STATE OF MINNESOTA

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August 25, 2014

Dr. Burl W. Haar, Executive Secretary
Mr. Mark Oberlander, Supervisor, Telecom Analysis
Minnesota Public Utilities Commission
350 Metro Square Building
121 Seventh Place East
St. Paul, MN 55101

RE: In the Matter of a Petition by Minnesota Energy Resources Corporation for Authority to Increase Natural Gas Rates in Minnesota
MPUC Docket No. G011/GR-13-617
OAH Docket No. 8-2500-31126

Dear Dr. Haar:

The enclosed Limited Exceptions of the Minnesota Department of Commerce to the ALJ Report is hereby filed in the above referenced matter

Very truly yours,

/s/ **Linda S. Jensen**

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AFFIDAVIT OF SERVICE

RE: In the Matter of a Petition by Minnesota Energy Resources Corporation for Authority to
Increase Natural Gas Rates in Minnesota
MPUC Docket No. G011/GR-13-617
OAH Docket No. 8-2500-31126

STATE OF MINNESOTA)
) ss.
COUNTY OF RAMSEY)

I, Patricia Silberbauer, hereby state that on the 25th day of August, 2014, I efiled the attached Limited Exceptions of the Minnesota Department of Commerce to the ALJ Report, and served the same by United States Mail, upon all parties on the attached service list, postage prepaid, by depositing the same at St. Paul, Minnesota.

See attached service list

/s/ Pat Silberbauer

Subscribed and sworn to before me
on August 25, 2014

/s/ Sandra A. Bush
Notary Public - Minnesota
My Commission Expires Jan. 31, 2015

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13-617 8/25/14

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BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION
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Beverly Jones Heydinger	Chair
David C. Boyd	Commissioner
Nancy Lange	Commissioner
Dan Lipschultz	Commissioner
Betsy Wergin	Commissioner

In the Matter of the Application by MERC for Authority to Increase Natural Gas Rates in Minnesota

MPUC Docket No. G-011/GR-13-617

LIMITED EXCEPTIONS OF THE MINNESOTA DEPARTMENT OF COMMERCE TO THE ALJ REPORT

August 25, 2014

LIMITED EXCEPTIONS TO THE ALJ REPORT

I. INTRODUCTION

The Minnesota Department of Commerce (Department or DOC) appreciates the detailed Findings of Fact, Conclusions of Law, and Recommendations (ALJ Report) of the Administrative Law Judge (ALJ). The ALJ Report provides thorough review and discussion of parties' positions on the many complex technical issues raised, and includes reasoned analyses regarding the ALJ's recommendations. The Department accepts the great majority of the recommended Findings of Fact, with the limited exceptions set forth below.

A decision by the Minnesota Public Utilities Commission (Commission) to adopt all or part of an ALJ Report is guided by the requirements of the Minnesota Administrative Procedures Act. Minn. Stat. Ch. 14 (MAPA). MAPA requires that Commission orders in contested cases be in writing, based on the record and include the Commission's findings of fact and conclusions on the material issues. Minn. Stat. § 14.62 subd. 1. Such a Commission order will be upheld on appeal unless it is affected by an error of law, is unsupported by substantial evidence in view of the entire record as submitted, or is arbitrary or capricious. Minn. Stat. § 14.69. With the modifications discussed herein, the Commission's adoption of the ALJ Report would fulfill these requirements.

The Department files limited exceptions regarding the following issues:

- Rate of Return
- Discount Rate for Future Pension Expenses
- Uncollectible Expenses, and
- Calculation of Conservation Cost Recovery Charge (CCRC)
-

The Department also recommends exceptions in the nature of corrections to the ALJ Report in part III below.

II. EXCEPTIONS

A. Rate of Return: Dr. Amit's Testimony Supports a Return on Equity of 9.29 Percent (With Flotation Costs) for MERC, rather than 9.79 Percent in the ALJ Report

The Department continues to support Dr. Amit's recommended Return on Equity (ROE) for MERC of 9.29 percent with flotation costs and, thus, respectfully takes exception to the ALJ Report's recommended return on equity (ROE) of 9.79 percent.[1] In particular, the record does not support the Report's recommendation (which is based on citations to Dr. Amit's testimony) that MERC's risk profile is higher than that of the Department's comparison group[2] such that an ROE higher than the results of Dr. Amit's Discounted Cash Flow (DCF) analysis is warranted. The Department also disagrees with the Report's conclusion that the results of Dr. Amit's updated Capital Asset Pricing Model (CAPM) of 9.79 percent with flotation costs is an appropriate basis for MERC's ROE or, in contrast to Dr. Amit's DCF result, "yields a better and more reasonable result."[3] Dr. Amit's testimony supports neither conclusion. Accordingly, the Department takes exception to Proposed Findings 112, 116, 172, 173 and 174, as discussed further below.

1. Fundamentals of ROE Analysis

Determining a reasonable ROE for MERC must be based on reasoned analysis; it would not be appropriate, for example, simply to search for a desired outcome regardless of the flaws in a model that might produce such an outcome. Nor is a comparison of parties' ROE numbers sufficient foundation to determine the reasonableness of a particular ROE figure. Rather, as the Department demonstrated in great detail through the testimony of Dr. Amit, the key to a

[1] ALJ Report para. 173.
[2] ALJ Report para. 112, 116 and 172.
[3] ALJ Report para 112, 116, 172 and 173.

reasonable ROE for MERC is reliance on a properly applied DCF method, based on reasonable inputs, together with confirmation of the reasonableness of the DCF analysis by use of a properly applied CAPM analysis.[4] Having checked the reasonableness of his DCF analyses through his application of CAPM, the results of Dr. Amit's DCF analysis of 9.29 percent (with flotation costs) is well-supported in the record as a reasonable ROE for MERC.[5]

As further confirmation of the reasonableness of Dr. Amit's analysis, Dr. Amit's corrections for the flaws in Mr. Moul's analysis yielded an ROE of 9.25 percent (with flotation costs), which is only 4 basis points below Dr. Amit's recommendation of 9.29 percent.[6]

It is also important to acknowledge that Dr. Amit used the CAPM method only as a check on the reasonableness of his DCF analysis.[7] Dr. Amit agreed with the theoretical soundness of the CAPM method, but identified practical difficulties in application that eliminated the CAPM as a stand-alone method for determining a reasonable ROE, as emphasized in bold as follows:

> The basic premise of CAPM is that any risk that is company-specific can be diversified away by investors. [Ex. 200 at 28 (Amit Direct)]. Therefore, the only risk that matters is the systematic risk of the stock. *Id.* This systematic risk is measured by beta. *Id.* **While the CAPM is theoretically sound, its use raises some difficult issues including difficulties in determining the appropriate beta, the appropriate riskless asset, and the effect of taxes. *Id.* For these reasons, the Department used the CAPM results only as a check on the reasonableness of its DCF analyses. *Id.***

Thus, to the extent that the ALJ Report relies on Dr. Amit's CAPM analysis, the Report necessarily supports Dr. Amit's DCF-produced ROE of 9.29 percent and not the CAPM result, itself.

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[4] Ex. 200 at 6-7, 28 (E. Amit Direct); DOC Ex. 202 at 5, 11 (E. Amit Surrebuttal).
[5] Ex. 202 at 11-12 (E. Amit Surrebuttal). Moreover, Dr. Amit showed the many instances in which MERC misapplied the DCF method, its CAPM, its Risk Premium and other analyses. Ex. 200 at 45-59, 61-68 (E. Amit Direct); Ex. 202 at 13-21 (E. Amit Surrebuttal).
[6] Ex. 202 at 17 (Amit Surrebuttal).
[7] Ex. 200 at 28 (E. Amit Direct).

