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AN EQUAL OPPORTUNITY EMPLOYER

November 17, 2016

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: Errata to Comments of the Minnesota Department of Commerce, Division of Energy Resources
Docket No. G011/AI-16-284

Dear Mr. Wolf:

On August 31, 2016, the Minnesota Department of Commerce, Division of Energy Resources (Department) filed comments in the following matter:

A Request by Minnesota Energy Resources Corporation (MERC) for Approval of the WEC Energy Group Affiliated Interest Agreement between WEC Energy Group, Inc. (WEC) and its regulated and non-regulated subsidiaries.

The Department wishes to correct an error in the amount referenced on Page 11, second paragraph, second sentence that had read \$100.00. The filing should have read \$100,000. A corrected copy of the Department's comments is attached. The Department apologizes for any confusion this error may have caused.

Sincerely,

/s/ BEN KAMARA
Financial Analyst

BK/ja
Attachment



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August 31, 2016

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: **Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. G011/AI-16-284

Dear Mr. Wolf:

Attached are the Comments of the Minnesota Department of Commerce, Division of Energy Resources (DOC or Department) in the following matter:

A Request by Minnesota Energy Resources Corporation (MERC) for Approval of the WEC Energy Group Affiliated Interest Agreement between WEC Energy Group, Inc. (WEC) and its regulated and non-regulated subsidiaries.

The petition was filed on April 1, 2016 by:

Amber S. Lee
Regulatory and Legislative Affairs Manager
Minnesota Energy Resources Corporations
1995 Rahncliff Court, Suite 200
Eagan, MN 55122

The Department recommends that the Minnesota Public Utilities Commission (Commission) **approve** MERC's proposed Affiliated Interest Agreement (AIA) with WEC Energy Group **with modifications and reporting requirements**. The Department is available to answer any questions the Commission may have.

Sincerely,

/s/ BEN KAMARA
Financial Analyst

BK/ja
Attachment

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

COMMENTS OF THE
MINNESOTA DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

DOCKET No. G011/AI-16-284

I. SUMMARY OF MINNESOTA ENERGY RESOURCES CORPORATION'S PETITION

Pursuant to Minn. Stat. §216B.48, Minn. R. 7825.2200,¹ and the September 14, 1998 *Order Initiating Repeal of Rule, Granting Generic Variance, and Clarifying Internal Operating Procedures* in Docket No. E,G999/CI-98-651 (98-651 Order), Minnesota Energy Resources Corporation (MERC or the Company) filed a request with the Minnesota Public Utilities Commission (Commission) for approval of its new Affiliated Interest Agreement with WEC Energy Group, Inc.(WEC Energy AIA). Through its petition, MERC seeks to consolidate its intercompany affiliated contracts into a single agreement that applies to transactions both among the members of the WEC organization and with WEC Business Services LLC (WBS). Under MERC's proposal, the WEC Energy AIA, if approved by the Commission, would replace two affiliated interest service agreements previously approved by the Commission and currently in effect. Specifically, MERC stated that the WEC Energy AIA would replace and combine the WEC Energy Group Affiliated Interest Agreement (WEC AIA) approved in Docket No. G011/AI-15-704 and the Master Affiliated Interest Agreement (Master AIA) between the predecessor to WBS and its regulated utility affiliates approved in Docket No. G007,011/AI-07-779.²

MERC proposed an effective date of for the WEC Energy AIA on the first day of the fiscal quarter following approval by the state regulatory commissions with jurisdiction over the agreement. MERC also requested that upon approval of the WEC Energy AIA, the Commission terminate the WEC AIA and the Master AIA.

II. BACKGROUND

MERC stated that, since its inception on July 1, 2006, the Company received Commission approval in sixteen affiliated interest dockets that define different aspects of MERC's

¹ Titled "Utilities with Affiliated Interests; Filing."

² Filing, pages 1-2

relationship with its parent and affiliates.³ The following lists the majority of the agreements.

- 1) The Wisconsin Public Service Resources Corporation affiliated interest agreement (WPSR AIA) between WPSR and its public utility subsidiaries, including MERC, was submitted in Docket No. G007,011/AI-06-1052. This WPSR AI governs the provision of inter-company services provided by and among affiliates within the Integrys holding company system other than services provided by Integrys Business Support, LLC, which was the centralized service company within the Integrys holding company system. The Commission issued its Order approving the contract on March 18, 2008, with the following requirements:

Approved the Agreement with the following modifications:

Required MERC to limit its Category 2 services to administrative and corporate costs that are difficult to bid out and more cost effective for an affiliate to do than a third party;

Put MERC on notice that it should be prepared to demonstrate in the Company's next rate case that its Category 1 allocation method provides similar results compared to the Commission's preferred general allocation method, or that the Company's method better serves the public interest; and

Made no finding on the appropriateness of the cost allocation methodologies set forth in the Agreement at this time.

This WPSR AIA was modified in the 10-783 docket. The Commission's December 5, 2013 Order approving the agreement:

Approved the proposed Affiliated Interest Agreement between Integrys and all of the wholly-owned regulated subsidiaries of Integrys (including MERC), one partially-owned regulated subsidiary of Integrys, and all wholly-owned non-regulated subsidiaries of Integrys, as approved by the Illinois Commerce Commission and the Public Service Commission of Wisconsin, including the Addendum.

