

ISSUE DATE: March 24, 1997

DOCKET NO. E, G-001/PA-96-184

ORDER APPROVING MERGER WITH CONDITIONS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Joel Jacobs  
Marshall Johnson  
Dee Knaak  
Mac McCollar  
Don Storm

Chair  
Commissioner  
Commissioner  
Commissioner  
Commissioner

In the Matter of the Petition by Interstate  
Power Company for Approval to Merge with  
IES Industries, Inc. and WPL Holdings, Inc.

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**PROCEDURAL HISTORY**

On March 1, 1996, Interstate Power Company (Interstate or the Company) filed a petition seeking approval of a proposed merger among Interstate, WPL Holdings, Inc. and IES Industries, Inc.

On April 18 and 29, 1996, the Department of Public Service (the Department) filed procedural comments.

On May 1, 1996, the Company filed procedural comments.

On September 18, 1996, the Department filed comments on the merits of the petition. The Department recommended that the Commission approve the proposed merger with certain conditions and clarifications.

On October 9, 1996, the Company filed reply comments.

On October 17, 1996, Victor and Elizabeth Bryson filed a Notice of Protest in this proceeding. The Brysons stated that they currently own a parcel of Minnesota property which Interstate had formerly used as a manufactured gas plant (MGP) facility. The Brysons have alleged that they suffered damages from their unknowing acquisition of the property, which is contaminated from the MGP operations. The Brysons are currently pursuing settlement of their claims against Interstate. The Brysons claim in their Notice of Protest that the proposed merger would harm their settlement efforts because “an acceptable settlement with an even larger utility will be more difficult.”

On January 15, 1997, the matter came before the Commission for consideration.

## FINDINGS AND CONCLUSIONS

### **I. THE PROPOSED MERGER**

Interstate is predominately an operating public utility that distributes natural gas and generates, transmits, and distributes electricity in Minnesota, Iowa, and Illinois.

IES Industries, Inc. (IES Industries) is a holding company whose subsidiary, IES Utilities Inc. (IES Utilities), is predominately an operating public utility that distributes natural gas and generates, transmits, and distributes electricity in Iowa.

WPL Holdings, Inc. (WPL) is a holding company whose principal utility subsidiaries are Wisconsin Power and Light (Wisconsin P&L) and South Beloit Water, Gas and Electric Company. WPL generates, transmits, and distributes electric energy in southwestern and central Wisconsin and northern Illinois. WPL also distributes natural gas to retail customers and transports customer-owned gas.

Under Interstate's proposal, the merger of WPL, IES Industries, and Interstate would take place in two stages.

First, IES Industries would merge with and into WPL; the two would become Interstate Energy (IE). IE would have Wisconsin P&L and IES Utilities as its utility subsidiaries.

Second, IE would merge with Interstate; as a result, Interstate would become a utility subsidiary of IE. IE's three utility subsidiaries--Wisconsin P&L, IES Utilities, and Interstate--would continue to operate as separate entities for a minimum of three years following the merger.

At the time of the petition, Interstate was uncertain if Wisconsin law mandates that each IE utility subsidiary be incorporated in the State of Wisconsin. If the law so mandates, Interstate requests the Commission's approval to purchase certain water properties owned by Wisconsin P&L. Included in the acquisition would be approximately 39 miles of water distribution facilities, three active wells, one elevated storage tank, and related properties and rights. The purchase price would be approximately \$3 million, the net book value as of the date of the acquisition. After the merger, Interstate would own and operate the water system under the jurisdiction of the Wisconsin Public Service Commission.

The proposed merger requires approval from the Federal Energy Regulatory Commission (FERC). As part of the FERC approval process, Interstate has petitioned FERC for approval of a Coordination Agreement among Interstate, Wisconsin P&L and IES Utilities.

## **II. COMMENTS OF THE PARTIES**

### **A. The Department**

#### **1. The Criteria for Commission Approval**

The Department stated that the proposed merger must be examined under Minn. Stat. § 216B.50, which governs Restrictions on Property Transfers and Mergers, and Minn. Rules, parts 7825.1600-.1800, which control utilities' Acquisition of Property.

Under Minn. Stat. § 216B.50, the Commission must find that the proposal is “consistent with the public interest” in order to approve the merger.

#### **2. The Department's Four Main Issues**

In its application of the public interest standard to the proposed merger, the Department focused on four main issues: 1) By how much, if any, would the merger reduce costs to Minnesota gas and electric ratepayers? 2) Would the resulting operational changes affect the reliability or risk to Minnesota gas and electric customers? 3) Would the merger allow IE to exercise excessive market power in the regional markets for electric capacity and energy, thereby restricting output and raising rates? 4) Would the merger reduce the regulatory authority of Minnesota agencies, thereby impeding the State's ability to balance pertinent policy criteria?

