Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: November 6, 2014 ....**Agenda Item No. 4

Companies: Interstate Power and Light Company ("IPL" or "Interstate") and Minnesota Energy Resources Corporation ("MERC" or the "Company") (together the "Petitioners")

Docket No. G001,G011/PA-14-107

In the Matter of a Request for Approval of the Asset Purchase and Sale Agreement Between Interstate Power and Light Company and Minnesota Energy Resource Corporation

Issue(s): Is the proposed sale consistent with the public interest?
Should the Commission approve the proposed sale?
If so, should the approval be with conditions?
Should the Commission approve the proposed rate increase for IPL customers outside of a rate case?

Staff: Clark Kaml 651-201-2246
Jorge Alonso 651-201-2258
Sundra Bender 651-201-2247
Andrew Twite 651-201-2245

Relevant Documents

Initial Petition for Approval .... February 4, 2014
Department of Commerce (Department) Comments .... April 7, 2014
Office of the Attorney General (OAG) Comments .... April 7, 2014
Petitioners' Reply Comments .... May 9, 2014
Office of the Attorney General Reply Comments .... May 9, 2014
Department Supplemental Reply Comments .... June 12, 2014
Petitioners' Initial Supplemental Comments .... June 13, 2014
Office of the Attorney General Initial Supplemental Comments .... June 13, 2014
Office of the Attorney General Reply Comments .... July 3, 2014
Petitioners' Reply Comments .... July 3, 2014
Petitioners' Response to Commission Questions .... July 25, 2014
Petitioners' Response to OAG Questions .... August 4, 2014
Department Second Supplemental Reply Comments .... September 2, 2014
Office of the Attorney General Reply Comments .... September 3, 2014

The attached materials are workpapers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless noted otherwise.

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Issues

Is the proposed sale consistent with the public interest?
Should the Commission approve the proposed sale?
If so, should the approval be with conditions?
Should the Commission approve the rate increase for IPL customers outside of a rate case?

Introduction

Interstate Power and Light Company (IPL) and Minnesota Energy Resources Corporation (MERC) have proposed to sell IPL's Minnesota gas distribution system and assets and transfer IPL's service rights and obligations to MERC. IPL and MERC stated that the following terms and conditions recommended by the Department are agreed to by IPL and MERC and are reasonable. If these terms and conditions are attached to the Commission's approval of this property transfer, the Petitioners believe this property transfer would be consistent with the public interest.

1. Immediate transition of IPL customers to MERC's rates, as determined in MERC's pending rate case, upon approval of the acquisition is consistent with the public interest and within the Commission's authority.

2. No adjustments should be made to the proposed sale of assets on account of deferred taxes.

3. The $2.6 million already paid by IPL for clean-up costs associated with FMGP sites should be transferred to MERC as a regulatory asset upon closing of the proposed asset sale. In its next rate case, MERC would include this regulatory asset for cost recovery. Additionally, regarding future FMGP expenses associated with the Austin site, MERC would record those costs as regulatory assets and include them for cost recovery in MERC's next rate case. Recovery of those FMGP costs should be allowed in a MERC future rate case if these expenses are found to be prudent.

4. IPL will continue to meet its reporting requirements under Docket No. G-001/M-06-1166 until the Transaction is approved and closes or until ordered otherwise by the Commission. MERC would intend to submit annual filings upon approval of the Transaction to account for its spending at the Austin site, assuming such filings would be helpful to the Commission. Upon implementation of MERC's next rate case, MERC would agree to continue to submit annual compliance filings to account for annual expenditures and recovery from ratepayers.

The Department recommended the Commission approve the proposed asset sale with the following provision:

1. The petition met all the necessary filing requirements, including the requirements under Minn. State. §216B.50 and Minnesota Rules 7825.1600-1800.

2. The proposed Agreement would have no significant impact on MERC's operation of its distribution system and on its gas supply.

3. IPL's current rates are significantly lower than IPL's current cost of service. Therefore, IPL could not remain financially viable under its existing rates.

4. Since IPL's current rates are significantly lower than IPL's current cost of service, to ascertain that the proposed asset sale is consistent with the public interest, it is appropriate to compare IPL's current revenue requirements for its Minnesota ratepayers with MERC's revenue requirements for IPL's Minnesota ratepayers.

5. Under MERC's pending rate case, for MERC's revenue requirements to exceed IPL's current revenue requirements to serve IPL's Minnesota ratepayers, MERC's approved rates in its pending rate case would have to be greater than 82.26 percent of MERC's requested incremental revenue requirements. This is very unlikely, given that the Department, in its Surrebuttal Testimony, recommends an incremental revenue requirement for MERC of only 56.10 percent of MERC's proposed incremental revenue requirements.

6. With respect to the environmental clean-up costs related to the Austin FMGP site, i.e. the $2.6 million expense paid, but not yet recovered by IPL, and the future expenses associated with the environmental costs of the Austin FMGP site, the Department believes these should be recorded as regulatory assets. In its next rate case, MERC would include these regulatory assets in its rate base and request recovery of these costs via return on and of these assets. Recovery would be allowed if these expenses are found to be prudent.

The OAG-AUD does not believe the Commission should approve this transaction unless it imposes conditions that ensure the transaction is consistent with the public interest. The OAG recommended the following conditions:

1. Maintain the current rates for IPL's gas customers until a rate case is filed authorizing a change in their rates;

2. Separately identify the costs associated with setting rates between IPL's former customers and MERC's current customers until they are integrated during a future rate case;

3. Maintain IPL's current obligation to remediate contaminated manufactured gas plants located in Minnesota and deny the Petitioners' request to transfer that obligation to MERC;

4. Require MERC to take up the compliance reporting requirements in Docket No. G-001/M-06-1166, and require MERC to provide additional compliance reporting on IPL's past and future FMGP expenditures;

5. Preserve the benefit of deferred taxes that the IPL customers have paid for by implementing a transaction adjustment refund or creating a regulatory asset account to reduce rate base in a future rate case; and,

6. Conduct public hearings in IPL's service territory to allow ratepayers to meaningfully participate in the process.

The main issue for the Commission to decide is whether the proposed transaction is consistent with the public interest, as required by Minn. Stat. § 216B.50. In considering this question, the Commission will need to decide whether the terms and conditions agreed to by the Petitioners and the Department are sufficient, for example, are the agreed upon terms and conditions for handling the environmental clean-up costs associated with the former manufactured gas plant sites reasonable and consistent with the public interest. Or, alternatively, should the Commission's approval of this transaction be conditioned further by the terms and conditions recommended by the OAG-AUD that would require MERC to postpone the proposed rate increase for current IPL customers until MERC files its next rate case, the preservation of deferred tax benefits, and holding public hearings.

Relevant Statutes and Rules

MINN. STAT. § 216B.50, RESTRICTIONS ON PROPERTY TRANSFER AND MERGER

Minn. Stat. §216B.50 requires a public utility to obtain Commission approval prior to selling, acquiring, leasing, or renting any plant as an operating unit or system in this state for a total consideration in excess of $100,000, or merge or consolidate with another public utility or transmission company operating in this state, without first being authorized so to do by the commission. Upon the filing of an application for the approval and consent of the commission, the commission shall investigate, with or without public hearing. The commission shall hold a public hearing, upon such notice as the commission may require. If the commission finds that the proposed action is consistent with the public interest, it shall give its consent and approval by order in writing. In reaching its determination, the commission shall take into consideration the reasonable value of the property, plant, or securities to be acquired or disposed of, or merged and consolidated.

MINN. RULES 7825.1600-1800.

7825.1600, Definitions for Approval to Acquire Property.
7825.1700, Procedure for Approval to Acquire Property.
7825.1800, Filing Requirements for Petitions to Acquire Property.

Background

On February 4, 2014, Interstate Power and Light Company and Minnesota Energy Resources Corporation filed a petition with the Minnesota Public Utilities Commission for approval of the sale of IPL's Minnesota natural gas distribution system and assets, and transfer of IPL's service rights and obligations in Minnesota to MERC (Petition).

On April 7, 2014, the Department filed Comments requesting that the Petitioners provide additional information.

Also on April 7, 2014, the OAG filed Comments recommending that the Commission approve the Petition only with the imposition of several conditions.

On May 9, 2014, the Petitioners filed Reply Comments.

Also on May 9, 2014, the OAG filed Reply Comments recommending conditions prior to an approval of the Petition.

On May 16, 2014, the Commission issued a Notice of Additional Comment Period and requested additional information regarding the recovery of present and future non-Austin FMGP remediation costs.

On June 12, 2014, the Department filed Supplemental Reply Comments.

On June 13, 2014, the Petitioners filed Initial Supplemental Comments, accepting the Department's recommendations regarding the recovery of FMGP costs.

On June 13, 2014, the OAG filed Initial Supplemental Comments recommending the commission reject the Petitioners Proposal. However, if the asset transfer is approved, OAG recommended conditions be placed on the approval.

On July 3, 2014, the Petitioners and the Office of the Attorney General each filed Reply Supplemental Comments.

On July 25, 2014, the Petitioners provided responses to the Commission's additional questions and filed the First Amendment to the Asset Purchase and Sale Agreement between MERC and IPL (the Amendment) as Attachment A.

August 4, 2014, the Petitioners provided responses to the OAG's additional questions.

On September 2, 2014, the Department filed Second Supplemental Reply Comments.

On September 3, 2014, the Office of the Attorney General filed a Reply to Petitioners' Responsive Comments.

Proposed Transaction

Interstate Power and Light Company (IPL) and Minnesota Energy Resources Corporation (MERC) have proposed to sell IPL's Minnesota gas distribution system and assets and transfer of service rights and obligations to MERC pursuant to an Asset Purchase and Sale Agreement dated September 3, 2013 (Transaction). The purchase price to be paid by MERC to IPL will equal the book value of the Minnesota Gas Assets at closing, subject to certain adjustments. Based on a year-end closing and the book value of the Minnesota Gas Assets as of December 31, 2012, the purchase price would be approximately $9,335,000.

Upon completion of the Transaction:

> IPL will transfer to MERC the local distribution assets and pipeline capacity rights used to provide natural gas distribution service to approximately 10,600 customers in IPL's natural gas service areas in Minnesota.
>
> To the extent that such rights can be transferred, IPL will transfer to MERC all of IPL's rights and obligations to provide natural gas distribution service to those natural gas distribution customers.
>
> MERC will, subject to the regulation of the Commission, commence natural gas service to the public in each such transferred area pursuant to the terms and conditions of MERC's current rates and tariffs.
>
> IPL will no longer provide natural gas distribution service in Minnesota and will no longer be a Minnesota public utility providing natural gas distribution service.

To minimize any period of uncertainty for customers, the Petitioners want to close the Transaction during the third quarter of 2014. They explained that closing of the Transaction is independent of Commission review of the proposed transfer of IPL's Minnesota electric distribution system and assets to Southern Minnesota Energy Cooperative (SMEC).

The Petitioners stated that they are not required to make filings for the Transaction with the Iowa Utilities Board, the Federal Trade Commission or the U.S. Department of Justice under the Hart-Scott-Rodino Antitrust Improvements Act of 1976. The Transaction will not provide MERC with any greater market power in Minnesota than is currently possessed by IPL.

Party Positions

PETITIONERS

IPL is an Iowa corporation and an investor-owned utility, headquartered at 200 First Street, SE, in Cedar Rapids, Iowa. IPL is a separate legal entity and first tier wholly owned subsidiary of Alliant Energy Corporation, a public utility holding company. At year-end 2012, IPL's Minnesota gas service included approximately 10,600 natural gas distribution customers with natural gas through-put of approximately 1,516,000 dekatherms in 2012. A list of the Minnesota communities served by IPL was included in Attachment A to the petition. The proposed transaction is for the transfer of these Minnesota customers to MERC.

MERC, a wholly-owned subsidiary of Integrys Energy Group, Inc., provides gas service to approximately 214,000 customers in Minnesota, including service to customers contiguous to IPL's Minnesota service territory.

Gas Asset Purchase and Sale Agreement

The Gas Asset Purchase and Sale Agreement for the sale of the Minnesota Gas Assets to MERC, included as Attachment D to the Petition, contains the contractual provisions for the asset sale. It includes the following:

Transaction Structure: The Gas Asset Purchase and Sale Agreement transaction is structured as a sale of assets with IPL selling the Minnesota Gas Assets to MERC.

Purchase Price: The price will equal the book value of the Minnesota Gas Assets at closing. Based on the book value of the Minnesota Gas Assets as of December 31, 2012, the purchase price would be approximately $9,335,000.

Assumed Liabilities: With some exceptions, including the Austin Former Manufactured Gas Plant (Austin FMGP) site, IPL retains liability for pre-closing conditions, events, and liabilities related to the Minnesota Gas Assets and related business. MERC assumes liabilities for post-closing conditions, events and liabilities related to the Minnesota Gas Assets and the business.

Indemnification: Subject to exceptions (e.g., representations and warranties of IPL regarding ERISA, benefit plans, and environmental matters survive for 24 months after closing), claims for indemnification arising out of breaches of representations and warranties must be made within 15 months after closing.

Limitations on Liability: A Party seeking indemnification will have no reimbursable claim of any breach of representations or warranties until incurred losses exceed at least one percent of the final purchase price. The aggregate liability of a Party for any breach of representations or warranties shall not exceed 20 percent of the final purchase price.

Termination. The Gas Asset Purchase and Sale Agreement provides that it may be terminated under certain circumstances, including:

By either party if there has been a material breach of the Gas Asset Purchase and Sale Agreement or the Confidentiality Agreement between IPL and MERC which is not cured within 30 days after written notice of the breach;

By either party in the event of failure to obtain certain necessary regulatory approvals in form and substance acceptable to each Party or third party consents or a court order or injunction prohibiting closing;

By either party in the event that closing has not occurred within 18 months of the signing of the Gas Asset Purchase and Sale Agreement or such shorter period negotiated by the Parties;

By MERC if there has been a material adverse effect which remains in effect; or if IPL has elected not to repair or replace certain casualty losses that, in the aggregate, exceed $500,000.

Post Transaction Operation and Rates

System Operations

The Petitioners stated that they expect a seamless system integration into MERC's distribution system. They stated that:

> The operating pressures are consistent between the systems.
>
> The IPL Gas Inspection Maintenance and Management System (GIMMS) will facilitate a ready integration with MERC's recordkeeping system.
>
> IPL uses the same materials as MERC, avoiding the need for MERC to acquire additional inventory.
>
> IPL regulator stations use the same configurations and regulators as MERC.
>
> Gas distribution system safety issues have been addressed in the IPL Distribution Integrity Management Plan (DIMP). MERC will incorporate the IPL DIMP into MERC's DIMP to assure compliance with the requirements of the Minnesota Office of Pipeline Safety (MNOPS).

Gas Supply

MERC and IPL gas customers are currently served from the same Northern Natural Gas (NNG) interstate pipeline system. Through a pre-arranged release, all of the IPL NNG transportation and storage capacity used to serve the Minnesota customers will be permanently released to MERC on NNG's Electronic Bulletin Board (EBB) system.

Customer Rates and Terms of Service

The Petitioners noted that IPL's Minnesota gas customers have not had a base gas rate increase in almost 18 years. The Petitioners argued that, relative to other Minnesota gas utilities for that period of time, these customers have had good service and lower than "market" rates. They noted that from 2000 to 2013, IPL's gas customers in Iowa had three rate increases:

IPL Iowa Gas Rate Cases 2000-2013

Year/Docket No.	ROE	Rate Increase (%) In non-fuel revenue	Residential Customer Charge Increase
2001 / RPU-02-7	11.05%	25%	$7.75 to $10.00
2004 / RPU-95-8	10.80%	18%	No change
2012 / RPU-12-2	10.00%	13%	$10.00 to $13.00

The Petitioners stated that IPL's Minnesota gas utility system is generally similar to the IPL Iowa gas utility and argued that it is highly unlikely that the Minnesota IPL gas utility was

somehow exempt or sheltered from the external factors that were responsible for IPL's need to adjust Iowa gas customers' rates three times during this period. Minnesota gas customers have avoided routine rate cases due to the small size of the IPL Minnesota gas customer group and the disproportionate costs of bringing otherwise necessary and routine rate cases.

As support for their position, the Petitioners provided a table indicating that over the last nine years, IPL's Minnesota gas business reported an average return on equity (ROE) of negative 1.67% while its authorized ROE is10.75%:

IPL Minnesota Gas Earned ROEs

Year	IPL MN Gas ROE
2004	10.14%
2005	1.41%
2006	-10.76%
2007	-0.47%
2008	3.61%
2009	13.43%
2010	-17.14%
2011	5.75%
2012	-21.04%
Average	-1.67%

The Petitioners argued that it would not be reasonable to evaluate public interest assuming that such low ROEs could or should be sustained. Reviewing the number of gas rate cases of MERC, its predecessor utility, and the other Minnesota investor-owned gas utilities (IOU) between 1996 and 2013 indicates that IPL's three Iowa gas rate cases are not outliers. Over this time period MERC/Aquila, Xcel/NSP gas, and CenterPoint/Minnegasco have each had four rate cases.

The Petitioners argued that IPL's Minnesota residential gas customers have been afforded lower gas distribution costs than all other Minnesota investor owned gas utilities' residential customers. This situation is neither sustainable nor stable and does not provide an appropriate basis for evaluation of the impact of the Transaction. Since the rate impacts of deferring a transition from demonstrably lower than market rates to MERC's rates will only become more pronounced, the sooner the IPL Minnesota gas customers are integrated into MERC's rates, the better.

The Petitioners proposed to transfer the IPL customers to MERC's rates and tariffs in effect as of the time of closing of the Transaction. They argued that the benefits of a quick integration of IPL customers are:

1. Immediate transfer would minimize time delay, costs, and the potential for even larger rate increases for current IPL customers that would likely result if the integration of IPL's 10,600 customers into MERC was delayed to a subsequent MERC rate case.

2. The rate differentials between MERC's interim rates and IPL's legacy rates vary by class and their disparities should be addressed before they become more pronounced. Furthermore, a delayed transition to MERC rates will exacerbate the disparities.

3. If a rate transition is deferred, MERC will have to create and administer a separate billing system for IPL's gas customers. Dual billing systems would provide a customer service challenge and require MERC personnel to learn, implement, and administer a separate set of rates and tariffs.

