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December 8, 2014

Dr. Burl W. Haar, Executive Secretary
Minnesota Public Utilities Commission
121 Seventh Place East, Suite 350
St. Paul, MN 55101

RE: Interstate Power and Light Company and Southern Minnesota Energy Cooperative
Docket Nos. E001, E132, E114, E6521, E142, E135, E115, E140, E105, E139, E124,
E126, E145/PA-14-322
Interstate Power and Light Company and Southern Minnesota Energy Cooperative's
Reply Comments

Dear Dr. Haar:

Enclosed for eFiling with the Minnesota Public Utilities Commission (Commission) please find Interstate Power and Light Company and Southern Minnesota Energy Cooperative's Reply Comments in the above-referenced dockets.

Copies of this filing have been served on the Minnesota Office of Attorney General – Residential and Small Business Utilities Division, the Minnesota Department of Commerce, Division of Energy Resources, and the attached service list.

Very truly yours,

/s/ Samantha C. Norris
Samantha C. Norris
Senior Attorney

SCN/kcb
Enclosures

cc: Service List

STATE OF MINNESOTA

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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

Chair
Commissioner
Commissioner
Commissioner
Commissioner

<p>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</p>	<p>DOCKET NOS. E001, E132, E114, E6521, E142, E135, E115, E140, E105, E139, E124, E126, E145/PA-14-322</p>
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AFFIDAVIT OF SERVICE

STATE OF IOWA)
) ss.
COUNTY OF LINN)

Kathleen C. Balvanz, being first duly sworn on oath, deposes and states:

That on the 8th day of December, 2014, copies of the foregoing Affidavit of Service, together with Interstate Power and Light Company and Southern Minnesota Energy Cooperative's Reply Comments, were served upon the parties on the attached service list, by e-filing, overnight delivery, electronic mail, facsimile and/or first-class mail, proper postage prepaid from Cedar Rapids, Iowa.

 /s/ Kathleen C. Balvanz
Kathleen C. Balvanz

Subscribed and Sworn to Before Me
this 8th day of December, 2014.

 /s/ Kathleen J. Faine
Kathleen J. Faine
Notary Public
My Commission Expires on February 20, 2015

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STATE OF MINNESOTA

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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

**Chair
Commissioner
Commissioner
Commissioner
Commissioner**

**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**

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

**REPLY COMMENTS OF INTERSTATE POWER AND LIGHT COMPANY
AND SOUTHERN MINNESOTA ENERGY COOPERATIVE**

The following Reply Comments are submitted to the Minnesota Public Utilities Commission (Commission) by Interstate Power and Light Company (IPL) and Southern Minnesota Energy Cooperative (SMEC) (collectively Petitioners) in response to the November 10, 2014 Supplemental Reply Comments of the Department of Commerce, Division of Energy Resources (Department) and the Comments of the Office of Attorney General - Antitrust and Utilities Division (OAG). The Department and OAG recognize that there are no issues relating to operational, customer service, or service quality matters.¹ As to the issue of costs and rates, these Reply Comments will demonstrate that:

1. The Transaction will provide substantial customer benefits for much longer than three years, and those longer-run benefits fully support approval of the Transaction;
2. The OAG's criticisms of the Department's short run analysis are misplaced;
3. The Transaction price and the Wholesale Power Agreement are reasonable, contrary to the OAG's claims; and
4. Additional modifications and customer benefits are not needed to support approval of the Transaction.

¹ Department November 10 Supplemental Reply Comments at 5-7 (citing Department October 6 Reply Comments); OAG November 10 Comments at 2.

In addition, these Reply Comments will show that the Transaction properly treats other topics raised in November 10 Comments, including appropriate reporting by SMEC and the twelve cooperatives that formed SMEC (SMEC Member Cooperatives).

1. The Transaction will provide substantial customer benefits for much longer than three years, and those longer-run benefits fully support approval of the Transaction.

The Transaction will provide substantial longer-run customer benefits. These longer-run benefits (i.e., benefits beyond the first three years), when, combined with the lack of concerns regarding operational, customer service, or service quality matters, result in the Transaction being compatible with the public interest.² Further, while there may be some disagreement over the level of short-run benefits (or, in the opinion of the OAG, short-run detriments), the presence of such significant long-run advantages greatly reduces the significance of short run impacts or a precise calculation of short-run impacts of the Transaction.

