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DEPARTMENT OF
COMMERCE

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April 22, 2011

Burl W. Haar
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: **Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. G011/M-10-1169

Dear Dr. Haar:

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

> A petition by Minnesota Energy Resources Corporation--PNG (MERC or Company) for approval by the Minnesota Public Utilities Commission (Commission) of a change in demand entitlement for its Viking Gas Transmission System Purchased Gas Adjustment (PGA) effective November 1, 2010.

The filing was submitted on November 1, 2010. The petitioner is:

> Gregory J. Walters
> Minnesota Energy Resources Corporation
> 3460 Technology Drive NW
> Rochester, MN 55901

The Department recommends that the Commission **approve** MERC's proposal due to the significant reductions in costs for ratepayers. The Department is available to answer any questions that the Commission may have.

Sincerely,

/s/ MARLON GRIFFING
Financial Analyst
651-297-3900

MG/ja
Attachment

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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

DOCKET NO. G011/M-10-1169

I. SUMMARY OF THE COMPANY'S PROPOSAL

Pursuant to Minnesota Rules 7825.2910, subpart 2, Minnesota Energy Resources Corporation--PNG (MERC or the Company) filed a demand entitlement petition (*Petition)* on November 1, 2010. In its *Petition*, MERC requests that the Minnesota Public Utilities Commission (Commission) accept the changes in the Company's contracted capacity for customers served off the Viking Gas Transmission Company (Viking) system. The Company requests that adjustments in firm contract demand entitlements provisionally be included in the Company's purchased gas adjustment (PGA) effective November 1, 2010.

MERC requests changes regarding its Viking firm pipeline demand entitlement levels[1] as follows:

- increase its total Design-Day requirement to 7,292 dekatherms (Dkt);
- replace 1,098 Dkt/day of firm backhaul with a right to call on up to 1,098 Dkt/day for three winter months. Thus, there is no change in the amount of firm transportation capacity actually available to MERC-PNG-VGT customers during winter peak periods; and
- increase its reserve margin to 1,431 Dkt, or 19.6 percent, using resources that cost much less than previously used resources.

[1] The Department has included Department Attachment 1, which shows the effect of the demand-entitlement changes in MERC's PNG-Viking jurisdiction.

Specifically, MERC requested that the Commission accept the following changes included in Table 1 below in the Company's overall level of contracted capacity.[2]

Table 1: MERC's Proposed Total Entitlement Changes from 2009-2010 to 2010-2011		
Type of Entitlement	**Proposed Changes: Increase or (Decrease) in Dkt**	**Increase or (Decrease) in Cost of Entitlement**
NNG TF-12 Base	(255)	($23,149)
NNG TF-12 Variable	(178)	($19,422)
NNG TFX-12	(105)	($19,053)
NNG TF-5	(389)	($18,713
NNG TFX-5	(172)	($13,049)
NNG TF-12 (Backhaul)*	(1,098)	($12,409)
Wadena Delivered Option	1,098	$2,965
Sum of Increases	1,098	$2,965
Sum of Decreases	1,098	($105,795)
Net Change	0	($102,830)

*-The volume of this item is excluded from the calculation of design-day capacity because it is a backhaul to transport gas to Viking. Although this expense serves only to make other entitlements available to PNG customers on Viking, it does count as a cost of delivering entitlements.

MERC's proposed changes would reduce total demand costs by $102,830. For General Service customers (which include residential customers), heating customers using 132 Mcf would pay $23.24 less per year as a result of this change. According to the Company, this amount represents a 2.68 percent decrease in demand costs over those charged in the October 2010 purchased gas adjustment (PGA).

The changes in the resources for meeting the Design-Day requirement would enable MERC to propose reductions for all affected customer classes when MERC includes FDD Storage contracts costs in the demand portion of the PGA.[3] It has been the Department's position since the Company's 2008-2009 demand entitlement filing (Docket No. G011/M-08-1328) that these costs should be included in the commodity portion of the PGA rather than the demand portion because all ratepayers benefit from storage gas. MERC includes an attachment calculating costs when these FDD contracts are booked in the commodity portion of the PGA.[4] In this attachment, this aspect of the proposal would result in the General Service class receiving a larger decrease in rates, while the Small Volume Interruptible, Large Volume Interruptible, and Small Volume Firm classes would receive rate increases.

[2] The table and other material in these Comments reflect insertions and deletions to MERC's Attachments 6 and 8 presented in Department Attachment 2. The Department developed these corrections in conjunction with a Company representative in an informal telephone conversation.