4. Immediate transition to MERC rates would benefit IPL Minnesota customers by facilitating a more timely transfer of their legacy responsibility for FMGP liabilities to the much broader MERC customer base. IPL Minnesota gas customers are currently incurring, on average, approximately $50 per year attributable to FMGP clean up expense. If, upon approval of the Transaction, MERC is allowed to collect IPL's current level of rate recovery for FMGP costs of $494,017 per year and this amount is spread across MERC's entire customer base by an immediate transition to MERC rates, as proposed, this cost element could be reduced to approximately $2.23/year, based on continued collection of the $494,017 per year.[1]

MERC has implemented telemetering for all interruptible rate classes. Currently IPL has only one customer served by telemetering. MERC anticipates it would complete the conversion of the remaining IPL customers who qualify for telemetering on MERC tariffs within 18 months of approval.

Remediation Liability

The Transaction initially required MERC to assume responsibility for the first $3 million of environmental remediation costs for the Austin FMGP and 50% of any remediation costs in excess of $3 million. IPL would be liable for 50% of any remediation costs for the Austin FMGP Site in excess of $3 million and all remediation costs for the Albert Lea, Fairmont, New Ulm, Owatonna and Rochester, Minnesota FMGP sites. As discussed below, this arrangement has been modified through the First Amendment to the Asset Purchase and Sale Agreement between MERC and IPL.

According to the Petitioners' July 25, 2014 Comments, investigation and remediation activities have been completed for all sites except Austin. New Ulm, Albert Lea and Owatonna are expected to receive site closure from the MPCA in 2014, 2015, and 2016, respectively. Rochester and Fairmont have already received site closure from the MPCA.

April 7 and May 9, 2014 Reply Comments

Introduction

On April 7, 2014, the Minnesota Department of Commerce, Division of Energy Resources (the Department) and the Office of the Attorney General, Antitrust and Utilities Division filed comments in response to the Petition.

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[1] The aspect of the transaction has been changed by the First Amendment to the Asset Purchase and Sale Agreement between MERC and IPL as discussed below.

The Petitioners' May 9, 2014 Reply Comments, submitted in response to the Department's and OAG's April 7, 2014 Comments, repeated many of the arguments and explanations contained in the original Petition.

The Department concluded that the Petition met all of the necessary filing requirements, including the requirements under Minn. Stat. §216B.50 and Minnesota Rules 7825.1600-1800. Before making its final recommendation, the Department requested the Petitioners provide additional information; however, it made the following conclusions and preliminary recommendations:

> The proposed Agreement would have no significant impact on MERC's operation of its distribution system and on its gas supply.
>
> IPL's rates are generally lower than MERC's proposed rates; however, this conclusion applies to MERC's interim rates which are likely significantly higher than the final rates to be approved by the Commission.
>
> IPL's current rates are significantly lower than IPL's current cost of service. Therefore, IPL could not remain financially viable under its existing rates.
>
> IPL's rates, based on IPL's current revenue requirements, may be higher or lower than MERC's final rates depending on the Commission's final decision in MERC's current rate case. However, based on the Commission's decision in MERC's most recently completed rate case and based on the Department's recommendations in MERC's current rate case, IPL's updated rates are likely to be higher than MERC's final approved rates.
>
> The Agreement should be modified to exclude certain provisions for treatment of the environmental costs associated with the Former Manufactured Gas Plant sites.

The Petitioners stated that they agreed with many of the Department's conclusions. They explained why they considered the provisions for the FMGP cost recovery to be consistent with Commission policy and the public interest.

The OAG Comments recommend that, if the Commission approves the Transaction, it do so only with certain conditions. The Petitioners stated that except for the recommendation to conduct public hearings, the OAG recommendations should be rejected.

FMGP Cost Recovery Continuation

The OAG recommended that the Petitioners' FMGP cost recovery mechanism be eliminated. As a condition of approval, the Petitioners argued that the Commission should approve the recovery of FMGP clean-up costs.

The Department raised two primary concerns with the Agreement's provisions regarding FMGP costs. First, the Department asserted that the record lacks support for the $494,017, originally established in 1996 for past clean-up costs at the Rochester and Albert Lea FMGP Sites, used in the FMGP Adjustment Annual Payment calculation. In 2007, the Commission continued this payment level for recovery of IPL's future FMGP costs as long as IPL had deferred FMGP

clean-up costs. The Petitioners argued that, because past and ongoing remediation costs are higher than the annual approved recovery amount, continuation of this level of cost recovery would be appropriate following the Transaction.

Second, the Department asserted that because MERC's pending rate case does not include the Austin FMGP mitigation costs, MERC should not be able to recover the annual $494,017. The Petitioners argued that, since the 2007 approval occurred outside of a rate case, the tracking and accounting procedure recommended in Reply Comments will address any concerns regarding Commission review of costs.

The Petitioners argued:

> Prior payment of these costs by IPL does not eliminate the ratepayers' obligation to repay IPL. The distinction between the responsibilities of IPL ratepayers and MERC ratepayers is eliminated if the Commission approves the Transaction.
>
> Treating IPL customers differently for a single cost is inconsistent and would be contrary to the public interest. Immediate transition of IPL customers to MERC's rates, including transition of responsibility for previously incurred and yet unrecovered FMGP clean-up costs, is consistent with the public interest. The proposed FMGP cost recovery process would simply continue the cost tracking and recovery process that has been used since 1996, providing ongoing assurance that ratepayers will pay no more than the reasonable and prudent clean-up costs that have been, and will be, incurred. Including MERC in this process will not impair these protections or alter the transparent recovery of and accounting for remediation costs.
>
> Transfer of the FMGP rate element currently being collected by IPL as part of the approval of this transaction is consistent with the public interest. IPL and MERC customers will receive an incremental benefit from the addition of the IPL customers to MERCs system by added efficiencies of scale as well as a broader customer base for the sharing of common costs. Over the long term, these efficiencies will offset the minimal costs associated with incorporating the existing IPL FMGP rate recovery mechanism.

FMGP Cost Recovery Policy

The Petitioners argued that their FMGP cost recovery proposal is consistent with the Commission's environmental policy, which recognizes both the public policy benefits of environmental clean-up of FMGP sites and that utilities should not be discouraged or financially penalized for taking reasonable and prudent steps to remediate FMGP sites. A sale of gas utility assets from one provider to another does not diminish these considerations. Transfers of ownership, even transfers of ownership outside of utility ownership do not negate this policy, nor do they undermine the Commission's recognition that recovery of FMGP clean-up costs is appropriate.

The Petitioners argued that their FMGP cost recovery proposal meets the Commission's standards and criteria for FMGP clean-up cost recovery, and the sale of assets to MERC will not negate that fact. The Commission has consistently based its FMGP cost recovery decisions on the principles which include: (i) utilities are allowed to recover the reasonable costs of providing

utility service; (ii) the connection of FMGP sites to providing utility service; and (iii) the public benefits resulting from supporting environmental clean-up of FMGP sites.

The Petitioners noted that the Commission recognized that IPL did not own the Austin, New Ulm, Owatonna, or Rochester FMGP sites at the time the clean-up costs were required to be incurred but nonetheless approved IPL's recovery for the remediation of those sites. Accordingly, transfer of ownership does not eliminate the right to recover FMGP clean-up costs.

FMGP Cost Recovery Tracking Process

The Petitioners original FMGP cost recovery proposal was fundamentally a continuation of the FMGP cost recovery process used since 1996. The proposal would have maintained the same rate of recovery ($494,017 per year) and would have provided for recovery of future FMGP clean-up costs, previously incurred clean-up costs, would have maintained tracking, and assured that ratepayers would pay for only prudent and reasonable clean-up costs without any double recovery. The main change was the order of FMGP cost recovery to first provide for recovery of MERC's future Austin FMGP site clean-up costs, with recovery of the remaining balance of IPL's previous clean-up costs and future Austin FMGP clean-up costs to follow.

The Petitioners' proposed FMGP clean-up cost recovery will include $2.6 million for IPL's previously incurred and unrecovered FMGP costs. The Transaction contemplates that the future clean-up costs for the Austin FMGP site will be collected.

Response to the OAG's Recommendation

The OAG objected to the Petitioners' proposed treatment of FMGP clean-up cost recovery and recommended that MERC assume no FMGP clean-up costs and that IPL retain responsibility for all FMGP costs with no recovery, including retaining all of the Austin site liability.

The Petitioners argued that the OAG recommendation must be rejected because it would deny IPL the opportunity to recover reasonable and prudently incurred FMGP clean-up costs and would impose an unwarranted financial penalty for IPL. The Petitioners noted that the OAG, as it has done in several prior cases, based its argument on the assertion that MERC's ratepayers have not obtained any benefit from the Austin FMGP site and should not be required to pay its related cleanup costs. The Commission has recognized that the responsibility applies to all ratepayers, not just the ones in the immediate area. The Commission has consistently rejected the OAG's argument in prior cases involving IPL and other utilities.

If the Transaction is approved, all of the former IPL customers will become MERC customers, and all of the reasonable and prudently incurred costs of providing service to those customers, including the FMGP clean-up costs that arose from prior utility service, are appropriately recoverable from all MERC customers. The Petitioners argued that the transfer resulting from the Transaction cannot be recognized for some purposes and not for others. If the Transaction is approved and recognized for purposes of transferring gas service responsibility to MERC, the transfer of Austin FMGP site clean-up costs to MERC must also be recognized.

Response to the OAG's Additional Recommendations

The OAG recommended that if the Commission decides to approve the transaction, the Commission should:

1. Maintain current rates for IPL's gas customers until a rate case is filed;

2. Separately identify the costs associated with setting rates between IPL's former customers and MERC's current customers for at least five years;

3. Deny the request to transfer IPL's obligation to remediate contaminated former manufactured gas plant liabilities to MERC;

4. Incorporate current deferred taxes into rates for former IPL customers; and

5. Conduct public hearings to allow ratepayers to participate in the process.

Rates

In addition to items previously discussed on the Customer Rates and Terms of Service section, the Petitioners response to the OAG's recommendations regarding rates stated:

> Minn. Stat. §216B.06 does not require a full rate case filing before the Commission may approve transition of customers within a new service territory into existing utility rates. The Commission has discretion to regulate the affairs of public utilities. The Legislature has directed the Commission to ensure that rates for regulated utility service are just, reasonable, and not unduly discriminatory, (Minn. Stat. §§ 216B.03, 216B.07), and has authorized the Commission to establish the appropriate rates. In approving a property transfer under Minn. Stat. § 216B.50, the Commission has broad authority to approve rate changes as a component of the transaction being approved where it finds such approval to be "consistent with the public interest."

The Petitioners stated that the OAG acknowledges that the Commission has previously approved immediate rate transitions as part of acquisition approvals. They noted that Minn. Stat. §216B.06 provides in relevant part "No public utility shall directly or indirectly, by any device whatsoever, or in any manner, charge, demand, collect, or receive from any person a greater or less compensation for any service rendered or to be rendered by the utility than that prescribed in the schedules of rates. . ."

The applicable standard for the Commission's review is not whether a full rate case has been undertaken but whether the proposal is consistent with the public interest. The Petitioners' proposal of immediate rate transition is consistent with the public interest and will result in significantly less negative impact on customers as compared to OAG's alternative proposal to delay transition. The OAG acknowledges that leaving rates unchanged until a subsequent rate case is filed could result in rate shock.

The Petitioners stated that limiting IPL customer rate-increases to 3% annually would not account for cost increases that have occurred, leading to ongoing under-recovery of costs.

Rate Design

The Petitioners noted that since IPL and MERC have different tariffs and rate structures, the transfer of IPL customers to MERC's tariffs and rates will result in relatively minor but unavoidable rate design changes. The OAG's exaggerated illustrations of rate differences and the inquiry into class cost shifts resulting from the proposed transaction miss the point.

The focus of the public interest analysis should acknowledge the Department's observation that the current IPL rates are unsustainable. The Petitioners look forward to further input from the Department and discussions on how to transition IPL customers to MERC's sustainable rates as soon as possible.

Deferred Taxes

Responding to the OAG's Comments regarding deferred tax benefits, the Petitioners stated:

> The OAG attempts to overstate the impacts of the reset of deferred taxes. In doing so, the OAG fails to account for the fact that IPL will actually have to pay these deferred taxes to the applicable taxing authorities in the year of sale, and that customers will then benefit from MERC being entitled to step up its tax basis and restart accelerated tax depreciation on the acquired assets.
>
> The OAG does not address the impact on customers that would result from a potential tax normalization violation and the resulting loss by MERC of its ability to claim accelerated tax depreciation. The Internal Revenue Service has indicated in prior rulings that the type of direct offset, such as the OAG's recommended refund of IPL's deferred taxes, in future rates to compensate customers for the reset of deferred taxes and loss of deferred income tax credit benefit in the context of a taxable sale of regulatory assets would be a violation of the tax normalization rules. This violation would preclude MERC from claiming accelerated tax depreciation on both the acquired assets and other assets MERC may acquire in the future.
>
> Offsetting the tax consequence of the sale (i.e., IPL's having to recognize and pay its deferred tax liabilities), MERC will be allowed an offsetting step up in the tax basis of the acquired assets, and will be allowed to restart tax depreciation on the total tax basis in acquired assets. Beginning in the year of sale, MERC will be entitled to greater accelerated tax depreciation deductions than IPL would have otherwise been entitled to apply. Therefore, the impact on customers of resetting deferred taxes is temporary, and the present value to customers that would be associated with the reset of deferred taxes and rate base in the year of sale would be significantly less than IPL's current balance of deferred tax of approximately $2.7 million.
>
> The Commission has previously considered a number of cases in which all of the assets of a utility or telephone company were transferred to another entity and never required that ratepayers receive deferred taxes. None of those cases show that the selling entity's deferred taxes were transferred to the purchaser or that flow-through to ratepayers was required.

> In approving MERC's acquisition of Aquila, Inc., the Commission rejected the OAG's recommendation that the Commission "determine the magnitude of the lost tax benefits to ratepayers and, based on that, determine the length of the rate freeze that will be required to prevent harm to ratepayers from the proposed sale," concluding that "imposing a rate freeze could potentially require MERC to earn less than a reasonable return on its investment."

In response to the recommendation to hold a public hearing, the Petitioners stated that, if the Commission would find it to be necessary, they would not object.

Answers to Department Requests for Further Information

The Department recommended that, in reply comments, the Petitioners provide an explanation of the differences between IPL's and MERC's Conservation Cost Recovery Adjustment (CCRA), Gas Affordability Program (GAP), and natural gas costs.

Differences between IPL's CCRA and MERC's CCRA

The Petitioners stated that there are several factors, such as service territories, industrial bases, and costs of gas, that are generally relevant to explaining the differences between IPL and MERC's CCRA factors. The primary driver of the differences relates to the volatility in IPL's smaller annual CIP spending (and related true-ups). For IPL, one large project in a given calendar year can exceed IPL's total gas CIP budget. The effect of a one-year true up was demonstrated in the following example:

> IPL had a budget of $497,245 in 2012 when the CCRA factor of $0.0308 per therm was calculated. However, only $391,089 was spent by the end of 2012. As a result, there was a significant change in the following year (2013) CCRA factor, moving from a positive charge of $0.0308 in 2012 to the credit of $0.0135 in 2013.

Differences between IPL's GAP and MERC's GAP

The Petitioners stated that the differences between MERC's Gas Affordability Program (GAP) factor and IPL's GAP factor are primarily due to: 1) the calculation for recovery of the volumetric surcharge by each respective utility; 2) participation levels within each utility's GAP; and 3) retention levels within each utility's GAP. MERC and IPL believe that substantial customer benefits would result from combination of their GAPs.

First, IPL bills the GAP surcharge to all tariff rates. In contrast, MERC bills the GAP surcharge to only the General Service (GS) rate.

Next, GAP participants must be enrolled in Low Income Home Energy Assistance Program (LIHEAP) in order to participate. Their 2013 GAP Annual Reports show that MERC and IPL had 8% and 4% LIHEAP participation rates, respectively. The 2013 Reports also show that MERC's retention rate was 95% and IPL's was 79%.

The reason for this difference in participation levels may be largely due to the effects of the Salvation Army, which MERC uses to implement its GAP. IPL had previously used the South East Minnesota Citizens Action Council (Semcac) to implement its GAP. In recent years,

Semcac decided that with the small budget available and other priorities, it would no longer be able to implement IPL's GAP. While IPL is still getting the potential LIHEAP names from Semcac, IPL is now using internal resources to implement its GAP. Following the Transaction, the GAP in IPL's current areas would be implemented by the Salvation Army. MERC has achieved higher GAP retention rates than IPL.

MERC and IPL's GAPs are almost identical in design. Both have percent of income and arrears forgiveness components; participants are held to identical participation rules; and they are funded by a volumetric surcharge. However, the MERC and IPL GAPs are quite different in budget, participation level, administration, and promotional activity.

Differences between IPL's Gas Costs and MERC's Gas Costs

The Petitioners stated that their comparison assumes that the commodity part of gas costs is similar between the two utilities. The differences that exist are due to differences in underlying demand rates.

The demand rates in MERC and IPL's most recent purchased gas adjustment (PGA) filings are slightly different. MERC's November 2013 demand rate for General Service (GS) customers was $0.17177 per therm while IPL's November 2013 demand rate for Rate 10 customers was $0.12378 per therm. MERC's demand costs and subsequent per therm demand rate for General Service customers is greater than IPL's General Service customers (Rate 10) for several reasons.

First, a significant portion of the demand rate differential is due to the fact that MERC contracted Firm 50,000 Dth/day transportation service with Bison Pipeline LLC/Northern Border Pipeline Company (NBPL) went into effect when the new Bison pipeline went into service and has higher demand costs. The Bison/NBPL contract costs account for approximately $0.0659 of the total $0.17177 per therm MERC demand rate.

Some of the rate differential between IPL and MERC is attributable to the recovery method for Firm Deferred Delivery (FDD) storage contract costs. MERC's demand rate is designed to recover FDD storage costs whereas IPL recovers via the commodity rate. This makes IPL's demand rate lower and its commodity rate higher than MERC's (when all costs are equal). MERC's November 2013 demand rate for GS customers without the FDD storage contract costs was $0.15220 per therm. The Department has recommended, and MERC agrees, that future storage gas cost recovery be done through the commodity portion of the PGA rather than the demand portion.

In summary, the differences are due to the different underlying demand rates.

