Minnesota Public Utilities Commission
Staff Briefing Papers

Meeting Date: January 19, 2017 .... **Agenda Item #5

Company: Minnesota Energy Resources Corporation (MERC)

Docket Nos. **G-011/M-16-654 (Balaton Project)**
In the Matter of the Petition of Minnesota Energy Resources Corporation for Approval for Recovery of Natural Gas Extension Project Costs (NGEP) through a Rider and for Approval of a New Area Surcharge (NAS) for the Balaton Project.

G-011/M-16-655 (Esko Project)
In the Matter of the Petition of Minnesota Energy Resources Corporation for Approval for Recovery of Natural Gas Extension Project Costs (NGEP) through a Rider and for Approval of a New Area Surcharge (NAS) for the Esko Project.

Issues: Should the Commission approve Minnesota Energy Resources Corporation's (MERC's) request for a Natural Gas Extension Project Costs (NGEP) Rider and a New Area Surcharge (NAS) for the Balaton Project?

Should the Commission approve Minnesota Energy Resources Corporation's (MERC's) request for a Natural Gas Extension Project Costs (NGEP) Rider and a New Area Surcharge (NAS) for the Esko Project?

Staff: Bob Brill 651-201-2242

Relevant Documents

<u>Docket No. G-011/M-16-654 (Balaton Project)</u>
MERC - Initial Petition and Attachments (TS)..August 2, 2016
Department of Commerce (Department) – Comments (TS)...................................October 3, 2016
MERC - Reply Comments...October 13, 2016
Representative Pat Garofalo – Letter supporting the projects ....October 25, 2016
Department – Response to Reply Comments ....November 16, 2016
MERC – Additional Reply Comments (TS)...November 23, 2016
Department – Additional Response to Reply Comments .... December 22, 2016

<u>Docket No. G-011/M-16-655 (Esko Project)</u>
MERC - Initial Petition and Attachments (TS)..August 2, 2016
Department of Commerce (Department) – Comments (TS)...................................October 3, 2016
MERC - Reply Comments...October 13, 2016
Representative Pat Garofalo – Letter supporting the projects ....October 25, 2016

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Should the Commission approve Minnesota Energy Resources Corporation's (MERC's) request for a Natural Gas Extension Project Costs (NGEP) Rider and a New Area Surcharge (NAS) for the Esko Project? (Docket No. 16-655)

Introduction

At present, certain areas of Minnesota do not have natural gas services available. These areas historically have used propane, heating oil, or wood as their primary heat source during the winter. The polar vortex conditions during the 2013-14 winter heating season caused Minnesota Governor Mark Dayton to issue Emergency Executive Order 14-02 in response to propane supply issues. This Order provided new emphasis on developing natural gas projects whether economical or uneconomical to serve un-served or inadequately served areas.

The Commission previously determined that service line extensions must be economical at tariffed rates; existing customers must not unduly subsidize service line and main extensions for a new customer(s). For extensions longer than the line allowance, the customer is required to pay a Contribution In Aid of Construction (CIAC). For uneconomical natural gas projects that would require an undue subsidization from existing customers, the Commission approved New Area Surcharge (NAS) tariffs. This tariff required customer(s) in the new area to be responsible for the costs of providing service to the area. By permitting a utility company to collect a NAS factor in addition to the tariffed rates, the project(s) become economical.

In Docket No. 11-1045, MERC petitioned the Commission for approval of its NAS tariff proposal.[1] MERC's NAS was designed to permit MERC to extend service into these new areas where it was previously uneconomical to serve.

In 2015, the Minnesota Legislature passed into law Minn. Stat. § 216B.1638. This allowed public utilities to petition the Commission outside of a general rate case for a Natural Gas Extension Project Rider (NGEP Rider Statute). The NGEP Rider allows a utility to collect a portion of its natural gas extension project's revenue deficiency from all of the utility's customers, including transport customers. Thus, making natural gas extension project's more economical for the utility and its potential customers to serve these previously un-served or inadequately areas.

In these dockets (16-654 and 16-655), MERC petitioned the Commission for approval of its proposed combination of cost recovery methods - miscellaneous rate change and tariff petition using its NAS tariff and the NGEP Rider Statute to recover costs to extend natural gas service to

[1] The Commission's July 26, 2012 Order approved the NAS tariff provision.

Balaton and Esko, Minnesota (MN) customers. MERC's requested cost recovery through the NGEP Rider is ***less than*** 33 percent of the project's revenue deficiency (less than the maximum amount that may be authorized) pursuant to the NGEP Rider Statute.[2] The remaining project costs will be recovered through MERC's approved NAS tariff.

The Department recommended that the Commission deny approval of MERC's Balaton and Esko initial petitions, where both projects would recover costs through a NGEP Rider and its proposed 25-year NAS factors.[3] The Department recommended that the Commission approve its 30-year NAS factors for both the Balaton and Esko projects, where cost recovery would be from just subscribing NAS customers.

Background

On August 2, 2016, MERC filed its miscellaneous rate petitions for the Balaton and Esko projects. MERC proposed cost recovery through its current NAS tariff and through the newly approved NGEP Rider Statute, Minn. Stat. §216B.1638.

On October 3, 2016, the Department filed *Comments* recommending that the Commission deny approval of MERC's *Initial Petitions* through the two recovery mechanisms. The Department recommended that the Commission approve its revised 30-year NAS factors for cost recovery.

On October 13, 2016, MERC filed *Reply Comments* responding to the Department October 3rd *Comments*.

On October 25, 2016, Representative Pat Garofalo filed his letter in support of MERC's Rochester, Balaton, and Esko projects.

On November 16, 2016, the Department filed its *Response Comments* to MERC October 13th *Reply Comments*.

On November 23, 2016, MERC filed its *Additional Reply Comments* responding to the Department's November 16th *Response Comments.*

On December 22, 2016, the Department filed its *Additional Response* to MERC's October 13th *Reply Comments* and November 23rd *Additional Reply Comments*.

The two dockets are similar, but not exactly identical records. MERC states that most of its cost information for these two dockets is non-public, trade-secret information.

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[2] The actual percentage MERC requested to recover through the NGEP Rider is less than 33%, but has been marked as *Trade Secret*. See MERC's *Initial Petition*, p.1.

[3] MERC can extend NAS projects up to 30-year terms.

MINN. STAT. §216B.1638 RECOVERY OF NATURAL GAS EXTENSION PROJECT COSTS.[4]

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.

[4] See the Department's October 3, 2016 *Comments*, Attachment 2

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.

Parties Positions

Compliance with Previous Commission Order Requirements

MERC claimed that its *Initial Petitions* (16-654 and 16-655) met all the Commission requirements for a NAS and NGEP miscellaneous rate modification request.[5] MERC provided its proposed clean and redline tariff sheet amendments in its *Initial Petitions*, Exhibit A.

