

**Minnesota Public Utilities Commission**  
*Staff Briefing Papers*

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**Meeting Date:** November 14, 2013..... **Agenda Item #**  \*\*5

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**Company:** Minnesota Energy Resources Corporation (MERC)

**Docket No.** G-011/GR-13-617  
In the Matter of the Application by MERC for Authority to Increase Natural Gas Rates in Minnesota

**Issues:** **Should this filing be accepted, the proposed rates suspended, this matter referred to the Office of Administrative Hearings, and interim rates set as requested by the Company?**

**Staff:** Andy Bahn ..... 651-201-2249  
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Bob Brill..... 651-201-2242  
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Ann Schwieger ..... 651-201-2238  
Bob Harding ..... 651-201-2237

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***Relevant Documents***

MERC - Initial Filing & Interim Rate Petition ..... Sep. 30, 2013  
MERC – Supplemental Filing..... Oct. 8, 2013  
Department - Comments ..... Oct. 10, 2013  
SLGI - Comments ..... Oct. 11, 2013  
MERC - Reply Comments ..... Oct. 14, 2013

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The attached materials are workpapers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless otherwise noted.

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*November 6, 2013*

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## Statement of the Issues

- Should this filing be accepted as complete? Should the Commission require the Company to file supplemental information?
- Should the proposed rates be suspended? If so, for what period?
- Should this matter be referred to the Office of Administrative Hearings for a contested case proceeding? If so, are there issues in addition to the standard rate case issues the Commission would like parties to address?
- What level of interim revenue increase should be set? How should the increase be collected from customers?

## Introduction

On September 30, 2013, Minnesota Energy Resources Corporation (MERC) filed a general rate case with the Minnesota Public Utilities Commission (Commission) under Docket No. G-011/GR-13-617. The Company is seeking authority for an increase of its Minnesota retail natural gas rates of approximately \$14.188 million, or 5.52%, based on a proposed return on equity of 10.75%, as of January 1, 2014, without suspension by the Commission. On average, the proposed rate change would increase the bill of the typical residential gas customer who uses 859 therms a year by \$4.71 per month, or \$56.57 annually, or approximately 7.0%.

MERC proposed an interim revenue deficiency of approximately \$12.4 million, or 4.82%, based on the 9.70% return on equity approved in the Company's last rate case. However, the Company is requesting an interim rate increase of approximately \$12.1<sup>1</sup> million, or 4.70%, effective on January 1, 2014.<sup>2</sup> The proposed interim rates would increase the bill for a typical residential gas customer by \$3.35 per month or \$40.21 annually.

Pursuant to Minn. Rules, Part 7825.2700, subpart 2, and Part 7825.3200, part B, MERC has also submitted a separate miscellaneous rate change filing seeking to restate the Base Cost of Gas for interim rates in Docket No. G-011/MR-13-732. This docket is on the agenda for the Commission's November 14, 2013 meeting.

The main issues at this stage of a rate case are whether to accept the filing, suspend the proposed final rates, refer this matter to the Office of Administrative Hearings (OAH) for a contested case proceeding, and set interim rates subject to refund.

## Background

On October 2, 2013, the Commission issued its notice requesting comments on whether MERC's filing complies with the filing requirements in Minn. Stat. § 216B.16, Minn. Rules, Parts

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<sup>1</sup> MERC proposes to collect less than the full amount of the interim rate increase from its Super Large Volume (SLV) and FLEX rate customers.

<sup>2</sup> MERC is waiving its right under Minn. Stat. §216B.16 to have interim rates in effect no later than 60 days after the initial filing.

7825.1300 to 7825.4400 and Commission Orders. The Commission also asked for comments as to whether this rate application should be referred to the OAH for a contested case proceeding.

On October 8, 2013, MERC submitted additional information to supplement its September 30 filing. The two items included in the October 8 supplemental filing were a filing requirement in MERC's 2010 rate case stemming from the Commission's decision in MERC's 2008 rate case. MERC does not believe it was required to provide this information in this rate case, but did submit the information pertaining to new material costs related to tampering and reconnection of gas service and abnormal construction charges, such as frost charges due to the winter construction period.

On October 10, 2013, the Department of Commerce, Division of Energy Resources (Department) submitted comments recommending that the Commission accept MERC's filing as substantially complete. The Department emphasized that its review up to this point in the proceeding is limited to whether the Company provided at least some of the information on the issues, rather than on the merits of the information provided. The Department maintains its right to further develop the issues through information requests to the Company.

The Department recommended the matter be referred to the OAH for a contested case proceeding. The scope of the contested case proceeding should include the following issues, as well as other issues raised by parties relevant to the Company's proposed rate increase:

- 1) Is MERC's proposed test year revenue increase reasonable?
- 2) Has MERC appropriately ensured that costs proposed to be paid by ratepayers pertain only to regulated utility costs?
- 3) Are MERC's proposed capital structure, cost of capital, and return on equity reasonable?
- 4) Is MERC's proposed rate design reasonable?

On October 11, 2013, the Super Large Gas Intervener's (SLGI) submitted comments in support of the interim rate petition filed by MERC and recommended the Commission find exigent circumstances to deviate from the formula in the interim rate statute. As support to its claim of exigent circumstances, SLGI cited the recent Minnesota Supreme Court decision in Minnesota Power's 2009 rate case. In that case, the court found that the Commission is not limited to considering the factors set forth in statute when determining whether exigent circumstances exist and upon a finding of exigent circumstances, the statutory formula does not apply.

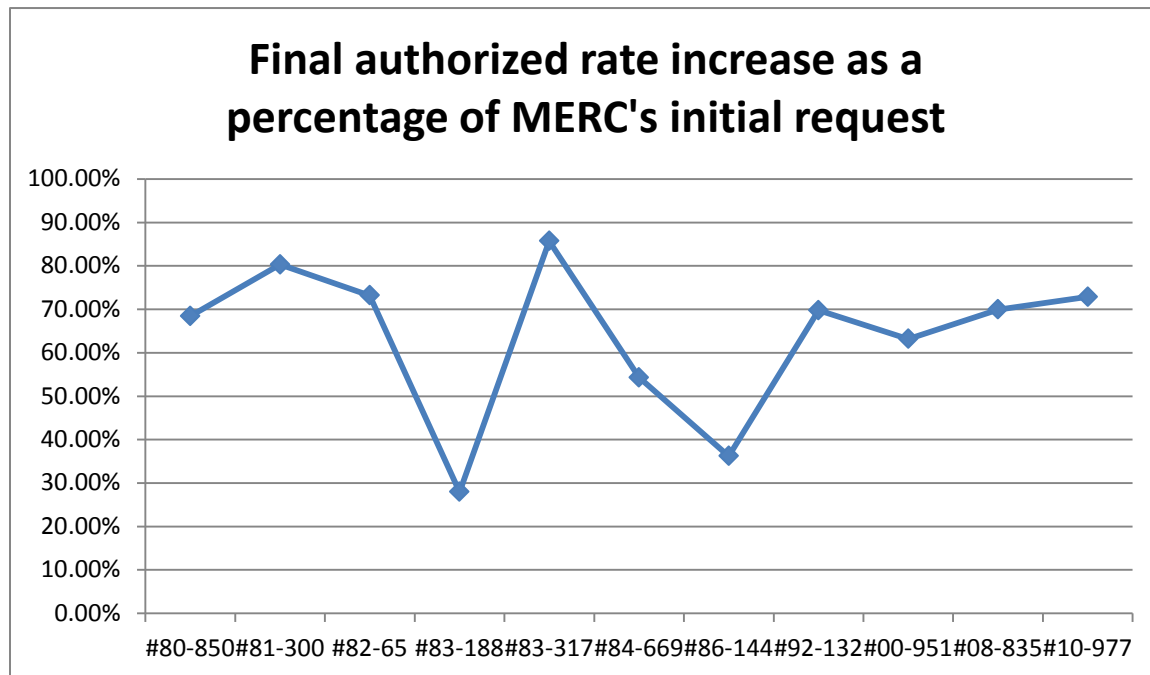
On October 14, 2013, MERC submitted comments supporting the Department's recommendation that the Commission find its application substantially complete and refer the matter to the OAH for a contested case hearing. MERC also agreed with the SLGI's recommendation in support of MERC's interim rate petition.

## Prior Rate Cases

MERC and its predecessors have filed eleven rate cases since 1980.

File Year	Utility Name	\$ Increase Requested	% Increase	\$ Final Increase Granted	Final %	ROE Allowed
1980	Peoples Natural Gas	\$ 2,121,563	1.40%	\$1,452,000	0.96%	14.50%
1981	Inter-City	\$ 2,800,000	5.60%	\$2,248,200	4.50%	15.00%
1982	Peoples Natural Gas	\$ 6,919,000	3.80%	\$5,065,000	2.80%	14.90%
1983	Peoples Natural Gas	\$ 2,967,000	1.40%	\$829,000	0.40%	15.08%
1983	Inter-City	\$ 3,251,800	6.40%	\$2,787,288	5.49%	15.25%
1984	Inter-City	\$ 1,874,835	3.70%	\$1,017,700	2.01%	14.75%
1986	Peoples Natural Gas	\$ 8,144,000	5.76%	\$2,948,000	2.09%	12.75%
1992	Peoples Natural Gas	\$ 7,232,621	7.80%	\$5,044,589	5.44%	11.60%
2000	UtiliCorp	\$ 9,846,647	6.24%	\$6,220,310	4.00%	9.93%
2008	MERC	\$ 22,041,889	6.38%	\$15,418,492	5.49%	10.21%
2010	MERC	\$ 15,165,309	5.18%	\$11,047,296	4.19%	9.70%

In the previous eleven rate cases, final authorized rates have been in the range of 28 to 86 percent of the Company’s proposed rates as represented by the following chart. In the last four rate cases filed since 1992, the range has been narrower, between 60 to 72 percent of the Company’s proposed final rates.



## MERC's Application

MERC is asking for an increase in rates of approximately \$14.188 million, or approximately 5.52% percent of total revenues<sup>3</sup>, effective January 1, 2014. According to MERC, rate relief is sought at this time for the following reasons:

MERC experienced a revenue deficiency of approximately \$13.889 million in 2012.

General inflation has increased Operations & Maintenance (O&M) expenses at a rate of 3.74%.

Known & Measurable (K&M) changes from 2012 to 2014 resulted in an increase of costs associated with the following:

- IBS (Integrys Business Support)-Customer relations,
- Vacant positions that existed at MERC during 2012,
- Uncollectable expenses,
- Sewer lateral project,
- Gate station upgrades,
- Mapping project,
- Additional positions at MERC,
- Depreciation and return charges from Integrys Business Support,
- Vacant position that existed at Integrys Business Support during 2012.

K&M changes from 2012 to 2014 that resulted in a decrease of costs associated with the following:

- Memberships,
- General allocation factor,
- Advertising expense,
- Long term incentive pay, restricted stock and stock options expense,
- Economic development,
- Incentives,
- Audit of Vertex,
- Benefits.

MERC has included its 2013 approved Conservation Improvement Plan (CIP) expenses in the test year.

MERC has projected a continual increase in Property Tax Expense as discussed in MERC's last rate case.

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<sup>3</sup> Staff notes that the proposed increase is approximately 5.52% of total natural gas revenues and approximately 5.50% of total revenues (including late payment & other revenues).

MERC is requesting amortization of rate case expenses over a two year period due to a large transmission project that is anticipated to go into service in 2015.

## Comparison of Authorized and Proposed Revenue Requirement

The following abbreviated schedule compares the revenue requirement approved in MERC's 2010 rate case, Docket No. G-007,011/GR-10-977, and the proposed revenue requirement in this docket.

