Rates for Gas Serv. in Minn.*, 559 N.W.2d 130, 133 (Minn. Ct. App. 1997), *aff'd*, 574 N.W.2d 408 (Minn. 1998); *Minn. Power & Light Co. v. MPUC*, 342 N.W.2d 324, 330 (Minn. 1983).

**B. For Interim Rates, Minnesota Statutes Prescribe the Limited Factors that can be Considered.**

In contrast to the contested case proceeding to establish final rates, the interim rate statute requires the Commission to implement interim rates in a streamlined and near-formulaic manner. So long as the utility's petition to increase rates is determined to be complete, interim ratemaking may not include evidence or commentary other than the utility's petition, and is based on a defined calculation using the utility's "proposed test year cost of capital, rate base, and expenses..." Minn. Stat § 216B.16, subd. 3(b). Thus the formula for establishing the petitioning utility's interim rates is straightforward and typically relies almost entirely on the utility's initial petition (with supporting documentation) to increase rates. The decision of the Commission is largely ministerial.

There are several reasons for this streamlined interim rate process and reliance on the Company's rate increase petition. First, interim rates are intended "to permit the utility to maintain its current rate of return but not to improve it pending consideration of its request to increase its rates." *In re the Application of Peoples Natural Gas Co. for Auth. to Increase Rates for Gas Util. Serv. in Minn.*, 389 N.W.2d 903, 909 (Minn. 1986) ("*Peoples Natural Gas*"); *In re Petition of Minn. Power & Light Co.*, 435 N.W.2d. 550, 556 (Minn. Ct. App. 1989) ("The purpose of the interim [rate] period is to prevent the 'potentially confiscatory effect of regulatory delay.'"). Second, the utility bears all risk with regard to interim rates, since they must refund excess interim rates with interest, but may only collect shortfalls in interim rates from the date of the Commission's "final

determination" (order prior to rehearing) to the date final rates are implemented.<sup>8</sup> Minn. Stat. § 216B.16, subd. 3(c).

While the requirement that all rates made in Minnesota must be reasonable applies to both interim and final rates (*Peoples Natural Gas Co.*, 389 N.W.2d at 908), "[t]he reasonableness of the interim rate increase itself is assured by the statutory provision for refund in the event 'that the interim rates are in excess of the rates in the final determination.'" *In re Petition of Inter-City Gas Corp. for Auth. to Change its Schedule for Gas Serv. in Minn.*, 389 N.W.2d 897, 902 (Minn. 1986) ("*Inter-City Gas*") (emendations and emphasis added) (quoting Minn. Stat. § 216B.16, subd. 3). Consequently, interim rates are established solely on the basis of the company's filing and a statutory formula, and Commission discretion is de minimis. *Peoples Natural Gas Co.*, 389 N.W.2d at 909.

**C. The Exception for "Exigent Circumstances" is Narrow and Does Not Override the Other Limitations of the Interim Rate Statute**

Minnesota Statutes § 216B.16, subdivision 3(b) provides:

Unless the commission finds that exigent circumstances exist, the interim rate schedule shall be calculated using the proposed test year cost of capital, rate base, and expense, except that it shall include: (1) a rate of return on common equity for the utility equal to that authorized by the commission in the utility's most recent rate proceeding; (2) rate base or expense items the same in nature and kind as those allowed by a currently effective order of the commission in the utility's most recent rate proceeding; and (3) no change in the existing rate design.

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<sup>8</sup> The statute does not discuss whether the utility is entitled to interest. *Id.*

(Emphasis added.) This raises two questions: (a) does the plain meaning of the words "except that [the interim rate schedule] shall include" establish a limitation on the adjustments that the Commission can make to the utility's proposed interim rate schedule when exigent circumstances exist? or (b) if these words are ambiguous, must the term "exigent circumstances" nevertheless be read and applied narrowly to effect the legislature's intention: "to permit the utility to maintain its current rate of return but not to improve it pending consideration of its request to increase its rates" while preventing the potentially confiscatory effect of regulatory delay" since "the reasonableness of the interim rate increase itself is assured by the statutory provision for refund[s]"?