While there are some differences in the analyses performed by the Petitioners and the Department, both have identified customer benefits accruing during the first three years after the close of the Transaction.³ The OAG, on the other hand, claims that the Petitioners' and Department's cost-benefit analyses show more benefits than are really available.⁴ As described in Section 2, the OAG's argument is based on the mistaken assumption that the Department's cost benefit analysis (which covers only the 3-year period 2015-2017) includes all of the benefits of the Transaction. To the contrary, a 3-year cost benefit analysis is far too short to provide a full assessment of the Transaction or the long-run benefits it will provide.⁵ Rather, it is well

² See Petition at 33-35 (explaining the Commission has consistently interpreted the "public interest" criteria contained in Minn. Stat. § 216B.50, subd. 1 to require a showing of compatibility with the public interest, not necessarily affirmative benefits).

³ Department October 6 Reply Comments at 11-14, 25; Department November 10 Supplemental Reply Comments at 3-4.

⁴ OAG November 10 Comments at 2-4. The OAG has also challenged the Petitioners' calculation of short term benefits. See OAG October 6 Reply Comments at 9-11.

⁵ The Petitioners presented an analysis of the rate impacts of the 4-year period 2014-2017, but that analysis did not attempt to reflect all relevant cost impacts.

established that an analysis should reasonably reflect the time period over which a sale or acquisition will remain in effect.⁶ Thus, the key point is that when the substantial longer-term benefits of the Transaction are considered, it is clear that the Transaction meets the public interest criteria of Minn. Stat. § 216B.50 irrespective of any short run impacts.

These substantial longer-term customer benefits are a result of the fundamental economic advantages enjoyed by SMEC and the SMEC Member Cooperatives. These economic advantages will remain in effect for many years, and lead to benefits that are far more significant than even the positive short-term benefits of the Transaction, and would also outweigh any hypothetical short run detriments. Any analysis that does not consider – or that explicitly rejects – these longer-run benefits will understate the benefits of the Transaction to customers.

The record demonstrates that the Transaction reflects the following fundamental economic facts:

- (1) the costs of power supply and transmission will be the essentially same for IPL and the SMEC Member Cooperatives following the closing; and

⁶See *In the Matter of the Petition of Northern States Power Company d/b/a Xcel Energy for Approval of Competitive Resource Acquisition Proposal and Certificate of Need*, Docket No. E002/CN-12-1240, Order Directing Xcel to Negotiate Draft Agreements with Selected Parties at 9 (May 23, 2014)(“The Levelized Cost of Electricity represents the net present value of the expected annual costs ... divided by annual generation over the term of the proposal.”) (emphasis added); *In the Matter of the Joint Application for Approval of Transfer of Control of tw telecom of minnesota, llc to Level 3 Communications, Inc.*, Docket No. P5981, 5733/PA-14-570, Order (Aug. 12, 2014)(adopting the July 18, 2014 recommendations of the Department of Commerce in which the Department cited \$240 million in annualized synergies (that translated to \$2 billion of net present value)); *In the Matter of Minnesota Power’s Request for Approval of a Power Purchase Agreement with Manitoba Hydro Company*, Docket No. E015/M-11-938, Order (Feb. 1, 2012)(adopting Department recommendations that found power purchase agreement to be in the public interest based on levelized cost comparison for the duration of the proposed contract); *In the Matter of Interstate Power and Light Company’s Petition for Approval of Eligibility for Investment in Whispering Willow - East, Renewable Energy Recovery Adjustment, and 2010 Rate*, Docket No. E001M/GR-10-312, Amended Findings of Fact, Conclusions of Law, and Recommendation at ¶¶ 29, 34, 41 (Oct. 17, 2013)(evaluating the reasonableness of the Whispering Willow – East project using a levelized cost analysis performed over the 25-year life of the asset)(adopted by Order Adopting Administrative Law Judge’s Report and Findings at 2 (Dec. 26, 2013)).

- (2) SMEC and the SMEC Member Cooperatives have significant cost advantages resulting from far lower costs of capital (1.59% while SMEC owns the assets purchased from IPL and 3.38% after those assets are transferred to the SMEC Member Cooperatives) vs. IPL's cost of capital of approximately 7.98%).

These fundamental economic benefits were identified in the Petition:

The cost of owning the distribution facilities should be lower under Cooperative ownership by the SMEC Member Cooperatives for several reasons. First, the cost of capital for SMEC Member Cooperatives will be lower than the cost of capital for IPL. SMEC will have a 100% debt structure and the cost of debt is estimated to be 1.59%. ... The cost of capital for the SMEC Member Cooperatives when the distribution facilities are transferred from SMEC to the SMEC Member Cooperatives, currently estimated to be 3.38%, will also be lower than the cost of capital for IPL. In contrast, the IPL cost of capital from the last general rate case is 8.1% and the projected cost of capital if IPL filed for a base rate increase in 2014 would be 7.98% (using the Return on Equity of 10.35 percent authorized in IPL's last electric rate case), as shown on **Attachment J, Schedule E.**⁷

The Petition also identified the benefits of exemption from income taxes available to SMEC and the SMEC Member Cooperatives:

Second, SMEC and the SMEC Member Cooperatives are exempt from federal and state income taxation. The result of this exemption is that there is no tax cost related to the return on investments in distribution facilities owned by SMEC or later by the SMEC Member Cooperatives. The effect of this tax exemption will be significant.⁸

As stated above, the long-run benefits of these fundamental economic advantages are not reflected in a shorter-run 3-year cost benefit analysis, which results in a substantial understatement of the actual long-run customer benefits of the Transaction. When a longer-run cost-benefit analysis is used, it is clear that customers receive significant ongoing benefits from the Transaction, even when potential cost adjustments suggested by the parties are fully reflected. As a result, the record shows that the Transaction meets the public interest standard of Minn. Stat. § 216B.50 and there are no material fact issues because there are no plausible facts that would change that conclusion.

⁷ Petition at 42

⁸ Petition at 43.

The primary sources of the fundamental economic advantages -- and the resulting substantial, ongoing benefits of the Transaction -- are the significantly lower costs of capital and the exemption from income taxes that are available to SMEC and the SMEC Member Cooperatives. These fundamental economic advantages lead to customer benefits, even with recovery of the full \$122 million investment. Specifically, the long-term net benefits to customers beginning in year 4 were estimated to be \$5.0 million per year, as explained in the Petitioners' response to Department IR No. 57, a copy of which is included as Attachment 1 to these Reply Comments. If an adjustment is made to reflect the effect of the FERC 10.97% ROE (as the OAG has proposed), a net annual benefit of \$3.9 million remains, as shown in Table 1 below:

Table 1

Annual Cost of Capital and Income Tax Benefits
(with OAG adjustment to reflect the claimed effect
of a FERC 10.97% ROE on power costs)
(\$ million)

Long-Term Benefit Analysis	IPL costs	SMEC costs
Net Rate Base	\$82.5	
Acquisition Cost (Assets + Premium + SMEC Transaction Costs)**		\$122.1
x Cost of Capital (@ 10.35% ROE for IPL)	7.98%	3.38%
= pretax cost	\$6.6	\$4.1
x Income Tax Effect (Federal + State)	1.71	1.0
x TIER	N/A	1.5
= After tax cost	\$11.2	\$6.2
Annual Financing Benefit Including Full Acquisition Cost		\$5.0
Annual Effect of Adjustment to FERC ROE (10.97% to 9.8%)		-\$1.1
Annual Net Benefit of the Transaction		\$3.9

The OAG also recommended that the analysis reflect a potential reduction of IPL's ROE to 9.80% when comparing future retail rates with and without the Transaction. As shown below, substantial annual benefits remain even when this additional OAG's recommendation is made.

Specifically, this recommended adjustment reduces the annual net benefit of the Transaction by only \$300,000 per year to \$3.6 million, as shown in Table 2 below:

Table 2
Annual Cost of Capital and Income Tax Benefits
(with OAG adjustment to reflect the claimed effect of a FERC 10.97% ROE
and IPL Retail ROE of 9.80%)
(\$ million)

Long-Term Benefit Analysis	IPL costs	SMEC costs
Net Rate Base	\$82.5	
Acquisition Cost (Assets + Premium + SMEC Transaction Costs)**		\$122.1
x Cost of Capital (@ 9.8% ROE for IPL)	7.71%	3.38%
= pretax cost	\$6.4	\$4.1
x Income Tax Effect (Federal + State)	1.71	1.0
x TIER	N/A	1.5
= After tax cost	\$10.8	\$6.2
Annual Financing Benefit Including Full Acquisition Cost		\$4.7
Annual Effect of Adjustment to FERC ROE (10.97% to 9.8%)		-\$1.1
Annual Net Benefit of the Transaction		\$3.6

This calculation also reflects the OAG's proposed adjustment concerning calculation of power costs, the costs of the full \$122.1 million purchase price, and a lower assumed 9.80% ROE for IPL.⁹ Notably, there are substantial long-term benefits even after all of the OAG's recommended adjustments to costs are reflected.¹⁰

Because the effects of the Transaction will remain ongoing with no set time limit, the analysis and these annual benefits should be reflected over a much longer period than the first three years following the Transaction. Looking at the longer-run effects and the net present value of those effects shows very substantial customer savings (even with adjustments recommended by the OAG), as shown in the following Table 3:

⁹ Attachment 2 shows the calculation of the 7.71% overall cost of capital for IP, reflecting a 9.80% ROE.

¹⁰ This analysis fairly reflects that fact that: (1) there is no basis to conclude that SMEC O&M costs will increase beyond the IPL O&M costs; and (2) there is no basis to conclude that there will be any significant differences in transmission and fuel costs since these 3rd party costs will be the same for both IPL and SMEC.