<b>Financial Summary</b>	<b><u>Authorized</u> 2010 Rate Case - Docket No. G-007,011/GR-10- 977</b>	<b><u>Proposed</u> 2013 Rate Case - Docket No. G-011/GR-13-617</b>
Rate Base	\$189,808,628	\$198,314,568
Rate of Return	7.8275%	8.0092%
Return on Equity	9.70%	10.75%
Required Operating Income	\$14,857,270	\$15,883,387
Revenue (including gas revenue)	\$275,772,942	\$257,945,932
Expenses (including gas expenses)	\$260,915,672	\$250,388,600
Operating Income	\$14,857,270	\$7,557,332
Income Deficiency	-----	\$8,326,055
Conversion Factor	1.704	1.704
Revenue Deficiency	-----	\$14,187,597

The proposed increase of approximately \$14.188 million can be attributed to the following changes since rates were increased in the 2010 rate case:

Increase in Rate Base	\$1.135 million
Decrease in Net Income	12.439 million
Increase in Rate of Return	<u>0.614 million</u>
Total	\$ 14.188 million

The Company's requested increase when compared to its last filing shows an income deficiency primarily due to revenue and expense changes and to a lesser extent, increased rate base.

In this petition, the Company has requested to include a Conservation Improvement Plan (CIP) expense level<sup>4</sup> of \$8.920 million from its 2013-2015 CIP Triennial plan.<sup>5</sup> The Company's last

<sup>4</sup> The Conservation Cost Recovery Charge (CCRC) is the amount included in base rates dedicated to the recovery of CIP costs as approved by the Commission in the Company's general rate case.

<sup>5</sup> See Docket No. G007,G011/CIP-12-548 and Seth DeMerritt Direct Testimony pp. 41-42.



rate case CIP level was \$8.454 million,<sup>6</sup> which results in a CIP expense increase of \$0.446 million or a 5.5% increase. Over the past few years, MERC has had numerous customers apply for and receive CIP exemption from the Commission that has resulted in a reduction to sales determinants available for the Conservation Cost Recovery Charge (CCRC) calculation. This is illustrated in the below table (in therms):

<b>Docket Number</b>	<b>10-977<sup>7</sup></b>	<b>13-617<sup>8</sup></b>	<b>Difference</b>	<b>% Change</b>
Sales volume	683,768,889	662,833,577	- 20,935,312	- 3.06
Less: CIP Opt-out volumes	125,111,337	296,086,744	170,975,407	136.66
CCRC applicable Volumes	558,657,552	366,746,833	-191,910,719	- 34.35

Using its CIP costs from its 2013 CIP triennial report and 2014 CCRC applicable sales volumes, the Company calculated its proposed \$0.02432/therm CCRC rate.<sup>9</sup> The previous rate case reflected a \$0.01513/therm CCRC rate. The result is an increase of \$0.00919/therm, or a 60.74% increase in the CCRC rate from the last rate case. The CCRC rate is a component of the Company's distribution rate charged to non CIP exempt customers. Staff notes that while the CIP expense increase seems modest, the CIP Opt-out sales volumes have greatly increased, thus producing a large increase in the Company's requested distribution rate charged to non CIP exempt customers.

<sup>6</sup> MERC's April 12, 2012 Compliance filing, Attachment E, Docket No. G007,007/GR-10-977.

<sup>7</sup> See MERC Docket No. G-007,011/GR-10-977, Compliance Filing date April 12, 2012, Attachment E.

<sup>8</sup> See Seth DeMerritt Direct Testimony, Exhibit SSD-24.

<sup>9</sup> Ibid.

When compared to the previous rate case, and contributing to the \$12.4 million decrease in net income, the following table illustrates revenue and expense changes by major groups:

	Prior Rate Case <sup>10</sup>	2014 Test Year	Change in \$	Change in %
Operating Revenues	(275,772,942)	(257,945,932) <sup>11</sup>	17,827,010	-6%
Purchased Gas Costs	185,725,253	173,412,058	(12,313,195)	-7%
Other Production & Gas Supply	753,171	715,001	(38,170)	-5%
Transmission	52,851	94,181	41,330	78%
Distribution	13,495,501	17,894,619	4,399,118	33%
Customer Accounting	11,350,358	11,801,783	451,425	4%
Customer Service & Information	792,674	927,914	135,240	17%
Administrative & General	16,249,165	15,998,503	(250,662)	-2%
Amortization	8,856,622	9,656,957	800,335	9%
Depreciation	10,164,714	9,347,278	(817,436)	-8%
Taxes Other than Income Taxes	6,952,636	8,896,360	1,943,724	28%
Income Taxes	6,522,727 <sup>12</sup>	1,643,011	(4,879,716)	-75%
Other Interest Expense	0	935	935	100%
Total Operating Expenses	260,915,672	250,388,600	(10,527,072)	-4%

The primary drivers of the projected decrease in net income appear to be a projected decrease in operating revenues net of the change in the cost of gas of approximately \$5.5 million, and projected increases in distribution expense of approximately \$4.4 million; Customer Accounting of approximately \$0.5 million, Taxes Other than Income Taxes of approximately \$1.9 million (including an increase in property taxes of approximately \$1.6 million), and amortization (primarily of CIP and Rate Case Expenses) of approximately \$0.8 million. These and other smaller increases in expenses are partially offset by decreases in depreciation expense of approximately \$0.8 million and Administrative & General expense of approximately \$0.3 million.

Due to the reduction in Operating Income, Income Taxes are approximately \$4.9 million lower; however, most or all of these “savings” will be eliminated once new rates are approved and Operating Income rises accordingly. For instance, if the full rate increase request were to be approved, Income Taxes would increase from approximately \$1.6 million to \$7.5 million. When compared to the prior case, the \$4.9 million net decrease would become a \$1 million increase.

<sup>10</sup> July 13, 2012 FINDINGS OF FACT, CONCLUSIONS, AND ORDER, Docket No. G-007,011/GR-10-977 (10-977 July 13, 2012 Order).

<sup>11</sup> Projected revenues include retail revenues at current rates plus late payment and other revenue.

<sup>12</sup> 10-977 July 13, 2012 Order at page 47 Income Taxes of \$1,958,586 plus the difference of \$4,564,141 between the Gross Revenue Deficiency and Income Deficiency shown at page 45 of the Order.

Rate Base increased approximately 4.5% since the last rate case. Major components of the change in rate base include:

- An increase in net utility plant of \$3.8 million.
- A decrease in cash working capital of \$6.6 million.
- An increase in Materials & Supplies of \$1.5 million.
- A decrease in Gas Storage of \$0.8 million.
- An increase in Other Assets & Liabilities of \$10.7 million, which according to the Company is primarily the result of benefit plan funding. Staff notes that this line item has more than doubled since the last rate case.

### Proposed Test Year Cost of Capital

In its most recent rate case (G-007,011/GR-10-977) Minnesota Energy Resources Corporation was authorized a rate of return of 7.8275 percent based on a cost of long term debt of 6.55 percent, a cost of short term debt of 0.1833 percent, and a return on equity of 9.70 percent.

In this case, MERC is requesting a rate of return on common equity of 10.75 percent and an overall cost of capital of 8.0092 percent.

The filing requirements regarding rate of return and cost of capital are found in Minnesota Rules, Part 7825.4200. The Company complied with this rule by providing the information in Lisa J. Gast Testimony & Exhibits, Volume 2.

The proposed test year capital structure and cost of capital is:

Component	Percent of Total	Cost Rate	Weighted Cost
Long-Term Debt	44.64%	5.5606%	2.4823%
Short-Term Debt	5.05%	2.3487%	0.1186%
Common Equity	50.31%	10.75%	5.4084%
Total (ROR)			8.0092%

## **Proposed Test Year Sales Forecast**

### **Compliance with Commission Rate Case Orders**

The Company stated that it has met its sales forecast filing requirements related to its last two rate cases. The Commission's September 14, 2009 Order After Reconsideration in Docket No. G-007,011/GR-08-835 required MERC to:

- 1) Work with the Department and other interested parties in advance of its next rate case filing to ensure that it has adequate sales and revenue data, its forecasting technique is based on Industry standards, and it has sufficient evidence substantiating its data and forecasting technique;
- 2) Prepare summary spreadsheets that link together its test year sales and revenue estimates, the CCOSS and its rate design schedules, and provide these in its initial filing; and
- 3) Separate sales and revenue forecasts by individual rate classes, for each of its Purchased Gas Adjustment systems.

In MERC's last rate case, Docket No. G-007,011/GR-10-977, MERC agreed to work with Department staff in preparing the sales forecast for its next rate case and to provide sales forecasting data 30 days prior to the filing of MERC's next rate case.

To comply with these requirements in this case:

MERC had informal discussions with the Department about MERC's data and new forecasting methodology described in Section II, PROPOSED SALES FORECAST.

Discussed the second issue in the Direct Testimony of Seth S. DeMerritt.

Provided the information for the third requirement in, Exhibit \_\_\_ 19 (HWJ-1), Schedule E-1. This schedule provides separate sales forecasts by individual revenue classes for each Purchased Gas Adjustment system. The revenue forecasts for each revenue class are included in the Direct Testimony and Exhibits of Gregory J. Walters.

MERC provided sales forecast data to the Department and the OAG in the form of MERC responses to pre-filed data requests. The data was provided to the Department on August 20th and the OAG on August 22, 2013.

### **MERC's Proposed Forecast**

In this case, MERC proposed a forecasted test year ending on December 31, 2014. In its proposed test year, MERC has approximately 214,691 customers, including transportation customers and throughput of approximately 662,833,577 therms of natural gas per year.

As demonstrated in the following comparison, MERC forecasts more customers but lower total throughput and a reduction in average use per residential customer.

	2008 Authorized in Docket 08-835	2011 Authorized in Docket 10-977	2012 Weather Normalized	2013 Weather Normalized	2014 Test Year
Total Throughput	711,979,740	683,768,889	705,670,670	696,279,200	662,833,577
Number of Residential Customers	185,664	189,875	189,630	192,071	192,587
Total Number of Customers w/o Transportation Customers	208,482	211,775	211,286	213,984	214,523
Residential Sales (therms)	167,000,519	168,210,413	164,370,008	180,179,583	165,401,857
Residential Use-Per-Customer (therms)	899	886	867	938	859

MERC based its forecast on 20 year normalized weather over the period 1993 through 2012. MERC explained that 2013 contains the first six months of actual data, and 6 months of forecast data. Temperatures were colder than normal in January through June of 2013 and reflect a higher use per customer.

### **Class Cost of Service Study**

Minnesota Rules, Part 7825.4300(c) requires a request for a change in rates to include:

A cost-of-service study by customer class of service, by geographic area, or other categorization as deemed appropriate for the change in rates requested, showing revenues, costs, and profitability for each class of service, geographic area, or other appropriate category, identifying the procedures and underlying rationale for cost and revenue allocations. Such study is appropriate whenever the utility proposes a change in rates which results in a material change in its rate structure.

MERC provided a class cost of service study in Informational Requirement Document 12, Schedules 1 through 9.

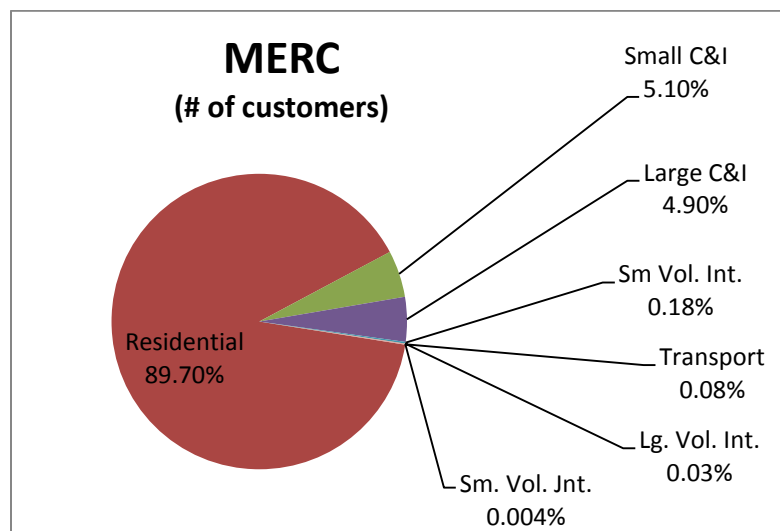
The Company complied with the Commission's June 29, 2009 Findings of Fact, Conclusions of Law, and Order, in Docket No. G-007,011/GR-08-835. In that docket, the Commission required that in future Class Cost of Service Studies, MERC include an explanatory filing identifying and describing each allocation method used in the study and detailing the reasons for concluding that each allocation method is appropriate and superior to other allocation methods considered. MERC provided this information in Volume 3, Informational Requirement Document 12, Schedule 7.

