G-008/C-91-942 ORDER GRANTING PARTICIPANT STATUS AND DENYING REQUESTS FOR RECONSIDERATION

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Marshall Johnson	Commissioner
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Dee Knaak	Commissioner

In the Matter of the Complaint of the Minnesota Alliance for Fair Competition Against Minnegasco, a Division of Arkla, Inc.

ISSUE DATE: July 28, 1994

DOCKET NO. G-008/C-91-942

ORDER GRANTING PARTICIPANT STATUS AND DENYING REQUESTS FOR RECONSIDERATION

PROCEDURAL HISTORY

On November 27, 1991, the Minnesota Alliance for Fair Competition (MAC), a trade organization of plumbing, electrical and appliance associations, filed a complaint against Minnegasco, a division of Arkla, Inc. (Minnegasco or the Company). The complaint alleged that Minnegasco subsidizes its nonregulated appliance sales and service operations through its regulated utility operations, offers preferential treatment to ratepayers who use its appliance sales and service operations, and uses its appliance inspection service to manipulate ratepayers into purchasing appliances from Minnegasco.

On January 29, 1992, the Commission issued its ORDER SEVERING MINNEGASCO FROM THE INVESTIGATION DOCKET, GRANTING DISCOVERY RIGHTS, REQUIRING REPORT AND AUTHORIZING COMMENTS. In that Order the Commission established the current complaint proceeding.

On November 10, 1992, the Commission issued its ORDER ESTABLISHING ACCOUNTING PROCEDURES AND REQUIRING FURTHER FILINGS. In that Order the Commission directed Minnegasco to adopt cost separation principles developed by the Federal Communications Commission (FCC). The Order also required the Company to charge the cost of carbon monoxide (CO) checks to nonregulated operations and to submit filings regarding its winter residential gas leak detection program and various allocation issues. The Commission declined to set a license fee for the use of Minnegasco's name.

On May 5, 1993, the Commission issued its NOTICE AND ORDER FOR HEARING. The Commission found that there were significant issues in dispute which required a contested case proceeding.

On March 24, 1994, following a full contested case proceeding, the Commission issued its ORDER APPROVING COST ALLOCATION METHODS AND LEAK SURVEY PLAN WITH MODIFICATIONS, REQUIRING REPORT, FINDING VALUE IN GOOD WILL, AND DEFERRING VALUATION TO RATE CASE. In that Order the Commission reaffirmed that structural separation of the Company's regulated utility and nonregulated appliance operation was not necessary. The Commission found that Minnegasco's cost allocation system, embodied in its cost apportionment manual (CAM), was appropriate. The Commission required the Company and the Department of Public Service (the Department) to form a work group to explore further simplifications and improvements to the Company's CAM. The Commission approved the Company's Winter Residential Leak Survey (WRLS) with two modifications: a cost recovery cap of 20% of service lines in a given community; disallowance of costs of conducting repeat checks. Finally, the Commission found that there is value to Minnegasco's good will as used by its nonregulated appliance affiliate. The Commission deferred further consideration of good will, including its valuation, to the Company's ongoing rate case.

On April 4, 1994, Minnegasco filed a petition for reconsideration of the March 24 Order. MAC filed a petition for reconsideration on April 13, 1994.

On April 13, 1994, a group of four utilities filed a request for participant status in the complaint docket. The petitioning utilities were Northern States Power Company, Northern Minnesota Utilities, Otter Tail Power, and Peoples Natural Gas Company (together, the Utilities).

On April 14, 1994, the Department and the Residential Utilities Division of the Office of the Attorney General (RUD-OAG) filed responses to Minnegasco's petition for reconsideration.

On April 22, 1994, and May 5, 1994, the Commission issued its ORDERS GRANTING RECONSIDERATION to allow further time to consider the petitions for reconsideration filed by Minnegasco and MAC.

On April 25, 1994, the Department and Minnegasco filed responses to MAC's petition.

The matter came before the Commission for consideration on July 7, 1994.

FINDINGS AND CONCLUSIONS

I. Introduction

In this Order the Commission will first address the Utilities' Request for Participant Status. The Commission will next analyze the two issues raised by MAC in its Petition for Reconsideration. Finally, the Commission will consider Minnegasco's Request for Rehearing on four issues in the March 24, 1994, Order.

II. The Utilities' Request for Participant Status

A. The Utilities' Argument

The Utilities filed a Request for Participant Status and Comments. Before any consideration of the Utilities' comments, the Commission must decide if the Utilities should be allowed to participate in the proceedings.

