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In the Matter of the Application of the Grand Rapids Public Utilities Commission to Extend Its Assigned Service Area into the Area Presently Assigned by Lake Country Power

Grand Rapids Public Utilities Commission,

Relator,

vs.

Minnesota Public Utilities Commission,
Lake Country Power,

Respondents.

BRIEF OF RESPONDENT LAKE COUNTRY POWER

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STATEMENT OF THE CASE

Grand Rapids Public Utilities Commission (GRPUC) is acquiring three parcels of Lake County Power's (LCP) territory containing approximately 140 residential customers and one commercial customer. The ultimate issue for determination is the amount of compensation which GRPUC must pay LCP for this acquisition under the four factors set forth in Minn. Stat. § 216B.44. The amount of compensation for the "loss of revenue to the utility formerly serving the areas" is the only factor of the four in dispute.

Three times in the last 16 years the Court of Appeals has reviewed decisions of the Minnesota Public Utilities Commission (Commission) determining compensation for the acquisition of electric service territories. In the Matter of the Complaint by Kandiyohi Cooperative Electric Power Association against Willmar Municipal Utilities Commission for Extending Electric Service In and Adjacent to Westwind Estates, 455 N.W.2d 102 (Minn. App. 1990); In Re the Complaint Regarding the Annexation of a Portion of the Service Territory of People's Cooperative Power Association by the City of Rochester (North Park Additions), 470 N.W.2d 525 (Minn. App. 1991); Application by the City of Rochester for an Adjustment of its Service Area Boundaries with People's Cooperative Power Association (People's Cooperative 498 Docket), 556 N.W.2d 611 (Minn. App. 1996).

For a fourth time, on May 9, 2006, the Court of Appeals in an unpublished opinion again affirmed the basic principles used by the Commission in determining compensation for the loss of service territory. In the Matter of the Application of the City of Buffalo to Extend its Assigned Service Area Into the Area Presently Assigned to Wright-Hennepin Cooperative Electric Association, No. 05-1410 (May 9, 2006), reviewed denied (July 19, 2006).* The

* LCP acknowledges that unpublished opinions are not precedential. Minn. Stat. § 480A.08 Such opinions can be used, however, for their persuasive value. Becker v. State Farm Mut. Auto Ins. Co., 596 N.W.2d 697, review

decision of the Administrative Law Judge (ALJ) in this proceeding misconceived and misapplied several principles for determining compensation as set forth in the above four cases. In addition, the ALJ made several, erroneous findings of fact. The Commission reversed the ALJ on all major issues and reinstated the standard compensation formula which it has used, as approved by the Court of Appeals, for determining compensation under the statute.

There is substantial evidence to support the Commission's Findings, Conclusions, and Order that compensation be set at 30 mills/kWhs for present and future customers for a period of ten years. GRPUC filed a Petition with the Commission for reconsideration/rehearing of its April 1, 2005 Order. The Commission did not review that Order.

STATEMENT OF THE ISSUES

LCP will address the issues raised in GRPUC's Initial Brief.

STANDARD OF REVIEW

LCP concurs in the standard of review set forth in Respondent Minnesota Public Utilities Commission's Brief.

ARGUMENT

I. THE COMMISSION'S ORDER PRESCRIBED REASONABLE COMPENSATION FOR THE SERVICE TERRITORY ACQUIRED.

GRPUC contends that the Commission's Order contained no reasonableness checks. As a consequence, GRPUC claims that the prescribed compensation is unreasonable and unconstitutional. Past Commission orders have made clear that the purpose of compensation under the loss of revenue in Minn. Stat. § 216B.44 is to make the Cooperative whole after the acquisition of its service territory has transpired. As the Commission stated in Complaint of People's Cooperative Power Association, Docket No. E-132/SA-88-270 (1989): "This formula,

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granted, reversed 611 N.W.2d 7, on remand, review denied. Since this case and the Buffalo appeal have some similar issues, the Court of Appeals decision on the Buffalo appeal has persuasive impact for this appeal.

particularly the inclusion of loss of revenue, evinces a legislative intent to place the displaced utility in the same financial position it would have occupied had the acquisition not occurred." Order, p. 9. The Court of Appeals affirmed that position in the North Park Additions appeal.

