

December 24, 2012

Dr. Burl W. Haar
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: **Supplemental Response Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. G007,011/AI-10-783

Dear Dr. Haar:

On July 12, 2010, Minnesota Energy Resources (MERC or the Company), a subsidiary of Integrys Energy Group, Inc. (Integrys), filed a petition with the Minnesota Public Utilities Commission (Commission) in the following matter:

Petition of Minnesota Energy Resources Corporation for Approval of an Affiliated Interest Agreement (Agreement).

The Minnesota Department of Energy Resources (Department) is filing these Supplemental Response Comments in response to Additional Reply Comments filed by MERC on November 19, 2012. MERC agreed with and accepted all of the conditions recommended by the Department in Supplemental Response Comments filed November 7, 2012, except the Department's recommendation that the Commission condition its approval of MERC's petition upon MERC obtaining approval of the cost study that is part of the Agreement prior to MERC filing a general rate case.

As set forth in the attached Supplemental Response Comments, the Department continues to recommend **conditional approval** of the Agreement.

The Department is available to answer any questions the Commission may have.

Sincerely,

/s/ MARLON GRIFFING
Financial Analyst
651-297-3900

MG/jl
Attachment

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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

DOCKET NO. G007,011/AI-10-783

I. BACKGROUND

Minnesota Energy Resources Corporation (MERC) filed a petition with the Minnesota Public Utilities Commission (Commission) on July 12, 2010, for approval of an affiliated interest agreement (Agreement). The Agreement would be between Integrys Energy Group, Inc. (Integrys) and all of the wholly owned regulated subsidiaries of Integrys, including MERC, one partially owned regulated subsidiary of Integrys and all wholly owned non-regulated subsidiaries of Integrys.¹

In its September 17, 2010 Reply Comments, MERC requested that the Commission defer scheduling consideration of this issue until any changes made to the Agreement by the Illinois Commerce Commission (ICC) and the Public Service Commission of Wisconsin (PSCW), which were also considering the Agreement, were known. The Department subsequently agreed with the request.

On February 9, 2011, MERC filed notice that the ICC approved the Agreement with modifications, notably to Sections 4.3 and 4.4, on December 15, 2010. On April 25, 2012, MERC filed notice that the PSCW had approved the Agreement as modified by the ICC.

¹ The Agreement covers the wholly-owned regulated subsidiaries of Integrys, Michigan Gas Utilities Corporation, Minnesota Energy Resources Corporation, North Shore Gas Company, The Peoples Gas Light and Coke Company, Upper Peninsula Power Company, and Wisconsin Public Service Corporation; the partially-owned regulated subsidiary of Integrys, Wisconsin Valley Improvement Company; and the wholly-owned non-regulated subsidiaries of Integrys, Integrys Energy Group, Inc. and its subsidiaries; Integrys Energy Services, Inc. and its subsidiaries; and Integrys Business Support, LLC.

On August 8, 2012, the Department filed additional comments recommending approval with modifications pertaining to reporting requirements.

On August 20, 2012, MERC filed additional response comments agreeing with most of the Department's recommendations but requesting further discussion about the cost study.

On August 31, 2012, the Department filed supplemental response comments recommending that the Commission approve the Agreement as approved by the ICC and the PSCW, including the Addendum, provided that the Commission requires MERC to file in this docket:

- the annual internal audit report according to revised Section 4.3;
- the cost study covering the period ending December 31, 2011, within 30 days of the date of an Order approving the Agreement; and
- the annual updates to the cost study and subsequent cost studies according to revised Section 4.4.

On September 10, 2012, MERC filed additional comments agreeing with the intent of the Department's proposed modifications to the Agreement but requesting that the Agreement not be amended since that would require more processes in other states. Instead, MERC requested that the Commission require the reports through its Order rather than through amendments to the Agreement.

On September 18, 2012, the Department filed Additional Supplemental Response Comments agreeing with MERC's request that the Commission include the reporting requirements as points in an Order approving the Agreement rather than amending the Agreement. The Department listed six conditions regarding filing requirements for MERC. One of the requirements was that MERC file the cost study pertaining to the period ending December 31, 2011, which is required by Section 4.4 of the Agreement (non-IBS cost study), within 30 days of the date of an Order approving the Agreement.

On October 1, 2012, MERC filed Additional Supplemental Reply Comments stating that the non-IBS cost study was not completed since MERC had not received regulatory approval of the Agreement. Therefore, MERC stated that it could not file the non-IBS cost study within 30 days of a Commission Order. The Company said it planned to file a non-IBS cost study in May 2015 based on 2014 data.

On October 3, 2012, MERC filed as an informational item the cost study for Integrys Business Support (IBS), the centralized service company within the Integrys holding company system. The IBS cost study was prepared for Docket No. G007,011/AI-07-779, but does not pertain to non-IBS costs.

