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August 25, 2016

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 Seventh Place East, Suite 350
St. Paul, MN 55101

VIA ELECTRONIC FILING

Re: In the Matter of the Petition of Minnesota Energy Resources Corporation
for Authorization to Establish Amortization Periods Related to Pre-
Acquisition Pension and Other Postretirement Benefit Costs

Docket No. G011/M-15-992

Dear Mr. Wolf:

Minnesota Energy Resources Corporation ("MERC") appreciates the opportunity to reply to the Department of Commerce, Division of Energy Resources ("Department") comments regarding MERC's request to establish amortization periods for its pension and other post-employment benefit ("OPEB") costs and credits that the company incurred before the acquisition of its corporate parent, Integrys Energy Group, Inc. ("Integrys"), by WEC Energy Group, Inc. ("WEC," f/k/a Wisconsin Energy Corporation).

In these Reply Comments, MERC clarifies that:

1. MERC does not object to the Department's recommendation that Integrys Business Services ("IBS")-related costs be transferred to MERC's balance sheet rather than remain on separate financial statements, such that MERC would recognize both costs related to the IBS legacy benefit plans and MERC-specific costs as a combined regulatory asset to be amortized over 14 years.
2. MERC is not seeking a deferral of new costs; rather, the pension and OPEB costs at issue have long existed as a regulatory asset as a result of the application of generally accepted accounting principles ("GAAP") and associated ratemaking to the Company's pension and OPEB costs. The issue is therefore not whether deferral of new out-of-test-year costs is appropriate, but rather, what amortization period or periods should be established for these existing net regulatory assets and liabilities in light of their fixed valuation at the time of the WEC/Integrys merger.
3. This is not a ratemaking petition, and MERC recognizes that its request for a particular amortization period does not guarantee cost recovery of these assets or a return on them in future rate cases. Therefore, MERC disagrees with the Department's proposal that Supplemental Executive Retirement Plan ("SERP")

costs should not be amortized because these costs are typically not recoverable. Indeed, MERC's current cost recovery request in its pending rate case specifically excludes SERP costs. The request for cost recovery in the rate case is completely independent of MERC's request for amortization in this docket, which has the sole purpose of aligning regulatory and GAAP books and records to reduce administrative costs.

Further, MERC disagrees with the Department's proposal to "ring-fence" these assets so they cannot be included in rate base or earn a return. The Department's "ring-fence" proposal is based on the same pension and rate base arguments that have been more fully fleshed out and addressed in the Company's currently pending rate case. We note also, solely for informational purposes, that no other state approving amortization of these net regulatory assets and liabilities has concluded that "ring-fencing" is necessary.

Rather than create additional administrative costs by either excluding SERP costs from the amortization or requiring MERC to "ring-fence" the pension and OPEB assets, MERC recommends that the Commission approve a common amortization for all assets and defer any cost recovery or ratemaking decisions to MERC's current and future rate cases.

At this time, all other jurisdictions affected by the WEC/Integrus merger have approved an updated amortization of these costs, with the goal of reducing the costs of administering multiple actuarial analyses. MERC therefore seeks approval of this petition to avoid the costs of a separate actuarial analysis solely for MERC (at an estimated cost in excess of \$100,000 incurred annually for the life of these assets). Approving this petition would also avoid MERC internal administrative costs to develop separate accounting in conjunction with the actuary each year. Finally, MERC seeks to set the amortization of these assets to a period that will avoid virtually any customer impact resulting from the purchase accounting revaluation of existing net regulatory assets and liabilities. Overall, MERC brings this petition to avoid potential additional customer expenses.

Please contact me at (651) 322-8965 if you have any questions.

Sincerely,

/s/ Amber S. Lee

Amber S. Lee
Regulatory and Legislative Affairs Manager
Minnesota Energy Resources Corporation

Enclosures
cc: Service List

STATE OF MINNESOTA

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Beverly Jones Heydinger	Chair
Nancy Lange	Commissioner
Dan Lipschultz	Commissioner
Matt Schuerger	Commissioner
John Tuma	Commissioner

In the Matter of the Petition of Minnesota
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and Other Postretirement Benefit Costs

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REPLY COMMENTS

Minnesota Energy Resources Corporation ("MERC") submits these comments in response to the July 25, 2016, comments of the Minnesota Department of Commerce, Division of Energy Resources ("Department") in the above-referenced matter ("July 25 Response Comments").