Required MERC to terminate the affiliated interest agreement approved by the Commission in Docket No. G-007,011/AI-06-1052 upon the effective date of this Agreement.

Required MERC to file its non-IBS cost study by May 1, 2015.

³ MERC lists the sixteen affiliated interest dockets in its Attachment 1, pages 8-9. DOC Attachments A and B include additional information on these agreements.

Required MERC to file with the Commission billing reports showing its charges, as a Providing Party, to any Receiving Party to which it provided services under the Agreement during the preceding calendar year and billing reports showing its payments, as a Receiving Party, for service received from Providing Parties under the Agreement during the preceding calendar year by May 1 of each year.

Required MERC to file the annual internal audit report in this docket no later than July 1 of each audit year.

Required MERC to file the annual updates to the cost study in this docket by May 1 of each applicable year.

Required MERC to file subsequent cost studies in this docket with the Commission by May 1 of each applicable year.

Required MERC to file a study with the Commission three years from the effective date of the Agreement providing information sufficient to enable the Commission to determine whether the Agreement should continue, be modified, or be discontinued.

- 2) The Wisconsin Public Service Company (WPSC) Gas Supply Procedures AIA (Gas Supply Procedures AIA) between WPSR, MERC and other Integrys subsidiaries governs the provision of capacity releases and opportunity sales available to the market. One submission, Docket No. G007,011/AI-06-1416, is the extent of the regulatory history of this agreement. In the Commission's March 5, 2008 Order approving the petition stated:

Approved the centralized gas procurement arrangement including the [gas supply] GS Procedures on the condition that MERC maintain records that support WPSC's decisions on the prices involved in the transactions.

MERC shall petition for approval from the Commission prior to an extension of WPSC's centralized gas procurement service to any non-regulated affiliates.

- 3) The Tax Allocation affiliated interest agreement (Tax Allocation AIA) delineating the allocation of consolidated income tax among the Integrys affiliates was originally filed in Docket No. G007, 011/M-07-1241, which the Commission approved on July 21, 2008. MERC updated the Tax Allocation AIA in Docket Nos. G007, 011/AI-11-545 (approved on November 23, 2011) and G011/AI-13-623 (approved October 15, 2013). The Company also filed a new agreement on July 29, 2015 in Docket No. G011/AI-15-705 (approved October 6, 2015).

- 4) The Master Affiliated Interest Agreement (Master AIA) governs the provisions of goods, services and property between service company affiliates, (pre-merger- Integrys Business Services, post-merger – WEC Business Services or WBS) and MERC and Integrys’ other subsidiaries.⁴ The original Master AIA between Integrys Business Services (IBS) and its public utility subsidiaries was approved in Docket No. G007,011/AI-07-779. The Commission’s May 26, 2009 Order approving the agreement stated:

Clarify that the approval was limited to the normal services provided by a service company under a holding company arrangement as specified in the agreement and provision of any services under Section 1.1 beyond the normal service company "services," must first be approved by the Minnesota Commission in an affiliated interest filing prior to such services being provided.

- 5) Minnesota Energy Resources Corporation Affiliated Interested Agreement between WEC Energy Group, Inc. (WEC) and its regulated and non-regulated subsidiaries. The Agreement was needed to reflect the merger between MERC’s former corporate parent, Integrys Energy Group and Wisconsin Energy Corporation. The AIA replaced Integrys Energy Group with WEC but maintained the substantive terms of the existing WPSR AIA. The WEC AIA was approved by the Commission in Docket No. G011/AI-15-704.

In the instant docket, MERC stated in the filing that the proposed agreement is intended to replace the WEC Energy Group Affiliated Interest Agreement previously approved on June 25, 2015 by the Commission in Docket No. G011/AI-15-704 (“the WEC Agreement”), and the Master Affiliated Interest Agreement between Integrys Business Support, LLC. (the predecessor to WBS) and its regulated utility affiliates (“Master AIA”) previously approved in Docket No. G007,011/AI-07-779.⁵ The Company noted several changes to the WEC Agreement, including:⁶

- Increasing the trigger from \$100,000 to \$250,000 for certain detailed reporting requirements;
- Expanding the operational services that WBS may provide beyond gas engineering support;
- Adding limiting language in the market price study;
- Combining similar allocators into one allocator;

⁴ Integrys agreed to propose the formation of a centralized service company as part of the process of obtaining the state approvals in Illinois and Wisconsin for its merger with Peoples Energy Corporation in 2007.

⁵ Filing, page 2.

⁶ The full list of changes is provided in Attachment 3 of MERC’s filing and DOC Attachment B to these comments.

- Reducing the sampling required for the audit.

The Minnesota Department of Commerce, Division of Energy Resources (Department or DOC) provides its analysis of the MERC's proposal below.

