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September 16, 2014

VIA ELECTRONIC MAIL AND E-FILING

Burl W. Haar
Executive Secretary
Minnesota Public Utilities Commission
121 Seventh Place East, Suite 350
St. Paul, MN 55101

Re: Letter Proposing Revised Decision Alternatives and Further Clarifying the Issue of Recovery of Test Year Conservation Improvement Program Expense
In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to Increase Rates for Natural Gas Service in Minnesota
MPUC Docket No. G-011/GR-13-617
OAH Docket No. 8-2500-31126

Dear Dr. Haar:

Minnesota Energy Resources Corporation ("MERC") submits this letter and proposed additional decision alternatives in attempt to clarify the issue of the recovery of the test-year Conservation Improvement Program ("CIP") expense. This issue has continued to develop during the entire proceeding, including recent letter filings made by the Department of Commerce and MERC on September 8 and 10, 2014. While there continues to be some disagreement regarding the appropriate mechanism for recovery, MERC believes the parties agree that MERC's test-year CIP expense of $9,396,422, as approved in MERC's triennial plan, is the appropriate level of CIP expense. Further, the parties and Commission staff agree with the basic premise that MERC should be allowed to recover the full amount of its approved CIP expenses. The recovery of MERC's test year CIP expense is a fundamental issue in this case and MERC believes further clarity of this issue is necessary and offers these decision alternatives to ensure the recovery of MERC's test year CIP expenses.

On hearing of this matter before the Commission on September 18, 2014, MERC proposes to recommend additional decision alternatives related to test-year CIP expense. MERC believes further clarification of the options as presented to the Commission is necessary to ensure MERC receives full recovery of these costs. Attachment A to this letter is a redline of additional decision alternatives and clarifications MERC believes will further clarify these issues. Notably, in place of Decision Option 90, MERC recommends the following:

90a. Choose not to adopt the ALJ Findings 580-582 and instead approve one of the three alternatives below:

1) MERC shall collect $5,638,332 of its test-year CIP expenses through the CCRC and $3,758,090 of its test-year CIP expenses via the CCRA with the CCRC being set at $0.01469 and $0.00979 being added to the CCRA at the time of final rate implementation; MERC shall continue to include the CCRC factor in its base distribution rate and maintain its CCRA factor in its current format; or

2) MERC shall collect all of its test-year CIP expenses through the CCRC with the CCRC being set at $0.02448 and $0.00000 being added to the CCRA at the time of final rate implementation; MERC shall continue its current CCRC calculation methodology by including the CCRC factor in its base distribution rate and maintain its CCRA factor in its current format; or

3) MERC shall collect all of its test-year CIP expenses through the CCRA with the CCRC being set at $0.00000 and $0.02448 being added to the CCRA at the time of final rate implementation; instead of including the CCRC charge in its base distribution rate, MERC shall recover all CIP expenses via the CCRA factor, which appears as a separate line item on its customer's bills.[1]

These three options were further defined and clarified in MERC's September 10, 2014, Reply Letter and reflect MERC's understanding of the various positions with respect to the allocation of recovery via the CCRC and CCRA. As summarized in MERC's September 10 letter, MERC believes it is the clear intent of the Administrative Law Judge ("ALJ") to recommend that MERC's CCRC be set to $0.00000 and that recovery of CIP expense flow through the CCRA rather than Distribution Rates. MERC believes this was explicitly set out in the ALJ's recommendation at Finding 582, which provides: "Additionally, the Administrative Law Judge recommends that the CCRC should be added to the CCRA on January 1, 2015, or with implementation of final rates, whichever occurs later." This approach would simplify cost recovery and be more transparent for MERC customers.

As shown in Attachment B to this letter, under any of these three options, MERC would recover its budgeted test year CIP expense – either through the CCRC factor, the CCRA factor, or a combination of these. As summarized in this schedule, any over-collection resulting from the interim rate CCRC factor under each of these options would be refunded to customers as

[1] MERC believes these revised decision alternatives should also replace the decision alternatives 97-100. MERC will incorporate the Commission's CCRC and CIP determinations into its interim rate refund and overall CIP tracking and accounting as necessary and will include all necessary components in its final compliance filing.

part of the interim rate refund, thus ensuring that MERC recovers no more than the approved amount. Further, MERC will submit a compliance filing outlining the CCRC portion of the interim rate refund if the Commission's ruling requires such refund.

