

November 14, 2016

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: **Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. G011/M-16-87

Dear Mr. Wolf:

Attached are the comments of the Minnesota Department of Commerce, Division of Energy Resources (Department) in the following matter:

Minnesota Energy Resources Corporation's (MERC) Petition for Approval of a Variance to the Purchased Gas Adjustment (PGA) Rules to Allow Recovery through the PGA of Amounts Paid for Kansas Gas Storage Taxes Associated with Contracts Acquired from Interstate Power and Light Company (IPL).

The petition was filed on January 27, 2016 by:

Amber S. Lee
Regulatory and Legislative Affairs Manager
1995 Rahncliff Court, Suite 200
Eagan, MN 55122

The Department requests that MERC provide additional information in reply comments. The Department will offer additional comments and recommendations in subsequent response comments after it has reviewed the additional information.

The Department is available to answer any questions that the Minnesota Public Utilities Commission may have.

Sincerely,

/s/ SACHIN SHAH
Rates Analyst

SS/It

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

COMMENTS OF THE
MINNESOTA DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

DOCKET No. G011/M-16-87

I. BACKGROUND AND SUMMARY OF THE UTILITY'S PROPOSAL

A. OVERALL PROPOSAL

Pursuant to Minn. Stat. §216B.16, Subd. 7, and related Minn. Rules 7825.2390 to 7825.2920, (Purchased Gas Adjustment "PGA" rules), Minnesota Energy Resources Corporation (MERC or the Company) filed a variance petition (Petition) on January 27, 2016. The Company requests the Minnesota Public Utilities Commission's (Commission) approval to include recovery of past and on-going Kansas ad valorem taxes (KAVT), related to natural gas storage contracts associated with MERC's acquisition of Interstate Power & Light's (Interstate or IPL) Minnesota natural gas assets, in the current cost of natural gas supply.¹

MERC also requested a variance to Minn. Rule 7820.4000 (the Billing Errors Rule) "to adjust the [fiscal year ending] FYE 2016 true-up beginning balance for MERC-Albert Lea used for the calculation of the FYE 2017 gas cost true-up factor . . ."

Minn. Rules 7825.2500 allows utilities to adjust rates to reflect:

Changes in cost resulting from changes in the commodity-delivered gas cost and demand-delivered gas cost for purchased gas and changes in the cost of fuel consumed in the manufacture of gas or peak shaving gas volumes. This provision is entitled purchased gas adjustment.

Minn. Rules 7825.2400 defines "commodity-delivered gas cost" and "cost of purchased gas" as follows:

"Commodity-delivered gas cost" is the portion of the cost of purchased gas charged a distributing gas utility for its gas

¹ Petition, pages 1-7.

supplies and supply-related services, as defined in subpart 12, that is a function of the volume of gas taken. It refers to the cost of purchased gas, including associated costs incurred to deliver the gas to the utility's distribution system.

"Cost of purchased gas" is the cost of gas as defined by the Minnesota uniform system of accounts, class A and B gas utilities, including accounts 800, 801, 802, 803, 804, 804.1, 805, 805.1, 808.1, 809.1, 810, 854, and 858 for energy purchased, as provided by Code of Federal Regulations, title 18, part 201, as amended through April 1, 1998. These accounts are incorporated by reference. The cost of purchased gas also includes the normal and ordinary cost of injection and withdrawal of gas from storage at the time of withdrawal. All gas public utilities shall use this definition regardless of class.

As to the time period allowed to be considered in the PGA true-up calculations, Minn. Rules 7825.2700, subpart 7 states:

The true-up amount is the difference between the commodity and demand gas revenues by class collected by the utility and the actual commodity-delivered gas cost and demand-delivered gas cost by class incurred by the utility **during the year**. The true-up adjustment must be computed annually for each class by dividing the true-up amount by the forecasted sales volumes and applied to billings during the next 12-month period beginning on September 1, each year, provided that the adjustment has been filed under part 7825.2910, subpart 3. [Emphasis added]

As a general matter, ad valorem taxes are state taxes based on the value of property located in that state. In its Petition, MERC stated the following:

On December 8, 2014, the Commission issued an Order Approving Sale Subject to Conditions in Docket No. G001/011/PA-14-107, approving MERC's acquisition of IPL's Minnesota natural gas assets and the transfer of IPL's Minnesota service rights and obligations to MERC. As part of the Asset Purchase and Sale Agreement, executed on September 3, 2013, MERC acquired a total of \$151,247 in unrecovered Kansas storage costs for the period 2009 through April 30, 2015.

MERC stores natural gas on the Northern Natural Gas Pipeline system (Northern or NNG) in Kansas.² NNG's storage fields include facilities in Kansas, which imposes ad valorem taxes

² *Id.*

on gas held in fields in its state.³ The validity of Kansas ad valorem taxes on natural gas in storage has been the subject of litigation.⁴

B. PROPOSED LENGTH OF VARIANCE

Regarding the length of variance, the Company states the following in its Petition on page 2:

In particular, MERC requests a variance under Minn. R. 7829.3200 to Minn. R. 7820.4000 to adjust the FYE 2016 true-up beginning balance for MERC-Albert Lea [MERC-ABL] used for the calculation of the FYE 2017 gas cost true-up factor in order, to allow MERC to collect the \$151,247 of costs incurred on behalf of legacy IPL customers for natural gas storage for the 2009 through April 30, 2015, through the MERC-Albert Lea PGA.

... Additionally, MERC requests authorization to continue to recover future Kansas storage tax costs associated with the assumed IPL storage contracts through the FY2018 [Annual Automatic Adjustment] AAA period, to allow recovery of applicable Kansas storage tax through December 31, 2017. At that time, MERC would either request extension of the variance for continued recovery of costs through the commodity portion of the PGA or would incorporate those costs into base rates in a future rate case, as MERC has done with its own Kansas storage tax expense.