Finally, Dr. Amit explained at length why a macro risk analysis of companies in a comparable group is required for a reasonable ROE analysis.[8] On the contrary, a micro risk analysis regarding particular concerns such as leverage or size is inappropriate because it divides the proxy or comparable group too finely such that no company would qualify for selection for the overall comparison group, and would overemphasize the micro characteristic which is unreasonable.[9] Therefore, in addition to the reasons provided in subsequent discussion, below, the Report's mistaken conclusion that MERC is "riskier" than the companies in the Department's comparison group is incorrect and without foundation at least in part because it appears to be based on adoption of the results of inappropriate micro risk analyses of singular riskier factors such as leverage or size without also accounting for the myriad of other potential risk factors.

2. Exception to Proposed Finding 112

ALJ Report Proposed Finding 112 states incorrectly that Dr. Amit concluded that MERC appears to be somewhat riskier than his comparison group, the Natural Gas Comparison Group (NGCG). The Report states:

> 112. Based upon his examination of 2012 common equity ratios and 2012 long-term debt ratios for companies in the NGCG and MERC, Dr. Amit concluded that the NGCG and MERC present similar investment risks, although "MERC appears to be somewhat riskier than NGCG." [FN 112: [Amit Direct] at 13]].

The conclusion that "MERC appears to be somewhat riskier than NGCG" is an inaccurate conclusion because it is based only on a partial reading of Dr. Amit's Direct Testimony on page 13. A complete reading of his Direct Testimony at 13 shows a discussion of various financial risk measures and his statement that only two quantitative risk measures are available; the equity ratio and long-term debt ratio. He testified that if one were to consider *only*

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[8] Ex. 200 at 60-61 (E. Amit Direct).
[9] Ex. 200 at 60-61, 66-68 (E. Amit Direct).

the two specific risk measures of equity ratio and long-term debt ratio, then MERC would appear to be somewhat riskier than NGCG, as follows:

> Therefore, based on the only available Market quantitative financial risk measures for MERC, MERC appears to be somewhat riskier than NGCG.

Continuing this review, however, shows that Dr. Amit on page 13 of his Direct Testimony made clear that he did not conclude that MERC is riskier than NGCG. Rather, the statement above continued that:

> However, both the equity and debt ratios for MERC are well inside the range of the group's +/- one standard deviation from the means, and three of the companies in NGCG have higher debt ratios than MERC.

Further, he concluded that "MERC's investment risks are reasonably similar to the investment risks of the companies in my comparison group."[10] Dr. Amit testified, as follows:

> **Q. Dr. Amit, please state your conclusion regarding the investment risks of MERC versus the investment risks of a typical company in your comparison group (NGCG).**
>
> A. Based on the only available quantitative market risk measures for MREC (debt ratio and equity ratio) and based on the fact that both MERC and the companies in my comparison group are engaged in the same line of business (natural gas distribution), and are similarly regulated by the stated in which they operate, I conclude that MERC's investment risks are reasonably similar to the investment risks of the companies in my comparison group.

Moreover, on pages 60 through 63 of his Direct Testimony, Dr. Amit explained why MERC's investment risk is not greater than Mr. Moul's Comparison group investment risk. Dr. Amit summarized this issue, as follows:

> **Q. Please summarize your analysis of Mr. Moul's first group of risk indicators.**
>
> A. Based on my analysis of Mr. Moul's first group of risk indicators, I conclude that there is not a valid basis to conclude that MERC's investment risk is greater than Mr. Moul's Delivery group investment risk.

[10] Ex. 200 at 13 (E. Amit Direct).

For the reasons stated above, the ALJ's Report's Proposed Finding 112 is erroneous. Therefore, Proposed Finding 112 should read:

> 112. Based upon his examination of 2012 common equity ratios and 2012 long-term debt ratios for companies in the NGCG and MERC, and based on Dr. Amit's analysis of all the other risk factors for the companies in the NCGC and for MERC, Dr. Amit concluded that the NGCG and MERC present similar investment risks~~, although "MERC appears to be somewhat riskier than NGCG."~~.

3. Exception to Proposed Finding 116

ALJ Report Proposed Finding 116 states incorrectly that Dr. Amit's NGCG included companies whose risk profiles were lower than MERC's, with citation to Dr. Amit's Direct and Rebuttal Testimonies. The Report states:

> 116. Moreover, as noted above, Dr. Amit's NGCG included companies whose risk profiles were lower than MERC's – presumably with easier access to capital. [FN 116: Ex. 200 at 13 (E. Amit Direct); Ex. 201 at 3-4 (E. Amit Rebuttal).]

Proposed Finding 116 is erroneous for the same reasons as explained in detail with respect to the Department Exception to Proposed Finding 112. That is, a complete reading of Dr. Amit's Direct Testimony at page 13 shows his conclusion that MERC's investment risks are reasonably similar to the investment risks of the companies in his comparison group."

For the reasons stated above, Proposed Finding 116 is erroneous. Therefore, Proposed Finding 116 should read:

> 116. Moreover, as noted above, the companies in Dr. Amit's NGCG have an overall risk profile similar to MERC's ~~included companies whose risk profiles were lower than MERC's – presumably with easier access to capital.~~

4. Exception to Proposed Finding 172

Proposed Finding 172 is incorrect; it builds on the ALJ Report's earlier conclusions that MERC's risk profile is higher than that of the Department's comparison group – conclusions that

are corrected by the Department's Exceptions to Proposed Findings 112 and 116 as discussed above. Proposed Finding 172 states, as follows:

> 172. Yet, because MERC's risk profile is higher than the comparison group used by the Department, in the view of the Administrative Law Judge, Dr. Amit's recommendation of 9.40 percent understates the appropriate return on equity. [FN 172: Ex. 200 at 13 and 14 (E.Amit); Ex. 201 at 3-4 (E. Amit Rebuttal).]

This finding is based on an incomplete or partial reading of Dr. Amit's Direct and Rebuttal Testimonies. Dr. Amit observed that "MERC appears to be somewhat riskier than NGCG." The sentence immediately after that observation indicates that the word "appears" is critical. Specifically, as noted above, Dr. Amit stated that "However, both the equity and debt ratios for MERC are well inside the range of the group's +/- one standard deviation from the means, and three of the companies in NGCG have higher debt ratios than MERC." Thus, based on consideration of the totality of risk measures Dr. Amit concluded that, "MERC's investment risks are reasonably similar to the investment risks of the companies in my comparison group."[11]

There are several additional reasons that Proposed Finding 172 is erroneous. First, Dr. Amit's summary of his risk analysis of the companies in his NGCG and as applied to MERC demonstrates that MERC's risk profile is not higher than Dr. Amit's comparable group of companies, as follows

> **Q. Please summarize your analysis of Mr. Moul's first group of risk indicators.**
>
> A. Based on my analysis of Mr. Moul's first group of risk indicators, I conclude that there is not a valid basis to conclude that MERC's investment risk is greater than Mr. Moul's Delivery group investment risk.
>
> **Q. Please summarize the results of your risk-screen analysis.**

[11] Ex. 200 at 12-13 (E. Amit Direct).

A. Both MERC and the companies in my NGCG are mostly engaged in the distribution of natural gas and are similarly rate-of-return regulated by the states in which they operate. Therefore, their business risks are somewhat similar. Regarding the specific risk measures, MERC is a subsidiary company and therefore, does not have beta, STDPC or a credit rating. Therefore, the only market-related quantitative risk measures available for comparison are the long-term debt ratios and the equity ratios.

The average 2012 long-term debt ratio of NGCG is 42.90 percent as compared to 47.01 percent for MREC (the long-term debt ratio for MRC is calculated excluding short-term debt from the capital structure, to make it comparable to the long-term debt ratio for NGCG). The average 2012 ratio for NGCG is 57.10 percent as compared to 52.99 percent for MERC (once again excluding short-term debt from the capital structure). Therefore, based on the only available market quantitative financial risk measures for MERC, MERC appears to be somewhat riskier than NGCG.

However, both the equity and debt ratios for MERC are well inside the range of the group's +/- one standard deviation from the means, and three of the companies in NGCG have higher debt ratios than MERC.