While MERC is open to the Department's recommendation, as summarized in its September 8, 2014, Supplemental Letter, MERC would need to work with the Department to reach agreement on the accounting proposed to ensure full recovery of MERC's test year CIP expense. Attachment C to this letter is the Department's revised Operating Income Adjustments submitted with its September 8 Supplemental Letter. MERC believes that the 3,758,090 increase to revenue (highlighted in yellow) should instead be a reduction to the amortization expense entry on line 15. This modification would result in no change to the Department's revenue deficiency calculation, but the CCRC would be calculated using a CIP expense of 5,638,332 and generate a CCRC rate of $0.01469 per therm.

MERC also proposes that Decision Option 93 is only relevant if the Commission chooses to adopt either alternative 90a (1) or (2), as summarized above and in Attachment A to this filing. If the Commission adopts Decision Alternative 90a (3), however, Decision Alternative 93 should not be approved, as it would not be applicable and would likely only create additional confusion in future filings.

While the question of the appropriate mechanism for CIP cost recovery, either via the CCRC or the CCRA, is a policy question, MERC's recovery of its approved CIP expenses is required by statute and the Commission should ensure that MERC is permitted full recovery of its CIP costs in this proceeding.

Please contact me at 612-340-2881 if you have any questions regarding this matter.

Sincerely yours,

__/s/ Michael J. Ahern__________________

Michael J. Ahern

cc: Service List

Conservation Improvement Program (CIP) Expenses

(Please see staff briefing papers, pages 118-142)

November 27th Commission Order requiring MERC to show how it is tracking and handling CIP expenses in the development of the test year operating expenses

82. Accept MERC's response as satisfying the Commission's March 27th Order requirements, or

83. Determine that MERC's response has not sufficiently satisfied the Commission's March 27th Order requirements.

Minn. Stat. 216B16, subd. 1 Requirements

84. Adopt the Department's finding that MERC has met the requirements of Minn. Stat. 216B.16, subd. 1.

Test Year CIP Expenses

85. Adopt the ALJ finding that MERC recover $9,396,422 in test year CIP expenses.

CCRC Calculation for Final Rates

86. Adopt the ALJ recommendation <u>(ALJ Finding 612)</u> that <u>MERC's CCRC calculation methodology is reasonable and </u>the final rates compliance filing include the calculation of the CCRC rate based upon terms of the Commission's Order.

Impact of the Department's sales forecast projection

87. Adopt the ALJ recommendation and approve the Department's adjusted sales forecast for calculating the final compliance report's CCRC factor.

Unamortized Balance in the CIP Tracker Account (CCRA)

88. Allow MERC to keep its on-going CIP tracker balance within its CCRA tracker mechanism and do not require MERC to "roll-in" its CIP tracker balance into MERC's CCRC calculation.

Carrying Charges in MERC's CIP tracker

89. Adopt the ALJ recommendation to allow MERC to apply to its CIP tracker account carrying charges that are equal to the overall rate of return approved for MERC in this general rate case.

Impact on Revenue Deficiency (Are CIP revenues and expenses "revenue neutral"?

(Please see staff briefing papers, pages 127-142)

Revenue Deficiency Calculation Methodology in Rate Cases

~~90. Adopt the ALJ's recommendations in findings 580 and 581 that require MERC to balance test-year CIP revenue with test-year CIP expenses, and reflect the appropriate charges as part of the final approved CIP rate by setting the CIP revenue equal to the CIP expense so that final rates include CIP revenue and CIP costs of $9,396,422. The ALJ states that will increase transparency in ratemaking and potentially reduce future audit costs and rate case expenses and further.~~

90a. Choose not to adopt the ALJ Findings 580-582 and instead approve one of the three alternatives below:

1) MERC shall collect $5,638,332 of its test-year CIP expenses through the CCRC and $3,758,090 of its test-year CIP expenses via the CCRA with the CCRC being set at $0.01469 and $0.00979 being added to the CCRA at the time of final rate implementation; MERC shall continue to include the CCRC factor in its base distribution rate and maintain its CCRA factor in its current format; or

2) MERC shall collect all of its test-year CIP expenses through the CCRC with the CCRC being set at $0.02448 and $0.00000 being added to the CCRA at the time of final rate implementation; MERC shall continue its current CCRC calculation methodology by including the CCRC factor in its base distribution rate and maintain its CCRA factor in its current format; or

3) MERC shall collect all of its test-year CIP expenses through the CCRA with the CCRC being set at $0.00000 and $0.02448 being added to the CCRA at the time of final rate implementation; instead of including the CCRC charge in its base distribution rate, MERC shall recover all CIP expenses via the CCRA factor, which appears as a separate line item on its customer's bills.

