

PUBLIC SERVICE COMMISSION OF WISCONSIN

Memorandum

April 24, 2014

FOR COMMISSION AGENDA

TO: The Commission

FROM: Robert Norcross, Administrator
Jodee Bartels, Auditor
Gas and Energy Division

RE: Application of Consolidated Water Power Company and 1330-AE-102
NewPage Wisconsin System, Inc., for Approval of an
Affiliated Interest Agreement

Suggested Minute: The Commission (approved/modified and approved/did not approve) the series of affiliated interest transactions between Consolidated Water Power Company and NewPage Wisconsin System, Inc., and directed Commission staff to prepare an order in this docket consistent with its decision.

On January 22, 2014, Consolidated Water Power Company (CWPCo) and NewPage Wisconsin System, Inc. (NewPage), applied for approval of a series of affiliated interest transactions that would convey certain interest in CWPCo-owned properties to NewPage and certain interests in NewPage-owned properties to CWPCo, with the stated purpose of achieving a more complete physical and legal separation between the two entities.

The applicants are affiliated interests as defined in Wis. Stat. § 196.52. The proposed transactions are contracts or arrangements under Wis. Stat. § 196.52(3)(a). The applicants request approval of these transactions under Wis. Stat. § 196.52, the affiliated interest statute.

The Commission issued a Notice of Investigation and Request for Comments in this matter on February 21, 2014. ([PSC REF#: 199623](#).) No comments were received and no hearing was held. Under Wis. Stat. § 196.52(3)(d)2, if no hearing is held, the Commission shall take final

action on the application within 90 days after issuing the Notice of Investigation or the application is considered approved. Here, the 90 day period expires on May 22, 2014.

The Parties

CWPCo is a Wisconsin corporation and a public utility as defined in Wis. Stat. § 196.01(5)(a). CWPCo owns and operates five federally-licensed hydropower projects along the Wisconsin River, which have a collective generating capacity of 33 megawatts (MW).¹ CWPCo also owns distribution assets that provide electric service to approximately 90 customers, including NewPage.

NewPage is a domestic corporation, headquartered in Miamisburg, Ohio, and employs about 5,600 people. It manufactures coated and specialty paper, and has paper mills in Stevens Point, Biron, and Wisconsin Rapids, Wisconsin.² NewPage is a subsidiary of NewPage Corporation (NewPage Corp.).

History

Consolidated Paper, Inc., the original holding company containing CWPCo, was formed in 1894 and organized as Consolidated Water Power Company. The name was changed to Consolidated Water Power and Paper Company in 1902, and to Consolidated Paper, Inc. (CPI), in 1962. In 1918, CPI organized CWPCo as the Oneida Paper Company. The name of Oneida Paper Company was changed to Oneida Power Company (and the corporation's purpose was changed from being a private utility to being a public utility) in 1919. Oneida Power Company changed its name to CWPCo in 1926. CWPCo remained a wholly-owned subsidiary of CPI until 2000, when

¹ CWPCo is the licensee for Federal Energy Regulatory Commission (FERC) Hydropower Projects Nos. 1953 (Dubay), 2110 (Stevens Point), 2590 (Whiting), 2192 (Biron), and 2256 (Wisconsin Rapids).

² NewPage owns eight paper mills in Kentucky, Maine, Maryland, Michigan, Minnesota, and Wisconsin, with a total annual production capacity of about 3.5 million tons of paper. NewPage had \$3.1 billion in net sales in 2012. In Wisconsin, NewPage employs about 1,700 people and operates three mills located at Biron, Wisconsin Rapids, and Stevens Point.

CPI merged into Stora Enso North American, Inc. (SENA). In 2007, NewPage acquired SENA and thereby acquired CWPCo.

On September 7, 2013, NewPage Corp. and 13 of its subsidiaries (not including CWPCo) filed for relief under Chapter 11 of the Bankruptcy Code. Under the restructuring plan approved by the U.S. Bankruptcy Court at the end of 2012, all of NewPage Corp.'s stock is now owned by NewPage Investment Company, LLC, a direct, wholly-owned subsidiary of NewPage Holdings. Most of the stock of NewPage Holdings is owned by financial institutions and investment funds that were first lien creditors of NewPage Corp. prior to the bankruptcy.

On January 8, 2014, Verso Paper Corp. (Verso), a Delaware corporation, announced that it had entered into a definitive agreement to acquire NewPage. The Commission approved the acquisition in docket 1330-EI-100 by its Final Decision dated April 3, 2014. ([PSC REF#: 201584.](#))

Affiliated Interest Transactions

Historically, the NewPage paper mills adjacent to CWPCo's hydroelectric projects have not only consumed the vast majority of the electricity that those projects produced, but in some instances were originally built for the purpose of serving the mill, not the public.³ As a result, the paper mills and the public utility hydro projects have had very close operating relationships and a commingling of certain properties and buildings.