Q. Dr. Amit, please state your conclusion regarding the investment risks of MERC versus the investment risks of a typical company in your comparison group (NGCG).

A. Based on the only available quantitative market risk measures for MERC (debt ratio and equity ratio) and based on the fact that both MERC and the companies in my comparison group are engaged in the same line of business (natural gas distribution), and are similarly regulated by the state in which they operate, I conclude that MERC's investment risks are reasonably similar to the investment risks of the companies in my comparison group.

Second, in support of Finding 172, the ALJ Report referred to Amit Direct at 13 and 34 and Amit Rebuttal at 3-4 in footnote 172. There is no discussion of risk comparison in Amit Direct at 34 or at Amit Rebuttal at 3-4. Further, Dr. Amit's testimony on page 13 of his Direct has been shown, above, not to support a conclusion that MERC's risk profile is higher than Dr. Amit's comparable group.

Third, on pages 60-63, of his Direct Testimony, and as quoted above, Dr. Amit concluded that the record does not support a finding that MERC's investment risk is greater than the investment risk of companies in MERC's comparable group, as follows:

> Based on my analysis of Mr. Moul's first group of risk indicators, I conclude that there is not a valid basis to conclude the MERC's Investment risk is greater than Mr. Moul's Delivery group investment risk.[12]

Finally, Dr. Amit testified that his analysis of MERC's claimed risk factors showed that no upward adjustment of ROE for MERC is reasonable because MERC's risk is similar to the Department's NGCG's risk. Specifically, Dr. Amit concluded, based on his analysis of MERC witness Mr. Moul's Direct and Rebuttal Testimonies, that:

> No upward adjustment of the ROE for MERC is warranted due to risk-specific factors for MERC.[13]

Based on the above analysis, Dr. Amit reasonably concluded that no upward adjustment to the ROE is reasonable because MERC's risk is similar to NGCG's risk.

For the reasons stated above, Proposed Finding 172 is erroneous. Therefore, Proposed Finding 172 should read:

> 172. Because MERC's risk profile is similar to the NCGC's risk profile, Dr. Amit's recommendation of 9.29 percent with flotation costs presents an appropriate return on equity. ~~Yet, because MERC's risk profile is higher than the comparison group used by the Department, in the view of the Administrative Law Judge, Dr. Amit's recommendation of 9.40 percent understates the appropriate return on equity.~~

5. Exception to Proposed Findings 173 and 174

In Proposed Findings 173 and 174 the ALJ Report rejects Dr. Amit's DCF result of 9.29 percent with flotation costs and, instead, erroneously adopts the result of Dr. Amit's CAPM analysis of 9.79 percent as the recommended ROE for MERC. This proposed finding is wholly erroneous largely for the reasons discussed previously in these Exceptions including the fact that

[12] Ex. 200 at 63 (E. Amit Direct).

[13] Ex. 200 at 68 (E. Amit Direct); Ex. 202 at 17 (E. Amit Surrebuttal).

Dr. Amit expressly limited use of his CAPM analysis *only* as a check on the reasonableness of his DCF analysis.[14] Proposed Findings 173 and 174 state as follows:

> 173. In the view of the Administrative Law Judge, the results of Dr. Amit's updated CAPM with flotation costs – namely, a recommended ROE of 9.79 percent – yields a better and more reasonable result. This higher percentage is:
>
> (a) more reflective of the investment risks MERC presents when seeking capital;
>
> (b) one basis point from MERC's updated DCF analysis, which rendered a[n] ROE of 9.8 percent;
>
> (c) supported by Dr. Amit's ECAPM analysis, which resulted in an estimated ROE mean for the NGCG of 9.96 percent with flotation costs;
>
> (d) comfortably within the overall range for Dr. Amit's DCF and TGDCF analyses (with a low of 8.61 percent to a high of 10.14 percent, including flotation costs); and
>
> (e) close to the average ROE determinations made by state utility commissions for the eleven natural gas rate cases that were resolved during the fourth quarter of 2013 – specifically, an average ROE of 9.83 percent. [FN omitted]
>
> 174. Based upon the records in these proceedings, a return on equity for MERC of 9.79 percent is reasonable and appropriate.[FN 174 omitted: ALJ Report recommended capital structure]

The Department will not repeat its Exceptions analyses other than to give brief reasons why the record does not support these proposed findings. First, Dr. Amit's CAPM analysis confirms the reasonableness of Dr. Amit's DCF result of 9.29 percent with flotation costs and does not support reliance on the CAPM as a stand-alone ROE result.[15] Second, Dr. Amit fully rebutted MERC's argument that its investments risk somehow warrants an upward adjustment to ROE[16] such that the statement in paragraph (a) is inaccurate and unsupported by the record.

[14] Ex. 200 at 28 (E. Amit Direct).
[15] Ex. 202 at 11 (E. Amit Surrebuttal). *See also* Ex. 200 at 28 (E. Amit Direct).
[16] Ex. 200 at 61-66 (E. Amit Direct); Ex. 202 at 16-18, 21 (E. Amit Surrebuttal).

Third, reference in paragraph (b) to MERC's updated DCF result must be disregarded in that Dr. Amit demonstrated the many ways in which MERC misapplied its DCF analysis.[17] Fourth, paragraph (c) must be rejected because Dr. Amit clearly did not conclude that his ECAPM result was a reasonable ROE for MERC,[18] and his ECAPM analysis resulted in an estimated ROE mean for the NGCG of 9.76 percent, not 9.96 percent.[19] Fifth, paragraph (d) suggests incorrectly that Dr. Amit determined that any number within the range of ROEs of his comparison group would be a reasonable ROE for MERC; he did not. Dr. Amit concluded that the mean ROE of his comparison group of 9.29 percent with flotation costs is reasonable.[20] Finally, paragraph (e) suggests mistakenly that comparing the ROEs of other state-regulated utilities last year is a reasonable way to determine the ROE for MERC. The Department's Initial Brief summarized Dr. Amit's testimony making clear that such an analysis is irrelevant to the determination of MERC's ROE in the present rate case, as follows:

> Contrary to Mr. Moul's claim, recent commission decisions do not show that Dr. Amit's recommended ROE is too low. [Ex. 202 at 18–19 (Amit Surrebuttal)]. The average ROE for the group of eleven natural gas rate cases determined in the fourth quarter of 2013, was 9.83 percent compared to Dr. Amit's Direct Testimony ROE of 9.40 percent. *Id.* at 18. However, the range of those allowed ROEs went from a low of 9.08 percent to a high of 10.25 percent. *Id.* This range means that some allowed ROEs were significantly below Dr. Amit's initial recommendation of 9.40 percent, *id.*, and lower than Dr. Amit's final recommended ROE of 9.29 percent. Moreover, based on Mr. Moul's own argument, his recommended ROE of 10.75 percent is unreasonably high. *Id.* at 19.
>
> Dr. Amit also observed that state utility commission decisions issued in the fourth quarter of 2013 are likely based on data from 2012 and early 2013. Ex. 202 at 19 (Amit Surrebuttal). Thus, such decision[s] likely reflect outdated economic and financial data that are not relevant to the current MERC general rate case. *Id.*

[17] Ex. 200 at 45-51 (E. Amit Direct); Ex. 202 at 13-14, 16 (E. Amit Surrebuttal).
[18] Ex. 200 at 32-34 (E. Amit Direct). *See* Ex. 202 at 31-32 (E. Amit Surrebuttal).
[19] Ex. 200 at 33 (E. Amit Direct).
[20] Ex. 202 at 2, 11-12 (E. Amit Surrebuttal).

