MINNESOTA DEPARTMENT OF COMMERCE

85 7TH PLACE EAST, SUITE 500
SAINT PAUL, MINNESOTA 55101-2198
MN.GOV/COMMERCE
651.539.1500 FAX: 651.539.1547
AN EQUAL OPPORTUNITY EMPLOYER

November 21, 2016

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: **Supplemental Response Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. G011/M-15-992

Dear Mr. Wolf:

Attached are the Response Comments of the Minnesota Department of Commerce, Division of Energy Resources (Department or DOC) in the following matter:

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

The petition was filed on November 20, 2015 by:

> Amber Lee
> Minnesota Energy Resources Corporation
> 1995 Rahncliff Court, Suite 200
> Eagan, MN 55122

The Department recommends that Minnesota Public Utilities Commission approve the petition with conditions. The Department is available to answer any questions the Minnesota Public Utilities Commission may have.

Sincerely,

/s/ JOHN KUNDERT
Financial Analyst

JK/lt
Attachment

MINNESOTA DEPARTMENT OF COMMERCE

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

SUPPLEMENTAL RESPONSE COMMENTS OF THE MINNESOTA DEPARTMENT OF COMMERCE DIVISION OF ENERGY RESOURCES

DOCKET NO. G011/M-15-992

I. BACKGROUND

On November 20th, 2015, Minnesota Energy Resources Corporation (MERC or the Company) petitioned the Minnesota Public Utilities Commission (Commission) for approval of deferred accounting treatment of approximately $9.5 million of MERC-specific pension and other post-employment benefit (OPEB) assets and liabilities, along with the pro-rated equivalent of approximately $604,000 of Integrys Business System-related (IBS) pension and OPEB assets and liabilities.[1] The Company's petition (Petition) requested that the MERC-specific costs be amortization over a 15 year period and that the IBS-related costs be amortized over 5 to 11.5 years. MERC asserted that the costs were the result of actions taken related to Integrys' acquisition by WEC Energy Group in June 2015.

On April 20th, 2016, the Minnesota Department of Commerce (Department or DOC) filed comments on MERC's petition, requesting that MERC indicate in Reply Comments whether any of the pension amounts identified in the instant proceeding were included in the Company's concurrent rate case (Docket No G011/GR-15-736). In addition, the Department concluded that MERC's proposal to include the Legacy IBS components identified as Pension Restoration, Peoples Energy Supplemental Plan and Post Retirement Life should be denied. The Department also recommended that the Commission deny MERC's proposal to amortize the costs associated with its Supplemental Executive Retirement Plan (SERP) costs for either MERC's or Integrys Business Support's, LLC (IBS) legacy benefit plans. The Department deferred its final recommendation to the Commission, pending review and assessment of MERC's Reply Comments.

[1] IBS provided support services to MERC under an affiliated interest agreement. IBS was renamed as WEC Business Services (WBS) after Integrys' acquisition by WEC Energy Group in June, 2015.

On May 2nd, 2016, MERC filed its Reply Comments. MERC noted in its Reply Comments that the Company's request didn't pertain to the Aquila regulatory asset(s) the Commission approved in Docket No. G007, 011/M-06-1287. That approved amortization will continue apace until the Aquila regulatory asset is fully amortized in June 2026 and was included in MERC's recently concluded rate case. The Company also noted that the net pension and OPEB assets that MERC proposed to amortize in this docket were created in 2007 as a response to the requirements contained in Financial Accounting Standard (FAS) 158. They are not the result of the Aquila merger. The costs and credits that MERC is requesting to recover in its proposed amortization relate to past employee service as well as unrecognized gains and losses related to changes in actuarial assumptions related to the pension plans and OPEBs in question. Specifically, the costs and credits MERC seeks to include in its proposed amortization existed prior to WEC Energy Group's acquisition of Integrys (and MERC). MERC's proposal is to establish a reasonable amortization period for these assets because their values were fixed at the time of the merger between Integrys and the WEC Energy Group in June of 2015. The act of freezing the values of those assets at that time (June 30, 2015) was due to requirements included in Generally Accepted Accounting Principles (GAAP) related to purchase accounting. The basis of MERC's petition is to reflect the change in the fair market value of the pension and OPEB assets and liabilities that changed over time (called "mark-to-market"). As this Petition is the result of purchase accounting, this request reflects a one-time treatment of the assets and liabilities. The costs and credits included in the proposed amortization will not be marked-to-market in the future.