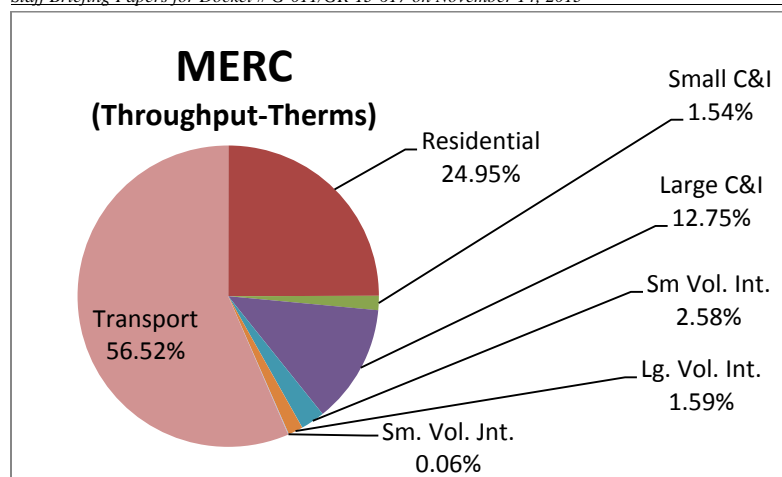
## Proposed Rate Design

The following summary is an overview of some of MERC’s proposed changes and is not meant to be a complete or comprehensive catalog of MERC’s rate design proposal in this docket.

MERC provides sales service and transportation service. Sales service customers receive a fully bundled service from MERC. MERC procures wholesale natural gas, interstate pipeline transportation and distributes and resells gas to sales service customers. Sales service customers consist primarily of residential, small and large commercial and industrial customers.

Transportation customers are customers that acquire their own gas supplies via unregulated gas suppliers and procure their own pipeline transportation to MERC’s town border stations. MERC delivers this third party gas to the transportation customers’ premises through MERC’s gas distribution system. Approximately 90% of MERC’s customers are residential customers and less than one tenth of one percent of customers are transportation customers. However, transportation accounts for 56.5% of the throughput (or volumes of gas moved) on MERC’s distribution system. Residential sales account for less than 25% of the throughput on MERC’s distribution system.





MERC has approximately 192,600 residential customers compared to 168 transportation customers. MERC's residential customers account for sales of approximately 165.5 million therms and transportation customers are responsible for approximately 375 million therms. Customers are divided further within two rate areas (MERC-NNG and MERC-Consolidated).

### Class Revenue Apportionment<sup>13</sup>

The following table contains MERC's proposed apportionment of each customer class' responsibility for MERC's revenue requirements under current and proposed rates as well as each customer class' proposed dollar amount and percentage increase. Columns two and three, customers and sales in therms, represent MERC's sales forecast in this case.

Customer class	Forecasted # of customers	Forecasted Sales Therms	Current revenue (\$)	Proposed revenue (\$)	Proposed Increase	
					(\$)	(%)
Residential	192,586	165,401,857	155,031,326	165,926,460	10,895,134	7.03%
Small C&I	10,959	10,197,153	10,036,113	10,934,066	897,953	8.95%
Large C&I	10,513	84,534,106	70,398,482	71,528,985	1,130,503	1.61%
Sm. Vol. Int.	389	17,126,938	10,307,647	10,446,301	138,654	1.35%
Lg. Vol. Int.	68	10,537,913	5,290,795	5,434,443	143,648	2.72%
Sm. Vol. Joint	8	392,300	241,948	245,720	3,772	1.56%
Transport	168	374,643,410	5,884,408	6,858,027	\$979,207	16.64%
<b>Total</b>	<b>214,691</b>	<b>662,833,677</b>	<b>257,186,463</b>	<b>271,374,002</b>	<b>14,187,539</b>	<b>5.52%</b>

Please note that the proposed rate increases for transportation service may appear relatively high compared to the increases for sales service on a percentage basis in the table above. The reason for this is that transportation revenue numbers do not include the cost of gas. This reduces the

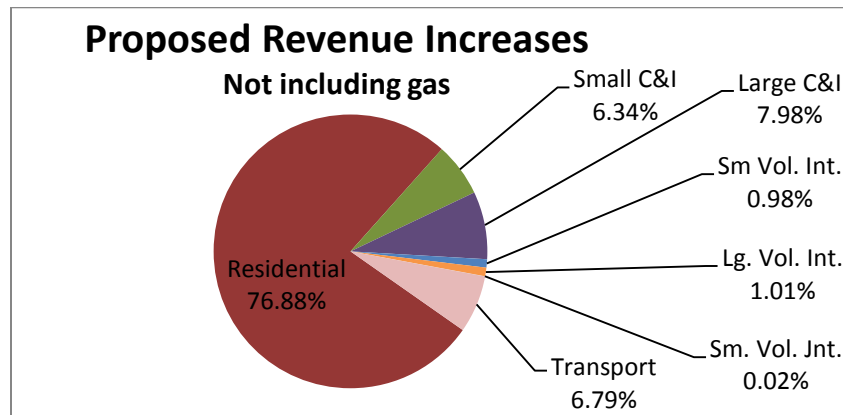
<sup>13</sup> All tables in this rate design section are based on numbers from MERC's initial filing, Harry W. John, Exhibit\_(HWJ-1) Schedule E-1 & E-2 and Gregory J. Walters Exhibit\_(GJW-1) Schedule 3.

size of the current revenue number for transportation service that is the basis for the percentage increase calculation.

The following table reflects the apportionment of each class if the cost of gas is excluded from the revenue numbers. This table is included in the briefing papers because changes in the cost of gas are collected through the purchased gas adjustment (PGA) mechanism, a rider used to recover changes in fuel costs automatically outside of a rate case.

MERC Customer Class	Total Revenue		Proposed Increase	
	Current	Proposed	(\$)	(%)
Residential	\$52,317,255	\$63,212,368	\$10,895,113	20.83%
Small C&I	\$3,795,889	\$4,693,828	\$897,940	23.66%
Large C&I	\$18,674,673	\$19,805,205	\$1,130,532	6.05%
Sm Vol. Int.	\$2,523,705	\$2,662,404	\$138,699	5.50%
Lg. Vol. Int.	\$518,793	\$662,470	\$143,678	27.69%
Sm. Vol. Jnt.	\$64,890	\$68,661	\$3,772	5.81%
Transport	\$5,884,408	\$6,863,615	\$979,207	16.64%
<b>TOTAL</b>	<b>\$83,779,612</b>	<b>\$97,968,553</b>	<b>\$14,188,941</b>	<b>16.94%</b>

If MERC’s proposal is approved in its entirety, residential customers would be responsible for about 77% of the proposed revenue increase resulting from the increased customer and distribution charges. In percentage terms, MERC’s proposed revenue increases, not including the cost of gas, are apportioned among the customer classes as follows:





## Basic Monthly Service Charges and Per Therm Delivery Charges

MERC proposed increases in the customer charges and delivery charges for all sales service customers. MERC also proposed increases in customer charges for transportation service customers.

Sales Service Customer Class (usage in therms)	Basic Charge (per month)			Delivery Charge (per therm)		
	Current	Proposed	Inc. (%)	Current	Proposed	Inc. (%)
Residential	\$8.50	\$11.00	29.41%	\$0.19754	\$0.22848	15.66%
Small C&I (<1500)	\$14.50	\$18.00	24.14%	\$0.18525	\$0.22817	23.17%
Large C&I (>=1500)	\$35.00	\$45.00	28.57%	\$0.16868	\$0.16713	-0.92%
Sm Vol. Int. (Peak Day <2000)	\$150.00	\$165.00	10.00%	\$0.10647	\$0.11048	3.77%
Lg. Vol. Int. (Peak Day >=2000)	\$175.00	\$185.00	5.71%	\$0.03568	\$0.04854	36.04%

MERC Transportation Customer Class	Total Fixed Charge (Per Month) <sup>14</sup>		
	Current	Proposed	Increase (%)
Small volume	\$220	\$275	25.00%
Large volume	\$245	\$295	20.41%
Super large volume	\$370	\$460	24.32%

MERC has several customer classes split among small, large, super large volume, resale and flex customers. Each class has a unique delivery charge, and MERC proposed increases in the delivery charges for small and large volume transportation customers, but did not propose a

<sup>14</sup> “The proposed ... customer charge for customers receiving transportation service are the same as for the comparable sales service, except there is an additional monthly charge to cover the added administrative costs of providing transportation service. ... The current administrative charge is \$70.00 per metered account for all transportation customers. MERC proposes to increase the administrative charge to \$110.00.” [Walters, direct, pp. 23-24]

delivery charge increase for SLV, resale and FLEX transportation customers because of these customers' ability to by-pass MERC's system.

<b>MERC Transportation Customer Class</b>	<b>Proposed Increase in delivery charge (%)</b>
Small volume interruptible and joint	3.77%
Large volume interruptible and Joint - CIP applicable	36.04%
Large volume interruptible - CIP Exempt	19.37%
Super large volume, resale and flex	0.00%

If MERC's proposal is approved in its entirety, MERC would be authorized to increase the amount of revenue it collects using customer charges by approximately \$7.7 million per year and the overall amount of revenue it collects from distribution charges by approximately \$6.5 million per year as shown in the table below.

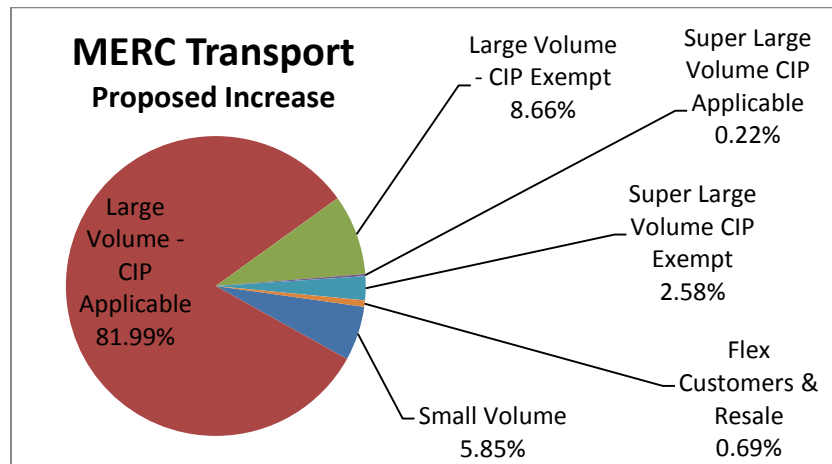
<b>MERC Customer class</b>	<b># of Customers</b>	<b>Total Annual Fixed Charge Revenue</b>		<b>Proposed Increase</b>	
		<b>Current</b>	<b>Proposed</b>	<b>(\$)</b>	<b>(%)</b>
Residential	192,586	\$19,643,772	\$25,421,352	\$5,777,580	29.41%
Small C&I	10,959	\$1,906,866	\$2,367,144	\$460,278	24.14%
Large C&I	10,513	\$4,415,460	\$5,677,020	\$1,261,560	28.57%
Sm Vol. Int.	389	\$700,200	\$770,220	\$70,020	10.00%
Lg. Vol. Int.	68	\$142,800	\$150,960	\$8,160	5.71%
Sm. Vol. Jnt.	8	\$23,122	\$25,320	\$2,198	9.51%
Transport	168	\$969,284	\$1,102,303	\$133,019	13.72%
<b>TOTAL</b>	<b>214,691</b>	<b>27,801,503</b>	<b>35,514,319</b>	<b>\$7,712,816</b>	<b>28.26%</b>

<b>MERC Customer class</b>	<b>Sales Therms</b>	<b>Total Annual Delivery Charge Revenue</b>		<b>Proposed Increase</b>	
		<b>Current</b>	<b>Proposed</b>	<b>(\$)</b>	<b>(%)</b>
Residential	165,401,857	\$32,673,483	\$37,791,016	\$5,117,533	15.66%
Small C&I	10,197,153	\$1,889,023	\$2,326,684	\$437,662	23.17%
Large C&I	84,534,106	\$14,259,213	\$14,128,185	-\$131,028	-0.92%
Sm Vol. Int.	17,126,938	\$1,823,505	\$1,892,184	\$68,679	3.77%
Lg. Vol. Int.	10,537,913	\$375,993	\$511,510	\$135,518	36.04%
Sm. Vol. Jnt.	392,300	\$41,768	\$43,341	\$1,573	3.77%
Transport	374,643,410	\$4,915,124	\$5,761,312	\$846,188	17.22%
<b>TOTAL</b>	<b>662,833,677</b>	<b>55,978,109</b>	<b>62,454,234</b>	<b>\$6,476,125</b>	<b>11.57%</b>

The following table describes how MERC’s total revenues from customer charges and delivery charges (not including the cost of gas) are apportioned among all transportation customers.

