Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: April 23, 2014 .... **Agenda Item # 7

Company: Greater Minnesota Gas, Inc. (GMG)

Docket No. G022/M-12-1279
In the Matter of GMG's Notice of Change in Demand Entitlements

Issues:

1. Should the Commission (a) accept GMG's design-day analysis, or (b) reject GMG's design-day analysis and find that GMG did not purchase adequate capacity to serve its firm customers on a peak day?

2. Should the Commission allow GMG to recover associated demand costs through the monthly Purchased Gas Adjustment effective November 1, 2012?

3. Should the Commission open an investigation to study rural Minnesota natural gas needs and how the current regulatory system meets those needs?

Staff: Sundra Bender 651-201-2247
Robert Harding 651-201-2237

Relevant Documents

GMG – Initial Filing .... March 25, 2013
DOC – Comments .... June 7, 2013
GMG – Reply Comments .... June 17, 2013
DOC – Response to Reply Comments .... July 16, 2013

The attached materials are workpapers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless otherwise noted.

Statement of the Issues

1. Should the Commission (a) accept GMG's design-day analysis, or (b) reject GMG's design-day analysis and find that GMG did not purchase adequate capacity to serve its firm customers on a peak day?

2. Should the Commission allow GMG to recover the associated[1] demand costs through the monthly purchased gas adjustment effective November 1, 2012?

3. Should the Commission open an investigation to study rural Minnesota natural gas needs and how the current regulatory system meets those needs?

Introduction

A demand entitlement filing is required whenever a gas utility changes the level of demand-related services to which it is entitled by contract. These filings allow the Commission to look at the supply-side resources a gas utility plans to have available to meet firm customer demand for gas. These filings must include the utility's forecast of design-day demand by customer class and the change in design-day demand, if any, that necessitate the demand revision. Also examined are the reasonableness of the estimated design day reserve margin and the level and type of demand costs passed through the purchased gas adjustment.

Minnesota Rules

Minnesota Rules require gas utilities to make a filing whenever there is a change in their entitlement to demand-related services provided to them by a supplier or transporter of natural gas.

Minnesota Rule part 7825.2910, Subp. 2, Filing upon a change in demand.
This rule is in the Automatic Adjustment of Charges rules, Minn. Rules parts 7825.2390 through 7825.2920, and requires gas utilities to file to increase or decrease demand, to redistribute demand percentages among classes, or to exchange one form of demand for another.

Minnesota Rule part 7825.2400, Subp. 13a. Demand.
This rule defines demand as "the maximum daily volumes of gas that the utility has contracted with a supplier or transporter to receive."

Minnesota Rule part 7825.2400, Subp. 13d. Design day.
This rule defines design-day as "a 24-hour-day period of the greatest possible gas requirement to meet firm customer needs."

[1] The demand costs associated with the proposed demand entitlements.

Minnesota Rule parts 7851.0010, subpart 21 and 7610.0800, subpart 21. Peak day.
Both of these rules define peak-day as "the 24-hour period of greatest gas sendout." Peak-day send-out is often referred to in comparison to the design day forecast. The historical peak-day and the amount of gas sent-out from the gas utilities' system, refers to the actual amount of gas sent out from the LDC over a 24-hour time period. Each year has a peak-day and each utility has a record for its all-time, historical peak-day. Peak-days are usually lower than the design-day and to ensure the ability to provide reliable service to firm customers, the peak-day should always be less than the design-day plus a reserve margin.

Issues

1. **Should the Commission (a) accept GMG's design-day analysis, or (b) reject GMG's design-day analysis and find that GMG did not purchase adequate capacity to serve its firm customers on a peak day?**

2. **Should the Commission allow GMG to recover the associated demand costs through the monthly purchased gas adjustment effective November 1, 2012?**

Background
GMG initially filed its petition as a compliance filing in Docket No. G022/M-10-1165 on November 1, 2012. The Minnesota Department of Commerce, Division of Energy Resources (Department or DOC) informed GMG of the filing error in a November 26, 2011 letter and opened the current docket. GMG resubmitted its initial filing in this docket on March 25, 2013.

On June 7, 2013, the Department filed comments recommending that the Commission (1) withhold its decision on GMG's design-day analysis and total entitlement level until GMG provides sufficient support for its total entitlement level, and (2) allow the proposed recovery of associated demand costs effective November 1, 2012.

On June 17, 2013, GMG filed reply comments.

On July 16, 2013, the Department responded to GMG (DOC Response) and recommended that the Commission reject, without prejudice, GMG's design-day analysis; find that GMG did not purchase adequate capacity to serve its firm customers on a peak day; and allow the proposed recovery of associated demand costs effective November 1, 2012 through the monthly Purchased Gas Adjustment (PGA). The Department also recommended that GMG submit the following, as soon as possible:

- GMG's estimates for the amount of demand resources needed to serve not only existing customers but expected new customers that GMG is adding to its system; and

- Information about the customers GMG expects to add to its system before the end of March, 2014, including any, and all, available information about the size and expected load of these new customers.