The Utilities made their request for participant status pursuant to Minn. Rules, part 7830.0700, which provides:

> The presiding officer(s) may hear the views or evidence of any person or organization as to the subject matter, but no person shall become or shall be deemed to have become a party to the proceeding by reason of such participation in the hearing. Any person may enter an appearance in any proceeding, but no person shall become or shall be deemed to have become a party to the proceeding by reason of having entered an appearance therein.

The Utilities argued that they would be affected by the precedent set in this proceeding.

Specifically, the Utilities questioned the Commission's finding regarding the value of good will. The Utilities reasoned that they should be allowed participant status in this docket because the possibility of being affected by the Commission's decision gave them a legitimate interest in the outcome of the proceeding.

No party opposed granting the Utilities participant status.

B. Commission Analysis

The Commission agrees with the Utilities that they should be granted participant status in this proceeding. The four Utilities have organizational structures which bear some resemblance to Minnegasco's. The Utilities have a legitimate interest in the decisions reached in the proceedings. Allowing the Utilities' comments to be heard should not prejudice any party and should be useful for consideration of the issues.

The Commission will grant the Utilities' request for participant status in this proceeding. Having granted the request, the Commission will consider the Utilities' comments as the Commission forms determinations on these issues.

II. MAC's Request for Reconsideration, Clarification, and Amendment of the March 24, 1994, Order

MAC asked the Commission to reconsider its decision not to require structural separation of Minnegasco's regulated and nonregulated entities. MAC also asked for amendment or clarification of the portion of the March 24, 1994, Order which approves Minnegasco's CAM but does not expressly require a compliance audit process.

A. Structural Separation of the Regulated and Nonregulated Entities

1. The March 24, 1994, Order

In the March 24, 1994, Order, the Commission noted that it had first found Minnegasco's structural separation unnecessary in its November 10, 1992, ORDER ESTABLISHING ACCOUNTING PROCEDURES AND REQUIRING FURTHER FILINGS.

Since the November 10, 1992 Order, contested case proceedings had been conducted regarding MAC's complaint. In his report in those proceedings, the ALJ had recommended against imposing structural separation on Minnegasco. The ALJ had found that Minnegasco's use of its CAM, if improved and carefully monitored, would prevent cross-subsidization.

The Commission concluded that the full record in the contested case proceeding supported the Commission's original November 10, 1992, decision against structural separation for Minnegasco.

2. MAC's Arguments

MAC argued that Minnegasco's financial filings in its ongoing rate case were corroborating evidence of past cross-subsidization. Rate case filings indicated that Minnegasco's allocation of costs to the nonregulated appliance entity increased by more than $5 million after adoption of the CAM. MAC argued that this rate case financial information corroborated over half of the subsidy MAC had originally alleged, and therefore supported the need for structural separation.

MAC also argued that Minnegasco's adamant opposition to structural separation indicates that substantial subsidies remain.

MAC cited Minn. Stat. § 216B.03, which states that doubts regarding reasonableness of rates should be resolved in favor of the consumer. MAC urged the Commission to require structural separation of Minnegasco's regulated utility and its nonregulated appliance enterprise.

3. Commission Analysis

The Commission finds that MAC is raising exactly the same arguments as have been raised and answered in contested case proceedings and two previous Commission Orders. The figures cited from the Minnegasco rate case do not alter any of MAC's arguments or require a change in the Commission's decision.

The Company's change in allocation to the nonregulated entity does not of itself indicate that prior cross-subsidization took place. As the ALJ stated at p. 13 of his January 5, 1994, report, "the change in methodology necessarily produced a change in reported results. This is not evidence of a subsidy, only of a change in methodology." The Commission agreed with this viewpoint at p. 5 of the March 24, 1994, Order: "Neither does the fact that allocations will necessarily change with the use of the CAM show that allocations under preCAM methods resulted in cross-subsidization."

The Minnegasco rate case financial figures do not persuade the Commission that its previous decision against the imposition of structural separation was in error. If the Commission did not expect some change in results from adoption of the FCC methodology, it would have been pointless to order its adoption. The Commission notes that accounting is a discipline which can, and often does, allow more than one correct answer. Change in results simply does not equal proof of prior improper accounting.

The Commission will not grant MAC's request for reconsideration of this issue.

B. Annual Independent Compliance Audits

1. The March 24, 1994, Order

In the March 24, 1994, Order, the Commission noted that a number of questions had been raised regarding Minnegasco's allocations. The Commission recognized that improvements could be made in the Company's allocation methods. The goal of the improvements would be a more comprehensible and readily monitored system.

In order to address these issues, the Commission ordered the formation of a work group composed of representatives of the Company, the Department, and Commission Staff. The work group's analysis of the Company's allocation methods would help determine if further simplifications are necessary and if the Company's internal controls are adequate. The Commission ordered the work group to submit a report on cost allocations and reporting requirements to the Commission on or before October 1, 1994.

