

ISSUE DATE: June 25, 1996

DOCKET NO. E-002/PA-95-500

ORDER ESTABLISHING PROCEDURAL FRAMEWORK

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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

In the Matter of Northern States Power  
Company's Petition for Approval to Merge  
with Wisconsin Energy Corporation

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**PROCEDURAL HISTORY**

On August 4, 1996, Northern States Power Company (NSP or the Company) filed its petition for approval of a merger with Wisconsin Energy Corporation (WEC) in the above-captioned matter. As part of its filing, NSP also requested Commission approval to acquire certain gas properties of NSP-Wisconsin, to defer accounting on its merger expenses, and to reduce retail electric rates by 1.5 percent across the board and freeze them for four years.

Pursuant to Commission notice which varied the time frame for comments, interested parties filed initial comments and petitions to intervene by January 15, 1996. The following parties were granted intervenor status and filed initial comments in this proceeding: The Izaak Walton League, Minnesotans for an Energy Efficient Economy and the Environmental Law and Policy Center of the Midwest (The Environmental Coalition); the City of St. Paul; the Energy CENTS Coalition; Otter Tail Power Company; Minnesota Power; Wisconsin Public Service, Madison Gas and Electric, Wisconsin Electric Cooperative Association and the Citizen's Utility Board (Wisconsin Intervenors); the International Brotherhood of Electrical Workers; Cooperative Power; and Dairyland Power. The Department of Public Service and the Office of the Attorney General - Residential Utilities and Antitrust Divisions (OAG) intervened as of right and also filed comments in this matter. A number of parties requested that the Commission set this matter for contested case hearing.

On March 1, 1996, NSP and the following parties filed response comments: the Department, the OAG, the Wisconsin Intervenors, Minnesota Power and Otter Tail Power, the Environmental Coalition, and the Energy CENTS Coalition.

On March 13, 1996, the Commission requested additional comments relating to procedural issues in this matter. The Commission invited comment in writing to be filed no later than Tuesday, April 2, 1996 addressing such procedural issues as the identification of any material factual disputes which would require a contested case hearing and the proposed scope of any hearing which has been requested.

Between April 1 and 3, 1996, the Commission received comments on these procedural issues from the following parties: NSP, the Energy CENTS Coalition, the Wisconsin Intervenors, the Environmental Coalition, Otter Tail Power, the Department, the OAG, and Minnesota Power.

On June 6, 1996, the Commission met to consider this matter.

## **FINDINGS AND CONCLUSIONS**

The issues considered by the Commission in this Order are procedural:

- 1) should this matter be set for contested case hearing and
- 2) if so, what issues should be considered in the course of that contested case proceeding.

### **A. Positions of the Parties Re: the Necessity of A Contested Case Proceeding**

#### **1. Northern States Power**

NSP argued that the Commission has the discretion to forego a contested case hearing. NSP stated that the Commission is not required under Minn. Stat. § 216B.50 to hold a contested case hearing. The Company stated that the Commission should only hold a hearing if it believes the filing of testimony and the cross examination of witnesses are essential before it can confidently reach a decision. If the Commission does require a hearing, NSP requested that the scope of the hearing be clearly defined.

NSP further argued that it has responded to all significant issues raised by the intervenors. It suggested that some parties simply oppose the merger on philosophical grounds or because they believe it will make NSP a stronger competitor. The Company stated that there appeared to be no factual disputes on the central economic aspects of the merger, such as the rate reduction, rate freezes, and the allocation of savings to jurisdictions. It suggested that the Commission could ask NSP and the parties to resolve any remaining issues on a collaborative basis.

The Company argued that a hearing on market power issues in Minnesota is unnecessary and untimely, even though a factual dispute exists. It asserted that without holding a hearing, the Commission could decide any of the following: 1) that the benefits of the transaction outweigh the market impacts, 2) that the Company's commitments mitigate any incidental effects, or 3) that the market impacts are small or nonexistent. The Commission could also investigate these issues later, after other jurisdictions conclude their proceedings on market power and Mid-Continent Area Power Pool (MAPP) has had a chance to develop its restructuring effort.

Regarding rate issues, NSP stated that Minn. Stat. § 216B.16, which sets out the procedures necessary for a general rate change begins with the phrase "Unless the Commission otherwise orders..." NSP argued that the typical rate procedures need not be followed if the Commission

otherwise orders. The proposed rate reduction and freeze are part of the merger application, in order to provide immediate benefits to customers. The Company argued that a general rate case would delay the delivery of merger benefits to customers.

Moreover, the Company noted that it had made this filing under Minn. Stat. § 216B.50, not § 216B.16. It argued that the Commission, therefore, can impose a rate reduction and freeze as a reasonable condition of the merger.

NSP stated that if the Commission determines that its Minn. Rules, parts 7825.3200 to 4400 govern rate changes, it would request a waiver of those requirements. The Company stated that the information required in these rules would not assist the Commission in determining if the merger is in the public interest. It further argued that it would be difficult to develop the schedules and information on a post-merger 1997 scenario. While the Company expressed confidence that it could achieve the merger savings identified, it stated that the particular sources of savings are not known with certainty.

The Company argued that granting such a waiver (variance from the requirements of those rules) would not adversely impact the public interest. The Company argued that a unilateral rate reduction offer should not require the detailed analysis associated with typical rate cases. NSP stated that if the Commission finds that it cannot order a rate reduction under § 216B.50, the Company would be willing to decouple the requests for merger approval and a rate reduction and the Commission could proceed with whatever rate investigations it deemed appropriate.

