MINNESOTA DEPARTMENT OF COMMERCE

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April 15, 2015 **PUBLIC DOCUMENT**

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101

RE: **PUBLIC** Comments of the Minnesota Department of Commerce, Division of Energy Resources
Docket No. G011/M-15-165

Dear Mr. Wolf:

Attached are the **PUBLIC** comments of the Minnesota Department of Commerce, Division of Energy Resources (DOC) in the following matter:

Minnesota Energy Resources Corporation (MERC) to Modify MERC's Main and Service Extension Model and Amend MERC's Extension Tariffs

The petition was filed on February 13, 2015 by:

Dave Kult
General Manager
Minnesota Energy Resources Corporation
1995 Rahncliff Court, Suite 200
Eagan, MN 55122

The DOC recommends **approval** of MERC's request for approval to modify MERC's main and service extension model and to amend MERC's extension tariff and is available to answer any questions the Minnesota Public Utilities Commission may have.

Sincerely,

/s/ NANCY A. CAMPBELL
Financial Analyst

/s/ MARK A. JOHNSON
Financial Analyst

NAC/MAJ/lt
Attachment

MINNESOTA DEPARTMENT OF COMMERCE

PUBLIC DOCUMENT

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

PUBLIC COMMENTS OF THE MINNESOTA DEPARTMENT OF COMMERCE DIVISION OF ENERGY RESOURCES

DOCKET NO. G011/M-15-165

I. SUMMARY

On February 13, 2015, Minnesota Energy Resources Corporation (MERC or the Company) filed a petition requesting approval to (1) revise and update the Customer Extension Model MERC uses to determine whether customer contributions in aid of construction (CIAC) are required to support a natural gas extension project to provide a more equitable distribution of costs and benefits between new customers, existing customers, and shareholders and to make the model consistent with MERC's approved New Area Surcharge (NAS) model; and (2) amend MERC's tariffs to remove the step-by-step input and assumption details used by MERC in conducting its analysis and add a general description of the revised extension model.

II. BACKGROUND

In its petition, MERC noted that prior to the Company's acquisition of Aquila's Minnesota natural gas operations in 2006, the Commission required Aquila to publish its complete Feasibility Model in its tariffs on file with the Commission. This was due to the Commission determining that Aquila had not properly charged for extensions and that extensions were not cost justified.[1] As a condition of approval of MERC's acquisition, MERC was required to adopt Aquila's tariffs, including the existing Feasibility Model.[2] Those tariffs indicate that the

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[1] In the Matter of a Petition by Peoples Natural Gas Company and Northern Minnesota Utilities, Divisions of UtiliCorp United Inc. for Authority to Increase Natural Gas Rates in Minnesota and to Consolidate the Two Utilities in Docket No. G007,011/GR-00-951, *Order Accepting and Adopting Settlement* (July 29, 2003) (requiring Aquila to work with Commission staff and the Department to develop an appropriate exhibit in their tariff that would enable the main and service extension feasibility model to be replicated using current inputs); *Order Accepting Compliance Filing as Modified and Requiring Further Filing* (November 21, 2003) (requiring Aquila to file a modified exhibit for its tariff book on main and service extension feasibility models correcting a number of deficiencies that were identified).

[2] In the Matter of the Sale of Aquila, Inc's Minnesota Assets to Minnesota Energy Resources Corporation, Docket No. G007,011/M-05-1676, *Order Approving Sale Subject to Conditions* (June 1, 2006).

Feasibility Model is included as an exhibit to the tariffs and that any changes to the model are not effective until a revised exhibit is filed.

MERC's existing tariffs refer to the main and service extension calculations as a Feasibility Study or Feasibility Model. MERC proposed to revise the model, renaming it the Customer Extension Model because the customer ultimately determines what is financially feasible.

The Company indicated that the proposed new Customer Extension Model follows a similar methodology to MERC's New Area Surcharge (NAS) model which was recently approved by the Commission. Specifically, the Company referenced the Commission's July 26, 2012 *Order Approving New Area Surcharge with Modifications and Requiring Revised Tariff Sheet* in Docket No. G007,011/M-11-1045 and the Commission's September 5, 2014 *Order Approving New Area Surcharge and Proposed Tariff Modification* in Docket No. G011/M-14-524.

The DOC notes for purposes of general understanding that the Customer Extension Model tends to be used for lower cost projects with a smaller CIAC that is paid upfront by the customer, with the projects becoming cost effective in a 1- to 3-year timeframe. In contrast, the New Area Surcharge Model tends to be used for higher cost projects such as for new towns first served by gas or for longer connections, where CIAC costs are financed over a longer time period of approximately 30 years.

On March 10, 2015, the Company filed *Corrections to Initial Petition*, which clarified/revised three points that are discussed below in the DOC Analysis Section.

