

STATE OF MINNESOTA  
OFFICE OF ADMINISTRATIVE HEARINGS  
FOR THE  
PUBLIC UTILITIES COMMISSION

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

**FINDINGS OF FACT,  
CONCLUSIONS, AND  
RECOMMENDED ORDER**

The above-entitled matter came on for an evidentiary hearing before Administrative Law Judge Beverly Jones Heydinger on May 25, 2004 in Buffalo, Minnesota, and May 26 and 27, 2004 in Saint Paul, Minnesota. A public hearing was held in Buffalo on May 25, 2004. The hearing record remained open after the hearing for submission of posthearing briefs. The hearing record in this matter closed with receipt of a clarifying letter on October 1, 2004.

Kathleen M. Brennan and Andrew J. Shea, Attorneys at Law, McGrann, Shea, Anderson, Carnival, Straughn & Lamb, Chartered, 800 Nicollet Mall, Suite 2600, Minneapolis, MN 55402-7035, appeared for the City of Buffalo (City).

Harold LeVander, Jr., Attorney at Law, Felhaber, Larson, Fenton & Vogt, P.A., 444 Cedar Street, Suite 2100, Saint Paul, MN 55101-2136, appeared for Wright Hennepin Cooperative Electric Association (WHCEA).

Ginny Zeller and Karen Finstad Hammel, Assistant Attorneys General, 445 Minnesota Street, Suite 1400, Saint Paul, Minnesota 55101-2131, appeared for the Minnesota Department of Commerce (Department).

Stuart Mitchell, Rate Analyst, 121 Seventh Place East, Suite 350, Saint Paul, Minnesota, appeared on behalf of the Staff of the Minnesota Public Utilities Commission (Commission or PUC).

**NOTICE**

Notice is hereby given that, pursuant to Minn. Stat. § 14.61, and the Rules of Practice of the Minnesota Public Utilities Commission ("Commission") and the Office of Administrative Hearings, exceptions to this Report, if any, by any party adversely affected must be filed according to the schedule that the Commission will announce. Exceptions must be specific and stated and numbered separately. Proposed Findings of Fact, Conclusions and Order should be included, and copies thereof shall be served upon all parties. Oral argument before a majority of the Commission will be permitted to

all parties adversely affected by the Administrative Law Judge's recommendation who request such argument. Such request must accompany the filed exceptions or reply (if any), and an original and 15 copies of each document should be filed with the Commission.

The Commission will make the final determination of the matter after the expiration of the period for filing exceptions as set forth above, or after oral argument, if such is requested and one is held.

### **STATEMENT OF ISSUES**

Through this proceeding, the parties have resolved all but the following issues.

- Is WHCEA serving areas within its service territory when no customers are located in those areas and WHCEA's only nearby facility is a 3-phase line running adjacent to the property?
- Over what period should lost revenue from customers be calculated?
- What is the appropriate level of compensation for lost revenue from existing customers?
- Under what circumstances should WHCEA receive compensation for lost revenue from future customers?
- What is the appropriate level of compensation for lost revenue from future customers?

In addition to the above contested issues, the City and WHCEA have agreed on three of the items of compensation. A Finding on those items has been included in this Report, along with an analysis of the disputed issues.

Based upon all the proceedings herein, the Administrative Law Judge makes the following:

### **FINDINGS OF FACT**

#### **Jurisdictional-Procedural Background**

1. On July 1, 2003, the City filed a Petition with the Commission under Minn. Stat. § 216B.44, requesting extension of the City's assigned service area to include three recently annexed areas. These areas were identified as Martineau's Subdivision, Sundance Ridge, and Mill Creek Inn. All three of the areas lie within the assigned service area of WHCEA. WHCEA joined the City in asking for a contested case hearing on the City's Petition. The City also requested that the Commission grant it the right to serve the annexed area pending the determination of compensation in this proceeding. WHCEA objected to that request.

2. On October 16, 2003, the Commission issued an Order denying the City's request for interim service rights and issuing the Notice and Order for Hearing directing that a contested case hearing be convened to determine the amount of compensation that the City should pay to WHCEA for the adjustment of the assigned service territories.

3. On March 2, 2004, the Commission issued an Order approving a request to amend the October 16, 2003 Order, to include the Trueman-Welters parcel, the Bentfield Mills Addition, and the St. Francis School/Church to the areas to be assessed in this proceeding.

### **Summary of Public Comments**

4. A public hearing was conducted on this matter at Buffalo, Minnesota on May 25, 2004. Members of the public were given the opportunity to testify. The Mayor of Buffalo and an employee of the City's electric utility both testified to reliability of the City's electric service to customers. Both testified that customers near Buffalo, but outside of the City's assigned service area, call to complain of service outages. The owner of the Mill Creek Inn testified that he may have been improperly charged for electrical service from WHCEA. An employee of the Minnesota Municipal Utilities Association (MMUA) who resides in Buffalo testified that the City did not have unlimited resources and that the scope of the City's resources should be considered in arriving at a reasonable compensation amount.

### **Description of the Utilities' Service Areas**

5. The City of Buffalo is situated between Buffalo Lake (in the southwest) and Lake Pulaski (in the northeast). The City boundary extends approximately halfway around Buffalo Lake, with significant development all along the area from the lakeshore to Highway 55.<sup>[1]</sup> The City boundary also extends northeast from Highway 55 around the entire lakeshore of Lake Pulaski. Development is dense in the area between the two lakes, and extends thinly around the west shore of the lake. Very dense development is located on the east shore of Lake Pulaski.<sup>[2]</sup>

6. The City provides electricity to most of the area within its municipal boundary. A number of annexed areas that were being served by WHCEA are now within the City boundary and have remained with WHCEA as their electricity provider. The City has 4,200 electric customers.<sup>[3]</sup> The City's annual sales in kilowatt hours (kWh) is just below 100 million kWh.<sup>[4]</sup> In 1974, the City had 2,000 customers, and has experienced slow growth in customers and electrical sales over the past 30 years.<sup>[5]</sup>

7. WHCEA provides electricity to a large area outside of municipal boundaries in Wright County and Hennepin County. In the general area around the City, most of the area to the west is served by WHCEA.<sup>[6]</sup> To the east, electric service is provided by WHCEA and Northern States Power.<sup>[7]</sup> Over its entire service area, WHCEA serves approximately 38,000 retail customers.<sup>[8]</sup> WHCEA's service area

encompasses almost all of Wright County and large parts of northwestern and western Hennepin County. WHCEA's annual sales are just below 700 million kWh.<sup>[9]</sup>

8. WHCEA has experienced steady growth in its number of customers served. In 1974, WHCEA had approximately 13,000 customers.<sup>[10]</sup> At that time, the City had 2,000 electric customers. WHCEA has had relatively uniform annual growth over the following years to reach 35,000 customers. WHCEA adds approximately 2,000 new customers per year.<sup>[11]</sup> The City experienced little growth over this period, currently serving 4,200 customers.<sup>[12]</sup>

9. In the general vicinity of the City, WHCEA provides electricity in its service area via a three-phase primary overhead line (3-phase line) running around the City to both the east and west. This 3-phase line runs south from the WHCEA's Black Lake substation (located approximately four miles north of the City). The 3-phase line branches east adjacent to the eastern shore of Lake Pulaski then directly south to WHCEA's Mary Lake substation (located approximately three miles south of the City on Highway 55).<sup>[13]</sup> The 3-phase line also branches to the west of the City, providing electricity to the thinly developed areas to the west and south of the City. The western loop of the 3-phase line merges with the eastern branch south of the City and terminates at the Mary Lake substation.<sup>[14]</sup>