2. MAC's Argument

MAC stated that during the contested case proceedings several witnesses, including representatives from the Department and Minnegasco, had noted the need for frequent allocation compliance audits. MAC stated that addressing this need should not be left up to the discretion of the work group. MAC asked the Commission to amend or clarify its previous Order to require annual compliance audits (if structural separation were not imposed).

3. Commission Analysis

The Commission finds that MAC has raised no new argument to change the Commission's policy decision regarding the benefits of a work group. After the work group's report is filed, there can be further consideration of the need for, and the timing and frequency of, compliance audits.

The Commission will not grant MAC's request to clarify or amend its previous Order on this issue.

III. Minnegasco's Petition for Rehearing

Minnegasco sought rehearing of four issues in the March 24, 1994, Order: 1) the Commission's determination that the cost of emergency leak checks should be allocated between Minnegasco's regulated and nonregulated operations on the basis of the location of the leak; 2) the 20% cap placed on WRLS checks in any given geographic area and the disallowance of repeat WRLS checks; 3) the determination allocating all of the costs of this complaint investigation to the nonregulated operations; and 4) the Commission's decision regarding good will.

A. Allocation of the Costs of Emergency Leak Checks

1. The March 24, 1994, Order

In the March 24, 1994, Order, the Commission adopted the ALJ's recommendation to allocate costs of gas leak checks according to the location of the leak. Costs of responding to a gas leak would thus be charged to the nonregulated business if the gas leak is on internal piping or associated with an appliance, and to the regulated entity if the leak is on the utility system. The Commission found that this allocation method is consistent with FCC precedent and with principles of cost causation.

2. Minnegasco's Argument

Minnegasco stated that the Commission based its finding on this issue on FCC cost allocations for inside and outside telephone wiring. Minnegasco argued that checking a gas leak is fundamentally different from repairing telephone wiring, because a gas leak may be highly damaging and even life-threatening.

Minnegasco stated that it is not significant that requests for gas leak checks come in on appliance service telephone lines, or that repairs are effected by appliance service technicians. Gas leak checks are a fundamental utility function because a utility must respond to a safety concern, whether or not the utility has a nonregulated appliance affiliate.

Minnegasco compared the gas leak check issue with the Commission's finding regarding Peoples Natural Gas Company's repairs of customer-owned farm-tap lines in ORDER REJECTING PROPOSAL, ALLOWING SERVICE, AND REQUIRING FURTHER FILINGS, Docket No. G-011/M-91-989 (October 26, 1992). In that decision the Commission allowed rate case recovery of utility costs of repair of privately owned farm-tap lines. At p. 3 of that Order the Commission reasoned:

> Requiring farm-tap customers to pay for emergency leak calls or [Office of Pipeline Safety]-mandated gas line inspections could discourage customers from essential safety practices. Such a result would be against public policy.

Minnegasco argued that the same reasoning should apply to gas leak checks and that the costs should be allocated solely to the regulated entity.

Minnegasco also argued that Minn. Stat. § 216B.16, subd. 11, requires that all gas leak check costs must be allocated to the utility. That statute provides:

> All costs of a public utility that are necessary to comply with state pipeline safety programs under sections 216D.01 to 216D.07, 299F.56 to 299F.64, or 299J.01 to 299J.17 must be recognized and included by the commission in the determination of just and reasonable rates as if the costs were directly incurred by the utility in furnishing utility service.

Because the cited statutory sections require utility response to emergency leak calls, Minnegasco reasoned that Minn. Stat. § 216B.16, subd. 11, does not allow cost allocation between the regulated and the nonregulated entity. All emergency response costs must be recovered by the utility.

3. Comments of the Department

The Department agreed with the Commission's decision allocating costs of gas leak checks between the regulated and the nonregulated entities according to the leak location. The Department stated that Minn. Stat. § 216B.16, subd. 11, did not contemplate a utility competing with itself for gas emergency response business, as is the case with Minnegasco and its nonregulated appliance affiliate. The Department noted that Minnegasco's appliance service business markets its emergency response service. Because Minnegasco has chosen to set up a nonregulated affiliate to handle many of the emergency calls, the costs in this case must be allocated between the regulated and the nonregulated entity.

4. Commission Analysis

Minnegasco states that overriding safety concerns separate cost allocations for gas leak checks from FCC telephone cost allocations for inside and outside wiring. Minnegasco cites safety concerns as the reason that the Commission must follow its farm-tap precedent and allow the utility recovery of all emergency response costs.

