MINNESOTA
PUBLIC UTILITIES COMMISSION

Staff Briefing Papers

Meeting Date	September 2, 2021	Agenda Item 7*
Company	CenterPoint Energy Resources Corp., d/b/a/ CenterPoint Energy Minnesota Gas (CenterPoint, CPE, Company)	
Docket No.	**G008/M-21-383**	

In the Matter of the Petition of CenterPoint Energy for Approval for Recovery of a Natural Gas Extension Project Costs through Rate Base Treatment and for a New Area Surcharge for the Lake Jessie Project

Issues

1. Should the Commission grant approval of cost recovery for the extension of natural gas service to an area near the town of Alexandria, located in Douglas County, Minnesota ("Lake Jessie Project")?

2. What form of cost recovery should the Commission approve, if it grants project approval?

Staff Andrew Larson Andrew.m.larson@state.mn.us 651-201-2259

✓ **Relevant Documents**	**Date**
CenterPoint Energy - Initial Filing/Petition	June 7, 2021
Minnesota Propane Association Public Comment	July 1, 2021
Department of Commerce – Comments (Public & Trade Secret)	August 2, 2021
CenterPoint Energy - Reply Comments	August 12, 2021
Department of Commerce – Response to Comments	August 17, 2021

I. Statement of the Issues

A. Should the Commission grant approval of cost recovery for the extension of natural gas service to an area near the town of Alexandria, Minnesota located in Douglas County, Minnesota ("Lake Jessie Project")?

B. What form of cost recovery should the Commission approve, if it grants project approval?

II. Introduction

In the early 1990's, several of the gas utilities got approval from the Commission to establish New Area Surcharges (NAS) to allow expansion of natural gas service into areas that would not have been justified by the utilities' standard natural gas service extension models. The additional costs for the expansion were to be paid by those getting the new natural gas service, through a monthly surcharge until the excess cost was paid off. In 2015, the legislature passed the Recovery of Natural Gas Extension Project (NGEP) Cost statute which allowed 33 percent of annual excess expansion costs to be collected from all ratepayers.

CPE has proposed to use both its NAS tariff and its NGEP rider tariff for its expansion of natural gas service into Lake Jessie. The proposed monthly surcharge to new customers in the Lake Jessie would be $12.89, anticipated to be collected over 16 years.

The Department questioned why CPE would not recover total project costs with the NAS over the full 30-year useful life. CPE answered that customers would not be willing to pay the higher total cost compared to that of the 16-year NAS. The Department also asked the Company to adjust property tax expense calculations to account for the 1-year lag between assessments and payments.

With these questions resolved, the parties had no further outstanding issues.

III. Background

On June 7, 2021, CenterPoint submitted a miscellaneous rate change and tariff filing requesting an extension of service to an area near the town of Alexandria, located in Douglas County, Minnesota ("Lake Jessie Project, Project").[1] The Company requested to include a portion of the Project in "Net Utility Plant In Service" in its 2022 rate case and to establish a NAS for customers located in the Lake Jessie Project.

On August 2, 2021, the Minnesota Department of Commerce, Division of Energy Resources (Department) filed Comments in which it determined that CenterPoint's proposed rider recovery rate proposals in its Petition were consistent with the Commission's approvals in the Company's Nowthen NAS project in Docket G008/M-19-840. The Department requested additional information from CenterPoint on NAS 16-year and 30-year terms before giving final approval. The Department also requested that CenterPoint correct the timing of property tax payment cashflows, which lag property tax assessments by one year.

On August 12, 2021 CenterPoint submitted Reply Comments, responding to the Department's concerns and request for additional information. The Company explained why it believed a 30-year NAS recovery term with no Natural Gas Expansion Project (NGEP) rider recovery would result in fewer customer subscriptions compared to a 16-year NAS term with recovery of revenue deficiencies in its 2022 rate case.

On August 17, 2021 the Department submitted Response Comments in which it accepted the Company's explanation for customers' preference for the 16-year NAS with the NGEP over the 30-year NAS with no NGEP.