10. The eastern branch of the 3-phase line provides service to the densely developed area on the north and east side of Lake Pulaski.<sup>[15]</sup> This densely developed area is located within the municipal boundary of the City, but electrical service is provided by WHCEA. Electric customers in this area are served by the 3-phase line, numerous A-phase lines, numerous B-phase lines, and secondary feeder lines.<sup>[16]</sup> The portions of WHCEA's service area that are adjacent to, but outside of the municipal boundary are essentially undeveloped, with minimal electric distribution facilities installed.<sup>[17]</sup>

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### **Description of the Annexed Service Areas**

11. The Mill Creek Inn property (Area 1) is located on the western end of the City, adjacent to Area 2 (described in the next finding). Area 1 is a small plot containing a single commercial customer, the Mill Creek Inn, and five residential customers.<sup>[18]</sup>

12. Sundance Ridge (Area 2) is a proposed development of 290 residences on the western edge of the City, adjacent to the northwest corner of Buffalo Lake and just north of the Mill Creek Inn property.<sup>[19]</sup> The area to the east of Sundance Ridge was within the City's municipal boundary prior to the annexation. Sundance Ridge is proposed for construction that is of similar density to the area to the east. At the time of annexation, WHCEA was serving one residential customer within Area 2.<sup>[20]</sup> WHCEA did not install substantial facilities for providing electrical service to Area 2 or the other parcels within WHCEA's service area adjacent to Area 2. The installation of substantial

distribution facilities is required before electrical service can be provided to the customers that will be located within Area 2.

13. Bella Vista (Area 3) is a proposed development of 49 residences situated on the western edge of the City, adjacent to the east side of Albert Lake and bordered on the south by 25<sup>th</sup> Street NW.<sup>[21]</sup> The area to the southeast of Bella Vista was within the City's municipal boundary prior to the annexation. Bella Vista is proposed for construction that is of similar density to the area to the southeast which is receiving electrical service from the City. At the time of annexation, WHCEA was serving one residential customer within Area 3.<sup>[22]</sup> WHCEA did not install substantial facilities for providing electrical service in or adjacent to Area 3.

14. Grandview (Area 4) is a proposed development of 62 residences and apartments with a total of 75 units situated adjacent to State Highway 55 at the northwest edge of the City.<sup>[23]</sup> Grandview is bordered on the south by 25<sup>th</sup> Avenue NW. The area to the south of 25<sup>th</sup> Avenue NW was within City's municipal boundary prior to the annexation. Grandview is proposed for construction that is of similar density to the area to the south. At the time of annexation, WHCEA was serving one customer within Area 4 (a maintenance shed that has been removed). WHCEA did not install substantial facilities for providing electrical service to Area 4 or the other parcels within WHCEA's service area adjacent to Area 4.

15. A church school is being developed on a plot of land (Area 5) at the northern-central edge of the City. No other customers are anticipated on that land. To the south of Area 5 is residential development that remains within the WHCEA's service area. At the time of annexation, Area 5 was bare ground with no customers being served by WHCEA. Area 5 is shaped to avoid including two customers served by WHCEA.<sup>[24]</sup> WHCEA's service area entirely surrounds Area 5. The residential development to the south consists of approximately forty residential customers, served by WHCEA using a B-phase line and secondary feeders.<sup>[25]</sup>

16. The Trueman-Welters property (Area 6) is located on the southeast border of the City, adjacent to Calder Avenue NE.<sup>[26]</sup> Area 6 is in the service area of WHCEA. No electric customers are currently located in Area 6. Only one customer is anticipated to locate with Area 6 in the future.<sup>[27]</sup> The eastern loop of WHCEA's 3-phase line runs along the western edge of Area 6. One 12v drop is located on the property.<sup>[28]</sup> There are no other facilities situated in Area 6. The City forecasts that an underground primary cable, padmount distribution transformer, or secondary service will be required to be installed when a customer requests service in Area 6.<sup>[29]</sup>

17. Property on the eastern edge of the City (Area 7) is slated for construction of the City Garage. No other future customers are anticipated in Area 7. Area 7 is approximately one-half mile north of Area 6, also along Calder Avenue NE.<sup>[30]</sup> The eastern loop of WHCEA's 3-phase line runs along the western edge of Area 7. WHCEA has no other facilities in Area 7. The City forecasts that similar facilities to those slated for Area 6 will need to be installed when electrical service is provided to the City Garage.<sup>[31]</sup>

18. The City's service area extends eastward north of Area 6 and south of Area 7 to form an irregular T-shape. Half of the eastern boundary of Area 6 and all of the eastern boundary of Area 7 abut the City's existing service area. The annexation results in the City's service area forming a regular rectangle with these parcels.<sup>[32]</sup>

### **Description of Facilities Construction in the Service Areas**

19. The City has identified eleven improvements it has made to its electric distribution system that enable the City to meet additional load requirements and improve reliability. These improvements include increasing the total output of a substation to 60 megawatts (MW) and adding underground distribution feeders on the south and west sides of the City. These improvements have all taken place in the last five years and totaled \$3,156,531 in capital costs incurred by the City.

20. The only distribution facilities that WHCEA has recently constructed near the seven annexed areas is a replacement 3-phase line to provide a more reliable connection between the Mary Lake substation and the Black Lake substation.<sup>[33]</sup> That construction occurred in 1987.

21. The only area in the immediate vicinity of the City where WHCEA has installed extensive distribution facilities is the eastern shore of Lake Pulaski. That area is within the City's municipal boundaries. None of these distribution facilities are near the annexed areas. WHCEA has installed modest distribution facilities adjacent to (but not in) Area 5 and in Area 1 to serve existing customers there.

### **Description of Proposed Construction by WHCEA**

22. WHCEA has a 2002-2011 long-range plan for providing electricity within its service area.<sup>[34]</sup> The only proposed construction of distribution facilities affecting the annexed areas is an additional substation.<sup>[35]</sup> WHCEA has proposed to build a new substation, located south of Lake Pulaski.<sup>[36]</sup> The proposed substation would connect the east and west loops of the WHCEA 3-phase line. WHCEA has indicated that the substation is needed to improve electric service to existing customers and will be built whether or not WHCEA serves customers in the annexed areas.<sup>[37]</sup> Because of current demand and projected customers outside the annexed area, the loss of new customers in the annexed areas will not reduce the size of the proposed substation.<sup>[38]</sup>

23. WHCEA's long range plan forecasts the ongoing electricity demand in the cooperative's service area. In assessing WHCEA's system capacity for meeting that demand, the long range plan concluded, "Major system improvements will be necessary to improve the voltage and loading to acceptable levels."<sup>[39]</sup>

### **Experience with Prior Annexed Service Areas**

24. Since 1988, the City annexed six service areas from WHCEA (not including the annexed areas in this proceeding). Three of those annexations were to create industrial/commercial parks and three were subdivided for residential development.<sup>[40]</sup> The City identified materials, labor, and equipment expenses of \$1,842,678.23 for

capital improvements required to serve those six annexed service areas.<sup>[41]</sup> None of those capital improvements are included in the general distribution upgrades described in Finding 19, above.<sup>[42]</sup>

25. In 1990, the City of Rochester (Rochester) annexed a number of properties from People's Cooperative Power Association. As part of the adjustment of service areas, Rochester was required to compensate the cooperative for lost revenue from existing and future customers. The annexed areas contained 350 existing customers. The remainder of the annexed areas was bare ground, projected for development resulting in Rochester serving approximately 6,000 new customers.<sup>[43]</sup> Rochester was required to pay compensation in the amount of \$7,450,000.<sup>[44]</sup> In order to serve those additional customers, Rochester acquired the existing facilities in the area for approximately \$350,000. Rochester invested an additional \$36,000,000 in electricity distribution infrastructure (not including additional generating capacity) to provide adequate service to those areas.<sup>[45]</sup>

### **Analysis of Service in the Annexed Area**

26. The availability of electricity from an adjacent 3-phase line establishes that WHCEA is serving the annexed areas within the meaning of Minn. Stat. § 216B.44. WHCEA is entitled to compensation for loss of revenue from the existing eight customers in the annexed areas. WHCEA uses a ten-year planning period. Awarding future net revenues from existing customers over a ten-year period is appropriate compensation to WHCEA for the annexation of those customers and consistent with the Commission's holdings in *Olivia I* and *People's Cooperative*.<sup>[46]</sup>

27. The City and WHCEA have agreed on the amount of compensation required for the "original cost of the property, less depreciation" and "expenses resulting from integration of facilities, and other appropriate factors."<sup>[47]</sup> The parties agreed that the original cost amount should be \$5,097, the integration compensation should be \$10,168, and the "other appropriate factor" is zero. The parties differ on how to appropriately calculate the "loss of revenue to the utility formerly serving the area", both in identifying what customers should be included in the calculation and how the appropriate rate of compensation should be calculated.

