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March 4, 2009

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 Office of Energy Security**
Docket Nos. G011/M-08-1330 and G007,011/MR-08-836

Dear Dr. Haar:

Attached are the *Comments* of the Minnesota Office of Energy Security (OES) in the following matter:

A request (*Petition*) submitted by Minnesota Energy Resources Corporation-PNG (MERC-PNG or the Company) for approval of a change in demand entitlements on its Great Lakes Gas Transmission, L.P. (Great Lakes) pipeline system.

The *Petition* was filed on November 3, 2008 by:

Greg Walters
Regulatory and Legislative Affairs Manager
Minnesota Energy Resources Corporation
519 1st Avenue SW
PO Box 6538,
Rochester, MN 55903-6538

Based on its investigation, the OES recommends that the Minnesota Public Utilities Commission (Commission):

- **withhold approval, pending further clarification by MERC-PNG**, of the Great Lakes system demand entitlement level**,** and subject to the Commission's pending decisions regarding the Contracted Demand (CD) units in Docket Nos. G011/M-07-1404 (07-1404) and G007,011/GR-08-835 (08-835);

- **withhold approval, pending further clarification by MERC-PNG**, of the Purchase Gas Adjustment (PGA) recovery of costs associated with the Company's proposed demand entitlement level effective November 1, 2008, and subject to the Commission's pending decisions regarding the CD units in Docket Nos. 07-1404 and 08-835; and

- **require** the Company in its final compliance Base Cost of Gas filing in Docket G007,011/MR-08-836 (08-836) to remove all volumes related to the FT0011 7-month non-winter service from the Company's final base cost of gas calculations.

Regarding the clarification noted above, the OES recommends that the Company provide the following in its *Reply Comments*:

- a detailed explanation of why its current peak day and design-day requirement calculation approach for its MERC-PNG Great Lakes PGA system, MERC-PNG Northern Natural Gas Co. (Northern) PGA system, and MERC-Northern Minnesota Utilities (MERC-NMU) PGA system show an increase in the design-day requirement while the same approach results in a decrease in design-day requirement for its MERC-PNG Viking Gas Transmission Co. (Viking) pipeline system;

- data related to the sales volumes the Company uses to estimate its growth rate including any, and all, models and assumptions necessary to replicate the growth rate;

- identification, by service and interstate pipeline contract, of the amount of Contracted Demand (CD) units included in the proposed design-day and peak-day entitlement levels and in the historical levels indicated on OES Attachments 1 and 2;

- information as to whether the Company had sufficient capacity available for firm customers during the recent cold spells experienced in December 2008 and January 2009;

- results of recalculating the design day requirements in the 07-1404 docket for the 2007-2008 heating season using the same approach used by the Company in the current docket;

- a detailed explanation and reconciliation between the 59 customers Daily Firm Capacity (DFC) data used in the calculation of the firm peak-day estimate and for the 24 customers shown in MERC's Exhibit GJW-1, Schedule 12 in Docket No. 08-835; and

- the reasons associated with the proposed specific changes in demand volumes for MERC-PNG's Great Lakes PGA system design-day deliverability entitlements and to its portfolio of other services.

The OES intends to review this information and provide its final recommendations in subsequent comments. The OES is available to answer any questions that the Commission may have.

Sincerely,

/s/ SACHIN SHAH
Rates Analyst
651-296-7540

SS/sm
Attachment

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

COMMENTS OF THE
MINNESOTA OFFICE OF ENERGY SECURITY

DOCKET NO. G011/M-08-1330 and G007,011/MR-08-836

I. SUMMARY OF MERC-PNG'S PROPOSAL

Pursuant to Minnesota Rules 7825.2910, subpart 2 (Filing Upon Change in Demand), on November 3, 2008, Minnesota Energy Resource Corporation-PNG (MERC-PNG or the Company), submitted a demand entitlement filing (*Petition*) for its Great Lakes Gas Transmission, L.P. (GLGT or Great Lakes) pipeline system.[1] In its *Petition*, MERC-PNG requests the Minnesota Public Utilities Commission's (Commission) approval to "change demand levels by type" on the GLGT system for service to its Minnesota firm customers. Specifically, MERC-PNG requests to change its overall level of demand entitlement (capacity). In addition, MERC-PNG requests that the Commission approve recovery of the associated demand costs in the monthly Purchase Gas Adjustment (PGA) effective November 1, 2008.

II. THE OES'S ANALYSIS OF MERC-PNG'S PROPOSAL

The Minnesota Office of Energy Security (OES) reviewed MERC-PNG's proposed design-day requirement, proposed demand entitlement, and resulting reserve margin. Additionally, the OES compared this year's amounts with previous years' amounts. Based on its investigation to date, the OES concludes that, overall, the Company has provided a reasonable basis for its proposal. However, to confirm that MERC-PNG's service to its firm customers is reliable, the OES

[1] MERC-PNG also serves Minnesota customers off the Northern Natural Gas Co. (NNG or Northern) pipeline system and the Viking Gas Transmission Co. (VGT) pipeline system. On November 3, 2008, MERC-PNG submitted the following requests with respect to these two systems:

- A request to change the demand entitlements on the NNG system for the 2008-2009 heating season in Docket No. G011/M-08-1328; and
- A request to change the demand entitlements on the VGT system in Docket No. G011/M-08-1331.

In addition, on November 3, 2008, MERC-NMU submitted a request to change demand entitlements in Docket No. G007/M-08-1329. The OES separately addresses each of these three requests in these dockets.

requests additional information in MERC-PNG's *Reply Comments*. The OES also notes that this overall conclusion is subject to the Commission's pending decisions regarding the Contracted Demand (CD) units in Docket Nos. G011/M-07-1404 (07-1404) and G007,011/GR-08-835 (08-835) as discussed below.[2] The OES's analysis of the Company's request includes three parts:

- the proposed overall demand entitlement level;
- the specific proposed changes; and
- the PGA cost recovery proposal.

A. MERC-PNG'S GREAT LAKES SYSTEM PROPOSED DESIGN-DAY REQUIREMENT, PROPOSED DEMAND ENTITLEMENT LEVEL, AND RESULTING RESERVE MARGIN

1. Background

MERC-PNG serves its customers from three interstate pipelines: Northern, Viking, and Great Lakes. The customers that MERC-PNG serves with gas from GLGT are located in northern Minnesota, separate from MERC-PNG's system in southern Minnesota.

