STATE OF MINNESOTA

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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

DOCKET NOS: E001, E132, E114, E6521, E142, E135, E115, E140, E105, E139, E124, E126, E145/PA-14-322

IN THE MATTER OF A REQUEST FOR APPROVAL OF THE ASSET PURCHASE AND SALE AGREEMENT BETWEEN INTERSTATE POWER AND LIGHT COMPANY AND SOUTHERN MINNESOTA ENERGY COOPERATIVE	**REPLY COMMENTS OF MINNESOTA MUNICIPAL UTILITIES ASSOCIATION**

SYNOPSIS

The Minnesota Public Utilities Commission (the "Commission") must "investigate" and determine whether the proposed transaction in this matter is "consistent with the public interest." Minn. Stat. § 216B.50. Minnesota Municipal Utilities Association ("MMUA") appreciates the opportunity to participate in this proceeding. MMUA has participated from the perspective of local units of government, publicly-owned, self-regulated municipal utilities, and the transfer of electric service territory, with which its members are quite familiar. The discovery process has assisted in developing the record.

After reviewing the information that has been provided, MMUA respectfully notes that there are a number of issues that remain unclear, and that would benefit from further investigation by the Commission to assist it in determining the public interest.

Based on its participation in the Commission's informal process to date, MMUA submits that a contested case proceeding provides the most efficient manner to address these issues.

ANALYSIS

I. THE COMMISSION SHOULD FURTHER DEVELOP THE RECORD TO DETERMINE THE PUBLIC INTEREST.

MMUA participated in the Informational Meetings held on July 17-18, served information requests, and reviewed the Joint Petitioners' responses to other parties' informational requests filed in this matter. This information has assisted in developing the record. But there are some fundamental questions that remain unanswered, and that would benefit from further investigation by the Commission. MMUA has identified seven particular issues, and other interested parties may provide additional areas that would benefit from further information and as potential conditions for any order approving the transaction.

1. "Premium" Above Asset Value.

The transaction includes a premium above the identified value of the facilities. This premium has been described to include an $8.55 million "IPL gain on sale" after IPL's transaction costs. (Department of Commerce ("DOC") Information Request ("IR") 63; MMUA IR 6). But the acquisition premium has also been described as the "Acquisition Price over Net Book Value" in the amount of $16.9 million. (DOC IR 57, 63).

The basis of the premium appears to be grounded in negotiations. (DOC IR 57) ("the result of arms-length negotiations between IPL and representatives of SMEC and the SMEC member cooperatives"). Although the responses also referenced "publicly

announced electric distribution asset sales," the underlying sales were not detailed or provided. *Id.* Instead, the rationale appears to be the product of negotiations and the decision of the parties. *Id.* (premium "also represents an amount that the SMEC Member Cooperatives determined to be reasonable in relation to the benefits that are expected to accrue over time.").

From the Commission's perspective, it is difficult to assess the reasonableness of the premium over the net value of the assets. It is difficult to determine whether the premium represents a fair and reasonable amount, or whether the ratepayers have been prejudiced by either receiving too little or too great a purchase amount. No objective standard has been provided. In past cases, the Commission has denied recovery of an acquisition premium as a condition of approving the sale. *In the Matter of the Sale of Aquila, Inc.'s Minnesota Assets to Minnesota Energy Resources Corporation*, Docket No. G007,011/M-05-1676, Order Approving Sale Subject to Conditions, at 6-7 (June 1, 2006). The Commission should further investigate the reasonableness of the purchase price, considering the premium above the value of the assets.

2. Reasonableness of Purchase Terms and Costs.

A number of components of the transaction do not have a basis in terms of a determined or calculated value; instead, they were the product of negotiation, which makes it difficult for the Commission to assess the reasonableness of the negotiated result.

a. Wholesale Power Arrangement. The transaction is contingent upon the wholesale power agreement with IPL. (OAG IR 14). No value analysis quantifying the

value of the wholesale power agreement has been performed. *Id.* It is difficult to determine the appropriate value of this required component of the transaction, and to assess whether the consideration offered in return was appropriate, too high, or too low, to the prejudice of the ratepayers.

b. The $2/megawatt Credit. The Joint Petitioners have explained that this credit is "not a calculated value." (OAG IR 2). Instead, it was intended to "moderate" the increase in rates for the IPL customers. *Id.* But the Commission could conclude that a different approach or credit is appropriate to moderate rate increases and to satisfy the public interest standard.

c. Nature of the Transaction. This transaction was not the product of a request for proposals, a narrowing of finalists, and a final agreement with one purchaser, as the Commission has evaluated in past cases. *In the Matter of the Sale of Aquila, Inc.'s Minnesota Assets to Minnesota Energy Resources Corporation*, Docket No. G007,011/M-05-1676. Instead, here, the buyer and seller were the only parties involved in the negotiations. SMEC approached IPL and initiated the discussions. (OAG IR 3). No other potential purchasers were identified. "No alternative transactions were considered." (OAG IR 1). Accordingly, no objective assessment of the terms and conditions of the transaction was presented. Instead, the parties negotiated terms that they found to be acceptable. Because only the Joint Petitioners interacted in this transaction, the Commission should further investigate the reasonableness of the terms and conditions.