1. By how much, if any, would the merger reduce costs to Minnesota gas and electric ratepayers?

After a careful analysis, the Department determined that total merger-related benefits over ten years will be between \$592.1 million and \$648.1 million (compared to the Company's projected net benefits of \$749 million). The Department estimated Minnesota electric operation benefits of \$13.9 million to \$15.5 million, and Minnesota gas operation benefits of \$4.3 million to \$6.4 million over the ten year period.

The Department concluded that, while the exact amount of savings is impossible to project, the majority of estimated savings appear likely to occur. The Department recommended a four-year conditional electric and gas rate freeze, with certain exceptions for “extraordinary events,” to provide more assurance that Minnesota consumers would benefit from the merger. Because the estimated level of merger savings in the early years is not high enough to materially lower rates, the Department did not recommend either an electric or gas rate reduction at this time.

2. Would the resulting operational changes affect the reliability or risk to Minnesota gas and electric customers?

The Department reviewed the merger for potential operation changes and their effects on the cost and reliability of Interstate's electric service. The Department specifically addressed

issues related to: central dispatch; operational transmission constraints; reliability councils; and quality of service.

The Department also examined the effects of the merger on gas operational issues.

The Department concluded that the proposed merger would not have an adverse effect on the cost or reliability of Interstate's gas or electric service.

3. Would the merger allow IE to exercise excessive market power in the regional markets for electric capacity and energy, thereby restricting output and raising rates?

The Department concluded that Interstate has provided adequate proof that the proposed merger will not have a negative impact on regional competition. The Department stated that the merger will not facilitate Interstate's use of its market power in the generation services market to inappropriately raise electricity prices. The Department also noted that FERC's open access policy on transmission services specifically prohibits the setting of discriminatory prices for transmission services.

4. Would the merger reduce the regulatory authority of Minnesota agencies, thereby impeding the state's ability to balance pertinent policy criteria?

Here the Department examined two issues: the effect of the holding company structure on the state's regulatory oversight; and the effect of the merger on integrated resource planning under Minnesota statute.

The Department stated that the proposed merger would not for the most part affect the jurisdiction or oversight of Minnesota regulators. The Department nevertheless cited one aspect of the transaction which could affect regulatory oversight. The Department noted that Interstate has asked FERC to approve a Coordination Agreement among Interstate, Wisconsin P&L, and IES Utilities as part of the FERC approval process. The Department stated that this arrangement could affect Minnesota ratepayers by limiting the Commission's jurisdiction regarding Interstate's capacity purchases.

The Department recommended that the Commission address the jurisdictional issue by placing two conditions on its approval of the merger. First, up to and during its next electric rate case, Interstate will not claim federal preemption with respect to any cost of service item charged to Interstate under the Coordination Agreement. Second, either prior to or during its next electric rate case, Interstate, in consultation with the Department and the Residential Utilities Division of the Office of Attorney General (RUD-OAG), will convene a meeting of interested parties to discuss and recommend to the Commission ways to amend the Coordination Agreement or otherwise resolve the parties' regulatory oversight concerns.

The Department also noted that Interstate is required under Minnesota law to submit an integrated resource plan (IRP) in Minnesota. Interstate's current IRP is based on Interstate's system-wide needs; after the merger, Interstate's IRP will be based on IE's system-wide needs. Also, the post-merger IRP will have to be filed with both the Minnesota Commission and the

Wisconsin Commission. The Department noted that Minnesota's and Wisconsin's resource planning directives may be inconsistent.

The Department stated that the proposed merger simply points up the fact that more and more utility resource plans are being filed in multiple state jurisdictions. Such filings will require increased cooperation among power pools with whom the utility is associated.

Based upon these observations, the Department recommended that the Commission continue to pursue joint resource planning with regulatory commissions in the states in which IE and Interstate serve. The Department also recommended that the Commission's approval of the merger contain specific steps to establish a higher degree of inter-jurisdictional cooperation regarding the issue of resource planning.

### **3. Other Recommendations of the Department**

The Department made two other recommendations. First, the Department recommended that the Commission find that Interstate has fully complied with filing requirements for the transfer of the water properties. If necessary for Interstate to meet the mandates of Wisconsin law, the Commission should approve Interstate's acquisition of the Ripon water properties.

Second, the Department recommended that the Commission condition approval on the merger's qualifying as a pooling of interests. If the merger is identified as a pooling of interests rather than as a purchase, the Company would not be eligible for recovery of an acquisition adjustment or good will costs.

#### **B. Interstate**

Interstate did not object to or elaborate on three Department recommendations: the pooling of interests accounting concept; the pursuit of joint resource planning with other states; and the requirement to separately identify merger-related costs in the Company's Jurisdictional Annual Reports.

