

Staff Briefing Papers

Meeting Date August 1, 2019

Agenda Item **3

Company Minnesota Energy Resources Corporation

Docket No. **G-011/M-18-182**

In the Matter of the Petition of Minnesota Energy Resources Corporation for Approval of a Natural Gas Extension Project (NGEP) Cost Rider Surcharge for the Recovery of 2019 Rochester Project Costs

G-011/M-18-281

In the Matter of Minnesota Energy Resources Corporation's Request for Approval of a Gas Utility Infrastructure Cost (GUIC) Rider

G-011/M-19-282

In the Matter of the Petition of Minnesota Energy Resources Corporation for Approval of 2020 Gas Utility Infrastructure Cost (GUIC) Rider Revenue Requirement and Revised Surcharge Factor

G-011/GR-17-563

In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to Increase Rates for Natural Gas Service in Minnesota

Issues Should the Minnesota Public Utilities Commission approve, modify, reject, or request additional information regarding Minnesota Energy Resource Corporation's request to suspend its Natural Gas Extension Project rider surcharge and its Gas Utility Infrastructure Cost rider surcharge from direct connect customers?

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The attached materials are work papers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless noted otherwise.



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Relevant Documents

Date

Docket No. G-011/M-18-182

PUC - Staff Briefing Papers May 16, 2019

PUC - Order Approving NGEP Rider Surcharge With Modifications June 18, 2019

Docket No. G-011/M-18-281

PUC - Staff Briefing Papers December 6, 2018

PUC - Order Approving Gas Utility Infrastructure Cost Rider With
Modifications And Requiring Compliance Filing February 5, 2019

PUC - Staff Briefing Papers April 1, 2019

PUC - Order Approving Compliance Filing April 25, 2019

Docket Nos. G-011/M-18-182 & G-011/M-18-281

Minnesota Energy Resources Corporation – Letter June 28, 2019

Encore Energy Services, Inc. – Letter July 1, 2019

PUC – Notice of Comment Period July 2, 2019

Super Large Gas Intervenors – Comments July 11, 2019

Office of the Attorney General – Comments July 11, 2019

Department of Commerce – Comments July 11, 2019

OAG – Reply Comments July 18, 2019

MERC – Reply Comments July 18, 2019

PUC – Speak Up Comments (None Received) July 16, 2019

I. Statement of the Issues

Should the Minnesota Public Utilities Commission approve, modify, reject, or request additional information regarding Minnesota Energy Resource Corporation's request to suspend its Natural Gas Extension Project rider surcharge and its Gas Utility Infrastructure Cost rider surcharge from direct connect customers?

II. Introduction

On June 28, 2019, Minnesota Energy Resources Corporation (MERC) filed an emergency request to suspend the collection of its Minnesota Public Utilities Commission (Commission) approved NGEP and GUIC rider surcharges (emergency request) from specific large customers that have demonstrated an ability and intent to bypass MERC's system and connect directly with Northern Natural Gas, Inc. (Northern) which is the interstate pipeline that serves the Minnesota (Direct Connect Customers). MERC contends that it will cause irreversible harm to the Company's other ratepayers should the Direct Connect customers bypass MERC's system since the Direct Connect Customers pay a significant portion of MERC's fixed costs. In addition to its request to suspend the collection NGEP and GUIC rider surcharges from Direct Connect Customers, MERC also proposes to refund to Direct Connect Customers any amounts already collected. The Company requested action on this matter by August 1, 2019.

On July 1, 2019, Encore Energy Services, a business providing consulting services on energy-related services, filed a letter in support of MERC's petition.

On July 2, 2019, the Commission issued a Notice of Comment Period for parties to comment on MERC's petition. The Minnesota Department of Commerce, Division of Energy Resources (Department), the Minnesota Office of Attorney General – Residential Utilities and Antitrust Division (OAG), and Super Large Gas Intervenors (SLGI) provided comments; MERC and the OAG provided response comments.

The Department recommends the Commission deny MERC's request to suspend the NGEP rider surcharge for Direct Connect Customers. Unlike its recommendation for the NGEP rider, the Department recommends that the Commission approve MERC's request to suspend the GUIC rider for Direct Connect Customers. An alternative solution would be to suspend the GUIC rider surcharge for all customer classes until additional analysis can be completed. The Department is opposed to MERC's request to refund or provide a discount to effectively provide a "refund" from the non-direct connect customers to the Direct Connect Customers.

The OAG's position is that MERC's request to suspend the NGEP and GUIC rider surcharges for the Direct Connect Customers runs contrary to statute, specifically the language of the NGEP Statute. Additionally, the OAG argues that MERC's emergency request is simply an untimely request for reconsideration "packaged as an emergency request." The OAG does not believe MERC has fully demonstrated that the bypass threat is real, significant, and has a high probability of occurring. Because of its concern about retroactive ratemaking, the OAG also

recommends the Commission deny MERC's request to refund or true-up monies already collected from Direct Connect Customers.

SLGI supports MERC's request for suspension of the GUIC and NGEP rider surcharges for Direct Connect Customers and a refund of amounts collected under the riders back to their initial effective dates. However, SLGI requests that the Commission require MERC to expand the requested relief to include all Class 5 Transportation Customers.

No party requested reconsideration of the Commission's Orders in the GUIC or the NGEP dockets. If the Commission wishes to take up MERC's request, it may need to reopen the February 5 and April 25, 2019 GUIC orders and the June 18, 2019 NGEP order.

III. Relevant Statutes

A. 216B.1638 Recovery of Natural Gas Extension Project Costs (NGEP Statute)

Subdivision 1. **Definitions.** (a) For the purposes of this section, the terms defined in this subdivision have the meanings given them.

(b) "Contribution in aid of construction" means a monetary contribution, paid by a developer or local unit of government to a utility providing natural gas service to a community receiving that service as the result of a natural gas extension project, that reduces or offsets the difference between the total revenue requirement of the project and the revenue generated from the customers served by the project.