1. The plain meaning of the statutory phrase "except that it shall include" mandates a formula for interim rates even when exigent circumstances exist.

The interim rate statute does allow the Commission to adjust the test year cost of capital, rate base, revenues, and expenses proposed by a utility based on exigent circumstances. Minn. Stat. § 216B.16, subd. 3(a). But the plain reading of the phrase "except that [the interim rate schedule] shall include" is that, even if exigent circumstances exist, the Commission must include rate base and expense items of the same kind approved in the utility's last rate case, and allow the utility its currently authorized rate of return on those items. *Id.* at subd. 3(b)(1), (2), (3). In other words, a finding of "exigent circumstances" allows the Commission to adjust the Company's proposed test year cost of service elements, but does not authorize the Commission to adjust interim rates so as to eliminate those things that the interim rate schedule "shall include."

By reading the statute as broadly as it did – using exigent circumstances to adjust interim rates without any regard to whether Minnesota Power would be able to earn its return on common equity or recover for rate base items and expenses of the same kind as those approved in its last rate case – the Commission read the word "except" right out of the statute.

If the legislature wanted to invest the Commission with unfettered discretion to determine interim rates levels when exigent circumstances exist, the statute could have simply said as much in Subdivision 3(b), without exception. But the "except it shall include" language limits that discretion. It was error for the Commission to utilize a finding of exigent circumstances to disregard these statutory requirements.

2. Even if ambiguous, the context of the "exigent circumstances" language limits its application only to the elements of the interim rate formula.

Even if the plain meaning of the statute did not explicitly limit the ways the Commission may adjust a utility's proposed interim rate schedule when exigent circumstances exist, the term "exigent circumstances" must be read in the context of the purpose for the interim rate statute. Given the careful balancing of interests achieved in the interim rate statute, it could not seriously be argued that the term exigent circumstances was intended to give the Commission carte blanche to substitute its subjectively determined concerns for the carefully crafted objective measures in the interim rate formula.

In context, and in virtually every case where "exigent circumstances" have been found by the Commission to exist, an "exigent circumstance" must be relevant to the

specific ratemaking formula in the statute, i.e. one that impacts the Company's cost of capital, rate base, revenues, or expenses. To base a reduction of interim rates on a circumstance wholly collateral to that formula, or to find exigent circumstances as a justification to simply "throw out" the rest of the interim rate statute, could not have been intended by the legislature.

For these reasons, the Commission has never, either before or after this interim rate order, made an across-the-board reduction to interim rates to reflect its pre-hearing prediction of what it may allow in final rates. To the contrary, where the Commission has found exigent circumstances to exist, it has ruled on a circumstance that is intrinsic to the rate formula and has made only a targeted and narrow adjustment to a specific rate case item or element of the interim rate formula.

For example, in *Otter Tail Power Co. v. MPUC*, the court of appeals affirmed the Commission's finding of exigent circumstances to modify solely the cost of equity element for interim rates. 417 N.W.2d 677, 679 (Minn. Ct. App. 1988). Where changes in the law required a utility to incur certain expenses that were not of the same type previously incurred, the Commission has found exigent circumstances to allow inclusion of that particular expense in addition to expenses of the same nature and kind that the interim rate schedule "shall" include. *In re the Application of Minnegasco, a Div. of NorAm Energy Co., for Auth. to Increase Natural Gas Rates in Minn., Order Setting Interim Rates at 4*, Docket No. G-008/GR-95-700 (Oct. 10, 1995) ("The Commission was directed by the Minnesota legislature to order a pilot low-income discount program for one utility" and therefore the "unique circumstance" called for inclusion of the specific

expense in interim rates); *In the Matter of the Petition of N. States Power Co. for Auth. to Increase Rates for Elec. Serv. In Minn.*, Order Setting Interim Rates at 3, Docket No. E-002/GR-92-1185 (Dec. 31, 1992) ("[T]he Commission finds that the new allocation method compelled by FERC constitutes an exigent circumstance, allowing the inclusion of the fund in the Company's interim rates"). App. 183 and 176.