Table 3
Estimated Customer Benefits
(including OAG adjustments to IPL ROE and claimed power cost effects)
(\$ millions)

	Estimated Benefits (before power costs)	Claimed differences in power costs**	Net Customer Benefits
Year 1*	\$2.0	(\$0.7)	\$1.3
Year 2*	\$5.2	(\$0.7)	\$4.5
Year 3*	\$6.8	(\$0.9)	\$5.9
Year 4	\$4.7	(\$1.1)	\$3.6
Year 5	\$4.7	(\$1.1)	\$3.6
Year 6	\$4.7	(\$1.1)	\$3.6
Year 7	\$4.7	(\$1.1)	\$3.6
Year 8	\$4.7	(\$1.1)	\$3.6
Year 9	\$4.7	(\$1.1)	\$3.6
Year 10	\$4.7	(\$1.1)	\$3.6
Net Present Value	\$30.9	(\$6.5)	\$24.4

*Source: DOC October 6 Reply Comments, page 12, Table 4:

** 9.80% ROE to 10.97% ROE

The annual net benefits in Table 3 for years 1 through 3 reflect the analysis presented by the Department in its Reply Comments, adjusted to reflect the effects of the FERC 10.97% ROE recommended by the OAG. The annual net benefits for years 4 through 10 reflect the analysis presented in Table 2, which also reflects both an adjustment for the FERC 10.97% ROE and a 9.80% ROE for IPL.

As shown in Table 3, the net present value to customers over 10 years is approximately \$24.4 million. The net present value of \$3.6 million in annual savings in years 4 through 10 alone (approximately \$14.7 million)¹¹ is more than sufficient to ensure the Transaction is consistent with the public interest even if there were no benefits in the short-run analysis of years 1-3. The facts are quite simple and straightforward – a 4.33% lower cost of financing on

¹¹ The calculation of the Net Present Value of the cost benefits in years 4-10 is provided on Attachment 3 to these Reply Comments.

\$122 million in assets when combined with tax exemption provides clear savings that will result in benefits to customers, and the longer the time horizon the greater the benefits to be realized.

In addition, even a 10-year analysis understates the actual benefit to customers. The effect of the Transaction will be permanent; the cost of capital and tax exemption advantages of SMEC and the SMEC Member Cooperatives will extend for 25 years or more. The net present value of the SMEC Member Cooperatives' low cost of capital and exemption from income taxes as represented in this transaction over 25-years would be approximately \$42.9 million.¹² Accordingly, it is clear that the Transaction provides substantial customer benefits that are not affected even if there were to be some short-run added customer costs, which there are not.

2. The OAG's criticisms of the Department's short run analysis are misplaced.

The OAG's criticisms of the Department's short-run analysis are also completely misplaced. The OAG's position completely overlooks the fact that the majority of IPL's annual increases would be based solely on expenses for fuel and transmission. This makes the OAG's assumption of a 60% recovery inaccurate and insufficient to even cover the increases in cost since IPL's last rate case filing. The Department analysis is based on the differences between the expected IPL rates and the expected SMEC rates in 2015-2017 and shows a net present value of customer benefits of \$11.8 million. It also reflects lower retail revenues resulting from IPL rate increases than were assumed by Petitioners. Despite those lower retail revenue projections, the Department still showed net short-term benefits. The cumulative differences between the IPL and Department estimates of IPL's rates are approximately \$13.1 million as shown on Table 4 below:

¹² See calculation on Attachment 4.

Table 4

Differences between IPL and Department revenue estimates
(\$ millions)

	2014	2015	2016	2017	Total
IPL Revenue Estimate	\$80.5	\$88.2	\$92.4	\$100.2	\$361.3
Department Revenue Estimate	\$78.5	\$83.4	\$90.3	\$96.3	\$348.2
Difference (IPL Customer Benefit)	\$2.0	\$4.8	\$2.4	\$3.9	\$13.1

As a result, there is no support for the OAG’s criticisms of the Department’s analysis.

3. The OAG’s claims that the purchase price is excessive and the Wholesale Power Agreement terms are unreasonable are baseless and do not support any adjustment.

The OAG claims that the purchase price under the Asset Purchase Agreement is excessive and should be reduced.¹³ The OAG also asserts that the terms of the Wholesale Power Agreement are unreasonable.¹⁴ Both claims are without merit and inconsistent with past asset transfer cases¹⁵ because (1) there is a significant net customer benefit after recovery of the entire purchase price and (2) the customers will become owners of the transferred assets (as a result of cooperative membership).