GMG

According to GMG the factors contributing to the need for a change in demand include an increase in Design Day requirements and a change in resources required to meet the Design Day needs and provide an adequate reserve margin.

GMG stated that its objective for calculating Design Day customer demand is to accurately forecast anticipated firm customer demand at design temperatures, so that adequate firm resources will be available if Design Day weather occurs.

GMG used linear regression analysis and an estimate of 4,678 firm customers for the 2012-2013 heating season to project a Design Day forecast of 4,964 Dth for the 2012-2013 heating season.

Based on its analysis, GMG determined that additional firm transportation capacity was needed to meet the increase in firm customer demand forecasted for the Design Day and to provide an adequate reserve margin. GMG renewed some expiring firm transportation contracts with Northern Natural Gas (NNG) and increased the capacity on one contract, due to a built-in step increase, by 165 Dths. This increase resulted in total Design-Day capacity of 5,209 Dth and an estimated reserve margin of 245 Dths (capacity of 5,209 Dth less Design Day forecast of 4,964 Dth), or approximately 4.94 percent.

The increase in demand entitlements was effective October 1, 2012, but not picked up in GMG's monthly purchased gas adjustments until November 2012.

In Reply Comments, GMG provided additional peak-day send-out information requested by the Department. Since the heating season in question in this proceeding was already over, GMG was able to provide the following information: during the 2012-2013 heating season the peak-day send-out occurred on January 31, 2013 and the peak-day send-out amount was 5,038 Dth.

GMG also noted that, while GMG nearly reached the capacity of its reserve margin during the 2012-2013 season, it did not, despite exponential growth.

GMG acknowledged the Department's concern that it has less of a reserve margin than desirable. However, according to GMG, public safety was not in any jeopardy because the desired reserve margin for GMG is less than the real meter error margin at some of the larger Town Border stations in Minnesota. Nevertheless, GMG agreed with the Department's observation that utilities should plan for an adequate reserve margin and given GMG's growth, GMG's reserve margin should be higher.

Rather than focusing on GMG's 2012-2013 usage portfolio and traditional design day regression analysis, GMG invited a partnered approach to determining an appropriate demand entitlement contract level for the upcoming heating season. GMG requested that the Commission order the Department and GMG (and if desired, Commission staff) to review GMG's current circumstances and anticipated growth and work together to determine the appropriate level of entitlement needed for the upcoming 2013-2014 heating season. GMG stated that "Neither the Department nor GMG is effectively protecting the public interest or efficiently serving the

Commission's goals by engaging in analysis with data that is not suited to accurately predict future needs as a result of GMG's growth."

In response to the Department's concerns regarding GMG's regulatory filings, GMG stated that the Department accurately identified a shortfall in GMG's performance with respect to regulatory filing requirements. GMG assured the Commission that it is taking steps to address the situation. GMG has recently hired an in-house attorney whose primary job responsibilities will include meeting regulatory mandates. GMG stated that it is confident that by dedicating that individual to meeting regulatory needs, GMG's performance will improve and its timeliness issues will ultimately be resolved.

In summary, GMG requested that the Commission:

1. Approve GMG's Contract Demand Entitlement Petition and permit GMG to increase its demand entitlement to assure sufficient reserve margins.
2. Allow the proposed recovery of associated demand costs effective November 1, 2012.
3. Order the Department to work cooperatively with GMG and, if appropriate, with Commission staff to determine the appropriate reserve margin for the approaching 2013-2014 heating season.

DOC

On June 7, 2012, the Department filed Comments expressing concern that GMG had not secured sufficient demand entitlements to ensure reliable firm service on a peak day. Based on issues related to GMG's design-day analysis, the Department initially recommended that the Commission withhold a decision on GMG's design-day analysis and total entitlement level until GMG provides sufficient support for its total entitlement level. The Department concluded that GMG's proposed recovery of overall demand costs is reasonable despite concerns with the design-day analysis and filing irregularities.

In its initial comments, the Department stated that GMG did not provide sufficient data to calculate peak-day send-out over the two most recent heating seasons (2010-2011 and 2011-2012). However, the Department analyzed GMG's design-day proposal by multiplying GMG's all-time per-customer peak-day send-out of 1.1315 Dth/day (from the 2008-2009 heating season) by its projected customer counts for the 2012-2013 heating season (4,678 customers) to determine whether GMG's proposed entitlement level would be sufficient under most circumstances. The result was a throughput amount of approximately 5,293 Dth/day. This estimated peak-day throughput is greater than the total entitlement level that GMG procured for the 2012-2013 heating season, which raises the possibility of GMG not having sufficient entitlements to serve firm customers on a design day.

