Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: August 11, 2016 .... Agenda Item #3*

Company: Minnesota Energy Resources Corporation ("MERC", "Company")

Docket No. G-007,011/GR-10-977

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

Issues: Should the Commission accept Minnesota Energy Resources Corporation's annual revenue decoupling evaluation report for 2015, and approve Minnesota Energy Resources Corporation's revenue decoupling rate adjustments?

Staff: Jorge Alonso 651-201-2258

Relevant Documents

MERC - 2015 Revenue Adjustment Calculation .... March 1, 2016
MERC - 2015 Revenue Decoupling Report .... April 29, 2016
Minnesota Department of Commerce - Comments .... June 1, 2016
MERC Reply - Comments .... June 10, 2016

The attached materials are workpapers 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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Statement of the Issues

Should the Commission accept Minnesota Energy Resources Corporation's annual revenue decoupling evaluation report for 2015, and approve Minnesota Energy Resources Corporation's revenue decoupling rate adjustments?

Introduction

This is the Commission's third annual review of Minnesota Energy Resources Corporation's (MERC's) full revenue decoupling program.

The Company and the Department of Commerce ("Department" or "DOC") are in agreement on recommending that the Commission:

1. Approve MERC's Revenue Decoupling Evaluation Report ("Evaluation" or "Report") for calendar-year 2015.

2. Allow MERC to continue assessing its revenue decoupling adjustments and approve the Company's annual decoupling adjustment.

Background

Minn. Stat. § 216B.2412, Decoupling of Energy Sales from Revenues

According to Minn. Stat. § 216B.2412, the objective of revenue decoupling is to:

A. Reduce MERC's disincentive to promote energy efficiency by making the Company's revenue less dependent on energy sales.

B. Achieve energy savings, and

C. Not harm ratepayers.

Pilot Revenue Decoupling Program

On July 13, 2012, the Commission issued its Findings of Fact, Conclusions of Law, and Order ("Order") in Minnesota Energy Resources Corporation's 2010 general rate case, in this docket. As part of this Order, the Commission authorized a three year pilot "full" revenue decoupling mechanism ("RDM") that encompassed the Residential and the Small Commercial and Industrial customer classes. In conjunction with the implementation of rates authorized as a result of the 2010 rate case, MERC's revenue decoupling pilot program became effective on January 1, 2013.

MERC's pilot revenue decoupling program was scheduled to run through December 31, 2015; however, in its Order after last year's annual filing, the Commission indefinitely extended

MERC's decoupling pilot "until such time as the Commission makes a determination as to its permanence".[1]

One of the conditions of the Commission's approval of MERC's revenue decoupling mechanism was that MERC was required to file an annual Revenue Decoupling Evaluation. The Commission reaffirmed the Evaluation requirement in its 2015 Order approving the 2014 Evaluation.

This is the Company's third annual Evaluation and it encompasses the period of January 1 to December 31, 2015.

Parties' Positions

Minnesota Energy Resources Corporation – Adjustment Calculation Filing

In advance of its full Evaluation filing for calendar-year 2015, MERC filed its Revenue Decoupling Mechanism ("RDM") adjustment calculations that went into effect March 1, 2016.

Table 1 – MERC's 2015 RDM Adjustment Calculations

	Residential	Small C&I
2015 RDM Surcharge/(refund)	$3,283,235.08	$59,397.78
2013 Reconciliation Adjustment	$145,449.15	$71,636.17
Total Surcharge/(refund)	$3,428,684.23	$131,033.95
Forecasted Sales, therms	169,606,110	10,622,007
Surcharge/(Refund) Rate, per therm	$0.02022	$0.01234

Minnesota Energy Resources Corporation – Evaluation Report

On April 29, 2016, Minnesota Energy Resources Corporation submitted its full Evaluation for the period of January 1 to December 31, 2015. The Report provides a large amount of information about the Company's various conservation programs, their costs and, ultimately, their overall results and energy savings. The Company's conservation programs are discussed in the briefing papers under DOC Comments.

The Report also includes the required monthly and annual data necessary to calculate the corresponding decoupling rate adjustment.