In its April 11, 2000 *Order* in Docket No. G011/M-99-1552, the Commission required Peoples Natural Gas Co. (currently MERC-PNG) to update all relevant demand information every two years, regardless of whether there was a change in the demand entitlement level. Prior to the 1999 filing, Peoples' GLGT demand entitlement level was approved in 1990, and there were serious reliability concerns during the 1998-1999 heating season.

In MERC-PNG's last demand entitlement filing in the 07-1404 Docket, despite MERC-PNG's use of a statistically valid model, the OES had some concerns related to the previous design-day model's ability to accurately forecast use per customer during a peak-day situation.[3]

The OES's concern was that the use of linear regression analysis may bias design-day estimates (above or below) actual peak-day usage. Thus, the OES recommended that MERC-PNG provide the following additional information from the 2007-2008 heating season in its subsequent demand entitlement filing (which is the instant filing):

- daily throughput data;
- daily firm throughput data;
- estimated daily firm throughput using MERC's design-day models;
- daily firm customer counts;
- daily heating degree day values;

[2] At the time of these *Comments*, the Commission has not issued an *Order* in MERC-PNG's Great Lakes system 2007-2008 heating season demand entitlement filing, Docket No. 07-1404.
[3] A peak-day situation is defined by the Commission as 24-hours of -25°F temperatures.

- peak-day throughput estimates; and
- estimates of firm baseload natural gas usage at zero heating degree days.

In its May 27, 2008 *Reply Comments* in Docket No. 07-1404, MERC-PNG agreed to provide the above information in its next demand entitlement filing to the extent the information was available. MERC-PNG also stated the information it could or could not provide as follows:

> MERC is able to provide daily total throughput data, daily heating degree values, peak-day throughput estimates, and estimates of firm base load natural gas usage at zero heating degree days. As noted in MERC's response to the OES' Information Request No.8 in this docket, however, daily firm throughput data is not available because firm customers are read once a month and the read date varies depending on the assigned billing cycle. No MERC firm customers are able to measure daily consumption by telemetry. Additionally, MERC is required to balance all MERC customers behind MERC city gates, whether firm, interruptible, or transportation. MERC therefore does not forecast firm requirements only. Instead, MERC forecasts system wide requirements, which include firm, interruptible, and transportation. Finally, MERC does not track daily firm customer counts. Customer counts are maintained on a monthly basis.

In Attachment 10 of its *Petition* MERC-PNG provided the comparison between daily system-wide estimates and actual throughput consumption (which includes interruptible and transportation volumes that are located behind MERC-PNG citygates). MERC-PNG also provided average monthly customer counts in Attachment 11 of its *Petition*.

2. *Design-Day Requirement*

In its *Petition,* MERC-PNG explains the peak-day model it uses to estimate the design-day requirement. In its *Petition*, MERC-PNG provided a summary of the changes it made to its firm peak day calculations and how this new approach compared to the approach it took in the previous year's demand entitlement filing. The primary reason the Company cites for the change in approach was that it wanted to introduce less error into its data and regression analysis. MERC-PNG's three major differences in methodology are as follows:

1. In 2007, estimates of the daily transport and interruptible volumes were removed from the total metered daily throughput to get estimated daily firm load before any regressions were performed. This method assumed that transport and interruptible loads were not weather sensitive but more process load. Thus, the estimate for the amount of natural gas used by interruptible customers was the total amount used by these customers, divided by the number of days in the month (assuming a load

factor of 100 percent). This method did not recognize that interruptible customers can and often do use more natural gas on some days compared to others. In 2008, the transport and interruptible volumes were backed out after regressions were performed on measured daily throughput volumes. The estimate of the amount of natural gas used by interruptible customers assumed a load factor for these customers of approximately 66 percent,[4] which should more accurately reflect the amount of natural gas interruptible customers use during a peak day;

2. In 2007, actual changes in customer counts were used to calculate growth rates. In 2008, forecasted changes in volumes were used (however, in both years there were increases in customer counts); and

3. In 2007, Farm Taps were handled uniquely, whereas in 2008, they were not treated differently from any other customer.

In previous demand entitlement filings, MERC-PNG used approximately five heating seasons of data in its design-day regression models, while it uses three heating seasons of data in its current design-day study. MERC-PNG states on pages 8 and 9 of its *Petition* that after examining daily data for three, four, and five heating seasons, it determined that three heating seasons of data provided the best results.

MERC-PNG also provided the model results via an email dated January 12, 2009 in its response to an informal OES Information Request. Based on its review, the OES concludes that MERC-PNG conducted its design-day study using a statistically valid model. The OES notes the increase in MERC-PNG's estimate of its design-day requirement for the GLGT system, which is the estimate of firm customer needs on a peak day. This increase seems appropriate given that MERC-PNG forecasted an increase in the number of firm design-day customers from 5,816 to 5,874. Specifically, as indicated in OES Attachment 2, MERC-PNG's proposed design-day requirement increased 749 Mcf/day (or approximately 7.84 percent) from 9,550 Mcf/day to 10,299 Mcf/day. This change is significant given the projected 1.00 percent customer growth rate for the 2008-2009 heating season.

However, given that the Company used the same approach in calculating the peak day and design-day requirements for MERC-PNG's Northern PGA system, MERC-PNG's Great Lakes PGA system, MERC-PNG's Viking PGA system, and MERC-NMU, the increase in the design-day requirements for the Great Lakes PGA system (as well as increases in the design-day requirements for the Northern PGA system and MERC-NMU) seems unusual when compared to the decrease in design-day requirements for the Viking PGA system in Docket No. G011/M-08-1331 (08-1331).

[4] MERC-PNG's new method divides total use by interruptible customers by 20 days rather than (approximately) 30, resulting in a load factor of 66 percent.

As mentioned in the OES *Comments* in the 08-1331 Docket, in response to follow-up questions from the OES, MERC-PNG indicated that the decrease in the estimate of firm customer use on the Viking PGA system was due to more accurately estimating peak period natural gas usage by interruptible customers. Specifically, as explained above, MERC-PNG changed its previous method of assuming that interruptible customers use the same amount of natural gas every day to a more realistic assumption that interruptible customers' natural gas use varies depending on daily circumstances.

