STATE OF MINNESOTA
BEFORE THE
MINNESOTA PUBLIC UTILITIES COMMISSION

Nancy Lange	**Chair**
Dan Lipschultz	**Commissioner**
Matt Schuerger	**Commissioner**
Katie Sieben	**Commissioner**
John Tuma	**Commissioner**

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 Nos. E001, 115, 140, 105, 139, 124, 126, 145, 132, 114, 6521, 142, 134/PA-14-322 **THIRD[1] AMENDED COMPLIANCE FILING BY SOUTHERN MINNESOTA ENERGY COOPERATIVE ON TRANSITION PERIOD RATES**

INTRODUCTION AND BACKGROUND

On June 8, 2015, the Minnesota Public Utilities Commission (Commission) issued an Order[2] approving the joint petition submitted by Southern Minnesota Energy Cooperative (SMEC) and Interstate Power and Light Company (IPL) requesting approval of the sale of IPL's Minnesota electric distribution system and assets, and the transfer of IPL's Minnesota service rights and obligations, to SMEC, which is an electric cooperative association comprised of 12 rural electric cooperatives (Member Cooperatives).[3] The Commission's approval of the sale and

[1] The only amendment in this version of SMEC's compliance filing is a revision to the summary percentages under Scenario 2 for BENCO provided on page 7.

[2] *In the Matter of a Request for the Approval of the Asset Purchase and Sale Agreement Between Interstate Power & Light Co. & S. Minn. Energy Coop.*, Order Approving Agreement Subject to Conditions, Docket Nos. E001, 115, 140, 105, 139, 124, 126, 145, 132, 114, 6521, 142, 135/PA-14-322 (June 8, 2015) (hereinafter, "June 8, 2015 Order").

[3] SMEC's Member Cooperatives include: BENCO Electric Cooperative, Brown County Rural Electrical Association, Federated Rural Electric Association, Freeborn-Mower Cooperative Services, Minnesota Valley Electric Cooperative, Nobles Cooperative Electric, People's Energy Cooperative, Redwood Electric Cooperative, Sioux Valley Energy (of Colman, South Dakota), South Central Electric Association, Steele-Waseca Cooperative Electric, and MiEnergy Cooperative (formed in 2017 as a result of the merger between Hawkeye REC and Tri-County Electric Cooperative).

transfer of service rights from IPL to SMEC was subject to certain conditions, including the Commission's retention of jurisdiction to enforce the terms and conditions of a 5-year rate plan[4] (Rate Plan) agreed to by SMEC and IPL when they submitted the joint petition. As the Commission recognized in its June 8, 2015 Order, the agreed-upon Rate Plan "reasonably ensures that IPL customer rates will be maintained separately from existing SMEC customer rates until merging them is an appropriate regulatory outcome.[5]"

The Rate Plan provides that with certain limited exceptions, for the first thirty-six months after closing of the sale[6] (Three-Year Initial Period), SMEC and its Member Cooperatives "will adopt IPL's retail rates effective as of the date of Closing [of the sale and transfer], as approved by the Commission in Docket No. E-001/GR-10-276," for members located in service territories acquired from IPL (Acquired Areas).[7] Having complied with initial requirement for the Three-Year Initial Period, SMEC Member Cooperatives are now at the stage of establishing rates for the next twenty-four months after the closing (Two-Year Transition Period), which begins on August 1, 2018.

The Rate Plan sets guidelines governing the establishment of rates by each SMEC Member Cooperative for its respective Acquired Area. The purpose of this filing is to provide the

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[4] *In the Matter of a Request for the Approval of the Asset Purchase and Sale Agreement Between Interstate Power & Light Co. & S. Minn. Energy Coop.*, Proposed SMEC Rate Plan, (Attachment G to Joint Petition), Docket Nos. E001, 115, 140, 105, 139, 124, 126, 145, 132, 114, 6521, 142, 135/PA-14-322 (April 15, 2014) (hereinafter, "Rate Plan").