Of additional concern to the Department was the fact that GMG's peak-day send-out during the 2008-2009 heating season occurred on a day when average heating degree days (HDDs) were 80, which is 10 HDDs warmer than the 90 HDD figure used by GMG to calculate its design day.

The Department stated that GMG's lack of peak-day send-out data from the previous two heating seasons impaired the Department's ability to fully review GMG's design-day analysis.

However, the Department stated that the information from the 2008-2009 heating season strongly suggests that GMG may have difficulty serving firm customers on a [design] day.

On July 16, 2013, the Department filed Response Comments in which it focused on the potential for GMG's design-day analysis and approach to obtaining firm supplies to result in insufficient firm entitlements in the future. The Department stated that this issue is especially concerning given that GMG did not file its petition until after the heating season was completed.[2] The Department also responded to policy issues raised by GMG in Reply Comments.

According to the Department, GMG procured a total entitlement amount of 5,209 Dth, which is only 171 Dth greater than the 2012-2013 peak day (January 31, 2013) send-out of 5,038. The Department stated however, since the peak send-out occurred on a day that was significantly warmer than a design day, this fact raises the concern that GMG would not have had sufficient firm capacity had an all-time peak day[3] occurred.

The Department also analyzed potential design-day usage using data strictly from the 2012-2013 heating season. Based on the Department's assumptions and analysis, the result is consumption on a 90 HDD design day of approximately 6,932 Dth/day, which is 1,185 Dth greater than GMG's procured entitlement level. According to the Department, this estimated entitlement figure suggests that GMG's firm customers would have been at significant risk if a 90 HDD design day had occurred during the most recent heating season.

In its response to reply comments, the Department stated that the "cost recovery proposed by Greater Minnesota in its original filing is reasonable, because all of those costs were needed to serve firm demand and, in fact, additional capacity and associated costs would have been justified."

The Department recommended that the Commission approve the proposed recovery of demand costs but reject, without prejudice, Greater Minnesota's design-day analysis and find that the Company did not purchase adequate capacity to serve its firm customer[s] on a peak day.

Alternatively, the Department stated that it may be reasonable to simply accept Greater Minnesota's petition, taking no specific action on the analyses therein, and allow the Company to recover the proposed demand costs. Either option would end the current proceeding and allow all parties to move forward and improve future analyses. However, given the extent to which the Company put its ratepayers at risk during the 2012-2013 heating season, the Department stated that it believes rejection, without prejudice, of Greater Minnesota's design-day analysis, while still approving the recovery of demand costs, is the most appropriate solution at this time.

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[2] Staff notes that GMG initially erroneously filed its petition on November 1, 2012 as a compliance filing in Docket No. G-022/M-10-1165.

[3] Staff believes that January 31, 2013 was GMG's all-time peak day as of that date, and believes that the Department is expressing its concern that GMG would not have had sufficient firm capacity had all-time low average daily temperatures occurred.

The Department agreed with GMG that refinements to GMG's design-day analysis may be appropriate given its anticipated growth rate. The Department stated that it will certainly be available to discuss design-day approaches that GMG identifies. To make this process work, and given that the utility has the burden to support its design-day methodology, the Department recommended that GMG file, as soon as possible, and certainly before November 1, the following information in order to assess GMG's need for the 2013-2014 heating season:

- GMG's estimates for the amount of demand resources needed to serve not only existing customers but expected new customers that GMG is adding to its system; and
- information about the customers GMG expects to add to its system before the end of March, 2014, including any, and all, available information about the size and expected load of the new customers.

In summary, the Department recommended that the Commission:

- reject, without prejudice, GMG's design-day analysis and find that GMG did not purchase adequate capacity to serve its firm customers on a peak day; and
- allow the proposed recovery of associated demand costs effective November 1, 2012 through the monthly Purchased Gas Adjustment.

The Department also recommended that GMG file the following, as soon as possible, to assess Greater Minnesota's need for the 2013-2014 heating season:

- GMG's estimates for the amount of demand resources needed to serve not only existing customers but expected new customers that GMG is adding to its system; and
- information about the customers GMG expects to add to its system before the end of March, 2014, including any, and all, available information about the size and expected load of the new customers.

PUC Staff Comment

GMG had adequate capacity to serve firm customers on the peak day that occurred during the 2012-2013 heating season. This also appears to have been its all-time high peak sendout at the time. Thus, staff believes the record is clear that GMG did procure sufficient entitlements to serve firm demand on its peak day in 2012-2013. However, a design-day event did not occur during the 2012-2013 heating season. As the Department's analysis shows, GMG may not have had sufficient capacity to ensure reliable firm service had a design day event occurred during the 2012-2013 heating season. The important thing is to remedy this situation.