Since the design-day requirement is intended to estimate the amount of natural gas used by firm customers on the peak day, it is important to estimate as accurately as possible the amount of natural gas used by interruptible customers on the peak day, since this amount is subtracted from the total system throughput. Thus, underestimating interruptible customer use results in overestimating peak day firm customer use.

In the 08-1331 Docket, MERC-PNG's methodology change increased the amount of natural gas use attributed to interruptible customers, and correspondingly decreased the estimate of peak-day requirements for Viking PGA system firm customers. In the 08-1331 Docket, the OES agreed with MERC-PNG that the previous method underestimated use by interruptible customers and thus overestimated natural gas use by firm customers. The OES also agreed with MERC-PNG that it is difficult to know with certainty the amount of natural gas used by interruptible customers, so it is important to check whether this change still ensures that MERC-PNG provides reliable service to firm customers on peak days. However, in this *Petition*, the peak day requirements increased.

It is important to note that when using the same design-day calculation methodology, MERC-PNG proposes increases in its design-day requirements for its MERC-PNG Great Lakes PGA system, MERC-PNG Northern PGA system, and for its MERC-NMU PGA system, while at the same time MERC-PNG proposes a significant decrease in the design-day requirement for its MERC-PNG Viking PGA system. The OES concludes that it is important to further investigate the effects of MERC-PNG's change in methodology. Given this occurrence, the OES requests that MERC-PNG provide in its *Reply Comments* a detailed explanation of why its current peak day and design-day requirement calculation approach for its MERC-PNG Great Lakes PGA system, MERC-PNG Northern PGA system, and for its MERC-NMU PGA system show an increase in the design-day requirement and the same approach results in a decrease in design-day requirements for its MERC-PNG Viking PGA system.

As discussed above, MERC-PNG made an adjustment to its design-day calculations involving the sales growth rate. In previous demand entitlement filings, MERC-PNG used changes in forecasted design-day customer numbers as a proxy for its sales growth rates. In this docket, MERC-PNG instead uses forecasted changes in sales volumes to estimate its growth rate. On page 12 of its Petition, MERC-PNG states the following:

> Because the Peak Day Forecast is based on firm load, General Service volumes (GS-residential, commercial and industrial firm) were used as a proxy to calculate growth

> rates. These growth rates were then applied to the adjusted regression results.

MERC-PNG does not provide these forecasted volumes in its *Petition*; therefore, the OES recommends that MERC-PNG provide these data, and any, and all, models, data and assumptions necessary to replicate the sales growth rate in its *Reply Comments.*

The OES investigated historic peak-day sendout per customer information. OES Attachment 2 shows GLGT's all-time peak-day sendout per actual peak-day customer was 1.6222 Mcf/day during the 1998-1999 heating season. OES Attachment 2 also shows that the all-time peak-day sendout per design day customer was 1.6845 Mcf/day during the 1998-1999 heating season.[5]

3. Preliminary Conclusions Regarding Proposed Overall Demand Entitlement Levels

MERC-PNG's proposed total entitlement level of 10,500 Mcf/day reflects a proposed increase of 500 Mcf/day from its 2007-2008 heating season level of 10,000 Mcf/day, along with the Company's expected increase of 58 customers. These changes would reduce the reserve margin by 2.76 percent from 4.71 percent to 1.95 percent, which may result in fewer resources being available to respond to high demands on MERC-PNG's Great Lakes PGA system. Further, the Company's proposed increase in design-day requirements results in an anticipated design-day per customer of 1.7533 Mcf/day. The total entitlement per customer of 1.7875 Mcf/day is greater than the seven-year average peak day sendout per peak-day customer of 1.3473 Mcf/day and greater than the all-time peak day sendout per design-day customer of 1.6845 Mcf/day.

The OES asked if the Company had sufficient capacity and gas supply for firm customers available during the recent cold spell in December 2008. The Company's representative indicated that MERC-PNG did not experience any operational problems and that it had gas supply available for firm customers. The OES appreciates MERC-PNG's response, and the fact that MERC-PNG was able to meet its firm customers' needs. However, given that the Great Lakes system has no peak shaving ability, or available storage, and the fact that MERC-PNG's response only addressed supply rather than capacity, the OES requests that the Company provide information in its *Reply Comments* on whether the Company had sufficient firm capacity available during the recent cold spells experienced in December 2008 and January 2009.

As noted above, the OES's preliminary conclusion is that the Company's proposal appears to be reasonable. However, it is important to ensure that MERC-PNG has sufficient resources available to serve firm customers' needs, particularly since MERC-PNG does not have storage or peak shaving resources on the Great Lakes system. Thus, the OES requests that MERC-PNG provide in its *Reply Comments* the information identified above. The OES will review the information related to firm capacity availability provided by the Company and subsequently provide the OES's final recommendations regarding the proposed entitlement levels of 10,500 Mcf/day.

4. Contracted Demand Units

The OES notes that the entitlement numbers in column 7 of OES Attachment 2 may not be an apples-to-apples comparison from year to year since the 2007-2008, and presumably the 2008-2009 numbers, include the CD units whereas historical numbers, for example the Commission approved entitlement level of 9,686 Mcf/day in Docket No. G011/M-05-1726 for the 2005-2006 season, exclude the CD units.

In its April 29, 2008 *Comments* in the 07-1404 Docket, the OES requested that MERC-PNG discontinue recovery of 314 Mcf/day of T-17 service related to contracted demand that it recovered from joint-rate customers and included in the monthly PGA for recovery by all demand rate customers. In the OES's June 12, 2008 *Response Comments* in 07-1404 Docket, the OES was concerned with the Company's statement in its *Reply Comments* in the 07-1404 Docket that these contracted demand volumes were used for planning purposes and any usage deviation from these planned volumes were added or subtracted from total firm volumes. The OES was concerned that firm customers were subsidizing joint-rate customers. As a result, the OES recommended that the Commission require that MERC-PNG file testimony in its next rate case related to its joint-rate service tariffs and whether firm customers subsidize joint-rate customers.