For the reasons stated above, Proposed Findings 173 and 174 are erroneous. Therefore, Proposed Finding 173 should be stricken and Proposed Finding 174 should read:

> ~~173. In the view of the Administrative Law Judge, the results of Dr. Amit's updated CAPM with flotation costs — namely, a recommended ROE of 9.79 percent — yields a better and more reasonable result. This higher percentage is:~~
>
> ~~(a) more reflective of the investment risks MERC presents when seeking capital;~~
>
> ~~(b) one basis point from MERC's updated DCF analysis, which rendered a ROE of 9.8 percent;~~
>
> ~~(c) supported by Dr. Amit's ECAPM analysis, which resulted in an estimated ROE mean for the NGCG of 9.96 percent with flotation costs;~~
>
> ~~(d) comfortably within the overall range for Dr. Amit's DCF and TGDCF analyses (with a low of 8.61 percent to a high of 10.14 percent, including flotation costs); and~~
>
> ~~(e) close to the average ROE determinations made by state utility commissions for the eleven natural gas rate cases that were resolved during the fourth quarter of 2013 — specifically, an average ROE of 9.83 percent. [FN omitted]~~
>
> 174. Based upon the records in these proceedings, the Department's updated DCF ROE result of 9.29 percent with flotation costs (Amit Surrebuttal at 2) ~~a return on equity for MERC of 9.79 percent~~ is the most reasonable and appropriate result for MERC's cost of equity.
>
> [Footnote 174 regarding the final capital structure should read: Consistent with the recommended Common Equity and Overall Rate of Return on page 12 of Dr. Amit's Surrebuttal Testimony, ~~T~~the resulting recommended capital structure should ~~would~~ be corrected to read:

	Capitalization Ratio	**Cost Percentage**	**Weighted Cost**
Long-Term Debt	0.4464	0.055606	0.024823
Short-Term Debt	0.0505	0.023487	0.001186
Common Equity	0.5031	0.0929 ~~0.0979~~	0.046738 ~~0.049253~~
Total:	1	**Rate of Return:**	7.2747% ~~7.5262%~~

> [Ex. 202 at 12 (Amit Surrebuttal) [the Department agrees with the ALJ Report's Long-Term Debt and Short-Term Debt numbers]].

6. Clarifications and Corrections

The Department identifies the following clarifications and corrections are needed for Proposed Findings 160-162:

> 160. Application of the ECAPM analysis resulted in an estimated ROE mean for the NGCG of 9.76 ~~9.96~~percent with flotation costs. [FN: Ex. 200 at 33 (Amit Direct)]
>
> 161. In Dr. Amit's Direct Testimony, ~~T~~the ECAPM's ROE was appreciably higher than Dr. Amit's CAPM's ROE and somewhat close to the mean of his DCF's ROE for the NGCG.
>
> 162. In his Direct Testimony, Dr. Amit's CAPM and ECAPM results for the NGCG lie within the range of Dr. Amit's DCF/TGDCF estimated ROEs – specifically, between 8.61 percent and 10.14 percent.

B. Discount Rate for Future Pension Expenses

Paragraphs 232 to 256 of the ALJ Report discuss what discount rate should be assumed for future pension expenses when determining the test-year pension and post-retirement life insurance costs.

As an initial matter, the Department has not taken a position on MERC management of its pension plans, such as its change from a defined benefit to a defined contribution plan for union and non-union employees, other than to note that the Department has not advocated for reductions, increases, or any other changes in pensions to be paid to utility employees. The Department has, however challenged the assumptions that utilities propose in rate cases to estimate the amounts to charge to ratepayers in current rates to fund pensions in future years.

The ALJ Report correctly found at paragraph 239 that "at the crux of the dispute is the parties' very different assessments of the near-term risks to the plan" upon which the actuarial assumptions used to set discount rates are based.

MERC proposed test year expenses for pensions that resulted from use of discount rates that were in accord with GAAP and the guidance in Accounting Standards Codification Topic

715. ALJ Report paragraph 234. The Department does not dispute GAAP's annual financial accounting, but maintains that, for ratemaking purposes, the Company's proposed test year expense for pension costs is inappropriate because the discount rates MERC proposed were unreasonable. ALJ Report paragraph 236.

The Department continues to maintain that it is inappropriate for test year expenses of a regulated utility such as MERC to be based upon discount rates that are less than the expected rate of return on the plan's assets. Eight percent is set forth as the Company's expected return on plan assets in its January 2014 update. MERC Ex. 26 at 11, 14, 15 (C. Hans Direct).

It is not reasonable for ratemaking purposes to establish a level of pension expense in the test year based on ASC 715. The Commission's ratemaking function of establishing a reasonable level of pension expense in rates materially differs from the utilities' financial reporting and accounting functions prescribed under ASC 715. First, companies annually change the level (update) of pension expense based on the requirements in ASC 715. Thus, if the level of pension expense in rates is determined based on ASC 715, it is highly unlikely that the pension expense going forward will be the same over time because of the frequent updates. In contrast, for ratemaking purposes, the level of pension expense in rates should reflect the likely and reasonable expense going forward, until the utility next chooses to file a rate case. DOC Ex. 219 at 26–27 (M. St. Pierre Surrebuttal).

Second, MERC provided no support for its proposition that the ratemaking function should anticipate that regulated utilities may experience severe financial distress, under which that utility company could be required to "settle" its pension benefits, as contemplated under ASC 715. *Id.* at 28. Under the prescriptions of ASC 715,

> The discount rate is developed by selecting an actual bond portfolio *to settle* each plan's expected future benefit payments.

MERC Ex. 27 at 9 (Hans Rebuttal) (emphasis added). Furthermore, under the prescriptions of ASC 715:

> [T]he discount rate is intended to represent the rate at which benefit obligations, payable by the plan in the future, *could be settled.* The rates of return on high-quality fixed-income investments currently available and expected to be available during the period to maturity of the benefits are used in determining the discount rate.

MERC Ex. 27 at 8 (C. Hans Rebuttal) (emphasis added).

The record does not support a determination that MERC is likely to go bankrupt or face a financial collapse that would require it to immediately "settle" its future pension obligation before its next rate case or that it is at imminent risk of having to do so. Regulated utilities like MERC are highly unlikely to ever have to "settle" their pension benefits in the manner contemplated under ASC 715 and would be expected to inform the Commission about any such occurrence of severe financial distress that could compel a non-regulated company into settlement of pensions. Further, regulated utilities like MERC have the right under Minnesota Statutes to request an increase in retail rates and receive interim-rate revenues, should they encounter such distress. Minn. Stat. § 216B.16 (2012). Moreover, even if MERC were to experience such financial distress, it is highly unlikely that MERC would be required to immediately settle its future pension benefits. MERC has not shown that it is likely to incur financial distress and be required to "settle" (cash out) its pension benefits as contemplated under ASC 715. DOC Ex. 219 at 28 (M. St. Pierre Surrebuttal). ASC 715 simply provides no reasonable basis for the Commission to use in deciding the reasonable discount rate for setting a regulated utility's pension expense in a retail ratemaking proceeding. Further, given the purpose of ASC 715—to protect pension assets when a company is under financial duress—and the contrary purpose of the determination of test-year expenses under the ratemaking provisions of

Minnesota Statues, it is unreasonable to set rates set based on requirements for annual financial statement purposes. Tr. at 217 (M. St. Pierre). Use of a discount rate developed under ASC 715 for the purpose of ratemaking would introduce a bias toward inflated test-year expenses, because discount rates developed under ASC 715 are generally lower than the expected return on assets. The assumption under ASC 715 is that a company would *presently* pay more to settle each plan's expected future benefit payments, so the discount rate is lower than the long-term expected return on the investment assets. DOC Ex. 219 at 28 (M. St. Pierre Surrebuttal).

Third, any concern that the Department's recommendation is not consistent with the pension plan's target allocation is misplaced. Ms. Hans noted that "[c]urrently, the pension plan assets have a target allocation of 70% equity and 30% fixed income." DOC Ex. 219 at 28 (M. St. Pierre Surrebuttal) (*citing* MERC Ex. 27 at 11 (C. Hans Rebuttal)). If no financial duress is presumed, however, there is also no need to determine an allocation of investment income to calculate a discount rate. The Department's recommendation is not to change the underlying economics used to determine these two factors, of a discount rate and return on plan assets rates, in order to produce the same results, as suggested by Ms. Hans. The recommendation is simply to match the discount rate to the eight percent expected return on assets to avoid unreasonable biased (and inflated) test-year expenses for ratemaking purposes. DOC Ex. 219 at 28 (St. Pierre Surrebuttal). The only reason MERC's discount rate and expected long-term growth rate assumptions differ is because MERC applies to the discount rate an inapplicable accounting standard that increases the premium to be charged to ratepayers under which MERC is expected to "settle" at present its future pension obligation. It is unreasonable to assume for ratemaking purposes that MERC will face financial duress that would require such settlement, certainly not prior to MERC's next rate case.