The Commission disagrees with Minnegasco's analysis. The Commission's cost allocation decision does not mean that safety concerns would be sacrificed or that emergency responses would not occur. The Commission's allocation decision is a cost recovery issue for Minnegasco, not a barrier to repair of gas leaks.

In the farm-tap situation, customers who owned the farm-tap equipment might be deterred from keeping it under repair if Peoples did not undertake the duty (and costs) of repair. In the Minnegasco situation, customers will presumably continue to call either Minnegasco or the appliance operation to respond to emergency leaks, no matter how the response costs are eventually allocated. The public policy reasoning behind the farm-tap decision therefore does not apply to Minnegasco's emergency repair situations.

The Commission agrees with Minnegasco that its duties as a regulated utility clearly require the Company to ensure that a response is available for emergency leaks. The Company has chosen to set up a nonregulated affiliate which handles many of the emergency calls. The Commission is confident that allocation of all costs to the utility would not be necessary in order for Minnegasco to carry out its duty of ensuring emergency response.

The Commission agrees with the Department that Minn. Stat. § 216B.16, subd. 11, does not apply to this situation, in which a regulated utility has set up a nonregulated entity to respond to many emergency calls. In this set of circumstances, it is necessary to allocate costs between the regulated and the nonregulated entity so that appropriate costs follow revenues to the nonregulated operation.

The Commission will not grant Minnegasco reconsideration of this issue.

B. Winter Residential Leak Surveys

1. The March 24, 1994, Order

In the March 24, 1994, Order, the Commission approved Minnegasco's basic WRLS plan, with two further requirements: 1) the Commission imposed a survey percentage cap allowing cost recovery for a maximum number of survey checks, consisting of 20% of the service lines in a given community per year; 2) the Commission did not allow costs of conducting repeat checks (defined as multiple visits to one site on a single job ticket or job order) as part of the WRLS.

At Order Paragraph No. 5, the Commission established a filing requirement to monitor the WRLS in the future:

> On or before May 31 of each year beginning in 1994 and ending in 1996 or with the Company's next filed rate case, whichever occurs first, Minnegasco shall file a summary report on winter residential leak surveys as recommended by the Department.

2. Minnegasco's Argument

Minnegasco stated that safety concerns required reconsideration of the survey percentage cap and nonrecovery of repeat check costs.

Minnegasco stated that there is no record refuting the value of repeat checks or supporting a percentage cap.

According to the Company, the fact that leaks are unpredictable means that repeat checks are an important part of the WRLS. Minnegasco noted that a Department witness as well as a Minnegasco witness stated that costs of repeat checks compare favorably to the potential costs of undetected leaks.

Minnegasco stated that the same safety and cost balancing concerns call for reconsideration of the survey percentage cap.

3. Comments of the Department

The Department stated that costs of repeat checks should be recovered by the utility. The Department argued that public policy requires the Commission to err on the side of safety, given the random nature of leaks and the potential human and economic costs of a gas explosion.

4. Commission Analysis

The Commission does not find reason to reconsider its decision regarding the survey percentage cap. The Commission still finds that a survey cap is a worthwhile means of ensuring that the regulated utility is not paying more for safety inspections than necessary.

Neither have the parties presented anything which requires reconsideration of the Commission's decision on recovery of repeat check costs. The Commission notes, however, its reference in the March 24, 1994, Order to possible future reevaluation of this issue.

At this time, the Company has submitted its May 31, 1994, WRLS compliance filing pursuant to the Commission's Order. The Department has commented favorably on the Company's filing. The Company and the Department have agreed that the Company will be submitting a more comprehensive report in May, 1995, after certain record-keeping systems become available.

The Commission will await the filing of the Minnegasco's May 31, 1995 WRLS compliance filing. After that filing is made and the Department has had an opportunity to submit an analysis and report, the Commission may reassess and possibly reconsider its prior decision. The Commission will not grant reconsideration of its finding regarding repeat checks at this time.

C. Allocation of Costs of the Complaint Docket

1. The March 24, 1994, Order

In the March 24, 1994, Order, the Commission ordered the Company to allocate 100% of the regulatory investigation costs to the nonregulated entity.

2. Minnegasco's Argument

Minnegasco argued that 100% allocation to the nonregulated entity is contrary to FCC allocation methods endorsed by the Commission. Under the FCC method, investigation costs would be allocated under the general allocator. Minnegasco compared the costs of investigation to the costs of FCC audits, for which costs are allocated under the general allocator.

3. Comments of the Department

The Department stated that Minnegasco had raised nothing new which would warrant reconsideration of this issue.