(c) "Developer" means a developer of the project or a person that owns or will own the property served by the project.

(d) "Local unit of government" means a city, county, township, commission, district, authority, or other political subdivision or instrumentality of this state.

(e) "Natural gas extension project" or "project" means the construction of new infrastructure or upgrades to existing natural gas facilities necessary to serve currently unserved or inadequately served areas.

(f) "Revenue deficiency" means the deficiency in funds that results when projected revenues from customers receiving natural gas service as the result of a natural gas extension project, plus any contributions in aid of construction paid by these customers, fall short of the total revenue requirement of the natural gas extension project.

(g) "Total revenue requirement" means the total cost of extending and maintaining natural gas service to a currently unserved or inadequately served area.

(h) "Transport customer" means a customer for whom a natural gas utility transports gas the customer has purchased from another natural gas supplier.

(i) "Unserved or inadequately served area" means an area in this state lacking adequate natural gas pipeline infrastructure to meet the demand of existing or potential end-use customers.

Subd. 2. **Filing.** (a) A public utility may petition the commission outside of a general rate case for a rider that shall include all of the utility's customers, including transport customers, to recover the revenue deficiency from a natural gas extension project.

(b) The petition shall include:

(1) a description of the natural gas extension project, including the number and location of new customers to be served and the distance over which natural gas will be distributed to serve the unserved or inadequately served area;

(2) the project's construction schedule;

(3) the proposed project budget;

(4) the amount of any contributions in aid of construction;

(5) a description of efforts made by the public utility to offset the revenue deficiency through contributions in aid to construction;

(6) the amount of the revenue deficiency, and how recovery of the revenue deficiency will be allocated among industrial, commercial, residential, and transport customers;

(7) the proposed method to be used to recover the revenue deficiency from each customer class, such as a flat fee, a volumetric charge, or another form of recovery;

(8) the proposed termination date of the rider to recover the revenue deficiency; and

(9) a description of benefits to the public utility's existing natural gas customers that will accrue from the natural gas extension project.

Subd. 3. **Review; approval.** (a) The commission shall allow opportunity for comment on the petition.

(b) The commission shall approve a public utility's petition for a rider to recover the costs of a natural gas extension project if it determines that:

(1) the project is designed to extend natural gas service to an unserved or inadequately served area; and

(2) project costs are reasonable and prudently incurred.

(c) The commission must not approve a rider under this section that allows a utility to recover more than 33 percent of the costs of a natural gas extension project.

(d) The revenue deficiency from a natural gas extension project recoverable through a rider under this section must include the currently authorized rate of return, incremental income taxes, incremental property taxes, incremental depreciation expenses, and any incremental operation and maintenance costs.

Subd. 4. **Commission authority; order.** The commission may issue orders necessary to implement and administer this section.

Subd. 5. **Implementation.** Nothing in this section commits a public utility to implement a project approved by the commission. The public utility seeking to provide natural gas service shall notify the commission whether it intends to proceed with the project as approved by the commission.

Subd. 6. **Evaluation and report.** By January 15, 2017, and every three years thereafter, the commission shall report to the chairs and ranking minority members of the senate and house of representatives committees having jurisdiction over energy policy:

- (1) the number of public utilities and projects proposed and approved under this section;
- (2) the total cost of each project;
- (3) rate impacts of the cost recovery mechanism; and
- (4) an assessment of the effectiveness of the cost recovery mechanism in realizing increased natural gas service to unserved or inadequately served areas from natural gas extension projects

B. 216B.1635 Recovery of Gas Utility Infrastructure Costs (GUIC Statute)

Subdivision 1. **Definitions.**

- (a) "Gas utility" means a public utility as defined in section 216B.02, subdivision 4, that furnishes natural gas service to retail customers.
- (b) "Gas utility infrastructure costs" or "GUIC" means costs incurred in gas utility projects that:
 - (1) do not serve to increase revenues by directly connecting the infrastructure replacement to new customers;
 - (2) are in service but were not included in the gas utility's rate base in its most recent general rate case, or are planned to be in service during the period covered by the report submitted under subdivision 2, but in no case longer than the one-year forecast period in the report; and

(3) do not constitute a betterment, unless the betterment is based on requirements by a political subdivision or a federal or state agency, as evidenced by specific documentation, an order, or other similar requirement from the government entity requiring the replacement or modification of infrastructure.

(c) "Gas utility projects" means:

(1) replacement of natural gas facilities located in the public right-of-way required by the construction or improvement of a highway, road, street, public building, or other public work by or on behalf of the United States, the state of Minnesota, or a political subdivision; and

(2) replacement or modification of existing natural gas facilities, including surveys, assessments, reassessment, and other work necessary to determine the need for replacement or modification of existing infrastructure that is required by a federal or state agency.

Subd. 2. Gas infrastructure filing. A public utility submitting a petition to recover gas infrastructure costs under this section must submit to the commission, the department, and interested parties a gas infrastructure project plan report and a petition for rate recovery of only incremental costs associated with projects under subdivision 1, paragraph (c). The report and petition must be made at least 150 days in advance of implementation of the rate schedule, provided that the rate schedule will not be implemented until the petition is approved by the commission pursuant to subdivision 5. The report must be for a forecast period of one year.

Subd. 3. Gas infrastructure project plan report. The gas infrastructure project plan report required to be filed under subdivision 2 shall include all pertinent information and supporting data on each proposed project including, but not limited to, project description and scope, estimated project costs, and project in-service date.

