

**Minnesota Public Utilities Commission**  
*Staff Briefing Papers*

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**Meeting Date:** December 18, 2014 ..... **Agenda Item # 3 \*\***

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**Company:** Minnesota Energy Resources Corporation (MERC or the Company)

**Docket No.** G-011/GR-13-617  
In the Matter of a Petition by Minnesota Energy Resources Corporation for  
Authority to Increase Natural Gas Rates in Minnesota

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**Issues:** Should the Commission reconsider and/or clarify its October 28, 2014 Findings of  
Fact, Conclusions, and Order?

**Staff:** Sundra Bender .....651-201-2247  
Bob Brill..... 201-2242  
Clark Kaml..... 201-2246  
Ann Schwieger ..... 201-2238

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***Relevant Documents***

PUC - Findings of Fact, Conclusions, and Order ..... Oct. 28, 2014  
MERC - Request for Reconsideration and Clarification ..... Nov. 17, 2014  
OAG – Petition for Clarification ..... Nov. 17, 2014  
MERC – Answer ..... Dec. 1, 2014  
OAG – Answer ..... Dec. 1, 2014

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*December 10, 2014*

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## Statement of the Issue

Should the Commission reconsider and/or clarify its October 28, 2014 Findings of Fact, Conclusions, and Order?

### Introduction

On October 28, 2014, the Commission issued its Findings of Fact, Conclusions, and Order which authorized an increase in Minnesota jurisdictional revenues of approximately \$7,580,774 per year to produce jurisdictional total gross revenue of approximately \$267,874,613, based on a rate of return on common equity capital of 9.35% for the test-year ending December 31, 2014.

On November 17, 2014, petitions for reconsideration or clarification were filed by Minnesota Energy Resources Corporation (MERC) and the Minnesota Office of Attorney General-Antitrust and Utilities Division (OAG).

MERC requested reconsideration or clarification of two issues:

- MERC asked that it be allowed to reduce its interim rate refund obligation by \$313,695 by using 2014 NYMEX estimates of the cost of gas (rather than the 2015 NYMEX estimates) in calculating the value of MERC's gas storage balance and the amount of uncollectible expense.
- MERC also asked that in preparing the class cost of service study (CCOSS) in its next rate case that it not be required to collect data on additional variables that impact the unit cost of mains installations. Instead, MERC proposed that it report on the potential availability, reliability, usefulness, and associated expenses of collecting data on additional variables that may impact the unit cost of mains installations.

OAG requested reconsideration of two issues.

- OAG asked the Commission to reconsider and deny \$284,725 in estimated travel and entertainment expenses allocated to MERC from its service company, Integrys Business Services (IBS).
- OAG also asked the Commission to modify its October 28 Order to state that it makes no finding on the proper method of allocating income tax expense to customer classes in the CCOSS in future rate cases.

On December 1, 2014, MERC and the OAG submitted answers to the petitions for reconsideration.

Please see Attachment A for a recap of the votes on these issues at the Commission's September 24 agenda meeting. (The issues are listed in the recap in the same order as they appear in these briefing materials and not in the order they were voted on during Commission deliberations on September 24.)

## Minnesota Statutes and Commission Rules

Petitions for reconsideration are subject to Minn. Stat. § 216B.27, and Minn. Rules, part 7829.3000.

Petitions for reconsideration are denied by operation of law unless the Commission takes action within sixty days of the request. If the Commission takes no action on MERC's or the OAG's petitions, the requests would be considered denied as of January 16, 2015. The Commission may also take specific action to deny the petition by issuing an order denying reconsideration.

If the Commission takes up a party's request for reconsideration, the Commission can: (1) reconsider, and (a) affirm, (b) modify or (c) reverse its initial decision, or (2) toll the time period to allow additional time for reconsideration, or (3) deny the petition for reconsideration and thereby affirm the initial decision. The Commission may also reconsider its Order on its own motion.

Because MERC's and the OAG's requests for reconsideration would be considered denied on January 16, 2015 if not acted on, staff recommends that the Commission deliberate on the merits of the petition at this meeting. If significant or substantive changes or clarifications are made to the October 28, 2014 Order, the Commission may want to toll the time period to ensure there is an adequate amount of time available to write an order.

## Travel and Entertainment Expenses

PUC Staff: Ann Schwieger

### References

PUC, Findings of Fact, Conclusions, and Order, pages 25-26

OAG, Request for Reconsideration, pages 4-14

MERC, Answer to Petition for Reconsideration, pages 1 and 5-8

### Issue

OAG is asking the Commission to reconsider its October 28 decision and deny unreported travel and entertainment expenses allocated to MERC from MERC's service company, Integrys Business Services (IBS). OAG recommends the Commission use a proxy amount of \$284,725, i.e. the amount of reported travel and entertainment expenses, for the unreported amount of travel and entertainment expenses.

### Background

MERC submitted documentation for \$284,725 of 2012 actual travel expenses, entertainment expenses and separate, itemized expenses for MERC's board of directors and ten highest-paid employees as part of its informational requirements in the Company's most recent rate case. MERC also requested cost recovery of an unknown amount of travel & entertainment expenses

that were allocated to MERC by its service company, Integrys Business Support (IBS). The Company did not provide a separate, detailed, itemization of the IBS expenses as it did for MERC.

The amount of the actual travel & entertainment expenses allocated from IBS is unknown because MERC did not provide a detailed schedule of the expenses included in its “Miscellaneous General Expense” account. MERC reported that the amount of expense recorded in that account was \$647,885.<sup>1</sup> In 2012, MERC’s actual travel expenses were \$284,728. This leaves \$399,160 of unsupported expenses recorded in the Miscellaneous General Expense account. It is not possible to determine if all of the unsupported expenses included in the account are attributable to IBS’ allocated travel and entertainment expenses or if they are a combination of travel and entertainment expenses and other, miscellaneous general expenses.

## Department

The Department reviewed MERC’s travel and entertainment expenses and recommended excluding \$7,770 of expenses that did not appear to be reasonably related to Minnesota regulated utility operations. The Department also recommended that the Commission exclude corporate aircraft expenses of \$956. The Company accepted the Department’s proposal to exclude these expenses.

The Department also concluded that employee travel and entertainment expenses allocated to MERC from Integrys Business Support (IBS), MERC’s service company, should have been filed for review. MERC agreed to provide all travel and entertainment expenses, including expenses related to its affiliates’ employees, in future rate-case filings.

## OAG

During the course of discovery in the rate case, the OAG asked MERC to produce the documentation to support the IBS expenses. The Company refused.

The OAG objected to MERC recovering travel and entertainment expenses because MERC failed to comply with the filing requirements of Minn. Stat. §216B.16, subd. 17:

- 1.) Many of the expenses claimed by MERC are not supported by a business purpose demonstrating how the expenses are reasonable and necessary for the provision of utility services. MERC has failed to satisfy the statutory requirements for itemizing travel and entertainment expenses and justifying their necessity. As such, the OAG has no reasonable alternative but to recommend that all travel and entertainment expenses in the amount of \$284,725 be denied.
- 2.) MERC is required by law to separately itemize the date, amount, vendor name, and business purpose of every travel and entertainment expense it seeks to recover. MERC failed to do so because MERC did not file separately itemized travel and entertainment

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<sup>1</sup> MERC 2014 Rate Case G011/GR-13-617, September 30, 2013, Volume III, Informational Requirement – 5, Schedule C-6, Line 103.

expenses that were allocated to it IBS. The OAG recommended the Commission deny all travel and entertainment expenses related to IBS that were not itemized separately. The OAG recommended denying an additional \$284,725 as proxy<sup>2</sup> of IBS expenses.