C. PROPOSED PGA RECOVERY

MERC proposes PGA recovery from ratepayers of ongoing tax obligations as well as recovery of the actual taxes incurred for the period 2009 through April 2015.⁵ For ongoing tax obligations, MERC proposes “to recover future Kansas storage tax costs associated with the assumed IPL storage contracts through the FY2018 AAA period, to allow recovery of applicable Kansas storage tax through December 31, 2017.”⁶ The Company states that it meets the requirements for a variance from the PGA rules to enable it to “recover these Kansas storage gas costs for past periods and for . . . continued recovery of Kansas storage gas costs through the commodity portion of the PGA on a going-forward basis.”⁷

Regarding the lump sum recovery of the assumed IPL storage contracts, MERC states the following:⁸

³ *Id.*

⁴ *Id.*

⁵ On the cover of the Petition, MERC states, “...for the period 2008 through April 30, 2015 and for ongoing recovery through the PGA.” 2008 is an error.

⁶ Petition at 2.

⁷ Petition at 4.

⁸ *Id.*

As part of the Asset Purchase and Sale Agreement, executed on September 3, 2013, MERC acquired a total of \$151,247 in unrecovered Kansas storage costs for the period 2009 through April 30, 2015.

In Attachment A of its Petition, MERC reports an amount of \$148,312.48 for the lump sum recovery of the 2009 through 2014 costs. MERC estimated that its proposal would result in an approximately \$8.25 annual increase for the average residential customer.⁹

MERC did not provide an amount for what it proposes for the ongoing recovery of costs.

D. COURT DECISIONS ON AD VALOREM PROPERTY TAX

MERC stated the following:¹⁰

A full history of the Kansas property tax on natural gas stored in the State of Kansas was outlined in Xcel Energy's Petition for Approval of a Rule Variance to Include a State of Kansas Storage Tax in the Purchased Gas Adjustment filed February 6, 2015, in Docket No. G002/M-15-149. The State of Kansas has had a property tax on underground storage of natural gas for many years. Originally, the tax was assessed against interstate natural gas pipelines; however, in 2004, Kansas enacted legislation to tax owners of natural gas commodities stored in Kansas for resale in others states. The 2004 legislation was overturned by the Kansas Supreme Court in 2007. In 2009, the Kansas legislature modified the tax legislation for the collection of tax from public utilities located outside of Kansas. That legislation was appealed to the Kansas Supreme Court and to the United States Supreme Court, which denied certiorari on October 6, 2014, and upheld the tax. Effective October 2014, taxes for the period 2009-2014 became due to the Kansas counties where gas is stored.

Regarding the Court decisions, in Northern States Power Company d/b/a Xcel Energy (Xcel) petition referenced above in Docket No. G002/15-149 (Docket 15-149), Xcel stated the following:¹¹

... Similar to the mid-2000's, we and others vigorously challenged the tax's renewed application to out-of-state utilities. Unfortunately, our available legal challenges were exhausted in

⁹ Petition at 2.

¹⁰ Petition at 4-5.

¹¹ See Xcel Energy's initial petition in Docket No. G002/15-149 at pages 2-3.

October 2014 when the United States Supreme Court denied certiorari, resulting in the tax being upheld.³

3 Missouri Gas Energy v. State of Kansas, Div. of Property Valuation, 135 S.Ct. 151 (2014).

The taxes applicable during the period of appeals were legally deferred until all legal avenues were exhausted, so we did not seek recovery until we were certain the Company and its customers would incur the tax, which has now occurred. In late 2014, the Kansas counties in which we maintain stored natural gas on the Northern system issued invoices to the Company for the 2009-2014 period.

E. IMPACT ON RATES

The Company stated the following on page 7 of the Petition:

The proposed recovery will also not result in significant rate impact on MERC's Albert Lea PGA. The projected rate impact for an average residential customer is projected to be \$0.69 per month or \$8.25 during the course of the year. The table below provides a summary of average rate impact by customer class for recovery of the lump sum costs for the period 2009 through April 30, 2015.

According to MERC, "The costs are directly related to the provision of natural gas service in Minnesota. To require MERC to absorb these costs would unfairly penalize the Company for a cost over which it has no control."¹²

Further, according to MERC, "The requested variance would allow recovery of the costs of the Kansas gas storage tax liability acquired from IPL from the legacy IPL retail natural gas customers through the PGA. The additional revenue would be offset by the costs incurred for Kansas storage tax liability and would have no net impact on MERC's earnings."

Thus, under MERC's proposal, the changes would only affect PGA charges and would not affect non-gas revenues.¹³

¹² Petition Page 7.

¹³ Petition Page 8.

F. VARIANCE REQUEST

Minn. Rule 7829.3200 states:

The commission shall grant a variance to its rules when it determines that the following requirements are met:

- A. enforcement of the rule would impose an excessive burden upon the applicant or others affected by the rule;
- B. granting the variance would not adversely affect the public interest; and
- C. granting the variance would not conflict with standards imposed by law.

In its Petition, MERC argues that the Commission should grant variances to Minn. Rule 7825.2400, subp. 12, and Minn. Rule 7825.2700 because the three standards for granting a variance under Minn. Rule 7829.3200 are met as summarized below:

- MERC claims that enforcement of the rule would impose an excessive burden on the Company and prevent the Company from recovery of prudently incurred costs that were acquired as part of MERC's acquisition of IPL's Minnesota natural gas assets; these costs are directly related to the provision of natural gas service in Minnesota; and to require MERC to absorb these costs would unfairly penalize the Company for a cost over which it has no control;
- MERC claims that granting the variance would not adversely affect the public interest since "the tax is a direct cost for natural gas delivered; the Commission has previously approved recover of costs related to Kansas' storage tax for Xcel Energy and, in so doing, found that such action would not adversely affect the public interest;" and
- MERC claims that granting the variance would not conflict with standards imposed by law. Further, MERC stated that, "The Commission recently approved a variance to allow Xcel Energy to recover these same types of costs in Docket No. G002/M-15-149. The Commission has therefore previously determined such variance to the PGA rules not to conflict with standards imposed by law."¹⁴

MERC also requested approval of a variance to Minn. Rule 7820.4000 (the Billing Errors Rule) but did not provide specific support for that request.

¹⁴ Petition, page 7.

II. ANALYSIS OF MERC'S PROPOSAL

The Minnesota Department of Commerce, Division of Energy Resources' (Department or DOC) analysis of the Company's variance request includes the following parts:

- prior variances granted by the Commission;
- the legal standard;
- MERC's variance request; and
- PGA classification of costs and issues needing clarification.