IV. Relevant Tariffs, Statutes and Commission Orders

Under normal circumstances, the terms and conditions and method of cost recovery for extending service to new customers is covered by CenterPoint's service extension policy which is explained in its tariff in the section entitled New Area Surcharge Rider, Section V, Rate Schedules and Applicable Provisions, Developmental Service. Service under the NAS tariff schedule is available only to geographical areas that have not previously been served by the Company. This rate schedule will enable natural gas service to be extended to areas where the cost would otherwise have been prohibitive under the Company's present rate and service extension policy. If approved, the total billing rate would equal to the currently authorized rates plus a fixed monthly NAS. All customers in the same rate class will be billed the same surcharge. The NAS will be treated as a CIAC for accounting and ratemaking purposes. A standard model is used to calculate the annual revenue requirement for the average service life of the plant installed. The model compares the total revenue requirements for each year with the retail revenues generated from customers served (actual and/or expected) by the project to determine if a revenue deficiency or revenue excess exists.

For CenterPoint's new residential customers, the tariff allows for a new meter and an allowance of 105 feet of service line per customer without charge. Any excess footage over the allowance

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[1] CenterPoint Energy, *In the Matter of the Petition of CenterPoint Energy for Approval for Recovery of a Natural Gas Extension Project Costs through Rate Base Treatment and for a New Area Surcharge for the Lake Jessie Project*, June 7, 2021, Docket No. G008/M-21-383.

is collected from the customer as CIAC, which is a monetary contribution paid by a developer or land owner, to a utility providing natural gas service to a community receiving that service as the result of a natural gas extension project. CIAC reduces or offsets the difference between the project's total revenue requirement and the revenue generated from the customers served by the project.

Additionally, CenterPoint, for groups of customers in newly expanded service areas, has a NAS tariff that represents a fixed monthly charge for the installation cost of new gas service and is estimated to cover the economic portion of the project that customers are willing and able to pay.

In 2015, the legislature enacted the Recovery of Natural Gas Extension Project (NGEP) Costs statute (Minn. Stat. § 216B.1638) which allows a utility to file a petition outside of a general rate case for the recovery of NGEP costs in the amount of the revenue deficiency, which is the required revenue requirement less the NAS and any CIAC.

In its most recent decision involving a proposal from a utility to extend service to an area that would be uneconomic to serve under the terms and conditions of the utility's tariff (CenterPoint's Nowthen project),[2] the Commission authorized a NAS and deferred accounting for the costs that would have otherwise been recovered with a NGEP rider surcharge.

V. Parties' Comments

A. Description of the proposed NGEP rider

The Lake Jessie Project is designed to extend natural gas service to a currently unserved area near the town of Alexandria, located in Douglas County, Minnesota, by connecting new customers to the existing natural gas main located on County Road 81. Services and meters will be installed in accordance with customers' requests.

The Department agreed with CenterPoint that, according to Minn. Stat. § 216B.1638, subd. 3 (b), the project meets the criteria for an NGEP project. This Petition represents CenterPoint's second request to recover the costs of extending service to a new area using a NGEP rider. This Petition also represents only the fifth time that a utility has requested an NGEP rider in conjunction with a NAS request.

The calculation of the NGEP-eligible recovery amount follows the precedent in the MERC Rochester NGEP case,[3] which allowed for up to 33 percent of the annual incremental revenue requirement to be recovered in the NGEP rider. Similar to its Nowthen project, CenterPoint proposed to forego the NGEP recovery amount between now and the 2022 rate case, and

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[2] Order Approving the Nowthen natural gas extension project with cost recovery through the New-Area Surcharge (NAS) rates, *In the Matter of the Petition of CenterPoint Energy (CenterPoint) for Approval for Recovery of Natural Gas Extension Project Costs through a Rider or in the Alternative for Regulatory Asset Treatment and for a New Area Surcharge for the Nowthen Project*, Docket No. G011/M-19-840. (August 4, 2020)

[3] Docket No. G-011/M-18-182.

instead will roll this amount into the rate case. Afterwards, 33 percent of the annual revenue deficiency would be reflected in base rates until the end of the depreciable life of the assets, which is 30 years.

B. Proposed schedule and budget

CenterPoint estimated the project budget based on the assumption that the completion of construction will occur before the 2021/22 winter season, allowing customers to receive natural gas service by the beginning of the 2021/22 winter heating season. The main benefits of the project are to make natural gas service available to a currently unserved population, and to provide future expansion opportunities. Other related costs such as conversion of new appliances from the customer's previous fuel to natural gas are the responsibility of the customer.