As shown in table 1 above, the 2015 RDM adjustment calculation resulted in surcharges to both classes subject to decoupling - Residential customers' total surcharge is $3,283,235 and Small Commercial & Industrial customers' is $59,398. Since the Company recovers surcharges/refunds on a volumetric basis, a true up of a previous year's adjustment is necessary to make the Company and ratepayers "whole"; therefore, the coming year's adjustment will include 2013 true-up surcharges for both classes. Residential customers' 2013 true-up surcharge

[1] Order (informal), this docket, August 11, 2015

is $145,449 and Small Commercial & Industrial customers' is $71,636 thus making the total surcharges $3,428,684 and $131,034, respectively.

Department of Commerce – Comments

On June 1, 2016, the Department filed comments on MERC's Evaluation Report and recommended that the Commission allow MERC to continue its revenue decoupling pilot program and approve the Company's proposed change (adjustment) to the annual revenue decoupling rate.

The DOC also recommended that MERC, in Reply Comments:

a. Provide an estimate of the impact of the RDM customer classes' surcharges on rates and average bills.

b. Explain whether the Company could provide energy savings for its Small C&I customer class separate from its other classes.

The Department's filing also provided analysis of several other subjects.

MERC's Progress Towards attaining 1.5% Energy Savings Goals

The Department noted that MERC provided both qualitative and quantitative information showing changes in the results of MERC's Conservation Improvement Program. The DOC highlighted some of MERC's programs.

Addition of New Projects or New Measures in an Existing Project

MERC did not add any new CIP projects or measures in 2015.

Changes in CIP spending

The Department noted that, although MERC's 2015 expenditures were 21% higher than those in 2014, the Company's 2013-2015 expenditures were 3% lower than the previous three years' expenditures.[2] However, the DOC stated that it does not believe that a change in MERC's CIP spending is particularly important because:

1. Only the Residential and Small Commercial and Industrial (Small C&I) customer classes are decoupled and thus only changes to energy savings and expenditures for those customer classes are relevant;

2. Changes in CIP expenditures are not a good measure of whether decoupling is removing a disincentive for the utility to encourage its customers' energy conservation

[2] As discussed in last year's Evaluation, it should be noted that, as a result of some large customers opting out of the program, MERC's 2013 expenditures were substantially lower.

improvements. Since utilities have trackers to recover the costs of CIP expenditures, CIP expenditures by themselves do not have the potential impact of reducing MERC's profits.

The Department mentioned that it prefers examining changes in CIP energy savings.

Changes in CIP energy savings

The Department pointed out that MERC's Report shows two ways of measuring changes in energy savings – the first one includes the 2010-2012 energy savings from its Home Energy Reports behavioral change project and the second one does not. The Department did not find it reasonable to exclude a project that was offered during the years used as a baseline for comparison; however, it found it reasonable to modify the energy savings associated with the Home Energy Reports project to reflect the changes in how the Department measures these energy savings.

The Department noted that, as can be seen in Table 2, MERC's 2015 total energy savings were 34% percent higher than the previous year's savings; however, the 2013-2015 average savings were marginally lower than the previous three years' savings. Thus, overall, MERC did not demonstrate an increase in total CIP energy savings for the period of 2013- 2015 compared to 2010-2012.

Since MERC's approved RDM focuses only on the Residential and Small C&I classes, the Department considered that, in the context of evaluating MERC's revenue decoupling mechanism, changes in Residential and Small C&I energy savings are what is important. As Table 2 indicates, MERC's Residential Customers' energy savings increased 16% between 2014 and 2015 and their 2013-2015 energy savings were 5% higher than for the preceding three years.

Since MERC did not report Small C&I energy savings separately, the Department requested that, in Reply Comments, the Company indicate whether it could provide this information in its 2016 Report.

Table 2 - Comparison of Energy Savings (in MCF), with 2010-2012 Energy Savings to Reflect 3-Year Life of Residential Behavioral Savings Project[3]

	Average 2010-2012	2013	2014	2015	Average 2013-2015	2015 as % of 2014	2013-2015 as % of 2010-2012
Low-Income Projects	8,492	11,207	8,139	8,114	9,153	100%	108%
Residential Projects	189,703	208,071	180,137	209,604	199,271	116%	105%
C/I Projects	235,975	205,542	180,792	275,664	220,666	152%	94%
Total Savings	434,170	424,821	369,068	493,382	429,090	134%	99%

[3]Table includes reductions to MERC's historical residential projects to recognize that the energy savings from behavior projects are now assumed to have a three-year life, instead of one year, and that a project that would have been assumed to save 300 MCF when the behavior projects were first approved are now assumed to save 100 MCF. The Department is currently working with interested parties to re-examine the issue of how to count savings from behavioral projects.

