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November 7, 2018

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VIA ELECTRONIC FILING

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 Seventh Place East, Suite 350
St. Paul, MN 55101

Re: In the Matter of Petition of Minnesota Energy Resources Corporation for Approval for Recovery of Natural Gas Expansion Project Costs through a Rider and for Approval of a New Area Surcharge for the Pengilly Project, Docket No. G011/M-18-460

Reply Comments of Minnesota Energy Resources Corporation

Dear Mr. Wolf:

On October 29, 2018, the Minnesota Department of Commerce, Division of Energy Resources (“Department”) filed Comments in the above-referenced docket addressing Minnesota Energy Resources Corporation’s (“MERC’s” or the “Company’s”) Petition for approval of a Natural Gas Extension Project Rider (“NGEP Rider”) and a New Area Surcharge (“NAS”) for the Pengilly Project and requesting that MERC provide additional information in Reply Comments. In particular, the Department requested that MERC address:

1. The reasonableness and prudence of the proposed Pengilly Project costs for which the Company is proposing recovery in light of the previous scope and cost of the Pengilly New Area Surcharge Project submitted in Docket No. G011/M-17-566, and
2. Additional support for the Company’s calculation that the amount proposed for recovery through the NGEP rider is equal to or less than 33 percent of the Pengilly Project revenue deficiency.

Additionally, with respect to the NGEP surcharge calculation, the Department notes that it prefers a cost recovery mechanism in which the costs allocated to the NGEP Rider are recovered during the useful life of the extension project. The Department concludes that MERC’s proposal to recover a portion of the Pengilly Project costs through an

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NGEP Rider surcharge of \$0.00013 per therm over a one-year period would provide for “accelerated cost recovery of the NGEP costs” and would be “inequitable in that only current ratepayers would be required to pay costs while future ratepayers receiving the benefits would not pay.”¹

MERC thanks the Department for its review and submits these Reply Comments to respond to the Department’s request for additional information and recommendations.

A. Reasonableness of Proposed Project Costs and Scope

MERC originally filed a Petition for approval of the Pengilly NAS Project in Docket No. G011/M-17-566 on July 25, 2017, but subsequently requested withdrawal of that Petition on March 12, 2018, stating that “based on the proposed schedule for completion of the necessary interstate pipeline tap upgrade, which is anticipated late 2018, MERC is reevaluating the project boundaries. While MERC intends to proceed with the Pengilly NAS Project, based on recent feedback from the Pengilly town board and potential customers, MERC is evaluating whether the project boundaries can be expanded.”² As a result of the expanded scope of the proposed Project and associated increase in costs of the overall Project, MERC’s Petition in this docket requested to recover a portion of Project costs through an NGEP Rider surcharge under Minn. Stat. § 216B.1638.

In its Comments, the Department states that “a comparison of customer numbers in **TRADE SECRET** Table 3 indicates that MERC forecasts an increase of **[TRADE SECRET DATA BEGINS... [REDACTED] ...TRADE SECRET DATA ENDS]** in the 18-460 docket. That percentage increase is significantly less than the percentage increase in capital costs identified in **Trade Secret** Table 2.”³ In particular, the Department’s Comments note that the total capital costs for the Pengilly Project increased from **[TRADE SECRET DATA BEGINS [REDACTED] ...TRADE SECRET DATA ENDS]**.⁴

Based on this comparison, the Department notes that it “cannot state that MERC’s proposed project costs in this docket are reasonable” and requests that MERC explain in reply comments how **[TRADE SECRET DATA BEGINS... [REDACTED] ...TRADE SECRET DATA ENDS]**.

¹ Department Comments at 14.

² MERC Petition (June 29, 2018).

³ Department Comments at 9.

⁴ Department Comments at 7.

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[REDACTED]
...TRADE SECRET DATA ENDS].

MERC responds by first pointing out that the additional Project costs for the updated Pengilly Project are a result of expanding the Project area to potentially connect an additional [TRADE SECRET DATA BEGINS... [REDACTED] ...TRADE SECRET DATA ENDS]. In particular, the expanded Project scope results in an increase in available customers from the originally-filed [TRADE SECRET DATA BEGINS... [REDACTED] ...TRADE SECRET DATA ENDS]. The nominal change identified in the Department's Table 3 is based on both the expanded scope and assumptions regarding the expanded number of available customers who will sign up for natural gas service in the Project area.

As with all prior NAS projects, MERC must make reasonable assumptions about the percentage of available customers who will actually sign up to take natural gas service as part of the Project. Following withdrawal of the original Pengilly NAS Petition in Docket No. 17-566, MERC worked with the township to obtain additional information regarding customer interest in converting to natural gas service. The township conducted a survey of residents in order to determine interest in the extension Project. As a result of that information, as well as MERC's recent experience with customer connections on other NAS projects, MERC reduced the overall percentage of projected customer connections from [TRADE SECRET DATA BEGINS... [REDACTED] ...TRADE SECRET DATA ENDS].⁵ Therefore, while the updated Pengilly Project scope creates the potential for [TRADE SECRET DATA BEGINS... [REDACTED] ...TRADE SECRET DATA ENDS], the result of a lower percentage of projected customer connections [TRADE SECRET DATA BEGINS... [REDACTED] ...TRADE SECRET DATA ENDS]. It is important to note that if more customers choose to participate in the Project than MERC estimates, additional NAS revenue would be collected and the NAS would terminate sooner than projected.