91. Adopt PUC staff's recommendation that would require MERC to have a pre-meeting with the Department and PUC staff before filing subsequent rate cases. (structured similar to the required pre-filing meeting on sales forecast)

Interim Rate Period CCRC Factor

~~92. Adopt the ALJ's recommendation that MERC CCRC calculation methodology is reasonable, but adopt PUC staff's recommendation to require MERC to update its CCRC factor to reflect the Department recommended 2014 CIP expenses of $9,396,422 and to correct its CIP applicable volumes to the Department recommended level in its final rates compliance.~~

93. Adopt the ALJ recommendation that would require MERC to report in its final rates compliance filing the calculation of the CCRC rate based upon terms of the Commission's Order. [DUPLICATIVE OF DECISION ALTERNATIVE 83]

94. [IF THE COMMISSION APPROVES ALTERNATIVE 90a, 1) or 2)] Adopt the ALJ recommendation [ALJ FINDING 613] that in future general rate-case filings, MERC should change the CCRC rate at the beginning of interim rates and again at final rates.

Over/Under Collected Interim Period CIP Revenues

95. Adopt the ALJ recommendation to the Commission that MERC's proposal to credit the CIP tracker balance, in the event that it under-collects CIP expense during interim rate period, is reasonable

96. Adopt the ALJ recommendation and in addition adopt PUC staff recommendation to add "to debit the CIP balance, in the "to debit the CIP balance, in the event that it over-collects the CIP expense during the interim period, is reasonable."

Presentation of CCRC and CCRA in the future

~~97. Adopt the ALJ recommendation assuming that MERC removes its CCRC factor from its base distribution rate along with the CIP expenses and account for the entire program through its CIP tracker account. Require MERC to combine the CCRC and CCRA into one CIP charge that would be adjusted through MERC's annual CIP tracker mechanism, in accordance with current tariff provisions.~~

~~98. Adopt the ALJ recommendation assuming that MERC calculates its CCRC factor as it currently does, but instead of including the CCRC charge in its base distribution rate, require MERC to combine its CCRC base factor and the current CCRA factor into one line item on its customer's bills.~~

~~99. Adopt the ALJ recommendation assuming that MERC calculates its CCRC factor as it currently does, but instead of including the CCRC charge in its base distribution rate, require MERC to separately state its CCRC base factor and the current CCRA factor on separate lines on its customer's bills.~~

~~100. Require no change to MERC's current handling of its CIP revenues and expenses. Require MERC to continue its current CCRC calculation methodology by including the CCRC factor in its base distribution rate and maintain its CCRA factor in its current format.~~

ATTACHMENT B
Docket No. G-011/GR-13-617
16-Sep-14

Minnesota Energy Resources Corporation
Calculation of Proposed CCRC Factor for 2014 Test Year

Line No.	Description	Option 1	Option 2	Option 3
1	Base Rate CIP Expense	$ 5,638,332	$ 9,396,422	$ -
2	Sales (Minnesota only)	689,625,513	689,625,513	689,625,513
3	Opt-out customers	305,799,314	305,799,314	305,799,314
4	CCRC applicable Sales	383,826,199	383,826,199	383,826,199
5	Calculated CCRC Factor ($/therm)	$ 0.01469	$ 0.02448	$ -
6	CCRA Increase at January 1st or Final Rate Implementation	$ 0.00979	$ -	$ 0.02448
7	Total CIP Expense collection (CCRC + CCRA)	$ 9,396,422	$ 9,396,422	$ 9,396,422
8	Proposed Refund to Customers (Adjustment for CIP Only)	$ 3,282,149	$ (475,941)	8,920,481
9	CIP Tracker Adjustment - a positive is a deferral of costs to a later date	$ 3,696,321	$ (61,769)	$ 9,334,653
10	Customer Effect based on CIP Decisions	$ (414,172)	$ (414,172)	$ (414,172)

*The customers see an increase in costs due to CIP Expense being increased from $8.9m in the initial filing to $9.4m as agreed to by the DOC and MERC

Option 1: DOC interpretation of ALJ Report
Option 2: MERC original Position
Option 3: MERC interpretation of ALJ report