The Commission has likewise found exigent circumstances to warrant a narrow departure from the rate design element where specific and unique customer needs existed. *In re the Application of Peoples Natural Gas Co., a Div. of UtiliCorp United, Inc., for Auth. to Increase Its Rates for Natural Gas Serv. in the State of Minn.*, Order Setting Interim Rates at 3, Docket No. G-011/GR-92-132 (May 29, 1992) (The Commission found that the utility's need to meet the market rate for its large customers, who were capable of bypassing the system, constituted exigent circumstances justifying a change in rate design for that class). App. 172. Lastly, the Commission has found exigent circumstances existed to accommodate a specific calculation required to implement a pre-approved tariff. *In the Matter of the Application of Midwest Gas, a Div. of Iowa Pub. Serv. Co., for Auth. to Increase its Rates for Gas Serv. in the State of Minn.*, Order Approving Increased Participation and Modifying Tariff at 3, Docket No. G-010/GR-90-678 (Nov. 9, 1990). App. 167.

Here, the Commission did not determine that specific circumstances necessitated a revision to an item or element in the Company's test year rate of return, rate base,

revenues or expenses.<sup>9</sup> Rather than implementing the interim rate statute with narrow modifications of the statutory elements, the Commission created its own non-statutory formula to achieve a desired end result – interim rates reduced to a pre-judged flat percentage of the Company's requested final rates based on past rate cases.

**D. The Commission's Interim Rate Order Relied on Circumstances That Do Not Qualify as "Exigent" Under the Statute.**

The Commission found that exigent circumstances existed on the basis of three assumed facts taken together: (1) the size of the Company's rate request relative to the size of its prior rate requests; (2) the timing of the Company's rate case filing in relation to its prior rate case; and (3) the impact of the economic downturn on ratepayers. None of these bases qualifies as an "exigent circumstance" under the interim rate statute. Reversible error exists if any one of them is an invalid contributing factor to a finding of exigent circumstances.

1. The Size of the Company's Rate Request Reflects its Costs of Service and By Law Cannot Constitute Exigent Circumstances.

Minnesota Statutes § 216B.16, subdivision 3(b) does not permit the Commission to reduce interim rates on the ground that the size of the utility's rate request is perceived to be too large. Rather, the size of a rate request is controlled by the ratemaking formula

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<sup>9</sup> In fact, three of the Commissioners noted that the Commission's decision to reduce Minnesota Power's interim rate increase just happened to cover the Company's increased capital costs in rate base as a result of meeting the legislature's environmental mandates, but nothing more. T. 53, 56-57 and 58-59. Perforce, this meant that the increase was not recovering any of the Company's authorized return on equity for those new rate base items, nor recovering any of the Company's other new expenses of the same nature and kind as those expenses it was already recovering.

– the utility has the right to request rates that will produce revenues sufficient to recover reasonable operating expense and a fair rate of return on the investment in rate base. Subdivision 3(b) expressly requires allowance of the full amount requested (without qualifications regarding the size of the increase) so long as the utility's interim rate calculation follows the statutory formula.<sup>10</sup> Because the size of a rate request is dictated by the cost of service, and a utility has a statutory and constitutional right to recover its legitimate costs, it would be contradictory to conclude that the amount of costs could present an "exigent circumstance" that would warrant a reduction in rates.

Moreover, "the reasonableness of the interim [rate] increase itself is assured by the statutory provision for refund in the event 'that the interim rates are in excess of the rates in the final determination.'" *Inter-City Gas*, 389 N.W.2d at 902 (emphasis added) (quoting Minn. Stat. § 216B.16, subd. 3). The Commission's Interim Rate Order states that the refund mechanism may be insufficient for Minnesota Power ratepayers who could not afford to pay heightened rates during the interim period and wait for a refund. But the statutory scheme precludes such assumptions. It is not for the Commission to upset the statutory balance set forth by the legislature in the interim rate statute, and certainly not to do so without a basis in tested evidence.

