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May 2, 2011

VIA ELECTRONIC FILING

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

Re: In the Matter of the Petition of Minnesota Energy Resources Corporation–PNG
for Approval of a Change in Demand Entitlement for its Great Lakes Gas
Transmission System;
Docket No. G011/M-10-1167

Dear Dr. Haar:

Enclosed please find the Reply Comments of Minnesota Energy Resources Corporation
("MERC") in response to the March 16, 2011 Comments of the Minnesota Department of
Commerce, Division of Energy Resources in the above-referenced docket.

Thank you for your attention to this matter.

Sincerely yours,

/s/ Michael J. Ahern

Michael J. Ahern

cc: Service List

**STATE OF MINNESOTA
BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION**

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

In the Matter of the Petition of Minnesota
Energy Resources Corporation-GLGT for
Approval of a Change in Demand Entitlement

Docket No. G007/M-10-1167

**REPLY COMMENTS OF
MINNESOTA ENERGY RESOURCES CORPORATION**

Minnesota Energy Resources Corporation-PNG (“MERC” or “Company”) submits to the Minnesota Public Utilities Commission (“Commission”) these Reply Comments in response to the March 16, 2011 Comments of the Minnesota Department of Commerce, Division of Energy Resources (“Department”) in the above referenced matter.

A. Design-Day Requirement

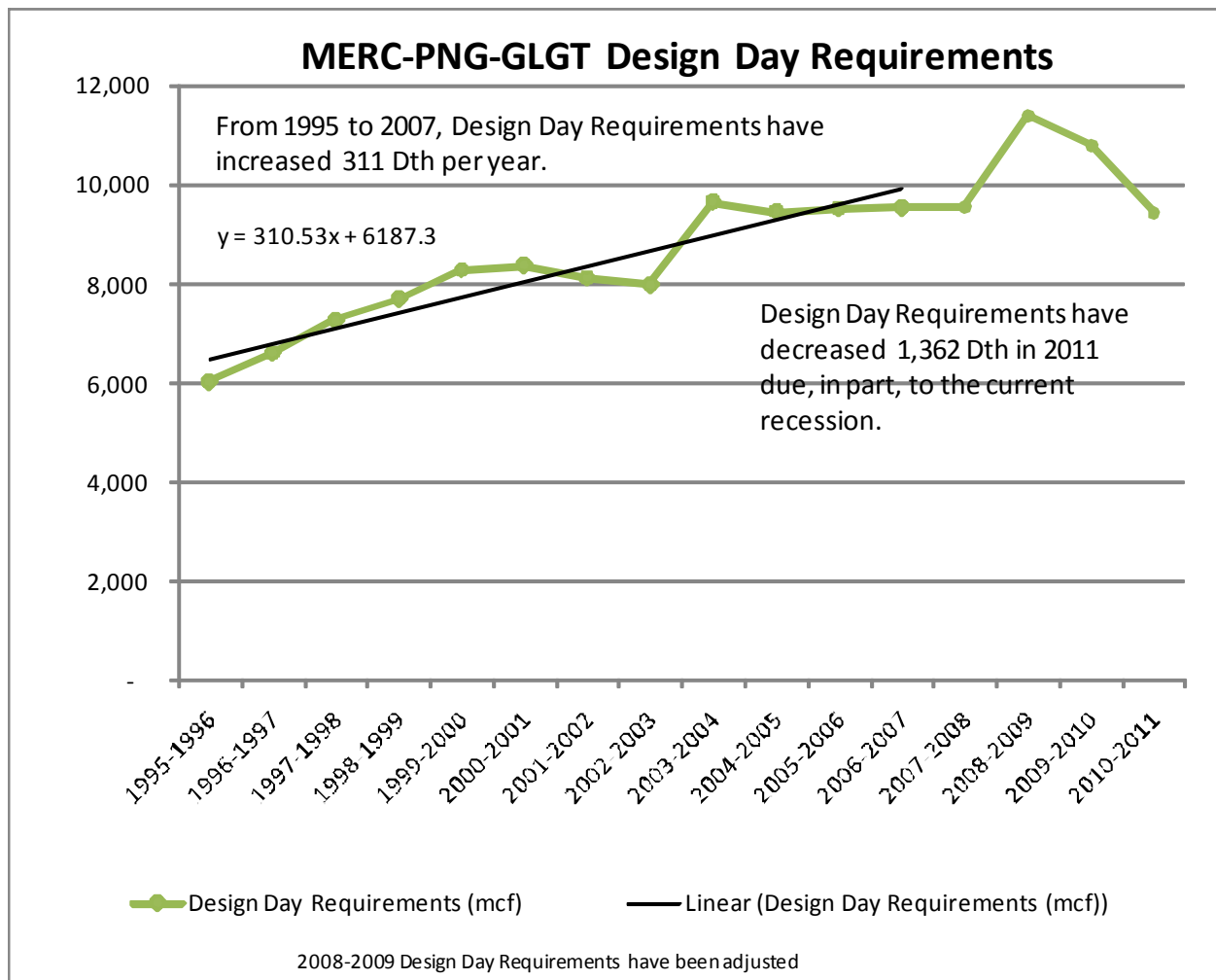
With respect to MERC’s overall entitlement level, the Department notes that, compared to its 2009-2010 demand filing (Docket No. G011/M-09-1283), MERC has proposed a higher reserve margin due to decreases in customer growth. The Department is concerned that MERC is recovering costs that are too high to meet the needs of firm customers. The Department cites to MERC’s design-day studies in its 2009-2010 demand filing, wherein MERC reduced its estimate of the peak-day sendout during the 2008-2008 heating season and also indicated declines in customer growth. The Department questions why MERC has not reduced the amount of total entitlements in this filing. The Department, therefore, concludes that the proposed reserve margin of 21.8 percent is too high to charge firm customers since these customers do not