Subd. 4. Cost recovery petition for utility's facilities. Notwithstanding any other provision of this chapter, the commission may approve a rate schedule for the automatic annual adjustment of charges for gas utility infrastructure costs net of revenues under this section, including a rate of return, income taxes on the rate of return, incremental property taxes, incremental depreciation expense, and any incremental operation and maintenance costs. A gas utility's petition for approval of a rate schedule to recover gas utility infrastructure costs outside of a general rate case under section 216B.16 is subject to the following:

(1) a gas utility may submit a filing under this section no more than once per year; and

(2) a gas utility must file sufficient information to satisfy the commission regarding the proposed GUIC. The information includes, but is not limited to:

(i) the information required to be included in the gas infrastructure project plan report under subdivision 3;

(ii) the government entity ordering or requiring the gas utility project and the purpose for which the project is undertaken;

(iii) a description of the estimated costs and salvage value, if any, associated with the existing infrastructure replaced or modified as a result of the project;

(iv) a comparison of the utility's estimated costs included in the gas infrastructure project plan and the actual costs incurred, including a description of the utility's efforts to ensure the costs of the facilities are reasonable and prudently incurred;

(v) calculations to establish that the rate adjustment is consistent with the terms of the rate schedule, including the proposed rate design and an explanation of why the proposed rate design is in the public interest;

(vi) the magnitude and timing of any known future gas utility projects that the utility may seek to recover under this section;

(vii) the magnitude of GUIC in relation to the gas utility's base revenue as approved by the commission in the gas utility's most recent general rate case, exclusive of gas purchase costs and transportation charges;

(viii) the magnitude of GUIC in relation to the gas utility's capital expenditures since its most recent general rate case; and

(ix) the amount of time since the utility last filed a general rate case and the utility's reasons for seeking recovery outside of a general rate case.

Subd. 5. Commission action. Upon receiving a gas utility report and petition for cost recovery under subdivision 2 and assessment and verification under subdivision 4, the commission may approve the annual GUIC rate adjustments provided that, after notice and comment, the costs included for recovery through the rate schedule are prudently incurred and achieve gas facility improvements at the lowest reasonable and prudent cost to ratepayers.

Subd. 6. Rate of return. The return on investment for the rate adjustment shall be at the level approved by the commission in the public utility's last general rate case, unless the commission determines that a different rate of return is in the public interest.

Subd. 7. Commission authority; rules. The commission may issue orders and adopt rules necessary to implement and administer this section.

IV. Background

A. Historical MERC Rate Cases

MERC'S Class 5 (Super Large Volume) Transportation customers consist mostly of the taconite facilities located on the Iron Range in northern Minnesota, forest products companies (i.e. paper mills, etc.), and electric generation facilities. MERC's transportation customers acquire their own gas supplies through unregulated gas suppliers and arrange for the delivery of such supply to a Town Border Station. With respect to interstate gas transportation, many of MERC's super large volume transportation customers are "Main Line" or "Direct Connect" customers meaning they are connected directly to the interstate pipeline. MERC owns no pipe and performs no physical distribution of the gas. MERC's services to these customers are largely administrative. As a result, the costs of remaining MERC customers must offset the corresponding costs of bypassing MERC's system in order for those customers to remain on MERC's system.

MERC noted that the Commission has recognized the threat of bypass during previous rate case proceedings.¹

The Commission has consistently acknowledged that the potential loss of these customers constitutes a justifiable concern. In each of MERC's rate cases filed since 2008, the Commission has consistently recognized these customers' sensitivity to price increases and the detrimental impacts that would occur to all ratepayers if they were to bypass, and the Commission has held that the potential loss of these customers constitutes exigent circumstances warranting the waiver of an interim rate increase for MERC's Super Large Volume transportation customers.

In the 2008 rate case the Commission observed:²

The Super Large Volume customers were treated differently from other customers before this case, and they have been treated differently throughout this case. Because they have the ability to bypass the natural gas utility by converting their fuel source to propane or fuel oil - thereby depriving other customers of any contribution they would otherwise make to recovery of fixed costs - their rates have generally been set below the embedded, fully distributed cost of service. Instead, their rates have been set so that at a minimum they recover the incremental cost of service (the extra costs they actually impose on the system) and whatever contribution to fixed costs can be risked by bypass.

¹ Docket No. G-011/GR-17-563, Rebuttal Testimony of Amber S. Lee, page 12, at 11-17

² *In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to Increase Rates for Natural Gas Service in Minnesota*, Docket No. G-007, 011/GR-08-835, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER, at 21 (June 29, 2009).

In the 2013 rate case, the Commission noted:³

MERC and the Department also agreed to minimize rate increases for the super-large-volume and flex customer classes, since these customers are very cost-sensitive and are able to bypass MERC's system, a result which would harm MERC's other customers.

The overall price sensitivity of the Direct Connect Customers had been discussed in MERC's most recent general rate case, Docket No. G-011/GR-17-563. In her direct testimony, Ms. Amber Lee, on behalf of MERC, stated:⁴

Class 5 customers represent MERC's largest-use customers. Although these customers are served on MERC's distribution system, rather than upstream off the pipeline, their enormous volumes and proximity to an alternate supply source give them an economic incentive to bypass the distribution system if MERC's rates are not competitive. For this reason, Class 5 rates should not be too much above incremental costs.

However, Staff reviewed the *Findings of Fact, Conclusions of Law, and Order* issued December 26, 2018 and notes that it does not specifically address bypass.

B. Natural Gas Extension Project Rider (Docket #18-182)

MERC's NGEF is designed to expand the capacity of MERC's natural gas distribution system in and around the City of Rochester to meet current and forecasted demand related to the Mayo Clinic Destination Medical Center initiative. MERC seeks to recover a portion of the project's costs under the NGEF statute, which allows rider recovery of one third of the revenue deficiency from an eligible natural gas extension project.⁵ The remaining costs would be recovered through base rates or the Company's purchased-gas-adjustment rider. On May 5, 2017, the Commission issued its initial Order Approving Rochester Project and Granting Rider Recovery with Conditions.⁶

On February 28, 2018, MERC filed its NGEF Petition requesting a forecasted 2019 revenue deficiency of approximately \$1.3 million, subject to true-up. MERC also proposed a 2019 NGEF rate factor of \$0.00150 per therm applicable to all customer classes to be effective January 1, 2019.⁷

³ *In the Matter of a Petition by Minnesota Energy Resources Corporation for Authority to Increase Natural Gas Rates in Minnesota*, Docket G-011/GR-13-617, FINDINGS OF FACT, CONCLUSIONS, AND ORDER, at 49 (October 28, 2014).