The Company's recovery of reasonable interim rates, as assured by the interim rate formula, becomes impossible if the Commission is permitted to simply presume, without an evidentiary record, that a utility's interim rate request is too large because it exceeds

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<sup>10</sup> Here, there is no dispute that the Company's interim rate request was made consistent with the interim rate statute.

the utility's prior rate requests. Such a presumption ignores the factors that may unavoidably contribute to the requested increase – such as capital investments to maintain system reliability, environmental improvements to comply with statutory and regulatory mandates, loss of revenues due to declines in customer usage, and inflation.<sup>11</sup>

2. The Timing of the Company's Rate Filing Was Expressly Permitted by Statute and Therefore, as a Matter of Law, Could Not Constitute "Exigent Circumstances."

The Commission further erred by concluding that the timing of Minnesota Power's rate case could constitute exigent circumstances. The timing of rate case filings is specifically addressed in Minn. Stat. § 216B.16, subd. 3(e). That section expressly authorizes a utility to file a successive rate case at least four months after the commission's final determination in the previous rate case (unless this “delay” would be a burden upon the utility, ratepayers, or shareholders), or 12 months after the filing of a previous rate case "for which the commission has extended the suspension period under subdivision 2." Minn. Stat. § 216B.16, subd. 3(e) and (e)(2). There is no provision in the statute that would authorize the Commission to expand the waiting period between rate case filings.

A final determination in Minnesota Power's prior rate case was issued on May 4, 2009 – more than four months before the November 2, 2009 filing date of the present case. And this rate case was filed 17 months after the May 2008 filing of the Company's

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<sup>11</sup> Even if it could reasonably be assumed that the mere size of a rate request could constitute or contribute to an emergency, the Commission undertook no countervailing consideration whether the utility could reasonably sustain a reduction in that rate request, nor whether such a reduction might likewise create an emergency for the utility.

prior rate case. Given the express statutory permission to file within these time frames, an even longer period between rate case filings cannot constitute an "exigent circumstance."<sup>12</sup> Accordingly, the Commission had no statutory authority to consider the timing of Minnesota Power's November 2008 rate case as an exigent circumstance.

3. The Economy and its Impact on Ratepayers are Not Relevant to a Determination of the Cost of Service and Therefore By Law Could Not Constitute Exigent Circumstances.

The Commission's third basis for finding exigent circumstances was the state of the economy. Interim Rate Order at 3.

Under Minn. Stat. § 216B.16, subd. 3(b), interim rates must permit recovery of the Company's total cost of service, determined by the Company's proposed test year cost of capital, rate base, revenues and expenses. Likewise, in setting reasonable rates the Commission must give due consideration to "the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing [] service, including adequate provision for depreciation of its utility property used and useful in rendering service to the public, and to earn a fair and reasonable return upon the investment in such property."<sup>13</sup> Minn. Stat. § 216B.16, subd. 6. Although the utility's costs of service can be

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<sup>12</sup> Even if the timing of the rate filing could be considered, the Commission's factual determination was erroneous. The Interim Rate Order asserts that the 2009 case was filed "one day after the increase approved in the last rate case went into effect," implying that such timing worked a hardship on ratepayers. But the dollar increase from the 2008 rate case first impacted ratepayers on August 1, 2008, per the 2008 Interim Rate Order. The final rates that took effect on November 1, 2009 were an overall decrease from the interim rates implemented effective August 1, 2008.

<sup>13</sup> Again, the Commission's assumptions include no analysis of the impact of the same economic downturn on the Company. Minnesota Power acknowledges that the economy declined significantly in the 2008 to 2009 timeframe and that the downturn took a toll on

tested in the evidentiary hearing conducted for final rates, the statute does not allow them to be tested for interim rates. Instead, the statute provides that those rates are to be determined summarily without any right to immediate judicial review.

