

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair
Commissioner
Commissioner
Commissioner
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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

ISSUE DATE: June 8, 2015

DOCKET NO. E-001, 115, 140, 105,
139, 124, 126, 145, 132, 114, 6521, 142,
135/PA-14-322

In the Matter of the Joint Petition for Approval
of Transfer of Transmission Assets of
Interstate Power and Light Company to
ITC Midwest LLC

DOCKET NO. E-001/PA-07-540

ORDER APPROVING AGREEMENT
SUBJECT TO CONDITIONS

PROCEDURAL HISTORY

On April 15, 2014, Interstate Power and Light Company (IPL) and Southern Minnesota Energy Cooperative (SMEC) (together, the Joint Petitioners) filed a joint petition for approval of the sale of IPL's Minnesota electric distribution system and assets, and the transfer of its Minnesota service rights and obligations, to SMEC. SMEC is an electric cooperative association of 12 rural electric cooperatives.¹ SMEC expects to ultimately transfer the assets, customers, and service rights and obligations acquired from IPL to its member cooperatives.

On June 30, 2014, the Commission found that it was unable to resolve the issues raised by the petition without a more developed record, ordered additional record development, set timelines for the development of the record, and delegated to the Executive Secretary authority to vary deadlines.²

On October 10, 2014, the Commission solicited public comments on the proposed transaction. The Joint Petitioners, the Minnesota Department of Commerce Division of Energy Resources (the Department), and the Office of the Attorney General (the OAG) filed comments and reply comments. The Minnesota Chamber of Commerce (the Minnesota Chamber) also filed

¹ Minnesota Valley Electric Cooperative, of Jordan; Steele-Waseca Cooperative Electric, of Owatonna; People's Energy Cooperative, of Oronoco; Tri-County Electric Cooperative, of Rushford; Freeborn-Mower Cooperative Services, of Albert Lea; BENCO Electric Cooperative, of Mankato; Brown County Rural Electrical Association, of Sleepy Eye; South Central Electric Association, of St. James; Redwood Electric Cooperative, of Clements; Federated Rural Electric Association, of Jackson; Nobles Cooperative Electric, of Worthington; and Sioux Valley Energy, of Colman, South Dakota.

² Docket No. PA-14-322, Order Requiring Additional Record Development (June 30, 2014).

comments recommending conditions for approval, and the Minnesota Municipal Utilities Association filed comments raising concerns about the completeness of the record.

The Department recommended approval of the petition with conditions, including requirements intended to economically protect transitioned customers in the years following the transaction. The OAG expressed concern about the transaction and recommended that approval only be granted subject to conditions, if at all.

On November 18, 2014, the Commission required that a minimum of three public hearings be held in the affected service areas.³ The Office of Administrative Hearings conducted public hearings in Storden on January 15, 2015, and in Stewartville and Albert Lea on January 21, 2015. Transcripts from the hearings were filed with the Commission.

On December 8, 2014, the Minnesota Chamber petitioned to intervene in this proceeding. No objections to the petition were received. Under Minnesota Rule 7829.0800, subp. 5, the petition is deemed granted.

On March 12, 2015, the Department filed a letter detailing an agreement it had reached with the Joint Petitioners concerning how to implement and enforce a method of economically protecting former IPL ratepayers in the years following the transaction. On March 18, 2015, the Joint Petitioners filed a letter confirming the agreement with the Department.

On April 30, 2015, the Commission met to consider the petition.

FINDINGS AND CONCLUSIONS

I. Summary of Commission Action

The Commission has investigated this matter as required by Minn. Stat. § 216B.50, duly noticed and received oral argument from interested parties, and reviewed all filings herein. The Commission concludes that the proposed transaction is consistent with the public interest only if subject to certain conditions, which are detailed in this order. The Commission will therefore approve the petition subject to the conditions discussed below and listed in ordering paragraph 1, items (a) – (f).

II. Introduction and Background

A. The Proposed Transaction

The proposed transaction between IPL and SMEC will affect approximately 42,000 IPL customers in 19 Minnesota counties. The transaction is subject to Minn. Stat. § 216B.50, under which the Commission has the authority to authorize the transaction if the Commission finds that the sale is consistent with the public interest.