As discussed below, the DOC preliminarily recommends that the Commission approve a variance to include recovery in the PGA of ad valorem taxes related to natural gas storage, with specific conditions and reporting requirements. The Commission approved similar variances for Xcel and IPL in 2005 and 2006, and more recently for Xcel in 2015.

A. PRIOR VARIANCES GRANTED

The Commission granted one-year variances to Minn. Rule 7825.2400, subd. 12 to Xcel¹⁵ and Interstate¹⁶ for property tax incurred on stored natural gas. Specifically, the ordering paragraphs of the Commission's November 4, 2005 *Order Granting Variance and Imposing Requirements* in each of Docket Nos. G002/M-05-534 and G001/M-05-266 stated:

1. The Commission hereby grants Xcel [Interstate] a one year variance to Minn. Rule 7825.2400, subp. 12 to allow the recovery of the January 1, 2004, 2005, and 2006 assessed tax in the PGA.
2. Xcel [Interstate] shall include the Kansas property tax as a separate line item in its monthly PGA.
3. Xcel [Interstate] shall submit a report with its Annual Automatic Adjustment report detailing the total amount collected from ratepayers during the gas year
4. Xcel [Interstate] shall file a quarterly report on the status of all administrative and legal activities regarding the Kansas property tax until such time as all administrative and legal avenues are exhausted.
5. If the Kansas property tax is overturned, Xcel [Interstate] shall refund immediately all charges collected through the PGA pursuant to Minnesota Rule 7825.2700, subp. 8.

¹⁵ The Commission granted Xcel a one-year variance in Docket No. G002/M-05-534 (05-534). A one-year extension was granted in Docket No. G002/M-06-905 (06-905).

¹⁶ The Commission granted Interstate a one-year variance in Docket No. G001/M-05-266. A one-year extension was granted in Docket No. G001/M-06-1226.

Thus, Xcel and Interstate were required to refund all charges collected through the PGA if the court overturned the Kansas property tax.¹⁷ On August 22, 2008, the Commission issued orders in Docket No. G002/M-05-534 and the subsequent Docket No. G002/M-06-905 that terminated the quarterly reporting requirement and closed the dockets.

The Commission's reasons for granting the variances in its November 4, 2005 *Orders* for Xcel and Interstate are virtually identical except for the company names. The Commission's reasons for granting Xcel's [Interstate's] variance were as follows:

First, enforcing the rule as written would impose an excessive burden on Xcel's [Interstate's] ratepayers. Given current natural gas market conditions, the Department has advised the Commission that the Company's [Interstate's] ratepayers will benefit from the Company maintaining adequate gas reserves in storage as a hedge against price volatility for the current heating season. Strict enforcement of the definition of "cost of gas" in Minn. Rules, Part 7825.2400, subd. 12 would prevent the Company from recovering Kansas tax payments on natural gas it holds in storage in Kansas. The Department advised that if the Company is not allowed to recover these tax costs through the PGA it would not maintain an optimum level of natural gas reserves in storage as a hedge against price volatility.

The Commission finds that absent adequate gas storage, Xcel's [Interstate's] ratepayers could experience severely burdensome price fluctuations during the current heating season. The Commission therefore finds that in the unique circumstances of this docket, strict enforcement of the definition of "cost of gas" in Minn. Rules, Part 7825.2400, subd. 12 would impose an excessive burden on the Company's ratepayers. Also, in the event that a challenge to the new property tax is successful, the PGA will allow the immediate discontinuance of collecting that tax and provide an efficient mechanism to track and return tax amounts that have been collected from customers. Absent PGA recovery, return of the amounts collected from ratepayers would be much more cumbersome, delayed, and potentially mismatched.

Second, granting the variance will not adversely affect the public interest. Given the current market volatility, encouraging

¹⁷ In Xcel's quarterly compliance report filed September 26, 2007 in Docket Nos. 05-534 and 06-905, the Company stated that the Kansas Supreme Court had affirmed the exemption of underground stored natural gas inventories from property taxation in Kansas and Xcel subsequently refunded approximately \$4,207,307 to ratepayers. Interstate received an exemption and did not pay the tax. Thus, Interstate's customers were not charged for this tax.

establishment of reserves via such storage is clearly in the public interest.

Third and finally, granting the variance does not conflict with standards imposed by law. The definition of “cost of gas” is defined solely in a Commission rule (Minn. Rules, Part 782[5].2400, subd. 12) and hence is subject to expansion via variance pursuant to Minn. Rules, Part 782[9].3200.¹⁸

The DOC agrees with MERC that the Company’s current request is similar to Xcel’s and Interstate’s previous requests to recover property taxes in the PGA. However, there is a slight difference in the previous Xcel and Interstate proposals compared to the current MERC proposal.

The prior Kansas ad valorem tax situation for Xcel and Interstate was different than in this case because, previously, the Supreme Court of Kansas’ finding was based on a property tax exemption for inventory and the Company and other litigants prevailed. In this case, litigation went further with appeals filed by the Company and others with the Supreme Court of the United States of America (SCOTUS). Additionally, according to MERC, on October 6, 2014, SCOTUS “denied certiorari” resulting in the tax being upheld. In other words, the difference in circumstances between the instant Petition and past related dockets is that there is no longer uncertainty regarding whether MERC is subject to the Kansas ad valorem tax.

Further, in this case and similar to Xcel’s case in Docket 15-149, MERC received a tax bill dating back to 2009, thus raising questions about retroactive ratemaking. However, in Docket 15-149, the Commission in its October 21, 2015 *Order Varying Minn. R. Part 7825.2400 And Requiring Filings*, under III. A, Summary of Commission Action, stated the following:

The Commission will grant the requested variance to recover the Kansas tax through the PGA, but will grant separate variances for past-storage assessments and future-storage assessments. The Company [Xcel] will be required to amortize over five years PGA recovery of the lump-sum tax assessment for past storage. The variance for future assessments will be limited to one year.

¹⁸ November 4, 2005 *Orders Granting Variance and Imposing Requirements*, pages 2 and 3.

