

**BEFORE THE  
PUBLIC SERVICE COMMISSION OF WISCONSIN**

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Application Of Wisconsin Energy Corporation	)	
For Approval Of A Transaction By Which	)	
Wisconsin Energy Corporation Would Acquire	)	Docket No. 9400-YO-100
All Of The Outstanding Common Stock Of	)	
Integrus Energy Group, Inc.	)	

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**DIRECT TESTIMONY OF LANE KOLLEN**

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1 **Q. Please state your name and business address.**

2 A. My name is Lane Kollen. My business address is J. Kennedy and Associates, Inc.  
3 ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia  
4 30075.

5  
6 **Q. What is your occupation and by whom are you employed?**

7 A. I am a utility rate and planning consultant holding the position of Vice President and  
8 Principal with the firm of Kennedy and Associates.

9  
10 **Q. Please describe your education and professional experience.**

11 A. I earned a Bachelor of Business Administration in Accounting degree and a Master of  
12 Business Administration degree from the University of Toledo. I also earned a Master of  
13 Arts degree from Luther Rice University. I am a Certified Public Accountant ("CPA"),  
14 with a practice license, a Certified Management Accountant ("CMA"), and a Chartered  
15 Global Management Accountant ("CGMA"). I am a member of several professional  
16 organizations.

1 I have been an active participant in the utility industry for more than thirty years,  
2 initially as an employee of The Toledo Edison Company from 1976 to 1983 and  
3 thereafter as a consultant in the utility industry. I have testified as an expert witness on  
4 planning, ratemaking, accounting, finance, and tax issues in proceedings before  
5 regulatory commissions and courts at the federal and state levels on nearly two hundred  
6 occasions.

7 I have testified before the Public Service Commission of Wisconsin on numerous  
8 occasions, including Docket Nos. 05-UR-103, 6680-CE-170, 6680-UR-116, 6690-UR-  
9 119, 05-UR-104, 6680-UR-117, 05-UR-105, 4220-UR-117, and 05-UR-106. I also have  
10 been involved in more than a dozen utility merger proceedings before state regulatory  
11 commissions and the Federal Energy Regulatory Commission (“FERC”) and have  
12 testified in many of those proceedings, although some of the proceedings were settled  
13 prior to hearing. My qualifications and regulatory appearances are further detailed in  
14 Ex.-WIEG-Kollen-1.

15  
16 **Q. On whose behalf are you testifying?**

17 A. I am testifying on behalf of the Wisconsin Industrial Energy Group, Inc. (“WIEG”), an  
18 association of large industrial and manufacturing businesses, many of which take electric  
19 service from Wisconsin Electric Power Company (“WEPCO”), a subsidiary of Wisconsin  
20 Energy Corporation (“WEC” or the “Applicant” in this proceeding), or Wisconsin Public  
21 Service Corporation (“WPSC”), a subsidiary of Integrys Energy Group, Inc. (“Integrys”).  
22 In this proceeding, WEC seeks approval to acquire Integrys (the “transaction”). Upon  
23 consummation of the transaction, WEC will become Wisconsin Energy Group (“WEG”).

1 The transaction will affect the electric rates charged by WEPCO and WPSC to the  
2 members of WIEG.

3  
4 **Q. What is the purpose of your testimony?**

5 A. The purpose of my testimony is to address and make recommendations regarding WEC's  
6 request for approval of the proposed transaction to ensure that the acquisition, if  
7 approved, truly meets the statutory requirements of Wis. Stat. 196.795(3) that it is in the  
8 "best interests of utility consumers, investors, and the public."

9 I may need to amend, supplement, or withdraw this testimony, however, and  
10 expressly reserve the right to do so. Yesterday, January 13, 2014, I received a news  
11 release that Michigan Governor Rick Snyder's office jointly released with Michigan's  
12 Attorney General, WEC, Upper Peninsula Power Company (a regulated subsidiary of  
13 Integrys) ("UPPCO"), Invenergy, and Cliffs Natural Resources announcing a series of  
14 agreements that may affect WPSC's and WEPCO's utility customers and the public. The  
15 agreements reportedly include, among other things, the sale of certain Integrys and  
16 WEPCO assets to UPPCO (including Presque Isle Power Plant). With the agreements,  
17 Michigan's Governor, Attorney General, and Cliffs Natural Resources will not object to  
18 WEC's acquisition of Integrys. I have not had any opportunity to review the series of  
19 agreements, much less consider how those agreements affect utility customers and the  
20 public. The effects could be beneficial, or harmful, or even some combination of the two.  
21 Without question, though, the Michigan agreements will have effects on Wisconsin. I  
22 cannot offer final recommendations until I have had a reasonable opportunity to  
23 understand how the agreements with Michigan will affect Wisconsin interests.