Petitioners' June 13, 2014, Initial Supplemental Comments

Introduction

On June 12, 2014 the Department filed Supplemental Reply Comments in response to the Commission's Notice recommending:

1. If the asset sale is approved, then IPL's current ratepayers should pay MERC's rates as determined in MERC's current rate case;

2. No adjustment should be made to the proposed sale of assets on account of deferred taxes; and

3. The $2.6 million already paid by IPL for clean-up costs associated with former manufactured gas plant (FMGP) sites should be transferred to MERC as a regulatory asset upon closing of the proposed asset sale. In its next rate case, MERC would include this regulatory asset in its rate base for cost recovery.

Future FMGP expenses associated with the Austin site would be recorded as regulatory assets and included in rate base for cost recovery in MERC's next rate case. The Department recommended that recovery of these costs be allowed in a MERC future rate case if these expenses are found to be prudent.

On June 13, the Petitioners filed Initial Supplemental Comments in response to the Commission's Notice, and to respond to the Department's June 12, 2014 Supplemental Reply Comments.

Petitioners stated that they agree with the Department's recommendations, as outlined in the Department's June 12, 2014 Supplemental Reply Comments regarding the terms for approval of the Transaction, including the treatment of recovery of previously incurred and future costs relating to FMGP sites in Minnesota and the transition of current IPL customers to MERC's rates. Petitioners believe the Department's recommendation for approval of the Transaction is consistent with the public interest and requested that the Commission approve the Transaction as recommended by the Department and as explained in greater detail in the Petitioners' June 13 Initial Supplemental Comments.

The Notice of Additional Comment Period requested information pertaining to the compliance reporting requirements under Docket No. G-001/M-06-1166. The Petitioners agreed to continue the annual reporting requirements until the Commission issues an order for a different treatment. Additional costs incurred will be added to the initial balance ($2.6 million) to be recovered. As described in greater detail below, the Petitioners agree with the Department's recommendation that recovery of FMGP costs from ratepayers not occur until the FMGP costs are approved in MERC's next rate case.

Response to the Department's Recommendations

The Petitioners agreed with the Department's recommendation to treat the Austin FMGP environmental costs as a regulatory asset, but noted that the existing FMGP net regulatory asset to be acquired by MERC is associated with deferred costs and expenses for cleanup at all of IPL's Minnesota FMGP sites, not just the Austin FMGP site. The IPL Regulatory Asset net of environmental and regulatory liabilities is currently valued at approximately $2.6 million but the purchase price would be determined at the time of closing.

As summarized in the Department's comments, following approval of the proposed asset sale, MERC would seek approval to include the existing amount of the Regulatory Asset, along with

any deferred future additional cleanup costs expenditures incurred by MERC for the Austin FMGP site, in rate base in its next rate case filing. Upon the Commission's review and approval, those costs would be included in an amortization expense and recovered from all MERC ratepayers, including but not limited to current IPL customers. Other than for the Austin site, MERC ratepayers or current IPL customers will not be responsible for any future cleanup costs. The Austin FMGP site's future expenditures would remain subject to prudence review by the Commission.

The Petitioners stated that they would memorialize this modification to their original Agreement in the form of an Amendment to the Agreement and would file a copy of that Amendment when signed. The Amendment will reflect MERC's agreement to acquire IPL's existing FMGP Regulatory Asset for a purchase price equal to the value of that Regulatory Asset at the time of closing. The purchase of IPL's FMGP Regulatory Asset will be financed through a promissory note for the amount of the Regulatory Asset to be held in favor of IPL. Once MERC's directly incurred cleanup costs at the Austin site are first recovered, MERC will pay IPL back the value of that note (i.e., the value of the Regulatory Asset) from ratepayer supplied funds authorized in MERC's next rate case.

Upon filing of MERC's next rate case and approval by the Commission for MERC to include the existing FMGP Regulatory Asset and any additional cleanup cost expenditures incurred through the filing of that rate case into rate base, MERC would complete an annual calculation of the amount collected through rates and the amount spent on cleanup at the Austin site as of the date of the calculation to determine payback to IPL for the promissory note. Because MERC will acquire the FMGP Regulatory Asset for all regulatory purposes, this Amendment will significantly simplify the rate recovery associated with past and future cleanup costs for the IPL FMGP sites.

Response to Commission Questions

The Petitioners' Comments also addressed questions raised by the Commission. In response to the question of how the companies will handle recovery of present and future non-Austin remediation costs the Petitioners stated that the value of IPL's FMGP Regulatory Asset is net of environmental and regulatory liabilities at closing and will reflect IPL's net regulatory asset related to the unrecovered amount of remediation spending at its Minnesota FMGP sites, including Austin, as of the closing date.

Post-closing, IPL is retaining the responsibility to remediate the Albert Lea, Fairmont, and Owatonna sites (no further remediation expense is anticipated for the Fairmont and Rochester sites); however, those future expenses will not be recovered from MERC's or IPL's ratepayers after the Transaction closes. No recovery will be sought from MERC ratepayers (including the former IPL customers) of any future remediation costs for FMGP sites other than Austin.

In response to the question of how will the companies handle the annual compliance reporting requirements under Docket No. G-001/M-06-1166, the Petitioners explained that IPL will continue to meet its reporting requirements until the Transaction is approved and closes or until ordered otherwise by the Commission. IPL anticipates that if the Transaction closes in 2014, its last report under Docket No. G-001/M-06-1166 would be filed in 2015, as it will not have any recovered amounts or expenditures after the Transaction closes.

Consistent with the Commission's prior orders with respect to FMGP remediation recovery, the Petitioners stated that they anticipate that the Commission would require MERC to account for its Austin remediation expenditures and recovery of those expenditures from ratepayers in a manner similar to that established in Docket No. G-001/M-06-1166.

The Petitioners stated that MERC would intend to submit annual filings upon approval of the Transaction to account for its spending at the Austin site. Upon implementation of MERC's next rate case, MERC would agree to continue to submit annual compliance filings to account for annual expenditures and recovery from ratepayers.

Petitioners' July 3 Reply Supplemental Comments

The Petitioners filed short Reply Supplemental Comments in response to the Commission's May 16, 2014 Notice of Additional Comment Period. The Petitioners indicated that they were finalizing an amendment to the Asset Purchase and Sale Agreement dated September 3, 2013, to memorialize an amendment to the Agreement consistent with the recommendations of the Department.

Petitioners stated that the amended terms of the Agreement alleviate many of the concerns raised by the OAG related to the Former Manufactured Gas Plant (FMGP) aspect of the proposed transaction. The Petitioners stated that the OAG's remaining recommendations, including the proposal that rate transition of IPL customers to MERC rates be delayed and the proposal that an adjustment be made to account for deferred taxes, would not be in in the public interest and were addressed fully in Petitioners' Initial Supplemental Comments and May 9, 2014, Reply Comments.

The Petitioners stated that the following terms and conditions, as recommended by the Department and agreed to by Petitioners, are reasonable and in the public interest:

> Immediate transition of IPL customers to MERC's rates, as determined in MERC's pending rate case, upon approval of the acquisition is consistent with the public interest and within the Commission's authority.
>
> No adjustments should be made to the proposed sale of assets on account of deferred taxes.
>
> The $2.6 million already paid by IPL for clean-up costs associated with FMGP sites should be transferred to MERC as a regulatory asset upon closing of the proposed asset sale. In its next rate case, MERC would include this regulatory asset for cost recovery. Additionally, regarding future FMGP expenses associated with the Austin site, MERC would record those costs as regulatory assets and include them for cost recovery in MERC's next rate case. Recovery of those FMGP costs should be allowed in a MERC future rate case if these expenses are found to be prudent.
>
> IPL will continue to meet its reporting requirements under Docket No. G-001/M-06-1166 until the Transaction is approved and closes or until ordered otherwise by the Commission. MERC would intend to submit annual filings upon approval of the Transaction to account for its spending at the Austin site, assuming such filings would be helpful to the

Commission. Upon implementation of MERC's next rate case, MERC would agree to continue to submit annual compliance filings to account for annual expenditures and recovery from ratepayers.

Petitioners' July 25 Comments

On July 7, 2014, the Commission asked the Petitioners additional questions regarding the handling of FMGP costs, both past and future. On July 25, 2014, the Petitioners filed responses to those questions and all relevant information has been previously discussed in this Brief; therefor it will not be repeated here.

August 4, 2014 Comments

On July 7, 2014, the OAG submitted additional questions for Petitioners. The Petitioners' August 4 Comments were filed in response to those additional questions. Many of the issues have already been argued and, as in the previous section, are not repeated here. Other main points from those comments are:

IPL does not currently have information available to calculate revenue requirements for the IPL-Minnesota Gas jurisdiction for a 2014 projected test year or the information necessary to perform a class cost of service study.

Attachment C to the August 4 Comments provided an update to MERC's revenue deficiency and overall rate increase as proposed in MERC's rebuttal position in MERC's current rate case, Docket No. G-011/GR-13-617. MERC's rebuttal position revenue deficiency is $12,159,454. The revenue deficiency including IPL's operating expenses and rate base is $13,148,338. The overall proposed final rate increase in MERC's pending rate case, based on MERC's rebuttal position, is 4.08%. The overall increase with incorporation of IPL customers, based on incorporation of IPL's operating expenses and rate base, would be 4.23%. Under this analysis, if IPL customers are transitioned to MERC's proposed final rates upon approval of the proposed Transaction, MERC would under-recover in the amount of $466,048.

The Petitioners included rate comparisons of new rates for all IPL customers based upon IPL's current costs. They also included rates after removing deferred taxes from rate base on a calculation of MERC rates with IPL rate base and operating expenses.

IPL's total deferred tax assets are $2,355,756 as of December 31, 2013. Details of all deferred taxes including liabilities were provided in IPL's response to OAG Information Request No. 108. Deferred taxes are not tracked by customer class. Customers pay taxes based on regulatory income and expenses multiplied by the statutory tax rate. If these same taxes are not paid or received from the government in the current year due to tax laws, they become deferred tax liabilities or assets, respectively.

Once the sale transaction occurs, the deferred tax assets and liabilities will be settled with the government and, therefore, will have no further impact on rates, since the amount paid to the government would be consistent with the regulatory tax expense.

In its last electric rate case (Docket No. E001/GR-10-276), IPL estimates that there were approximately 200 individuals at the Albert Lea public hearing and less than 20 at each of the other two public hearings held in Winnebago and Stewartville. IPL does not have any records indicating attendance at any other IPL public hearings held in the last 15 years.

DEPARTMENT

Department April 7 Comments

At present, IPL serves a small number of Minnesota retail customers (about 10,600) off of its facilities located in Iowa. The Companies propose that these customers be served by MERC by means of MERC taking interstate gas transportation service from IPL.

Justification for the Transaction

The Companies state that the standard of review is Minn. Stat. §216B.50 – Restrictions On Property Transfer and Merger. Minn. Stat. §216B.50 states, among other things, that if the Commission finds that the proposed action is consistent with the public interest, it shall give its consent and approval by order in writing. The Companies argue that to justify the proposed Agreement they do not have to show that it would provide public benefits but rather that the Agreement is compatible with the public interest. To support this position, the Companies cite earlier Commission Orders in Docket Nos. G008/PA-90-604, G002/PA-99-1268, and G007,011/M-05-1676. The Companies argue that the proposed Agreement is consistent with the public interest due to the following factors:

> Transferring the IPL customers into MERC's utility operations is expected to produce a continuation of good service at reasonable prices to current IPL customers as well as incremental long-term benefits for all MERC customers.
>
> The acquisition of IPL's gas business adds over 10,000 customers to MERC's Minnesota gas business, achieving modest economies of scale to the benefit of all of MERC's current and future customers.
>
> The ability of MERC to integrate and expand service to the IPL gas customers (a less than 5 percent addition) should enable a seamless transition with no degradation of service quality or safety.
>
> The modest total acquisition cost would enable financing from Integrys' internally generated funds. This approach ensures that the acquisition financing costs will be as low as possible to the benefit of the customers.
>
> The integration of IPL into MERC would also provide a greater variety of tariffed services to former IPL customers.
>
> The Agreement would limit the liabilities associated with remediation costs of IPL's Former Manufactured Gas Plant (FMGP).

Department Analysis

Introduction

1. Required Approval for Acquiring Properties

The Companies request Commission approval of the Gas Asset Purchase and Sale Agreement between IPL and MERC under Minn. §216B.50 and Minnesota Rules 7825.1600–1800.

2. Criteria for Assessing the Agreement

Minnesota Stat. §216B.50 governs acquisition of utility properties for total value exceeding $100,000. To approve an acquisition under that statute, the Commission must find that the acquisition "is consistent with the public interest." The statute further requires that:

> In reaching its determination, the Commission shall take into consideration the reasonable value of the property, plant or securities to be acquired or disposed of.

The Commission has historically used a balancing test to determine if an acquisition is "consistent with the public interest," weighing detriments against benefits. Among the factors considered have been: effects on rates, effects on service quality, effects on reliability, effects on the Commission's authority to regulate the company, effects on corporation financing, possible cross-subsidization and economies of scale.

The Commission may condition its approval if it finds that conditions are necessary to preserve the public interest. Such conditions can include periodic filings of information, rate freezes, rate reductions or service-quality requirements. In determining whether the acquisition is consistent with the public interest, the Department focused on the following three issues:

> Would the Agreement increase costs to either IPL's or MERC's gas ratepayers?
>
> Would the resulting operational changes affect reliability and quality of service for IPL's or MERC's gas ratepayers?
>
> Would the Agreement reduce the regulatory authority of Minnesota agencies, thereby impeding the State's ability to best balance ratepayers' interest with MERC's and IPL's?

Legal and Procedural Issues

The Department stated that the Petitioners appear to have requested approval of the Agreement under the appropriate Minnesota Statutes and Rules. A transfer of property from one public utility to another public utility is subject to Commission approval under Minn. Stat. §216B.50. The Petitioners appropriately filed their petition pursuant to this Minnesota Statute. Additionally, a transfer of property as proposed by the Petitioners must satisfy the requirements of Minn. Rules 7825.1700 and 7825.1800. Minn. Rule 7825.1700 requires two things:

> The petition must be approved by formal written order from the Commission; and

> If consideration for such a transaction (transfer of property) is a security or securities, then the Petitioners must file for approval of capital structure concurrently with their petition for transfer of property.

The Petitioners filed for approval of their petition under Minn. Stat. §216B.50. The proposed transaction involves no securities in consideration of the proposed transfer of property. Therefore, the Department concludes that the Petition satisfies all the requirements of Minn. Rule 7825.1700.

Minn. Rule 7825.1800 lists the filing requirements for a petition to acquire property. It consists of four parts, A through D, of which only parts B-D are applicable to a transfer of property. The Department reviewed the petition and concluded that the information provided in the petition includes all the required information in parts B through D of Minn. Rule 7825.1800.

The Department concluded that that the Petitioners' petition satisfies all the legal and procedural requirements.

Gas Operational Issues

The proposed Agreement would require MERC to integrate IPL's natural gas services in Minnesota into its own natural gas services system in Minnesota. To be consistent with the public interest, such integration must be seamless and may not result in operational issues for MERC's post-transaction integrated natural gas system. The operational issues consist of two parts: operation of the distribution system and gas supply.

The Department stated that, based on the Petitioners' explanations, it does not anticipate any operational issues associated with the proposed sale of assets from IPL to MERC.

Effect on Ratepayers

The Department stated that to be consistent with the public interest, the proposed transaction may not result in a significant rate increase for either IPL's or MERC's ratepayers.

The Petitioners indicate the following benefits:

> Combining the IPL customers into MERC's utility operations is expected to produce a continuation of good service at reasonable prices to current IPL customers as well as incremental long-term benefits for all MERC customers.
>
> The acquisition of IPL's gas business adds over 10,000 customers to MERC's Minnesota gas business, achieving modest economies of scale to the benefit of all of MERC's current and future customers.
>
> The nexus, familiarity and ready ability of MERC to integrate and expand service to the IPL gas customers (a less than 5 percent addition) should enable a seamless transition with no degradation of service quality or safety.

> The modest total acquisition cost would enable financing from Integrys' internally generated funds. This approach ensures that the acquisition financing costs will be as low as possible to the benefit of the customers.
>
> The integration of IPL into MERC would provide a greater variety of tariffed services to current IPL customers.

The Department stated that it agrees with the Petitioners' arguments that MERC's acquisition of IPL's natural gas assets in Minnesota would not result in significant operational issues, would not impose unreasonable financial burden on MERC and may result in very small economies of scale for MERC.

The Department stated that for the transaction to be consistent with the public interest, IPL's ratepayers must not be worse off as a result of paying MERC's rates instead of paying IPL's rates. Therefore, the Department compared the rates that, absent the proposed transaction, would have been charged to IPL's ratepayers with the rate that would be charged to IPL's ratepayers under the proposed transaction. When the Department compared IPL's 2014 rates to MERC's rates based on each customer class' average annual bills, it concluded that it appears that IPL's ratepayers would be worse off under the proposed transaction.

However, the Department stated that, since IPL's last Minnesota gas rate case was in 1996 and its [customer?] charges and distribution charges remain unchanged since then, IPL's current rates do not reasonably represent its current cost of providing natural gas service to Minnesota customers. Therefore, it is very likely that IPL's current cost of service is much higher than is reflected in IPL's rates. As indicated by its 2004 through 2012 MN average return on equity of -1.13 percent, IPL's rates are significantly lower than its cost of service. To make the appropriate comparison, the Department asked IPL to calculate its revenue requirements using 2014 as the projected test year. The Petitioners provided 2014 revenue requirements in their supplemental response to the Department Information Request No. 5 using the following assumptions:

> The rates for MERC are based on MERC's interim rates in Docket No. G011/GR-13-617;
>
> IPL's projected revenue requirements for 2014 are based on 2013 data adjusted for known and measurable changes and weather normalized; and
>
> IPL's proposed 2014 rates are based on MERC's proposed rate design for its currently pending rate case. The table below summarizes the rate comparisons.

Comparison of MERC's Rates with IPL's Projected Rates

Residential	MERC	IPL	MERC Rates as % of IPL Rate
Annual Distribution Costs	$315	$298	105.70%
Total Costs	$895	$802	111.60%

Small Commercial & Industrial			
Annual Distribution Costs	$967	$1,038	93.16%
Total Costs	$3,341	$3,145	106.23%
Large Commercial& Industrial			
Annual Distribution Costs	$4,033	$5,021	80.32%
Total Costs	$16,080	$15,486	103.84%
Small Volume Interruptible Commercial & Industrial			
Annual Distribution Costs	$11,483	$5,045	227.61%
Total Costs	$47,474	$40,461	117.33%
Large Volume Transportation			
Annual Distribution Costs	$40,131	$59,232	67.75%
Total Costs	$55,055	48,961	112.45%

(For large volume transportation, the total cost for IPL is less than its distribution cost due to a conservation credit of $12,379.97.)