NSP argued that its current rate levels are just and reasonable, as are the proposed post-merger rate levels. If anything, NSP is concerned about the possibility that it will experience unreasonably low earnings during the freeze period due to its inability to achieve the identified merger savings. The Company argued that approval of the merger should not be held up pending a rate investigation. The Commission's authority to investigate rates at any time is preserved, the Company noted, even during the rate freeze period.

## **2. Department of Public Service**

The Department argued that a contested case hearing is not necessary to decide this case. It claimed that most of unresolved issues in this case are issues of policy which do not revolve around disputed facts. For example, the impairment of state regulatory authority is a matter of judgement based upon state and federal statutes. The Department further argued that uncertainty as to the effects of open access in the electric industry cannot be resolved by a contested case hearing.

With respect to the impact of the merger on competition, the Department continued to argue that this is unlikely to be illuminated in a contested hearing because, in the Department's view, it is primarily a matter of speculation about the future. The Department claimed that the disagreement here is not about the facts but about how to interpret and speculate from the facts.

In areas where factual disputes may exist, they involve matters which will not be known until the merger takes place or can be explored in separate proceedings. The Department cited as an example the rate decrease. Whether the Company's proposed decrease is appropriate is uncertain, but any party can request it be investigated at any time.

The Department noted that the Commission could request additional information or discussion from the parties on unresolved issues, but continued to assert that a contested case is not likely to add significantly to the understanding of these issues.

Regarding the rate issues, the Department indicated that Minn. Stat. § 216B.16 is the only statute which authorizes a general rate change. However, a rate change can be decided without a contested case hearing if the Commission determines that "all questions of the reasonableness of the rates...can be resolved to the satisfaction of the Commission." The Department concluded that the Commission could approve NSP's proposed rate reduction consistent with Minn. Stat. § 216B.16 at this time, suggesting that the Commission could treat the Company's filing as if it were a § 216B.16 filing.

The Department stated that this would not be an appropriate time to commence an investigation into the reasonableness of NSP's post-merger rates. An investigation may even delay the achievement of merger savings. In addition, the Department noted that the Commission could order an investigation post-merger, if need for further reductions is indicated.

### **3. Office of the Attorney General**

The OAG reviewed the standard for requiring a contested case proceeding and noted that the Commission's procedural rules focus on the identification of material factual disputes. The OAG noted that some of the issues raised by the parties may be resolved through written submissions, without expert testimony and cross-examination. It stated that the identification of one or several disputed issues of material fact does not mean that all issues related to the merger should be referred for hearing.

The OAG provided procedural recommendations for each of the four issues about which it had raised concerns: 1) the effect of the merger on costs and rates, 2) service quality (including reliability and environmental quality), 3) potential impairment of effective regulation, and 4) anticompetitive concerns.

#### **Costs and Rates**

With respect to cost and rate issues, the OAG stood by its earlier proposals and indicated that these issues could likely be resolved without a contested case. However, it noted that other parties have raised questions about whether the projected costs savings could be realized without a merger. If substantial savings are available without a merger, and the merger creates other impacts detrimental to the public interest, the OAG argued that it may be appropriate to reduce rates rather than allow the merger. The OAG stated that whether or not the claimed savings are realizable in absence of the merger appears appropriate for contested case

proceedings.

### Quality of Service

The OAG indicated that it continues to have serious concerns regarding the post-merger quality of service. However, it stated that the Commission can resolve these concerns as a matter of policy. If the Commission required additional information in this matter, the OAG stated that the Commission could request additional written submissions from the parties. With respect to environmental quality issues, the OAG stated that if the Commission believes that material disputed facts exist regarding the environmental impacts of the merger, it should set the question of the likelihood and the magnitude of those impacts for hearing.

### Impairment of State Regulation

While the OAG remained concerned about this issue, it did not believe the issue lent itself to a contested case proceeding. The OAG recommended that the Commission decide this issue on the basis of written submissions.

### Market Power Issues

The OAG noted that a number of parties have raised issues relating to competitive concerns caused by the merger. The Federal Energy Regulatory Commission (FERC) has set market power issues for hearing in its consideration of the merger. The OAG stated that while the FERC's hearing may lead to significant factual development, it does not remove the need for state review. The FERC may not address Minnesota-specific issues, especially the merger's effect on retail customers. The OAG recommended that the Commission set for hearing the issue of the impacts of the potential anticompetitive effects of the merger on retail rates, and continue to monitor the FERC proceeding.

### Rate Issues

The OAG stated that nothing in Minn. Stat. § 216B.50 exempts a utility from complying with the rate change statute, Minn. Stat. § 216B.16. NSP's proposal is a change in general rates, and § 216B.16 applies. However, the OAG suggested that NSP's filing could be found to meet the minimum requirements of the statutory language. It recommended that the Commission require NSP to identify those rules for which it believes it requires a variance in order to carry out its rate plan.

The OAG also continued to express concern that NSP's proposal returns only 60 percent of the Company's projected cost savings to ratepayers. The OAG recommended an automatic and complete annual review of NSP's post merger earnings to ensure that rates do not result in windfall profits for the merged entity.

In sum, then, the OAG recommended that the Commission set at least the following issues for contested case hearing: 1) identification of that portion of the claimed cost savings which can be achieved in the absence of the merger and 2) the impact of the merger on rates for Minnesota retail customers.