need that level of reserve margin to ensure reliable service. The Department invites the Company to address in Reply Comments why its design-day requirement amount is reasonable.

MERC Response

1. Impact of Economy on Design-Day Requirements

The graph below provides a historical perspective of the design day requirements forecast along with the long-term best fit trend line. It is clear that the most recent year has exhibited less positive growth than the long-term trend line would suggest. (Note that the design-day forecast for the 2008-2009 winter has been re-stated to agree with the forecast process used for 2009-2010 and 2010-2011.)



As the above graph demonstrates, from 1995 through 2007, Design Day requirements increased 311 Dth per year. However, the 2011 Design Day requirement decreased 1,362 Dth, which MERC believes is due to the current state of the economy since 2008. MERC's Design Day calculation is based upon the previous three years December through February data. That means the winter data from December 2007 through February 2008, December 2008 through February 2009 and December 2009 through February 2010 data was used to calculate the Design Day requirement. These numbers are lower than previous years, especially the data from December 2008 through February 2009 because of the impacts of the recession.

Table 1 depicts total throughput on the GLGT pipeline from 2006 through 2010. The table demonstrates a decrease in throughput beginning in 2009. Since the data utilized for the design day calculation is based on throughput data from the previous three winter periods, a portion of the data would have been during the decrease in throughput due to impacts on the economy. MERC believes the data used in the design day calculation, especially in 2009 was an anomaly resulting in much lower design day requirements.

Table 1:
GLGT Annual Throughput (Bcf)

Year	Throughput	% Change
2006	7.68	
2007	7.59	-1.22%
2008	7.49	-1.27%
2009	6.79	-9.30%
2010	6.35	-6.57%

A large percentage of MERC's annual throughput on the NNG pipeline is due to the taconites. Table 2 indicates the approximate annual throughput from MERC's taconite

customers from 2006 through 2010. The table clearly demonstrates a large reduction in throughput in 2009 and a large rebound in 2010.

