

E-015/M-91-654 ORDER ACCEPTING SETTLEMENT AND CLOSING DOCKET

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm
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Chair
Commissioner
Commissioner
Commissioner

In the Matter of the Joint
Petition of Minnesota Power, the
Office of the Attorney General,
the Department of Public
Service, the Taconite
Intervenors, Blandin Paper
Company, and Potlatch
Corporation for Approval of an
Agreement Regarding Litigation
Award and Rate Investigation

ISSUE DATE: April 13, 1992

DOCKET NO. E-015/M-91-654

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PROCEDURAL HISTORY

I. Proceedings to Date in the Rate Investigation

On August 24, 1990, the Commission issued two Orders in Docket No. E-015/PA-90-153, In the Matter of the Petition of Minnesota Power to Sell a Twenty Percent Ownership Share in the Boswell Generating Unit No. 4 Facilities to the Wisconsin Public Power Incorporated System. The first decision, ORDER APPROVING TRANSFER OF PROPERTY, gave Minnesota Power and Light Company (Minnesota Power or the Company) the authority to transfer 20 percent of its ownership in the Boswell Steam Electric Generating Station Unit No. 4 (Boswell 4) to Wisconsin Public Power, Inc. System (WPPI). Under the terms of the purchase agreement between Minnesota Power and WPPI, the transfer would close between May 1, 1990 and October 31, 1991. To remedy the uncertainty of the closing date, the parties to the contract agreed that Minnesota Power would buy back Boswell 4 capacity and energy from WPPI for a period of time after the transfer.

The other Order rendered on August 24, 1990 stemmed from the facts of the first. Because Minnesota Power would realize a cost saving from the partial transfer of Boswell 4, the Commission concluded that the Company's revenue needs might eventually be reduced. The Commission therefore issued its ORDER FOR INVESTIGATIONS, in which it ordered two separate investigations of Minnesota Power's rates. The first investigation would commence on the date Minnesota Power's buy-back amount was reduced from 100% to 60%; the second investigation would commence on the date the second buy-back period was terminated. The investigations were assigned to the docket herein.

On September 26, 1991, Minnesota Power filed the required information for its first rate investigation, pursuant to the Commission's August 24 ORDER FOR INVESTIGATIONS. On January 14, 1992, the Residential Utilities Division of the Office of the Attorney General (RUD-OAG) and the Department of Public Service (the Department) filed direct testimony in response to the Company's filing.

Commencing in June, 1991, parties in interest began meeting regularly regarding Minnesota Power's rate investigation. The parties included Minnesota Power, the RUD-OAG, the Department, and Minnesota Power's Large Power customers, the Taconite Intervenors¹, Blandin Paper Company and Potlatch Corporation. On January 17, 1992, the parties filed a Joint Petition and Settlement (the Settlement) addressing issues of the rate investigation as well as other matters.

II. Proceedings to Date Regarding the Armco Litigation Award

In July, 1986, Reserve Mining Company (Reserve), a major customer of Minnesota Power, shut down its operations due to bankruptcy. At the time of the shutdown, Reserve was obligated to take power from Minnesota Power for five more years under an existing Electric Service Agreement.

In August, 1986, Minnesota Power filed suit in federal district court against Armco, Inc., Reserve's parent company. Minnesota Power sought recovery of the amounts due and owing under the five-year Electric Service Agreement with Reserve. The district court judgment in Minnesota Power's favor was upheld at the federal appellate court level. As a result of the federal action, Minnesota Power received an award of approximately \$21.9 million from Armco, Inc. on July 18, 1991.

On January 17, 1992, Minnesota Power, the RUD-OAG, the Department, the Taconite Intervenors, Blandin Paper Company and Potlatch Corporation filed a Joint Petition and Settlement which provided, among other things, an allocation of the litigation award.

III. Summary of the Joint Petition and Settlement

The Joint Petition and Settlement filed by the parties contains the following provisions:

¹ Hibbing Taconite Joint Venture, Inland Steel Mining Company, National Steel Corporation, Eveleth Taconite Company, Eveleth Expansion Company, and USX Corporation.

1. Minnesota Power will refund \$6.5 million of the litigation award to Minnesota Power retail customers, together with interest. The refund will take place at the same time that any interim rate refund is made in Minnesota Power's next general rate case, or by January 1, 1994, if no rate case is filed prior to that date.
2. The refund will be allocated to customer rate classes using the same rate design that was in place from July 1, 1987 to the present. The percentage allocation will be as follows:

Residential	13.96%
General Service	9.90%
Large Power & Light	12.18%
Large Power	62.34%
Municipal Pumping	0.82%
Lighting	0.80%

The individual refund within each rate class, except for Large Power, will be distributed based on the retail revenues received during the interim rate period in the next general rate case, or, if there is no interim rate period, the refund will be distributed based on sales for the most recent 12 month period. For the Large Power class, the individual refund will be distributed based on revenues received from each Large Power customer for the time period from July, 1987 through June, 1991.

