STATE OF MINNESOTA
BEFORE THE PUBLIC UTILITIES COMMISSION

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

DOCKET NO. G-001, G-011/PA-14-107

In the Matter of a Request for Approval of the Asset Purchase & Sale Agreement Between Interstate Power and Light Company and Minnesota Energy Resources Corporation.

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

I. INTRODUCTION

The Office of the Attorney General - Antitrust and Utilities Division ("OAG") submits the following initial supplemental comments in response to the Request for Approval of the Asset Purchase and Sale Agreement between Interstate Power and Light and Minnesota Energy Resources Corporation. Without additional conditions, the proposed transaction is inconsistent with the public interest because it would result in dramatic rate increases, the loss of millions of dollars in deferred taxes, and unreasonable shifts in manufactured gas remediation costs, all without the procedural protections afforded by a rate case. Accordingly, if the Commission approves the proposal the OAG recommends that the following conditions be imposed to ensure that the transaction is consistent with the public interest:

1. Maintain the current rates for IPL's gas customers until a rate case is filed authorizing a change in their rates;

2. Separately identify the costs associated with setting rates between IPL's former customers and MERC's current customers until they are integrated during future a rate case;

3. Maintain IPL's current obligation to remediate contaminated manufactured gas plants located in Minnesota and deny the Petitioners' request to transfer that obligation to MERC;

4. Require MERC to take up the compliance reporting requirements in Docket No. G-001/M-06-1166, and require MERC to provide additional compliance reporting on IPL's past and future FMGP expenditures;

5. Preserve the benefit of deferred taxes that the IPL customers have paid for by implementing a transaction adjustment refund or creating a regulatory asset account to reduce rate base in a future rate case; and,

6. Conduct public hearings in IPL's service territory to allow ratepayers to meaningfully participate in the process.

II. THE FORMER MANUFACTURED GAS PLANT REMEDIATION PROPOSAL IS INCONSISTENT WITH THE PUBLIC INTEREST.

A. PETITIONER'S PROPOSAL FOR FMGP REMEDIATION COSTS IS UNFAIR FOR RATEPAYERS.

The Petitioners' Former Manufactured Gas Plant ("FMGP") proposal is not consistent with the public interest. Under the proposed transaction, MERC would take responsibility for the remaining remediation costs of the Austin FMGP,[1] which are estimated to be $2.665 million to $4.1 million.[2] MERC would pay for remediation at the Austin site until costs reach $3 million; after that threshold, IPL and MERC will share costs equally.[3] IPL would retain responsibility for the remediation costs of the remaining FMGP sites at Albert Lea, Fairmont, New Ulm, Owatonna, and Rochester.[4] In addition, MERC's customers will pay IPL $2.6 million for previously incurred FMGP costs. In order to pay for the future remediation costs and the costs that IPL has already incurred, the transaction assumes that MERC would begin to collect an

[1] Petition, 18.
[2] Petitioners' Reply Comments, 4.
[3] Petition, 18.
[4] *Id.*

additional $497,017 in rates annually, the same level of recovery that was approved for IPL.[5] After reaching its $3 million threshold, MERC will begin to direct revenues collected from ratepayers to IPL in a cost-sharing mechanism that is not clearly defined in the Petition. Several aspects of this proposal are problematic.

First, MERC would have no authority to collect FMGP remediation costs because they are not included in MERC's current rate case, Docket No. G-011/GR-13-617. The OAG agrees with the Department's position that MERC should not be allowed to collect rates that were not authorized by a rate case.[6] In addition, the Department expressed concern that the $497,017 annually that IPL currently collects for FMGP remediation would not be appropriate going forward.[7] The Petitioners correctly point out that the Commission has approved of IPL's collection of this amount for remediation each year,[8] but did not squarely address the Department's concern. The Department noted that the $497,017 that was approved by the Commission was for all six of IPL's FMGP sites, not just Austin. The Department noted that the record does not reflect whether it would be proper for MERC to collect the full amount for just one of the FMGP sites, and the OAG agrees.