28. WHCEA has requested compensation for the loss of revenue from future customers over the ten-year planning period. The City maintained that such an award was inappropriate since WHCEA is experiencing "explosive growth" and the size of the City's anticipated acquisitions is small enough to fall within the "rounding error in [WHCEA's] plans."<sup>[48]</sup> Prior Commission rulings have held that such compensation may or may not be appropriate based on the circumstances. The Department indicated that, since the *Olivia I* decision, the Commission has not been asked to rule on a proposal for a compensation period of less than ten years.<sup>[49]</sup>

29. There is only one anticipated future customer in Area 7. That customer is the City itself, which is building the City Garage on the site. Under these circumstances,

the holding in *Olivia I* applies, since there is no anticipated development that is being done outside of the City's own investment.

30. In Area 1, the Mill Creek Inn parcel, there are no anticipated future customers. No compensation is appropriate for lost revenue from future customers.

31. Sundance Ridge (Area 2) has one existing customer and 290 residences under construction or planned. WHCEA is losing the opportunity to serve those 290 future customers. WHCEA is requesting compensation for the lost revenue from those future customers. The City maintains that no such award is appropriate since WCEHA has made no significant investments in distribution infrastructure to serve the area.

32. While Sundance Ridge qualifies as a "bare ground" annexation due to the lack of significant distribution facilities, the risk of development is being borne by a private party, not the City. The same analysis applies to Areas 3, 4, and 6.

33. WHCEA has not made significant investments to serve the annexed areas. Insufficient load to serve existing customers has resulted in problems identified by the City and investments by the City to address those problems.<sup>[50]</sup> The only investment identified in the vicinity of the annexed areas was the upgrading of the 3-phase line done in 1987, intended to address service reliability problems for existing customers. WHCEA's two substations serving its customers are distant from the annexed areas and have been in use for a long period of time. Those facilities are insufficient to provide reliable service to WHCEA's existing customers. WHCEA has not made investments to serve the annexed area that are significant enough to support an award of lost revenue from future customers.<sup>[51]</sup>

34. The City has made significant investments to enable the City to meet additional load requirements and improve reliability. Eleven improvements to its electric distribution system were identified, including an increase in the total output of a substation to 60 megawatts (MW) and additional underground distribution feeders on the south and west sides of the City. The improvements have all taken place in the last five years and totaled \$3,156,531 in capital costs incurred by the City.<sup>[52]</sup>

35. The City has made the necessary investment in electric distribution to ensure that the new demands on the City's system will be met. WHCEA has not made significant investment to serve the annexed area. The City shares its investment costs over a customer base that has increased slowly over the past thirty years. In recent years, WHCEA has experienced as much customer growth annually as the City has experienced over this thirty-year period.<sup>[53]</sup> Sales by kWh closely correlate to the number of customers served by the City and WHCEA.<sup>[54]</sup> The City notes that growth of WHCEA's kWh sales from 2000 to 2002 is equivalent to the entire load of the City.<sup>[55]</sup>

36. A concern expressed in *People's Cooperative* is that municipal utilities could vastly expand their service area at the expense of neighboring cooperatives. Taken in the aggregate, the size of the annexed areas is small, encompassing specifically identified areas that are located near or adjacent to the pre-annexation

municipal boundaries. Area 2, Area 3 and Area 4 are all “bare ground” parcels that have adjacent development within the City’s pre-annexation municipal boundary. Area 6 is a bare ground parcel. There are only a few customers in the vicinity of Area 6. All of the adjacent developed areas receive their electric service from the City. The density of the existing development in the City is consistent with the proposed density of development in the annexed parcels. For these four areas, annexation does not constitute the “absurd results” that the Commission was concerned with in **People’s Cooperative**.<sup>[56]</sup>

37. The impact of the annexation on WHCEA does not result in lost recovery of costs associated with facility development in contemplation of services in the area. Neither are there demonstrated margin losses that would increase the cost of services and decrease the real value of facilities for other WHCEA patrons. These were factors that supported the award in the **People’s Cooperative** matter, affirmed in **North Park Additions**.<sup>[57]</sup> The absence of investment in facilities precludes loss of recovery of such investment. The rapid, consistent growth of WHCEA’s customer base demonstrates that there will be no margin losses that will increase costs or decrease the value of facilities for existing customers.

38. Among the annexed parcels, Area 5 has different characteristics, in location, type of future customer, and presence of some development served by WHCEA adjacent to the parcel. WHCEA has made some investment in the residential area immediately south of Area 5. Further, the future customer is a school, which is an institutional customer that can be readily supplied with minimal distribution facilities added by the utility. The customer will be purchasing electricity at the Commercial and Industrial rate (CI60).<sup>[58]</sup> Area 5 is near the pre-annexation municipal boundary, but not adjacent to the City. Area 5 was shaped to exclude adjacent existing facilities from the annexed area. The borders of the annexed area constitute the sort of gerrymandering of the annexed service area that is criticized in **People’s Cooperative**.<sup>[59]</sup> These different characteristics support the conclusion that awarding compensation to WHCEA for lost revenue from the future customer in Area 5 is appropriate.

### **Lost Revenue Calculation**

39. The parties disagree on how compensation for lost revenue from future customers should be calculated. WHCEA has proposed calculating gross revenue from the sales to future customers, deducting the purchased power expense, avoided incremental investment in new facilities, depreciation expense, consumer accounting expense, administrative and general expenses, personal property taxes, and interest expense.<sup>[60]</sup> WHCEA indicated that no projects could be avoided or deferred due to not handling the proposed load in all seven annexed service areas.<sup>[61]</sup> An adjustment was made to reflect the reduction of load on substation transformer capacity.<sup>[62]</sup>

40. By applying the anticipated amounts in the formula described above, WHCEA arrived at a loss of revenue calculation for all seven annexed parcels of \$1,163,518.<sup>[63]</sup> Dividing this revenue amount by the anticipated electricity sales amounts to 31.2 mills/kWh for future customers and 28.2 mills/kWh for existing

customers.<sup>[64]</sup> WHCEA proposed applying the mill rate to actual sales as the preferred method of calculating appropriate compensation.<sup>[65]</sup>

41. The City asserted that WHCEA’s formula overstated the appropriate mill rate, the appropriate length of the compensation period, and inappropriately included compensation for loss of revenue from future customers.<sup>[66]</sup> Using a mill rate of 11.2 mills/kWh for existing customers, a two-year compensation period, and no future customer compensation, the City arrived at a total compensation figure (adjusted to present value) of \$20,527.<sup>[67]</sup>