III. DOC ANALYSIS

A. *PROPOSED AMENDMENTS TO MERC'S FEASIBILITY MODEL*

1. Need for Amended Customer Extension Model

According to MERC, the Company currently uses an outmoded extension model that was inherited from its predecessor to ascertain a project's feasibility and determine the required CIAC for main and service extensions.[3] MERC noted this model was developed for a company with investment criteria different from MERC's. MERC's current model places an overwhelming majority of the costs of installing a new line on the new customer. MERC noted that because the new customer is the principal beneficiary of the new line, it is understandable that the new customer will pay a significant portion of the new line's costs. However, according to MERC the new customer is not the sole beneficiary of the line extensions, since adding new customers allows for a broader spreading of fixed costs which benefits the existing customer base. MERC also noted that rate base additions and related earnings benefit the Company and shareholders. MERC indicated that as a result of recent increases in demand for new services, MERC determined it was time to update and revise its extension model and underlying assumptions to address current costs and conditions.

[3] See MERC Tariff Sheet Nos. 9.07-9.13.

MERC noted that the proposed revised Customer Extension Model allows the shareholders and new customers to share in the cost of line extensions.[4] MERC indicated that it was mindful of the Commission's concerns that existing customers should not subsidize growth, since the new model only allows a sharing of the burden if existing customers benefit from the extension. If the new line extension is not a net revenue generator over the course of the line's life, the Company recovers the deficiency from the new customer through a CIAC. MERC included public and nonpublic versions of the proposed Customer Extension Model as Attachment A to the Company's initial filing.

To ensure that the mechanics of the proposed Customer Extension Model are clearly understood, the DOC asked the Company in Information Request No. 1 to provide a copy of the spreadsheet of its proposed Customer Extension Model (Attachment A in the Company's petition) with a hypothetical project and a narrative summary explaining the hypothetical project and how that information is consistent with the spreadsheet numbers for the hypothetical project. MERC provided the following narrative response, plus a spreadsheet showing the calculations. The Company stated that the hypothetical project in "IR 1 Hypothetical" includes one residential customer added in the first year. **[TRADE SECRET DATA HAS BEEN EXCISED].**[5] Based on our review, the DOC considers the calculations and assumptions for this hypothetical example to be reasonable. The Department provides discussion and analysis of the method and assumption changes separately below.

2. Proposed Revisions to Feasibility Model for Extension of Company Mains and Services – Method Changes

For residential customers where *both* a main and service extension is required and for *all* extensions to serve commercial and industrial customers, regardless of whether a main extension is involved, MERC proposed to use a standard Customer Extension Model that is designed to calculate the total revenue requirement for each year of the average service life of the plant installed. The Customer Extension Model would compare the total revenue requirements for each year with the retail revenues generated from customers served

[4] MERC corrected its statement that shareholders and "new" customers and not "existing" customers share in the costs of line extensions on page 1 of its March 10, 2015 *Corrections to Initial Petition*. In response to DOC Information Request No. 3 (a) the Company noted this correction by indicating that new customers and not existing customers share in the costs of the line extension. The Company also noted in DOC Information Request No. 3 (b) that shareholders provide the funds for construction, which will be recovered from customers through rates.

[5] The Department included as DOC Attachment A, a copy of the public and trade secret responses to Information Request Nos. 1 to 10. The Department notes that the trade secret spreadsheets for Information Request Nos. 1 and 2 are available upon request for entities who can receive trade secret data.

(actual and/or expected) by the project to determine if a revenue deficiency or revenue excess exists.

According to MERC, for residential customers, the proposed Customer Extension Model incorporates the cost for a 75-foot main/service line, with any excess footage billed after the installation not to exceed $5.00 per foot. Customers who need only service line extensions will still receive the 75-foot allowance, even though the Customer Extension Model would not be applicable. As with other residential customers, excess footage is capped at $5.00 per foot and charged after installation.

MERC noted that the Net Present Value (NPV) of the yearly revenue deficiencies or excesses would be calculated using a discount rate equal to the approved overall rate of return authorized in the most recent general rate case.[6] A total NPV of approximately zero ($0) would indicate that a project is self-supporting. Any costs in excess of the NPV would be recovered through a CIAC.

MERC also noted that the proposed Customer Extension Model follows a similar methodology to MERC's NAS feasibility model recently approved by the Commission in September 2014.[7]

The DOC asked the Company in Information Request No. 2 (a) to explain if the calculated CIAC amount would be the same for identical projects under the Customer Extension Model and the New Area Surcharge Feasibility Model. The Company indicated that the Customer Extension and NAS Models would yield the same CIAC charge if MERC had not updated the operations and maintenance (O&M) expense, book depreciation rate and service line costs based on current cost data in the Customer Extension Model.[8] The Company also noted that the Customer Extension Model is used to calculate the upfront CIAC a customer must pay for the extension of service, whereas, the NAS model calculates MERC's cost of financing the CIAC for up to 30 years.

The DOC asked MERC in Information Request No. 2 (b) to provide a spreadsheet of the New Area Surcharge Feasibility Model using the same hypothetical project information used in DOC information request no. 1. The DOC also asked MERC in Information Request No. 2 (c) to explain all differences in the methodology between MERC's New Area Surcharge Feasibility Model and MERC's Customer Extension Model, and explain why each difference is appropriate. MERC provided Attachment "IR 2 Hypothetical" as a trade secret attachment.