⁴ Docket G-011/GR-17-563, Lee Direct, Page 52 lines 15-19

⁵ Minn. Stat. § 216B.1638, subd. 3(c).

⁶ Docket G-011/M-15-895

⁷ Docket G-011/M-18-182

On May 15, 2019, the day before the NGEF Petition was scheduled to be discussed by the Commission, SLGI filed a letter in opposition to the volumetric rate design in both the GUIC and NGEF riders. SLGI discussed the bypass threat, noting that it had been previously acknowledged by the parties and the Commission in MERC's previous general rate case, Docket No. G-011/GR-17-563. SLGI appeared and provided oral comments at the Commission's May 16, 2019 agenda meeting.

On June 18, 2019, the Commission issued its order for the NGEF petition. MERC's petition was approved with modifications, as proposed by the Department, on a volumetric, per-therm basis. The approved amount was \$0.00050 per therm, subject to true-up, but was revised to \$0.00052 per-therm in the Company's compliance filing. It is important to note that no parties petitioned to reconsider the matter.

C. Gas Utility Infrastructure Cost Rider (Docket #18-281)

A GUIC rider may be approved by the Commission for two types of projects: 1) Replacement of natural gas facilities located in the public right-of-way required by the construction or improvement of a highway road, street, public building, or other public work by or on behalf of the United States, the State of Minnesota, or a political subdivision, and, 2) Replacement or modification of existing natural gas facilities, including surveys, assessments, reassessment and other work necessary to determine the need for replacement or modification of existing infrastructure that is required by a federal or state agency.

On April 13, 2018, MERC filed a petition to establish an ongoing GUIC. The 2019 revenue requirement requested by the Company was \$3.64 million, subject to future true-up, and the 2019 GUIC rate factor was proposed to be \$0.00415 per-therm.

On February 5, 2019, the Commission approved MERC's request for a GUIC, with modifications, subject to a compliance filing. On February 7, 2019, MERC submitted its compliance filing to implement its 2019 GUIC rider surcharge of \$0.00413 applicable to all customers.⁸ On April 25, 2019, the Commission issued an order approving MERC's compliance filing as filed. No parties petitioned to reconsider the matter.

⁸ *In the Matter of Minnesota Energy Resources Corporation's Request for Approval of a Gas Utility Infrastructure Cost Rider*, Docket No. G-011/M-18-281, ORDER APPROVING GAS UTILITY INFRASTRUCTURE COST RIDER WITH MODIFICATIONS AND REQUIRING COMPLIANCE FILING (February 5, 2019).

V. Parties' Positions

A. Comments

1. Department

a. NGEF Rider

The Department recommends the Commission deny MERC's request to suspend the NGEF rider surcharge for Direct Connect Customers. Specifically, the NGEF Statute states that the rider "shall include all of the utility's customers, including transport customers, to recover the revenue deficiency."

Additionally, the Department questions whether the NGEF rider surcharge is significant enough to justify making the change.⁹

The overall impact to these direct connect customers is much smaller than that of the current GUIC Rider; furthermore, the NGEF Statute requires that all customers pay a portion of the rider. It is unclear whether suspension of the rider is allowed and, if so, whether it would be equitable for all other ratepayers to be required to absorb the NGEF rider costs while a new rider recovery proposal is considered. The Department notes that suspension of this current rider to direct connect customers would increase the NGEF rider charges to other ratepayers from \$0.00052 per therm to \$0.00094 per therm. Given the relative size of the total revenue deficiency (\$400,989), the lack of information regarding potential threat of bypass for all or some of the direct connect customers based on the impact of the NGEF on its own, and the plain language of the NGEF Statute requiring all MERC customers to pay, the Department recommends that the Commission deny MERC's request to suspend the NGEF rider surcharge for direct connect customers.

[Footnote Omitted]

b. GUIC Rider

Unlike its recommendation for the NGEF rider, the Department recommends that the Commission approve MERC's request to suspend the GUIC rider for Direct Connect Customers. The Department agrees that, given the significance of the volumetric factor, charging the approved rate to Direct Connect Customers is material and presents a real bypass threat. The Department also states:¹⁰

...Regarding rate design, subdivision 4 (2)(v) of the GUIC Statute merely states that the utility must file "calculations to establish that the rate adjustment is consistent

⁹ Department Comments, at 9-10.

¹⁰ Department Comments, at 2-3.

with the terms of the rate schedule, including the proposed rate design and an explanation of why the proposed rate design is in the public interest.” Thus, even if the Commission determines that it continues to be reasonable for MERC to charge the GUIC rate as it was approved and filed, it appears that the statute would not prohibit the Commission, on a prospective basis, from exempting the direct connect customers from paying for the GUIC costs authorized by the Commission, assuming the Commission determines that such a new rate design is in the public interest recognizing that such a rate change likely would cause prospective rates to increase for other MERC customers.