In its July 25 Response Comments, the Department recommended that: (1) MERC should show why the pension and other post-employment benefit ("OPEB") amounts were unforeseeable, and therefore eligible for deferral; (2) the Supplemental Executive Retirement Plan ("SERP") plan cost component of these assets should not be amortized; (3) these pension/OPEB assets should be "ring-fenced" and excluded from rate base so that they do not earn a return; and (4) Integrys Business Services ("IBS")-related costs should be transferred to MERC's balance sheet, such that MERC's combined MERC/IBS regulatory asset would be amortized over 14 years. In terms of timing, the Department also agreed the Minnesota Public Utilities Commission ("Commission") should authorize the requested regulatory treatment as of June 30, 2015, with amortization beginning January 1, 2016.

The Department further stated it would provide its final recommendation in response to these additional MERC comments. MERC appreciates the Department's review in this matter and agrees that the combined IBS and MERC regulatory asset should be included on MERC's balance sheet and amortized over 14 years beginning January 1, 2016. MERC responds below to each of the additional issues raised by the Department.

I. The Deferred Accounting Standard is Inapplicable, But Would Be Met In Any Event.

A. The Deferred Accounting Standard Does Not Apply.

In its July 25 Response Comments, the Department first suggested that MERC should be required to meet the standard for establishing a new cost deferral. Specifically, the Department concluded that most aspects of the deferral standard have been met, but requested that MERC provide additional information addressing that the costs at issue in this docket were unforeseeable.

In response, it is important to clarify initially that the purpose of this petition is to establish a new amortization schedule for *existing* regulatory assets, rather than to establish a deferral for new out-of-test-year costs that did not previously exist. The deferred accounting standard set forth in the Department's July 25 Response Comments applies when, as the Department notes, "evaluating a Company's request for deferred accounting treatment."¹ As the Commission further concluded in its 2009 Order cited in the Department's July 25 Response Comments, "[d]eferred accounting is a valuable regulatory tool used primarily to hold utilities harmless when they incur out-of-test year expenses that, because of their nature or size, should be eligible for possible rate recovery as a matter of public policy."² In other words, the deferred accounting standard applies when a utility seeks to establish a new deferral of new costs incurred outside a test year.

In contrast, and as described in MERC's prior comments in this docket, the regulatory assets being amortized have existed since 2007 and consist of multiple years of "smoothing" pension and OPEB expense consistent with the 2006 issuance of Financial Accounting Standard ("FAS") 158. FAS 158 required companies to separately record the gains and losses associated with pension and OPEB assets and liabilities subject to smoothing. MERC and IBS have been separately recording the deferral and amortization, or "smoothing," of gains and losses related to the pension and OPEB plans as regulatory assets since 2008, after the 2006 issuance of FAS 158. This smoothing has likewise benefited customers by reducing the impact of gains and losses incurred in any one year since 2008.

With the occurrence of the WEC/Integritys merger, Generally Accepted Accounting Principles ("GAAP") and the Commission's Order in the WEC/Integritys merger docket³ required the companies to freeze the fair market value of these pre-existing assets and liabilities as of the date of the merger. Because these assets have existed since 2008 and continue to exist, the purpose of this petition is not to seek regulatory asset status or deferral of new costs, but rather to establish a reasonable revised regulatory amortization period to continue to defer these costs in light of the merger.

¹ Department July 25, 2016 Response Comments.

² *In the Matter of the Petition for Approval of Deferred Accounting Treatment of Costs Related to the Cancelled Sutherland Generating Station Unit 4*, Docket No. E001/M-09-336, ORDER DENYING PETITION FOR DEFERRED ACCOUNTING at 3 (Dec. 18, 2009).