Fourth, the Commission is not required to follow GAAP's ASC 715 for ratemaking purposes, and it would be wrong and harmful to ratepayers in this circumstance to do so. There may be some similarities, but there are also important differences between a decision by the Commission for ratemaking purposes and financial standards used for other purposes. The Commission's ratemaking function, of establishing a reasonable level of pension expense in rates, differs materially from the utility's accounting or bookkeeping functions as prescribed under ASC 715, which is intended to protect pension assets from companies that may go bankrupt. Factual differences include the fact that, the level of pension expense in rates must reflect the likely and reasonable expense going forward until the Company's next rate case. In contrast, financial reporting for companies changes every year (and sometimes more often) to reflect changing circumstances. DOC Ex. 219 at 29 (M. St. Pierre Surrebuttal). It is important that the purpose for using a particular accounting standard is applicable in the situation presented to a decision-maker.

Finally, after the close of the evidentiary hearing record, in its Initial Post Hearing Brief, MERC for the first time proposed a new methodology for establishing the test year cost: use of a "five-year historical average" of earlier discount rates. MERC's new post-hearing proposal was not examined by any party to the contested case proceeding by means of pre-hearing discovery and analysis, nor was it vetted or subject to cross-examination during the hearing in this proceeding on behalf of the public; this proposed new costing methodology is neither reasonably reliable nor appropriate for consideration in this proceeding.

Moreover, a methodology that averages several years of discount rates is inappropriate if each of those annual discount rates was inflated, based on the incorrect actuarial assumption that MERC must immediately "settle" its pension obligation; averaging several such erroneously

inflated rates would overstate annual pension expense. This approach results in a factually unsupported discount rate and inappropriately overstates test year expenses to be charged to ratepayers.

The ALJ correctly observed that:

> 245. From the perspective of the Department, to the extent that any discount rate that is applied to the expected future benefit payments is less than the plan's rate of return, the amounts that are allocated to satisfy pension obligations will be overstated. As the Department reasons, MERC's proposed discount rates reflect both the amounts that are needed for near-term payouts to beneficiaries and a premium paid by ratepayers so that the Company could fully resolve all of its future pension liabilities, in a short time, if it needed to do so.
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> 246. Arguing that the risk that MERC will need to resolve its long-term pension liabilities quickly, during the period that the new rates will be in effect, is quite low, the Department maintains that this added premium is unreasonable.
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> 247. In the view of the Administrative Law Judge, the Department has both the better policy argument and the weaker case law. To the extent that MERC maintains that its rates should reflect contingent plans for near-term settlement of its pension obligations ... those arguments do not persuade this tribunal. *This is because having a discount rate that is lower than the overall rate of return on plan assets, means that the test year pension amounts will include the costs of covering a contingent, and speedy resolution of MERC's pension liabilities.*
>
> 248. *There is real doubt whether an otherwise reasonable ratepayer would pay (a good bit) more in order to address that contingency.*

ALJ Report, paragraphs 245-248 (emphasis added) (citations omitted).

The five-year average discount rate also is unreliable for ratemaking because each annual discount rate used in the calculation is forecasted. The Department strongly disagrees with the Company's assertions that its actuarial determination of its pension costs is "based on actual December 31st, 2013 discount rates" and "[t]he 2014 test year costs proposed by MERC are now known with a certainty; it is not an estimate." Tr. at 55 (C. Hans) (Doc. ID 20145-99937-01).

The Company's 2014 test-year actuarial costs, and each of the previous five years' actuarial costs, including each year's discount rates, are merely estimates based on multiple assumptions. As such, an "actual" discount rate does not exist. MERC's characterization of the rates being "actual" merely refers to the fact that the Company has calculated the actuarial costs according to ASC 715 that it will report for each year's financial statement purposes. The mere fact that the Company has used the various years' discount rates for financial reporting not only fails to make these estimate rates reliable for ratemaking, the effect of ASC 715 ensures that they are not appropriate for ratemaking purposes.

Finally, the Department appreciates the conclusion noted above in the ALJ Report that "the Department has the better policy argument" (ALJ Report paragraph 247) and that "[t]here is real doubt whether an otherwise reasonable ratepayer would pay (a good bit) more in order to address [the] contingency [that MERC would have to settle its pension asset in the near term]" (ALJ Report paragraph 248). In addition, the Department appreciates the observation that the Commission's decision in the CenterPoint Rate Case (Docket No. G008/GR-13-316) was issued after the record in the instant case was closed.

The fact that the record was closed in the instant case when the Commission made an unexpected decision in the CenterPoint case is key given that the Commission's decision in the CenterPoint Rate Case is vastly different from the Commission's previous decision of the same contested issue in Xcel Energy's prior Rate Case (Docket No. E002/GR-12-961), for reasons that are not clear.[21] There was no expectation in the instant case that the Commission would rule in a

[21] The Commission's September 3, 2013 Findings of Fact, Conclusions of Law and Order at page 7 adopted the proposed finding of the ALJ Report in that proceeding, which stated:

162. The Department objected to the Company's proposed SFAS 87 Discount Rate, both as originally proposed and the rebuttal proposal. The Department maintained that the

(Footnote Continued on Next Page)

concurrent docket in contradiction to its decision in the prior Xcel case regarding the appropriate discount rate to use for pension assets for ratemaking purposes. Thus, the record in the instant case is not adequately developed to address that unexpected outcome. Given the timing of the Commission's decision in the CenterPoint case, there was no opportunity to develop the record further in the instant case on this issue.

If the Commission is inclined to set the discount rate at a lower level (such as the average of five years of discount rates that assume MERC would need to settle its pension assets in the near term), the Department requests that the Commission send this issue back to the ALJ to be

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(Footnote Continued from Previous Page)

> SFAS 87 Discount Rate should match the EROA rate, which is higher. The Department noted that the Discount Rate and the EROA rate used by the Company to calculate the NSPM pension expense are the same (7.5% in Direct Testimony). The Department asserted that the Company should also match the SFAS 87 Discount Rate to the EROA for the XES plan. The Department maintained that this approach ensures that the discount rate, which is used to measure the time value of money, is consistent with the level of expected return on assets. According to the Department, if the two do not match, then the pension obligation will be overstated and unnecessarily increase the liability to be addressed. The Department estimated that increasing the SFAS 87 Discount Rate used for the XES Plan from 5 percent to 7.5 percent (the EROA amount) would result in an $870,450 reduction to the pension expense.
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> 163. The Company countered that if the Department's recommendation on the SFAS 87 Discount Rate were adopted for the XES Plan, it would lead to permanent under recovery of costs by the Company because there are significant differences between the accounting method used for the XES plan and the accounting method used.
>
> 164. The Administrative Law Judge concludes that the Department's recommendation to use a 7.5 percent Discount Rate for the XES plan is reasonable. This approach is consistent with the approach used by the Company for the NSPM plan and appropriately matches the discount rate to the EROA. The Company has not adequately explained why a different Discount Rate should be used for the XES Plan for ratemaking purposes. Accordingly, the Administrative Law Judge recommends that the Discount Rate for the XES Plan be set at 7.5 percent, the same level as is recommended for the EROA rate.

Xcel Energy Rate Case, Docket No.E002/GR-12-961, ¶¶ 162-164. (citations omitted).

developed further in this contested case proceeding to provide adequate and due process consistent with meeting the public interest.