C. Contributions in Aid of Construction (CIAC)

In accordance with Minn. Stat. § 216B.1638, subd. 2 (b)(4), CenterPoint proposed to offset the revenue deficiency through CIAC which Lake Jessie Project customers pay for via the monthly NAS charges. CenterPoint has engaged the Lake Jessie Project community to assure that the proposed CIAC (paid via the NAS) is reasonable and feasible on a load and cost basis, meaning that the project is reasonable in terms of potential new customer demand and the Company's profitability. Over 40 customer applications have been collected.

D. Revenue deficiency and proposed allocation

In its initial filing, CenterPoint proposed to recover the estimated revenue deficiency across its customer classes including industrial, commercial, residential, and transport customers, on a per-therm basis. The Department requested through discovery that the Company provide a discussion to explain how it arrived at the estimated budget, and whether it was reasonable. In response to a Department's Information Request, CenterPoint explained that several thousand feet of pipe required directional boring due to conflicts with sewer lines, right-of-ways, trees, wetlands, and driveways, which drove project costs.[4] In response, the Department had no further objections to these construction costs.

E. New Area Surcharge Rider for the Lake Jessie Project

Customers fund the NAS surcharge by making CIAC so that the project becomes economically feasible for CenterPoint, based on its projected participation rates. However, CenterPoint shareholders bear the risk of actual results falling short of projections.

The Department has also concluded that the Company has provided all necessary documentation including: an updated tariff and all workpapers, proposed surcharge rates by customer class, and the proposed customer notice.

[4] Department of Commerce, Comments, August 2, 2021, p. 2, and information request in attachment 2.

CenterPoint employed the Commission-approved NAS calculation methodology to find the NAS tariff rate for the Lake Jessie Project. This method compares total revenue requirements by year with customer-paid retail revenue to determine if there is a revenue deficiency. In addition, since the Company is requesting to recover a share of future revenue deficiencies through base rates, it has reduced the amount recoverable through the NAS by 33 percent of the cumulative revenue deficiencies for the life of the project. This adjustment prevents the Company from double recovery of the revenue deficiency—once from the NAS, and again from the NGEP mechanism.

F. Preferred alternative to NGEP

The Department inquired of CenterPoint why it did not pursue the NGEP alternative whereby a regulatory asset would be created and the NGEP Rider charge would appear as a separate line item on customer bills.[5] The Company stated that such a line item charge would be too small to register on customer bills. Instead, by adding the NGEP estimated cost recoveries to the 2022 rate case, CenterPoint can, at the time of the rate case, adjust the estimates to actual figures. CenterPoint would still forego the first year of NGEP cost recovery.

G. Proposed NAS for project

CenterPoint proposed to recover costs via the NAS for a period of up to 16 years, or until the revenue deficiency is eliminated, whichever comes first.

In its review of NAS rates, the Department noted that CenterPoint did not make an adjustment for the one-year lag in property tax payments compared to the assessment date.[6] Property taxes are authorized for recovery for both the NAS and NGEP, but only on a cash flow basis. Consistent with the property tax treatment in CenterPoint's Nowthen NAS, the Department requested the Company to recalculate the NAS tariff to account for the time value of money from the one-year lag between property tax assessment and payment.

The proposed NAS assumes a surcharge lifetime of 16 years, which is when net present value equals zero at the weighted average cost of capital rate of 6.86 percent[7]. The Department recommended the NAS surcharge with the above modification to property tax expense and the monthly surcharges shown in the table below.

[5] Department of Commerce, Comments, August 2, 2021, pp. 9-10.

[6] Department of Commerce, Comments, August 2, 2021, pp. 5-6.

[7] *In the Matter of the Application by CenterPoint Energy Resources Corp., d/b/a CenterPoint Energy Minnesota Gas for Authority to Increase Natural Gas Rates in Minnesota,* G-008/GR-19-524, Staff briefing papers, pg. 32.