The Commission's Order in this proceeding describes the relevant inquiries that are made in the ultimate calculation of the loss of revenue. Order, pp. 3-4. The Commission uses the "net revenue loss" method. First, the total revenues from the acquired areas are ascertained. Second, the expenses which will be avoided after the areas are acquired are determined. Third, the avoided expenses are subtracted from the total revenues, leaving a net revenue loss amount. Fourth, this net revenue loss amount is extended over ten years, and the cumulative amount is reduced to a present value lump sum. In all recent cases, this lump sum amount is converted into a per kilowatt hour mill rate, and compensation is paid at this mill rate over the ten year period

This compensation formula, and the economic loss that it was designed to measure, was approved by the Court of Appeals in North Park Additions, 470 N.W.2d 525 (Minn. App. 1990) and implicitly approved again in the People's Cooperative 498 Docket, 556 N.W.2d 611 (Minn. App. 1996). Both expert witnesses, Mr. Eicher for LCP, and Mr. Berg for GRPUC, used this compensation formula for developing their loss of revenue calculations. Ex. 1, DRE-6, p. 1 and Ex. 22, DAB-1, p. 2. Both expert witnesses ultimately arrived at identical calculations for the gross revenues from the acquired areas at $135,425.00. Tr. 2, p. 196. The only significant differences which Mr. Eicher and Mr. Berg had related to the calculation of avoided purchased power expenses and whether there were any avoided system improvements, which has a "trickle down" impact on the avoided expense items of interest, depreciation, and operations and maintenance.

GRPUC argues that the Commission rejected four tests of the reasonableness of the compensation determined as proposed by the ALJ. The Commission rejected these four tests with good reason. None of them is a reasonable arbiter of compensation as the Commission Order amply demonstrates.

The Department of Commerce exhibit showing past settlements/contested cases before the Commission test fails because the various proceedings in that exhibit dealt with numerous local financial circumstances between the municipal utility and the cooperative that are totally different from the case at hand. That point is aptly demonstrated by Mr. Berg's testimony that the appropriate mill rate in this case should be 16.5 mills/kWhs. His testimony in that regard is more than twice the average of the past settlements/contested cases exhibit.

The multiplier of gross revenues test fails because it has no inherent economic justification. The Commission is assigned the responsibility of setting compensation based on the application of the statutory factors to the facts of the case. Neither party advocated the use of a multiplier test, and the ALJ had no evidence in the record upon which to recommend it. As the Order indicates, the multiplier test has not been referred to by the Commission since the Olivia case 20 years ago.

The system area versus acquired areas margin comparison test fails because the loss of revenue factor for the areas covers not only margin, but more importantly, coverage for the residual costs of operation that remain after the acquisition which are not avoided such as the backbone distribution system, administrative/general, customer accounting, and on-going operations and maintenance. The ALJ's calculation of system margin (2.6%) compared to what he referred to as the area margin (40.4%) is comparing apples and oranges. Finally, the comparison to GRPUC's retail rates fails because the Commission is charged with determining

compensation based on the four factors in the statute. The focus of the inquiry is on the economic loss to the displaced utility, not the affordability of compensation to the municipal utility.

In summary, to compute the appropriate loss of revenue, two fundamental questions are asked. First, what revenues will be lost as a result of the acquisition? Second, what expenses will be avoided or not incurred as a result of the acquisition? If the questions asked under the statute are proper, and the answers given in response are correct, the result, by definition, is reasonable. As in past cases, the Commission replicated that analytical process once again in this proceeding.