Staff notes that GMG filed its Petition for Change in Contract Demand Entitlement for the 2013-2014 Heating Season on August 19, 2013, in Docket No. G022/M-13-730 (13-730). Staff further notes that, in response comments filed on January 10, 2014 in 13-730, the Department stated that it does not have additional concerns regarding the Company's reserve margin at this time. In 13-730, the Department is recommending that the Commission approve GMG's proposed (as revised in GMG's reply comments) level of demand entitlements for the 2013-2014 heating season. GMG's request that the Commission order the Department to work cooperatively with GMG and, if appropriate, with Commission staff to determine the appropriate reserve margin for the 2013-2014 heating season is likely moot at this time.

Issue

3. **Should the Commission open an investigation to study rural Minnesota natural gas needs and how the current regulatory system meets those needs?**

GMG

In its reply comments on page 6, GMG proposed that the Commission order a study relative to the provision of natural gas service in rural Minnesota. GMG stated the following:

> GMG clearly recognizes the multiple public policy issues that must be addressed by the Commission. Unfortunately, the current system essentially binds the Department's ability to exercise discretion or be flexible with regard to changing rules and adapting policy to meet the changing needs of rural utility providers. Nonetheless, as a rural provider, GMG has concerns that the Department may not be in a position to help it and other rural providers meet the natural gas needs of rural Minnesota.
>
> GMG is certain that it is not the intent of the State to deny natural gas service to rural Minnesota, especially given its economic and environmental benefits. Likewise, GMG does not believe that it was the State's intent to create a regulatory system that inadvertently promotes the disingenuous use of corporate structures to circumvent regulation. However, GMG believes that both are consequences of the current system. Therefore, GMG proposes that the Commission order a study relative to the provision of natural gas service in rural Minnesota. From GMG's perspective, there are five issues of particular import, namely:
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> 1. Review of those portions of rural Minnesota that do not currently have natural gas service;
> 2. Determination of whether it serves the public interest to expand the provision of natural gas service to those areas;
> 3. Examination of how new natural gas utility companies in Herron Lake, Minnesota and seven communities near Clara City, Minnesota are structured to avoid state regulation;
> 4. Deliberation about whether any regulatory changes would assist with extending natural gas service in Minnesota if extension would serve the public interest; and,
> 5. Consideration of whether an advocate should be appointed to promote and foster the expansion of natural gas service to rural areas while balancing the many public policy concerns that must be addressed.
>
> GMG believes that such a study would benefit both the public interest and the interests of the entities charged with representing the public interest.

In summary, GMG requested that the Commission:

> Order a study of rural Minnesota natural gas needs and how the current regulatory system meets those needs.

DOC

The Department also responded to GMG's policy discussion regarding natural gas service in rural Minnesota. GMG's discussions, according to the Department, were based on three points: 1) the current regulatory structure is designed for non-rural utilities; 2) the current regulatory structure does not meet the needs of rural natural gas providers; and 3) the current provision of natural gas in rural Minnesota is a public good. The Department stated that, generally speaking, each of the three areas speaks to issues that should be addressed at the legislative level.

The Department identified that the Commission has previously reviewed the idea of providing service to uneconomic areas and competition between utilities, and stated the following:[4]

> In terms of the current regulatory structure, the idea of providing service to uneconomic areas has been reviewed previously by the Commission. In its March 31, 1995 *Order Terminating Investigation and Closing Docket* in Docket No. G999/CI-90-563, the Commission summarizes its findings and conclusions in that proceeding (DOC Attachment R-2). This investigation was launched in response to competition between two regulated utilities and whether service inducements offered to various customers were prohibited by existing extension policies at the time. Of particular relevance to this docket, the Commission investigation led to the creation of New Service Area (NSA) charges. The Commission subsequently approved several NSAs for different regulated gas utilities in the State. As such, if a community approaches Greater Minnesota and asks for natural gas service, even if the cost of service is uneconomic, there are structures that exist within the current regulatory structure that may facilitate expansion.
>
> In addition, on the topic of competition between providers, the Commission considered many of the public good questions (*e.g.*, low-cost of natural gas compared to alternatives) discussed by Greater Minnesota in its *Reply Comments*. Ultimately, the Commission found that judgment on these subjects was not required. Specifically, the Commission noted that there is no statutory prohibition against competition between two or more gas utilities (conceivably this would also extend to non-regulated entities such as propane dealers). Minnesota Statutes §§ 216B.37 through 216B.43 lay the frame work for service territory as they relate to electric utilities, but the Legislature provides no laws governing service territory for natural gas utilities. The Commission also found that it has the capacity to balance the interest of utilities, competed-for customers, and current customers on a case-by-case basis.

[4] July 16, 2013 DOC *Response Comments* beginning at page 5.

Regarding the policy considerations raised by the Company, the Department does not believe an in-depth investigation is warranted. The issues raised by Greater Minnesota are interesting; however, the Department believes Legislative action is necessary to address the issues raised by the Company.