- 3.) MERC is required by statute to separately itemize any dues and expenses for memberships in organizations or clubs. Just as with IBS travel and entertainment expense, MERC failed to itemize membership dues for several organizations. MERC included more than sixty thousand dollars in membership dues in its 2014 test year without separately itemizing them as the statute requires. These expenses, in the amount of \$63,245, should be excluded because they were not itemized as required by statute.
- 4.) The membership expenses should also be excluded because MERC has not established that the membership dues are beneficial for MERC's customers. Membership dues are recoverable "only to the extent that the activities they support directly benefit ratepayers." The membership expenses should be excluded because MERC has not provided any evidence showing why they are reasonable.

In total, the OAG recommended that the Commission disallow \$632,695 in travel and entertainment expenses and membership dues. To permit MERC to recover those expenses would grant MERC recovery of expenses that violate a clear statutory instruction and encourage similar violations by other utilities in the future. For that reason, the OAG recommended that the Commission reject MERC's request to recover travel and entertainment expenses.

## MERC

MERC responded to the OAG's objections and stated the travel and entertainments expenses should be allowed for the following reasons:

- 1.) Contrary to the OAG's position, MERC has fully complied with the requirements of Minn. Stat. § 216B.16, subd. 17 with respect to the Company's T&E expenses. The plain language of Minn. Stat. § 216B.16, subd. 17, which applies reporting requirements only to "the utility" filing a rate case, does not require MERC to disclose the information requested by the OAG, which relates to MERC's service company, or affiliates of MERC.
- 2.) The membership dues were paid through IBS and they were not included as itemized expenses in MERC's informational filing. MERC provided the requested information regarding these expenses in response to information requests from the OAG. It is appropriate to include these dues in MERC's operating expense because MERC's membership in these organizations strengthens MERC's relationships with the communities it serves and ultimately benefits ratepayers.

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<sup>2</sup> In this case the OAG defines proxy as a figure that could be used to represent the value of something in a calculation.

- 3.) Despite the OAG's objections, MERC and the Department are in agreement about the appropriate amount of T&E expense. While the Department agreed with the OAG in surrebuttal testimony that MERC's T&E expenses allocated from its service company should have been filed in this rate case, the Department did not make any recommendation regarding that issue. MERC has agreed to provide additional information regarding all T&E expenses, including expenses related to its service company and employees who work for affiliates of MERC, in future rate case filings. MERC does not believe this additional information is required by the applicable statute, but will nonetheless provide the information to assist the Department and OAG in review of MERC's data.

MERC believes it has met its obligations under Minn. Stat. § 216B.16, subd. 17, and has fully documented and justified its proposed test year T&E expense. MERC requested that the Commission accept the agreement between MERC and the Department and find MERC's proposed T&E expense reasonable.

### **Administrative Law Judge**

The Administrative Law Judge disagreed with the OAG's recommendation to exclude all expenses incurred outside of Minnesota, stating that, for a wholly owned subsidiary like MERC, whose parent company has significant central-office operations in another state, out-of-state travel can fulfill an important purpose that benefits ratepayers. The ALJ found that, subject to the modifications agreed to by MERC, the Company's travel, entertainment, and other employee expenses were reasonable and should be approved.

### **Commission Order**

The Commission adopted the ALJ's findings, conclusions, and recommendations. The Commission agreed with the Department that MERC should have itemized the IBS expenses, but did not agree with the OAG's recommendation that they be excluded entirely because that argument was not well founded. In its October 28 Order, on page 26, the Commission stated:

“First, the expenses are necessary for the provision of utility service, since MERC employees must travel out of state to transact business with MERC's parent company.

Moreover, a blanket exclusion of the IBS expenses would be unduly punitive, since MERC did not intend to violate the law. Finally, the Company has agreed to itemize these expenses in future rate cases. Thus, beginning with MERC's next rate case, the IBS expenses will be itemized and receive greater scrutiny.

With respect to MERC's membership dues, the Commission generally agreed with MERC that its ratepayers benefit from the Company's membership in professional organizations. Membership in such organizations allows employees to stay abreast of developments in their fields, with a resulting effect on service quality and efficiency.

However, the Commission found that membership in the Edison Electric Institute is unnecessary for the provision of natural-gas service. The Commission required MERC to reduce Administrative and General Expenses by \$3,496 for dues to the Edison Electric Institute, as well as the \$7,770 in general travel and entertainment expenses and \$956 in corporate aircraft expenses that MERC has agreed to exclude.

Finally, the Commission required the Company in future rate-case filings to (1) meet the reporting requirements of Minn. Stat. § 216B.16, subd. 17 for all travel and entertainment expenses, including expenses related to employees working for MERC affiliates, and (2) allocate any costs not specific to Minnesota based on the allocation factor MERC files in its direct testimony and identify which costs have been allocated.”

## OAG - Petition for Reconsideration

The OAG stated that the Commission should reconsider the determination it made allowing the Company to recover all of its travel and entertainment expenses based on the following reasons:

- 1.) **The Commission unreasonably deviated from its own precedence and failed to correctly apply Minnesota law.** The law provides that “the commission *may not allow*” travel and entertainment expenses that do not “comply” with the reporting requirements. When it stated that “MERC should have itemized the IBS expenses” in its Order, the Commission acknowledged that MERC violated the reporting statute by requesting recovery for unreported travel and entertainment expenses. Once the Commission reached this conclusion, the only lawful and reasonable subsequent action was for the Commission to disallow the unreported expenses.

Furthermore, to the extent that there was any doubt about the amount of expenses, or whether the expenses should have been reported, Minnesota law unequivocally *required* the Commission to decide the issue “in favor of the consumers.” The Commission did not do so. Instead, the Commission provided a series of justifications for failing to correctly apply the law, which is not sufficient.

- 2.) **The Commission’s reasoning for allowing the unreported expenses is flawed.** In its Order, the Commission stated three primary reasons for allowing MERC to recover expenses that were not itemized as required by law: first, the Commission stated that the expenses were “necessary for the provision of utility service;” second, the Commission stated that excluding the IBS expenses “would be unduly punitive, since MERC did not intend to violate the law;” and, third, the Commission stated that MERC “has agreed to itemize these expenses in a future rate case.” These reasons do not provide sufficient justification for allowing recovery of expenses that violate Minnesota law or failing to resolve any doubts about the unreported expenses in favor of the ratepayers.
- 3.) **The Commission’s Order does not reflect the reasoning the Commission discussed during deliberations.** The Commission discussed two reasons for allowing MERC to recover travel and entertainment expenses that were not reported as required by



Minnesota law. First, several commissioners indicated that they were not in favor of disallowance because they did not know the total amount of expenses that were unreported, and that any disallowance would only be possible by picking a number out of the air. Second, several commissioners stated that they were concerned that the OAG has not raised the same argument with other utilities in the past. The Commission did not discuss whether the expenses were “necessary for the provision of utility services” or whether a disallowance would be “unduly punitive” because MERC did not intend to violate the law. The Commission should modify its Order to accurately reflect the deliberations.