III. DEPARTMENT ANALYSIS

A. STATUTORY REQUIREMENTS FOR AFFILIATED-INTEREST AGREEMENTS

Minnesota Statutes dictate the requirements necessary to be met for affiliated service agreements at Minnesota Statute section 216B.48, subd. 3 as follows:

No contract or arrangement, including any general or continuing arrangement, providing for the furnishing of management, supervisory, construction, engineering, accounting, legal, financial, or similar services, and no contract or arrangement for the purchase, sale, lease, or exchange of any property, right, or thing, or for the furnishing of any service, property, right, or thing, other than those above enumerated, made or entered into after January 1, 1975 between a public utility and any affiliated interested 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), made or entered into after August 1, 1993, is valid or effective unless and until the contract or arrangement has received the written approval of the commission. [Emphasis added]

Minnesota Statute section 216B.48, subd. 3 additionally provides two tests to be applied by the Commission in cases of affiliated-interest contracts; the burden of proof for satisfying these tests rests with the Company:

The commission shall approve the contract or arrangement made or entered into after that date only if it clearly appears and is established upon investigation that it is reasonable and consistent with the public interest. No contract or arrangement may receive the Commission's approval unless satisfactory proof is submitted to the commission of the cost to the affiliated interest of rendering the services or of furnishing the property or service to each public utility. Proof is satisfactory only if it includes the original or verified copies of the relevant cost records and other relevant accounts of the affiliated interest, or an abstract or summary as the commission may deem adequate, properly identified and duly authenticated, provided, however, that the commission may, where reasonable, approve or disapprove the contracts or arrangements without the submission of cost records or

accounts. *The burden of proof to establish the reasonableness of the contract or arrangement is on the public utility.*
[Emphasis added]

The burden of proof is on the Company to show that the service agreement is both reasonable and consistent with the public interest; if the Commission determines that MERC has met its burden of proof, the Commission shall approve the agreement.

Finally, Minnesota Statute section 216B.48, subd. 6 is clear that the Commission has continuing authority over the affiliated-interest agreement if actual experience under the agreement results in rates that are unreasonable:

Subd. 6. Commission retains continuing authority over contract.

The commission shall have continuing supervisory control over the terms and conditions of the contracts and arrangements as are herein described so far as necessary to protect and promote the public interest. The commission shall have the same jurisdiction over the modifications or amendment of contracts or arrangements as are herein described as it has over such original contracts or arrangements. The fact that the commission shall have approved entry into such contracts or arrangements as described herein shall not preclude disallowance or disapproval of payments made pursuant thereto, if upon actual experience under such contract or arrangement it appears that the payments provided for or made were or are unreasonable.

B. FILING REQUIREMENTS

In Docket No. E, G-999/CI-98-651 the Commission provided minimum filing requirements that must be satisfied within 30 days of executing a contract or arrangement with an affiliate.⁷ This docket also requires that within 30 days of executing a contract or arrangement with an affiliate, the utility must make a filing that includes the following information:

1. A heading that identifies the type of transaction.
2. The identity of the affiliated parties in the first sentence.
3. A general description of the nature and terms of the agreement, including the effective date of the contract or arrangement and the length of the contract or arrangement.
4. A list and the past history of all current contracts or agreements between the utility and the affiliate, the consideration received by the affiliate for such contracts or agreements, and a summary of the relevant cost records related to these ongoing transactions.

⁷ In the Matter of a Commission Investigation into Procedures for Reviewing Public Utility Affiliated Interest Contracts and Arrangements, ORDER INITIATING REPEAL OF RULE, GRANTING GENERIC VARIANCE, AND CLARIFYING INTERNAL OPERATING PROCEDURES (September 14, 1998).

5. A descriptive summary of the pertinent facts and reasons why such contract or agreement is in the public interest.
6. The amount of compensation and, if applicable, a brief description of the cost allocation methodology or market information used to determine cost or price.
7. If the service or good acquired from an affiliate is competitively available, an explanation must be included stating whether competitive bidding was used and, if it was used, a copy of the proposal or a summary must be included. If it is not competitively bid, an explanation must be included stating why bidding was not used.
8. If the arrangement is in writing, a copy of that document must be attached.
9. Whether, as a result of the affiliate transaction, the affiliate would have access to customer information, such as customer name, address, usage or demographic information.
10. The filing must be verified.

The Department reviewed the instant petition and concludes that MERC complied with the filing requirements under Minnesota Rule 7825.2200B. In Attachment 1 of the petition, MERC provides the affiliated-interest requirements for Minnesota Rule 7825.2200B, with the information for each requirement in one location, along with a brief explanation on how they have satisfied each requirement.

C. ANALYSIS OF PROPOSAL

1. Overall Review

The Department reviewed the proposed WEC Energy AIA, focusing on any substantive changes made as a result of this effort to combine the existing WEC Agreement and the Master AIA. Given the Company's proposed changes, the Department requested more information in order to have a better understanding of the Company's proposal. Specifically, the Department requested further information regarding:

- overhead costs,
- services beyond gas engineering support,
- dollar amount trigger for reporting requirements, and
- reporting and internal audit requirements.