Table 2:
Annual Taconite Throughput (Bcf)

Year	Throughput	% Change
2006	25.5	
2007	23.0	-9.86%
2008	22.2	-3.46%
2009	14.2	-35.82%
2010	24.3	70.65%

According to a March 27, 2011 article in the Duluth News Tribune, titled “Tac is back, Range revs up”, the taconite industry hit rock bottom in 2009 but is now fully operational and looking to further expand. The article highlights a study by the University of Minnesota-Duluth that found approximately “18,000 jobs [are] directly or indirectly tied to the mining industry in the region – from railroad and ports to engineers and the doctors and dentists who have miners as patients. Mining also is equipment-intensive, consuming tires, trucks, explosives and fuel.” That translates into potential lower natural gas consumption by those who are directly or indirectly impacted by the reduction in taconite mining. But as the industry rebounds as it has in 2010 and runs at full capacity, natural gas consumption should potentially increase by those who are directly or indirectly impacted by the taconite industry. Although the taconite throughput is in the PNG-NNG annual throughput, the taconite mines are located in the geographical regions of some communities served off of GLGT. Please see Attachment A, the referenced article from the Duluth News Tribune.

A large percentage of MERC’s annual throughput on the GLGT pipeline is due to the paper and forest industry. Table 3 indicates the approximate annual throughput from load in

those industries. The table clearly demonstrates a large reduction in throughput in 2008 and 2009.

Table 3:
Annual Paper/Forest Industry
Throughput (Bcf)

Year	Throughput	% Change
2006	5.1	
2007	6.0	17.31%
2008	4.5	-24.68%
2009	3.9	-14.47%
2010	3.8	-2.74%

MERC has not seen the rebound in throughput from the paper and forest industries compared to the taconite industry, but as the economy continues to rebound, MERC believes the opportunity exists for increased throughput in these industries in the future.

As the economy rebounds, MERC believes there is a risk of turning back pipeline capacity based on current Design Day requirements. If MERC chooses to turn back capacity and as the economy continues to rebound and the Design Day requirements increase, as MERC believes to be the case, MERC may not be able to get capacity back on the interstate pipeline(s). The majority of pipelines MERC operates on are fully subscribed and if additional capacity is required, the pipeline(s) would require a pipeline expansion to increase capacity. The cost of a pipeline expansion can be substantially more costly than pipeline(s) maximum tariff rates. For example, MERC requested preliminary cost estimates from the NNG pipeline to increase delivery at the Worthington, MN TBS. NNG indicated that to increase the capacity by 5,000 Dth, MERC would have to agree to a ten (10) year agreement at a \$1.80 per Dth. The NNG maximum tariff rate on an annual rate is approximately \$.32 per Dth. The cost to expand is almost six (6) times the cost of the NNG maximum tariff rate.

Based on a potential for the economy to rebound and the potential cost of capacity if a pipeline expansion were required to contract for additional capacity after turning back current capacity, MERC believes the current levels of capacity are reasonable and prudent.

2. Uncertainty in Design-Day Forecast

The design-day forecast consists of three main parts:

1. Regression analysis of daily metered data and daily weather data.
2. Adjusting the regression results for non-firm customers who do not have daily meters.
3. Adding back the portion of joint firm customer demand that requires firm service even under design-day conditions.

The two most reliable parts of this forecast are part 1: the regression analysis, because it is supported by actual daily metered data, and part 3: adding back the firm portion of the joint firm customer demand, because that is based on actual signed contracts that clearly define the firm supply needs of the joint firm customers. The regression results include a confidence level of 97.5% meaning that there is only a 2.5% chance that actual load under design-day conditions will not exceed the regression-based forecast for those customers with daily meters included in the regression data.

However, the part 2 data related to the non-firm customers who do not have daily meters is based on monthly billing data. Inferring daily activity from monthly totals is statistically problematic – this is often referred to as a granularity deficiency in the data. As a general rule, the forecast time granularity should not be shorter than the granularity of the data. For example, forecasting monthly or annual activity using monthly data is generally considered acceptable because the annual activity simply adds up the monthly activity. Going the other way, or making accurate daily data from monthly data, creates uncertainty.

For example, a non-firm customer without a daily meter has January consumption of 3,100 Dkt. The design-day forecast process uses the approach from MERC's tariff that estimates a customer's MDQ as monthly consumption divided by 20 in situations where the customer's actual daily consumption is not available. This customer would then show an estimated MDQ of 155 Dkt ($= 3,100 \text{ Dkt} / 20$), which is the amount that would be subtracted from the regression estimate.

