Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: June 12, 2015 .....Agenda Item No. 5**

Company:	Minnesota Energy Resources Corporation ("MERC" or the "Company")
Docket No.	G-011/PA-14-664 In the Matter of a Request for Approval of the Merger Agreement between Integrys Energy Group, Inc. and Wisconsin Energy Corporation
Issues:	Should the Commission request additional comments?
	Is the proposed sale consistent with the public interest?
	Should the Commission approve the proposed sale?
	If the Commission approves the sale, should there be any conditions?
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 ..... August 6, 2014
Commission Order Finding Jurisdiction, Granting Variance, and Establishing Procedures ..... February 24, 2015
MERC Update on the Wisconsin Energy Corporation and Integrys Energy Group, Inc. Merger ..... April 3, 2015
MERC Supplemental Information ..... April 9, 2015
Department of Commerce (DOC) Comments ..... April 20, 2015
Office of the Attorney General-Residential Utilities and Antitrust Division Comments (OAG) ..... April 20, 2015
MERC Reply Comments on Proposed Conditions ..... April 27, 2015
Department of Commerce Supplemental Comments ..... May 12, 2015
MERC Update on Proceedings in Other Jurisdictions ..... May 18, 2015
MERC Submission of May 21, 2015 Final Decision of the Public Service Commission of Wisconsin in 9400-YO-100 ..... May 22, 2015
Department Errata to 55/12/2015 filing ..... May 26, 2015
MERC Letter Accepting DOC Conditions ..... May 28, 2015

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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Summary Statement of Final Party Positions

The three parties to this matter, Minnesota Energy Resources Corporation (MERC), the Department of Commerce (Department), and the Office of the Attorney General-Antitrust and Utilities Division (OAG-AUD), agreed on many of the conditions recommended to be placed on the proposed merger in order for the Commission to find it consistent with the public interest. In a letter filed May 28, 2015 (after these briefing papers were substantially complete), MERC stated that it agreed with all the Department's proposed conditions as clarified in the Department's May 26, 2015 filing. The OAG-AUD, however, stated in its April 20, 2015 filing that the conditions agreed to by MERC and the Department were necessary, but not sufficient, to approve the merger and recommended several additional conditions.

Background

PROCEDURAL HISTORY

On August 6, 2014, Minnesota Energy Resources Corporation filed a petition with the Commission that reported on the proposed merger (the Proposed Transaction) of MERC's corporate parent, Integrys Energy Group Inc. (Integrys), with Wisconsin Energy Corporation (WEC). Together, Integrys and WEC are referred to as the "Companies" or "Petitioners".

On October 20, 2014, the Department of Commerce and the Office of the Attorney General – Antitrust and Utilities Division each filed comments on the petition.

On October 30, 2014, MERC and the OAG each filed reply comments.

On November 24, 2014, the Department filed comments recommending approval of the petition with conditions. On that same day the OAG filed comments.

On December 12, 2014, MERC filed supplemental reply comments.

On February 24, 2015, the Commission issued an Order Finding Jurisdiction, Granting Variance, and Establishing Procedures (February 24, 2015, Order).

On April 3, 2015, MERC filed an Update on the Wisconsin Energy Corporation and Integrys Energy Group, Inc. merger.

On April 9, 2015, MERC filed supplemental information.

On April 20, 2015, the Department of Commerce and the Office of the Attorney General each filed comments. The Department recommended approval of the proposed merger with conditions. The OAG stated that, as proposed, the merger is not consistent with the public interest.

On April 27, 2015, MERC filed reply comments on proposed conditions.

On May 12, 2015, the Department filed supplemental comments.

On May 18, 2015, MERC filed an update on other jurisdictions' proceedings.

On May 22, 2015, MERC filed with the Minnesota Commission, the May 21, 2015 Final Decision of the Public Service Commission of Wisconsin in the *Application of Wisconsin Energy Corporation for Approval to Acquire the Outstanding Common Stock of Integrys Energy Group, Inc.*, Docket No. 9400-YO-100.

On May 28, 2015, MERC filed a letter indicating that it accepted the Department's position.

COMPANIES AND PROPOSED TRANSACTION

MERC, a wholly owned subsidiary of Integrys, is a Delaware corporation headquartered in Rosemount, Minnesota. It provides natural gas service to approximately 227,185 customers in Minnesota.

Integrys is a public utility holding company headquartered in Chicago, Illinois. It owns and operates six regulated natural gas and electric utilities, serving a total of 2.1 million customers in Wisconsin, Minnesota, Michigan, and Illinois.

WEC is a public utility holding company headquartered in Milwaukee, Wisconsin. It serves 1.1 million electric customers and 1.1 million natural gas customer throughout Wisconsin and Michigan's Upper Peninsula.

The Proposed Transaction is a merger between WEC and Integrys that will result in WEC becoming the corporate parent of Integrys' holding company. MERC stated that none of its assets are being transferred and WEC intends to fold the Integrys holding company structure in its current form into the WEC holding company structure. According to the Agreement and Plan of Merger (the Agreement) dated June 22, 2014, WEC will acquire 100% of Integrys' outstanding common stock and Integrys' shareholders will receive 1.128 WEC shares plus $18.58 in cash for each Integrys share. As of June 20, 2014, total consideration was valued at $71.47 per Integrys share.

The Proposed Transaction will be financed by issuing new WEC stock and by WEC taking on approximately $1.5 billion in acquisition related debt. The overall transaction value is approximately $9.1 billion, with $5.8 billion being paid for Integrys shares and $3.3 billion of assumed Integrys debt.

PURPOSE OF THE MERGER AND IMPACT ON MERC

MERC explained that the Proposed Transaction will result in MERC achieving greater investment in infrastructure as well as an increase in geographic and asset diversity, which will enable WEC Energy Group to meet the changing energy industry's demands. The Company stated that the Proposed Transaction will not directly affect MERC's day-to-day operations, its capitalization, its service to Minnesota customers, or its rates. The Proposed Transaction will create a regulated utility system in the Midwest in which MERC is a stronger utility - both financially and operationally.

MERC made the following commitments:

- MERC will not request to recover the acquisition costs or any acquisition premium of the Proposed Transaction from Minnesota ratepayers;
- MERC will honor all existing labor contracts;
- Except through natural attrition, there will be no workforce reductions at MERC as result of the Proposed Transaction; and
- MERC will maintain its current level of charitable contributions and community involvement after the closing of the Proposed Transaction.

MERC stated that regulators should not require merger savings nor impute such savings, since there is no record evidence showing that the merger will result in immediate merger savings. MERC customers will benefit from the Proposed Transaction because it will create new opportunities over time to realize savings. The record supports a finding that no material savings (or cost increases) due to the Proposed Transaction will occur at MERC in the near term.

Relevant Statutes, Rules and Commission Orders

MINN. STAT. § 216B.48, RELATIONS WITH AFFILIATED INTEREST

Minn. Stat. § 216B.48 defines affiliated interests and explains that no contract or arrangement between a public utility and any affiliated interest as defined in subdivision 1, clauses (1) to (8), or any arrangement between a public utility and an affiliated interest as defined in subdivision 1, clause (9), is valid or effective unless and until the contract or arrangement has received the written approval of the commission.

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. [emphasis added]

MINN. STAT. § 216B.51, STOCK PURCHASE

Minn. Stat. § 216B.51 states that no public utility shall purchase voting stock in another public utility doing business in Minnesota without receiving Commission approval in writing or by order.

MINN. RULES, PARTS 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.

