ISSUE DATE: October 8, 1996

DOCKET NO. E-015/M-95-1441

ORDER APPROVING SERVICE EXTENSION TARIFF AS MODIFIED

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Joel Jacobs	Chair
Marshall Johnson	Commissioner
Dee Knaak	Commissioner
Mac McCollar	Commissioner
Don Storm	Commissioner

In the Matter of A Request by Minnesota Power for a Modification to its Service Extension Tariff

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PROCEDURAL HISTORY

On December 27, 1995, Minnesota Power (MP or the Company) filed a request to modify its Service Extension tariff.

On January 23, 1996, the Minnesota Department of Public Service (the Department) filed a request for a time extension for comments in this matter per Minn Rules 7828.1400, subd. 8.

On February 26, 1996, the Department filed its initial comments in this matter

On March 7, 1996, MP provided replies to the Department's comments.

On June 10, 1996, the Company filed a supplement to its original petition.

On July 10, 1996, the Department supplied additional comments on the Company's June 10, 1996 supplemental filing.

On September 5, 1996, the Commission met to consider this matter.

FINDINGS AND CONCLUSIONS

I. MP's Proposed Tariff Changes

MP has proposed various modifications to its electric service extension tariff: Electric Rate Book - Volume 1, Section VI. MP stated that the purpose of its proposed modifications was 1) to negate the impact of increasing distribution costs on existing customers that result from adding new customers to the Company's system, 2) to more accurately determine line extension costs , and 3) to make the Company's Extension Rules easier to understand and easier to administer.

Specifically, the Company proposed to

- reduce the extension allowance from $2,800 to $850;

- eliminate the requirement that it adjust the allowance level whenever Handy-Whitman Index of Public Utility Construction Costs increased by 5 percent or $250;[1]

- reduce the maximum three phase extension cost covered under the guaranteed annual revenues (GAR) provisions from $280,000 to $30,000 and handle any extension costs over $30,000 on an individual customer basis;

- discontinue use of the formulas in Schedule A as the basis for calculating whether a three phase customer can guarantee annual revenues in lieu of making a lump sum payment for the cost of a line extension; instead, limit the option to three phase customers with a five year contract and require that the GAR must be equal to or greater than 1/3 of the costs relating to the entire line extension;

- adopt a new provision authorizing the installation of meter pedestals;[2]

- alter the formula used to calculate the costs of converting from overhead service to underground service;[3]

- identify additional costs incurred by the Company as a result of special conditions that impede the installation of distribution facilities so that the customer is aware of the possibility of increased extension costs resulting from any such special conditions;

- adopt a new section distinguishing between line extensions for distribution and transmission service.

II. The Department's Comments

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[1] In its June 10, 1996 supplemental filing, MP proposed that instead of simply eliminating the adjustment requirement, the Commission require the Company to file annual average embedded cost studies with the Commission for review, approval and adjustment of the allowance, as warranted.

[2] A meter pedestal is a post mounted meter located some distance from the actual building structure being served. Where service is provided by the Company to a meter pedestal, the customer remains the property owner of all facilities from the meter pedestal to the customer's premises.

[3] In its June 10, 1996 supplemental filing, MP requested that it be allowed to withdraw this proposal.

A. Changes Agreed Upon As Initially Proposed

With respect to the tariff changes proposed in the Company's initial filing, the Department agreed with the following: 1) the new provision authorizing meter pedestal extensions; 2) transmission service extensions; and 3) the section regarding special conditions, with the addition of language requiring the Company to provide cost estimates.

B. Additional Department Comments

In addition to the issues addressed above in Section A, the Department commented on five specific issues:

1. Reduction of the Extension Cost Allowance

Regarding the proposed reduction of the extension cost allowance, the Department recommended that the Commission

- approve the Company's proposal of $850 allowance for all single phase customers except the Lighting class;
- require MP to file annual compliance filings of fully embedded average cost studies for single phase extension costs, for review and approval of allowances; and
- require MP to submit, as a compliance filing in its next general rate case, fully allocated embedded cost studies regarding allowances to single phase and three phase General Service, Municipal Pumping, and Large Light and Power customers.