4. Commission Analysis

The Commission does not agree with Minnegasco that the Commission must assign the investigation costs according to the general allocator. The Commission remains convinced that all costs of investigation should be allocated to the nonregulated enterprise because the costs are directly caused by Minnegasco's engaging in its nonregulated appliance business. The Commission retains the authority to order a specific allocation which is an exception to FCC methods when the circumstances warrant.

The Commission will not grant Minnegasco's request for reconsideration of this issue.

D. Good Will

1. The March 24, 1994, Order

In the March 24, 1994, Order, the Commission stated that it would use the term good will to convey the value of the utility's name, reputation, and image. The Commission found that logic and the record indicate that a value flows to the nonregulated entity from Minnegasco's conduct of its regulated utility business. The Commission found that ratepayers have supported the business which has created the value and therefore have an "equitable interest" in the value of the good will. The Commission stated that the actual quantification of the value would be determined as part of Minnegasco's ongoing rate case proceeding. The Commission indicated that it would consider as one valuation alternative a percentage of the nonregulated entity's revenues.

The Commission found that its authority to determine that there is value in good will derives from its duty to set just and reasonable rates under Minn. Stat. §§ 216B.03 and 216B.08 and from its supervision over affiliated interests under Minn. Stat. § 216B.48.

The Commission found that its inherent ratemaking authority to impute utility revenue was recognized in <u>In the Matter of the Application of Northwestern Bell Telephone Company</u>, 367 N.W. 2d 655 (Minn. App. 1985).

2. Minnegasco's Arguments

Minnegasco stated that the Commission lacks statutory authority to impute utility revenue from the affiliate's use of good will because good will belongs to the shareholders, not the ratepayers. Good will is not recorded as an asset on Minnegasco's books and is not included in rate base. Good will advertising is not allowed as a cost in setting rates. Because good will is a shareholder asset, the Commission lacks authority to require shareholders to make payments to ratepayers for the use of good will.

Minnegasco stated that the <u>Northwestern Bell</u> case does not provide authority for the Commission to impute utility revenue in this case. Minnegasco distinguished the <u>Northwestern Bell</u> case because it involved an actual transfer of property (directory operations) to an affiliate and a rate filing that reflected the operations that were transferred. Minnegasco stated that the <u>Northwestern Bell</u> case did not give the Commission the authority to impute revenues to a utility for shareholder assets, without statutory authority or record support.

Minnegasco argued that the affiliated interest statute, Minn. Stat. § 216B.48, does not provide authority for the Commission's actions here. Minn. Stat. § 216B.48 provides the Commission supervisory control over affiliate transactions as necessary to protect and promote the public interest. The public interest requires proper cost allocations, not imputations of revenues beyond the costs allocated to the nonregulated entity for services and resources provided to those operations.

Minnegasco argued that the Commission had been correct in its November 10, 1992, Order, when it chose not to impose license fees for the use of Minnegasco's name. In that Order, the Commission required Minnegasco's adoption of FCC cost allocation principles. These methods go beyond the prevention of cross-subsidization to ratepayer sharing of the benefits of the regulated/nonregulated relationship. At Exhibit 1, pp. 12-13 of the MAC complaint docket, Minnegasco quoted an FCC explanation of the effect of fully allocated cost methodologies:

> Our purposes should transcend prevention of cross-subsidy. Our goal of just and reasonable treatment of ratepayers requires that ratepayers participate in the economies of scale and scope which we believe can be achieved through integration of nonregulated enhanced services within the basic service network.

According to Minnegasco, the Commission's decision went beyond the law in imputing revenues which were not supported by ratepayer costs. The Commission therefore violated its duty to set just and reasonable rates.

Minnegasco stated that it does not dispute that there is value in good will. It contends, however, that there is nothing in the record to support a finding that ratepayers must be compensated for that value.

Minnegasco cited the opinions of other state commissions which have denied a royalty adjustment because good will belongs to the shareholders.

Minnegasco argued that the Commission provided no justification for reversing its November 10, 1992, Order, or for failing to follow the ALJ's recommendation. The Commission's decision is therefore arbitrary and capricious.

3. The Utilities' Arguments

The Utilities stated that good will is an intangible asset which represents the difference between a business's market value and its net book value. Good will is a shareholder asset because it is paid for by shareholders, generated by shareholders' management efforts, and all risks of loss are borne by the shareholders.

The Utilities noted that Minn. Stat. § 216B.16, subd. 8, disallows recovery for good will advertising.[1] The Utilities argued that good will is therefore without cost to ratepayers.