The Commission in its October 21, 2015 *Order Varying Minn. R. Part 7825.2400 and Requiring Filings*, under Ordering points 1 and 2 stated the following:

1. The Commission hereby varies Minn. Rule 7825.2400 for one year to allow recovery of the current year's assessed Kansas natural gas storage tax, and for five years to allow amortized recovery of the 2009–2014 lump-sum assessed tax through the PGA commodity factor.
2. Xcel shall recover its current-year assessed Kansas natural gas storage tax through the PGA commodity factor for a one-year period to begin as soon as is practicable.

Thus, the Commission has allowed recovery of the Kansas storage tax expense for both the prior lump sum amounts that were billed in 2014 as well as the future tax assessments.

B. LEGAL STANDARD

The PGA is governed by Minn. Stat. §216B.16, subd. 7, which allows certain specific costs to be included in rates between general rate cases and is an exception to the ban on rate changes outside of a general rate case. Minnesota Statute §216B.16, subd. 7 states:

Energy and emission control products cost adjustment. Notwithstanding any other provision of this chapter, the commission may permit a public utility to file rate schedules containing provisions for the automatic adjustment of charges for public utility service in direct relation to changes in:

1. federally regulated wholesale rates for energy delivered through interstate facilities;
2. direct costs for natural gas delivered;
3. costs for fuel used in generation of electricity or the manufacture of gas; or
4. prudent costs incurred by a public utility for sorbents, reagents, or chemicals used to control emissions from an electric generation facility, provided that these costs are not recovered elsewhere in rates. The utility must track and report annually the volumes and costs of sorbents, reagents, or chemicals using separate accounts by generating plant. (Emphasis added.)

Based on the statute, only direct costs for natural gas delivered are allowed to be included in the PGA. Because the PGA is an exception to normal ratemaking, the costs that are allowed to be recovered through the PGA are intended to be limited. The PGA was not intended to substitute for a rate case where all the costs and revenues can be examined as a whole. The following rule specifies what costs constitute the direct costs of gas. This rule does not allow inclusion in PGA recovery of costs that are merely related to or associated

with the cost of gas. As noted above, the cost of gas is defined in Minn. R. 7825.2400, subp. 12 which states:

Cost of purchased gas; incorporation by reference. "Cost of purchased gas" is the cost of gas as defined by the Minnesota uniform system of accounts, class A and B gas utilities, including accounts 800, 801, 802, 803, 804, 804.1, 805, 805.1, 808.1, 809.1, 810, 854, and 858 for energy purchased, as provided by Code of Federal Regulations, title 18, part 201, as amended through April 1, 1988. These accounts are incorporated by reference. The cost of purchased gas also includes the normal and ordinary cost of injection and withdrawal of gas from storage at the time of withdrawal. All gas public utilities shall use this definition regardless of class.

The uniform system of accounts provides specific guidance as to what costs are recorded in the accounts listed in the rule. Clearly, the property tax is not defined by the rules to be a direct cost of gas as claimed by MERC when it argues that:¹⁹

. . . The tax is a prudently-incurred cost that was acquired as part of MERC's acquisition of IPL's Minnesota natural gas assets. The costs are directly related to the provision of natural gas service in Minnesota. To require MERC to absorb these costs would unfairly penalize the Company for a cost over which it has no control. ...

. . . The legacy-IPL customers have received a benefit from the gas storage contracts for storage in Kansas and the costs associated with the Kansas storage tax are a direct cost for the natural gas delivered to those customers.

However, MERC cannot flow the costs of the property taxes related to storage in the PGA unless the Commission grants a variance to the rule.

MERC mentioned in its Petition that the Commission previously approved variances to the PGA Rules for recovery of storage costs. MERC stated the following:²⁰

The Commission has previously approved recover of costs related to Kansas' storage tax for Xcel Energy and, in so doing, found that such action would not adversely affect the public interest.

The Department has discussed the prior variances above.

¹⁹ Petition at pages 6-7.

²⁰ *Id.*

MERC argued that including the tax with other direct costs of gas is appropriate. However, the Department notes that simply because the tax is associated with or related to storage does not justify allowing the same method of recovery for property taxes and natural gas costs. Still, as noted in previous, similar requests for variances, discussed above, the Commission may grant a variance to these rules to allow PGA recovery of ad valorem taxes, if warranted. As such, the DOC agrees with MERC that the Company may pass these costs through its PGA only if the Commission grants MERC a variance to Commission rules to allow such recovery.

C. *MERC'S VARIANCE REQUEST*

1. *Recovery Through the PGA*

MERC requested a variance to Minn. R. 7825.2400, subp. 12 and Minn. R. 7825.2700. MERC stated the following:

MERC is requesting similar treatment for recovery of the Kansas storage tax expense. In particular, MERC is requesting recovery of the Kansas storage tax expense for the period 2009-2015 through the MERC-Albert Lea PGA, and authorization to continue to recover the Kansas storage tax expense associated with storage contracts acquired from IPL for expense through the FY2018 AAA period, to allow recovery of applicable Kansas storage tax through December 31, 2017.²¹

MERC must obtain Commission approval of a variance from Minn. R. 7825.2400, subp.12, in order to recover the Kansas gas storage tax expense acquired from IPL through the PGA. Minn. R. 7825.2400, subp. 12, defines the cost of purchased gas as the cost of gas defined by the Minnesota uniform system of accounts, including specific accounts set forth by the Federal Energy Regulatory Commission ("FERC"); and defines "demand delivered gas cost" as the portion of the cost of purchased gas "other than the commodity-delivered gas costs," including "associated costs incurred to deliver the gas to the utility's distribution system." Additionally, MERC must obtain a variance from Minn. R. 7825.2700, subpart 7, which requires that a true-up address only costs and credits arising within the relevant reporting year.²²

²¹ Petition at page 5.

²² Petition at page 6.

a. *Allowable Costs Recovered through the PGA*

Property tax generally, and the ad valorem property tax on storage gas specifically, is a legitimate cost that MERC should be allowed to recover. However, recovery of costs through a special ratemaking mechanism such as a PGA rider must be carefully considered, especially for retroactive costs from the 2009-2014 period. Since the ad valorem tax is not a direct cost of gas as defined by the PGA rules, the Commission must consider whether to allow an exception to the limited types of cost that may be recovered through the PGA. There are typically two alternative ways of recovering the tax:

1. allow recovery in base rates in the revenue requirement in MERC's next general natural gas rate case (MERC's last rate case was in 2015 in Docket No. G011/GR-15-736); or
2. allow recovery through the PGA by varying the rule.