The Department recommends adoption of the ALJ Report subject to the following changes to paragraphs on discounting of future pension expenses as follows:

243. Likewise, in its Initial Post Hearing Brief, MERC proposed use of a "five-year historical average" of earlier discount rates. Such an approach was approved by the Commission, after the close of the evidentiary hearing in this proceeding, *In the Matter of an Application by CenterPoint Energy Resources Corp.*[243] MERC's proposal has not been examined in discovery, vetted or subject to cross-examination in this proceeding on behalf of the public and thus is not ripe for consideration in this proceeding. An approach that averages five years of discount rates is inappropriate if each of those annual discount rates is based on the factually erroneous assumptions that MERC must immediately "settle" its pension obligation; averaging several of such erroneous rates continues to overstate annual pension expense. This approach results in a factually unsupported discount rate and inappropriately overstates pension expense to be charged to ratepayers.

245. From the perspective of the Department, to the extent that any discount rate that is applied to the expected future benefit payments is less than the plan's rate of return, the amounts that are allocated to satisfy pension obligations will be overstated. As the Department reasons, MERC's proposed discount rates reflect both the amounts that are needed for near-term payouts to beneficiaries and a premium paid by ratepayers so that the Company could fully resolve all of its future pension liabilities, in a short time, if it needed to do so.[245] MERC presented no evidence that it must immediately "settle" its future pension obligation or that it is at imminent risk of having to do so.

[243] *See* MERC'S INITIAL POST-HEARING BRIEF, at 61 (June 24, 2014); *see also In the Matter of an Application by CenterPoint Energy Resources Corp. d/b/a CenterPoint Energy Minnesota Gas For Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-008/GR-13-316, FINDINGS OF FACT, CONCLUSIONS AND ORDER, at 12 (June 9, 2014) (Doc. ID No. 20146-100252-01).

[245] Ex. 217 at 29 (M. St. Pierre Direct); Ex. 219 at 28 (M. St. Pierre Surrebuttal) (Accounting Standards Codification Topic 715 recognizes discount rates that are lower than the expected rates of return on plan assets because "[t]he assumption is that a company would pay more to settle each plan's expected future benefit payments so the discount rate is lower than the long-term expected return on the investment assets").

248. The Administrative Law Judge concludes that there is real doubt whether an otherwise reasonable ratepayer would pay (a good bit) more in order to address that contingency.[248] Where doubt exists, it should be resolved in favor of ratepayers. Minn. Stat. § 216B.03 (2012).

249. ~~With that said, the facts and circumstances described in *In the Matter of an Application by CenterPoint Energy Resources Corp,* are indistinguishable from the case at bar. Use of a five-year historical average in this case will undoubtedly "buffer the effects" of any below-average discount rates and, in the Commission's view, "is more reasonable than a discount rate determined at a single point in time …."[249]~~ The ALJ finds that it is not reasonable for the Commission to be guided by ASC 715 when deciding the reasonable discount rate when setting a regulated utility's pension expense in a retail ratemaking proceeding. The Commission is not required to follow GAAP's ASC 715 for ratemaking purposes, and it would be wrong in this circumstance to do so. The Department has demonstrated that its calculated 2014 test year pension benefit expense is reasonable and should be accepted in this rate case.

250. ~~Applying the principles announced in *CenterPoint*, the Administrative Law Judge concludes that use of a five-year historical average of discount rates is more appropriate than application of the expected rate of return on plan assets. This is because use of a single rate of return, as the discount rate, necessarily amounts to a "discount rate determined at a single point in time."[250]~~ The ALJ finds that MERC's test year pension expense should be decreased by $1,350,012 for 2014.

251. ~~Because the Order in *CenterPoint* was issued after the close of the evidentiary hearing in this case, the parties themselves will need to confer as to the appropriate adjustments to test-year pension expenses.[251]~~

254. With respect to MERC's proposed post retirement life insurance expense, the Department recommended~~s~~ an increase of $3,853 based on changing

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[248] *See id.; see also, In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota,* OAH Docket No. 68-2500-30266 at 33-34 (July 5, 2013) (Doc. ID No. 20137-88857-01); *In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota*, Docket No. E-002/GR-12-961, FINDINGS OF FACT, CONCLUSIONS, AND ORDER at 7 (Sept. 3, 2013) (Doc. ID No. 20139-90902-01).

[249] ~~*In the Matter of an Application by CenterPoint, supra,* at 12.~~

[250] *Id.*

[251] *Id.*

the discount rate to equal MERC's expected return on plan assets in its January 2014 update.[254]

255. The Administrative Law Judge finds that MERC's actuarial determined 2014 test year post-retirement medical plan expense and the Department's life insurance expense is reasonable and most accurately reflects the cost that MERC will incur during the test year.[255]

C. Uncollectible Expenses

The ALJ Report at paragraphs 283 to 296 discusses the test-year uncollectible expense. The Company initially proposed to recover $1,765,884 for its test-year uncollectible debt expense. The Department's proposed uncollectible expense is approximately $1,661,164, or a decrease of $104,720 from MERC's initial test year forecast of $1,765,884. Department Post Hearing Reply Brief, page 25.

MERC had calculated its 2014 test-year uncollectible expense using an average of the three past years, 2010-2012. Dividing those years' uncollectible expense by tariff revenues[30] generated a percentage of tariff revenues of 0.650401 percent. MERC then applied this percentage to MERC's 2014 test year forecasted tariff revenues plus its proposed rate increase of $14,000,000. MERC Ex. 19 at 16–17 (S. DeMerritt Direct); MERC Ex. 24 at 9 (S. DeMerritt Rebuttal). The ALJ Report at paragraph 296 recommended that the Commission use this averaging methodology, and specifically, use an average percentage of tariffed revenue from the three most-recent years (2011, 2012, and 2013).

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[254] Ex. 219 at 33 (M. St. Pierre Surrebuttal).

[255] Ex. 27 at 4-12.

[30] MERC's proposed "tariffed revenues" is a combination of two figures: tariffed sales revenue at present rates of $257,506,848. MERC Ex. 24 at SSD-3 (S. DeMerritt Rebuttal). MERC's tariffed sales revenue at present rates of $257,506,848 incorrectly included Michigan revenue of $320,286. MERC Ex. 19 at SSD-4 (S. DeMerritt Direct). Thus, the Minnesota tariffed sales revenue at present rates would have been $257,186,462. Department Post-Hearing Reply Brief at p. 24, n. 43, 46 and Attachment 1.

The Department continues to disagree with the Company's proposal and ALJ's recommendation to use an average of three past years when calculating the uncollectable expense ratio in this instance for the following reasons. First, averaging several years' revenues is not a reasonable methodology for calculating an expense in circumstances where there is a clear trend for costs to be varying in a single direction. Averaging several years' revenues can be appropriate when costs vary significantly up and down from year to year. DOC Ex. 219 at 36 (St. Pierre Surrebuttal.) In those circumstances, averaging allows for a leveling of booms and busts, which is a fair approach. Such fluctuation is not the case here, however. An averaging methodology is not reasonable for MERC's uncollectable debt expense because there is a clear downward trend, with annually lower costs every year since MERC's last rate case, as shown in the table below. DOC Ex. 219 at 36 (M. St. Pierre Surrebuttal); DOC Ex. 218 at MAS-25 (M. St. Pierre Direct Attachment). It is not appropriate to use averaging when there is a trend of diminution in cost, especially when any doubt as to reasonableness must be resolved in favor of the consumer. Minn. Stat. § 216B.03 (2012). The table below demonstrates that MERC's uncollectible ratio has been dropping by approximately 0.10 percent each year since MERC's last general rate case test year, 2011.

