STATE OF MINNESOTA
BEFORE THE PUBLIC UTILITIES COMMISSION

Beverly Jones Heydinger	Chair
Dr. David C. Boyd	Commissioner
Nancy Lange	Commissioner
Dan Lipschultz	Commissioner
Betsy Wergin	Commissioner

In the Matter of a Request for Approval of the Asset Purchase & Sale Agreement Between Interstate Power and Light Company and Southern Minnesota Energy Cooperative	**Docket Nos. E-001, E-115, E-140, E-105, E-139, E-124, E-126, E-145, E-132, E-114, E-6521, E-142, E-135/PA-14-322**

COMMENTS OF THE OFFICE OF THE ATTORNEY GENERAL - ANTITRUST AND UTILITIES DIVISION

I. INTRODUCTION

The Office of the Attorney General ("OAG") submits the following comments in response to the October 10, 2014 Notice of Additional Comment Period issued by the Minnesota Public Utilities Commission ("Commission") in the matter of IPL's proposed sale of its distribution assets to the Southern Minnesota Energy Cooperative ("SMEC"). For the reasons set forth below, the proposed transaction, as currently structured, is not in the public interest, as it requires ratepayers to fund the purchase of IPL's distribution assets at an excessive price, while also prohibiting the cooperatives from purchasing power from whatever source provides the best price. While the transaction is lucrative for IPL, it is unfair to ratepayers. For these reasons, the OAG recommends that the Commission only approve the sale after appropriate modifications are made to ensure that it is fair for all stakeholders.

II. RESPONSE TO COMMISSION QUESTIONS

A. IS THE PROPOSED TRANSACTION IN THE PUBLIC INTEREST AND WHAT ARE THE RATE IMPACTS ON CURRENT IPL CUSTOMERS?

Parties have submitted extensive comments on whether or not the transaction is in the public interest. This determination can be impacted by several variables, including potential rates, service quality, operational concerns, and customer service scores. The analysis performed by the Department of Commerce ("Department") indicates that operational issues, customer service, and service quality matters for IPL's existing service territory will not be negatively impacted by the proposed transaction, and that IPL's customers will likely not see decreased service quality and customer service if the transaction is completed.

The OAG, however, has significant concerns about whether the transaction is in the public interest from a rate-making perspective. The Department and Petitioners have each conducted cost-benefit analyses of the proposed transaction. The OAG previously commented on the cost-benefit analysis provided by Petitioners, which calculated an overall benefit to customers of approximately $21.67 million. As the OAG noted, the cost-benefit analysis conducted by the Petitioners is flawed because it failed to account for the increased costs of generation assets and because it incorporated IPL's return on equity ("ROE") established years ago. For its part, the Department concluded from its cost-benefit analysis that IPL customers can expect a benefit of $11.80 million.[1] The Department's analysis is based on a comparison of hypothetical rates from 2015-2017 with and without the transaction. While the Department's benefit calculation is significantly lower than Petitioners' calculation, the Department admits that even its calculation likely over-estimates the benefits of the transaction by assuming that IPL would be awarded significant and repeated rate increases if the transaction did not occur:

[1] DOC Reply Comments at 12.

> The Department believes its second assumption – that IPL will file annual rate cases beginning in 2015, is a very favorable assumption from IPL's perspective. A third assumption, that IPL would be awarded 100% of its requested increases is also very favorable to the company[2]

The OAG takes the position that both of the assumptions used in the Department's analysis are not only "very favorable" to Petitioners; they are, in fact, unreasonable. IPL's proposed rate increases would assuredly be disputed. Assuming that IPL would win every issue in every case it could bring going forward defies common sense. The OAG recognizes that the Department's methodology required that it make some assumptions, and that the Department appropriately disclosed and explained how its assumptions were "very favorable" to the company. Nonetheless, the purported $11.80 million benefit derived from the Department's cost-benefit analysis is skewed heavily in favor of the proposed transaction. Moreover, the Department notes that it did not attempt an in-depth investigation of the estimated revenue requirements for 2014-2018, and that a contested case proceeding would be necessary for that to be accomplished.[3]

Contrary to the analyses presented by IPL and the Department, there is significant evidence to conclude that the rate impact of the proposed transaction may not benefit ratepayers. If, for example, the rate increases assumed in the Department's analysis in 2015-2017 are reduced to 60% of the amount proposed by IPL, the benefit from 2015-2017 diminishes from $11.80 million to only $0.17 million on a net present value basis, as shown below:

[2] *Id.* at 12.
[3] *Id.* at 14.