2. Allowance Level Review

Regarding provisions for Commission review of allowance levels, the Department initially suggested that the Commission continue to require the Company to make a compliance filing whenever the Handy-Whitman Index of Public Utility Construction Costs increased by 5 percent. In its later filed Supplemental Comments, the Department changed its position on this issue, recommending that the Commission accept the Company's revised proposal to file annual cost studies for allowance level review and approval.

3. Changes in the Availability of the GAR Option

Regarding the Company's proposed changes in the GAR option, the Department stated that it supported the Company's proposal but initially recommended 1) clarifying language; 2) a compliance filing cost study for three phase extensions; and 3) a compliance filing with an analysis of whether the Guaranteed Annual Revenues (GARs) were sufficient to recover the costs previously recovered in the customer Charges-in-Aid-of-Construction (CIACs).

In its final comments, the Department 1) noted that the Company had adopted the Department's recommended clarifying language in its supplemental filing; 2) clarified that the compliance filing of a fully allocated embedded cost study regarding cost justifications of three times annual revenues for non-single phase extensions should be filed in the Company's next general rate case; and 3) withdrew its concern about the adequacy of the GARs.

4. Reapportionment of Extension Costs

As noted above, the Department found it reasonable to cap at $30,000 the size of extension automatically subject to the GAR option in lieu of CIAC. The Department recommended, however, that the Company retain certain language in Section XI of the Company's current tariff. The Section XI language in question provides for potential refunds to customers whose extensions are handled individually (those costing in excess of $30,000) in the event that the customer's contract demand increased or other customers are served during the ten-year period following the initial extension. In its initial filing, the Company had eliminated this language. The Department noted that the language sought to ensure that a customer whose extension is handled individually and based on actual costs will not be required to pay more or less than their fair CIAC.

5. Overhead to Underground Conversions

With respect to the Company's initial proposal regarding overhead to underground conversions, the Department objected to the Company's proposal and recommended that the Commission adopt a different method for computing service drops and distribution facilities. When the Company proposed to withdraw its proposal, the Department recommended that the Company be allowed to do so.

III. Commission Analysis

A. General Finding

The Commission finds that MP's proposed service extension tariff, as modified, is reasonable and will approve it. The principal modifications to the service extension tariff initially proposed will be addressed separately in **III, B**. Finally, additional requirements will be specified in **III, C**.

B. Modifications to Initially Proposed Tariff

1. Information to be Provided About Special Conditions, Including the Projected Costs Thereof

MP has agreed with the Department's recommendation to modify the initially proposed language and in its reply comments has proposed specific language describing surface impediments. Part VIII, Paragraph 5, as approved by the Commission, then, is as follows:[4]

> 5. The extension cost will include excess installation costs incurred by the Company because of special conditions that impede the installation of distribution facilities. Such special conditions include, but are not limited to ground frost, surface or subsurface impediments, and submarine installations. Surface or sub-surface impediments may include, but are not limited to: rock, bedrock, subsurface structures, and wetlands.

In addition, the Commission notes that the language introducing the five points listed in Part VIII: Special Conditions indicates that the Company will supply the customer with cost projections regarding special conditions before beginning construction of any extension. To assure that this information is provided to customers before they enter into agreements with the Company for service extensions, the Commission will require MP to strengthen the tariff language in this regard by amending the last sentence of Part II as follows:

> The Extension Cost shall include the customer's choice of either an overhead or underground service drop and projections of special condition costs anticipated.

2. Guaranteed Annual Revenues (GARs) in Lieu of a Contribution-in-Aid-of-Construction (CIAC)

Under the Company's present tariff, three phase customers have the option of guaranteeing annual revenues in lieu of making a lump sum payment (contribution-in-aid-of-construction or CIAC) to cover the cost of a line extension. Under the existing tariff, the amount of GARs necessary to qualify for this option are determined based on formulas set forth in Schedule A of the tariff.