Department Revised Proposed New Area Surcharges--16 Year Period	
Class	($/month)
Residential	$12.89
Commercial A	$20.34
Commercial/Industrial B	$28.48
Commercial/Industrial C	$74.60
Small Volume Interruptible A	$81.38
Small Volume Interruptible B	$128.85
Large Volume Interruptible	$1,424.13
Large Volume Firm	$1,424.13

H. Advantages of the 16-year NAS with NGEP compared to the 30-year NAS

The Department asked CenterPoint why it could not have proposed the NAS on a straight 30-year basis with no defraying of customer costs via the NGEP, meaning that Lake Jessie Project customers would pay all related costs identified in the revenue requirement.[8] The NAS directly charges customers for project costs while the NGEP socializes a portion of costs. While CenterPoint generally stated that the 30-year NAS alone would not provide a sufficiently attractive price to encourage customers to switch to natural gas, the Department in response asked in an information request for a more specific answer.

CenterPoint responded by stating that using the 30-year NAS alone would not be a feasible or reasonable choice for customers, thus significantly reducing the projected number of new sign-ups. The monthly residential NAS rate would jump from $12.89 to $18.23.

Following up on CenterPoint's response to the information request, the Department asked the Company to explain why the 30-year NAS rates would significantly lower the number of customer sign-ups. In Reply Comments filed August 12, 2021, CenterPoint stated that customers are aware of the total cost of the 30-year NAS, which was estimated to be greater than the cost of the 16-year NAS for CPE's Nowthen 16-year NAS project.[9]

In Response Comments filed August 17, 2021, the Department recommended the Commission approve CenterPoint's Lake Jessie Project.[10] The Company's proposed approach credits (reduces) the project costs to be recovered through the NAS Rider by the present value of 33 percent of the cumulative annual revenue deficiencies estimated over the useful life of the project, foregoes NGEP-rider eligible recovery of project costs between now and the Company's next rate case, and includes for base rate recovery in a future rate case the NGEP-rider-eligible amount applicable at the time of the relevant rate case.

I. Reporting Requirements

[8] Department of Commerce, Comments, August 2, 2021, pp. 8-9.

[9] CenterPoint Energy, Reply Comments, August 12, 2021.

[10] Department of Commerce, Response Comments, August 17, 2021.

The Company proposed to report by March 1 of each year the following details on the Lake Jessie Project NAS rider: 1) the number of customers divided by classes used to calculate the surcharge revenue and the retail margin revenue; and 2) the actual surcharge and retail revenue received to date and projected surcharge revenue for the remaining term of the surcharge, and the actual capital costs and projected remaining capital costs for the Lake Jessie Project.

VI. Public Comments

In a Public Comment filed on July 1, 2021, the Minnesota Propane Association (MPA) urged the Commission to decide the Lake Jessie Project based on economic considerations that promote fair competition. Propane competes with natural gas and other fuels in Minnesota, but without the benefit of socialization of costs in a monopoly market structure. In the interest of transparency, it is important that potential customers understand the total costs of conversion so they can make informed decisions.

Because of certain trade secret designations in the record, it is difficult for potential customers, other incumbent CenterPoint customers, and the public to know their true cost of extension of natural gas service. The Commission should carefully examine these redactions of data to ascertain if they truly serve the public interest in the context of the social contract that grants regulated utilities monopoly status. Also, fair disclosure of information would help to ensure natural gas is reasonably priced.

On the subject of cost causation in utility ratemaking, the MPA argued that gas utility costs should be assigned to the parties that cause thee costs. Compelling existing natural gas customers to bear the costs of a NGEP violates this principle and results in higher natural gas bills for those customers who did not require the utility investment. Good ratemaking principles avoid, as much as possible, subsidies and inter-customer cost shifting.

CenterPoint should instead only accept natural gas extension projects that make economic sense for its current and potential customers. The Company should take those projects that pay for themselves, including a rate of return, over a reasonable period of time. Such projects like the Lake Jessie Project are economic in nature and not technically necessary for the purposes of safety and reliability.

Furthermore, the concept of an “inadequately served area” falsely implies that residents do not have sufficient access to various sources of fuel. The market is only inadequately served from the point of view of natural gas. The MPA accepts a greater range of competition from the introduction of natural gas as long as the playing field is fair. The customer’s payment of the NAS surcharge with CIAC should cover the expense of the expansion.