3. Future Capital Investments.

The Joint Petitioners have noted that after the transaction, SMEC does not anticipate making significant expenditures on the system. (MMUA IR 8). The Joint Petitioners have supplemented this response to note that SMEC's Engineering Committee has identified a preliminary list of projects to interconnect the two systems and to enhance reliability. (Dept. of Commerce IR 52). The Engineering Committee has estimated $7 million in capital projects planned for 2015. *Id.*

In addition, it is likely that additional infrastructure investments will be required in the near-term, given the age of some facilities. (Dept. of Commerce IR 54: average age of IPL distribution transformers is 22.4 years old); (Dept. of Commerce IR 20: Burns and McDonnell Nov. 2013 Report did not "specifically identify equipment that needs immediate replacement, it is possible that some of the older equipment may need overhauls or replacement in the near future." *Id.* at 24 (identifying 1959 transformer that "can last 5-10 more years in service), at 25 (1965 transformer "will need to be replaced in approximately 10 years), at 30 (transformer "will only l[ast] 5-10 more years in service), at 44 (estimating "average life of the distribution system to be 18 years.")).

It is unclear whether these capital costs will be financed in some respect through this transaction. Alternatively, the transferred customers may be responsible for these capital costs in future rates. The Commission should further investigate the impact and role of these near-term capital costs as part of this transaction.

4. Rates for Former IPL Customers.

The Joint Petitioners have proposed that the Commission require SMEC to charge the proposed rates to former IPL customers in the first three years. But the

Commission will not evaluate results; "the decision will simply be whether a reasonable method has been used" for PCA component. (Joint Petitioners' Sept. 4, 2014 Comments at 23). Thereafter, for two years, the Commission may only enforce the proposed process, without any authority to set rates. *Id.* at 24.

Even in the initial three-year period, the Commission has been asked to effectively authorize a rate increase without the benefit of a fact-finding rate case proceeding. (MMUA IR 2, Attach. MMUA-2A, noting "net increase" of total system revenues of 18%, 15.3% increase for residential customers, 16.9% increase for small commercial customers, and 22% increase for large commercial customers); *see also* (Dept. of Commerce IR 3, Attach. DOC-3B at 2).

In past rate cases involving IPL, the Commission has acted to the benefit of ratepayers in excluding certain costs such as travel by officers. (Dept. of Commerce IR 2, Attach DOC-2A, Schedule B-9, removing "all officer travel and entertainment expenses from the test year"). No similar protections have been offered in the present transaction. (Dept. of Commerce IR 53 (summarizing annual Member Cooperative Board compensation, including travel, ranging from $75,860 to $462,567 in 2013). The Commission should further investigate protections for ratepayers consistent with IPL's past rate recovery.

5. Legal Status and Future Implications.

The Joint Petitioners have referred to SMEC as a "paper generation and transmission" cooperative. SMEC noted that "it will not be providing electric service at retail" and that its Member Cooperatives will provide retail service. (MMUA IR 16). The Joint Petitioners elaborated that SMEC provides power supply and transmission

services without owning or operating any such facilities. (Dept. of Commerce IR 41). The Joint Petitioners noted that "[a] paper G&T may be formed under the state's statutes as either Joint Action Agencies or Cooperatives." *Id.*

The Joint Petitioners did not identify any other current entities in Minnesota without either transmission or generation facilities. *Id.* Although MMUA does not dispute the legitimacy of SMEC, the notion of a joint action agency, cooperative, or similar entity that may satisfy fundamental requirements by contract raises additional questions. It is difficult to fully comprehend a generation and transmission cooperative without either generation or transmission. And the distribution Member Cooperatives provide "service at retail" without distribution facilities (which are initially owned by SMEC). This approach creates a slippery slope in which a "hybrid" entity that purports to satisfy the technical provisions of a statute nonetheless lacks the expected fundamentals.

In the present case, for example, it may be difficult to pinpoint the practical responsibilities. If an aggrieved person wished to bring a claim concerning the improper operation of facilities, would the claim be directed to a Member Cooperative, as the operator and provider of electric service at retail, or to SMEC, as the owner of the facilities? If the Commission sought to enforce a provision in its final order, is it possible for SMEC and the individual Member Cooperatives to respectively claim that the "other" party is somehow responsible, leaving the Commission with regulatory uncertainty.

This uncertainty is only highlighted by the unknown nature of SMEC's future plans. Although SMEC was organized to assist with this transaction and to administer the wholesale power agreement, representatives have also noted that SMEC may

thereafter continue to exist, with unclear roles and responsibilities. The Commission should further consider these issues, and appropriate requirements in its order. At a minimum, the Commission should retain the right to review and approve the final form of agreements such as the operation and maintenance agreements.

