Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: **December 20, 2012 .... *Agenda Item # _8_**

Company: Minnesota Energy Resources Corporation (MERC or the Company), on behalf of its two operating divisions, MERC-PNG and MERC-NMU

Docket No. G-007,011/GR-10-977
In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to Increase Rates for Natural Gas Service in Minnesota

Issue: Should the Commission approve Minnesota Energy Resources Corporation's compliance filing?

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Relevant Documents

PUC - Findings of Fact, Conclusions of Law, and Order .... Jul. 13, 2012
PUC - Order Denying Reconsideration and Clarifying Language .... Sep. 12, 2012
MERC - Compliance Filing .... Sep. 21, 2012
MERC - Revised Tariff Sheets .... Oct. 9, 2012
MERC - Additional Revised Tariff Sheets .... Oct. 15, 2012
DOC -Comments .... Oct. 22, 2012
MERC - Reply Comments .... Oct. 24, 2012
MERC - Additional Revised Tariff Sheets (Nos. 9.14 - 9.17).................................... Nov. 9, 2012

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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December 13, 2012

Table of Contents

Statement of the Issue 1
Background 1
Related Dockets and Issues 3
Revised Base Cost of Gas 3
Vertex Billing and Rate Case Process Review 3
Staff Comment 3
Incentive Compensation Refund Mechanism 3
Rate Schedules and Rate Design 4
Revised Tariff Sheets 4
Revenue Decoupling Mechanism (RDM) Tariff 4
Revenue Decoupling Notice to Customers 4
Conservation Improvement Programs 5
Conservation Cost Recovery Charges (CCRCs) & Conservation Cost Recovery Adjustments (CCRAs) & Conservation Improvement Program (CIP) Tracker Account 6
Effective Date of Final Non-Gas Rates 10
Refund Plan 10
New/Revised Base Cost of Gas 13
Effective Date and Implementation of Gas Cost Rate Area Consolidation 13
Customer Notices 14
Presentation of Financial Information in Future Rate Cases 15
Decision Alternatives 17
Incentive Compensation Refund Mechanism 17
Revised Tariff Sheets 17
Revenue Decoupling Notice to Customers 17
Conservation Improvement Programs 17
Conservation Cost Recovery Charge 17
Conservation Improvement Program Tracker Account 18
Effective Date of Final Rates 18
Refund Plan 18
Base Cost of Gas 18
Customer Notices 18
Presentation of Financial Information in Future General Rate Cases 19
Staff Recommendation 19

Statement of the Issue

Should the Commission approve Minnesota Energy Resources Corporation's compliance filing?

Background

On November 30, 2010, Minnesota Energy Resources Corporation (MERC) on behalf of its two operating divisions MERC-PNG and MERC-NMU, filed a request for a general increase in its natural gas rates. MERC requested an annual increase of $15,165,309, or approximately 5.18 percent, over the current retail rates of its two operating divisions, MERC-PNG and MERC-NMU. MERC also asked to complete the consolidation (i.e. equalization) of the non-gas distribution (i.e. margin) rates it charges in the MERC-PNG and MERC-NMU rate areas, and to consolidate its gas cost recovery rates by reducing the number of PGA rate areas from four to two.

On January 28, 2011, the Commission issued three orders that accepted MERC's filing as substantially complete, suspended MERC's proposed final rates, extended the deadline for the Commission's final determination, set this matter for contested case hearing, and authorized an interim rate increase of $7,525,236, or approximately 2.57 percent, per year effective February 1, 2011 and subject to refund. The authorized amount of the interim rate increase for MERC-PNG was $5,628,322, an increase of approximately 2.42 percent,[1] and for MERC-NMU, the authorized amount of the interim rate increase was $1,896,914, an increase of approximately 3.14 percent.

On July 13, 2012, the Commission issued its *Findings of Fact, Conclusions of Law, and Order* (July 13 Order) which authorized MERC to increase its total gross annual Minnesota jurisdictional revenues by $11,047,296 to produce total gross annual jurisdictional operating revenues of $275,772,942.[2] In its compliance filing, MERC allocated the $11,047,296 rate increase between MERC-PNG and MERC-NMU as follows:

- MERC-PNG, the increase was $9,938,110, or approximately 4.8 percent, and
- MERC-NMU, the increase was $1,109,110, or approximately 2.0 percent.

On September 12, 2012, the Commission issued its *Order Denying Reconsideration and Clarifying Language* (September 12 Order) which upheld the decision in the Commission's July 13 Order.

On September 21, 2012, MERC submitted its compliance filing, and on October 9[3] and 15,[4] and

[1] MERC's request included an interim revenue deficiency of $5,716,422 or approximately 2.46 percent for MERC-PNG, and $1,896,914 or approximately 3.14 percent for MERC-NMU, for a total revenue deficiency of $7,613,336 or approximately 2.60 percent; however, MERC asked to recover less than the full interim revenue deficiency by foregoing $88,100 of what it could have collected from its Super Large Volume customers.
[2] MERC's final authorized revenue requirement was based on an authorized rate of return on common equity of 9.70 percent, and a test year ending on December 31, 2011 that includes 211,961 customers and throughput of 683,768,889 therms (approximately 68.4 Bcf) of natural gas.
[3] MERC's October 9 filing corrected the customer charge listed on Tariff Sheet 5.50 (for SLV Service) and updated

on November 9,[5] MERC amended its compliance filing.

On October 22, 2012, the Minnesota Department of Commerce, Division of Energy Resources (Department) submitted comments on MERC's compliance filing and recommended the Commission

- approve MERC's proposed tariff sheets as amended by the revised tariffs filed on October 9, 2012, and October 15, 2012, but defer consideration of the proposed conservation cost recovery charge (CCRC) and conservation cost recovery adjustment (CCRA) language on
    - tariff sheets 5.21 (paragraphs 9 and 10) and 5.25 (paragraphs 8 and 9), in this docket, and
    - tariff sheet 7.02, in Docket No. E,G-999/CI-11-1149;[6]
- consider amending the proposed customer notices to reflect that the PGA consolidation would occur in July 2013, in addition to any other revisions the Commission may require;
- defer any decision regarding MERC's proposed base cost of gas to Docket No. G-007,011/MR-12-1028;
- approve MERC's proposed refund plan;
- require MERC to submit, within 10 days of the refund, a compliance filing that shows MERC-NMU's actual refund and interest paid by rate area and class; and
- approve MERC's proposed conservation cost recovery charge (CCRC) of $0.01513 per therm, which is to be implemented at the time of final rates; and
- approve MERC's request to implement the consolidation of its PGA systems in July 2013 on a bill-rendered basis.

The Department also recommended that

- in future general rate cases, MERC's filings reflect financial adjustments to the Company's positions in pre-filed direct testimony, and
- the Commission require MERC to notify the Commission (in this docket) when MERC files its proposal to modify its May CIP modification filing.

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the distribution rates on Tariff Sheets 5.00-5.51 to reflect the final distribution rates submitted in Schedule B (Revised Schedule of Rates).

[4] MERC's October 15 filing provided additional revisions to MERC's recently approved new area surcharge rider, on Tariff Sheets 9.14 - 9.17, that were necessary to fully incorporate the Commission's determinations regarding the calculation of the contribution in aid of construction in the New Area Surcharge Rider. (Please also see Docket No. G-007,011/M-11-1045)

[5] MERC's November 9 filing provides additional amendments and corrections to MERC's New Area Surcharge tariffs to clarify that the discount rate used for the present value calculation is the cost of long term debt from this rate case. (Please also see Docket No. G-007,011/M-11-1045)

[6] Please see: *Order Amending Tariff Language and Requiring Compliance Filing*; In the Matter of the Minnesota Public Utilities Commission's Implementation of Minnesota Laws 2011, Chapter 97, Sections 8, 18, 19, 21, and 31; Docket No. E, G-999/CI-11-1149; September 17, 2012

On October 24, 2012, MERC submitted its reply to the Department and agreed to all of the Department's recommendations.

Related Dockets and Issues

Revised Base Cost of Gas

MERC's proposed new base cost of gas, in Docket No. G-007,011/MR-12-1028, is on the agenda for the Commission's December 20 meeting.