Second, the OAG has identified an additional, related problem. IPL claims to have incurred $2.6 million in FMGP costs that it has not yet recovered, and seeks to recover those costs from MERC's customers after the transaction. But the proposed transaction only transfers liability of the Austin site to MERC, and IPL will retain liability for the remaining sites. IPL has not demonstrated that all $2.6 million of the unrecovered costs were related to the Austin site. It

[5] Petitioners' Reply Comments, 4.
[6] Comments of the Minnesota Department of Commerce, Division of Energy Resources, 11.
[7] *Id.*
[8] Petitioners' Reply Comments, 17.

would be unreasonable for IPL to recover costs that were caused by other FMGP sites when MERC would only assume liabilities for the Austin plant.

In addition, the entire concept of MERC's ratepayers providing compensation to IPL is very unusual. Under the proposal, IPL would be receiving revenues collected from Minnesota ratepayers for previously incurred FMGP remediation costs. In addition, IPL would receive revenues from ratepayers for FMGP costs that it will incur in the future, at a time when IPL claims that it will no longer be a public utility.[9] Furthermore, the Petition does not provide any detail as to IPL's involvement in future remediation. Whether IPL is providing funding for future remediation, or IPL employees are actually performing remediation work, it is unclear what authority the Commission would have over such an arrangement if IPL is not a public utility.

The Petitioners attempt to defend their FMGP proposal by interpreting the Commission's precedent. The OAG recognizes that in previous cases the Commission has allowed utility companies to collect rates for FMGP remediation even when the ratepayers did not benefit from the FMGP while it was operating.[10] But the proposal in this case requires repayment by customers who are so attenuated from the FMGP sites that it would be unreasonable, especially given the concerns brought forward by the Department. MERC has service territories in southern Minnesota, near the Austin FMGP site. But MERC also has customers in northern Minnesota, hundreds of miles from the Austin FMGP. These customers would be required to pay for remediation of a FMGP that has not been in operation for eighty years only because their

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[9] Petition, 2.
[10] *See In re Interstate Power Co.*, Docket. No G-001/GR-95-406 (Feb. 29, 1996) *aff'd sub nom. Matter of Request of Interstate Power Co. for Auth. to Change its Rates for Gas Serv. in Minnesota*, 559 N.W.2d 130 (Minn. Ct. App. 1997).

utility purchased the assets of another utility. While the Commission has ordered customers to pay for remediation on the basis of land ownership in the past, it is not a requirement. The Petitioners clearly recognize this, in that their proposal would require IPL to pay for remediation costs at the five FMGP sites other than Austin, even though MERC will be providing natural gas service for those areas.

In this case, and under these circumstances, it would be inequitable to shift FMGP costs to MERC. MERC has no authority to collect rates to pay for the remediation. The OAG recommends that the Commission order IPL to retain liability for the Austin FMGP, including any future costs that must be incurred. In the event that the Commission does approve the proposal to transfer liability for the Austin FMGP to MERC, the OAG recommends that MERC collect no revenues for purposes of remediation until they have been approved in a rate case proceeding. Finally, the OAG recommends that IPL be prohibited from collecting rates from MERC customers for costs that were incurred before the transaction or after IPL ceases to be a public utility in Minnesota.

B. THE COMMISSION SHOULD REQUIRE MERC TO BEGIN FMGP ANNUAL COMPLIANCE REPORTING.

In its Notice of Additional Comment, the Commission requested comments on how the Petitioners will handle the compliance reporting requirements that were established in Docket No. G-001/M-06-1166. In that case, IPL was ordered to make annual filings demonstrating its FMGP expenditures for the year, the cumulative expenditures to date, and any recovery of those expenditures.[11] If the Commission approves the transaction as proposed, it appears that MERC will begin to incur FMGP costs that would be covered by the Commission's Order. In addition,

[11] *See In re Interstate Power Co.*, G-001/GR-95-406 (Feb. 29, 1996) (establishing IPL's requirement to file annually).

IPL would incur a portion of any costs in excess of $3 million for remediation of the Austin plant and, presumably, all costs for the five other FMGP plants, although this is unclear from the Petition.

If the Commission approve the transaction as proposed, the OAG recommends MERC be ordered to take up IPL's responsibility for annual filings in Docket No. G-001/M-06-1166. The OAG also recommends that MERC be ordered to include in its compliance filings the costs incurred by IPL or revenue that is directed to IPL under the provisions of this transaction. If the Commission adopts the OAG's recommendation for IPL to retain all FMGP liabilities, the OAG recommends that MERC still be ordered to make annual compliance filings to account for IPL's expenditures and recovery.