COMMISSION FEBRUARY 24, 2015 ORDER

The Commission's February Order noted that it received comments and reply comments from MERC, the Minnesota Department of Commerce, and the Minnesota Office of the Attorney General – Antitrust and Utilities Division (the "Parties"). The Order found the Commission has jurisdiction to approve or reject the proposed merger under Minn. Stat. §§ 216B.48 and 216B.50; varied the filing requirements to eliminate the provision of unnecessary data; and adopted the parties' schedule for MERC to provide information regarding how other jurisdictions are evaluating the proposed merger, and for interested parties to comment.

The Order required:

> MERC to file updates on the Integrys and WEC merger proceedings in other jurisdictions by April 5, 2015.
>
> Interested parties to file comments on MERC's filing and the proceedings in other jurisdictions by April 20, 2015.
>
> MERC and other interested parties to file reply comments by April 27, 2015.

Party Positions

APPLICABLE STANDARD

MERC

MERC argued that the Commission's decision should be informed by the applicable legal standard and the record developed to satisfy that standard. Minn. Stat. § 216B.50 authorizes the Commission to approve the merger if it finds that the proposed transaction is "consistent with the public interest." It noted that in the past the Commission has found that this standard does not

require an affirmative finding of public benefit, just a finding that the transaction is compatible with the public interest.

It argued that any condition imputing mandatory ratepayer savings would be inconsistent with the applicable standard. There is no obligation to artificially impose savings to offset shareholder value. As the Minnesota Supreme Court has held, utility assets belong to the utility, not to ratepayers; it exceeds statutory authority to impute corporate value to ratepayers.

Further, the OAG's demand for ratepayer concessions under these circumstances is contrary to law. Closely analogous precedent shows that the OAG's position is flawed and the imposition of such conditions would be inconsistent with Commission practice.

MERC submits that the Proposed Transaction easily satisfies the relevant legal standard. The record supports a finding that the transaction is affirmatively in the best interests of Minnesota ratepayers whether or not any conditions are imposed. Once the Proposed Transaction is consummated, MERC will be both a financially and operationally stronger utility.

While the conditions listed in Attachment A are reasonable, imposing additional conditions such as coerced ratepayer "savings" or arbitrary financial or operational limitations would be inconsistent with the applicable standard and are not supported by the record.

Department of Commerce

The Department stated that 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 corporate financing, possible cross-subsidization and economies of scale.

If the Commission chooses to approve a transaction, the Commission may condition its approval if it finds that conditions are necessary to preserve the public interest. In determining whether the Proposed Transaction is consistent with the public interest, the Department focused on the following three issues:

- Would the Agreement increase costs to MERC's ratepayers?
- Would the Agreement affect reliability and quality of service for MERC's ratepayers?
- Would the Agreement reduce the regulatory authority of Minnesota agencies, thereby impeding the State's ability to best balance ratepayer interests with MERC's interests?

Office of the Attorney General

The OAG argued that Minnesota law provides that utilities may only engage in a merger transaction if the Commission finds that the proposed transaction is "consistent with the public interest." If a transaction is not consistent with the public interest, then the Commission should either impose conditions to protect ratepayers or deny the transaction. It stated that the primary

analysis in determining whether a transaction is consistent with the public interest is whether the benefits of the transaction outweigh the possible detriments to ratepayers.

The OAG recommended that, if the Commission approves the proposed transaction, it impose the conditions to which the Petitioners have agreed. It argued that additional conditions are necessary to protect and insulate ratepayers from the possible detriments of the proposed transaction. Without the additional conditions, the proposed transaction would not be consistent with the public interest.

APRIL 3 AND 9 INFORMATIONAL FILINGS AND RESPONSES

MERC

In response to the Commission's February 24 Order, MERC's April 3 filing:

> Provided the Commission with an overview of the proceedings in other jurisdictions and the conditions being considered in those jurisdictions.
>
> Provided a list of the conditions being considered in Minnesota.
>
> Stated that MERC will not oppose the Commission's finding that it has jurisdiction over the proposed merger.

MERC requested that the Commission approve the merger and adopt the set of later agreed-upon conditions set forth in Attachment A to its April 3rd filing (condition 73 was modified in MERC's April 27, 2015 filing). MERC argued that the record shows that the merger is in the public interest stating:

> No adverse changes will occur in the Commission's regulation of MERC's rates, standards and practices.
>
> Substantial steps have been taken to insulate Minnesota ratepayers from any potential adverse effects of the merger.
>
> The combined holding company will be a stronger platform which will benefit MERC and its customers.
>
> MERC will continue to be subject to the Commission's plenary authority for all activities in Minnesota.

MERC requested that the Commission not condition approval of the transaction on a rate moratorium, required merger savings, or bill credits. MERC argued that such conditions go beyond the standard of "consistent with the public interest" and are not supported by the record.

To allow for timely consummation of the transaction, MERC requested that the Commission approve the transaction by May of 2015. In its April 27, 2015 filing, MERC requested approval by June 12, 2015.

Merger Conditions

MERC accepted the Department's proposal to impose some conditions placed on WEC, Integrys, or their operating subsidiaries in other states as conditions to approving the Proposed Transaction. Given MERC's size and business, Minnesota law, and Commission expectations, MERC expressed concern about the feasibility and appropriateness of imposing conditions that are not applicable in Minnesota. The potential merger conditions in other states have been categorized as follows:

- Those applicable in Minnesota and agreed upon for inclusion by the Commission;
- Those covered by MERC's existing commitments in this proceeding or by operation of Minnesota law;
- Those not applicable in Minnesota; and
- Those for which the Parties have not reached consensus as to their applicability.

MERC proposed that the Commission apply the set of conditions that the parties have all agreed can be applicable to MERC (Attachment A of MERC's April 3, 2015 comments). Of the +145 conditions raised in other jurisdictions (Attachment C of MERC's April 3 filing), the Parties agreed that over 107 were either not applicable to MERC; covered by MERC's broad commitments already made in Minnesota; or covered by operation of Minnesota law.

The Parties agreed that twenty-five conditions not previously offered by MERC were applicable. Of the remaining conditions, thirty-eight remain unresolved or in contention between the Parties (Attachment B of MERC's April 3 filing).

MERC stated that the best outcome is for the Commission to adopt the agreed-upon conditions set forth in Attachment A.

Unresolved Merger Conditions

MERC stated that the unresolved merger conditions mainly relate to open issues already before the Commission in this proceeding concerning:

- a potential rate moratorium.
- merger savings.
- service quality.

MERC requested that the Commission not adopt the proposed conditions, including a rate moratorium or mandated merger savings, which Parties were unable to reach consensus.

MERC explained that a rate moratorium is not appropriate in Minnesota for several reasons:

> Integrys' large Illinois gas company can utilize a rate rider to recover its Accelerated Main Replacement Program costs during the two year rate moratorium period and the other Illinois gas utility does not have such a capital intensive program under way. A similar rider does not exist in Minnesota and MERC is embarking on a series of capital projects to maintain service quality in several communities.

MERC has announced its expectation to file a rate case in September 2015.

It is MERC's understanding that the Commission expects to utilize MERC's upcoming rate case to address Alliant Energy's legacy customers' gas rates.

Department Analysis

The Department's representation of potential merger conditions was similar to MERC's. The Department identified 82 of the 145 proposed merger conditions provided by MERC as not being applicable to this proceeding (Attachment A to the Department's April 20, 2015 comments).

The Department identified 30 of the proposed merger conditions as being applicable to this proceeding but already covered by operation of Minnesota law or included in or substantially similar to the list of conditions to which MERC had already agreed in this proceeding (Attachment B to the Department's April 20, 2015, comments).

The Department identified 33 of the proposed merger conditions provided by MERC as requiring additional analysis or review. The Department's review initially concluded that the Commission should add 2 conditions to its approval of MERC's proposal:

Number/ Category	**Condition**	**Proposed Language**
65/Financial	Increased capital costs associated with holding company actions	Deny recovery of increased financing costs due to rating agency downgrades.
66/Financial	Increased capital costs associated with holding company actions	Any increased capital costs determined by the Commission as related to downgrading or other credit degradation of the holding company and/or non-utility affiliates should be removed from the cost of capital for WEPCO, WG, and/or WPSC.