6. Public Participation.

MMUA recognizes that the Joint Petitioners have filed a number of resolutions by local units of government supporting the transaction. But it is unclear what information was provided to these governing bodies concerning the sale. According to the informational request responses, the Joint Petitioners conducted a webinar for large commercial and industrial customers on May 13, 2014, posted information on their websites, and offered to meet with interested persons upon request. (Dept. of Commerce IR 14; Minn. Chamber of Commerce IR 9). It does not appear that the Joint Petitioners provided a separate webinar or informational meeting for local units of government. It is somewhat difficult to assess the weight of these resolutions of support. The Commission should not substitute the resolutions of support in lieu of fully developing the record.

7. Other Measures of Reasonableness.

The Joint Petitioners have argued that the transaction is reasonable because it results from arms-length negotiations. But the public interest presents a broader concept. Taking this argument to its logical conclusion, contrary to Section 216.50, the Commission need not "investigate" but would automatically accept any result because it was negotiated. To follow the language of the statute, MMUA submits that it would be

helpful for the Commission to consider other standards that have addressed various aspects of the public interest in the electric industry.

For example, Minnesota law addresses the determination of damages in an electric service territory proceeding in which the parties cannot agree upon damages. Minn. Stat. §§ 216B.44, .47 (2014). The Commission's goal in electric service territory cases is to fairly compensate the displaced utility. *In re Complaint regarding the Annexation of a Portion of the Serv. Territory of People's Coop. Power Ass'n by the City of Rochester (North Park Additions),* 470 N.W.2d 525, 528 (Minn. App. 1991) (reasoning goal was to put the displaced utility in the same position it would hold but for the City's acquisition), *rev. denied* (Minn. July 24, 1991).

The specific statutory criteria include: (1) the original cost, less depreciation, of facilities, (2) integration system costs with serving remaining customers, (3) loss of revenue to the displaced utility, and (4) other appropriate factors. Minn. Stat. §§ 216B.44, .47. As in electric service territory proceedings, this transaction transfers "existing and future customers in IPL's existing service territory." (MMUA IR 2).

The statutory criteria of assessing damages in electric service territory proceedings complement the Commission's task of determining whether the proposed sale is consistent with the public interest. In both types of proceedings, the Commission considers and determines a fair result. The public interest is not benefited by terms and conditions that impose too high of a purchase price or an inadequate purchase price; ratepayers who are transferred will not benefit from any excess paid and will likely be required to supplement any shortfall. In a similar vein, the remaining ratepayers of the incumbent utility (here, IPL) do not benefit from insufficient compensation.

Similarly, in considering electric service territory agreements executed in 1974, Minnesota law required the Commission to consider certain specific criteria: "The commission shall approve a contract if it finds that the contract will eliminate or avoid unnecessary duplication of facilities, will provide adequate electric service to all areas and customers affected, and will promote the efficient and economical use and development of the electric systems of the contracting electric utilities." Minn. Stat. § 216B.39, subd. 4. These criteria provide another lens through which the Commission may evaluate the public interest in this transaction.

Yet another resource in Minnesota law arises in valuation matters such as condemnation, in which fair market value presents a guiding principle. This concept determines value after considering three approaches: (1) the applicable assets, (2) the income stream, and (3) comparable market sales. S*tate v. Strom*, 493 N.W.2d 554, 558-59 (Minn. 1992); *see also County of Ramsey v. Miller*, 316 N.W.2d 917, 919 (Minn. 1982); *City of Moorhead v. Red River Valley Cooperative Power Assn*, 830 N.W.2d 34, 38-39 (reasoning that fair market value principles may be applied in future cases, if meaningful consideration is given to statutory factors); *In re Grand Rapids Public Utilities Comm'n*, 731 N.W.2d 866, 872 (Minn. App. 2007) ("We observe that in future cases, it may be appropriate for the Commission to consider alternative-revenue formulas as a 'reasonableness check' to its valuation determination under the statute."). No one approach controls. All three methods are considered to assess the reasonableness of the value conclusion.

In the present case, the Joint Petitioners offer their own arms-length negotiations as the measure of a reasonable result. It would be helpful to consider alternative

checks and balances to objectively determine the reasonableness of the proposed transaction.

CONCLUSION

MMUA respectfully requests that the Commission further investigate the issues identified by MMUA, as well as other interested parties. A contested case proceeding provides an efficient opportunity to address these issues. At a minimum, the Commission should seek further comments before setting a hearing to consider and decide the merits.

Dated: October 6, 2014

McGRANN SHEA CARNIVAL
STRAUGHN & LAMB, CHARTERED

By: s/Kathleen M. Brennan
Kathleen M. Brennan (No. 256870)
800 Nicollet Mall, Suite 2600
Minneapolis, Minnesota 55402-7035
Phone: 612-338-2525
Fax: 612-339-2386

Counsel for Minnesota Municipal Utilities Association