³ ORDER APPROVING MERGER SUBJECT TO CONDITIONS, Docket No. G011/PA-14-664 (June 25, 2015).

Consequently, in the current docket, MERC requests only that the Commission approve the proposed amortization periods for the MERC and IBS pension and OPEB net regulatory assets and liabilities existing as of the time of the WEC/Integritys merger. As discussed in more detail below, the Company accepts the Department's proposed amortization period for these assets, which effectively obviates any potential future rate impact of this amortization. However, MERC is not seeking any particular findings that future rate recovery is guaranteed or assumed; MERC recognizes that such determinations will be made in rate recovery proceedings.

B. The Deferred Accounting Standard Is Met if Applicable.

As noted above, these pension and OPEB costs existed prior to the WEC/Integritys merger such that the deferred accounting standard does not apply. It would establish an impossible standard to require that a utility can only continue to defer an existing regulatory asset if it can prove the costs already being deferred are suddenly unforeseeable.

Even if, however, the Commission determined that the Company should meet the standard for new deferrals and establish these costs were unforeseeable, these costs meet that standard. The fact of the merger itself, and therefore the future applicability of purchase accounting requirements, was an unusual event that was not foreseeable in the ordinary course of business. Further, the specific fair market value of the assets and liabilities as of the time of the merger, the appropriate amortization period needed to avoid cost impacts to customers, and the audit costs associated with maintaining separate books could not be predicted until after the merger occurred and purchase accounting rules were applied.

The Company appreciates that, although the Department requested additional information to determine whether these costs were unforeseeable, the Department recognized that the costs are unusual and material to MERC. In light of these conclusions and the additional information discussed above, the deferred accounting standard is satisfied if applicable.

II. Agreement with Amortization Period and Methodology.

MERC does not object to the Department's recommendation that IBS-related costs should be transferred to MERC's balance sheet rather than remaining on separate financial statements. While not all jurisdictions have employed this method, the Wisconsin Public Service Commission ("Wisconsin Commission") concluded that "the balance of IBS's unrecognized costs and credits at the time of the acquisition could be allocated to [Wisconsin Public Service Company ("WPSC")] at the end of 2015 and held constant" because "these unrecognized costs and credits relate to employee service that had already been performed." The Wisconsin Commission further concluded that it was reasonable for the WPSC balance and the allocated portion of the IBS balance of the unrecognized costs and credits relating to the pension and OPEB be combined into

one number on WPSC's balance sheet and amortized over the period of time that most closely approximates current amortized amounts.⁴

While MERC's proposed amortization amounts differ slightly from the Department's due to the Department's proposal to exclude SERP assets from the amortization (which is discussed in more detail below), MERC takes no issue with the Wisconsin Commission's conclusions or the Department's recommendation to transfer IBS-related costs to MERC's balance sheet. MERC further accepts the Department's proposal to amortize the combined assets over 14 years to approximate the combined current annual amortization for these accounts.

III. Impact on Concurrent Rate Case.

A. "Ring-Fencing" is Not Appropriate, Particularly On This Record.

The Department also proposes that the net regulatory assets and liabilities that MERC seeks to amortize should be "ring-fenced" -- that is, excluded from inclusion in rate base. MERC respectfully requests that this recommendation be denied in this docket on the grounds that (i) this is a ratemaking issue best decided in contested case proceedings; (ii) the Department's support for this proposal in this docket is, in any event, a partial summary of its positions on including pension assets and liabilities in rate base set forth in MERC's pending rate case; and (iii) the Department's position fails to recognize the value of pension contributions to MERC customers and the reasonable bases for the Company to earn on a return on these assets.

In its Initial Comments in this proceeding, the Department requested that MERC clarify the connection of this petition to its concurrent rate case. MERC noted in its prior Reply Comments that this petition does not require any particular ratemaking outcome in the rate case. MERC further acknowledged that, "the Commission will have the opportunity to determine the overall cost recovery of pension and OPEB costs in the rate case." This includes the determination whether pension and OPEB net assets and liabilities, including those discussed in this amortization docket, should be included in rate base.