[3] MERC Attachment 4, Page 1 of 4.

[4] MERC Attachment 4, Page 3 of 4.

Since this issue has been thoroughly discussed in the previous two demand entitlement filings, the Department does not provide additional discussion here and maintains its recommendations in the previous demand entitlement filings regarding FDD storage costs.[5]

II. THE DEPARTMENT'S ANALYSIS OF THE COMPANY'S PROPOSAL

The Department's analysis of the Company's request includes the following sections:

- the proposed overall demand entitlement level;
- the design-day requirement;
- the reserve margin; and
- the PGA cost recovery proposal.

A. THE COMPANY'S DEMAND ENTITLEMENT LEVEL

1. Proposed Overall Demand Entitlement Level

As indicated in Department Attachment 1, the Company's requests would not change the firm transportation capacity overall; rather, MERC proposes to substitute 1,098 Mcf of the "Wadena delivered option" for a total of 1,098 Mcf of various contracts for firm transportation on NNG. According to MERC-PNG, this option is much less expensive:

> As shown in Attachment 6, MERC-PNG-VGT proposes a decrease in the Viking Backhaul contract and the NNG Chisago contract that delivers gas into the VGT system for design day deliverability for the upcoming heating season.
>
> MERC also purchased a Wadena Call Option on VGT for PNG-VGT and NMU (VGT) customers. The transaction allows MERC to call on gas up to 1,098 Dkt/day from December 1, 2010 through February 28, 2011. The right to call on the gas costs $.03 Dkt for the 1,098 Dkt/day call rights for the 90 day period (December 1, 2010 through February 28, 2011. The option substituted the need to contract for firm backhaul on VGT to meet the design day. The cost of the VGT backhaul would have been approximately $12,409 compared to the $2,965 option cost.

This substitution of the Wadena Call Option for the five NNG contracts and the NNG TF-12 backhaul decreases costs $102,830 for MERC-PNG-VGT customers. See Table 1. The storage portion of MERC's capacity portfolio accounts for an additional $25,933 in savings. The total of the reduced costs is $128,763. See Department Attachment 2.

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[5] Docket Nos. G011/M-08-1328 and G011/M-09-1285

Thus, while MERC-PNG's filing indicates an increase in its total entitlement level in Dkt as shown below, there is not an increase in firm transportation; moreover, MERC's proposal would decrease costs of serving customers by using less expensive resources.

Previous Entitlement (Dkt)	Proposed Entitlement (Dkt)	Entitlement Changes (Dkt)	% Change From Previous Year
7,625	**8,723**	**1,098**	**14.40**

The Department analyzes below the proposed changes, the proposed Design-Day requirement, and proposed reserve margin. As discussed further below, the Department has concerns associated with the level of the reserve margin shown in MERC's filing and whether the procured capacity that determines the reserve margin is reasonable. However, since there is no change in the amount of firm transportation MERC intends to use to serve its firm customers and since MERC's proposal reduces peak-day costs, the Department concludes that the Company's proposal is reasonable.

2. Design-Day Requirement

The Company used the same basic design-day study it employed in its previous demand entitlement filing.[6] The Department analyzed this proposal based on a review of peak-day levels from previous periods and an informal telephone conversation with a MERC representative. In the conversation, the Company indicated that MERC had concerns that its forecast, although yielding an increase of 431 Dkt/day in the design-day requirement, would be low if demand continued to pick up as the economy rebounded from the low levels of consumption associated with the Great Recession of 2008-2010. See MERC Attachment 1, Page 3 of 3. Thus, the Company contracted for the Wadena Call Option as a backstop in case its forecast was low compared with actual demand. The Department concludes that MERC's design-day study, and accompanying entitlements, adjusted for concern over the accuracy of its design-day forecast, are reasonable to ensure sufficient capacity to serve firm customers on a peak day. The Company was able to make the upward adjustment in design-day capacity very inexpensively, acquiring the right for the 1,098 Mcf of the Wadena Call Option at $0.90 per Dkt for three months, for a total of $2,965. That total contrasts favorably with the costs of the NNG contracts it is replacing. For example, the TF-5 contract for 389 Dkt at $9.63 per Dkt for five months alone had costs of $18,713. Therefore, the Department recommends that the Commission approve MERC's proposal to substitute the Wadena Call Option for the NNG resources.