#### **4. Minnesota Power**

MP stated that this merger is inconsistent with the interests of its retail ratepayers. MP predicted that the potential anticompetitive impacts of the merger will crowd out competitors and restrict the ability to buy or sell energy in the bulk power market. It suggested that the following contested material issues of fact exist:

- whether NSP's continued participation in MAPP is in the best interest of utilities and consumers in Minnesota
- whether the merger would increase transmission market power
- whether the merger will increase market power in regional generation capacity markets
- whether NSP and WEC will control constraints on the Twin Cities and MAPP-WUMS transmission interfaces
- how the proposed Independent Tariff Administrator can and will prevent Primergy from manipulation of transmission access
- whether the proposed merger will result in higher rates for Minnesota Power's retail customers

MP stated that it has attempted to frame the issues of material contested fact as narrowly as possible, and stated that it would not unnecessarily broaden the scope of any hearing required by the Commission. It further suggested that the Commission consider conducting a joint hearing with the Public Service Commission of Wisconsin (PSCW) on market power issues and impacts on retail customers in the current and future retail markets, due to the common issues of fact involved.

#### **5. Otter Tail Power**

Otter Tail Power (OTP) noted that regulators' previous analyses of mergers have focused essentially on whether the merging utilities' ratepayers were better off after the merger than before. Due to increased competition in the generation market, contemporary merger analysis is focusing more on market power issues and potential impacts on the competitive positions of other utilities and their retail customers.

OTP stated that the Commission has the authority to handle market power issues either through a contested case proceeding or through notice and comment. In either case, it argued that before the Commission can make a determination that the merger is in the public interest, the Commission must satisfy itself with regard to the following:

- how transactions between merger partners, and transactions of other entities, through the MAPP-WUMS interface will work, given physical constraints, FERC Order 888, and the MAPP restated agreement
- whether the merger will increase market power by the Applicants in the transmission market or the regional generation capacity market
- whether the applicants' proposals to relieve their ability to constrain MAPP-WUMS interfaces are capable of eliminating undue influence
- whether the proposed ITA offers a realistic barrier to Primergy's motive to manipulate transmission access
- whether the merger will result in higher rates, lessened reliability, or a lessened assurance of adequate power pool reserves, adversely affecting the retail customers of OTP, MP, or other Minnesota retail electric customers

With respect to rate issues, OTP stated that Minn. Stat. § 216B.16 appears to be the only statute which allows the utility to propose a general change in rates. However, the Commission does not need to conduct a contested case if it can otherwise satisfy itself on the reasonableness of the proposed rates. OTP took no position on the reasonableness of NSP's rates, an issue which it asserted pales in relation to the larger market power issues in the competitive industry.

## **6. Wisconsin Intervenor**

The Wisconsin Intervenor listed a number of issues which they asserted were deserving of a contested case hearing:

### **Exaggerated or Inaccurate Cost-Savings Claims**

The Wisconsin Intervenor noted that several parties have suggested that the Applicants' merger-related savings claims are inaccurate or exaggerated. Although NSP disputed these claims, the Wisconsin Intervenor stated that the Company did not provide further substantiation or detail for the projected savings. The Wisconsin Intervenor argued that it cannot determine whether benefits outweigh detriments without a reliable, accurate estimation of savings benefits.

### **Anticompetitive Effects of the Merger**

The Wisconsin Intervenor stated that the factual disputes, as well as differences in analyses and opinion, over Primergy's effects on competition are numerous and must be resolved before the merger's impact on the Minnesota and Wisconsin markets can be accurately predicted. They cautioned the Commission to resist NSP's efforts to substitute the FERC record for hearings in Minnesota, arguing that to do so would bind Minnesota citizens to results of a hearing held in Washington, D.C., by a regulatory body with a much broader agenda.

### **Adverse Effects on Quality of Service**

The Wisconsin Intervenor noted that NSP has not made any commitments with respect to Primergy's participation in MAPP and MAIN beyond four years. The Wisconsin Intervenor

argued that the Company has failed to detail 1) its view of the future of MAPP and MAIN, 2) how Primergy would mesh its memberships in MAPP and MAIN, and 3) whether it would continue commitments to any successors to the current reliability councils. A hearing would permit the Commission to examine the long-term influence of Primergy on the region's reliability structures.

#### Reduced Customer Service

The Wisconsin Intervenors argued that, particularly in light of the personnel reductions proposed by the Company, the parties' concerns that customer service will suffer as a result of the merger are valid and deserve exploration. The Wisconsin Intervenors noted that NSP provided no commitments or examples of how it will preserve satisfactory levels of customer service.

#### Effects on Electric Industry Restructuring

The Wisconsin Intervenors stated that the Commission needs to investigate Primergy's approach to restructuring, especially how it would ensure that performance-based ratemaking would not increase residential rates.

#### Regulatory Impairment

The Wisconsin Intervenors stated that although NSP has offered to waive its right to federal preemption under the Interchange Agreement for the next four years, the long-term effect is still a shift of jurisdiction from the states to the FERC. In addition, the issue of reduced authority over resource planning due to Primergy's regional operation has not been resolved.

#### Rate Issues

The Wisconsin Intervenors argued that a rate hearing is necessary as a part of this process. They argued that if NSP cannot develop a test year for the annual period following the merger, as it claims, it also cannot know whether the proposed rate plan sufficiently captures the merger efficiencies that are due ratepayers.