- 4.) **The Commission’s statement that the “expenses are necessary for the provision of utility service” cannot be supported by the record in this case.** MERC did not itemize or report the expenses at issue. Any conclusion about whether the expenses were necessary to provide utility service is unfounded and unsupported. The Commission does not know if the expenses were necessary, because the Commission, like the OAG, does not know what the expenses were or even how much they were. Furthermore, whether the expenses were “necessary for the provision of utility service” is not relevant to the OAG’s recommendation for disallowance. The OAG recommended that the IBS expenses be disallowed because they were not itemized, not because they may have been for an unreasonable purpose. If the expenses were not necessary for the provision of utility service, that would be another reason to recommend disallowance, but it does not have any impact on whether the expenses were properly itemized as required by Minnesota law.
- 5.) **MERC’s intent for failing to itemize the expenses is irrelevant to the issue of whether the expenses should be recovered from ratepayers.** The reporting statute does not give utilities a “free pass” if they violate the statute unintentionally, and neither does any other provision of the Minnesota Public Utilities Act. In fact, it seems to be presumed that most violations would be unintentional, as individuals who intentionally violate the Act are subject to a monetary penalty. Furthermore, while MERC claims that it did not “intend” to violate the law, its failure to correct the error when given the opportunity makes it equally culpable for the violation. The OAG sent an information request asking MERC to itemize the IBS expenses on January 30, 2014. MERC had many opportunities over the following months to correct the violation, but chose not to do so. Even if MERC did not “intend” to violate the law, MERC is still culpable for the violation because it failed to act to correct the violation when it had the chance to do so. For the Commission to imply otherwise is a dangerous precedent.
- 6.) **The fact that MERC has agreed to itemize IBS expenses in its future rate cases does not protect the interests of ratepayers who are currently being asked to pay for expenses that violate Minnesota law.** Minnesota law requires that every utility rate be “just and reasonable.” A rate that includes unreported travel and entertainment expenses is not just and reasonable because the expenses are in violation of Minnesota law. The fact that MERC will not request similar unreported expenses in the future does not change the fact that it would be unjust, unreasonable, and unlawful to collect unreported expenses from ratepayers in this case.

- 7.) **The fact that no party raised similar issues in other cases is not a reason to allow the expenses in this case.** The OAG did not raise the issue of service company expenses in other cases because other utilities provide that information. MERC did not. Further, the Commission has previously recognized that a utility cannot hide behind the fact that an issue is raised for the first time and was not addressed in previous rate cases. The Commission has previously stated:

*“Every rate case implicates literally hundreds of issues that must be addressed, deferred, or treated as non-issues in the course of a tight (normally, ten-month) time frame. The parties make their best judgments on which issues merit litigation during the rate-case timeframe, and they do not lose the right to raise other issues in subsequent cases.”*

- 8.) **The Commission specifically disagreed with the ALJ’s conclusion that the proxy disallowance was unreasonable because the record did not reflect a specific number.** It is true that, as a result of MERC’s failure to report the expenses, the Commission does not know the true amount of unreported expenses. It is possible that the OAG’s proxy recommendation is greater than the total of unreported expenses. On the other hand, it is also possible that the OAG’s proxy recommendation under-estimates the unreported expenses, and that MERC would be happy to escape with the disallowance that has been requested. As discussed above, MERC could have “remedied” the uncertainty by producing information about the IBS expenses. In fact, if the proxy was significantly larger than the unreported expenses, MERC would have every incentive to provide a total amount that was lower than the proxy. Since MERC chose not to provide the total amount of expenses, it is more likely that the OAG’s proxy does under-estimate the total amount of unreported expenses. Either way, to satisfy both the Commission’s precedent and Minnesota law, the Commission must meet its obligations to uphold Minnesota law and to resolve doubts in favor of consumers by accepting the reasonable proxy proposed by the OAG.
- 9.) **The Commission should reconsider its decision because it departed from the Commission’s precedent and would create a poor precedent for the future.** One way to interpret the Commission’s decision is that a utility is likely to get full recovery of an expense if the Commission does not have enough information to determine the precise amounts that should be disallowed. The public policy concerns of this precedent are clear and significant.

Profit maximizing firms, like MERC and other utilities, will have every incentive to under-report or conceal information on every issue where they anticipate a challenge to their recovery. For example, by refusing to itemize or explain the unreported expenses either in its direct filing or when the OAG asked for more information, MERC effectively guaranteed recovery of the unreported expenses because it did not provide the Commission with the data necessary to determine a precise number. If the Commission’s decision stands, it is likely that other utilities will conceal or refuse to provide similar information in future cases in order to maximize their chance at full recovery.

## MERC – Answer to OAG’s Petition for Reconsideration

MERC stated the Commission should deny the OAG’s petition as it pertains to travel and entertainment expenses. MERC believes the OAG’s Petition raised no new issues, presented no new evidence, and does not otherwise justify reconsideration. The record in this case fully demonstrates the reasonableness of the Commission’s decision with respect to travel and entertainment expenses. The Company stated the following:

- 1.) **The Commission did not conclude that MERC violated the statutory requirements.** Rather, the Commission interpreted the statute to require that, going forward, MERC provide information for all travel and entertainment expenses, including expenses related to employees working for MERC affiliates. MERC has agreed in future cases to provide the information required under Minn. Stat. § 216B.16, subd. 17, for its affiliates. The Commission has significant discretion to determine appropriate penalties, sanctions, and disallowances in rate case proceedings and the Commission acted well within its discretion in this case.
- 2.) **Contrary to the position taken by the OAG, the Commission’s written Order need not rely only on the reasoning referenced during Commission deliberations.** “The Commission may modify a decision prior to the issuance of an Order and may continue deliberations and change its decision during the course of those deliberations. . . . The Commission acts through its Orders.”<sup>3</sup> With respect to its decision on MERC’s travel and entertainment expenses here, the Commission’s Order properly reflects the decision made during deliberations and the Commission has acted well within the scope of its authority in reaching its decision on MERC’s travel and entertainment expenses.

### Staff Comment

The Commission needs to decide if it would like to reopen this issue for reconsideration. OAG and MERC have clearly expressed their positions and arguments. Staff notes that the vote on this point was three to two as indicated in Attachment A to these briefing papers.

The decision alternatives are at the end of the briefing papers on pages 23-25. If the Commission wants to reconsider and deny unreported travel and entertainment expenses allocated to MERC from MERC’s service company, Integrys Business Services (IBS), then alternative #5 is the appropriate decision alternative.

If the Commission does not want to reconsider or wants to deny reconsideration, then alternative #6 is the appropriate alternative.

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<sup>3</sup> *In re Petition of Rosemount Cogeneration Joint Venture*, 1989 WL 509763 (Minn. P.U.C.); see also *In re Excelsior Energy, Inc.*, 782 N.W.2d 282, 296 (Minn. Ct. App. 2010) (“But the commission does not speak through deliberations of the commissioners; it speaks only through written orders.”)

## Interim Rate Refund Adjustment

PUC Staff: Sundra Bender & Bob Brill

### References

Order, pp. 12-13 and 17-18

MERC Petition for reconsideration, pp. 2-5 and Attachments A & B

(None of the other parties submitted an answer to this part of MERC's petition for reconsideration.)

### Issue

MERC is seeking clarification or reconsideration in calculating its interim period rate refund; specifically, the amounts for uncollectible expense and gas storage balance. MERC believes that its interim rate refund should be reduced by calculating its uncollectible expense and gas storage balance based on the base cost of gas amounts that reflect the September 15, 2014 NYMEX - January through December 2014 commodity pricing.

