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March 30, 2009

VIA ELECTRONIC FILING

Burl W. Haar
Executive Secretary
Minnesota Public Utilities Commission
121 Seventh Place East, Suite 350
St. Paul, MN 55101

Re: In the Matter of the Petition of Minnesota Energy Resources Corporation-NMU for Approval of a Change in Demand Entitlement
Docket No. G007/M-08-1329
Docket No. G007,011/MR-08-836

Dear Dr. Haar:

Enclosed please find the Reply Comments of Minnesota Energy Resources Corporation ("MERC") in the above-referenced dockets.

Thank you for your attention to this matter.

Sincerely yours,

Michael J. Ahern

cc: Service List

STATE OF MINNESOTA
BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

David C. Boyd	Chair
J. Dennis O'Brien	Commissioner
Thomas Pugh	Commissioner
Phyllis A. Reha	Commissioner
Betsy Wergin	Commissioner

In the Matter of the Petition of Minnesota Energy Resources Corporation-NMU for Approval of a Change in Demand Entitlement

Docket No. G007/M-08-1329
Docket No. G007,011/GR-08-836

REPLY COMMENTS OF
MINNESOTA ENERGY RESOURCES CORPORATION

Minnesota Energy Resources Corporation-NMU ("MERC" or "Company") submits to the Minnesota Public Utilities Commission ("Commission") these Reply Comments in response to the March 4, 2009 Comments of the Minnesota Office of Energy Security ("OES") in the above referenced matter.

A. <u>Design-Day Study</u>

1. The OES noted that using the same design-day calculation methodology, the Company proposes significant increases in its design-day requirement for its MERC-PNG Northern PGA system, MERC-PNG Great Lakes PGA system, and for its MERC-NMU PGA system, while at the same time the Company proposes a significant decrease in the design-day requirement for its MERC-PNG Viking PGA system. The OES requested that MERC provide a detailed explanation of this result in its Reply Comments.

<u>Response</u>

MERC believes the important point to focus on that supports the new methodology is the result when regressing total volumes. The following table indicates the total regressed results for each MERC system utilizing the 2008-2009 methodology for the 2007-2008 season compared to the 2008-2009 season:

System	2007-2008 Total Point Estimate	2008-2009 Total Point Estimate	Variance	Variance %
PNG-GLGT	11,529	12,159	630	5.46%
PNG-NNG	251,200	248,585	(2,615)	-1.04%
PNG-VGT	9,877	10,038	161	1.63%
NMU	84,763	84,632	(131)	-0.15%

As the data shows, there is not a large variance from one season to another utilizing the new methodology. MERC believes this is an important starting point to support the methodology. The major differences are based upon the methodology of deducting interruptible and transportation volumes. The new methodology requires taking the peak month consumption for interruptible and transportation customers and dividing by twenty (20) days, then dividing by ten (10) to convert to Dth. This approach calculates a Maximum Daily Quantity (MDQ) to be subtracted from the total regressed point estimate. In addition, MERC adds back the firm contracted volumes for the Joint Rate customers to calculate design day.

Unfortunately, MERC was not able to simulate the same methodology for calculating MDQ volumes to deduct for the 2007-2008 season because the data was not available in the same format as the data for 2008-2009 season. Without having an equal simulation, MERC cannot adequately address why PNG-GLGT, PNG-NNG and NMU design day increased and PNG-VGT decreased. MERC feels confident that there is adequate capacity to meet customer requirements as filed but would appreciate the opportunity to meet and discuss the new methodology with the OES.

2. The OES also recommended that the Company recalculate the design day requirements in Docket No. G007/M-07-1402 for the 2007-2008 season using the approach used by the Company in the current docket. The OES stated that this information would help confirm whether the Company's revised method still ensures reliable peak day firm service.