On July 25th, 2016, the Department filed its Response to MERC's Reply Comments. The DOC provided an analysis that used the decision criteria the Commission has developed to determine if deferred accounting is warranted. The Department concluded that MERC's request met two of the three criteria. Specifically the costs were unusual and were large enough to have a significant impact on MERC's financial position. However, the DOC concluded that MERC had not shown that the costs were unforeseeable and asked MERC to provide information in support of its position in its Supplemental Response Comments. The Department also included several additional recommendations;

1) MERC shouldn't be allowed to recover the costs associated with the Integrys Supplemental Executive Retirement Program (SERP), which is $137,819 or 1.36 percent of the total $10,141,140 that MERC requests for deferral.
2) The Company shouldn't be allowed to include the remaining $10,003,321 million (total net of SERP) in pension and OPEB-related assets in its rate-base and shouldn't be allowed to earn a return on those assets.[2]
3) MERC should be allowed to transfer the amount identified as its Integrys Business Services (IBS) related costs of $566,401 to MERC's balance sheet. Adding the MERC's IBS-related costs to the MERC-specific costs of $9,436,920 results in the total amount of $10,003,321 that should be recognized as the amount of costs deferred as a result of this docket.

[2] The DOC used the term "ring-fence" to describe the treatment of those assets.

4) The appropriate amortization period for MERC's deferred costs is 14 years.
5) MERC's request that the Commission authorize the requested treatment as of June 30, 2015, with the amortization beginning January 1, 2016 should be approved.

On August 25th, 2016 MERC filed its Supplemental Reply Comments. In those comments the Company noted that it opposed several of the Department recommendations including that:

1) The SERP costs identified in the amount of $137,819 be disallowed. Thus, the Company believes the entire amount it proposed $10,141,140 should be deferred, rather than the $10,003,321 recommended by the Department.
2) The remaining $10.0 million in pension and OPEB-related assets be ring-fenced such that it would not be included in rate base. MERC stated that adoption of this recommendation would create a situation in which the Company wouldn't be allowed to earn a return on those assets.

The Company also noted that the Deferred Accounting Standard the Department used in its analysis in its Response Comments was inapplicable, but would be met in any event. MERC did agree with the Department's recommendations that the IBS-related costs and the MERC-specific costs be combined as a regulatory asset and be amortized over 14 years. The Company also provided some supplemental information as to the status of WE Energy Corporation's requests for similar treatment in several other jurisdictions.

Relevant Documents Submitted in Docket No. G011/GR-15-736

On April 12, 2016, MERC witnesses Ms. Christine Hans and Mr. Seth Demerrit filed Rebuttal Testimony in the Company's most recent rate case (Docket No. G011/GR-15-736) that requested recovery of an additional $654,997 in annual pension expense as a result of the costs identified in this proceeding. The Department opposed the inclusion of those expenses in MERC's 2016 Test Year and the Company withdrew its proposal at the evidentiary hearing.

III. ANALYSIS

From the Department's perspective, MERC identified several topics in its Comments dated August 25th, 2016:

- The deferred accounting standard is inapplicable
- If the deferred accounting standard is applicable, MERC meets the requirements
- Ring-fencing of the $10.3 million in additional pension liabilities is not appropriate

- SERP amortization does not equate to cost recovery
- Potential for incremental administrative costs associated with the DOC proposal, and
- Agreement with DOC's amortization period and methodology

The Department addresses these topics in order.

A. DEFERRED ACCOUNTING CRITERIA

The Department corrects a statement in our July 25, 216 Response Comments. On page 4 the Department stated: "Consequently, MERC initiated this position requesting that the Commission approve deferred accounting for the losses MERC and Intregrys realized as a result of WEC's acquisition of Integrys." That statement, by itself, is inaccurate; MERC has not requested approval of deferred accounting for the $10.3 million liability the Company sustained as a result of marking its pension and OPEB assets to market at the time of WEC's acquisition of Integrys. However, that statement, in its context, reflects the somewhat complex requirements of GAAP under purchase accounting:

> Consistent with the description provided in (B) above, MERC and its parent company Integrys were meeting the GAAP requirements associated with reporting their respective pension-related information in their financial statements. When Integrys was acquired by WEC Energy Group, Inc., on June 29th, 2015, this "business" combination required WEC to recognize the gains and losses in [Accumulated Other Comprehensive Income] AOCI on both MERC and Integrys' balance sheets that related to pension and OPEB assets. Consequently, MERC initiated this petition requesting that the Commission approve deferred accounting for the losses MERC and Integrys realized as a result of WEC's acquisition of Integrys.

As MERC stated on page 2 of its August 25, 2016 filing, GAAP "required the companies to freeze the fair market value of the pre-existing assets and liabilities as of the date of the merger."