The applicants desire to convey certain buildings, easements, and parcels of real property to each other in order to separate and more precisely define CWPCo's hydropower and electric

³ The hydroelectric projects did not become dedicated to utility use until 1919.

distribution assets and NewPage's paper mill assets at four of CWPCo's five hydroelectric project sites.⁴

The applicants state that CWPCo and NewPage conveyances will help CWPCo continue to comply with the terms of its hydroelectric licenses issued by the Federal Energy Regulatory Commission (FERC). Under those licenses, CWPCo's hydroelectric projects must include ownership or control of all lands and project works that are necessary for their operation. Most of the property currently owned by NewPage that will be transferred to CWPCo is necessary for project-related operations. Historically, NewPage has conducted mill-related operations in CWPCo-owned buildings and on project lands without documentation memorializing that use.⁵ To formally document the use, CWPCo must receive FERC approval. FERC approval is required under the hydro license before formally conveying an interest in lands for a non-project use.⁶

Many of the property ownership issues were first identified during the Great Lakes Utility (GLU)⁷ and the Wisconsin Rapids Water Works and Lighting Commission's⁸ transactional due diligence. Significant work to disentangle the assets was commenced at that time, but was put on hold when NewPage entered bankruptcy. The applicants wish to complete disentangling the assets at this time.

⁴ The four CWPCo hydroelectric projects sites that are the subject of the application are: Whiting Hydroelectric Project; Stevens Point Hydroelectric Project; Biron Hydroelectric Project; and Wisconsin Rapids Hydroelectric Project.

⁵ FERC has been aware of these uses for a period of time.

⁶ CWPCo filed with FERC on March 14, 2014, for a Change in Land Rights for Project No. 2590-059, Whiting Hydroelectric Project; Project No. 2110-031, Stevens Point Hydroelectric Project; Project No. 2192-041, Biron Hydroelectric Project; and Project 2256-071, Wisconsin Rapids Hydroelectric Project.

⁷ GLU was involved in an aborted transaction to acquire CWPCo's hydroelectric projects. See Order dated September 12, 2013, docket 2345-EB-100, [PSC REF#: 190593](#).

⁸ Before the acquisition by NewPage, CWPCo transferred approximately 1,080 customers in the towns of Biron, Grand Rapids, Plover, and Grant, Wisconsin, as well as distribution facilities, to the city of Wisconsin Rapids. See, Final Decision dated November 8, 2007, docket 5-BS-162, [PSC REF#: 85374](#).

A general description of the proposed property conveyance (buildings and land) as well as the easement conveyances and diagrams are included in the application in [PSC REF#: 197539](#), pages 5 through 10, as well as in [PSC REF#: 199738](#), which contains additional history and color-coded diagrams of the proposed conveyances. All of the conveyances will be at a nominal consideration. In total, CWPCo will transfer about 6.9 acres in fee to NewPage, and NewPage will transfer about 5.6 acres in fee to CWPCo.

Discussion

CWPCo hydroelectric projects and NewPage paper mills have been operating shared assets without any clear distinction since the mid-1920s, if not earlier. The proposed conveyances attempt to separate those assets. But this is not a case of a clear distinguishable transfer of a building and the underlying land. Instead, it is often the transfer of a portion of a building, such as a wall, with or without the associated underlying land. Even where the conveyance is land, it is not always a clear parcel, but rather oddly-shaped pieces or narrow passage-like portions of land. Some of the land exchanges involve substations. CWPCo owns all of its assets within the substation parcels that are currently owned by NewPage. This land exchange will place fee title of the substations with CWPCo. The substations are fenced, and CWPCo has had ultimate responsibility for them.

Because of the transfers involved, there are numerous associated easements to ensure that the parties have the necessary operational access.

There are two primary issues in this docket: valuation of the assets exchanged, and determination of any associated transfer of environmental liability.

Value

NewPage is exempt from the section of Wis. Stat. § 196.795(5)(k) that states:

No public utility affiliate may transfer, sell, or lease to any nonutility affiliate with which it is in a holding company system any real property which, on or after November 28, 1985, is held or used for provision of utility service except by public sale or offering to the highest qualified bidder.

However, to approve the transaction under Wis. Stat. § 196.52, some attempt at establishing a value of the conveyed assets is necessary.

CWPCo states that appraisals of the parcels have not been conducted. The buildings or portions of buildings being transferred from CWPCo to NewPage are very old, often divided, and cannot be used for residential or non-industrial purposes because of their location. The real estate conveyances are for small tracts of land that are located within or directly adjacent to the hydroelectric projects and paper mill facilities. CWPCo states that these lands can therefore be used for little else aside from supporting CWPCo's hydroelectric projects or NewPage's paper mill operations. Therefore, CWPCo contends the value of these parcels in the market is likely to be very low—less than \$1 million, possibly less than \$250,000.