Response

MERC completed the design day analysis for the winter of 2007-2008 utilizing the new design day methodology. The data utilized to subtract out the interruptible and transportation volumes for 2007-2008 was not available in the same format as it was in 2008-2009, so MERC was not able to simulate exactly as it did in the 2008-2009 design day. The resulting 2007-2008 design day requirement is 69,032 Dth. MERC's design day requirement for the 2008-2009 winter is 63,724 Dth. MERC believes the important point to focus on that supports the new methodology is the result when regressing total volumes. The total regressed volumes result in a point estimate of 84,763 Dth for the recalculated 2007-2008 winter compared to 84,632 Dth for the 2008-2009 winter. Please see Attachment 1 (MERC 2007&08 Peak Day Forecast Recalculation Using 2008&09 Methodology), Attachment 2 (NMU-Centra Winter 2007&08 Peak Day Re-Run), Attachment 3 (NMU-GLGT Winter 2007&08 Peak Day Re-Run), Attachment 4 (NMU-VGT Winter 2007&08 Peak Day Re-Run), Attachment 5 (NMU-NNG Winter 2007&08 Peak Day Re-Run), and Attachment 6 (NMU-GLGT&VGT Winter 2007&08 Peak Day Re-Run).

3. The OES noted that the Fargo weather station, which MERC used to determine its weather coefficients, has a maximum heating degree day below the Commission prescribed peak-day weather standard of -25ºF for 24 hours. The OES recommended that the Company

provide a full discussion in its Reply Comments of whether its peak-day weather assumptions, on page 6 of the Company's Petition, are sufficient to meet the Commission's peak-day standard of -25ºF for 24 hours.

Response

MERC did not use the Fargo weather station alone to establish the weather coefficients for NMU. As indicated on Page 6 of the Company's Petition there are six (6) weather stations that are listed in determination of the peak day requirement, of which four (4) weather stations were utilized for the design day calculation for NMU. On the Centra pipeline, the International Falls weather station was utilized for the design day calculation. On the Great Lakes Gas Transmission (GLGT) pipeline, Bemidji and Cloquet were utilized for the design day calculation. On the Northern Natural Gas (NNG) pipeline, Cloquet was utilized. On the Viking Gas Transmission (VGT) pipeline, the Fargo and Bemidji weather stations were utilized for the design day calculation. MERC protects in a range from 103 to 107 adjusted HDD which is greater than the -25ºF for 24 hours Commission peak-day standard.

4. The OES noted that MERC used forecasted changes in sales volumes to estimate its growth rate but did not provide these forecasted volumes in its Petition. The OES recommended that the Company provide these data in its Reply Comments, along with any, and all, models, data, and assumptions necessary to replicate the growth rate.

Response

Please see Attachment 7 (MERC 2009 Design Day Growth Factors) for the growth rate data.

5. The OES discussed a smaller adjustment MERC undertook with respect to its farm tap customers. The OES recommended that MERC provide a full discussion of the changes to the design-day related to these customers and whether it classifies farm taps as firm or non-firm customers.

Response

MERC has both firm and interruptible farm tap customers. The volumes from farm tap customers were included in the total throughput numbers which were regressed to establish a point estimate. Volumes for interruptible farm tap customers would have been reflected in the MDQ calculation explained in the response to paragraph 1 which was subtracted from the total regressed point estimate. There were no farm tap customers on a Joint Rate. If there had been any farm tap customers that were on a Joint Rate, the firm portion would be added to the total regressed point estimate.

6. The OES noted that the Company's service territory has experienced two extreme cold weather events since the Petition was filed, one in December 2008 and one in January 2009. Considering the recent cold weather and the changes in design-day calculations, the OES recommended that MERC provide the following in its Reply Comments:

a) a full discussion of MERC-NMU's firm system performance during the two recent cold weather events;
b) a full discussion of MERC-NMU's interruptible customer policy and whether interruptions during the recent cold weather events occurred according to the Company's policy;
c) the dates that peak usage occurred during each month in the 2008-2009 heating season;
d) daily Heating Degree Days and Adjusted Heating Degree Days for each day during the 2008-2009 heating season;
e) total daily system throughput for each day during the 2008-2009 heating season; and

f) total Daily Firm Capacity (DFC) throughput volumes for each day during the 2008-2009 heating season.

<u>Response</u>

a) MERC experienced a sustained cold spell from January 12-16, January 23-26, and February 2-3, 2009. Attachment 8 (MERC Jan09 & Feb09 Coldest Days) shows the unadjusted/adjusted HDD, MERC contracted firm capacity, MERC nominations, third party nominations and total consumption for all customers (sales and transportation) on all MERC pipelines. MERC does not nominate for PNG and NMU customers separately but nominates for MERC customers system-wide on all pipelines.