Vertex Billing and Rate Case Process Review

During the course of this proceeding, in response to concerns about the data used in the development of MERC's test-year sales forecast, MERC agreed to conduct a complete audit of its billing system. On October 12, 2012, MERC submitted its internal audit services report prepared by PricewaterhouseCoopers, LLP ("PwC") entitled *Minnesota Energy Resources Corporation-Vertex Billing and Rate Case Process Review*.

On October 19, the Commission issued its *Request for Comments on MERC's Vertex Billing and Rate Case Process Review*. The Commission's notice allowed thirty days for comments and two weeks for replies. On November 1, the Minnesota Office of the Attorney General, Antitrust and Utilities Division (OAG) asked for a thirty day extension. On November 1, the Commission granted OAG's request and extended the date for comments until December 13 and for replies until December 27.

Staff expects the *MERC-Vertex Billing and Rate Case Process Review* will be scheduled for a Commission meeting in 2013.

Staff Comment

In most respects, staff believes MERC's compliance filing can be approved as

- amended by MERC on October 9 and 15,
- recommended by the Department on October 22, and
- further amended by MERC on November 9.

However, the Commission may want to take note of, or consider taking exception to, the following points.

Incentive Compensation Refund Mechanism

MERC was asked to clarify how the $1 per customer refund threshold would be implemented in the refund mechanism. The Department footnoted that the test year incentive compensation includes non-executive compensation of $1,262,723 and executive compensation of $45,398.

The Department reviewed the numbers and agreed with MERC's calculations and proposed mechanism.

The Commission may wish to clarify whether non-executive and executive amounts subject to refund or tracking are to be calculated separately in determining whether the total annual amount earned in allowable plans (and paid out the following year) is less than the $1,308,121 included in the test year and thus subject to inclusion in the tracked amount to be refunded when the balance reaches an average of $1 per customer. That is, calculated with no netting of an annual overpayment in executive or non-executive incentive compensation with an annual underpayment in the other.

Rate Schedules and Rate Design

The class revenue apportionment authorized in the Commission's July 13 Order is based on the class revenue apportionment agreed to by MERC and the Department and recommended by the ALJ. Staff reviewed the proposed rate schedules and rate design in MERC's September 21 compliance filing and believes the proposed rate schedules and rate design agree with the class revenue apportionments authorized in the Commission's Order.

Revised Tariff Sheets

The Commission approved MERC's request to complete the consolidation (i.e. equalization) of the non-gas distribution rates (i.e. the non-gas margin rates) charged in the MERC-PNG and MERC-NMU rate areas. MERC's proposed tariff sheets implement this consolidation of MERC's non-gas rates.

In addition, MERC provided several (three) amendments to the tariff sheets proposed in the September 21 compliance filing. These amendments were requested by the Department and correct errors or omissions in the September 21 filing. Staff believes they should be approved.

Revenue Decoupling Mechanism (RDM) Tariff

MERC was asked to clarify several details related to the RDM tariff and explain how MERC would implement the revenue decoupling mechanism on a part-year basis if final rates go into effect before or after January 1st. MERC had requested a December 1st effective date for final rates and the RDM. MERC provided this explanation in schedule H of its September 21 compliance filing. The Department recommended the Commission accept all of the RDM-related sections of MERC's compliance filing. Staff agrees. However, with the January 1 effective date the part-year implementation of the RDM will not be necessary.

Revenue Decoupling Notice to Customers

MERC's revenue decoupling mechanism becomes effective on January 1, 2013 with the implementation of final rates and terminates on December 31, 2015 (after three years) unless extended. In its July 13 Order, in ordering paragraph 11(I), the Commission directed MERC to

> … explain its revenue decoupling program in its notice to customers about final rates at the end of this case and in another notice when the first annual revenue decoupling rate adjustment is implemented on customer bills.

In its notice to customers (copies attached), MERC described revenue decoupling as follows.

> Also, the MPUC approved MERC's request for a revenue decoupling mechanism for residential and small commercial customers. Revenue decoupling separates the link between the amount of revenue MERC collects from its customers and the amount of natural gas they use. Revenue decoupling allows MERC to adjust its rates up or down each year to make up for any shortfall or any excess in sales revenue. The purpose of revenue decoupling is to reduce MERC's disincentive to promote energy conservation and energy efficiency. The first annual revenue decoupling rate adjustment will appear on customer bills in 2014.

The first decoupling rate adjustment will appear on customer bills on March 1, 2014. MERC will need to send customers another notice at that time when the new line item for the revenue decoupling rate adjustment appears on customer bills.

Staff has also been advised that MERC should probably supplement this customer notice information with a detailed "revenue decoupling - frequently asked questions" and answers. This could be posted on MERC's website for consumers that want more information about how the revenue decoupling mechanism works and how the rate adjustments are actually calculated.

Conservation Improvement Programs

In its response to the Department recommendation that MERC notify the Commission (in this docket) when MERC files its proposal to modify its 2013-2015 Triennial CIP Plan, MERC provided the following clarification

> … MERC notes that after discussion and meetings with interested parties including Minnesota Center for Environmental Advocacy and Isaac Walton League of America, MERC is in the process of preparing Requests for Proposals (RFPs) to develop projects for the multi-family and small business markets. Once a bidder is selected (pending regulatory approval), MERC will file the additional projects as modifications to the 2013-2015 Triennial CIP Plan with the Department and, as recommended, will notify the Commission of the filing.[7]

Staff notes, that in the Department's decision on MERC's 2013-2015 Triennial CIP Plan, the Department ordered MERC

> … to submit a program modification request by March 1, 2013 proposing additional CIP offerings the Company committed to developing under its decoupling agreement, and reflecting a baseline efficiency of 90 percent for

[7] MERC, reply comments, p. 2

residential furnace retrofits in 2014 and 2015. The modification request may include additional programmatic changes to compensate for the reduced furnace savings.[8]

Staff agrees with the Department's recommendation that MERC notify the Commission when the proposed modifications to MERC's 2013-2015 Triennial CIP Plan are filed. Staff believes this notification will provide the Commission with additional certainty about MERC's commitment to energy conservation in the context of MERC's pilot revenue decoupling program and whether MERC is making progress towards achieving a 1.5 percent rate of annual energy savings.

Conservation Cost Recovery Charges (CCRCs) & Conservation Cost Recovery Adjustments (CCRAs) & Conservation Improvement Program (CIP) Tracker Account

The Commission's Order in this docket dated July 13, 2012 required MERC to do the following:

> Ordering paragraph 12(H)
> A recalculation of the Conservation Cost Recovery Charge, using the Commission-approved test year CIP expense and the Commission-approved test year sales volumes less the appropriate CIP exempt volumes, but including the three non-exempt CIP customers' volumes erroneously excluded by MERC in its original petition.
>
> Ordering paragraph 12(I)
> A demonstration that the CIP tracker account has been properly credited with the appropriate Conservation Cost Recovery Charge amounts during the interim rate period or an explanation of how the Company plans to ensure that the tracker account is properly credited after final rates have been determined.

Ordering paragraph 12(H)
In its Compliance Filing dated September 21, 2012 MERC filed its revised CCRC factor calculation. As directed in Ordering paragraph 12(H), MERC filed its revised CCRC factor calculation. MERC's original CCRC factor calculation was filed in Witness Seth DeMerritt's direct testimony, in Exhibit ___ (SSD-17). Of which, line 3 of his exhibit represents the volumes excluded from the CIP calculation as volumes from customers with CIP exemptions. MERC erroneously excluded the volumes associated with the three customers that were considered CIP exempt, but were not in fact CIP exempt; the September 21 revised calculation has corrected this erroneous exclusion by reinstating the volume of these CIP participating customers which resulted in a consolidated CCRC factor of $0.01513.

In order to verify MERC Compliance filing's CCRC calculation, staff issued its Informational Data Request No. 2 which requested MERC to explain the differences between Line 3 – Opt-out customers in the original CCRC and its revised CCRC calculations.

[8] *Decision*, In the Matter of Minnesota Energy Issue Resource Corporation's 2013-2015 Triennial Conservation Improvement Plan, Docket No. G-007,011/CIP-12-548, October 29, 2012, p. 14

The Department review concluded that MERC's proposed calculation of its CCRC comports with the Commission's requirement. The Department recommended that the Commission approve MERC's proposed CCRC of $0.01513 per therm, which is to be implemented at the time of final rates in this docket.