Under the Company's proposed revised tariff, the amount of GARs necessary to support the line extension is no longer computed pursuant to the Schedule A formulas. The schedule A formulas are eliminated and a single formula is established: the amount of GARs necessary to support the line extension must be equal to or greater than 1/3 of the costs relating to the entire line extension.
In its comments, the Department suggested changes to the language of Part IV, paragraphs 2 and 3. The Department's proposed changes clarify the intent to grant three times annual revenue credit toward extension costs. MP has accepted those changes and the Commission finds them appropriate. The paragraphs in question will be approved, modified from MP's initial filing as indicated below:

> 2. No advance contribution for extension costs will be required, if the customer e~~E~~nters into a five year Electric Service Agreement ~~guaranteeing annual revenues equal to or greater than 1/3 of~~ where the Company's costs relating to the entire extension are equal to or less than

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[4] MP added the underlined language in response to the Department's February 26, 1996 Comments.

three times the Customers guaranteed annual revenues, or

3. If the Customer e~~E~~nters into a five year Electric Service Agreement ~~guaranteeing annual revenues which support less than 1/3 of~~ where the Company's costs relating to the entire e~~E~~xtension ~~Cost~~ are greater than three times the Customer's guaranteed annual revenues, the Customer will be required to ~~and~~ pay the Company in advance a Contribution for the balance of the Extension Cost not supported by guaranteed annual revenues.

The Company's support for the change to a single formula for computing the requisite GARs (cost = or < 3 times GARs) is based on an analysis of estimated marginal revenues and costs. The Company also noted that other utilities in the state have similar policies. While the Commission finds this support adequate for the present and will approve the change, it would prefer a fully embedded average cost analysis and information in the record indicating how the Schedule A formulas were developed. The Commission notes that the Company's proposal would produce no net monetary revenue reduction from the group of customers whose service extensions cost under $30,000. Accordingly, while the Commission will approve the revision at this time, it will review the basis of this policy more fully in the Company's next general rate case. In that case, the Company will be required to provide an embedded cost study to help examine whether any interclass subsidy has resulted from this change.

3. Reduction of Maximum GAR Amount to $30,000

Under MP's current service extension tariff, if extension costs are $280,000 or less, the sharing of extension costs between the Company and the prospective customer is determined according to formulas set forth in Schedule A.[5] Beyond the cap, i.e. for extensions costing in excess of $280,000, the sharing of extension costs is a matter of negotiation between the Company and the prospective customer.

In its initial filing, MP proposed to reduce the cap (the maximum extension cost covered under the GAR provision) to $30,000. In effect, this proposal reduced the expense level beyond which the sharing is a subject for negotiation between the Company and the customer from $280,000 to $30,000.

On the one hand, the Commission is concerned (as was the Department), that MP has proposed the $30,000 figure without providing an analysis showing that the $30,000 cap is optimal and equitable for all MP's customers. On the other hand, the Commission understands that reducing the cap (thereby increasing the number of extensions in which cost-sharing is subject to negotiation) would give the Company additional discretion and flexibility to attract and maintain large customers on its system. In addition, while the dollar amount of the reduction is

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[5] As noted above, the Company has proposed to eliminate the complicated formulas of Schedule A and move to a straight-line 3 time GARs rule, i.e. that the annual guaranteed revenue times 3 must equal or exceed the costs relating to the entire line extension. As noted, this simpler method will be approved as a worthwhile simplification of the process, making it easier for customers to understand and apply.

substantial, the number of line extensions the Company expects in the above-$30,000 range is quite limited.

On balance, since most of MP's extensions cost less than $30,000, the Commission finds that the $30,000 cap has, at least, threshold merit as an interim measure. The Commission, therefore, will approve this change on a pilot basis and will require the Company to file in its next rate case information about the revenue impacts and results of the application of this policy compared to the existing tariff.

4. Elimination of Language Regarding Cost Reapportionment/Customer Refunds

MP's current tariff contains language in Section XI addressing reapportionment of extension costs under certain circumstances to customers whose extensions were individually negotiated. In its initial filing, MP eliminated that language. In response to comment from the Department, the Company agreed to restore that language to Section XI.