The Department notes that approving MERC’s request would also shift the Direct Connect Customers’ share of the \$3.63 million GUIC revenue deficiency for 2019 to the other customer classes. This would increase the per-therm rate to \$0.00851 per-therm for all non-direct connect customers. The Department provided Table 1 to demonstrate the average bill impact for the various customer classes.¹¹

Table 1: Annual Impact of MERC’s Proposed GUIC Adjustment on Certain Sales Class Customers

Customer Class	Average Monthly Use	GUIC Rate Change	Monthly Bill Impact	Annual Bill Impact
Residential Sales	72	\$0.00438	\$0.32	\$3.78
C&I Firm Class 1	85	\$0.00438	\$0.37	\$4.47
Ag Grain Dryer--Class 1 SCI	186	\$0.00438	\$0.81	\$9.78
C&I Firm Class 2	507	\$0.00438	\$2.22	\$26.65
C&I Firm Class 3	9,692	\$0.00438	\$42.45	\$509.41
Ag Grain Dryer--Class 1 LCI	234	\$0.00438	\$1.02	\$12.30
C&I INT Class 2 SVI	4,794	\$0.00438	\$21.00	\$251.97
C&I INT Class 3 SVI	18,838	\$0.00438	\$82.51	\$990.13
Ag Grain Dryer--Class 1 INT (SVI)	666	\$0.00438	\$2.92	\$35.00
Ag Grain Dryer--Class 2 INT (SVI)	1,726	\$0.00438	\$7.56	\$90.72
C&I INT Class 2 LVI	1,538	\$0.00438	\$6.74	\$80.84
C&I INT Class 3 LVI	58,581	\$0.00438	\$256.58	\$3,079.02
Power Generating INT--Class 1	89,909	\$0.00438	\$393.80	\$4,725.62
C&I Joint Class 2	5,288	\$0.00438	\$23.16	\$277.94

MERC’s customers recently experienced a rate increase with the conclusion of MERC’s 2017 rate case. The cumulative effect of that rate increase, as well as the one proposed by MERC in the current docket, will likely be noticed by the non-direct connect customers. In fact, some of the increases may trigger rate shock concerns. An alternative solution would be to suspend the GUIC rider surcharge for all customer classes until additional analysis can be completed.

¹¹ Department Comments, filed July 11, 2019, Page 6, appears as Table 2 in Department Comments; renumbered as Table 1 in Staff Briefing Papers

c. Refund Proposal

The Department is opposed to MERC's request to refund or provide a discount to effectively provide a "refund" from the non-direct connect customers to the Direct Connect Customers. The Department argues that the currently authorized GUIC rate is a lawful rate and that changes to the rate need to be prospective, not retrospective.¹²

...if a utility has correctly charged an approved rate, refunds of all or a portion of the revenues received under that rate are not allowed even if there are claims that the approved rate is unjust or discriminatory. Therefore, it is the Department's understanding that if the Commission approves the Company's proposal to discontinue this rate for direct connect customers, approval must be implemented on a prospective basis. Discounting or "refunding" revenues recovered in accordance with a lawful rate and then subsequently charging the sum of the discount to other ratepayers, as if the past and current rate did not exist but instead was the proposed new rate, is inequitable and would constitute retroactive application of a rate change...

Additionally, the Department notes that none of the Direct Connect Customers have left MERC's system yet and therefore no regulatory harm has been done. The Department recommends that any suspensions authorized should be done on a prospective basis.

2. Office of the Attorney General

a. NGEP and GUIC Riders

Similar to the arguments presented by the Department, the OAG's position is that MERC's request to suspend the NGEP and GUIC rider surcharges for the Direct Connect Customers runs contrary to statute, specifically the language of the NGEP Statute. Additionally, the OAG argues that MERC's emergency request is simply an untimely request for reconsideration "packaged as an emergency request."

The OAG does not believe MERC has fully demonstrated that the bypass threat is real, significant, and has a high probability of occurring. The OAG states that the Company bears the burden of proof that its request is reasonable, not that intervening parties must prove the request is unreasonable. The OAG suggests that, at a minimum, the Company provide a detailed cost-benefit analysis with the customers that have threatened to bypass the system.¹³

MERC has not explained which customers are most likely to leave its system, or if all direct connect customers are equally likely to leave. Based on the existing record, the Commission cannot know that any of the Company's direct connect customers actually pose a viable bypass threat. Even if MERC could convince the Commission that some portion of its direct connect customers posed such a

¹² Department Comments, at 11.

¹³ OAG Comments, at 5-6.

threat, any such potential threat would not justify a class-wide remedy without a quantitative showing that the magnitude and likelihood of the bypass threat outweighs the increased costs that MERC's proposal seeks to impose on its other customer classes. Such an analysis should include the average residential bill impact of both the proposed rate change and the hypothetical bypass.

The OAG notes that MERC has remedies available to modify rate design. The NGEP and GUIC statutes both allow for the Company to argue for a rate design that it deems appropriate or MERC could file a rate case. The OAG recommends, however, that this request be denied.

b. Refund Proposal

The OAG raises concerns about retroactive ratemaking in its comments.¹⁴

MERC has not even attempted to argue that the direct connect rates were invalid ab initio, thus there is no basis for refunding direct connect customers amounts paid pursuant to Commission-approved rates. Even if the Commission determines that direct connect customers must be given rate relief to avoid a harmful bypass, these large customers should not be able to "claw back" money already paid by having the utility retroactively charge smaller customers to recover those funds. The rates and rider surcharges currently in effect have been lawfully ordered by the Commission; it would be inequitable to require other customer classes to foot the bill for money that direct connect customers have already paid under those orders.

Therefore, the OAG recommends that the Commission deny MERC's request to refund or true-up monies already collected from Direct Connect Customers.