The Company filed testimony in its current rate case in the 08-835 Docket. In the OES's July 25, 2008 *Supplemental Comments* in the 07-1404 Docket, the OES concluded that the inclusion of contracted demand volumes in the Company's PGA cost recovery was reasonable. Thus, the issue of CD units is currently pending before the Commission in the 07-1404 Docket and in the 08-835 Docket. Additionally, the OES requests the Company in its *Reply Comments* to identify separately, by service and interstate pipeline contract, the amount of CD units included in the proposed design day and peak-day entitlement levels along with the historical entitlement levels as shown in OES Attachments 1 and 2.

5. Number of Joint Sales Customers

The OES also requests that MERC-PNG reconcile a number in this docket with a number in the Company's rate case. Specifically, when the Company calculated the "Daily Firm Capacity (DFC) customer selections" in its calculations, as described on pages 11 and 12 of MERC-PNG's *Petition*, the number of joint interruptible customers used in the data was 59 customers. However, in MERC's general rate case, the Direct Testimony and Exhibits of Company Witness, Gregory J. Walters, Exhibit GJW-1, Schedule 12 shows approximately 24 joint sales customers in the 2008 test year. The OES requests the Company in its *Reply Comments* to provide a detailed explanation, and reconciliation, for the 59 customers DFC data used in the calculation of the firm peak-day estimate calculations and the 24 customers mentioned in the rate case. If, as a

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[5] When design-day forecasts of other Minnesota regulated natural gas companies are examined, the 1995-1996 and 1993-1994 heating seasons are generally where historic peak-day throughputs occurred. However, MERC-PNG has information only from the 1995-1996 heating season going forward.

result of this reconciliation, the Company's firm peak-day estimates and calculations change then the OES expects the Company will update and provide any and all such results in its *Reply Comments*.

6. *Reserve Margin*

As noted above, and as indicated in OES Attachment 2, the Company's proposal results in a positive reserve margin for the Great Lakes PGA system customers of 1.95 percent, a decrease of 2.76 percent from the 2007-2008 heating season reserve margin of 4.71 percent. However, as noted above, MERC-PNG made a number of changes to its estimation methods compared to last year's demand entitlement filing, so the two years may not be directly comparable. The current 1.95 percent reserve margin on the Great Lakes PGA system is within the OES's five percent margin threshold, and thus does not appear to overstate the amount of resources MERC-PNG needs to serve its customers. However, since the Great Lakes system does not have peak shaving or storage, customers on this system may be more susceptible to service issues during a peak-day situation if the design-day estimates are incorrect. Peak shaving and storage facilities provide additional natural gas supplies on peak days; for those systems that lack such facilities it may be appropriate to maintain larger reserve margins. The OES will review MERC-PNG's *Reply Comments* for further information on this topic.

B. MERC-PNG'S SPECIFIC PROPOSED DEMAND ENTITLEMENT CHANGES

In addition to the overall assessment as to whether MERC-PNG has sufficient resources to meet firm customers' need on a peak day, the OES also assesses whether the type of resources MERC-PNG proposes to serve firm customers are reasonable. There are two types of demand entitlement changes. The first type is design-day deliverability; which in this petition does not affect the amount of transportation available to MERC-PNG's Great Lakes PGA system customers during the winter peak. The second type does not affect design-day deliverability level, but does affect the demand costs recovered from ratepayers through the PGA.

1. *Design-Day Deliverability Changes*

As indicated in OES Attachment 1, MERC-PNG's proposal would increase the Company's pending total design-day capacity (total entitlement) by 500 Mcf/day. This total proposed increase in total entitlement is caused by an increase of 500 Mcf/day in FT8466 12-month service.

Regarding the above increase, MERC-PNG does not provide a detailed explanation in its filing to support the above specific proposed demand change. As a result, the OES requests that the Company provide the reasons, and detailed explanations, for the above change in entitlement level in its *Reply Comments*.

2. *Other Demand Entitlement Changes*

a. *Background on GLGT's FT0011 7-Month Service*

In its April 29, 2008 *Comments* in the 07-1404 Docket, the OES noticed that MERC-PNG's FT0011 contract appeared to be a new charge[6] and had relatively high costs compared to other Great Lakes' PGA system transportation contracts. As mentioned by the OES in its April 29, 2008 *Comments* in the 07-1404 Docket, during a telephone conversation with MERC on December 12, 2007, the Company had stated that the FT0011 contract, and the accompanying T-11 service, were a means of securing storage, but the storage that this service was meant to secure was unavailable at the time. In response, the OES issued discovery related to these transportation contracts. In the FT0011 service agreement, MERC had stated that the agreement was also related to the Great Lakes FT0016 agreement and it would remain in effect for as long as the FT0016 agreement was active. In the June 12, 2008 *Response Comments* of the OES in 07-1404 Docket, the OES noted that the Company confirmed in its *Reply Comments* in the 07-1404 Docket that there was currently no storage available and there were few storage projects that would work with the FT0011 contract. The OES also noted that the Company described in its *Reply Comments* in the 07-1404 Docket the relationship between its FT0011 and FT0016 agreements and that there were no operational ties between the two agreements and that the Company did not have a "Gas Storage Agreement." As a result, the OES concluded that the cost recovery of the FT0011 costs from ratepayers was unreasonable.

In the OES's July 25, 2008 *Supplemental Comments* of the OES in the 07-1404 Docket, the OES concluded that MERC-PNG be required to:

- calculate the amount of costs recovered from ratepayers to date through the PGA from its FT0011 agreement and provide this amount on the record in the September 1, 2008 true-up filing;
- provide, in the September 1, 2008 true-up filing, the amount of money recovered through the capacity release market, credited through the PGA, for its FT0011 agreement; and
- immediately discontinue cost recovery associated with its FT0011 agreement and refund to its ratepayers the net difference between the total recovered PGA costs and the total amount received in the capacity release market credited to the PGA for the FT0011 contract.

The Company submitted a letter on September 23, 2008 in Docket Nos. G007/M-07-1402 and G011/M-07-1404, in which it stated that it has followed the OES recommendation by outlining the demand costs and capacity credits received for the FT0011 agreement for the period July 1, 2007 through June 2008 in Schedule N of MERC-PNG's and MERC-NMU's Annual Automatic

[6] The OES at the time analyzed past Aquila demand entitlement filings and noticed that Aquila did not recover costs associated with this FT0011 contract resource in its monthly PGAs.