The Department noted that the Proposed Transaction's only discernible short-term impact to MERC was the incremental effect on the holding company's credit rating. These two merger conditions are related to that issue.

In its May 12, 2015, Supplemental Comments, the Department stated that OAG recommendation number 32 covers the conditions listed above and that the Department supports the OAG's proposed recommendation:

> If MERC's cost of debt increases during the next three calendar years, Minnesota ratepayers will be held harmless from any rate impact unless MERC can demonstrate that its increased cost of debt was not caused by the proposed transaction.

The Department's Attachment C to its April 20, 2015 filing, contains 23 conditions accepted by MERC.

The non-Minnesota proposed merger conditions that MERC has not accepted and the Department does not recommend the Commission adopt cover the following topics:

- Rate freezes;
- Bill credits;
- Earnings caps; and
- Dividend prohibitions or restrictions.

The Department stated:

> MERC anticipates filing a rate case as soon as 2015. One of the drivers for that general rate proceeding will be the integration of MERC's newly acquired gas properties into its system. It would be inconsistent to condition the Company's proposal in this docket with a rate freeze while assuming MERC will file a rate case sometime within the next 8 months. The same rationale holds for a proposed condition that would attempt to impose bill credits for MERC customers in Minnesota.
>
> The rationale for an earnings cap is that the utility would be likely to earn a return on equity (ROE) above the Commission's authorized ROE from its last general rate case. Since MERC's existing service territory is not experiencing significant or sustained economic growth and MERC's appropriate ROE will again be examined in the upcoming rate case, suggests that, from a ratepayer perspective, the value of an earnings cap is not significant.
>
> The Department noted that, by limiting the holding company's access to those funds, dividend prohibitions or restrictions could decrease the Applicant's borrowing costs. The Department's recommendation regarding the capping of service company's costs is a simpler approach that yields a similar result.

MERC currently receives service from Integrys Business Services (IBS) under an Affiliated Interest Agreement (AIA). After the Proposed Transaction, MERC will enter into an AIA with WEC Business Services LLC. The Department stated that it is concerned that the cost of the services currently provided by IBS to MERC may increase after it is replaced by WEC Business Services. However, the Department agreed with MERC's assessment that any new affiliated interest agreement between MERC and Wisconsin Energy Corporation (WEC) Business Services will require Commission approval and that the Department's concern regarding service costs could be addressed in that future proceeding as well as in future rate cases. As a result, the Department withdrew its recommendation to limit costs allocated or assigned from IBS for the first three years after the Proposed Transaction is executed.

MERC Response to Department Recommendations

In its May 28, 2015 filing, MERC stated that it accepts the revised set of conditions proposed by the Department, including the 23 conditions in Attachment C of the Department's April 20, 2015, filing and the additional condition proposed by the Department pertaining to the cost of debt.

MERC disagreed with the Department's recommendation to restrict cost allocations or assigns from Integrys Business Support, LLC. MERC argued that under Minn. Stat. § 216B.48, subd. 3, it must seek Commission approval of any affiliated interest agreement it may enter into with WEC Business Services. The approval process of the affiliated interest agreement will give the

Commission the opportunity to scrutinize the agreement and ensure that the proposed allocations are reasonable and appropriate. Additionally, the outcome can then be reviewed through the rate case process. MERC argued that there may be instances where costs allocated from WEC Business Services could increase for reasons unrelated to the Proposed Transaction. Because the Commission retains ongoing authority to review these costs when MERC seeks a rate increase to recover them, the Department's proposed condition is unnecessary and could harm MERC for reasons unrelated to the Proposed Transaction.

As noted above, based on MERC's arguments, in its May 12, 2015, filing, the Department withdrew its proposal on this issue.

OAG Analysis

The OAG stated that MERC provided an accurate summary of the dialogue among the parties in this proceeding. In its April 20, 2015 comments, the OAG provided a list of conditions that have been agreed to between the OAG, the Department, and the Petitioners. The OAG explained that its list combined conditions which are duplicative, and made minor, non-substantive changes to the language for clarity.

Conditions Covered By Existing Order or Law

The OAG argued that some of the conditions that are "covered by Minnesota law" are important and recommended that the Commission specifically include them in its Order to clarify what the Petitioners have agreed is required by law. Since these conditions are already required by law, including them in the Commission's order should not be controversial and will ensure that there are no misunderstandings in the future. The OAG recommended the following conditions, which the Petitioners have agreed are already required by Minnesota law, be specifically included in the Commission's Order if the proposed transaction is approved:

> 22. Regardless of whether a Commission review is performed, the cost of any acquisition condition from another jurisdiction subsequently found to have an adverse cost impact on Minnesota shall be absorbed by WEC Energy without recourse to, or reimbursement by, MERC. (MERC, April 3, 2015 comments, Attachment C, Condition 46).
>
> 23. All books and records of all entities in the corporate structure, including the service company, shall be readily available for Commission and Department staff review in a reasonable manner, subject to approval by the Commission. (MERC, April 3, 2015 comments, Attachment C, Conditions 82, 121).
>
> 24. If, in the future, Wisconsin Energy Group or its subsidiaries are down-sized in any significant way, the absolute cost allocation to MERC shall not increase unless the Petitioners demonstrate that the cost allocation is just and reasonable. (MERC, April 3, 2015 comments, Attachment C, Condition 122).
>
> 25. The commission shall have approval authority over allocation methodology and factors. If the allocation methodology and factors ultimately approved by the Commission differ from those approved in other jurisdictions, the holding company should absorb any cost differentials. (MERC, April 3, 2015 comments, Attachment C, Condition 129).

26. Commission staff shall review MERC's Low Income Programs in future rate cases, to ensure that the programs continue to produce optimal benefits. (MERC, April 3, 2015 comments, Attachment C, Condition 104).

27. MERC shall not defer transition costs. (MERC, April 3, 2015 comments, Attachment C, Condition 135).

28. For severance and/or early termination costs the Petitioners shall provide detailed information in any rate proceeding on each instance of severance and/or early termination, including the position, the reasoning, the costs and savings, etc., in sufficient detail for the Commission to make a determination on whether the cost is an unrecoverable transaction cost or a transition cost. (MERC, April 3, 2015 comments, Attachment C, Conditions 139, 140).

MERC Comment on Conditions Covered by Minnesota Law

MERC argued that it is unnecessary to restate conditions already covered by the Commission's authority over aspects of MERC's operations. MERC is concerned that the OAG's proposed conditions may be interpreted in the future to impose additional substantive burdens on MERC.

MERC noted that, under Minnesota law, the Commission possesses the general authority to regulate the situations implicated by each of the seven conditions recommended by the OAG. As an example, MERC noted that, in a rate case, the Commission retains authority to review any costs of the Proposed Transaction due to the imposition of conditions in other states (condition 46). A blanket prohibition at this time would limit the Commission's authority to review these costs at some future time and would make judgments now that are not necessary for the Commission to approve the Proposed Transaction.

MERC indicated that another example is condition 129. The Commission already has authority to review cost allocation factors. Rather than restate the Commission's authority, the OAG seeks to impose a further substantive requirement by limiting MERC's ability to request to alter allocation factors if circumstances warrant. This condition would prejudge the reasonableness of allocation factors without a record to support the specific reasons underlying any such adjustment. Under Minnesota law, the Commission may accept or reject changes to allocation factors. To the extent the OAG is intending to impose further restrictions beyond what is required by Minnesota law, such additional conditions are unreasonable and unnecessary for the Proposed Transaction to meet the "consistent with the public interest" standard.