MERC's initial Pengilly Project scope included [TRADE SECRET DATA BEGINS... [REDACTED] ...TRADE SECRET DATA ENDS]. In this docket, MERC has proposed an expanded Project area, in response to requests from the township, which

⁵ As discussed in MERC's March 2, 2018, Annual New Area Surcharge Compliance Filing in Docket Nos. G011/M-15-441, G011/M-17-210, G011/M-15-776, G011/M-17-211, G011/M-16-221, G011/M-17-212, G011/M-16-654, and G011/M-16-655, many of MERC's approved NAS projects have experienced slower than projected customer sign-ups.

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includes [TRADE SECRET DATA BEGINS...

...TRADE SECRET DATA ENDS].

The Commission expressly concluded in its Order Approving cost Recovery for New Area Surcharge Tariffs for Balaton and Esko Projects, that “the Balaton and Esko natural gas extension projects will serve an inadequately served or un-served area in Minnesota,” and that the project costs “are reasonable and will be prudently incurred.”⁶ As shown in Table 1 below, the proposed scope (based on number of customers within the Project area) and capital costs for the expanded Pengilly Project are not dissimilar from the Balaton NAS Project, which the Commission found to be reasonable and prudent.

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Ultimately, the proposed expanded Pengilly Project scope will increase the number of potential customers able to connect to natural gas service if they choose to do so and is being proposed in response to feedback from the township as well as from potential customers. While MERC’s continuing experience with NAS projects has resulted in the need to adjust the assumptions and expectations for customer connections for these projects, the proposed expanded Pengilly Project and costs are reasonable, prudent,

⁶ *In the Matter of the Petition of Minn. Energy Res. Corp. for Approval of Nat. Gas Extension Project Costs through a Rider and for Approval of a New Area Surcharge for the Balaton Project*, Docket No. G011/M-16-654, Order Approving Cost Recovery for New Area Surcharge Tariffs for Balaton and Esko Projects (Feb. 9, 2017); see also Docket No. G011/M-16-655 (same order provided in Esko project docket).

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and appropriate to expand natural gas to a currently unserved area in Itasca County, Minnesota.

B. Compliance with 33 Percent NGEPRider Limitation

Second, with respect to the requirement of the NGEPRider Statute, that “the Commission must not approve a rider under this section that allows a utility to recover more than 33 percent of the costs of a natural gas extension project,”⁷ MERC stated in its Petition that the amount proposed for recovery through the NGEPRider is equal to **[TRADE SECRET DATA BEGINS... [REDACTED] ...TRADE SECRET DATA ENDS]**. In its Comments, the Department correctly acknowledges that the statutory requirement “simply references ‘costs’ in setting the 33 percent limit.”⁸ Nevertheless, the Department asks that MERC describe and support its revenue deficiency approach in Reply Comments, noting that “[d]ividing capital costs by a revenue requirement is not an apples-to-apples comparison and thus should not be used to determine the percentage of costs relative to the statutory requirement.”⁹

The language of the NGEPRider Statute with respect to the 33 percent cap provides that “[t]he commission must not approve a rider under this section that allows a utility to recover more than 33 percent of the costs of a natural gas extension project.”¹⁰ The statutory language is clear and unambiguous — the cap applies to the overall costs of the natural gas extension project.¹¹ Therefore, the fact that the Company is proposing to recover only **[TRADE SECRET DATA BEGINS... [REDACTED] ... TRADE SECRET DATA ENDS]** of the total project costs through an NGEPRider surcharge fully satisfies the statutory limitation that the Commission not approve a rider that allows a utility to recover more than 33 percent of the costs of a natural gas extension project.

Nevertheless, the Department has previously taken the position that the 33 percent statutory provision should be interpreted to apply to the project revenue requirement

⁷ Minn. Stat. § 216B.1638, subd. 3(c).

⁸ Department Comments at 12.

⁹ Department Comments at 13.

¹⁰ Minn. Stat. § 216B.1638, subd. 3(c).

¹¹ Under Minn. Stat. § 645.16, “[w]hen the words of a law in their application to an existing situation are clear and free from all ambiguity, the letter of the law shall not be disregarded under the pretext of pursuing the spirit.” “The objective of statutory interpretation is to ascertain and effectuate the Legislature’s intent. If the Legislature’s intent is clear from the statute’s plain and unambiguous language, then [a court] interpret[s] the statute according to its plain meaning without resorting to the canons of statutory construction.” *State v. Rick*, 835 N.W.2d 478, 482 (Minn. 2013) (citation omitted).