MERC Transport Customer Class/Type (usage in therms)	Total Revenue		Proposed Increase	
	Current	Proposed	(\$)	(%)
Small Volume	\$807,203	\$867,128	\$59,925	7.42%
Large Volume - CIP Applicable	\$2,407,822	\$3,206,623	\$798,802	33.18%
Large Volume - CIP Exempt	\$429,999	\$513,340	\$83,341	19.38%
Super Large Volume CIP Applicable	\$82,986	\$85,146	\$2,160	2.60%
Super Large Volume CIP Exempt	\$1,552,006	\$1,576,846	\$24,840	1.60%
Flex Customers & Resale	\$604,392	\$614,532	\$10,140	1.68%
<b>Total</b>	<b>\$5,884,408</b>	<b>\$6,863,615</b>	<b>\$979,207</b>	<b>16.64%</b>

Large volume – CIP applicable customers would be responsible for 82% of the total proposed revenue increases for transportation service customers, not including the cost of gas. In percentage terms, MERC’s proposed revenue increases for transportation services, not including the cost of gas, are apportioned among the transportation customer classes accordingly.



### Revenue Decoupling

MERC is not requesting any changes to the methodology of its pilot decoupling mechanism that was approved by the Commission in MERC’s last rate case. MERC is requesting that the sales and fixed charge accounts used in the decoupling calculation are updated to reflect what is ultimately approved in this rate case.

## Staff Analysis

### Should this filing be accepted, and if so, as of what date?

#### Completeness

##### Compliance with rules and statutes

Staff reviewed this filing for compliance under Minn. Stat. § 216B.16 and Minn. Rules 7825.3100 through 7825.4400. Staff agrees with the Department of Commerce, Division of Energy Resources (the Department) analysis and believes MERC's filing substantially complies with these requirements.

##### Compliance with and issues from prior Commission orders/recent & pending dockets before the Commission

Staff believes the Company has made a good faith effort to comply and respond to the orders issued in MERC's last rate case as well as other orders that have a bearing on this case. The Company provided a 26-page filing requirements Compliance Table which is located in Volume I of the filing.

#### Date of Acceptance

Staff agrees with MERC and the Department and believes MERC's filing was substantially complete as of September 30, 2013, the date MERC submitted its application.

### If this filing is accepted, should the proposed rates be suspended, pursuant to Minn. Stat. § 216B.16, Subd. 2?

The Commission generally suspends proposed final rates during a rate case while the Company's application is investigated. The statute provides for interim rates during the suspension period. These interim rates are subject to refund if they are higher than approved final rates.

The statutory deadline for the Commission to issue its final order in this matter is ten months from the date this filing was found to be substantially complete, pursuant to Minn. Stat. §216B.16, Subd. 2(a). If this case is accepted as of September 30, 2013, then the Commission's deadline for issuing an order would be July 30, 2014.

However, the Commission has the authority to set a deadline up to ninety days later, pursuant to Minn. Stat. §216B.16, Subd. 2(f):

If the commission finds that it has insufficient time during the suspension period to make a final determination of a case involving changes in general rates because of the need to make a final determination of any pending case involving changes in general rates under this section or section 237.075, the commission may extend the suspension period to allow up to a total of 90 additional calendar days to make

the final determination. An extension of the suspension period under this paragraph does not alter the setting of interim rates under subdivision 3.

One major rate case was recently decided by the Commission, and is in the compliance stage: Xcel Electric, Docket No. E-002/GR-12-961. Another general rate case (filed approximately two months before this one) is pending at the Office of Administrative Hearings (OAH): CenterPoint Energy (CenterPoint), Docket No. G-008/GR-13-316. The Commission did not extend the suspension period in either of those two rate cases, however, at the Administrative Law Judge's (ALJ's) prehearing and scheduling conference, CenterPoint agreed to a seven day extension of the deadline to allow the ALJ an additional week to prepare her report and recommendation to the Commission. Under this schedule, the Commission will have only sixty days (approximately) from the time it receives the ALJ's Report and when it needs to issue an order on the merits of CenterPoint's request for a rate increase.

Besides the pending CenterPoint rate case, Xcel Electric (Xcel) has filed another electric rate case, on November 4, 2013, in Docket E-002/GR-13-868. Xcel asked for a multiyear rate plan in that filing which allows the Commission an additional ninety days to process Xcel's request (until December 1, 2014) pursuant to Minn. Stat. § 216B.16, Subd. 19(c). In addition, the Commission may extend the deadline in the Xcel rate case an additional ninety days beyond December 1, 2014, pursuant to Minn. Stat. § 216B.16, Subd. 2(f).

Absent an extension of time in the MERC rate case, there will be less than two months between the statutory deadline in the MERC rate case and the CenterPoint rate case. Staff does not believe that schedule would allow a sufficient amount of time between the two cases for the Commission to make a final determination in the MERC rate case within the normal ten month suspension period.

This scheduling difficulty is exacerbated in MERC's case by the need to make initial decisions in the Xcel electric rate case immediately after the initial decision in the MERC case. Final decisions in the CenterPoint rate case may need to be made at approximately the same time as the MERC evidentiary hearings. Staff believes extra time in the MERC rate case would allow for more flexible scheduling and more time for the Commission to make its decision.

The Department, OAG, and other parties who wish to participate in the CenterPoint, MERC and Xcel electric rate cases could also be disadvantaged, and the records in these cases may not be developed adequately by the parties, if the Commission does not extend the suspension period. The Department and other interveners will need, in a relatively short period of time, to prepare testimony and participate in evidentiary hearings in the CenterPoint, MERC and Xcel rate cases, as well as prepare briefs, participate in oral argument, work on reconsideration, while also carrying out discovery and investigation in this and the other rate cases.

As has been the Commission's practice over the last several years, Commission and Department staff have discussed rate case scheduling and have attempted to develop schedules that allow all of these cases (as well as others) to be workable from both intervener and Commission perspectives. Staff is making a recommendation below on extending the suspension period

based on staff's understanding of what is workable (and a corresponding recommendation in the next section on the date for the ALJ report).

Staff recommends that the Commission find that it will have insufficient time under the standard ten-month time frame to make a determination on final rates in the instant MERC rate case because of the need to make final determinations in the pending CenterPoint and recently filed Xcel electric rate cases. While the Commission did not extend the deadline in the CenterPoint case, staff recommends the Commission extend the suspension period in the MERC rate case by the full 90 days allowed by the statute. Assuming the Commission accepts the MERC rate case as complete as of September 30, 2013, staff believes the Commission should suspend the proposed rates until October 28, 2014.

### **If this filing is accepted, should this matter be referred to the Office of Administrative Hearings for a contested case?**

The Department recommended the Commission refer this matter to OAH for a contested case proceeding. The Commission is required to refer a rate case to OAH for a contested case proceeding unless the Commission finds that all significant issues can be resolved to its satisfaction, pursuant to Minn. Stat. § 216B.16, Subd. 2(b). Staff does not believe the Commission can make such a finding absent a fully developed record and recommends setting this matter for a contested case hearing.

If the Commission suspends the final rates for additional time, i.e. until October 28, 2014, then staff recommends the Commission request the ALJ's report by August 12, 2014. This report date would give the Commission more time (i.e. two-and-a-half months) than the customary two months prior to the statutory deadline. Staff believes this is reasonable given the longer suspension period and the number of other pending rate cases.

If the Commission does not suspend final rates for the additional ninety day time period and the deadline for the Commission's order in this case is July 30, 2014, then to ensure the Commission has sufficient time to consider this matter and issue its order within the ten month statutory deadline, staff recommends the Commission request the ALJ's report be received by May 30, 2014. This is consistent with the Commission's practice of asking for the ALJ report approximately two months prior to the Commission's statutory deadline for issuing its order.

### **Identification of issues of special interest or requiring additional, supplemental testimony**

In its September 30, 2013 filing, MERC provided a "Filing Requirement Compliance Table"<sup>15</sup> which includes a list of information required under a number of Commission orders and identifies where in MERC's pre-filed testimony these issues are addressed. The Commission may want to include a general request that parties thoroughly review issues identified in the Commission's past orders. If the Commission wants to give special emphasis to any of these particular requirements, it could do so at this time.

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<sup>15</sup> MERC's September 30, 2013 filing, Vol. 1 at Compliance Table tab. MERC correction, clarification letter received on October 8, 2013.

The Commission may also want to include in its Notice And Order For Hearing, a request that parties thoroughly address and develop (in addition to the standard rate case issues) a complete record (e.g. in testimony, at hearing, and if applicable, in settlement documents) on the issues noted below, and any other issues the Commission may identify.

*CCRC and CCRA amounts associated with Northshore Mining billing error*

In its last rate case (10-977), the Company discovered that three customers were incorrectly not billed applicable CIP charges. These customers were not billed the CCRC or the Conservation Cost Recovery Adjustment (CCRA) charges from the inception of the Company's ownership, July 2006. In its July 13, 2012 Order, the Commission required the Company to fund the CIP account for the unbilled CCRC and CCRA revenues from July 1, 2006 to the date of customers' CIP exemption; approximately \$1 million was credited to the Company's CIP account. The funding reinstated the CIP account to its proper level as if the customer had been properly billed. As a result of this docket and the Vertex Billing Audit, it was staff's understanding that no other customers were incorrectly billed, i.e. not charged for CIP.

In the Company's Direct Testimony,<sup>16</sup> it indicated that it discovered another customer, Northshore Mining (Northshore),<sup>17</sup> that was not properly billed CIP charges since the inception of its ownership, July 1, 2006. Northshore is a Super Large Volume transportation customer whose gas is directly supplied by Northern Natural Gas's pipeline. Northshore is considered a by-pass threat. Upon discovery of this error by the Company, it notified Northshore and Northshore has petitioned for a CIP exemption with the Commissioner of the Department of Commerce. If the CIP exempt petition is granted, the CIP exemption would be effective January 1, 2014. The Company's direct testimony does discuss this billing error, but it does not include any applicable volumes, rates, or CCRC and CCRA amounts associated with the error. Staff recommends that the Commission require the Company to file supplemental direct testimony reflecting the calculation of the applicable CCRC and CCRA charges since the inception of the Company's ownership, July 2006.

*Adequacy of the Vertex billing audit*

The parties to this docket may want to look at whether the Vertex billing audit from the last rate case accomplished what it was supposed to accomplish, and if not, then parties may want to identify the specific problems and propose a remedy (in testimony) in this case.

*Verification of test-year CIP expenses*

Additionally, the Company has included the \$8.920 million CIP expense reflected in SSD-24 in the amortization line stated in Vol. III, Informational Requirement Document 5, Schedule C-8. However, it is unclear from the record at this point whether the Company's proposed test year operating expenses include any other CIP related expenses. Staff recommends that, in order to have a clear record for the total amount of CIP expenses included in the proposed test year, the

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<sup>16</sup> See Seth DeMerritt Direct Testimony, p. 44.

<sup>17</sup> Id.

Commission request additional information regarding the Company's tracking and handling of CIP expenses in the development of the test year operating expenses.