MERC noted that the Department agrees that it is unnecessary to restate ongoing obligation to comply with the law.

Additional Conditions to Protect Ratepayers

The OAG argued that additional conditions are necessary to ensure that Minnesota ratepayers are not harmed by the impacts of the financial and operational reorganization of MERC's corporate parent.

Limits to the Recovery of Transition Costs

The OAG recommended that the Commission adopt a condition regarding transition costs. The OAG stated that it appears that the Petitioners assign the costs of this business reorganization to three categories: the acquisition premium, transaction costs, and transition costs. The Petitioners have not defined these costs in this proceeding. In order to ensure that conditions related to the acquisition premium, transaction costs, and transition costs can be managed effectively, the OAG recommended that the Commission define transaction costs as those costs that are related to the closing of the proposed transaction, and define transition costs as costs to integrate or reorganize the utilities after the transaction is closed.

The OAG noted that the Petitioners have already agreed that they will not recover any part of the acquisition premium or transaction costs from Minnesota ratepayers. The OAG noted that the Petitioners have also agreed to conditions regarding transition costs in other states:

> In Illinois, the Petitioners have agreed that "transition costs may be recoverable to the extent that the transition costs produce savings."
>
> In Wisconsin, the Petitioners have agreed that "WEPCO, WG, and WPSC can recover acquisition related transition costs from the Wisconsin retail jurisdiction, only if and to the extent [that] . . . the acquisition-related savings realized by each utility's ratepayers are equal to or greater than its acquisition-related transition costs."

The transition costs would not exist if Integrys and WEC had not decided to merge, a business transaction which is not necessary for MERC, or any of the other utilities, to provide utility service. As such, the transition costs are not likely to be necessary for the provision of utility service and would be ineligible for recovery under traditional ratemaking principles. On the other hand, transition costs that will produce measurable cost savings for ratepayers are in the best interests of ratepayers, and encouraging Integrys and WEC to make cost-saving investments is sound policy. The OAG recommended that the Commission adopt a condition similar to the conditions that the Petitioners have agreed to in other jurisdictions and recommended the following language be included in the Commission's Order:

> 29. MERC may request recovery of transition costs if and only to the extent that MERC can demonstrate that the transition costs produce acquisition-related savings that are greater than the transition costs.

MERC Response to Limit on the Recovery of Transition Costs

MERC's position is that transition costs are appropriately reviewed through a rate case. A rate case is a more appropriate proceeding to address transition costs because the actual costs will be known, and the potential benefits (both monetary and operational) will have been analyzed. It argued that MERC will bear the burden to show that these costs are just and reasonable. The OAG's proposed condition seeks to make a blanket determination now.

MERC stated that it agrees with the essence of such a condition. MERC expects the acquisition related savings to accrue over five to ten years following completion of the Proposed Transaction, and a rate case would afford the Commission the ability to judge the acquisition

related savings over time. Further, transition costs incurred today may result in benefits over time and a rate case is the proper opportunity to review those specifics. Additionally, the Proposed Transaction could result in many non-monetary benefits such as superior service and better infrastructure.

MERC stated that, if the Commission decides it should impose such a condition, the following language should be used:

> MERC may request recovery of transition costs if and only to the extent that MERC can demonstrate that the transition costs produce acquisition-related savings over time that are greater than the transition costs or result in operational benefits.

MERC stated that this language would allow MERC the ability to demonstrate the savings over a period of time rather than immediately and would allow MERC's customers to capture the nonmonetary benefits that the Proposed Transaction will produce.

Protection for Ratepayers in the Event of Ratings Agency Downgrades

In order for the proposed transaction to be consistent with the public interest, the benefits of the transaction must not be outweighed by the costs of the transaction. The Petitioners claim that one of the primary benefits of the transaction is that it will produce a "much stronger platform" for MERC. Parties in other jurisdictions have expressed doubt about whether the proposed transaction will actually lead to improved access to capital, and have raised concerns that the new corporate entity could be subject to credit rating downgrades, leading to increased costs for capital.

According to Richard Hahn, an expert consultant testifying on behalf of the Wisconsin Citizen's Utility Board, the Petitioners have not produced any evidence that a larger company will lead to a better credit rating. Mr. Hahn's independent analysis indicates that smaller utility companies may in fact have better credit ratings than larger utilities. Mr. Hahn noted that Moody's, Standard and Poor's, and Fitch all downgraded WEC's ratings outlook shortly after the proposed transaction was announced. Standard and Poor's downgraded Integrys in addition to WEC. As Mr. Hahn noted, Standard and Poor's stated:

> [T]he incremental debt associated with this transaction will weaken WEC's financial measures. Therefore, we believe that the company's consolidated financial risk profile could fall toward the lower end of our 'significant' financial risk profile category, leaving little room for underperformance relative to our forecast.

The OAG noted that a ratings agency downgrade could turn one of the transaction's only potential benefits into a detriment that will harm Minnesota ratepayers. If the proposed transaction leads to a credit rating downgrade, it would be the direct result of a business reorganization that is not necessary to provide natural gas service to MERC's ratepayers. Any ratings downgrade that results from this transaction should be the shareholders' problem, not the ratepayers'. The OAG argued that it is thus necessary to impose conditions to protect ratepayers in the event of a ratings agency downgrade.

The OAG noted that the Commission reviewed similar issues when Otter Tail Power reorganized its corporate structure in 2009, in Docket Number E-017/PA-08-058. In that Docket, the Commission imposed several conditions related to capital structure and debt that are appropriate in this case. The OAG recommended the following conditions to ensure that Minnesota ratepayers are held harmless from ratings agency downgrades and changes to MERC's capital structure:

> 30. MERC will not issue dividends if doing so would cause it to be out of compliance with the capital structure approved by the Commission pursuant to Minnesota Statutes section 216B.49.
>
> 31. MERC shall request and obtain Commission approval pursuant to Minnesota Statutes section 216B.48 and/or Minnesota Statutes section 216B.49 before it includes any debt provided by its parent companies in its capital structure.
>
> 32. If MERC's cost of debt increases during the next three calendar years, Minnesota ratepayers will be held harmless from any rate impact unless MERC can demonstrate that its increased cost of debt was not caused by the proposed transaction.

MERC Response to Dividend Restrictions and Capital Structure Conditions

MERC argued that the OAG's proposed conditions related to the issuance of dividends and the inclusion of debt in MERC's capital structure are inapplicable and should be rejected. MERC has been exempted from making annual Capital Structure filings pursuant to Minn. Stat. § 216B.49 until its capital structure includes encumbered property in Minnesota.

If circumstances change, MERC would be required to make a filing under Minn. Stat. § 216B.49 or through a rate case proceeding to seek Commission approval for these changes and the Commission would have an opportunity to consider the proposed capital structure at that time.

MERC noted that it has already agreed to submit a compliance report describing MERC's post-merger capital structures and identifying any capital structure adjustments that resulted from the Proposed Transaction. Any additional conditions with respect to MERC's capital structure are unnecessary and inappropriate.

Cost of Debt Condition

MERC originally opposed the OAG's proposal that, unless MERC can prove otherwise, the Commission hold Minnesota ratepayers harmless for any increased cost of debt that may occur for three years after the Proposed Transaction. As noted above, in its May 28, 2015, filing, MERC adopted the cost of debt condition contained in the Department's May 26, 2015 filing which is identical to that proposed by the OAG in its April 20, 2015, comments as number 32.

MERC argued that the OAG's proposed cost of debt conditions are unnecessary and could adversely affect ratepayers. Since the Proposed Transaction's announcement, no credit ratings agencies have downgraded WEC's or any of its affiliates' ratings. MERC claimed that financial markets have, overall, reacted positively to the Proposed Transaction. Integrys's senior unsecured rating was upgraded on news of the Proposed Transaction. If these conditions are imposed, they could result in the very type of future downgrade that the Parties seek to prevent. The credit rating of a utility holding company is partially based on a supportive regulatory environment. Likewise, an unsupportive environment can have adverse consequences on the holding company's credit.