³ Docket No. PA-14-322, Order Directing Public Hearings to be Held (November 18, 2014).

The proposed transaction would have IPL transfer to SMEC the local distribution assets used to supply power and electric service to all of IPL's approximately 42,000 retail customers in Minnesota. IPL would also transfer to SMEC its rights and obligations to provide electric service to those customers. Current IPL retail customers would receive service from one of the individual SMEC member cooperatives and become members of that individual cooperative. Eventually, rights and obligations to serve customers in IPL's current electric service areas in Minnesota would be divided among, and transferred to, the twelve SMEC electric distribution cooperatives.

Immediately following the closing, IPL would withdraw from providing retail electric service in Minnesota and cease being a public utility in the state.

B. Record Development

After the Commission ordered additional record development, the Joint Petitioners responded to information requests made by the Department, the OAG, and the Minnesota Chamber of Commerce. As the record was developed, the Commission designated a lead commissioner, Commissioner Wergin, to resolve discovery and record-development related disputes.⁴ In addition, three public hearings were conducted in affected territories by the Office of Administrative Hearings.

As a result of these record development efforts, no party has indicated that the record is insufficient to determine whether the proposed transaction is in the public interest if appropriate conditions are imposed. The Commission is satisfied that the record is adequate to evaluate the transaction in light of the relevant legal standard.

III. The Legal Standard

Minn. Stat. § 216B.50 provides that:

No public utility shall sell, acquire, lease, or rent any plant as an operating unit or system in this state for a total consideration in excess of \$100,000, or merge or consolidate with another public utility or transmission company operating in this state, without first being authorized so to do by the commission.

It further states that “[i]f the commission finds that the proposed action is consistent with the public interest, it shall give its consent and approval by order in writing.” Accordingly, the Commission must determine if the proposed transaction is consistent with the public interest.

Because the proposed transaction involves the sale of assets to an entity not ordinarily subject to the Commission's jurisdiction, it presents unique considerations for the required public interest evaluation. However, because that entity is an electric cooperative association, the Commission must also be guided by the Legislature's findings concerning electric cooperatives. The Legislature has found that “cooperative electric associations are presently effectively regulated

⁴ Docket No. PA-14-322, Order Establishing Response Deadline and Designating Lead Commissioner (December 11, 2014).

and controlled by the membership under the provisions of chapter 308A”⁵ This finding informs the Commission’s reasoning about the proposed transaction’s relationship with the public interest.

Additionally, the proposed transaction must comply with Minn. Rules 7825.1700 and 7825.1800 which establish procedural and content requirements for property-acquisition petitions. The Commission concludes that the petition has satisfied the relevant filing requirements in Minnesota Rules and will proceed to consider its merits.

IV. Positions of the Parties

A. The Joint Petitioners

In their petition, the Joint Petitioners propose that IPL sell its Minnesota electric distribution system and assets, and transfer its retail electric service rights and obligations in Minnesota, to SMEC. SMEC comprises 12 member cooperatives already providing electric distribution service to approximately 135,000 members in southern Minnesota.

As a result of the transaction, current IPL retail customers would become members of the individual SMEC member cooperative serving their territory. Subject to a 10-year wholesale power agreement, IPL would sell power to SMEC to serve the former IPL customers. SMEC would also agree to offer employment to current IPL Minnesota employees involved in electric distribution-system work.

The Joint Petitioners assert that the proposed transaction results in a net benefit to current IPL customers. They argue that the benefits of lower interest rates and tax advantages available to SMEC more than offset the costs of the transaction.

Joint Petitioners also argue that their proposed five-year plan to transition IPL customers to SMEC rates will adequately protect the customers from rate shock or from being disadvantaged as a consequence of joining their respective cooperative electric distribution systems. For the first three years, rates will be based on existing IPL base rates (with certain adjustments). The cooperatives will prepare Class Cost of Service Studies (CCOSS) for their existing territory and for their acquired territory. The cooperatives will use these studies to plan for a two-year transition period.