MERC stated that it will be denied recovery of \$313,695 of revenues if the Commission does not adjust MERC's interim rate refund to allow recovery of *actual* non-gas costs during 2014.<sup>4</sup>

### Introduction

In this and all other natural gas rate cases, the base cost of gas factors are reset<sup>5</sup> to coincide with implementation of interim rates and normally the start of the rate case test-year. The base cost of gas includes but is not limited to the commodity and demand cost of gas. The commodity cost of gas included in the base cost of gas is typically based on the company's projected sales forecast for the test-year and New York Mercantile Exchange (NYMEX) gas commodity pricing.

Besides helping to determine the company's overall revenue requirement, the base cost of gas amount is used to value the inventory of natural gas the company expects to have in storage during the test-year. The value of the gas storage balance is a component of the company's rate base on which it earns a rate of return and can also affect the calculation of how much working capital the company needs to finance its operations on a short term basis. Further, the base cost of gas is often used to estimate the company's test-year uncollectible (or bad debt) expense, which also affects cash working capital and interest synchronization.

### MERC's Base Cost of Gas

In Docket No. 13-732, MERC filed its new base cost of gas as reflected in Table 1 (below), in Column A, based on May 15, 2013 NYMEX pricing. As required by the Commission's Order,<sup>6</sup> MERC submitted its updated base cost of gas on April 15, 2014 based on March 27, 2014

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<sup>4</sup> MERC's November 17, 2014 Petition for Reconsideration and Clarification at p. 5

<sup>5</sup> Pursuant to Minn. Rule, part 7825.2700, subp. 2

<sup>6</sup> November 27, 2013, ORDER SETTING NEW BASE COST OF GAS, Docket No. 13-732. The Commission Order required MERC to provide one base cost of gas update during the rate case process.

NYMEX pricing. See Table 1, Column B. The Department requested an additional update to reflect the agreed upon sales forecast. MERC's response to the Department is reflected in Laura Otis Surrebuttal Testimony;<sup>7</sup> see Table 1, column C.

The Commission's Base Cost of Gas Order<sup>8</sup> required MERC to provide at least one update during the course of the rate case, but did not make it a requirement that the updated base cost of gas be used in the rate case revenue requirement calculation. Upon the filing of its Rebuttal Testimony, MERC proposed to use the April 15, 2014 base cost of gas update in its revenue requirement calculation.

As illustrated in Table 1, the overall dollar amount of the base cost of gas increased from the initial petition to the Department's information request by \$41,447,523. This substantial increase was primarily driven by an explosion on the TransCanada Pipeline that occurred in January 2014, an extraordinary event. The March 27, 2014 NYMEX prices used in MERC's April 15, 2014 update reflect cost of gas increases caused by the TransCanada incident.

This increase in the base cost of gas led to discussions between MERC and the Department towards the end of this proceeding (after the staff briefing papers were issued) which led to an agreement that MERC would make an updated base cost of gas filing that would reflect September 15, 2014 NYMEX pricing using January through December 2015 commodity pricing. This updated base cost of gas was used to replace the calculations that reflected the impact of the TransCanada incident; see Table 1, column D.

Table 1-Summary of Base Cost of Gas

| Type of Costs                  | Docket No.<br>13-732<br>Initial Petition | April 15,<br>2014 Petition | Data Response to the<br>Department<br>Informational Request | As Directed by the<br>Commission's<br>Final Order <sup>9</sup> |
|--------------------------------|--|----------------------------|---|--|
|                                | (A)                                      | (B)                        | (C)   | (D)  |
| Commodity                      | \$131,079,652                            | \$161,577,838              | \$172,526,796   | \$131,410,841  |
| Demand                         | \$42,331,387                             | \$42,331,387               | \$42,331,766  | \$42,331,766   |
| Total                          | \$173,411,039                            | \$203,909,225              | \$214,858,562   | \$173,742,607  |
| Increase over initial Petition |  | \$30,498,186               | \$41,447,523  | \$331,568  |

### MERC's Petition for Reconsideration

The Commission's Order<sup>10</sup> required MERC to: 1) update its base cost of gas to reflect NYMEX pricing estimates for January through December 2015, and 2) use the 2015 gas cost estimate to adjust the revenue deficiency amount attributable to uncollectible expense and calculate the storage balance.

<sup>7</sup> See LBO Ex. LBO-S-4

<sup>8</sup> November 27, 2013, ORDER SETTING NEW BASE COST OF GAS, Docket No. 13-732

<sup>9</sup> October 28, 2014, FINDINGS OF FACT, CONCLUSIONS AND ORDER, Docket No. 13-617

<sup>10</sup> October 28, 2014, FINDINGS OF FACT, CONCLUSIONS AND ORDER at pp. 12 and 18, Docket No. 13-617

MERC complied with the Commission Order using September 15, 2014 NYMEX pricing<sup>11</sup> to reflect its updated base cost of gas, storage balances, and uncollectible expense used to calculate its final rate revenue requirements. But, MERC does not agree that the January through December 2015 pricing should be used to calculate its interim rate refund. MERC believes that for interim rate refund purposes, the January through December 2014 pricing<sup>12</sup> for base cost of gas should be used to calculate uncollectible accounts and storage gas balances. MERC states that this would allow it to recover its *actual* non-gas costs for the interim rate period.<sup>13</sup>

In its *Petition for Reconsideration and Clarification*,<sup>14</sup> MERC requested that the Commission clarify its Order in two ways. First, MERC requested that the Commission clarify the base cost of gas to be used for purposes of calculating the final base cost of gas and for purposes of calculating the uncollectible expense and gas storage balance amounts to be used in the calculation of MERC's *final rates*. Second, MERC requested that the Commission clarify its Order with respect to appropriate base cost of gas to be used to calculate the uncollectible expense and storage gas balance for the *interim rate period*. Specifically, MERC requested that the Commission clarify that:

- the updated base cost of gas filed with MERC's 7 day compliance filing reflecting NYMEX pricing estimates<sup>15</sup> for January-December 2015 be used for purposes of calculating the final base cost of gas in Docket No. 13-732 and for purposes of calculating the uncollectible expenses amount and gas storage balance amount to be used in the calculation of MERC's final rates; and
- for purposes of determining the amount of the interim period rate refund, MERC shall use a base cost of gas reflecting NYMEX pricing estimates<sup>16</sup> for January-December 2014 to calculate the uncollectible expense and gas storage balances that apply during the interim rate period; and
- MERC's interim rate refund be calculated as the difference between final approved rates and interim rates assuming the updated uncollectible and gas storage amounts are used.

MERC stated:

Providing for an adjustment to the calculation of interim rates is well within the Commission's authority and provides a more narrowly tailored outcome to ensure MERC is permitted to recover the non-gas costs associated with the higher-than-average gas costs during 2014 while also ensuring final rates reflect normal and anticipated costs adjusted to remove the impacts of cost anomalies.

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<sup>11</sup> January through December 2015

<sup>12</sup> September 15, 2014 NYMEX

<sup>13</sup> MERC's November 17, 2014 Petition for Reconsideration and Clarification, p. 3

<sup>14</sup> Dated November 17, 2014

<sup>15</sup> Dated September 15, 2014

<sup>16</sup> Ibid

## Should the Commission clarify and/or reconsider its Order?<sup>17</sup>

MERC stated that it will be denied recovery of \$313,695 of revenues if the Commission does not adjust MERC's interim rate refund to allow recovery of actual non-gas costs during 2014.<sup>18</sup>

The \$313,695 represents the approximate<sup>19</sup> difference between the amount by which MERC is entitled to increase Minnesota jurisdictional revenues pursuant to the Commission's Order (\$7,580,774)<sup>20</sup>, and the gross revenue deficiency MERC calculated for interim rate refund purposes (\$7,894,468). This includes the recalculation of uncollectible expense and gas storage balances based on September 15, 2014 NYMEX – January through December 2014 prices. Staff calculates that: (1) MERC's recalculated uncollectible expense using a base cost of gas based on September 15, 2014 NYMEX – January through December 2014 prices rather than 2015 prices, increases the revenue deficiency approximately \$198,583, and (2) MERC's recalculated gas storage balance using September 15, 2014 NYMEX – January through December 2014 prices rather than 2015 prices, increases the revenue deficiency approximately \$115,112.

