

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair
Commissioner
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In the Matter of Minnesota Power's Petition for Approval of Affiliated Interest Agreements and Purchase of Transmission Facilities from Rainy River - Taconite Harbor

ISSUE DATE: June 5, 200

DOCKET NO. E-015/AI-01-1648

DOCKET NO. E-015/AI-01-1988

In the Matter of Minnesota Power's Petition for Approval of Intra-Company Transfer of Taconite Harbor Electric Generation Station and Associated Assets from Rainy River Energy Corporation - Taconite Harbor to Minnesota Power

ORDER ESTABLISHING PROCESS TO SELECT AN INDEPENDENT APPRAISER, REQUIRING APPRAISAL AND REPORT

PROCEDURAL HISTORY

In its May 22, 2002 Order in Docket No. E-015/AI-01-1648, the Commission approved the transfer of the transmission assets from Rainy River - Taconite Harbor to Minnesota Power (MP or the Company). Because the value assigned to the various parcels of land is integral in arriving at the amounts allocated to the regulated transmission facilities, the Commission directed MP to submit further substantiation of the land values.

In its June 11, 2002 Order in Docket No. E-015/AI-01-1988, the Commission approved the transfer of the electric generation facility from Rainy River - Taconite Harbor to MP, to be held within the regulated entity but not included in the regulated utility accounts. Because the unregulated land component is integral in arriving at the value allocated to the generation assets, the Commission directed the filing of additional substantiation of the values assigned to the land in the purchase from LTV.

On June 18, 2002, MP submitted additional information in compliance with the above orders, including a discussion of its in-house land valuation methodology.

On July 18, 2002, the Minnesota Department of Commerce (the Department) filed comments. Among other things, the Department expressed concern that there was no independent real estate valuation. The Department recommended that the Commission defer the issue of land valuation until sufficient information becomes available from property tax records. The Department stated that once the sale is recorded, information necessary to determine an independent low end valuation would be available.

On September 17, 2002, the Commission issued an Order in which it expressed concern about the real estate valuation being performed by MP's in-house real estate staff. The Commission directed that the values assigned to the transmission and generation assets be subject to the results of further Department review of the 2002 property tax valuations.

On April 2, 2003, the Department recommended increasing the value of the land from \$10 million to \$15 million. Alternatively, the Department recommended that the Commission direct MP to have an independent appraisal to determine the fair market value of the land.

On April 28, 2003, MP replied that its \$10 million valuation of the land was appropriate.

The Commission met on May 29, 2003 to consider this matter.

FINDINGS AND CONCLUSIONS

I. BACKGROUND

In October of 2001, Rainy River - Taconite Harbor (a subsidiary of MP) and Cleveland Cliffs, Inc. purchased substantial portions of LTV's Minnesota assets through LTV's bankruptcy proceeding. The portions purchased by MP included various parcels of land, the transmission line from Taconite Harbor to Hoyt Lakes, and the coal-fired generation units located at Taconite Harbor.

MP acquired the generation, transmission, land and other assets from LTV for a bundled price, approximately \$76 million. Few cost records exist to support the price paid for each part. In order to assign a reasonable value to the transmission and generation assets within MP's utility accounts, the Company reduced the overall purchase price by \$10 million, the amount the Company estimated to be the value of the non-utility land. After the land adjustment and smaller adjustments for fuel inventories, the Company allocated \$4.4 million to the transmission assets and approximately \$56 million to the generation assets.

The Department noted that the valuation of the land is a key component in the allocation of the overall purchase price to the transmission assets (and possibly the generation assets) in a future rate proceeding and that a low land valuation could lead to potentially larger gains for MP on the non-utility land at a future sale. The Department raised a concern, shared by the Commission, that MP's \$10 million figure resulted from the Company's internal staff review rather than from an independent appraisal.

In its September 17, 2002 Order, the Commission deferred the review of land valuations to enable the Department to review the counties' 2002 property tax valuations.

II. THE DEPARTMENT'S RECOMMENDATION

In its evaluation of the LTV land, the Department focused on both the property tax values and the fair market values derived from MP's sales of land, timber and gravel during 2001 and 2002. Comparing the property tax values in 2001 and 2002 with the fair market transactions, the Department recommended a revised fair market value for the LTV land of \$15 million. The Department determined this number by using the estimated \$9.1 million for 2002 property tax values as a low level floor in the valuation of the transaction.

The Department also recommended an independent valuation if the Commission was not convinced that the Department's \$15 million valuation for the LTV property was reasonable.

III. MP'S RECOMMENDATION

MP objected that the Department's concern for the future effect of the valuation on the generation and transmission assets for ratemaking proposes has caused it to improperly extrapolate tax valuations and changes in market price in order to unjustly inflate the 2001 valuation. MP argued that appreciation of the real estate since it was purchased (October 2001) is not relevant to the valuation for purposes of this docket. MP also argued that the Department overestimated the value of the lands not yet recorded when the Department did its survey (split lands, originally owned jointly with Cliffs-Erie) since those lands are substantially less valuable than the LTV lands that had been deeded directly to MP. MP also argued that the Department improperly extrapolated the fair market value of the LTV lands from the sales of prime segments in 2002.

MP maintained that its internal evaluation of \$10 million was correct, but at the hearing proposed that the land be appraised by an independent appraiser selected and paid by MP from a list of ten appraisers selected by the Department from the list of appraisers maintained by the Department of Natural Resources.

IV. THE COMMISSION'S ANALYSIS AND ACTION

The Commission believes that concern for the integrity of the process supports requiring an independent appraisal of the lands MP has acquired from LTV and that the selection of the independent appraiser should not be made solely by the Company. The Commission concludes that a fair and efficient selection process for the independent appraiser is as follows:

- 1) after the Department of Natural Resources updates its list of appraisers on July 1, 2003, the Department of Commerce will compile a list of 10 appraisers;

2) from that list of 10 appraisers the Department of Commerce and MP will jointly select an appraiser; and

3) once the appraisal is complete, the Department of Commerce will bring the appraisal to the Commission.

Both MP and the Department have agreed to work with this selection process. MP will defray the expense of the appraisal which, when it has been completed, the Department will bring to the Commission for approval.

ORDER

1. Minnesota Power (MP or the Company) and the Minnesota Department of Commerce (the Department) shall select an independent appraiser for the land portion of the LTV assets acquired by MP from the recent LTV bankruptcy proceeding and shall do so following the process described above in this Order.
2. MP shall defray the expense of the appraisal.
3. When the appraisal has been completed, the Department will bring it before the Commission for approval.
4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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