The Utilities argued that ratepayers do not gain a legal or equitable interest in good will as a result of paying for gas service. Ratepayers can only gain a right to share in the economic benefits of good will through the application of two factors: 1) the right to gain follows the risk of loss; and 2) the economic benefit follows the economic burden. The Utilities cited the Commission's November 27, 1991, Northern States Power Company rate case final Order,[2] in which the Commission refused to make a rate adjustment for the gain on sale of utility land. Ratepayers had provided neither a return of nor a return on investment, and had not shared in the risk of loss on the investment.

The Utilities argued that the Commission cannot rely for authority on the affiliated interest statute, because it does not apply. The affiliated interest statute gives the Commission authority to impute revenues where regulatory goods or services are transferred at a cost that is unreasonably low; good will is not a regulatory good or service.

4. Arguments of the Department and the RUD-OAG

The Department argued that the Commission's decision regarding good will is not unlawful or confiscatory. The Department cited a number of decisions in which other state commissions have imposed royalty payments or some other form of revenue imputation in similar situations.

The RUD-OAG argued that Minnegasco's good name has been built on the rates paid by utility customers. For this reason, it is appropriate that the nonregulated operation compensate utility ratepayers for the use of the Minnegasco name.

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[1] Minn. Stat. § 216B.16, subd. 8 does allow rate recovery for advertising for safety, conservation, and certain education purposes.

[2] In the Matter of the Application of Northern States Power Company for Authority to Increase Its Rates for Electric Service in the State of Minnesota, Docket No. E-002/GR-91-1, FINDING OF FACT, CONCLUSIONS OF LAW, AND ORDER.

The RUD-OAG cited the Northwestern Bell case as authority for the Commission's imputation of revenues. The RUD-OAG disagreed with Minnegasco's assertion that the Northwestern Bell case did not constitute authority for revenue imputation because it is factually distinct from the present case.

Like the Department, the RUD-OAG cited a number of decisions in other states in which commissions have imputed revenue for the value of good will.

5. Commission Analysis

i. The Commission has the authority to find that there is value to a utility's name, image, and reputation, as used by the utility's nonregulated affiliate.

The Commission disagrees with Minnegasco's and the Utilities' assertions that the Commission may not impute revenue for the affiliate's use of good will because good will is a shareholder asset, unsupported by ratepayer cost.

Ratepayers inarguably pay the costs of utility operations. Good will, though intangible, arises from and is intrinsic to the core utility business. Reliable provision of service, good management (i.e. paid employee) decisions, and the use of utility plant itself all result in a name, image, and reputation for the utility. Good will is the engendered by much more than utility institutional advertising.

The need for recognition of intangible good will can arise when the utility makes the choice to set up an affiliated entity which shares the utility name and engages in related but nonregulated business. When the utility moves out of the regulated, monopolistic environment into a competitive, nonregulated realm, value attaches to the good will of the core utility. The concept of imputing revenue from the nonregulated affiliate's use of good will is equitable, because ratepayers supporting the utility enterprise are, and will continue to be, part of the venture into nonregulated competition. In addition, should diversification prove financially unfavorable, ratepayers bear the risk of a consequent higher cost of capital for the regulated entity.

A reasonable imputation of revenue for the nonregulated entity's use of good will is not a subsidy, nor a punitive or anti-competitive measure. No subsidy for the utility ratepayers exists, because the ratepayers are paying the costs of the utility enterprise from which good will arises. A fee for the use of good will, like a franchise fee, is not a penalty but simply a means of recognizing the value of good will. A reasonable imputation of revenue is not anti-competitive because the utility always has the option of using a different name for the nonregulated affiliate. In the affiliate's nonregulated, competitive environment, choosing whether to pay the price for something of value, such as good will, is a normal market decision.

The Commission disagrees with the Utilities' argument that good will is acquired by shareholders when they pay a market price for utility assets which is higher than the assets' net book value. A market price higher than book value derives from the conduct of the core utility operations. The costs of utility operations are borne by ratepayers.

The fact that good will is not on the utility's books or found in rate base is also not a persuasive cost argument against revenue imputation. As an intangible asset, the value of good will can be determined by the Commission in the context of a rate proceeding. As the Oklahoma public utility commission stated:

> [T]he Commission is not convinced by [Southwestern Bell Telephone Company's] arguments that because the image and reputation associated with the telephone company are not reflected as an item in SWBT's books, imputation is inappropriate. In accordance with [the Uniform System of Accounts], SWBT can only reflect in its books those assets which are purchased at a cost. However, this Commission still has the authority, in the ratemaking process, to recognize imputed benefits accruing to the consolidated company by virtue of the goodwill and reputation associated with the telephone subsidiary, regardless of whether the asset is reflected on the telephone company's books. These intangible assets have conferred a genuine economic benefit on SWBT's affiliates, and need not be reflected as a separate account to be recognized for ratemaking purposes in this docket.
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> Re: Southwestern Bell Telephone Company, 137 PUR 4th 63, 153 (Okla. C.C. 1992).