[6] In its March 10, 2015 *Corrections to Initial Petition* filing, MERC corrected the proposed discount rate, indicating that the discount rate would be equal to the overall rate of return, rather than the cost of long-term debt as stated in its initial filing. The Company also made this correction in response to Department Information Request No. 7.

[7] In the Matter of Minnesota Energy Resources Corporation's Petition for Approval of a New Area Surcharge Rider, *Order Approving New Area Surcharge with Modifications and Requiring Revised Tariff Sheet*, Docket No. G007,011/M-11-1045 (July 26, 2012); In the Matter of the Petition of Minnesota Energy Resources Corporation for Approval of a Tariff Revision and New Area Surcharge for the Ely Lake Project, *Order Approving New Area Surcharge and Proposed Tariff Modification*, Docket No. G011/M-14-524 (September 5, 2014).

[8] The Company noted by phone that they will update the assumptions in the New Area Surcharge model when they file their next New Area Surcharge, expected around late 2015.

MERC also indicated that there are no differences in the methodology between the Customer Extension Model and the NAS model. However, as noted in response to DOC Information Request No. 2 (a), the three inputs that drive the calculation were updated.

In addition to the three assumption updates for O&M expense, book depreciation rate, and service line costs, the DOC notes that, while both the proposed Customer Extension Model and the NAS model use the overall rate of return for the discount rate in calculating CIAC, the New Area Surcharge also uses the long-term debt rate as the discount rate in calculating the present value of the surcharge revenues (financing costs) only for purposes of the "Gross Plant Investment" (see Tariff Sheet No. 9.15, Section 3 New Area Surcharge Rider, Part 3 Gross Plant Investment).[9] However, because the proposed Customer Extension Model applies to situations in which the CIAC, if any, is paid upfront and therefore does not incorporate financing costs, use of the long-term debt rate as used in the NAS model is not relevant to the proposed Customer Extension Model. The DOC considers the overall rate of return as approved in MERC's most recent rate case to be a reasonable discount rate for purposes determining CIAC and annual revenue deficiency or excess amounts, and cash flows, because it provides consistency throughout the tariff in evaluating whether extension projects are cost effective, or whether they become cost effective with a CIAC.

Based on our review, the DOC considers the Company's Customer Extension Model to be a reasonable method to use to determine projected revenue deficiencies and excesses, including the CIAC amounts necessary to make projects cost effective and appropriately share costs and revenues caused by new customers on the system. Further, the DOC concludes that it is appropriate for the Customer Extension Model to use the overall rate of return for purposes of the discount rate, because it is consistent with the use of the overall rate of return in the New Area Surcharge model given that the long term debt discount rate is only used for the financing portion of the New Area Surcharge, which is not applicable to the Customer Extension Model since the Customer Extension Model CIAC is paid upfront and not financed.

The DOC asked MERC in Information Request No. 4 to explain how and where, in Attachment A to the Petition, the proposed Customer Extension Model incorporates the cost for a 75-foot service line. The Company explained that the 75-foot service line is the average length of all of the service lines installed at the time of MERC's most recent rate case. This average length is incorporated into the model by using the average cost of the 75 feet as the service line cost found under the "Annual Inputs" tab under "Residential Service Line" in the attachment to MERC's response to Information Request No. 1, "IR 1 Hypothetical." The DOC also asked MERC to provide support for the $5.00 (or less) per-foot installation charge. The Company indicated that the per-foot installation charge is based on the actual cost MERC pays its construction contractor to install each foot of service line, plus

[9] The Commission approved using the long term debt only for purposes of the discount rate used in calculating the present value of the surcharge revenues. The surcharge revenues reduce the cumulated plant in service in determining the "Gross Plant Investment" for the New Area Surcharge Rider. See Commission's July 26, 2012 Order in Docket No. E007,011/M-11-1045, and MERC's November 9, 2012 Compliance Filing. The Department notes all other calculations in the New Area Surcharge Rider use the overall rate of return for purposes of the discount rate.

the cost of the materials. The per-foot cost changes each year depending on the awarded blanket contract and applicable cost of materials. The contract with MERC's construction contractor was competitively bid. This year, MERC will pay its contractor **[TRADE SECRET DATA HAS BEEN EXCISED]** Additionally, the prices for materials are negotiated by MERC's parent company, Integrys Energy Group, which is able to negotiate on behalf of all of its subsidiary utilities to obtain the best possible price for materials. Based on the DOC's review, we consider MERC's response to information request no. 4 to be reasonable.

3. Proposed Revisions to Feasibility Model for Extension of Company Mains and Services – Assumption and Input Descriptions

MERC included revised Tariff Sheets Nos. 9.00 to 9.13 with a proposed effective date of "Upon Commission Approval" as Attachment B to the Company's filing. The proposed tariff describes the contents and general operation of the revised Customer Extension Model. MERC listed the 16 terms and contents for its revised Customer Extension Model on pages 5 and 6 of its filing that correspond directly to the terms and contents approved in MERC's NAS model. As noted above, MERC's March 10, 2015 *Corrections to Initial Petition*, corrected number 16 "Present Value of Cash Flows" so that the discount rate used is equal to the most recently approved "rate of return" instead of the "cost of long term debt."