Based on this comparison, IPL ratepayers would pay more under MERC's rates even when IPL's current rates are updated to reflect IPL's current cost of service. The Department notes the following regarding the above comparison:

a. Estimated Rates Reflecting Updated Revenue Requirements

The total cost includes Conservation Cost Recovery Adjustment (CCRA), Gas Affordability Program (GAP), and energy costs for both utilities. The CCRA reflects the annual true-up cost of the Conservation Improvement Program (CIP), which may vary annually. GAP cost levels may reflect the number of low income customers of each utility. Finally, energy costs may vary from year to year, and in any given year may be higher or lower for MERC in comparison to IPL.

Better total cost comparisons can be made if the differences between IPL's and MERC's costs are better understood. Therefore, the Department recommended that, in reply comments, the Petitioners provide an explanation of the differences between IPL's and MERC's CCRA, GAP, and natural gas costs.

The Petitioners compared IPL ratepayers' current revenue requirements to IPL ratepayers' revenue requirements if served by MERC in response to the Department Information Request No. 5. The revenue requirements under IPL are $4,462,844. The revenue requirements under MERC's interim rates, for IPL's ratepayers would be $4,792,913. Therefore, under MERC's interim rates IPL's ratepayers would annually have to pay $330,009 more than under IPL's updated cost of service.

The Department noted that the interim rates may not be the appropriate rates for comparison with IPL's rates. In MERC's most recent rate case (Docket No. G011/GR-10-997), the Commission only approved a rate increase that was 72.8 percent of MERC's original rate increase request. In its current rate case (Docket No. G011/GR-13-617), MERC requested a revenue increase of

$14,187,599. The Department claimed that allowing MERC to recover the same percent of its original request as in its last rate case would result in lower rates for IPL's ratepayers under MERC's rates than under IPL's currently updated rates.

b. Former Manufactured Gas Plant Mitigation Costs on Rates

As part of the proposed Agreement, responsibility for some of the current and future remediation costs would be transferred from IPL to MERC. The Petitioners originally proposed that MERC be allowed to collect IPL's current level of rate recovery for FMGP costs at the Austin FMGP site of $494,017 per year until the time that the clean-up obligations have been met.

The Department had concerns about the Agreement's provisions regarding FMGP liabilities stating:

> First, the record lacks support for the $494,017 used in the calculation of the FMGP Adjustment Annual Payment, since the $494,017 that is currently included in IPL's rates represents costs associated with several FMGP sites, not just the Austin site.
>
> Second, MERC's pending rate case does not include the Austin FMPG mitigation costs; therefore, MERC will not be recovering $494,017 per year for these costs.

As discussed above, in response to the Department's concerns, the Petitioners filed a First Amendment to Asset Purchase and Sale Agreement.

The Department stated that MERC will only be able to adjust its revenue requirements to account for those mitigation costs in its next rate case on a going forward basis. The Department further concluded that Section 2.8 of the Agreement should be modified as follows:

> The language should state that the Purchaser, commencing with the first anniversary of the Closing Date, make annual cumulative calculation of the FMGP Adjustment Annual payments. No additional provisions should be included in Section 2.8. The Department notices that, if the petition is approved, the above mentioned mitigation cost would not impact MERC's ratepayers at least until MERC files a new rate case.

Department Conclusions and Recommendations

The Department concluded that:

> The petition met all the necessary filing requirements, including the requirements under Minn. Stat. §216B.50 and Minnesota Rules 7825.1600-1800.
>
> The proposed Agreement would have no significant impact on MERC's operation of its distribution system and on its gas supply.
>
> IPL's rates are generally lower than MERC's proposed rates; however this conclusion applies to MERC's interim rates which are likely significantly higher than the final rates to be approved by the Commission.

IPL's current rates are significantly lower than IPL's current cost of service. Therefore, IPL could not remain financially viable under its existing rates.

IPL's rates, based on IPL's current revenue requirements, may be higher or lower than MERC's final rates depending on the Commission's final decision in MERC's current rate case. However, based on the Commission's decision in MERC's most recently completed rate case and based on the Department's recommendations in MERC's current rate case, IPL's updated rates are likely to be higher than MERC's final approved rates.

The Agreement includes inappropriate provisions for treatment of the environmental costs associated with the Austin FMGP site.

The Department stated that it would make its final recommendations in its reply comments but recommended that:

1. In its reply comments, the Petitioners provide the following explanation:

   a. The reasons for the differences between IPL's CCRA and MERC's CCRA.
   b. The reasons for the differences between IPL's GAP and MERC's GAP.
   c. The reasons for the significant differences between IPL's gas costs and MERC's gas costs.
   d. The dates when IPL expects to (1) file the provision under 18 CFR 284.224 with FERC (2) the expected timeline for FERC authorization and (3) MERC's plans for serving IPL customers prior to FERC authorization.

2. Section 2.8 of the Agreement be amended as proposed by the Department comments.

Department June 12 Comments

Response to the Petitioners' Reply Comments

Non-distribution rate components

CCRA

In their Reply Comments, the Petitioners provided reasonable explanation for IPL's and MERC's different CCRA rates. Generally, the CCRA rate reflects the annual true-up adjustments for Conservation Improvement Programs. The CCRA varies across utilities, depending on customer class composition, actual versus budgeted CIP expenses and the nature of the CIP program. The Department notes that the CCRA component of the rates is not very significant. For example, based on the Department's information request, No. 5, the CCRA cost for IPL residential customers is only about 1.72 percent of their total bill for the 2014 projected test-year.

GAP

The Petitioners provided reasonable explanation for the difference between IPL's and MERC's Gas Affordability Program rates. The Petitioners explained that the final GAP rate depends on three main factors:

The calculation of the volumetric surcharge;

The participation levels; and

The retention levels of customers receiving service under GAP.

The Department concluded that the Petitioners' explanation is reasonable. The Department also noted that the GAP component of the rate is very small. For the residential customer class, the GAP component is only about 0.4 percent of the customer total annual bill.

Gas Costs

The Petitioners, at pages 37 and 38 of their Reply Comments, explained the gas cost difference between IPL and MERC. There are two main factors for the discrepancy in gas costs. First, MERC's contract with Bison Pipeline/Northern Pipeline Company for Firm Transportation service includes a significantly higher demand rate than IPL's demand rate. Second, each company recovers Firm Deferred Delivery (FDD) storage contract costs in a different manner. The Department finds the Petitioners' explanation to be reasonable. Also, the Department recently recommended that MERC recover FDD costs in the same way as IPL. MERC agreed with the Department recommendation.

Comments on the OAG Reply Comments

Department stated that the main conclusions of the OAG are:

The proposal of asset sale from IPL to MERC is not in the public interest because it would significantly increase the rates to be paid by current IPL ratepayers.

If the proposed asset sale is approved, IPL's ratepayers should continue to pay their current rates until MERC files a new rate case.

Rate Comparison

The Department claimed that the OAG used inappropriate methodology to compare IPL's and MERC's rates. The Department identified two issues with the OAG's analysis.

First, the OAG used actual 2013 sales for IPL to compare the rates. For ratemaking purposes, the data should be based on weather normalized, not actual, sales data.

Second, since IPL's current rates do not reflect IPL's true cost of service and are not sustainable, for comparison purposes, the rates for IPL should not be the current rates.

Therefore, MERC's proposed rates should be compared to IPL's estimated rates based on IPL's 2014 projected cost of service.

Finally, IPL's 2014 projected rates should not be compared to either MERC's interim rates or MERC's proposed rates since, based on the previous Commission Order in MERC's most recent rate case, and based on the Department's analysis in MERC's current rate case (Docket No. G001/GR-13-617), the final rates for MERC in its current rate case are likely to be significantly lower than MERC's interim or proposed final rates.

The Department disagreed with the OAG's conclusion that the proposed asset sale is counter to the public interest because of the potential increased rates for IPL's current ratepayers.

Appropriate Rates for Current IPL Ratepayers

The Department disagreed with the OAG's position that, if the asset sale is approved, then current IPL ratepayers should continue to pay their current rates until MERC's next rate case. The Department argued that, under the OAG's proposal, MERC would charge two different rates to its residential class, which may be inconsistent with the requirements of Minn. Stat. §216B.03. The Department also restated its position that IPL's 2014 projected revenue requirements are significantly higher than IPL can recover from its ratepayers under IPL's current rates. Therefore, if the asset sale is approved and IPL's ratepayers continue to pay the current rates, they would likely face a rate shock in MERC's next rate case. This is the case because in the next MERC rate case, IPL ratepayers would not only have to provide for the already significant revenue deficiency, but would also have to pay for the increased revenue deficiency between now and MERC's next rate case.

Department Rate Comparison

The Department stated that, in supplemental response to the Department's information request No. 5, the Petitioners provided IPL's revenue requirements using 2014 as a test year. The Department compared the average annual customer bills under MERC's interim rate and IPL's projected 2014 revenue requirements.

Bill Comparison Under MERC's Interim Rates

Class	Annual Bill MERC	Annual Bill IPL	MERC Rate as % of IPL Rate
Residential	$315	$298	105.7%
Small Commercial & Industrial	$967	$1,038	93.16%
Large Commercial& Industrial	$4,033	$5,021	80.32%
Small Volume Interruptible	$11,483	$5,045	227.61%
Large Volume Transportation	$40,131	$59,232	67.75%

The Department stated that this comparison is somewhat misleading because the comparison across customer classes assumes MERC's proposed rate design versus IPL's existing rate design which assigns all incremental revenue requirements for IPL to the volumetric distribution charges. Additionally, this comparison is based on MERC's interim rates, which are likely to be

significantly higher than the final rates to be approved by the Commission in Docket No. G011/GR-13-617.

The Department's position in its Surrebuttal Testimony recommends 48.08 percent of the incremental revenue requirements requested by MERC. MERC's proposed incremental revenue requirements are 1.372 percent higher than its incremental revenue requirements under its interim rates. Thus, the 48.08 percent must be increased by 1.372 percent when applied to the interim rate.

If the Department's Surrebuttal position on revenue requirements is approved, the MERC final rates would reflect only 65.96 percent (48.08% x 1.372) of MERC's interim rates. The Table below compares IPL's rates based on IPL's 2014 projected revenue requirements with MERC's interim rates as adjusted by the Department's recommended revenue requirements.

Comparison Under DOC's Proposed Revenue

Class	Annual Bill MERC	Annual Bill IPL	MERC Rate as % of IPL Rate
Residential	$303	$298	102%
Small Commercial & Industrial	$926	$1,038	89%
Large Commercial& Industrial	$3,877	$5,021	77%
Small Volume Interruptible	$11,038	$5,045	219%
Large Volume Transportation	$42,567	$59,232	72%

The Department notes that, like the previous comparison, the above rate comparison by class is somewhat misleading because it depends on the particular rate designs for IPL and MERC. To avoid the impact of different rate designs for IPL and MERC, the Department compared the overall revenue requirements for IPL's ratepayers under IPL's 2014 projected revenue requirements and under MERC's proposed interim rates. Under MERC's proposed interim rates, IPL's incremental revenue requirements would be $4,462,844. Based on the Department's Surrebuttal position, the Department-proposed incremental revenue requirements for MERC would be 63.42 percent of MERC's proposed incremental revenue requirements under its interim rate; therefore, IPL's incremental revenue requirements under MERC's rates would be $3,039,802. IPL's ratepayers would have to pay less under MERC's rates than under IPL's rates, assuming IPL's 2014 projected revenue requirements.

The incremental revenue requirements for IPL's ratepayers under MERC's rates would exceed the IPL incremental revenue requirements only if MERC's approved rates are greater than 93 percent of MERC's proposed interim rates, or 82.26 percent of MERC's revised incremental revenue requirements of $12,159, 454.

Conclusions Regarding Rates

Because of the different rate designs used by MERC and IPL, IPL's incremental revenue requirements for 2014 should be compared to IPL's incremental revenue requirements under MERC's proposed rates.

Using MERC's proposed interim rate, the incremental revenue requirements under MERC are $330,069 greater than the incremental revenue requirements assuming IPL's 2014 projected incremental revenue requirements.

Based on the Department's position in its Surrebuttal Testimony, IPL's incremental revenue requirements for MERC would be $1,423,042 greater than the incremental revenue requirements under IPL's 2014 projected incremental revenue requirements.

The incremental revenue requirements for IPL, under MERC's rates, would exceed the incremental revenue requirements for IPL under IPL's 2014 incremental revenue requirements, only if the Commission approves an incremental revenue requirement for MERC which is at least 82 percent of the incremental revenue requirements proposed by MERC in its Rebuttal Testimony.

Deferred Taxes

The Department agreed with the Petitioners' position that no adjustments should be made to the proposed sale of assets on account of deferred taxes. It stated that, under regulatory treatment, depreciation expenses are calculated using the straight-line method; thus at each year, rates appropriately reflect the income taxes associated with straight-line depreciation expenses. Since IPL is allowed to use an accelerated depreciation rate, its actual taxes may be lower than what is currently reflected in its electric rates. The difference between the actual and regulatory income taxes is recorded as deferred taxes.

If IPL sells its assets to MERC, IPL would have to pay back its balance of deferred taxes to the appropriate taxing authority. Therefore, counter to the proposal by the OAG, the proposed sale transaction requires no additional adjustment regarding the outstanding deferred balances.

FMGP Treatment

IPL already paid $2.6 million for clean-up costs associated with the Austin site. At this point, IPL has not recovered any of these costs from its ratepayers. The Department proposed that the $2.6 million would become MERC's regulatory asset upon closing of the proposed asset sales. In its next rate case MERC would include this regulatory asset in its rate base for cost recovery.

Regarding any future FMGP expenses associated with the Austin site, MERC would record them as regulatory assets and would include them in its rate base for cost recovery in MERC's next rate case.

Department Conclusions and Recommendations

The Department concluded that:

1. The petition met all the necessary filing requirements, including the requirements under Minn. State. §216B.50 and Minnesota Rules 7825.1600-1800.

2. The proposed Agreement would have no significant impact on MERC's operation of its distribution system and on its gas supply.

3. IPL's current rates are significantly lower than IPL's current cost of service. Therefore, IPL could not remain financially viable under its existing rates.

4. Since IPL's current rates are significantly lower than IPL's current cost of service, to ascertain that the proposed asset sale is consistent with the public interest, it is appropriate to compare IPL's current revenue requirements for its Minnesota ratepayers with MERC's revenue requirements for IPL's Minnesota ratepayers.

5. Under MERC's pending rate case, for MERC's revenue requirements to exceed IPL's current revenue requirements to serve IPL's Minnesota ratepayers, MERC's approved rates in its pending rate case would have to be greater than 82.26 percent of MERC's requested incremental revenue requirements. This is very unlikely, given that the Department, in its Surrebuttal Testimony, recommends an incremental revenue requirement for MERC of only 56.10 percent of MERC's proposed incremental revenue requirements.

6. The Petitioners' proposed treatment of the environmental costs associated with the Austin FMGP site is inappropriate.

7. Based on its conclusion in number 5 and the Department's proposed treatment of the environmental costs related to the Austin FMGP site, the Department concluded that the proposed asset sale as modified by the Department is consistent with the Public interest.

Based on its analysis and conclusions, the Department recommended that the Commission approve the proposed asset sale with the following provision:

The $2.6 million expense paid, but not yet recovered by IPL, to account for the environmental costs of the Austin FMGP site, and the future expenses associated with the environmental costs of the Austin FMGP site, should be recorded as regulatory assets. In its next rate case, MERC would include these regulatory assets in its rate base and request recovery of these costs via return on and of these assets. Recovery would be allowed if these expenses are found to be prudent.

September 2 Comments

The Department's September 2 Comments stated that the Department reviewed and analyzed the following:

1. The Petitioners' Petition;

2. The Petitioners' Reply Comments, Initial Supplemental Comments, and Reply Supplemental Comments;

3. The Petitioners' First Amendment to Asset Purchase and Sale Agreement;

4. The Petitioners' responses to the Commission's and the OAG's additional questions;

5. The OAG's Comments, Reply Comments, Initial Supplemental Comments and Reply Supplemental Comments.

Based on its review and analysis, the Department's previous conclusions remained unchanged except for the last two. Based on the Petitioners' Amendment, the Department replaced its previous recommendations 6 and 7 with the following:

6. The Petitioners' treatment of the FMGP cost as proposed in the Petitioners' First Amendment is appropriate.

Based on its analysis the Department concluded that the proposed Asset Purchase and Sale Agreement, as amended, is consistent with the public interest. The Department recommended that the Commission approve the proposed Asset and Purchase Sale Agreement, as amended.

OFFICE OF THE ATTORNEY GENERAL

OAG April 7 Comments

The OAG recommended that, if the Commission was going to approve the transaction, it should do so only with conditions to protect ratepayers' interests. Specifically, the OAG recommended that the Commission take the following actions to ensure that the sale is consistent with the public interest:

1. Maintain the current rates for IPL's gas customers until a rate case is filed authorizing a change in rates;

2. Separately identify the costs associated with setting rates between IPL's former customers and MERC's current customers for at least five years;

3. Maintain IPL's current obligation to remediate contaminated manufactured gas plants located in Minnesota and deny the Petitioner's request to transfer the obligation to MERC;

4. Incorporate the level of deferred taxes currently reflected in IPL's Minnesota jurisdictional reports into the rates for former IPL customers by amortizing it over a period of five years; and,

5. Conduct public hearings in IPL's service territory to allow ratepayers to meaningfully participate in the process.

Legal Standards

The OAG's position is consistent with others that Minn. Stat. § 216B.50 applies to the proposed transaction.

Analysis

Rate Increase

One of the OAG's concerns is that the Petitioners propose to substantially increase the natural gas rates for more than ten thousand IPL customers without filing a rate case. As originally proposed, the Transaction would also immediately increase the rates of more than two hundred thousand MERC customers who would take on the added expense of IPL's FMGP in Austin. Without a general rate case filing, the Commission does not have the information necessary to make an informed decision about whether the proposed rate increases are just and reasonable. Increasing rates outside of a rate case does not conform with the Commission's historic treatment of property acquisition matters and is not consistent with the public interest. If the Petitioners believe it is necessary to increase rates for customers, they should seek an increase by filing a rate case.