As the file indicates, during the coldest weather experienced during 2009, MERC had adequate nominated capacity to meet total system requirements. MERC did not fully utilize all of its firm capacity on any of the days. In addition, MERC has to make sure the total system is balanced on a daily basis, which is why MERC has to factor in third party nominations and compare to total system usage, not just firm usage.

b) MERC offers three levels of interruptible service: small volume, large volume and super large volume. The following describes the qualifying criteria for each level:

<u>Super Large Volume</u>: Customers must have capacity to take 4,000 dekatherm (Dth) or more per day and annual consumption of 1,200,000 Dth. *See* MERC Tariff, Sheet No. 5.50.

<u>Large Volume</u>: Customers must have taken 200 Dth or more per day at least once in a calendar year. *See* MERC Tariff, Sheet No. 8.02.

<u>Small Volume</u>: Customer’s consumption should not exceed 199 Dth in any given day. *See* MERC Tariff, Sheet No. 8.02.

Interruptible service is offered to commercial/industrial customers. Interruptible customers agree to have their gas service interrupted, curtailed or discontinued at any time at the option of the Company. According to MERC's tariff, the largest customers are the first to be curtailed. There are penalties associated with unauthorized use of natural gas during a curtailment period, with penalty costs based on tariff language. *See* MERC Tariff, Sheet Nos. 8.41 – 8.42.

The follow curtailments occurred in December 2008:

- MERC-PNG NNG - 2 curtailments at North Branch and Webster, in accordance with the Company's tariff.

The following curtailments occurred in January 2009:

- MERC-NMU - 1 curtailment at Moose Lake, in accordance with the Company's tariff.
- MERC-PNG NNG - 7 curtailments at Eagan, Fairmont, Webster and Worthington, in accordance with the Company's tariff.

In all instances, large volume customers were curtailed before any small volume customers were required to curtail. No customers incurred any curtailment penalties.

c) The following table contains the total throughput peak day usage. The data is for all PNG and NMU customers, including sales, interruptible and transportation volumes. Data is not yet available for March 2009.

Month/ Year	Peak Day	Peak Volume
Nov-08	11/20/08	323,057
Dec-08	12/15/08	423,628
Jan-09	01/15/09	414,224
Feb-09	02/03/09	368,016

d) MERC utilizes four weather station for forecasting purposes for NMU on the Centra, GLGT, NNG and VGT pipelines, which are Bemidji, Cloquet, Fargo and International Falls, Minnesota, as discussed in response A.3 above. Please see Attachment 9 (MERC Winter 2008-09 NMU HDD Data).

e) Please see Attachment 9 (MERC Winter 2008-09 NMU HDD Data). This data includes throughput throughput volumes for all MERC PNG and NMU customers on the Centra, GLGT, NNG and VGT pipelines.

f) MERC is unable to provide firm volumes on a daily basis because many customers (e.g., residential, small volume) do not have daily telemetry. Information is only available on a daily basis for total throughput as shown on Attachment 9 (MERC Winter 2008-09 NMU HDD Data).

B. <u>Demand Entitlement Changes</u>

Based on its review of other pipeline entitlements, the OES expressed some concerns with MERC's PGA cost recovery proposal.

1. First the OES noted that the Firm Deferred Delivery (FDD) volumes listed in Attachment 4, Page 2 of 2, do not reconcile with the same volumes presented in Attachment 8. The OES recommended that MERC provide a full discussion in its Reply Comments of the inconsistencies in the volumes reported for its FDD storage contracts and which volumes are the correct amounts to include in the demand entitlement filing.

Response

The volumes listed in Attachment 4, page 2 of 2, are correct. MERC inadvertently failed to add the FDD Capacity and Reservation Charge on Contract Number 118215 as shown in Attachment 4, Page 2 of 2, to Attachment 8. The November 2008 entitlement should have shown 7,980 volumes for FDD Storage Capacity and 92,014 volumes for FDD Reservation Charge on Attachment 8.