42. The mill rates advanced by the City and WHCEA for existing customers were incorrect, due to the use of an incorrect billing rate for the sole commercial customer in Area 1. With the revision in the amount charged to the commercial customer, the estimated gross revenue net (gross revenue less the cost of purchased power) was very similar for the two parties.<sup>[68]</sup> After the hearing, more accurate information resulted in newly calculated mill rates for existing customers of 17.9 mills/kWh proposed by WHCEA and 11.73 mills/kWh proposed by the City.<sup>[69]</sup> The ten-year compensation figure for existing customer revenue was \$35,293 as calculated by WHCEA and \$23,153 as calculated by the City.<sup>[70]</sup>

43. For existing customers, the competing calculations of annual net loss of revenue from existing customers are as follows:

	<u>WHCEA Figures</u>	<u>City Figures</u>
Revenue	\$16,023.00	\$16,061.00
Power Cost	10,738.00	10,951.00
Operation/Maintenance	327.00	467.00
Depreciation	250.00	642.00
Customer Accounting	96.00	120.00
Property Taxes	190.00	291.00
Admin/General	96.00	120.00
Interest	<u>237.00</u>	<u>956.00</u>
Total Expenses	\$11,936.00	\$13,557.00
Annual Net Revenue Loss	\$4,087 (17 mills/kWh)	\$2,504 (10.4 mills/kWh)
Ten Years	17.9 mills/kWh (DRE Supplemental	11.73 mills/kWh (DAB Supplemental

Net Loss of Revenue	Testimony, at 1 )	Testimony, at 3)
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[71]

44. When installing service to a new customer, WHCEA imposes a CIAC fee to defray the costs of construction. This charge reduces the capital cost to WHCEA since the entire cost to install the new service is not paid by the cooperative. The City asserts that the CIAC is a policy of WHCEA that artificially inflates the net lost revenue under the **People's Cooperative** compensation formula. This inflation occurs by reducing the cost to the cooperative by the amount to be contributed by the consumer. WHCEA maintains that the CIAC is an accepted practice and that the reduced capitalization of the facilities constructed is an accepted accounting practice. [72]

45. The Department assembled a list of 19 service area settlements and 2 orders over the past 13 years. [73] In seventeen settlements, the mill rate ranged from 5 to 10 mills, most for a period of 10 years. One settlement was for 15 mills for a 5-year period and another was for 25 mills for a 10-year period. The mill rates for the two Commission compensation orders were 13.7 and 11 mills. The 13.7 mill/kWh award was for a single, very large customer and relied explicitly on the formula in the **People's Cooperative** decision. [74]

46. By taking into account the cost of improvements necessary to the electricity distribution system and not using the CIAC to adjust the calculation, the City's analysis of lost revenue is more accurate. The City's analysis is the appropriate method of calculating the appropriate compensation for lost revenue. WHCEA has shown that adjustments to the City's figures are appropriate for off-peak heating sale discounts, customer accounting costs, and administrative expenses. [75] With these adjustments, the net revenue loss from existing customers is calculated as follows:

	-	<u>Adjusted Figures</u>
Revenue		\$16,061.00
Power Cost		10,738.00
Operation/Maintenance		467.00
Depreciation		642.00
Customer Accounting		96.00
Property Taxes		291.00
Admin/General		96.00
Interest		<u>956.00</u>

Total Expenses		\$13,286.00
Annual Net Revenue Loss		\$2,775

47. The annual net revenue loss figure can be divided by the consumption by kWh to arrive at the appropriate mill rate for the compensation award for existing customers. Using the figure of 240,239 kWh results in a mill rate of 11.55. Over a ten-year period, the unadjusted compensation for lost revenue from existing customers is \$27,750. That amount should be reduced by the present value of the award to arrive at the current compensation amount for lost revenue from existing customers.<sup>[76]</sup>

48. Only Area 5 meets the existing standards that require compensation of lost revenue for future customers. WHCEA has calculated a mill rate for compensation of lost revenue from future customers of 31.0 mills/kWh.<sup>[77]</sup> WHCEA's mill rate fails to account for the significant expenses that WHCEA would incur to serve this additional customer. The City calculated a mill rate for future customers of 11.22.<sup>[78]</sup> The City's mill rate accounts for the significant investments needed to serve the future customer in Area 5 and is within the range of reasonableness that reflects amounts agreed to or awarded for future compensation in similar circumstances.

Based upon the foregoing findings, the Administrative Law judge makes the following:

## CONCLUSIONS

1. The Minnesota Public Utilities Commission and the Administrative Law Judge have jurisdiction over the subject matter of this proceeding pursuant to Minn. Stat. Ch. 216B and section 14.50.

2. Any of the foregoing Findings containing material that should be treated as a Conclusion is hereby adopted as a Conclusion.

3. The seven areas identified for inclusion in the City's exclusive service territory have been annexed by the City and are now within the City's municipal boundary. By operation of Minn. Stat. § 216B.44, the City is entitled to acquire the annexed service territory, upon payment of appropriate compensation.

4. The City and WHCEA have agreed that the value of the preexisting facilities being acquired, less depreciation, is \$5,097.00. WHCEA should receive compensation in the agreed-upon amount.

5. The City and WHCEA have agreed that the integration costs caused by the service territory adjustment is \$10,168. WHCEA should receive compensation for the integration costs in the agreed-upon amount.

6. Compensation for some loss of revenue from the acquired areas is appropriate over a reasonable planning period. WHCEA uses a ten-year long-range forecasting period for making facilities construction decisions. Ten years is the appropriate period for loss of revenue compensation.

7. Loss of revenue compensation for existing customers is appropriate based on a net revenue calculation. The City has demonstrated that its method for calculating net revenue more accurately reflects the actual gross revenue and costs incurred to provide electricity to WHCEA's existing customers. The anticipated electricity sales to the existing customers, at a mill rate of 11.55 reflecting net revenue per kWh, over a period of ten years results in an award of \$27,750. That amount is the appropriate compensation for the loss of revenue from existing customers, adjusted to current value.

8. Based on the standards set out in the Commission decision in ***People's Cooperative***, loss of revenue compensation for future customers is only appropriate for the customer located in Area 5. The City has demonstrated that its method for calculating net revenue more accurately reflects the actual gross revenue and costs incurred to provide electricity to future customers. Appropriate compensation for the loss of revenue from the future customer in Area 5 can be arrived at by applying the mill rate of 11.22 to actual sales to that customer. That compensation can be paid on an ongoing basis over the ten-year compensation period.

9. The City and WHCEA have agreed that there is no compensation appropriate for other appropriate factors.

10. The record supports the proposed settlement of all the uncontested matters arrived at by the parties and that proposed settlement should be adopted.

Based upon the foregoing Findings and Conclusions, it is the recommendation of the Administrative Law Judge to the Public Utilities Commission that it issue the following:

**ORDER**

1. WHCEA is entitled to compensation for lost revenue from existing customers in the annexed service area for a period of ten years. WHCEA is entitled to compensation for lost revenue from the future customer in Area 5 for a period of ten years.

2. The compensation to be paid to WHCEA for lost revenue from existing customers in the annexed service area is to be calculated by using the mill rate of 11.55, multiplied by the projected kWhs of electricity to be purchased by those customers, adjusted to present value. The compensation to be paid to WHCEA for lost revenue from future customers in the annexed service area is to be calculated by using the mill rate of 11.22 multiplied by the actual kWhs of electricity purchased by the customer in Area 5.

3. The compensation to be paid to WHCEA for preexisting facilities being acquired, less depreciation, is the amount of \$5,097.00, as agreed to by the parties. The compensation to be paid to WHCEA for the integration costs caused by the service territory adjustment is \$10,168 as agreed to by the parties.

4. The ongoing mill rate compensation is payable for ten years from the date of transfer.

Dated this 26<sup>th</sup> day of October, 2004.