To justify depriving the utility of the right to a hearing before setting interim rates and of judicial review immediately after, the statute assures the utility that the ratemaking formula will be used to protect its interest. To justify depriving ratepayers of a hearing and immediate judicial review, the statute assures ratepayers that the ratemaking formula will be tied to the utility's last adjudication and that any excess of interim rates will be refunded.

Under this regulatory format, the Commission must determine the utility's interim rates on the basis of the utility's "cost factors" – that is, the reasonable dollars-and-cents that make up its cost of service and the amount by which present rates are not covering that cost of service. *St. Paul Area Chamber of Commerce v. MPUC*, 312 Minn. 250, 255, 251 N.W.2d 350, 354 (1977) (holding that in setting rate amounts the Commission may only consider cost factors on which substantial evidence has been presented); *Bluefield*, 262 U.S. at 685-86. The requirement to establish the total rates on the basis of cost factors alone exists because rates set by a commission must not be confiscatory, but rather must permit the utility to earn a return on property it employs for the public service. *Id.*

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Minnesota Power customers. However, the same economic downturn likewise took a significant toll on the Company – a balancing factor never considered by the Commission. Even if the economic downturn could be considered an exigent circumstance, any reasonable judgment regarding the impact of the economy would necessarily include a balanced review of the impacts on both ratepayers and the utility.

The state of the economy does not change a utility's costs, especially as to capital projects begun and costs incurred prior to the economic downturn. To the contrary, it would typically cause the utility's revenues to decline, leaving it unable to recover its cost of service at current rates. In contrast, the impact of the economy on ratepayers is a non-cost factor that, by law, is irrelevant to the utility's cost of service for rate-setting purposes.<sup>14</sup> By reducing Minnesota Power's proposed interim rate increase on the basis of the economy and its impact on ratepayers – both non-cost factors – the Commission violated Minn. Stat § 216B.16, subds. 3(b) and 6.

For these reasons, the Commission's Interim Rate Order was contrary to law, was not based on substantial evidence, and was arbitrary and capricious.

#### **IV. THE COMMISSION'S PROCESS FOR REDUCING MINNESOTA POWER'S INTERIM RATE RECOVERY EXCEEDED ITS STATUTORY AND CONSTITUTIONAL AUTHORITY.**

##### **A. The Commission Arbitrarily Prejudiced the Company's Rate Request by Reducing the Interim Rate Recovery to 60% of Final Rates.**

Even if the Commission could find exigent circumstances, the "remedy" of an across the board reduction in interim rates was not authorized, violated due process, and was arbitrary and capricious.

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<sup>14</sup> It is only when the Commission undertakes the determination of rate design, which occurs after establishing the revenue requirement for final rates, that the Commission may balance non-cost factors such as the ability to pay, tax consequences, and the ability to pass on increases. *St. Paul Area Chamber of Commerce*, 312 Minn. At 256, 251 N.W.2d at 355. Because a customer's ability to pay may be considered solely in allocating the total cost of service among customer classes, the state of the economy has no legal relevance to setting the total level of interim rates and could only be considered to make a change in the allocation (i.e., a change in rate design). The Commission did not make any change in rate design due to the exigent circumstances findings discussed here.

Ultimately, the Commission's finding of exigent circumstances was used to reduce the Company's interim rate request to a level the Commission predicted it would approve for Minnesota Power's final rates. In addition to not being authorized by the interim rate statute, this decision violated statutory and constitutional rights to due process because it prejudged the merits of the Company's rate request without providing any hearing, and because it was based on "facts" (i.e., prior rate orders) having no relevance to this particular test year.

The statutes require a full evidentiary hearing before the Commission decides the merits of a utility's proposed final rates. Minn. Stat. § 216B.16, subs. 2, 5 and 6; Minn. Stat. Ch. 14 (2008). The Commission presumed – before even initiating the contested case proceeding – that at an evidentiary hearing the Company would show that only 60% of the rates requested were justified. This presumption exceeds the Commission's statutory authority. The statute requires the Commission to decide interim rates *ex parte*, relying on the Company's petition, and final rates only after a full evidentiary hearing. It does not permit the Commission to predict the likely level of final rates without a hearing and then apply that prediction to interim rates.