PUC Staff Comment

In the early 1990s, the Commission conducted an investigation into competition between gas utilities in Minnesota which looked at three main issues

- service to areas not currently served,
- Commission response to multiple service providers in an area, and
- review of LDC service extension contracts.

In its March 31, 1995 Order Terminating Investigation And Closing Docket,[5] the Commission reviewed what had happened with new area service (NAS) surcharges while this investigation was pending. The Commission found that the development of NAS surcharge mechanisms had, at that time, adequately addressed the Commission's concern about service to under-served areas.

> A brief summary of the developments in this area subsequent to formation of the work group is in order:
>
> The study group explored how to extend gas service to communities that request gas service but cannot be served economically at tariffed rates. In response to this question, three LDCs in 1991 proposed a surcharge mechanism to cover the cost of extending service to new communities.
>
> The Commission was encouraged by these attempts to respond to this problem but found it necessary to reject the three filings. Instead, the Commission directed the Department and Commission Staff to conduct a study and file a report identifying the policy issues involved in establishing an appropriate regulatory framework for the provision of natural gas service in areas where service is not currently provided because it is not economically justified under currently tariffed rates.
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> On March 12, 1992, the Department and Commission Staff submitted their Report on Issues for New-area Rates. The report covered financial issues, rate design and various compliance and reporting issues concerning these new rates.
>
> Subsequently, the Commission has received, reviewed and approved new area rates proposals from Northern Minnesota Utilities (NMU), Northern States Power, and Midwest Gas (now Minnegasco). An additional new area rates proposal by Minnegasco is pending: Docket No. G- 008/M-94-1075.

[5] In the Matter of an Inquiry into Competition Between Gas Utilities in Minnesota, Docket No. G-999/CI-90-563

> In view of these developments, the Commission finds that the question of how to encourage natural gas service to new areas has been adequately addressed. [Order, at pp. 3-4, footnotes omitted]

While GMG currently does not have a new area service surcharge mechanism, GMG could ask for one. As is the case with all utilities, GMG's current rates and tariffs provide a structure under which the company may extend service to new customers when certain conditions are met. Gas utility extension policies and tariffs are generally interpreted to obligate the gas utility to extend service to a new customer if the new customer meets the terms of the Company's tariff, for example, when the customer is willing to pay a contribution-in-aid-of-construction when required.

GMG's extension policy

For individual new customers and smaller groups of new customers, GMG received authority in 2012 to modify its gas main and service line extension tariff.[6] This decision authorized GMG to "rationalize" its extension policy by making it a requirement that extensions to new customers be economically feasible.

GMG's gas main extension policy

GMG was allowed to change its original policy for main extensions that allowed or (required) the Company to extend gas mains to new customers without collecting a contribution-in-aid-of-construction when there were ten or more new customers per mile of new gas main. In its decision, the Commission allowed GMG to eliminate the ten customers per mile (i.e. 528 feet of new main per customer) "allowance" for extensions to new customers. This policy was replaced with a requirement that new extensions be economically feasible. Under this new policy, a new extension project would be considered economically feasible if new load is expected to provide GMG with gross margins (i.e. revenue less the cost of gas)[7] equal to or greater than 18% of GMG's estimated cost for the project.

In its economic feasibility model, GMG defined new load attributable to the new gas mains (i.e. the extension project) to include expected new residential customers, future growth, as well as commercial, industrial and agricultural load in the area of the new project.

At the time this was approved, the Department had pointed out that the Company's goal is to "ensure existing customers do not see future rate increases due to new customers being added at less than the incremental cost to provide service."

GMG's new economic feasibility model, as requested by GMG and approved by the Commission, should help GMG accomplish that goal. If GMG's original policy had continued, GMG's shareholders or its existing customers would probably have wound up unduly subsidizing extensions of new mains for new customers. Even though GMG's current non-gas

[6] ORDER AUTHORIZING GAS MAIN AND SERVICE LINE EXTENSION TARIFF MODIFICATIONS, In the Matter of the Petition of Greater Minnesota Gas, Inc. for Approval to Modify its Gas Main Extension Rules and Service Charges, Docket No. G-022/M-12-468 (September 26, 2012)

[7] GMG agreed to the Department's suggestion that GMG's main extension rules be clarified so that the conditions specifically refer to <u>annual</u> gross margins.

distribution rates are more than double the rates of the next highest gas utility, these rates are not high enough to support extensions to new customers at a density of ten customers per mile.

Excess footage charges

When these revisions were authorized, GMG also proposed to change its policy that permitted GMG to charge $2.00 per foot for each foot of new gas main installed over the allowed amount of 528 feet. GMG proposed that

> In situations where customer contributions are required, each customer will be required to pay a contribution such that gross margins are projected to be 18% of estimated project costs after excluding costs equal to the customer's contribution in aid of construction.

For new service lines, GMG proposed to keep the current 250 foot per customer allowance but asked for permission to replace the current $1.76 per foot charge for excess footage to the following

> Any footage beyond the 250 feet will be charged at the Company's estimated material and contractor cost for the excess footage at the time of installation, but shall not exceed $5.00 per foot.