The issue of whether to include pension and OPEB assets and liabilities in rate base is the subject of pages of testimony -- as well as substantial briefing -- by both the Department and the Company in MERC's pending rate case. The Company provided significant discussion from two different witnesses explaining, for example, that: (i) contributions to MERC's and its service company's pension and OPEB funds significantly reduce annual expense for customers; (ii) these contributions fund a fundamental cost of service (that is, compensating employees who provide utility service); (iii) these contributions can *only* be used to fund a cost of service and reduce customer expense, rather than creating a shareholder return; (iv) any return on the pension and OPEB contributions acts as a return to customers because they further reduce customer expense; and (v) including these assets in rate base creates no incentive for the Company to incur losses in its pension and OPEB plan assets, as such

⁴ Docket No. 6690-GF-136, ORDER at 4-5 (Apr. 27, 2016).

losses reduce the value of the assets eligible to earn a return. MERC therefore believes that it is appropriate to include pension and OPEB assets and liabilities in rate base.

The Department's support for its proposal to "ring-fence" the net regulatory assets and liabilities that are the subject of this petition is limited to one paragraph in its July 25 Response Comments:

The rationale for the Department's recommendation to ring-fence this \$10.0 million in pension and OPEB-related assets recognizes the perverse incentive that approval of the Company's proposal could create if those assets were allowed to be included in MERC's rate-base and, by extension, the Company was allowed to earn a return on those assets.⁷

7. For example, inclusion of these assets including AOCI in MERC's rate base would allow the Company to earn a return on the losses incurred on its pension plan. The Commission would be rewarding MERC's inability to earn its expected return on those assets.

As noted above, no such incentive exists. Because the EROA inures to the benefit of customers -- not ratepayers -- by reducing pension expense, and because any reduction in the pension asset reduces the level of return the Company can earn, the inclusion of these assets in rate base creates no perverse incentives.

Additionally, the pre-merger net regulatory assets and liabilities that are the subject of this petition were incurred in the same manner that pension and OPEB assets and liabilities are currently being incurred post-merger. Both are the subject of cost recovery requests in MERC's current rate case. Consequently, the arguments for rate base recovery of all applicable pension and OPEB assets set forth in the Company's rate case proceeding apply equally to the subset of costs that are the subject of this amortization docket.

That said, this amortization petition was filed in an effort to reduce the customer costs of maintaining separate books and records for the assets in question, rather than to determine ratemaking. As such, whether such assets should earn a return or increase/reduce rate base is irrelevant to this docket. This is no different from the circumstances with respect to MERC's acquisition of the Aquila assets, in which the Commission approved a new amortization schedule for the pension/OPEB assets acquired from Aquila (different from the pre-WEC pension/OPEB assets and liabilities). Notably, the Aquila amortization petition was approved without the need for separate ring-fencing. MERC therefore respectfully submits that a contested case proceeding is the appropriate place in which to determine the 2016 test year treatment of all these costs.

Because no complete record has been developed to support a determination that these assets should be excluded from rate base in perpetuity, and because the rate base treatment of certain of these assets is an open issue in MERC's rate case where the record is substantially more complete than in these limited comments, MERC

recommends that the Department's "ring-fencing" proposal should be denied in this docket.

B. SERP Amortization Does Not Equate to Cost Recovery.

In its July 25 Response Comments, the Department also continues to recommend that the Commission deny MERC's proposal insofar as it would "create a regulatory asset for [Supplemental Executive Retirement Plan] costs." This recommendation does not recognize that (i) a regulatory asset for SERP costs existed prior to the merger due to application of general accounting and ratemaking rules and procedures; and (ii) the existence of a regulatory asset does not equate to rate recovery. For instance, although net asset/liabilities have existed previously for MERC and IBS SERP costs, MERC did not seek recovery of SERP costs in its prior rate case and does not seek recovery of these non-qualified pension assets in its current rate case. The ongoing amortization of these assets and liabilities is independent of their rate recoverability.