The Wisconsin Intervenors noted that the Public Service Commission of Wisconsin (PSCW) is conducting full rate cases with 1997 test years for both WEPCO and NSP-W in order to establish a pre-merger baseline for investigating the merger's effects on Wisconsin electric and gas rates. Moreover, the Wisconsin Intervenors argued that Minn. Stat. § 216B.16 requires a rate case filing for any change in rates and asserted that NSP's petition for merger approval does not provide sufficient information to evaluate the 1997 test year with or without a merger.

The Wisconsin Intervenors recommended that the Commission hold a preliminary rate case to establish a baseline for evaluating merger savings, which should be followed by a hearing on the merger petition.

## **7. Energy Cents Coalition and the MCAA**

The Energy CENTS Coalition and the MCAA reiterated the comment that the Commission could narrow the scope of further proceedings by reexamining the public interest standard as it relates to mergers and by clearly articulating the criteria it will use to determine whether this merger is consistent with the public interest.

ECC and MCAA recommended a contested case hearing be required to examine cost and savings issue, particularly to determine whether or not cost savings could be achieved without a merger. It further recommended a contested case hearing to determine the effect of Primergy on competition in the electric utility industry.

ECC and MCAA also recommended that the Commission take further comment and replies to issues raised regarding customer service standards and low income programs, including the issue of the potential for cost shifting among customer classes during a rate freeze period through revenue neutral rate design, and jurisdictional issues.

Finally, ECC and MCAA recommended that the Commission establish a mechanism for passing through additional savings due to post-merger cost reductions. It argued that the Commission should not approve this merger if it does not result in lower rates, and that all ratepayers should continue to benefit from merger savings.

## **8. Environmental Coalition**

The Environmental Coalition stated that it has submitted evidence showing that the merger is likely to cause pollution, impairment, or destruction of the air, water, land or other natural resources within the state and noted that NSP's response denied that the merger will have significant environmental impacts. This issue is, therefore, according to the Coalition, a disputed material fact which can only be resolved through a contested case hearing. The Coalition proposed the following three environmental issues be set for hearing:

- will the proposed merger exacerbate air quality problems in Minnesota?
- will the proposed merger spur construction of unnecessary transmission capacity, with the attendant environmental impacts?
- will the proposed merger impair effectiveness of Minnesota laws designed to limit the environmental impacts associated with electric power generation?

### **Effect on Air Quality**

The Coalition asserted that there is not enough record information on Primergy's proposed system operations to resolve questions about increased utilization of coal plants, and associated increases in air emissions. The Coalition asserted that further modeling in an environmental

impact statement (EIS) and contested case proceeding would determine the most likely post-merger operations and emissions scenarios.

#### Construction of Transmission

The Coalition argued that the merger will result in a demand for new transmission capacity as utilities bordering Primergy attempt to circumvent its transmission system. While NSP denies that transmission will be built, the Coalition pointed out that NSP also denies any anticompetitive effects in connection with the merger. This issue must be addressed along with other market power issues in an EIS and contested case hearing.

#### Regulatory Impairment

The Coalition argued that the Commission cannot decide this case without determining whether the corporate structure proposed for Primergy could impair regulatory effectiveness. It questioned the effects of the merger on resource planning, demand-side management programs, commitments to build renewable energy projects and retail ratemaking. It asserted that these issues should be addressed comprehensively in an EIS prepared in advance of the hearings, included in the evidentiary record, and subjected to rigorous examination in a contested case proceeding.

### **B. Commission Analysis**

The questions before the Commission at this time are

- 1) whether the record to date contains sufficiently clear and accurate information upon which to apply its judgement to the issues involved in this case, and
- 2) if not, in what manner additional information with respect to facts and policy options should be obtained.

Central to its consideration are the formal requests for contested case hearing submitted by Minnesota Power and Otter Tail Power, the Wisconsin Intervenors, the Energy CENTS Coalition and Minnesota Community Action Association, and the Environmental Coalition. In its procedural comments, the OAG also recommended that some issues be set for contested case hearing.

The Commission's applicable procedural rule (Minn. Rules, Part 7829.1000) states in relevant part:

If a proceeding involves contested material facts and there is a right to a hearing under statute or rule, or if the commission finds that all significant issues have not been resolved to its satisfaction, the commission shall refer the matter to the Office of Administrative Hearings for contested case proceedings,....

The record of this case shows a number of factual disputes, ranging from the level of savings

available from the merger to the ability of Primergy to manipulate the capacity of the MAPP-WUMS interface. The Commission must evaluate whether the facts underlying these disputes are material to its public interest determination in the merger. In addition, the Commission will consider whether any of the policy issues disputed in this record would benefit from the scrutiny of a hearing prior to the Commission making its determination.

In making its procedural determinations, the Commission will discuss areas where parties claim material factual disputes and significant unresolved issues, and make findings with respect to the need for further proceedings to address these issues. The disputes will be organized into the following areas: Merger Savings, Rates Issues, Competitive Issues, Regulatory Impairment, Customer Service Quality, and Environmental Issues.

### **1. Merger Savings**

NSP has claimed that the merger will result in \$2.2 billion in gross savings and \$1.95 billion in net savings over ten years. Of first-year net savings, the Company allocated \$31.7 million to its Minnesota electric jurisdiction and \$4.4 million to its Minnesota gas jurisdiction.

The Department raised two issues with respect to NSP's merger savings estimates: 1) whether certain savings are achievable at all and 2) whether certain savings could be achieved in absence of the merger. Based on its analysis, the Department placed gross ten-year merger savings somewhere between \$1.24 and \$1.52 billion. Of the \$2.2 billion in estimated gross savings claimed by NSP, the Department claimed that between \$351.7 million and \$631.7 million are uncertain or unlikely to be achieved, and that \$328.3 million (attributed to the closing of the Eau Claire office, production dispatch savings, and gas supply savings) could be achieved without the merger.