The Department determined that MERC complied with the filing requirements for Docket No. G007,011/M-11-1045,[6] Minn. Rules Part 7829.1300, and Minn. Stat. §216B.1638.[7] [8] The Commission's July 26, 2012 Order in Docket No. 11-1045 required that any miscellaneous rate change filing for a specific NAS project shall include at a minimum:

- an updated surcharge tariff sheet and its related spreadsheets with and without the proposed surcharge for each new surcharge area;
- the work papers showing all underlying assumptions concerning interest rates, costs, depreciation, demographics, rate structure, etc.;
- a surcharge rate for each customer class, even if no customers are anticipated for the class;
- the Company's proposed customer notice; and
- all pertinent contract demand entitlement change requests as soon as the required information is ascertained.

Staff believes that MERC's Balaton and Esko projects are compliant with:

- prior Commission Order Requirements, i.e. Docket No. 16-221 Order requiring the removal of the CCRC rate from its distribution rate and giving each customer the proper service line extension allowance;
- MERC's NAS tariff's model;
- MERC's use of its current reserve margin, MERC has sufficient natural gas supply to support these two projects.

[5] See MERC's *Initial Petition*, Exhibits A – D, as *Trade Secret*.
[6] The Department concluded that MERC provided the information required by the Commission's July 26, 2012 Order.
[7] See the above Relevant Statues for the filing requirements.
[8] See the Department's October 3rd *Comments*, pp. 7-8.

Cost Recovery of the NNG's Pipeline System Upgrades

In its *Initial Petitions*, MERC proposed project costs for its Balaton and Esko, MN projects. MERC's project cost estimates included NNG system enhancement costs and the Balaton and Esko natural gas distribution system costs. NNG pipeline system enhancements were necessary to enable MERC to have the ability to have additional gas supply delivered to a proposed receipt points.

MERC expects to use its existing NNG transportation contracts (demand entitlements) to transport the additional natural gas supply, with no additional NNG revenue. NNG is an open access interstate pipeline, but does not have an obligation to construct the necessary facilities, per Federal Energy Regulatory Commission (FERC) rules and regulations. MERC must pay NNG a CIAC to construct the additional facilities to make deliveries into the Balaton and Esko areas.

The Department stated that MERC's *Initial Petition* was unclear on how these NNG enhancement costs would be recovered, whether the recovery would be through MERC's Purchased Gas Adjustment mechanism (PGA) or through the proposed NAS factors, or some mix of recovery mechanisms. The Department requested that MERC provide an explanation regarding the accounting and recovery of the NNG enhancement costs and a full description of these enhancements in *Reply Comments.*

In *Reply Comments,*[9] MERC's stated:

> *None of the NNG costs would be subsequently recovered through MERC's PGA. This is because NNG would require recovery of its capital costs upfront through a contribution in aid of construction from MERC rather than providing for recovery of such costs through a capacity contract. As noted in MERC's Initial Petition, at this time, no demand entitlement changes are anticipated to be required because MERC anticipates the demand needs of the Balaton and Esko Project customers will be served off existing demand contracts.*

MERC's proposed to recover a portion of the NNG's pipeline system enhancement costs through the NAS factor and the remaining portion of costs recovered through the NGEP Rider factor. MERC's system-wide PGA mechanism will not be impacted by NNG's pipeline system enhancement costs. The Department later concluded that MERC's explanation was reasonable. Based on the Department's recommendation, the NNG enhancement costs would be recovered through just the NAS factors. Staff believes that the NNG enhancement costs are eligible for recovery. The Commission will determine how these costs will be recovered.

Cost Recovery Through MERC's NAS tariff and the NGEP Rider Statutes

Are the Balaton and Esko Projects in the Public Interest?

Staff believes that the Commission will have to decide whether the Balaton project is in the public interest. Based on Governor Dayton's Executive Order 14-02, giving un-served

[9] MERC's October 13th *Reply Comments*, p. 10-11.

customers the ability to convert from their current alternative fuel (such as propane, electric, wood, and others) to natural gas would provide customers with a benefit.[10]

MERC stated its proposed NAS factor was in the public interest, because natural gas was less expensive than other alternative fuels, and potential new customers would benefit from the additional fuel choice.

As part of its analysis, the Department reviewed competitive fuel alternatives. MERC provided propane pricing, the weekly price per gallon of propane in MN reported by the U.S. Energy Information Administration (EIA) for the 2006-2007 through 2015-2016 winter heating seasons.[11] MERC further provided the historic monthly residential natural gas pricing for the Balaton area, including the commodity cost of gas, distribution charges, and any other access charges.[12] The Department compared delivered residential natural gas costs to the propane costs, see following tables:

Table 1: Balaton Residential Natural Gas and Propane Annual Costs Comparison

Annual Cost (April – March)	Natural Gas Annual Residential Cost MERC PGA[13]	Natural Gas Annual Resid. Cost including 30-yr NAS[14]	Propane Annual Residential Cost[15]	Annual Savings with Natural Gas[16]
2011-2012	$760	$1,128	$1,974	$846
2012-2013	$753	$1,120	$1,499	$378
2013-2014	$866	$1,233	$2,279	$1,046
2014-2015	$875	$1,242	$1,732	$490
2015-2016	$678	$1,046	$1,220	$175
Total	$3,932	$5,769	$8,703	$2,934

[10] The propane fuel option has too many outside variables that could impact its pricing, such as heavy railroad use by oil producers that drive-up the cost of delivery.
[11] The EIA weekly Minnesota propane price is obtained from the Department of Commerce's Energy Assurance Division as part of the State Heating Oil & Propane Program (SHOPP). The Department obtains weekly residential market pricing for propane from 28 suppliers. The pricing excludes taxes, discounts, and specific charges to individual customers. The prices are also for residential customers only and do not include apartments, multiple family dwellings, businesses, or institutions.
[12] See the Department's October 3, 2016 *Comments*, Attachment 5 (16-654).
[13] Ibid.
[14] The Department's calculation added $30.61 per month to the total residential monthly cost from its Attachment 5.
[15] See the Department's October 3, 2016 *Comments*, Attachment 4.
[16] Please note propane pricing is a weekly Minnesota average from the EIA for the winter months that was annualized based on average equivalent natural gas usage multiplied by the simple average of each winter's pricing. The Department anticipates that the savings is actually higher due to any specific delivery charges to Balaton or fixed charges associated with purchase of propane.

Table 2: Esko Residential Natural Gas and Propane Annual Costs Comparison

Annual Cost (April – March)	Natural Gas Annual Residential Cost MERC PGA[17]	Natural Gas Annual Resid. Cost including 30-yr NAS[18]	Propane Annual Residential Cost[19]	Annual Savings with Natural Gas[20]
2011-2012	$766	$1,116	$1,882	$766
2012-2013	$727	$1,078	$1,805	$727
2013-2014	$849	$1,200	$2,049	$849
2014-2015	$870	$1,221	$2,091	$870
2015-2016	$678	$1,029	$1,707	$678
Total	$3,890	$5,644	$9,534	$3,890

The Department concluded that for the previous five years, Balaton and Esko residential customers could have experienced savings if natural gas was available, even with the Department's recommended 30-year NAS factors (annual savings ranged from $175 to $1,046).[21] The Department believes that the Balaton and Esko projects are in the public interest.