Description	2014	2015	2016	2017
IPL Revenue Requirement	**78.5**	**81.41**	**85.58**	**89.18**
% Change from Prior Year		3.7%	5.1%	4.2%
SMEC Revenue Requirement		**81.4**	**85.1**	**89.5**
% Change from Prior Year		3.7%	4.5%	5.2%
Annual Nominal Benefit		0.01	0.48	-0.32
Cumulative Nominal Benefit		0.01	0.49	0.17
Present Value of Annual Benefit in Current $ 2015-2017 *		**$0.17**		

*Discounted at IPL's Cost of Capital

Additionally, if only 60% of IPL's assumed increase is granted, and IPL does not request a rate increase in each year, like the Department assumes, the net present benefit becomes a detriment. These calculations also do not incorporate any effects of the Wholesale Power Agreement ("WPA"), which is discussed below. Based on these variances, it is unclear at best whether the transaction provides an overall benefit to customers' distribution rates, before consideration of the WPA.

B. ARE THE TERMS OF THE WHOLESALE POWER AGREEMENT REASONABLE?

It is unclear whether the WPA is reasonable for IPL's existing ratepayers, although the evidence suggests that it likely is not. Petitioners assert that the WPA benefits IPL's existing ratepayers by assuring an uninterrupted power supply after the transaction is completed.[4] The significance of this benefit would seem to depend upon: (1) whether IPL's existing ratepayers would have an uninterrupted power supply without the WPA and, (2) whether the WPA provides the uninterrupted power supply at a competitive rate—particularly if an alternative source is available. If, for example, the various cooperatives have alternative power sources at

[4] *See* Petitioners' September 4, 2014 Comments at 6.

significantly better rates, then requiring them to execute the WPA and purchase power from IPL for ten years is a detriment.

a. Secure Supply of Power

The OAG attempted to determine whether the various SMEC cooperatives would have alternative power supplies for the customers added to their systems if the transaction is approved and, if so, whether the WPA provides this power at a competitive rate. The OAG's fourth question in its August 7, 2014 filing asked SMEC: "what options would SMEC and/or its members have to obtain the necessary power and transmission services to serve IPL's existing customers," assuming they had not executed the WPA.[5] The OAG also explicitly asked whether the cooperatives' respective Generation and Transmission ("G&T") providers were able to provide these services and the projected costs.[6] Petitioners' response, however, did not indicate whether the various G&Ts could provide the necessary services for IPL's current customers. Rather, Petitioners simply stated that the SMEC cooperatives had to obtain permission from their respective G&T providers to enter into the WPA.[7] Petitioners also claimed that "[n]o comparison of the cost of IPL and the respective G&Ts is available."[8] In context, the OAG takes this response to indicate that a comparison of the wholesale rates that SMEC will receive from the WPA versus what cooperatives would receive from their various G&Ts is not available.

Petitioners' reluctance to affirmatively state whether the G&Ts have sufficient power and transmission services to serve IPL's existing customers suggests that the purported benefit of the WPA—assuring these services for current IPL customers—may be overstated. Other evidence also seems to support this conclusion. First, Petitioners indicated that the WPA is a condition

[5] Questions of the Office of the Attorney General – Antitrust and Utilities Division (Aug. 7, 2014).
[6] *Id.*
[7] Petitioners' September 4, 2014 Comments, Attachment B at OAG Information Request No. 4.
[8] *Id.*

required by IPL for completing the Asset Purchase Agreement.[9] The fact that IPL, rather than the various SMEC cooperatives, is conditioning the sale on the WPA suggests that SMEC's cooperatives are not concerned about their ability to obtain the power necessary to serve these customers. From that standpoint, the purpose of the WPA appears to be to limit any stranded costs for IPL's generation assets used to serve Minnesota customers. While it is understandable for IPL to try to minimize its stranded costs, it is unclear how requiring Minnesota ratepayers to use assets of a company leaving the state is in their interest, if other resources available.

Second, the Integrated Resource Plans ("IRP") filed by Great River Energy ("GRE"), a G&T cooperative that serves several SMEC member cooperatives, suggest that it has a capacity surplus sufficient to serve all of IPL's existing customers. GRE's 2012 IRP states that it serves 645,000 retail customers in Minnesota and that it expects an annual capacity surplus of 26% in 2014.[10] GRE also expects a capacity surplus of 13% when the WPA would terminate in 2024.[11] This surplus would exist without any generation added to GRE's fleet. Assuming that IPL's current customer portfolio is substantially similar to GRE's customer portfolio, a 13% capacity surplus would equate to sufficient capacity to serve more than 96,000 additional customers.[12] Given this information, there is no evidence suggesting that GRE is unable to serve an additional 42,000 customers now or in the future, and would have ample time to add additional resources if circumstances were to change. Moreover, two intervenors in GRE's IRP docket concluded that GRE overestimated future demand in its IRP filing, and this was a factor contributing to the

[9] Petitioners' September 4, 2014 Comments, Attachment B at OAG Information Request No. 14.
[10] GRE IRP Initial Filing at 1, 54, Dkt. No. 12-1114 (Nov. 1, 2012).
[11] *Id*. at 54.
[12] 645,000/0.87 = 741,379. 741,379 – 645,000 = 96,379.