3. Super Large Gas Intervenors

a. NGEP and GUIC Riders

SLGI submitted comments largely in support of MERC's request. In its comments, SLGI consulted with an engineer to provide an initial cost analysis for the Direct Connect Customers to bypass MERC's system. Because the Direct Connect Customers do not need to acquire any additional pipe, the only assets needed to bypass MERC's system would be an odorizer and related equipment. The ongoing costs needed to maintain the system and purchase mercaptan would cost approximately \$0.002 per-therm. Further, the engineer determined that the additional costs with being a direct connect customer of Northern, specifically increased penalties and/or balancing assets, would also be approximately \$0.002 per-therm. In total, the

¹⁴ OAG Comments, at 4.

consultant estimates that the Direct Connect Customers could bypass MERC's system for approximately \$100,000 per customer¹⁵ and approximately \$0.004 per-therm.¹⁶

SLGI noted that the current distribution charge for CIP-exempt Class 5 Transportation customers is currently \$0.00448 per-therm. The combined cost of the NGEF and GUIC rider surcharges is currently \$0.00463 per-therm, notwithstanding any additional increases in future rider periods. SLGI suggested that the base rate, excluding any rider surcharge, leaves the Direct Connect Customers "teetering on the threshold of justifying a bypass" and that there would be no economic benefit to those customers remaining on MERC's system.

b. Application to all Class 5 Transportation Customers

SLGI recommended a single modification to MERC's proposal. SLGI contended that MERC's proposal to suspend the Commission approved NGEF and GUIC rider surcharges for Direct Connect Customers would violate Minn. Stat. § 216B.03 which states that "rates shall not be unreasonably preferential, unreasonably prejudicial, or discriminatory, but shall be sufficient, equitable, and consistent in application to a class of consumers." SLGI argues that MERC does not distinguish between direct connect and non-direct connect customers in its Transportation Service Tariff.¹⁷

All members of SLGI are part of MERC's Class 5 Transportation customer class, but not all members of SLGI are direct-connect customers. MERC's Transportation Services Tariff distinguishes between firm and interruptible customers, and CIP-exempt and CIP-applicable customers, but it does not differentiate direct-connect customers. Thus, if the Commission were to approve the suspension of the NGEF and GUIC riders to direct-connect customers only, it would be discriminating and differentiating among customers within the same class and therefore violate Minn. Stat. § 216B.03.

[Footnotes Omitted]

SLGI recommended that the NGEF and GUIC rider surcharge be suspended for all Class 5 Transportation Customers.

¹⁵ Affidavit of Kenneth C. Graeber, filed as Exhibit A of the SLGI's Comments, at 9.

¹⁶ *Id.* at 15.

¹⁷ SLGI Comments, at 4.

B. Reply Comments

1. Office of the Attorney General

a. MERC's request is not supported by the record

The OAG noted that rate design decisions are generally determined in either general rate cases or rider dockets. The current request is neither, but rather, requires the Commission to make a major rate decision in a shortened timeframe.

Additionally, the OAG reviewed the analysis provided by SLGI and considers it to be incomplete in several ways.¹⁸

First, Mr. Graeber overlooks important capital costs that direct-connect customers would have to incur to bypass MERC's system. Mr. Graeber states that the main service MERC provides direct-connect customers is odorizing natural gas. He estimates the total installed cost of an odorizer to be approximately \$100,000, which includes the odorizer itself, a tank to hold odorant, and a concrete pad.¹¹ However, according to MERC, an odorizer can cost as much as \$200,000.¹² MERC also owns supervisory control and data acquisition ("SCADA") equipment at each odorization site, equipment whose cost Mr. Graeber fails to include in his analysis.

Mr. Graeber's analysis of the operation and maintenance ("O&M") expenses necessary to bypass MERC's system is similarly incomplete. He assumes that there will be no O&M costs associated with bypass other than the cost of purchasing odorant and transferring it into a tank. He asserts that "an odorizer does not require any appreciable amount of O&M" expense beyond these two costs, but he fails to address the fairly obvious expense of either paying an employee to manage the odorizer or contracting for this service.

Mr. Graeber overlooks still other benefits that direct-connect customers gain by having MERC odorize gas for them. These benefits consist primarily in avoiding the uncertainty and cost of managing odorization, including the risk and cost of odorizer equipment failures, replacements, or maintenance. These costs should be readily quantifiable. For example, the risk of odorizer equipment failure could be quantified through the premiums that a customer would need to pay to insure against any losses stemming from such failure...

Additionally, the OAG notes that none of the Direct Connect Customers have committed to leaving MERC's system if the request is denied nor have the Direct Connect Customers committed to remaining on MERC's system if the request is approved in full.

¹⁸ OAG Response Comments, at 5-6.

b. The impact of granting MERC's request is similar to the impact of denying MERC's request

The Department calculated a \$0.048 per-therm impact for non-Direct Connect Customers if MERC's request is approved. The OAG applied an average of 871 therm usage for a residential customer to determine that the average annual impact for a residential customer is estimated to be \$4.18. The OAG compared that impact to MERC's estimated residential impact of the Direct Connect Customers leaving the system, which the Company estimated ranged from \$0.95 to \$4.83 per-therm. The OAG reasons that the impact of approving and denying the request are similar, and therefore MERC's request should be denied.

c. Direct Connect Customers are a separate customer class

The OAG responded to SLGI's assertion that the Commission should suspend the NGEP and GUIC rider surcharge for all Class 5 Transportation Customers.

The statute does not define "class," but under standard legal usage, the term refers to a "group of people, things, qualities, or activities that have common characteristics or attributes." In other words, a "class of consumers" is determined by whether its members share characteristics that are relevant to the rate to be charged them. In this extremely unusual case, the relevant characteristic is the likelihood that a customer will bypass MERC's system. The direct-connect class, whose members have ready access to the interstate pipeline, is a proxy for customers who are likely to bypass (though for the reasons previously discussed, it is unlikely that all of these customers are prepared to leave MERC's system).

This logic could be applied to other customer classes that contain Direct Connect Customers. If potentially other classes containing Direct Connect Customers also became exempted, the rate impact on residential and small businesses would be even greater. Therefore, the OAG argued that the Commission should recognize that a class of customers need only to share similar characteristics in order to be considered a "class."

2. MERC

a. Authority to Grant Relief

MERC cited Minn. Stat. § 216B.25 in its response.¹⁹

The commission may at any time, on its own motion or upon motion of an interested party, and upon notice to the public utility and after opportunity to be heard, rescind, alter, or amend any order fixing rates, tolls, charges, or schedules, or any other order made by the commission, and may reopen any case following the issuance of an order therein, for the taking of further evidence or for any other

¹⁹ Minn. Stat. § 216B.25 was referenced by MERC in its Response Comments. The full statute is reproduced by Staff in these Briefing Papers.

reason. Any order rescinding, altering, amending, or reopening a prior order shall have the same effect as an original order.