/s/ Beverly Jones Heydinger  
BEVERLY JONES HEYDINGER  
Administrative Law Judge

-  
Reported: Angie D. Threlkeld, R.P.R, C.R.R  
Shaddix & Associates  
Three Volumes  
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**MEMORANDUM**

Resolution of this matter requires application of the seemingly contradictory holdings in *Olivia I* and *People's Cooperative*. Each of the parties has attempted to fit this matter within one holding or the other. But there are consistent themes through both Commission holdings that aid in the resolution of this matter.

### **Statutory Standards for Service Area Annexation**

Minnesota is divided into geographic electric service areas by Minn. Stat § 216B.37. Each utility has the exclusive right to provide electric service within its assigned area.<sup>[79]</sup> Annexation of areas into a municipality does not obligate the municipality to extend electrical service into the newly annexed territory. Under Minn. Stat. § 216B.41, the newly annexed areas can be served by the municipality if “a municipality which owns and operates an electric utility elects to purchase the facilities and property of the electric utility as provided in section 216B.44.”

Minnesota Statute § 216B.44 establishes the means of adjusting a municipal electric service area. Where the municipality determines to expand its service area within its corporate boundaries:

the municipality shall thereafter furnish electric service to these areas unless the area is already receiving electric service from an electric utility, in which event, the municipality may purchase the facilities of the electric utility serving the area.<sup>[80]</sup>

The statute sets out the standards for compensation of the utility losing a portion of its service area. Those standards are:

The municipality acquiring the facilities shall pay to the electric utility formerly serving the area the appropriate value of its properties within the area which payment may be by exchange of other electric utility property outside the municipality on an appropriate basis giving due consideration to revenue from and value of the respective properties. In the event the municipality and the electric utility involved are unable to agree as to the terms of the payment or exchange, the municipality or the electric utility may file an application with the commission requesting that the commission determine the appropriate terms for the exchange or sale. After notice and hearing, the commission shall determine appropriate terms for an exchange, or in the event no appropriate properties can be exchanged, the commission shall fix and determine the appropriate value of the property within the annexed area, and the transfer shall be made as directed by the commission. In making that determination the commission shall consider the original cost of the property, less depreciation, loss of revenue to the utility formerly serving the area, expenses resulting from integration of facilities, and other appropriate factors.<sup>[81]</sup>

### **Caselow Standards for Service Area Annexation**

The Commission has previously applied the statutory standards for extending municipal service into annexed areas. In 1986, the Commission applied the compensation standards when the City of Olivia annexed service territory of the Renville-Sibley Cooperative.<sup>[82]</sup> The Renville-Sibley Cooperative had a total of 2,300 “member-consumers” at the time of the annexation.<sup>[83]</sup> Thirty-eight customers (27 residential and 11 commercial) were located in the annexed service area.<sup>[84]</sup> The Commission concluded that compensation should be paid for depreciated original costs, the loss of future revenue from existing customers, and integration expenses. The Commission did not include the loss of revenue from future customers, including customers from an industrial park (developed by Olivia).

In arriving at its conclusion on awarding future revenues for existing customers, the Commission stated:

The Commission agrees with the ALJ and finds that in giving up the annexed area, the Cooperative will lose revenue from electric sales that it needs to meet continuing expenses. The revenue from the customers in the acquisition area will no longer go to the Cooperative. The burden for the continuing expenses will pass to the remaining members of the Cooperative. To prevent a rate increase for those member consumers as a result of the acquisition, it is appropriate for the City to pay compensation for this loss of revenue.<sup>[85]</sup>

In refusing to award compensation for lost revenue from future customers, the Commission noted that the acquisition price had left the cooperative in no worse position than if Olivia had not acquired that service area.<sup>[86]</sup> Since Olivia was bearing the risk of developing the industrial park where the future customers would be located, no compensation for lost revenue from future customers was appropriate.<sup>[87]</sup>

The Minnesota Court of Appeals resolved a dispute over which utility was serving a customer in *ITMO the Complaint by Kandiyohi Cooperative Electric Power Association*.<sup>[88]</sup> In that matter, a municipal utility initiated electrical service to a customer in an annexed area without an adjustment in the service area that was assigned to a cooperative. The cooperative had a 3-phase line that ran along a boundary of the annexed area, but no facilities to provide distribution of electricity to individual customers.<sup>[89]</sup> The cooperative complained to the Commission, and the PUC concluded that the cooperative “had facilities in place capable of adequately serving the annexed area.”<sup>[90]</sup> On appeal, the Minnesota Court of Appeals held that the annexed area was capable of receiving service from the cooperative and the municipal utility would have to follow the procedure in Minn. Stat. § 216B.44 to obtain the right to serve that area.<sup>[91]</sup>

The Commission revisited the issue of future revenues in the annexation of a portion of the service area of People’s Cooperative Power Association by the City of Rochester (described above at Finding 25).<sup>[92]</sup> A forty-acre tract of land was annexed by Rochester for residential development.<sup>[93]</sup> At the time of the annexation, the developer had requested electric service from People’s Cooperative and facilities were

in place that were capable of serving the future residential customers in the annexed area.<sup>[94]</sup>

The Commission concluded that the area was receiving service from People's Cooperative and that compensation for lost revenue was appropriate despite the lack of any customers on the annexed area. The Commission stated:

It would be unfair to foreclose utilities from serving areas that they made investments to serve, without awarding compensation, just because the customers on whose behalf the investments were made are not yet present. The inequity is especially obvious in this case, where the developer building homes in the area had requested service from People's before the City decided to serve it. Such a policy would also undermine the utilities' confidence in service area stability, decreasing their willingness to invest to meet the future needs of their service areas and jeopardizing the statutory goal of ensuring economical, efficient, and adequate electric service throughout the state.<sup>[95]</sup>

The facilities identified by the Commission included four substations, transmission and distribution lines, and a 3-phase line.<sup>[96]</sup> The Commission also noted that power supplies for the residential development had been obtained from the wholesale supplier to People's Cooperative.<sup>[97]</sup> The Commission also expressed concern over the potential for abuse of the annexation process, stating:

Furthermore, the City's and the [Minnesota Municipal Utility Association's] interpretation [that areas with no customers should receive no future lost revenue compensation] would lead to absurd results. It would allow municipalities to carve out for themselves large portions of other utilities' service areas, carefully bypassing sites on which facilities were located, and thereby avoid paying compensation. Obviously, this would be both inequitable and at odds with the statutory goals of promoting the orderly development of adequate statewide electric service and avoiding unnecessary duplication of facilities.<sup>[98]</sup>

On appeal of the Commission's Order, the Minnesota Court of Appeals addressed the issue of appropriate compensation under Minn. Stat. § 216B.44.<sup>[99]</sup> In **North Park Additions**, the Court of Appeals held that the lack of existing customers on the annexed land did not preclude an award of future revenue for lost customers since the Commission established a factual record on which the award was based, stating:

The commission determined that lost revenues for services to be sold in the affected area demonstrated both (1) lost recovery of costs associated with facility development in contemplation of services in the area, and (2) margin losses that would increase the cost of services and decrease the real value of facilities for other patrons.<sup>[100]</sup>

Minnesota Municipal Utilities Association (MMUA), an intervenor in **North Park Additions**, asserted that the Commission's formula to calculate lost revenue from future customers "omitted capital investments needed to provide services in the area."<sup>[101]</sup> The Court of Appeals concluded that, "the evidence utilized by the commission and the judge took into account the amortized cost of providing service in the area."<sup>[102]</sup>

### **Bare Ground Annexation**

Area 7 is a bare ground parcel where the only customer is the City. Under the Commission holding in **Olivia I**, no lost revenue from this future customer is appropriate, since the City is bearing the burden of developing the parcel. Areas 2, 3, 4, 5 and 6 are bare ground parcels where the development is being conducted by private parties. Under these circumstances, the holding in **Olivia I** does not apply to preclude an award of compensation for loss of future customers.