Staff agrees with the Department's conclusion, that the Balaton and Esko projects appear to be in the public interest based on the Department's recommended 30-year NAS factors without the NGEP Rider because the customers will have an additional fuel alternative that could save money. Also, the proposed Balaton and Esko are compliant the Governor's Executive Order.

How should MERC Recover Balaton and Esko Project Costs?

PUC staff reviewed MERC's *Initial Petition* and the various rounds of *Comments*, and appreciates both parties work. Staff believes that all issues have been resolved, except for MERC's proposed cost recovery of Balaton project costs, see the following discussion.

In its **August 2, 2016 *Initial Petitions***, MERC proposed Balaton and Esko project cost recovery through a combination of its NAS tariff and the NGEP Rider Statute.[22] [23] MERC proposed 25-year NAS factors to recover a portion of the Balaton and Esko uneconomical costs.[24] Further, influencing MERC's NAS factors calculation was its prior NAS experience and the local

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[17] See the Department's October 3, 2016 *Comments*, Attachment 5 (15-655).

[18] The Department's calculation added its 30-year NAS factor to the total monthly cost from its Attachment 5.

[19] See the Department's October 3, 2016 *Comments*, Attachment 4.

[20] Please note propane pricing is a weekly Minnesota average from the EIA for the winter months that was annualized based on average equivalent natural gas usage multiplied by the simple average of each winter's pricing. The Department anticipates that the savings is actually higher due to any specific delivery charges to Balaton or fixed charges associated with purchase of propane.

[21] Further, the Department noted that the weekly Minnesota Residential average did not include any delivery charges to Balaton or fixed charges associated with propane purchase. The Department believed that the savings would have been greater if propane pricing would have been more transparent.

[22] MERC proposed to recover a portion of its project costs through a monthly payment from just the Balaton customers (the NAS factor) and the remaining costs would be recovered through a volumetric rate collected from all of MERC customers (the NGEP Rider), see MERC's *Initial Petition*, pp. 5-9, marked as *Trade Secret*.

[23] MERC's goal in developing a NAS factor was to promote the project and encourage Balaton customers to sign up for the service. MERC balanced its NAS model results with the percentage of costs assigned to the NGEP Rider factor.

[24] MERC's *Initial Petition*, pp. 5-9, marked as *Trade Secret*.

economy. MERC believed that a higher stand-alone NAS factor would price both projects out-of-the-market and would deter Balaton and Esko customers from signing up to receive service.

MERC's proposed NAS factors:

Table 2: MERC's Proposed 25-Year NAS Factors by Customer Class[25]

Customer Class	**Balaton** NAS Factors	**Esko** NAS Factors
	(1)	(2)
Residential	$24.14	$24.18
Small Commercial and Industrial	$45.75	$45.81
Large Commercial and Industrial	$114.37	$114.53
Small Volume Interruptible	$419.34	$419.95
Large Volume Interruptible	$470.17	$470.85

MERC's proposed to recover the remaining project costs (not recovered through the NAS factors) using the NGEP Rider Statute (Minn. Stat. §216B.1638), over a one-year period.[26] The statute provided that "[a] public utility may petition the Commission outside 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.[27]" The revenue deficiency for the NGEP Rider Statute was defined as:

> *The deficiency in funds that results when [1] projected revenues from customers receiving natural gas service as the result of a natural gas extension project, plus [2] any contribution in aid of construction paid by these customers, fall short of the total revenue requirement of the natural gas extension project.[28]*

MERC anticipated that Residential, Small and Large Commercial & Industrial, and Small Volume Interruptible customer classes will take the NAS service.[29] MERC noted that the NAS factor would recover cost from just the Balaton and Esko subscribing customers. The NGEP Rider factor would recover costs from all of MERC's customers, including the Balaton and Esko customers.

In its **October 3, 2016 *Comments***, the Department's analysis included a review of previous Commission Orders, CIAC definitions, and Minn. Stat. §216B.1638 language for guidance in determining the appropriateness of using MERC's proposed combination of cost recovery mechanisms (NAS factor and the NGEP Rider factor) in a single project.

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[25] Ibid.
[26] The NGEP Rider Statute, was approved by the 2015 Minnesota Legislature.
[27] The calculation of the revenue deficiency "must include [1] the currently authorized rate of return, [2] incremental income taxes, [3] incremental property taxes, [4] incremental depreciation expenses, and [5] any incremental operation and maintenance costs." Subdivision 2 sets forth the requirements for a petition seeking approval of an NGEP Rider and Subdivision 3 of the statute provides that the Commission must not approve a rider that allows a utility to recover more than "33 percent of the costs of a natural gas extension project." The required information for a petition seeking approval of an NGEP is provided below.
[28] Minn. Stat. § 216B.1638, subd. 1(f). The "total revenue requirement" of a project means "the total cost of extending and maintaining natural gas service to a currently unserved or inadequately served area." Id., subd. 1(g).
[29] See MERC's Initial Petition, Exhibit A, both marked as *Trade Secret*.

Commission Orders

The Department reviewed the Commission's July 26, 2012 Order,[30] where the Commission defined the MERC's NAS factor as:

> *A New Area Surcharge (NAS) is designed to permit a natural gas company to extend service into a new area it would be uneconomic to serve at tariffed rates, by permitting the company to collect a surcharge in addition to the tariffed rate. This makes natural gas available to communities previously not served by a natural gas utility* ***without imposing the costs of expansion on existing ratepayers****.* [Emphasis added]

The Department also reviewed MERC's Docket G011/M-16-221 petition – the Fayal Township-Long Lake NAS Project, where MERC stated the project was in the public interest because:

> ...***MERC's existing customers will not be subsidizing this project because the New Area Surcharge is calculated to ensure the project is load and cost justified over the project life. [Emphasis added]***

The Department argued that the Commission's Order in the 11-1045 docket set precedent as to who should pay for uneconomic expansion projects.[31] [32] The Department further reviewed the CIAC definitions in Minn. Stat. §216B.1638 and the NAS Rider.[33]

In order to assess the reasonableness of MERC's NAS calculation, and how the NAS tariff and NGEP Rider interact, the Department requested MERC to calculate different NAS recovery alternatives using the same proposal assumptions.

- Study 1 – a 25-year NAS factor option without a NGEP Rider recovery.
- Study 2 – a 30-year NAS factor option with MERC's proposed NGEP Rider recovery.
- Study 3 – a 30-year NAS factor option without a NGEP Rider recovery.