In response to a Commission staff data request, CWPCo provided an estimated value of the conveyances based on tax assessments of the conveyance or adjacent lands and a calculated per-acre value within the tax parcel multiplied by the total size of each conveyance (land only). These estimates are for reference only. The estimated value of CWPCo's conveyance to NewPage is \$75,569.11, and the estimated value of NewPage's conveyance to CWPCo is \$96,406.17. (Response to Request No. JB2 01.01, [PSC REF#: 200168](#).) In total, the CWPCo land transfers in fee to NewPage will amount to approximately 6.9 acres, and the NewPage land transfers in fee to CWPCo will amount to approximately 5.6 acres, with a net difference of only 1.3 acres.

Given the nature of the transactions and the type and characteristics of the conveyances involved, it is reasonable to conclude that the value of the transactions is under \$1 million.

Environmental

In answer to Commission staff's inquiries about potential environmental liabilities, CWPCo states that the purpose of the conveyances is to rectify various real estate issues to ensure FERC compliance; the conveyances are not being proposed as a means of transferring environmental liabilities between parties. The application is silent as to responsibility for environmental liability. It appears neither party intends to contractually assume responsibility for potential environmental liabilities. To the extent any such liabilities exist, responsibility would be determined under state or federal law.⁹ As a result, regardless of intent, the potential remains for the transfer of environmental liabilities by virtue of transferring ownership. Given the very close operating relationships and a commingling of certain properties and buildings, ascertaining responsibility could be difficult.

In May 2010, Limited Phase I Environmental Site Assessments¹⁰ were conducted on some of the properties as part of the due diligence for the failed GLU transaction. CWPCo believes that given the nature of the parcels not covered by the May 2010 Phase I reports and the fact that the parties are transferring about the same amount of property to each other, there is no need to conduct additional Phase I reports on the remaining property. Other than Phase I reports, no other Site Screening, Environmental Audit, or Phase II Environmental Assessments have been conducted for parcels, buildings, or portions of buildings that are contained in the conveyances.

⁹ Under Wisconsin law, the person who "possesses or controls a hazardous substance which is discharged or who causes the discharge of a hazardous substance shall take the actions necessary to restore the environment to the extent practicable" Wis. Stat. § 292.11(3). Under federal law, liability can be imposed upon either the current or former owner or operator. 42 U.S.C. §9607(a).

¹⁰ Phase I Reports were provided to the Commission in confidential filings: [PSC REF#s: 200169, 200171, 200197, 200199, 200200, 200202, 200222, 200224, 200225, 200226, 200227, 200229, 200230, and 200231.](#)

The Phase I reports did not identify any material recognized environmental conditions (RECs) on the parcels described in the application. Based upon past due diligence, the parties state that they are not aware of any material environmental issues associated with any of the proposed conveyances.

To mitigate the risk arising from potential unknown or new environmental conditions, NewPage has environmental insurance policies on the mill locations at each hydroelectric project site.¹¹ The policies cover NewPage Holdings, Inc., and subsidiaries, including NewPage and CWPCo. The parties state that these policies are intended to cover unknown pre-existing conditions that existed prior to December 21, 2007, as well as new conditions that materialize after that date, subject to the terms and conditions of the policies.¹²

Conclusion

The early history of the hydroelectric projects indicates that most were in operation for a period of years before becoming dedicated to utility service. The paper mills and the hydroelectric dam sites have an 80- to 90-year history of being operated in tandem, of shared buildings, land, and even substations. The parties never reimbursed each other for the use of the assets, and the assets are recorded on the books of the party with the majority usage. While the proposed transactions attempt to provide a more complete separation between the two entities, that separation remains elusive. As long as the paper mills operate on the dam structures and utilize common walls and portions of buildings, physical separation appears impossible. Therefore, no transfer or exchange of assets at this point can create a complete physical separation.

¹¹ A copy of the pollution legal liability policy was provided to the Commission in a confidential filing. ([PSC REF#: 201774](#).)

¹² The policy period for the unknown conditions currently extends to December 21, 2017. The policy for new conditions currently extends to December 21, 2016.

It may be reasonable for the Commission to approve the proposed transactions to further the legal separation of the two entities. The value of the conveyances may be as defined by the parties. There is no clear and accurate way to estimate the value of a portion of a building or an oddly-shaped parcel of land.