Lastly, the favored treatment of natural gas expansion projects damages the competitive position of competing fuel sources which must provide products on a profitable basis. The MPA urged the Commission to carefully examine this case and not be rushed by the imminent arrival of the winter heating season. It recommended the Commission reject this application in its current form for the reasons outlined above.

VII. Staff Analysis

The Lake Jessie NAS/NGEP project provides another choice in energy service to residential customers. With the approach of the 2021/22 winter heating season, time is of the essence. Consistent with the Nowthen project, CenterPoint sought to employ both the NGEP and NAS statutes for the Lake Jessie Project, which would have the effect of lowering the NAS to a more affordable cost for customers.

CenterPoint proposed to combine the NAS rider surcharge and replace the NGEP rider surcharge with cost recovery in the next rate case in 2022, while foregoing collection of NGEP in the first year. The monthly NAS would run for no more than 16 years. If costs are recovered sooner, then they would stop.

Staff notes that a significant benefit to CenterPoint is the prospect of future expansion beyond the Lake Jessie area. Also, in its goal seek scenario, CenterPoint appeared to have the freedom to adjust the number of years of the NAS to make the monthly NAS payments attractive to customers in terms of their willingness and ability to pay.

Staff also observes that CenterPoint expresses the benefits to Lake Jessie Project customers in a concentrated fashion while not directly acknowledging the dispersed, yet tiny costs borne by its existing customers embedded in their base rates. Firms may have various valid reasons for such pricing strategies.

CenterPoint and the Department have no outstanding issues.

VIII. Decision Options

Should the Commission grant approval of cost recovery for the extension of natural gas service to an area near the town of Alexandria, located in Douglas County, Minnesota (“Lake Jessie Project”)?

1. Approve cost recovery for the extension of natural gas service to an area near the town of Alexandria, located in Douglas County, Minnesota (“Lake Jessie Project”); [CenterPoint, Department] <u>or</u>

2. Do not approve cost recovery for the extension of natural gas service to an area near the town of Alexandria, located in Douglas County, Minnesota (“Lake Jessie Project”).

What form of cost recovery should the Commission approve, if it grants project approval?

3. Approve CenterPoint's proposed combination of NAS Rider and base rate cost recovery for the Lake Jessie Project as recommended by the Department and agreed by CenterPoint[11]:

• Approve CenterPoint's proposed combination of NAS Rider and base rate cost recovery for the Lake Jessie Project. The Company's proposed approach (1) credits (reduces) the project costs to be recovered through the NAS Rider by the present value of 33% of the cumulative annual revenue deficiencies estimated over the useful life of the project, (2) foregoes NGEP-ridereligible recovery of project costs between now and the Company's next rate case, and (3) includes for base rate recovery in a future rate case the NGEP-rider-eligible amount applicable at the time of the relevant rate case.

• Approve the following 16-year NAS Rider rates for cost recovery of a portion of the Lake Jessie Project:

Customer Class	*Monthly Charge Revised for Property Tax Treatment*
Residential	$12.89
Commercial A	$20.34
Commercial/Industrial B	$28.48
Commercial/Industrial C	$74.60
Small Volume Interruptible A	$81.38
Small Volume Interruptible B	$128.85
Large Volume Interruptible	$1,424.13
Large Volume Firm	$1,424.13

• Require CenterPoint to provide, in the future rate case in which the Company includes Lake Jessie Project costs for recovery, a discussion demonstrating that the Lake Jessie Project costs included in for recovery in base rates were reasonably and prudently incurred.

• Approve CenterPoint's proposed customer notice, updated as necessary with the applicable effective date and approved NAS Rider rates.

• Require CenterPoint to file by March 1 of each year a report on the Lake Jessie Project that includes the following information:

o The number of customers, divided by classes, used to calculate the NAS Rider surcharge revenue and the retail margin revenue; and

o The actual NAS Rider surcharge and retail revenue received to date, projected surcharge revenue for the remaining term of the surcharge, and the actual project capital costs and forecasted remaining capital costs.

[CenterPoint , Department] <u>or</u>

[11] Department of Commerce, August 17, 2021, p. 5.

4. Deny approval of any method of cost recovery.