Results are as follows:

Table 3: Alternative Balaton NAS Factors Recovery Options

Customer Class	MERC as filed Original–25yr. NAS/NGEP Rider	Study 1- 25-yr NAS /No NGEP Rider	Study 2- 30-yr. NAS with NGEP Rider	Study 3- 30-yr. NAS with no NGEP Rider
Residential	$24.14	$34.15	$21.58	$30.61
Small C&I	$45.75	$64.70	$40.90	$57.99
Large C&I	$114.34	$161.76	$102.24	$144.98
SVI	$419.34	$593.11	$374.88	$531.60
LVI	$470.17	$665.00	$420.32	$596.04

[30] Docket No. 11-1045.
[31] In the Long Lakes project, the project costs were recover only from the customers taking the service, through a NAS factor. In the Balaton and Esko projects MERC proposed to recover costs through its NAS tariff and NGEP Rider cost recovery mechanisms.
[32] The Department believed that MERC's statements in its Balaton and Esko projects were different Long Lakes Project statements.
[33] See Department's *Comments*, pp. 8-11.

Table 4: Alternative Esko NAS Factors Recovery Options

Customer Class	MERC as filed Original–25yr. NAS/NGEP Rider	Study 1- 25-yr NAS /No NGEP Rider	Study 2- 30-yr. NAS with NGEP Rider	Study 3- 30-yr. NAS with no NGEP Rider
Residential	$24.18	$32.38	$21.79	$29.21
Small C&I	$45.81	$61.35	$41.28	$55.35
Large C&I	$114.53	$153.38	$103.19	$138.38
SVI	$419.95	$562.39	$378.38	$507.39
LVI	$470.85	$630.56	$424.24	$568.90

The Department concluded that if the NGEP Rider was removed from MERC's proposal, the Balaton Residential NAS factor increased by $10 per month or 40 percent (Table 3 difference between MERC as filed and Study 1). The Esko Residential NAS factor increased by $8 per month or 33 percent (Table 4 difference between MERC as filed and Study 1).

If the Balaton NAS factor was re-calculated to a 30-year term and no NGEP Rider (Table 3, Study 3 and Table 5 below), the increase over MERC's NAS proposal was approximately $6.50 per month or 27 percent. The increase over Esko MERC's proposal was approximately $5.00 per month or 21 percent (Table 4, Study 3 and Table 6 below).

Table 5: Comparison of MERC's 25-year NAS Factors with NGEP Rider to the Department's 30-year NAS Factors, with no NGEP Rider for the Balaton project.

Balaton Project Customer Class	MERC's 25-year Proposed NAS factors	The Department's 30-year Recommended NAS factors-Study 3	Difference	Percent Change
Residential	$24.14	$30.61	$6.47	26.80%
Small C&I	$45.75	$57.99	$12.24	26.75%
Large C&I	$114.37	$144.98	$30.61	26.76%
SVI	$419.34	$531.60	$112.26	26.77%
LVI	$470.17	$596.04	$125.97	26.79%

Table 6: Comparison of MERC's 25-year NAS Factors with NGEP Rider to the Department's 30-year NAS Factors, with no NGEP Rider for the Esko project.

Esko Project Customer Class	MERC's 25-year Proposed NAS factors	The Department's 30-year Recommended NAS factors-Study 3	Difference	Percent Change
Residential	$24.18	$29.21	$5.03	20.80%
Small C&I	$45.81	$55.35	$9.54	20.83%
Large C&I	$114.53	$138.38	$23.85	20.82%
SVI	$419.95	$507.39	$87.44	20.82%
LVI	$470.85	$568.90	$98.05	20.82%

The Department further concluded that MERC's NAS factors were not supported by the docket's record and that MERC did not use available data to develop its NAS factors.[34] This docket's record did not reflect any evidence that NAS factors outside of MERC's range would be unsuccessful.[35] The Department believes that MERC's use of NGEP Riders would cause a partial upfront recovery reducing MERC's risks of under collecting its investment and provide a quicker return of its investment than the NAS tariff.[36]

Based on its analysis, the Department concluded that using a combination of the NAS and NGEP Rider cost recovery mechanisms for a single project would be inappropriate. The Department recommended that the Commission deny cost recovery through MERC's proposed 25-year monthly NAS factors[37] and its one-year NGEP Rider factors.[38] Instead, the Department recommended its 30-year monthly NAS factors, developed to recover the full Balaton and Esko costs without recovery through the proposed NGEP Rider factors (Table 3, Study 3 and Table 4, Study 3).

In its **October 13, 2016** ***Reply Comments***, MERC disagreed with the Department's cost recovery conclusions. MERC believes that its Balaton and Esko projects qualify for NGEP rider recovery and that Commission precedent does not exist to exclude MERC from using the NAS factors and NGEP Rider in its initial petitions.

MERC disagreed with the Department assertion that the NGEP Rider conflicts with current NAS tariff provisions. MERC believed that its NAS tariff or the NGEP Rider Statute language did not prohibit it from using its proposed combination of recovery mechanisms in the same project.[39]

MERC further supported its proposed NAS factor by referring to the Legislative Energy Commission ("LEC") report, which evaluated state energy policy, investigated options to help users of propane convert to natural gas or other heating sources. The LEC report suggested policies to promote the extension of natural gas service to communities that were uneconomical, even with a NAS rider.[40] The report noted that the upper limit of a NAS surcharge was typically about $25 per month.[41] To bridge the gap between the NAS revenues and total project's revenue

[34] See the Department's *Comments*, pp. 8-11.
[35] The Department believed other factors would influence customer's NAS decision making process, such as, cost of alternative fuels, cost to convert to natural gas, and the cost of natural gas.
[36] MERC's NAS tariff requires it and its shareholders to accept the monetary risk of not signing up a sufficient number of customers during the NAS term (i.e., if MERC does not have sufficient customer sign-ups, MERC will not recover the full revenue requirements of the project).
[37] See Table 2 for all customer classes.
[38] See MERC's *Initial Petition,* pp. 4-9 for NGEP Rider factor calculation, marked as *Trade Secret.*
[39] MERC believed that the NGEP Rider and the NAS were two tools intended for the same purpose, to help achieve the goal of extending natural gas service to those areas that are not currently served.
[40] See Legislative Energy Commission, Propane Conversion Strategies at 13 (Jan. 15, 2015) available at https://www.leg.state.mn.us/docs/2015/mandated/150040.pdf
[41] Given this limitation, the $25 per month charge necessarily limits the amount of revenue that can be collected from new area customers.

deficiency, the LEC report suggested that the Legislature "direct the Public Utilities Commission to allow utilities to spread some or all of the costs of expansion among existing customers."[42] [43]

The Senate Committee on Environment and Energy hearing on the NGEP bill, was where the co-author of the bill explained the rationale behind the bill:

> *[T]he current process analyzes if there is a revenue deficiency or not and then allows the option of having a New Area Surcharge added on to help cover the deficiency. If that is not enough to cover the deficiency, the project does not go forward. So what we're proposing . . . is to, in order to cover that deficiency, to allow the current, existing member base to pay part of the cost of the expansion . . . up to 33 percent of the project cost, to help cover the deficiency in order to move natural gas usage forward in Minnesota.*[44]

MERC requested that the Commission approve its proposed combination of cost recovery mechanisms to recover its Balaton and Esko costs.