Interstate proposed a three year rate freeze rather than the four years proposed by the Department. The Company insisted on an exemption from the rate freeze for prompt requests for recovery of manufactured gas plant (MGP) costs and for miscellaneous tariff filings.

Interstate asked the Commission to approve the merger because it is consistent with the public interest and will provide significant net benefits to Interstate's customers.

### **III. COMMISSION ACTION**

The Commission finds that Interstate has demonstrated that the proposed merger is consistent with the public interest and should be approved, pursuant to Minn. Stat. § 216B.50. The Commission agrees with the Department that merger-related benefits are sufficient to justify the proposal. The Commission also agrees with the Department that the proposed merger is unlikely to adversely affect either regional markets or the state's regulatory oversight.

The Commission will approve the merger proposal subject to modifications or clarifications of several components of the proposal. The Commission discusses those modifications or clarifications below.

**A. The Treatment of Purchased Power Contracts**

The Department recommended that the Commission condition its approval of the merger upon a requirement that, up to and during Interstate's next rate case, the Company will not claim federal preemption regarding any cost of service item charged to Interstate under the Coordination Agreement, if the Commission disallows recovery for the item on the grounds of imprudence. The Department also recommended that, prior to or during the next electric rate case, Interstate would convene a meeting of interested parties to discuss and recommend ways to amend the Coordination Agreement or otherwise resolve the parties' regulatory oversight concerns.

Interstate generally accepted these recommendations, with the following clarification: at least six months prior to expiration of the rate freeze period, Interstate will meet with interested parties to discuss a Coordination Agreement.

The Commission agrees with the Department's recommendations and the Company's clarification. The Commission finds, however, that further jurisdictional protections are necessary. The Commission does not believe that the need to preserve its jurisdiction will necessarily cease at the conclusion of Interstate's next rate case. It is possible that parties will not have agreed to convene by that time, or that a revised Coordination Agreement will not have been drafted. The Commission will therefore add a further condition to those recommended by the Department and clarified by the Company: The Commission will approve the merger upon the condition that Interstate will not claim federal preemption regarding any cost of service item under the Coordination Agreement until: 1) the Commission finds that an acceptable alternative to the Coordination Agreement has been agreed upon by the parties; or 2) the Commission finds that this merger condition is no longer necessary or appropriate.

**B. Multi-State Integrated Resource Planning**

In written comments, the Department had recommended that the Commission approve the merger conditioned upon the Company's pursuing joint resource planning with the states in which the Company's operating companies would provide retail service. At the January 15 meeting, however, the Department indicated that the parties were aware of the Commission's concern regarding developments in this area. The Department stated that the parties will work toward implementing joint resource planning; the Commission need not place this condition on its approval of the merger.

The Commission agrees with the Department. While the Commission will not place any condition upon its merger approval to convey its concern regarding this issue, the Commission trusts that the parties are aware of it and will work cooperatively to develop multi-state integrated resource planning.

### **C. Accounting Treatment of the Merger**

Business combinations must be recorded using either the purchase method of accounting or the pooling-of-interests method. The appropriate method is determined under generally accepted accounting principles. Under Accounting Principles Board Opinion No. 16, if a business combination meets 12 specific conditions, the pooling method of accounting must be used. If any of the 12 conditions is not met, the purchase method of accounting must be used.

The primary difference between the two accounting methods is in how assets are valued after the combination. Under the purchase method, assets are revalued after the combination to set book value of the assets to current market value. Any difference between book value and market value is recorded as good will (also known as an acquisition premium). Under the pooling method, the post-combination assets are valued at the same book value as was previously recorded on the companies' pre-merger books. No good will or acquisition adjustment will show on the books as a result of the combination.

The Department's main concern regarding accounting methods seems to be the possibility of the Company's requesting recovery of an acquisition premium as a result of the asset combination. While requiring that the Company use the pooling method would preclude recovery of an acquisition premium, the Commission notes that the accounting method is governed by accounting standards and is not elective.

The Commission will therefore modify the Department's recommendation as follows. The Commission will approve the merger upon the condition that Interstate not seek recovery of any acquisition price over book value. This will preclude recovery of any acquisition premium, whether considered as good will or as an acquisition adjustment.

### **D. Jurisdictional Annual Reports**

The Commission agrees with the Department's recommendation that Interstate be required to identify its merger-related costs in its Jurisdictional Annual Reports filed with the Department.

The Commission notes that most costs associated with the merger should be incurred in approximately the next four years. The Commission will therefore not make the reporting requirement indefinite, but will limit the requirement to jurisdictional annual reports filed in the next eight years. Eight years will provide some closure to the reporting requirement, while allowing a comfortable margin for reporting any "tag ends" of the merger-related costs.

The Commission further notes that the parties may address this issue in future jurisdictional filings, if either party believes that the eight year reporting requirement is either unduly burdensome or insufficient.