Staff also suggests the Commission request that parties specifically and thoroughly address the following issues in the course of the contested case proceedings:

*Record update if a sales forecast change or commodity pricing forecast update would potentially have an impact on the commodity or demand base cost of gas rates*

The per dekatherm demand and commodity rates proposed in MERC's companion base cost of gas filing, Docket No. G-011/MR-13-732, are based on the sales forecast used by MERC in its general rate case and pricing forecasts issued in May 2013. In the event the sales forecast changes, or the pricing forecasts are updated, the per dekatherm demand and/or commodity rates may also change. As such, any sales forecast change or updated pricing forecasts may make it necessary to adjust the purchased gas rates reflected in the base cost of gas petition and the rate case revenue schedules. Staff recommends that the Commission request that MERC make the necessary adjustment to the per unit demand and commodity cost of gas rates if the sales forecast and/or pricing forecasts change. MERC stated in its Base Cost of Gas Filing that it would agree to update the base cost data if the Commission finds it to be necessary due to a significant change in NYMEX pricing, or for changes in the forecasted sales data. This will eliminate the need to revise the operating income statement after the Commission's Order in the rate case. Staff included decision alternatives in the base cost of gas briefing papers and in MERC rate case briefing papers for Commission consideration.

*Late payment and other revenues*

MERC's Informational Requirements Document 5, Schedule C-4 shows a decrease in projected test year Other Revenues, but this Schedule is not cross referenced to any supporting testimony. Staff recommends that the Commission request the parties to address the Company's test year forecast for Late Payment and Other Revenues.

*Regulatory assets and liabilities*

MERC's Informational Requirements Document 2, Schedule B-6 shows a significant increase in proposed test year Regulatory Assets and Liabilities, but the projected increase is not cross referenced to any supporting testimony. Staff recommends that the Commission request the parties to address and fully develop the record with regard to the Company's proposed test year Regulatory Assets and Liabilities.

*Joint rate service*

MERC offers a "joint rate" service to all of its larger interruptible sales and transportation customers. This service is available for small-volume (SV), large-volume (LV) and super-large-volume (SLV) customers. According to the information in MERC's filing, there are small-volume joint rate sales customers and large-volume and super-large-volume joint rate transportation customers.

The term "joint rate" appears to mean that customers taking this service pay interruptible rates and have the option of switching part or all of their requirements from interruptible to firm service for a year, starting on November 1, if the customers provide MERC with ninety days



advance notice and if MERC is able to provide the service. This is consistent with the switching between interruptible terms and conditions of service for all interruptible customers.

The main difference between joint and interruptible service from a rate standpoint is the Daily Firm Capacity (DFC) charge. In this case MERC proposes to increase the Daily Firm Capacity (DFC) charge. For example, MERC's schedules indicate a proposed increase in the Daily Firm Capacity charge from \$0.23 to \$0.25 per therm of demand.<sup>18</sup> However, this rate does not appear in any of the joint rate tariffs. The joint rate sales tariffs do, however, include a daily firm capacity charge (in \$/MDQ) that is different from the per therm DFC charge. For example, the rate per therm of DFC indicated in the proposed tariff for the small volume joint interruptible sales-NNG customers appears to go up from \$1.965620 to \$2.00712 per MDQ.<sup>19</sup> The rate per therm of DCF in the proposed tariff for the small volume joint interruptible sales-Consolidated customers appears to go up from \$0.56880 to \$0.59037 per MDQ.<sup>20</sup> MDQ refers to Maximum Daily Quantity which is the customers highest (or historical peak) monthly usage divided by twenty.<sup>21</sup>

It is not clear from MERC's joint rate tariffs how MERC provides joint (firm and interruptible) sales and transportation service. For that matter, it is not clear how MERC charges its customers for joint rate service and how much of the Daily Firm Capacity charge applies to margin revenue and how much for the cost of gas and how much of the cost of gas, if any, is credited back to firm and or system customers.

Staff recommends the Commission ask MERC for an explanation of how it administers joint rate service and the joint rates in its tariff. Staff believes this explanation should include examples of different billing scenarios that demonstrate how the joint rates are administered for sales and transportation joint rate customers compared to interruptible sales and transportation customers. These examples should include an explanation of how joint rate customers are charged for the interruptible and firm parts of the service they are taking and any credit MERC may provide to firm (or system) sales customers for the joint rate sales customer's use of MERC's entitlement to upstream firm pipeline capacity. Staff also believes MERC should explain the methodology it employs for the design of these rates, how all elements of these rates are calculated, how these rates are applied to the joint rate tariffs and to customer bills, and the billing arrangements MERC employs for charging joint rate customers the rates that appear in the joint rate tariff.

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<sup>18</sup> Please see Walters, Exhibit GKW-1, schedule 2, p. 1 of 2, and schedule 3.

<sup>19</sup> MERC, proposed final tariff sheets, redlined, 54th Revised Sheet No. 5.10 - Rate Schedule SVI-NNG Small Volume Interruptible Service.

<sup>20</sup> MERC, proposed final tariff sheets, redlined, 54th Revised Sheet No. 5.14 - Rate Schedule SVI-Consolidated Small Volume Interruptible Service.

<sup>21</sup> MERC, proposed final tariff sheets, redlined, 2<sup>nd</sup> Revised Sheet No. 8.04 - Paragraph N. Maximum Daily Quantity (MDQ)

## **If this filing is accepted, should interim rates be set as requested by the Company?**

MERC proposed an interim revenue deficiency of approximately \$12.4 million or 4.82% based on the 9.70% ROE approved by the Commission in MERC's last rate case. However, the Company is asking to collect an interim rate increase of only \$12.1 million, or 4.70%.

### **Interim Rate Statute**

Minn. Stat. § 216B.16, Subd. 3, states in part that:

(a) Notwithstanding any order of suspension of a proposed increase in rates, the commission shall order an interim rate schedule into effect not later than 60 days after the initial filing date. The Commission shall order the interim rate schedule *ex parte* without a public hearing. ... [and]

(b) Unless the Commission finds that exigent circumstances exist, the interim rate schedule shall be calculated using the proposed test year cost of capital, rate base, and expenses, except that it shall include: (1) a rate of return on common equity for the utility equal to that authorized by the commission in the utility's most recent rate proceeding; (2) rate base or expense items the same in nature and kind as those allowed by a currently effective order of the commission in the utility's most recent rate proceeding; and (3) no change in the existing rate design. . . .

### **Effective Date for Interim Rates**

If the Commission accepts MERC's filing as substantially complete as of September 30, 2013, and suspends the proposed final rates, then the Commission must order interim rates into effect within 60 days, i.e. no later than November 29, 2013, pursuant to Minn. Stat. § 216B.16, Subd. 3(a).

However, MERC requested interim rates be made effective for service rendered on and after January 1, 2014. According to MERC:

Although more than sixty days after filing of the Application, MERC waives its right under the statute to have interim rates in effect not later than 60 days after the initial filing and requests an effective date of January 1, 2014 to correspond with the start of the test year.<sup>22</sup>

Staff believes the Commission should follow the interim rate statute and issue an order by November 29 that sets interim rates.

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<sup>22</sup> MERC, Notice of Petition for Interim Rates, p. 2

Staff also believes the Commission should grant the Company's request to defer putting interim rates into effect (until January 1) which the Commission did in MERC's last rate case but for a shorter period of time. In that case, the Commission extended the effective date from September 29, 2008 to October 1, 2008. In this case, customers of MERC would benefit by delayed implementation of interim rates as the customer would continue to pay currently approved rates, not the higher interim rates, for an additional month.

## Financial Matters

Minn. Stat. § 216B.16, Subd. 3(b) states, in part:

(b) Unless the commission finds that exigent circumstances exist, the interim rate schedule shall be calculated using the proposed test year cost of capital, rate base, and expenses, except that it shall include: (1) a rate of return on common equity for the utility equal to that authorized by the commission in the utility's most recent rate proceeding; (2) rate base or expense items the same in nature and kind as those allowed by a currently effective order of the commission in the utility's most recent rate proceeding; and....

MERC proposed an interim rate increase, subject to refund, of approximately \$12.402 million<sup>23</sup> based on the following revenue summary:

Rate Base	\$198,314,568
Rate of Return	7.4809%
Required Operating Income	\$14,835,769
Net Operating Income	\$7,557,893
Income Deficiency	\$7,277,876
Revenue Conversion Factor	1.704
Revenue Deficiency	\$12,401,502

The interim rate revenue deficiency is a \$1.786 million decrease from MERC's \$14.188 million general rate case increase request. This difference is attributable to two factors: a decrease of \$1.785 million due to the return on equity variance resulting from MERC's use, as required, of a 9.70% interim rate of return on equity instead of the requested 10.75%, and a decrease of \$0.001 million in Administrative & General expenses. The decrease in Administrative & General expenses is due to the removal of corporate aircraft expenses for interim rates. Corporate aircraft expenses were disallowed in the last rate case.

According to the Company, MERC only included items for interim rates that were approved in MERC's last rate case for rate base and expenses.<sup>24</sup> MERC stated that it is not seeking recovery

<sup>23</sup> As discussed elsewhere in these briefing papers, MERC in proposing to collect less than the full amount of the interim rate increase from its Super Large Volume customers, as well as its Flex rate customers.

<sup>24</sup> DeMerritt Direct at page 45.

of the following in final rates in this rate case, and thus no adjustments are necessary for interim rates for these items:

Advertising expenses associated with goodwill and economic development, 50% of economic development costs, LTIP [Long Term Incentive Pay], Restricted Stock, Stock Options, 70% of Executive Incentive, Executive Deferred Comp ESOP, or Supplement Executive Retirement Plan, except the non—qualified pension plan costs authorized by the Commission in Docket No. G007,011/ M-06-1287 and allowed in MERC's last rate case.<sup>25</sup>

MERC also stated that:

- There are no acquisition or transaction costs associated with Aquila in the proposed test year;<sup>26</sup>
- MERC has not included any research activity expenses in the test year;<sup>27</sup>
- MERC removed the costs associated with the Vertex billing audit from the test year;<sup>28</sup>
- Balances associated with the Gas Affordability Program were removed from rate base in this case;<sup>29</sup>
- MERC has excluded all organization membership dues from the proposed test year;<sup>30</sup>
- MERC decreased O&M Expenses for the difference between its general allocation methodology and the general allocation methodology allowed in the last rate case;<sup>31</sup>
- MERC did not have any expenses related to gifts;<sup>32</sup> and
- MERC incurs labor costs for employees who engage in lobbying activity, but it did not have any external expenses related to lobbying activities.<sup>33</sup>

Staff reviewed the interim rate request attempting to determine whether the request is generally consistent with statutes, prior Commission policy statements, and prior Commission Orders affecting MERC. Staff did not attempt to determine the appropriateness of any issue for final rates. Questions of that nature are best reserved for review within the course of the proceeding for final rates.

## Operating Expenses

Staff questioned whether some expenses included in the proposed test year were of the same nature and kind as expenses included in MERC's last rate case. Specifically, staff questioned:

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<sup>25</sup> DeMerritt Direct at page 46.

<sup>26</sup> DeMerritt Direct at page 25.

<sup>27</sup> Ibid.

<sup>28</sup> DeMerritt Direct at page 24.

<sup>29</sup> DeMerritt Direct at page 32.

<sup>30</sup> DeMerritt Direct at page 22.

<sup>31</sup> Ibid.

<sup>32</sup> DeMerritt Direct at page 49.

<sup>33</sup> Ibid.

### *Lobbying Expenses*

Lobbying expenses were disallowed in MERC's last rate case. As noted above, MERC's testimony in this rate case stated that "MERC incurs labor costs for employees who engage in lobbying activity, but it did not have any external expenses related to lobbying activities." Therefore staff requested that MERC identify all lobbying expenses, including labor related lobbying costs, included in the proposed test year. MERC responded that lobbying expenses are in FERC account 426430—Other Expend for Civic, etc. and that this account was not included in the rate case calculation of the revenue requirement for either interim rates or final rates.

