BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Gregory Scott	Chair
Edward A. Garvey	Commissioner
Marshall Johnson	Commissioner
LeRoy Koppendrayer	Commissioner
Phyllis A. Reha	Commissioner

In the Matter of the Petition by Minnesota Power for Approval of Asset Separation and Accounting Methodology

ISSUE DATE: August 8, 2002

DOCKET NO. E-015/M-01-1416

ORDER APPROVING PETITION, WITH CLARIFICATIONS AND REQUIREMENTS

PROCEDURAL HISTORY

On July 26, 2000 in Docket No. E-999-CI-99-1261, the Commission issued its ORDER ADOPTING BOUNDARY GUIDELINES FOR DISTINGUISHING TRANSMISSION FROM GENERATION AND DISTRIBUTION ASSETS. In that Order, the Commission adopted Boundary Guidelines for functionally separating transmission from generation and distribution functions. The Commission directed that the guidelines be used wherever issues of identifying the assets involved in generation, transmission or distribution arise.

On September 17, 2001, Minnesota Power Company (MP) filed its request seeking specific Commission approval of its application of the Boundary Guidelines and the resulting reclassification of Minnesota Power's generation, transmission and distribution assets. In addition, MP requested approval of its Accounting Methodology for asset accounting and functional cost assignment for use in all future asset-related or cost-based proceedings before the Commission.

On December 3, 2001, Great River Energy (GRE) commented that it did not oppose MP's proposed classification, but requested that the Commission's decision be limited to this proceeding and not serve as a precedent for other utilities.

On February 1, 2002, the Department filed comments recommending approval, subject to MP adequately addressing issues raised by the Department.

On March 15, 2002, MP filed reply comments.

The Commission met on June 6, 2002 to consider this matter.

FINDINGS AND CONCLUSIONS

I. BOUNDARY GUIDELINES

In its comments on MP's filing, the Minnesota Department of Commerce (the Department) generally approved MP's application of the Boundary Guidelines, but raised concerns regarding the possible misclassification of MP's 46kV system as distribution assets.

In reply comments, MP provided a detailed analysis of its 46kV system[1] showing that the Company had properly classified the system as distribution assets.

Based on the Department's recommendation, the Company's response, and the Commission's own review of MP's filing, the Commission finds that MP's application of the Boundary Guidelines is appropriate in all respects, including its classification of its 46 kV system as distribution, and will approve it.

Finally, in its comments on MP's filing, Great River Energy (GRE) expressed the concern that the results of the current MP proceeding not be used as precedence for how the Boundary Guidelines will be applied to other utilities statewide. GRE stated that transmission owners should continue to be free to fully apply the Boundary Guidelines and not be bound by interpretations used by MP.

In response to GRE's concern, the Commission notes that the Commission's July 26, 2000 Order adopting Boundary Guidelines states at page 4:

> The guidelines have the advantage of providing a uniform, state-wide framework for analyzing asset separation issues, while providing for individualized application to various utilities.

The July 26, 2000 guidelines clearly countenance application to specific facts and circumstances and the petition by MP, obviously, only addresses the specific facts and circumstances of MP. Therefore, the findings in this proceeding are specific to this proceeding and do not extend beyond MP.

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[1] MP applied the Relevant Factor tests identified in Appendix A to the Commission's July 26, 2000 ORDER ADOPTING BOUNDARY GUIDELINES FOR DISTINGUISHING TRANSMISSION FROM GENERATION AND DISTRIBUTION ASSETS in Docket No. E-999-CI-99-1261.

II. ACCOUNTING METHODOLOGY

A. MP's Request

MP explained that it was providing the Commission an opportunity to review and understand the new Accounting Methodology for asset accounting and functional cost assignment that it had implemented in 1998. MP specifically requested that the Commission approve MP's use of that Accounting Methodology in future proceedings before the Commission. MP reported that its new methodology has not produced any change in MP's current rates and noted that no rate change can occur outside a rate case. The Company emphasized that it was simply seeking approval to use the methodology, with approval of specific applications occurring in future proceedings where the Commission and parties would be able to examine specific impacts of the accounting methodology.

MP asserted that its new Accounting Methodology advances the asset separation process begun by the Commission in the Boundary Guidelines Docket by functionalizing the utility assets that are not addressed by the Boundary Guidelines, placing them into the appropriate Federal Energy Regulatory Commission (FERC) Electric Plant Accounts and into what MP refers to as its Lines of Business.[2]

MP explained that its new Accounting Methodology replaces the historical method of capturing costs with a new Chart of Accounts and Work Order System that uses Activity-Based Costing and Line of Business reporting. MP argued that rather than gathering costs by responsibility center and cost code, the new Accounting Methodology properly assigns costs to business functions, while maintaining compliance with FERC and the Commission's accounting rules.

In sum, MP described its new procedures and methodologies and asserted that they provide the proper accounting foundation for identifying MP's key emerging business operations and for accurately identifying their assets and costs.