The OAG believes that an order of this nature is necessary because IPL claims that it will not be a public utility in Minnesota if the transaction is approved as proposed, and it is unclear whether the Commission would have any authority to require IPL to continue compliance filings.[12] Alternatively, it is possible that the Commission could require IPL to consent to continued filing until all FMGP remediation is complete, regardless of IPL's status as a public utility. In this case, however, the OAG recommends that particular care be taken to ensure that the Commission retains jurisdiction.

III. DEPRIVING IPL CUSTOMERS OF PRE-PAID DEFERRED TAXES IS INCONSISTENT WITH THE PUBLIC INTEREST.

IPL's customers have accumulated millions of dollars in deferred tax benefits that will be lost if the Commission approves the Petition without modification. The deferred tax benefits are, at heart, pre-payments of income taxes that result from the differences between book income and taxable income due to depreciation. From 2010 to 2012, the average balance of IPL's deferred

[12] *See* Petition, 2.

tax account was $7 million; IPL claims that it will reduce this balance to $2.66 million in 2013.[13] Deferred taxes of $2.66 million are equivalent to approximately 25% of IPL's rate base, given that the estimated book value of the IPL's assets is less than ten million dollars.[14] The loss of these benefits is a detriment to the public interest, and the Petitioner's proposal should be denied if conditions are not imposed to preserve the benefits of the deferred taxes that the IPL customers have already paid for.

Protecting the IPL customers from the loss of deferred tax benefits is consistent with the Commission's precedent. The Commission noted that a utility proposal should be rejected "if the tax-related losses are sufficient, either by themselves or in conjunction with other considerations, to outweigh the benefits of the exchange."[15] The loss of these deferred tax benefits, especially in conjunction with the other concerns that have been raised with the transaction, would be unfair to the IPL customers. This inequity is one reason, in addition to the other reasons addressed in the OAG's Initial Comments and Reply Comments, that the OAG recommends that the Commission order the IPL customers to be maintained at their current rates until they can be fairly assessed during a rate case.

If the Commission does increase rates for IPL customers, the OAG believes that it would be inconsistent with the public interest to do so without adjusting the increase to ensure that the IPL customers retain the benefits of the deferred income taxes they have already accrued. In its Initial Comments, the OAG recommended that the value of the deferred tax loss be incorporated into the IPL customers' rates. In response, the Petitioners protest that the IPL customers are required to surrender their deferred tax benefits because a direct transfer would violate the

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[13] *See* Petitioners' Reply Comments, 27.
[14] Petition, 8.
[15] *In re Minnegasco, Div. of Arkla, Inc.*, Docket No. G-008, 010/PA-93-92, 1993 WL 597808, at *3 (July 23, 1993).

normalization rules of the Internal Revenue Service. But there are alternatives that would both satisfy the IRS rules and preserve the benefit that the IPL customers are entitled to.

The Commission could order the Petitioners to utilize a transaction adjustment to refund the value of the deferred income taxes to the IPL customers. IPL has been involved in such a proceeding in the past. In *In the Matter of the Joint Petition for Approval of the Transfer of Transmission Assets of re Interstate Power and Light Company and ITC Midwest LLC*, IPL petitioned the Commission to allow it to sell its electric transmission assets to ITC Midwest.[16] IPL held existing deferred tax balances that could not be transferred to ITC because of IRS normalization rules.[17] In order to complete the sale, IPL and ITC agreed to implement an Alternative Transaction Adjustment that directed some of the proceeds of the sale to ratepayers in order to mitigate the negative aspects of the transaction.[18] A portion of the Alternative Transaction Adjustment was used to offset for the loss of deferred taxes for ratepayers.[19] It is clear that the Alternative Transaction Adjustment does not violate IRS normalization rules because IPL has proposed to transfer the entire credit to another entity along with the sale of its electric utility assets in Docket 14-322.[20] The OAG believes that a similar mechanism could be employed in this case so that the IPL customers do not lose the benefit of their accumulated deferred taxes while avoiding any violation of IRS rules.

