

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

Beverly Jones Heydinger	Chair
David C. Boyd	Commissioner
Nancy Lange	Commissioner
Dan Lipschultz	Commissioner
Betsy Wergin	Commissioner

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

Docket No. G-011/M-13-617

**ANSWER TO RECONSIDERATION OF
THE OFFICE OF THE ATTORNEY
GENERAL – RESIDENTIAL UTILITIES
AND ANTITRUST DIVISION**

The Office of the Attorney General – Residential Utilities and Antitrust Division (“OAG”) respectfully submits its Answer to Minnesota Energy Resources Corporation’s (“MERC” or the “Company”) Request for Reconsideration and Clarification filed on November 17, 2014. Specifically, the OAG will respond to MERC’s request for the Commission to reconsider Order Point 32(a) within the Commission’s Findings of Fact, Conclusions, and Order issued on October 28, 2014. The purpose of this Answer is to clarify the OAG’s concerns with MERC’s minimum system analysis and how Order Point 32 is related to these concerns.

Throughout this case, the OAG has voiced its concerns with the zero-intercept study that MERC used to classify the costs of its distribution system. It is important to ensure that the distribution system is classified correctly because the distribution system is MERC’s single largest investment; errors in classification can lead to significant changes in revenue apportionment. The OAG identified many problems with the ordinary least squares (“OLS”)

regression that MERC used in its zero-intercept study, but the OAG's primary contention was that MERC's entire methodology, or lack thereof, was flawed.

As a result of those concerns, the OAG made several recommendations that would help MERC improve its regression in the future.¹ Those recommendations were adopted by the Commission as Order Point 32, which provides:

32. MERC shall take the following actions in preparing future class cost of service studies:

- a. collect data on additional variables that impact the unit cost of mains installation;
- b. avoid aggregating or averaging data and use data at the finest level reasonable;
- c. check ordinary-least-squares regression assumptions and correct for violations; and
- d. make any future zero-intercept analysis more transparent to ensure that MERC's work can be easily replicated.²

MERC does not object to Order Points 32(b), (c), or (d), but asks that the Commission reconsider Order Point 32(a).³ Instead, MERC suggests that the Commission remove 32(a), and replace it with an order directing that, "In addition, in its next rate case MERC shall report on the potential availability, reliability, usefulness, and associated expense of collecting data on additional variables that may impact the unit cost of mains installations."⁴ MERC advances several reasons why it believes the Commission should reconsider Order Point 32(a), which can be summarized briefly. MERC does not want to collect additional data because it "does not

¹ Nelson Direct, at 34–35.

² Findings of Fact, Conclusions, and Order, *In the Matter of a Petition by Minnesota Energy Resources Corporation for Authority to Increase Natural Gas Rates in Minnesota*, G-011/GR-13-617 (Oct. 28, 2014).

³ MERC Request for Reconsideration and Clarification, at 6.

⁴ *Id.* at 13.

maintain historical data on additional variables,” and alleges that collecting data on additional variables would be difficult, expensive, and time-consuming.⁵

The Commission should deny MERC’s request for two reasons. First, the data collection required by Order Point 32(a) is necessary for MERC to perform an analysis that is reliable. This is particularly important given the significant weight MERC’s distribution system has on its CCOSS. Second, MERC’s request to replace the data collection requirement with an evaluation period serves no purpose other than to delay any opportunity to improve the reliability of MERC’s zero-intercept analysis.

I. THE DATA COLLECTION REQUIRED BY ORDER POINT 32(A) IS NECESSARY.

The OAG did not recommend that MERC collect more data for the sake of data-collection; rather, the OAG made the recommendation because more data is necessary to ensure that the zero-intercept study in MERC’s next case is reliable.⁶ The need for additional data flows directly from the OAG’s overall concern for MERC’s research methodology; MERC’s zero-intercept study is fundamentally flawed because it assumes that only one variable has an impact on the cost of installing gas mains. As a result of this “specification bias” or “omitted variable bias,”⁷ the OLS regression that MERC used for its zero-intercept study violates several econometric requirements that are necessary to ensure reliable results.

In order to correct this error for its next case, and conduct an OLS regression that satisfies the foundational requirements of econometrics, MERC will need to include additional variables in its model. And in order to incorporate those additional variables, MERC will need to collect data on the variables that are to be included. The Commission’s Order provides clarity in that it

⁵ MERC Request for Reconsideration and Clarification, at 6–9.

⁶ Nelson Direct, at 11–39.