The Commission approved GMG's request to modify its policy on extension allowances. GMG's extension allowances for new customers are more generous for new customers than other Commission-rate-regulated investor-owned gas utilities because the allowances are larger. However, these are not "free" extensions. The cost of the extension allowances are, at least in theory, paid for by all of GMG's other customers when the cost of these allowances are included in GMG's calculation of its rate base in a future rate case.

GMG's Utility Purchases Transport Services (UPTS) tariff

At approximately the same time that its extension policy was revised, in 2011, the Commission approved GMG's request for a new Utility Purchases Transport Services (UPTS) tariff that allows GMG to provide service outside of (i.e. beyond) another retail gas utility's service area when it is not economic for the other utility to extend service beyond its area.[8] GMG would implement this service by including the other utility's full retail distribution rate including gas costs into GMG's monthly purchased gas adjustment mechanism for these new customers. Staff is not aware of any projects that have been completed under GMG's UPTS tariff.

GMG could request authorization for a New Area Surcharge mechanism

In addition to its extension policy and UPTS tariff, GMG could apply for permission to use a new area surcharge for large new projects or to extend service to a new area or a new town. New area surcharges (NAS) have been used by CenterPoint and Xcel for several very large projects and a few smaller projects. A few of the larger projects involved extending service to more customers than are currently served by GMG. With the new area surcharge, which are

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[8] ORDER AUTHORIZING NEW RETAIL SERVICE, In the Matter of the Petition of Greater Minnesota Gas, Inc. to Provide New Utility Purchase for Resale Service, Docket No. G-022/M-11-804 (December 22, 2011)

usually in effect for up to 15 years, CenterPoint and Xcel's rates are roughly equivalent to GMG's standard rates. For GMG to add a surcharge to its standard rates, whether it's through the UPTS tariff or through an application for a new area surcharge, would require customers to be willing to pay those higher rates. Staff believes that at present, because of the difference between natural gas and propane prices, customers may be more willing to commit to paying substantial premiums over what other natural gas customers are paying for 15 or more years. However, this depends on whether the customer believes the current propane shortage will continue for that long a period of time.

Statutory framework for small gas utility exemption from Commission rate regulation

Minnesota does not have a policy goal of state-wide universal gas service in statute and does not have a policy of assigning exclusive rights to gas service areas. This means there is no state-wide universal gas service, no exclusive service rights to gas service areas, and there is no requirement that a company obtain a certificate of convenience and necessity to begin providing retail natural gas service in a new area regardless of whether that area is currently unserved or already served by another gas utility. (Certificates of need, however, are required for certain kinds of large energy facilities.)

However, under the current statutory framework there are exemptions from Commission rate regulation for small gas utilities under certain conditions. Arguably, without the constraint of Commission oversight over the rates the small utility charges, the utility may be able to charge rates that are enough higher that it can afford to extend service to customers that other utilities cannot afford to under their Commission approved rates. However, in order to qualify for this exemption, the utility has to obtain permission for the exemption from the local governing body which retains oversight responsibility for the rates charged in its jurisdiction. Staff does not really believe that this gives small exempt utilities an unfair advantage over Commission-rate regulated companies.

Under the definition of public utility in Minn. Stat. § 216B.02, subd. 4, the statute states that

> …. In addition, the provisions of this chapter shall not apply to a public utility whose total natural gas business consists of supplying natural, manufactured, or mixed gas to not more than 650 customers within a city pursuant to a franchise granted by the city, provided a resolution of the city council requesting exemption from regulation is filed with the commission. The city council may rescind the resolution requesting exemption at any time, and, upon the filing of the rescinding resolution with the commission, the provisions of this chapter shall apply to the public utility. …
>
> … No person shall be deemed to be a public utility if it produces or furnishes service to less than 25 persons. …

In addition, there is an exemption from Commission rate regulation for small gas utilities in

Minn. Stat. § 216B.16, subd. 12:

> (a) A municipality may file with the commission a resolution of its governing body requesting exemption from the provisions of this section for a public utility that is under a franchise with the municipality to supply natural, manufactured, or mixed gas and that serves 650 or fewer customers in the municipality as long as the public utility serves no more than a total of 2,000 customers.
>
> (b) The commission shall grant an exemption from this section for that portion of a public utility's business that is requested by each municipality it serves. Furthermore, the commission shall also grant the public utility an exemption from this section for any service provided outside of a municipality's border that is considered by the commission to be incidental. The public utility shall file with the commission and the department all initial and subsequent changes in rates, tariffs, and contracts for service outside the municipality at least 30 days in advance of implementation.
>
> (c) However, the commission shall require the utility to adopt the commission's policies and procedures governing disconnection during cold weather. The utility shall annually submit a copy of its municipally approved rates to the commission.
>
> (d) In all cases covered by this subdivision in which an exemption for service outside of a municipality is granted, the commission may initiate an investigation under section 216B.17, on its own motion or upon complaint from a customer.
>
> (e) If a municipality files with the commission a resolution of its governing body rescinding the request for exemption, the commission shall regulate the public utility's business in that municipality under this section.