In addition, the Department assessed whether:

- the proposed price or cost is reasonable,
- the agreement would affect the competitive situation,
- the effective date is reasonable,
- the privacy of customer data is adequately protected, and
- the agreement would impair effective regulation.

a. *Overhead costs*

In DOC Information Request No. 4 the Department asked for clarification regarding the phrase “Less detail defining the ‘overhead’ component of cost and other cost descriptions” included in the Company’s list of changes to Article III.

The Company replied:

The WEC Agreement lists many specific overhead costs within 3 categories: 1) benefits, 2) administrative and general costs, and 3) office space. In addition to the listing, these categories also include general references such as “other employee benefits” and “miscellaneous expenses.” Consequently, many of the detailed items are more in the nature of examples than an exhaustive and complete list of every cost in the category. The proposed agreement is intended to include the same overhead costs (benefits, administrative and general costs, and office space) without providing unnecessary details in the agreement. Listing detailed specific items may create an agreement where frequent updating would be required to reflect changes that have little substantive effect. Two examples of specific overhead costs that could potentially become dated are 1) various retirement savings programs (there are many types of retirement savings programs in place today and new ones could be developed in the market or adopted by the company) or 2) telephone costs (as the mobile society has developed, telephone usage has declined significantly, and this trend can be expected to continue).

The Department agrees with the Company in that it may not be necessary or administratively feasible to list all potential overhead costs in the WEC Energy AIA. However, not listing all of the potential services and costs does not relieve MERC of its burden of proof to demonstrate the reasonableness of costs that MERC proposes to charge to ratepayers. For example, MERC will need to show why an affiliate is “uniquely qualified” to provide services or that “economies of scale” offset the loss to ratepayers of the benefits of competitive bidding.

To make this point clear, the Department recommends that the Commission’s Order in this proceeding use language similar to that in the Commission’s Order in Docket G007,011/AI-06-1052, noted above:

Put MERC on notice that it should be prepared to demonstrate in the Company's rate cases that its proposed allocation methods provide similar results compared to the Commission's preferred general allocation method, or that the Company's method better serves the public interest.

b. Services beyond gas engineering support

The Department issued DOC Information Request No. 6 in respect to Appendix C of the proposed agreement, which states in part: “Expanding the operating services that WBS may provide beyond gas engineering support (gas and electric, support and field services).” Specifically, the Department asked:

- a. Is it the Company’s intent that MERC will be contracting for additional operational services from WBS in the future?
- b. If so, please provide a list of these services.

The Company replied:

- a. The Company does not have any specific intent for MERC to contract for specific additional operational services from WBS in the future. Rather, the affiliated interest agreement was written to provide flexibility for appropriate services to be provided to any WEC Energy Group utility (a) directly by the utility’s employees, (b) by employees of affiliated utilities or (c) by WBS employees, depending on which method was the most cost-effective and efficient method to serve our customers.b. See response to sub-part (a) of this question.

The Department appreciates MERC’s explanation and concludes that MERC’s approach is satisfactory given the latitude of services highlighted in its filing.⁸ As noted above, MERC’s proposed expansion of its affiliated interest agreement does not in any way relieve MERC of its burden of proof to show that costs and revenues related to such transactions that MERC proposes to include or exclude from rates are reasonable, as Minnesota Statute §216B.48 subd. 6 indicates above.

c. Trigger for reporting requirements

The proposed WEC Energy AIA proposes to alter the reporting requirements such that the amounts in the schedules that will be provided to the Commission each year can be aggregated if the amounts are less than \$250,000. The increase in the amount from \$100,000 to \$250,000 that would trigger detailed reporting to the Commission prompted a concern regarding whether that increase could lead to a violation of Minnesota Statute section 216B.50, subd. 1, which requires 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, 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.

⁸ Filing Attachment 2, page 25.

MERC provided the following response to DOC information Request No.3:

Article V of the proposed AIA includes an increase from \$100,000 to \$250,000 on the WBS annual filing with state commissions, including the MPUC, for the following categories:
3 (b) Account 923 Outside Services Employed,
3 (c) Pension and Benefit Program,
3 (d) Account 930.1 General Advertising Expenses, and
3 (g) Account 426.1 Donations.

Based on historical filings, this modification will not change the content of 3 (c) as the various pension and benefit programs well exceed the \$250,000 threshold, 3 (d) has never had a single payee in excess of \$100,000, and 3 (g) has been \$0 since the Service Company has been in existence.

Schedule 3 (b) Outside Services Employed will likely be impacted by this increase. While it is true that the legacy Integrys operating utilities are the same size, note that the legacy WEC utilities were not part of the holding company when the service company was formed and these reporting standards developed. Also, with a larger holding company system, the service company now has a broader range of prospective vendors, conceivably increasing the potential number of vendors, the amounts spent on each vendor and the allocation among the service recipients. Below is the 2015 3 (b) list of Payees and amounts as filed (columns 1 and 2). Note that with the higher tolerance (column 4) the miscellaneous category only increases to 23% of the total outside services (column 5). This restated miscellaneous payee category represents the information fairly and does not have a significant impact on the evaluation of the material.