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**Q. What are the statutory requirements that apply in this proceeding?**

A. WEC seeks approval of the transaction pursuant to Wis. Stat. § 196.795(3), which requires that the acquisition of a Wisconsin holding company be “in the best interests of utility consumers, investors and the public.”<sup>1</sup> The statute provides, among other things, that

No person may take, hold or acquire, directly or indirectly, more than 10% of the outstanding voting securities of a holding company, with the unconditional power to vote those securities, unless the commission has determined, after investigation and an opportunity for hearing, that the taking, holding or acquiring is in the best interests of utility consumers, investors and the public.

I focus here on the “best interests” of both “utility consumers” and the “public.” The “best interests” of these two groups substantially overlap and I consider the two the same for purposes of my testimony. If “best interests” is to have any meaning, this test demands that “utility consumers” and the “public” will receive some benefit from the acquisition. They must be more than indifferent to WEC’s proposal. But indifference is not the test. WEC must show more than that “utility consumers” and the “public” will not be harmed. Thus, there must be actual benefits from the transaction to the utility consumers and the public in addition to any benefits that WEC and Integrys investors may realize. The Commission certainly recognizes that WEC does not directly represent the best interests of either utility consumers or the public. WEC directly represents only the best interest of its investors. Of course, the “best interests” of utility consumers and the public may be diametrically opposed to the “best interests” of investors.

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<sup>1</sup> Throughout my testimony I use “utility consumers” and “utility customers” interchangeably.

1           The Commission must ensure that the acquisition is in the “best interests” of  
2 WEPCO and WPSC’s customers and the public by conducting an independent and  
3 thorough “investigation” of the transaction and imposing the conditions necessary to  
4 ensure first that they are not harmed by the transaction and, second, that customers  
5 benefit from the transaction. WEC, though, has provided no evidence that customers will  
6 not be harmed, much less that they will benefit.

7  
8 **Q. Why do you believe that WEC has not offered such evidence?**

9 A. They did not offer such evidence because, surprisingly, there is no evidence. WEC  
10 expressly stated that it did not analyze whether the proposed acquisition would result in  
11 customer savings. It did not estimate transition costs or potential savings.

12  
13 **Q. Is it unusual, in your experience, for utilities or their holding companies not to**  
14 **estimate transition costs and potential savings when assessing a merger or**  
15 **acquisition and then seeking approval from regulators?**

16 A. Yes. The fact that WEC has not performed any such studies is highly unusual. I have  
17 participated in more than a dozen utility merger and acquisition proceedings over the last  
18 two decades. In every one of those proceedings, except this one, the utility has studied  
19 the post-merger organization and quantified estimated transition costs and savings.  
20 Indeed, it is difficult to imagine that any business, particularly one the size of WEC,  
21 would even consider acquiring another business without such an analysis.

1 **Q. Please summarize your conclusions.**

2 A. WIEG opposes the proposed transaction as described in the WEC Application  
3 (“Application”) and supporting Direct Testimony. WEC has utterly failed to demonstrate  
4 that the transaction is in the best interests of customers and the public. Nevertheless,  
5 WIEG may support the proposed transaction if the Commission imposes conditions  
6 necessary to ensure that the acquisition is in the “best interests of utility consumers . . .  
7 and the public.” Such conditions are necessary to ensure first that there is *no harm* to  
8 utility consumers and the public and, second, that there are *savings or other quantifiable*  
9 *benefits* that inure to the *benefit* of WEPCO and WPSC customers..

10 Unfortunately, while WEC claims that there will be benefits from the proposed  
11 acquisition, it has provided nothing more than general and vague descriptions of such  
12 potential benefits.<sup>2,3</sup> WEC has failed to identify, quantify, or offer any specific customer  
13 benefits or savings, even though it must do so in order to meet statutory requirements.  
14 Inexplicably, WEC has not even studied or quantified such potential benefits or the post-  
15 acquisition integration or other transition costs.<sup>4,5</sup> In my experience in other utility

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<sup>2</sup> The Application at 11 states, “However, even with no short-term merger-related cost savings, utility customers will benefit from the Transaction because they will be served by a larger, more diversified, financially strong energy company with deep roots in Wisconsin. WEC expects that utility customers will also benefit -- not immediately, but over time -- from a variety of opportunities.”

<sup>3</sup> Direct-WEC-Reed-34 states, “Merger-related savings typically accrue over time, and after upfront investment, through enhanced purchasing power, economies of scale, joint resource planning over a larger and more diverse system, the documentation, adoption and implementation of best practices, other efficiencies in operations and maintenance and project management, sharing administrative and other services over a larger organization, and the improved use of technology.”

<sup>4</sup> The Application at 3 states, “While a detailed analysis of potential savings that may result from the transaction over time has not been performed, an examination of savings attributable to similar transactions suggest that over time the Transaction is likely to generate net savings in the range of three to five percent of non-fuel O&M of the combined company.