In the two-year transition period, the cooperatives will determine whether to merge existing and acquired customer rates, however the Joint Petitioners have agreed that no rate will be increased by more than 5 percent per year (excluding the operation of the Power Cost Adjustment (PCA) mechanism⁶) to facilitate the merger of a Legacy Area and Acquired Area rate.

⁵ Minn. Stat. § 216B.01.

⁶ The PCA mechanism will be the automatic adjustment method used by SMEC cooperatives to adjust for changes in the cost of power supply and transmission from the amount included in base rates as determined in IPL’s last rate case.

Rates not merged in accordance with those limitations will be maintained separately and established according to the results of the CCOSS. The Joint Petitioners have agreed that SMEC and SMEC member cooperatives will be subject to the Commission's jurisdiction to require performance in accordance with the proposed five-year transition plan.

Additionally, IPL is in the process of returning amortized gains to its customers subject to a previous Commission order.⁷ The Commission required the return of a remainder of a gain on the sale of IPL's transmission system. A four-year amortization period for the return of the funds was approved. If this transaction is approved, the Joint Petitioners have agreed to return the balance owed to IPL customers through the wholesale power sales agreement.

B. The Department

The Department thoroughly evaluated the proposed transaction to determine whether it was consistent with the public interest. As part of its analysis, the Department considered the likely effects on IPL customers if the transaction were approved, and also if it were not approved. It recommended that the Commission approve the petition only subject to additional conditions primarily directed at protecting the interests of IPL customers.

The Department recommended three conditions:

- For the five years following the transaction, require that SMEC annually file reliability information with the Commission for IPL's former service territory;
- For the first three years following the transaction, require that SMEC annually provide actual weather-normalized annual revenue requirements for IPL's former service territory; and
- Require a bill credit to IPL's former ratepayers if the actual weather-normalized annual revenue requirement in any of those first three years exceeds the forecasted annual revenue requirement by more than 2 percent.

As the record developed, the Department and the Joint Petitioners discussed the Department's proposed customer protection mechanisms, and agreed to more detailed requirements that clarify how the Department's proposed bill credit should be calculated.⁸ The Department proposed the following:

- A bill credit will be applied to reduce rates for the former IPL electric customers in the event the actual weather-normalized revenues from IPL's former customers exceed the Petitioners' forecasted revenues by more than 2 percent, determined as provided below.

⁷ *In the Matter of the Application of Interstate Power and Light Company for Authority to Increase Rates for Electric Service in Minnesota*, Docket No. E-001/GR-10-276, Order After Reconsideration Clarifying and Modifying Order of August 12, 2011, at 2. (November 8, 2011).

⁸ Minnesota Department of Commerce, Letter to Daniel P. Wolf (March 12, 2015).

- The actual weather-normalized revenues and forecasted weather-normalized revenues will be based on total revenues less revenues related to fuel costs. Revenues related to fuel costs will be excluded from the comparison calculations and the determination of the 2 percent threshold. As a result, the customer protection mechanism and calculations will reflect forecasted and actual distribution, non-fuel related power supply, and transmission costs. Measures will be calculated on a cost per unit basis, as described below.
- This comparison of actual weather-normalized revenues to forecasted revenues will be made on a cumulative basis, measured over the 36-month period following the close of the Transaction, as shown on Attachment A [to the Department's letter] and further explained below.
- The 36-month period is expected to include a part of 2015, all of 2016 and 2017, and a part of 2018. The forecasts for the portion of 2015 and for 2016 and 2017 included in the 36-month period will be based on the information included in the Application. Forecast information pertaining to 2018 was not included in the Application. Petitioners provided comparable forecasted 2018 power supply and transmission costs in their response to Department Information Request No. 48. The forecast by SMEC for the part of 2018 included in the 36-month period will be determined using the same methods reflected in the Application applying the power supply and transmission cost information provided in DOC IR 48.
- Actual weather-normalized revenues for the 36-month period will be determined using the same methods as used in the Application.
- To the extent reasonably practical, determinations of the partial year forecasts and actual weather-normalized results for 2015 and 2018 will be made based on factors specific to the portions of the years 2015 and 2018 that are included in the 36-month period.
- Annual reports showing a comparison of actual weather-normalized results and forecasted results will be made for each 12-month period within 60 days following the end of each 12-month period, beginning within the initial 12-month period and including the periods ending 24 months and 36 months following the closing of the Transaction. These reports should also show the actual weather-normalized fuel costs.