### **E. Water Properties**

The Commission agrees with the Department that Interstate has submitted the necessary filings to support its request for authority to acquire the Wisconsin water properties. The Department

stated that the property transfer would likely have no impact on Minnesota gas and electric operations and ratepayers. Since the water system will remain under Wisconsin jurisdiction, the Company will maintain property and cost records for the water system that are separable from its Minnesota cost and property records.

The Commission approves Interstate's proposal to acquire WPL's water properties in Ripon, Wisconsin.

#### **F. The Rate Freeze**

The Department recommended that the Commission freeze Interstate's electric and gas rates for a period of four years from the effective date of the merger. The Department found that the four year rate freeze would help insulate Minnesota ratepayers from any possible adverse effect of the proposed merger.

The Department noted that, in Iowa, Interstate proposed exceptions to the rate freeze for "government-mandated programs." The Department found this exception too vague. In the alternative, the Department recommended that the Commission allow exceptions to the rate freeze for "extraordinary events," which would include federal or state agency mandates. The Department believed that exceptions for extraordinary events will ensure that the Company has adequate revenues to provide reliable electric service, even in the case of unforeseen events.

The Department recommended that the overall rate freeze exception for "extraordinary events" be clarified and conditioned as follows:

1. The category of extraordinary events should exclude those events that are due to the risks normally borne by shareholders.
2. Proposed exceptions due to extraordinary events must be accompanied by sufficient evidence.
3. Filings for exceptions due to extraordinary events must include events that would lower rates, as well as those that would raise rates.
4. Requests for exceptions for any reason are limited to one filing per year.

The Company generally found these Department recommendations acceptable. The Company added that it must have an exception to the rate freeze to seek prompt recovery of MGP cleanup costs, and for miscellaneous tariffs and automatic adjustments.

At the January 15, 1997 hearing, the Department representative stated that the Commission's adoption of the Department's recommended exceptions would not preclude Interstate from seeking recovery of MGP cleanup costs during the rate freeze. The Department did not wish to have a specific exception for recovery of MGP cleanup costs, however.

Having considered the parties' written and oral comments regarding the exceptions to the four year rate freeze, including the Department's articulation of its understanding of the Company's ability to seek recovery of MGP costs, the Commission will adopt the Department's recommended clarifications of, and conditions on, the rate freeze exception for extraordinary events.

#### **IV. THE BRYSON NOTICE OF PROTEST**

Under Minn. Stat. § 216B.50, the Commission must determine if the proposed merger is consistent with the overall public interest. Having carefully considered the filings and oral arguments in this case, the Commission has determined that the proposal is consistent with the public interest and should be approved.

The Brysons claim that the proposed merger may delay their settlement efforts because they will be forced to deal with "an even larger utility." The Commission finds that this claim is speculative. Even granted its greatest possible weight, it cannot outweigh the Department's careful finding of net public benefit from the merger.

The Commission has noted the Brysons' notice of protest. No further action is necessary or will be taken.

#### **ORDER**

1. The Commission approves Interstate's March 1, 1996 petition seeking approval of a proposed merger, with the following conditions and clarifications:
  - a. Up to and during Interstate's next rate case, the Company will not claim federal preemption regarding any cost of service item charged to Interstate under the Coordination Agreement, if the Commission disallows recovery for the item on the grounds of imprudence.
  - b. Prior to or during the next electric rate case, Interstate will convene a meeting of interested parties to discuss and recommend ways to amend the Coordination Agreement or otherwise resolve the parties' regulatory oversight concerns.
  - c. At least six months prior to expiration of the rate freeze period, Interstate will meet with interested parties to discuss a Coordination Agreement.
  - d. Interstate will not claim federal preemption regarding any cost of service item under the Coordination Agreement until: i) the Commission finds that an acceptable alternative to the Coordination Agreement has been agreed upon by the parties; or ii) the Commission finds that this merger condition is no longer necessary or appropriate.

- e. Interstate will not seek recovery of any acquisition price over book value. This will preclude rate recovery of any acquisition premium, whether considered as good will or as an acquisition adjustment.
  - f. Interstate will identify its merger-related costs in its Jurisdictional Annual Reports filed with the Department for the next eight years.
  - g. The Commission approves Interstate's proposal to acquire WPL's water properties in Ripon, Wisconsin.
  - h. The Commission approves a freeze of Interstate's gas and electric rates for four years from the effective date of the merger, with an exception for extraordinary events, clarified and conditioned as follows:
    - i. The category of extraordinary events should exclude those events that are due to the risks normally borne by shareholders.
    - ii. Proposed exceptions due to extraordinary events must be accompanied by sufficient evidence.
    - iii. Filings for exceptions due to extraordinary events must include events that would lower rates, as well as those that would raise rates.
    - iv. Requests for exceptions for any reason are limited to one filing per year.
2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar  
Executive Secretary

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