Adjustment (AAA) and True-up reports filed on September 5, 2008.[7] Further, MERC-PNG stated that it has followed the OES's recommendation and has refunded to its ratepayers the difference between the total recovered PGA costs and the amount received in the capacity release market credited to the PGA for the months of April and May 2008. MERC-PNG also made the following statement in its September 23, 2008 *Letter*:

> MERC additionally notes that it has terminated the FT0011 agreement effective June 30, 2008. In return for Great Lakes Gas Transmission (GLGT) agreeing to terminate the FT0011 agreement prior to its termination date, MERC extended transportation agreement FT0016 for an additional five (5) year term, with a termination date of October 31, 2015.

In addition to the above transportation change, the Company proposes a decrease in its FT0011 7-month non-winter service of 423 Mcf/day capacity. The Company states that this agreement was terminated.

However, the OES is concerned with the inclusion of the 423 Mcf/day of capacity related to MERC-PNG's FT0011 7-month non-winter service in the Company's Base Cost of Gas filing in Docket No. G007,011/MR-08-836. The Commission issued its *Order Setting New Base Cost of Gas* on September 25, 2008 in Docket No. G007,011/MR-08-836. Given the concerns noted by the OES in several rounds of *Comments* in the 07-1404 Docket, MERC-PNG's incorporation of the OES recommendations related to the FT0011 agreement, and the fact that this contract has been terminated by the Company, the OES believes that the inclusion of volumes related to the FT0011 7-month non-winter service in the initial base cost of gas filing are unreasonable. Therefore, the OES recommends that the Commission require the Company, in its final compliance base cost of gas filing, to remove all volumes related to the FT0011 7-month non-winter service from the Company's final base cost of gas calculations.

b. Nexen Storage Exchange Agreement

As shown in MERC-PNG Attachments 4 and 8, and as indicated in OES Attachment 4, MERC-PNG proposes to decrease its Nexen Exchange Agreement on the GLGT PGA system by 13,251 units. As mentioned in MERC-PNG's July 8, 2008 *Reply Comments* in Docket No. G007/M-07-1402 (07-1402), the Company states that the Nexen Storage Agreement is an exchange agreement and because of FASB (Financial Accounting Standards Board) accounting rules, MERC-PNG does not classify the agreement as storage. The Nexen Storage Exchange agreement allows MERC-PNG to give gas to a third party during the summer at an agreed upon delivery point and the gas is re-delivered by the same third party at an agreed upon delivery point during the winter. The OES in its *Supplemental Comments* dated July 25, 2008 in the 07-1404 Docket agreed that the Nexen Exchange agreement was not a true storage contract and as such, its costs should be recovered through demand costs and not commodity costs.

[7] Please see Docket Nos. G999/AA-08-1011, G007/AA-08-1067, and G011/M-08-1068.

Regarding the above decrease, MERC-PNG does not provide a detailed explanation in its filing to support the above specific proposed change to its portfolio of other services. As a result, the OES requests that the Company provide the reasons, and detailed explanations, for the above change to its portfolio of other services in its *Reply Comments*.

c. Previous PGA Demand Volumes

On a separate issue, MERC-PNG has been consistent between the volumes identified in its October PGA monthly report and the volumes identified in its initial BCOG filing in Docket No. G007,011/MR-08-836. The Commission issued its *Order Setting New Base Cost of Gas* on September 25, 2008 in Docket No. G007,011/MR-08-836. However, the OES notes that MERC-PNG has been using the 2000 rate case volumes in its monthly PGA reports from at least September 2008 and prior periods.[8] The OES expects MERC-PNG, after the end of the general rate case in the 08-835 Docket, to comply with Minnesota Rules including Minnesota Rule 7825.2700, subpart 5, and Minnesota Rule 7825.2400, subpart 3 in the Company's future PGA and demand entitlement filings. Specifically, Minnesota Rule 7825.2700, subpart 5 states in part that the demand adjustment must be computed using test year demand volumes for three years after the end of the utility's most recent general rate case test year. After this time period, the demand adjustment must be computed on the basis of the annual demand volume. Minnesota Rule 7825.2400, subpart 3 defines the annual demand volume as follows:

> "Annual demand volume" is the annual sales volume adjusted by an average percentage change in sales computed over the preceding three-year period, normalized for weather. Annual demand volume includes interruptible sales to the extent that demand cost is incurred to service interruptible customers.

Thus, MERC-PNG would use the Commission-approved test year demand volumes for three years after the end of its general rate case test year (which was calendar year 2008 in the 08-835 Docket) and the definition cited above in the Company's future PGA and demand entitlement filings.

C. MERC-PNG'S GREAT LAKES PGA COST RECOVERY PROPOSAL

The demand entitlement changes discussed above represent the demand entitlements for which MERC-PNG's firm customers on the Great Lakes PGA system would pay. In its *Petition*, the

[8] On May 11, 2001, the Commission issued its *Order Modifying And Accepting Settlement* (May 11, 2001 Order) in Aquila Networks-NMU's and Aquila Networks-PNG's general rate case in Docket No. G007,011/GR-00-951. In its June 1, 2006 Order Approving Sale Subject to Conditions, (Docket No. G007,011/PA-05-1676) the Commission approved Aquila Inc.'s (Aquila) sale of its two divisions operating in Minnesota, Aquila Networks-PNG and Aquila Networks-NMU to Minnesota Energy Resources Corporation (MERC), a subsidiary of WPS Resources Corporation. MERC has two divisions: MERC-PNG and MERC-NMU.