<sup>5</sup> Direct Testimony of John Reed at 34 states, “While neither the Companies nor I have conducted a

1 merger proceedings, this is without precedent. Instead, WEC proposes that the  
2 Commission approve the transaction without the information necessary to determine if it  
3 meets the statutory standard and then proposes that the Commission address the actual  
4 transition costs and savings in future rate proceedings.<sup>6,7</sup> Yet, the Commission must make  
5 the determination in *this* proceeding as to whether the transaction is in the “best interests”  
6 of utility consumers and the public. That requires certain findings and the imposition of  
7 certain requirements in *this* proceeding that cannot be deferred to future rate proceedings.  
8 WEC has failed even to address how the Commission might go about identifying,  
9 quantifying or addressing the costs and savings in future WEPCO or WPSC rate  
10 proceedings if it does not resolve these issues upfront in this proceeding.

11 WEC also claims that it has not studied how best to organize and staff the post-  
12 merger companies, particularly the centralized service company and the provision of  
13 services to WEPCO and WPSC compared to the pre-merger structure.<sup>8,9</sup> The failure to  
14 perform such studies before seeking approval of the merger exposes WEPCO and WPSC  
15 customers to the potential costs of overlapping and duplicate services and costs, with no  
16 time frame or actual plan to sort it all out after the fact.

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detailed analysis of potential merger synergy savings specific to the merger of WEC and Integrys, I have examined the synergy savings attributable to many other mergers.”

<sup>6</sup> *Id* at 8 states, “Savings that are realized over time, and the transition costs necessary to achieve those savings, will be reflected through the future rate case processes in each state.

<sup>7</sup> Response to 01-HS-02 in MPSC Case No. U-17682, a copy of which is attached as Ex.-WIEG-Kollen-2.

<sup>8</sup> WEC presently provides certain services to WEPCO and Wisconsin Gas. WEPCO presently provides certain services to WEC and other WEC affiliates. Integrys Business Support presently provides certain services to WPSC and other Integrys affiliates. After the acquisition, WEC plans to rename IBS as WE Business Support (“WEB”) and use WEB to provide services to both the former WEC affiliates and the former Integrys affiliates.

<sup>9</sup> WEC has “no specific plans” for modifying the scope of centralized business services, according to its response to TM-JA-10 in MPSC Case No. U-17682, a copy of which is attached as Ex.-WIEG-Kollen-3.

1           WEC also has failed to offer any proposal or methodology to measure or track the  
2 transition costs incurred or savings achieved. Transition costs likely will include among  
3 other activities restructuring the holding company and utility organizations, including the  
4 provision of services directly by WEPCO and the centralized service company; voluntary  
5 severance programs to reduce headcounts; integration of existing information technology  
6 (“IT”) hardware platforms and software systems, *e.g.*, general ledger and other business  
7 systems, power plant and other control systems, and customer service and call center  
8 systems. The transition costs will include both capitalized costs (assets) and operating  
9 expenses.<sup>10</sup>

10           There is no question that the transaction will impose risks and costs on WEPCO  
11 and WPSC, which the two utilities intend to recover from their respective customers as  
12 those costs are incurred, regardless of whether those costs lead to any actual savings.

13           The merger likely will result in increased rates, at least in the next few years,  
14 compared to the status quo, unless the Commission imposes specific hold harmless  
15 conditions. The Companies propose to include all transition costs and savings, if any, in  
16 rates as the costs are incurred or savings are achieved. The transition costs will be  
17 incurred upfront in the early years subsequent to the acquisition, while savings, if any  
18 actually are achieved, will be not be realized until long into the future.

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<sup>10</sup> Response to AG 2.04 in ICC Docket 14-0496, a copy of which is attached as Ex.-WIEG-Kollen- 4.



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**Q. Please summarize your recommendations.**

A. I recommend that the Commission reject WEC’s request for approval of the transaction, as described in its Application, unless the Commission imposes certain conditions necessary to ensure that the transaction is in the “best interests” of utility consumers and the public. The transaction must not only *not harm* utility consumers, it must *benefit* them. I recommend that the Commission adopt the following hold harmless conditions (1-7), which will work to protect customers from paying any increased costs that may result from the transaction. I also recommend several benefit conditions (8-10), which will work make more certain that the transaction is in the best interests of customers. Because WEC has provided no evidence of any positive customer benefit, in the near or far term, the benefit conditions I recommend can be considered by the Commission as benefits supporting the transaction. Because WEC has not offered any analysis, we cannot know for certain whether my proposed benefit conditions will sufficiently offset possible harms from the transaction, they certainly will provide more customer benefit than WEC has identified:

**HOLD HARMLESS CONDITIONS**

1. WEC/WEG and its affiliates, including WEPCO and WPSC, shall hold harmless ratepayers from any and all risks resulting from and costs incurred in conjunction with or caused by the transaction. This includes the acquisition premium costs, regardless of which entity or the manner in which the costs are recorded; the transaction costs, regardless of where or the manner in which the costs are recorded or when they are recorded; the transition costs that are incurred to integrate the systems and operations of WEC and Integrys and all of their affiliates, including WEPCO and WPSC, as well as the transition costs incurred to achieve savings; and all

1 hidden costs, including increases in financing costs and loss of tax  
2 benefits.