MERC recommended that the Commission remain neutral and not impose conditions that could affect the capital markets. There could be other completely unrelated factors that could lead to a credit downgrade of MERC's corporate parents. If a downgrade were to occur, it would be fact intensive to determine the potential factors contributing to such a downgrade and then to determine how much of any increased borrowing cost is due to any one particular contributing factor. MERC argued that it would be speculative and inconsistent with the public interest to impose blanket conditions related to MERC's cost of debt under the guise of reviewing the Proposed Transaction.

MERC noted that the Commission retains full control over the impact of any changes in MERC's cost of debt on Minnesota ratepayers. Through both the rate case process and the requirements of Minn. Stat. § 216B.49, should MERC's future cost of debt increase and should it seek to recover these increased costs from ratepayers, it would need to bring its request to the Commission prior to doing so. Therefore, the Commission would have the ability to develop a record to determine the justness and reasonableness of any increased cost of debt at that time.

Additionally, this particular proposed condition is impracticable because it would essentially require MERC to prove a negative – demonstrate that its increased cost of debt was not caused by the Proposed Transaction. Credit ratings are adjusted for a variety of reasons, some having to do with a company's financial metrics and others attributable to regulatory action or the larger economy. The current regulatory structure in which the cost of debt is examined by the Commission in the context of a rate case strikes the appropriate balance of permitting the Commission to examine the cost of debt without imposing an undue burden on the utility.

Financial Protections for Consumers

The OAG stated that its' primary concern with the proposed transaction is that the transaction, as currently structured, is designed to create value for shareholders but has no provision to share any transaction benefits with the ratepayers who support the Petitioners' business. The OAG noted that the Petitioners claim that they have not even studied the potential transaction benefits.

The OAG stated that this claim is unreasonable and argued that it is difficult to imagine that any business would even consider acquiring another business without performing a financial benefits study.

The OAG provided several examples of parties in other states expressing similar concerns. In Wisconsin, witnesses for Commission Staff and the Wisconsin Industrial Energy Group stated that, based on their experience, the Petitioners' claim that they have not studied the benefits of the transaction and have no plan for how to integrate the two companies is basically unprecedented. The OAG noted that the new entity's only source of cash to service the acquisition debt will be to draw cash from utility subsidiaries like MERC.

The OAG noted that parties' concerns in other states are supported by academic research. The OAG previously provided academic research concluding that the primary "role of utility mergers is to obtain synergies." According to the study cited in the OAG's Initial Comments, utilities that merge "project estimated synergies net of the expected premia they will pay to the target," or they would not enter into the transactions. The Petitioners' claim that they have not studied the possible synergy benefits of the transaction does not change the fact that synergy benefits exist, and that they should be shared with ratepayers.

The OAG noted that, as a result of these concerns, parties in other states have a broad spectrum of financial conditions to ensure that the proposed transaction's benefits are shared with ratepayers, not just with shareholders:

> In both Illinois and Wisconsin, parties have recommended that the Commission freeze rates for either two or five years to ensure that ratepayers are not harmed by the transaction:
>
> In both Wisconsin and Illinois, parties have recommended limitations on when regulated subsidiaries can be required to pay dividends to corporate parents.
>
> In Wisconsin, parties have recommended that the relevant Wisconsin utilities be subjected to earnings caps following the transaction.
>
> In Wisconsin, parties have recommended millions of dollars in direct bill credits immediately upon the close of the transaction.

The OAG stated that these conditions are primarily designed to resolve parties concerns by ensuring that ratepayers share in the financial benefits up-front.

The OAG recommended that the Petitioners be required to actually produce the cost savings that they claim the transaction will create, and that they be held accountable if they fail to do so. The OAG stated that its recommendation is significantly less onerous for the Petitioners because it allows them to produce synergy savings over time, instead of up-front, and does not limit the regulatory tools available to the Petitioners. The OAG noted that the proposed merger will undoubtedly result in benefits for the utilities, holding companies and shareholders; otherwise, the companies would not agree to the transaction.

O&M Expenses

The OAG argued that it is important that the Commission take action to require that MERC demonstrate actual savings as a result of the proposed transaction because utilities can request full recovery of their O&M expenses. Because, regardless of whether or not cost savings were achieved, the utility will request O&M recovery from ratepayers, the utility has little incentive to control O&M expenses or take steps to reduce them

As a result, it is necessary to incentivize MERC and its corporate parents to actually produce the savings that should result from the proposed transaction. The OAG stated that creating milestones will incentivize MERC to produce the O&M savings necessary to balance the financial interests of the proposed transaction. If the savings fail to materialize, then ratepayers will have no financial benefit from the transaction to balance the shareholders' benefits.

The OAG recommended that the Commission require MERC to demonstrate at least $2 million annually in ratepayer savings by 2018 as a direct result of the proposed transaction. The OAG noted that the Commission applied a similar condition in the merger of Northern States Power and New Century Energy. In that case, the Commission ordered that "NSP must demonstrate that the projected merger savings for the proposed test year have been achieved . . .; if the savings have not been achieved, the Commission may impute the projected savings shortfall into revenues." The OAG argued that a similar condition is appropriate in this case.

The Petitioners claim that they expect anticipated savings of three to five percent in non-fuel O&M expenses over a five to ten year ramp-up period. Based on MERC's non-fuel O&M expenses in its 2013 rate case, savings of three to five percent would be between $1.35 million and $2.26 million a year, without accounting for present value. Setting an expectation of $2 million in savings is a reasonable balancing point. The OAG recommends that the Commission impose the following condition:

> 33. In any general rate case filed after 2018, MERC must demonstrate $2 million annually in ratepayer savings as a direct result of the proposed transaction. If MERC fails to do so, the Commission may impute the projected savings shortfall into revenues.

MERC Response to OAG Cost Savings Recommendation

MERC opposed the OAG's recommendation to require at least $2 million of ratepayer savings annually beginning in 2018. MERC argued that this condition is unsupported. Unlike other mergers, this transaction is not premised on achieving immediate savings through cost-cutting measures. MERC anticipates non-fuel operations and maintenance ("O&M") savings over time; however, this is not the basis for the transaction and is not part of the public interest rationale for this transaction.

If downstream savings are realized, ratepayers will be the ultimate beneficiaries of those savings. MERC noted that, based on economies of scale, other recent mergers have seen three to five percent non-fuel O&M savings over a period of five to ten years. To the extent such savings may ultimately be realized, they would be reflected in MERC's cost structure which would be reflected through lower rates and deferred rate cases.

MERC argued that the OAG's reliance on the conditions ordered by the Commission in the Northern States Power and New Century Energy ("Xcel Energy") merger to support this condition illustrates the OAG's flawed reasoning. The Xcel Energy merger was predicated, in part, on obtaining merger savings. The Xcel Energy merger savings were overwhelmingly achieved through consolidating programs and staff reductions. In contrast, one of the conditions MERC has agreed to is that, except through normal attrition, there will not be material workforce reductions for two years. This distinguishes this case from the Xcel Energy precedent.

MERC General Response to OAG Recommendations

MERC does not agree with the OAG's recommended conditions and requested that the Commission deny them. MERC argued that the OAG's rewritten conditions do not accurately reflect the record and it prefers that the list of conditions submitted by MERC or the Department be used by the Commission. Using the original conditions will prevent inconsistent conditions across jurisdictions and complications that may result from changing the wording.

Condition 73

MERC noted that condition 73 did need clarification. The OAG rewrote condition 73 to state:

> 14. MERC shall not loan funds or borrow funds from its post-acquisition parent or other regulated subsidiaries. (Condition 73).