The DOC asked the Company in Information Request No. 8 (a) to provide the calculations and support for Average Rate Base. The Company indicated that the calculation is Average New Plant plus Average Accumulated Deferred Income Taxes (ADIT) equals Average Rate Base. The Company explained that the ADIT is the average of the beginning and the end of the year accumulated deferred income tax. ADIT consists of two components: ADIT on depreciation and ADIT on CIAC. The Company noted that at the end of the service life of the plant installed, the balance of ADIT will be zero. The Company also provided a trade secret calculation.

The DOC asked the Company, in Information Request No. 8 (b), to explain what depreciation rate and salvage rate is used for Book Depreciation. The Company indicated that the depreciation rate used is 2.0833% based on combined life for mains, service lines and meters of 48 years, with no salvage value assumed.

Based on the DOC's review, the assumptions and inputs for the Customer Extension Model appear reasonable.

4. Proposed Revisions to Feasibility Model for Extension of Company Mains and Services – Specific Inputs and Additional Changes

On pages 6 to 8 of MERC's initial filing, the Company discussed the differences between the existing Feasibility Model and the proposed Customer Extension Model. The Company proposed changes to a) Incremental Operating and Maintenance (O&M) Expense Calculation, b) Customer Footage Allowance, and c) Miscellaneous Changes, as discussed below.

a) *Incremental O&M Calculation*

The Company provided the following explanation in its filing for how the revised Customer Extension Model changes how incremental O&M expense is calculated per customer. To calculate incremental O&M in a given year, the total O&M expense is divided by the average number of customers in that year. Total O&M is comprised of customer account expenses, which include expenses related to supervision, meter reading, records collection and retention, uncollectible accounts, disputed bills, and miscellaneous expenses. Total O&M expense also includes customer service expenses for supervision, customer assistance, and advertising. According to the Company, the remaining components of the O&M expense are line locating and emergency call out expenses. The O&M expense along with the allowed rate of return, book depreciation, and property tax, drive the revenue requirement. The total revenue requirement, in turn, is used to determine the total revenue excess or deficiency of an extension.

In DOC Information Request No. 9 (a) and (b), the DOC asked to the Company to explain how the incremental O&M expense was previously calculated and why the new method is reasonable. The Company indicated that the current model uses 33 percent of the margin to determine incremental O&M expense. According to MERC, this method was developed by Aquila and MERC has no exact documentation showing the calculation. However, MERC believes the calculation includes more expenses than what is truly incremental. MERC explained that the new incremental O&M calculation uses a 5-year average of actual incremental O&M expense. The Company considers this method reasonable because it is based on actual O&M expenses, i.e. the costs related to adding one additional customer. The Company also explained that using a 5-year average balances the need to account for annual variations in O&M expenses with the fact that these expenses generally increase with time.

The DOC asked MERC to explain what is included in the component of O&M called "Miscellaneous Expense" and support why these costs are reasonable to include. MERC explained that "Miscellaneous Expense" within O&M customer accounts expenses include charges in FERC account 905000. The Company noted that 2014 included $395,000 in charges in Miscellaneous Expenses that should have been included in Customer Records/Collections. However, the Company noted that these dollars would still be included in the incremental O&M calculation. The Company stated that the charges include planning, compliance, and contract services, and are expenses incurred as a direct result of extending service to new customers. Consequently, according to the Company, they must be included in the incremental O&M expense to accurately calculate the total cost of extending service to new customers over the course of the line's life.

b) *Customer Footage Allowance*

According to the Company, the revised Customer Extension Model reflects a cost-based approach and provides a fixed value allowance, integrated into the model itself. The Company noted that these cost allowances would be updated periodically pursuant to the Company's cost evaluations. MERC believes that this approach is more equitable than the approach under MERC's existing Feasibility Model. The Company noted that with the current footage allowance, customers' avoided costs vary widely based on the length of the extension. Under the new Customer Extension Model, all new customers would receive the same cost savings.

The DOC asked the Company in DOC Information Request No. 10 (a) to explain and provide an example of what the Company means by providing a fixed value allowance. The Company noted that the "fixed value" is merely an average cost of service line that was reviewed by the Commission in the Company's last rate case. According to the Company, if there is a main installed for a new service line, the fixed value allowance is used to estimate the cost of the service line. If there is no main installed, the customer is allowed 75 feet at no charge, which is the average length of a service line determined in the Company's last rate case.

The DOC asked the Company in DOC Information Request No. 10 (b) to explain how the Company would determine the updates for the cost allowance. The Company noted that it would use the average cost for a 75-foot service line extension from the last rate case filing. The cost allowance would be updated annually at the beginning of each construction season based on actual costs to install a residential service. According to MERC's response to DOC Information Request No. 10 (c), the Company intends to update the cost allowance based on actual costs from the previous year.

c) Miscellaneous Changes

On pages 6 and 7 of its initial filing, MERC also requested the following changes to the Customer Extension Model that do not affect how CIAC is calculated:

- changing the name of the model from "Feasibility Study" to "Customer Extension Model", since the new name more accurately reflects the model's purpose;
- grammatical change – changing "one time charge" to "one-time charge" in describing extra charges required when a thawing device is needed to excavate bell holes;
- rather than stating the Company will "conduct" the Customer Feasibility Model, the tariff has been revised to state that the Company will "complete" the model.