3  
4 2. WEC/WEG and Integrys shall retain all acquisition premium and  
5 transaction costs on their accounting books and shall not “push-down”  
6 these costs onto the WEB, WEPCO or WPSC accounting books.

7  
8 3. WEG, WEPCO, and WPSC shall not seek ratemaking recovery of, seek  
9 authority to defer, or defer on their accounting books any transition costs  
10 (capital or expense) incurred to integrate WEC and Integrys and their  
11 affiliates, any transition costs (capital or expense) incurred to achieve  
12 savings, or any other costs caused by or due to the acquisition, unless  
13 specifically authorized in this proceeding.

14  
15 4. WEC/WEG and its affiliates, including WEPCO and WPSC, shall  
16 separately identify on their accounting books all acquisition premium  
17 costs, if any; transaction costs, if any; transition costs (capital and  
18 expense); and all other costs caused by the acquisition on their accounting  
19 books and WEPCO and WPSC shall remove these costs, as well as any  
20 amounts assigned or allocated from WEB, from the per books amounts  
21 through *proforma* adjustments in their rate filings.

22  
23 5. WEC/WEG and its affiliates, including WEPCO and WPSC, shall extend  
24 the *benefit* to WEPCO and WPSC customers of any concession or  
25 condition imposed by another regulator resulting in a benefit or benefits to  
26 a utility and/or its customers in a federal jurisdiction and/or a non-  
27 Wisconsin state jurisdiction.

28  
29 6. WEC/WEG and its affiliates, including WEPCO and WPSC, shall hold  
30 WEPCO and WPSC customers harmless from the effects of any  
31 conditions that are imposed by the FERC, Federal Communications  
32 Commission (“FCC”), Michigan Public Utilities Commission (“MPUC”),  
33 Illinois Commerce Commission (“ICC”), Minnesota Department of  
34 Commerce (“MDOC”), and any other regulatory entities with jurisdiction  
35 over the transaction.

36  
37 7. WEC/WEG and its affiliates, including WEPCO and WPSC, shall not  
38 propose any levelization or subsidization of rates between WEPCO and  
39 WPSC or propose a merger between WEPCO and WPSC that will or may  
40 result in any levelization or subsidization of rates between WEPCO and  
41 WPSC for at least five years after the consummation of the transaction.

1                    **BENEFIT CONDITIONS**  
2

- 3                    8.        Due to WEC’s failure to identify or quantify specific benefits to WEPCO  
4                    and WPSC customers, the utilities shall provide benefits to customers  
5                    through a writeoff of all amounts in their respective transmission escrows.  
6  
7                    9.        WEPCO and WPSC shall implement an earnings mechanism whereby the  
8                    revenue requirement effect of WEPCO’s and WPSC’s actual earnings in  
9                    excess of their authorized returns on equity are refunded to customers for  
10                    four years following the consummation of the proposed transaction.  
11  
12                    10.       WPSC shall withdraw or delay its application to construct the Fox Energy  
13                    Center 3. Subsequently, WEPCO and WPSC will work cooperatively in  
14                    generation resource planning to minimize the costs of such resources to  
15                    their respective customers.  
16

17                    I believe it likely that other parties may recommend conditions other than those I  
18                    have outlined here. For instance, others are likely to address concerns about ATC  
19                    ownership—concerns WIEG likely shares. Those parties may propose conditions related  
20                    to ATC ownership. I will respond to proposals by Staff or any other party in my Rebuttal  
21                    Testimony.  
22

23    **Q.        Why should the Commission impose these conditions in this proceeding rather than**  
24                    **approve the transaction now and address the costs and potential savings in future**  
25                    **rate proceedings?**

26    A.        First and foremost, this is the only proceeding in which the Commission can consider the  
27                    transaction and whether it is in the “best interests” of utility consumers and the public.  
28                    Second, the Commission can only make a “best interests” finding if it conducts an  
29                    “investigation” and finds sufficient evidence to support it. The Applicant certainly has  
30                    not provided sufficient evidence. Third, it is unlikely that the Commission can  
31                    retroactively impose conditions on recovery of costs in future rate proceedings.

1 Practically, and likely legally, such conditions must be imposed in this proceeding.  
2 Fourth, the failure to resolve certain issues, particularly the recovery of transition costs,  
3 will undoubtedly result in significant and unnecessary controversy in future rate  
4 proceedings.

5 In short, the Commission is under no obligation to approve this transaction in this  
6 proceeding. If the transaction does not benefit customers, then it should be rejected  
7 unless the Commission conditions approval with the assurances necessary to benefit  
8 customers and keep them from any harm.