The Department's letter also included a template for calculating the agreed-to adjustments.⁹ The Joint Petitioners agreed to these additional requirements.

⁹ Id. at 3, and Attachment A.

C. The OAG

The OAG challenged the Joint Petitioners' method of establishing that the transaction would result in a net benefit. In the OAG's view, the method has shortcomings, and should be supplemented with other methods of analyzing the transaction. It also highlighted that IPL customers would become members of twelve different co-ops, and be put into different circumstances, limiting the value of analyses that consider the effect on customers in the aggregate.

The OAG disagreed with the Department's analysis, and recommended that approval be subject to additional conditions. It argued that the Department's determination of a net benefit was speculative, having been based on hypothetical future IPL rate increases, and possibly based on unreasonable assumptions. The OAG argued that the benefits to IPL are certain, while the benefits to IPL ratepayers are speculative.

The OAG also specifically challenged the reasonableness of the wholesale power purchase arrangement and the proposal that SMEC would pay a premium above IPL's net book value as part of the transaction. The OAG recommended that the Commission impose a condition that would prevent any gain on the sale from being passed on to IPL customers. It also recommended that IPL be required to pay transaction costs, and that the sale price paid by SMEC to IPL be reduced by the amount of the gain that IPL will receive in the form of increased return on equity on generation assets in Iowa used to serve Minnesota customers.

D. The Minnesota Chamber

The Minnesota Chamber expressed concern about the effect of IPL becoming a wholesale power provider, subject to Federal Energy Regulatory Commission (FERC) rate jurisdiction rather than the jurisdiction of this Commission. It argued that this jurisdiction change would not adequately protect former IPL customers.

Also among the Minnesota Chamber's concerns were whether expected low interest rates would continue to be available to benefit customers into the future, whether anticipated benefits would be realized by IPL ratepayers or be shared by all SMEC members, and whether customers were adequately protected from significant rate increases. The Minnesota Chamber proposed a number of additional conditions directed at mitigating these concerns.

The Minnesota Chamber proposed to deny IPL a distribution asset acquisition premium, and to impose several conditions on the transfer of IPL's generation assets from retail (Commission) jurisdiction to wholesale (FERC) jurisdiction. It further recommended:

- requiring a substantially larger per-MWh rate credit for acquired customers to pass on "the full estimated benefit" of the transaction;
- requiring SMEC to bill member cooperatives using the same methodology that IPL uses to bill SMEC; and
- prohibiting merger of existing and acquired customer rates unless the rate impact is less than 1%.

V. Commission Action

Based on its review of the record, the Commission concludes that the proposed transaction is consistent with the public interest only subject to certain conditions. The Commission will therefore approve the petition subject to the conditions discussed below and set forth in the ordering paragraphs.

A. Conditions

The Commission agrees with the Department that, with appropriate conditions protecting IPL customers, the net benefits to IPL customers outweigh the costs of the transaction. IPL customers will benefit from lower costs of capital and from tax advantages inherent to electric cooperatives. These benefits exceed the costs, including the premium above book value that SMEC has agreed to pay and the anticipated increased power supply costs incurred by acquiring power at wholesale from IPL.

This conclusion is based in part on rate increases IPL customers could expect to face even if the transaction were not approved. Anticipating hypothetical future rates necessarily involves a degree of speculation, but the Commission concludes that the Department has demonstrated that its analysis is based on reasonable estimates and forecasts. It is reasonably likely that IPL ratepayers would otherwise experience rate increases over the next three years, the magnitude of which render this transaction a net benefit to them.

With the conditions proposed by the Department and agreed to by the Joint Petitioners, the Commission finds that, the interests of customers will be adequately protected after the transaction. The five-year phased transition plan reasonably ensures that IPL customer rates will be maintained separately from existing SMEC customer rates until merging them is an appropriate regulatory outcome.

The Commission will further require that repayment to IPL ratepayers ordered on November 8, 2011, be completed as part of the wholesale power agreement. This will ensure that the remaining proceeds from the gain on the sale of IPL's transmission system are returned to IPL ratepayers.