The Company stated the condition 73 was unclear and failed to ensure that current intercompany borrowing can continue. MERC stated that this condition should reflect that MERC will maintain any separate credit facilities to the extent they existed prior to approval of the Proposed Transaction. This is necessary to reflect the fact that MERC currently does not have its own separate credit facility, but is able to borrow from the Integrys holding company under inter-company loan agreements.

MERC suggested modifying Condition 73 in Attachment A to state:

> Prohibit MERC from loaning funds to or borrowing funds from post-acquisition parent or other regulated subsidiaries except to the extent that such borrowing arrangements existed prior to approval of the Proposed Transaction.

MERC has historically borrowed from Integrys pursuant to an affiliated interest agreement approved in Docket No. G-007,011/AI-09-1108. It has done so to take advantage of Integrys' lower cost of short term borrowing.

Due to MERC's historic reliance on funds from Integrys, and the high likelihood that MERC will rely on borrowing from its corporate parent after the Proposed Transaction is closed, the OAG's proposed condition would likely require MERC to needlessly incur higher costs of debt.

PROCEEDINGS IN OTHER JURISDICTIONS

The Proposed Transaction is being reviewed or has been resolved by other state and federal agencies. WEC and Integrys' Proposed Transaction is currently being reviewed by four other agencies: Illinois, Michigan, Wisconsin, and the Federal Energy Regulatory Commission ("FERC"). The U.S. Department of Justice ("DOJ") has completed its Hart-Scott-Rodino ("HSR") review of the transaction and determined there is no anticompetitive harm from the Proposed Transaction.

The Federal Energy Regulatory Commission approved the merger on April 7, 2015. A copy of the FERC approval was submitted into this record by MERC with its April 9, 2015 filing.

Michigan Public Service Commission approved the Proposed Transaction on April 23, 2015 by approving the Amended and Restated Settlement Agreement in Michigan and finding that the merger is in the public interest. A copy of the Michigan order approving the settlement agreement was attached to MERC's April 27 filing as Attachment B.

On April 30, 2015, the Public Service Commission of Wisconsin voted to approve the transaction in docket 9400-YO-100. The Wisconsin Order was issued on May 21, 2015 and is attached to MERC's May 22, 2015 filing. MERC's April 3, 2015 filing contains discussions of the issues and party positions in the Wisconsin proceeding. MERC's May 18, 2015 update provides more discussion of the conditions adopted and rejected by the Public Service Commission of Wisconsin.

The Illinois Commerce Commission is reviewing the Merger under Section 7-204 of the Illinois Public Utilities Act ("Illinois PUA") in Illinois docket number 14-0496. On May 14, 2015, an Administrative Law Judge issued a proposed order recommending approval. A copy of that proposed order was included as Attachment A to MERC's May 18, 2015 filing. There is a statutory deadline for the docket ending on July 6, 2015. MERC's April 3, 2015 filing contains a more detailed explanation of the Illinois case.

MERC's April 3, 2015 filing includes a list of witnesses and their testimony in each of these proceedings (Attachment D) and a list of other jurisdictions' electronic links to any briefs and briefing papers.

IS THE PROPOSAL CONSISTENT WITH THE PUBLIC INTEREST?

MERC

MERC claimed that the benefits of the Proposed Transaction are:

> Integrating best practices in distribution operations, capital project management, system reliability and customer service.
>
> Enhanced purchasing power.
>
> Sharing of administrative and other services over a larger organization.
>
> Improved access to capital markets will enable Company to pass along the benefits of lower cost debt to consumers; and

Joint resource planning over a bigger footprint.

In reply comments, MERC stated that savings that are realized over time will be reflected in future rate case proceedings; however, WEC has not conducted a detailed analysis of the potential merger savings.

Department

The Department recommendation indicates that it thinks the transaction is consistent with the public interest with the additional conditions contained in its recommendations as Attachment C and a restatement of the OAG's condition number 32.

OAG

The OAG stated that, as currently structured, the proposed transaction is not consistent with the public interest because it will create significant shareholder value but will not share any benefits with ratepayers. The OAG recommended that the Commission approve the proposed transaction only with the conditions it proposed.

MERC Agreements, Commitments, and Recommendation

MERC stated that the Proposed Transaction would have no effect on rates. MERC stated that the record supports approval of the merger subject to the conditions set forth in Attachment A to its April 27, 2015, filing.

MERC requested that the Commission approve the Proposed Transaction on or before June 12, 2015, and promptly issue its order. It also requested that the Commission order state the order is "effectively immediately."

Department Recommendation

The Department recommends that the Commission approve MERC's petition with the 23 conditions listed in Attachment C of the Department's April 20, 2015 comments and the following condition proposed by the OAG:

> If MERC's cost of debt increases during the next three calendar years, Minnesota ratepayers will be held harmless from any rate impact unless MERC can demonstrate that its increased cost of debt was not caused by the proposed transaction.

This condition is identical to one proposed by the OAG in its April 20, 2015 comments as number 32.

OAG Recommendation

The OAG recommended that if the Commission approves the Proposed Transaction it should only do so with the following conditions to protect ratepayers:

The conditions to which MERC, WEC, and Integrys have agreed, as reflected in the OAG's April 20, 2015, filing. and

The conditions that MERC, WEC, and Integrys agree are already covered by Minnesota law. and

The following additional conditions:

29. MERC may request recovery of transition costs if and only to the extent that MERC can demonstrate that the transition costs produce acquisition-related savings that are greater than the transition costs.

30. MERC will not issue dividends if doing so would cause it to be out of compliance with the capital structure approved by the Commission pursuant to Minnesota Statutes section 216B.49.

31. MERC shall request and obtain Commission approval pursuant to Minnesota Statutes section 216B.48 and/or Minnesota Statutes section 216B.49 before it includes any debt provided by its parent companies in its capital structure.

32. If MERC's cost of debt increases during the next three calendar years, Minnesota ratepayers will be held harmless from any rate impact unless MERC can demonstrate that its increased cost of debt was not caused by the proposed transaction.

33. In any general rate case filed after 2018, MERC must demonstrate $2 million annually in ratepayer savings as a direct result of the proposed transaction. If MERC fails to do so, the Commission may impute the projected savings shortfall into revenues.

STAFF COMMENT

Public Interest Standard

In previous merger cases, the Commission has been concerned that the merger not result in higher costs for Minnesota ratepayers, reduce quality of service, or reduce the Commission's ability to protect Minnesota ratepayers.

This filing indicates that the merger is for strategic reasons; it results in a combined company with strong cash flow that can be prudently invested in needed energy infrastructure. The Petition states that, ultimately, the Proposed Transaction is consistent with the public interest because MERC and its customers will be served by a larger, more diversified, financially stronger holding company capable of integrating MERC into a strong corporate structure. The merger is not expected to have significant costs savings in the near term. MERC expects the acquisition related savings to accrue over five to ten years following completion of the Proposed Transaction.

When determining whether the merger is consistent with the public interest, the focus will be on whether there are negative consequences for ratepayers. MERC has made numerous

commitments to protect Minnesota ratepayers and ensure ongoing Commission authority. The Department and the OAG think additional conditions or restrictions beyond those initially offered or already agreed to by MERC are necessary.

As in all major utility undertakings, there is concern over the potential impact on the cost of capital. Although the Petitioners do not expect a negative cost of capital impact, at this time, the cost of capital impact is not known. From a ratepayer protection perspective, the OAG's and Department's recommendation to hold Minnesota ratepayers harmless from any rate impact resulting from a change in the cost of debt is reasonable.