While **Olivia I** does not preclude an award, that holding does not require an award in this matter. WHCEA asserts that the Commission's ruling in **People's Cooperative**, upheld on appeal in **North Park Additions**, does require an award of lost revenue from future customers.

Neither the Commission's decision in **People's Cooperative**, nor the Court of Appeals decision in **North Park Additions**, requires that an annexation of bare ground result in an award of lost revenue from future customers. The analysis in **People's Cooperative** sets out a number of factual circumstances that supported such an award in that matter.

**People's Cooperative** holds that an award of future compensation is appropriate in annexed areas where utilities have "made investments to serve."<sup>[103]</sup> Those investments in **People's Cooperative** included four substations, transmission and distribution lines, and a 3-phase line. The cooperative in that matter also purchased additional power to supply the future customers.<sup>[104]</sup>

The Commission revisited the "bare ground" compensation award in a subsequent annexation case. In that matter, the Commission clarified the standard for awarding compensation, stating:

"Having facilities in place capable of serving the area," and similar phrases used in bare ground cases, are short hand methods of saying that utilities that intend to discharge their duty to serve an area and have taken reasonable steps consistent with that duty are entitled to compensation. They do not have to show that they have in place the facilities and capacity to serve the area for the entire compensation period.<sup>[105]</sup>

WHCEA has not made significant investments to serve the annexed areas. WHCEA has not taken reasonable steps consistent with their duty to the area. Insufficient load to serve existing customers has resulted in problems identified by the City and investments by the City to address those problems.<sup>[106]</sup> The only investment identified in the vicinity of the annexed areas was the upgrading of the 3-phase line

done in 1987, intended to address service reliability problems for existing customers. WHCEA's two substations serving its customers are distant from the annexed areas and have been in use for a long period of time. Those facilities are insufficient to provide reliable service to WHCEA's existing customers. WHCEA has not made investments to serve the annexed area that are significant enough to support an award of lost revenue from future customers.<sup>[107]</sup>

The City has made significant investments to enable the City to meet additional load requirements and improve reliability. Eleven improvements to its electric distribution system were identified, including an increase in the total output of a substation to 60 megawatts (MW) and additional underground distribution feeders on the south and west sides of the City. The improvements have all taken place in the last five years and totaled \$3,156,531 in capital costs incurred by the City.<sup>[108]</sup>

Another concern identified by the Commission in *People's Cooperative* is fostering the "statutory goals of promoting the orderly development of adequate statewide electric service and avoiding unnecessary duplication of facilities."<sup>[109]</sup> The record in this matter demonstrates that the City has made the necessary investment in electric distribution to ensure that the new demands on the City's system will be met. WHCEA has not made significant investment to serve the annexed area. The City shares its investment costs over a customer base that has increased slowly over the past thirty years. In recent years, WHCEA has experienced as much customer growth annually as the City has experienced over this thirty-year period.<sup>[110]</sup> Sales by kWh closely correlate to the number of customers served by the City and WHCEA.<sup>[111]</sup> The City notes that growth of WHCEA's kWh sales from 2000 to 2002 is equivalent to the entire load of the City.<sup>[112]</sup>

Part of the concern expressed in *People's Cooperative* is that municipal utilities could vastly expand their service area at the expense of neighboring cooperatives. Taken in the aggregate, the size of the annexed areas is small, encompassing specifically identified areas that are located near or adjacent to the pre-annexation municipal boundaries. Area 2, Area 3 and Area 4 are all "bare ground" parcels that have adjacent development within the City's pre-annexation municipal boundary. Area 6 is a bare ground parcel with only City customers in the vicinity. All of the adjacent developed areas receive their electric service from the City. The density of the existing development in the City is consistent with the proposed density of development in the annexed parcels. For these four areas, annexation does not constitute the "absurd results" that the Commission was concerned with in *People's Cooperative*.<sup>[113]</sup>

Further, the impact of the annexation on WHCEA does not result in lost recovery of costs associated with facility development in contemplation of services in the area. Neither are there demonstrated margin losses that would increase the cost of services and decrease the real value of facilities for other WHCEA patrons. These were factors that supported the award in the *People's Cooperative* matter, affirmed in *North Park Additions*.<sup>[114]</sup> The absence of investment in facilities precludes loss of recovery of such investment. The rapid, consistent growth of WHCEA's customer base

demonstrates that there will be no margin losses that will increase costs or decrease the value of facilities for existing customers.

Areas 2, 3, 4, and 6 are bare ground parcels that are adjacent to equivalently developed City-served areas. The annexing of those parcels does not lead to absurd results. WHCEA has not made investments to serve those areas. No failure to recover investments in those areas will occur and, therefore, no increase in costs will be borne by WHCEA's customers. The City has incurred substantial investments to serve these areas and those costs will be borne by the City's customers. WHCEA would obtain a windfall, and the City incur excessive costs, if lost revenue were to be awarded to WHCEA. Under these circumstances, no award of lost revenue from future customers for Areas 2, 3, 4, and 6 is appropriate.

The appropriate compensation for loss of revenue from Area 5 is different from the other bare ground parcels, due to the factual differences with that parcel. WHCEA serves a modestly developed residential area immediately south of Area 5. In annexing this parcel, the City has extended into the contiguous service area of WHCEA. The annexation avoids the residential area south of Area 5 and several facilities adjacent to the annexed area. The future customer is a large institutional consumer that can be supplied with electricity with minimal distribution facilities. The shape of Area 5 was intended to exclude adjacent existing facilities from the annexed area to reduce the compensation to WHCEA. The borders of the annexed area constitute the sort of gerrymandering of the annexed service area that is criticized in *People's Cooperative*.<sup>[115]</sup> These factual differences support the conclusion that awarding compensation to WHCEA for lost revenue from the future customer in Area 5 is appropriate.

### **Future Customer Compensation**

Regarding future customers, the City and WHCEA disagreed as to whether any payment for lost revenue from future customers was required as appropriate compensation. If any such compensation was to be paid, the City asserted that two years was the appropriate period for calculating the total, while WHCEA asserted that ten years was appropriate. Similarly, if compensation is required, the method of calculating that compensation was disputed.

As stated in Finding 26, it is appropriate to compensate WHCEA for ten years, the planning period actually used by the utility. This period has been accepted by the Commission in prior decisions.

WHCEA's calculation of lost revenue from future customers relies upon a formula established in *People's Cooperative*. The formula takes the revenue that the cooperative would have received from the annexed areas, subtracts the expenses that the cooperative incurs to obtain that revenue, projects the loss of revenue over ten years, adjusts that figure for inflation, and reduces the amount derived to its present value.<sup>[116]</sup> The expressed goal of the calculation was to "put the displaced utility in the same position it would have occupied had the acquisition not occurred."<sup>[117]</sup>

The City asserts that the calculation of expenses that WHCEA would incur is distorted by the absence of any backbone distribution expenses and the use of a net figure for plant investment by deducting the contribution in aid of construction (CIAC) that is paid by new cooperative customers. WHCEA maintains that no system improvements are planned beyond the Pulaski substation and three short feeders to connect that facility to WHCEA's 3-phase line.<sup>[118]</sup> The Department's analysis of the competing calculations shows that the major differences lie in the depreciation, property tax, and interest factors, all of which are based on the system upgrade question.<sup>[119]</sup>

The City has shown that any reliable electrical system will require improvements to handle increased load. The City has made significant investments to ensure reliable service. WHCEA has not made these investments.<sup>[120]</sup> If WHCEA were to actually meet the anticipated increased electricity demand from any or all of the annexed areas, WHCEA would incur the costs of making the improvements referred to in its long-range plan.<sup>[121]</sup> The experience of Rochester in serving the annexed area in **People's Cooperative** supports the conclusion that an award of lost revenue from future customers must include an adjustment to account for the avoidance of the cost of such investments.