9  
10 **Q. Please explain why the Commission should ensure that WEC holds customers**  
11 **harmless from any and all risks resulting from and costs incurred due to the**  
12 **acquisition, including the effects of conditions imposed by the FERC, FCC, MPUC,**  
13 **ICC, MDOC, and any other regulatory entities that must approve the transaction.**

14 A. Fundamentally, WEC has not offered any tangible or quantified benefits from this  
15 transaction other than generalized and vague assurances of potential savings and  
16 improved access to capital. Yet, the ratepayers are exposed to harm from additional costs  
17 directly caused by the transaction. These additional costs include: 1) the allocation of  
18 costs from WEG, WEB, and WEPCO after the acquisition is completed and until WEG  
19 sorts out the provision of centralized services; 2) an increase in interest expense due to  
20 the credit downratings of WEG and for the utilities; 3) tax net operating losses that must  
21 be financed; 4) lost Section 199 income tax deductions that increase income tax expense;  
22 5) transition costs to integrate hardware platforms and software systems and other utility  
23 infrastructure; and 6) transition costs that exceed savings, especially in the early years.

1           In addition, WEPCO and WPSC utility customers are exposed to harm from  
2 conditions imposed by other regulators that may result in lost revenues and/or increased  
3 costs, harm that would not be visited upon utility customers but for the acquisition. Thus,  
4 the Commission should endeavor to protect customers from lost revenues or increased  
5 costs through a condition to hold harmless customers from the adverse impact on rates of  
6 any conditions imposed by other regulators or, alternatively, through a condition that  
7 requires WEC/WEG, WEPCO, and WPSC to demonstrate that any conditions imposed  
8 by other regulators do not and will not harm Wisconsin utility customers.

9           Further, in the Joint Application of WEC and Integrys to the FERC for approval  
10 of the transaction, WEC and Integrys have offered a “‘hold harmless’ commitment, *i.e.*  
11 for a period of five years, they will not seek to include merger-related costs in wholesale  
12 cost-based rates unless they can demonstrate that merger-related savings are equal to or  
13 in excess of all of the transaction-related costs.<sup>11</sup> In their Joint Application, WEC and  
14 Integrys explained how they would implement this “hold harmless” commitment in the  
15 FERC proceeding as follows:

16           To ensure compliance with the hold-harmless commitment, Wisconsin  
17 Energy and Integrys and their respective subsidiaries will track  
18 separately merger-related costs, including costs incurred for the  
19 purpose of effectuating the Transaction and costs incurred to integrate  
20 Integrys into Wisconsin Energy. These costs include, among others,  
21 external legal and banking costs, as well as internal labor costs. This  
22 separate tracking mechanism will enable the Applicants and their  
23 subsidiaries to exclude merger-related costs as appropriate from FERC-  
24 jurisdictional rates, or to demonstrate that merger-related savings  
25 exceed such costs.  
26

27           In short, WEC has offered a hold harmless condition for FERC-regulated

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<sup>11</sup> FERC Docket No. EC14-00126, Application at 34-35.

1 wholesale customers, but has failed to make a similar hold harmless offer or commitment  
2 for Wisconsin utility customers. If the Commission approves the transaction in this  
3 proceeding and does not adopt the WIEG recommendation to exclude all acquisition-  
4 related costs from WEPCO and WPSC rates, then it should at least adopt a hold harmless  
5 similar to that offered by WEC and Integrys in the FERC proceeding. It also should  
6 make clear that it will thoroughly investigate all costs and all claimed savings in future  
7 proceedings to ensure that the hold harmless achieves the objectives set forth in this  
8 proceeding.

9  
10 **Q. Has WEC studied the post-merger organization structure, including the provision of**  
11 **centralized services, and quantified the estimated transition costs and potential**  
12 **savings?**

13 A. No. WEC has confirmed that it did not do so in numerous responses to discovery in this  
14 proceeding and in the transaction proceedings in other jurisdictions, as evidenced in  
15 Schedules 2, 3 and 5 of Exhibit-WIEG-Kollen-1. WEC has failed to identify any specific  
16 opportunities for organization synergies or efficiencies, although it has positioned the  
17 former Integrys Business Support (and plans to rename it as WEB) as a direct subsidiary  
18 of WEG and apparently plans to use WEB to provide centralized services to the former  
19 WEC affiliates as well as the former Integrys affiliates. Despite making this  
20 organizational decision, WEC has not studied and has no formal plan and no time frame  
21 to actually implement any organizational changes to actually achieve efficiencies and  
22 savings. Yet, the provision of administrative and general services is usually one of the  
23 most significant areas of potential savings in utility mergers and acquisitions.

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**Q. Did WEC consider transition costs and potential savings in its internal “valuation” of the acquisition?**

A. No. Again, it is highly unusual in my experience that there are no studies of the costs that will be incurred or the potential savings that will be achieved by the utilities involved in a merger or acquisition.