However, the Company's characterization of its request appears to be misleading. MERC stated at page 3 of its August 25, 2016 filing that "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/Integrys merger." That statement gives the impression that the Commission need only approve a change in the amortization period to 14 years. But MERC is also asking the Commission to allow it to recover an additional $10.3 million from ratepayers that is required under GAAP to be expensed in the year recognized. As a result, the Department concludes that MERC's request for the additional $10.3 million is a request for deferred accounting.

In our Comments dated July 25, 2016, the Department identified three primary criteria for evaluating a company's request for deferred accounting treatment and concluded that MERC's request met two of the three criteria. MERC stated in its Comments dated August 25, 2016 that:

> The fact of the merger itself, and therefore the future applicability of purchase accounting requirements 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 Department appreciates MERC's statement that mergers undertaken by a parent company may not be known in the ordinary course of business. Moreover, while MERC should have been aware of the requirements of purchase accounting, the Department agrees with the Company that the extent of the costs may not have been foreseen, due to difficulty predicting markets. Thus, the costs Company proposes to defer meet the Commission's criteria in a broad sense and the Department concludes that MERC has met the Commission's standard for allowing those pension-related costs to be deferred.

B. RING-FENCING

As noted previously, while the Department recommended that the Commission allow MERC to recover $10.1 million of pension and OPEB-related costs, it also recommended that the Commission ring-fence those assets such that the Company would be precluded from including those assets in its rate base.

The Department notes that MERC notified it on November 21st, 2016 that it would no longer oppose the concept of ring-fencing these assets. Thus, the Department concludes that this issue is resolved between the parties.

C. SERP AMORTIZATION DOES NOT EQUATE TO COST RECOVERY AND POTENTIAL FOR ADDITIONAL ADMINISTRATIVE COSTS

The Department's recommendation that MERC not be allowed to include SERP costs in the amortization was also policy-based. MERC provided some additional information in its August 25th comments that complicates the Department's recommendation.

> 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. . . . 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.[3]

The Department is concerned by the language regarding the potential for the incurrence of additional administrative costs. MERC explained in response to an informal Department inquiry that the incremental administrative costs it would incur regarding this issue would be internal.

There is a second aspect to incremental costs that relates to additional actuarial costs the Company identified. MERC stated in its Petition "At the same time, this proposal will reduce the administrative cost of otherwise requiring WEC to conduct multiple actuarial valuations of pension and OPEB assets to reflect regulatory requirements differently from GAAP."[4]

In DOC Information Request No. 2, the Department asked MERC to provide the analysis that supported this statement. The Company replied: "That statement was based on a conversation with the Company's independent actuary, Willis Towers Watson, which indicated that the incremental annual cost of preparing a second set of actuarial valuations for MERC along would be approximately $150,000.[5]

MERC also explained in response to an informal request that the Company had already incurred those incremental actuarial costs.

Given this information, the Department concludes that the only incremental costs associated with the Petition at this juncture are internal and that the Department's recommendations will not increase the Company's pension-related expenses at this point. Thus, the Department continues to recommend that the Commission require MERC to exclude the $137,819 in SERP costs from the deferred account.

---

[3] MERC's August 25, 2016 Comments at page 6.
[4] MERC's petition doesn't have page numbers, but the statement is on page 4 of 14 of the document at the end of the third full paragraph.
[5] A copy of this information request and the Company's response is included as Attachment A.

D. PROPOSED AMORTIZATION PERIOD AND METHODOLOGY

In its Comments dated July 25, 2016, the Department recommended that the Commission approve an amortization period of 14 years for the assets in question. MERC agreed with this recommendation in its August 25, 2016 comments. Thus, the Department concludes that this issue is resolved between the parties.

IV. RECOMMENDATIONS

The Department's recommendations are the following:

- Allow for the creation of an amortization of MERC's pension and OPEB assets equal to $10,003,321 million;
- Set the amortization period at 14 years;
- Allow the amortization to begin January 1, 2016;
- Allow MERC to book $566,401 in costs related to IBS legacy benefit plans to its balance sheet (this amount is included in the $10.003,321 figure above);
- Require MERC to ring-fence the $10,003,121 in costs it is being allowed to amortize such that none of those costs are eligible to be to be recovered in rate base, and
- Don't allow MERC to include its requested $137,819 in SERP costs in the deferred account.

/lt

State of Minnesota
DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

Nonpublic [ ]
Public [X]

Utility Information Request

Docket Number: G011/M-15-992 Date of Request: 3/21/2016

Requested From: Minnesota Energy Resources Corporation Response Due: 3/31/2016

Analyst Requesting Information: John Kundert

Type of Inquiry:

[ ]......Financial	[ ]......Rate of Return	[ ]......Rate Design
[ ]......Engineering	[ ]......Forecasting	[ ]......Conservation
[ ]......Cost of Service	[ ]......CIP	[ ]......Other:

If you feel your responses are trade secret or privileged, please indicate this on your response.