Department October 22, 2012 Recommendation[9]

- approve MERC's proposed conservation cost recovery charge (CCRC) of $0.01513 per therm, which is to be implemented at the time of final rates;

Staff has reviewed this docket's record and the data provided in staff's Information Request No. 2, and believes that MERC reasonably explained the differences in Line 3 between the two filings. The difference is due to MERC reinstating the volumes associated with the three customers erroneously considered CIP exempt.

Therefore, Staff recommends the Commission adopt the Department recommendation.

[**Staff comment**: MERC has stated that it continued to charge the CCRC that was approved in the 2008 rate case, and that there was no incremental increase in the CCRC during the interim rate period. Thus, MERC asserted that the CIP tracker account requires no additional CCRC credit. The Department agreed with the Company that, since there was no incremental increase in the CCRC during the interim rate period, MERC should not be required to credit the CIP tracker account for any additional amounts associated with the interim rate increase. Staff agrees with the Department recommendation on this issue.]

<u>Ordering paragraph 12(I)</u>
In the course of developing the record in this case, MERC discovered that since 2003, two customers were erroneously considered exempt from paying CIP costs. MERC acquired Aquila on July 1, 2006 and continued Aquila's billing practices which led to the erroneous CIP exemption classification. It is undisputed among the parties that MERC did not collect CCRC revenue from the two customers it identified, and because of this, the CCRC was miscalculated in the previous rate case. Another customer was identified as CIP exempt for CCRC calculation volume purposes, but was correctly assessed a CCRC by MERC during this time period. The combination of these customers represents three customers MERC has identified as CIP exempt, which was an erroneous assumption, as discussed above.

After considering the parties' arguments and the ALJ's recommendation, the Commission modified the ALJ's recommendation to require MERC to credit its NMU CIP tracker with a revenue amount to be calculated by the Company. The exact amount was to be determined in consultation with the Department, and represented uncollected amounts from July 2006, through February 2011, plus the additional revenue amount from March 2011 to the date final rates became effective in this docket.

[9] For further details, see the Department comments dated October 22, 2012 in this docket.

The Commission adopted the ALJ's finding that MERC had not established it was reasonable to fail to collect CIP charges from some of its non-exempt customers and to compensate by collecting those amounts from MERC's other non-exempt customers, and that an appropriate remedy would be reasonable to require MERC to credit its CIP tracker for uncollected amounts.

By requiring a credit for the uncollected amounts going back to July 2006, the Commission required MERC to account for uncollected amounts by going back to the date MERC acquired Aquila's assets. On that date, MERC had the obligation to identify and correct the billing error. Accordingly, it served as an appropriate and equitable look-back date for establishing MERC's responsibility to address the under-collection in its CIP account.

The Commission agreed with the Department's recommendation that MERC need not include a carrying charge in its CIP tracker credit.

From the record, staff was unable determine if the appropriate amounts had been credited back to MERC's CIP tracker per the Commission directive. This led to staff issuing Information Request No. 3. MERC provided the requested information. One of the three customers was a MERC-PNG customer, while other the two customers are MERC-NMU customers.

As illustrated in MERC Witness DeMerritt's Rebuttal Testimony,[10] MERC erroneously excluded its MERC-PNG customer volumes in certain CCRC calculations in this docket, but correctly billed the CCRC factor to this customer as MERC's data response reflects. This MERC action caused the last rate case CCRC factor to be over-stated, but this customer's CCRC revenue was properly recorded in the CIP tracker. MERC's response to staff's Information Request No. 3 further supports MERC's previous statements. The other two MERC customers were erroneously considered CIP exempt, thus the respective volumes were excluded from MERC's original CCRC calculation.

Staff believes that this volume omission had a small impact on the 08-835 rate case CCRC factor calculation, which is corrected in this docket and that the revenues have been properly credited to the CIP tracker.

MERC's compliance filing dated September 21, 2012, Schedule F, page 3 of 3, reflects a MERC CIP tracker account payment of $358,392.02.[11] MERC's response to staff's Information Request No. 3 further provided staff with all of MERC's payments to the CIP tracker account made on behalf of the two remaining MERC-NMU customers that were erroneously considered CIP exempt.

As illustrated in MERC's response to staff's Information Request No. 3, the $358,392.02 CIP tracker account payment represents the July 1, 2006 to December 31, 2009 time period. Further MERC has made an additional payment of $448,526[12] to the CIP tracker payment which represents the January 2010 to May 31, 2011 time period. Payments from June 2011 through December 2011, MERC states that it has credited the CIP tracker account balance on a monthly

[10] See Witness DeMerritt's rebuttal testimony, pp. 24 and 25 in docket.
[11] MERC's payment was made in May 2012.
[12] MERC's payment was made in May 2011.

basis for the CCRC revenues attributable to these two customers. The total amount credited to the CIP tracker account was $168,003 for this time period. The total amount credited to MERC's CIP tracker account for these two customers erroneously considered CIP exempt has been $974,921 which represents the time period beginning July 1, 2006 to December 31, 2011.

Effective January 1, 2012, one of the two MERC-NMU customers was granted a CIP-exemption and MERC stopped crediting the tracker for the amounts attributable to that customer at that time. The other MERC-NMU customer currently has a CIP-exemption petition pending at the Commission. MERC stated that it is tracking the 2012 CCRC revenues attributable to that customer.[13] MERC further stated that in the event the Commission denies that petition or does not make the exemption retroactive to January 1, 2012, MERC will credit the 2012 MERC-NMU tracker for the 2012 CCRC amounts attributable to that customer for the appropriate time period regardless of the effective date.

Staff has reviewed MERC's response to staff's Information Request No. 3 and believes that the response is generally reasonable and representative of CIP tracker account payments for the July 1, 2006 through December 31, 2011 time period. Staff believes that MERC has adequately addressed Ordering Paragraph 12(I) as stated in the Commission July 13, 2012 Order and that the Commission should accept that MERC has met the requirements of Ordering Paragraph No. 12(I) and approve MERC's CIP tracker account payments as having adequately addressed this issue.

<u>MERC's CCRA factor and the CIP tracker account balances</u>

As suggested by MERC Witness DeMerritt in his direct testimony, MERC's CCRA factor adjustment filing and CIP tracker account balance will reviewed in MERC's CCRA filings in Docket Nos. G-007/M-12-443 and G-011/M-12-444. These two filings are currently pending before the Commission.

Staff believes MERC's CCRA factor adjustment and the CIP tracker account should be dealt with in these other dockets. Therefore, the Commission should make it clear in this docket's order that no determination has been made on any information provided in the record regarding MERC's current CCRA factor or MERC's CIP tracker account within this docket.

<u>MERC Tariff Sheets</u>

MERC submitted its tariff compliance filings dated October 9 and 15, 2012 which relate to the CCRC section[14] and Conservation Cost Recovery Adjustment (CCRA) section [15] of MERC's tariff in separate proceedings; Docket Nos. E,G-999/CI-11-1149[16] and G-007,011/M-12-321. The Department has stated that it will file comments on these dockets concerning MERC's and other Minnesota gas and electric utilities' CIP compliance tariff filings at a later date. Thus, the Department recommends that the Commission defer consideration of the proposed CCRC and CCRA language on tariff sheets 5.21 (paragraphs 9 and 10), 5.25 (paragraphs 8 and 9), and 5.51

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[13] Amount calculated through November 2012 is $149,400.

[14] See 2nd Revised Sheet No. 5.21, 1st Revised Sheet No. 5.25, and 2nd Revised Sheet No. 5.51.

[15] See 3rd Revised Sheet No. 7.02.

[16] See the Commission's September 17, 2012 Order Amending Tariff Language and Requiring Compliance Filings in Docket No. 11-1149 (NAS Order).

(paragraph 8 and 9), as well as tariff sheet 7.02 until the Commission makes its determination in Docket Nos. 11-1149 and 12-321.