Put differently, the request for amortization of these costs has no impact on whether MERC will be permitted to recover these costs in this or a future rate case. Rather, the Company seeks regulatory approval for amortization of these assets solely to avoid the administrative costs of accounting for them differently on its financial accounting books and records. As with any regulatory asset, MERC recognizes that the existence of a deferral or amortization does not guarantee rate recovery or create any presumption of rate recoverability.

There is a relatively small numerical difference between including or excluding the SERP assets in the amortization. The overall MERC/IBS asset would total \$10,141,140 if SERP assets are included, whereas excluding them only reduces the asset to \$10,003,321. Under either circumstance, the singular administration of these assets reduces administrative costs and burdens and does not affect rate recovery eligibility. As such, there is no reason to exclude SERP assets from the amortization.

IV. Update on Other Jurisdictions.

As set forth in MERC's prior comments, MERC notes solely for the Commission's information that other WEC subsidiaries have received approval of their proposed accounting treatment for similar assets.⁵ In light of these approvals, should this Commission likewise approve MERC's Petition, legacy-Integritys utilities have secured all of the approvals needed to maintain a single set of actuarial books and records for the assets at issue in this Petition. MERC notes further that none of these regulatory agencies have excluded SERP costs from the approved amortization schedules, nor

⁵ The Illinois Commerce Commission issued an order approving similar accounting treatment for MERC's affiliates, The Peoples Gas Light and Coke Company and North Shore Gas Company, in Docket No.15-0606. The Michigan Public Service Commission issued an order approving similar accounting treatment for MERC's affiliates, WPSC and Michigan Gas Utilities Corporation, in Case No. U-17967. The Wisconsin Commission issued an order approving similar accounting treatment for WPSC in Docket No. 6690-GF-136. MERC recognizes that this Commission is not bound by the decisions of other jurisdictions, but provides this information in case it is useful to the Commission or its Staff.

ring-fenced the assets in this docket, even though rate recovery of these assets may ultimately vary by jurisdiction.

V. Conclusion

For the reasons discussed herein, MERC respectfully requests that the Commission authorize the amortization of pre-merger MERC and IBS pension and OPEB assets and liabilities totaling \$10,141,140 over 14 years, on a combined basis, effective January 1, 2016. MERC also respectfully requests that the Commission permit the SERP amortization as included in the \$10.1 million total, with the understanding that this decision does not determine future rate recovery (or lack thereof) of SERP costs. Finally, MERC requests that the Commission defer any determination as to whether pension or OPEB assets and liabilities should be included in rate base to MERC's rate proceedings, where this issue is fully fleshed out with supporting testimony and exhibits and the benefit of a full evidentiary record.

MERC notes that its proposed outcome is consistent with the determinations of other jurisdictions where MERC operates. This outcome would also be consistent with this Commission's determinations in Docket No. G007,011/M-06-1287, where the Commission approved MERC's petition to amortize pension and OPEB net regulatory assets and liabilities as a result of the Aquila acquisition, such that MERC continued to recognize approximately the same pension cost level that Aquila would have recorded had it continued to own its natural gas distribution assets.

Overall, this outcome would align regulatory cost with the historical actuarial recognition, properly reflect the value of pension and OPEB costs allocated to MERC, and reduce MERC's administrative and actuarial costs on behalf of MERC's customers.

Respectfully submitted,

Minnesota Energy Resources Corporation

/s/ Amber S. Lee_____

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In the Matter of the Petition of Minnesota
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Periods Related to Pre-Acquisition
Pension and Other Postretirement Benefit
Costs

Docket No. G011/M-15-992

CERTIFICATE OF SERVICE

I, Kristin M. Stastny, hereby certify that on the 25th of August, 2016, on behalf of Minnesota Energy Resources Corporation (MERC), I electronically filed a true and correct copy of the enclosed Reply Comments on www.edockets.state.mn.us. Said documents were also served via U.S. mail and electronic service as designated on the attached service list.

Dated this 25th day of August, 2016.

/s/ Kristin M. Stastny
Kristin M. Stastny

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