As discussed in Subsection A.3 below, the level of reserve margin shown in MERC's filing is quite high. That MERC believed it needed an unusually high reserve margin to ensure having sufficient capacity raises the possibility that the Company's design-day methodology does not produce reasonable estimates in the aftermath of extreme economic events. The Department

[6] See Docket No. G011/M-09-1285.

concludes that the Company's response, using experience and judgment to override the result of the forecast in this filing, was reasonable. However, the Department recommends that MERC explicitly state in future demand entitlement filings any concerns it has about its forecast and give an explanation for any adjustments to either its design-day forecast or its design-day capacity it makes in response.

3. Reserve Margin

As indicated in Department Attachment 1, the results of the calculation of the MERC reserve margin are as follows:

Total Entitlement (Dkt)	Design-day Estimate (Dkt)	Difference (Dkt)	Reserve Margin %	% Change From Previous Year[7]
8,723	**7,292**	**1,431**	**19.62**	**8.9**

MERC's proposed PNG Viking PGA system reserve margin is nearly 20 percent. This figure is significantly above the Department's preferred 5-7 percent range. The Department's calculates that MERC needs 7,657 Dkt/day to 7,802 Dkt/day for its PNG Viking PGA system reserve margin to be 5-7 percent. Thus, the total entitlement level would need to be decreased by 1,066 Dkt/day to 921 Dkt/day to fall within the range. However, as discussed further below, MERC has reasonably addressed concerns about a reserve margin that is too high.

The main concern associated with a utility carrying too large of a reserve margin is that it subjects ratepayers to rates that are unreasonably high. A company may incur expenses that are unreasonable given that its likelihood of needing all of a high volume of gas is negligible. However, as explained above, the Department concludes that MERC's justification for proposing an unusually high reserve margin is reasonable. The Company has valid concerns that its forecast is too low. Furthermore, MERC has acquired the additional protection for an extreme cold-weather event that the large reserve margin provides, for much less than it was paying for a smaller volume of gas. The Company also explained that its need to honor the terms of certain of its contracts leaves it less flexibility than it would like as it builds its design-day capacity. Consequently, MERC has had to acquire the rights to firm transportation in blocks that are larger than it would prefer. Thus, although the Department does not endorse a reserve margin of nearly 20 percent, the Department concludes that MERC has fully mitigated concerns about charging customers too much and the Company's reserve margin is reasonable in these circumstances.

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7 As shown on Department Attachment 1, the Company's average reserve margin since 2000-2002 is 5.61 percent.

B. THE COMPANY'S PGA COST RECOVERY PROPOSAL

The demand entitlement amounts listed in MERC Attachment 5 represent the demand entitlements for which the Company's firm customers would pay. In its *Petition*, the Company compares its October 2010 PGA to its November 2010 PGA as a means of comparison for its changes (the Company's Attachment 7, page 1 of 2). The Company's demand entitlement proposal would result in the following annual rate impacts:[8]

- Annual bill decrease of $23.24, or approximately -2.68 percent, for the average General Service customer consuming 132 Dkt annually;
- Annual bill decrease of $203.74, or approximately -1.18 percent, for the average Small Volume Interruptible customer consuming 3,499 Dkt annually of contracted demand; and
- Annual bill decrease of $6,619.90, or approximately -1.42 percent, for the average Large Volume Interruptible customer consuming 113,688 Dkt annually of contracted demand; and
- Annual bill decrease of $226.68, or approximately -1.17 percent, for the average Small Volume Firm customer consuming 3,908 Dkt annually of contracted demand.

The Department continues to recommend that MERC include FDD Storage contracts costs in the commodity portion of the PGA rather than the demand portion, upon which the above rate effects are based. Therefore, the Department recommends that the Commission approve the transactions that cause the reduction in rates shown above, but adopt the allocation that the Department favors.

III. THE DEPARTMENT'S RECOMMENDATIONS

The Department recommends that the Commission approve MERC's proposal.

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[8] These annual bill impacts are based on the Company's allocation of FDD Storage contracts to the demand portion of the PGA and not the commodity portion of the PGA as advocated by the Department. MERC Attachment 7, Page 2 of 2, presents the Department's position.