Therefore, the fact that the window for reconsideration is closed in both riders doesn't change the fact that the Commission can reopen any docket at any time.

MERC also noted that the Commission routinely uses true-up mechanisms to order refunds and surcharges. Specifically, MERC discussed Docket E, G-999/CI-17-895, the Commission investigation into the impact of the Tax Cuts and Jobs Act on regulated utilities. In that docket, the Commission ordered the change in rates to be effective the date of the tax law change and ordered refunds from the utilities.

Lastly, MERC also stated that the Commission could exclude the Direct Connect Customers from the NGEPS rider surcharge and still be in compliance with the NGEPS Statute.²⁰

While the Department and OAG correctly note that the NGEPS Rider Statute, Minn. Stat. §216B.1638, subd. 2, allows a utility to petition the Commission for a rider that "shall include all of the utility's customers, including transport customers," subdivision 1(h) of the NGEPS Statute defines "transport customer" to mean "a customer for whom a natural gas utility transports gas the customer has purchased from another natural gas supplier." With respect to the direct connect customers at issue in MERC's proposal, as a practical matter, the Company does not transport gas those customers have purchased from another natural gas supplier. Unlike other transport customers, MERC does not own or operate any pipe or other underground distribution facilities with respect to serving the direct connect customers. Indeed, the nonexistence of any such distribution facilities is a condition of direct connect transportation service under MERC's Commission-approved tariffs. Rather, as referenced in the July 1, 2019 filing made by Encore and the July 11, 2019, Comments filed by SLGI, the only facilities owned by MERC for serving the direct connect customers is an odorizer and associated odorization equipment. Thus, the Commission could reasonably conclude those customer should be excluded from the surcharge under the language of the NGEPS Statute. Additionally, the remainder of MERC's transportation customers would continue to be assessed the approved surcharge rate, despite approval to suspend the charge for the narrow class of uniquely situated direct connect customers.

b. MERC's request is in the Public Interest

MERC disagreed with the OAG's analysis that the threat of bypass has not been established in the record. The Company believes the named dockets, as well as several rate cases, support the conclusion that the suspension of rider surcharges for Direct Connect Customers is necessary in order to prevent bypass.

²⁰ MERC Response comments, at 6.

The remaining customers would not be harmed by MERC's proposal. Comparing the impact of charging Direct Connect Customers the rider surcharges and suspending the rider surcharges does not accurately reflect the alternatives. The Company believes that the Direct Connect Customers will permanently leave MERC's system if the relief sought is not granted. Regardless of whether MERC's request is approved or denied, the Direct Connect Customers will not pay the rider surcharge and the revenue requirement shortfall will become the burden of the other ratepayers. Therefore, the decision before the Commission is whether or not to grant MERC's request in order to keep the Direct Connect Customers on MERC's system and paying for a portion of the system's fixed costs.

VI. Staff Analysis

A. Changes to rate design

As the OAG noted, the Commission generally considers changes to rate design in a general rate case or in rider dockets. This gives interested parties and the Commission ample time to review the impacts on each rate class in order to assure that the resulting rates are just, reasonable, and in the public interest. Although parties are able to advocate for what they consider to be a more reasonable rate design in any docket, typically the Commission has held either a volumetric rate or has approved a rate design based on revenue apportionment from the previous rate case. MERC's request to modify rate design in a shortened window, while unusual, is not prohibited by any statute or Commission policy.

Staff also highlights that the Direct Connect Customers rates have routinely been set below the embedded, fully distributed cost of service. The Direct Connect Customers rates are set so that at a minimum, the Company recovers the incremental cost of service from the Direct Connect Customers. Had the GUIC and NGEF projects been introduced in a general rate case as opposed to the riders, it is likely that the Direct Connect Customers would not have been assigned a surcharge to pay for these projects, but rather, the customers would likely have continued to be held at competitive market rates.

B. Timing of SLGI's filing and MERC's request

As MERC acknowledged, the timing of its request is not ideal. As discussed above no party filed for reconsideration of the Commission's order in either the NGEF or GUIC petitions.

As noted above, SLGI provided comments on MERC's GUIC and NGEF riders one day prior to the Commission hearing on the NGEF rider, despite being a party that actively participated in the initial NGEF decision in Docket No. G-011/M-15-895. SLGI did not participate in the approved GUIC filing and instead filed its letter to the 2020 GUIC rider docket. SLGI acknowledges that its participation in these riders comes both "too early and too late."

Despite concerns with timing, Staff believes the issues raised by SLGI are real and material; the Commission may wish to give less weight to procedural concerns in the interest of considering MERC's request as it affects the public interest.

Because no party asked for reconsideration in either docket (#18-182 or #18-281), the Commission may need to reopen the February 5 and April 25, 2019 GUIC orders and the June 18, 2019 NGEP order to take up MERC's request.

C. Direct Connect Transportation Service in MERC's Tariff

SLGI raises concerns about the Commission offering preferential treatment to certain customers if MERC's request is approved without extending the suspension of rider surcharges to all Class 5 Transportation Customers. MERC and the OAG disagree, noting that the Direct Connect Customers have unique characteristics that distinguish them from other customers in the Class 5 Transportation class.

In MERC's most recent general rate case, Docket No. 17-563, the Commission approved Tariff Sheet 6.50, which discusses Direct Connect Transportation Service.²¹

1. Availability: A customer qualifies for service under this schedule if (1) the customer is directly connected to the interstate pipeline with no Company-owned underground distribution facilities and (2) no non-Direct Connect customers are served off of the same point of interconnection. Farm Tap customers are not eligible for this service.