Based on the DOC's review of specific input and miscellaneous changes to the Customer Extension Model, the DOC considers the Company's changes to be reasonable.

B. REMOVING STEP-BY-STEP EXTENSION MODEL FROM MERC'S TARIFFS

MERC is requesting approval to remove the step-by-step listing of model inputs and assumptions from its tariffs. The Company noted that prior to MERC's acquisition of Aquila's Minnesota natural gas operations in 2006, and the Commission required Aquila to publish its complete Feasibility Model in its tariffs on file with the Commission. This was due to the Commission determining that Aquila had not properly charged for extensions that were not cost justified.[10] As a condition of approval of MERC's acquisition, MERC was required to adopt Aquila's tariffs, including the existing Feasibility Model.[11] Those tariffs expressly indicate that the Feasibility Model is set forth in an exhibit to the tariffs and that any changes to the model will not be effective until an amended exhibit is filed. The Company discussed this issue in greater detail in Section III of the petition.

MERC noted that this treatment is no longer appropriate as a result of MERC consistently demonstrating compliance with the Commission's extension policies and properly applying the Feasibility Model as set forth in MERC's tariffs. The Company also noted that no other natural gas utility operating in Minnesota is required to including its extension model in its tariffs and that MERC's inclusion of this model in publicly available tariffs places MERC at a competitive disadvantage without justification. Therefore, MERC requests that the Commission lift the requirement that the details of the model be published in MERC's tariff and approve its request to amend the tariff sheets to remove the step-by-step model.

MERC proposed to instead include within the Company's tariffs a general description of the methodology and inputs used in its revised Customer Extension Model. According to the Company, these descriptions are similar to the information provided in MERC's NAS tariff. Attached to the Company's initial filing as Attachment B are clean and redline versions of MERC's tariffs reflecting the removal of the step-by-step model, as well as the proposed revisions discussed in detail above.

The DOC is not aware of any concerns with MERC's ability to comply with its service extension tariff or of any instances in which the Company may have charged incorrect rates to customers due to potential errors made in conducting a Feasibility Study. The DOC does not see a reason to continue to require MERC to include the detailed cost inputs in its tariff, creating a possible competitive disadvantage. As result, the DOC recommends that the Commission approve the removal of the detailed cost inputs in the step-by-step model for the Customer Extension Model.

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[10] In the Matter of a Petition by Peoples Natural Gas Company and Northern Minnesota Utilities, Divisions of UtiliCorp United Inc. for Authority to Increase Natural Gas Rates in Minnesota and to Consolidate the Two Utilities in Docket No. G007,011/GR-00-951, *Order Accepting and Adopting Settlement* (July 29, 2003) (requiring Aquila to work with Commission staff and the Department to develop an appropriate exhibit in their tariff that would enable the main and service extension feasibility model to be replicated using current inputs); *Order Accepting Compliance Filing as Modified and Requiring Further Filing* (November 21, 2003) (requiring Aquila to file a modified exhibit for its tariff book on main and service extension feasibility models correcting a number of deficiencies that were identified).
[11] In the Matter of the Sale of Aquila, Inc's Minnesota Assets to Minnesota Energy Resources Corporation, Docket No. G007,011/M-05-1676, *Order Approving Sale Subject to Conditions* (June 1, 2006).

IV. DOC RECOMMENDATIONS

The DOC recommends that the Commission approved MERC's proposal, including:

1) revised and updated Customer Extension Model and related assumptions to be used to determine whether customer contributions in aid of construction (CIAC) are required to support natural gas extension projects; and,

2) amended tariffs to remove the step-by-step input and assumption details used by MERC in conducting the Customer Extension Model, replacing it with a general description of the revised extension model.

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PUBLIC DOCUMENT—TRADE SECRET DATA HAS BEE

State of Minnesota

Department of Commerce
Division of Energy Resources

Utility Information Request

Docket Number: G011/M-15-165 Date of Request: February 27, 2015

Requested From: Minnesota Energy Resources Corporation Response Due: March 9, 2015

Analysts Requesting Information: Nancy Campbell and Mark Johnson

Type of Inquiry:

[X]......Financial	[ ]......Rate of Return	[ ]......Rate Design
[ ]......Engineering	[ ]......Forecasting	[ ]......Conservation
[ ]......Cost of Service	[ ]......CIP	[ ]......Other:

If you feel your responses are trade secret or privileged, please indicate this on your response.

Request No.	
1	Subject: Customer Extension Model, Attachment A

MERC provided a spreadsheet of its proposed Customer Extension Model in Attachment A (trade secret) of the petition.

a) Please provide a copy of the spreadsheet for a hypothetical project.

MERC Response:

See Attachment "IR 1_Hypothetical," attached to this response. The Trade Secret version of this attachment contains trade secret information, including pricing information that is not generally known to and not readily ascertainable by competitors of MERC, who could obtain economic value from its disclosure.