First, the significant overall net customer benefits (\$24.4 million after 10 years) are explained above. The existence of those benefits meets the Commission’s criteria for recovery of the entire purchase price, as explained in Petitioners’ November 10 Comments:

In *Midwest Gas*, the Commission allowed recovery of the premium that “equals savings ... due to the acquisition” and “to the extent that is it able to demonstrate that the acquisition provides comparable benefits to ratepayers ... that ... would not have been realized absent the acquisition.”¹⁶

Thus, the Transaction, including the costs related to the Wholesale Power Agreement, meets the Commission’s standards without further adjustment.

¹³ OAG November 10 Comments at 8-9.

¹⁴ OAG November 10 Comments at 7-8.

¹⁵ *E.g., In the Matter of the Application of Midwest Gas, a Division of Iowa Public Service Company, for Authority to Change Its Schedule of Gas Rates for Retail Customers within the State of Minnesota*, Docket No. G010/GR-90-678, Findings of Fact, Conclusions of Law, and Order at 8, 13 (July 12, 1991) [*hereinafter Midwest Gas Order*].

¹⁶ Petitioners’ November 10 Comments at 29-30 (citing *Midwest Gas Order* at 7-8).

In addition, unlike prior asset transfers that the Commission has reviewed, customers will obtain the added benefit of ownership of the assets (through cooperative membership) as a result of the Transaction.¹⁷ This provides further support for the Transaction and a further basis to reject the OAG recommendation to reduce the purchase price.

Finally, the OAG asserts that “It is unclear whether the WPA is reasonable for IPL’s existing ratepayers, although the evidence suggests that it likely is not.” The OAG’s assertion misses the fact that the pricing of the proposed Wholesale Power Agreement is based on an average embedded cost revenue requirement, which is very similar to the methodology used by the Commission in the determination of retail rates. Further, the Wholesale Power Agreement is an integral component of the overall Transaction, and it is essential to the Transaction that IPL continue to provide power supply as provided in the Wholesale Power Agreement.¹⁸ It is unreasonable for the OAG to attempt to capture the significant benefits associated with the Transaction while arbitrarily altering or discarding elements of the Wholesale Power Agreement and making assumptions on market power prices. The Wholesale Power Agreement and the underlying pricing of the embedded cost RES-5 tariff, both individually and as a broader part of the Transaction, is reasonable and should be adopted.

4. Additional customer credits and benefits are not needed to support the Transaction.

The Department has requested the Commission establish a credit to protect IPL’s current ratepayers from significant deviations in the forecasted costs during the Initial Three-Year Period:

the Department recommends that the Commission condition the sale to require that SMEC provide actual weather normalized annual revenue requirements for IPL’s former service territory annually for the first three years following the proposed transaction’s effective date; and provide a bill credit to IPL’s former ratepayers if the actual weather normalized annual revenue requirement in any

¹⁷ Petitioners’ November 10 Comments at 36-37.

¹⁸ See Petitioners’ September 4 Comments at Attachment B, OAG IR Nos. 1, 14.

year exceeds the forecasted annual revenue requirement by more than 2 percent.¹⁹

Petitioners acknowledge the Department's goal of providing customer benefits and protections -- significant customer benefits and protections have already been built into the Transaction (including an automatic \$2 per MWh credit). Further, as explained above, the scope of the longer-run benefits resulting from the Transaction will completely outweigh any short-run risks or even short-run added costs.

The Transaction reflects an appropriate approach to the two functions of electric service: (1) distribution; and (2) power supply (including transmission). Distribution costs have been fixed at the levels recovered in IPL current approved rates for the first three years following the closing, and thereafter will benefit from the substantially lower costs of capital and exemption from income taxes available to SMEC and the SMEC Member Cooperatives. Because the Cooperatives are committing to use IPL's existing rates, with modifications as described in the Petition, any increases in distribution costs during the 3-year Initial Period from the projections will inherently be absorbed by the Cooperatives, and not by the former IPL customers.

As to power supply (including transmission), the costs of power supply at retail and at wholesale are based on the same underlying owners and assets as well as similar ratemaking methodologies. As a result, the power supply cost projections if IPL were to continue to operate at retail are in line with the cost for wholesale power supply cost for SMEC, which will continue whether annual power supply costs increase or decrease.

As a result, the addition of possible customer bill credits for deviation from the cost projections during the Initial Three-Year Period proposed by the Department is wholly unnecessary to support a finding that the Transaction is consistent with the public interest. Specifically, as shown above, customers will obtain a net benefit of approximately \$24.4 million

¹⁹ Department November 10 Supplemental Reply Comments at 4.

(net present value) over the initial 10 years following closing. The Petitioners submit that this benefit more than justifies any impacts within the Initial Three-Year Period.

