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March 22, 2012

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

Re: Minnesota Energy Resources Corporation's (MERC's) Demand Entitlement Petition for Approval of a Change in Demand Rates on its Northern Minnesota Utilities (NMU) Purchased Gas Adjustment (PGA)

Docket No. G011/M-11-1088

MERC Reply Comments

Dear Dr. Haar:

Enclosed please find the Reply Comments of Minnesota Energy Resources Corporation (MERC) in the above-referenced docket.

Please feel free to contact me at (612) 340-2881 if you have any questions.

Sincerely yours,

/s/ Michael J. Ahern

Michael J. Ahern

cc: Service List

STATE OF MINNESOTA
BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

David C. Boyd	Commissioner
J. Dennis O'Brien	Commissioner
Phyllis A. Reha	Commissioner
Betsy Wergin	Commissioner

In the Matter of the Petition of Minnesota Energy Resources Corporation for Approval of a Change in Demand Entitlement for its Northern Minnesota Utilities (NMU) Transmission System

Docket No. G007/M-11-1088

REPLY COMMENTS OF MINNESOTA ENERGY RESOURCES CORPORATION

Minnesota Energy Resources Corporation (MERC) submits to the Minnesota Public Utilities Commission (Commission) these Reply Comments in response to the March 12, 2012, Comments of the Department of Commerce, Division of Energy Resources Corporation (Department) in the above-referenced matter.

<u>Proposed Overall Demand Entitlement Level</u>

The Department seeks clarification and requests MERC to provide the following additional information regarding the NNG Zone GDD Option:

- Details on the call Option contract such as the volumetric rates, the reservation rates, which party is responsible for capacity to ensure supply on a peak day and whether those transportation costs are included in the rate and costs shown in the Petition.
- A comparable cost-benefit analysis to the LS Power contract assuming that no winter capacity may be available on NNG; and

- A detailed explanation on the reliability aspect of the Company's choice to enter into an options contract for peaking service in the winter period and whether this is a short-term or a long-term contract.

The Department also seeks clarification regarding Contract No. 112486 with TFX-5 service. Specifically, the Department seeks clarification whether MERC increased its capacity under this contract or if there was an error in the allocation between MERC-PNG and MERC-NMU.

Lastly in this regard, the Department requests additional information regarding MERC-NMU's acquisition of additional capacity in Viking FT-A contracts AF0014, AF0102, and AF0183, and the balancing agreement of 4,607 units under contract ML0021. The Department requests:

- Details on the balancing agreement contract ML0021 and explanations on why only the firm customers are paying for this service; and
- A comparable cost-benefit analysis on the Wadena Call Option assuming that winter capacity may be available on VGT.

MERC Response

The gas daily call option delivered to MERC's EF Zone that MERC entered into was a short term contract for a period starting December 1, 2011, through February 29, 2012. The purpose of the contract was to replace the LS Power contract, meet the theoretical peak day and address the positive reserve margins that have occurred in the previous demand entitlement filings. The reservation costs of the gas daily call option were reflected in the demand entitlement filing, which was allocated between PNG-NNG and NMU. The total reservation cost of the transaction was $34,125 (PNG-NNG $30,672 and NMU $3,453). The reservation cost was calculated by taking the daily call option volume of 12,500 Dth times 91 days (number of days during the term) times $.03 reservation rate (12,500 x 91 x $.03). If MERC had called on the gas daily option, MERC would have paid a volumetric rate of IFERC Ventura + $.61. The call option was a delivered service, meaning MERC's supplier would utilize its own firm NNG transportation to deliver the supply to MERC's Zone EF delivery point. The $.61 premium would include the cost of NNG's TF5 maximum tariff rate, plus cost of fuel, transportation commodity plus ACA. MERC only pays for volumetric charges if the option was called on. As stated previously, this transaction was entered into to meet the theoretical peak day. MERC did not call on the gas daily call option, so MERC incurred no volumetric charges.

As previously stated the reservation cost of the gas daily call option was $34,125. The reservation cost of the LS Power contract, as filed in the 2010/11 Demand Entitlement filing was $379,428 (PNG-NNG $338,369 and NMU $41,059). By entering into the gas daily call option, MERC recognized a savings in demand costs of $345,303 for MERC's PNG-NNG and NMU customers. The LS Power contract allowed MERC to call on capacity and supply up to 29,120 Dth. By terminating the LS Power contract and replacing with the delivered gas daily call option, MERC was able to decrease the positive reserve margin.

To compare the gas daily call option to cost of NNG TF5 capacity, assuming capacity is available, MERC would have to contract for the entire winter period, November through March at maximum tariff rates. The cost of 12,500 Dth of NNG TF5 capacity would be $947,063 (12,500 Dth x $15.153 TF5 maximum tariff rate x 5 months). By entering into the gas daily call option, MERC would have recognized a savings in demand costs of $902,938 for MERC's PNG-NNG and NMU customers.

In regards to Contract No. 112486 with TFX-5 service, the same amount of capacity (59,171 Dth) was allocated between PNG-NNG and NMU in the 2010/11 and 2011/12 Demand Entitlement filings. MERC allocates the capacity between PNG-NNG and NMU based on theoretical peak day. The allocated percentages in the 2010/11 filing was 89.18% PNG-NNG and 10.82% NMU. The allocated percentages in the 2011/12 filing was 89.88% PNG-NNG and 10.12% NMU. The change in the allocated percentages caused the TF5 volumes to increase on PNG-NMU and decrease on NMU.