In his **October 25, 2016 *Letter Supporting MERC Expansion Projects***, Minnesota Representative Pat Garofalo stated his support for the Balaton project (Docket No. 16-654), Esko project (Docket No. 16-655), Rochester project (Docket No. 15-895). Representative Garofalo stated the following with respect to MERC's use of the NGEP Rider Statute in the cost recovery of these projects:

> *…..The NGEP rider bill was intended to give utilities an additional tool to use, in combination with the New Area Surcharge mechanism, to make system extensions and expansions affordable where they previously would not have been. In passing the NGEP legislation, the Legislature discussed the need for an additional tool to supplement the New Area Surcharge mechanism in order to make extensions to more new areas possible.*

In its **November 16, 2016 *Response to MERC's Reply Comments***, the Department continued to recommend that the Commission deny MERC's proposed recovery of Balaton and Esko Project costs through a combination of both the NGEP Rider and 25-year NAS factors. Instead, the Department recommended to the Commission that 30-year NAS factors be approved to recover the entire Balaton and Esko project costs without using the NGEP Rider.

In its **November 23, 2016 *Supplemental Reply Comments***, MERC continued to argue its position, to recover its Balaton and Esko project costs through its proposed recovery mechanisms. MERC believed the docket's record supported the Balaton and Esko Projects, and that its proposed cost recovery was reasonable and consistent with the public interest.

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[42] Propane Conversion Strategies at 15. (To do this, utilities could be allowed to build an expansion fund in advance through a rider on customers' bills, and use the fund to subsidize the costs of expansion projects as they are proposed.").

[43] See MERC's *Reply Comments*, pp. 4-5 and the above MERC discussion.

[44] March 17, 2015 Hearing of the Senate Committee on Environment and Energy (Statement of Sen. Skoe) available at https://www.leg.state.mn.us/senatemedia/saudio/2015/cmte_envenergy_031715a.MP3 (7:40-8:24).

MERC responded to the Department's use of Study 1 through Study 3 in its *Comments* (see Tables 3 and 4), where the NAS factor recovery period increased from 25 years to 30 years and further with and without the NGEP Rider recovery. MERC believes that these studies reflect incorrect assumptions.

MERC believed that the Department's alternative 30-year NAS proposals did not take into account the potential customer reaction to the price increase caused by a lengthened recovery term (25-years to 30-years). MERC claimed that it would not expect the same customer participation rate with lengthening the recovery period.

MERC believes that the customer participation would adjust downward with a 30-year NAS, which would result in even higher surcharges across all customer classes. MERC estimated its customer projection would decrease by approximately 27 percent if its 25-year NAS charge/NGEP Rider proposal were changed to a 30-year NAS without a NGEP Rider, see Table 5. MERC estimated the following NAS factors adjusted for customer participation:

Table 7: Balaton NAS Factor Comparison with MERC's Adjusted Customer Projections[45]

Customer Class	MERC Proposed 25-year NAS with NGEP Rider-as filed	Adjusted DOC Recommendation at 30-year NAS no NGEP Rider with reduction	Difference
Residential	$24.14	$47.11	$22.97
Small C&I	$45.75	$89.25	$43.50
Large C&I	$114.75	$223.13	$108.38
SVI	$419.34	$818.16	$398.82
LVI	$470.17	$917.33	$447.16

Table 8: Esko NAS Factor Comparison with MERC's Adjusted Customer Projections[46]

Customer Class	MERC Proposed 25-year NAS with NGEP Rider-as filed	Adjusted DOC Recommendation at 30-year NAS no NGEP Rider with reduction	Difference
Residential	$24.18	$38.91	$14.73
Small C&I	$45.81	$73.72	$27.91
Large C&I	$114.53	$184.30	$69.77
SVI	$419.95	$675.78	$255.83
LVI	$470.85	$757.69	$286.84

MERC further argued that the Department's cost studies do not reflect the correct assumptions for Balaton and Esko customers who do not use propane. MERC believed that conversion costs

[45] See MERC's November 23, 2016 *Supplemental Reply Comments*, Attachment A, marked as *Trade Secret*.
[46] See MERC's November 23, 2016 *Supplemental Reply Comments*, Attachment A, marked as *Trade Secret*.

will deter some potential customers from converting to natural gas. MERC provided the fuel sources, see the following table:

Table 9: Fuel Sources Used by Balaton customers

Fuel Source	Customer Percentage
Bottle, Tank, or LP Gas (Propane)	55%
Electricity	23%
Fuel Oil, Kerosene	20%
Other	1%

Table 10: Fuel Sources Used by Esko customers

Fuel Source	Customer Percentage
Bottle, Tank, or LP Gas (Propane)	28%
Electricity	15%
Fuel Oil, Kerosene	47%
Other	10%

Approximately 45 percent of the Balaton residents and 72 percent of the Esko residents currently use fuel sources other than propane and their conversion costs will be higher than propane users. MERC believed that this will create an additional constraint to customers converting to natural gas.

In its **December 22, 2016 *Additional Response Comments* to the MERC's *Supplemental Reply Comments***, the Department stated that it continues to believe that MERC did not fully justify its proposed use of a 25-year NAS factor and its proposed NGEP Rider factor. In its *Initial Petition* and its *Reply Comments*, MERC made statements that it used customer outreach and/or survey data to support its NAS factors, MERC has not provided that information in these docket's record. In addition, the Department believed MERC has not provided support for its reduced customer count when it calculated its revised 30-year NAS factors.

As noted in its *Comments*, the Department believes that NAS projects require MERC and its shareholders to accept the monetary risk of insufficient customer participation. Allowing the use of the NGEP Rider in addition to an NAS factor decreases MERC's risk by shifting costs to existing customers. The Department believes that a cost-based NAS factor for an uneconomic project should be collected from the subscribing Balaton and Esko customers. Because of this docket's lack of support, the Department continued to support its recommended 30-year monthly NAS factors without a NGEP Rider.

Further, that the Commission has discretion in determining the costs recovery method(s) associated with extending MERC's service to un-served areas. The Department recommended the Commission carefully consider at what point to go beyond the use of an NAS factor and require all utility customers to pay for the costs of extending service to an area that is uneconomic to serve.

Department Recommendations

The Department recommended that the Commission deny MERC's Petition to recover Balaton and Esko Project costs through both the NGEP Rider and a NAS (MERC proposed a 25-year recovery term. The Department recommended that a 30-year NAS be approved for the Balaton and Esko Projects with no recovery through a NGEP Rider. Specifically, the Department recommends that the Commission:

1) Establish a New Area Surcharge for Balaton and Esko customers as follows:

Table 11: Department's Recommended NAS Factors over a 30-year term.

Customer Class	Balaton NAS Factors	Esko NAS Factors
Residential	$30.61	$29.21
Small Commercial and Industrial	$57.99	$55.35
Large Commercial and Industrial	$144.98	$138.38
Small Volume Interruptible	$531.60	$507.39
Large Volume Interruptible	$596.04	$568.90

2) Allow the NAS to be in effect until the projected revenue deficiency is satisfied, but for no longer than 30 years.