Without daily telemetry to provide the actual daily consumption, it is possible that this customer actually used nearly the same amount each day (more reflective of a constant process load than a heat load), and 31 days would have been the more accurate divisor, meaning that 100 Dkt ($= 3,100 \text{ Dkt} / 31$) should have been used as the reduction to the regression estimate. In this case, the regression estimate should have been reduced by 100 Dkt instead of 155 Dkt, and the adjusted firm design-day forecast was 55 Dkt too low. If this nearly flat load characteristic is shared by all of MERC's non-firm customers without daily meters, then the non-firm reduction from the regression results is about 35% too high, and the NMU firm design-day forecast as filed is too low by about 670 Dkt¹.

To be fair, without daily telemetry to provide the actual daily consumption, it is also possible that this customer actually used gas for three work weeks (more reflective of a process load for three weeks and then shutting down the other week), and 15 days would have been the more accurate divisor, meaning that 207 Dkt ($= 3,100 \text{ Dkt} / 15$) should have been used as the reduction to the regression estimate. In this case, the regression estimate should have been reduced by 207 Dkt instead of 155 Dkt, and the adjusted firm design-day forecast was 52 Dkt too high. If this partial-month load characteristic is shared by all of MERC's non-firm customers

¹ Calculated on a base number for non-firm customer monthly volume of 38,659 Dkt and a growth rate of -2.28667%.

without daily meters, then the non-firm reduction from the regression results is about 34% too low, and the firm design-day forecast as filed is too high by about 630 Dkt.²

The lack of daily data for all non-firm customers brings uncertainty regarding the proper design day adjustment for them. For reasons discussed above, this uncertainty could result in a NMU design day forecast between 8,810 Dkt (= 9,440 Dkt filed - 630 Dkt) and 10,110 Dkt (= 9,440 Dkt filed + 670 Dkt). The proposed NMU supply entitlement is 11,500 Dkt. If the non-firm customers without daily meters really consume the same amount every day in the month, resulting in the design day forecast of 10,110 Dkt, **the reserve margin would be 13.7%** (= (11,500 Dkt – 10,110 Dkt) / 10,110 Dkt).

Partly to improve the accuracy of MERC's design day requirements forecast, MERC has requested and the Commission has approved telemetry for all non-firm customers in Docket No. G007,011/GR-08-835. MERC has clarified in Docket No. G007,011/GR-10-977 that this requirement would not apply to farm tap customers who have a relatively low daily load in the winter. The availability of daily readings from telemetry for non-firm customers will reduce the uncertainty associated with the non-firm adjustment to the regression results since the adjustments for these customers will be based on daily data instead of monthly data. Gradual improvement will be seen over a three year period since the MERC design-day regressions rely on three full winters of daily metered data, so the best results will be obtained when the non-firm customers have had daily meter readings for three consecutive winters and their daily consumption can be more accurately removed from the firm load regression data before the firm load regressions are performed.

²Calculated on a base number for non-firm customer monthly volume of 1,294,926 Dkt and a growth rate of -0.06615%.

In MERC's PNG-VGT Demand Entitlement filing, Docket No. G011/M-10-1169, the Department recommended that the Commission approve MERC's proposal. The Department concluded that MERC's design-day study and accompanying entitlements, adjusted for concern over the accuracy of its design-day forecast, are reasonable to ensure sufficient capacity to serve firm customers on a peak day.³ The same comments hold true in this docket as well. While it can be challenging to forecast entitlements in the aftermath of extreme economic conditions, and adjusting regression results for non-firm customers who do not have daily data adds to this challenge, MERC believes that its proposal ensures sufficient capacity to serve its firm customers on a peak day.

B. Reserve Margin

The Department notes that MERC's proposed reserve margin of 21.82 percent represents a significant increase over last year's reserve margin. However, the Department has chosen to withhold its comments on the reserve margin until MERC has addressed the reasonableness of its reserve margin and design-day requirement, and therefore sufficiently justified its proposal, in its Reply Comments.