Under the first option, parties would typically evaluate MERC's proposal for including a representative amount of ad valorem taxes on natural gas storage in the test year and the Commission would allow a certain amount to be recovered in rates at that time, until the Company's subsequent rate case.²³ In Docket No. G011/GR-15-736 (Docket 15-736), MERC requested recovery of \$286,509 of Kansas ad valorem taxes.²⁴ No party opposed the Company's request; the Commission approved the request through its October 31, 2016 *Findings of Fact, Conclusions, and Order*. The record in Docket 15-736 is not clear as to whether the \$286,509 includes some or all of the former Interstate property tax costs. According to MERC, it executed the Asset Purchase and Sale Agreement with IPL on September 3, 2013. On December 8, 2014, the Commission issued an *Order Approving Sale Subject to Conditions* in Docket No. G001,G011/PA-14-107 (Docket 14-107). According to MERC, the Order approved MERC's acquisition of IPL's Minnesota natural gas assets and the transfer of IPL's Minnesota service rights and obligations to MERC. On September 30, 2015, MERC filed an application for authority to increase its rates for natural gas service in Minnesota in Docket No. G011/GR-15-736. Considering that MERC had the opportunity to include the KAVT amounts associated with the IPL purchase in MERC's rate case petition, it appears logical to assume that the Company did include those amounts.

Therefore, it is not clear that, absent approval of the instant Petition, MERC would have to wait to recover the former Interstate property tax costs until such time that it chooses to file the next natural gas rate case. Given that MERC filed its most recent rate case in 2015 with a 2016 test-year, well after the SCOTUS decision was made, and well after the IPL Asset Purchase and Sale Agreement was executed and approved by the Commission, the Department requests that, in Reply Comments, MERC explain whether it included any (whether past or the on-going assessments) of the KAVT costs associated with the former

²³ For example, see MERC's April 29, 2015 Compliance Filing in Docket 13-617 and the Commission's June 3, 2015 Order.

²⁴ See <https://www.edockets.state.mn.us/EFiling/edockets/searchDocuments.do?method=showPoup&documentId={1B831408-C481-42EE-BBB6-C830124F85F6}&documentTitle=20159-114396-07> at page 5.

IPL contracts in its current rate case in Docket No.G011/GR-15-736. If so, we request that MERC quantify what was included, and if not, to explain why the costs were not included.

Minnesota utilities recover Kansas ad valorem taxes differently, depending on the circumstances at the time of recovery requests. For example, in Docket No. G011/GR-13-617 (Docket 13-617), MERC began recovering the Kansas ad valorem taxes in base rates beginning January 1, 2011.^{25,26,27} However, the timing of MERC's rate case was such that the decision of the SCOTUS was not yet available; thus, MERC was not allowed to recover Kansas ad valorem taxes from prior years.²⁸ Xcel Energy's 2004 general rate case²⁹ was closed before the Commission decided on Xcel's previous (prior to Docket 15-149) variance requests. Similarly, Interstate did not have a pending general rate case in progress at the time of its variance request.³⁰

Assuming the MERC is not already recovering Kansas ad valorem taxes associated with the acquired Interstate storage contracts, allowing MERC to recover the Kansas ad valorem tax through the PGA may be appropriate in this case, particularly for Kansas ad valorem taxes associated with current/ongoing gas use, given that the Commission's decisions in Docket Nos. G002/M-05-534, G001/M-05-266, G001/M-06-1266, G002/M-06-905, and 15-149 allowed PGA recovery for Xcel and Interstate in similar circumstances as mentioned above, and for the reasons set forth below. In addition, if the Commission concludes that the circumstances surrounding recovery of costs for the 2009-2014 period at issue in the instant proceeding are similar to the circumstances resulting in PGA recovery of 2009-2014 taxes in Xcel's Docket 15-149, it may also be appropriate to allow MERC to recover those costs through the PGA.

b. Classification of the Costs in the PGA

Purchased gas costs passed through the monthly PGAs to customers are classified as either demand-delivered gas costs (demand costs) or commodity-delivered gas costs (commodity costs). Generally, demand costs are recovered only from firm sales service customers while commodity costs are recovered from both firm and interruptible sales service customers. Both firm and interruptible sales customers use storage gas so both sets of customers receive the benefit of the hedge against winter price increases resulting from the use of storage gas.

²⁵

<https://www.edockets.state.mn.us/EFiling/edockets/searchDocuments.do?method=showPoup&documentId={779B8497-D47D-47DC-9E9A-080950AD3CFB}&documentTitle=20145-99274-07>

²⁶

<https://www.edockets.state.mn.us/EFiling/edockets/searchDocuments.do?method=showPoup&documentId={D41DF766-9A5F-429B-BDA3-8A72D42DA287}&documentTitle=201410-103797-01>

²⁷

<https://www.edockets.state.mn.us/EFiling/edockets/searchDocuments.do?method=showPoup&documentId={5E7B0969-0073-45B8-BC2E-A6E778E4A5F7}&documentTitle=201410-104203-01>

²⁸ See MERC's April 29, 2015 Compliance Filing in Docket 13-617 and the Commission's June 3, 2015 Order.

²⁹ Docket No. G002/GR-04-1511.

³⁰ Interstate had not filed a general rate case since 1995.

MERC's proposal is to include the property tax in the commodity portion of the PGA rather than as a demand cost. As a result, under the Company's proposal, the ad valorem property taxes would be charged to all sales customers. The Department agrees that this proposal is reasonable.

2. *The Three Variance Requirements*

As more fully discussed below, the Department's discussion of the 3 criteria for granting a variance is preliminary. The Department will re-assess its analysis after reviewing the Company's reply comments.

a. *Excessive Burden*

MERC argued that not granting the variance would be an excessive burden to the Company. MERC further stated as follows:³¹

The tax is a prudently-incurred cost that was acquired as part of MERC's acquisition of IPL's Minnesota natural gas assets. The costs are directly related to the provision of natural gas service in Minnesota. To require MERC to absorb these costs would unfairly penalize the Company for a cost over which it has no control.