Commission's denial of GRE's Petition.[13] This indicates GRE's ability to serve IPL's existing customers is even greater. Similarly, GRE's 2014 IRP, which was filed on October 31, 2014, states that GRE has excess capacity and does not need new generation resources to meet its expected future obligations for fifteen years, even after its planned addition of SMEC members in 2025.[14] Accordingly, it appears that Petitioners' claim that the WPA benefits customers by assuring a continuous supply of power is overstated.

b. Costs of the WPA

Even if the power provided by the WPA is available to SMEC cooperatives through other means, the OAG recognizes that the WPA may still be reasonable if it provides the power at a competitive price. Similar to their reluctance to state whether the cooperatives have other options to obtain power, however, Petitioners claim that a comparison between the cost of providing power to SMEC through the WPA and the cost of obtaining power from the various G&Ts is not available. Again, Petitioners' reluctance to affirmatively show that customers will pay less for power under the WPA than they would otherwise pay suggests that customers may, in fact, pay more. Moreover, while a cost-comparison of the WPA and other resources has not been produced, it is undisputed that obtaining power through the WPA will increase the rate of return currently paid by ratepayers for IPL's generation assets. As the OAG previously pointed out, the costs of IPL's generation assets will be billed as a pass-through to Minnesota ratepayers at FERC formula rates, including a current ROE of 10.97 percent.[15] IPL's current, Commission-approved ROE is 10.35 percent, which would likely decrease if it filed another rate case.[16]

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[13] *See* Order Rejecting Resource Plan and Setting Future Filing Requirements, *In the Matter of Great River Energy's 2012 Integrated Resource Plan* at 4-5, Dkt. No. 12-1114, (Sept. 26, 2013).
[14] Great River Energy Resource Plan 2015-2029 at 86, Dkt. ET2/RP-14-813 (Oct. 31, 2014).
[15] *See* OAG Reply Comments at 7-8 (Oct. 6, 2014), citing Petitioners' Response to OAG Question 11.
[16] *See* OAG Reply Comments at 8 (Oct. 6, 2014).

Applying FERC's formula rates to IPL's generation assets, as contemplated in the Agreement, will likely lead to higher costs for serving the company's existing customers.

The increased costs to ratepayers of applying FERC's formula rates to IPL's generation assets will likely be significant. In response to an information request from the Department, IPL determined that applying its FERC-approved ROE of 10.97 percent, versus a hypothetical ROE of 9.8 percent, results in the company collecting more than $4.3 million in additional rates between 2015 and 2019—half the duration of the WPA.[17] It is likely that the cumulative effects of the WPA's higher ROE will be even greater than $4.3 million when calculated over the full ten years. It is not reasonable for ratepayers to pay such a significant premium for use of the same generation assets currently serving IPL's customers, particularly since it appears that cooperatives' respective G&Ts are capable of providing these services at lower rates. In this light, it appears that the terms of the WPA are not reasonable.

C. ARE THE TERMS OF THE ASSET SALE REASONABLE?

Based on the analysis above, it appears that the proposed transaction, as currently structured, will result in increased rates for customers and is likely not in the public interest. The OAG acknowledges, however, that evaluating the reasonableness of future distribution rates or the WPA in isolation may lead to an incomplete analysis. Since Petitioners request approval of the Asset Purchase Agreement, their analysis has focused on whether the APA is or is not in the public interest. The OAG has previously commented that it does not believe that certain terms of the Asset Purchase Agreement are reasonable; namely, the OAG questions whether IPL is entitled to a gain on sale of approximately $8.85[18] million. Petitioners, however, produced

[17] Petitioners' Response to DOC IR 67 (Attached as Exhibit 1).
[18] Petitioners' Response to DOC IR 57 (Attached as Exhibit 2).

financial models[19] that they claim demonstrate that the roughly $122 million sale price is reasonable for the assets that would be sold to SMEC. The $122 million sale price was supported, in part, from a discounted cash flow analysis of IPL's assets. But the DCF modeling used by Petitioners also incorporates assumptions about what IPL would receive in future rate cases from 2013 to 2022. If these assumptions were modified—either by assuming IPL would not receive all of its requested increases, or that IPL would not request annual rate increases—the DCF analysis relied on by Petitioners likely would not justify the current proposed terms of sale.