[5] June 8, 2015 Order at 8.

[6] The closing occurred on July 31, 2015. After the closing of the sale from IPL to SMEC, the Commission subsequently approved SMEC's transfer of service rights of IPL's former customers to the SMEC Member Cooperatives. *See In the Matter of Southern Minnesota Energy Cooperative's Petition Requesting Approval to Adjust Electric Service Territories of the Twelve Member Cooperatives*, Order, Docket Nos. E-001, 132, 114, 104, 142, 135, 115, 140, 105, 139, 124, 126, 145/SA-15-986; E-001, 132, 114, 104, 142, 135, 115, 140, 105, 139, 124, 126, 145/PA-14-322 (Jan. 7, 2016).

[7] Rate Plan, *supra* note 4 at 1.

Commission and interested parties with notice that SMEC and its Member Cooperatives have complied with the terms of the Rate Plan with respect to the rates established by each Member Cooperative for the Two-Year Transition Period.

RATE PLAN REQUIREMENTS

For purposes of establishing Transition Period rates, the Rate Plan first provides as follows:

> During the Initial Period, each SMEC Member Cooperative will prepare Class Cost of Service Studies (CCOSS) as part of developing a long range Rate Plan. The CCOSS will address the cost to serve 1) the Legacy Area,[8] 2) the Acquired Area, and 3) the Combined Area. The CCOSS for each SMEC Member Cooperative's Legacy Area and Acquired Area will reflect the Acquired Area and Legacy Area specific direct assigned costs for purchased power and distribution facilities. Margin requirements will be determined in the same manner and using the same criteria for Acquired Areas and Legacy Areas. For example, if a SMEC Member Cooperative establishes its target margin on the basis of a Times Interest Earned Ratio (TIER) of 2.0, it will use that method and metric for both the Acquired Area and Legacy Area. Other costs common to both Acquired Areas and Legacy Areas,[] such as Customer Accounting, Customer Service and Information, Sales, A&G and fixed costs related to General Plant will be allocated to Acquired Areas and Legacy Areas and then to each rate class based on appropriate allocation factors in a non-discriminatory manner.[9]

Upon the completion of the foregoing CCOSS, the Rate Plan explains:

> Based on the results of the CCOSS's, the SMEC Member Cooperatives will develop a plan to either 1) continue to serve the Acquired Areas and Legacy Areas under separate area cost based rate structures, or 2) merge the rates of the two areas over time in a manner that mitigates any undue hardship to customers, or 3) some combination thereof. Key to this determination will be the impact of the plan on the bills of the affected customers.[10]

With respect to the actual process for establishing Two-Year Transition Period rates, the Rate Plan goes on to state that "[d]uring the Transition Period, unless the criteria for merging the

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[8] "Legacy Areas" refer to those areas that the SMEC Member Cooperatives already served prior to the sale of assets and transfer of service territories from IPL.

[9] Rate Plan, *supra* note 4 at 4.

[10] *Id.* at 5.

area rates as outlined [herein] are met, each Member will maintain separate rate structures for the Legacy and Acquired Areas.[11]"

The Rate Plan provides that a Member Cooperative may only merge one or more Legacy Area and Acquired Area rates if: (1) "the projected revenue produced by the Legacy Area and Acquired Area rates in question are within 5 percent of each other;" and (2) "No rate will be increased by more than 5 percent per year, excluding the operation of the PCA mechanism,[12] to facilitate the merger of [the] rate[s].[13]"

If the foregoing criteria for merging rates are not met, the Rate Plan requires that "[e]ach Member Cooperative will maintain separate rates for its Acquired Area and Legacy Area[.][14]" This requirement is confirmed by the Commission's June 8, 2015 Order, which provides, "Rates not merged in accordance with [the Rate Plan] limitations will be maintained separately and established according to the results of the CCOSS.[15]" Under such circumstances, "[t]he rates for the Acquired Area will be designed to recover, in total, the sum of the class revenue requirements for the Acquired Area, as determined by the CCOSS . . . .[16]" The Rate Plan

[11] *Id.*

[12] "PCA mechanism" refers to a Power Cost Adjustment mechanism "designed to track changes in the cost of purchased power and transmission delivery service from the amount included in IPL's current base rates and the Renewable Energy Recovery (RER) surcharge." *Id.* at 1.