The Commission does not find that imputation of revenue for the nonregulated entity's use of Minnegasco's good will runs counter to the Commission's two-part test for sharing in the 1991 NSP rate case Order: ratepayer sharing in burdens/benefits; ratepayer sharing in the risk of loss. As the Commission has stated previously, the fact that good will is an intangible asset means that it may not appear on utility books or in rate base; this does not mean that imputation of revenue is not appropriate. As the Commission has also stated previously, ratepayers inarguably do incur the costs of the core utility business, from which the value of good will arises. Ratepayers do share in the burdens, benefits, and risks of loss of the utility enterprise which engender utility name, reputation, and image. It is reasonable and equitable that ratepayers also share in the value of that good will if the utility chooses to move into the realm of nonregulated competition.

In most cost arguments, imputation of revenue is thought of as a cost issue regarding ratepayer or shareholder rights in good will. Imputation of revenue can also be thought of as a means of protecting ratepayers from a utility's decisions resulting in lost revenue opportunities. As the New York Supreme Court stated in its affirmation of the Rochester Telephone Corporation public utility commission opinion[3] cited in the March 24, 1994, Order:

> In any event, the RVAM[4] is not designed to compensate ratepayers for an interest in the intangible assets, but to protect the ratepayers when the utility allows its unregulated affiliates to use utility assets without compensation. The PSC is required to protect utility ratepayers by assessing the prudence of utility actions. [Citations omitted].
>
> <u>In the Matter of Rochester Telephone Corporation et al. v. Public Service Commission of the State of New York et al.</u>, No. 69820 (N.Y. Sup. Ct. June 30, 1994)

Viewed in this manner, imputation of revenue is authorized by the Commission's duty to protect ratepayers and to set rates which are just, reasonable, and in the public interest.

For all these reasons, the Commission finds that there is clear authority for finding a value in good will and for imputing revenue for the nonregulated entity's use of the utility's good will.

ii. Adoption of FCC cost allocation principles does not remove the need for imputation of revenue.

The Commission disagrees with Minnegasco's argument that revenue imputation for good will is not necessary because under FCC cost allocation methods the benefits of related operations are already shared. The FCC's concept of shared economies of scale and scope really refers to shared costs between the regulated and nonregulated entities. Shared economies of scale and scope would not encompass the concept of good will--a potential ongoing, franchise-like value arising from the affiliation between the regulated and nonregulated entities. FCC cost allocations do not cover the intangible benefit of good will to the nonregulated entity and would not preclude the imputation of revenue to compensate the regulated utility.

iii. The Commission's authority to impute revenue is found in statutory and case law.

The Commission deferred the actual disposition and valuation of good will to Minnegasco's ongoing rate case. At this time, however, the Commission reaffirms that its authority to set a value for good will and to recognize that value in rates is clear.

Although the Commission agrees with Minnegasco and the Utilities that there are factual

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[3] <u>Re Rochester Telephone Corp.</u>, 145 PUR 4th 419 (1993).

[4] Regulated value assurance mechanism. The Court declared that an RVAM was necessary "to recognize the free transfer from the utility to its affiliates of such intangible assets as the utility's name and reputation." Order at p. 3.

distinctions between the Northwestern Bell case and the Minnegasco situation, the Northwestern Bell case provides clear authority for the Commission's imputation of revenue in a ratemaking situation. While denying the Commission's authority to void a particular transfer of an affiliated interest, the Northwestern Bell Court affirmed the Commission's ability to impute revenue to arrive at just and reasonable rates:

> The Commission's hands aren't completely tied. If it decides that the contract was not in the best interests of the ratepayer and that the fees paid by West Direct to Northwestern were unreasonable, it can make an adjustment to Northwestern's rate request.
>
> Northwestern Bell at p. 661.

There is thus clear precedent in Minnesota for the imputation of revenues when necessary for the setting of just and reasonable rates.

The Commission also disagrees with Minnegasco's and the Utilities' argument that the Commission lacks authority under the affiliated interest statute, Minn. Stat. § 216B.48, to impute revenues for the nonregulated entity's use of the utility's good will. Minnegasco stated that the public interest standard of the statute did not cover imputation of revenues not supported by ratepayer costs. The Utilities stated that good will is not a regulatory good or service and is thus not covered under the statute.

The Commission reaffirms its authority under Minn. Stat. § 216B.48 to impute revenues where necessary to protect and promote the public interest. The public interest requires that the regulated entity be compensated for the nonregulated entity's use of the utility's good will. As the Commission has previously stated, the ratepayers have supported the costs of the regulated utility enterprise from which good will flows. Although good will is not a regulatory good or service in the ordinary meaning, it arises from and is intrinsic to the overall regulatory goods and services which comprise the utility operations.