B. The Department

The Department noted that under MP's new methodology the Company will be initially entering its financial data to a chart of accounts different from the FERC Uniform System of Accounts (USOA or FERC account system) and has proposed a mapping process to map MP's accounting data to FERC accounts. The Department reported that it had reviewed the Company's mapping process and found that it provides an adequate audit trail for future verification purposes, while allowing for a more clear accounting distinction for non-regulated activity and better isolating and classifying the utility costs.

The Department concluded that MP's proposed accounting methodology is reasonable both for

[2] A Line of Business is a strategically defined business unit for which a financial statement or analyses are desired. MP's Lines of Business include generation, transmission, distribution, and MPEX (MP's energy marketing division for the Company's retail and wholesale activities).

reporting and ratemaking purposes with four exceptions:

1. **Allocation of General Plant Costs:** The Department recommended that where a general plant asset is used in multiple lines of MP's business, at a minimum, allocations should be made to all of those lines of business that benefit. Alternatively, the Department stated, it may be more appropriate to assign shared general plant to the Corporate Support function to help ensure that costs are allocated to all Lines of Business that benefit from general plant.

2. **Accounting for MPEX:** The Department recommended that in MP's next rate case, the Company should be required to explain how MPEX is accounted for in the rate case, since MPEX provides for both retail and wholesale transactions. The Department requested the Commission to clarify that any Commission decision regarding MPEX in this Order would not preclude consideration of the wholesale revenue credit method in future proceedings regarding MPEX.

3. **Allocation Methods:** The Department recommended that the Commission either defer review of the 50 different allocation methods until the next rate case or require MP and interested parties to further review the allocation methods, working off the table provided by MP in response to Department information request No. 16, and provide comments to the Commission in 45 days.

4. **MP's Corporate Equity Allocator vs. General Allocator:** The Department recommended that the Commission require the parties to work out the Corporate Equity Allocator concern as addressed by the Department and provide comments to the Commission in 45 days. Alternatively, the Department stated, Commission should require MP to explain why its Corporate Equity Allocator is superior to the Commission's general allocator, or why the Corporate Equity Allocator is cost causative and fairly allocates costs in MP's next rate case.

C. MP's Reply to the Department's Recommendations

In Reply Comments, MP addressed each of the Department's concerns: allocation of general plant, accounting for MPEX, allocation methods in general, and the corporate equity allocator in particular.

MP maintained that the assignment of certain general plant costs (service center costs and fiber optic cable and equipment costs) to Corporate Support, with a subsequent allocation of costs to other Lines of Business, is appropriate. Regarding the Department's concerns about allocation methods and treatment of MPEX, the Company argued that these concerns are not as much about Accounting Methodology (the subject of this docket and Order) as they are specific issues that will arise in future relevant asset-related or cost-based proceedings.

D. Commission Analysis and Action

On the basis of the Department's recommendation and the Commission's own analysis, the Commission will approve MP's accounting methodology petition, with several safeguarding requirements and clarifications, as discussed below.

1. Assignment and Allocation of Plant Costs that are Shared by Multiple Lines of Business

At the hearing, MP explained why it preferred to assign assets that are shared by multiple lines of business to the line of business that is the primary user and then, subsequently, to allocate costs used for/by non-primary users to such non-primary users. The Company explained that in this proceeding it was seeking approval of a system whose purpose was to 1) functionalize assets to the greatest extent possible and 2) get its managers used to watching their costs and expenses and billing the managers of other functions for any services provided to those managers. The Company acknowledged that when it came to a rate case it would need to prove that its costs were properly allocated between jurisdictional customers (e.g. distribution customers) and non-jurisdictional wholesale customers (e.g. transmission customers).

The Department raised the concern that if 100 percent of the shared plant costs are assigned to the primary user, some residual cost would tend to remain with the primary user and not be properly assigned to other users. The Department preferred that the shared costs be assigned to Corporate Support (rather than being assigned directly to the line of business that is the primary user) and then allocated from the Corporate Support Account to all lines of business that benefit. The Department argued that this approach provided important internal controls promoting the proper allocation of costs between jurisdictional customers and non-jurisdictional wholesale customers and that this be readily verifiable.

At the hearing, the Department offered an alternative solution, that the Commission accept the Company's cost assignment approach in this docket but also direct the Company to identify, in advance of its next rate case, any assets shared between business functions and provide studies of how the costs are allocated.

The Commission finds that the Department's alternative has merit. MP's goals and the Department's concerns are not incompatible and the Department's alternative proposal successfully addresses them both.

The Commission finds that the Company's functionalization approach is reasonable for the Company's purposes in this docket and will approve it. At the same time, the Commission shares the Department's concern to assure 1) that costs related to shared assets be properly assigned to all of the lines of business that benefit form the assets and 2) that when it comes to a rate case, the Department will be able to readily analyze whether proper allocation has occurred. To ensure that the Company achieves proper allocations and that in the next rate case the Department will be able to readily verify whether proper allocation has occurred, therefore, the Commission will require MP to identify assets shared between functions and provide studies of how the costs are allocated.