### *Other Interest*

MERC's proposed test year Operating Statement has a line item expense, Other Interest \$935, which did not appear in MERC's last rate case. Staff requested that MERC identify where expenses of this nature were allowed in MERC's last rate case or explain why this expense need not be removed for the purpose of calculating the interim rate revenue deficiency. MERC responded that the "Other Interest" amount is related to an election option within the Deferred Compensation Plan, and that deferred compensation was included in MERC's last rate case within FERC Account 926050. Therefore, MERC stated that this component should be included for the purposes of calculating the interim rate revenue deficiency.

### *Gifts and Membership Dues*

MERC represented in its last rate case that no expenses related to gifts and membership dues were included. Therefore, staff questioned the inclusion of the following two items for interim rate purposes:

- Account 926070 Christmas Gift Ck Exp-Retirees & LTD \$4,240<sup>34</sup>
- Account 930200 A&G Assoc & Club Dues & Exp \$6,962<sup>35</sup>

MERC responded that account 926070 represents an employee benefit expense. The cost relates to the expense of providing gift cards to retirees and those employees on long term disability each year during the Christmas holiday. MERC also stated that these costs were included in final rate recovery in Docket No. G007,011/GR-10-977.

With respect to account 930200 A&G Assoc & Club Dues & Exp., MERC replied that this account relates to an employee benefit expense from gains and losses on deferred compensation expense charged from Integrys Business Support. Upon researching this item, MERC determined that this expense is not being charged to the correct FERC account, as it is not related to any association or club dues type activity.

With the possible exception of the "Christmas Gift Ck Exp" of \$4,240, it appears to staff that the expenses included in the interim rate calculation are of the same nature and kind as those allowed by the Commission in MERC's last rate case. While it appears that MERC may have included Christmas Gift Ck Expenses in its last rate case, it also appears that the Commission may have

<sup>34</sup> \$4,242 shown in MERC's Vol. III, Informational Requirement Document 5, Schedule C-6, less Michigan allocation of \$2.

<sup>35</sup> \$6,965 shown in MERC's Vol. III, Informational Requirement Document 5, Schedule C-6, less Michigan allocation of \$3.

relied on and approved MERC's position that its expense level did not include Gift expenses.<sup>36</sup> If the Commission wishes to exclude this item from the interim rate calculation, it would reduce the interim revenue deficiency by approximately \$4,240.

## Rate Base

With respect to rate base, MERC's Information Document 2, Schedule B-6 appears to include numerous items in the rate base line item Regulatory Assets and Liabilities that are of a different nature than those included in the Company's last rate case. For example, the Company has included a regulatory asset for FAS 158<sup>37</sup> of \$16,587,916<sup>38</sup> and one for unamortized Rate Case expenses in the amount of \$1,315,335. These types of assets were not included in the last rate case. MERC also included some other assets, including one (Deferred Debit-LT A/R Arrearage) which was specifically excluded from rate base in MERC's last rate case, and a number of what appear to be various accrued expense liabilities, which also were not included in the last rate case. See Attachment A for a comparison of the Regulatory Assets and Liabilities included in the last rate case to those proposed to be included in the current case.

Staff requested that MERC identify all of the regulatory assets and liabilities included in the proposed test year that are of a different kind than those included in the rate base approved in MERC's last rate case, Docket No. G007,011/GR-10-977. The Company responded that the Post Retirement Life Asset \$19,777, the Reg Asset FAS 158 for \$16,587,916, and all of the other liabilities included in various accounts beginning with numbers 228 and 242 and totaling \$5,038,741, were all related to the ratepayer supplied funding adjustment that was approved in MERC's 2011 rate case. However, the Company did not show where any of these kinds of assets or liabilities were included in rate base in MERC's last rate case. The ratepayer supplied funding adjustment in MERC's last rate case was accomplished by a credit to working capital, not an inclusion of additional regulatory assets. MERC also responded that unamortized rate case expenses were not included in MERC's last rate case, and that the Deferred Debit-LT A/R Arrearage asset was specifically excluded from rate base in MERC's last rate case and should be excluded from rate base in this case for purposes of setting interim and final rates.

Simply because a cost is a regulatory asset or liability does not make it the same nature and kind as another regulatory asset or liability. The underlying causes of regulatory assets and liabilities can be different, thus creating regulatory assets and liabilities of different kinds.

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<sup>36</sup> Docket No. G007,011/GR-10-977, DeMerritt Direct at page 57 and May 17, 2012 Deliberation Outline for May 22 and May 24, 2012 Agenda Meetings, Deliberation Alternative 57.

<sup>37</sup> Staff note: FAS 158 requires in part that an employer who sponsors one or more single-employer defined benefit plans to recognize the funded status of a benefit plan in its statement of financial position.

<sup>38</sup> Staff notes that the numbers for individual Regulatory Assets and Liabilities are for total Company, Minnesota and Michigan, and the Minnesota and Michigan allocation was calculated based on the total.

The only Regulatory assets and liabilities included in the proposed test year that appear to be of the same type as those included in the last approved rate case are the following:

	#10-977 <u>2011</u>	#13-617 <u>2014 Proposed</u>
Purch Acctg Effect Benefits	\$8,934,972	\$7,147,977
Cloquet Plant Amortization	35,413	17,705
Labor Loader	6,608	2,304
Deferred Taxes	(40,474)	(39,556)
2010 Health Care Leg/Medicare Part D Subsidy	(88,749)	(103,444)
Derivatives	( 8,970)	<u>(244,050)</u>
Total (Minnesota & Michigan)		\$6,780,936
Estimated Minnesota allocation of above (See Attachment A)		\$6,767,428

The balance of approximately \$12,875,378<sup>39</sup> of the regulatory or other assets and liabilities included in the proposed test year appear to be of a type not included in the approved revenue requirement in the last rate case. See Attachment A.

If the Commission finds that \$12,875,378 of the regulatory or other assets and liabilities included in the proposed test year are of a different kind than those included in current rates, they should be removed from the calculation of the interim revenue deficiency. The revenue deficiency for interim rates would be reduced by approximately \$1,641,289,<sup>40</sup> from \$12.402 million to \$10.760 million.

Staff notes that, at a minimum, the Deferred Debit-LT A/R Arrearage asset should be removed from rate base for interim rates since this asset was specifically excluded in the last rate case. The total Company amount of this asset is \$17,066. Staff estimates the Minnesota allocation included in rate base to be approximately \$17,012. The removal of this item only from interim rates would reduce the revenue deficiency by approximately \$2,169.

<sup>39</sup> MERC's filing Vol. III, Informational Requirement 2, Schedule B-1 Minnesota Proposed Test year allocation of Regulatory Assets & Liabilities \$19,642,806 minus the Minnesota allocation of Regulatory Assets and Liabilities of the same nature as included in the last rate case of \$6,767,428 equals \$12,875,378.

<sup>40</sup>  $(\$12,875,378) \times 7.4809275\% \times 1.704 = (\$1,641,289)$ .

## Cost of Capital

Minn. Stat. §216B.16, Subd. 3(b) reads:

Unless the commission finds that exigent circumstances exist, the interim rate schedule shall be calculated using the proposed test year cost of capital, rate base, and expenses, except that it shall include: (1) a rate of return on common equity for the utility equal to that authorized by the commission in the utility's most recent rate proceeding; ...

In its most recent rate case (G007,011/GR-10-977) Minnesota Energy Resources Corporation was authorized a rate of return of 7.83% based on the following:

Component	Percent of Total	Cost Rate	Weighted Cost
Long-Term Debt	44.68%	6.55%	2.93%
Short-Term Debt	4.93%	0.1833%	0.01%
Common Equity	50.48%	9.70%	4.89%
Total (ROR)			7.83%

The Company is proposing an interim cost of capital of 7.48% based on the following:

Component	Percent of Total	Cost Rate	Weighted Cost
Long-Term Debt	44.64%	5.5606%	2.4822%
Short-Term Debt	5.05%	2.3487%	0.1186%
Common Equity	50.31%	9.700%	4.88%
Total (ROR)			7.48%

The Company's proposed cost of capital for interim rates follows the statute requiring that rate schedules be calculated using the proposed test year cost of capital and with the exception that the rate of return on common equity to be used shall be that authorized by the Commission in the utility's most recent rate proceeding.



## Rate Design

MERC is requesting an interim rate adjustment that will increase MERC's test year revenues by approximately \$12.1 million, or 4.70% above present rates, including the cost of gas. MERC asks for an interim rate increase of 14.8% on all fixed and distribution charges, not including the cost of gas, for all sales service customers and small and large volume transportation customers. In addition, MERC is asking for the same 14.8% interim rate increase on all fixed and distribution charges, not including the cost of gas, for transportation for resale customer.<sup>41</sup> For super large volume and flex customers, MERC is asking for a 14.8% interim rate increase on the customer and administrative charge, which will have a small overall impact on these customer's bills. MERC requests to keep the distribution charge for super large volume and flex customers the same as their current rates.

	MERC Customer Class	Test Year Revenues (not including gas)		Proposed Interim Increase	
		Current	Proposed Interim	(\$)	(%)
Sales	Residential	\$52,317,255	\$60,060,209	\$7,742,954	14.80%
	Small C&I	\$3,795,889	\$4,357,680	\$561,792	14.80%
	Large C&I	\$18,674,673	\$21,438,525	\$2,763,852	14.80%
	Small Volume Interruptible	\$2,523,705	\$2,897,213	\$373,508	14.80%
	Large Volume Interruptible	\$518,793	\$595,574	\$76,781	14.80%
	Small Volume Joint	\$64,890	\$74,493	\$9,604	14.80%
Transport	Small Volume	\$807,203	\$926,669	\$119,466	14.80%
	Large Volume	\$2,837,821	\$3,257,818	\$419,997	14.80%
	Super Large Volume, Flex & Resale	\$2,239,384	\$2,262,430	\$23,045	1.03%
TOTAL		\$83,779,612	\$95,870,611	\$12,090,999	14.43%

(The above table was calculated based on numbers from MERC's initial filing, Harry W. John, Exhibit \_\_\_(HWJ-1) schedule E-1 and E-2.)

<sup>41</sup> The Transportation for resale rate applies only to the town of Ogilvie, Minnesota, where the distribution system is owned by Northwest Pipeline. Northwest transports its gas supplies through the existing MERC system to provide service to Ogilvie.

**Should the Commission find exigent circumstances and approve MERC's request to not collect the full amount of the interim rate increase from its Super Large Volume ("SLV") and flex customers?**

MERC

According to MERC:

...MERC proposes to collect less than the full amount of the interim rate increase from its Super Large Volume ("SLV") customers, as well as MERC's FLEX rate customers. The SLV customers are especially sensitive to rate increases, even during a period of interim rates, and have the ability to bypass MERC's system in favor of alternative natural gas service they may receive elsewhere, and the FLEX rate customers have contracted rates in place. The departure of the SLV customers from MERC's system would result in a significant permanent increase in rates for MERC's remaining customers. Therefore, MERC requests that the Commission find that exigent circumstances exist to alter the present rate design during the period of interim rates. The Commission has previously found exigent circumstances justifying a departure from existing rate design under similar circumstances. ...

...MERC proposes to recover some of the interim rates increase attributed to its SLV and FLEX rate customers in the MERC system rather than forgo the entire amount. In particular, MERC proposes to increase the customer charge for these customers by the same 14.74% requested as the interim rate increase request for MERC. This increase will have a small overall impact on these customers' bills and is not expected to create a bypass situation. MERC proposes to keep the distribution charge for the SLV and FLEX rate classes consistent with their current rates, which are also the rates MERC proposes in the final rate design. The Commission has previously authorized such increases where a utility sought a small increase in final rates for certain classes of customers. ...

However, while MERC proposes to collect less than the full amount of the interim rate increase from its SLV and FLEX rate customers it does not seek to recover the difference from its other customer classes.

SLGI

The Super Large Gas Interveners (SLGI) supported MERC's request to collect less than the full amount of the interim rate revenue deficiency from MERC's super large volume (SLV) industrial customers. SLGI believes the Commission's decisions in the Company's last two rate cases support a finding of exigent circumstances in this docket that would allow MERC to forgo collecting a portion of the interim rate revenue deficiency that it would otherwise be entitled to collect under the interim rate statute. SLGI argued that the exigent circumstances in this docket are that a large interim rate increase would lead MERC's SLV industrial customers to consider bypassing MERC's system.