Rate Increase Process

The OAG noted that The Minnesota Public Utilities Act details the comprehensive procedures used for changing rates by filing a rate case in Minnesota Statutes section 216B.16. When proposing a rate change, the utility bears the burden of proving that the rate change is just and reasonable. The utility must provide evidence to support the rate change by filing a cost-of-service study, as well as "statements of facts, expert opinions, substantiating documents, and exhibits," and details about its energy conservation plan. Once the Commission has established utility rates, "no public utility shall . . . by any device whatsoever, or in any manner, charge, demand, collect, or receive from any person a greater or less compensation for any service rendered . . . than that prescribed in the schedules of rates." The OAG stated that, by crafting such a detailed procedure for ensuring that rate increases are just and reasonable, the legislature clearly intended for those procedures to be used when utilities request rate increases. Instead, because it will be less complicated for MERC to administer, the Petitioners ask the Commission to implement a rate increase outside of a rate case and without any input from ratepayers.

The OAG claimed that the Petitioners argue that the Commission should disregard the well-established ratemaking process because the proposed shortcut would be easier and cheaper to administer. Instead of providing the Commission with the information required to decide whether the proposed rate increase is just and reasonable, MERC would increase the rates of IPL's residential customers by potentially more than 45% and shift FMGP cleanup costs of almost $4 million onto MERC customers without the benefit of a contested hearing or the opinions and analysis of the many experts who would provide the testimony necessary to evaluate the rate increase request.

The OAG noted that the initial filing in MERC's recent rate case comprises four volumes, including testimony and exhibits from 14 company witnesses. Additional testimony was filed by many interveners, including the OAG. In comparison, the filing in this case is made up of fewer than 40 pages and is accompanied by only a handful of exhibits. The record contains no expert testimony or analysis. Rather than making a considered determination with input from many sources, the Commission would have to rely on the Petitioners' assurances that the rate increase is just and reasonable.

The OAG added that permitting an increase outside of a rate case could open the door for other utilities to seek similar advantages in the future and create a dangerous precedent for increasing rates without applying the procedural safeguards of Minnesota Statutes § 216B.16.

Historical Treatment

The OAG noted that the Commission has not historically increased rates through property acquisition dockets. When the OAG asked the Petitioners for the legal authority to increase rates outside of a rate case, they initially identified a twenty-six-year-old case in which the Commission ordered a purchasing utility to decrease rates of customers acquired by the transaction. Specifically, the Petitioners note that in the 1988 sale of Bigfork Valley Electric to Minnesota Power and Light (Docket No. E-014,013/PA-88-34), on page 3 of its Order the Commission found that "if the sale is approved, Bigfork's customers will become customers of [Minnesota Power] at the applicable existing MP rates."

The OAG stated that the next sentence in the Commission's Order states: "This is likely to result in rate reductions of up to 45% for Bigfork's residential customers and 30% for other customers." The Commission approved the sale and the altered rates only after it had concluded that the sale would not increase rates for either the Bigfork customers who would be joining MP or the customers that MP already served.

The OAG noted that the Commission has periodically approved rate reductions in the context of property acquisitions. In *In the Matter of a Petition by N. Minnesota Utilities for Approval of a Proposed Acquisition of Natural Gas Distrib. Facilities from the City of Warroad, Minnesota and of an Increase in Demand Units*, the Commission noted that approving the sale and moving the Warroad customers to Northern Minnesota Utilities would reduce their rates by nearly $200 per year based on average usage, and reduced firm customer rates by approximately 23 percent. In both of these cases, the Commission approved rate changes in the context of property acquisitions only when the proposal would reduce the rates of all customers. The OAG argued that those situations could not be more different from the Petitioners' proposal, which would increase rates for both the new customers and MERC's existing customers.

The OAG noted that the Petitioners also provided a copy of a thirty-five-year-old case in which the Commission permitted a utility to increase utility rates in a property acquisition docket on the day these Comments were filed: *In the Matter of the Joint Petition of Minnesota Power and Light Co. and Rainy River Improvement Co. Requesting an Order Authorizing the Purchase of all of the Electric Utility Property of Rainy River by Minnesota Power and Light (Rainy River).* Based on its limited opportunity to review the case, the OAG concluded that the matter further demonstrates why the Commission should deny the Petitioners' request to increase rates for IPL customers.

In the Rainy River case, Rainy River and Minnesota Power and Light ("MP&L") requested authorization for MP&L to purchase Rainy River's entire electric system and expand its service area to include Rainy River's customers. The Commission initially approved the transaction, but withdrew its approval when it determined that doing so would increase rates and ordered MP&L to submit alternative rate proposals. Rather than increase the Rainy River customer's rates directly, the Commission ordered MP&L to phase-in their rates over a period of three years

utilizing a series of riders. In reviewing and approving the Rainy River sale, the Commission never considered increasing rates immediately at any time.

The Rainy River sale is distinguishable from the matter at hand for several reasons. First, the Commission only approved the Rainy River sale after hearing testimony that acquiring Rainy River would actually decrease the cost of service for MP&L's entire system. In contrast, the Petitioners in this case have not established that purchasing IPL's assets would reduce MERC's cost of service, and no testimony has been introduced to that effect.

Second, while the Commission did ultimately approve a limited phase-in of rates, it appears that, at the time the Commission rescinded its prior approval of the Rainy River Sale, MP&L had already included the Rainy River assets in rate base in its ongoing general rate case. The Commission thus had the opportunity to consider the Rainy River assets in the context of MP&L's general rate case. In this case the Commission would have no similar opportunity, as MERC's ongoing rate case does not include the IPL assets.

Third, the Rainy River sale regarded significantly lower increases in rates than the Petitioners have proposed in this case. Rainy River residential customers would have seen increased average annual charges of 21.4%, while commercial and industrial customers would have increases of up to 64%. Under the Petitioners' proposal, IPL's residential customers would see average annual charges increase by 45.18%, while some commercial and industrial customers could have increases of more than 150%.

Fourth, the Commission held public hearings before originally approving the Rainy River sale, and only approved the phase-in after soliciting comments from all parties to the sale and to MP&L's ongoing rate case. There have been no public hearings in this matter thus far, and the parties to MERC's pending rate case will not have the opportunity to present their comments. For all of these reasons, the Rainy River asset sale does not support the Petitioners' proposal to increase IPL customers' rates immediately.

The OAG stated that a more recent Commission decision involving MERC asset purchases demonstrates the Commission's preferred method for transitioning customers between utilities. In 2006, MERC purchased Aquila, Inc.'s assets and began to provide natural gas distribution service to additional customers in Minnesota. After the sale, MERC continued to operate the two divisions purchased from Aquila as separate divisions, Peoples Natural Gas and Northern Minnesota Utilities. The Commission ordered that the new divisions maintain the same rates, terms and conditions that they had under Aquila. Additionally, MERC agreed that the rates would remain under the Aquila tariffs until MERC filed a new rate case, which MERC agreed to delay as part of the sale. Until they were consolidated in its 2010 rate case, MERC operated the divisions separately for more than four years.

The OAG argued that MERC should follow the same process in this purchase and keep the IPL customers separate until they can be integrated by a rate case. MERC's recent experience in charging multiple rates as part of a merger should also minimize any claimed burden the company faces in administering the IPL customers separately from current customers.

Potential Over-Recovery

The OAG argued that the specific facts of this case also demonstrate why the Commission should be hesitant to approve rate increases outside of rate cases. In response to Department discovery requests, IPL stated that it believes a rate case for its Minnesota customers would establish a revenue deficiency of less than $1 million. The OAG is concerned that converting the IPL customers to MERC's proposed rates would generate revenues for MERC in excess of this claimed deficiency. Based on the data provided in Attachment F to the Petition, the OAG estimates that IPL's annual non-gas revenues are approximately $3.521 million. In comparison, if the IPL customers were converted to the rates that MERC has proposed in Docket 13-617, MERC would receive non-gas revenues of approximately $5.275 million. Accordingly, transferring IPL customers to the rates that MERC has proposed in its pending rate case would result in increased revenues of approximately $1.7 million from IPL customers, which is approximately $750,000 more than IPL's own estimated revenue deficiency.

Change in Revenue Recovery

Customer Class	Customers	Annual Revenue (w/o Gas Costs) Using IPL Current Rates	Annual Revenue (with Gas Costs) Using IPL Current Rates	Annual Revenue (w/o Gas Costs) Using MERC's Proposed Rates	Annual Revenue (with Gas Costs) Using MERC's Proposed Rates
Residential	9411	$ 2,258,377.15	$ 6,786,724.20	$ 3,278,774.52	$ 8,323,670.00
C&I < 1,500	1192	$ 891,454.82	$ 3,083,644.59	$ 1,242,169.59	$ 3,684,422.39
C&I > 1,500	10	$ 35,612.36	$ 129,221.92	$ 37,437.40	$ 41,725.00
SVI – Sales	48	$ 220,374.82	$ 1,800,275.48	$ 570,023.81	$ 2,104,996.77
LVI – Transportation	2	$ 115,800.91	N/A	$ 147,500.29	N/A
TOTALS	10663	**$ 3,521,620.06**	**$ 11,799,866.20**	**$ 5,275,905.61**	**$ 14,254,814.16**
	Incremental rate difference (w/o Gas Costs) =				$ 1,754,285.56
	Incremental rate difference (with Gas Costs) =				$ 2,454,947.96

Assuming that IPL's claimed revenue deficiency is fully adopted without a single adjustment, IPL customers would pay approximately $750,000 in excess of the deficiency if converted to MERC rates. This estimate does not account for the claimed efficiency gains that Petitioners believe justify their proposal and illustrate why the Commission has historically been hesitant to increase rates outside of a rate case. The Commission does not have sufficient information on which to make a determination regarding the proposed rate increase. The Petitioners have not provided the type or breadth of information the Commission needs to conduct a comprehensive analysis and make an informed decision on whether the proposed rate increases are just and reasonable.

The Petitioners' attempt to increase rates while avoiding the ratemaking process should be denied. If MERC wishes to increase rates, it may do so by filing a rate case.

IPL'S FMGP Obligations

The OAG noted that the Austin FMGP began producing manufactured gas in 1905 and continued until about 1935. IPL was not the only owner of the site while it was producing manufactured gas, but it held the site from 1924 to 1947. IPL customers have already paid approximately $8.6 million for remediation of the six FMGP sites, and currently pay approximately $500,000 each year. The remaining cleanup costs of the Austin FMGP are estimated at up to $4 million.

The OAG opposes the transfer of cleanup obligations for IPL's FMGP site located in Austin. The Petitioners have not demonstrated that it is consistent with the public interest to either allow IPL to shift its FMGP liabilities to MERC or to increase the rates to MERC's entire customer base outside of a rate case. Additionally, the proposed transaction would shift costs onto MERC's customers in order to clean up a manufactured gas plant from which they have never benefited. It is equitable for IPL to bear the cost of remediating the Austin site because IPL owned the plant while it produced manufactured gas (for eleven years from 1924 to 1935). In contrast, MERC never owned the site during production. The cleanup costs would be shifted further from the customers and service area that originally incurred the costs if they were to become MERC's customers' responsibility. The OAG added that the Petitioners have agreed that the costs of the other five FMGP sites will remain IPL's responsibility, but have not demonstrated why the Austin plant should be treated differently. The OAG believes that responsibility for remediation of the Austin site should also remain with IPL. MERC's customers should not be subjected to an increase of rates outside of a rate case in order to indemnify IPL for its cleanup obligations.

Rate Design

The OAG noted that the proposed transaction would increase IPL customers' rates and also alter rate design. The Petitioners claim that the rate increase is necessary to avoid delay, disruption, and the expense of filing a rate case to integrate the IPL customers into MERC's existing customer base, but provide no analysis of the effects such a change would have on rate design. Based on the data in the Petition, the OAG believes that the proposed rate changes will have a significant impact on rate design that is not consistent with the public interest.

In order to provide the Commission with an expanded and more detailed portrait of the rate consequences of the utilities' proposal, the OAG separately analyzed the customer charge, the distribution charges, and the total annual bill, as well as comparing IPL's current rates to MERC's approved interim rates in Docket 13-617.

Customer Charge Comparison

Customer Class	IPL Current	MERC Interim	% Change to MERC	MERC Proposed	% Change to MERC Proposed
General Service - NNG Residential	$ 5.00	$ 9.59	91.80%	$ 11.00	120.00%
General Service - NNG C&I < 1,500	$ 5.00	$ 16.36	227.20%	$ 18.00	260.00%
General Service - NNG C&I > 1,500	$ 5.00	$ 39.49	689.80%	$ 45.00	800.00%
SVI - NNG Sales	$ 14.00	$ 169.26	1109.00%	$ 165.00	1078.57%
LVI - NNG Transportation	$ 100.00	$ 197.47	97.47%	$ 295.00	195.00%

Applying MERC customer charges to current IPL customers would result in increases for all customer classes. Residential customers would see an increase of 91.80% to MERC's interim rates, and an increase of 120% to MERC's proposed rates. Small C&I customers would see increases of more than 200%, while large C&I customers would see increases of 60% to 800%. Incredibly, Small Volume Interruptible customers would see customer charge increases of more than 1000%. The OAG stated that increases of this magnitude are unheard of and would clearly constitute rate shock.

The following table provides the results of the distribution charge analysis, which include the volumetric non-gas distribution charge, the Conservation Cost Recovery Charge (CCRC) and the Gas Affordability Program (GAP) charge.

Distribution Charge Comparison

Customer Class	IPL Volumetric Charge	MERC Interim Volumetric Charge	$ Change to MERC Interim	% Change to MERC Interim	MERC Proposed Volumetric Charge	$ Change to MERC Proposed	% Change to MERC Proposed
General Service NNG Residential	$0.21349	$0.24450	$ 0.03101	14.53%	$ 0.25670	$0.04321	20.24%
General Service NNG C&I < 1,500	$0.21349	$0.23064	$ 0.01715	8.03%	$ 0.25639	$0.04290	20.09%
General Service NNG C&I > 1,500	$0.21349	$0.21194	$ (0.00155)	-0.73%	$ 0.19535	$(0.01814)	-8.50%
SVI - NNG Sales	$0.06200	$0.14174	$ 0.07974	128.61%	$ 0.13871	$0.07671	123.72%
LVI - NNG Transportation	$0.06199	$0.06186	$ (0.00013)	-0.21%	$ 0.07676	$0.01477	23.83%

Converting IPL customers to MERC's interim or proposed rates would result in a wide disparity of rate changes. Only IPL's ten Large C&I and two Large Volume Transportation customers could possibly expect a volumetric rate decrease. The rest of IPL's customers would see unreasonably large volumetric rate increases. Residential customers would see distribution charge increases of more than 14% under MERC's interim rates, and more than 20% under MERC's proposed rates. Volumetric charge increases of this scale are not consistent with the public interest, especially given that the Petitioners have provided no justification for the increases other than the convenience of avoiding a general rate case. The OAG stated that due process should not be sacrificed for the Petitioners' convenience.

The overall impact, by class, on the average annual customer bills is summarized in the following table:

Average Annual Bill Comparison

Customer Class	IPL Current Annual Bill	MERC Interim Annual Bill	$ Change MERC Interim	% Change MERC Interim	MERC Proposed Annual Bill	$ Change MERC Proposed	% Change MERC Proposed
Residential	$ 239.97	$ 321.19	$ 81.22	33.85%	$ 348.40	$ 108.43	45.18%
C&I < 1,500	$ 747.86	$ 939.44	$ 191.58	25.62%	$ 1,042.09	$ 294.22	39.34%
C&I > 1,500	$ 3,561.24	$ 3,949.70	$ 388.46	10.91%	$ 3,743.74	$ 182.50	5.12%
SVI - Sales	$ 4,591.14	$12,142.99	$7,551.85	164.49%	$11,875.50	$ 7,284.35	158.66%
LVI - Transportation	$57,900.46	$58,951.19	$1,050.73	1.81%	$73,750.15	$15,849.69	27.37%

This table provides analysis of the difference between IPL customers' current average annual bill and the average annual bills customers would face under MERC's interim and proposed rates. Using the customer data provided in Attachment F, the OAG estimated that an IPL residential customer's average bill without gas is approximately $239.97 per year. Under MERC's interim rates, that annual bill would be $321.19, an increase of more than 33%. Under MERC's proposed rates, the annual bill would increase to $348.40 per year, 45% greater than their current bill. IPL customers would also pay increased fuel costs under MERC rates.

The OAG noted that the proposed transaction would shift cost recovery between classes. Under MERC's proposed rates residential and Small C&I customers would be subject to a volumetric rate increase of approximately 20%, and Small Volume Interruptible customers would see a volumetric rate increase of more than 120%. Large C&I customers would see a volumetric rate decrease of more than 8%. It appears that the proposal would significantly change the proportion of costs paid by each class because each class would see rate changes of different magnitudes.

The OAG argued that these changes are not supported by any cost allocation analysis from Petitioners. In order to determine a just and reasonable allocation of rates between customer classes, the Commission must consider, among other factors, the cost of service, ability to pay, tax consequences, and ability to pass on rate increases in order to ensure that rates are just and reasonable. The OAG claimed that the Petitioners have not submitted a class cost of service study or discussed any non-cost factors to justify changes to rate design. Without this analysis, Petitioners cannot substantiate the changes they propose to the cost allocation of IPL customers.

Limiting Rate Increases

The OAG argued that the Commission should approve the proposal only with the condition that IPL customers' rates are unchanged. The OAG recognized that, if such a condition is imposed, MERC may request full consolidation of the IPL customers into MERC rates in its next rate case, creating a likelihood of rate shock at that time. The Commission will have the opportunity to consider how the former IPL customers' rates should differ from the rates of the larger MERC customer base at that time. If IPL customers' rates are increased following MERC's next rate case, the increases should be phased-in gradually over a period of time in order to prevent rate shock. Based on the limited record at this time, the OAG believes that it would be reasonable to

limit any rate increases to no more than three percent annually for five years following the sale until the rates meet MERC's allowed rates.

Deferred Taxes

Deferred taxes are recorded by a utility to recognize the payment of taxes by customers based on book income, while the utility pays taxes based on taxable income. The primary difference between book income and taxable income is depreciation expense, which is accelerated for tax purposes but not for book purposes. IPL's deferred taxes, which are essentially early payments of income taxes from ratepayers to the utility, will be lost as a result of the proposed transaction, and the IPL customers would lose the benefit of the early tax payments they have made.