Table 2-Summary of MERC's Proposed Interim Rate Adjustments

|                       |           |
|-----------------------|-----------|
| Uncollectible Expense | \$198,583 |
| Gas Storage Balances  | \$115,112 |
| Total                 | \$313,695 |

If the Commission chooses to clarify, or reconsider, its Order with respect to the calculation of the interim rate refund, it may wish to separately consider the appropriate base cost of gas amounts to be used in calculating the test-year uncollectible expense and gas storage balance.

MERC stated that if its clarification or reconsideration request is denied it would not recover its actual 2014 expenses because it would not be authorized to adjust its base cost of gas amounts to the January through December 2014 NYMEX pricing estimates for the purpose of calculating the uncollectible expense and gas storage balance used in the interim rate refund calculation.

### a. Uncollectible Expenses

In its final rate determination, the Commission required MERC to calculate its test-year uncollectible (bad debt) expense by applying 0.549760% to the sum of the following figures: test-year forecasted revenues at present rates, the new base cost of gas, and the approximate revenue deficiency, rounded down to the closest million.<sup>21</sup>

The final revenue requirement included an amount for base cost of gas valued using the September 15, 2014 NYMEX reflecting January through December 2015 commodity pricing, as

<sup>17</sup> October 28, 2014, FINDINGS OF FACT, CONCLUSIONS AND ORDER, Docket No. 13-617

<sup>18</sup> MERC's November 17, 2014 Petition for Reconsideration and Clarification at p. 5

<sup>19</sup> Staff notes that there appears to be a \$1 rounding difference.

<sup>20</sup> October 28, 2014, FINDINGS OF FACT, CONCLUSIONS AND ORDER, Docket No. 13-617 at page 56.

<sup>21</sup> October 28, 2014, FINDINGS OF FACT, CONCLUSIONS AND ORDER at page 18, Docket No. G011/GR-13-617.

reflected above in Table 1, column D. The resulting test year bad debt expense was calculated to be \$1,465,016.<sup>22</sup>

MERC agreed to the Commission required uncollectible expense calculation to determine its final rate increase on a going forward basis. However, MERC proposes to use a different uncollectible expense calculation to calculate the increase upon which its interim rate refund would be calculated. For the interim rate refund period revenue requirement, MERC is proposing to use the September 15, 2014 NYMEX, but reflecting January through December 2014 commodity prices in calculating the base cost of gas revenues to be included in the uncollectible expense calculation. This increases MERC's uncollectible expense as opposed to the January through December 2015 commodity pricing used in the final rate revenue requirement calculation.

For the interim rate refund, MERC proposed to recalculate uncollectible expense<sup>23</sup> to reflect a base cost of gas of approximately \$209,703,308 (or initial filing cost of gas tariffed revenues of approximately \$173,412,058 plus \$36,291,250). MERC's recalculation results in a test year uncollectible expense of \$1,662,713,<sup>24</sup> which is \$197,697 higher than the test-year uncollectible expense used in the determination of final rates. Based on staff's calculations, if this difference is flowed through the financial schedules changing the cash working capital and interest synchronization calculations, etc., it would increase the gross revenue deficiency (or rate increase) by approximately \$198,583. (Please see table 2 above.)

MERC's position appears to be that, because of the spike in gas prices due to the TransCanada incident which occurred in 2014, the actual gas prices incurred in 2014 by MERC were higher than the estimated gas prices for 2015, and therefore non-gas costs such as uncollectible expense should be higher than estimated for final rates. MERC's proposal for calculating the interim rate refund is to replace one estimate of test-year uncollectible expense with another estimate of 2014 uncollectible expense based on September 15, 2014 NYMEX pricing for 2014 rather than NYMEX pricing for 2015.

The question for the Commission is whether it believes there is reason to clarify its decision on the calculation of uncollectible expense for the purpose of determining the amount of the interim rate refund. The Commission vote on both the base cost of gas and uncollectible expense matters for final rate determination was 5-0, with Commissioners Heydinger, Boyd, Lange, Lipshultz and Wergin present.

If the Commission believes there is reason to clarify its decision on the calculation of uncollectible expense for the purpose of determining the amount of the interim rate refund, it

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<sup>22</sup> Tariffed revenues at present rates from filing \$257,186,462, including a base cost of gas of approximately \$173,412,058, plus margin forecast adjustment of \$1,965,866, plus base cost of gas adjustment of \$330,549, plus a rounded down revenue deficiency, increase of \$7,000,000 for total tariffed revenues of \$266,482,877 multiplied by 0.549760% = \$1,465,016. Or Retail Revenue at present rates from the Operating Income Summary on page 55 of the Commission's Order, \$259,482,876 plus the revenue deficiency rounded down of \$7,000,000 = \$266,482,876 x 0.549760% = \$1,465,016.

<sup>23</sup> Using the September 15, 2014 NYMEX prices reflecting January through December 2014 commodity pricing

<sup>24</sup> The calculation is essentially the same as above except that it adds a base cost of gas adjustment of \$36,291,250 instead of \$330,549 (representing a total cost of gas of \$209,703,308 instead of \$173,412,058) and results in total tariffed revenues of \$302,443,578 multiplied by 0.549760% = \$1,662,713.



raises the question of the appropriate method by which to include this in the calculation of the interim rate refund considering interim rates are likely to be in effect for longer than one year. This is addressed further below in the implementation section.

### **b. Gas Storage Balances**

In its final rate determination, MERC's gas storage balance was calculated using the September 15, 2014 NYMEX - January through December 2015 commodity pricing. MERC calculates its gas storage balance by taking its monthly adjusted sales forecast times the average commodity cost of gas.

MERC agreed to the Commission required gas storage balance calculation for final rate determination, but disagreed with using it for the interim rate refund calculation. MERC believes it should be allowed to use the commodity cost of gas from September 15, 2014 NYMEX - January through December 2014 time period as opposed to its final rate calculation which used January through December 2015.

MERC stated that its proposal would allow it to collect its "*actual*" 2014 expenses; the proposed adjustment is \$115,112 which would lower MERC's interim rate period refund obligation.<sup>25</sup>

As with its 2014 uncollectible expense calculation, MERC's position appears to be that, because the TransCanada incident that occurred in 2014, 2014 actual gas prices were higher than the estimated gas prices for 2015, and therefore non-gas costs such as gas storage balance should be higher than estimated for final rates. MERC's proposal for calculating the interim rate refund is to replace one test-year gas storage balance estimate with another estimate for gas storage balance based on NYMEX pricing for 2014 rather than NYMEX pricing for 2015; MERC did not provide any evidence in this docket record stating what its *actual* 2014 gas storage balance actually was.

Staff generally agrees with MERC's statement regarding the increased commodity cost of gas in 2014, but MERC did not provide its *actual* 2014 gas storage balance. Besides, staff believes that MERC had already purchased the majority of its storage gas supplies for the 2013-2014 winter heating season before the cost of gas increased because of the TransCanada incident. Thus, its gas storage balances on an *actual* basis would not reflect the higher cost of gas. Also, the commodity cost of gas required to re-fill its storage capacity, which generally begins in April or May preceding the winter period, would not reflect the higher cost of gas because the commodity price paid by MERC for the injection cycle had already adjusted back to a more normal cost by April or May 2014.