## PUC Staff

The Commission's general practice on rate design for interim rates has been to require utilities to assess all classes of customers an equal percentage amount for the interim rate increase. The Commission's policy is based on statute and the assumption that the existing rate structure and rate design are equitable unless or until proven otherwise. Applying the interim rate increase to all customers equally does not attempt to prejudge any proposed change in revenue apportionment or rate design in a pending application.

The Commission has denied requests from utilities to exempt flexible rate customers from responsibility for interim rates and to shift responsibility for those interim revenues to the company's other customers. However, in its more recent decisions including MERC's last two rate cases, the Commission has generally left it to the utility to decide whether to try and collect an authorized interim rate increase from its flexible (market or negotiated) rate customers or to forego the revenue if the utility believes it will be bypassed if it tries to collect the interim rate increase from these customers. Because these are typically flexible rate customers, they are by definition subjecting the utility to competition, and the utility is authorized under the flexible rate statute to adjust the rates it charges these customers outside of a rate case. Typically, the minimum and maximum rates that these customers may be charged is set in a rate case and the flexible rate adjustments are tied to the cost of the customer's alternative source of fuel.<sup>42</sup>

Staff believes MERC's proposal is reasonable and generally consistent with the way the Commission set interim rates for these customers in MERC's last rate case. In that case, the Commission did find that exigent circumstances justified the Company's proposal to collect less than the full amount of the interim rate increase from its Super Large Volume customers. MERC did not seek recovery of the balance (or difference) between the increase to the distribution charge and the increase that would have been collected if MERC had assessed these customers the full amount of the interim increase.

Staff believes the circumstances of the super large volume and flex customers can be distinguished from MERC's residential and small business customers because of the SLV and flex customer's ability to subject MERC to effective competition, i.e. by threatening to bypass MERC.

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<sup>42</sup> Minn. Stat. § 216B.163. Flexible tariff.

**Is MERC's request to apply an equal percentage increase to all non-gas margin elements, i.e. the monthly customer charge, the distribution charge, and the demand charge (where applicable) consistent with the requirement in the interim rate statute that there be no changes made in the existing rate design?**

MERC stated that:

...no change has been made in the existing rate design, except as noted above. A uniform percentage equal to the proposed interim rate increase has been applied to the non-gas revenues (margins) currently being recovered from each customer class, other than the SLV and FLEX rate classes, as discussed above.

MERC's proposal is generally consistent with the way MERC implemented interim rates in MERC's last two rate cases. Staff believes this is consistent with the statutory requirement that there be no changes made in the existing rate design for interim rates. MERC's proposal would apply this increase equally to MERC's customers in proportion to the amount of revenue each customer class provides to MERC's operations regardless of whether they buy gas from MERC's system or transport their own gas supply and only use MERC's system for distribution (transportation) service.

MERC proposed to show the interim rate increase on customer bills as one single separate line item which will reflect the total amount of the interim charge applied to the bill. Staff believes this is consistent with the Commission's policy statement on interim rates, and will be the least confusing for MERC's customers.

**Interim tariff sheets**

Staff's review of MERC's filing of its interim tariff sheets found some discrepancies between the interim rate petition and tariff language in the interim tariff sheets. Staff recommends that MERC submit updated interim tariff sheets to accurately reflect what MERC has stated in its interim rates petition and testimony. These updates include the following:

1. An interim rate adjustment for the customer and administration charge for Super Large Volume Interruptible, and Flex transportation customers.
2. A per therm interim rate adjustment for daily firm capacity for all transportation customers receiving Joint service.

**Methods, procedures and interest rate for refunding**

Pursuant to Minn. Stat. §216B.16, Subd. 3, MERC's "Agreement and Undertaking" to make appropriate refunds if required is contained in Volume 1, Notice of Change in Rates.

As part of the Agreement and Undertaking, MERC makes an unqualified agreement concerning the refund of any portion of the requested increase in rates determined by the Commission to be unreasonable. The Company states:

MERC hereby agrees and undertakes to refund to its customers the amount, if any, collected during the interim rate period, plus interest at the current rate determined by the Commission, computed from the effective date of the interim rates through the date of refund. The refund shall be made in accordance with Minn. Stat. § 216B.16, Subd.(c) in a manner approved by the Commission.

In addition, MERC agrees to keep such records of sales and billings under the proposed interim rates as will be necessary to compute any potential refund.

Staff does not believe the Commission needs to address MERC's proposal to use the current rate of interest as determined by the Commission in this proceeding. In the event of an interim rate refund, all interested parties to this case will have had a chance to provide testimony or brief this issue.

### **MERC's Request Non-Public Salary Data**

Minn. Stat. § 216B.16, subd. 17<sup>43</sup> allows for the salary of one or more of the ten highest paid officers and employees, other than the five highest paid, to be treated as non-public information. MERC requests that the salaries of the sixth through the tenth highest paid employees be kept nonpublic for competitive reasons. Publicly disclosing this information could give competitors an advantage in terms of hiring and retaining key employees. Additionally, MERC believes it would be inappropriate to ignore each of the listed employees' rights to keep this information private. Individuals' rights to maintain the confidentiality of this kind of private information has increased in recent years, and therefore MERC believes this information should be protected to the greatest extent possible. Giving this information nonpublic status would not deprive the parties to this rate case information as this information will be available to the Commission and state agencies participating in the proceeding, and any other party could enter into a protective agreement to obtain the data if necessary. Giving this information nonpublic status would only keep the information private from non-interested parties. Requiring MERC to file this information as public data would make it publicly available on the internet, making it accessible to all persons, including those with absolutely no interest in these proceedings or MERC's rates.

In MERC's prior rate case, the ALJ made the following recommendation:

“MERC requested that the salaries of the sixth through tenth highest paid employees be kept nonpublic for competitive reasons related to the compensation of MERC's employees because publicly disclosing this information could give

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<sup>43</sup> Minn. Stat. § 216B.16, subd. 17[c] states: “Except as otherwise provided in this paragraph, data submitted to the commission under paragraph (a) are public data. The commission or an administrative law judge assigned to the case may treat the salary of one or more of the ten highest paid officers and employees, other than the five highest paid, as private data on individuals as defined in section 13.02, subdivision 12, or issue a protective order governing release of the salary, if the utility establishes that the competitive disadvantage to the utility that would result from release of the salary outweighs the public interest in access to the data. Access to the data by a government entity that is a party to the rate case must not be restricted.”

competitors an advantage in terms of hiring and retaining key employees and it would be inappropriate to ignore the employees' interest to keep this information private.

The salaries of the sixth through tenth highest paid employees should be treated as private data as individuals, as contemplated by Minn. Stat. §216B.16, subd. 17(c)".

The Commission followed the ALJ's recommendation in the last rate case. Staff believes it is appropriate to continue to treat this information as non-public data in this case.

## Public Hearing Locations

The date, time, and location of the public hearings is typically discussed and decided around the time of the pre-hearing conference by the Administrative Law Judge in consultation with the Company, parties, and the Commission. A formal Commission decision on this point is not needed for the purpose of issuing the Commission's orders at this time. However, in the interest of developing a schedule for this proceeding, staff's recommendation at this time would be for the ALJ to hold afternoon or evening hearings in Rochester, Rosemount and Cloquet, despite the low attendance at the hearings at these locations in previous rate cases. Some direction from the Commission on the appropriate number and location of public hearings to recommend to the ALJ would be welcome.

The following table summarizes the public hearing attendance in MERC's 2010 rate case.

Location, date & time	Member of the public in attendance	Member of the public who spoke
Rochester – June 23, 2011 (2:00 p.m.) Olmstead County Government Center	0	0
Rosemount – June 23, 2011 (7:00 p.m.) Dakota County Vo-Tech College	0	0
Cloquet – June 27, 2011 (7:00 p.m.) Cloquet City Hall	6	3
Totals	6	3

This next table summarizes public hearing attendance in MERC's 2008 rate case.

MERC 2008 Rate Case Public Hearing Locations	Date	Members of the public who	
		Attended	Spoke
Rochester	Jan. 8, 2009	5	5
Rosemount	Jan. 8, 2009	5	2
Cloquet	Jan. 12, 2009	1	1
Total		11	8

This next table summarizes public hearing attendance in the 2000 rate case.

MERC 2000 Rate Case Public Hearing Locations	Date	Members of the public who	
		Attended	Spoke
Rochester	Dec. 6, 2000	0	0
Cloquet	Dec. 7, 2000	3	2
Eagan	Dec. 12, 2000	1	1
St. Paul	Dec. 13, 2000	0	0
Video-conference: <sup>44</sup>			
Bemidji		0	0
Detroit Lakes		3	0
Grand Rapids	Dec. 13, 2000	2	1
International Falls		1	0
Thief River Falls		0	0
Worthington		3	1
Total		13	5

## Administrative and Compliance Issues

The Commission's practice in most rate cases has been to require: a) notice to municipalities and counties of the proposed rate change, b) public hearings at locations within the company's service area, and c) notice of evidentiary and public hearings.

The decision alternatives contain ordering language that is similar to the language used in notice and orders for hearing in previous general rate proceedings.<sup>45</sup> Staff recommends that this language be incorporated into the Commission's decisions in this docket. General rate case notice requirements can be found in Minn. Stat. § 216B.16, subd. 1, and Minn. Rules, Part 7829.2400, subparts 3 and 7.<sup>46</sup>

The Commission's practice has also been to require interim rate compliance filings. These filings typically include tariff sheets with supporting documents, and a Commission-approved notice to customers of the interim rate increase. Companies are also required to keep records of their sales and collections to support any potential interim rate refund obligation. The decision

<sup>44</sup> The public hearings by video-conference were conducted by the ALJ from a meeting room in St. Paul that was equipped for video-conferencing. The St. Paul site was linked to the six out-state sites, and the six hearings were held simultaneously. UtiliCorp representatives were in attendance at all of the remote sites. State agency representatives were in St. Paul.

<sup>45</sup> *Notice and Order for Hearing*, In the Matter of a Petition by Great Plains Natural Gas Company, a Division of MDU Resources Group, Inc., for Authority to Increase Natural Gas Rates in Minnesota, Docket No. G-004/GR-02-1682, November 19, 2002 (please see Ordering Paragraphs 3, 4 and 5)

<sup>46</sup> Staff also recommends the Commission require MERC to send a copy of the Commission's notice and order for hearing to all local governing bodies in its service area. This notification will ensure that these entities can make an appearance at the prehearing conference or make arrangements to intervene in this case if they are interested.. This notification is in addition to the notice required by Minn. Stat. § 216B.16, Subd. 1, and Minn. Rule 7829.2400, subp. 3, and is consistent with past Commission practice.

alternatives contain language typical of the language used in previous Commission Orders authorizing interim rates.

Staff recommends the Commission require all of the administrative and compliance related items listed in the decision alternatives. Customer notices are generally administrative items that are negotiated between Commission staff and the utility, and authority to approve notices is usually delegated to the Commission's Executive Secretary for the duration of the proceeding. Staff has been working with the Company to finalize these notices prior to issuance. Staff recommends continuing that practice here.

## Decision Alternatives

### 1. Acceptance

- a. Accept this filing as being in proper form and substantially complete as of September 30, 2013, or
- b. Reject this filing as not being in proper form and/or not being substantially complete.

If this filing is accepted as being in proper form and substantially complete as of a certain date, then the Commission should also decide the following:

### 2. Suspension of Proposed Final Rates

Suspend the proposed final rates until the Commission makes its final determination in this matter, and

- a. Find the Commission has insufficient time to make a final determination if the rates are suspended for a 10-month suspension period because of the need to make a final determination in other pending cases involving changes in general rates. Find that the rates in this case should be suspended for an additional ninety days, until October 28, 2014, or
- b. Do not make the finding in 2(a) above and allow this case to proceed on a ten-month timeline.