Yet, WEC failed to identify or quantify any of these costs or savings for the utilities, even in the “valuation” model relied on by WEC’s management and presented to its Board of Directors. WEC developed a “valuation” model to assess the economics of the transaction and the value that it could provide its shareholders. WEC would not provide a copy of this “valuation” model to WIEG or other parties in this case, although it allowed me and other parties one-time online controlled access to view the model and ask questions during a conference call with WEPCO personnel and WEC counsel. Based on this review, I was able to determine that WEC had not quantified or reflected any transition costs or potential savings for the utilities in its “valuation” model.

**Q. Did the valuation model project rate increases in future years?**

A. Yes. However, the model did not reflect the additional rate increases that WEPCO and WPSC will seek pursuant to WEC’s proposal to recover the transition costs through rates or any offsets to the costs due to any savings. Although it clearly understated the WEPCO and WPSC rate increases in future years, this modeling approach did not affect the valuation of the acquisition, presumably under the assumption that any transition costs would simply be recovered from WEPCO and WPSC customers regardless of magnitude

1 and regardless of whether any savings actually are achieved. Transition costs normally  
2 are incurred in the early years after a merger or acquisition to integrate the infrastructure  
3 of all of the affiliates. Transition costs also are incurred in the early years to achieve  
4 potential savings. Any achieved savings typically are achieved several or more years  
5 after the consummation of the merger or acquisition.<sup>12</sup>

6  
7 **Q. What does it mean for the certainty and timing of rate increases under the WEC**  
8 **proposal that WEPCO and WPSC rates reflect the transition costs as incurred and**  
9 **savings as achieved?**

10 A. WEC's proposal means that the transaction necessarily will result in rate increases to  
11 WEPCO and WPSC customers in the early years after the acquisition is consummated.  
12 This is due both to increases in expenses as well as the return of and on the capital  
13 investments in systems and other infrastructure necessary to integrate all of the acquired  
14 entities, which will not achieve savings, and the expenses and capital investments  
15 incurred to achieve savings. Any savings achieved will not be reflected in rates until  
16 subsequent years, usually five to ten years after the acquisition is consummated.<sup>13</sup>

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18  
19 **Q. WEC presented the testimony of Mr. John Reed wherein he reported the estimated**  
20 **savings arguably achieved by other utilities or their holding companies that merged**  
21 **or were acquired. Should the Commission rely on this analysis?**

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<sup>12</sup> In its response to DGK 1.01 in ICC Docket No. 14-0496, WEC stated that "merger-related savings typically accrue over time, and after upfront investment." I have attached a copy of this response as Ex.-WIEG-Kollen-5.

<sup>13</sup> Direct Testimony of John Reed at 34.



1 A. No. WEC has offered no analysis of the costs that it will incur or the potential savings  
2 that it may achieve. It could have and should have done so, but chose not to do so. Nor  
3 has WEC made any commitments to actually achieve any savings, let alone of such  
4 magnitude as to exceed any transition costs. The Commission should not simply assume  
5 that WEPCO and WPSC will achieve such savings. The statute requires that the  
6 Commission conduct an investigation and that it determine that the proposed transaction  
7 is in the best interests of utility consumers and the public. Yet, WEC's failure to provide  
8 an analysis or make any commitments to achieve savings essentially precludes the  
9 Commission from concluding that there actually will be any savings to WEPCO and  
10 WPSC customers, particularly given that WEC has not assessed its post-merger  
11 organizational or staffing requirements or identified and quantified its transition costs or  
12 any potential savings. The Commission should not accept the implicit premise that there  
13 will be savings to utility consumers without further evidence and a means of ensuring that  
14 savings actually are achieved. Moreover, there can be little doubt that the acquisition will  
15 result in increased costs that are placed on customers unless the Commission accepts the  
16 hold harmless and benefit conditions recommended by WIEG and other parties.

17  
18 **Q. In addition to the transition costs that will be incurred to integrate and to achieve**  
19 **savings, are there other hidden or less obvious costs that also may impact WEPCO**  
20 **and WPSC customers?**

21 A. Yes. The transaction may result in credit downratings at WEC/WEG and/or at WEPCO  
22 and/or WPSC.<sup>14</sup> A credit downrating likely will increase the cost of financing, not only

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<sup>14</sup> [REDACTED]

1 for debt, both short term and long-term, but also the return on equity. Credit downratings  
2 at WEC/WEG still may affect the cost of certain WEPCO and/or WPSC debt. Although  
3 such an increase in the cost of capital may be less obvious than transaction or transition  
4 costs, it nevertheless would be a direct result of the transaction. Customers should be  
5 held harmless from any such hidden costs.

6 In addition, the transaction may result in the loss of certain tax benefits that, if  
7 lost, will harm customers through increased rates. Tax deductions a regulated utility  
8 receives typically reduces the utility's revenue requirement and, as a consequence,  
9 customer rates as well. The temporary or permanent loss of any tax deduction will,  
10 therefore, increase customer rates. And here, the proposed transaction may result in a  
11 temporary reduction in the cost-free capital provided by accumulated deferred income  
12 taxes ("ADIT") and the permanent loss of Section 199 deductions. That is, the regulated  
13 utilities may lose the deductions, and revenue requirements then necessarily will increase,  
14 along with customer rates.