The Commission agrees with the Department's recommendation that this language be retained in the new tariff. This language aims to assure that customers whose extensions are handled individually and based on actual costs will not be required to pay more or less than their fair CIAC.

5. Trigger for Review of Allowance Levels

In a previous Order, the Commission required a filing whenever the Handy Whitman index[6] of public electric utility construction costs exceed 5 percent or a $250 increase in allowances.[7] In its initial filing, MP proposed that the Commission modify its previous Order and eliminate this requirement altogether. The Company would rather be allowed to decide when the costs have changed enough for it to request an allowance change.

The final proposal by the Company, accepted by the Department, was a request to allow the Company to file annual **embedded cost** updates for Commission review and allowance level approval. The Company proposed that the allowance be established based on actual embedded costs. In its supplemental filing, MP proposed that changes to the actual embedded costs be reviewed annually to establish appropriate allowance level changes.

The Commission finds that setting allowance rates using the average embedded cost approach is preferable to setting them with reference to the Handy-Whitman index because the index is a less direct indicator of the Company's actual costs than the actual costs themselves. To that extent, this Order will depart from the precedent set in the 1989 Order.

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[6] The Handy-Whitman Index is a nationally recognized source of information on the inflation rate of utility plant construction costs.

[7] In the Matter of a Request from Minnesota Power Company for Approval of Changes in the Company's Service Area Extension Rules, ORDER APPROVING AND MODIFYING SERVICE EXTENSION RULES (August 28, 1989) at page 3.

The Commission will not approve the Company's proposal to review the changes to the actual embedded costs annually. This further change from the approach taken in the 1989 Order is unwarranted. The Commission prefers to maintain the approach taken in its previous Order, i.e. to require a review by the Commission whenever the costs change by a stated value. Consistent with its adoption of the average embedded cost approach for the allowance level itself, it would seem reasonable to trigger review of the amount of the allowance based on changes to the actual costs also rather than annually, irrespective of actual cost changes, as proposed by the Company. In this case, the Commission will require compliance filings whenever the Company's average embedded costs change by five percent.[8]

C. Special Review Requirements

Regarding MP's proposal to reduce the extension cost allowance to $850, affecting all single phase and three phase customers except the lighting class, the Commission will approve that change, finding (as the Department suggested) that for now this amount is a reasonable proxy for the actual three phase costs. The Commission will require review of this item, however, in the Company's next rate case.

Similarly, the change adopted in this Order reducing the maximum extension cost covered under the GAR to $30,000 (see **III, B, 3** above) will be subject to review in the Company's next rate case. As part of its initial filing in that case, the Company will be required to include information about the revenue impacts and results of the application of this policy compared to the existing tariff.

Finally, regarding the elimination of Schedule A and adoption of a three times annual revenues rule for non-single phase extensions (changes approved in this Order as discussed in **III, B, 2**), the Commission will require the Company to file a fully embedded average cost study to provide

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[8] The Commission clarifies that this requirement does not preclude the Company from filing a request to change the allowance level whenever it wants.

a basis for reviewing this policy, including any possible interclass subsidy involved with this policy.

ORDER

1. MP's service extension tariff, as revised in its reply comments and supplemental filing and further modified in this Order, is approved.

2. Within 10 days of this Order, MP shall file service extension tariff consistent with what has been approved in this Order.

3. As part of its initial filing in its next rate case, MP shall address the following issues:

    a. reduction of the extension cost allowance to $850, affecting all single phase and three phase customers except the lighting class, as approved in this Order;

    b. discontinuance of Schedule A and adoption of a 1/3 cost of extension rule to compute the amount of annual revenues that a three phase customer must guarantee to avoid having to make a lump sum CIAC (discussed above in **III,B,2**); the Company's filing in its next rate case shall include a fully embedded average cost study to provide the cost basis for examining this policy change to determine whether any interclass subsidy has resulted from the change; and

    c. reduction of the maximum extension cost amount eligible for the GAR payment option to $30,000 (discussed above in **III, B, 3**), including information about the revenue impacts and results of the new policy compared to the results under the existing tariff.

4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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