These exemptions are designed for utilities that provide service in municipalities. The statute does not address what role other local governing bodies such as township boards, would have in the exemption process. Nevertheless, the Commission has not objected to an exempt utility providing “incidental” residential service in rural areas outside of a municipality or fairly substantial amounts of agricultural service in rural areas outside of a municipality.

Exempt small gas utilities in Minnesota

<u>Greater Minnesota Gas</u>

Greater Minnesota Gas started as an exempt small gas utility. However, it grew out of its exemption and now has close to 5,000 or more customers. In the transition to state-level

Commission oversight of its rates, GMG submitted a general rate case. In that filing, GMG asked to maintain its existing rates at the same level as when the Company started.

In addition to the approximately half-dozen investor-owned exempt small gas utilities there are approximately two dozen municipally-owned gas utilities. Municipally-owned utilities are exempt from Commission rate regulation.

The following is a short description of the other exempt, investor-owned small gas utilities in Minnesota that staff is aware of.

Dooley Gas[9]

Dooley Gas is indirectly owned by Dooley's Petroleum of Murdock. The Dooley Gas distribution system serves the communities of Clara City, Raymond, Maynard, Prinsburg, and Blomkest and a large rural area along U.S. Highway 71 south of Willmar. The system was expected to be installed and fully charged by October 1, 2013, and represents an estimated $8.5 million to $10 million investment. Dooley Gas is connected to a Northern Natural Gas line.

Heron Lake - Agrinatural Gas, LLC

Agrinatural appears to be a local distribution company that is regulated by the City of Heron Lake. Staff does not know a lot about this company but believes Heron Lake BioEnergy (an ethanol plant) is the main reason this project was developed. (Heron Lake BioEnergy started as a coal-fired ethanol plant and converted to natural gas.) According to newspaper reports, Heron Lake BioEnergy and farms located near the pipeline were able to receive natural gas starting in the summer or fall of 2011. Natural gas became available to the residents of Heron Lake in 2012. The high pressure pipeline that delivers gas to Agrinatural and the distribution utility did not request a permit of any kind from the Commission. Staff understanding is that the Minnesota Office of Pipeline Safety is in contact with the operator of these facilities (i.e. the pipeline and distribution facilities) to ensure their compliance with safety regulations. There are no small utility or municipal utility exemptions from state and federal pipeline safety regulations.

Northwest Natural Gas & Northwest Natural Gas of Murray County
(http://nwngas.com/Home_Page.html and http://nwgas.com/about.html)

According to Northwest's website, the Company has been in existence since 1991. Northwest Natural Gas began in the town of Ogilvie, MN and is owned by members of the Gorham family. In 1992, service was expanded to the Henderson area and in 1993 to the Maple River area. Northwest Natural Gas' headquarters was built in Mapleton in 1993. During the summer of 1993 pipeline was installed to feed the towns of Vernon Center, Good Thunder, Mapleton and Minnesota Lake. In 1994, the towns of Avoca, Currie, Dovray, Fulda and Slayton of Murray County were added. In 1999 the town of Cass Lake was added. The most recent addition was the city of Bingham Lake in Cottonwood County in 2008. Northwest Natural Gas employs four full-time and three part-time employees.

[9] Order Granting Small Gas Utility Franchise Exemption Under Minn. Stat. § 216B.16, Subd. 12, In the Matter of the Petition of Dooley's Natural Gas LLC for Exemption for Small Gas Utility, Docket No. G-6915/M-13-672 (January 7, 2014)

Staff's understanding is that Northwest Natural Gas & Northwest Natural Gas of Murray County are separately incorporated. Staff believes it is possible there are various, separately incorporated entities under the Northwest Natural Gas corporate umbrella that considered alone serve fewer than 2,000 customers. It's also possible that in total, on an aggregated basis, Northwest Natural Gas serves no more than 2,000 customers and qualifies for the small gas utility exemption.

If the affiliated interest statute (Minn. Stat. § 216B.48) were invoked, all of the Northwest gas utilities would be considered affiliates of one another and would, in total, probably exceed the 2,000 customer threshold and qualify for state-level regulation and oversight from the Commission. However, for the Commission to assert jurisdiction over these companies for rate setting purposes, the Commission would probably need to go through a process for establishing its jurisdiction. One approach would be to respond to complaints from consumers asking the Commission to assert jurisdiction to resolve the consumer's complaint. Alternatively, the Commission could respond to a request from a state agency asking the Commission to assert jurisdiction as a precautionary measure to deter the possibility of harm coming to these customers. A third alternative would be to assert jurisdiction in response to a complaint from a regulated competitor of the exempt utility.