15 For income tax purposes, transaction and transition costs generally are deductible  
16 when incurred, both on the consolidated tax returns of the holding companies and on the  
17 tax returns of the utilities. These transaction-related costs will reduce taxable income on  
18 the WEC, Integrys, and WEG consolidated income tax returns and on the utilities'  
19 individual returns, which may result in net operating losses ("NOL") and NOL  
20 carryforwards or increases in those amounts.<sup>15</sup> If the related accumulated deferred

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This is a realistic concern. WEC had \$810 million in NOL carryforwards at December 31, 2013, according to its 2013 10-K. WEPCO had \$217 million in NOL carryforwards at December 31, 2013, according to

1 income taxes (“ADIT”) are used to reduce the cost-free ADIT reflected in rates, utility  
2 customers will be harmed.

3 In addition, the reductions in the consolidated taxable income of the holding  
4 companies reduces and will limit the ability of the utility subsidiaries to take certain  
5 deductions, most notably the Section 199 domestic production activities deduction.  
6 Similarly, the reductions in the utilities’ taxable income also will limit their ability to take  
7 Section 199 deduction, assuming there was any remaining ability to do so after the  
8 limitations imposed based on the consolidated returns of the holding companies. Any loss  
9 or diminution of the Section 199 deduction in any tax year is permanently lost. It cannot  
10 be recovered in a subsequent year.

11 If these lost tax benefits are reflected in the WEPCO and WPSC costs for  
12 ratemaking purposes, they will increase the utilities’ revenue requirements, all else equal.  
13 Yet, such an increase in costs was directly caused by the transaction. Customers should  
14 be held harmless from any such hidden costs.

15  
16 **Q. Please explain why the Commission should ensure that WEC, WEPCO, WPSC, and**  
17 **all other affiliates whose costs are allocated to WEPCO and WPSC should**  
18 **separately account for transaction costs, transition costs to integrate, transition costs**  
19 **to achieve savings, hidden costs, and all other costs due to the proposed transaction**  
20 **as well as any achieved savings.**

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its 2013 FERC Form 1. Integrys had \$291 million in NOL carryforwards at December 31, 2013, according to its 2013 10-K. WPSC had no NOL carryforwards at December 31, 2013, according to its 2013 Form 1.

1 A. Considering that these costs would not exist if not for the proposed acquisition, these  
2 costs should not be borne by ratepayers. This accounting is necessary for the  
3 Commission to review and ensure that all costs caused by the transaction are removed  
4 from per books costs for ratemaking purposes. Only in this manner will the Commission  
5 have the information necessary to ensure that utility consumers and the public are not  
6 harmed in future rate proceedings and that utility customers obtain the benefits of savings  
7 that actually are achieved.

8 If the Commission does not direct WEC upfront to identify and track all of these  
9 costs through its accounting systems, then there likely will be extensive controversy over  
10 the quantification of costs caused by the transaction in future rate proceedings. The  
11 Commission can avoid this potential mess simply by adopting the hold harmless  
12 condition that previously recommended.

13

14 **Q. In response to PSCW-01.10, WEC stated that the WEG “companies will account for**  
15 **transition costs in accordance with GAAP. We intend to track separately transition**  
16 **related costs for future auditing.” Is this commitment sufficient?**

17 A. No. It merely states the obvious: that the companies will account for their costs in  
18 accordance with GAAP. However, GAAP does not require that transition costs be  
19 recorded or coded as transition costs. The Commission should make clear that the  
20 separate accounting applies to all acquisition-related costs, not only transition costs, and  
21 that it applies to all WEC/WEG affiliates whose costs are allocated to WEPCO and  
22 WPSC in addition to costs incurred directly by WEPCO and WPSC.

23

1 **Q. If any other federal or state regulator imposes or WEC agrees to any conditions or**  
2 **benefits in other proceedings addressing the transaction, should the Commission**  
3 **ensure that it and the parties in this proceeding retain the opportunity to address**  
4 **the applicability of those conditions or benefits in this proceeding?**

5 A. Yes. Certain conditions or benefits in other proceedings may affect WEPCO and/or  
6 WPSC, particularly if they impose requirements or other costs on WEC or its affiliates  
7 that ultimately affect WEPCO and/or WPSC utility customers. The Commission should  
8 condition its approval in this proceeding on a further review of the decisions in other  
9 proceedings to ensure that there is no harm to WEPCO and/or WPSC utility customers,  
10 and if there have been any concessions or benefits granted to other WEC affiliates, that  
11 the same or comparable benefits are extended to WEPCO and WPSC customers.