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[16] Order Approving Transfer of Transmission Assets, with Conditions, Docket No. E-001/PA-07-540 (Feb. 7, 2008).
[17] *Id.* at 18.
[18] *See* Rebuttal Testimony of Larsen, *In the Matter of the Joint Petition for Approval of the Transfer of Transmission Assets of re Interstate Power and Light Company and ITC Midwest LLC*, Docket No. E-001/PA-07-540, at 7–8. The relevant section of Larsen's Testimony is included as Exhibit A.
[19] *See* Order Approving Transfer of Transmission Assets, with Conditions, at 18, Docket No. E-001/PA-07-540 (Feb. 7, 2008).
[20] Petition, *In the Matter of a Request for the Approval of the Asset Purchase and Sale Agreement Between Interstate Power and Light Company and Southern Minnesota Energy Cooperative*, Docket No. 14-322, at 23 (Apr. 15, 2014).

Alternatively, the Commission could preserve the benefit of the deferred taxes by ordering MERC to create a regulatory asset to represent the value of the deferred taxes. At the time that MERC files a new rate case, this regulatory asset could be used to reduce rate base for the IPL customers in the same way that the deferred taxes would reduce rate base should IPL file a rate case. It would be unfair to deprive the IPL customers of a significant rate base reduction that they have accrued simply because their utility company no longer wishes to provide natural gas service in Minnesota. In order to ensure that the transaction is consistent with the public interest, it is necessary to implement a transaction adjustment, a regulatory asset account, or a similar method in order to address the inequity of depriving the IPL customers of the benefit they have accrued.

The Petitioners argue that the IPL customers will not lose a benefit because MERC will acquire a new tax basis in the assets and begin depreciation at a faster rate than IPL.[21] For this reason, the Petitioners believe that the IPL customers' loss of depreciated tax benefits will be temporary. MERC may accumulate additional depreciation in the future, but that does not replace the loss of deferred tax benefit that IPL customers have already accumulated. Additionally, IPL's deferred tax benefit is held on behalf of the IPL customers exclusively. If MERC later accrues deferred taxes as a result of future depreciation, that benefit would be spread across MERC's entire customer base. Furthermore, the size of the deferred tax benefits held by IPL is much more significant when applied to IPL's rate base of approximately $9 million than when used to offset the rate base of $198 million that MERC has proposed in its current rate case. This dilution would disadvantage the IPL customers if the transaction is approved.

[21] Petitioners' Reply Comments, 27.

IV. THE PROPOSED TRANSACTION IS INCONSISTENT WITH THE PUBLIC INTEREST.

A utility may not sell utility assets unless it shows that the transaction is "consistent with the public interest."[22] The Commission should reject the Petitioners' proposal because they have failed to show that the claimed benefits of the transaction will outweigh the detriments suffered by their customers.

The Petitioners' proposal would harm the IPL customers in several ways. In its Initial Comments and Reply Comments, the OAG demonstrated that the proposal would dramatically increase natural gas rates for all IPL customers. Transitioning the IPL customers directly to MERC's rates would increase average annual bills by 52% for residential customers, and 41% for small commercial and industrial customers.[23] MERC would recover more than $4 million in additional revenues from the IPL customers per year,[24] even though IPL claims that its revenue deficiency is less than $1 million.[25] More than $2.3 million of the increased rates would come from the residential class.[26]

These dramatic rate increases serve to highlight the primary deficiency with the Petitioner's proposal: The Petitioners ask for the opportunity to increase rates, and increase them by a significant margin, without filing a rate case or following the standard procedures that are used to increase utility rates in the state of Minnesota. The Petitioners ask for MERC to be permitted to increase the revenue paid by the IPL customers, even though they have not provided documentation or substantiated any additional costs that would justify any increase in IPL's

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[22] Minn. Stat. § 216B.50, subd. 1.
[23] OAG Reply Comments, Exhibit A.
[24] *Id.*
[25] OAG Reply Comments, Exhibit F, Response to DOC IR 5.
[26] OAG Reply Comments, Exhibit A.

revenue requirement, much less the $4 million that would actually be collected under MERC's rates.

The Commission has the duty to ensure that utility rates are "just and reasonable."[27] Procedures that have been developed to ensure that rates are just and reasonable are found in Minnesota Statutes section 216B.16, among other places, which establish the procedures for utility rate cases. Approving this proposal may open the door to other utility companies seeking to avoid rate cases by increasing rates through asset sales in the future. The procedural protections of a rate case, including the careful analysis of the utility's complete financial data by the company, the public agencies, and other parties, are necessary to be sure that the rates that consumers pay are fair. Without a rate case, the Commission will not have the opportunity to determine whether the new rates are fair for IPL customers.