MERC Response

In the Department's Comments in the VGT demand entitlement docket, the Department noted that although MERC's reserve margin was quite high, MERC had fully mitigated concerns about charging customers too much and that the Company's reserve margin was reasonable in these circumstances. In particular, the Department noted:

The Company has valid concerns that its forecast is too low. Furthermore, MERC has acquired the additional protection for an extreme cold-weather event that the large reserve margin provides, for much less than it was paying for a smaller volume of gas. The Company also explained that its need to honor the terms of

³ Department Comments, Docket No. G011/M-10-1169 (Apr. 22, 2011).

certain of its contracts leaves it less flexibility than it would like as it builds its design-day capacity. Consequently, MERC has had to acquire the rights to firm transportation in blocks that are larger than it would prefer. Thus, although the Department does not endorse a reserve margin of nearly 20 percent, the Department concludes that MERC has fully mitigated concerns about charging customers too much and the Company's reserve margin is reasonable in these circumstances.⁴

The same circumstances are true in this docket as well.

As discussed above, MERC has concerns that the design day requirement may be low due to the data from late 2008 through 2009, especially due to the taconite, forest and paper industries. In addition, the lack of daily metered data for MERC's non-firm customers makes it difficult to determine the proper design day adjustment for them. Consequently, MERC's reserve margin could be much lower than the 21 percent cited by the Department. Additionally, even though MERC does not contract for firm capacity to meet interruptible and transportation load, MERC still has the responsibility to balance the entire system with each respective pipeline. That means MERC not only has to deliver enough supply to meet General System firm volumes but also enough supply to meet General System interruptible volumes and any third party transportation volumes in excess of third party delivered supply.

MERC does not typically curtail interruptible load unless there are operational reason(s) or MERC is experiencing a peak day. For example, at the Worthington Town Border Station (TBS), MERC curtails due to pressure drops on the NNG pipeline because there is more demand on colder days than the NNG pipeline can physically deliver. With that said, MERC will typically purchase and deliver supply for interruptible customers, unless there are operational reason(s) to curtail.

When capacity is contracted with a pipeline, it is typically for a long term, typically three to five years. MERC doesn't have any firm capacity on GLGT expiring until October 31, 2011,

⁴ Department Comments at 5, Docket No. G011/M-10-1169 (Apr. 22, 2011).

so that would be the earliest MERC could turn back capacity. Beginning effective November 1, 2011, MERC has decreased 1,578 Dth on GLGT. Using the proration percentages in the filing, NMU customers would see a decrease of approximately 646 Dth. MERC is also concerned with turning capacity back, because the capacity could be subscribed by another party. In the event MERC needs future capacity, the pipeline may not have any to purchase. The pipeline could provide additional capacity by a pipeline expansion, but the cost would be greater than the pipeline maximum tariff rates, as explained above.

C. FDD Storage Costs

The Department notes that MERC includes the cost for its FDD contracts in the demand portion of the PGA. It is the Department's position that these costs should be included in the commodity portion of the PGA.

MERC Response

MERC agrees with the Department that it is appropriate to recover storage costs through the commodity rather than the demand portion of rates. On March 7, 2008, MERC made a Supplemental Filing in Docket No. G011/M-07-1404 in which the Company proposed to include storage costs in the commodity rate rather than the demand rate. The Commission has not yet issued a decision in Docket No. G011/M-07-1404 and has not yet approved MERC's proposal to shift storage costs from the demand portion of rates to the commodity portion of rates. MERC has not implemented its proposal in the monthly PGA because the Company is awaiting Commission approval of this change. MERC, however, has included attachments with its initial filing in this docket that calculates costs based on inclusion of these costs in the commodity portion of rates.⁵

⁵ See Petition, Attachment 4, pages 3-4 and Attachment 7, page 2.

DATED this 2nd day of May, 2011.

Respectfully submitted,

DORSEY & WHITNEY LLP

/s/ Michael J. Ahern _____

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Attorney for Minnesota Energy Resources
Corporation

Attachment A

Tac is back, Range revs up - Minnesota's iron ore industry has bounced back to full speed this spring, less than two years after hitting rock-bottom — one of the fastest turnarounds in a century of mining.

Duluth News Tribune (MN) - Sunday, March 27, 2011

Author: John Myers, Duluth News Tribune

Minnesota's iron ore industry has bounced back to full speed this spring, less than two years after hitting rock-bottom — one of the fastest turnarounds in a century of mining.