IPL reported deferred taxes for its Minnesota jurisdiction for the years 2010 through 2012 and projected 2013 as follows:

2010	$6.5 million
2011	$9.4 million
2012	$5.1 million
2013	$5.0 million

These deferred taxes are recorded in accounts 282 and 283 in accordance with FERC accounting requirements and are also reported by IPL in its Annual Jurisdictional Reports (AJR) each year.

The OAG noted that the Commission has expressed concerns about the loss of deferred taxes in other dockets and noted that, in Docket G-008,010/PA-93-92, the Commission stated that the sale would be denied "if the tax-related losses are sufficient, either by themselves or in conjunction with other considerations, to outweigh the benefits of the exchange." It noted that, in Docket E-001/PA-07-54, when IPL sought to sell transmission assets to ITC Midwest LLC, the Commission approved the sale only after the parties reached a settlement ensuring that a deferred tax loss was offset by an Alternative Transaction Adjustment.

IPL's customers in Minnesota have prepaid IPL's income taxes by $5 million as of December 31, 2013. Unlike its previous asset transfer docket, where it accounted for deferred tax loss through an Alternative Transaction Adjustment, IPL has proposed no method for ensuring that its customers retain the benefit of the deferred taxes IPL has accumulated on their behalf. It is not consistent with the public interest to deprive IPL customers of the benefit of the prepayments they have made. In order to protect this benefit for IPL customers, the OAG recommended that the balance of deferred taxes in 2013, $5 million, be incorporated into the IPL customers' rates over a period of five years. Spreading out the $5 million in deferred tax loss over five years will ensure that IPL customers are not deprived of the benefits of their prepayment.

Public Hearings

The OAG recommended that the Commission order public hearings on the Petitioner's proposal as permitted by Minnesota Statutes § 216B.50. The OAG stated that it does not anticipate that holding public hearings will resolve the issues that have been raised in its Comments or excuse the Petitioners from filing a rate case in order to increase rates. The Commission should hold public hearings because it would provide the best opportunity for ratepayers to comment on the

concerns raised by the OAG and other parties and to bring additional concerns to the Commission's attention.

Recommendations

From the limited financial data provided by the Petitioners, the OAG has determined that residential customers would see a customer charge increase of 120%, a volumetric rate increase of more than 20%, and an average annual bill increase of more than 45%. Such an increase creates a risk of rate shock.

Based on the Petition as initially filed, MERC's entire customer base would have been subject to increased rates due to the shifting FMGP costs from IPL to MERC. These increases depart from the Commission's precedent on asset purchases by increasing rates outside of a rate case. The Petitioners have not followed the procedures required by Minnesota Statutes § 216B.16, provided a class cost of service study, or presented any expert testimony that the Commission would normally rely upon to set rates. The OAG stated that the Petitioners have also failed to demonstrate that increasing rates outside of a rate case is consistent with the public interest, or that the proposal would result in rates that are just and reasonable.

The OAG recommended that, should the Commission approve the Petition, it do so only with conditions to protect both IPL and MERC ratepayers against unjustified rate increases:

1. Maintain the current rates for IPL's gas customers until a rate case is filed authorizing a change in rates;

2. Separately identify the costs associated with setting rates between IPL's former customers and MERC's current customers for at least five years;

3. Maintain IPL's current obligation to remediate contaminated manufactured gas plants located in Minnesota and deny the Petitioner's request to transfer the obligation to MERC;

4. Incorporate the level of deferred taxes currently reflected in IPL's Minnesota jurisdictional reports into the rates for former IPL customers by amortizing it over a period of five years; and,

5. Conduct public hearings in IPL's service territory to allow ratepayers to meaningfully participate in the process.

OAG May 9 Reply Comments

Introduction

The OAG filed reply comments in response to the initial submission of the Department of Commerce and to additional discovery provided by the Petitioners after the O AG's initial Comments were filed. The OAG provided updated estimates of the rate increase that would result from converting IPL customers to MERC's interim or proposed rates.

The OAG concludes that the large rate increases proposed by the Petitioners are not consistent with the public interest.

Rate Increases

The OAG stated that the impacts of transferring IPL customers to MERC rates will be even greater than the estimates provided in the OAG's initial Comments. Based on new and additional information, the OAG updated its rate comparison tables and attached them as Exhibit A to its Comments.

Transferring IPL's residential customers to MERC's interim rates will increase their average annual bills by approximately 48%. When compared to MERC's proposed rates, residential customers could see their bills increase by more than half, approximately 52.42%. Small C&I customers would see rate increases of 42.15% if transferred to MERC's interim rates, or 41.41% under MERC's proposed rates. Interruptible customers would see increases of even greater magnitudes, including a rate increase of 355.66% if small volume interruptible customers are transitioned to MERC's interim rates.

In addition to increased total bills, IPL customers would be subjected to customer charge increases. Residential customers would see their customer charge increased by more than 90%. Small C&I customers would see increases of more than 200%. Large customers would see customer charge increases that approach, and even exceed, 1000%. Transitioning IPL customers to MERC's proposed rates would result in more than $50 of unavoidable cost increases every year for every resident.

IPL customers might attempt to mitigate their increased fixed costs by using less gas, but their ability to do so will be limited because distribution rates will also be increased. Residential customers' distribution rates will increase by more than 30%, and small C&I customers will see increases of approximately 20%. Large volume interruptible customers will see increases of nearly 100% under MERC's proposed rates. Small volume interruptible customers will see increases of 200% to 300%. In addition to MERC's increased distribution charges, IPL customers would also have to pay higher fuel rates under either MERC's interim or proposed rates.

The result of these increases is that, without including the cost of gas, IPL customers will pay approximately $1.8 million in additional costs per year to receive natural gas service. More than $1 million of this additional revenue would be paid by residential customers. When the cost of gas is included, IPL customers will pay more than $4 million in additional costs and residential customers will bear approximately $2.3 million of the additional costs assuming that they do not alter their gas use. Transferring IPL customers to MERC's rates would result in millions of dollars of additional revenue without requiring the Petitioners to establish a new revenue requirement.

The OAG stated that the proposal's substantial rate increases raise several serious concerns. The Petitioners are asking the Commission to authorize significant rate increases without following the general rate case procedures established in Minnesota Statutes section 216B.16. The OAG stated that, even if the Commission had been provided with the necessary data, that information

has not been subjected to the level of critical analysis that allows the Commission to determine whether the requested rate increases are just and reasonable.

The OAG restated its concern over rate shock. It noted that Xcel Energy asked for authority to increase its customer charge from $7.11 for overhead residential customers and $9.11 for underground customers to $10.00 and $12.00, respectively, when Xcel had raised the customer charge by 15% only the year before. The Commission rejected the recommendation of the Company, the Department, and the ALJ and limited the increase to less than one dollar because of concerns about rate shock. Given the Commission's concern for rate shock in the Xcel case, which contemplated rate increases much smaller than a 90% increase to the customer charge in a single year and a 52.42% increase to average bills, it is clear that the rate increases proposed by the Petitioners could result in rate shock.

Use of Current Rates

The OAG has several concerns with the Department's analysis. First, the Department compared IPL's 2014 rates to MERC's rates and found that the proposed transfer would result in rate increases of: 17.46% for residential; 9.57% for small C&I; 16.13% for large volume interruptible customers; and no change for large volume transportation customers. The Department did not provide an estimate for large C&I customers. The OAG stated that it has been unable to determine how the Department calculated these estimates because it appears that the Department incorrectly identified the source of its data.

Second, in addition to calculating average annual bills, the Department produced a table described as a Comparison of MERC's Rates with IPL's Projected Rates. For purposes of its comparison, the Department accepted IPL's claim that its current rates do not recover its full cost of service and developed hypothetical future rates that could result if IPL filed a rate case instead of completing the proposed transaction. The OAG recognizes that the Department was attempting to provide the Commission with a direct comparison between MERC's future rates and what IPL rates could be if the Petition is not approved. While this analysis may be theoretically helpful, there are significant limitations in projecting future rates based only on the data provided by Petitioners. For example, in projecting IPL's future rates, it appears that the Department accepted at face value a 2014 revenue requirement projected by IPL. IPL has not provided the wealth of financial information that would be required to support a revenue requirement in a rate case. Further, the public agencies and other parties have not had the opportunity to conduct the critical analysis that is common in rate cases. It is likely that this type of critical analysis would uncover some costs that are not appropriate for full recovery.

After accepting IPL's claimed revenue requirement, the Department projected a new rate design for IPL customer classes based on the rate design that MERC has proposed in its pending rate case. This is also problematic for several reasons. First, at the time of the analysis, the Commission has not yet approved any final rates in MERC's pending rate case. Second, this method assumes that integrating the IPL customers into MERC's system will not result in any change to MERC's revenue apportionment or rate design. While the Department's method has theoretical merit for a limited purpose, it is likely that the practical effect of the incomplete data provided by the Petitioners is that the Department's projection is too high.

If IPL can substantiate its claims that its current cost of service is much higher than is reflected in its current rates, it would be entitled to a rate increase in the future by filing a rate case; otherwise, there is no guarantee that IPL customers' due process rights will be protected without the procedural protections provided by Minnesota Statutes § 216B.16.22. Assuming that an IPL rate case would result in increased rates is not enough to justify increasing rates before a rate case has even been filed. As such, there is not enough information to establish IPL's theoretical revenue requirement or rate design.

Rather than analyzing an unsubstantiated future rate for IPL customers, the Commission should base its analysis on the rates that currently exist: IPL's current rates and MERC's interim and proposed rates. The OAG performed this analysis and demonstrated that the Petitioner's proposal to transfer IPL customers to MERC rates would result in immediate and dramatic rates increases for all customers. The Petitioners have failed to establish that such a rate increase is consistent with the public interest.

Public Interest and Need to Establish Rates in a Rate Case

The established method for increasing utility rates is to file a rate case under Minnesota Statutes § 216B.16. The Petitioners propose to increase rates without following these statutory procedures. The OAG stated that the Petition does not identify any authority establishing that increasing rates without filing a rate case is consistent with the public interest.

The OAG stated that it did not have an opportunity to respond in full to the Petitioners' late citation to *In the Matter of the Joint Petition of Minnesota Power and Light Co. and Rainy River Improvement Co. Requesting an Order Authorizing the Purchase of all of the Electric Utility Property of Rainy River by Minnesota Power and Light (Rainy River).*
The OAG stated that it is clear that the Commission's decision in that case is distinguishable from the proposal in this docket. A careful evaluation of the Rainy River case, and a review of more recent Commission decisions like MERC's recent property acquisition in Docket No. G-008, 010/PA-93-92, supports the OAG's position that the Petitioners' proposal to increase rates for IPL customers without the procedural protections of a rate case is not consistent with the public interest.

Providing background for that case, the OAG noted that Rainy River was a wholly owned subsidiary of Boise Cascade Corporation, a paper manufacturer operating in International Falls. Rainy River provided mostly hydro-power, purchasing 51% of its power directly from Boise's hydro generation, and contracting with Ontario Hydro for the remaining 49%. In December, 1978, Rainy River learned that Ontario Hydro would not renew its contract, and Rainy River was faced with the sudden need to replace nearly half of its power requirements. Ultimately Rainy River decided to sell its assets and service area to MP&L rather than attempt to secure additional power.

The proposed sale would increase utility rates for Rainy River's residential and commercial customers. Comparatively, the purchase would have no impact on the rates of MP&L's existing customers. Without the contract from Ontario Hydro, Rainy River had only a few options: it could increase its rates in order to fund the construction of additional generation facilities, it could purchase additional power from other generators at rates similar to those proposed by MP&L, or it could sell its assets and service area to a company like MP&L.

Based on these options, the Hearing Examiner concluded that a significant rate increase for the Rainy River customers was "virtually unavoidable." The primary reason was that Rainy River's significantly cheaper hydro-power would likely have to be replaced with more expensive power. Additionally, Rainy River's generating and transmission plant was old and had been built at a time when utility construction was more economically feasible; most of the costs had been fully amortized, and replacing the plant with modern upgrades would be extremely expensive. The Examiner concluded that selling Rainy River's assets to MP&L was a strong alternative because neither Boise nor Rainy River had any particular expertise in the utility industry and their electricity generation business was a relic from a bygone era.

After the Commission adopted the full Examiner's findings, conclusions, and recommendation to approve the proposed purchase, it ordered MP&L to submit alternative proposals to mitigate "sudden and dramatic rate increase" from transferring the Rainy River customers to MP&L rates. MP&L submitted a proposal to phase-in the rate increase over several years and, after receiving comments from parties in both the service area docket and MP&L's ongoing general rate case, Docket No. E-15/GR-80-76, the Commission issued its Order Concerning a Phase-In of Rates on December 16, 1980. The Commission concluded that the proposed sale would result in a rate increase of 34% for residential customers, while commercial and industrial customers could see a rate increase of up to 64%. The Commission found that the sale would actually decrease the retail cost of service for the entire MP&L system, and would reduce MP&L's revenue deficiency by $2 million. The Commission concluded that it was appropriate for the Rainy River customers to share in some of the benefit that MP&L customers would receive from the transaction so the Commission ordered MP&L to phase in the proposed rate increases to Rainy River customers over a period of three years beginning on January 1, 1981.

The OAG claimed that the Rainy River case demonstrates that increasing utility rates outside of a rate case is not consistent with the public interest. It demonstrates that requests to immediately increase rates outside of a rate case should be denied, and that even limited proposals to phase-in "virtually unavoidable" rate increases over many years should be granted only when there are extenuating circumstances. The Petitioners have not demonstrated that any of the extenuating circumstances present in Rainy River exist in this case.

After unexpectedly losing nearly half of its power generation, Rainy River needed to provide alternative power or its customers would go without power. There is nothing sudden or unexpected about IPL's circumstances, and there is no danger that IPL customers will go without service. IPL claims that it requires a dramatic rate increase to meet its cost of service but, rather than the unexpected loss of a major power supplier such as in Rainy River, that situation is the result of IPL's judgment call not to file a rate case for nearly twenty years.

The OAG noted that when the Rainy River case was filed in 1978, the Minnesota Public Utilities Act was relatively new. The current rate case procedures, contained in Minnesota Statutes § 216B.16, comprise 19 separate subdivisions; in 1974, section 216B.16 had only seven subdivisions. The procedures did not have provisions for construction work in progress until 1977, and provisions to create a contested case by referring a docket to the Office of Administrative Hearings were not enacted until 1978, the very year that Rainy River was filed.

The OAG noted that, in order to ensure that the due process rights of ratepayers are protected when public utilities seek to increase rates, § 216B.16 has been amended more than forty times since it was enacted in 1974. Many of the procedures that today protect ratepayers' due process rights were not in place or not fully developed when the Rainy River case was decided.

The OAG stated that the Petitioners in this case are asking the Commission to ignore the additional procedural steps that were taken in Rainy River. Once it determined that the Rainy River sale would increase rates, the Commission ordered the petitioners to submit alternative proposals, required public hearings, received an Examiner's report, and solicited comments in multiple dockets before reaching a decision. Even after all of these additional procedures, the Commission did not immediately increase rates as the Petitioners propose to do in this docket. Granting the Petitioners' request would depart from the additional procedures the Commission required in Rainy River as well as the procedures the legislature has established for increasing utility rates. Further details serve to distinguish the Petitioners' proposal from the Rainy River case.

In Rainy River, the utilities had established that the sale would decrease retail cost of service for the entire MP&L system and would reduce MP&L's revenue deficiency by $2 million but the Petitioners have not established any similar facts in this case. One reason that they have been unable to do so is that there has been no critical analysis of IPL's alleged revenue deficiency, no consideration of the effect that transferring the IPL customers would have on MERC's revenue requirement, and no cost of service study. In Rainy River, the Commission had at least some of this information because MP&L had included the Rainy River assets in their ongoing rate case.

Recent Precedent

The OAG stated that in several recent cases, the Commission has expressed its preference for maintaining existing rates and keeping customers separate when they are transferred between utilities. The OAG's May 9 Reply Comments include many of the arguments previously made on this issue.

As an example, in *In the Matter of the Joint Petition of Minnegasco, a Division of Arkla, Inc., and Midwest Gas, a Division of Midwest Power Systems, Inc., for Authority to Exchange Assets, Utility Operations and Business*, Minnegasco agreed to exchange its natural gas properties in South Dakota for Midwest's natural gas properties in Minnesota. The Commission ultimately approved the sale but ordered that Midwest's former customers would "continue to be served under terms of Midwest's existing tariffs." The Commission noted that Minnegasco did not intend to consolidate the Midwest customers with its rates at the time of the exchange but it would do so in a future general rate case filing. In order to justify any consolidation, the Commission ordered Minnegasco to provide additional information in its next rate case including an explanation of the "used and usefulness of the combined peak-shaving facilities, concerning alternative capacity available or acquired through the exchange," an explanation for the "impact on current Minnegasco customers demonstrating that they would not be harmed as a result of the consolidation," as well as all information "needed to quantify and verify exchange related savings and cost increases."

Conclusion

If the Petitioners' proposal is granted, natural gas rates would immediately increase by 52.42% for residential customers and 41.41% for small commercial and industrial customers. The OAG requested that, should the Commission approve the Petitioners' transaction, IPL customers be maintained separately and at their current rates until they can be integrated in a comprehensive rate case. To protect of ratepayers' due process rights and ensure that that utility rates are just and reasonable, the Commission should require the Petitioners to increase rates for IPL customers by filing a general rate case.

OAG June 13 Initial Supplemental Comments

Introduction

The OAG stated that without additional conditions, the proposed transaction is inconsistent with the public interest because it would result in dramatic rate increases, the loss of millions of dollars in deferred taxes, and unreasonable shifts in manufactured gas remediation costs, all without the procedural protections afforded by a rate case. The OAG restated its position that, if the Commission approves the proposal, the previously discussed conditions should be imposed to ensure that the transaction is consistent with the public interest.

FMGP Remediation Proposal

The OAG restated its position regarding the FMGP issue. The OAG stated that several aspects of this proposal are problematic.

First, MERC would have no authority to collect FMGP remediation costs because they are not included in MERC's current rate case, Docket No. G-011/GR-13-617. The OAG agrees with the Department's position that MERC should not be allowed to collect rates that were not authorized by a rate case. Additionally, the Department expressed concern that the $497,017 annually that IPL currently collects for FMGP remediation would not be appropriate going forward. The Petitioners correctly point out that the Commission has approved of IPL's collection of this amount for remediation each year, but did not squarely address the Department's concern. The Department noted that the $497,017 that was approved by the Commission was for all six of IPL's FMGP sites, not just Austin. The Department noted that the record does not reflect whether it would be proper for MERC to collect the full amount for just one of the FMGP sites and the OAG agrees.