Minnesota courts have explicitly rejected predictions of final rate outcomes when reviewing a utility's interim rate proposal. In *Inter-City Gas*, the Minnesota Supreme Court addressed the extent to which the Commission could adjust the allocation of interim rates among customer classes. In doing so, the Court explicitly rejected consideration of past rate case outcomes, the amount of the utility's current rate proposal, and predictions of final rate outcomes during the interim rate-setting process:

The time strictures on MPUC action in setting interim rates and the absence of any public hearing militate against the introduction of any element of uncertainty into the existing rate design. It seems to us that reference to cost of service studies, the methods and rationale employed in earlier cases, the utility's current proposal, or predictions of the final determinations would demand much the same exercise of discretion that enters into MPUC's final determination, a process unsuited to an ex parte proceeding.

*Peoples Natural Gas*, 389 N.W.2d at 902 (emphasis added).

Basing interim rates on a prejudgment of the level of final rates further violates the Company's due process rights. Minn. Stat. § 216B.16, subs. 5 and 6 state that the Commission may only modify a utility's proposed change in rates after a hearing, and the modification must be based on consideration of the utility's need to meet the costs of furnishing service and earn a fair and reasonable return on its investments. These procedural requirements are necessary to satisfy due process requirements. *State v. Tri-State Tel. & Tele. Co.*, 204 Minn. 516, 521-22, 284 N.W. 294, 300 (1939) ("Due process demands that rates be fixed only after a hearing attended by at least the rudiments of fair play. The Commission is in consequence required to base its decision upon the evidence and arguments disclosed at the hearing; its order must be supported by findings of fact which are in turn sustained by the evidence.")

Despite this precedent, the Commission looked at three of Minnesota Power's prior rate cases and set the Company's interim rate level on the basis of the final determination

in those cases, each of which involved a different test year and thus different costs of capital, rate bases, revenues and expenses.<sup>15</sup>

Although the utility has the burden to prove that its proposed final rates are just and reasonable (Minn. Stat. § 216B.16, subd. 4), an interim rate request is presumptively fair and reasonable when (as all parties acknowledged in this case), they meet the requirements of the interim rate statute. The Commission's decisions to find exigent circumstances based on the outcomes in three prior Company rate cases and one prior Xcel Energy rate case was arbitrary and capricious.<sup>16</sup>

**B. The Commission Violated the Statutory Requirement That Interim Rate Schedules "Shall" be Set Ex Parte Without a Public Hearing.**

Subdivision 3(a) of Minn. Stat. § 216B.16 requires the Commission to order an interim rate schedule "ex parte without a public hearing." The Commission has interpreted this provision to mean that it "may not consider other parties' comments when setting interim rates." *See, e.g., In the Matter of the Application of CenterPoint Energy Minn. Gas, A Div. of CenterPoint Energy Resources Corp., for Auth. to Increase Natural*

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<sup>15</sup> In addition, the Commission arbitrarily considered three – rather than four or five or any other number – of the Company's most recent rates cases (1987, 1994, and 2008) and the most recent rate case of a different utility altogether. Add. 3-4; App. 44. The Commission did not address why those cases were most relevant, except to simply note that they were the most recent. Add. 3. Two of the cases were 15 and 20 years old. Given that passage of time, there can be no reasonable presumption that the results of cases with two-decades-old, unique factual scenarios were relevant.

<sup>16</sup> To the extent the Commission deemed past rate cases relevant to setting present interim rates, it did not address or consider cases likewise involving significant capital investments. For example, in the Company's 1977 and 1980 rate cases requested rate increases were largely driven by capital investments. Final rates allowed in those cases were 69% and 93% of the amounts requested, respectively. App. 55-56.

*Gas Rates in Minn.*, Order Setting Interim Rates at 2, Docket No. G-008/GR-05-1380 (Dec. 21, 2005). App. 191.