In summary, its proposal for both uncollectible expense and gas storage balance calculations, MERC is seeking recovery for both items by replacing one test-year estimate with another estimate. The test-year concept calculates expenses based on the best known projections. MERC is not seeking recovery of actual expenses for all the remaining cost of service items. It appears that MERC may be picking and choosing test-year estimates which collect additional

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<sup>25</sup> MERC proposed to increase the gas storage balance from the \$11,041,166 reflected in the Commission's Order for final rates, to \$12,212,331. As discussed above, this in turn increases the revenue deficiency by \$115,112.

dollars from the ratepayers in Minnesota. MERC has not provided any information comparing the 2014 test-year projections to its 2014 actuals. The Commission may want to consider whether it is fair to allow MERC to isolate two cost components from the final rate determination and to adjust those components while not adjusting other items that could either increase or decrease the remaining cost components in the final rate determination.

The question for the Commission is whether it believes there is reason to clarify its decision on the calculation of the gas storage balance for the purpose of determining the amount of the interim rate refund. The Commission vote on both the base cost of gas and gas storage balance matters for final rate determination was 5-0, with Commissioners Heydinger, Boyd, Lange, Lipshultz and Wergin present.

If the Commission believes there is reason to clarify its decision on the calculation of the gas storage balance for the purpose of determining the amount of the interim rate refund, it raises the question of the appropriate method by which to reflect this in the calculation of the interim rate refund considering interim rates are likely to be in effect for longer than one year. This is addressed further below in the section on implementation.

### **Implementation of the gas storage balance and uncollectible expense adjustments**

If the Commission decides to clarify, or reconsider its Order with respect to the calculation of the test-year uncollectible expense, and/or gas storage balance to be used for purposes of calculating the interim rate refund, it may wish to clarify the method by which it should be implemented. Staff believes there are at least two different methods that could be used, as follows:

- 1) Calculate the refund obligation in the usual way by determining the percentage difference between the approved interim rate increase (\$10,755,973) and the final approved revenue increase (\$7,580,774), apply that percentage to the interim revenues billed, add interest and deduct \$313,695, or \$115,112, or \$198,583, depending on the Commission's decision, and then calculate the refund factor; or
- 2) Increase the gross revenue deficiency (\$7,580,774) determined in the Commission's Order for final rates by the amount of the effect that either, a recalculated uncollectible (bad debt) expense (\$198,583), or a recalculated storage balance (\$115,112), or both (\$313,695), would have on the gross revenue deficiency, to determine the gross revenue increase percentage upon which to calculate the interim rate refund obligation. [Staff believes this is what MERC is recommending with its suggested clarification.]

The following is an example of the two implementation methods assuming the Commission wants to clarify its Order to allow MERC to use a recalculated uncollectible expense and gas storage balance for purposes of calculating the interim rate refund:

Example of the Two Methods

|   | <u>Method<br/>1</u> | <u>Method<br/>2</u> |
|---|---------------------|---------------------|
| <u>Basis of Refund Obligation</u>   |                     |                     |
| Approved level of Interim rate revenue  | \$10,755,973        | \$10,755,973        |
| Final approved revenue increase   | \$7,580,774         |                     |
| Revenue increase assuming updated<br>uncollectible expense and gas storage figures are used     |                     | <u>\$7,894,468</u>  |
| <u>Refund Factor Calculation</u>  |                     |                     |
| Difference  | \$3,175,199         | \$2,861,505         |
| difference divided by \$10,755,973  | 0.2952              | 0.2660              |
| <u>Calculation of Refund Obligation</u>   |                     |                     |
| Interim Revenues Billed (Hypothetical)  | \$15,100,000        | \$15,100,000        |
| Refund factor   | <u>0.2952</u>       | <u>0.2660</u>       |
| Refund amount   | \$4,457,570         | \$4,017,184         |
| Interest to Refund (hypothetical)   | \$101,840           | \$91,770            |
| Uncollectible expense adjustment  | (\$198,583)         |                     |
| Gas Storage balance adjustment  | <u>(\$115,112)</u>  |                     |
| Refund Obligation   | \$4,245,715         | \$4,108,954         |
| Refund Factor to be applied to customers' interim charges<br>above line divided by \$15,100,000 | 0.2812              | 0.2721              |

Staff believes Method 1 would be the least confusing and most straightforward as it would use the final approved rate increase in the calculation rather than a different rate increase calculated just for the purpose of calculating the interim rate refund.

## **Decision Alternatives**

The decision alternatives are at the end of the briefing papers on pages 23-25.

If the Commission wants to reconsider and clarify that MERC is authorized to use the updated base cost of gas filed with MERC's October 1, 2014 compliance filing reflecting NYMEX pricing estimates for January-December 2015 for purposes of calculating the final base cost of gas in Docket No. G-011/MR-13-732 and for purposes of calculating the uncollectible expenses amount and gas storage balance amount to be used in the calculation of MERC's final rates, then alternative #7 is the appropriate decision alternative.

With respect to MERC's proposed modification to the interim rate refund adjustment, if the Commission wants to reconsider and clarify that for calculating the amount of the interim rate refund, MERC may use a base cost of gas based on September 15, 2014 NYMEX - January through December 2014 prices to calculate the uncollectible expense, then alternative #9 is the appropriate decision alternative.

In addition, if the Commission wants to reconsider and clarify that for calculating the amount of the interim rate refund, MERC may use a base cost of gas based on September 15, 2014 NYMEX - January through December 2014 prices to calculate the gas storage balance, then alternative #11 is the appropriate decision alternative.

If the Commission reconsiders and adopts alternatives 9, 11 or both 9 and 11, the Commission will also need to decide whether to authorize MERC to implement this adjustment using one of the two methods described above. Decision alternative #14 would authorize MERC to use method number one (described above on pp. 16-17) and decision alternative #13 would authorize method number two (also described above).

## **Allocation of Income Tax Expense in the CCOSS in Future Rate Cases**

PUC Staff: Clark Kaml

### **References**

Order, pp. 42-44

OAG, Petition for Reconsideration, pp. 1-3

MERC, Answer, pp. 1-5

### **Order**

The Order noted the Administrative Law Judge found that allocating income taxes on the basis of class percentage share of rate base was mathematically equivalent to allocating income taxes on the basis of taxable income by class that fully and only reflects the class cost of service study.

The Order explains that the goal of a class cost of service study is to allocate responsibility for a particular cost to the customer class that caused the cost to be incurred. Basing interclass income-tax allocations on taxable income from the revenues collected from each customer class necessarily departs from cost-causation principles and incorporates the policy judgments built into the rates that generated those revenues. Such policy judgments do not belong in the class cost of service study, but in the rate design decisions made in the course of the rate case.

### **OAG - Petition for Reconsideration**

The Office of the Attorney General – Antitrust and Utilities Division, requested that the Commission reverse its Order regarding the allocation of income taxes. It argued that the Order takes a position that is opposite of how the Commission voted during its deliberations. It stated that by rejecting Decision Alternative 157, the Commission decided not to rule that income taxes should be allocated in a manner that fully and only reflects the CCOSS in future cases. The OAG argued that the Order contradicts the Commission’s decision. Decision Alternative 157 reads:

Determine that, in future rate cases, MERC should allocate income taxes by class on the basis of taxable income that fully and only reflects the CCOSS.