Response by: Dave Kult

Title: General Manager

Department: Minnesota Energy Resources

Telephone: (651)322-8903

List sources of information:

b) Please provide a narrative summary explaining the hypothetical project and how that information is consistent with your spreadsheet numbers for the hypothetical project.

MERC Response:

The hypothetical project in "IR 1_Hypothetical" includes one residential customer added in the first year. [**TRADE SECRET DATA BEGINS ...**

... TRADE SECRET DATA ENDS]

Response by: Dave Kult	List sources of information:
Title: General Manager	
Department: Minnesota Energy Resources	
Telephone: (651)322-8903	

PUBLIC DOCUMENT—TRADE SECRET DATA HAS BEEN EXCISED

State of Minnesota

DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

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[ ].....Cost of Service	[ ].....CIP	[ ].....Other:

If you feel your responses are trade secret or privileged, please indicate this on your response.

Request No.	
2	Subject: Customer Extension Model & New Area Surcharge Model MERC stated on page 2 of its filing that its proposed Customer Extension Model follows a similar methodology to MERC's New Area Surcharge Feasibility Model, which was recently approved by the Commission on September 5, 2014 in Docket No. G011/M-14-524. a) Please explain if the calculated contribution in aid of capital (CIAC) amount would be the same for identical projects under the Customer Extension Model and the New Area Surcharge Feasibility Model. **MERC Response:** The CIAC under the Customer Extension Model and the New Area Surcharge Feasibility Model ("NAS") would not be the same for an identical project. During the development of the Customer Extension Model, inputs that drive the calculation of the CIAC were updated. Specifically, MERC updated the O&M expense, book depreciation rate, and service line costs based on current cost data. But for these updates, the Customer Extension Model and the NAS would yield the same CIAC charge.

Response by: Dave Kult

Title: General Manager

Department: Minnesota Energy Resources

Telephone: (651)322-8903

List sources of information:

Nevertheless, the Customer Extension Model and the NAS serve different purposes. The Customer Extension Model is used to calculate the upfront CIAC a customer must pay for the extension of service. The NAS calculates MERC's costs of financing the CIAC for up to 30 years.

b) Please provide a spreadsheet of the New Area Surcharge Feasibility Model using the same hypothetical project information used in DOC Information Request No. 1.

MERC Response:

See Attachment "IR 2_Hypothetical," attached to this response. The Trade Secret version of this attachment contains trade secret information, including pricing information that is not generally known to and not readily ascertainable by competitors of MERC, who could obtain economic value from its disclosure.

c) Please explain all differences in the methodology between MERC's New Area Surcharge Feasibility Model and MERC's Customer Extension Model, and explain why each difference is appropriate.

MERC Response:

There are no differences in methodology between the Customer Extension Model and the NAS. As stated in response to (a), however, three inputs that drive the calculation were updated.

Response by: Dave Kult

Title: General Manager

Department: Minnesota Energy Resources

Telephone: (651)322-8903

List sources of information:

State of Minnesota
DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

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[ ]......Cost of Service	[ ]......CIP	[ ]......Other:

If you feel your responses are trade secret or privileged, please indicate this on your response.

Request No.	
3	Subject: Customer Extension Model

MERC stated on page 4 of its filing that:

> Accordingly, the proposed revised Customer Extension Model allows shareholders and existing customers to share in the cost of line extensions. Mindful of the Commission's concerns that existing customers should not subsidize growth, the new model only allows for a sharing of the burden if existing customers benefit from the extension. If the new line extension is not a net revenue generator over the course of the line's life, the Company recovers the deficiency from the new customer through a CIAC.

a) Please explain how existing customers share in the cost of the line extension if the Company recovers any deficiency from new customers through a CIAC.

MERC Response:

The statement that "...the proposed revised Customer Extension Model allows

Response by: Dave Kult

Title: General Manager

Department: Minnesota Energy Resources

Telephone: (651)322-8903

List sources of information:

shareholders and existing customers to share in the costs of line extensions" is inaccurate and MERC is filing a corrected version of the Petition in order to further clarify. MERC's revised Customer Extension Model does not require existing customers to subsidize or share the costs of service line extension because those costs are recovered in a CIAC if the new line is not a net revenue generator over the course of the line's life.

b) Please explain how shareholders share in the cost of the line extension if the Company recovers any deficiency from new customers through a CIAC.

MERC Response:

The shareholders are providing the funds for construction that will be recovered from customers through rates.

Response by:	Dave Kult	List sources of information:
Title:	General Manager	
Department:	Minnesota Energy Resources	
Telephone:	(651)322-8903	

PUBLIC DOCUMENT—TRADE SECRET DATA HAS BEEN EXCISED

State of Minnesota

DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

Utility Information Request

Docket Number: G011/M-15-165 Date of Request: February 27, 2015

Requested From: Minnesota Energy Resources Corporation Response Due: March 9, 2015

Analysts Requesting Information: Nancy Campbell and Mark Johnson

Type of Inquiry:
[X]......Financial
[ ]......Engineering
[ ]......Cost of Service
[ ]......Rate of Return
[ ]......Forecasting
[ ]......CIP
[ ]......Rate Design
[ ]......Conservation
[ ]......Other:

If you feel your responses are trade secret or privileged, please indicate this on your response.