3. Minnesota Power will allocate \$4.2 million of the Armco litigation award as a revenue credit for ratemaking purposes to retail customers over a 15 month amortization period beginning October 1, 1991 and ending December 31, 1992. The revenue credit will be recognized in the current rate investigation as well as the second rate investigation scheduled in September 1992.
4. Minnesota Power agrees to a rate increase moratorium through 1992.
5. The parties to the Settlement agree that there is no need for a change in Minnesota Power's rates in the current rate investigation.
6. The second rate investigation, currently scheduled for September 1992, with a test year of October 1992 through September 1993, will be canceled if Minnesota Power indicates that it will be filing a general rate case before year-end 1992.
7. The parties to the Settlement agree that the agreement constitutes a full and complete resolution of the entire Armco litigation award and no other legal or regulatory proceedings will be pursued.

On March 10, 1992, the Joint Petition and Settlement and the rate investigation came before the Commission for consideration.

FINDINGS AND CONCLUSIONS

IV. The Rate Investigation

Positions of the Parties

In its rate investigation filing, Minnesota Power stated that its sale of capacity to WPPI had reduced its cost of service by approximately \$10 million. However, Minnesota Power maintained that other increases had offset the cost decrease which resulted from the WPPI sale. Minnesota Power projected an overall rate of return of 8.75% and a return on common equity of 9.81% for the October 1991 to September 1992 test year.

The Department recommended various adjustments to the Company's test year rate base, operating income statement and cost of capital. The recommendations included adjustments to the unamortized rate case expenses in rate base, fuel inventory, cash working capital, various revenue and expense amounts in the operating income statement, CIP expenses and income taxes. The Department also included \$3.4 million of the Armco litigation award in Company test year revenues.

The Department used a discounted cash flow (DCF) analysis to arrive at a recommended cost of equity of 10.992% and an overall rate of return of 9.283%. Calculating with these figures, the Department arrived at a test year revenue deficiency of approximately \$2.5 million. The Department concluded that Minnesota Power's rates should not be reduced.

The RUD-OAG recommended adjustments to Minnesota Power's proposed rate base and operating income statement. The RUD-OAG's recommendation included adjustments to the Company's cash working capital, research and income tax expenses, and the inclusion of approximately \$3.4 million for the test year portion of the Armco revenue credit.

Although the RUD-OAG recommended an overall rate of return of 9.24%, it did not perform an analysis of the Company's cost of capital or calculate the Company's test year revenue needs. The RUD-OAG concluded that Minnesota Power's rates are fair and reasonable and that no adjustment to the rates is necessary.

Commission Action

The Commission agrees with the Department and the RUD-OAG that no adjustment to Minnesota Power's rates is necessary. Even if every adjustment to rate base and income statement advocated by

the Department and the RUD-OAG is taken into account, the Commission finds that the Company's present rates are not excessive. The Commission will terminate the current rate investigation. Further, the Commission will allow Minnesota Power to cancel the second rate investigation currently required under the Commission's August 24, 1990 Order, if the Company indicates that it will be filing a general rate case before year-end 1992. The Commission finds that this provision of the parties' Petition and Settlement is fair and reasonable, and should be adopted by the Commission.

V. The Armco Litigation Award

Summary of the Treatment of the Award in the Settlement

Minnesota Power received a final litigation award of approximately \$21.9 million from Armco on July 18, 1991. Various adjustments brought the amount pertaining to the Minnesota retail jurisdiction to \$10.7 million in the Petition and Settlement. The adjustments are as follows:

1. Approximately \$4.4 million for the portion of revenues that relate to the period prior to July of 1987, the beginning of the Company's last rate case test year;
1. Approximately \$.5 million for net legal costs of litigation;
2. Approximately \$5 million in carrying costs computed on pre-July 1987 settlement revenues, income taxes paid on uncollected revenues, and legal expenses;
3. Approximately \$1.3 million for the FERC wholesale jurisdiction part of the award.

After factoring in these adjustments, the parties agreed that \$10.7 million would be the portion of the litigation award which would be subject to allocation to Minnesota retail jurisdictional customers under the Settlement.