(1)	(2)	(3)	(4)	(5)
2015 Payee's - Account 923	2015 Filing \$'s		2015 Restated with 250K Tolerance	
CGI TECHNOLOGIES AND SOLUTIONS INC	433,500		433,500	
DELOITTE & TOUCHE LLP	541,674		541,674	
EC INFORSYSYSTEMS INC	188,327			
EXEQUITY LLP	148,898			
FOLEY & LARDNER	393,249		393,249	
INTERGRAPH CORP	126,716			
POMEROY IT SOLUTION SALES CO INC	1,826,066		1,826,066	
PRO UNLIMITED INC	3,808,765		3,808,765	
TOWERS WATSON	519,615		519,615	
VONYA GLOBAL LLC	105,737			
WELLS FARGO BANK NA	295,812		295,812	
XEROX CORP	172,969			
MISCELLANEOUS	1,600,252	16%	2,342,899	23%
TOTAL PAYEE'S - ACCOUNT 923	10,161,580		10,161,580	

The Department agrees with MERC that, to the extent that MERC acquires, sells leases or rents services that are not a “plant as an operating unit or system,” the \$100,000 limit in Minnesota statutes would not apply. Further, the schedules will be provided annually under MERC’s proposal, allowing the Commission and Department to review the accounts and request further information from MERC should further information be deemed necessary.

However, the Department recommends that the Commission: 1) allow this increase to apply only to services and not to any plant as an operating unit or system in this state, and 2) require the Company to supplement the reporting required by Article V of the AIA, highlighting all transactions that are over the \$100,000 threshold contained in Minnesota Statutes section 216B.50, subd. 1. Further, the Department recommends that the Commission deny MERC’s proposal to increase the limit above \$100,000 for any sales, acquisition, lease or rent of “any plant as an operating unit or system in this state for a total consideration in excess of \$100,000” given the requirements of Minnesota law. Instead, MERC would need to seek authorization from the commission prior to any such transaction.

d. Reporting and internal audit requirements

Finally, DOC Information Request 2 asked the Company to provide an analysis that compares the Commission’s reporting and internal audit requirements contained in the current agreements and the Commission’s reporting and internal audit requirements proposed in the new agreement. The Company replied, in part:

Relative to the currently-effective WEC Agreement, WEC Energy proposed adding requirements that are in the current service company agreement (e.g., the FERC Form 60 requirement) and, with the addition of the service company reporting, proposed

only the following substantive changes to the reporting requirements. First, for certain reports detailed in proposed Article V.3, the dollar trigger would change from \$100,000 to \$250,000 (see the response to IR 3). Second, for the cost study in proposed Article V.6, the description of that study is refined to accurately reflect its purpose. The study is relevant to assess if services provided to and received from Non-Regulated Parties are priced correctly (i.e., at the higher or lower of cost or fair market value). Thus, only services that a Non-Regulated Party receives or provides need to be in the study. Moreover, the purpose of the requirement is to gauge if an advantage existed for a Regulated Party to purchase from the market and not from its affiliate (i.e., the fair market value is lower than the Non-Regulated Party's cost) or if charging the Non-Regulated Party at cost would subsidize that party to the potential detriment of non-affiliated companies that may compete with the affiliate (i.e., if the Non-Regulated Party had to purchase a service in the market, it would have cost more). Thus, the types of services that ought to be reviewed are only those that are available in the market.

Relative to the currently-effective WEC Agreement, WEC Energy proposed only non-substantive changes to the audit requirements applicable to the non-Illinois utilities.

...

For the audit requirements applicable to the Illinois utilities and included in proposed Appendix E, WEC Energy proposed modifying the requirements as shown below. These changes do not affect MERC. Except for the unique case of W.E. Power, LLC, the non-regulated businesses for WEC Energy are a quite small part of the organization. The amount invested in and the income from these non-utility subsidiaries is very small. W.E. Power, LLC was established to own generating assets and lease them to Wisconsin Electric Power Company and other owners. The activities and costs of W.E. Power, LLC are closely monitored and audited under Public Service Commission of Wisconsin guidelines. As such, WEC Energy includes its results in its regulated portfolio although, for purposes of the WEC Energy AIA, W.E. Power, LLC is a "Non-Regulated Party." WEC Energy has no retail marketing affiliate. In the first quarter of 2016, WEC Energy divested the legacy Integrys non-regulated compressed natural gas (CNG) business segment. Overwhelmingly, the non-regulated entities are in the electric energy business and not in the natural gas business. The Illinois utilities employees have few, if any; support services to offer these entities and the Illinois utilities have few assets that would be of value to these entities. Reviewing a sample of

transactions is more appropriate than grouping transactions into strata and then reviewing a sample from each stratum. The detailed requirements in the audit section are not appropriate for WEC Energy.

The Department agrees in part and disagrees in part with MERC's proposal. The Department agrees that "the types of services that ought to be reviewed are only those that are available in the market." However, the Department does not agree that the study is relevant *only* to assess if services provided to and received from Non-Regulated Parties are priced correctly (i.e., at the higher or lower of cost or fair market value). The study also needs to assess whether MERC is overpaying or undercharging Regulated affiliates in the transactions when market alternatives to the transaction are available. Thus, the Department does not agree that only services that a Non-Regulated Party receives or provides need to be in the study; instead, services that either a Regulated or Non-Regulated Party receives or provides that are available in the market should be studied.