Furthermore, the Commission will not have the opportunity to determine whether MERC's rates are still reasonable after integrating 10,000 new customers into MERC's system, assuming millions of dollars in FMGP liability, and establishing a system that requires MERC to divert rates to IPL for years to come. The Commission has not had the opportunity to conduct the careful review required to determine whether the Petitioners' proposed rates are just and reasonable because the Petitioners have simply not provided the information necessary to make that determination. For that reason alone, the OAG recommends that the proposal be rejected.

The OAG has previously identified additional public detriments related to FMGP remediation costs, the loss of deferred tax benefits, and significant rate increases without the due process protections provided by a rate case. The Petitioners have few public benefits to point to in response to the varied and significant detriments for their customers. The Petition initially

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[27] Minn. Stat. § 216B.03.

claimed that "the continuation of good service at reasonable prices," "a seamless transition," and low financing costs would contribute to the public interest.[28] But none of these factors provide benefits of any kind. If the transaction would not result in the continuation of good service, or there were significant transition problems, or the transaction would require large financing costs, then the transaction would clearly not be consistent with the public interest regardless of any other concerns. This list is simply a recitation of neutral factors that are necessary for any utility sale. They provide no public benefit to balance the public detriments that have been identified by the Department and the OAG.

The only public benefit that is identified in either the Petition or the Petitioners' Reply Comments are "modest economies of scale" and a "greater variety of tariffed services" for IPL customers.[29] But the Petitioners have not identified what services MERC can provide that IPL cannot; presumably both companies can provide natural gas service. And the "modest economies of scale" that the Petitioners claim are undefined and nebulous. They certainly do not compare favorably to a 52% rate increase, the loss of the procedural protections from a rate case, and the loss of millions of dollars in deferred tax benefits. Other than these undefined "public benefits," the Petitioners have not identified anything that will balance out the clear harms that will be suffered by their customers.

Primarily, the Petitions rely on their claim that IPL's current rates are unsustainable, and that changing rates through a rate case would "merely increase costs" and cause delay.[30] But the OAG does not raise its concerns in order to cause unnecessary delay or force the Petitioners to bear unreasonable costs. The OAG raises its concerns because it believes that the proposal

[28] Joint Petition, 28.
[29] Joint Petition, 28; Petitioners' Reply Comments, 9.
[30] Petitioners' Reply Comments, 21–22.

would set rates that the Petitioners have not demonstrated are just and reasonable, that it would do so without protecting the due process rights of ratepayers, and would cause actual harm to consumers with little benefit in return. Furthermore, if either IPL or MERC were to file a rate case to determine just and reasonable rates for the IPL customers, they could request recovery of some or all of their rate case expenses, and they could establish interim rates that would allow them to collect increased revenues while the case was pending. It would always be less expensive and faster to allow the utility to increase rates without filing a rate case; the rate case procedures exist because the Commission and the legislature have determined that it is more important to ensure that the rates are fair. The Petitioners' desire to increase rates quickly and with little expense does not justify dispensing with the procedures that all other utilities use to increase utility rates, and it does not provide any benefit to the public that can balance the disadvantages that will be pushed on their customers. The proposed transaction is not consistent with the public interest because the disadvantages identified by the OAG and the Department outweigh any benefits of the transaction.

The OAG does not dispute that it is possible that IPL's current cost of service is higher than reflected in IPL's rates. If IPL is not collecting enough revenue to recover its costs because it has not filed a rate case for 18 years, then it is has had an obvious remedy available to it for the last 18 years. IPL could have filed a rate case. It did not do so. IPL's customers should not be subjected to a significant rate increase without the due process that is afforded by a rate case simply because its utility has decided not to do so. Instead, IPL or MERC should file a rate case and ask for authority to increase rates so that the Commission, the OAG, the Department, and all other interested parties can review the request and determine whether the resulting rates would be just and reasonable.