Nonetheless, the Commission accepted unsolicited third party comments on interim rates. During deliberations, the Commission acknowledged that it was not supposed to accept ex parte commentary but nonetheless invited third-party argument on the grounds that it might be helpful. T. 12-13. The Commission's decision and order went on to reflect precisely the arguments made by these third parties.<sup>17</sup> As such, the Commission further exceeded its statutory authority in the interim rate statute.

**V. THE APPROPRIATE REMEDY IS A REMAND ORDER REQUIRING THE COMMISSION TO ESTABLISH A METHOD FOR RECOUPMENT OF LOST REVENUES AS A RESULT OF THE COMMISSION'S ERROR.**

As previously discussed, the Commission's erroneous decision to set interim rates at 60% of the Company's proposed final rates resulted in final rates that were greater than the amounts collected through interim rates. Because Minnesota statutes do not address situations in which interim rate under recovery is due to reversible error by the Commission, the Company asked the Commission to identify a remedy in the event final rates exceeded interim rates. App. 58. The Commission did not respond.

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<sup>17</sup> The Commission not only failed to act ex parte as the statute requires, but departed from the statutory scheme solely to hear argument that supported one particular result. While the Company was allowed to respond with argument, no balanced presentation of evidence was invited nor provided. It further appeared that the Commission ignored the Company's filed testimony and supporting documentation showing that the utility was earning significantly below its allowed rate of return in 2009 and 2010, that the primary impetus for this rate case was the Company's sunk capital investments that it could not undo, and that the utility was likewise hurt by the economic downturn. App. 149-51 and 156-57.

In a typical situation – where the Commission sets interim rates according to the statutory scheme – the interim rate statute rectifies differences between the interim rate schedule and the final rates established at the end of the contested case proceeding. If final rates exceed interim rate levels (as when the limitations of the interim rate statute do not allow recognition of full cost increases), the Commission must prescribe a method by which the utility can recover the difference for the months between the initial order on final rates and the effective date of the final rates. *Id.* Accordingly, Minnesota Power has filed a plan with the Commission for recoupment of the shortfall in interim rates for the period from the Commission's initial order on final rates (November 2, 2010, as defined by Minn. Stat. § 216B.16, subd. 2(g)) to the date final rates go into effect (not yet determined but estimated to be June 1, 2011).

Here, however, interim rates were implemented effective January 1, 2010; thus, the erroneous Interim Rate Order also resulted in under recovery of interim rates for the period from January 1, 2010 to November 1, 2010, for a total of approximately \$4.4 million in lost revenues (excluding interest). Because this under recovery occurred as the result of Commission error, Minnesota Power seeks recoupment of these additional amounts pursuant to Minn. Stat. § 216.27 and the Minnesota Supreme Court's decision in *In the Matter of the Application of Minnegasco, a Div. of Arkla, Inc., for Auth. to Increase Its Rates for Natural Gas Serv. in the State of Minn.*, 565 N.W.2d 706 (Minn. 1997) ("*Minnegasco*").

In *Minnegasco*, "the central issue" was "whether the applicable statutes authorize the Commission, on remand, to order a recoupment remedy to compensate a public utility

for lost revenue occasioned by a rate order reversed on appeal as exceeding the Commission's statutory authority." *Id.* at 711. Minnegasco filed a rate case in November 1993 and obtained interim rates before proceeding to a contested case proceeding. *Id.* at 707. During the pendency of the year-long contested case to determine final rates, the Minnesota Alliance for Fair Competition ("MAC") filed a complaint before the Commission, alleging that Minnegasco's revenue deficiency was overstated as a result of certain agreements between the utility and its affiliates. *Id.* The Commission agreed and incorporated the revised revenues and costs into its final rate determination, thereby reducing final rates. *Id.* at 709. And because final rates were lower than interim rates, the Commission ordered the utility to refund the difference to ratepayers. *Id.*

However, the Minnesota Supreme Court eventually reversed the Commission's decision on the MAC complaint, such that the Commission's final rate order in the 1993 rate case had erroneously overstated the utility's revenues and understated its costs, producing an excessive interim rate refund. The utility sought recoupment of the excess refunds.