The Department does not oppose limiting the study to a review of a sample of transactions for the audit requirements applicable to the Illinois utilities, so long as MERC is put on notice that the burden of proof remains on MERC to show in rate proceedings that the proposed costs and revenues to be included in rates are reasonable. Further, it is expected that this change would not be concerning given that the provisions of Appendix E to the AIA are unlikely to affect MERC.

e. Amount of Compensation

MERC's proposed description of the cost allocation methodology or market information that would be used to determine the cost or price is as follows:

Services provided by a Regulated Party to another Regulated Party will be priced at cost; services provided by a Regulated Party to a Non-Regulated Party will be priced at the greater of cost or fair market value, services provided by a Non-Regulated Party to a Regulated Party will be priced at the lesser of cost or fair market value, and services provided by any Party to WBS or provided by WBS to any Party will be priced at cost. Costs for services provided by a Regulated Party include direct and indirect labor, equipment, materials and supplies, and overheads among other cost loaders. Costs for services provided by a Non-Regulated Party include costs of labor, equipment, materials and supplies, depreciation, and other reasonable overheads and costs as determined in accordance with accounting standards customarily used by businesses such as those in which the Non-Regulated Party is engaged. The fair market value of a service provided under the WEC Energy AIA means the cost determined by making a good faith effort to identify the costs in the relevant market for such or a similar service.

This description is consistent with the Commission's approval in Docket No. G011/M-15-704. Again, it will be MERC's burden to show that the costs and revenues the Company proposes to include in rates are reasonable, such as showing that the Company made a "good faith effort" to obtain an alternative to the affiliated transaction.

f. Competitive Bidding

Competitive bidding is required when products, services, or property acquired from an affiliate are competitively available, and is the preferred method to ensure that companies are not favoring their affiliates. MERC states that

Competitive bidding is not available to obtain the unique services that may most efficiently and cost effectively be obtained from WEC, the parent holding company, and its regulated and non-regulated subsidiaries. However, "the Parties have the right to refuse to provide services under the WEC Energy AIA, and the WEC Energy AIA does not create an exclusive right of first refusal associated with the provision of services under the WEC Energy AIA."⁹

The Department notes that competitive bidding is required when products or services are competitively available, and to ensure that utilities do not unduly favor their affiliates at ratepayers' expense. Thus, as noted above, it will be MERC's burden to show that the costs and revenues the Company proposes to include in rates are reasonable, such as showing that the Company made a "good faith effort" to obtain an alternative to the affiliated transaction.

g. Customer Information

In response to questions as to whether the affiliate would have access to customer information, the Company stated that:

Services provided by one affiliate to another under the WEC Energy AIA may require access to customer information. Section 8.12 of the WEC Energy AIA provides that each Party shall treat in confidence all information that it may obtain from or regarding the other Parties and their respective businesses during the term of the WEC Energy AIA. Additionally, each Party agrees to protect the other Parties' information using the same degree of care which it uses to protect its own confidential information, and in no event less than reasonable care. Except to the extent disclosure of such information is required by a governmental authority having jurisdiction, such information shall not be communicated to any person other than the Parties, and shall be shared among the Parties only to the

⁹ Filing page 11 of Attachment 1.

extent certain persons need to know such information in order for the Parties to perform under the WEC Energy AIA. If a Party is required to disclose confidential information to a governmental authority, such Party must take reasonable steps to make such disclosure confidential under the rules of such governmental authority.¹⁰

The Department provides several notes: first, the Commission has an ongoing proceeding, Docket No. E,G999/CI-12-1344, *In the Matter of a Commission Inquiry into Privacy Policies of Rate-Regulated Energy Utilities*, that has been examining issues of data privacy. Since the Commission has ongoing authority over affiliated-interest transactions, the provisions decided in that proceeding should apply to the WEC Energy AIA. Specifically, the phrase above should be modified as follows:

Additionally, each Party agrees to protect the other Parties' information using the same degree of care which it uses to protect its own confidential information, and in no event less than reasonable care. However, any Party with information about customers of MERC shall treat the information according to the requirements of the Minnesota Public Utilities Commission.

With this modification, the Department considers the Company's description of treatment and protection of customer information to be reasonable.

h. Effective Date

According to MERC, Section 8.1 of the WEC Energy AIA makes provision for the effective date of the AIA to be the first day of the fiscal quarter following approval or waivers of the Commission and the AIA will remain in full force and effect until and unless modified or terminated.¹¹ Department has no objection to the proposed date and concludes that the effective date is reasonable.

i. Rate Case Reporting Requirements

The Department notes that the changes proposed by the Company in its WEC Energy AIA do not change the continued requirement of the Company to follow the requirements provided in the Commission's September 28, 1994 Order in Docket No. E,G999 (1008 Docket). In the 1008 Docket, the Commission found that the following four basic hierarchical cost allocation principles, extracted from the comprehensive Federal Communications Commission (FCC) cost methodology, are the best means of ensuring proper cost separations between regulated and non-regulated activities. Additionally, the Department notes these cost allocation principles help to ensure reasonable cost assignments and allocations for all company entities.