[13] *Id.* at 5-6; *see also* June 8, 2015 Order at 4 ("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) mechanism) to facilitate the merger of a Legacy Area and Acquired Area rate.")

[14] Rate Plan, *supra* note 4 at 5.

[15] June 8, 2015 Order at 5.

[16] Rate Plan, *supra* note 4 at 5.

explains that "[t]he same approach will be used for the Legacy Area, with the total revenue requirements of the Acquired Area and Legacy Area being kept separate.[17]"

CCOSS METHODOLOGY

SMEC retained the National Rural Utilities Cooperative Finance Corporation (CFC) on behalf of its Member Cooperatives to complete the CCOSS required under the Rate Plan using 2016 as the test year. CFC completed two CCOSS scenarios for each Member Cooperative. Under the first scenario, CFC linked two cost studies, one for each cooperative's Legacy Area and one for its Acquired Area, to simulate a single study that allocated all costs equally between both areas using non-discriminatory factors (i.e., a CCOSS for the overall "Combined Area"). The purpose of this first study was to give the Member Cooperatives a better sense of what adjustments will need to be made when each cooperative determines it is appropriate to begin merging the rates of both areas.

In the second scenario, CFC again linked two cost studies for the Legacy and Acquired Areas of each cooperative. This time, however, CFC directly assigned the costs for purchased power and distribution facilities[18] attributable to each respective area as described in the Rate Plan. Other costs[19] common to both areas were allocated between the two areas and then to each rate class using non-discriminatory allocation factors. This second scenario provides each cooperative with the information necessary to determine rates during the Two-Year Transition Period that are designed to recover the sum of the class revenue requirements for each respective area independent of one another (i.e., maintaining separate, cost-based rate structures for the Legacy and Acquired Areas).

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[17] *Id.*

[18] Acquired plant sold to others was removed. Acquired area acquisition premium directly assigned.

[19] Costs assigned directly to Legacy area were legacy generation and transmission costs, Deferred Credits and adjusted legacy known purchased power costs.

CCOSS RESULTS

Although Member Cooperatives had some individual rates that met the criteria for merging Legacy and Acquired Area rates as outlined in the Rate Plan (i.e., the projected revenue from each area was within 5% of one another and no rate would need to be increased by more than 5% to facilitate the merger), the majority of the Member Cooperatives' rates did not satisfy the criteria for merging. Accordingly, the SMEC Member Cooperatives have all determined it is in the best interest of their respective cooperatives' members to maintain separate cost-based rate structures for the Legacy and Acquired Areas across all classes for the duration of the Two-Year Transition Period. As a result, the SMEC Member Cooperatives have relied on the second scenario results of the CCOSS completed by CFC, which specifically allocate the costs for purchased power and distribution facilities attributable to the Legacy Areas and Acquired Areas separately, as outlined in the Rate Plan.

The following table summarizes the overall annual percentage increase (or decrease) in rates that each Member Cooperative would need to implement in order to recover the sum of the class revenue requirements for each area for the given test year based on the results of the second scenario CCOSS:

Scenario 2: Specific Assignment of Purchased Power & Distribution Costs

Cooperative	Legacy Area	Acquired Area
BENCO	-5.18%	21.11%
Brown	-0.13%	3.89%
Federated	-0.13%	21.42%
Freeborn Mower	-4.94%	8.82%
MinnesotaValley	2.83%	20.47%
Nobles	-1.67%	10.19%
Peoples	5.81%	1.06%
Redwood	1.04%	17.67%
Sioux Valley	-0.49%	24.90%
South Central	0.11%	18.61%
Steele-Waseca	-1.15%	13.80%
MiEnergy	1.22%	15.97%