Company uses its November 2008 PGA as a means of comparison for its cost changes.[9] When comparing the proposed changes in rates to the Company's filed October 2008 PGA rates, the OES estimates that MERC-PNG's demand entitlement proposal results in the monthly rate impacts as shown in Table 1 below:

Table 1
OES Great Lakes PGA Cost Recovery
Monthly Rate Impact Compared to October 2008 PGA

Customer Class	Commodity Change ($/Mcf)	Commodity Change (Percent)	Demand Change ($/Mcf)	Demand Change (Percent)	Total Change ($/Mcf)	Total Change (Percent)	Effect on Annual Bill ($)
General Service	$0.0000	0.00	$(0.0031)	(0.39)	$(0.0031)	(0.03)	$(0.52)
Small Vol. Interruptible Service	$0.0000	0.00	$0.0000	0.00	$0.0000	0.00	$0.00
Small Vol. Firm Service	$0.0000	0.00	$0.0000	0.00	$0.0000	0.00	$0.00

The OES's analysis is somewhat different from that shown in MERC-PNG's petition. Unlike the Company, the OES holds the weighted average cost of gas constant, so as to isolate the increases in total gas costs associated solely with the demand cost of gas. As shown in Table 1, and OES Attachment 3, the OES analysis concludes that MERC-PNG's proposal would result in an annual bill decrease of ($0.52), or approximately (0.03) percent, for an average General Service customer consuming 167 Mcf annually.

III. THE OES'S RECOMMENDATIONS

Based on its investigation to date, the OES recommends that the Commission:

- **withhold approval, pending further clarification by MERC-PNG**, of the Great Lakes system demand entitlement level**,** and subject to the Commission's pending decisions regarding the CD units in Docket Nos. 07-1404 and 08-835;

- **withhold approval, pending further clarification by MERC-PNG**, of the PGA recovery of costs associated with the Company's proposed demand entitlement level effective November 1, 2008, and subject to the Commission's pending decisions regarding the CD units in Docket Nos. 07-1404 and 08-835; and

[9] The Company submitted revised Attachments 4, page 1 and 7 on November 5, 2008. MERC-PNG stated that it had not updated the proposed commodity and demand costs and the revised attachments should replace those in the *Petition*.

- **require** the Company in its final compliance base cost of gas filing to remove all volumes related to the FT0011 7-month non-winter service from the Company's final base cost of gas calculations.

The OES also recommends that the Company provide the following in its *Reply Comments*:

- a detailed explanation of why its current peak day and design-day requirement calculation approach for its MERC-PNG Great Lakes PGA system, MERC-PNG Northern PGA system, and MERC-NMU PGA system show an increase in the design-day requirement while the same approach results in a decrease in design-day requirement for its MERC-PNG Viking pipeline system;

- data related to the sales volumes the Company uses to estimate its growth rate including any, and all, models and assumptions necessary to replicate the growth rate;

- identification, by service and interstate pipeline contract, of the amount of CD units included in the proposed design-day and peak-day entitlement levels and in the historical levels indicated on OES Attachments 1 and 2;

- information, and detailed explanations as to whether the Company had sufficient capacity available for firm customers during the recent cold spells experienced in December 2008 and January 2009;

- results of recalculating the design day requirements in the 07-1404 docket for the 2007-2008 heating season using the same approach used by the Company in the current docket;

- a detailed explanation and reconciliation between the 59 customers Daily Firm Capacity (DFC) data used in the calculation of the firm peak-day estimate and for the 24 customers shown in MERC's Exhibit GJW-1, Schedule 12 in Docket No. 08-835; and

- the reasons associated with the proposed specific changes in demand volumes for MERC-PNG's Great Lakes PGA system design-day deliverability entitlements and to its portfolio of other services.

The OES intends to review this information and provide its final recommendations in subsequent comments.

/sm

Minnesota Office of Energy Security Attachment 1
MERC's Great Lakes Area Demand Entitlements Historical and Current Proposal

Docket No. G011/M-08-1330

2005-06 G011/M-05-1726	Quantity (Mcf)
T-17 *	3,791
FT-075 Res fee	1,973
FT-155 (12)	2,422
FT-155 (5)	1,500
Total Design Day Capacity	9,686
Total GL Transportation	9,686
Total Transportation	9,686
Total Seasonal Transport	1,500
Percent Seasonal on GL	15.5%

2006-07 G011/M-06-1537	Quantity (Mcf)	Change in Quantity
T-17 *	3,791	0
FT-075 Res fee	1,973	0
FT-155 (12)	2,422	0
FT-155 (5)	1,500	0
Total Design Day Capacity	9,686	0
Total GL Transportation	9,686	0
Total Transportation	9,686	0
Total Seasonal Transport	1,500	0
Percent Seasonal on GL	15.5%	0.0%

2007-08 G011/M-07-1404	Quantity (Mcf)	Change in Quantity
T-17	4,105	314
FT-075 Res fee	1,973	0
FT-155 (12)	2,422	0
FT-155 (5)	1,500	0
FT0011 **	0	0
Total Design Day Capacity	10,000	314
Total GL Transportation	10,000	314
Total Transportation	10,000	314
Total Seasonal Transport	1,500	0
Percent Seasonal on GL	15.0%	-0.5%

2008-09 G011/M-08-1330	Quantity (Mcf)	Change in Quantity
T-17	4,105	0
FT-075 Res fee	1,973	0
FT-155 (12)	2,422	0
FT-155 (5)	1,500	0
FT0011 **	0	0
FT8466 ***	500	500
Total Design Day Capacity	10,500	500
Total GL Transportation	10,500	500
Total Transportation	10,500	500
Total Seasonal Transport	1,500	0
Percent Seasonal on GL	14.3%	-0.7%

* These values do not include Contracted Demand (CD).
** MERC includes this contract in its analysis, while the OES omits its volumes for reasons explained in the body of *Comments in Docket No G011/M-07-1404*.
*** This contract was included in the 2007-2008 heating season in Docket No. G007/M-07-1402 and it appears that MERC is reallocating portion of the contract from MERC-NMU to MERC-PNG.
Please see Docket No. G007/M-08-1329.