The Wisconsin Intervenors further charged that much of the savings purported to be attributable to the merger could be obtained without a merger. The OAG stated that this issue could be appropriate for hearing; that if significant savings could be achieved without a merger and if the merger also results in substantial negative impacts, it may be appropriate to deny the merger and require a rate reduction.

In its response, the Company maintained that the level of merger savings has been carefully and accurately estimated, and that it anticipates that the full amount of the savings will be achieved. It further argued that it has already reduced merger savings to account for pre-merger initiatives, and that all remaining savings can be achieved only as a result of the merger.

The Commission finds that the disagreement between NSP and the parties on this issue is at base a factual dispute which may be material to the Commission's decision in this matter.

Certainly, the Commission is concerned with the level of merger savings in two respects, although the precision with which merger savings must be ascertained may differ in the two instances. First, the existence and magnitude of cost savings due to the merger is an important element in the public interest equation, to be weighed with and against other impacts of the merger. Second, the level of merger savings could play an important role in the determination

of just and reasonable rates.

Also important to the public interest determination is whether or not the savings could be achieved without a merger, as asserted by the Wisconsin Intervenors. While the Department identified only a small portion of savings which it claims could be achieved without the merger, the Wisconsin Intervenors alleged that a much higher portion of savings are not merger-related.

Upon review of the Department's analysis, the Commission finds that it is not satisfied that this issue has been developed to the full extent necessary to determine the public interest. The Department's comments suggested that it conducted only a general review of the Company's proposed savings in the area of corporate and operations labor. This category accounts for greater than 50 percent of the Company's proposed merger savings, and a portion of other savings also depend upon it. The Department stated that "a large portion of these reductions are expected in areas that are amenable to merger-related economies," but did not indicate that it had conducted an independent review of the reasonableness of current staffing levels and the possibility that reductions may be available even without the merger. This is important especially in light of the Wisconsin Intervenors' allegations and evidence which shows that NSP's merger partner, WEC, recently completed a significant downsizing, reducing employees by in excess of 1,000. As regulated utilities prepare to face greater competition, one effect can be a significant reduction in personnel. Unlike WEC, NSP has not yet gone through a substantial downsizing.

In short, the Commission finds that the savings attributed to corporate and operations labor, and all related savings, should be more closely examined in order to ascertain the extent to which these savings could be achieved without a merger.

## **2. Rate Issues**

The rate issues related to the merger are both procedural and substantive. The ultimate substantive rate issue in this docket is whether the merger will result in just and reasonable rates for NSP consumers. NSP has proposed to reduce electric rates by 1.5 percent and freeze them for four years, subject to certain exceptions. It further proposed to freeze gas rates for two years following the merger. Other parties have alleged that NSP's proposal will result in rates above cost.

On the procedural side, NSP has filed for this rate change under Minn. Stat. § 216B.50 as a condition for approval of the merger, and not under Minn. Stat. § 216B.16. It is further proposing that the change be implemented without a comprehensive look at its overall revenue requirements, which have not been reviewed by this Commission since the Company's last general rate case in Docket E-002/GR-92-1185. Finally, during the rate freeze the Company is proposing to be able to adjust its rates for certain single, identifiable cost increases considered to be beyond its control.

The question at this time is whether issues involved in evaluating the rate proposal element of

the Company's merger proposal would benefit from a contested case proceeding.<sup>1</sup> The Commission believes that they would, for the following reasons:

1. Since the Company's current rates are deemed fair and reasonable until shown otherwise, the Company's proposed level of rate reduction will result in fair and reasonable rates only if the rate reduction closely tracks merger-related savings. The Commission does not find persuasive the Company's arguments that it is appropriate to return less than 100 percent of the estimated merger savings to ratepayers on the grounds that the Company is assuming the risk associated with achieving the projected merger-related savings and that other cost increases may offset the Company's ability to return all merger-related savings to ratepayers.

- Regarding the risk argument, the Commission notes that the Company urges two contradictory positions: that the savings will be achieved in order to justify the merger while at the same time claiming that the risk of not achieving those savings justifies not returning them fully to ratepayers. In addition, even if the Company failed to achieve all savings in a timely manner in the first year, those savings would be in place for the remaining three years of the rate freeze period. This fact magnifies the potential windfall to the Company, even if the revenue reduction exceeds the savings in the first year of the merger.
- Regarding the offsetting costs argument, finding such offsetting costs is typically made in conjunction with a comprehensive look at the pre- or post-merger revenue requirements of the Company. In this case, NSP has asked the Commission to set just and reasonable rates on the basis that identified cost reductions are partially offset by unspecified cost increases. The Commission cannot make this determination without a more thorough, factual examination of the Company's revenue requirements.

Accordingly, the Commission finds that in order to determine just and reasonable rates, the Commission needs to establish merger savings with greater precision. The contested case proceeding will help in establishing those savings .