2. Second, the OES believes that the Company is treating the cost recovery of its FDD storage contracts incorrectly. In particular, FDD contracts are storage contracts that allow a utility to withdraw, or inject, natural gas into storage without any prior notice to the pipeline or storage company.[1] The OES noted that MERC agreed in its Supplemental Comments in Docket No. G007/M-07-1402 that it was appropriate to recover storage costs through the commodity rather than the demand portion of rates. Additionally, in its Reply Comments in that same docket, MERC requested a date of July 1, 2008 to shift these storage demand costs to the commodity portion of the PGA, but MERC has continued to recover FDD storage costs in the demand portion of the PGA. The OES recommended that MERC provide the following in its Reply Comments:

- a full discussion of why it continues to recover FDD storage costs through the demand cost recovery portion of the PGA rather than the commodity cost portion; and
- updated exhibits and attachments that show the effects of moving the FDD storage costs to the commodity cost recovery portion of the monthly PGA.

[1]MERC notes that the FDD storage contracts do require MERC to provide notice to the pipeline before withdrawing or injecting natural gas into storage.

Response

In an Order dated February 6, 2008 in Docket No. E,G-999/AA-06-1208, the Commission required all gas utilities to make a supplementary filing addressing the cost allocation of producer demand and storage costs in their demand entitlement dockets. The OES correctly noted that on March 7, 2008, MERC made a Supplemental Filing in Docket No. G007/M-07-1402 in which the Company proposed to include storage costs in the commodity rate rather than the demand rate. The OES agreed with MERC's proposal in its Comments dated June 12, 2008. In Reply Comments dated July 8, 2008, MERC requested that the Commission approve the proposed shift of storage costs from demand to commodity effective July 1, 2008. In Response Comments dated July 29, 2008, the OES recommended that the Commission approve the change effective April 1, 2008.

The Commission has not issued a decision in Docket No. G007/M-07-1402 and has not yet approved MERC's proposal to shift storage costs from the demand portion of rates to the commodity portion of rates. MERC therefore has not implemented its proposal in the monthly PGA because the Company is awaiting Commission approval of this change.

MERC, however, has provided with these Reply Comments updated Attachment 4, page 1 of 2, and Attachment 7 that show the effects of moving the FDD storage costs to the commodity cost recovery portion of the monthly PGA in the event the Commission approves the shift of storage costs from the demand rate to the commodity rate.

C. FT0011 Contract

The OES noted that MERC has terminated the FT0011 contract and has refunded costs related to this contract to ratepayers. The Company, however, included volumes related to the

FT0011 contract in its base cost of gas calculations in Docket No. G007,011/MR-08-836. Given that the FT0011 contract has been terminated, the OES concluded that inclusion of volumes associated with the FT0011 contract in MERC's base cost of gas calculations is unreasonable. The OES recommended that the Commission require MERC, in its final compliance in Docket No. G007,011/MR-08-836, to remove all costs and volumes related to the FT0011 contract from its final base cost of gas calculations.

Response

MERC submitted its initial base cost of gas filing in Docket No. G007,011/MR-08-836 on July 31, 2008. At that time, the Company had incurred demand costs related to the FT0011 contract from July through October 2007 and April through June 2008 that were included in the base cost of gas calculations. Moreover, when MERC filed its initial base cost of gas petition on July 31, 2008, MERC continued to disagree with the OES's recommendation that the Company be required to discontinue cost recovery associated with the FT0011 contract and refund to its ratepayers the net difference between the total recovered PGA costs and the total amount received in the capacity release market credited to the PGA for the FT0011 agreement.[2] MERC later agreed to refund this amount to it ratepayers in its Annual Automatic Adjustment report filed September 5, 2008 in Docket No. G999/AA-08-1011.[3] MERC recognizes, however, that the base cost of gas calculations include costs related to the FT0011 contract from July 2007 through October 2009, after the FT0011 contract was terminated.