Department recommendation was as follows:

- approve MERC's proposed tariff sheets as amended by the revised tariffs filed on October 9, 2012, and October 15, 2012, but defer consideration of the proposed tariff language concerning the conservation cost recovery charge (CCRC) and conservation cost recovery adjustment (CCRA) proposed tariff language on

    - tariff sheets 5.21 (paragraphs 9 and 10) , 5.25 (paragraphs 8 and 9) and 5.51 (paragraphs 8 and 9), in this docket, and
    - tariff sheet 7.02, in Docket No. E,G-999/CI-11-1149.[17]

Staff agrees. Staff believes that the Commission should make its determination regarding MERC's tariff proposal concerning tariff sheets 5.21 (paragraphs 9 and 10), 5.25 (paragraphs 8 and 9) and 5.51 (paragraphs 8 and 9), and tariff sheet 7.02, in Docket Nos. E,G-999/CI-11-1149 and G-007,011/M-12-321.

Effective Date of Final Non-Gas Rates

In its September 21 compliance filing, MERC asked to have final rates become effective December 1, 2012. MERC stated in its filing that it normally implements rate changes on a services-rendered, i.e. prorated, basis. If additional time is needed for the Commission to issue its order, MERC asked for permission to implement final rates on the first day of the month following the date the Commission issues its order.

Staff believes MERC's request to implement final rates on the first day of the month is reasonable. The Commission may want to specify a certain effective date in its order, for example January 1, 2013, to make it clear that MERC is authorized to implement final rates on the first day of the month.

Refund Plan

In its January 28, 2011 *Order Setting Interim Rates*, the Commission authorized an interim rate increase of $7,525,236, or approximately 2.57 percent, per year effective February 1, 2011. The authorized amount of the interim rate increase for MERC-PNG was $5,628,322, an increase of approximately 2.42 percent,[18] and, the authorized amount of the interim rate increase for MERC-NMU was $1,896,914, an increase of approximately 3.14 percent.

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[17] Please see: *Order Amending Tariff Language and Requiring Compliance Filing*; In the Matter of the Minnesota Public Utilities Commission's Implementation of Minnesota Laws 2011, Chapter 97, Sections 8, 18, 19, 21, and 31; Docket No. E, G-999/CI-11-1149; September 17, 2012

[18] MERC's request included an interim revenue deficiency of $5,716,422 or approximately 2.46 percent for MERC-PNG, and $1,896,914 or approximately 3.14 percent for MERC-NMU, for a total revenue deficiency of $7,613,336 or approximately 2.60 percent; however, MERC asked to recover less than the full interim revenue deficiency by foregoing $88,100 of what it could have collected from its Super Large Volume customers.

Within its Interim Rates, MERC's CIP expense level reflected a test period level of $8,454,427, but as previously mentioned above, MERC did not adjust the interim CCRC factor charged to its customers; leaving the CCRC factor at the 08-835 docket levels for funding the CIP tracker account. This MERC action created an "apples to oranges" comparison, where the annual CIP revenues are less than the annual CIP expenses. To correct this miss-match in the Interim Rate calculation, MERC imputed a level of revenue into the Interim Rate level of approximately $4.5 million so that the CIP revenues equal the CIP expenses. Thus, the $7,525,236 Interim Rate increase reflects a "zero impact" related to MERC's CIP program; in other words, the CIP revenues and CIP expenses are netted to zero.

As stated below, the final Commission authorized MERC increase is $11,047,296. However, this amount includes a CIP miss-match where the CCRC revenues are stated at the 08-835 docket levels and the CIP test year expenses are set at the $8,454,427 level; thus, the CIP revenues do not net against the CIP expenses. To correct for this in its refund plan, MERC is proposing to reduce the $11,047,296 by $4,442,542, which would reduce the CIP expense level to equal the revenue stream, thus there would be an "apples to apples" comparison at this point for the CIP program. Thus, the net increase to MERC's rates is $6,604,378 ($11,047,296 - $4,442,542) as reflected in the below table.

Staff believes that this MERC action creates a solution (within the refund plan) for addressing the difference between actual CIP revenues and actual CIP expense in calculating the overall Commission approved rate increase. However, staff would like to point out that no Commission determination should be made on the methodology used by MERC in its refund calculation and recommends that MERC, the Department, and PUC staff work together to develop alternatives to this methodology in MERC's next rate case.

In its July 13, 2012 *Findings of Fact, Conclusions of Law, and Order* (July 13 Order), the Commission authorized MERC to increase its total gross annual Minnesota jurisdictional revenues by $11,047,296 to produce total gross annual jurisdictional operating revenues of $275,772,942.

In its September 21 compliance filing, MERC allocated the $11,047,296 increase between MERC-PNG and MERC-NMU as follows:

- MERC-PNG, the increase was $9,938,110, or approximately 4.8 percent, and
- MERC-NMU, the increase was $1,109,110, or approximately 2.0 percent.

<u>Amount of refund for MERC-NMU customers</u>

Because the final rate increase for the MERC-PNG customers is more than the interim rate increase, MERC does not have a refund obligation for these customers. However, the final rate increase for the MERC-NMU customers is less than the interim rate increase. MERC proposed a refund for the MERC-NMU customers.

In its refund plan, MERC based its calculation of its refund obligation on the final ordered revenue increase for each group of customers less the imputed amount of CIP expense included in the interim rate revenue deficiency calculations.

	MERC-PNG	MERC-NMU
Test-year - interim rate increase	$5,628,322	$1,896,914
Test-year - final rate increase	$9,938,110	$1,109,110
Test-year - final ordered rate increase less imputed amount of CIP expense increase	$6,147,576	$456,802
Test-year - refund obligation	None	$1,440,112
Actual - refund obligation (estimated based on Feb. 2011 through Aug. 2012 actual data, these numbers will be revised.)	None	$2,083,211

MERC also provided separate calculation for MERC-PNG super large volume customers only that were not assessed the full interim rate adjustment due to exigent circumstances and for MERC-PNG without the exempt super large volume customers.

Staff believes that under the circumstances of this case, MERC's proposed refund, which provides for a refund for the MERC-NMU customers but not the MERC-PNG customers, is reasonable. Staff believes the refund methodology in this case is generally the same as the refund methodology approved in the last rate case except for the adjustment for imputed CIP expenses in the revenue deficiency calculation during the interim rate time period.

Staff agrees with the Department recommendation that MERC submit a report on the interim rate refund after the refund is completed. This is a standard compliance reporting item that is required of all utilities that have been authorized to collect interim rates.

Refund start date

In its compliance filing, MERC stated that

> Under Minnesota Statute § 216B.27, subd. 3, MERC is required to commence interim rate refunds within 120 days from the Commission's final determination in this matter. MERC requests the Commission approve MERC's interim rate refund plan and allow MERC to commence interim rate refunds on February 1, 2013.[19]

Staff notes that under MERC's proposed timeline, final rates would become effective on December 1 and the interim rate refund would not begin until February 1. Under MERC's proposed timeline, there would have been more than 120 days between the date of the Commission's final order and the start of the refund. MERC would not be in compliance with the requirement that refunds start within 120 days of the Commission's final determination.

Staff also notes that the refund in MERC's last rate case, in 2008, did not start within 120 days of the Commission issuing its final order. In the 2008 rate case, MERC needed extra time to correct its rate schedules and a certain amount of lead time in advance of the effective date for final rates and the refund to ensure the Company's various systems correctly handle these

[19] MERC, compliance filing, p. 1

changes.

Staff points this out because the schedule has slipped and final rate will not become effective December 1. Staff does not believe the extra time is necessarily a problem given the complexity of MERC's compliance filing and the complexity of certain related issues pertaining to MERC's billing system and the administration of MERC's CIP. The following table compares MERC's proposed December 1 effective date for final rates to a January 1 effective date. MERC asked for permission to implement final rates on the first day of the month following the date the Commission issues its order.

	MERC - proposed	MERC - actual
Commission's final determination: *Order Denying Reconsideration and Clarifying Language*	Sep. 12, 2012	Sep. 12, 2012
Final rates effective	Dec. 1, 2012	Jan. 1, 2013
Interim rate refund starts	Feb. 1, 2013	Mar. 1, 2013
Number of days between Commission's final determination and start of interim rate refund	142	170
Number of days MERC is out of compliance with Minn. Stat. § 216B.27, subd. 3	22	50

New/Revised Base Cost of Gas

Ordering paragraph 12(F) of the Commission's July 13 Order directed MERC to file, as required by Minn. Rule 7825.2700, subpart 2, a revised base cost of gas to be in effect on the date final rates are implemented. MERC filed its proposal under Docket No. G-007,011/MR-12-1028. MERC's proposal is on the agenda for this meeting in this separate docket.