<u>Community Utility Company</u>
This small natural gas utility is based in Racine, Minnesota.

<u>Sheehan's Gas</u>
Sheehan's gas utility provides natural gas distribution service in Bird Island, Buffalo Lake and Stewart.

<u>Other</u>
Many communities in Minnesota have expressed interest and are exploring the possibility of receiving natural gas service. Holdingford is one example. Belgrade is another. Because of recent increases in the cost of propane, consumer-driven interest in natural gas service has intensified. Because every community is different in size, potential load and proximity to the nearest supply of natural gas, i.e. a pipeline, etc., the feasibility of potential projects usually has to be evaluated independently.

Competition between utilities for new customers

As noted above and in the Department's comments, competition between utilities for new customers was investigated in the 90-563 docket. One approach to ensuring that only necessary and economic natural gas facilities and services are built would be for the legislature to pass a law requiring gas utilities to obtain a certificate of public convenience and necessity before extending service to a new community. A certificate of public convenience and necessity would imply exclusive service rights while a municipally granted franchise may not have exclusive service rights attached to the franchise. In any event, there are various pros and cons to this approach that could be used to ensure that the provider offering the best cost alternative for providing service was awarded the certificate.

Access to natural gas in unserved areas

The problem now, however, is that it is not economic for any provider to extend natural gas facilities and provide natural gas service to many locations in Minnesota. Customers in these areas want natural gas service but at rates they are willing to pay and can afford to pay. The New Area Surcharge model has been used by CenterPoint and Xcel for several large and a few smaller projects. However, in most instances, NAS projects need to be large enough to justify the administrative cost of using the NAS model. And, on a certain level, because GMG's rates are much higher than the rates charged by the other gas utilities, GMG's rates are similar to what the other, much larger companies would charge if a NAS surcharge were added to the larger companies' rates for a new project.

With propane prices as high as they are, it is probably safe to assume that anyone or any community that does not have access to natural gas would prefer natural gas to propane. However, high propane prices do not reduce the absolute cost of extending natural gas facilities to areas previously considered uneconomic to serve under existing rates (with or without a new area surcharge). It is possible that both alternatives (natural gas and propane) could be unaffordable without a subsidy from the utility's other customers or its shareholders.

Alternatively, a subsidy could come from a local, state or federal government. An example of a subsidy provided by someone else would be the Prairie Island Community paying for the cost of using the GMT natural gas pipeline so that its members could receive natural gas distribution service from Xcel Energy. This arrangement is described in GMG/GMT docket # PL-6580, G-022/AI-13-94.

Another example of a subsidy, would be the natural gas universal service funds used in Georgia and North Carolina that are used to help pay for pipeline projects in underserved areas.

Staff also notes that the Minnesota State Legislature is currently considering bills that would ask the Legislative Energy Commission to investigate the feasibility of converting propane gas users to natural gas. (As of April 2, 2014, these provisions were in S.F. 2477 and H.F. 2834.)

If the Legislative Energy Commission is directed by the Legislature to investigate this topic and the Commission opens an investigation to study this issue, the Commission may want to give some thought as to the best way to coordinate activity and avoid duplication of work.

Decision Alternatives

1. Demand Entitlements

   a) Reject, without prejudice, GMG's design-day analysis and find that GMG did not purchase adequate capacity to serve its firm customers on a ~~peak~~ design day. [DOC as modified by staff. This could potentially also be modified by just ending the sentence after the word analysis.][10]

   b) Approve GMG's petition and permit GMG to increase its demand entitlement to assure sufficient reserve margins. [GMG]

   c) Accept GMG's petition and take no specific action on the analyses therein. [DOC Alternative]

2. Demand Cost Recovery

   a) Allow the proposed recovery of associated demand costs through the monthly Purchased Gas Adjustment effective November 1, 2012. [GMG and DOC]

3. Study of Rural Minnesota Natural Gas Needs and the Current Regulatory System

   a) Open a new docket to study rural Minnesota natural gas needs and how the current regulatory system meets those needs. [GMG]

   b) Do not open a new docket. [DOC]

4. Other

   a) Require the Department to work cooperatively with GMG and, if appropriate, with Commission staff to determine the appropriate reserve margin for the approaching 2013-2014 heating season. [GMG]

   b) Take no action on this item.

Staff Recommendation

Staff recommends alternatives 1(a or c), 2(a), and 4(b). Staff believes 4(a) is now

[10] Staff has modified the Department's recommendation because, as explained by GMG, the Company did have enough capacity to serve its firm customers on the peak day. However, the Department's analysis shows that GMG may not have had enough firm capacity had a design day event occurred.

moot. Staff does not have a recommendation on whether a new docket should be opened to study rural Minnesota natural gas needs and how the current regulatory system meets those needs.