MERC's Revenue Decoupling Scenario Analysis

The Department noted that, by having three utilities experiment with revenue decoupling, it will allow parties to evaluate whether RDMs should continue, and if so, what are those program's most effective features. For example:

1. The type of revenue decoupling - full or partial,
2. Cap sizes on the RDM rate adjustments,
3. Whether caps should or should not be symmetrical,
4. Which customer classes should have an RDM.

The Department stated that, to present an analysis of these issues for the Commission's consideration, it intends to analyze MERC's experience at the end of its present pilot[4], after the 2018 year.

Revenue Deferral Adjustment for Each Rate Class

The Department analyzed MERC's filing and confirmed that, as a result of under-recoveries in calendar-year 2015, surcharges for Residential and Small C&I customers in 2016 will be approximately $3.3 million and $59,000, respectively. As mentioned above, the Company began collecting these surcharges on March 1, 2016. (These amounts do not include the 2013 adjustment)

Calculation of Deferrals

The Department explained that, for a gas utility, distribution costs are recovered through the customers' variable rate. During years in which sales are lower than forecasted, the utility does not fully recover its distribution costs; during years in which sales are higher than forecasted, the utility over collects the amount of revenues needed. The purpose behind a revenue decoupling mechanism is to allow the Company to recover forecasted distribution costs, regardless of sales.

[4] For clarification, the Commission he decoupling pilot was extended "until such time as the Commission makes a determination as to its permanence" and not 2018.

The Department provided Table 3 to illustrate MERC's RDM calculation:

Table 3 – DOC's Summary of MERC's Deferral Calculations for 2015

Line			**Residential**	**Small C&I**
1		Forecasted Annual Revenue Per Avg. Monthly Customer	$170.48	$151.86
2		Actual 2015 Revenue Per Avg. Monthly Customer	$148.99	$146.44
3	Line 1 minus Line 2	Under/(Over) Collection Revenues Per Customer	$21.49	$5.42
4		Forecasted Average Monthly Customers	192,587	10,959
5		2015 Actual Average Monthly Customers	200,979	9,983
6	Greater of Line 4 or 5 times Line 3	Calculated Surcharge/(Refund) per Customer Class	$4,319,039	$59,398
7		Cap	$3,283,315	$166,426
8	Lower of Line 6 and Line 7	Actual Surcharge/(Refund) per Customer Class	$3,283,315	$59,398

The Department noted that Residential customers would have been surcharged $4.3 million if it were not for the 10% cap.

After reviewing MERC's calculations the Department recommended that surcharges for both classes be approved. The Department also requested that the Company, in Reply Comments, provide the surcharges' average (per customer) annual impact for both classes.

MERC – Reply Comments

In Reply Comments, MERC stated that it currently does not break out the C&I sector; therefore, the Company does not report separately on Small C&I CIP achievements. MERC added that it would be able to separately report Small C&I energy savings in its 2016 Decoupling Evaluation Report but would not be able to breakout historical data on CIP energy savings between the Small and Large C&I classes.

As requested by Department and reflected on Table 4, MERC provided the 2015 surcharge's impact on customers.

Table 4 – Total Surcharge and Average Annual Bill Impact (2015 RDM Surcharge and 2013 Reconciliation Adjustment)

	Average Use Per Customer Approved in Current Decoupling Model	2015 Decoupling Surcharge	Average Annual Impact Per Customer	Average Monthly Impact Per Customer
Residential	881	$0.02022	$17.81	$1.48
GS-Small C&I	969	$0.01234	$11.95	$1.00

Staff Analysis

Although it does not impact the ultimate residential surcharge amount, Staff points out that the Department's table[5] explaining MERC's 2015 deferral calculations inaccurately represents the Company's deferral formula. Line 6 in the Department's table uses the greater of line 4 or line 5 (in the same table) whereas MERC's calculation lacks that "pick and choose" flexibility – the Company only uses line 4 as a driver.

In Table 5, Staff has reconstituted the Department's table to accurately reflect MERC's calculation.