V. CONCLUSION

The Petitioners' proposal would increase natural gas rates by approximately 52% for IPL's residential customers and more than 40% for IPL's small commercial and residential customers. It would strip the IPL customers of deferred tax benefits that they have already paid for in their rates, and it would unreasonably shift manufactured gas remediation costs. And it would do all of this without regard for the rate case procedures designed to protect the due process rights of ratepayers. For these reasons the OAG recommends that the Commission impose the following conditions if the asset transfer is approved:

1. Maintain the current rates for IPL's gas customers until a rate case is filed authorizing a change in their rates;

2. Separately identify the costs associated with setting rates between IPL's former customers and MERC's current customers until they are integrated during a future rate case;

3. Maintain IPL's current obligation to remediate contaminated manufactured gas plants located in Minnesota and deny the Petitioners' request to transfer that obligation to MERC;

4. Require MERC to take up the compliance reporting requirements in Docket No. G-001/M-06-1166, and require MERC to provide additional compliance reporting on IPL's past and future FMGP expenditures;

5. Preserve the benefit of deferred taxes that the IPL customers have paid for by implementing a transaction adjustment refund or creating a regulatory asset account to reduce rate base in a future rate case; and,

6. Conduct public hearings in IPL's service territory to allow ratepayers to meaningfully participate in the process.

Dated: June 13, 2014

Respectfully submitted,

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STATE OF MINNESOTA

BEFORE THE MINNESOTA OFFICE OF ADMINSTRATIVE HEARINGS

FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION

LeRoy Koppendrayer	**Chair**
David Boyd	**Commissioner**
Marshall Johnson	**Commissioner**
Thomas Pugh	**Commissioner**
Phyllis Reha	**Commissioner**

In the Matter of the Joint Petition for Approval of Transfer of Transmission Assets of Interstate Power and Light Company and ITC Midwest LLC	**MPUC DOCKET NO. E001/PA-07-540** **OAH DOCKET NO. 15-2500-19025-2**

REBUTTAL TESTIMONY OF JOHN O. LARSEN

1 **Q. Please state your name and your business address.**

2 A. My name is John Larsen. My business address is 4902 North Biltmore
3 Lane, Madison, Wisconsin 53718.

4 **Q. Are you the same John O. Larsen who previously filed direct**
5 **testimony in this proceeding?**

6 A. Yes.

7 **Q. What is the purpose of your rebuttal testimony?**

8 A. My rebuttal testimony generally responds to the testimonies of the
9 Minnesota Department of Commerce ("Department") witnesses Nancy
10 Campbell, Mark Johnson, and Hwikwon Ham, Office of Attorney General
11 ("OAG") witness Clark Kaml, and Municipal Coalition witness Joe
12 Linxwiler, Jr. Throughout my rebuttal testimony, I refer to the pending sale

1 regulatory liability account and used to offset the Allowance for Funds
2 Used During Construction ("AFUDC") on new investments in generation,
3 environmental compliance and advanced metering infrastructure ("AMI"). I
4 will refer to the proposed use of the Transaction Adjustment as an
5 "AFUDC offset" throughout my rebuttal testimony.

6 ***Alternative Transaction Adjustment***

7 **Q. Are the Joint Petitioners offering an alternative use of proceeds in**
8 **their rebuttal case to address the concerns expressed by the**
9 **Department and Mr. Linxwiler with respect to the Transaction**
10 **Adjustment?**

11 A. Yes. The Joint Petitioners have agreed to an alternative use of the
12 proceeds and other customer cost mitigation measures that would
13 address (in part) some of the concerns expressed by the Department and
14 intervenors. This alternative proposal is referred to throughout my rebuttal
15 testimony as the "Alternative Transaction Adjustment." I would stress,
16 however, that IPL continues to support the $60 million Transaction
17 Adjustment put forward in its direct case and the use of that Transaction
18 Adjustment as an AFUDC offset. IPL would ask the Commission to
19 determine which approach is in the customers' best interests in its
20 approval of the Transmission Transaction.

21 **Q. Please summarize the Alternative Transaction Adjustment the Joint**
22 **Petitioners have agreed to put forward in their rebuttal case.**

1 A. Under the Alternative Transaction Adjustment, IPL and ITC Midwest agree
2 to the following:

3 1. IPL will agree to refund $13,040,000 total company per year to its full
4 requirements customers in each of eight years, beginning in the year
5 customers experience an increase in rates related to transmission
6 charges assessed by ITC Midwest. Full requirements customers
7 include IPL's retail and wholesale customers located in Minnesota,
8 Iowa, and Illinois. The transmission-only customers that use IPL's
9 transmission facilities, but are not IPL's customers today or after the
10 Transaction closes, would not receive any portion of these refunds.
11 IPL will file a refund plan with the Commission (once Minnesota's retail
12 rates reflect the Transmission Transaction) to determine the allocation
13 of Minnesota's share of the refund among its retail rate classes.