	Approved	2011 Actual*	2012 Actual	2013 Actual**
Uncollectible Exp.	$2,031,888	$1,984,374	$1,313,501	$1,481,318
Tariffed Revenue		$255,269,107	$200,736,162	$26,9448,208
% of Tariffed Rev.		**0.777366%**	**0.654342%**	**0.549760%**

**MERC provided the 2011- 2012 information in MERC Ex. 19 SSD-4 (DeMerritt Direct).*
***MERC provided 2013 information in response to DOC IR 143. DOC Ex. 218 MAS-24 (St. Pierre Direct Attachment). The actual 2013 uncollectible expense ratio was 0.549760 percent. DOC Ex. 217 at 39 (St. Pierre Direct).*

This table shows that the actual 2013 uncollectible expense ratio decreased from 2012 by approximately 0.105 percent (0.654342 - 0.549760). Further, the actual 2013 uncollectible

expense ratio is also lower, by approximately 0.101 percent (0.650401 - 0.549760), than MERC's forecasted test year ratio. The Department concluded that MERC's proposed test-year uncollectible expense ratio of 0.650401 percent is unreasonable and that the more current 2013 ratio of 0.549760 percent should be used. DOC Ex. 219 at 36 (St. Pierre Surrebuttal).

Second, there is no factual evidence to support a conclusion that uncollectable debts reasonably could be expected to be greater in the 2014 test year than in 2013, to justify use of a averaging methodology based on future cost increases. To the contrary, the data indicates that the uncollectible expense rate has been going down, rather than upward. DOC Ex. 217 at 39 (St. Pierre Direct); DOC Ex. 219 at 36 (St. Pierre Surrebuttal). In every year since 2011, MERC's actual uncollectible expense was less than the $2,031,888 amount approved in the last rate case. DOC Ex. 19 at 36 (St. Pierre Surrebuttal). For these reasons, the ALJ Report's recommendation of using MERC's proposed averaging methodology for calculating the test-year uncollectible expense ratio is unreasonable. The more current actual 2013 ratio of 0.549760 percent should be used. DOC Ex. 217 at 39 (St. Pierre Direct); DOC Ex. 219 at 36 (St. Pierre Surrebuttal).

The Department also disagrees with the ALJ's recommendation, at paragraph 296 of the ALJ Report, to apply the uncollectible expense ratio to MERC's 2014 test year forecasted tariff revenues, plus "an assumed rate increase" of $12,000,000, because adding a $12,000,000 "assumed rate increase" to the test year forecasted tariff revenues, instead of adding the revenue deficiency that the Commission will determine, is inconsistent with other recommendations in the ALJ Report regarding the amount of the revenue deficiency. Because of this inconsistency, it is possible that the inclusion of the $12,000,000 in paragraph 296 may have been a simple editing mistake or oversight.

Even if inclusion of the $12,000,000 in paragraph 296 was intentional, it should not be adopted by the Commission. The uncollectible expense ratio is calculated by dividing bad debt expense by "tariffed revenues." Tariffed revenues is a combination of two figures: tariffed sales revenue plus the revenue deficiency. With respect to the problem that the calculation of uncollectible expense is "circular," MERC initially recommended using a revenue deficiency of $14,000,000 to calculate the amount of sales of $271,506,848. MERC Ex. 19 at 16–17 (DeMerritt Direct); MERC Ex. 19 at SSD-4 (DeMerritt Direct); Tr. at 223–225 (St. Pierre). In her Direct Testimony, Department witness Ms. St. Pierre recommended that once the Commission determines the revenue deficiency, the Commission could require MERC to adjust the uncollectible expense in its compliance filing for final rates accordingly. DOC Ex. 217 at 40 (St. Pierre Direct); DOC Ex. 219 at 37 (St. Pierre Surrebuttal). In Rebuttal, MERC Witness Mr. DeMerritt disagreed and proposed "to update the uncollectible expense with revenues calculated in Rebuttal Exhibit ___ (GJW-1)" and to "include $12,000,000 for an assumed rate increase based on MERC's current position for the revenue requirement," referring to his Rebuttal Ex. 24 (SSD-3) for the calculation of his uncollectible expense. DOC Ex. 219 at 37 (St. Pierre Surrebuttal) (*citing* MERC Ex. 24 at 9–10 (DeMerritt Rebuttal)). The ALJ Report at paragraph 296 adopted this Company proposal to "include $12,000,000 for an assumed rate increase" even though the ALJ Report elsewhere makes findings and recommendations that result in a much lower revenue deficiency. The record for this reason does not support the inclusion of the 12,000,000 "assumed rate increase" instead of the revenue deficiency amount that will be determined by the Commission.

In conclusion, the Department continues to recommend that the Commission use MERC's actual 2013 uncollectible expense ratio of 0.549760 percent rather than MERC's

proposed ratio of 0.650401 percent. To determine the test-year amount in the compliance filing, MERC should multiply this actual 2013 uncollectible expense ratio (of 0.549760) by the Department's and MERC's agreed-upon test-year tariffed sales revenue and add the revenue deficiency amount as determined by the Commission.

The Department recommends adoption of the ALJ Report only after amending the following paragraphs:

> 292. The Department recommended that MERC use the 2013 actual uncollectible expense ratio of 0.549760 percent rather than MERC's proposed ratio of 0.650401 percent. The Department argues that the averaging of uncollectible expenses (and percentages) is not appropriate when there is "a clear downward trend" in the levels of uncollectible expense.[292] MERC's uncollectible ratio has been dropping year after year by approximately 0.10 percent each year since MERC's last general rate case test year, 2011. Because doubt as to reasonableness must be resolved in favor of the consumer, Minn. Stat. § 216B.03 (2012), it is inappropriate to average when there is a trend of diminution in cost.
>
> 293. Specifically, the Department recommended that the 2013 percentage of tariffed revenue (0.549760%) be applied to corrected projections of tariffed revenue in the test year, for an uncollectible expense amount of ~~$1,657,805~~$1,661,164.[293]
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> 294. Pointing to the wide fluctuation in the rates of bad debt from year to year, the OAG-AUD argues that the methods of averaging urged by MERC ~~and the Department~~ are not reliable. It maintains that the Commission should instead consider economic factors, such as "the much improved economy and the lower relative price of natural gas," when assigning an uncollectible expense amount of $1,350,000 for the test year.[294]
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> 296. The Administrative Law Judge concludes that MERC's proposed test-year uncollectible expense ratio of 0.650401 percent is unreasonable and that the more current 2013 ratio of 0.549760 percent should be used ~~agrees with each of the parties, in part. In his view, the Commission should use the average percentage of tariffed revenue from the three most recent years (2011, 2012 and 2013) and then apply this percentage~~ and applied to

[292] Ex. 219 at 36 (M. St. Pierre Surrebuttal).
[293] DEPARTMENT REPLY BRIEF~~, PART 2 OF 2~~, at ~~75~~25.
[294] Ex. 151 at 6-7 (J. Lindell Direct).

> the sum of MERC's 2014 test year ~~forecasted~~ tariffed sales revenues agreed-upon by MERC and the Department, plus ~~an assumed rate increase of $12,000,000~~the revenue deficiency that the Commission approves in this rate case. This method relies upon the most-recent figures, accounts for ~~variability~~ the downward trend in the rates of uncollectible expense due to the much improved economy and the lower relative price of natural gas that the U.S is experiencing at present ~~and best carries forward the Commission's earlier approaches to these issues.~~[296]

D. Calculation of Conservation Cost Recovery Charge (CCRC)

At paragraph 577 of the ALJ Report, the ALJ noted that, under the Department's proposal, "MERC's revenue deficiency would be lowered and a corresponding amount would be included in the CCRA. *In this way, CIP expense would move from the Distribution Rate to the final approved CIP Rate on the customer's bill.*" (emphasis added) The ALJ observed that MERC was not opposed to this approach,

> [P]provided that the dockets related to the CCRA are finalized and an order is issued in a timely fashion. In addition, if changing the CCRC to $0.00000 were to occur in the current docket, MERC requests that its proposed *CCRC of $0.02462 be added to the CCRA* on January 1, 2015, or with implementation of final rates, whichever occurs later, so as not to delay the recovery of these expenses.

(ALJ Report, paragraph 579) (emphasis added).