Regarding balancing agreement contract ML0021, this is a balancing service covered under Viking Gas Transmission LMS Rate Schedule. The service allows MERC to balance with the pipeline on a daily basis in excess of a 5% tolerance up to 7,465 Dth/day. The volumes in excess of 5% up to 7,465 Dth/day are charged the LMS Daily Overrun rate of $.1737. MERC balances all customers behind their system, whether firm, interruptible or transportation. At the end of the month, all transportation customers are cashed out for the difference between nominations and actual consumption. ML0021 has historically been charged to firm customers through the Demand Entitlement filing. MERC would need to remove from the demand costs and move to commodity costs, similar to what the Department as recommended MERC to do with storage.

<u>Changes to Non-Capacity Items</u>

The Department seeks clarification as to why the storage contract numbers changed and requests MERC to verify the storage cycle volumes, the MSQ numbers and the storage reservation numbers and all of the calculations that are shown in Department Attachment 3 for MERC-PNG and MERC-NMU.

MERC Response

Contract number 121292 for 400,000 Dth that was filed in the 2010/11 Demand Entitlement filing terminated on 05/31/11. That agreement was a one year storage release of excess storage that LS Power had contracted with NNG. MERC agreed to acquire 400,000 Dth from LS Power for another one year term, that was effective June 1, 2011, through May 31,2012, which is reflected in the 2011/12 Demand Entitlement filing. Since this is handled via a storage release through NNG, NNG terminated the 121292 contract and assigned the new 122800 contract. NNG invoices MERC for the 400,000 Dth of capacity charges and LS Power receives a credit from NNG. In regards to the storage cycle volumes, the MSQ numbers and storage reservation numbers, MERC allocates the capacity between PNG-NNG and NMU based on theoretical peak day. The allocated percentages in the 2010/11 filing was 89.18% PNG-NNG and 10.82% NMU. The allocated percentages in the 2011/12 filing was 89.88% PNG-NNG and 10.12% NMU. The change in the allocated percentages caused the TF5 volumes to increase on PNG-NMU and decrease on NMU.

Department's Recommendation Regarding Storage Costs in the PGA

The Department reiterates its position that storage costs should be included in the commodity portion of the PGA rather than the demand portion. The Department has consistently recommended, beginning in Dockets G011/M-08-1328 and G011/M-09-1285, that the Commission require MERC to include certain storage costs in the commodity portion of the PGA rather than the demand portion.

MERC Response

MERC agrees certain storage costs should be included in the commodity portion of the PGA. In Docket No. G011/M-07-1405, the demand entitlement docket for its Northern Natural Gas Transmission System, MERC proposed to include storage costs in the commodity rate rather than the demand rate. In Comments dated June 12, 2008, the Department agreed with MERC's proposal. The Commission has not issued a decision in that docket and has not approved MERC's proposal to shift storage costs from the demand portion of rates to the commodity portion of rates. MERC therefore has not implemented its proposal in the monthly PGA because it is awaiting Commission approval of this change. MERC will adjust the recovery of costs accordingly when the Commission issues a decision requiring such adjustment. In the event the Commission decides to require the adjustment, MERC requests a reasonable time frame in which to make the adjustment and that the adjustment be made on a forward, not retroactive, basis.

<u>Department Inquiries Regarding Annual Demand Entitlement Filings</u>

The Department issued discovery to each regulated gas utility requesting input regarding the annual demand entitlement timeline and the reasonableness of acquiring capacity contracts for the upcoming heating season in excess of the amount estimated by the design-day analysis. Regarding excess capacity, MERC stated in Reply Comments in Docket 11-1083 that it utilizes the capacity release market to address excess capacity, but it could explore the use of non-recallable capacity releases, but only for volumes in excess of the positive five percent reserves. The Department suggests that if MERC wants to explore the use of non-recallable capacity releases above an adequate reserve margin calculated for the upcoming heating season, then MERC should provide information substantiating that these additional volumes will not be necessary in the current as well as future heating seasons or up until the time when such capacity is needed for design day and peak day conditions to reliably serve its firm customers.

MERC Response

At this time, MERC will not be entering into any non-recallable capacity releases since MERC's reserve margin is less than 5%.

DATED this 22nd day of March, 2012.

Respectfully submitted,

DORSEY & WHITNEY LLP

/s/ Michael J. Ahern_________

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Attorney for MERC

AFFIDAVIT OF SERVICE

STATE OF MINNESOTA)
) ss
COUNTY OF HENNEPIN)

Amber S. Lee hereby certifies that on the 22nd day of March, 2012, on behalf of Minnesota Energy Resources Corporation (MERC) she electronically filed a true and correct copy of the Comments on www.edockets.state.mn.us. Said documents were also served via U.S. mail and electronic service as designated on the attached service list.

/s/Amber S. Lee_______
Amber S. Lee

Subscribed and sworn to before me
this 22nd day of March, 2012.

/s/ Paula Bjorkman___________
Notary Public, State of Minnesota

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