Second, the OAG has identified an additional, related problem. IPL claims to have incurred $2.6 million in FMGP costs that it has not yet recovered and seeks to recover those costs from MERC's customers after the transaction. The proposed transaction only transfers the Austin site's liability to MERC and IPL retains liability for the remaining sites. IPL has not demonstrated that all $2.6 million of the unrecovered costs were related to the Austin site. It would be unreasonable for IPL to recover costs that were caused by other FMGP sites when MERC would only assume liabilities for the Austin plant. The OAG stated that the entire concept of MERC's ratepayers providing compensation to IPL is very unusual.

The OAG noted that the Petitioners attempted to defend their FMGP proposal by interpreting the Commission's precedent. The OAG recognizes that, in previous cases, the Commission has allowed utility companies to collect rates for FMGP remediation even when the ratepayers did not benefit from the FMGP while it was operating. However, the proposal in this case requires repayment by customers who are so attenuated from the FMGP sites that it would be unreasonable, especially given the concerns brought forward by the Department. MERC has service territories in southern Minnesota, near the Austin FMGP site, but MERC also has customers in northern Minnesota - hundreds of miles from the Austin FMGP. These customers would be required to pay for remediation of a FMGP that has not been in operation for eighty years only because their utility purchased the assets of another utility.

While, in the past, the Commission has ordered customers to pay for remediation on the basis of land ownership, it is not a requirement. The Petitioners clearly recognize this, in that their proposal would require IPL to pay for remediation costs at the five FMGP sites other than Austin, even though MERC will be providing natural gas service for those areas.
In this case, and under these circumstances, it would be inequitable to shift FMGP costs to MERC. MERC has no authority to collect rates to pay for the remediation. The OAG recommends that the Commission order IPL to retain liability for the Austin FMGP, including any future costs that must be incurred. In the event that the Commission does approve the proposal to transfer liability for the Austin FMGP to MERC, the OAG recommends that MERC collect no revenues for purposes of remediation until they have been approved in a rate case proceeding. The OAG recommended that IPL be prohibited from collecting rates from MERC customers for costs that were incurred before the transaction or after IPL ceases to be a public utility in Minnesota.

FMGP Annual Compliance Reporting

In its Notice of Additional Comment, the Commission requested comments on how the Petitioners will handle the compliance reporting requirements that were established in Docket No. G-001/M-06-1166. In that case, IPL was ordered to make annual filings demonstrating its FMGP expenditures for the year, the cumulative expenditures to date, and any recovery of those expenditures. If the Commission approves the transaction as proposed, it appears that MERC will begin to incur FMGP costs that would be covered by the Commission's Order.

If the Commission approves the transaction as proposed, the OAG recommends MERC be ordered to take up IPL's responsibility for annual filings in Docket No. G-001/M-06-1166. The OAG also recommended that MERC be ordered to include in its compliance filings the costs incurred by IPL or revenue that is directed to IPL under the provisions of this transaction. If the Commission adopts the OAG's recommendation for IPL to retain all FMGP liabilities, the OAG recommended that MERC still be ordered to make annual compliance filings to account for IPL's expenditures and recovery.

The OAG stated that it is possible that the Commission could require IPL, regardless of its status as a public utility, to consent to continued filing until all FMGP remediation is complete. The OAG recommended that particular care be taken to ensure that the Commission retains jurisdiction.

Deferred Taxes

Deferred taxes of $2.66 million are equivalent to approximately 25% of IPL's rate base, given that the estimated book value of the IPL's assets is less than ten million dollars. The loss of these benefits is a detriment to the public interest and, if conditions are not imposed to preserve the benefits of the deferred taxes that the IPL customers have already paid for, the Petitioner's proposal should be denied.

The OAG stated that protecting IPL customers from the loss of deferred tax benefits is consistent with the Commission's precedent. In Docket G-008,010/PA-93-92 the Commission noted that a utility proposal should be rejected "if the tax-related losses are sufficient, either by themselves or in conjunction with other considerations, to outweigh the benefits of the exchange." The loss of these deferred tax benefits, especially in conjunction with the other concerns that have been raised with the transaction, would be unfair to the IPL customers. This inequity is one reason that the OAG recommends that the Commission order the IPL customers to be maintained at their current rates until they can be fairly assessed during a rate case.

If the Commission does increase rates for IPL customers, the OAG believes that it would be inconsistent with the public interest to do so without adjusting the increase to ensure that IPL customers retain the benefits of the deferred income taxes they have already accrued. In its Initial Comments, the OAG recommended that the value of the deferred tax loss be incorporated into the IPL customers' rates. In response, the Petitioners stated that the IPL customers are required to surrender their deferred tax benefits because a direct transfer would violate the normalization rules of the Internal Revenue Service.

The OAG stated that there are alternatives that would both satisfy the IRS rules and preserve the benefit for IPL customers. The Commission could order the Petitioners to utilize a transaction adjustment to refund the value of the deferred income taxes to the IPL customers. IPL has been involved in such a proceeding in the past. In the Matter of the Joint Petition for Approval of the Transfer of Transmission Assets of Interstate Power and Light Company and ITC Midwest LLC, IPL petitioned the Commission to allow it to sell its electric transmission assets to ITC Midwest. IPL held existing deferred tax balances that could not be transferred to ITC because of IRS normalization rules. In order to complete the sale and to mitigate the negative aspects of the transaction, IPL and ITC agreed to implement an Alternative Transaction Adjustment that directed some of the proceeds of the sale to ratepayers. A portion of the Alternative Transaction Adjustment was used to offset for the loss of deferred taxes for ratepayers.

The OAG stated that it is clear that the Alternative Transaction Adjustment does not violate IRS normalization rules because IPL has proposed to transfer the entire credit to another entity along with the sale of its electric utility assets in Docket 14-322. The OAG believes that a similar mechanism could be employed in this case so that the IPL customers do not lose the benefit of their accumulated deferred taxes while avoiding any violation of IRS rules.

The OAG argued that, alternatively, the Commission could preserve the benefit of the deferred taxes by ordering MERC to create a regulatory asset to represent the value of the deferred taxes. At the time that MERC files a new rate case, this regulatory asset could be used to reduce rate base for the IPL customers in the same way that the deferred taxes would reduce rate base should IPL file a rate case. It would be unfair to deprive the IPL customers of a significant rate base

reduction that they have accrued simply because their utility company no longer wishes to provide natural gas service in Minnesota. In order to ensure that the transaction is consistent with the public interest, it is necessary to implement a transaction adjustment, a regulatory asset account, or a similar method in order to address this inequity.

The Petitioners argued that the IPL customers will not lose a benefit because MERC will acquire a new tax basis in the assets and begin depreciation at a faster rate than IPL. For this reason, the Petitioners believe that the IPL customers' loss of depreciated tax benefits will be temporary. MERC may accumulate additional depreciation in the future, but that does not replace the loss of deferred tax benefit that IPL customers have already accumulated.

Responding to this argument, the OAG noted that IPL's deferred tax benefit is held on behalf of the IPL customers exclusively. If MERC later accrues deferred taxes as a result of future depreciation, that benefit would be spread across MERC's entire customer base. Furthermore, the size of the deferred tax benefits held by IPL is much more significant when applied to IPL's rate base of approximately $9 million than when used to offset the rate base of $198 million that MERC has proposed in its current rate case. This dilution would disadvantage the IPL customers if the transaction is approved.

Inconsistent with the Public Interest

A utility may not sell utility assets unless it shows that the transaction is "consistent with the public interest." The OAG stated that the Commission should reject the Petitioners' proposal because they have failed to show that the claimed benefits of the transaction will outweigh the detriments suffered by their customers.

The Petitioners' proposal would harm the IPL customers in several ways. In its Initial Comments and Reply Comments, the OAG demonstrated that the proposal would dramatically increase natural gas rates for all IPL customers. Transitioning the IPL customers directly to MERC's rates would increase average annual bills by 52% for residential customers, and 41% for small commercial and industrial customers. MERC would recover more than $4 million in additional revenues from the IPL customers per year, even though IPL claims that its revenue deficiency is less than $1 million. More than $2.3 million of the increased rates would come from the residential class.

The rate increases serve to highlight the primary deficiency with the Petitioner's proposal. The OAG argued that the Petitioners ask for the opportunity to increase rates by a significant margin without filing a rate case or following the standard procedures that are used to increase utility rates in the state of Minnesota. Even though they have not provided documentation or substantiated any additional costs that would justify any increase in IPL's revenue requirement much less the $4 million that would actually be collected under MERC's rates, the Petitioners ask for MERC to be permitted to increase the revenue paid by the IPL customers.

The Commission has the duty to ensure that utility rates are "just and reasonable" and procedures to ensure this are found, among other places, in Minnesota Statutes § 216B.16, which establish the procedures for utility rate cases. Approving this proposal may open the door to other utility companies seeking to avoid rate cases by increasing rates through asset sales in the future. The OAG added that, without a rate case, the Commission will not have the opportunity to determine

whether the new rates are fair for IPL customers or whether MERC's rates are still reasonable after integrating 10,000 new customers into MERC's system. The OAG stated that the Commission has not had the opportunity to conduct the careful review required to determine whether the Petitioners' proposed rates are just and reasonable because the Petitioners have simply not provided the information necessary to make that determination. For that reason alone, the OAG recommended that the proposal be rejected.

The OAG noted that it has previously identified additional public detriments related to FMGP remediation costs, the loss of deferred tax benefits, and significant rate increases without the due process protections provided by a rate case. The Petitioners have few public benefits to point to in response to the varied and significant detriments for their customers. The Petition initially claimed that "the continuation of good service at reasonable prices," "a seamless transition," and low financing costs would contribute to the public interest but none of these factors provide benefits of any kind. If the transaction would not result in the continuation of good service, or there were significant transition problems, or the transaction would require large financing costs, then the transaction would clearly not be consistent with the public interest regardless of any other concerns. This list is simply a recitation of neutral factors that are necessary for any utility sale. They provide no public benefit to balance the public detriments that have been identified by the Department and the OAG.

The only public benefit identified in either the Petition or the Petitioners' Reply Comments are "modest economies of scale" and a "greater variety of tariffed services" for IPL customers. However, the Petitioners have not identified what services MERC can provide that IPL cannot.

Primarily, the Petitions rely on their claim that IPL's current rates are unsustainable and that changing rates through a rate case would "merely increase costs" and cause delay. The OAG does not raise its concerns in order to cause unnecessary delay or force the Petitioners to bear unreasonable costs, the OAG raises its concerns because it believes that the proposal would set rates that the Petitioners have not demonstrated are just and reasonable, that it would do so without protecting the ratepayers' due process rights, and would cause actual harm to consumers with little benefit in return. Furthermore, if either IPL or MERC were to file a rate case to determine just and reasonable rates for the IPL customers, they could request recovery of some or all of their rate case expenses and they could establish interim rates that would allow them to collect increased revenues while the case was pending.

The OAG noted that it would always be less expensive and faster to allow the utility to increase rates without filing a rate case; however, rate case procedures exist because the Commission and the legislature have determined that it is more important to ensure that the rates are fair. The Petitioners' desire to increase rates quickly and with little expense does not justify dispensing with the procedures that all other utilities use to increase utility rates and it does not provide any benefit to the public that can balance the disadvantages that will be pushed on their customers. The proposed transaction is not consistent with the public interest because the disadvantages identified by the OAG and the Department outweigh any benefits of the transaction.

The OAG stated that it does not dispute that it is possible that IPL's current cost of service is higher than reflected in IPL's rates. If IPL is not collecting enough revenue to recover its costs because it has not filed a rate case for 18 years, IPL's customers should not be subjected to a significant rate increase without the due process simply because its utility has decided not to do

so. Instead, IPL or MERC should file a rate case and ask for authority to increase rates so that the Commission, the OAG, the Department, and all other interested parties can review the request and determine whether the resulting rates would be just and reasonable.

Conclusion

The Petitioners' proposal would increase natural gas rates by approximately 52% for IPL's residential customers and more than 40% for IPL's small commercial and residential customers. It would strip the IPL customers of deferred tax benefits that they have already paid for and it would unreasonably shift manufactured gas remediation costs. It would do all of this without regard for the rate case procedures designed to protect the ratepayers' due process rights. The OAG recommended that the Commission impose the following conditions if the asset transfer is approved:

1. Maintain the current rates for IPL's gas customers until a rate case is filed authorizing a change in their rates;

2. Separately identify the costs associated with setting rates between IPL's former customers and MERC's current customers until they are integrated during a future rate case;

3. Maintain IPL's current obligation to remediate contaminated manufactured gas plants located in Minnesota and deny the Petitioners' request to transfer that obligation to MERC;

4. Require MERC to take up the compliance reporting requirements in Docket No. G-001/M-06-1166, and require MERC to provide additional compliance reporting on IPL's past and future FMGP expenditures;

5. Preserve the benefit of deferred taxes that the IPL customers have paid for by implementing a transaction adjustment refund or creating a regulatory asset account to reduce rate base in a future rate case, and

6. Conduct public hearings in IPL's service territory to allow ratepayers to meaningfully participate in the process.

July 3, 2014 Comments

The OAG stated that in its Initial Comments, Reply Comments, and Supplemental Comments, it identified many concerns with the Petitioners' proposed transaction. In Reply Supplemental Comments, the OAG responded to the issues raised in the Supplemental Comments filed by the other parties and clarified the OAG's primary concern with this case: that it is inconsistent with the public interest to subject the IPL customers to a massive rate increase without the procedural safeguards of a rate case. The OAG restated its position that the Commission should not approve the proposed transaction unless it imposes conditions to ensure that the transaction is consistent with the public interest.

The OAG argued that the Commission should compare the impact to current IPL customers' rates if transitioned to MERC's tariff.

According to the Department, the Commission should analyze the proposed transaction by comparing MERC's rates to "IPL's estimated [future] rates based on IPL's 2014 projected cost of service." To accomplish this analysis, the Department uses a new revenue requirement and rate structure that IPL provided in response to an information request. The OAG argued that the Department does not know what IPL's future rates might be because the Department did not do any analysis in order to find out. Instead, IPL told the Department what revenue it thought it might be entitled to after a rate case. The Department then used that number to reach the conclusion that the proposed transaction would, somehow, only increase rates for IPL's residential customers by 1%.

The OAG stated that the Department did not challenge the reasonableness of any of IPL's capital investment projects. The Department did not determine whether IPL's expenses were proper for rate recovery or met statutory reporting requirements. The Department did not create a proxy group or perform a discounted cash flow analysis to determine whether IPL's return on equity was proper. The Department did not consider whether IPL's revenue allocation methods were sound or whether its rate structure was fair to customers and designed to encourage energy conservation. The Department did not do any of the analysis that is standard when reviewing utility rate increases. Without this analysis, it is unreasonable for the Department to claim that it can predict what IPL's rates might be in the future.

The problems with attempting to estimate IPL's hypothetical rates in the future are the reason that the OAG used IPL's current rates to analyze the impact of the Petitioner's transaction. Without the analysis provided in a rate case, no party can know what IPL's rates would look like at the end of the case. The OAG believes that it is unwise to base conclusions about the rate impact of the proposed transaction based solely on limited data that was provided by the Petitioners, who have stated repeatedly that their preference is to close on the transaction as soon as possible. For that reason, the OAG recommends that, when considering whether the transaction is consistent with the public interest, the Commission compare IPL's current rates to the rates IPL customers would face if transitioned to MERC's tariffs. The OAG has performed this analysis, and the results demonstrate that moving the IPL customers to MERC's rates will result in significant rate increases for all customer classes.

For example, IPL's residential customers currently pay a total volumetric charge of $0.18649; under MERC rates their volumetric charge would increase to $0.25720 based upon MERC's updated request in its pending rate case. This would be an increase of 37.9%. The IPL customers also pay a customer charge of $5.00, which would be increased to $9.50 under MERC's updated proposed rates for an increase of 90%. Small business customers would see volumetric rate increases of nearly 20%, and a 260% increase to their customer charge. These numbers represent what would actually happen to the IPL customers, regardless of the Department's attempt to compute IPL's hypothetical future rates. The actual impact would be a 52.42% increase in the non-fuel bills for residential customers, and a 41.41% increase for small business customers. It is important that the Commission keep the true rate impact for IPL customers in mind when deciding whether the transaction is consistent with the public interest.

The OAG determined that the Petitioners' proposal would improperly shift former manufactured gas plant remediation costs to a utility that has no authority to collect rates for any related expenses; require additional remediation work to be performed by IPL after it is no longer a regulated utility; and strip millions of dollars in deferred tax assets from IPL ratepayers and deprive the ratepayers of rate base reductions that they have accumulated through pre-paid taxes. The transaction would dramatically increase natural gas rates for every IPL customer without any of the analytical process that traditionally ensures that utility rates are just and reasonable.

On top of these measurable detriments, the Petitioners' proposal departs from the Commission's historical precedent which favors separately administering customers who are transferred between utilities until they can be consolidated in a rate case.

When Minnegasco transferred property with Midwest Gas, the Commission ordered Minnegasco to defer consolidation of its new customers until its subsequent rate case, and ordered the utility to "fully justify its request to consolidate rates and PGAs and explain the impact on current Minnegasco customers demonstrating that they would not be harmed as a result of the consolidation." When MERC purchased two divisions of Aquila, Inc. in 2006, it operated them as separate entities for years before they were consolidated – in a rate case. The Commission's decisions for both Minnegasco and MERC establish the process to use when customers are transferred between utilities: they are maintained separately until they can be consolidated in a rate case proceeding.

The OAG argued that the Commission has the duty to ensure that utility rates in the State of Minnesota are "just and reasonable." The procedures used to ensure that rates are just and reasonable are the procedures of a rate case. Without the financial data and careful analysis provided by a rate case, the Commission cannot be sure that the Petitioners' proposal would result in rates that are fair for the customers of either IPL or MERC.

The OAG stated that the Petitioners also attempt to justify the immediate transfer by arguing that, based upon the assumption that utility rates will inevitably increase over time, waiting to transition the IPL customers would result in a marginally greater rate increase in the future. There are several reasons why this argument is unpersuasive. First, MERC has stated in its pending rate case that it intends to file a new rate case just next year. If that is the case, MERC, if it wishes to do so, will have the opportunity to consolidate the IPL customers in the near future. MERC's rates should not be significantly different after only one year as long as MERC's investments and expenditures are reasonable. And second, the need for a rate case is not related only to the size of the rate increase. Due to the magnitude of the proposed rate increase, rate shock is just as likely to occur if rates are increased immediately or increased in a future rate case. A rate case, however, is a significantly better option because a rate case would allow the Commission to control the process of increasing rates if rate shock appears likely.