If an additional mechanism is to be considered for the first three years after closing (as proposed by the Department), it is essential that the mechanism be clear, verifiable, and unambiguous. There are several features of the Department's recommendation that do not meet these criteria and would be likely to cause confusion and uncertainty if implemented. For example, the Department proposed to base the mechanism on a "weather normalized revenue requirement." This is not possible because the distribution component of the SMEC rates for the 3-year Initial Period is not based on a "revenue requirement"; it is based on IPL's current rates, subject to a \$2/MWh credit. As a result, the SMEC Member Cooperatives will receive whatever revenues these rates generate.

It should also be understood that the Department's proposal (a mechanism based on a "revenue requirement") is under-defined and would require Commission determinations of multiple factors (including costs, sales, and allocations (between retail and wholesale power jurisdictions). All of these factors are complex and could lead to future ambiguity and uncertainty throughout the first three years after closing of the Transaction. Therefore, Petitioners suggest that any further customer protections – protections that Petitioners do not believe are needed to find the Transaction in the public interest – would require significantly more definition.

While the Petitioners have demonstrated that the long-run benefits of the Transaction make the proposed sale consistent with the public interest without consideration of short run benefits or even if there were short run detriments, Petitioners also intend to review all comments submitted to the Commission to determine if there may be other means to address remaining concerns

5. The Transaction properly treats other topics raised in November 10 Comments.

a. Integrated Resource Plans

The Department recommends that SMEC be the sole responsible entity for filing Integrated Resource Plans (IRPs) with the Commission.²⁰ However, as the Petitioners have previously discussed, the statutory obligation to file IRPs in connection with this transaction resides with IPL, not SMEC.²¹

Following the closing, IPL will no longer qualify as a “public utility” under Minn. Stat. § 216B.02, subd. 4. However, the requirement to file IRPs, however, is not limited to “public utilities.” Rather, a broader class of utilities is also required to file IRPs under Minn. Stat. § 216B.2422, subd. 1(b), which states as follows:

“(b) ‘Utility’ means an entity with the capability of generating 100,000 kilowatts or more of electric power and serving, either directly or indirectly, the needs of 10,000 retail customers in Minnesota.” (Emphasis added.)

IPL meets this definition because it has generating capability of more than 100,000 kilowatts, and it will continue to serve the wholesale electric power needs of approximately 43,500 retail customers in Minnesota “indirectly” through SMEC and the SMEC Member Cooperatives. Direct retail service is not required to meet the definition of a “utility” for filing an IRP.

The application of the IRP filing requirement to entities other than public utilities is confirmed by Minn. Stat. § 216B.2422, subd. 2, which reads in part:

“The commission shall approve, reject, or modify the plan of a public utility as defined in section 216B.02, subdivision 4, consistent with the public interests. In the resource plan proceedings of all other utilities, the commission’s order shall be advisory, and the orders findings and conclusions shall constitute prima facie evidence which may be rebutted by substantial evidence in other proceedings.” (Emphasis added.)

²⁰ Department November 10 Supplemental Reply Comments at 7, 9.

²¹ See, e.g., Petitioners’ September 4 Comments at 26-27; Petitioners’ November 10 Comments at 23-25.

The focal point of IRP filings are generation facilities. SMEC will not own, operate, or control generation facilities, nor will it have the information necessary to submit an IRP. Thus, for both statutory and practical reasons, IPL must file the IRPs and has committed to doing so.

b. Renewable Energy Standards

The Department recommends that SMEC be the sole entity responsible for assuring that the SMEC Member Cooperatives meet their Renewable Energy Standards (RES) obligations.²² The Department also requested clarification on how SMEC would report the relevant information.²³

SMEC will be responsible for meeting the SMEC Member Cooperatives' obligations under the RES.²⁴ IPL will perform the MRETS reporting function with respect to SMEC's share of renewables obtained from IPL under the Wholesale Power Agreement. As to how that information will be reported, Section 19 of the Wholesale Power Agreement provides that IPL will give SMEC the necessary information to comply with the RES obligations. SMEC in turn will include that information in its RES filings with the Commission.

c. Reliability Information

The Department recommended that SMEC provide reliability information to the Commission in IPL's former service territory annually for a period of five (5) years after the closing of the transaction.²⁵ SMEC will undertake that responsibility, which information will include SAIDI, SAIFI, and CAIDI indexes, major service interruptions, and related outage data as described in Joint Petitioners' November 10, 2014 Initial Comments.²⁶

²² Department November 10 Supplemental Reply Comments at 7, 9.

²³ Department November 10 Supplemental Reply Comments at 7.

²⁴ Petitioners' September 4 Comments at 27-28; Petitioners' November 10 Comments at 25-27.

²⁵ Department November 10 Supplemental Reply Comments at 9.