As the first lakers of the 2011 season leave ore docks in Duluth, Two Harbors, Silver Bay and Superior with full loads of taconite bound for steel mills on the lower lakes, Iron Range taconite experts and workers say they are poised to hit full capacity in taconite production even as they plan to expand.

"Everyone is going at full capacity-plus right now and we've got new projects down the line," said Craig Pagel, executive director of the Iron Mining Association of Minnesota. "It's having a ripple effect on our whole region's economy."

Suddenly, an industry tied since the 1800s to national and global economic slumps and upturns seems to have shortened the period between bust and boom.

That's good news for Northeastern Minnesota's economy, which is tied to hard-rock mining more than most people know.

"Everyone's back to work now. You can have all the overtime you want. ... And they're trying to hire new people," said Jack Thronson, an electrician at Keetac in Keewatin and president of Steelworkers Local 2660. "It was pretty bad in 2009; we were down for most of a year. But things have changed so fast. The steel demand is supposed to be good for a while now."

Record bounce-back

It's been a whirlwind four years. In 2008, the industry was eating high on the hog, producing 39 million tons of taconite iron ore — one of the best years of the decade.

But the global economic meltdown that started in late 2008 caused one of the fastest downturns ever. Production in 2009 dropped by more than half to the lowest level since 1963, just 17 million tons.

For a few weeks in 2009, all six of the state's taconite plants were completely shut down, and nearly all their workers were laid off. It was suddenly slim pickings, rivaling the early 1980s when the industry lost half its workers, half its production and some 20,000 residents moved out of St. Louis County to find new homes and jobs elsewhere.

Fast-forward to 2010 and the recession quickly became old news. Taconite production rocketed back to 37.5 million tons and employment returned to 3,600 workers. Global steel demand turned healthy again and demand for Minnesota ore was heavy.

Experts say one key to the breakneck bounce-back was taconite plant owners quickly reacting to dwindling demand by squeezing off production. In years past, the industry responded at a snail's pace, often leading to huge stockpiles of unwanted ore followed by long periods of slowdown and shutdown.

"They shut down faster this time, with some very harsh consequences for the workers," said Drew Digby, regional analyst for the Minnesota Department of Employment and Economic Development. "But it's allowed them to bounce back faster as well."

The rebound has also meant more trains hauling taconite from the Range to Lake Superior and more freighters

hauling it across the Great Lakes and beyond.

"It's always good news when our Minnesota operations are at or near capacity, and that's where we are," said Sandy Karnowski, Cliffs Minnesota regional manager of public affairs.

For 2011, industry experts say production will hit at least 40 million tons, a mark not seen since LTV Steel permanently shuttered in 2000. Production could go higher if plants continue to push the efficiency envelope, Pagel said. "All indications are that world steel demand should remain high."

Good news compounded

Compounding the economic good news are new products and new markets.

Mesabi Nugget is making an iron nugget that can be used in electric mini-mills, a new market for Minnesota ore.

Ore concentrate pulled from what used to be waste by upstart producer Magnetation in Nashwauk is heading to Mexico.

And the growing new market of China is hungry for taconite pellets. Cliffs Natural Resources has said it will ship 1 million tons of Michigan and Minnesota taconite pellets there this year.

"The price per ton on that (taconite going to China) is something close to \$200, and it's never been that high before," Pagel said.

For the first time in any major way, the price that foreign steel mills are willing to pay for the ore will more than cover the huge cost of shipping taconite from Minnesota overseas. Minnesota-processed taconite is now competing with raw iron ore from Brazil and Australia.

Magnetation's Matt Lehtinen noted that his company's iron ore concentrate is being shipped to a Mexican mill by train, taking the place of raw ore from Brazil.

"It now matters more for Minnesota taconite whether India's growth rate is 8 percent or 12 percent than what sales are for the U.S. auto industry," Digby said.

Just how good is it now for the taconite companies?

Peter Kakela, Michigan State University professor and an expert on the global iron ore industry, said companies are selling taconite at four times what it cost to produce, a return on investment unheard of in the past when profits of a few dollars per ton were common.