These conditions are sufficient to ensure the transaction is consistent with the public interest. In the aggregate, the benefits of the transaction exceed the costs. The interest of IPL ratepayers in enjoying the benefits is adequately protected—in the near term by the proposed rate transition plan and the Department's proposed conditions, and in the long term by becoming members of electric cooperatives. The Commission therefore declines to impose any further conditions, such as those recommended by the OAG and the Minnesota Chamber.

The OAG has argued that the benefits to current IPL ratepayers are uncertain, and with different assumptions about future rate increases, the transaction may not benefit current IPL ratepayers without additional conditions. However, it is not uncertain that acquired IPL customers will benefit through reduced costs of capital and income tax liability. And the Commission concludes that the Department's estimates and forecasts are more likely than the OAG's. The record therefore sufficiently establishes that the anticipated benefits will outweigh the transaction's costs to acquired customers.

Conditions recommended by the Minnesota Chamber are likewise not necessary to bring the transaction in line with the public interest. The recommended conditions intended to further reduce the costs or increase the direct benefits to acquired IPL customers are not warranted in this case. The terms of the transaction have been reasonably arrived at by sophisticated parties bargaining at arms-length. The proposed transaction, including the reasonable and bargained-for distribution asset acquisition premium, provides an anticipated net benefit to IPL's Minnesota ratepayers.

Additionally, several of the Minnesota Chamber's recommended conditions arise from concerns about the shift in regulatory authority from the Commission to the co-ops and to FERC. The Commission concludes that, subject to the customer-protection conditions required above, both SMEC and IPL will be adequately regulated and that additional conditions are not necessary. The Commission cannot concur with the implication that FERC-determined wholesale rates will be inconsistent with the public interest. And the Commission is satisfied that, to the extent not already limited by the Joint Petitioners, co-op decisions to merge rates will be adequately regulated by their memberships.

B. Ongoing Enforcement

The Commission will retain jurisdiction to enforce the terms and conditions of the rate plan agreed to by the Joint Petitioners, as well as the conditions it imposes in this order, during the five year transition. To effectuate this oversight, the Commission will require filings pertaining to revenue requirements and reliability for acquired territory.¹⁰ In the following years, former IPL customers will be members of electric cooperatives, which are "effectively regulated and controlled by the membership."¹¹

Additionally, as recommended by the Department and agreed to by the Joint Petitioners, the Commission will require that, for the first three years, former IPL ratepayers receive a bill credit if the actual weather-normalized annual revenue requirement in any year exceeds the forecasted annual revenue requirement by more than 2%. This will guard against distributing savings of acquired IPL customers among existing SMEC members. The details of this limitation will be as laid out in the Department's March 12, 2015 letter.

ORDER

1. The Commission finds that that the proposed transaction is consistent with the public interest if certain conditions are applied. The Commission therefore approves the petition subject to the following conditions:
 - a. Annually, for the three years following the proposed transaction's effective date, SMEC must provide actual weather-normalized annual revenue requirements for IPL's former service territory.

¹⁰ The Joint Petitioners have agreed to provide the Commission with maps of the relevant service territories.

¹¹ Minn. Stat. § 216B.01. State law also provides a means by which members of electric cooperatives can elect to subject the cooperative to rate regulation by the Commission. Minn. Stat. § 216B.026.

- b. SMEC must provide a bill credit to IPL's former ratepayers if the actual weather-normalized annual revenue requirement in any year exceeds the forecasted annual revenue requirement by more than 2%.
- c. For (a) and (b) above, the Commission adopts the implementation programs as detailed in the Department's March 12, 2015 letter.
- d. Annually, for five years following the proposed transaction's effective date, SMEC must provide reliability information to the Commission for IPL's former service territory.
- e. Within 90 days of this order, SMEC must make a compliance filing describing what reliability information will be provided, who will be preparing and filing the information, and when it will be filed each year.
- f. IPL must return the remaining Alternative Transaction Adjustment to customers through a reduction in payments under the Wholesale Power Sales Agreement.

2. This order shall become effective immediately.

BY ORDER OF THE COMMISSION

Daniel P. Wolf
Executive Secretary



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