The ALJ agreed with the parties, stating that "*the CCRC should be added to the CCRA* on January 1, 2015, or with implementation of final rates, whichever occurs later." ALJ Report, paragraph 582 (emphasis added).

Despite this consensus of the ALJ and parties, the ALJ Report makes an erroneous recommendation regarding CCRC at paragraph 613 that should be corrected as follows:

613. The Administrative Law Judge recommends that:

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[296] ~~*See generally*, Ex. 19 at 16-17 (S. DeMerritt Direct); MERC Ex. 24 at 9 (S. DeMerritt Rebuttal); Ex. 218 MAS-25 (M. St. Pierre Direct Attachment); EVIDENTIARY HEARING TRANSCRIPT, at 229 (M. St. Pierre).~~ Ex. 24 at Schedule (SSD-3) (S. DeMerritt Rebuttal); Ex. 217 at 39 (M. St. Pierre Direct); Ex. 219 at 36-37 ~~and 44~~ (M. St. Pierre Surrebuttal)~~.;~~ Ex. 219 at 36 (M. St. Pierre Surrebuttal); Ex. 151 at 7 (J. Lindell Direct).

(1) MERC should report in its final rates compliance filing the calculation of the CCRC rate based upon the Commission's Order, with respect to the level of CIP expenses divided by the level of sales approved by the Commission;

(2) CIP would be recovered through one line item on a customer's bill (MERC CCRA); and

(3) If the Commission decides to keep the CCRC in the Distribution rate, then in future general rate-case filings, MERC should change the CCRC rate at the beginning of interim rates and again at final rates.

III. OTHER CORRECTIONS

A. Typographical Errors

The Commission may wish to correct the following typographical errors that appear in the ALJ Report.

- P. 29, footnote 181 should be changed to ~~Id. at 5.~~ Ex. 212 at 11 (L. Otis Direct).
- P. 29, footnote 182 should be changed to ~~Ex. 212 at 10-11 (L. Otis Direct)~~ *Id.* at 11-12.
- P. 30, footnote 188 should be changed to ~~*Id.* at LBO-11~~ *Id.* at 27.
- P. 30, footnote 190 should be changed to Ex. 212 at LBO- ~~11~~ 12 (L. Otis Direct).
- P. 30, footnote 191 should be changed to Ex. 212 at 28-29, 32 and Schedule (LBO-~~11~~ 12) (L. Otis Direct).
- P. 31, footnote 195 should be changed to ~~Ex. 39 at 8 (H. John Rebuttal).~~ *Id.* at 5-6; Ex. 39 at 8 (H. John Rebuttal).
- P. 34, footnote 209 should read: Ex. 26 at 4 (C. Hans Rebuttal); Ex. 217 at ~~29~~-30, 34, (M. St. Pierre Direct).
- P. 34, Finding 209 should read: The Department did recommend other adjustments to the 2014 employee benefit cost amounts (as determined by the actuarial analysis). The Department suggested revising both the measurement date and the plan asset value date, and changing the discount rate assumption so as to align it with the ~~expected return on plan assets~~ plan asset values as of December 31, 2013 .

- P. 34, footnote 211 should read: Ex. ~~217~~ 219 at 7 (M. St. Pierre Surrebuttal).

- P. 36, footnote 223 should read: Ex. 217 at ~~30~~ 29 (M. St. Pierre Direct)

- P. 36, footnote 224 should read: Ex. 217 at 30 (M. St. Pierre Direct)~~*Id.*~~

- P. 37, footnote 234 should read: *Id*; Ex. 219 at ~~n. 7~~26 (M. St. Pierre Surrebuttal); Ex. 27 at 8-9 (C. Hans Rebuttal).

- P. 37, footnote 236 should read: Ex. 217 at ~~30~~ 26-28 (M. St. Pierre Direct).

- P. 40, footnote 247 should read: Ex. ~~217~~ 219 at ~~31-32~~28 (M. St. Pierre Surrebuttal).

- P. 41, footnote 253 should read ~~*Id.* at 1 and Schedule CMH-1.~~Ex. 219 at 32.

- P. 41, Finding 254 should read: Yet, because, as noted above, the Department and MERC do not agree as to the appropriate discount rate on such expenses, the Department also recommended that the Commission require MERC to reduce its ~~rate base~~ base rates by $140,720.

- P. 97, footnote 656 should read: Ex. 203 at ~~13~~ 16 (S. Peirce Direct).

- P. 99, footnote 674 should read: Ex. ~~40~~ 42 at 7-8 (G. Walters ~~Direct~~ Rebuttal).

B. Other Clarification: Paragraphs 437 and 442

Paragraphs 437, 439 and 442 of the ALJ Report concern Rate Case Amortization. The Commission may wish to correct paragraphs 437, 439 and 442, which are ambiguous, as follows:

> 437. While MERC asserted that reliance upon the recent history of rate filings was not appropriate in this instance, it argued that if the Department's recommendation was adopted still other adjustments would be required. Specifically: (a) debiting the unamortized rate case balance of $257,985 on an annualized basis, and crediting amortization expense for the same amount; (b) use of a normalized level of rate case costs in test year expenses for accounting purposes, but one that is not an asset in rate base for ratemaking purposes such that the Company earns a return on this item; (c) a corresponding removal of $541,188 before allocation to Minnesota in deferred taxes from rate base; and (d) allocating only $540,106, which is the associated "Minnesota jurisdiction" share of these expenses.

439. The OAG-AUD agreed with the Department's recommendation and MERC agreed with this adjustment.[439]

442. The Administrative Law Judge finds that a two-year amortization period is appropriate in this case. However, in the event that the Commission concludes that a three-year amortization period is more appropriate, the ALJ further recommends that the unamortized rate ~~base~~ case balance of $257,985 be debited on an annualized ~~annual~~ basis and amortization expenses credited for the same amount.

IV. CONCLUSION

The Department respectfully requests that the Commission adopt the ALJ Report in full with the changes requested in these Limited Exceptions.

Dated: August 25, 2014

Respectfully Submitted,

s/ Linda S. Jensen

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[439] Ex. 153 at 1-2, 6 (J. Lindell Rebuttal); Ex. 24 at 15 (S. DeMerritt Rebuttal). Ex. 24 at 17 (S. DeMerritt Rebuttal); GR-13-617, MERC Issues Matrix at 11 (June 6, 2014)(Doc ID No. 20146-100192-01).

STATE OF MINNESOTA

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August 25, 2014

Dr. Burl W. Haar, Executive Secretary
Mr. Mark Oberlander, Supervisor, Telecom Analysis
Minnesota Public Utilities Commission
350 Metro Square Building
121 Seventh Place East
St. Paul, MN 55101

RE: In the Matter of a Petition by Minnesota Energy Resources Corporation for Authority to Increase Natural Gas Rates in Minnesota
MPUC Docket No. G011/GR-13-617
OAH Docket No. 8-2500-31126

Dear Dr. Haar:

The enclosed Limited Exceptions of the Minnesota Department of Commerce to the ALJ Report is hereby filed in the above referenced matter

Very truly yours,

/s/ **Linda S. Jensen**

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AFFIDAVIT OF SERVICE

RE: In the Matter of a Petition by Minnesota Energy Resources Corporation for Authority to Increase Natural Gas Rates in Minnesota
MPUC Docket No. G011/GR-13-617
OAH Docket No. 8-2500-31126

STATE OF MINNESOTA)
) ss.
COUNTY OF RAMSEY)

I, Patricia Silberbauer, hereby state that on the 25th day of August, 2014, I efiled the attached Limited Exceptions of the Minnesota Department of Commerce to the ALJ Report, and served the same by United States Mail, upon all parties on the attached service list, postage prepaid, by depositing the same at St. Paul, Minnesota.

See attached service list

/s/ Pat Silberbauer

Subscribed and sworn to before me
on August 25, 2014

/s/ Sandra A. Bush
Notary Public - Minnesota
My Commission Expires Jan. 31, 2015

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13-617 8/25/14

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