Request No.	
4	Subject: Customer Extension Model MERC stated on page 4 of its filing that for residential customers the proposed Customer Extension Model incorporates the cost for a 75-foot service line, with any excess footage billed after the installation not to exceed $5.00 per foot. Please explain how and where the proposed Customer Extension Model in Attachment A incorporates the cost for a 75-foot service line. **MERC Response:** The 75-foot service line is the average length of all of the service lines installed for the period of our most recent rate case. This average is incorporated into the model by using the average cost of the 75 feet as the service line cost found under the "Annual Inputs" tab under "Residential Service Line" in the attachment to MERC's response to Information Request No. 1, "IR 1_Hypothetical."

Response by: Dave Kult

Title: General Manager

Department: Minnesota Energy Resources

Telephone: (651)322-8903

List sources of information:

Please provide support for the $5.00 (or less) per foot installation charge.

MERC Response:

The per foot installation charge is based on the actual cost MERC pays its construction contractor to install each foot of service line, plus the cost of the materials. The per-foot cost changes each year depending on the awarded blanket contract and applicable cost of materials. The contract with MERC's construction contractor was competitively bid. This year, MERC will pay its contractor **[TRADE SECRET DATA BEGINS ...**

TRADE SECRET DATA ENDS]. The prices for materials are negotiated by MERC's parent company, Integrys Energy Group, which is able to negotiate on behalf of all of its subsidiary utilities to obtain the best possible price for materials.

Response by:	Dave Kult	List sources of information:
Title:	General Manager	
Department:	Minnesota Energy Resources	
Telephone:	(651)322-8903	

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Request No.	
5	Subject: Customer Extension Model – Residential Applicability Reference: Page 4 of the filing a) Does the Customer Extension Model only apply to residential customers who need both a main and service line extension? **MERC Response:** No, the Customer Extension Model applies to both residential and commercial and industrial customers. As to residential customers, the Customer Extension Model only applies to customers needing a main and service line extension. b) If a residential customer needs both a main and service line extension, is the residential customer charged for the first 75-feet of service line extension in the Customer Extension Model?

Response by: Dave Kult

Title: General Manager

Department: Minnesota Energy Resources

Telephone: (651)322-8903

List sources of information:

MERC Response:

Yes. The cost for the first 75 feet of a service line extension is included in the Customer Extension Model. This cost is based on the average cost for a 75-foot service line extension from MERC's last rate case filing.

c) Is it correct that if a residential customer needs only a service line extension, the Customer Extension Model does not apply and the customer will receive the first 75-feet of service line extension for free?

MERC Response:

A residential customer who needs only a service line extension that is less than 75 feet will not need to pay a contribution in aid of construction. The customer will pay for the cost of the line that exceeds 75 feet, any winter construction charges, and any abnormal construction costs.

Response by:	Dave Kult	List sources of information:
Title:	General Manager	
Department:	Minnesota Energy Resources	
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Request No.	
6	Subject: Customer Extension Model – Commercial and Industrial Customer Applicability Reference: Page 4 of the filing a) Does Customer Extension Model apply to all commercial and industrial customers who need both a main and service line extension? **MERC Response:** Yes. The Customer Extension Modes does apply to all commercial and industrial customers who need both a main and service line extension. b) Does the Customer Extension Model apply to all commercial and industrial customers who only need a service line extension? **MERC Response:** Yes. The Customer Extension Modes does apply to all commercial and industrial customers who need only a service line extension.

Response by: Dave Kult

List sources of information:

Title: General Manager

Department: Minnesota Energy Resources

Telephone: (651)322-8903

c) Will all commercial and industrial customers be charged for the first 75-feet of service line extensions under the Customer Extension Model?

MERC Response:

Yes. For all commercial and industrial customers the entire service line installation cost is included in the model, regardless of length. Because their installation costs can vary greatly, the model uses the cost of service lines as estimated by MERC's engineers in the construction design for each specific commercial/industrial line extension project.

Response by:	Dave Kult	List sources of information:
Title:	General Manager	
Department:	Minnesota Energy Resources	
Telephone:	(651)322-8903	

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Request No.	
7	Subject: Customer Extension Model – Method Reference: Page 5 of the filing Please explain why the Net Present Value (NPV) of the yearly revenue deficiencies or excesses should use a discount rate equal to the long-term debt authorized in the most recent general rate case proceeding. **MERC Response:** The NPV of the yearly revenue deficiencies or excesses does not use a discount rate equal to the long-term debt authorized in the most recent general rate case proceeding. The statement to the contrary in the filing was incorrect and MERC intends to file a correction to the filing in the docket. The NPV of the yearly revenue deficiencies or excesses uses the overall rate of return authorized in the most recent general rate case proceeding.