3) Require MERC to submit, as a compliance filing within 10 days of the date of the Order in the present dockets, the relevant tariff sheets that comply with the Commission's determination in this matter.

4) Require MERC to report on all New Area Surcharge rider projects in one document on March 1 of each year and file them in each of the following dockets:

   - Docket No. G-011/M-16-655 (Esko);
   - Docket No. G-011/M-16-654 (Balaton);
   - Docket No. G-011/M-16-221 (Fayal Township-Long Lake);
   - Docket No. G-011/M-14-524 as revised in Docket No. 15-776 (Ely Lake); and
   - Docket No. G-011/M-15-441 (Detroit Lake-Long Lake).

Staff Analysis

Cost Recovery

The Balaton and Esko projects are extensions to MERC's existing natural gas distribution system, but these areas are currently un-served.[47] Staff reviewed the Commission's policy on service line and main extensions. Previous Commission decisions and MERC's existing tariff state that a service line and main extension must be economical at tariffed rates; existing customers must not unduly subsidize the new service line extension customer(s).[48]

[47] MERC provides natural gas services to over 200,000 MN customers.
[48] The revenues collected offset the costs of the project, no revenue deficiency exists.

This docket's record demonstrates that both projects are uneconomical at MERC's existing tariff rates. The Commission previously determined that new uneconomical expansion project subscribing customers were responsible for the project costs to these previously un-served areas (Commission precedent). For these projects, a utility could request Commission approval for a New Area Surcharge (NAS) tariff.

In Docket No. 11-1045, the Commission exercised its general rate making authority and approved MERC's proposed NAS tariff.[49] MERC's NAS was designed as a financial tool that MERC could use to extend service into uneconomical un-served areas.[50] To date, the Commission has approved three MERC NAS projects.[51] By permitting a utility to collect a NAS factor in addition to the utility's tariffed rates, the project becomes economical.

In 2015, the Minnesota Legislature passed into law, Minn. Stat. § 216B.1638 (the NGEP Rider Statute) – a public utility may petition the Commission outside of a general rate case for a NGEP Rider that will recover a portion of the uneconomical natural gas expansion project costs from all system customers. However, the Commission must not approve a rider under this section that allows a utility to recover more than 33 percent of the costs (its revenue deficiency) for the natural gas extension project.

MERC's *Initial Petitions* requested a miscellaneous rate change to provide natural gas service to the Balaton and Esko, un-served areas.[52] The project costs included distribution system expansion costs (designing and constructing the Balaton and Esko area systems) and costs associated with installing NNG facilities for both Balaton and Esko areas (CIAC to NNG). MERC proposed Balaton and Esko cost recovery through a combination of its 25-year NAS factors and the NGEP Rider Statute.

MERC's proposal reflected: 1) NGEP Rider recovery of less than 33 percent of the project costs (recovered over a one-year period); 2) a NAS factor financing the remainder of project costs for a period of twenty-five years; 3) NNG costs recovery through its combined used of the NAS factor and NGEP factor; 4) including carrying costs at MERC's currently authorized short-term cost of debt; 5) a true-up mechanism for its NGEP Rider factor, in case MERC over or under-collects its actual NGEP Rider investment.

MERC believes that the NGEP Rider Statute reflects policy change from the Commission's previous position that uneconomic projects must be self-supporting.[53]

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[49] See the Commission's July 26, 2012 Order, Docket No. 11-1045.
[50] MERC's NAS model is calculated in a similar fashion as a loan. In this case the CIAC is the principal, the interest rate is the rate specified in the tariff and the term is the length of the surcharge in years. Like a loan, the longer the term of a loan, the lower the monthly payment will be. For example, a 30-year loan (Department proposal) has a lower monthly payment than a 25-year loan (MERC's proposal). So in terms of the monthly payment, extending the term makes the project more affordable. However, with a 25 year loan the total amount of interest paid will be less because of the shorter term.
[51] Docket Nos. 14-524 (later revised in 15-776), 15-441, and 16-221.
[52] See MERC's *Initial Petition*, Exhibit B for the service area map.
[53] The legislature's priority was to develop and expand natural gas access in Minnesota.

MERC states that the Balaton and Esko distribution system and NNG upgrade construction costs, and its NGEP Rider calculations implemented in these projects are trade secret.

MERC supported its cost recovery proposal by its use of customer surveys, prior NAS experience, the Balaton and Esko economy, and legislative history from when the NGEP Rider Statute was developed.

MERC stated that the original intent of NAS mechanism was to provide a financing tool to allow for the extension of natural gas service to new areas without involving other system customers. The NGEP Rider was developed and enacted into law for the purpose of making uneconomic projects more affordable for potential customers even if NAS factors are being used, another tool in MERC's toolbox for financing uneconomic projects.

The Department disagreed with MERC's *Initial Petition's* cost recovery proposal. The Department supported its position with primarily Docket No. 11-1045 and prior MERC docket statements. In its July 26, 2012 Order, the Commission stated:

> *"A New Area Surcharge (NAS) is designed….. **without imposing the costs of expansion on existing ratepayers**. [**Emphasis Added**][54]"*

Further, in MERC's Docket G011/M-16-221 petition – the Fayal Township-Long Lake NAS Project, MERC stated its project was in the public interest because:

> *.....**MERC's existing customers will not be subsidizing this project because the New Area Surcharge is calculated to ensure the project is load and cost justified over the project life. [Emphasis added]**[55]*

The Department expressed concerns with MERC's proposed cost recovery mechanisms. Specifically, the cost recovery of the NNG's pipeline system upgrades (addressed above), and cost recovery through a combination of both MERC's NAS tariff and the NGEP Rider Statute for a single project.

The Department argued that the Commission's Order in the 11-1045 docket and MERC's statement in the 16-221 docket set precedent as to who should pay for uneconomical expansion projects. The Department believes that for uneconomical expansion projects the subscribing NAS customers should pay the entire project costs. The Department also believes that MERC's statements used in the Balaton and Esko projects were different from its Long Lakes Project statements.[56]

The Department states that it appears there is a conflict between Commission precedent and Minnesota law. The Department noted that previous NAS expansion projects were designed to

[54] See the above Department *Comments* for the entire Order quote.
[55] See the above Department *Comments* for the entire quote.
[56] In the Long Lakes project, the project costs were recovered only from the customers taking the service, through a NAS factor. In the Balaton and Esko projects, MERC proposed to recover costs through its NAS tariff and NGEP Rider cost recovery mechanisms.

recover all project costs compared to the Legislature 2015 policy, that allows existing customers to share in the cost recovery. The Department recommended that the Commission deny MERC's proposed recovery, but instead approve its revised 30-year NAS factors (see Table 11) with no NGEP Rider recovery.