2. Accounting for MPEX

MPEX is MP's power marketing division for both retail and wholesale activities. The Commission notes the Department's recommendation and MP's agreement that MP provide in its next rate case an explanation of how MPEX is accounted for. To ensure that MP will be in a position to provide satisfactory explanations, the Commission notes MP has further agreed to maintain information about wholesale and retail transactions in sufficient detail to allow the development of allocators in future rate cases. The Commission finds that these agreements adequately address the issue at this time and will direct MP to abide by them.

3. Cost Allocations

The Department recommended that the Commission defer the review of MP's 50 different allocation methods to the next rate case or require MP and interested parties to further review the allocation methods, working off the table provided by MP in response to the Department's information request 16 and file comments with the Commission within 45 days.

MP indicated its preference to wait until the next rate case because it may not be beneficial to spend a lot of time reviewing allocation factors today when no issues incorporating them are before the Commission.

Allocations involve complicated and important fairness issues. They can require considerable time and effort to create and review, and they can assign substantial amounts of costs to various lines of business. Time to review the allocators in the context of a rate case is very limited, with the possible result being that the review may not be as complete as would be desirable.

The Commission, therefore, will not wait until MP's next rate case, as recommended by MP. Instead, the Commission will direct MP to meet with the Department, Commission staff, and the Minnesota Office of Attorney General's Residential and Small Business Utilities Division to review the allocation methods and overall accounting methodology and file a report on the outcome of this meeting within 30 days of the meeting.

In addition, to keep the Commission and Department apprized of allocator developments, the Commission will require MP to annually update the Department and Commission staff of changes to the allocators.

Finally, the Commission clarifies that this consultation and reporting is no substitute for the Commission's review of the merits of MP's allocators in MP's next rate case, where the Company will bear the burden of proof that its allocators are cost causative and fairly allocate costs.

4. Corporate Equity Allocator

The Department expressed concern that the corporate equity allocator likely does not allocate costs based on a cost causative basis. The Department recommended that the Commission require the parties to work out the corporate equity allocator concern and comment to the Commission within 45 days. MP did not dispute the Department's concern.

The Commission prefers that the parties address any differences regarding the corporate equity allocator well before the Company's next rate case and will direct the parties to begin doing so as part of their meeting to discuss other allocator issues and to report their progress on the corporate equity allocator issue when they report on the other allocators.

5. Clarifications Regarding Scope of Approval in This Order

The Commission and the parties retain rights to fully examine any specific impacts of the accounting methodology in future regulatory proceedings in which the accounting methodology is applied to assets, rates, or otherwise used for specifically required Commission determinations.

The Commission further clarifies that it is approving the proposed accounting methodology with the understanding and assurances 1) that the proposed system will provide information in a manner that sufficiently ties to the FERC account system and 2) that MP bears the burden to comply with Commission accounting requirements and for MP to meet its burden of proof in future rate cases;.

ORDER

1. MP's application of the boundary guidelines is approved, with the following two clarifications.

   a. Findings in this proceeding are specific to the facts presented as related to MP's system.

   b. The current operation of MP's system and circumstances related to applying the boundary guidelines are subject to continual change as business conditions change;

2. MP's accounting methodology petition is approved, with the following requirements and clarifications.

   a. The Commission and the parties retain rights to fully examine any specific impacts of the accounting methodology in future regulatory proceedings in which the accounting methodology is applied to assets, rates, or otherwise used for specifically required Commission determinations.

   b. The Commission is approving the proposed accounting methodology with the understanding and assurances 1) that the proposed system will provide information in a manner that sufficiently ties to the FERC account system and 2) that MP bears the burden to comply with Commission accounting requirements and for MP to meet its burden of proof in future rate cases.

   c. By September 30, 2002 MP shall meet with the Department, the Commission's staff, and the Minnesota Office of Attorney General's Residential and Small Business Utilities Division to review the allocation methods and overall accounting methodology, including those allocations attached to MP's response to Information Request 16 (including the equity allocator).

      Within 30 days of their required meeting, MP and the Department shall file a report on the outcome of this meeting .

      MP shall annually update the Department and Commission staff of changes to the allocators.

      MP bears the burden of proof in its next rate cast that its allocators are cost causative and fairly allocate costs.

   d. Regarding general plant, MP is hereby allowed to initially assign general plant assets to lines of business that are the primary users but is also required to

      1) eventually allocate costs related to the general plant to all lines of business that receive benefits from the general plant and

      2) identify assets shared between functions and provide studies of how the costs are allocated.

   e. Regarding MPEX, MP's energy marketing division for MP's retail and wholesale activities, the Commission accepts the Department's recommendation and MP's agreement on this subject and directs MP to

1) maintain information about wholesale and retail transactions in sufficient detail to allow the development of allocators in future rate cases; and

2) provide an explanation of how MPEX is accounted for in the next rate case.

The Commission clarifies that nothing in this Order precludes consideration of the wholesale revenue credit method for MPEX in future proceedings.

3. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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