Table 5 – Staff's Summary of MERC's Deferral Calculations for 2015

Line			Residential	Small C&I
1		Forecasted Annual Revenue Per Avg. Monthly Customer	$170.48	$151.86
2		Actual 2015 Revenue Per Avg. Monthly Customer	$148.99	$146.44
3	Line 1 minus Line 2	Under/(Over) Collection Revenues Per Customer	$21.49	$5.42
4		Forecasted Average Monthly Customers	192,587	10,959
5	Line 4 times Line 3	Calculated Surcharge/(Refund) per Customer Class	$4,138,695	$59,398
6		Cap	$3,283,315	$166,426
7	Lower of Line 5 and Line 6	Actual Surcharge/(Refund) per Customer Class[6]	$3,283,315	$59,398

As shown in table 5, the 10% cap impacted residential customers by reducing their surcharge by approximately $855,000. This marks the third time in three years that the cap factors in on the

[5] Table 3 in these briefing papers.
[6] Due to rounding, totals in this table slightly differ from actual numbers.

final surcharge/refund calculation for one or both decoupled classes; however, by limiting the amount of the RD surcharge, this is the first time that the cap has benefited ratepayers. Table 6 summarizes the cap impact for the last three years.

Table 6 – 10% Cap Impact, 2013-2015 (in $000s)

Year	Class	(Over)/Under Collection	10% Cap	Cap Impact	Benefits
2015	Residential	$4,139	$3,283	$855	Ratepayers (surcharge capped)
2014	Residential	($5,981)	$3,283	$2,698	MERC (refund capped)
2014	Small C&I	($672)	$166	$506	MERC (refund capped)
2013	Small C&I	($263)	$151	$112	MERC (refund capped)

A comparison of MERC's Residential 2014 $6 million (pre-cap) over-collection to 2015's $4.1 million (pre-cap) under-collection reveals a $10 million swing from one year to the next. A review of the Small C&I's changes reveals a (pre-cap) $731 thousand swing in the same direction.[7]

The reason for such radical reversal is the drop in MERC's sales from 2014 to 2015. As shown in Table 7, the sales decrease was seen across all classes except for Large Volume Interruptible & Joint.

Table 7 – MERC's 2015 & 2014 Annual Sales Comparison, Actual

Class	2015 Sales	2014 Sales	Decrease/ (Increase)	% Decrease
Residential	154,688,267	201,388,458	46,700,191	23.2%
Small C&I	9,330,256	14,950,997	5,620,741	37.6%
Large C&I	83,496,419	106,101,306	22,604,887	21.3%
SV Interruptible & Joint	18,520,624	25,636,667	7,116,043	27.8%
LV Interruptible & Joint	12,743,785	12,012,835	(730,950)	-6.1%
SV Transport	4,704,676	5,813,002	1,108,326	19.1%
LV Transport	87,077,376	98,162,828	11,085,452	11.3%
Super LV Interruptible & Joint	158,705,189	219,536,560	60,831,371	27.7%
Total	529,266,592	683,602,653	154,336,061	22.6%

Since 2014 sales include "polar vortex effects" an argument could be made that 2014 sales were artificially higher; therefore, in an effort to have a more "apples to apples" comparison, Staff filtered out sales for each year's first three months and compared the results. As shown on Table 8, the April to December comparison shows similar decreases along all classes.

[7] 2015's under-collection was $59 thousand and 2014's (pre-cap) over-collection was $672 thousand.

Table 8 – MERC's 2015 & 2014 April to December Sales Comparison, Actual

Class	2015 Sales Apr - Dec	2014 Sales Apr - Dec	Decrease/ (Increase)	% Decrease
Residential	68,665,543	89,564,635	20,899,092	23.3%
Small C&I	2,525,865	5,948,424	3,422,559	57.5%
Large C&I	36,169,386	49,879,747	13,710,361	27.5%
SV Interruptible & Joint	8,733,050	12,581,005	3,847,955	30.6%
LV Interruptible & Joint	9,041,154	9,493,142	451,988	4.8%
SV Transport	1,921,128	3,429,080	1,507,952	44.0%
LV Transport	57,531,934	68,465,540	10,933,606	16.0%
Super LV Interruptible & Joint	89,698,855	163,491,794	73,792,939	45.1%
Total	274,286,915	402,853,367	128,566,452	31.9%

Staff performed a final, weather-normalized sales comparison[8] and, as shown in table 9, the outcome was still a substantial decrease among all classes.