2. Other record evidence suggests that the Commission should review NSP's revenue requirements prior to determining the appropriate rate reduction related to the merger. For example, the Department's analysis projected that with NSP's estimated savings, the Company's 1997 ROE would be 11.62 percent, which is in excess of the 11.47 percent authorized in the Company's last general rate case and the 11.02 percent estimated by the

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<sup>1</sup> The Commission clarifies that while the reasonableness of rates resulting from the merger is an issue to be considered in evaluating whether the merger is consistent with the public interest, NSP can only obtain authority to actually change its rates through a filing made pursuant to Minn. Stat. § 216B.16. To date the Company has not made such a filing. Nothing in this Order transforms the Company's current § 216B.50 filing into a § 216B.16 filing and the Commission's decision to refer issues involved in the proposed rate reduction element of the merger proposal for contested case hearing is not to be confused with a Commission decision made in response to a § 216B.16 filing to suspend rates and hold a contested case hearing on various issues relevant to a rate change.

Department to be NSP's 1997 required ROE.

3. In addition to the necessity to ascertain that rates are just and reasonable, the Commission finds that a comprehensive review of NSP's revenue requirements would help develop a pre-merger baseline against which to weigh the actual effects of the merger on ratepayers. Without establishing a clear picture of the current cost profile of the Company, it will be nearly impossible for the Commission to evaluate the appropriateness of future cost allocations between NSP and WEC.

In conclusion, the Commission will refer for contested case hearing the issue of the Company's pre-merger revenue requirement, based on a 1996 test year adjusted for known pre-merger changes in 1997. It is expected that the contested case consideration of this revenue requirement issue would include consideration and result in findings by the ALJ with respect to the appropriate rate base, income statement, rate of return, and test year revenue requirement. To provide a sound record basis for thorough consideration of the pre-merger revenue requirement issue by the parties, the ALJ, and ultimately the Commission, the Company's filing of testimony, exhibits, and documentation supporting its proposed revenue requirement, similar to what it would file in a 216B.16 general rate proceeding on this issue, would be appropriate:

- Schedules showing the Company's proposed rate base on a total utility and Minnesota jurisdictional basis, including 1) schedules of adjustments, with explanation, made in calculating the jurisdictional rate base and 2) schedules of jurisdictional allocation factors used in allocating the total utility to the Minnesota jurisdiction, supported by statistics and an explanation of the assumptions used in determining the jurisdictional rate base. To be most beneficial, the adjustments for known and measurable changes to the 1996 data for 1997 would be separately identified.
- Schedules showing the Company's proposed operating income statement on a total utility and Minnesota jurisdictional basis, including schedules of adjustments with explanation made in calculating the jurisdictional operating income statement.
- Schedules showing the computation of total utility and jurisdictional federal and state income tax expense and deferred income taxes, supported by a detailed schedule showing the development of the combined state and federal income tax rates would be helpful, together with an explanation of assumptions and approaches in projecting revenues and expenses and schedules of jurisdictional allocation factors used in allocating the total utility to the Minnesota jurisdiction, supported by statistics and assumptions used in determining the jurisdictional rate base. It would be helpful for the Company to separately identify adjustments for known and measurable changes to the 1996 data for 1997.

- Rate of return schedules showing the development of the weighted cost of capital proposed for the test year, including supporting calculations.
- A schedule showing the calculation of the proposed revenue conversion factor.
- Annual report to stockholders including financial statements and statistical supplements for 1995.

Prompt filing of such items by the Company, based on as many months of actual 1996 data as is available, would greatly facilitate the contested case proceeding.

### **3. Competitive Issues**

Several parties to this proceeding contend that Primergy's ability to exercise market power as a result of this merger would have far-reaching and long term effects on this region and that ultimately, electric consumers in the region would be forced to pay more for electric energy than they would absent the merger. Particularly in the face of growing competition in the electric industry, which both increases the potential harm resulting from anti-competitive behavior and raises uncertainty as to the availability of merger-related savings to certain ratepayers following the freeze period, the long-term effects of anti-competitive behavior have the potential to completely eliminate benefits related to merger cost savings.

The arguments with respect to anti-competitive concerns raise substantial issues of disputed fact, particularly with respect to the extent to which Primergy could manipulate the MAPP-WUMS interface, its incentives to do so, and the resulting impact on other consumers in the upper Midwest, and particularly in Minnesota. The Commission finds that these issues are material to the Commission's public interest determination in this merger.

The Company and the Department offer various arguments against holding a hearing on market power, even if factual disputes exist. Both note that the FERC has set the market power issue for hearing, and that the FERC has particular authority to require various mitigation strategies in the face of market power. In addition, the Department argues that a hearing will not provide the Commission perfect information with respect to the potential anti-competitive effects of the merger, that it will delay other merger-related benefits, and that actual effects post-merger can be addressed through Commission-ordered mitigation strategies or antitrust enforcement.

- **FERC's Role:** FERC will be hearing the market power issues and has specific authority over the operation of the interstate transmission system. However, the FERC will not focus its hearing on Minnesota-specific concerns. Further, this Commission has a responsibility to approve this merger that is separate from the FERC's authority. If this Commission were to determine that the merger results in an unacceptable level of market power, it has the authority to either disapprove the merger or to place conditions on it, regardless of the FERC's decisions in this case.

- Adequacy of Information: the Commission will never have perfect information on the potential anti-competitive effects of the merger. However, perfect information is neither the objective of a hearing nor necessary for a sound Commission decision. Through a contested case hearing the Commission will obtain enough information on the potential for and likely impacts of anti-competitive behavior to ascertain whether potential negative impacts of market power outweigh estimated benefits associated with the merger and to determine whether those negative impacts can be mitigated, either through the Company's proposals or by some other means.

Accordingly, the Commission will specifically refer the following competitive issues for contested case hearing:

- to what extent will it be feasible for Primergy to use its transmission ownership and control of the MAPP-WUMS interface to restrict the flow of non-Primergy sales over its wires?
- what, if any, is the impact of such a restriction on Minnesota utilities other than Primergy?