The Department recommends the Commission defer any decision regarding MERC's proposed base cost of gas to Docket No. G-007,011/MR-12-1028. Staff agrees, however, staff also notes that MERC's request should be approved (or approved with modifications) if the Commission accepts MERC's compliance filing in this matter and authorizes final rates to go into effect on January 1, 2013 (or some other date.)

Effective Date and Implementation of Gas Cost Rate Area Consolidation

In this rate case, MERC requested permission to consolidate (i.e. equalize) the gas cost rates it charges (base cost plus monthly purchased gas adjustment) by reducing the number of gas cost rate areas from four to two. The Commission approved MERC's request effective July 1, 2013.

Normally, a change in rates becomes effective for all customers at the same time by requiring the new rates to become effective on a services rendered basis rather than a bills rendered basis. Implementation requires the company to prorate customer bills between billing cycles.

In its compliance filing, MERC asked to "drop in" the new gas cost rates on a "bills rendered basis effective July 1, 2013. MERC explained its request in the cover letter to its September 21 compliance filing as follows:

> MERC has identified the need to implement the consolidation of its Purchased Gas Adjustment (PGA) systems on a bill-rendered basis. MERC currently implements rate changes on a service-rendered basis. Because of billing system limitations, MERC is unable to simultaneously charge customers the cost of gas rates from their previous PGA rate and the new PGA rates. For purposes of the PGA consolidation, MERC therefore requests Commission authorization to implement the cost of a gas on a bill-rendered basis in July 2013. Attached Schedule I shows the average effect of a bill-rendered consolidation on customers by rate class. The effect of using a bill-rendered implementation on the average residential customer is less than $0.50, and any over-recovery of gas costs will later be trued-up in the Company's Annual Automatic Adjustment (AAA) filing. The billing limitation identified here does not apply to or affect the Company's consolidation of its distribution rates.[20]

The Department reviewed MERC's Schedule "I" which shows the effect of implementing the PGA rate area consolidation on a bills-rendered rather than a services-rendered basis. According to the Department

> The one-time effect of the PGA consolidation on the average residential customer ranges from a decrease of $0.22 for NMU Consolidated customers to an increase of $0.22 for Great Lakes customers. Any over-recovery would be trued up later. The Department concludes that MERC's calculations and implementation proposal are reasonable and recommends that the Commission approve MERC's request to implement the consolidation of its PGA systems in July 2013 on a bills-rendered basis.[21]

Customer Notices

On May 29, 2012, MERC sent PUC staff preliminary draft copies of its rate design schedules and customer notices. Over the summer, MERC and PUC staff exchanged several rounds of comments and by late September had reached agreement on the need for five different notices and language that would be sued in each of the five notices. MERC included copies of these notices in its September 21 compliance filing. The Department recommended the Commission consider requiring MERC to amend its proposed notices to reflect that the PGA consolidation will occur in July 2013.

On December 10, 2012, MERC sent PUC staff revised electronic copies of the customer notices that updated the effective date for final rate to January 1, 2013 and added the sentence recommended by the Department about the effective date of the PGA rate area consolidation. This sentence was added to the paragraph that explains the rate design changes authorized in this rate case related to the equalization of distribution rates (i.e. rate area consolidation) and reduction in the number of PGA rates from four to two.

[20] MERC, compliance filings, cover letter, p. 4
[21] Department, comments, p. 5

> Finally, the MPUC approved MERC's request to simplify its rate structure to make all of the distribution rates and customer charges for all MERC-PNG and MERC-NMU customers in the same customer class equal. The Commission also allowed MERC to consolidate its four gas cost recovery rates into two. This consolidation will become effective with bills created in July 2013. One rate is for the majority of MERC's customers, who are served off of the Northern Natural Gas Company interstate natural gas pipeline. The other is for MERC's remaining customers who are served by three other interstate pipelines that bring gas to MERC's customers primarily from Canada.

There are five proposed notices attached to the briefing papers, one for each of MERC-PNG rate areas and two for MERC-NMU, reflecting the allocation of MERC-NMU customers into the Northern Natural or the consolidated gas cost recovery rate areas. MERC indicated in a voice mail message that it would need to send these notices to its printer on December 7 in order to get them back in time from the printer to be used as bill inserts on January 2.

Staff believes these notices adequately explain the rate changes authorized by the Commission and can be approved.

Presentation of Financial Information in Future Rate Cases

In this proceeding, in the four successive rounds of testimony, starting with pre-filed direct and ending with prefiled sur-surrebuttal testimony, the Company's financial adjustments were presented as adjustments to the next most recent position taken rather than as adjustments to the position taken in the initial filing in pre-filed direct testimony. Parties found this approach difficult to work with and confusing because issues and adjustment had to be tracked through four rounds of testimony.

An example of how this approach to presenting adjustments unnecessarily complicated the development of a coherent record involves the issue of non-qualified pension plan costs. MERC was asked to clearly identify all non-qualified pension plan costs included in its filing and to clearly show that all non-qualified pension plan costs had been removed from the revenue requirement with the exception of the amount associated with the amortization of the regulatory asset created in Docket No. 06-1287. MERC referenced Ms. Christine Phillips Sur-Surrebuttal Testimony and stated, "This amount was removed from the revenue requirement as shown on MERC's financial position on page 5 of Sur-Surrebuttal Exhibit____(SSD-1)."

The Department provided the relevant quote from Ms. Christine Phillips' Sur-Surrebuttal Testimony and confirmed that Mr. Seth DeMerrit's Sur-Surrebuttal Exhibit____(SSD-1) reduced Administrative & General expense by $72,512 in column (b). The Department also stated that MERC's Schedule A – "Financial Schedules" are consistent with the Department's calculations and reflect the Commission's July 13 Order revenue requirement.

Staff did not find that these statements and schedules clearly identified the level of non-qualified pension plan costs included in MERC's initial pre-filed testimony, nor the amount, if any, that remained after the adjustments were applied. The parties frequently made recommendations in terms of adjustment amounts. Multiple witnesses from multiple parties used different starting points and grouped different items together through multiple rounds of testimony. This presented overlap between adjustments and various final recommendations were presented without numbers, or only in terms of adjustment numbers, which greatly increased the complexity.

In its comments, the Department stated that

> MERC's financial adjustments in this proceeding were built on top of each filing or position. For example, MERC's Surrebuttal filing reflected financial adjustments to the Company's Rebuttal position. In contrast, the Department's Surrebuttal filing reflected financial adjustments to the MERC's Direct position. The Department notes the difficulty this poses when trying to reconcile parties' adjustments. Therefore, in future general rate cases, to provide a reasonable check on the Company's adjustments, the Department requests that MERC's filings reflect financial adjustments to the Company's Direct position, similar to the Department's financial statements.[22]

In response, MERC stated that

> … the Department recommended that in future general rate cases MERC reflect financial adjustments to the Company's Direct position. MERC agrees with … the Department's recommendations as set forth above.[23]

Staff agrees with the Department and appreciates MERC's willingness to change the way it presents financial adjustments in successive rounds of testimony in future rate cases. Staff believes this will make MERC's next rate case less complicated.

[22] Department, comments, pp. 7-8
[23] MERC, reply comments, p. 2

Decision Alternatives

Incentive Compensation Refund Mechanism

1. Clarify that annual pay outs of less than $1,262,723 in allowable non-executive employee incentive compensation, plus annual payouts of less than $45,398 in allowable executive incentive compensation must be added to the tracker for refund. [PUC Staff]
   or

2. Clarify that annual pay outs of non-executive and executive incentive compensation amount less than $1,308,121 on a combined basis must be added to the tracker for refund.

Revised Tariff Sheets

3. Approve MERC's proposed tariff sheets as filed on September 21, 2012 and amended by the revised tariff sheets filed on October 9, 2012, October 15, 2012, and November 9, 2012, but defer consideration of the proposed conservation cost recovery charge (CCRC) and conservation cost recovery adjustment (CCRA) language on

   a. tariff sheets 5.21 (paragraphs 9 and 10) and 5.25 (paragraphs 8 and 9), in this docket, and
   b. tariff sheet 7.02, in Docket No. E,G-999/CI-11-1149.[24] [Department, MERC]

Revenue Decoupling Notice to Customers

4. Require MERC to supplement the revenue decoupling notice to customers with a "revenue decoupling frequently asked questions and answers" posted to MERC's website. Direct MERC to develop this information in consultation with the Commission's staff and CAO and to keep this information up-to-date during the revenue decoupling pilot program.