Docket No. G011/M-10-1169
Demand Entitlement Analysis--Minnesota Jurisdiction*

MERC-PNG's Viking Area Demand Entitlement Analysis

	Number of Firm Customers			Design-Day Requirement			Total Entitlement Plus Peak Shaving			Reserve Margin	
Heating Season*	(1) Number of Customers	(2) Change from Previous Year	(3) % Change From Previous Year	(4) Design Day (Dth)	(5) Change from Previous Year	(6) % Change From Previous Year	(7) Total Design-Day Capacity (Dth)	(8) Change from Previous Year	(9) % Change From Previous Year	(10) Reserve (7) - (4)	(11) % of Reserve [(7)-(4)]/(4)
2010-2011	4,675	267	6.06%	7,292	401	5.82%	8,723	1,098	14.40%	1,431	19.62%
2009-2010	4,408	(227)	-4.90%	6,891	(529)	-7.13%	7,625	0	0.00%	734	10.65%
2008-2009	4,635	49	1.07%	7,420	(715)	-8.79%	7,625	(915)	-10.71%	205	2.76%
2007-2008	4,586	63	1.39%	8,135	23	0.28%	8,540	(324)	-3.66%	405	4.98%
2006-2007	4,523	62	1.39%	8,112	198	2.50%	8,864	778	9.62%	752	9.27%
2005-2006	4,461	(63)	-1.39%	7,914	316	4.16%	8,086	268	3.43%	172	2.17%
2004-2005	4,524	211	4.89%	7,598	175	2.36%	7,818	300	3.99%	220	2.90%
2003-2004	4,313	89	2.11%	7,423	340	4.80%	7,518	293	4.06%	95	1.28%
2002-2003	4,224	9	0.21%	7,083	286	4.21%	7,225	400	5.86%	142	2.00%
2001-2002	4,215	23	0.55%	6,797	93	1.39%	6,825	0	0.00%	28	0.41%
2000-2001	4,192			6,704			6,825				
Average:			1.14%			0.96%			2.70%		5.61%

	Firm Peak-Day Sendout						
Heating Season*	(12) Firm Peak-Day Sendout (Dth)	(13) Change from Previous Year	(14) % Change From Previous Year	(15) Excess per Customer [(7) - (4)]/(1)	(16) Design Day per Customer (4)/(1)	(17) Entitlement per Customer (7)/(1)	(18) Peak-Day Send per Customer (12)/(1)
2010-2011	NA			0.3061	1.5598	1.8659	NA
2009-2010	4,704	(985)	-17.31%	0.1665	1.5633	1.7298	1.0672
2008-2009	5,689	(1,369)	-19.40%	0.0442	1.6009	1.6451	1.2274
2007-2008	7,058	143	2.07%	0.0883	1.7739	1.8622	1.5390
2006-2007	6,915	(849)	-10.94%	0.1663	1.7935	1.9598	1.5289
2005-2006	7,764	2,191	39.31%	0.0386	1.7740	1.8126	1.7404
2004-2005	5,573	(428)	-7.13%	0.0486	1.6795	1.7281	1.2319
2003-2004	6,001	85	1.44%	0.0220	1.7211	1.7431	1.3914
2002-2003	5,916	1,816	44.29%	0.0336	1.6768	1.7105	1.4006
2001-2002	4,100	(439)	-9.67%	0.0066	1.6126	1.6192	0.9727
2000-2001	4,539						
Average			2.52%	0.0760	1.6755	1.7676	1.3444

*-Per MERC

Docket No. G011/M-10-1169
Demand Entitlement Analysis--Corrections to MERC Filing

Attachment 6

Entitlement

Change	**Quantity (Dkt)**	**Change in Quantity**
NNG TF 12 mos. (backhaul)	0	-1,098

Attachment 8

Entitlement	**Entitlement Change (Dkt)**	**Months**	**October 2010 Tariff Rate**	**October 2010 Total Cost**	**November 2010 Total Cost**	**Entitlement Change**
Insert						
NNG-TF12 (NNG) (112495)	-178	12	$9.0926	$19,422	$0	-$19,422
FT-A Backhaul	-1,098	3	$3.7671	$12,409	$0	-$12,409
Delete						
Chisago Backhaul	-915	5	$3.7671	$17,234	$0	-$17,234

Calculation of Entitlement Change Items Costs

TF-12 Base (NNG) (112495)	-$23,149
TF-12 Variable (NNG) (112495)	-$19,422
TFX-12 (NNG) (112495)	-$19,053
TF-5 (NNG) (112495)	-$18,713
TFX-5 (NNG) (112486)	-$13,049
FT-A Backhaul	-$12,409
Wadena Delivered Option	$2,965
Total Change Net Cost	-$102,830

Calculation of Storage Change Items Costs

Nexen PSO	-$270,612
Niska Storage	$183,659
AECO/Emerson Swap	$61,020
Total Net Demand Cost	-$25,933

Total Change Demand Cost -$128,763

CERTIFICATE OF SERVICE

I, Sharon Ferguson, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, 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 No. G011/M-10-1169

Dated this **22nd of April, 2011**

/s/Sharon Ferguson

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