Request No.	
2	Reference: Page 4 of the petition Please provide the analysis that supports the Company's statement "this proposal will reduce the administrative costs of otherwise requiring WEC to conduct multiple actuarial valuations of pension and OPEC assets to reflect regulatory requirements differently from GAAP." **MERC Response:** That statement was based on a conversation with the Company's independent actuary, Willis Towers Watson, which indicated that the incremental annual cost of preparing a second set of actuarial valuations for MERC alone would be approximately $150,000.

Response by: Christine Hans

Title: Manager – Benefits Accounting

Department: Benefits Accounting

Telephone: (312) 240-4009

List sources of information:

CERTIFICATE OF SERVICE

I, Sharon Ferguson, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, e-mail, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

Minnesota Department of Commerce
Supplemental Response Comments

Docket No. G011/M-15-992

Dated this 21st day of November 2016

/s/Sharon Ferguson

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Michael	Ahern	ahern.michael@dorsey.com	Dorsey & Whitney, LLP	50 S 6th St Ste 1500 Minneapolis, MN 554021498	Electronic Service	No	OFF_SL_15-992_M-15-992
Julia	Anderson	Julia.Anderson@ag.state.mn.us	Office of the Attorney General-DOC	1800 BRM Tower 445 Minnesota St St. Paul, MN 551012134	Electronic Service	Yes	OFF_SL_15-992_M-15-992
Koby	Bailey	kabailey@integrysgroup.com	Minnesota Energy Resources Corporation (HOLDING)	200 East Randolph, Suite 2300 Chicago, Illinois 60601	Electronic Service	No	OFF_SL_15-992_M-15-992
Elizabeth	Brama	ebrama@briggs.com	Briggs and Morgan	2200 IDS Center 80 South 8th Street Minneapolis, MN 55402	Electronic Service	No	OFF_SL_15-992_M-15-992
Seth	DeMerritt	ssdemerritt@integrysgroup.com	MERC (Holding)	700 North Adams P.O. Box 19001 Green Bay, WI 543079001	Electronic Service	No	OFF_SL_15-992_M-15-992
Sharon	Ferguson	sharon.ferguson@state.mn.us	Department of Commerce	85 7th Place E Ste 500 Saint Paul, MN 551012198	Electronic Service	No	OFF_SL_15-992_M-15-992
Daryll	Fuentes	dfuentes@usg.com	USG Corporation	550 W Adams St Chicago, IL 60661	Electronic Service	No	OFF_SL_15-992_M-15-992
Amber	Lee	ASLee@minnesotaenergyresources.com	Minnesota Energy Resources Corporation	2665 145th St W Rosemount, MN 55068	Electronic Service	No	OFF_SL_15-992_M-15-992
John	Lindell	john.lindell@ag.state.mn.us	Office of the Attorney General-RUD	1400 BRM Tower 445 Minnesota St St. Paul, MN 551012130	Electronic Service	Yes	OFF_SL_15-992_M-15-992
Brian	Meloy	brian.meloy@stinson.com	Stinson,Leonard, Street LLP	150 S 5th St Ste 2300 Minneapolis, MN 55402	Electronic Service	No	OFF_SL_15-992_M-15-992

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Andrew	Moratzka	andrew.moratzka@stoel.com	Stoel Rives LLP	33 South Sixth St Ste 4200 Minneapolis, MN 55402	Electronic Service	No	OFF_SL_15-992_M-15-992
Colleen	Sipiorski	ctsipiorski@integrysgroup.com	Minnesota Energy Resources Corporation	700 North Adams Street Green Bay, WI 54307	Electronic Service	No	OFF_SL_15-992_M-15-992
Kristin	Stastny	kstastny@briggs.com	Briggs and Morgan, P.A.	2200 IDS Center 80 South 8th Street Minneapolis, MN 55402	Electronic Service	No	OFF_SL_15-992_M-15-992
Eric	Swanson	eswanson@winthrop.com	Winthrop Weinstine	225 S 6th St Ste 3500 Capella Tower Minneapolis, MN 554024629	Electronic Service	No	OFF_SL_15-992_M-15-992
Daniel P	Wolf	dan.wolf@state.mn.us	Public Utilities Commission	121 7th Place East Suite 350 St. Paul, MN 551012147	Electronic Service	Yes	OFF_SL_15-992_M-15-992