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rather than the total project costs.¹² While the Company continues to disagree that this interpretation is reasonable in light of the plain language of the NGEP Rider Statute, in order to avoid possible disagreement that the Company's proposed NGEP Rider recovery for the Pengilly Project satisfied the statutory limitation under any interpretation, MERC provided the alternative calculation showing that the amount proposed for recovery through the NGEP Rider is equal to **[TRADE SECRET DATA BEGINS... [REDACTED] ...TRADE SECRET DATA ENDS]**.

MERC calculated this amount by calculating the contribution in aid of construction ("CIAC") that would be required for the proposed Pengilly Project assuming no socialization of costs through an NGEP Rider. The calculated CIAC is the revenue required in the first year of the Project from customers participating in the NAS Project to fund the revenue requirement that is not recovered in the margin of the currently authorized base rates assuming no portion of the Project was socialized and recovered through an NGEP rider or collected via the NAS.

Ultimately, the alternative calculation showing that the proposed NGEP Rider recovery would amount to **[TRADE SECRET DATA BEGINS... [REDACTED] ...TRADE SECRET DATA ENDS]** was provided for informational purposes and is not relevant to a finding that MERC's proposal complies with the requirements of the NGEP Rider Statute. The plain language of the NGEP Rider Statute limits NGEP Rider recovery to 33 percent of the costs of a natural gas extension project and the Company's proposed NGEP recovery is well below that statutory limitation.

C. Calculation of NGEP Rider Surcharge Recovery

Finally, with respect to the proposed NGEP Rider recovery mechanism, the Department notes that MERC provided a comparison of three approaches for calculating the NGEP Rider surcharge and concludes that cost recovery in which the costs are allocated to the NGEP are recovered during the useful life of the Project is preferable.¹³ In particular, the Department concludes that an NGEP surcharge rate of \$0.00001 per therm based on recovery of the costs allocated to the NGEP over the useful life of the extension project (48 years) "matches the time-period over which the benefits of the project accrue to ratepayers with the recovery of the project costs."¹⁴

¹² See *In the Matter of the Petition of Minn. Energy Res. Corp. for Approval of a Nat. Gas Extension Project (NGEP) Cost Rider Surcharge for the Recovery of 2019 Rochester Project Costs*, Docket No. G011/M-18-182, DEPARTMENT COMMENTS (May 29, 2018).

¹³ Department Comments at 14.

¹⁴ Department Comments at 14.

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MERC acknowledges the importance of matching the recovery of utility costs with the timing of benefits in the case of capital investments. However, in this particular instance such an extended surcharge collection period is administratively burdensome and unnecessary in terms of materiality. The Company would need to further evaluate whether to proceed with the Project based on administrative challenges of such a surcharge.

It is useful to note that the NGEF Rider Statute does not require that the NGEF Rider surcharge be recovered over the useful life of the extension project. Further, because the costs of a natural gas extension project in accordance with an NGEF rider are costs being socialized to all customers for an extension that serves a limited group of customers, matching rate recovery to the useful life of the project is somewhat less relevant. In the Pengilly Project, the overall costs proposed for socialization result in a minimal impact to customer rates when recovered over a year. In particular, MERC's proposed surcharge calculation and recovery would equate to an average Residential customer bill impact of \$0.11 in the single year the surcharge is in effect. Any inequity of having current customers pay for a portion of costs related to a project that will be in service for a projected 48 years should appropriately be weighed against the practical and administrative considerations of extending recovery over 48 years based on a \$0.00001 per therm charge, as proposed by the Department.

And finally, MERC's proposal to calculate the year one rider recovery based on the net present value of the NGEF allocation recognizes the value of recovery over a single year. Because the bill impact of the proposed rider would be relatively small pursuant to a one-year recovery period, MERC believes such a recovery period is reasonable and appropriate.

The nonpublic version of this filing contains trade secret information. Specifically, the capital costs, estimated customer sign-ups, estimated customer usage, and description of the expanded Project area are not generally known to, and not readily ascertainable by, vendors and competitors of MERC, who could obtain economic value from their disclosure. MERC maintains this information as trade secret. Accordingly, the nonpublic version of this filing contains data that qualifies as "Trade Secret Data" pursuant to Minnesota Statutes Section 13.37, Subdivision 1(b).

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Please note that Amber Lee, who was listed as the utility employee responsible for the Petition filed in this docket, has left MERC. Please contact me at (920) 433-2926 if you have any questions regarding the information in this filing. Thank you for your attention to this matter.

Sincerely,

/s/ Seth DeMerritt

Seth DeMerritt
Senior Project Specialist
Minnesota Energy Resources Corporation

cc: Service List

In the Matter of the Petition of Minnesota Energy
Resources Corporation for Approval of a New
Area Surcharge for the Pengilly Project

Docket No G011/M-18-460

CERTIFICATE OF SERVICE

I, Kristin M. Stastny, hereby certify that on the 7th of November, 2018, on behalf of Minnesota Energy Resources Corporation (MERC), I electronically filed a true and correct copy of the enclosed Reply Comments 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.

Dated this 7th day of November, 2018.

/s/ Kristin M. Stastny
Kristin M. Stastny

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