As noted above, the DOC agrees that MERC should be allowed to recover storage-related property tax costs in a reasonable manner, but it does not necessarily follow that the only way for MERC to recover these costs is via the PGA. Further, as utilities typically point out, costs and revenues change between rate cases such that it is not possible for rates at any given time to reflect every cost and revenue. Finally, the KAVT costs at issue in this proceeding are relatively minor (\$148,312.48 for the lump sum recovery of the 2009 through 2014 costs) compared to those incurred by Xcel Energy (approximately \$5,000,000), therefore it is not clear whether the burden can be characterized as excessive.

Nonetheless, the DOC preliminarily agrees that recovery through the PGA of property taxes on natural gas storage would lessen the burden on MERC of incurring costs that may not have been included in base rates. In addition, in this case, cost recovery of the Kansas ad valorem tax owed from 2009 to the present has been delayed due to the uncertainty in the outcome of the legal process, and was not caused by a rate case timing decision. Therefore, the Department concludes that strict enforcement of the definition of "cost of gas" in Minn. Rule 7825.2400, subd. 12 would prevent the Company from recovery of past Kansas ad valorem tax costs that were incurred over several years but not billed to MERC until October 2014, which could be considered an excessive burden.

³¹ Petition at page 6.

b. Public Interest

MERC claimed that the public interest is not adversely affected by approval of the variance. MERC stated the following:³²

Additionally, the public interest is not adversely affected by granting the requested variance. The legacy-IPL customers have received a benefit from the gas storage contracts for storage in Kansas and the costs associated with the Kansas storage tax are a direct cost for the natural gas delivered to those customers. The Commission has previously approved recover [sic] of costs related to Kansas' storage tax for Xcel Energy and, in so doing, found that such action would not adversely affect the public interest.

The proposed recovery will also not result in significant rate impact on MERC's Albert Lea PGA. The projected rate impact for an average residential customer is projected to be \$0.69 per month or \$8.25 during the course of the year. The table below provides a summary of average rate impact by customer class for recovery of the lump sum costs for the period 2009 through April 30, 2015.

MERC proposed to recover the on-going annual costs of Kansas ad valorem taxes on a monthly basis through the PGA. MERC proposed to recover the July 2009 through October 2014 costs over a 12-month period by adjusting the "FYE 2016 true-up beginning balance for MERC-Albert Lea used for the calculation of the FYE 2017 gas cost true-up factor..." MERC provided a breakdown of the amounts incurred for the various periods in its Attachment A of the Petition.

The DOC observes that having natural gas storage is in the public interest since it enables price stability and assists with reliability. To the extent that granting a variance facilitates optimal use of storage, the variance would not adversely affect the public interest.

In terms of rate impact, in Docket 15-149, the Commission allowed Xcel to amortize Xcel's Storage costs for the period 2009-2014 over a five-year period, to reduce the impact of Xcel's one-time charge on ratepayers. In Docket No.G002/M-05-534, the Commission allowed Xcel to recover retroactive 2004 taxes that were billed to Xcel and payable in 2005, over a one-year period. Therefore, Commission precedent appears to support approval of MERC's request.

The Department notes that there are slight differences in the factual circumstances in the instant proceeding from the circumstances in those past cases. First, in MERC's case the Kansas ad valorem taxes (KAVT) are associated with the storage contracts that MERC acquired through its purchase of Interstate's gas operations and property in Docket 14-107.

³² Petition at page 7.

Second, the Commission, in Docket 15-736, has approved consolidation of the MERC-ABL PGA with the MERC-NNG PGA effective July 1, 2017,³³ which will result in a change in the set of customers from which these costs would be recovered. However, these differences do not materially impact the public interest criterion. Thus, the Department concludes that the public interest criterion has been met in this case, as it was met in Dockets 15-149 and 05-534.

c. Conflict with Standards Imposed by Law

MERC stated that there is no conflict with the law. MERC stated:³⁴

The proposed variance does not conflict with any standards imposed by law. The Commission recently approved a variance to allow Xcel Energy to recover these same types of costs in Docket No. G002/M-15-149. The Commission has therefore previously determined such variance to the PGA rules not to conflict with standards imposed by law.

Since the Commission has granted similar variances in the past, the DOC agrees that the requested variance does not conflict with law.

d. Conclusion

Based on the preliminary analysis above, the DOC concludes that a variance to Minn. Rule 7825.2400, subp. 12 and Minn. Rule 7825.2700 may be granted to allow MERC to recover in the PGA the ad valorem taxes on natural gas storage.

3. Length of Variance

As stated above, MERC requested a variance to Minn. Rule 7825.2400, subp. 12 to recover the ongoing Kansas ad valorem taxes. The Company stated the following:³⁵

In particular, MERC requests a variance under Minn. R. 7829.3200 to Minn. R. 7820.4000 to adjust the FYE 2016 true-up beginning balance for MERC-Albert Lea used for the calculation of the FYE 2017 gas cost true-up factor in order, to allow MERC to collect the \$151,247 of costs incurred on behalf of legacy IPL customers for natural gas storage for the 2009 through April 30, 2015, through the MERC-Albert Lea PGA.

³³ On October 31, 2016, the Commission issued its *Findings of Fact, Conclusions, and Order* in Docket 15-736. See the Administrative Law Judge's August 19, 2016 Findings of Fact, Conclusions of Law, and Recommendation. In particular, please see ALJ's finding #758.

³⁴ Petition at page 7.

³⁵ Petition Introduction and at page 2.

... Additionally, MERC requests authorization to continue to recover future Kansas storage tax costs associated with the assumed IPL storage contracts through the FY2018 AAA period, to allow recovery of applicable Kansas storage tax through December 31, 2017. At that time, MERC would either request extension of the variance for continued recovery of costs through the commodity portion of the PGA or would incorporate those costs into base rates in a future rate case, as MERC has done with its own Kansas storage tax expense.

See the table below that MERC provided on page 6 of its Petition.