¹⁰ Filing pages 11 and 12 of Attachment 1.

¹¹ Filing page 4 of Attachment 1.

The four basic hierarchical cost allocation principles are:

1. Tariffed rates shall be used to value tariffed services provided to the non-regulated activity.
2. Costs shall be directly assigned to either regulated or non-regulated activities whenever possible.
3. Costs which cannot be directly assigned are common costs which shall be grouped into homogeneous cost categories. Each cost category shall be allocated based on direct analysis of the origin of the costs whenever possible. If direct analysis is not possible, common costs shall be allocated based upon an indirect cost-causative linkage to another cost category or group of cost categories for which direct assignment or allocation is available.
4. When neither direct nor indirect measures of cost causation can be found, the cost category shall be allocated based upon a general allocator computed by using the ratio of all expenses directly assigned or attributed to regulated and non-regulated activities, excluding the cost of fuel, gas, purchased power, and the purchased cost of goods sold.

The Department recommends that the Commission require the Company to file in its next general rate case, Direct Testimony demonstrating continued compliance with the Commission's 1008 Docket requirements and providing support that the Company's cost assignments and cost allocations continue to be reasonable.

IV. CONCLUSION AND RECOMMENDATIONS

Based on its review of MERC's petition, the Department concludes that the proposed AIA as modified is reasonable and consistent with the public interest. Therefore, the Department recommends that the Commission:

- Approve MERC's WEC Energy AIA in the original filing with the following modifications:
 - Put MERC on notice that it should be prepared to demonstrate in the Company's rate cases that its proposed allocation methods provide similar results compared to the Commission's preferred general allocation method, or that the Company's method better serves the public interest. For example, MERC will need to show that the Company made a "good faith effort" to obtain an alternative to an affiliated transaction;
 - allow MERC's proposed increased limit from \$100,000 to \$250,000 to apply only to services and not to any plant as an operating unit or system in Minnesota;

- require MERC's internal audit to apply to both Regulated and Non-Regulated entities to assess whether MERC is overpaying or undercharging either Regulated or Non-Regulated affiliates in transactions when market alternatives are available;
- require the following to be added to the provision regarding treatment of customer data:
 - Additionally, each Party agrees to protect the other Parties' information using the same degree of care which it uses to protect its own confidential information, and in no event less than reasonable care. However, any Party with information about customers of MERC shall treat the information according to the requirements of the Minnesota Public Utilities Commission.
- Require the Company to file in its next general rate case, Direct Testimony demonstrating continued compliance with the Commission's 1008 Docket requirements and support that the Company's cost assignments and cost allocations continue to be reasonable;
- Require the Company to supplement the annual reporting required by Article V of the AIA, highlighting all transactions that are over the \$100,000; and
- Terminate WEC AIA and the Master AIA approved in Docket Nos. G011/AI-15-704 and G007,011/AI-07-779 respectively.

/ja

DOC Attachment A
Summary of the Areas Covered by MERC's Commission-Approved AIAs

- 1) The Wisconsin Public Service Resources Corporation affiliated interest agreement (WPSR AIA) between WPSR and its public utility subsidiaries, including MERC, was submitted in Docket No. G007,011/AI-06-1052. This WPSR AI governs the provision of inter-company services provided by and among affiliates within the Integrys holding company system other than services provided by Integrys Business Support, LLC, the centralized service company within the Integrys holding company system. This WPSR AI was modified in Docket No. G-007,011/AI-10-783.

The AIA covers the following services between regulated and non-regulated entities:

- i) Strategic Projects
 - ii) Transmission Services
 - iii) Compressed Natural Gas
 - iv) Corporate Airplane
 - v) Financing Charges
 - vi) Rent and Office Equipment Charges, and
 - vii) Warehouse Charges
- 2) The Wisconsin Public Service Company (WPSC) Gas Supply Procedures AIA (Gas Supply Procedures AIA) between WPSC, MERC and other Integrys subsidiaries governs the provision of capacity releases and opportunity sales available to the market. One submission, Docket No. G007,011/AI-06-1416 is the extent of the regulatory history of this agreement. The filing in this docket consisted of a manual of standards of conduct that govern the provision of capacity release and opportunity-sales in the market. The Minnesota Commission approved both the WPSR AI and the WPSC Gas Supply Procedures AIA on March 18, 2008. According to the Gas Supply Procedures, "Opportunity sales may involve a number of different transactions, including, but not limited to, gas supply only, bundled capacity release and gas supply, buy/sells, swaps, loans, buy-backs, and city gate transactions."
- 3) A Tax Allocation affiliated interest agreement delineating the allocation of consolidated income tax among the Integrys affiliates (Tax Allocation AIA) was filed originally in Docket No. G007, 011/M-07-1241. MERC updated the Tax Allocation AIA in Docket Nos. G007, 011/AI-11-545 and G011/AI-13-623. According to the Company, the Tax Allocation AIA is intended to facilitate and govern the filing of consolidated returns on behalf of Integrys and its subsidiaries that are subject to income tax. The Tax Allocation AIA also provides a method for allocating income tax liability among the parties.