Finally, the Commission reaffirms its finding that authority to determine a value in a utility's name and good will arises from the Commission's duty to set just and reasonable rates under Minn. Stat. §§ 216B.03 and 216B.08. As the New York Supreme Court stated when affirming the Rochester decision:

> We conclude that the 2% royalty established by the PSC falls within its broad authority to determine just and reasonable rates, which includes the right and responsibility to scrutinize transactions between a utility and its affiliates.
>
> Order at p. 4.

iv. Commissions in other jurisdictions have found value in good will.

Although there has been a split in state jurisdictions on the issue of good will, there is a considerable body of opinion supporting the Commission's finding.

As previously noted, the New York Supreme Court recently upheld the New York commission's authority to impute revenues for the affiliate's use of good will.

In the previously cited Southwestern Bell case, the Oklahoma commission found that the name, reputation, and image of the telephone company had benefitted its affiliates. The Commission adopted a 5% royalty adjustment based on the affiliates' sales.

The Florida public utility commission has found that it is in the public interest to require compensation for the affiliate's use of a utility's good will. In a 1989 case, the Florida Supreme Court upheld this concept, directing United Telephone Long Distance's affiliate as follows:

> to compensate [United] for the many intangible benefits it receives, including, but not

limited to the following: the use of the United name; the use of the United logo; reliance on the United reputation; immediate access to financing; and the ability to capitalize, through contractual arrangements, on a trained, skilled workforce.

United Telephone Long Distance, Inc. v. Nichols, 546 So. 2d 717, 719 (Fla. 1989).

In a decision cited by Minnegasco, the Illinois Commerce Commission did not adopt a royalty payment for good will. The Illinois commission did not, however, rule out the possibility of imputing revenue under different facts:

> The Commission agrees with [the utility] and Staff that in the current docket, the record does not provide the basis for imposing a transaction fee. As [the utility] and Staff have explained, [the affiliate] will pay to [the utility] the fully loaded costs of services provided under the Services and Facilities Agreement, and there is no evidence of record indicating that the method of compensation set forth in this Agreement is unreasonable. Whether a separate transaction fee would be appropriate in other dockets can be decided on the record developed in those proceedings.
>
> Re Illinois Power, 147 PUR 4th 225, 286 (1993).

The Commission notes that it is not bound by the commission or court decisions in these jurisdictions, and that a split in jurisdictions still exists on this issue. The above-cited decisions, as well as others, do indicate that there is a solid body of reasoning and opinion which supports the Commission's decision finding value in good will.

v. The Commission provided ample reasoning for its March 24, 1994, decision.

The Commission disagrees with Minnegasco's allegation that the March 24, 1994, decision was arbitrary and capricious. The Commission provided ample reasoning for its change from its November 10, 1992, decision against imposing a license fee.

As the Commission stated in the March 24, 1994, Order, since 1992 Minnegasco had adopted FCC cost allocation principles, the ALJ had conducted contested case proceedings, and the Complaint had come back to the Commission for disposition. The Commission was able to assess the issue of good will in the concrete, with the benefit of a full record and a history of implemented cost methodologies.

Having made its assessment, the Commission found that there was value to Minnegasco's name, image, and reputation (a fact that Minnegasco states it does not dispute). The Commission deferred the disposition of the value and its quantification for consideration in Minnegasco's ongoing rate case. The Commission provided ample and careful reasoning for its finding of good will value, citing to the history of rising industry competition, test results regarding the recognition of Minnegasco's name, decisions in other jurisdictions, and the statutory and case law derivation of its authority.

As the Court stated in the Northwestern Bell case, "an agency finding is arbitrary and capricious when its determination represents its will and not its judgment." Northwestern Bell at p. 660. Clearly, the Commission has given ample reason for its judgment that there is value to good will as used by the nonregulated entity.

vi. Conclusion

The Commission has clear authority to find value in good will and to impute revenue for the benefit of good will to a utility affiliate. The Commission has exercised its authority in this set of facts to find that there is value in Minnegasco's name, image, and reputation, as used by its nonregulated appliance affiliate. In the ongoing Minnegasco rate case, the Commission will address the disposition and valuation of good will.

The Commission reaffirms its March 24, 1994, Order on the issue of good will as well as on the other issues raised by Minnegasco and MAC.

ORDER

1. The Commission grants the Utilities' request for participant status.

2. The Commission denies the requests for reconsideration and rehearing filed by Minnegasco and the Minnesota Alliance for Fair Competition.

3. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)