MERC disagreed with the Department's understanding of MERC's NAS tariff and Minn. Stat. § 216B.1638 (NGEP Rider Statute), and believes that the language does not preclude MERC from using both recovery mechanisms for a single project. MERC believes the policy and goals of its NAS tariff and NGEP Rider Statute are not in conflict; rather, they are the same – to encourage the natural gas expansion service to inadequately served and un-served areas. MERC stated that higher NAS factors would price both projects out-of-the-market.

Staff agrees with the Department's statements that Commission NAS precedent was established for MERC in its 11-1045 docket – where the NAS factors were set to recover costs from subscribing customers, the project costs not recovered through tariffed rates. Also, that the Department correctly noted that MERC's Balaton and Esko NAS project statements were inconsistent with prior MERC NAS dockets.[57]

However, Commission precedent was determined before 2015, when the MN Legislature enacted Minn. Stat. §216B.1638 (NGEP Rider Statute) into law. The NGEP Rider Statute appears to give a utility company an additional financing tool for uneconomical expansion projects. The NGEP Rider Statute requires that 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.

Staff believes that the docket's records demonstrates that both the Balaton and Esko projects will extend natural gas service to an un-served area. The Department concluded likewise. Further, MERC stated that its Balaton and Esko project costs were reasonable and prudent. The Department, however, did not address the project's reasonableness or prudency.

To assess the reasonableness of the project, staff compared MERC's proposed 25-year NAS factors to other MN NAS projects, see Table 12:

Table 12: Summary of Approved Residential NAS Factors

MERC Docket No.	Approved Residential NAS factor
15-441 – Detroit Lake – Long Lake Project	$19.16 per month
15-776 – Revised Ely Lake Project	$25.45 per month
16-221 – Fayal Township – Long Lake	$21.16 per month
Average	$21.92 per month

[57] MERC's last NAS petition, 16-221, was filed on March 31, 2016 and did not request Commission approval under the NGEP Rider Statute. A utility must request NGEP Rider Statute.

Xcel Docket No.	Approved Residential NAS factor
14-583 – Barnesville	$23.99 per month
14-583 – Holdingford	$14.45 per month
14-583 – Pillager	$13.50 per month
Average	$17.31 per month

Staff realizes that each project has different assumptions in determining the NAS factor, but believes the comparison provides a ball-park (reasonable) comparison to other MN NAS factors. Table 12 illustrates that both the Balaton and Esko NAS factors, as proposed by MERC, are within the range of the other NAS factors (between $13.50 and $25.45 per month).[58] Staff notes that MERC's proposed Balaton and Esko NAS factors exclude the proposed costs recovered through the NGEP Riders. Staff believes that the Balaton and Esko projected costs appear to be reasonable and prudent.[59]

In regard to MERC and Department comments on extending the NAS factors collection from 25-years to 30-years, staff believes that there are numerous factors that will influence customer decisions to convert from their current fuel source to natural gas. As reflected in Tables 1 and 2, customers could have saved money by converting to natural gas, but these savings do not take into consideration the conversion costs to natural gas.

For customers not using propane (Table 9 and 10), the conversion costs would be more than propane conversion costs - 45 percent of the potential Balaton customers, and 72 percent of the Esko customers use other fuel sources than propane. Therefore, staff believes that it may be difficult to get these customers to convert to natural gas if the NAS factor is set too high. MERC indicated that its projects are in-the-market if the NAS factors are less than $25, but MERC did not provide documentation to illustrate this. MERC stated that the LEC report made statements that a monthly NAS factor of $25 was the upper limit.

From these dockets record, staff cannot determine if the $25 upper limit is reasonable or if the Department's 30-year all-inclusive NAS factors are in-the-market for these projects. MERC stated its 25-year NAS factors kept the projects in-the-market (but does not recover all of the project costs) and that the Department's recommended 30-year NAS factors would price the projects out-of-the-market.

MN Representative Garofalo's Letter stated the intent of the Legislature was to:

…..projects like the Esko and Balaton Projects, which extend natural gas service to previously unserved areas, the Statute also supports partial recovery of costs through an NGEP rider in combination with a New Area Surcharge.

Staff reviewed Minn. Stat. § 216B.1638 and MERC's NAS tariff and did not find any language that would preclude it from seeking Commission approval to use a combination of these cost

[58] Staff notes that MERC's proposed Balaton and Esko NAS factors are at the upper limit of the NAS range.
[59] Staff notes that the Balaton and Esko projects are independent of each other, that the projects are located in different areas of Minnesota.

recovery mechanisms. Staff believes that the Commission may wish to consider the use the NGEP Rider Statute in addition to MERC's NAS tariff for uneconomical projects. Staff believes that the Commission will need to determine if it wishes to modify its NAS policy and enable utilities to recover costs through both mechanisms. Further, staff believes that the Commission may wish to exercise caution in making its decision.

Staff further notes that if the Commission approves MERC's proposal, that permits it to use a combination of MERC's NAS tariff and the NGEP Rider Statute, MERC will recover a portion of its project costs at a faster pace than if the costs were recovered through MERC's NAS tariff. Under MERC's NAS tariff, MERC and its shareholders are at risk if a NAS factors do not collected the full investment costs through the NAS term. MERC's NGEP Rider Statute recovery proposal lessens its under-collection risk of the project's cost.

For costs recovered through the NGEP Rider Statute, MERC proposed a *true-up* mechanism for project costs by comparing the Actual Rider Costs to the costs collected through the one-year NGEP Rider. If the Actual Rider Costs exceed the NGEP rider collection, MERC would propose an additional NGEP Rider factor to collect the amount. If the Actual Rider Costs are less than what was recovered through NGEP Rider, MERC proposed a customer credit.

Staff is un-sure whether the proposed NGEP Rider true-up is necessary under the NGEP Rider Statute or if it is consistent with the NAS tariff, where MERC and its shareholders are responsible for any under-collected investment. At the end of the NAS period or if the full NAS investment is collected ahead of schedule, the NAS factor collection stops. If the NAS project has cost overruns the subscribing NAS customers do not have a financial obligation rather MERC and its shareholders suffer the consequences because the approved NAS factors stops after the established term.

If MERC under-estimates its costs in setting the NAS factor or if the NAS factors are set too high, MERC is required to stop collecting the NAS factor once the design costs are recovered or at the end of NAS term. This provides MERC with a financial incentive to accurately calculate its project costs and NAS factors when requesting NAS approval.

Staff believes that the Commission may wish to consider these protections if the NGEP Rider is approved and the Commission decides to address MERC's true-up proposal for cost recovery. MERC stated that if the Commission adopts the Department's recommendations, it would not continue with the Balaton and Esko petitions and would withdraw the petitions.

Disclosure of NAS factors and the NGEP Rider factors to Customers

In Docket No. 14-524, the Commission required MERC to disclose, at a minimum, to its Ely Lake project customers the monthly NAS factor, the annual cost of the NAS, and a statement that the NAS is expected to be charged for the Commission chosen recovery term and the related NAS amount charged for that period. PUC staff believes that the Commission should continue to require MERC to fully disclose this information to its Balaton and Esko customers, which would help make the NAS customers more knowledgeable and possibly forestall future complaints. The customer disclosure would include, at a minimum, the following information:

- The monthly surcharge rate and that the rate is in addition to the regular bill for gas service. MERC shall provide a pro forma gas bill for the month of January based on average customer use for that month in that area of Minnesota and also include the surcharge as a separate line item;

- The annual cost of the surcharge; and

- A statement that the surcharge is expected to be charged over the time period chosen by the Commission and what the total cost of the surcharge would be for that period.