II. THE COMMISSION'S DETERMINATION OF COMPENSATION WAS NOT ARBITRARY OR CAPRICIOUS.

GRPUC maintains that the Commission's Order was arbitrary and capricious for several reasons. GRPUC states that loss of revenue was awarded for future customers, when the evidence showed that no future customers would locate in the acquired areas. GRPUC Brief, p. 20. GRPUC's characterization of the evidence is untrue, and the ALJ's finding in this regard was clearly erroneous. Mr. Eicher estimated that 17 customers would locate somewhere in the acquired areas in the next ten years. Ex. 1, DRE-9, p. 2. While Mr. Mattei, GRPUC's witness, found Mr. Eicher's projection too optimistic, he testified as follows:

> "Based on the current relatively slow flat rate of population growth in Grand Rapids (Chart omitted) and the consistent rate of housing development demonstrated by the building permit records over the past four years, <u>I would estimate the addition of one or two dwellings per year</u> in the Mississippi Heights and Remer-Deschepper Additions (South of Deschepper Drive) over the next ten years." Ex. 20, p. 8.

GRPUC's evidence was that there would be some growth in the areas.

Furthermore, the ALJ found that the bare ground areas of Segment 2B were being served by LCP and that "Lake County is not precluded from an award of revenue from future customers by the 'investment to serve' criteria established in North Park." Finding of Fact No. 25. GRPUC made no exception to this finding, and it was adopted by the Commission. Order, p. 6. Established case law holds that if a utility has facilities in place capable of serving the areas, it is entitled to loss of revenue from any future customers that locate there. Any dispute concerning the precise number of customers is resolved by calculating the mill rate per kilowatt hour for future customers. In that way, GRPUC will pay only for the customers that actually locate in the acquired areas over the next ten years.

GRPUC claims that the Commission improperly overruled the ALJ's findings on the credibility of the parties' expert witnesses. The Commission adopted several findings and conclusions of the ALJ. Order, p. 6. It rejected other findings and conclusions and, the Commission set forth the reasons for doing so. Order, p. 6. The Commission's reasons for rejecting the ALJ's Report had little to do with witness credibility. Rather, they had to do with an ALJ Report that contained few findings of fact, did not systematically apply the net revenue loss compensation formula to either party's version of the facts, and did not analyze the accuracy of either party's formula inputs. The ALJ Report simply did not pass the credibility test.

GRPUC argues that the Commission's Order inverted the law, GRPUC Brief, p. 31. This argument is hard to understand. Cases involving fair housing acts and the No Child Left Behind Act seem irrelevant to the exercise of setting compensation for a service territory acquisition. No legal principles were inverted. GRPUC filed a petition to acquire LCP's service territory rights, and the Commission set the price for the acquisition. That is what Minn. Stat. § 216B.44 requires.

GRPUC states that the Commission's Order will undermine service territory stability and reasonable negotiations. No support whatever is offered for this far reaching claim. Furthermore, the Commission is charged statutorily with determining compensation for the loss of service territory, not to mediate settlement discussions between parties.

III. THE COMMISSION REACHED A REASONABLE DECISION ON THE CALCULATION OF AVOIDED PURCHASED POWER EXPENSES.

Mr. Eicher testified initially that the avoided purchased power expense should be 46 mills/kWhs Mr. Berg testified that it should be 61 mills/kWhs. The Commission set the avoided purchased power expense at 51 mills/kWhs. This number is clearly within the evidence submitted by the parties. Mr. Eicher based his calculation on average system load data, since actual load data for the acquired areas was not available. During the hearings, he recognized that LCP's system load factor could be higher than the load factor of the acquired areas, because LCP serves several large high load factor industrial customers. He testified that if the load factor for the acquired areas was adjusted downward from the system average load factor, the effect could be to raise his estimated purchased power expense to as high as 50 mills/kWhs.

Mr. Berg based his calculation of purchased power expense on a 2000 rate study and projected forward the wholesale costs in that rate study, using the increases in LCP's wholesale power costs from 2000 to 2004. He acknowledged that this rate study contained several components, i.e., a rate phase-in, a special assessment, and a substation charge, which components totaled $2,400,000.00, that were no longer components of LCP's 2004 wholesale power costs. Nevertheless, Mr. Berg made no adjustment to his calculation of purchased power expense in recognition of this fact.