Minnesota Office of Energy Security Attachment 2
MERC-PNG's Great Lakes Area Demand Entitlement Analysis
Docket No. G011/M-08-1330

	Number of Firm Customers			Design Day Requirement			Total Entitlement + Peak Shaving			Reserve Margin
Heating Season *	(1) Number of DD Customers	(2) Change From Previous Year	(3) % Change From Previous Year	(4) Design Day (Mcf)	(5) Change From Previous Year	(6) % Change From Previous Year	(7) Total Entitlement (Mcf)	(8) + Peak Shaving Change From Previous Year	(9) % Change From Previous Year	(10) % of Reserve Margin [(7)-(4)]/(4)
2008-2009	5,874	58	1.00%	10,299	749	7.84%	10,500	500	5.00%	1.95%
2007-2008#	5,816	69	1.20%	9,550	7	0.07%	10,000	314	3.24%	4.71%
2006-2007	5,747	68	1.20%	9,543	33	0.35%	9,686	0	0.00%	1.50%
2005-2006	5,679	165	2.99%	9,510	61	0.65%	9,686	0	0.00%	1.85%
2004-2005	5,514	103	1.90%	9,449	(198)	-2.05%	9,686	0	0.00%	2.51%
2003-2004	5,411	133	2.52%	9,647	1,659	20.77%	9,686	1,186	13.95%	0.40%
2002-2003	5,278	172	3.37%	7,988	(123)	-1.52%	8,500	0	0.00%	6.41%
2001-2002	5,106	134	2.70%	8,111	(254)	-3.04%	8,500	0	0.00%	4.80%
2000-2001	4,972	175	3.65%	8,365	92	1.11%	8,500	0	0.00%	1.61%
1999-2000**	4,797	341	7.65%	8,273	588	7.65%	8,500	2,422	39.85%	2.74%
1998-1999	4,456	241	5.72%	7,685	416	5.72%	6,078	0	0.00%	-20.91%
1997-1998	4,215	386	10.08%	7,269	665	10.07%	6,078	0	0.00%	-16.38%
1996-1997	3,829	336	9.62%	6,604	579	9.61%	6,078	0	0.00%	-7.96%
1995-1996	3,493			6,025			6,078			
Average Change Per Year:			4.12%			4.40%			4.77%	-1.29%

Per Peoples, the 2001-02 Design Day declined due to a downward trend in consumption and heat factor possibly due to high gas costs in 2000-01 and more energy efficient housing.

Firm Peak Day Sendout

Heating Season *	(11) Number of Peak Day Customers	(12) Firm Peak Day Sendout (Mcf)	(13) Sendout 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 Sendout per PD Customer (12)/(11)	(19) Peak Day Sendout per DD Customer (12)/(1)
2008-2009	unknown	unknown			0.0342	1.7533	1.7875	unknown	unknown
2007-2008	unknown	5,063	(1,709)	-25.24%	0.0774	1.6420	1.7194	unknown	0.8705
2006-2007	unknown	6,772	(959)	-12.40%	0.0249	1.6605	1.6854	unknown	1.1784
2005-2006 ***	unknown	7,731	1,608	26.26%	0.0310	1.6746	1.7056	unknown	1.3613
2004-2005	5,714	6,123	(1,543)	-20.13%	0.0430	1.7136	1.7566	1.0716	1.1104
2003-2004	5,529	7,666	567	7.99%	0.0072	1.7828	1.7901	1.3865	1.4167
2002-2003	5,411	7,099	1,104	18.42%	0.0970	1.5135	1.6105	1.3120	1.3450
2001-2002	5,099	5,995	(567)	-8.64%	0.0762	1.5885	1.6647	1.1757	1.1741
2000-2001	4,970	6,562	(576)	-8.07%	0.0272	1.6824	1.7096	1.3203	1.3198
1999-2000	4,627	7,138	(368)	-4.90%	0.0473	1.7246	1.7719	1.5427	1.4880
1998-1999	4,627	7,506	1,567	26.38%	-0.3606	1.7246	1.3640	1.6222	1.6845
1997-1998	unknown	5,939	588	10.99%	-0.2826	1.7246	1.4420	unknown	1.4090
1996-1997	unknown	5,351	427	8.67%	-0.1374	1.7247	1.5874	unknown	1.3975
1995-1996	unknown	4,924			0.0152	1.7249	1.7401	unknown	1.4097
Average Change Per Year:				1.61%	-0.0257	1.6832	1.6575	1.3473	1.3204

-- The analysis conducted by the OES does not include the 423 Mcf/day capacity related to MERC's FT0011 agreement.
This decision to omit these volumes is discussed in the body of the Comments in Docket No. G011/M-07-1404.
*Per Peoples, information prior to 1995 is not available.
**Corrected from peak day to design day number of customers.

*** The Company has not provided the number of peak-day customers beginning from the 2005-2006 heating season.

Prepared by the Minnesota Office of Energy Security

Minnesota Office of Energy Security Attachment 3
MERC-PNG's Great Lakes Area Demand Entitlments Rate Impacts as Revised by the OES
Docket No. G011/M-08-1330