Conditions

Three components differentiate the Department's Attachment C (April 20, 2015 DOC comments) from MERC's Attachment A (April 3, 2015 MERC comments):

The Department's Attachment C does not contain MERC's 10 unnumbered commitments.

The Department's Attachment C contains two conditions not included in MERC's Attachment A:

Original Number 23 stating that transition costs may be recoverable to the extent the transition costs produce savings.

Original Number 138 stating that WEPCO, WG, and WPSC can recover acquisition-related transition costs from the Wisconsin retail jurisdiction, only if and to the extent such costs are: (a) incurred by or allocated to each of the utilities (each utilities portion or share of acquisition-related transition costs), (b) associated with financial benefits that each utility's ratepayers will receive as a result of the acquisition, and (c) the acquisition-related savings realized by each utility's ratepayers are equal to or greater than its acquisition-related transition costs.

Both lists have been represented as conditions accepted by MERC.

Conditions Already Covered by MERC Commitments or Minnesota Law

The discussion regarding conditions "Already Covered by Minnesota Commitments made by MERC or by Minnesota law" raises important questions. As noted by the OAG, if the conditions are already covered by Minnesota law, there should be no objection to applying them as conditions to approval of the Petition. On the other hand, why is there a need to restate conditions that already exist? Commitments and statutes are subject to interpretation, including whether they already exist in Commission authority. The list itself does not reference where these conditions already exist. To eliminate any future disagreement or misunderstanding, staff thinks it would be appropriate to include the list of conditions "Already Covered by Minnesota Commitments made by MERC or by Minnesota law" in a Petition approval.

The OAG's recommendation number 26 is on the list of conditions already covered by MERC Commitments or Minnesota Law. It recommends that the Commission require the staff to review MERC's Low Income Programs in future rate cases. MERC and IPL submitted evaluations of

their low-income pilot programs (GAP) on June 1, 2015 in dockets 15-539 and 15-540. DOC and any other interested party may comment in writing on those filings. The low-income pilot programs are set to expire on December 31, 2015 unless the Commission extends the term of the two pilot programs or makes them permanent. (As of May 1st, IPL's GAP program was merged into MERC's.) If the Commission is inclined to have this program reviewed in the context of a future rate case it may want to modify the language to request that parties review MERC's Low Income Programs in future rate cases

Transition Cost Recovery

In order to ensure that conditions related to the acquisition premium, transaction costs, and transition costs can be managed effectively, the OAG recommended that the Commission define transaction costs as costs related to the proposed transaction's closing, and define transition costs as costs to integrate or reorganize the utilities after the closing. Such a clarification may prevent disagreements in the future.

MERC appears to oppose the OAG's recommendation to limit MERC's recovery of transition costs to the extent that MERC can demonstrate savings greater than the costs. However, MERC argued that transition costs should be reviewed through a rate case because the actual costs will be known, and the potential benefits will have been analyzed. MERC noted that it will bear the burden to show that these costs are just and reasonable. As noted above, MERC stated that it agrees with the essence of such a condition.

The concept behind the OAG's recommendation is not inconsistent with MERC's argument. Including the condition would synchronize ratepayer benefits and cost recovery while putting MERC on notice that savings must be demonstrated before recovery is allowed.

Capital Structure Restrictions

The OAG recommended capital structure conditions that would be subject to Minnesota Statutes § 216B.49. As MERC explained, it is not subject to Commission security issuances under § 216B.49. The statute applies to any public utility organized under the laws of Minnesota or any public utility subjecting utility property in Minnesota to an encumbrance. As a wholly owned subsidiary Integrys, a Wisconsin Corporation, that does not encumber Minnesota properties, MERC does not meet either of these conditions.

However, that does not preclude the Commission from conditioning an approval on MERC subjecting itself to annual Commission review of its sources and uses of funds and approval of its capital structure as contained in the OAG's recommendation number 31. The annual capital structure reviews would provide the Commission an opportunity to review current information regarding MERC's financial structure and capital investments that is otherwise seen only in rate cases. If the Commission thinks this would be valuable, it could adopt the OAG's recommendation or develop an alternative requiring similar information without specifically requiring a filing subject to Minn. Stat. § 216B.49.

As written, the OAG's recommendation number 30, restricting the issuance of dividends, would only apply if the Commission adopted some version of OAG recommendation number 31. In

reality, such a restriction would only be perfunctory. As a wholly owned subsidiary, the parent's financial situation would determine MERC's financial health.

Debt from Affiliates

Condition 73 restricts inter-company loans for MERC. As contained in MERC's April 3, 2015, and the OAG's April 20, 2015, filings, MERC is prohibited from loaning or borrowing funds from its post-acquisition parent or other regulated subsidiaries. MERC does not issue its own debt. It borrows from Integrys under inter-company loan agreements. As a result, this condition is problematic.

MERC's proposed additional language clarifies that there is an exception for borrowing arrangements existing prior to the approval of the Proposed Transaction.

A prohibition against intercompany loans is not necessarily in the utility's best interest or that of its customers. An intercompany loan could enable MERC to borrow at lower rates or avoid transaction costs; therefore, the Commission may want to modify the proposed condition further to allow intercompany borrowing or loans, if cost effective:

> Prohibit MERC from loaning funds to or borrowing funds from post-acquisition parent or other regulated subsidiaries except to the extent that such borrowing arrangements existed prior to approval of the Proposed Transaction or the transaction (i.e. the borrowing arrangements) costs less than MERC's other alternatives.

Cost of Business Services

MERC and the Department are correct in their representation that the Commission has an opportunity to review affiliated interest agreements in affiliated interest filings and during general rate cases. This would provide the Commission two opportunities to review any affiliated agreement that MERC enters into with WEC Business Services, LLC; however, in the affiliated interest filings, only the general agreement, not actual costs, are usually reviewed and approved Staff is concerned that rate cases are already filled with information subject to review. Adding the review of an affiliated interest arrangement when the review may involve analysis of dissimilar pre- and post-merger cost data may either limit the review time given to the arrangement or reduce the time given to other issues. To address this issue, in MERC's next general rate case filing, the Commission may want to limit MERC's recovery of allocated assigned costs or allocated corporate costs to MERC's current comparable corporate costs for the 12 months ended December 31, 2014. "Comparable" as used here would mean corporate services of the type and scope MERC currently has, recognizing the passage of time, such as inflation.

Another option is to place restrictions on the provision of service from the service company and the cost of financing. Condition number 37 in Wisconsin's May 21, 2015 Order states:

> In its performance of services, the service company: (a) shall follow applicable federal and state regulation, including codes and standards of conduct; (b) shall not give one or more entities in the corporate structure a competitive advantage in relevant markets; (c) shall not subsidize WEPCO, WG, and/or WPSC or cause WEPCO, WG, and/or WPSC

to subsidize an affiliate; and (d) may include a return on its net assets at a rate no higher than the prevailing weighed cost of capital for WEPCO, WG, and/or WPSC.

This condition is different than the cost of debt conditions discussed above, as it restricts the weighted cost of capital, not just the cost of debt. The Commission may want to consider a similar condition, modified to reflect MERC.

Savings

A review of merger transactions should include a cost/benefit analysis of who bears the risk. By prohibiting recovery of the transaction costs from ratepayers and requiring a demonstration of benefits to recover transition costs, the Parties' proposed conditions attempt to force cost recovery risk onto shareholders. If those conditions are imposed, it would be inappropriate to also require the Company to demonstrate or impute additional savings on an annual basis.

Severance Costs

Arguably, severance costs associated with the merger could be included as transition costs. As such, the Commission may want to specifically prohibit MERC from directly seeking recovery of any severance costs or allocating to MERC any severance costs incurred in other parts of the Company for the first 18 months following the merger's closing.

General requirements

To meet the goals of protecting ratepayers the Commission may want to add some merger conditions, including:

Until the end of its next Minnesota rate case, require MERC to maintain a detailed record, including description and amount, of its 2014 corporate costs.