The recording of a reduced amount for a capital investment as an accepted accounting practice is a different question from whether the amount of compensation calculated is accurate. There is no express treatment of a CIAC in the **People's Cooperative** decision. There is no CIAC where facilities are not constructed. Since CIAC is merely a policy of WHCEA (and there is some suggestion that the amount of CIAC varies between customers<sup>[122]</sup>), the CIAC figure is inappropriate for inclusion in the net revenue loss formula. The effect of applying CIAC to the Commission's formula is to inflate the net loss of revenue figure and grant a windfall to the cooperative. The windfall effect of applying CIAC is demonstrated through the comparison of the resulting mill rate with the mill rates that have been agreed to in other, similar matters.

Awarding WHCEA compensation at the mill rate of 11.22 for the actual electricity sales to the customer in Area 5 for a period of ten years is an appropriate resolution of the future compensation issue.<sup>[123]</sup> No such compensation is appropriate for Areas 1 and 7, since there will be no future customers in Area 1 and the City is the customer in Area 7.

### **Evaluation of Expert Testimony**

Both parties relied on their own experts in advocating for the differing compensation amounts advanced in this matter. The City relied upon the calculations of David Berg, P.E., R.W. Beck Consulting. WHCEA relied upon the calculations of Dennis Eicher, P.E., President of Power Systems Engineering, Inc. Both experts have used the formula set out in prior Commission orders in arriving at their conclusions regarding appropriate compensation. After careful consideration of the record, the ALJ finds that Berg's formulation better reflects the factual record established in this matter, and Berg's conclusion regarding compensation rates more accurately reflects the net revenue derived from electricity sales.

The differences in the calculations arise almost entirely from the treatment of CIAC and apportionment of system-wide costs as expenses in the generation of electricity for customers. CIAC has been discussed elsewhere in this Report. The City has introduced evidence from two utilities (the City and Rochester) showing that the provision of electricity to new customers imposes significant, measurable costs on the providing utility. The City has also introduced evidence that WHCEA's own planning calls for system improvements that are required if WHCEA is to serve significant numbers of new customers. Berg accounts for these costs; Eicher does not. Based on the record in this matter, Berg's calculation is more credible and has been relied upon by the ALJ in making the recommendation contained in this Report.

## **Summary**

The presence of a 3-phase line adjacent to the annexed areas demonstrates that WHCEA has the ability to serve those areas. The absence of reasonable investments by WHCEA in the vicinity needed to serve the future customers in the annexed areas demonstrates that WHCEA is not entitled to compensation for lost revenues from future customers. The City has planned to serve those customers and is entitled to benefit from making the reasonable investments needed to serve the area.

The only exception for future customer compensation is the one area that is not contiguous with the City's municipal boundary. The annexation of that area constitutes selective annexation of territory without compensation. The appropriate period of compensation for existing and future customers is ten years, the long-range planning period actually used by WHCEA. The record in this matter demonstrates that significant system-wide costs for transmission and distribution improvements are needed to serve WHCEA's customers. The formula to calculate the compensatory amounts must be based on actual costs to provide that service, including a factor for needed system investment. The mill rates of 11.55 for existing customers and 11.22 for future customers are reasonable rates of compensation.

**B.J.H.**

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<sup>[1]</sup> Ex. 19, Steffel Rebuttal, JS-4; Ex. 14, Berg Surrebuttal, DAB-10.

<sup>[2]</sup> *Id.*

<sup>[3]</sup> Ex. 19, Steffel Rebuttal, at 13.

<sup>[4]</sup> Ex. 19, Steffel Rebuttal, JS-6.

- [5] Ex. 19, Steffel Rebuttal, JS-5.
- [6] Ex. 19, Steffel Rebuttal, JS-4.
- [7] *Id.*
- [8] Ex. 19, Steffel Rebuttal, at 13.
- [9] Ex. 19, Steffel Rebuttal, JS-6.
- [10] Ex. 19, Steffel Rebuttal, JS-4.
- [11] Ex. 19, Steffel Rebuttal, at 13.
- [12] Ex. 19, Steffel Rebuttal, JS-5.
- [13] Ex. 4, Eicher Direct, DRE-2, page 4.
- [14] Ex. 4, Eicher Direct, DRE-2, page 4.
- [15] Ex. 14, Berg Surrebuttal, DAB-10.
- [16] Ex. 4, Eicher Direct, DRE-2, page 4.
- [17] *Id.*
- [18] Ex. 12, Berg Direct, DAB-1. WHCEA has identified security/street light accounts separate from the individual customer accounts. The City includes those sales in the sales to individual customers (compare Ex. 12, Berg Direct, DAB-1, to Ex. 5, Eicher Rebuttal, DRE-5R1).
- [19] Ex. 23, Bodin Rebuttal, LB-1.
- [20] Ex. 4, Eicher Direct, DRE-2, at 6.
- [21] Ex. 23, Bodin Rebuttal, LB-1.
- [22] Ex. 4, Eicher Direct, DRE-2, at 7.
- [23] Ex. 23, Bodin Rebuttal, LB-1.
- [24] Ex. 4, Eicher Direct, DRE-2, at 10.
- [25] Ex. 4, Eicher Direct, DRE-2, at 10.
- [26] Ex. 4, Eicher Direct, DRE-2.
- [27] Ex. 13, Berg Rebuttal, at 36.
- [28] Ex. 4, Eicher Direct, DRE-2.
- [29] Ex. 13, Berg Rebuttal, at 36.
- [30] Ex. 4, Eicher Direct, DRE-2.
- [31] Ex. 13, Berg Rebuttal, at 36.
- [32] Ex. 4, Eicher Direct, DRE-2, page 9.
- [33] Ex. 10, Hoveland Surrebuttal, at 7, HLD-5.
- [34] Ex. 17, Joens Rebuttal, at 3-4.
- [35] *Id.*
- [36] Ex. 14, Berg Surrebuttal, DAB-10.
- [37] Ex. 17, Joens Rebuttal, at 5.
- [38] *Id.* at 6.
- [39] Ex. 12, Berg Direct, at 29.
- [40] Ex. 19, Steffel Rebuttal, at 4, JS-2.
- [41] Ex. 20, Steffel Surrebuttal, JS2R (correcting errors in Ex. 19, Steffel Rebuttal, JS-2).
- [42] Ex. 19, Steffel Rebuttal, JS-1.
- [43] Tr. Vol. 1, at 21.
- [44] *Id.* at 22.
- [45] Ex. 2, Lorber Rebuttal, at 2-3.
- [46] ***ITMO the Application of the City of Olivia to Extend its Municipal Electric Service Area into the Area Served by Renville-Sibley Cooperative Power Association***, E-288, 136/SA-85-93 (Order Setting Compensation, June 27, 1986)(*Olivia I*) and (Order after Rehearing, October 1, 1986)(*Olivia II*); ***ITMO 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)***, E-132, 299/SA-88-270 (Order Determining Compensation, July 11, 1990)(*People's Cooperative*).
- [47] Minn. Stat. § 216B.44(b).
- [48] Tr. Vol. 2, at 179-181.
- [49] Tr. Vol. 3, at 121.
- [50] Ex. 20, Steffel Surrebuttal, at 3-6. The City installed a 3-phase line, at a cost of \$10,628, to ensure that a wastewater lift station would not be rendered inoperable or damaged by insufficient service from WHCEA. *Id.* JS-8.