⁷ Nelson Direct, at 12–15; Nelson Surrebuttal, at 6–12.

requires MERC to do the work necessary to include additional variables in its model. But MERC must collect additional data regardless of whether MERC has been specifically ordered to do so; at a basic level, MERC needs to include additional variables in order to do its analysis *right*, and additional data collection is a necessary step of that process. MERC will not be able to perform a successful, reliable OLS regression if it does not comply with Order Point 32(a), along with (b), (c), and (d).⁸

It is important to note that the OAG purposefully recommended that MERC have flexibility and freedom in choosing variables for its model.⁹ The OAG did not want to unintentionally require MERC to incur unreasonable costs in conducting its analysis. The flexibility of the Commission's existing order should allow MERC to determine what data it currently has, what data it can acquire at a reasonable cost, and how that data can be incorporated into its next zero-intercept model. For example, it has been less than two months since the Commission approved Order Point 32, and MERC has already identified a possible variable that the OAG did not suggest.¹⁰ As MERC continues to evaluate this matter, it is likely that MERC will discover additional variables that can improve the quality of its analysis.

MERC's request for reconsideration on Order Point 32(a) should be denied because the data collection is a necessary part of producing a reliable zero-intercept study. The recommendations in Order Point 32 are not unreasonable; rather, the requirements of Order Point 32, including 32(a), are the *minimum that is necessary in order to do a regression correctly*. It

⁸ It appears that MERC is confused on this issue. In MERC's filing for Reconsideration, it stated that "MERC's regression model is based on available, complete, and pertinent data that already includes all available variables that may impact the unit cost of the Company's distribution main installations." MERC Request for Reconsideration and Clarification, at 6–7. This statement concerns the OAG and indicates that MERC has not had an econometrician assess its zero-intercept model. The OAG conducted multiple statistical tests that demonstrate MERC's statement is not true, with a confidence level of over 99 percent. Nelson Direct, at 26–27, 29, 32.

⁹ Nelson Direct, at 13–15.

¹⁰ See MERC Request for Reconsideration and Clarification, at 8.

will likely take MERC some time and effort to incorporate additional variables into its OLS regression, but these are *necessary* steps towards ensuring that MERC's rates, which are based in part on the results of this zero-intercept study, are just and reasonable.

II. MERC'S PROPOSAL WOULD DELAY NECESSARY IMPROVEMENTS TO THE ZERO-INTERCEPT STUDY.

The Commission should also reject MERC's recommendation to replace Order Point 32(a) with a requirement to report on the "availability, reliability, and associated expense" of including additional variables in its study. Essentially, MERC's alternate proposal is based on the assumption that MERC will not be able to find and make use of enough data to improve its zero-intercept study for the next case. While some work may be required to improve MERC's model for the next rate case, that should not excuse MERC from making the effort to try. Ordering MERC to only *evaluate* data collection, rather than actually *doing* data collection and attempting to improve its model, would essentially be a "free pass" excusing MERC from making any attempt to improve its zero-intercept model for its next rate case.

Furthermore, if MERC's zero-intercept methodology is unreasonable, as the OAG's analysis suggests, then continuing to use the methodology to set rates will result in rates that are not based on reliable fact. Because MERC's unreasonable methodology could lead to unreasonable rates, it should be changed as quickly as possible. MERC's suggestion to study, rather than try to implement, improvements to its model would delay any further resolution of this issue into the rate case *after* the next rate case. In the interim, ratepayers will be charged rates based in part on a zero-intercept study that the OAG's analysis demonstrates is unreliable.

III. CONCLUSION

The Commission should deny MERC's request for reconsideration because Order Point 32(a) is a reasonable step towards fixing the problem that the OAG identified with MERC's zero-intercept study.

Dated: December 1, 2014

Respectfully submitted,

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December 1, 2014

The Honorable Eric L. Lipman
Administrative Law Judge
Office of Administrative Hearings
600 North Robert Street
P.O. Box 64620
St. Paul, MN 55164-0620

RE: *In the Matter of a Petition by Minnesota Energy Resources Corporation for Authority to Increase Natural Gas Rates in Minnesota*
MPUC DOCKET NO. G-011/GR-13-617
OAH Docket No. 8-2500-31126

Dear Judge Lipman:

Enclosed and e-filed in the above-referenced matter please find the Answer to Reconsideration of the Office of the Minnesota Attorney General – Residential Utilities and Antitrust Division.

By copy of this letter all parties have been served. An Affidavit of Service is also enclosed.

Sincerely,

s/ Ryan P. Barlow

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