²⁶ Petitioners' November 10 Comments at 15-16.

d. Rate Design

The Petitioners would like to clarify the Commission's oversight of the rate design in the former IPL service territories after the Transaction is closed.²⁷ SMEC's Rate Plan provides that during the Three-Year Initial Plan, the SMEC Member Cooperatives will each prepare an industry recognized Class Cost of Service Study (CCOSS) for the Legacy Area, the Acquired Area, and the Combined Area. Each Cooperative will utilize the results of these CCOSS along with other traditional cooperative rate design objectives (e.g., rate stability, avoidance of unacceptably abrupt changes, appropriate price signals, encouragement of energy and capacity efficiency, customer acceptance) to design the individual rates in each area. Further, during the Two-Year Transition Period following the Three-Year Initial Plan, rates cannot be merged between the Legacy Area and the Acquired Area unless they are within 5% of each other. In addition, no rate can be increased by more than 5% to accomplish a rate merger. The actual rate design decisions, however, will be made by the Board of Directors of each SMEC Member Cooperative.

6. Conclusion

For the reasons set forth above, and as the record fully shows, the Transaction is fully consistent with the public interest within the meaning of Minn. Stat. § 216B.50, and the Transaction should be approved without further conditions or modifications. Petitioners also intend to review all comments determine if there may be other means to address remaining concerns.

²⁷ See Department November 10 Supplemental Reply Comments at 8 ("The Commission will also continue to have limited oversight regarding rate design for the rates charged in the former IPL service territories for five years if the transaction is approved.").

Dated: December 8, 2014

Respectfully submitted,

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Attachment 1

DOC Information Request No. 57

Reference: Page 2 of Attachment C of IPL and SMEC's Response to Commission's additional questions issued on July, 14, 2014 submitted on August 1, 2014.

- a. In Entry #116 – Record gain on asset sale IPL identifies a gain of \$8,555,000.**
 - i. Please explain in detail the basis for this gain.**

RESPONSE:

The purchase price (with the acquisition premium, including gain) and the ratio of the purchase price to the net book value of the assets (the multiple) were the result of arms-length negotiations between IPL and representatives of SMEC and the SMEC Member Cooperatives. The sale was the result of a private negotiation initiated by representatives of the SMEC Member Cooperatives and did not reflect a request for proposals or other effort by IPL to obtain multiple proposals for consideration.

The multiple to net book value was determined to be reasonable and consistent with the range of multiples to net book value of publicly announced electric distribution asset sales of similar nature and size that had recently occurred as the Transaction was being negotiated by and between IPL and SMEC and SMEC Member Cooperatives.

The purchase price (including the gain and acquisition premium, including costs incurred by the SMEC Member Cooperatives in connection with the Transaction) 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.

The Transaction will provide clear and substantial benefits to customers that more than offset the acquisition premium to be recovered, with the result being that the acquisition premium is more than fully offset by cost savings. Among the benefits that are expected to accrue are expected cost benefits as a result of: (1) the SMEC Member Cooperative's substantially lower cost of capital in relation to IPL's cost of capital; and (2) the income tax exemption of the SMEC Member Cooperatives, which further reduces the costs that will accrue to customers and provides a further relative advantage in relation to the costs of continued operation by IPL. These cost advantages apply to the distribution assets that are to be transferred from IPL to the SMEC Member Cooperatives. An approximation of the annual benefit resulting from the lower cost of capital is as follows:

Transaction / Customer Benefit Analysis

\$ In Millions

Initial 3-year period	IPL costs	SMEC costs
Gross Plant	\$175.5	
Accumulated Depreciation	-\$70.3	
Net Plant Value	\$105.2	
Accumulated Deferred Taxes & Other Rate Base Adjustments*	-\$22.7	
Net Rate Base	\$82.5	
Acquisition Cost (Assets + Premium + SMEC Transaction Costs)**		\$122.1
x Cost of Capital	7.98%	1.57%
= pretax cost	\$6.6	\$1.9
x Income Tax Effect (Federal + State)	1.71	1.0
x TIER	N/A	1.5
= After tax cost	\$11.2	\$2.9
Benefit	\$8.4	

Long-Term	IPL costs	SMEC costs
Net Rate Base	\$82.5	
Acquisition Cost (Assets + Premium + SMEC Transaction Costs)*		\$122.1
x Cost of Capital	7.98%	3.38%
= pretax cost	\$6.6	\$4.1
x Income Tax Effect (Federal + State)	1.71	1.0
x TIER	N/A	1.5
= After tax cost	\$11.2	\$6.2
Benefit	\$5.0	

Customer Benefit	
Annual Benefit Years 1 - 3	\$8.4
Annual Benefit Year 4 -10	\$5.0
Net Present Value (NPV) at 8% discount rate	\$42.4
Acquisition Price over Net Book Value	\$16.9
Benefit to Cost Ratio	2.5

* Proxy estimate for Accumulated Deferred Income Taxes associated with the assets being sold

** Excluding working capital adjustments (\$8.8 Debit, \$5.2 Credit)

While further refinements could be made to these calculations, these calculations show that the Transaction will provide a substantial benefit in the form of a reduced cost of service after recovery of the acquisition premium.