On November 7, 2012, the Department filed Supplemental Response Comments (November 7 Comments) recommending conditional approval of the Agreement. The Department concluded

that it would be appropriate for the Commission to condition its approval of MERC's petition with the requirement that MERC obtain approval of the non-IBS cost study prior to MERC's next rate case. As noted above, MERC proposes to file its non-IBS study by May 2015. Thus, MERC would either need to wait to file its next rate case until the Company receives approval of the non-IBS study or, if MERC intends to file its next rate case sooner, the Company would need to file its non-IBS study sooner.

On November 19, 2012, MERC filed Additional Reply Comments in which the Company agreed with and accepted all of the conditions recommended by the Department except the recommendation that MERC would either need to wait to file its next rate case until the Company received approval of the non-IBS study or, if MERC intends to file its next rate case sooner, the Company would need to file its non-IBS study sooner. MERC stated that it believes this recommendation is without precedent or legal authority. As an alternative to the Department's recommendation, MERC suggested that the Department could initiate a review of the current non-IBS affiliated interest agreement (AIA) which the Commission approved in an Order issued March 18, 2008, in Docket No. G007,011/AI-06-1052 (AI-06-1052 AIA).

II. DEPARTMENT ANALYSIS

A. INTRODUCTION

As has been noted in previous MERC and Department filings in this docket, the proposed Agreement, if approved, would govern the provision of inter-company services provided by and among affiliates within the Integrys holding company system, other than services provided by IBS. The IBS Affiliated Interest Agreement approved by the Commission in Docket No. G007,011/AI-07-779 governs IBS's provision of shared services to MERC and the other regulated entities within the Integrys holding company system. The Agreement is proposed to supersede the AI-06-1052 AIA approved by the Commission, which currently governs the provision of goods, services, and property between Integrys and its regulated public utility subsidiaries, including MERC.

MERC and the Department agree that the five following items should be included as points in an Order issued in the current docket:

- Each year by May 1 MERC shall file with the Commission billing reports showing its charges, as a Providing Party, to any Receiving Party to which it provided Services under the Agreement during the preceding calendar year and billing reports showing its payments, as a Receiving Party, for Services received from Providing Parties under the Agreement during the preceding calendar year;
- MERC shall file the annual internal audit report in this docket with the Commission no later than July 1 of each audit year;

- MERC shall file the annual updates to the cost study in this docket with the Commission by May 1 of each applicable year;
- MERC shall file subsequent cost studies in this docket with the Commission by May 1 of each applicable year; and
- MERC shall file a study with the Commission three years from the effective date of the Agreement providing information sufficient to enable the Commission to determine whether the Agreement should continue, be modified, or be discontinued.

MERC objected to the following Department recommendation:

- MERC shall obtain approval of the non-IBS cost study prior to MERC's next rate case; in any event, MERC must file its non-IBS study no later than May 1, 2015.

B. ROLE OF THE NON-IBS COST STUDY

The Department stated in its November 7 Comments that the purpose of the non-IBS cost study is to prevent MERC's ratepayers from subsidizing unregulated enterprises of MERC or other unregulated affiliates of Integrys covered by the Agreement. The proposed rules appropriately would use the higher of cost or market value when the regulated utility provides service to a non-regulated affiliate and the lower of cost or market value when the regulated utility receives service from a non-regulated affiliate.

Because the reasoning for setting prices for transactions between affiliates in this manner was dealt with in its November 7 Comments, the Department will not address the matter further except to reiterate that the results of both a cost study and a fair-market value study are necessary if the Agreement is to function fully as intended. If either study is not available, ratepayers may not receive all of the intended benefits under the proposed Agreement.

C. NEED FOR A CURRENT NON-IBS COST STUDY

The Department concluded in its November 7 Comments that the services listed in Appendix C of the Agreement pertain to non-gas costs; therefore, the proposed affiliated-interest agreement will not have any effect on ratepayers until MERC's subsequent rate case. However, when MERC next files a rate case all of the Company's cost allocations will be subject to review by the Commission. In a rate case, MERC has the burden of proving that it has followed cost allocation rules so as to protect ratepayers. If MERC has not filed a non-IBS cost study when the Company files its next rate case, MERC risks having its proposed cost allocations found invalid and its cost-recovery requests disallowed.

The Department's intent in concluding that it is appropriate for the Commission to condition its approval of MERC's petition with the requirement that MERC obtain approval of the non-IBS cost study prior to MERC's next rate case is to protect ratepayers and to ensure that the record before the Commission is adequate to support its decision in a rate case. Proposed cost recovery

levels in MERC's next rate case must be supported by the record or, absent support, must be decided in favor of ratepayers. Absent a cost study in the record of MERC's next rate case, cost recovery under the Agreement would not be supported by the record.

The Department acknowledges that MERC may choose to: 1) file the non-IBS cost study prior to its next rate case, 2) file the non-IBS study concurrent with the Company's next rate case, or 3) bear the risk that the record in MERC's next rate case is not adequate to support its case pertaining to non-IBS costs and revenues. As such, the Department revises its recommendation to reflect these choices. Specifically, the Department revises its recommendation to state:

MERC ~~shall~~ may obtain approval of the non-IBS cost study prior to or concurrent with MERC's next rate case; in any event, MERC bears the burden of showing in its next rate case that its proposed recovery of costs and revenues pertaining to non-IBS transactions is reasonable. Further, MERC must file its non-IBS study no later than May 1, 2015.