Costs Incurred	Proposed Recovery Mechanism	Proposed Recovery Timeframe
IPL Kansas Storage Tax, Incurred from 2009 through April 2015 (approximately \$151,000)	MERC Albert Lea PGA via the FYE17 true-up (ACA) factor	September 1, 2016, through June 30, 2017 (assuming PGA consolidation is approved effective July 1, 2017)
Kansas Storage Tax Incurred on Legacy IPL Storage Contracts (May 2015 going-forward)	The commodity portion of the MERC Albert Lea PGA and MERC NNG PGA (if PGA consolidation is approved in GR-15-736)	MERC Albert Lea PGA from July 1, 2016, through June 30, 2017, and the MERC NNG PGA from July 1, 2017 through December 31, 2017 (assuming PGA consolidation is approved in Docket No. G011/GR-15- 736, effective July 1, 2017).

In Docket 15-149, the Commission approved, for the past lump-sum assessment, a 5-year variance for Xcel to match the amortization period. The Department notes that, in this case, amortizing the 2009 through April 2015 KAVT amounts over a 4- or 5-year period may not be appropriate since the Commission approved consolidation of MERC's Albert Lea and NNG PGA systems effective July 1, 2017. Thus, allowing most of the costs to be recovered by MERC's Albert Lea (legacy IPL) PGA customers is appropriate given that MERC's Albert Lea (legacy IPL) customers received the benefits of the storage during that time period.

For the on-going future storage assessments, the Commission approved a one-year variance for Xcel by stating the following:³⁶

The Commission will therefore limit the term of the variance for ongoing tax assessments to one year. While the Company has demonstrated its efforts to resist the application of this tax, now that the tax has withstood all available legal challenges, the Company should consider whether there are unexplored and less-costly alternatives that would serve the same purpose as storing gas in Kansas, without incurring the Kansas tax.

Given that the Commission has previously granted one-year variances for ongoing assessments in the various dockets mentioned above, that the proposed September 1, 2016 start to the recovery time period is past and that, to the extent feasible, it is appropriate to recover costs associated with MERC's legacy IPL customers from those same customers, the Department concludes that, pending the Company's provision of the information requested in these Comments, MERC's request for a variance sufficient to allow it to recover KAVT amounts through December 2017 appears to be reasonable.

D. RECOVERY AMOUNTS

1. Ongoing Recovery of Annual Costs

MERC stated the following regarding the annual recovery:³⁷

MERC is requesting similar treatment for recovery of the Kansas storage tax expense. In particular, MERC is requesting recovery of the Kansas storage tax expense for the period 2009-2015 through the MERC-Albert Lea PGA, and authorization to continue to recover the Kansas storage tax expense associated with storage contracts acquired from IPL for expense through the FY2018 AAA period, to allow recovery of applicable Kansas storage tax through December 31, 2017. At that time, MERC would either request extension of the variance for continued recovery of costs through the commodity portion of the PGA or would incorporate those costs into base rates in a future rate case, as MERC has done with its own Kansas storage tax expense.

However, in its Petition, MERC did not provide a projected amount for the ongoing recovery of costs. The Department requests that, in reply comments, MERC provide, in detail, the

³⁶ *Id.* at page 3.

³⁷ Petition Introduction and Page 5.

amounts MERC seeks to recover on an ongoing basis, the estimated bill impacts, and an explanation of how these specific amounts were determined.

2. *Lump Sum Recovery of the 2009 through 2014 Costs*

Regarding the lump sum recovery MERC stated the following:³⁸

As part of the Asset Purchase and Sale Agreement, executed on September 3, 2013, MERC acquired a total of \$151,247 in unrecovered Kansas storage costs for the period 2009 through April 30, 2015.

... IPL, which has contracted for natural gas from the NNG pipeline to serve its Minnesota natural gas customers, began receiving invoices from Kansas counties for its 2009-2014 natural gas storage tax expense in the fall of 2014. In December 2014, the Commission issued an Order approving MERC's acquisition of IPL's natural gas assets and the transfer of IPL's Minnesota service rights and obligations to MERC. Included in the final closing purchase price was \$151,247 of unrecovered Kansas gas storage tax costs.¹

¹ This amount includes actuals through December 31, 2014 and \$6,102.17 for the estimated tax liability for the period January 1, 2015 through April 30, 2015.

In the Company's February 4, 2014 initial filing in Docket No. Docket 14-107, MERC stated the following:³⁹

No deferred tax assets, deferred tax liabilities, regulatory deferrals of tax, or deferred tax credits of IPL are included with the sale of assets to the buyer.

In Attachment A of its *Petition*, MERC reports an amount of \$148,312.48 for the lump sum recovery of the 2009 through 2014 costs.

MERC has not proposed to report the tax costs as separate line items in the monthly PGAs, AAA report and annual PGA true-up filings. To clarify, the Department recommends that MERC provide, in the Company's AAA report and PGA True-Up filings filed in September each year, the actual amount paid in ad valorem tax as well as recovered from ratepayers by state. Additionally, the costs and revenues should be listed as separate line items.

³⁸ *Id.*

³⁹ See the Company's February 4, 2014 Filing in Docket No. G001,G011/PA-14-107 (Docket 14-107), at page 25.

The Department notes the Kansas ad valorem taxes are based on the storage inventory each January 1st. The Company also stated throughout its Petition that it wants to recover \$151,247 of unrecovered KAVT costs, and to recover the ongoing costs through the commodity portion of MERC's Albert Lea PGA and the MERC-NNG PGA (once PGA consolidation is implemented pursuant to the Commission's Order in Docket 15-736). The Department requests that MERC in its reply comments, clarify, and provide detailed explanations for the following:

- a) How did MERC determine the figure of \$151,247?
- b) MERC stated that it executed the Asset Purchase and Sale Agreement on September 3, 2013 and that it acquired a total of \$151,247 in unrecovered Kansas storage costs, yet in its February 4, 2014 Filing in Docket 14-107, MERC stated that it had no deferred tax assets, deferred tax liabilities, regulatory deferrals of tax, or deferred tax credits of IPL included with the sale of assets to the buyer. Once again, please explain in detail how MERC came to its conclusion that it "acquired a total of \$151,247 in unrecovered Kansas storage costs?"
- c) If the MERC estimated tax liability of \$6,102.17 (for January 2015 – April 2015) is added to the actual amount (for 2009-2014) shown in Attachment A of the Petition of \$148,312.48, it results in a total of \$154,414.51. Once again, how did MERC determine the \$151,247 amount?
- d) Please explain how the estimated tax liability of \$6,102.17 was determined.