In response to the OAG's recommendations, the Department argued that Minnesota law would not allow IPL's customers to pay different rates if they are transitioned to MERC. The OAG claimed that the Department's position does not align with the Commission's precedent. In 2006, MERC purchased two divisions of Aquila, Inc., People's Natural Gas and Northern Minnesota Utilities. Before the sale, the two divisions were operated separately. They continued to be operated separately after the sale. In MERC's 2008 rate case, the Commission determined a separate revenue requirement for both MERC-PNG and MERC-NMU, and the two divisions

were not consolidated until MERC's 2010 rate case. The Commission has previously allowed utilities to operate independent groups of ratepayers without violating the statute cited by the Department, and the Commission should do so in this case.

The OAG stated that it is also important to clarify that the OAG's position is not that the IPL customers should never receive a rate increase. It is also not the OAG's position that property acquisition is inconsistent with the public interest just because it would result in a rate increase. Rather, the OAG's position is that in this case, on these facts, it would be unfair to dramatically increase rates for the IPL customers because the Petitioners have not proven that the resulting rates would be just and reasonable. If the IPL customers must be subjected to such a significant rate increase in order for their utility to recover its costs, then they are entitled, at the very least, to know that that the Commission has reviewed every aspect of the utility's costs and determined that they are necessary. Additionally, it would be unfair to subject the IPL customers to a massive and immediate rate increase when the only reason for the increase is that IPL has declined to file a rate case in a reasonable time frame. For the foregoing reasons, the OAG recommends that, if the Commission approves the Petitioners' transaction, the IPL customers be administered separately at their current rates until they can be modified or consolidated in a rate case.

Conclusion

The OAG recommended that the Commission impose the following conditions if the asset transfer is approved:

1. Maintain the current rates for IPL's gas customers until a rate case is filed authorizing a change in their rates;

2. Separately identify the costs associated with setting rates between IPL's former customers and MERC's current customers until they are integrated during a future rate case;

3. Maintain IPL's current obligation to remediate contaminated manufactured gas plants located in Minnesota and deny the Petitioners' request to transfer that obligation to MERC;

4. Require MERC to take up the compliance reporting requirements in Docket No. G-001/M-06-1166, and require MERC to provide additional compliance reporting on IPL's past and future FMGP expenditures;

5. Preserve the benefit of deferred taxes that the IPL customers have paid for by implementing a transaction adjustment refund or creating a regulatory asset account to reduce rate base in a future rate case; and,

6. Conduct public hearings in IPL's service territory to allow ratepayers to meaningfully participate in the process.

OAG September 3 Comments

FMGP

In its September 3 Comments, the OAG stated that there are no material facts in dispute regarding the former manufactured gas plant costs. In response to the Commission's questions, the Petitioners introduced an amendment to the Petition. The OAG understands that pursuant to the amendment, MERC will purchase IPL's existing regulatory asset for FMGP remediation costs. In return, MERC will provide IPL with a promissory note to repay IPL for the regulatory asset from ratepayers' funds that MERC will request in its next rate case. Before directing ratepayer funds to IPL, MERC will use the funds to recover the costs it will incur to remediate the Austin FMGP site.

The amendment clarifies several issues regarding FMGP costs. First, the Amendment formalizes the mechanism by which IPL would recover $2.6 million in unrecovered remediation costs. Second, the Petitioners' response indicates that MERC will not seek recovery of remediation costs for Austin or for IPL's unrecovered costs until its next rate case. Finally, the Petitioners also clarified that IPL will not seek to recover any future costs for the other five sites from Minnesota ratepayers.

The OAG stated that it is still concerned that the Petitioners' FMGP proposal is not consistent with the public interest. The OAG's primary concern is that it would be inequitable to require MERC's ratepayers, many of whom live a significant distance from the FMGP plants, to pay for remediation when no ratepayers in their area obtained any benefit from the FMGP plants while they were in operation. In contrast, IPL owned the plants at the time they were operating, ratepayers in IPL's service area were near the FMGP plants and obtained some benefit before they were shut down. The OAG stated that it would be unreasonable for IPL to recover funds from MERC's ratepayers for unrecovered environmental costs that are related to plants for which IPL has retained liability. The OAG believes that it is inconsistent with the public interest to transfer liability for FMGP costs to MERC.

The OAG does not believe that a contested case is necessary for the Commission to reach a reasoned decision on the matter of FMGP remediation costs.

Disputed Issues of Facts Regarding Rates of Transferred Customers

The OAG argued that there are disputed material facts because IPL's current revenue requirement is unsubstantiated. The OAG's primary concern with the Petitioners' proposal is that it would result in a dramatic rate increase for the IPL customers immediately following the close of the transaction.

The Petitioners and the Department both agree that the transaction would lead to increased rates for the IPL customers. The Department analyzed the transaction by comparing MERC's rates to the hypothetical rates that would result if IPL filed a rate case. According to the Department, it is unreasonable to compare IPL's current rates to MERC's rates because IPL claims that its current rates are not sustainable. The OAG stated that it agrees with the Department in principle on several points: if IPL is not currently recovering its cost of service, then it would be entitled to increase rates by establishing its revenue requirement. It would be reasonable to compare IPL's

cost of service to the cost for MERC to provide natural gas service to the IPL customers if the parties had perfect information about IPL's revenue requirement.

Based on that analysis, the Commission could make an informed decision about whether IPL could provide a lower cost of service to its customers than MERC, and, if not, whether the efficiencies gained by transferring the customers to MERC would be sufficient to offset any detriments of the transfer.

The OAG argued that the parties do not have perfect information about IPL's revenue requirement because IPL has not filed a general rate case. Instead, in conducting its analysis, the Department used a projected 2014 revenue requirement that IPL provided in an information request. As discussed in the OAG's Reply Supplemental Comments, the Department did not conduct any analysis of whether IPL's proposed revenue requirement was reasonable. Given that the Department conducted significant analysis and recommended reductions to the revenue increase in the MERC, CenterPoint Energy, and Xcel Energy rate cases in the last year, the OAG believes that it is unreasonable for the Department to reach conclusions without performing similar analysis in this case. Additionally, a review of the rate cases filed in recent years indicates that Commission has not granted a utility its entire requested revenue increase in any rate case filed since 2010. For that reason, it is very unlikely that IPL would be awarded all of its requested increase after a contested rate. The record in this case does not provide accurate information about what IPL's revenue requirement is, and for that reason the Department's method is not based on reasonable analysis.

In order to mitigate this lack of information, the OAG asked the Petitioners to produce all financial information necessary to substantiate a new IPL rate. Specifically, the OAG asked the Petitioners to provide:

a. All financial information referenced in Minnesota Rules part 7825.3900–4400, including, but not limited to proposed rate base, operating income, overall rate of return, and the calculation of income requirements, income deficiency, and revenue requirements for a test year selected by the Petitioners;

b. A class cost of service study which classifies, functionalizes, and allocates all costs that will be recovered through rates. In preparing the class cost of service study, please classify IPL's natural gas distribution main system by using a zero-intercept study to determine the customer costs associated with a zero-inch diameter main;

c. A proposed rate structure for IPL customers based upon the costs identified in the class cost of service study, including the deferred tax assets currently held by IPL;

d. Travel and entertainment expense itemization as required by Minnesota Statutes section 216B.16; and,

e. All additional financial documentation that would be filed with a rate case in order to comply with any statute, rule, Commission order, or any other reason.

The OAG stated that the Petitioners responded by recreating incomplete financial information that had already been provided in information requests. The OAG stated that not only was the

information insufficient when compared to the breadth and depth of information that would be produced for a rate case, but the Petitioners failed to even restate the entirety of the OAG's questions in providing their response.

The OAG stated that it is not possible to properly analyze whether MERC can provide a lower cost of service to IPL's customers without determining IPL's current revenue requirement. The method for determining the revenue requirement for a utility in Minnesota is to file a general rate case.

The OAG stated that until either IPL or MERC files a rate case to establish the cost of service for the IPL customers, there are material facts in dispute about how much it costs to provide service to the IPL customers.

Contested Case or Rate Case Proceeding

The OAG stated that a contested case proceeding in this docket could not resolve the disputed issues. The purpose of a contested case proceeding in this case would be to determine IPL's revenue requirement. It is unlikely that IPL would be able to file a fully formed rate case in the accelerated time frame that the Petitioners are requesting in this case, and in fact, requiring IPL to file a rate case within this docket would likely lead to errors and inaccuracy because IPL is unprepared to file a rate case. As IPL indicated in its Response to the OAG's questions, "IPL does not currently have information available to calculate revenue requirements for the IPL-Minnesota Gas jurisdiction for a 2014 projected test year or the information necessary to perform a class cost of service study."

The OAG stated that it is unlikely that IPL could assemble the information and produce the expert testimony necessary to substantiate it without a significant delay. Given the fact that IPL is unable to file the rate case necessary to determine its revenue requirement, it is unclear what purpose a contested case in this matter would serve. The OAG stated that a contested case in this matter would not provide a reasonable replacement for a rate case. The rate case procedures set out in Minnesota Rules and Statutes provide the regulatory framework that is necessary to ensure that the Commission has all of the information and analysis necessary to reach a reasoned decision in establishing a utility's revenue requirement. It also provides robust mechanisms for the public, public agencies, and intervenors to participate in the case and provide further analysis for the Commission's review. These procedures are set out in rule and statute, and utilizing some alternative procedure would not provide an appropriate replacement.

Maintain Current Rates

The OAG stated that, if the Commission determines that the proposed transaction is consistent with the public interest, it would be inequitable and unreasonable to change rates for the IPL ratepayers because IPL has not established its cost of service.

The record in this case is insufficient to demonstrate IPL's revenue requirement because a revenue requirement must be established by a general rate case. Additionally, a contested case in this proceeding would not be an appropriate replacement for a general rate case because it would not provide similar procedural protections and IPL does not have the information necessary to file a rate case at this time.

If the Commission determines that the transaction is consistent with the public interest, maintaining the IPL customers at their current rates would eliminate the need for a contested case proceeding at this time because IPL's revenue requirement is only a material fact if the IPL customers would have their rates changed. If IPL customers are transferred at their current rates, MERC will be able to determine their revenue requirement in its next rate case. Given that MERC provided testimony indicating that it would likely file a rate case in 2015, it is possible that MERC could be collecting interim rates from current IPL customers within a few months.

The OAG noted that the Petitioners have claimed that MERC does not have the capability to maintain separate billing systems or that the cost of doing so would be too high. However, MERC operated separate billing systems just a few years ago, until it consolidated two divisions purchased from Aquila, Inc. in the course of its 2010 rate case. The same method should be used in this purchase: if the IPL customers are transferred, they should be maintained at their current rates until they can be consolidated during a rate case.

The Petitioners may also protest that transferring the IPL customers to MERC at their current rates would lead to an under-recovery for the utility. While this is possible, it is also irrelevant - IPL customers are currently charged the tariffed rates that were established in IPL's last rate case and the way to modify those rates is for IPL to file a rate case. If IPL is not currently earning its full cost of service, it is the result of a decision made by the company, not the ratepayers' fault.

Increasing rates during the course of a property acquisition docket and justifying the increase on the basis that IPL is not earning its full cost of service would be unreasonable and unfair for the IPL customers. Furthermore, if MERC files a rate case in 2015, it could start collecting interim rates in the near future and minimize any loss related to the cost of serving the IPL customers.

IPL customers are entitled to be treated the same as all other ratepayers and have their revenue requirement determined in a rate case, regardless of whether it is an IPL rate case or a MERC rate case. The OAG recommends that, if the Commission determines the transaction is consistent with the public interest, IPL customers be maintained at their current rates after they are transferred to MERC.

Public Hearings

In its Initial Comments, the OAG recommended that the Commission schedule public hearings so that ratepayers would have the opportunity to comment on the concerns raised by the OAG and the other parties in this proceeding. The Petitioners noted in their Reply Comments that they had no objection to a public hearing in this matter.

At the hearing in this matter on June 19, 2014, the Notice of Commission Meeting and the Commission's briefing papers indicated that the purpose of the hearing was to determine whether the Commission should hold public hearings. At the hearing, the Commission determined that the record required further development and established new procedures to determine whether any material facts were in dispute and chose not to hold public hearings in this case at that time. During the hearing, the Chair clarified that the purpose of the decision was not to reach a decision on scheduling public hearings during the agenda meeting.

In its Order Requiring Additional Record Development, the Commission indicated that, in reaching its decision, it had concluded that public hearings are expensive, "nearly always sparsely attended," and that holding hearings would not "meaningfully increase public awareness, understanding, or involvement in this case."

The OAG noted that Commission staff noted during the June 19 hearing that it was an awkward time to discuss holding public hearings because the public comment period was still open and the parties in the matter were still in the process of filing additional comments. Given that the Commission did not provide an opportunity for the OAG to present its reasoning in support of public hearings, and that Commission staff's concerns about the schedule no longer present a concern, the OAG believes that it is now proper to reconsider whether to schedule public hearings.

While the public comment process does provide consumers the chance to file their written comments, public hearings represent the only occasion for ratepayers to ask the utility questions in person. Public hearings also represent an occasion for the OAG and other parties to meet ratepayers face-to-face in a formal setting and describe the concerns that have been raised with the proposed transaction. The OAG stated that it continues to believe that the rate increases that would result from the proposed transaction are improper outside of a rate case. The normal context for significant rate increases is a general rate case, and a general rate case requires a public hearing.

The OAG stated that IPL has had significant attendance at public hearings in the recent past. In IPL's last rate case, which was for its electric utility, each of the three public hearings was well attended. The hearing at Albert Lea was attended by more than 200 ratepayers. The OAG noted that public hearing attendance has been increasing generally in recent years because of the increasing frequency of rate cases, and increasing public concern about utility rates. Hundreds of consumers appeared at public hearings scheduled in Xcel Energy's pending rate case. In those cases, the public hearings provided a meaningful chance for the public to learn about and participate in the process. The public should be afforded the same opportunity in this case. The OAG believes that measuring the attendance at public hearings in other cases is not a valid method for determining whether to hold public hearings in this case. Any number of ratepayers could attend a hearing in any particular case, but counting up the raw number of individuals who attended a public hearing is not the proper way to measure the value of holding hearings. The value of public hearings is that it provides ratepayers an additional avenue to participate if they wish to do so.

The OAG recommended that the Commission schedule public hearings in this matter. In order to limit the expense of holding public hearings, the OAG suggests that it may be possible to hold joint hearings along with the sale of IPL's electric assets in Docket Number 14-322. The expense of public hearings can be limited while still allowing meaningful participation.

STAFF COMMENT

The staff finds the proposal to increase rates for IPL's customers troubling. As discussed by the parties, if IPL were to establish rates based on current costs, the new rates would likely be different than current ones; however, rates that reflect IPL's current revenue requirements are

unknown. Furthermore, IPL's current revenue requirement estimate has not been critically analyzed.

As support for the claim that IPL's rates need to be increased, the Petitioners demonstrated that IPL's ROE has averaged -1.67 over the last 9 years. The return has been as high as 13.43% in 2009, and as low as negative 21.04% in 2012. This fluctuation in the return demonstrates the need for a critical review of IPL's revenue requirement before making a determination of the rate impact of transferring customers to MERC's rates.

Staff also has concerns regarding the FMGP costs. Although all the parties in this case have discussed the merits of whether or not IPL's unrecovered FMGP costs should be transferred to MERC, all the parties failed to point out the fundamental fact that the Commission has not reviewed IPL's FMGP costs since 2006 (Docket G001/M-06-1166). For this reason, Staff recommends that, if the Commission approves this transaction and allows FMGP costs to be recovered from MERC's ratepayers, in MERC's next rate case, the amount to be recovered be subject to a prudency review dating back to 2006. Staff also recommends that, as a condition for approval of this transaction, if any post-2006 amount is disallowed then IPL's note be reduced by that amount.

Commission Options

Some Commission options are:

A. Consistent with the Public Interest

1. Find that the proposed transaction is consistent with the public interest and approve the petition.

2. Find that the proposed transaction is not consistent with the public interest and deny the petition.

3. Find that the proposed transaction is not consistent with the public interest without some conditions and clarifications and approve the petition subject to the conditions the Commission deems appropriate.

4. Determine that the docket should be referred to the Office of Administrative Hearing for further record development.

B. Rates for IPL's Gas Customers

5. Determine that rates for current IPL gas customers should be maintained until a rate case is filed authorizing a change in rates.

6. Determine that, upon completion of the Transaction, current IPL gas customers should be transitioned to MERC's tariffs.

7. Determine that current IPL gas customers' rates should be transitioned to MERC's rates over a longer period, such as 3 or 5 years.

C. Separate Rate Design

8. Direct MERC to separately identify the costs associated with setting rates between IPL's former customers and MERC's current customers for at least five years;

9. Determine that there is no need to separately identify the costs associated with setting rates between IPL's former customers and MERC's current customers.

D. Former Manufactured Gas Plants

10. Find that it is appropriate to maintain IPL's current obligation to remediate contaminated manufactured gas plants located in Minnesota and deny the Petitioners' request to transfer the obligation to MERC.

11. Find that the First Amendment to the Asset Purchase and Sale Agreement appropriately addresses Former Manufactured Gas Plant (FMGP) issues and allow costs paid by IPL to be transferred to MERC and be set up as a regulatory asset.

12. Find that the FMGP amount to be transferred to MERC is approximately $2.6 million.

13. Find that the FMGP amount to be transferred to MERC is subject to prudency review during MERC's next rate case and any disallowance resulting from such review will be deducted from IPL's Promissory Note.

E. Deferred Taxes

14. Incorporate the level of deferred taxes currently reflected in IPL's Minnesota jurisdictional reports into the rates for former IPL customers by amortizing it over a period of five years.

15. Determine that the proposed transaction appropriately accounts for deferred taxes.

F. Public Hearings

16. Require public hearings in IPL's service territory to allow ratepayers to meaningfully participate in the process. Request the Office of Administrative Hearings to assign an Administrative Law Judge (ALJ) to conduct these hearings. The locations shall be set by the ALJ after consultation with the Commission's Executive Secretary and the parties.

17. Take no action.