In its next Minnesota rate case, require MERC to demonstrate that no part of the requested rate increase is a result of the merger.

Require MERC to report any significant operational changes in Minnesota, including any personnel reduction or reorganization of field operations that could have an impact on service quality.

Within 90 days of closing, require MERC to file the accounting entries that recorded the merger. This filing shall include the description, amount, FERC account name and number for each item, including the actual account entries for the merger-related costs.

Late Comments

Staff notes that MERC filed two rounds of additional comments outside of the noticed comment period. The second one, filed on May 18, under the auspices of an update on proceedings in other jurisdictions, commented on the Department's supplemental comments, conditions accepted and conditions rejected by the Public Service Commission of Wisconsin, and requested an expedited scheduling of the Commission meeting on or before June 12, 2015.

The Commission's February 24, 2015, Order in this Docket required Minnesota Energy Resources Corporation to file updates on the merger proceedings in other jurisdictions by April 5, 2015. While continued updates on the filing in other jurisdictions as they become available appears consistent with the intent of the Commission Order, the updates could be made simply by providing the Order and a transmittal letter. Since using the updates to provide additional comment or comparison to party positions appears to exceed the directive of the Commission's Order, these comments have not been discussed in these briefing papers.

Commission Options

Some Commission options are:

Procedural

1. Determine that parties should have an opportunity to respond in writing to comments filed after the Commission established April 27, 2015, deadline for reply comments prior to the Commission taking action on this matter.

2. Determine that additional written comments are not necessary.

Consistent with the Public Interest

3. Determine that the Commission cannot conclude that the Proposed Transaction is consistent with the public interest and deny the petition.

4. Determine that the Proposed Transaction is consistent with the public interest and approve the transaction as filed.

5. Determine that the Proposed Transaction is consistent with the public interest only if conditions identified below are applied. Approve the petition subject to one or more of the conditions identified by the Commission.

Agreed Upon Conditions

6. Adopt the twenty-three conditions contained in Attachment C of the Department's April 20, 2015, filing and the OAG's recommended condition number 32 from OAG's April 20, 2015 comments. (MERC, Department, & OAG)

7. Adopt the 10 unnumbered conditions contained in Attachment A of the Company's April 3, 2015 filing.

Conditions Already Covered by Commission Authority

8. Adopt the conditions that MERC, WEC, and Integrys agree are already covered by Minnesota law as reflected in the OAG's April 20, 2015 filing (pp. 5-6) and include these requirements in the order (OAG):

22. Regardless of whether a Commission review is performed, the cost of any acquisition condition from another jurisdiction subsequently found to have an adverse cost impact on Minnesota shall be absorbed by WEC Energy without recourse to, or reimbursement by, MERC. (MERC, April 3, 2015 filing, Attachment C, Condition 46).

23. All books and records of all entities in the corporate structure, including the service company, shall be readily available for Commission and Department staff review in a reasonable manner, subject to approval by the Commission. (MERC, April 3, 2015 filing, Attachment C, Conditions 82, 121).

24. If, in the future, Wisconsin Energy Group or its subsidiaries are down-sized in any significant way, the absolute cost allocation to MERC shall not increase unless the Petitioners demonstrate that the cost allocation is just and reasonable. (MERC, April 3, 2015 filing, Attachment C, Condition 122).

25. The commission shall have approval authority over allocation methodology and factors. If the allocation methodology and factors ultimately approved by the Commission differ from those approved in other jurisdictions, the holding company should absorb any cost differentials. (MERC, April 3, 2015 filing, Attachment C, Condition 129).

26. ~~Commission staff shall~~ Request parties to review MERC's Low Income Programs in future rate cases, to ensure that the programs continue to produce optimal benefits. (MERC, April 3, 2015 filing, Attachment C, Condition 104, as modified by the staff.)

27. MERC shall not defer transition costs. (MERC, April 3, 2015 filing, Attachment C, Condition 135).

28. For severance and/or early termination costs the Petitioners shall provide detailed information in any rate proceeding on each instance of severance and/or early termination, including the position, the reasoning, the costs and savings, etc., in sufficient detail for the Commission to make a determination on whether the cost is an unrecoverable transaction cost or a transition cost. (MERC, April 3, 2015 filing, Attachment C, Conditions 139, 140).

9. Determine that MERC may request recovery of transition costs only to the extent that MERC can demonstrate that the transition costs produce acquisition-related savings that are greater than the transition costs. (OAG, this is similar to DOC's condition number 23 in DOC's April 20, 2015 comments.)

Additional Financial Conditions

10. Require that MERC will not issue dividends if doing so would cause it to be out of compliance with the capital structure approved by the Commission pursuant to Minnesota Statutes section 216B.49. (OAG)

11. Require that MERC request and obtain Commission approval pursuant to Minnesota Statutes section 216B.48 and/or Minnesota Statutes section 216B.49 before it includes any debt provided by its parent companies in its capital structure. (OAG)

12. In its performance of services, the service company: (a) shall follow applicable federal and state regulation, including codes and standards of conduct; (b) shall not give one or more entities in the corporate structure a competitive advantage in relevant markets; (c) shall not subsidize WEPCO, WG, and/or WPSC or cause MERC to subsidize an affiliate; and (d) may include a return on its net assets at a rate no higher than the appropriate weighed cost of capital for MERC. (Based on condition number 37 in Wisconsin's May 21, 2015 Order modified by staff.)

Required Savings

13. Determine that in any general rate case filed after 2018, MERC must demonstrate at least $2 annually in ratepayer savings as a direct result of the proposed transaction. If MERC fails to do so, the Commission may impute the projected savings shortfall into revenues. (OAG)

Condition Number 73 (MERC, April 3, 2015 filing, Attachment C, p. 8 of 23)

14. Determine that the appropriate language for condition number 73 is the language as agreed to by the Parties:

    Prohibit MERC from loaning funds to or borrowing funds from the post-acquisition parent or other regulated subsidiaries.

15. Determine that the appropriate language for condition number 73 is the language as contained in the OAG's April 20, 2015, filing (OAG):

    MERC shall not loan funds or borrow funds from its post-acquisition parent or other regulated subsidiaries.

16. Determine that the appropriate language for condition number 73 is the language as proposed in MERC's April 27, 2015, filing (MERC):

    Prohibit MERC from loaning funds to or borrowing funds from post-acquisition parent or other regulated subsidiaries except to the extent that such borrowing arrangements existed prior to approval of the Proposed Transaction.

17. Determine that inter-company loans, if beneficial to MERC, are appropriate and modify the language of condition number 73 to reflect that option (staff alternative):

    Prohibit MERC from loaning funds to or borrowing funds from post-acquisition parent or other regulated subsidiaries except to the extent that such borrowing arrangements existed prior to approval of the Proposed Transaction or the transaction (i.e. the borrowing arrangement) costs less than other MERC alternatives.

Severance Costs

18. Prohibit MERC from seeking recovery of any merger-related severance costs (either directly incurred by MERC or allocated to MERC from another part of the Company) for the first 18 months following the merger's closing.

General Requirements

19. Until the end of its next rate case, require MERC to maintain a detailed record of the description and amount of each of its 2014 corporate costs.

20. In its next rate case, require MERC to demonstrate that no part of the requested rate increase is a result of the merger. (This is similar to MERC, April 3, 2015 filing, Attachment A, Condition 11.)

21. Require MERC to report, for 5 years, any significant operational changes in Minnesota, including any personnel reduction or reorganization of field operations that could have an impact on service quality.

22. Within 90 days of closing, require MERC to file the accounting entries that recorded the merger. This filing shall include the description, amount, FERC account name and number for each item, including the actual account entries for the merger-related costs.