As the results in the foregoing table reflect, there was a wide variation in the results of the CCOSS among the Member Cooperatives for the Acquired Areas. The higher percentages reflected in the Acquired Area results for some of the cooperatives are a natural consequence of several factors, including but not limited to the following: (1) former IPL members located in the Acquired Areas have essentially not seen any increase in rates since IPL's last rate case in 2010; (2) the cooperatives with higher percentages needed to recover the revenue requirements for the Acquired Areas generally also acquired a larger percentage of IPL's distribution assets (and correspondingly incurred the expenses associated with such asset acquisitions), and (3) significant differences in load factors among the cooperatives.

TRANSITION PERIOD RATES

Although the results of the CCOSS reflect the need for many of the Member Cooperatives to make significant adjustments to rates in their Acquired Areas in order to fully recover the class revenue requirements needed to serve members in those areas, the SMEC Member Cooperatives have proceeded with the development of Transition Period rates with member impact at the forefront of their considerations. Even though the Rate Plan places no cap on rate increases for the Acquired Areas in the event the cooperatives are maintaining separate rate structures during the Two-Year Transition Period, all of the SMEC Member Cooperatives have agreed to use the 5% cap identified in the Rate Plan for merged rates as a ceiling for purposes of developing the Transition Period rates for their respective Acquired Areas in order to provide economic protections to affected customers and protect against rate shock. Accordingly, all of the SMEC Cooperatives will increase the overall rates for the Acquired Areas within a range of 0% to 5% per year for the two-year Transition Period,[20] as reflected in the following table:

Overall Rate Increases by Transition Period Year for the Acquired Areas

Cooperative	Year 1	Year 2
BENCO	Up to 5.00%	Up to 5.00%
Brown	Up to 3.89%	Up to 3.89%
Federated	Up to 5.00%	Up to 5.00%
Freeborn Mower	Up to 5.00%	Up to 5.00%
MinnesotaValley	Up to 5.00%	Up to 5.00%
Nobles	Up to 5.00%	Up to 5.00%
Peoples	Up to 1.06%	Up to 1.06%
Redwood	Up to 5.00%	Up to 5.00%
Sioux Valley	Up to 2.50%	Up to 5.00%
South Central	Up to 5.00%	Up to 5.00%
Steele-Waseca	Up to 5.00%	Up to 5.00%
MiEnergy	Up to 5.00%	Up to 5.00%

CONCLUSION

As outlined herein, SMEC and its Member Cooperatives have complied with the terms of the Rate Plan with respect to the development of CCOSS and the establishment of rates for the Two-Year Transition Period. The 12 SMEC Member Cooperatives intend to implement rate

[20] SMEC notes that these overall percentage rate increases will be spread across all rate classes within the Acquired Areas based on appropriate allocation factors, as determined by each cooperative's board. Individual members will be affected differently because the actual changes in rates seen by members within different rate classes will not be uniform. SMEC further notes that the 0-5% range does not factor in the expiration of the $0.002/kWh credit provided to Acquired Area members "[i]n order to temper the increase resulting from the conversion from IPL's ESCR mechanism . . . to the SMEC PCA mechanism," which expires at the end of the Three-Year Initial Period. *See* Rate Plan, *supra* note 4 at 3-4.

changes reflecting the overall rate adjustments for the Acquired Areas described herein when the Two-Year Transition Period commences on August 1, 2018.

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FELHABER LARSON

By: *_/s/ Randi J. Winter_*
Sara G. McGrane, #233213
Randi J. Winter, #391354
220 South Sixth Street, Suite 2200
Minneapolis, MN 55402
(612) 339-6321
smcgrane@felhaber.com
rwinter@felhaber.com

Attorneys for Southern Minnesota Energy Cooperative