The Court first looked to the statutory scheme to determine whether a remedy was available to the utility, and stated that:

Minnesota Statutes section 216.27 governs Commission authority and procedure after a rate order is reversed by a reviewing court. It provides, "If the order of the commission is reversed, upon filing a copy of the order of reversal with the commission, it shall proceed to determine the reasonableness of the rates, fares, charges, and classification on the merits."

*Minnegasco*, 565 N.W.2d at 711 *citing* Minn. Stat. § 216.27. The Court noted that this statute authorizes Commission review of a reversed decision on the merits. *Id.* The

Court also cited case law supporting a recoupment remedy in the event of a reversed Commission decision:

Relevant case law also supports Minnegasco's argument for a recoupment remedy. Most importantly, we have found implied authority in the Commission's predecessor (the Public Service Commission) to order refunds on remand after a rate order is reversed. *See Northwestern Bell*, 299 Minn. at 28-30, 216 N.W.2d at 858-59. In that case, we concluded that a judicial decision reversing an order increasing rates should have more than "prospective effect," and ordered the Commission to allow a refund of the overcharges by crediting the accounts of current subscribers. ... If a refund power exists when a rate order is reversed as unlawfully excessive, a recoupment power is no less appropriate when a rate order is reversed as unlawfully deficient.

*Id.* at 712 (citations omitted) (emphasis added).

Finally, the Court determined that "Any remaining doubt about the Commission's authority to order revenue recoupment in this case is resolved by considering the inequity of denying Minnegasco a remedy." *Id.* at 713. There must be a meaningful remedy when the Commission exceeded its statutory authority, and rate stability did not justify enforcing "unlawfully calculated rates."<sup>18</sup> *Id.* Accordingly, the Court ordered the

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<sup>18</sup> *Minnegasco* stands for the proposition that there must be a meaningful remedy when a Court determines that a rate decision of the Commission exceeded its statutory authority. *See In re Qwest's Wholesale Serv. Quality Standards*, 702 N.W.2d 246, 259-60 (Minn. 2005) ("In [*Minnegasco*]... we held that the MPUC had the implied authority to impose a recoupment remedy to compensate a public utility for losses caused by an invalid commission order. ... We reasoned that if the MPUC did not have implied authority to impose the recoupment remedy, a public utility that ultimately prevailed in appealing a rate order would not have a meaningful remedy."); *Nw. Bell Tel. Co. v. State*, 299 Minn. 1, 28-30, 216 N.W.2d 841, 858-59 (1974) (holding that Commission had implied authority to require a rate refund after its rate order was reversed as unlawfully excessive); *Qwest Corp. v. MPUC*, 427 F.3d 1061, 1066 (8th Cir. 2005) ("*Minnegasco* has a limited holding that MPUC has the implied authority to order a recoupment remedy to correct its own mistake.")

Commission to determine the amount owed to Minnegasco and the means for Minnegasco's recoupment. *Id.*

The Commission's Interim Rate Order implemented interim rates totaling \$48.5 million annually. The Commission's final determination, issued November 2, 2010 and not reopened for reconsideration, set final rates at \$53.5 annually. Consistent with the Minnesota Supreme Court's decision in *Minnegasco*, Minnesota Power respectfully asks this Court to issue an order remanding the matter to the Commission for determination of the amounts lost and the appropriate means and schedule for recoupment.

## CONCLUSION

Minnesota Power respectfully requests that this Court reverse and vacate the Commission's Interim Rate Order, and remand the matter to the Commission for determination of the amounts lost as a result of the Interim Rate Order and the appropriate means for recoupment.

Respectfully submitted,

Dated: April 25, 2011.

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## CERTIFICATE OF COMPLIANCE

The undersigned counsel for Relator, certifies that this brief complies with the requirements of Minn. R. App, P. 132.01 in that it is printed in 13 point, proportionately spaced typeface utilizing Microsoft Word Word 2007 and contains 11,760 words, including headings, footnotes and quotations.

Dated: April 25, 2011

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