#### **4. Regulatory Issues**

##### **a. Impact of the Interchange Agreement**

Parties raised serious concerns that the merger will impair the Commission's ability to effectively oversee the operations of NSP and make prudence determinations over a large portion of costs which will affect NSP's retail rates. This is due to the formation of Primergy in a registered holding company structure, with NSP and WEC as wholly-owned utility subsidiaries of Primergy. As such, energy and capacity exchanges between the two subsidiaries will flow through a FERC-approved Interchange Agreement as wholesale transactions.

Parties have expressed concern that the Interchange Agreement, which was the result of settlement between NSP and NSP-W, their state regulators, and several wholesale customers, will not be adequate to protect Commission authority and Minnesota retail ratepayers when WEC is substituted for NSP-W in the agreement.

The impact of the amended Interchange Agreement on the Commission's authority, and the resulting impacts of the merger, are indeed a serious concern that must be addressed in considering the merger. While NSP and WEC have already submitted the amended Interchange Agreement to the FERC for approval, there is nothing which would preclude the Commission from requiring negotiation of a new Interchange Agreement or otherwise assuring the Commission's continued effective oversight of Minnesota retail costs and rates as a condition of merger approval. It appears that there is sufficient evidence on the record for the Commission to fashion a solution to this issue without a hearing or other proceeding.

##### **b. Resource Planning**

Parties note that resource planning for Primergy is likely to be a challenge for regulators. Both Minnesota and Wisconsin have comprehensive resource planning and competitive bidding processes for NSP and WEC. If Primergy is to operate as a unified system, it may become difficult for the Company and its regulators to reconcile competing interests and requirements in the respective states.

After the merger, NSP will continue to be subject to all laws and rules relating to resource planning in Minnesota, and has pledged to cooperate with both state processes. This issue may ultimately become one of interstate coordination and creative approaches to regulation of a regional entity. Commission Staff should be in contact with PSCW staff about potential solutions to this issue. However, the Commission does not believe that the matter requires further exploration of this issue prior to making its determination with respect to the merger.

### **c. Enforcement of Environmental Protection Laws**

The Environmental Coalition asserted that the merger will impair the ability of the state to enforce laws designed to protect the state's environment. However, NSP's Minnesota plants will remain under the permitting and regulatory authority of the Minnesota Pollution Control Agency (MPCA) and will continue to be subject to all MPCA and federal EPA laws and rules pertaining to environmental quality. The Commission does not believe that the record requires further development regarding this issue, either through a contested case hearing or by submission of additional written comments by the parties.

There are also a number of environmental policy goals which are intertwined with Commission regulatory processes, such as environmental cost quantification, renewables preferences, and investment in demand-side management. The Commission believes that the Coalition's concerns that these provisions will be impaired by the merger can be addressed under mechanisms to ensure that the state's interests in resource planning are preserved, as discussed above.

## **5. Customer Service Quality**

The Department and the OAG expressed concern that the merger will have a negative impact on customer service quality, particularly in light of the personnel and cost reductions proposed by the Company. Similar concerns were expressed by ECC and MCAA, and the Minnesota International Brotherhood of Electrical Workers (IBEW). The Department suggested that this concern could be resolved by setting service quality standards and providing incentives for the Company to meet them. The OAG recommended that NSP be required to file and comply with a service quality plan, and that the Commission should impose significant penalties for noncompliance.

Prior to its determination on the merger, the Commission will require NSP to develop and file a proposal for monitoring of customer service quality. In this proposal, the Company should identify key service quality indicators and propose a regular reporting regimen which will permit the Commission to easily monitor customer service quality. Because the Commission will want to review any potential changes in service quality, the Company should propose as some of its key indicators measures for which it has significant (two to five years) existing

data.

## **6. Environmental Issues**

The Environmental Coalition argued that the merger will result in increased air emissions, increased construction of transmission lines, and the potential for additional nuclear waste storage in Minnesota. It has requested that the Commission complete an Environmental Impact Statement (EIS) and hold hearings on the environmental issues prior to making its determination on the merger.

The Commission finds that the Coalition's issues, while disputed, are not material to the Commission's determination in this merger. The impacts alleged by the Coalition are either unrelated to the merger or require individual review and approval by this Commission or some other regulatory body to occur. As such, the Commission does not find a need for an EIS or hearings on these issues.

The Coalition asserted that the merger will provide NSP with the incentive to operate its coal plants at higher capacity factors, at a considerable increase in air emissions, in order to export power to Chicago. However, this incentive is present due to increasing competition in the industry and open access transmission, not due to the merger. In addition, outside of the Coalition's speculation with respect to price differentials between NSP and potential customers to the east, there is no evidence that increased use of these plants will occur. NSP, which is in a capacity deficit situation, has not proposed to run these plants at higher capacity factors to meet its own needs because it believes that there are better baseload options available. In an open access market, buyers to the east have many of the same alternatives as NSP. Rate differentials alone cannot demonstrate the probability of a power sale.

With respect to the Coalition's arguments regarding the possibility of increased construction of transmission, again, those impacts are not necessarily related to the merger. The topic of transmission constraints through western Wisconsin has been a perennial issue in the Wisconsin Advance Plan Process. In fact, the PSCW denied construction of one of the lines mentioned by the Environmental Coalition (the Arrowhead-Arpin line) because of its impacts on the environment. The need for increased transmission through the area will be exacerbated by increased competition in the industry, but not necessarily by the merger itself.