14 2. ITC Midwest will agree to provide a rate discount of $4,125,000 to its
15 customers in each of eight years, beginning in the year customers
16 experience an increase in transmission charges following
17 consummation of the Transaction. ITC Midwest would not seek to
18 recover this rate discount from customers in its Attachment O Formula
19 Rates annual true-up process or by any other means. ITC Midwest's
20 customers are defined for these purposes as those customers
21 (including IPL) that will take service under the Midwest ISO TEMT and
22 will be responsible for ITC Midwest's transmission revenue
23 requirement pursuant to Attachment O under the Midwest ISO TEMT.
24 (See rebuttal testimony of ITC Midwest witness Joseph Welch.)

25 3. IPL will commit to file for no greater than a 50% common equity capital
26 structure in its <u>first</u> electric retail rate proceeding in which rates are set
27 in Minnesota to reflect the Transmission Transaction.

28 4. ITC Midwest would commit not to seek from the FERC authority to
29 recover in rates the first $15 million of transaction costs. (See rebuttal
30 testimony of ITC Midwest witness Joseph Welch.)

1 In addition to the other conditions discussed below, the Alternative
2 Transaction Adjustment is conditioned on the Transaction being approved
3 in its entirety and closed by year-end 2007.

4 **Q. What percentage of the ITC Midwest rate discount would be reflected**
5 **in the rates of IPL's full requirements customers (wholesale and**
6 **retail)?**

7 A. IPL estimates that approximately 92% of the ITC Midwest rate discount
8 would be reflected in the rates of IPL's full requirements customers
9 (wholesale and retail) based on the percentage load these customers
10 comprise in IPL's transmission revenue requirement, as calculated under
11 its Attachment O under the Midwest ISO tariff. As such, IPL's full
12 requirements customers should benefit from approximately $16.835
13 million per year for each of eight years (in the forms of refunds and rate
14 discounts) related to the IPL and ITC Midwest refund obligations. These
15 refunds would begin, for IPL's Minnesota retail customers, in the first year
16 IPL's retail rates in Minnesota reflect the Transmission Transaction. In
17 nominal terms, this equates to customer payments of $134.68 million over
18 eight years.

19 **Q. How will IPL's full requirements customers (particularly Minnesota's**
20 **retail electric customers) receive the benefit from the ITC Midwest**
21 **rate discount?**

22 A. In its first general rate proceeding in Minnesota reflecting the
23 Transmission Transaction, IPL will reflect this rate discount in retail

1 revenue requirements as appropriate. Since the Transaction will not be
2 reflected in rates until IPL's next general rate proceeding, there will be no
3 lag between the recognition of the costs of the Transmission Transaction
4 and IPL's Minnesota retail customers receiving this benefit.

5 **Q. Will IPL need to establish a regulatory liability account to fund its**
6 **refund obligation?**

7 A. Yes. In order to be in compliance with Generally Accepted Accounting
8 Principles ("GAAP"), IPL will need to establish a regulatory liability account
9 in the year of closing sufficient (assuming interest accruals) to pay the
10 refund obligation. At this point in time, IPL believes the account will need
11 to be established at $89 million. IPL would ask the Commission to
12 authorize the establishment of this regulatory liability account and to
13 recognize in its order allowing the Transmission Transaction to proceed
14 that the regulatory liability account is being established for the sole
15 purpose of paying IPL's refund obligation entered into as a result of the
16 Transmission Transaction. As such, the regulatory liability account would
17 not be used to reduce rate base in any regulatory proceeding nor would
18 the interest accrued be used for anything other than the payment of the
19 refund obligation. Also, the Transaction must be approved in its entirety
20 and close by year-end.

21 **Q. Is IPL's refund obligation contingent on any other future ratemaking**
22 **conditions?**

1 A. Yes. The tax savings resulting from the payment of these refunds by IPL
2 should not be reflected in retail rates resulting from any Minnesota general
3 rate proceeding, because this tax savings is incorporated within the refund
4 and, as such, is already being returned to ratepayers as part of the refund.