Conservation Improvement Programs

5. Require MERC to notify the Commission (in this docket) when it files its Conservation Improvement Plan (CIP) CIP program modification filing in CIP Triennial Docket No. G007,G-011/CIP-12-548. [Department, MERC]

Conservation Cost Recovery Charge

6. Approve MERC's proposed conservation cost recovery charge (CCRC) of $0.01513 per therm, which is to be implemented at the time of final rates. [Department, MERC]

[24] Please see: *Order Amending Tariff Language and Requiring Compliance Filing*; In the Matter of the Minnesota Public Utilities Commission's Implementation of Minnesota Laws 2011, Chapter 97, Sections 8, 18, 19, 21, and 31; Docket No. E, G-999/CI-11-1149; September 17, 2012

Conservation Improvement Program Tracker Account

7. Accept MERC's crediting of its NMU CIP tracker with a revenue amount to be calculated by the Company, in consultation with the Department, representing uncollected amounts from July 2006, through February 2011, plus the additional revenue amount from March 2011 to the date final rates become effective in this docket. [PUC Staff]

8. Accept that although MERC and the Department agree that [although] MERC did not collect CCRC revenues from the three customers, MERC did correctly credit its CIP tracker account for CCRC amounts attributable to one of these customers. [PUC Staff]

9. Do not accept, approve or otherwise recognizes the validity of MERC's proposed CIP tracker account balances or calculations (estimated or otherwise for any time period) or MERC's proposed CCRA calculations (to the extent there are any in the compliance filing). [PUC Staff]

Effective Date of Final Rates

10. Authorize MERC to implement new, final rates on customer bills effective January 1, 2013 for services rendered on and after January 1, 2013. [MERC, PUC Staff]

Refund Plan

11. Approve MERC's interim rate refund plan as proposed. [MERC, Department]

12. Require MERC to submit, within 10 days of the completion of the refund, a compliance filing that shows MERC-NMU's actual refund and interest paid by rate area and class including all supporting calculations. [MERC, Department]

Base Cost of Gas

13. Defer any decision regarding MERC's proposed base cost of gas to Docket No. G-007,011/MR-12-1028. [Department, MERC]

14. Approve MERC's request to implement the consolidation of its PGA systems in July 2013 on a bills-rendered basis. [MERC, Department]

Customer Notices

15. Approve the revised customer notices attached to these briefing papers that include the January 1, 2013 effective date for final rates and the additional sentence about the effective date of PGA rate area consolidation. [MERC, PUC Staff]

Presentation of Financial Information in Future General Rate Cases

16. Require MERC, in future general rate cases, to prepare and submit its filings (i.e. testimony) so that these filings reflect the financial adjustments to the Company's positions in pre-filed direct testimony. [Department, MERC]

Staff Recommendation

Staff recommends the Commission approve decision alternatives one, three (a and b), and four through sixteen.

IMPORTANT INFORMATION
about your natural gas rates

NEW NATURAL GAS RATES BEGIN WITH THIS BILL

For Customers Served by Northern Natural Gas Pipeline

An Explanation Of Changes To Your Natural Gas Rates

On November 30, 2010, Minnesota Energy Resources-PNG (MERC-PNG) requested permission to increase its natural gas rates by approximately $13.7 million, or about 5.9%.

On July 13, 2012, the Minnesota Public Utilities Commission (MPUC) approved new natural gas rates for Minnesota Energy Resources customers. Overall, rates will increase approximately $9.9 million, or 4.7%, beginning January 1, 2013.

Under the MPUC's July 13, 2012 Order, the fixed customer charge for residential customers will increase from $7.25 to $8.50 per month, and the distribution charge will increase from $0.17746 to $0.19754. These rates are effective on January 2013 bills. Although the net effect on customers will vary by rate classification, the average residential customer using 75 therms of natural gas per month will see a $2.76 increase on their monthly bill.

Also, the MPUC approved MERC's request for a revenue decoupling mechanism for residential and small commercial customers. Revenue decoupling separates the link between the amount of revenue MERC collects from its customers and the amount of natural gas they use. Revenue decoupling allows MERC to adjust its rates up or down each year to make up for any shortfall or any excess in sales revenue. The purpose of revenue decoupling is to reduce MERC's disincentive to promote energy conservation and energy efficiency. The first annual revenue decoupling rate adjustment will appear on customer bills in 2014.

Finally, the MPUC approved MERC's request to simplify its rate structure to make all of the distribution rates and customer charges for all MERC-PNG and MERC-NMU customers in the same customer class equal. The Commission also allowed MERC to consolidate its four gas cost recovery rates into two. This consolidation will become effective with bills created in July 2013. One rate is for the majority of MERC's customers, who are served off of the Northern Natural Gas Company interstate natural gas pipeline. The other is for MERC's remaining customers who are served by three other interstate pipelines that bring gas to MERC's customers primarily from Canada.

Refund On Interim Rates

State law allowed Minnesota Energy Resources to collect an interim (temporary) rate increase while the MPUC considered our rate request. The interim increase of $5.7 million or 2.46%, began on February 1, 2011. Since the final increase is greater than the interim rate increase, Minnesota Energy Resources will not refund or collect any difference between these amounts.

Reasons For The Increase

Minnesota Energy Resources requested this increase due to reduced sales, and increased costs for customer service functions and conservation programs.

How The Rate Change Will Affect Monthly Bills

The MPUC's July 13, 2012 Order will affect individual monthly bills differently depending on natural gas use and customer type. The customer charges and the distribution charges recover only the cost of providing distribution service to our customers. These rates do not include the wholesale cost of gas, which is passed on to you directly at our cost without adding any additional fees to the price. Your monthly bills will continue to vary due to changes in the wholesale cost of natural gas.

Please see inside for an explanation of how the changes will impact your natural gas bill.

For More Information

If you would like more information, please visit us online at **minnesotaenergyresources.com**, visit your local Minnesota Energy Resources customer service office, or call **800-889-9508**.

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Change In Average Monthly Bills

This chart shows the effect of the rate change on monthly bills for MERC-PNG customers served off the Northern Natural Gas Pipeline with average gas use.

Customer Class	Average Monthly Usage (Therms)	Current Average Monthly Bill*	New Average Monthly Bill
General Service - Residential Sales	75	$69	$72
General Service - Small Commercial & Industrial Sales	80	$75	$80
General Service - Large Commercial & Industrial Sales	669	$547	$577
Small Volume Interruptible and Joint Sales	3,282	$2,019	$2,055
Large Volume Interruptible and Joint Sales	9,947	$5,196	$5,242
Transportation	200,252	$3,478	$4,036

Changes For Monthly Customer Charge And The Per Unit Gas Distribution Charge

This chart shows the effect of the current and authorized fixed customer charge and distribution charge for each MERC customer class.

Customer Class	Current Monthly Fixed Charge	Monthly Fixed Charge	Current Per Therm Distribution Charge	Per Therm Distribution Charge
Residential	$7.25	$8.50	$0.17746	$0.19754
Small Commercial & Industrial	$12.00	$14.50	$0.15022	$0.18525
Large Commercial & Industrial	$17.00	$35.00	$0.14984	$0.16868
Small Volume Interruptible & Joint	$80.00	$150.00	$0.11681	$0.10647
Large Volume Interruptible & Joint	$160.00	$175.00	$0.03248	$0.03568
Super Large Volume Interruptible & Joint	$160.00	$300.00	$0.00420	$0.00420
Transportation Administrative Fee*	$170.00	$70.00		

**The customer charge for customers receiving transportation service is the same as for comparable sales service, except for the additional monthly administrative fee.*

IMPORTANT INFORMATION
about your natural gas rates

NEW NATURAL GAS RATES BEGIN WITH THIS BILL

For Customers Served by Viking Gas Pipeline

An Explanation Of Changes To Your Natural Gas Rates

On November 30, 2010, Minnesota Energy Resources-PNG (MERC-PNG) requested permission to increase its natural gas rates by approximately $13.7 million, or about 5.9%.