The OAG requested that the Commission modify its Order to accurately reflect the Commission’s decision and clearly state that the Commission made no finding on the proper method to use in the future.

### **MERC - Answer**

MERC argued that while the Commission voted not to adopt Decision Option 157, it did not vote to adopt Decision Option 158. Decision Alternative 158 reads:

Make no determination regarding the treatment of income tax in the CCOSS of future rate cases.

The Commission took no action on the issue of the appropriate allocation of income taxes in future rate cases. MERC argued that the Commission's decision is accurately reflected in the Commission's Order. Therefore the OAG's request for reconsideration should be denied.

## **Staff Comment**

As noted by the parties, the Commission took no action on the issue of the appropriate allocation of income taxes in future rate cases. However, the Commission did determine that for the Class Cost of Service Study, taxable income should be based on allocation of costs within the Class Cost of Service Study (allocated by class on the basis of taxable income that fully and only reflects the CCOSS.)

The decision alternatives are at the end of the briefing papers on pages 23-25.

If the Commission wants to reconsider and clarify its decision regarding the allocation of income taxes in MERC's class cost of service studies, it may want to consider adopting alternative #16.

If the Commission does not want to reconsider or wants to reconsider and deny OAG's request, then alternative #15 would be the appropriate alternative.

## **Preparation of the CCOSS in MERC's next Rate Case Using Additional Variables**

PUC Staff: Clark Kaml

### **References**

Order, pp. 44-47, 60 & 61

MERC, Petition for Reconsideration, pp. 1-2, 6-15

OAG, Answer, pp. 1-6.

### **Order**

Ordering paragraph 32 of the Commission's Order states:

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

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

## **MERC - Petition for Reconsideration**

MERC requests clarification or, in the alternative, reconsideration and rehearing of the Commission's Order with respect to the specific requirements for Class Cost of Service Studies to be filed in MERC's future rate cases.

MERC requests that the Commission reconsider Order Point 32(a), which requires MERC to collect data on additional variables that impact the unit cost of distribution mains installations. MERC requests that the Commission amend its Order to require MERC to research the potential availability of additional variables. MERC suggests that the Commission remove 32(a), and replace it the following language: "In addition, in its next rate case MERC shall report on the potential availability, reliability, usefulness, and associated expense of collecting data on additional variables that may impact the unit cost of mains installations."

MERC did not object to Order Points 32(b), (c), or (d).

MERC argued that it has not maintained data on many of the additional variables and requiring data collection would require significant time and expense and would be inconsistent with what is required of other utilities. MERC argued that requiring the Company to research the collection of data on potentially available variables and report back to the Commission in its next rate case filing is a more reasonable step toward the objective of ensuring that the CCOSS fully considers all relevant variables while recognizing the limitations on MERC's ability to collect data on additional variables that the Company has not previously retained.

MERC noted that the OAG has suggested that MERC maintain data on variables such as number of fittings, number of valves, fitting and valve costs, year of installation, physical location of distribution main, type of installation, depth of installation, route selection, size of the main (i.e. pipe diameter), material type, material costs, labor costs, overhead costs, linear feet, and construction season. MERC stated that to its knowledge, no utility in Minnesota, has been required to maintain data on these variables.

MERC argued that its current data is sufficient for conducting a reliable and accurate zero-intercept analysis and it is unclear that the inclusion of any additional variables would meaningfully affect the results.

## **OAG - Answer**

The OAG stated that throughout this case it has expressed concerns with the zero-intercept study that MERC used to classify the costs of its distribution system. It is important to ensure that the distribution system is classified correctly because the distribution system is MERC's single largest investment; errors in classification can lead to significant changes in revenue apportionment. The OAG identified many problems with the ordinary least squares ("OLS") regression that MERC used in its zero-intercept study, but the OAG's primary contention was that MERC's entire methodology was flawed.

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

The OAG recommended that the Commission deny MERC's request for two reasons.

**First**, the OAG argued that the data collection required by Order Point 32(a) is necessary to ensure that the zero-intercept study in MERC's next case is reliable. The OAG stated that the need for additional data flows directly from the OAG's overall concern for MERC's research methodology.

OAG believes MERC's zero-intercept study is fundamentally flawed because it assumes that only one variable has an impact on the cost of installing gas mains. The OAG's response restated several of its concerns with MERC's analysis and stated that MERC will need to include additional variables in its model. In order to incorporate those additional variables, MERC will need to collect data on the variables that are to be included.

The OAG argued that MERC will not be able to perform a successful, reliable OLS regression if it does not comply with Order Point 32(a), along with (b), (c), and (d).

The OAG noted that it recommended that MERC have flexibility and freedom in choosing variables for its model. The flexibility of the Commission's Order should allow MERC to determine what data it currently has, what data it can acquire at a reasonable cost, and how that data can be incorporated into its next zero-intercept model.

**Second**, MERC's request to replace the data collection requirement with an evaluation only delays any opportunity to improve the reliability of MERC's zero-intercept analysis. The OAG believes the Commission should reject MERC's recommendation to replace Order Point 32(a) with a requirement to report on the "availability, reliability, and associated expense" of including additional variables in its study.

The OAG stated that ordering MERC to only evaluate data collection, rather than actually doing data collection and attempting to improve its model, would excuse MERC from making any attempt to improve its zero-intercept model for its next rate case.

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

## **Staff Comment**

A primary consideration for the Commission is whether it wants MERC to improve its zero-intercept method. The OAG continues to take exception to MERC's zero-intercept method. As also noted by the OAG, the Commission's Order does not list the specific variables to be used.

The decision alternatives are at the end of the briefing papers on pages 23-25. If the Commission wants to reconsider and change the requirement that MERC consider using additional variables



in the preparation of its class cost of service study in its next rate case, then alternative #17 is the appropriate decision alternative.

If the Commission does not want to reconsider or wants to reconsider and deny MERC's request for a modification to the Order, then alternative #18 or #19 would be the appropriate alternative.

## **Decision Alternatives**

### **Reconsideration of the October 28, 2014 Order**

1. Grant one or both petitions for reconsideration
  - a. Minnesota Energy Resources Corporation (MERC), and/or
  - b. Minnesota Office of Attorney General-Antitrust and Utilities Division (OAG), or
2. On its own motion, the Commission could move to reconsider the October 28, 2014 Order, or
3. Deny MERC's and/or OAG's petitions for reconsideration, or
4. Take no action and allow the petitions for reconsideration to be denied by operation of law.

**Note:** If the Commission grants reconsideration or decides on its own motion to reconsider to modify or clarify its October 28 Order, one or more of the following issues (as well as any other issues) could be addressed.

### **Travel and Entertainment Expenses**

5. Reconsider and deny unreported travel and entertainment expenses allocated to MERC from MERC's service company, Integrys Business Services. Use a proxy amount of \$284,725, i.e. the amount of reported travel and entertainment expenses, for the unreported amount of travel and entertainment expenses. (OAG)
6. Do not reconsider the decision reached during deliberations regarding MERC's travel and entertainment expenses and do not deny unreported travel and entertainment expenses allocated to MERC from MERC's service company, Integrys Business Services. (MERC)

## **Clarification Regarding Updated Base Cost of Gas Used for Final Rates**

7. Reconsider and clarify that the updated base cost of gas filed with MERC's October 1, 2014 compliance filing reflecting NYMEX pricing estimates for January-December 2015 be used for purposes of calculating the final base cost of gas in Docket No. G-011/MR-13-732 and for purposes of calculating the uncollectible expenses amount and gas storage balance amount to be used in the calculation of MERC's final rates. (MERC)
8. Do not clarify that the updated base cost of gas filed with MERC's October 1, 2014 compliance filing reflecting NYMEX pricing estimates for January-December 2015 be used for purposes of calculating the final base cost of gas in Docket No. G-011/MR-13-732 and for purposes of calculating the uncollectible expenses amount and gas storage balance amount to be used in the calculation of MERC's final rates.