12  
13 **Q. In addition to the prohibition against recovery of all costs related to the acquisition**  
14 **by WEPCO and WPSC through the ratemaking process to avoid harm to their**  
15 **utility customers, is there some way to ensure that there are benefits to utility**  
16 **customers?**

17 A. Yes. As I noted earlier, WEC has provided no evidence that utility consumers and the  
18 public will benefit in any way from the transaction. Without that benefit, WEC fails to  
19 meet its burden to show that the transaction is in utility consumers' best interests.  
20 Notwithstanding WEC's failure, the transaction may still be approved if this Commission  
21 ensures that utility consumers would benefit. And the Commission can ensure a benefit  
22 in the following ways, all of which it should adopt.

23 First, the Commission should direct WPSC to immediately withdraw or delay its

1 application for the Fox Energy Center 3. Then, after the acquisition, the Commission  
2 should direct WEPCO and WPSC to begin joint planning for their resource requirements.  
3 Either utility may need new generating resources at some future date. In determining  
4 need, analysis should consider the total generation resources of both utilities.

5 Second, the Commission can ensure that the WEPCO and WPSC customers  
6 achieve guaranteed benefits by requiring the utilities to writeoff all of their transmission  
7 escrow.

8 Third, the Commission should adopt an earnings mechanism whereby the revenue  
9 requirement effect of earnings in excess of the authorized return on equity for WEPCO  
10 and WPSC are refunded to customers for four years after the consummation of the  
11 proposed transaction. The actual earnings should be used as the starting point and reflect  
12 all ratemaking adjustments previously approved by the Commission as well as all  
13 adjustments necessary to remove the costs due to or caused by the acquisition. The actual  
14 earnings for this purpose also should reflect adjustments necessary to remove the effects  
15 of any refunds due to this mechanism.

16 The savings, quantified each year in this manner, should be deferred and then  
17 amortized over the next twelve month period as a rate reduction in the form of a surcredit  
18 rider. WEPCO and WPSC should make annual filings with the Commission to provide  
19 the calculation of its deferrals and the surcredit. Such an approach will provide timely  
20 rate reductions and ensure that the transaction is in the “best interests” of utility  
21 consumers and the public.

1 **Q. Please identify the specific hold harmless conditions, and benefits, that are**  
2 **encompassed in the recommendations set forth in the summary of your testimony.**

3 A. Earlier, at Direct-WIEG-Kollen-9, I summarized my recommendations, which included  
4 seven hold harmless conditions and three benefits conditions. Here, I itemize more  
5 specifically the seven hold harmless elements, which I recommend as 12 necessary  
6 conditions of approval (1-12), together with the three beneficial conditions (13-15).

7 **HOLD HARMLESS CONDITIONS**

- 8 1. Deny “push down” of acquisition premium and transaction costs for  
9 WEPCO and WPSC ratemaking purposes regardless of which entity  
10 records the costs, GAAP accounting requirements, and whether incurred  
11 before or after transaction closes, and.  
12
- 13 2. Deny recovery of acquisition premium in any form, whether write-up of  
14 assets or goodwill regardless of whether incurred before or after  
15 transaction closes and regardless of which entity records the costs.  
16
- 17 3. Deny recovery of transaction costs in any form, regardless of which entity  
18 records the costs and regardless of whether incurred before or after  
19 transaction closes.  
20
- 21 4. Deny ratemaking recovery of all transition costs. Flow through entirety of  
22 all actual savings to WEPCO and WPSC customers. If transition costs are  
23 allowed, then recovery should be limited to actual savings; savings in  
24 excess of transition costs flowed through 100% to customers.  
25 Alternatively, limit recovery of costs to projections as standalone entities  
26 for the next five years.  
27
- 28 5. Deny deferral of transition costs.  
29
- 30 6. Identify all transaction and transition costs in accounting system.  
31
- 32 7. Deny recovery or deferral of all involuntary and voluntary severance  
33 costs.  
34
- 35 8. Deny recovery of all investment costs incurred to install new systems or  
36 integrate existing systems to operate on a consistent platform or use  
37 consistent software after the merger.

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- 9. Deny recovery of increased financing costs due to rating agency downgrades.
- 10. Deny recovery of duplicate costs incurred by WE and Integrys service companies under Interim Affiliate Agreements.
- 11. Adopt a “most favored nation clause.” In other words, any concessions agreed to or conditions imposed by regulators in other jurisdictions should be adopted in Wisconsin.
- 12. Prohibit subsidization or “levelization” of the rates between WEPCO and WPSC.

**BENEFIT CONDITIONS**

- 13. Writeoff WEPCO and WPSC’s transmission escrows.
- 14. Adopt a savings surcredit mechanism based on WEPCO and WPSC’s actual earnings in excess of their authorized returns on equity.
- 15. Withdrawal or delay of WPSC’s application for a new natural gas-fired power plant known as Fox Energy Center 3. Going forward, WPSC and WEPCO must work jointly on their resource planning and generating resources.

28 **Q. Does this complete your testimony?**

29 A. Yes.