Also, every transmission line must go through an extensive environmental review process in order to receive a certificate of need and a route permit in Minnesota. The Commission does not need to hold a hearing at this point on the environmental impacts of speculative transmission lines when every line actually proposed will receive thorough review before construction is permitted.

Finally, with respect to nuclear waste storage, the Environmental Coalition acknowledges that no hearing is required on this issue, but that the merger should be conditioned on NSP not being permitted to accept off-site waste at the Prairie Island nuclear plant. The Commission can consider this condition when it makes its determination whether to approve the merger. However, this condition already exists in the Company's Certificate of Need for the independent spent fuel storage facility. Changes would need to be approved by the Commission (and potentially the legislature) prior to the Company being able to accept Point

Beach waste at Prairie Island.

## **7. Low Income Issues**

ECC and MCAA have argued that the impact on low-income customers must be considered in the context of the merger. The Commission notes that the ECC and MCAA have not shown that the merger would impact the interests of low-income customers differently from the interests of any customer. In any event, all customers will benefit from the Commission's careful review of pre- and post-merger revenue requirements. The Commission clarifies, however, that the issue of rate design will not be explored in the course of this merger review since there are no indications that the merger will differently impact the underlying costs of serving various customers or that it somehow invalidates current rate design.

With respect to other issues raised by the ECC and MCAA, such as the Company's continuing its commitments and services to low income customers, the Commission finds that it has a sufficient record to address those issues in its merger determination.

## **8. Gas Rate Issues**

Parties have not made non-fuel gas cost savings as great an issue as they have made of electric cost savings. However, the Department did recommend no deferral and amortization of merger-related costs for gas customers absent a showing that customers will receive merger-related benefits and the OAG recommended that gas customers should also receive the benefit of a rate reduction and freeze. In response to these comments the Company offered a two-year gas rate freeze, subject to the same exceptions as proposed in the electric rate freeze.

The Company alleged large current and future revenue deficiencies for the gas utility. There is no evidence on this record to either support or refute the Company's allegations. While the Commission could set the issue of gas utility revenue requirements to hearing along with the electric issues, this does not appear to be a significant dispute. The Commission can address gas rate issues in consideration of the proposed rate freezes.

## **9. Rate Freeze Issues**

In addition to the electric rate reduction, NSP has proposed a four-year electric rate freeze and a two-year gas rate freeze, subject to certain exceptions for uncontrollable costs. Both the Department and the OAG supported a rate freeze, subject to modification of some of the conditions under which the Company could request rate changes.

The Commission will refer the electric rate freeze proposal to contested case hearing to determine what the ultimate relationship is, if any, between those savings and the rate freeze and, in general, to consider the characteristics of a reasonable electric rate freeze, e.g. exceptions, duration, etc. Regarding the gas rate freeze, however, the Commission finds that the record is currently adequate to make a determination on the policy issues related to that proposed rate freeze. Therefore, no further hearing or comment should be required in that regard.

## **10. Other Issues**

There are at least two other issues which the Commission will need to decide in conjunction with the Company's request for merger approval: 1) the request for deferred accounting of merger costs and 2) the petition for transfer of gas property. The Commission finds that the record on both of these issues is sufficient and no further hearing or comment is necessary before the Commission decides these issues.

### **C. Commission Action**

Based on its analysis of the various issues raised in this matter in light of the record to date and the ultimate issues to be decided regarding NSP's merger proposal, the Commission will

- 1) set the matter for hearing with respect to certain issues identified in Ordering Paragraph 1;
- 2) take further comment regarding the customer service quality issue as set forth in Ordering Paragraph 2; and
- 3) resolve the following issues on the basis of the current record, without additional comment:
  - gas rate freeze
  - effective regulation
  - low-income concerns
  - environmental concerns
  - gas property transfer
  - deferred accounting of merger-related costs

With respect to the issues for which the Commission decides to request additional comments or decide based on the current record, the Commission will deliberate and decide these issues at a future hearing, most likely in conjunction with the Commission's deliberations regarding the ALJ's report and recommendation regarding the issue identified for contested case proceedings.

### **ORDER**

1. A contested case proceeding shall be held in the Office of Administrative Hearings (OAH)<sup>2</sup> regarding the following issues:
  - what are the expected Minnesota jurisdictional merger-related net savings by year for ten years following the merger?
  - what are the characteristics of a reasonable electric rate freeze (e.g. exceptions, duration, etc.) in these circumstances?

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<sup>2</sup> See the Commission's NOTICE AND ORDER FOR HEARING in this matter, issued contemporaneously, in which the Commission refers the matter to the Office of Administrative Hearings for a contested case proceeding.

- what is the Company's pre-merger revenue requirement, based on a 1996 test year adjusted for known pre-merger changes in 1997?
  - to what extent will it be feasible for Primergy to use its transmission ownership and control of the MAPP-WUMS interface to restrict the flow of non-Primergy sales over its wires?
  - what, if any, is the impact of such a restriction on Minnesota utilities other than Primergy?
2. Within 60 days of the Commission's Order, NSP shall file a customer service quality monitoring plan. Parties shall be allowed 30 days to comment on that plan.
  3. The Commission will resolve the following issues on the basis of the current record, without additional hearing or comment:
    - gas rate freeze
    - effective regulation
    - low-income concerns
    - environmental concerns
    - gas property transfer
    - deferred accounting of merger-related costs.
  4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar  
Executive Secretary

(S E A L)

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