While the environmental condition of the properties to be conveyed cannot be known with certainty, the environmental diligence completed in 2010 did not reveal any material environmental issues.¹³ To mitigate environmental risks, NewPage currently has in place environmental insurance policies on the mill locations at each of the hydroelectric project sites, which are the subject of this application. While any claim would be subject to the terms and conditions of the policies, to the extent that any unknown environmental liabilities exist at any of the properties at issue, NewPage and CWPCo could pursue insurance coverage.

While the Commission could consider conditioning its approval upon NewPage indemnifying CWPCo for potential environmental liabilities associated with any properties NewPage is conveying to CWPCo, such a condition may not be reasonable given the combined history of common use of the sites. Reliance upon the environmental insurance policy is likely a more reasonable means of dealing with the potential environmental risks. The Commission may wish to include a condition that the parties will make reasonable efforts to ensure that the policy remains in effect through the policy period. The Commission may also want to encourage NewPage and CWPCo to consider extending the policy or securing similar coverage upon expiration of the current policy, provided it is commercially reasonable, economical and practical when considering the nature of the potential environmental risks.

¹³ While the Phase I reports are a bit dated, there has not been a material change in the use of the properties.

Commission Alternatives

Alternative One: Approve the affiliated interest transactions without conditions.

Alternative Two: Approve the affiliated interest transactions with conditions.

Alternative Three: Deny the affiliated interest transactions.

RDN:JJB;jlt:DL: 00916246

Key Background Documents:

[Final Decision \(signed & mld 11/8/07\) - PSC REF#: 85374](#)

[Order to Reopen and Request for Comments signed and served 9-13-13 - PSC REF#: 190593](#)

[Application of Consolidated Water Power Company and NewPage Wisconsin System Inc. for Approval of an Affiliated Interest Agreement - PSC REF#: 197539](#)

[Notice of Investigation and Request for Comments signed and served 2-21-14 - PSC REF#: 199623](#)

[Responses to Jodee Bartels Data Requests - PSC REF#: 199738](#)

[Final Decision signed and served 4-3-14 - PSC REF#: 201584](#)

[Response of Consolidated Water Power Company and NewPage to PSCW's Second Set of Data Requests - PSC REF#: 200168](#)

[JB2 01.04 - Confidential Phase I Environmental Site Assessment Report for the Wisconsin Rapids Hydroelectric Project - PSC REF#: 200169](#)

[JB2 01.06 Confidential AECOM Report - PSC REF#: 200171](#)

[Part 1 of 2 - JB2 01.04 - Confidential Phase I Environmental Site Assessment Report for the Biron Hydroelectric Project - PSC REF#: 200197](#)

[Part 2 of 2 JB2 01.04 - Confidential Phase I Environmental Site Assessment Report for the Biron Hydroelectric Project - PSC REF#: 200199](#)

[\(Part 1 of 2\) JB2 01.04 Phase I Environmental Site Assessment Report for the Whiting Hydroelectric Project - PSC REF#: 200200](#)

[\(Part 2 of 2\) JB2 01.04 - Confidential Phase I Environmental Site Assessment Report for the Whiting Hydroelectric Project - PSC REF#: 200202](#)

[\(Part 1 of 8\) JB2 01.04 - Confidential Phase I Environmental Site Assessment Report for the Stevens Point Hydroelectric Project - PSC REF#: 200222](#)

[\(Part 2 of 8\) JB2 01.04 - Confidential Phase I Environmental Site Assessment Report for the Stevens Point Hydroelectric Project - PSC REF#: 200224](#)

[\(Part 3 of 8\) JB2 01.04 - Confidential Phase I Environmental Site Assessment Report for the Stevens Point Hydroelectric Project - PSC REF#: 200225](#)

[\(Part 4 of 8\) JB2 01.04 - Confidential Phase I Environmental Site Assessment Report for the Stevens Point Hydroelectric Project - PSC REF#: 200226](#)

[\(Part 5 of 8\) JB2 01.04 - Confidential Phase I Environmental Site Assessment Report for the Stevens Point Hydroelectric Project - PSC REF#: 200227](#)

[\(Part 6 of 8\) JB2 01.04 - Confidential Phase I Environmental Site Assessment Report for the Stevens Point Hydroelectric Project - PSC REF#: 200229](#)

[\(Part 7 of 8\) JB2 01.04 - Confidential Phase I Environmental Site Assessment Report for the Stevens Point Hydroelectric Project - PSC REF#: 200230](#)

[\(Part 8 of 8\) JB2 01.04 - Confidential Phase I Environmental Site Assessment Report for the Stevens Point Hydroelectric Project - PSC REF#: 200231](#)

[CONFIDENTIAL - CWPCO and NewPage's Supplemental Response to PSCW's Second Set of Requests - Response to Request No. JB2 01.05 - PSC REF#: 201774](#)