2. Applicability and Character of Service: This rate schedule shall apply to transportation service provided for customers who are directly connected to an interstate natural gas pipeline. Service is available to qualifying direct connect customers on a firm or interruptible basis, contingent on adequate interstate pipeline and distribution capacity.

3. Rates, Terms, and Conditions of Service. Applicable rates, terms, and conditions of service are set forth in Tariff Sheet Nos. 6.00-6.07 except with respect to the following:

A. Nomination, Balancing, and Scheduling Charges. Direct connect transportation customers shall not be subject to daily balancing or scheduling charges except that such customers must pay for any balancing or scheduling penalties from pipelines that they cause Company to incur.

Staff believes this tariff sheet, along with the definitions of classes provided by the OAG are sufficient to give the Commission the authority to independently decide whether to approve or deny MERC's request to suspend the NGEP and GUIC rider surcharge for Direct Connect Customers only without being unreasonably preferential, unreasonably prejudicial, or discriminatory.

²¹ MERC Tariff and Rate Book, 3rd Revised Sheet No 6.50.

D. Financial Considerations

On the surface, there are two primary ways in which rates could be impacted depending on the Commission's action regarding MERC's request. If the rider surcharge is suspended for the Direct Connect Customers, the non-Direct Connect Customers will experience an increase in rider surcharge, presumably in the Company's next rider (and true-up) filing. If the Direct Connect Customers bypass MERC's system, there will be lost (base rate) revenues that will be absorbed by other classes in the Company's next general rate case. Table 2 demonstrates how the various outcomes would impact the firm residential customer class.

Table 2: Residential Rate Impacts

	Currently authorized per-therm rate	Projected per-therm rate ²²	Amount of increase	Annual bill impact for residential customers (871 therms) ²³
NGEP	\$0.00052	\$0.00094	\$0.00042	\$0.37
GUIC	\$0.00413	\$0.00851	\$0.00438	\$3.81
Total Riders	\$0.00465	\$0.00945	\$0.00480	\$4.18
Total rate impact if all MERC's request is approved				\$4.18
Base rate impact if all Direct Connect Customers bypass				\$4.83 ²⁴
Total rate impact if all Direct Connect Customers bypass				\$9.01

The effects of bypass are additive of one another. MERC's analysis, of which the parties relied on, only considered the base rate impact of bypass. Staff believes the analysis was conducted in this way due to MERC's assumption that either the Commission would approve its request or that Direct Connect Customers would leave the system. MERC did not contemplate a scenario in which Direct Connect Customers remain on the system paying the NGEP and GUIC rider surcharges. Therefore, the impacts of the Commission's decision would be limited to the base rate impact, which is calculated by MERC to be \$4.83.

The Commission may wish to consider rate shock while deciding whether or not to grant MERC's request. Final rates from MERC's general rate case, Docket No. G-011/GR-17-563, went into effect on July 1, 2019. The culmination of those rates, the additional rider surcharge for the NGEP and GUIC riders, and potentially a \$1.6 million+ item in the Company's next rate case (if the Direct Connect Customers bypass) will likely be noticed by the rest of MERC's customers.

²² Projection based on either MERC's petition being approved, thereby assigning all revenue requirements to the remaining non-direct connect customers OR if Direct Connect Customers leave MERC's system.

²³ See footnote 22

²⁴ Confirmed with MERC that this number only considers base rates.

VII. Decision Options

Natural Gas Extension Project Rider (Docket #18-182)

If the Commission reopens its June 18, 2019 Order, then

1. Approve MERC's request to suspend its NGEP rider surcharge for Direct Connect Customers. (MERC)
2. Require MERC to suspend its NGEP rider surcharge for all Class 5 Transportation Customers. (SLGI)
3. Require MERC to suspend its NGEP rider surcharge for all customers.

If the Commission does not reopen its June 18, 2019 Order, then

4. Deny MERC's request to suspend its NGEP rider surcharge for Direct Connect Customers. (OAG, Department)
5. Dismiss, without prejudice, MERC's request to suspend its NGEP rider surcharge for Direct Connect Customers.

Gas Utility Infrastructure Cost Rider (Docket #18-281)

If the Commission reopens its February 5 and April 25, 2019 Orders, then

6. Approve MERC's request to suspend its GUIC rider surcharge for Direct Connect Customers. (MERC, Department)
7. Require MERC to suspend its GUIC rider surcharge for all Class 5 Transportation Customers. (SLGI)
8. Require MERC to suspend its GUIC rider surcharge for all customers. (Department – Alternative Proposal)

If the Commission does not reopen its February 5 and April 25, 2019 Orders, then

9. Deny MERC's request to suspend its GUIC rider surcharge for Direct Connect Customers. (OAG)
10. Dismiss, without prejudice, MERC's request to suspend its GUIC rider surcharge for Direct Connect Customers.

Rider True-Up Mechanism

If the Commission decides to suspend rider surcharges for one or more customer classes, then

11. Require MERC to address any potential refunds or surcharges in the next NGEP and GUIC rate-factor adjustment and true-up filings. (MERC)
12. Authorize MERC to use deferred accounting to track any potential refunds or surcharges in the NGEP and GUIC riders and address the deferred balance in MERC's next rate case.

Customer Refund Proposal

13. Approve MERC's request to refund all NGEP and GUIC rider surcharge amounts collected. (MERC, SLGI)
14. Deny MERC's request to require non-Direct Connect or non-Class 5 Transportation Customers to pay for the refund to Direct Connect or Class 5 Transportation Customers. (Department, OAG)

Compliance Filings

If the Commission decides to suspend rider surcharges for one or more customer classes, then

15. Require MERC to make a compliance filing, within 30 days, with updated tariff sheets with supporting schedules and calculations for impacted customer classes.

If the Commission decides to authorize refunds for one or more customer classes, then

16. Require MERC to make a compliance filing, within 30 days, with refund amounts for all customers by class with supporting schedules and calculations.