The Company also filed a new agreement on July 29, 2015 in Docket No. G011/AI-15-705. The driver for this filing is the merger between MERC's former corporate parent, Integrys Energy Group and the Wisconsin Energy Corporation.

- 4) The Master Affiliated Interest Agreement (Master AIA) governs the provisions of goods, services and property between service company affiliate, (pre-merger – Integrys Business Services, post-merger – WEC Business Services) and MERC and Integrys' other subsidiaries. The Minnesota Commission issued an Order approving

the IBS AIA between Integrys Support and its regulated affiliates on March 5, 2008 and clarified its approval of that agreement on May 26, 2009. Submissions regarding the Master AIA before the Commission include:

- a. Docket No. G007,011/AI-07-779 (07-779): the original Master AIA between Integrys Business Services (IBS), the service company affiliate and its public utility subsidiaries;
- b. Docket No. G007,011/AI-08-1376: modification of the Master AIA between IBS and its public utility subsidiaries;
- c. Docket No. G007, 011/AI-09-1244: additional modification of the Master AIA;
- d. Docket No. G007,011/A1-11-168: additional modification of the Master AIA;
- e. Docket No. G007,011/AI-12-910: additional modification of the Master AIA; and
- f. Docket No. G011/AI-13-934: additional modification of the Master AIA.

In Docket No. G011/AI-13-934, Integrys provided the following description of the Master AIA:

The Master AIA provides the terms and conditions under which Integrys Support provides professional and other services to its regulated affiliates, including MERC. Under the Master AIA, Integrys Support currently provides a wide range of services to the regulated affiliates, including the following:

- Administrative services;
- Corporate development;
- Corporate secretary;
- Environmental;
- Executive management;
- Governmental relations, corporate communications, and regulatory processes;
- Financial services;
- Human resources;
- Information technology;
- Legal services;
- Supply chain;
- Engineering services;
- Gas supply;
- Customer relations; and
- Project services.

5) The WEC Energy AIA is a combination of affiliated interest agreements between MERC and WEC and was submitted in Docket No. G011/AI-15-704 on July 29, 2015. The impetus for this new Agreement was the merger between MERC's former corporate parent, Integrys Energy Group and Wisconsin Energy Corporation. The filing essentially requested approval to replace "Integrys Energy Group" with "WEC," but maintain the substantive terms of the existing agreement. There were no substantive changes to the WPSR AIA other than:

- The change of MERC's corporate parent to WEC;

- An updated list of subsidiaries to include WEC subsidiaries;
- The new operative date of the agreement; and
- Various ministerial changes.

DOC Attachment B (Reproduced from Petition Attachment 3)

WEC ENERGY GROUP AFFILIATED INTEREST AGREEMENT SUMMARY OF NOTABLE CHANGES FROM WEC AGREEMENT AND MASTER AIA

1. Art. II.6: Rather than a presumption that WBS is the dominant service provider, if both WBS and another company are willing and able to provide a service, then the receiving party may select the service provider.
2. Art. III: Less detail defining the “overhead” component of cost and other cost descriptions.
3. Art. V.2: For certain detailed reporting requirements, increase the trigger from \$100,000 to \$250,000.
4. Art. V.6: Limiting language in the market price study (services “that a Non-Regulated Party provides or receives and for which a reasonable substitute is widely available in the relevant market.”)
5. Appendix C: Moving “Customer” as a WBS service only available to regulated utilities to available to all subsidiaries.
6. Appendix C: Expanding the operational services that WBS may provide beyond gas engineering support (gas and electric, support and field services).
7. Appendix C: Combining similar allocators into one (e.g., number of devices and not number of personal computers, number of phone lines, etc.).
8. Appendix D: For regulated party to regulated party services, making all services “major” and none “incidental” [for Appendix E, “Fleet” remains incidental]
9. Appendix D: For non-regulated / regulated services, making three services “major”; currently, all services in this category are “incidental” [for Appendix E, leaving all incidental]
10. Appendix D: Defining “management” to include CEO/President, direct reports and those persons’ direct reports [currently, no definition].
11. Appendix E: reducing the sampling required for the audit, which will reduce the amount of detail produced by the audit.
12. Significant provisions that are retained with little or no change:
 - a. Pricing of services (to and from WBS at cost; regulated to non-regulated at higher of cost or market; non-regulated to regulated at lower of cost or market).
 - b. Detailed PUC reporting and internal audit requirements, largely moved from the service company AIAs.
 - c. Normal and customary contract terms and conditions (e.g., indemnities, representations and warranties, definitions of key terms, agency rights)
 - d. Services and allocators applicable to WBS are largely unchanged [Appendix C changes noted above]
 - e. Services that non-WBS companies may provide are largely the same but movement from “incidental” to “major” in some cases [Appendix D changes noted above]

CERTIFICATE OF SERVICE

I, Marcella Emeott, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, e-mail, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

Minnesota Department of Commerce
Errata to Comments

Docket No. Docket No. G011/AI-16-284

Dated this 17th day of November 2016

/s/Marcella Emeott

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