The parties agreed that Minnesota Power will refund \$6.5 million of the \$10.7 million to ratepayers, together with interest. The refund will take place at the same time that any interim rate refund is processed in Minnesota Power's next general rate case, or by January 1, 1994, if no rate case is filed prior to that date.

Under the Settlement, Minnesota Power will allocate the remaining \$4.2 million of the litigation award as a revenue credit for retail customers over a fifteen month amortization period. In the current rate investigation \$3.4 million will be recognized, while the balance will be recognized in the second rate investigation scheduled in September, 1992.

Commission Action

The Commission has examined the parties' Petition and Settlement regarding the Armco litigation award and finds that the Settlement is fair and reasonable.

A sharing of the litigation award between ratepayers' refund and revenue credit is equitable. Ratepayers absorbed through rates the effects of Armco's previous bad debt under the unfulfilled Electric Service Agreement. It is fair that Minnesota Power ratepayers should recover through refund and credit a portion of the award which is based on the revenue loss from Reserve's failure to pay under the Electric Service Agreement.

Ratepayers benefit from the portion of the award which is allocated to a revenue credit because the increased revenue was part of the negotiation which resulted in a rate increase moratorium. It is fair that shareholders also indirectly benefit from this allocation, which is included in revenues and not directly refunded to ratepayers. Shareholders undertook the risk of a three year legal action against Armco without any guarantee of recovery. If the shareholders had not pursued that litigation, no amount of money would have been recovered from Armco. It is also fair that amounts which represent lost revenues before the Company's last rate case should not be recovered by ratepayers through refund. Ratepayers did not absorb these losses through rates and thus should not be compensated for them.

The Commission also notes that the parties entered into the Settlement with full awareness of the realities of litigation. There are real risks and uncertainties to pursuing litigation rather than agreeing to a settlement. The parties all were free to weigh those risks, as well as the delays that litigation would bring, before entering into the Settlement. At the hearing, representatives of the parties who were present stated that they had looked at the alternative of pursuing further litigation and decided that acceptance of the Settlement was in the best interests of their clients.

The Commission finds that ratepayers benefit from the Settlement. There will be a cash refund to ratepayers from Minnesota Power at the same time that any interim rate refund is made in Minnesota Power's next general rate case, or by January 1, 1994, if no rate case is filed prior to that date. The Company has agreed to a rate increase moratorium through 1992. As expressed at the hearing, the Company's Large Power customers are pleased with this rate stability feature.

Although the ratepayers' refund will be delayed until the Company's next rate case interim refund process or until January 1, 1994, if no rate case is filed prior to that date, the interest which will be paid on the outstanding amount will help

to keep the ratepayers whole. The parties to the Settlement found the limited delay acceptable, in light of the overall benefits of the agreement.

Finally, the Commission finds that it is in the public interest to encourage this type of settlement and agreement. The parties have met on numerous occasions and engaged in arms' length negotiations which resulted in the Settlement. The alternative of litigation would be costly and time consuming for the utility, its customers and the public agencies. The Settlement has been subject to close scrutiny by the Commission to assure that the terms are fair and reasonable. The Commission finds the Settlement acceptable.

VI. Issues to be Addressed in the Next Rate Case

In the Commission's ORDER AFTER RECONSIDERATION AND HEARING in Minnesota Power's last general rate case, Docket No. E-015/GR-87-223, the Commission noted that the treatment of excess demand revenues and the associated discount should be reexamined in Commission's investigation of a transfer between Northern States Power (NSP) and Minnesota Power. The Commission ordered the parties to consider the cost of service implications of excess demand and the effectiveness of various levels of the excess demand discount in spurring additional production by customers in the Large Power class. Because the Boswell 4 transfer between NSP and Minnesota Power never took place, these issues have never been addressed. The Commission will therefore require Minnesota Power to address these issues in its next general rate case or next rate investigation, whichever comes first.

ORDER

1. The Joint Petition and Settlement dated January 17, 1992, is accepted.
2. The rate investigation in the current docket is closed.
3. Minnesota Power will be allowed to cancel the next rate investigation scheduled under the Commission's August 24, 1990 ORDER FOR INVESTIGATIONS (currently scheduled for September, 1992) if the Company files its next general rate case by December 31, 1992. Minnesota Power must notify the Commission of its plans, if any, to file a general rate case by September 26, 1992.

4. As part of its next general rate case or next rate investigation, whichever comes first, Minnesota Power shall file a review of the cost of service implications of excess demand and the effectiveness of various levels of the excess demand discount in spurring additional production by customers in the Large Power class.
5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)