III. CONCLUSION AND RECOMMENDATION

Preliminarily, the Department recommends that the Commission approve a variance to include recovery in the PGA of ad valorem taxes related to natural gas storage; however, the Department's final recommendation will depend on MERC's response to the following issues:

- Given the KAVT costs incurred on the IPL NNG storage contracts (that MERC has assumed from May 2015 onward), the Commission's approval of MERC's PGA consolidation of MERC-ABL and MERC-NNG, and the timing of the Commission's decision in this matter, please provide the estimated amounts that MERC will seek to recover from the old MERC-ABL and MERC-NNG PGAs and provide the associated bill impacts.
- In its Petition, MERC did not provide a projected amount for the ongoing recovery of costs. The Department requests that, in reply comments, MERC provide, in detail, the amounts MERC seeks to recover on an ongoing basis, the estimated bill impacts, and an explanation of how these specific amounts were determined.
- Given that MERC filed its most recent rate case in 2015 with a 2016 test-year, well after the SCOTUS decision was made, and well after the IPL Asset Purchase and Sale Agreement was executed and approved by the Commission, please address whether MERC included any (whether past or ongoing) of the KAVT costs

associated with the former IPL contracts in its current rate case in Docket No. G011/GR-15-736. If so, we request that MERC quantify what was included, and if not, to explain why the costs were not included:

- Regarding the \$151,247 of unrecovered KAVT costs, please provide detailed explanations of the following:
 - a) How did MERC determine the figure of \$151,247?
 - b) MERC stated that it executed the Asset Purchase and Sale Agreement on September 3, 2013 and that it acquired a total of \$151,247 in unrecovered Kansas storage costs, yet in its February 4, 2014 Filing in Docket 14-107, MERC stated that it had no deferred tax assets, deferred tax liabilities, regulatory deferrals of tax, or deferred tax credits of IPL included with the sale of assets to the buyer. Once again, please explain in detail how MERC came to its conclusion that it “acquired a total of \$151,247 in unrecovered Kansas storage costs?”
 - c) If the MERC estimated tax liability of \$6,102.17 (for January 2015 – April 2015) is added to the actual amount (for 2009-2014) shown in Attachment A of the Petition of \$148,312.48, it results in a total of \$154,414.51. Once again, how did MERC determine the \$151,247 amount?
 - d) Please explain how the estimated tax liability of \$6,102.17 was determined.

Should the Commission approve MERC’s Petition, the Department recommends that MERC be required to provide, in the Company’s AAA report and PGA True-Up filings filed in September each year, the actual amount paid in ad valorem tax as well as recovered from ratepayers by state. Additionally, the costs and revenues should be listed as separate line items.

Upon review of MERC’s Reply Comments, the Department will make a final set of recommendations to the Commission.

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CERTIFICATE OF SERVICE

I, Sharon Ferguson, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, e-mail, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

**Minnesota Department of Commerce
Comments**

Docket No. G011/M-16-87

Dated this 14th day of November 2016

/s/Sharon Ferguson

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Michael	Ahern	ahern.michael@dorsey.com	Dorsey & Whitney, LLP	50 S 6th St Ste 1500 Minneapolis, MN 554021498	Electronic Service	No	OFF_SL_16-87_M-16-87
Julia	Anderson	Julia.Anderson@ag.state.mn.us	Office of the Attorney General-DOC	1800 BRM Tower 445 Minnesota St St. Paul, MN 551012134	Electronic Service	Yes	OFF_SL_16-87_M-16-87
Koby	Bailey	kabailey@integrysgroup.com	Minnesota Energy Resources Corporation (HOLDING)	200 East Randolph, Suite 2300 Chicago, Illinois 60601	Electronic Service	No	OFF_SL_16-87_M-16-87
Seth	DeMerritt	ssdemerritt@integrysgroup.com	MERC (Holding)	700 North Adams P.O. Box 19001 Green Bay, WI 543079001	Electronic Service	No	OFF_SL_16-87_M-16-87
Sharon	Ferguson	sharon.ferguson@state.mn.us	Department of Commerce	85 7th Place E Ste 500 Saint Paul, MN 551012198	Electronic Service	No	OFF_SL_16-87_M-16-87
Daryll	Fuentes	dfuentes@usg.com	USG Corporation	550 W Adams St Chicago, IL 60661	Electronic Service	No	OFF_SL_16-87_M-16-87
Amber	Lee	ASLee@minnesotaenergyresources.com	Minnesota Energy Resources Corporation	2665 145th St W Rosemount, MN 55068	Electronic Service	No	OFF_SL_16-87_M-16-87
John	Lindell	john.lindell@ag.state.mn.us	Office of the Attorney General-RUD	1400 BRM Tower 445 Minnesota St St. Paul, MN 551012130	Electronic Service	Yes	OFF_SL_16-87_M-16-87
Brian	Meloy	brian.meloy@stinson.com	Stinson, Leonard, Street LLP	150 S 5th St Ste 2300 Minneapolis, MN 55402	Electronic Service	No	OFF_SL_16-87_M-16-87
Andrew	Moratzka	andrew.moratzka@stoel.com	Stoel Rives LLP	33 South Sixth St Ste 4200 Minneapolis, MN 55402	Electronic Service	No	OFF_SL_16-87_M-16-87

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Colleen	Sipiorski	ctsipiorski@integrysgroup.com	Minnesota Energy Resources Corporation	700 North Adams Street Green Bay, WI 54307	Electronic Service	No	OFF_SL_16-87_M-16-87
Kristin	Stastny	kstastny@briggs.com	Briggs and Morgan, P.A.	2200 IDS Center 80 South 8th Street Minneapolis, MN 55402	Electronic Service	No	OFF_SL_16-87_M-16-87
Eric	Swanson	eswanson@winthrop.com	Winthrop Weinstine	225 S 6th St Ste 3500 Capella Tower Minneapolis, MN 554024629	Electronic Service	No	OFF_SL_16-87_M-16-87
Daniel P	Wolf	dan.wolf@state.mn.us	Public Utilities Commission	121 7th Place East Suite 350 St. Paul, MN 551012147	Electronic Service	Yes	OFF_SL_16-87_M-16-87