Table 9 – MERC's 2015 & 2014 Annual Sales Comparison, Weather-Normalized

Class	2015 Sales	2014 Sales	Decrease/ (Increase)	% Decrease
Residential	163,148,342	181,131,228	17,982,886	9.9%
Small C&I	9,655,179	13,352,435	3,697,256	27.7%
Large C&I	88,231,769	96,330,856	8,099,087	8.4%

MERC's sales decline is more pronounced when one considers that the Company's 2015 customer count increased as a result of its purchase of IPL's gas assets. Other than mentioning that weather was warmer than normal, MERC did not attempt to address the reasons for its sales decline. In order to supplement the record, the Commission may want to order MERC to make a supplemental filing within thirty (30) days of the Commission's Order on the 2015 Report discussing the reasons for the drop in 2015 sales.

As shown in Table 1 above, the *total* surcharge amount for each class in comprised of two numbers – the 2015 adjustment factor and a $145 thousand reconciliation adjustment for 2013. Staff was unable to find the Company's calculation of this reconciliation adjustment on the record. To ensure the adjustment's calculation is reasonable, the Commission may want to order the Company to file this information within thirty (30) days of issuing its Order on 2015 Report. To eliminate this oversight in the future, the Commission may also want to order MERC to include future reconciliation adjustment calculations to be included in its Decoupling Annual Report initial filing.

Finally, as part of its filing, the Company provides sales information on all non-decoupled classes and what a decoupling impact would have been had those classes been included in the pilot program. In order to collect additional information, the Commission has been regularly ordering all companies with a decoupling program to file decoupling calculations for *all* classes.

[8] MERC only provides weather normal adjustments for Residential and C&I customers.

Staff's review of MERC's non-decoupled classes data uncovered possible errors in the Company's pro-forma revenue decoupling data for three classes: SV Transport, LV Transport and Super LV Interruptible & Joint. As shown in Table 10, December 2015 customer counts were substantially lower than the previous eleven months' average.

Table 10 – MERC 2015 Customer Counts
SV Transport, LV Transport & Super LV Interruptible & Joint

Class	2015 Average Customer Count, January-November	2015 Customer Count, December
SV Transport	50	3
LV Transport	105	35
Super LV Interruptible & Joint	24	16

Staff reviewed December customer counts for prior years and found that previous customer counts did not materially change when compared to January to November averages; therefore, Staff concludes that is possible that reported December 2015 for the classes listed in Table 10 might not be correct. Although the three classes in question are not subject to decoupling, the Commission has expressed a desire to have a database of "theoretical decoupling calculations" for non-decoupled classes; therefore, the Commission may want to order the Company to file, within thirty (30) days of the Commission's Order on the 2015 Report, one of the following:

- If customer counts are incorrect, provide a corrected Excel file with accurate customer counts and their corresponding revised theoretical decoupling calculations, or
- If customer counts are correct, file an explanation for the dramatic reductions in customer counts and if the Company anticipates the reductions to be permanent.

Decision Alternatives

1. <u>2015 Annual Revenue Decoupling Evaluation Report</u>

    a. Accept MERC's revenue decoupling evaluation report for 2015. (MERC, DOC)

    b. Reject MERC's revenue decoupling evaluation report for 2015.

2. <u>Revenue Decoupling Adjustments</u>

    a. Accept MERC's revenue decoupling adjustment calculations and approve their implementation effective March 1, 2016. (MERC, DOC)

    b. Reject MERC's revenue decoupling adjustment calculations. Require MERC to reverse all adjustments from March 1, 2016 on and require MERC to submit a compliance filing (within 30 days of the Commission issuing its order in this docket) that explains how MERC is implementing the Commission's decision.

3. 2015 Sales Decline

    a. Order MERC to make a supplemental filing no later than thirty (30) days after the Commission's Order on the 2015 Report discussing the reasons for the drop in 2015 sales. (Staff)

    b. Take no action.

4. 2013 Reconciliation Adjustment

    a. Order MERC to file its calculation of the 2013 reconciliation adjustment no later than thirty (30) days after the Commission's Order on the 2015 Report. (Staff)

    b. Take no action.

5. Future Reconciliation Adjustments

    a. Order MERC to include future reconciliation adjustment calculations in its Decoupling Annual Report initial filing. (Staff)

    b. Take no action.

6. SV Transport, LV Transport & Super LV Interruptible & Joint Customer Counts

    a. Order MERC to file, within thirty (30) days of the Commission's Order on the 2015 Report, one of the following:

        - If customer counts are incorrect, provide a corrected Excel file with accurate customer counts and their corresponding revised theoretical decoupling calculations, or
        - If customer counts are correct, file an explanation for the reductions in customer counts and if the Company anticipates the reductions to be permanent. (Staff)

    b. Take no action.