5 **Q. Has IPL adjusted its cost-benefit analysis to reflect the Alternative**
6 **Transaction Adjustment?**

7 A. Yes. Using a methodology very similar to that employed by Mr. Linxwiler,
8 IPL expanded its cost-benefit analysis to include three more years and to
9 capture the impact on IPL's transmission-only customers. The rebuttal
10 testimony of Mr. Hampsher supports this expanded analysis. The
11 expanded cost-benefit analysis indicates a net present value benefit of
12 $15.3 million for customers (including transmission-only customers) for
13 eight years resulting from this Transaction under the Alternative
14 Transaction Adjustment. This modeling is discussed in the rebuttal
15 testimony of Mr. Hampsher.

16 **Q. What concerns of the Department and intervenors are resolved, in**
17 **part, by the alternative proposal for the use of proceeds?**

18 A. First, the Alternative Transaction Adjustment addresses the concerns of
19 Mr. Johnson (DT pp. 7-10) and Mr. Linxwiler (DT pp. 18-20) who argue
20 that IPL's cost-benefit analysis provides either minimal or no benefits to
21 customers over the first five years of the Transaction. By changing the
22 use of the Transaction Adjustment from an AFUDC offset to a customer

1 refund, the Joint Petitioners replace a future benefit with a current and
2 ongoing customer benefit over an eight year period.

3 Second, the Alternative Transaction Adjustment addresses, in part,
4 the concerns of Mr. Johnson (DT p. 12-15), Mr. Kaml (DT pp. 12-13), and
5 Mr. Linxwiler (DT pp. 14; 21-23) with respect to the cost of capital
6 reduction. To provide certainty around this assumption, IPL commits to
7 not to file for any higher than a 50% common equity ratio in its first electric
8 rate proceeding that reflects the Transmission Transaction.

9 Third, the Alternative Transaction Adjustment extends the cost-
10 benefit analysis to eight years. This change is in response to arguments
11 by Mr. Johnson (DT pp. 5-7), Mr. Kamil (DT pp. 17-18) and Mr. Linxwiler
12 (DT pp. 14-18) that the cost-benefit analysis should cover more than five
13 years.

14 Fourth, the Alternative Transaction Adjustment provides over $15
15 million of benefits to customers over an eight-year period in present value
16 terms. This $15 million provides a customer benefit cushion in the
17 modeling to address concerns expressed by Mr. Johnson (DT pp. 14-17)
18 and Mr. Linxwiler (DT pp. 24-27) that the A&G reduction for IPL assumed
19 in the direct case cost-benefit analysis is overstated.

20 Fifth, the Alternative Transaction Adjustment addresses the
21 concerns expressed by Mr. Linxwiler (DT pp. 27-34) that the cost-benefit
22 analysis should include the impact on transmission-only customers that
23 use IPL's transmission facilities, even though these customers' rates are

1 not jurisdictional to the Commission. The cost-benefit analysis supporting
2 the Alternative Transaction Adjustment reflects the impact on
3 transmission-only customers. (See Exhibit____(CAH-2), Schedule E.)
4 Sixth, the Alternative Transaction Adjustment addresses the
5 concerns of Mr. Linxwiler (DT p. 23) that the Transaction Adjustment
6 should be shared with transmission-only customers. The ITC Midwest
7 rate discount proposed under the Alternative Transaction Adjustment will
8 benefit transmission-only customers taking service under the Midwest ISO
9 tariff.
10 **Q. By committing to the Alternative Transaction Adjustment, are you**
11 **conceding that the AFUDC offset proposed as part of the**
12 **Transaction Adjustment provides little or no benefits to customers**
13 **during the first five years after the Transaction as claimed by Mr.**
14 **Johnson (DT p. 11) and Mr. Linxwiler (DT pp. 18-19)?**
15 A. No. The Petitioners continue to believe that the Transaction Adjustment
16 provides significant benefits to customers as supported in the rebuttal
17 testimony of Mr. Hampsher.
18 ***Length of the Study Period***
19 **Q. By agreeing to the Alternative Transaction Adjustment and**
20 **expanding the cost-benefit analysis by three years, is IPL conceding**
21 **the arguments of the Department, OAG, and Mr. Linxwiler that the**
22 **cost-benefit analysis should have been for a longer time period?**