The Commission was faced with a situation where it could not adopt either party's calculation of purchased power expense. With respect to Mr. Berg's calculation of 61

mills/kWhs, the Commission reasoned that adjusting his calculation for the three components that were no longer part of LCP's wholesale power expenses, together with an adjustment to his calculation for the fact that he failed to reduce purchased power expense by the discounted wholesale rates for off-peak sales, could produce a reduction of his purchased power expense to approximately 51 mills/kWhs.

With respect to Mr. Eicher's calculation of purchased power expense of 46 mills/kWhs, the Commission reasoned that his initial calculation did not adequately recognize the differences in load factor between LCP's system as a whole and the acquired areas. Mr. Eicher's adjustment of purchased power expense to 50 mills/kWhs, which was 10 mills higher than the purchased power expense for LCP's system as a whole, was entitled to credence. The Commission observed that LCP had firsthand knowledge of its own load characteristics, and that LCP had applied the net revenue loss formula in an accurate and straightforward manner throughout the case. In the end, the Commission balanced the available evidence offered by both parties and concluded that 51 mills/kWhs was the appropriate purchased power expense.

GRPUC contends that "LCP offered new evidence calculating the wholesale power expenses at 52.9 mills/kWhs..." GRPUC Brief, p. 35. In its Exceptions to the Report of the ALJ, p. 12, LCP presented a calculation of purchased power expense based on implicit load factors for the acquired areas in the 2000 rate study used by Mr. Berg. That calculation showed a resultant purchased power expense of 52.9 mills/kWhs. That calculation was not new evidence, nor did it represent LCP's position regarding appropriate purchased power expense. Rather the point was to show that Mr. Berg's purchased power expense calculation substantially overstated the load factor for the acquired areas. It demonstrated that using Mr. Berg's own data, his purchased power expense was too high.

IV. THE COMMISSION PROPERLY DETERMINED THAT THERE WERE NO AVOIDED SYSTEM IMPROVEMENTS THAT SHOULD BE RECOGNIZED IN DETERMINING LOSS OF REVENUE.

GRPUC maintains that the Commission ignored evidence submitted by GRPUC of the investments made by the City of Rochester and the City of Buffalo for serving areas after each city had acquired service territory from their neighboring electric cooperatives. This evidence has nothing to do with any issue in this case. Rather what is at issue is the amount of compensation which should be paid in recognition of the investment made by LCP in providing service to the areas prior to their acquisition.

GRPUC insists that its calculation of avoided system improvements uses the "incremental" rather than the "averaging/allocation" approach. That is simply not true. While Mr. Berg used 11 miles of local three-phase distribution line at a replacement cost of $552,000.00 and a new substation at a cost of $690,000.00, he still allocated a share of these local costs to the areas without any attempt to determine whether such allocated costs were also avoided. In fact, they will not be avoided.

LCP has no plans to construct any system improvements for the areas for several years beyond the compensation period as the ALJ found. Finding of Fact No. 16 If there are no system improvements contemplated, then obviously such improvements cannot be avoided. GRPUC claims that the acquisition will free up capacity on the LCP system for other purposes. Any freed up capacity from the acquisition is of no benefit to LCP, since it already has more capacity than needed to serve these areas for the indefinite future. Mr. Berg could not point to one place on LCP's system where any freed up capacity would be of any value. Regardless of GRPUC's description of the method that it used in determining avoided costs, it clearly used the "allocation" rather than the "incremental" method.

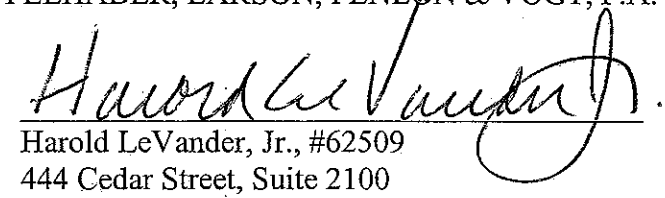
CONCLUSION

For the reasons stated above, the Court of Appeals should affirm the Commission's Order.

Dated: September 20, 2006.

Respectfully submitted,

FELHABER, LARSON, FENLON & VOGT, P.A.



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