On July 13, 2012, the Minnesota Public Utilities Commission (MPUC) approved new natural gas rates for Minnesota Energy Resources customers. Overall, rates will increase approximately $9.9 million, or 4.7%, beginning January 1, 2013.

Under the MPUC's July 13, 2012 Order, the fixed customer charge for residential customers will increase from $7.25 to $8.50 per month, and the distribution charge will increase from $0.17746 to $0.19754. These rates are effective on January 2013 bills. Although the net effect on customers will vary by rate classification, the average residential customer using 65 therms of natural gas per month will see a $2.56 increase on their monthly bill.

Also, the MPUC approved MERC's request for a revenue decoupling mechanism for residential and small commercial customers. Revenue decoupling separates the link between the amount of revenue MERC collects from its customers and the amount of natural gas they use. Revenue decoupling allows MERC to adjust its rates up or down each year to make up for any shortfall or any excess in sales revenue. The purpose of revenue decoupling is to reduce MERC's disincentive to promote energy conservation and energy efficiency. The first annual revenue decoupling rate adjustment will appear on customer bills in 2014.

Finally, the MPUC approved MERC's request to simplify its rate structure to make all of the distribution rates and customer charges for all MERC-PNG and MERC-NMU customers in the same customer class equal. The Commission also allowed MERC to consolidate its four gas cost recovery rates into two. This consolidation will become effective with bills created in July 2013. One rate is for the majority of MERC's customers, who are served off of the Northern Natural Gas Company interstate natural gas pipeline. The other is for MERC's remaining customers who are served by three other interstate pipelines that bring gas to MERC's customers primarily from Canada.

Refund On Interim Rates

State law allowed Minnesota Energy Resources to collect an interim (temporary) rate increase while the MPUC considered our rate request. The interim increase of $5.7 million or 2.46%, began on February 1, 2011. Since the final increase is greater than the interim rate increase, Minnesota Energy Resources will not refund or collect any difference between these amounts.

Reasons For The Increase

Minnesota Energy Resources requested this increase due to reduced sales, and increased costs for customer service functions and conservation programs.

How The Rate Change Will Affect Monthly Bills

The MPUC's July 13, 2012 Order will affect individual monthly bills differently depending on natural gas use and customer type. The customer charges and the distribution charges recover only the cost of providing distribution service to our customers. These rates do not include the wholesale cost of gas, which is passed on to you directly at our cost without adding any additional fees to the price. Your monthly bills will continue to vary due to changes in the wholesale cost of natural gas.

Please see inside for an explanation of how the changes will impact your natural gas bill.

For More Information

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Change In Average Monthly Bills

This chart shows the effect of the rate change on monthly bills for MERC-PNG customers served off the Viking Pipeline with average gas use.

Customer Class	Average Monthly Usage (Therms)	Current Average Monthly Bill*	New Average Monthly Bill
General Service - Residential Sales	65	$56	$58
General Service - Small Commercial & Industrial Sales	67	$60	$65
General Service - Large Commercial & Industrial Sales	499	$376	$403
Small Volume Interruptible and Joint Sales	3,020	$1,836	$1,875
Large Volume Interruptible and Joint Sales	93,218	$46,411	$46,724
Transportation	11,808	$1,082	$1,101

Changes For Monthly Customer Charge And The Per Unit Gas Distribution Charge

This chart shows the effect of the current and authorized fixed customer charge and distribution charge for each MERC customer class.

Customer Class	Current Monthly Fixed Charge	Monthly Fixed Charge	Current Per Therm Distribution Charge	Per Therm Distribution Charge
Residential	$7.25	$8.50	$0.17746	$0.19754
Small Commercial & Industrial	$12.00	$14.50	$0.15022	$0.18525
Large Commercial & Industrial	$17.00	$35.00	$0.14984	$0.16868
Small Volume Interruptible & Joint	$80.00	$150.00	$0.11681	$0.10647
Large Volume Interruptible & Joint	$160.00	$175.00	$0.03248	$0.03568
Super Large Volume Interruptible & Joint	$160.00	$300.00	$0.00420	$0.00420
Transportation Administrative Fee*	$170.00	$70.00		

**The customer charge for customers receiving transportation service is the same as for comparable sales service, except for the additional monthly administrative fee.*

IMPORTANT INFORMATION

about your natural gas rates

NEW NATURAL GAS RATES BEGIN WITH THIS BILL

For Customers Served by The Great Lakes Pipeline

An Explanation Of Changes To Your Natural Gas Rates

On November 30, 2010, Minnesota Energy Resources-PNG (MERC-PNG) requested permission to increase its natural gas rates by approximately $13.7 million, or about 5.9%.

On July 13, 2012, the Minnesota Public Utilities Commission (MPUC) approved new natural gas rates for Minnesota Energy Resources customers. Overall, rates will increase approximately $9.9 million, or 4.7%, beginning January 1, 2013.

Under the MPUC's July 13, 2012 Order, the fixed customer charge for residential customers will increase from $7.25 to $8.50 per month, and the distribution charge will increase from $0.17746 to $0.19754. These rates are effective on January 2013 bills. Although the net effect on customers will vary by rate classification, the average residential customer using 70 therms of natural gas per month will see a $2.65 increase on their monthly bill.

Also, the MPUC approved MERC's request for a revenue decoupling mechanism for residential and small commercial customers. Revenue decoupling separates the link between the amount of revenue MERC collects from its customers and the amount of natural gas they use. Revenue decoupling allows MERC to adjust its rates up or down each year to make up for any shortfall or any excess in sales revenue. The purpose of revenue decoupling is to reduce MERC's disincentive to promote energy conservation and energy efficiency. The first annual revenue decoupling rate adjustment will appear on customer bills in 2014.

Finally, the MPUC approved MERC's request to simplify its rate structure to make all of the distribution rates and customer charges for all MERC-PNG and MERC-NMU customers in the same customer class equal. The Commission also allowed MERC to consolidate its four gas cost recovery rates into two. This consolidation will become effective with bills created in July 2013. One rate is for the majority of MERC's customers, who are served off of the Northern Natural Gas Company interstate natural gas pipeline. The other is for MERC's remaining customers who are served by three other interstate pipelines that bring gas to MERC's customers primarily from Canada.

Refund On Interim Rates

State law allowed Minnesota Energy Resources to collect an interim (temporary) rate increase while the MPUC considered our rate request. The interim increase of $5.7 million or 2.46%, began on February 1, 2011. Since the final increase is greater than the interim rate increase, Minnesota Energy Resources will not refund or collect any difference between these amounts.

Reasons For The Increase

Minnesota Energy Resources requested this increase due to reduced sales, and increased costs for customer service functions and conservation programs.

How The Rate Change Will Affect Monthly Bills

The MPUC's July 13, 2012 Order will affect individual monthly bills differently depending on natural gas use and customer type. The customer charges and the distribution charges recover only the cost of providing distribution service to our customers. These rates do not include the wholesale cost of gas, which is passed on to you directly at our cost without adding any additional fees to the price. Your monthly bills will continue to vary due to changes in the wholesale cost of natural gas.

Please see inside for an explanation of how the changes will impact your natural gas bill.

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Change In Average Monthly Bills

This chart shows the effect of the rate change on monthly bills for MERC-PNG customers served off the Great Lakes Pipeline with average gas use.

Customer Class	Average Monthly Usage (Therms)	Current Average Monthly Bill*	New Average Monthly Bill
General Service - Residential Sales	70	$57	$60
General Service - Small Commercial & Industrial Sales	89	$74	$79
General Service - Large Commercial & Industrial Sales	614	$440	$470
Small Volume Interruptible and Joint Sales	3,155	$1,956	$2,006
Transportation	26,759	$1,598	$1,564

Changes For Monthly Customer Charge And The Per Unit Gas Distribution Charge

This chart shows the effect of the current and authorized fixed customer charge and distribution charge for each MERC customer class.