Response by: Gary Simons List sources of information:

Title: Director of Operations Accounting

Department: Gas Utility Group

Telephone: (651)322-8925

PUBLIC DOCUMENT—TRADE SECRET DATA HAS BEEN EXCISED

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Request No.	
8	Subject: Customer Extension Model Terms and Conditions

Reference: Page 5-6 of the filing

a) Please provide calculations and example for #8 Average Rate Base.

MERC Response:

Calculation: Average Net Plant + Average Accumulated Deferred Income Taxes (ADIT) = Average Rate Base.

ADIT is the average of the beginning and the end of the year accumulated deferred income tax. ADIT consists of two components: accumulated deferred income taxes on depreciation and accumulated deferred income taxes on contribution in aid of construction. At the end of the service life of the plant installed the balance of ADIT will be zero.

Example: The following example is based on year one of the hypothetical used in response to DOC Information Request No. 1.

Response by: Gary Simons

Title: Director of Operations Accounting

Department: Gas Utility Group

Telephone: (651)322-8925

List sources of information:

[TRADE SECRET DATA BEGINS ... ... TRADE SECRET DATA ENDS]

b) Please explain for #10 Book Depreciation, what depreciation rate and salvage rate is used.

MERC Response:

The deprecation rate used is 2.0833%. The average life for mains, services, and meters combined is 48 years. The rate is calculated by dividing 1 by 48. There is no salvage value assumed.

Response by:	Gary Simons	List sources of information:
Title:	Director of Operations Accounting	
Department:	Gas Utility Group	
Telephone:	(651)322-8925	

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Request No.	
9	Subject: Customer Extension Model – Specific Inputs and Additional Changes – Incremental O&M Calculation Reference: Page 6-7 of the filing The Company stated on pages 6-7 that: To calculate incremental O&M in a given year, the total O&M expense is divided by the average number of customers in that year. a) Please explain how the incremental O&M was previously calculated. **<u>MERC Response:</u>** The current model uses 33% of margin. The margin equals the volume of gas purchased multiplied by distribution rates. This method was developed by Aquila and while MERC has no exact documentation showing the calculation, we believe that Aquila included more expenses in their incremental calculation than what we feel is truly incremental.

Response by: Gary Simons

Title: Director of Operations Accounting

Department: Gas Utility Group

Telephone: (651)322-8925

List sources of information:

b) Please explain why the new calculation for incremental O&M expense is reasonable.

MERC Response:

The new calculation uses a 5-year average of actual incremental O&M. This method is reasonable because it is based on actual O&M expenses. Incremental O&M includes the additional charges that are related to adding one additional customer. Using a 5-year average balances the need to account for annual variations in O&M expenses with the fact that these expenses generally increase with time.

c) What is included in the component of O&M called "Miscellaneous Expense" and support why these costs are reasonable to include?

MERC Response:

"Miscellaneous expenses" within O&M customer accounts expenses include charges in FERC account 905000. 2014 included $395,000 in charges that should have been included in Customer Records/Collections. These dollars would still be included in the incremental O&M calculation. These charges include planning, compliance, and contract services. These expenses are incurred as a direct result of extending service to new customers. Consequently, they must be included in the incremental O&M expense to accurately calculate the total cost of extending service to new customers over the course of the line's life.

Response by:	Gary Simons	List sources of information:
Title:	Director of Operations Accounting	
Department:	Gas Utility Group	
Telephone:	(651)322-8925	

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Request No.	
10	Subject: Customer Extension Model – Customer Footage Allowance

Reference: Page 7 of the filing the Company stated:

> The revised Customer Extension Model will adopt a cost-based approach and provide a fixed value allowance, integrated in the model itself. These cost allowances will be updated periodically pursuant to the Company's cost evaluations.

a) Please explain and provide an example of what the Company means by providing a fixed value allowance.

MERC Response:

The "fixed value" is merely the average cost of a service line that was reviewed by the Commission in our last rate case. If there is main installed for the new service line, the fixed value allowance is used to estimate the cost of the service line. If there is no main installed, the customer is allowed 75 feet at no charge, which is the average length of a service line from our last rate case. See attachment to Information Request No. 1, IR 1_Hypothetical for an example of how the fixed value is used in the Customer

Response by: Dave Kult

Title: General Manager

Department: Minnesota Energy Resources

Telephone: (651)322-8903

List sources of information:

Extension Model.

b) Please explain how the Company will determine the updates for the cost allowances.

MERC Response:

Initially, MERC will use the average cost for a 75-foot service line extension from the last rate case filing. The cost allowance will be updated annually at the beginning of each construction season based on actual costs to install a residential service.

c) How often does the Company plan to update the Company's cost evaluations and through what process?

MERC Response:

Costs will be updated annually at the beginning of the construction season based on actual costs from the previous year.

Response by:	Dave Kult	List sources of information:
Title:	General Manager	
Department:	Minnesota Energy Resources	
Telephone:	(651)322-8903	

CERTIFICATE OF SERVICE

I, Linda Chavez, hereby certify that I have this day served copies of the following document on the attached list of persons by electronic filing, e-mail, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

MINNESOTA DEPARTMENT OF COMMERCE – COMMENTS

Docket Nos. **G011/M-15-165**

Dated this **15th** day of **April, 2015**.

/s/Linda Chavez

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