Additionally, the Commission has previously expressed hesitation in allowing transaction costs of an asset sale to be recovered from ratepayers.[20] Absent removing these costs from the sale price in the current transaction, the Commission is unable to address this concern over the long term. The SMEC cooperatives have submitted to limited Commission jurisdiction over rates for a five-year period. But the costs that SMEC cooperatives will pay for IPL's assets will not go away because SMEC agrees to certain rates for these years. Rather, the SMEC cooperative must obtain the financing necessary to purchase these assets, the costs of which must be recovered from ratepayers, either now or in the future. Therefore, once the transaction is closed and the five-year rate mitigation plan has expired, and after the Commission loses jurisdiction, SMEC will be able to charge rates that will recover the full costs of the purchase, including transaction costs and the gain on sale. For this reason, the Commission should require Petitioners to lower the sale price to a reasonable level that does not include a gain on sale for IPL or transaction costs.

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[19] Petitioners' Response to Response to DOC IR 66 (Attached as Exhibit 3).

[20] Order Approving Sale Subject to Conditions, *In the Matter of the Sale of Aquila, Inc.'s Minnesota Assets to Minnesota Energy Resources Corporation* at 6-7, Dkt. No. G-007,011/M-05-1676 (June 1, 2006) (precluding MERC from recovering transaction costs associated with the sale and requiring MERC to propose recovery of any transaction costs in a future rate case).

D. HOW WILL COMMISSION AUTHORITY CHANGE?

If the proposed transaction occurs, IPL's customers would be incorporated into their respective cooperatives and, as a general matter, the Commission's authority to regulate aspects of their service will change to reflect the regulatory structure for cooperatives. As the Commission is aware, with limited exceptions, the Commission does not have authority to regulate the operations of electric cooperatives.[21] Specifically, the Commission does not regulate the rates charged by electric cooperatives.[22] Accordingly, the Commission would cease to have authority to regulate the distribution rates for IPL's current customers.

In this case, however, the Commission would not lose all of its authority to regulate the rates charged by SMEC cooperatives. Rather, the Commission would retain the authority to enforce any conditions of the sale it imposes, including any authority to enforce rate commitments of cooperatives. Minnesota Statutes section 216B.50 provides that "no public utility shall sell, acquire, lease, or rent any plant as an operating unit or system in this state for a total consideration in excess of $100,000 . . . without first being authorized to do so by the Commission." After an application for the sale of property approval is filed, the Commission is instructed to investigate whether or not the sale is consistent with the public interest.[23] If the sale is not consistent with the public interest, then the Commission should either impose conditions to protect ratepayers or deny the application. If the Commission determines that specific conditions are required to ensure that a transaction is in the public interest, its approval of the sale is subject to those conditions, which it retains authority to enforce.

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[21] Minn. Stat. § 216B.01 (2013). *See e.g.* Minn. Stat. § 216B.17, subd. 6a (granting Commission authority to review consumer complaints of cooperatives); Minn. Stat. § 216B.096 (requiring cooperative utilities to comply with Minnesota's "Cold Weather Rule.")

[22] Cooperatives may become subject to rate regulation by the Commission by holding a vote of their member stockholders. Minn. Stat. § 216B.026 subd. 1. None of the SMEC cooperatives are currently subject to rate regulation. Petitioners' September 4, 2014 Comments, Attachment B at OAG Information Request No. 6.

[23] Minn. Stat. § 216B.50, subd. 1.

Petitioners have proposed a rate mitigation plan that they claim limits potential rate increases for IPL's customers for the first five years after the transaction is completed.[24] Petitioners acknowledge that the Commission "will retain authority and jurisdiction to require SMEC and each SMEC Member Cooperative to perform the applicable terms and conditions" of its plan.[25] For the same reasons, the Commission would retain authority to enforce any modifications of Petitioners' rate mitigation plan that it deems reasonable.

III. RECOMMENDATION

The OAG has significant concerns with the terms of the sale and its potential effect on ratepayers in Minnesota. While IPL exits Minnesota with an $8.85 million profit on its distribution assets in Minnesota and $4.3 million in additional gains over the first five years from increased rates of return on equity for its Iowa generation assets used to serve Minnesotans, ratepayers are left with uncertain benefits, certain detriments, and $16.9 million in closing costs related to the sale. For these reasons, the OAG recommends that, should the Commission approve the transaction, it require that IPL forego any gain on sale of its distribution assets, order that transaction costs be paid by IPL, and also recommends that the sale price paid by SMEC to IPL be reduced by the amount of the gain that IPL will receive in the form of increased return on equity on generation assets in Iowa used to serve Minnesota customers. The OAG recommends

[24] *See* Petition at 22-26.
[25] *Id.* at 26.

that this final recommendation be done in the form of a rate refund mechanism that SMEC must implement and maintain for the first five years post-transaction.

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Respectfully submitted,

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