MERC
Operating Income Adjustments
Test Year Ending December 31, 2014

Line No.	Description	Sales Forecast LBO (a)	Base Cost of Gas Update LBO (a)	CIP Rev. & Exp. MAS (b)	Property Tax MAS (c)	Pension Expense MAS (d)	Post-Ret. Medical MAS (e)	Post-Ret. Life MAS (f)	Executive Incentives MAS (g)	Bad Debt Expense MAS (h)	ICE Deferral MAS (i)	Mapping Project MAS (J)	Misc. Service LL (k)	Rate Case Travel LL (l)	Rate Case Amort. LL (m)	Charitable Contributions LL (n)	Aircraft Expense LL (o)	Travel & Entertain. LL (p)	Interest Synch. (q)	ALJ Total Adjustments (r)
	UTILITY OPERATING REVENUES																			
1	Natural Gas Revenue	$0	$43,412,663	$3,758,090																$47,170,753
2	Late Payment Revenue																			$0
3	Other Revenue												$51,493							$51,493
4	Total Operating Revenues	$0	$43,412,663	$3,758,090	$0	$0	$0	$0	$0	$0	$0	$0	$51,493	$0	$0	$0	$0	$0	$0	$47,222,246
	UTILITY EXPENSES																			
5	Cost of Gas	$0	$41,446,798																	$41,446,798
6	Production																			$0
7	Gas Supply																			$0
8	Transmission																			$0
9	Distribution											($165,000)								($165,000)
10	Customer Accounts									$293,478	($322,226)									($28,748)
11	Customer Services																			$0
12	Sales																			$0
13	Administrative & General					($668,392)	($140,720)	$0	($27,857)							($16,105)	($956)	($7,770)		($861,800)
14	Depreciation																			$0
15	Amortization			$475,941										($10,963)	$0					$464,979
16	Property tax				($118,260)															($118,260)
17	Other taxes																			$0
18	Other Interest Expense																			$0
19	Subtotal utility expenses	$0	$41,446,798	$475,941	($118,260)	($668,392)	($140,720)	$0	($27,857)	$293,478	($322,226)	($165,000)	$0	($10,963)	$0	($16,105)	($956)	($7,770)	$0	$40,737,969
20	OPERATING INCOME BEFORE TAXES	$0	$1,965,865	$3,282,149	$118,260	$668,392	$140,720	$0	$27,857	($293,478)	$322,226	$165,000	$51,493	$10,963	$0	$16,105	$956	$7,770	$0	$6,484,278
21	State Income Taxes 9.706%	$0	$190,807	$318,565	$11,478	$64,874	$13,658	$0	$2,704	($28,485)	$31,275	$16,015	$4,998	$1,064	$0	$1,563	$93	$754	$0	$629,364
22	Federal Income Taxes 31.603%	$0	$621,272	$1,037,258	$37,374	$211,232	$44,472	$0	$8,804	($92,748)	$101,833	$52,145	$16,273	$3,464	$0	$5,090	$302	$2,456	$0	$2,049,226
23	Interest Sync	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$\boxed{\$96,080}$	$96,080
24	Subtotal income taxes	$0	$812,079	$1,355,823	$48,852	$276,106	$58,130	$0	$11,507	($121,233)	$133,108	$68,160	$21,271	$4,528	$0	$6,653	$395	$3,210	$96,080	$2,774,670
25	NET OPERATING INCOME AFTER TAXES	$0	$1,153,786	$1,926,326	$69,408	$392,286	$82,590	$0	$16,350	($172,245)	$189,118	$96,840	$30,222	$6,434	$0	$9,452	$561	$4,560	($96,080)	$3,709,607

( ) = Reduction.

Prepared by the Commerce Department

AFFIDAVIT OF SERVICE

STATE OF MINNESOTA)
) ss
COUNTY OF HENNEPIN)

Kristin M. Stastny hereby certifies that on the 16th day of September, 2014, on behalf of Minnesota Energy Resources Corporation (MERC) she electronically filed a true and correct copy of the enclosed Letter on www.edockets.state.mn.us. Said documents were also served via U.S. mail and electronic service as designated on the attached service list.

/s/ Kristin M. Stastny______
Kristin M. Stastny

Subscribed and sworn to before me
This 16th day of September, 2014.

/s/ Alice Jaworski_________
Notary Public, State of Minnesota

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