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Residential	$7.25	$8.50	$0.17746	$0.19754
Small Commercial & Industrial	$12.00	$14.50	$0.15022	$0.18525
Large Commercial & Industrial	$17.00	$35.00	$0.14984	$0.16868
Small Volume Interruptible & Joint	$80.00	$150.00	$0.11681	$0.10647
Large Volume Interruptible & Joint	$160.00	$175.00	$0.03248	$0.03568
Transportation Administrative Fee*	$170.00	$70.00		

**The customer charge for customers receiving transportation service is the same as for comparable sales service, except for the additional monthly administrative fee.*

IMPORTANT INFORMATION

about your natural gas rates

NEW NATURAL GAS RATES BEGIN WITH THIS BILL

For Customers Served by NMU-Northern Natural Pipeline

An Explanation Of Changes To Your Natural Gas Rates

On November 30, 2010, Minnesota Energy Resources-NMU (MERC-NMU) requested permission to increase its natural gas rates by approximately $1.4 million, or about 2.4%.

On July 13, 2012, the Minnesota Public Utilities Commission (MPUC) approved new natural gas rates for Minnesota Energy Resources customers. Overall, rates will increase approximately $1.1 million, or 2.1%, beginning January 1, 2013.

Under the MPUC's July 13, 2012 Order, the fixed customer charge for residential customers will increase from $7.25 to $8.50 per month, and the distribution charge will decrease from $0.21759 to $0.19754. These rates are effective on January 2013 bills. Although the net effect on customers will vary by rate classification, the average residential customer using 72 therms of natural gas per month will see a $0.20 decrease on their monthly bill.

Also, the MPUC approved MERC's request for a revenue decoupling mechanism for residential and small commercial customers. Revenue decoupling separates the link between the amount of revenue MERC collects from its customers and the amount of natural gas they use. Revenue decoupling allows MERC to adjust its rates up or down each year to make up for any shortfall or any excess in sales revenue. The purpose of revenue decoupling is to reduce MERC's disincentive to promote energy conservation and energy efficiency. The first annual revenue decoupling rate adjustment will appear on customer bills in 2014.

Finally, the MPUC approved MERC's request to simplify its rate structure to make all of the distribution rates and customer charges for all MERC-PNG and MERC-NMU customers in the same customer class equal. The Commission also allowed MERC to consolidate its four gas cost recovery rates into two. This consolidation will become effective with bills created in July 2013. One rate is for the majority of MERC's customers, who are served off of the Northern Natural Gas Company interstate natural gas pipeline. The other is for MERC's remaining customers who are served by three other interstate pipelines that bring gas to MERC's customers primarily from Canada.

Refund On Interim Rates

State law allowed Minnesota Energy Resources to collect an interim (temporary) rate increase while the MPUC considered our rate request. The interim increase of $1.9 million or 3.14%, began on February 1, 2011. Since the final increase is less than the interim rate increase, Minnesota Energy Resources will refund any difference between these amounts.

Reasons For The Increase

Minnesota Energy Resources requested this increase due to reduced sales, and increased costs for customer service functions and conservation programs.

How The Rate Change Will Affect Monthly Bills

The MPUC's July 13, 2012 Order will affect individual monthly bills differently depending on natural gas use and customer type. The customer charges and the distribution charges recover only the cost of providing distribution service to our customers. These rates do not include the wholesale cost of gas, which is passed on to you directly at our cost without adding any additional fees to the price. Your monthly bills will continue to vary due to changes in the wholesale cost of natural gas.

Please see inside for an explanation of how the changes will impact your natural gas bill.

For More Information

If you would like more information, please visit us online at **minnesotaenergyresources.com**, visit your local Minnesota Energy Resources customer service office, or call **800-889-9508**.

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Change In Average Monthly Bills

This chart shows the effect of the rate change on monthly bills for MERC-NMU customers served off the NMU – Northern Natural Gas Pipeline with average gas use.

Customer Class	Average Monthly Usage (Therms)	Current Average Monthly Bill*	New Average Monthly Bill
General Service - Residential Sales	72	$67	$67
General Service - Small Commercial & Industrial Sales	94	$87	$89
General Service - Large Commercial & Industrial Sales	478	$403	$408
Small Volume Interruptible and Joint Sales	5,867	$3,415	$3,549
Large Volume Interruptible and Joint Sales	14,358	$7,358	$7,476
Transportation	6,667	$906	$931

Changes For Monthly Customer Charge And The Per Unit Gas Distribution Charge

This chart shows the effect of the current and authorized fixed customer charge and distribution charge for each MERC customer class.

Customer Class	Current Monthly Fixed Charge	Monthly Fixed Charge	Current Per Therm Distribution Charge	Per Therm Distribution Charge
Residential	$7.25	$8.50	$0.21759	$0.19754
Small Commercial & Industrial	$12.00	$14.50	$0.18564	$0.18525
Large Commercial & Industrial	$17.00	$35.00	$0.19660	$0.16868
Small Volume Interruptible & Joint	$80.00	$150.00	$0.09560	$0.10647
Large Volume Interruptible & Joint	$160.00	$175.00	$0.02846	$0.03568
Super Large Volume Interruptible & Joint	$160.00	$300.00	$0.00850	$0.00850
Transportation Administrative Fee*	$170.00	$70.00		

**The customer charge for customers receiving transportation service is the same as for comparable sales service, except for the additional monthly administrative fee.*

IMPORTANT INFORMATION
about your natural gas rates

NEW NATURAL GAS RATES BEGIN WITH THIS BILL

For Customers Served by NMU-Consolidated Pipeline

Refund On Interim Rates

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An Explanation Of Changes To Your Natural Gas Rates

On November 30, 2010, Minnesota Energy Resources-NMU (MERC-NMU) requested permission to increase its natural gas rates by approximately $1.4 million, or about 2.4%.

On July 13, 2012, the Minnesota Public Utilities Commission (MPUC) approved new natural gas rates for Minnesota Energy Resources customers. Overall, rates will increase approximately $1.1 million, or 2.1%, beginning January 1, 2013.

Under the MPUC's July 13, 2012 Order, the fixed customer charge for residential customers will increase from $7.25 to $8.50 per month, and the distribution charge will decrease from $0.21759 to $0.19754. These rates are effective on January 2013 bills. Although the net effect on customers will vary by rate classification, the average residential customer using 66 therms of natural gas per month will see a $0.08 decrease on their monthly bill.

Also, the MPUC approved MERC's request for a revenue decoupling mechanism for residential and small commercial customers. Revenue decoupling separates the link between the amount of revenue MERC collects from its customers and the amount of natural gas they use. Revenue decoupling allows MERC to adjust its rates up or down each year to make up for any shortfall or any excess in sales revenue. The purpose of revenue decoupling is to reduce MERC's disincentive to promote energy conservation and energy efficiency. The first annual revenue decoupling rate adjustment will appear on customer bills in 2014.

Finally, the MPUC approved MERC's request to simplify its rate structure to make all of the distribution rates and customer charges for all MERC-PNG and MERC-NMU customers in the same customer class equal. The Commission also allowed MERC to consolidate its four gas cost recovery rates into two. This consolidation will become effective with bills created in July 2013. One rate is for the majority of MERC's customers, who are served off of the Northern Natural Gas Company interstate natural gas pipeline. The other is for MERC's remaining customers who are served by three other interstate pipelines that bring gas to MERC's customers primarily from Canada.

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Change In Average Monthly Bills

This chart shows the effect of the rate change on monthly bills for MERC-NMU customers served off the NMU-Consolidated Pipeline with average gas use.

Customer Class	Average Monthly Usage (Therms)	Current Average Monthly Bill*	New Average Monthly Bill
General Service - Residential Sales	66	$60	$62
General Service - Small Commercial & Industrial Sales	78	$74	$77
General Service - Large Commercial & Industrial Sales	501	$422	$426
Small Volume Interruptible and Joint Sales	5,250	$3,064	$3,191
Large Volume Interruptible and Joint Sales	30,037	$15,217	$15,449
Transportation	144,988	$2,803	$4,466

Changes For Monthly Customer Charge And The Per Unit Gas Distribution Charge

This chart shows the effect of the current and authorized fixed customer charge and distribution charge for each MERC customer class.

Customer Class	Current Monthly Fixed Charge	Monthly Fixed Charge	Current Per Therm Distribution Charge	Per Therm Distribution Charge
Residential	$7.25	$8.50	$0.21759	$0.19754
Small Commercial & Industrial	$12.00	$14.50	$0.18564	$0.18525
Large Commercial & Industrial	$17.00	$35.00	$0.19660	$0.16868
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Transportation Administrative Fee*	$170.00	$70.00		

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