The net benefits provided by the Transaction are also reflected in the anticipated cost savings discussed on pages 36-38 of the Joint Petition. Further, cooperative members have the added protection of cooperative membership, which includes obtaining an allocated ownership interest in margins resulting from rates paid and in some cases credits based on those margins.

Attachment 2

The calculation of the 7.71% Cost of Capital shown below is based on an ROE of 9.80% is shown below using the information provided in Attachment J, Schedule E to the Petition:

Line No.		(a) Year End Principal (1)	(b) Adjustments to Principal (2)	(c) Adjusted Principal	(d) Adjusted Capitalization Ratios	(e) Adjusted Avg. Cost of Money by Components (2)	(f) Adjusted Average Cost of Capital
✓ 1	Long-term debt	\$ 1,389,927,970	189,575,501	\$ 1,579,503,471	44.705%	5.685% ✓(3)	2.541%
✓ 2	Preferred Stock	183,056,250	11,545,326	194,601,576	5.508%	5.241% ✓(4)	0.289%
✓ 3	Common equity	1,593,334,744	165,696,999	1,759,031,743	49.787%	9.800%	4.879%
✓ 4	Total	<u>\$ 3,166,318,964</u>	<u>\$ 366,817,826</u>	<u>\$ 3,533,136,790</u>	<u>100.000%</u>		<u>7.709%</u>

(1): Reflects 13-MA for December 31, 2013
(2) Adjustments to reflect 13-MA for December 31, 2014

Attachment 3

Calculation of net present value of the Net Customer Benefits in years 4-10 following the closing of the Transaction.

	Estimated Benefits (before power costs)	Claimed differences in power costs**	Net Customer Benefits
Year 1*	\$0.0	\$0.0	\$0.0
Year 2*	\$0.0	\$0.0	\$0.0
Year 3*	\$0.0	\$0.0	\$0.0
Year 4	\$4.7	(\$1.1)	\$3.6
Year 5	\$4.7	(\$1.1)	\$3.6
Year 6	\$4.7	(\$1.1)	\$3.6
Year 7	\$4.7	(\$1.1)	\$3.6
Year 8	\$4.7	(\$1.1)	\$3.6
Year 9	\$4.7	(\$1.1)	\$3.6
Year 10	\$4.7	(\$1.1)	\$3.6
Net Present Value	\$19.2	(\$4.5)	\$14.7

* Source: DOC October 6 Reply Comments, page 12, Table 4

** 9.80% ROE to 10.97% ROE

Attachment 4

Calculation of net present value of the Net Customer Benefits over 25 years following the closing of the Transaction.

	Estimated Benefits (before power costs)	Claimed differences in power costs**	Net Customer Benefits
Year 1*	\$2.0	(\$0.7)	\$1.3
Year 2*	\$5.2	(\$0.7)	\$4.5
Year 3*	\$6.8	(\$0.9)	\$5.9
Year 4	\$4.7	(\$1.1)	\$3.6
Year 5	\$4.7	(\$1.1)	\$3.6
Year 6	\$4.7	(\$1.1)	\$3.6
Year 7	\$4.7	(\$1.1)	\$3.6
Year 8	\$4.7	(\$1.1)	\$3.6
Year 9	\$4.7	(\$1.1)	\$3.6
Year 10	\$4.7	(\$1.1)	\$3.6
Year 11	\$4.7	\$0.0	\$4.7
Year 12	\$4.7	\$0.0	\$4.7
Year 13	\$4.7	\$0.0	\$4.7
Year 14	\$4.7	\$0.0	\$4.7
Year 15	\$4.7	\$0.0	\$4.7
Year 16	\$4.7	\$0.0	\$4.7
Year 17	\$4.7	\$0.0	\$4.7
Year 18	\$4.7	\$0.0	\$4.7
Year 19	\$4.7	\$0.0	\$4.7
Year 20	\$4.7	\$0.0	\$4.7
Year 21	\$4.7	\$0.0	\$4.7
Year 22	\$4.7	\$0.0	\$4.7
Year 23	\$4.7	\$0.0	\$4.7
Year 24	\$4.7	\$0.0	\$4.7
Year 25	\$4.7	\$0.0	\$4.7
Net Present Value	\$49.4	(\$6.5)	\$42.9

* Source: DOC October 6 Reply Comments, page 12, Table 4

** 9.80% ROE to 10.97% ROE