MERC-PNG GREAT LAKES SYSTEM
RATE IMPACT OF THE PROPOSED DEMAND CHANGE -- MODIFIED BY THE OES
November 1, 2008

All costs in $/MMBtu	Last Rate Case G011 GR-92-132	Last Demand Change G011/ M-07-1403 Nov. 07	Most Recent PGA Oct. 08	Oct-08 PGA with Current Demand Entitlement Change	Result of Proposed Change: Change from Last Rate Case	Change from Last Demand Change	Change from Last PGA	Change from Last PGA $
1) General Service: Avg. Annual Use:			**167**	**Mcf**				
Commodity Cost	$2.8377	$6.1010	$6.9436	$6.9436	144.69%	13.81%	0.00%	$0.0000
Demand Cost	$0.2068	$0.8461	$0.7995	$0.7964	285.11%	-5.87%	-0.39%	($0.0031)
Commodity Margin	$1.1771	$1.1771	$1.6263	$1.6263	38.16%	38.16%	0.00%	$0.0000
Total Cost of Gas	$4.2216	$8.1242	$9.3694	$9.3663	121.87%	15.29%	-0.03%	($0.0031)
Avg Annual Cost	$705.01	$1,356.74	$1,564.69	$1,564.17	121.87%	15.29%	-0.03%	($0.52)
Effect of proposed commodity change on average annual bills:								$0.00
Effect of proposed demand change on average annual bills:								($0.52)
2) Small Vol. Interruptible: Avg. Annual Use:			**3,063**	**Mcf**				
Commodity Cost	$2.8377	$6.1010	$6.9436	$6.9436	144.69%	13.81%	0.00%	$0.0000
Demand Cost								
Commodity Margin	$0.9000	$0.9000	$1.2434	$1.2434	38.16%	38.16%	0.00%	$0.0000
Total Cost of Gas	$3.7377	$7.0010	$8.1870	$8.1870	119.04%	16.94%	0.00%	$0.0000
Avg Annual Cost	$11,448.58	$21,444.06	$25,076.78	$25,076.78	119.04%	16.94%	0.00%	$0.00
Effect of proposed commodity change on average annual bills:								$0.00
Effect of proposed demand change on average annual bills:								$0.00
3) Small Vol. Firm: Avg. Annual Use:			**5,148**	**Mcf**				
	Avg, Annual CD units:		**51**					
Commodity Cost	$2.8377	$6.1010	$6.9436	$6.9436	144.69%	13.81%	0.00%	$0.0000
Demand Cost	$1.6270	$3.4580	$3.4580	$3.4580	112.54%	0.00%	0.00%	$0.0000
Commodity Margin	$0.9000	$0.9000	$1.2434	$1.2434	38.16%	38.16%	0.00%	$0.0000
Demand Margin	$1.5000	$1.5000	$2.0724	$2.0724	38.16%	38.16%	0.00%	$0.0000
Total Cost of Gas	$3.7377	$7.0010	$8.1870	$8.1870	119.04%	16.94%	0.00%	$0.0000
Total Demand Cost	$3.1270	$4.9580	$5.5304	$5.5304	76.86%	11.54%	0.00%	$0.0000
Avg Annual Cost	$19,401.16	$36,294.01	$42,428.73	$42,428.73	118.69%	16.90%	0.00%	$0.00
Effect of proposed commodity change on average annual bills:								$0.00
Effect of proposed demand change on average annual bills:								$0.00

Note: Average Annual Average based on PNG Annual Automatic Adjustment Report in
Docket No. E,G999/AA-06-1208

Note: The Commodity and Demand Margin numbers are subject to change once the Company's General Rate Case in Docket No. G007,011/GR-08-835 is finalized and the Commission issues its Decision. Thus in the subsequent Demand Entitlement filings, the Margin numbers will change.

Minnesota Office of Energy Security Attachment 4 MERC-PNG's Great Lakes Area Demand Entitlements --
PGA Impacts with Updated Entitlement Levels
Docket No. G011/M-08-1330

October 2008 PGA						
I.MERC-PNG's Great Lakes System -- Current Cost of Gas Effective						
		Volume	Months	Rate	Current	Rate/CCF
A. GS-5	T-17 Demand	4,105	12	$3.4580	$170,341	$0.01975
	FT-075- Res Fee	1,973	12	$3.4580	$81,872	$0.00949
	FT-155 (12)	2,422	12	$3.4580	$100,503	$0.01165
	FT-155 (5)	1,500	5	$3.4580	$25,935	$0.00301
					$0	$0.00000
					$378,651	$0.04389
	Exchange	175,759		$1.7700	$311,093	$0.03606
						$0.00000
	Rate Case 2008 General Sales Service Volumes in Therm			8,626,910		
	Current Demand Cost of Gas/Therm					$0.07995
	Current Commodity Cost of Gas/Therm					**$0.69436**
	Rate Case 2000 All Classes Volumes-Therm			10,663,940		
	All Classes Commodity				$7,404,613	
	Total Cost of Gas/Therm					$0.77431
B. SVI-5	Current T-17 Commodity Cost of Gas-Therm					$0.69436
C. SJ-5	Current T-17 Demand Cost of Gas-Therm					$0.34580
	Current T-17 Commodity Cost of Gas-Therm				$0	$0.69436
D. LJ-5	Current T-17 Demand Cost of Gas-Therm					$0.34580
	Current T-17 Commodity Cost of Gas-Therm					$0.69436
	Total Cost of Gas				$8,094,358	

October PGA with update entitlement levels-- as modified by the OES						
I.MERC-PNG's Great Lakes System -- Current Cost of Gas Effective						
		Volume	Months	Rate	Current	Rate/CCF
A. GS-5	T-17 Demand	4,105	12	$3.4580	$170,341	$0.01975
	FT-075- Res Fee	1,973	12	$3.4580	$81,872	$0.00949
	FT-155 (12)	2,422	12	$3.4580	$100,503	$0.01165
	FT-155 (5)	1,500	5	$3.4580	$25,935	$0.00301
	FT8466	**500**	**12**	**$3.4580**	**$20,748**	**$0.00241**
					$399,399	$0.04630
	Nexen Exchange	**162,508**		**$1.7700**	**$287,639**	**$0.03334**
	Rate Case 2008 General Sales Service Volumes in therms			8,626,910		
	Current Demand Cost of Gas/therm					$0.07964
	Current Commodity Cost of Gas/Therm					**$0.69436**
	Call Option Premium				0	$0.00000
	Rate Case 2008 All Classes Volumes-Therm			10,663,940		
	All Classes Commodity				$7,404,613	$0.69436
	Total Cost of Gas/Therm					$0.77400
B. SVI-5	Current T-17 Commodity Cost of Gas-CCF					$0.69436
C. SVJ-5	Current T-17 Demand Cost of Gas-CCF					$0.34580
	Current T-17 Commodity Cost of Gas-CCF					$0.69436
D. LVJ-5	Current T-17 Demand Cost of Gas-CCF					$0.34580
	Current T-17 Commodity Cost of Gas-CCF					$0.69436
	Total Cost of Gas				$8,091,652	

Prepared by the Minnesota Office of Energy Security

STATE OF MINNESOTA)
) ss
COUNTY OF RAMSEY)

AFFIDAVIT OF SERVICE

I, **Sharon Ferguson**, being first duly sworn, deposes and says: that on the **4th** of **March, 2009**, served the **Minnesota Office of Energy Security Comments**

MNPUC DOCKET NUMBER: G011/M-08-1330

XX by depositing in the United States Mail at the City of St. Paul, a true and correct copy thereof, properly enveloped with postage prepaid

XX electronic filing

/s/Sharon Ferguson

Subscribed and sworn to before me

this 4th day of March , 2009

/s/ Lisa Maria DeTomaso

Lisa Maria DeTomaso
Notary Public-Minnesota
Commission Expires Jan 31, 2011

G011/M-08-1330

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