## **Interim Rate Refund Adjustment**

### **Uncollectible Expense**

9. Reconsider and clarify that for purposes of determining the amount of the interim rate refund, MERC shall use a base cost of gas calculation based on the September 15, 2014 NYMEX - January through December 2014 prices to calculate the uncollectible expense that should apply to calculate the interim rate refund. (MERC) OR
10. Do not reconsider and clarify that for purposes determining the amount of the interim rate refund, MERC shall use a base cost of gas calculation based on the September 15, 2014 NYMEX - January through December 2014 prices to calculate the uncollectible expense.

### **Gas Storage Balance**

11. Reconsider and clarify that for purposes of determining the amount of the interim rate refund, MERC shall use a base cost of gas calculation based on the September 15, 2014 NYMEX - January through December 2014 prices to calculate the gas storage balance that should apply to calculate the interim rate refund. (MERC) OR
12. Do not reconsider and clarify that for purposes determining the amount of the interim rate refund, MERC shall use a base cost of gas calculation based on the September 15, 2014 NYMEX - January through December 2014 prices to calculate the gas storage balance.

## **Implementation of the gas storage balance and uncollectible expense adjustments**

13. Clarify that MERC's interim rate refund will be calculated as the difference between final approved rates and interim rates assuming the updated (based on September 15, 2014 NYMEX pricing for January through December 2014) uncollectible expense and gas storage figures are used. [MERC] [If both adjustments (#s 9 & 11) and implementation Method 2 are selected. However, if only one adjustment is selected, uncollectible expense or storage balance, this decision option should be modified accordingly.] OR

14. Clarify that MERC's interim rate refund obligation will be calculated based on the difference between the interim rate increase and the final approved increase and that an uncollectible expense adjustment of \$198,583, and a gas storage balance adjustment of \$115,112, will be deducted from the refund obligation to determine the final refund obligation. [Staff] [If both adjustments (#s 9 & 11) and implementation Method 1 are selected. However, if only one adjustment is selected, uncollectible expense or storage balance, this decision option should be modified accordingly.]

### **Allocation of income tax expense in the CCOSS in future rate cases**

15. Determine that the Order reflects the Commission's decision. (MERC) OR
16. Determine that the Order does not reflect the Commission's decision and modify the Order to state that the Commission made no finding on the proper method to use in the future. (OAG)

### **Preparation of the CCOSS in MERC's next rate case using additional variables**

17. Decide to reconsider Ordering paragraph 32 and modify it as proposed by MERC:

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

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

In addition, in its next rate case MERC shall report on the potential availability, reliability, usefulness, and associated expense of collecting data on additional variables that may impact the unit cost of mains installations. (MERC)  
OR

18. Determine that Ordering paragraph 32 does not need to be modified. (OAG) OR
19. Take no action

**Summary of Commission Deliberations on September 24, 2014  
Relevant to MERC's and OAG-AUD's Petitions for Reconsideration**

**Travel, Entertainment, and Related Employee Expenses**

Chair Heydinger moved to take the following actions:

- A. Reduce Administrative and General Expenses by the \$7,770 agreed to between the Company and the Department, an additional \$956 in corporate aircraft expense, and an additional \$3,496 for dues to the Edison Electric Institute.
- B. Require the Company in future rate case filings to meet the reporting requirements of Minn. Stat. § 216B.16, subd. 17 for all T&E Expenses, including expenses related to employees working for MERC affiliates.
- C. Require the Company in future rate case filings to allocate any costs not specific to Minnesota based on the allocation factor MERC files in its Direct Testimony and identify which costs have been allocated.

The motion passed 3-2. Commissioners Lange and Lipschultz voted no.

**Cost of Gas**

Chair Heydinger moved to require MERC to provide a filing within seven days in this docket that updates the base cost of gas reflecting NYMEX pricing estimates for January through December 2015. These figures shall be used to adjust the revenue deficiency amount identified in decision option 54, and MERC shall use these figures as the new base cost of gas.

The motion passed 5-0.

**Uncollectable Expense**

Commissioner Boyd moved to adopt the Department's position to use the 2013 ratio of 0.549760% and apply to test year forecasted tariff revenues at present rates as determined by the Commission's decisions in this rate case and the new base cost of gas, determined in accordance with requirements set in this case, plus the approximate revenue deficiency determined by the Commission's decisions (i.e., rounded down to the closest million to eliminate the circular reference).

The motion passed 5-0.

## **Gas Storage Balance**

Chair Heydinger moved to adopt an appropriate gas storage balance number based on the base cost of gas decision made in this case as reflected in the compliance filing required in the cost of gas section above.

The motion passed 5-0.

## **CCOSS Issues**

Chair Heydinger moved to take the following actions:

- A. *Income Tax Allocation*—Determine that, for the Class Cost of Service Study, taxable income should be based on allocation of costs within the Class Cost of Service Study (allocated by class on the basis of taxable income that fully and only reflects the CCOSS.)
- B. *Meter Reading Costs*—Approve MERC’s proposed allocation of FERC Account 902: Meter Reading.
- C. *Correction to ALJ’s Report on Meter Reading*— Modify Finding 649 as proposed by the OAG to be consistent with the OAG’s position that it does not agree that MERC’s allocation is reasonable.
- D. *Customer Records and Accounts*— Determine that MERC’s allocation of Account 903 costs are reasonable.
- E. *Main Distribution Cost Studies*—Adopt the OAG’s proposed modifications to Finding 631 to provide more explanation of the differences between the minimum size method and the zero-intercept method.
- F. *Main Distribution Cost Allocation*— Determine that 68.3 percent of MERC’s distribution mains were classified as customer costs and 31.7 percent were classified as demand costs.

The motion passed 5-0.

## **Class Cost of Service Study (CCOSS)**

Commissioner Wergin moved to determine that although a CCOSS is not precise, it can be a useful tool for setting rates and to amend the ALJ’s Report as necessary to reflect this determination.

The motion passed 5-0.

### **Use of CCOSS in this Case**

Commissioner Wergin moved to accept MERC's CCOSS as a useful tool for the purpose of setting rates.

The motion passed 5-0.

### **Allocating Income Tax Costs in Future Rate Cases**

Commissioner Wergin moved to determine that, in future rate cases, MERC should allocate income taxes by class on the basis of taxable income that fully and only reflects the CCOSS.

The motion failed 2-3. Chair Heydinger and Commissioners Lange and Lipschultz voted no.

### **CCOSS in Next Rate Case**

Chair Heydinger moved to require MERC to submit two CCOSSs in its next rate case. One study should be based on the zero-intercept method and the other on the minimum distribution method.

The motion passed 5-0.

### **Data Collection for Future CCOSS**

Chair Heydinger moved to require MERC to take the following actions in preparing future Class Cost of Service Studies:

- A. collect data on additional variables that impact the unit cost of mains installation;
- B. avoid aggregating or averaging data and use data at the finest level reasonable;
- C. check OLS regression assumptions and correct for violations; and
- D. make any future zero-intercept analysis more transparent to ensure that MERC's work can be easily replicated.

The motion passed 5-0.