On September 25, 2008, the Commission issued an Order Setting New Base Cost of Gas in Docket No. G007,011/MR-08-836, setting a new base cost of gas to be implemented with interim rates. In that Order, the Commission directed MERC to file a revised new base cost of

[2] *See* MERC's Reply Comments dated July 9, 2008 and the OES's Response Comments dated July 29, 2008 in Docket No. G007/M-07-1402.
[3] *See* MERC's Letter dated September 23, 2008 filed in Docket No. G007/M-07-1402.

gas reflecting the removal of the gas for company use no later than 10 days from the date of that Order and delegated to the Executive Secretary the authority to approve the revised base cost of gas schedules. MERC filed the revised base cost of gas schedules on September 19, 2008, and the Executive Secretary approved the revised base cost of gas on September 26, 2008. The Commission also directed MERC to work with the OES and the Commission to identify acceptable time increments and data sources for updates during the rate proceeding. MERC subsequently filed updates to the commodity cost of gas in both the rate case and base cost of gas proceedings on October 29 and December 22, 2008 and January 27, 2009. The last update was filed just prior to the evidentiary hearing in the rate case proceeding.

The OES now recommends that the Commission require an additional change to the Company's base cost of gas calculations following completion of the rate case proceeding. MERC notes that removing the FT0011 contract costs from the base cost of gas docket has a very small impact on the base cost of gas. The annual FT0011 contract costs for MERC-NMU in the base cost of gas filing were approximately $62,000, total estimated demand costs were approximately $6,240,000, and total estimated gas costs were approximately $44,800,000. Using the annual sales projection of 69,321,120 therms from the base cost of gas filing, the approximate effect of removing costs associated with the FT0011 contract from the base cost of gas calculation is approximately ($0.00089) per therm.

Additionally, the costs associated with the FT0011 contract are not currently included for recovery through the monthly PGA and have not been included since November 2008, the proposed effective date for MERC's current demand entitlement filing.[4] Therefore the inclusion

[4]Although the FT0011 contract was terminated effective June 30, 2008, MERC failed to remove the costs for this contract from its PGA filings for July – September 2008. MERC proposes to refund these costs to its ratepayers in its Annual Automatic Adjustment filing due September 1, 2009.

of the FT0011 contract in the base cost of gas calculations will cause no harm to ratepayers because the costs of this contract will not be charged to ratepayers through the PGA.

MERC, however, agrees to remove all costs and volumes related to the FT0011 contract from its latest update to the base cost of gas dated January 27, 2009, and to submit the revised base cost of gas calculation as part of its rate case compliance filing.

D. <u>PGA Cost Recovery</u>

Based on an examination of MERC's cost recovery proposal submitted in its initial filing and the revised spreadsheets filed on November 5, 2008, the OES noted that the demand cost estimates are not the same. The OES concluded that MERC did not provide support for the change in demand costs with its revised spreadsheets and was not able to complete its analysis. Based on the change in demand costs included in the revised spreadsheets and the Company's cost recovery proposal for its storage related contracts, the OES withheld any recommendation on MERC's cost recovery proposal until MERC provides sufficient evidence supporting its demand cost changes and cost recovery proposal.

<u>Response</u>

When MERC made its initial filing on November 3, 2008, Attachment 4, page 1 of 2, and Attachment 7 included estimated demand costs that had been used as placeholders in preparation of the attachments pending calculation of the actual demand costs. Soon after filing, MERC realized that it had failed to replace the estimated costs with the actual demand costs and that Attachments 4 and 7 were not accurate. MERC therefore filed revised attachments that included the actual demand costs on November 5, 2008.

DATED this 30th day of March, 2009.

Respectfully submitted,

DORSEY & WHITNEY LLP

/s/ Michael J. Ahern_____________

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Attorney for MERC

AFFIDAVIT OF SERVICE

STATE OF MINNESOTA)
) ss.
COUNTY OF HENNEPIN)

Sarah J. Kerbeshian, being first duly sworn on oath, deposes and states that on the 30th day of March, 2009, the Reply Comments of Minnesota Energy Resources Corporation were electronically filed with the Minnesota Public Utilities Commission and the Minnesota Department of Commerce. A copy of the filing was delivered by first class mail to the remaining individuals on the attached service list.

/s/ Sarah J. Kerbeshian

Subscribed and sworn to before me
this 30th day of March, 2009.

/s/ Alice A. Jaworski
Notary Public, State of Minnesota

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