"For years — decades, even — the price hovered in that \$30 to \$35-per-ton range. ... And now someone is paying \$200. They've never seen anything like this before," Kakela said. "There's your incentive for all the expansions people are talking about. That's why everything is running at full capacity."

Huge economic impact

Not only have mines recalled all the 3,600 Steelworkers who were laid off in 2009, but about 100 jobs have been added. With the increasing pace of retirements by aging Steelworkers, 1,000 of today's workers are new employees never before in the taconite business. The industry continues to recruit local students onto "wrench-smart" training and engineering career tracks at local colleges and universities.

Digby said there is no doubting taconite's impact on the region, even as the service economy becomes larger. In 2009, when checks from the mines stopped, the region's entire payroll numbers crashed and sent shock waves through the regional economy.

Taconite has "been especially important in Northeastern Minnesota as the wood-products jobs continue to dwindle," Digby said.

Mining amounts to about 2 percent of total regional employment and 8 percent of regional sales. Health care, by comparison, accounts for 14 percent of employment and 8 percent of sales. But a 2009 UMD study showed the

direct and related economic contribution of mining amounts to 30 percent of the regional domestic product.

That UMD study found some 18,000 jobs directly or indirectly tied to the mining industry in the region — from railroad and ports to engineers and the doctors and dentists who have miners as patients. Mining also is equipment-intensive, consuming tires, trucks, explosives and fuel.

Still, direct employment in the taconite industry has dropped from more than 15,000 at its peak, to 5,600 in 2001 to about 3,700 now. Digby said that, while mining is still big and now growing, its role as an employer is shrinking as health care, education and other service industries grow at a faster pace.

“On one hand they have become far more able to adapt to the global economy and become more efficient with technology and innovation. And that’s great for the industry and for stability,” Digby said. “The downside of that is it has usually meant fewer people employed, and that limits (taconite’s) impact on the regional economy going forward, at least as far as direct employment is concerned.”

Prepare now for downturn

Tony Sertich, commissioner of the Iron Range Resources and Rehabilitation Board, said the current good times are spurring mining companies to invest in new and improved operations worldwide. That’s most noticeable now with the India-owned Essar Steel plant near Nashwauk, expected to be the first major steel mill on the Iron Range by 2015.

“That’s been the goal since Day One, to not just be at the front end of the mining industry but to get that added value and the added jobs and benefits right here,” Sertich said.

Sertich said economic analysis he’s seen points to another four-year period of high demand for steel and ore. But the good times won’t last forever.

“We know there are going to be boom and bust cycles and we need to leverage these good times for the inevitable downturn,” Sertich said. “We have to help the companies invest now to stabilize for the future. These multinational companies are eager to make investments in the early stages of a good forecast, so we can’t miss this opportunity.”

The industry could add another 1,000 direct jobs in coming years, Pagel said, and that doesn’t count the potential for copper-nickel mining operations such as PolyMet and Twin Metals.

Kakela said the good times appear to be here for a while, thanks to unrelenting demand for steel in Asia and to new efforts on Minnesota’s Iron Range.

“I don’t see any downturn in global demand right now anywhere on the horizon,” he said. “And northern Minnesota is poised to supply that demand because it’s really become the cradle of innovation for iron ore worldwide.”

Caption: Workers load limestone at the DM&IR ore docks in West Duluth in front of a mountain of taconite pellets waiting to be shipped down the Great Lakes. (Bob King / rking@duluthnews.com)

Section: News

Record Number: 8bf8160bd84ef5293914b199d6c4c183e0dd

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AFFIDAVIT OF SERVICE

STATE OF MINNESOTA)
) ss.
COUNTY OF HENNEPIN)

Sarah J. Sorenson, being first duly sworn on oath, deposes and states that on the 2nd day of May, 2011, the Reply Comments of Minnesota Energy Resources Corporation were electronically filed with the Minnesota Public Utilities Commission and the Minnesota Department of Commerce. A copy of the filing was delivered by electronic service or first class mail to the remaining individuals on the attached service list.

/s/ Sarah J. Sorenson _____

Subscribed and sworn to before me
this 2nd day of May, 2011.

/s/ Sara Garcia _____
Notary Public, State of Minnesota

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