### 3. Referral of this Matter to the Office of Administrative Hearings for a Contested Case Proceeding

- a. Request the ALJ's report on or before August 12, 2014 if the Commission adopts alternative 2(a) above. If the deadline for the Commission's decision is extended beyond ten months plus ninety days at any point during this proceeding for any reason (e.g. settlement discussions, waiver, etc.) request the ALJ's report at least two-and-a-half- months before the extended deadline for the Commission's decision. or



- b. Request the ALJ's report within eight months of the date of the Commission's acceptance of this filing, i.e. on or before May 30, 2014, if the Commission adopts alternative 2(b) above. If the statutory deadline for the Commission's decision is extended beyond the normal ten months at any point during this proceeding for any reason (e.g. settlement discussions, waiver, etc.) request the ALJ's report at least two months before the extended deadline for the Commission's decision.
4. Issues for Supplemental Testimony or Exhibits
- a. Require the Company to file supplemental direct testimony within thirty days reflecting the calculation of the applicable CCRC and CCRA charges since the inception of its ownership, July 2006. Provide the applicable Northshore volumes, CCRC and CCRA rates, and the CCRC and CCRA amounts, by month for the stated period of time, July 2006 through December 31, 2013.
  - b. Require MERC to file supplemental direct testimony within thirty days on the adequacy of the Vertex billing audit with respect to finding CIP-related and other billing errors. Request parties to address the adequacy of the Vertex billing audit in finding these errors.
  - c. Require the Company to provide additional information regarding the Company's tracking and handling of CIP expenses in the development of the test year operating expenses.
  - d. Potential impact of updated sales forecasts and commodity pricing forecast updates on the demand and commodity cost of gas rates. Require MERC to provide updated sales forecasts and commodity pricing forecasts from its general rate case and information on the potential impact of these updates on its per dekatherm demand and/or commodity cost of gas rates. These updates should be filed in this docket and the related base cost of gas matter, in Docket No. G-011/MR-13-732.
  - e. Request parties to address MERC's test-year forecast for late payment and other revenues in their prefiled direct testimony.
  - f. Request parties to address and fully develop the record on MERC's proposed test-year regulatory assets and liabilities.
  - g. Require MERC to provide supplemental testimony within thirty days that explains how it administers joint rate service and the joint rates in its joint rate tariffs, as described in the staff briefing papers. Ask parties to address the reasonableness of MERC's joint rate service with respect to both gas and non-gas costs and rates, and whether MERC's joint rate tariff language needs to be clarified to better explain how MERC administers this service.

## 5. Effective Date of Interim Rates

If the proposed final rates are suspended, the Commission is required to set interim rates as of a certain effective date.

- a. Set interim rates to be effective for service rendered on and after November 29, 2013 (sixty days after MERC's September 30, 2013 filing date), and
- b. Grant MERC's request to waive its right under the statute to put interim rates into effect on November 29 and authorize MERC to implement interim rates for service rendered on and after January 1, 2014.

## 6. Interim Rates (Financial Matters)

- a. Approve an annual interim rate revenue deficiency of \$12.402 million, or 4.82 percent. or
- b. Approve an annual interim rate revenue deficiency of \$12.397 million,<sup>47</sup> or 4.82 percent. or
- c. Approve an annual interim rate revenue deficiency of \$10.760 million,<sup>48</sup> or 4.18 percent. or
- d. Approve an annual interim rate revenue deficiency of \$10.756 million,<sup>49</sup> or 4.18 percent. or
- e. Approve an annual interim rate revenue deficiency of some other amount.<sup>50</sup>  
and
- f. If the Commission makes any adjustments to the level of interim rates proposed by the Company, direct MERC to file revised financial schedules and calculations (interim rate base, income statement, cost of capital, and revenue summary) and class revenue schedules reflecting the Commission's modifications within 5 days of this meeting.

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<sup>47</sup> \$12,401,502 less \$4,240 (for Christmas Gift Check Expense-Retirees & LTD).

<sup>48</sup> \$12,401,502 less \$1,641,289 (for removal of \$12,875,378 from rate base for regulatory or other assets and liabilities that are included in the proposed test year that are of a different kind than those included in current rates).

<sup>49</sup> \$12,401,502 less \$1,641,289 (for removal of \$12,875,378 from rate base for regulatory or other assets and liabilities that are included in the proposed test year that are of a different kind than those included in current rates) and less \$4,240 (for Christmas Gift Check Expense-Retirees & LTD).

<sup>50</sup> For example, adjust the Company's proposed interim revenue deficiency to exclude just the Deferred Debit-LT A/R Arrearage asset, from approximately \$12.402 million to \$12.400 million.

## 7. Interim Rates (Capital Structure & Cost of Capital)

- a. Approve Minnesota Energy Resources Corporation's proposed interim cost of capital for setting interim rates, or
- b. Determine that exigent circumstances exist and adopt some other cost of capital structure and component costs for setting interim rates.

## 8. Interim Rates (Rate Design)

- a. Approve MERC's request to collect the interim rate increase as a uniform interim rate adjustment to the base rate portion of customer bills, i.e. the basic service charge, the delivery charge (excluding the conservation cost recovery adjustment (CCRA), the gas affordability program (GAP) adjustment, and the base cost of gas. And to display the interim rate increase on customer bills using a single, line-item interim rate adjustment; and
- b. Find exigent circumstances and approve MERC's request to assess but forgo collection of the interim rate increase from its super large volume and market rate service (flexible rate) rider customers, and to not seek recovery of the difference from its other customers; and
- c. Order MERC to update Interim Tariff sheets to accurately reflect Interim Rate Petition and testimony (as discussed in the briefing papers under interim rate tariff sheets).

## 9. Data Classification of Employee Salary

- a. Approve MERC's request to classify the salaries of the sixth through tenth highest paid employees as non-public, private data. or
- b. Deny MERC's request to classify the salaries of the sixth through tenth highest paid employees as private data.

## 10. Administrative & Compliance Issues

- a. In the Notice and Order for Hearing, require the following:
  - i. This Order will be served on the Company, which shall mail copies of the Order to all municipalities, counties, and local governing bodies in its Minnesota service area.
  - ii. Public Hearings shall be held in this matter at locations within the service area of the Company.

- iii. The Company shall give the following notices of the evidentiary and public hearings:
  1. Individual written notice to each customer, which may be in the form of a bill insert, and shall be served at least ten days before the first day of hearings.
  2. Written notice to the governing bodies of all municipalities, counties, and local governing bodies in the area affected and to all parties in the Company's last two rate cases. These notices shall be mailed at least ten days before the first day of hearings.
  3. Display advertisements in legal newspapers of affected counties and other newspapers of general circulation within the Company's Minnesota service area. These advertisements shall appear at least ten days before the first day of hearings. They shall include the heading **RATE INCREASE NOTICE**, which shall appear in bold face type no smaller than 30 points.
  4. The Company shall submit proposed notices for Commission approval prior to publication or service. And
- b. In the Order Setting Interim Rates require the following:
  - i. Order the Company to file with the Commission and the Department of Commerce-Division of Energy Resources interim rate tariff sheets and supporting documentation reflecting the decisions herein. The Company's filing should also include the notice to customers, approved by the Executive Secretary, regarding the rate change under the interim rate schedule.
  - ii. Order the Company to keep such records of sales and collections under interim rates as would be necessary to compute a potential refund. Any refund should be made within 120 days of the effective date of the Commission's final order in a manner approved by the Commission.
  - iii. Order the Company to include with each customer's first bill under the interim rate schedule a notice of the rate change, approved by the Executive Secretary. Upon completion of this task, the Company shall certify this fact to the Commission. And
  - iv. Require MERC to maintain records of CIP costs and collection through the interim period so that it can be ascertained that recoveries dedicated to CIP are properly recorded as CIP.

## 11. Approval of Notices and Customer Bill Inserts

- a. Delegate authority to approve notices, bill inserts, and bill format to the Commission's Executive Secretary for the duration of this proceeding, or
- b. Do not delegate authority to the Commission's Executive Secretary.

## Concluding Comment & Recommendation

If the Commission accepts this filing as substantially complete, the Commission should also suspend the proposed final rates, set this matter for contested case hearing, and request the ALJ's report and recommendation within a sufficient amount of time for the Commission to issue its order before the statutory deadline.

With respect to interim rates financial issues, staff recommends the Commission approve a revised interim increase amount of approximately \$10,760,213, or of approximately \$10,755,973, and that the base cost of gas in this docket be consistent with the base cost of gas decision in docket 13-732. With respect to the interim rate design issues, staff recommends the Commission approve MERC's proposal. Staff also recommends all of the administrative and compliance items listed under alternative 10(a and b) and recommends the Commission delegate to the Commission's Executive Secretary authority to approve notices and customer bill inserts for the duration of this proceeding.

Staff recommends alternatives 1(a), 2(a), 3(a), 4(a through g), 5(a and b), 6(c or d), 6(f), 7(a), 8(a, b and c), 9(a), 10(a and b), and 11(a).

The public hearing schedule does not require Commission action at this time but if the Commission would like to provide guidance on this, staff will relay that information to the Administrative Law Judge.

Attachment A		A	B	C	D
		13-617	10-977	2014	2014
		Proposed	Approved	Proposed	Proposed of
		2014	2011	of the same	a different
Regulatory Assets & Liabilities		Test Year	Test Year	Kind	kind
					= A - C
128515	Post Retirement Life Asset	19,777			19,777
182015	Reg Asset-Short Term	9,365,070			9,365,070
182312	Reg Asset-FAS 158	16,587,916			16,587,916
182314-15	Reg Asset-GAP Start up				
182351	Reg Asset -Purch Acctg Effect Benefits	7,147,977	8,934,972	7,147,977	
182375	ARO Depreciation Accrual		131,437		
182391	[Medicare Part D Subsidy]		(88,749) 2/		
182513	Rate Case unamortized expenses	1,315,335			1,315,335
182517	Reg Asset-ST Offset	(9,365,070)			(9,365,070)
182901	Cloquet Plant Amortization	17,705	35,413	17,705	
186028	Labor Accruals		1,477		
186390	Labor Loader	2,304	6,608	2,304	
186591	Deferred Debit-LT A/R Arrearage	1/ 17,066			17,066
228200	Injuries & Damages Reserve	(217,943)			(217,943)
228210	Workers Comp Claim Reserve	(6,054)			(6,054)
228300	Def Cr-Sup Ret Select SERP	(163,731)			(163,731)
228305	Supple Remp Ret Plan SERP	(19,719)			(19,719)
228310	Pension Restoration	(53,763)			(53,763)
228315	Post Ret Health Care admin	(2,590,545)			(2,590,545)
228320	Post Ret Health Care NonAdmin	(749,060)			(749,060)
228331	Accr Pens Liab-CHI Retire Plan	(1,214,798)			(1,214,798)
242070	Current Pension Obligation	(20,572)			(20,572)
242072	Current Pension Restoration	(2,556)			(2,556)
254009	Reg Liab-Cost to Fwd-External	(255)			(255)
254015	Reg Liab-Derivatives Long Term		(8,970)		
254391	Reg Liab-2010 Health Care Leg	(103,444)		(103,444) 2/	
254400	Reg Liab Deferred Taxes	(39,556)	(40,474)	(39,556)	
254450	Reg Liab-Derivatives	(244,050)		(244,050)	
	Total before Minnesota/Michigan Allocation	19,682,034	8,971,714	6,780,936	12,901,098
	Production Alloc	6.7235% 1,323,319		455,916	867,405
	Transmission Alloc	1.8296% 360,096		124,064	236,038
	Distribution Alloc	89.7762% 17,669,776		6,087,667	11,582,116
	Customer Alloc	1.6708% 328,846		113,296	215,552
	Minnesota Alloc			MN	
	Production	100.0000% 1,323,319		455,916	867,403
	Transmission	89.9121% 323,770		111,549	212,221
	Distribution	99.9836% 17,666,875		6,086,668	11,580,207
	Customer	99.9991% 328,843		113,295	215,548
	Total MN	19,642,806	minus	6,767,428 =	12,875,378
1/	This asset was specifically excluded in MERC's last rate case.				
2/	According to MERC, the 2010 Health Care Leg liability included in account 254391 in the proposed test year is like the Health Care Reform Legislation Medicare Part D Subsidy liability approved in the last rate case and included in account 182391.				