III. DEPARTMENT'S CONCLUSION AND RECOMMENDATIONS

The Department concludes that, to ensure that ratepayers are adequately protected according to the cost-allocation rules identified above, that it is appropriate for the Commission to condition its approval of MERC's petition with the following revised requirement:

MERC ~~shall~~ may obtain approval of the non-IBS cost study prior to or concurrent with MERC's next rate case; in any event, MERC bears the burden of showing in its next rate case that its proposed recovery of costs and revenues pertaining to non-IBS transactions is reasonable. Further, MERC must file its non-IBS study no later than May 1, 2015.

Thus, the Department's full recommendation is that the Commission approve MERC's proposal with the following conditions:

- Each year by May 1 MERC shall file with the Commission billing reports showing its charges, as a Providing Party, to any Receiving Party to which it provided Services under the Agreement during the preceding calendar year and billing reports showing its payments, as a Receiving Party, for Services received from Providing Parties under the Agreement during the preceding calendar year;
- MERC shall file the annual internal audit report in this docket with the Commission no later than July 1 of each audit year;

- MERC shall file the annual updates to the cost study in this docket with the Commission by May 1 of each applicable year;
- MERC shall file subsequent cost studies in this docket with the Commission by May 1 of each applicable year;
- MERC shall file a study with the Commission three years from the effective date of the Agreement providing information sufficient to enable the Commission to determine whether the Agreement should continue, be modified, or be discontinued; and
- MERC may obtain approval of the non-IBS cost study prior to or concurrent with MERC's next rate case; in any event, MERC bears the burden of showing in its next rate case that its proposed recovery of costs and revenues pertaining to non-IBS transactions is reasonable. Further, MERC must file its non-IBS study no later than May 1, 2015.

/jl

CERTIFICATE OF SERVICE

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

Supplemental Response Comments of the Division of Energy Resources of the Minnesota Department of Commerce

Docket No. G007,011/AI-10-783

Dated this **24th day of December 2012**

/s/Jan Mottaz

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Michael	Ahern	ahern.michael@dorsey.com	Dorsey & Whitney, LLP	50 S 6th St Ste 1500 Minneapolis, MN 554021498	Electronic Service	No	OFF_SL_10-783_AI-10-783
Julia	Anderson	Julia.Anderson@ag.state.mn.us	Office of the Attorney General-DOC	1800 BRM Tower 445 Minnesota St St. Paul, MN 551012134	Electronic Service	Yes	OFF_SL_10-783_AI-10-783
Michael	Bradley	bradley@moss-barnett.com	Moss & Barnett	4800 Wells Fargo Ctr 90 S 7th St Minneapolis, MN 55402-4129	Electronic Service	No	OFF_SL_10-783_AI-10-783
Sharon	Ferguson	sharon.ferguson@state.mn.us	Department of Commerce	85 7th Place E Ste 500 Saint Paul, MN 551012198	Electronic Service	Yes	OFF_SL_10-783_AI-10-783
Burl W.	Haar	burl.haar@state.mn.us	Public Utilities Commission	Suite 350 121 7th Place East St. Paul, MN 551012147	Electronic Service	Yes	OFF_SL_10-783_AI-10-783
Richard	Haubensak	RICHARD.HAUBENSAK@CONSTELLATION.COM	Constellation New Energy Gas	Suite 200 12120 Port Grace Boulevard La Vista, NE 68128	Paper Service	No	OFF_SL_10-783_AI-10-783
John	Lindell	agorud.ecf@ag.state.mn.us	Office of the Attorney General-RUD	1400 BRM Tower 445 Minnesota St St. Paul, MN 551012130	Electronic Service	Yes	OFF_SL_10-783_AI-10-783
Brian	Meloy	brian.meloy@leonard.com	Leonard, Street & Deinard	150 S 5th St Ste 2300 Minneapolis, MN 55402	Electronic Service	No	OFF_SL_10-783_AI-10-783
Andrew	Moratzka	apm@mcmlaw.com	Mackall, Crouse and Moore	1400 AT&T Tower 901 Marquette Ave Minneapolis, MN 55402	Electronic Service	No	OFF_SL_10-783_AI-10-783
Ann	Seha	seha.ann@dorsey.com	Dorsey & Whitney	Suite 1500 50 South Sixth Street Minneapolis, MN 554021498	Paper Service	No	OFF_SL_10-783_AI-10-783

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Eric	Swanson	eswanson@winthrop.com	Winthrop Weinstine	225 S 6th St Ste 3500 Capella Tower Minneapolis, MN 554024629	Electronic Service	No	OFF_SL_10-783_AI-10-783
Gregory	Walters	gjwalters@minnesotaenergyresources.com	Minnesota Energy Resources Corporation	3460 Technology Dr. NW Rochester, MN 55901	Paper Service	No	OFF_SL_10-783_AI-10-783