[51] WHCEA asserts that failure to compensate the displaced utility for lost revenue from future customers will discourage necessary investment in distribution facilities. There is no evidence in the record of this matter that WHCEA has made any such investments beyond the 3-phase line in 1987.

[52] Ex. 19, Steffel Rebuttal, JS-1.

[53] Ex. 19, Steffel Rebuttal, JS-5.

[54] Ex. 19, Steffel Rebuttal, JS-6.

[55] Ex. 13, Berg Rebuttal, at 51.

[56] **People's Cooperative**, at 8.

[57] **North Park Additions**, 470 N.W.2d at 529.

[58] Ex. 4, Eicher Direct, DRE-8.

[59] **People's Cooperative**, at 8.

[60] Ex. 4, Eicher Direct, at 40-41.

[61] Ex. 4, Eicher Direct, at 39.

[62] *Id.*

[63] Ex. 4, Eicher Direct, at 42.

[64] Ex. 6, Eicher Surrebuttal, at 5 (Table 1 (Revised)).

[65] Ex. 4, Eicher Direct, at 42.

[66] Ex. 14, Berg Surrebuttal, at 4.

[67] *Id.*

[68] Lusti Supplemental Rebuttal, at 3 (\$5,285 for WHCEA, \$5,262 for the City).

[69] Eicher Supplemental DRE-6R3, at 1; Berg Supplemental Ex., DAB-1 rev. 7-26-04, 10 yr., at 1.

[70] *Id.*

[71] WHCEA Brief, at 28. The City mill rate of 11.73 differs from the rate recited in the brief, but matches the rate contained in the City's testimony. Berg Supplemental Ex., DAB-1 rev. 7-26-04, 10 yr., at 1.

[72] Ex. 6, Eicher Surrebuttal, at 14-15.

[73] Ex. 24, Lusti Rebuttal, DVL-4.

[74] **ITMO the Petition by the City of Rochester for Approval of an Adjustment of its Service**

**Territory Boundaries with People's Cooperative Services, Inc. (Celestica Property)**, PUC Docket No. E-132,299/SA-02-496 (Order Determining Compensation issued June 19, 2003)(**Celestica**).

People's argued for a mill rate of 24 kWh in **Celestica**, asserting that its rate schedule should be used to calculate compensation, rather than the actual cost to the cooperative. Rochester argued that People's would need to build additional distribution circuits, therefore the expense deductions in the net revenue calculation should be higher, reflecting a system-wide avoidance of additional costs. The Commission concluded that the cost of service was the correct approach, and that the need for additional distribution equipment had not been shown. **Celestica**, at 7.

[75] WHCEA Brief, at 28-29.

[76] To ensure accuracy, the ALJ leaves that calculation to the parties and the Commission staff.

[77] Ex. 6, Eicher Surrebuttal, DRE-9R1, at 1.

[78] Ex. 13, Berg Rebuttal, DAB-9, at 1.

[79] Minn. Stat. § 216B.40.

[80] Minn. Stat. § 216B.44(a).

[81] Minn. Stat. § 216B.44(b)(emphasis added).

[82] **ITMO the Application of the City of Olivia to Extend its Municipal Electric Service Area into the Area Served by Renville-Sibley Cooperative Power Association**, E-288, 136/SA-85-93 (Order Setting Compensation, June 27, 1986)(**Olivia I**) and (Order after Rehearing, October 1, 1986)(**Olivia II**).

[83] **Olivia I**, at 12.

[84] *Id.*

[85] **Olivia I**, at 13.

[86] **Olivia I**, at 13.

[87] *Id.*

[88] **ITMO the Complaint by Kandiyohi Cooperative Electric Power Association**, 455 N.W.2d 102 (Minn.App. 1990).

[89] **Kandiyohi**, at 103.

[90] *Id.* at 103-104.

[91] *Id.* at 104.

<sup>[92]</sup> The forty-acre parcel is only one of a number of parcels annexed and for which compensation was required. The total area ultimately annexed came to approximately 15 square miles. Tr. Vol. 1, at 24.

<sup>[93]</sup> **ITMO 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)**, E-132, 299/SA-88-270 (Order Determining Compensation, July 11, 1990)(**People's Cooperative**).

<sup>[94]</sup> **People's Cooperative**, at 5.

<sup>[95]</sup> **People's Cooperative**, at 6-7.

<sup>[96]</sup> The Commission noted that Rochester was not acquiring these facilities. **People's Cooperative**, at 7.

<sup>[97]</sup> *Id.* at 7, footnote 3.

<sup>[98]</sup> **People's Cooperative**, at 8.

<sup>[99]</sup> **ITMO 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, 528 (Minn. App. 1991), *rev. denied* (Minn. July 24, 1991)(**North Park Additions**)

<sup>[100]</sup> **North Park Additions**, 470 N.W.2d at 529.

<sup>[101]</sup> *Id.* at 530.

<sup>[102]</sup> *Id.*

<sup>[103]</sup> **People's Cooperative**, at 6-7.

<sup>[104]</sup> Rochester and People's Cooperative came before the Commission again on the annexation of 25 parcels totaling 2,684 acres. **ITMO the Applicant by the City of Rochester for an Adjustment of its Service Boundaries with People's Cooperative Power Association**, Docket No. E-2999, 132/SA-93-498 (November 30, 1995)(**People's 498 Docket**). The Commission again awarded People's compensation for the bare ground annexation, over Rochester's objection. **People's 498 Docket**, at 10.

<sup>[105]</sup> **People's 498 Docket**, at 9-10.

<sup>[106]</sup> Ex. 20, Steffel Surrebuttal, at 3-6. The City installed a 3-phase line, at a cost of \$10,628 to ensure that a wastewater lift station would not be rendered inoperable or damaged by insufficient service from WHCEA. *Id.* JS-8.

<sup>[107]</sup> WHCEA asserts that failure to compensate the displaced utility for lost revenue from future customers will discourage necessary investment in distribution facilities. There is no evidence in the record of this matter that WHCEA has made any such investments beyond the 3-phase line in 1987.

<sup>[108]</sup> Ex. 19, Steffel Rebuttal, JS-1.

<sup>[109]</sup> **People's Cooperative**, at 8.

<sup>[110]</sup> Ex. 19, Steffel Rebuttal, JS-5.

<sup>[111]</sup> Ex. 19, Steffel Rebuttal, JS-6.

<sup>[112]</sup> Ex. 13, Berg Rebuttal, at 51.

<sup>[113]</sup> **People's Cooperative**, at 8.

<sup>[114]</sup> **North Park Additions**, 470 N.W.2d at 529.

<sup>[115]</sup> **People's Cooperative**, at 8.

<sup>[116]</sup> **People's Cooperative**, at 11.

<sup>[117]</sup> *Id.*

<sup>[118]</sup> Ex. 6, Eicher Surrebuttal, at 13.

<sup>[119]</sup> Ex. 24, Lusti Rebuttal, DVL-5.

<sup>[120]</sup> The Pulaski substation is only proposed to be built by WHCEA. This is not an existing investment that would justify a finding the WHCEA has made investments to serve the annexed areas.

<sup>[121]</sup> The City estimates that the kilovolt-amperes of load would increase by 2,000 if WHCEA were to serve all the new customers in this matter. Ex. 13, Berg Rebuttal, at 15. The City estimates that the additional load would required significant substation and distribution capacity. *Id.*

<sup>[122]</sup> Tr. Vol 1, at 161.

<sup>[123]</sup> The 11.22 figure is taken from the City's ten-year lost revenue calculation. Ex. 13, Berg Rebuttal, DAB-9, at 1. Adjustments to the formula inputs may result in a different mill rate, but no expert testimony was available after the record closed to accurately calculate the new rate. The Commission may seek those appropriate inputs in ordering the reasonable compensation that WHCEA is entitled to receive from the City.