Compliance Filings

The Commission has required annual compliance filings for MERC's other NAS projects. If the Balaton and Esko projects are approved and NAS factors are approved for both projects, staff believes MERC should file annual reports on these two projects at the same time MERC files annual reports on its other NAS projects.

In addition, if the Commission approves MERC's request for a NGEP Rider, staff recommends the Commission require MERC to submit annual reports at the same time as the NAS project annual reports so that that the Commission will be able to prepare evaluations and reports for the Legislature that are required by the NGEP statute.[60] Staff recommends MERC include the following information in its reports:

1. the number of NGEP projects proposed and approved;
2. MERC's total cost for each project and the amount of cost recovered through base rates, an NAS surcharge, if applicable, and the NGEP Rider cost recovery mechanism;
3. rate impact in total and by customer class of the NGEP Rider; and
4. MERC's assessment of the effectiveness of the cost recovery mechanism (NGEP Rider) in realizing increased natural gas service to unserved or inadequately served areas from natural gas extension projects.

If any of the cost or other information in MERC's annual reports is claimed to be trade secret, non-public information that the Commission is required to provide in reports to the Legislature pursuant to Minn. Stat. 216B.1638, subd. 6, MERC should explain the reason for keeping the information trade secret in sufficient detail so that the Commission is able to comply with the Legislature's request for an evaluation and report on MERC's extension projects.

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[60] Minn. Stat. 216B.1638, Subd. 6. Recovery of Natural Gas Extension Project Costs. 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.

Decision Alternatives

Public Interest

1. Determine that the Balaton and Esko natural gas extension projects will serve an inadequately served or un-served area in Minnesota.
2. Determine that the Balaton and Esko natural gas extension projects will not serve an inadequately served or un-served area in Minnesota.
3. Determine that MERC's Balaton and Esko estimated project costs are reasonable and will be prudently incurred.
4. Determine that MERC's Balaton and Esko estimated project costs are not reasonable and will not be prudently incurred.

Cost Recovery - Balaton

5. Approve MERC's proposed Balaton cost recovery through its 25-year NAS factors and its NGEP Rider factor (trade secret), see Table 13.

Table 13: MERC Proposed Balaton 25-year NAS Factors

Customer Class	Balaton NAS Factors
Residential	$24.14
Small Commercial and Industrial	$45.75
Large Commercial and Industrial	$114.37
Small Volume Interruptible	$419.34
Large Volume Interruptible	$470.17

6. Deny MERC's cost recovery proposal, instead adopt the Department's 30-year NAS factors - cost recovery for all project costs, with no NGEP Rider recovery, see Table 14.

Table 14: Department's Balaton 30-year NAS Factors

Customer Class	Balaton NAS Factors
Residential	$30.61
Small Commercial and Industrial	$57.99
Large Commercial and Industrial	$144.98
Small Volume Interruptible	$531.60
Large Volume Interruptible	$596.04

7. Approve some other cost recovery methodology.

Cost Recovery - Esko

8. Approve MERC's proposed Esko cost recovery through its 25-year NAS factors and its NGEP Rider factor (trade secret), see Table 15.

Table 15: MERC Proposed Esko 25-year NAS Factors

Customer Class	Esko NAS Factors
Residential	$24.18
Small Commercial and Industrial	$45.81
Large Commercial and Industrial	$114.53
Small Volume Interruptible	$419.95
Large Volume Interruptible	$470.85

9. Deny MERC's cost recovery proposal, instead adopt the Department's 30-year NAS factors - cost recovery for all project costs, with no NGEP Rider recovery, see Table 16.

Table 16: Department's Esko 30-year NAS Factors

Customer Class	Esko NAS Factors
Residential	$29.21
Small Commercial and Industrial	$55.35
Large Commercial and Industrial	$138.38
Small Volume Interruptible	$507.39
Large Volume Interruptible	$568.90

10. Approve some other cost recovery methodology.

True-up Mechanism for the NGEP Rider

11. If MERC's proposed NGEP Rider is approved, approve MERC's requested true-up mechanism, as proposed by MERC.

12. If the proposed NGEP Rider is approved, do not approve MERC's requested true-up mechanism as proposed by MERC. Instead, direct MERC to stop collecting the NGEP Rider factor if its investment is recovered before the expiration of the one-year recovery period. Further, require MERC to stop collecting its NGEP Rider factor at the end of its one-year recovery term.

Carrying Costs

13. Approve MERC's carrying cost proposal to use its currently authorized short-term debt percentage through the one-year NGEP Rider period.

14. Do not approve MERC carrying cost proposal to use its currently authorized short-term debt percentage through the one-year NGEP Rider period.

Disclosure to Customers

15. Require MERC to disclose to potential customers the following at a minimum:

    - The monthly surcharge rate and that the rate is in addition to the regular bill for gas service. Provide a pro forma gas bill for the month of January based on average customer use for that month in that area of Minnesota and also include the surcharge as a separate line item.
    - The annual cost of the surcharge.
    - A statement that the surcharge is expected to be charged for the Commission chosen recovery term and what the total cost of the surcharge would be for that time period.

or

16. Do not require the Company to provide the suggested information to potential customers.

MERC Compliance Filing

17. Require MERC to file a compliance filing within 30 days of the Commission issuing its Order in this docket that revises MERC's NAS tariff sheets for these two projects and NAS customer notice to correspond to the Commission's chosen NAS recovery term, and, if so ordered, tariff sheets reflecting MERC's NGEP Rider factor with the appropriate NGEP customer notice.

Annual Reporting Requirements

18. Require MERC to file annual New Area Surcharge compliance reports for the Balaton and Esko projects at the same time and in the same format as MERC files annual reports on its other NAS projects.

19. Require MERC to file annual Natural Gas Extension Project Cost Rider annual reports for the Balaton and Esko projects at the same as it files its annual NAS reports. The NGEP annual reports should include at least the following information:

    a. the number of NGEP projects proposed and approved;
    b. MERC's total cost for each project and the amount of cost recovered through base rates, an NAS surcharge if applicable, and the cost recovery mechanism (NGEP Rider);
    c. rate impact in total and by customer class of the NGEP Rider;
    d. MERC's assessment of the effectiveness of the cost recovery mechanism (NGEP Rider) in realizing increased natural gas service to unserved or inadequately served areas from natural gas extension projects; and
    e. For any information in these reports that is designated trade secret, non-public data, MERC should explain the reason for the secrecy in sufficient detail for the Commission to comply with the Legislature's request for an evaluation and report on MERC's extension projects, pursuant to Minn. Stat. 216B.1638, Subd. 6.