MINNESOTA PUBLIC UTILITIES COMMISSION

Staff Briefing Papers

Meeting Date	June 3, 2021		Agenda Item **1
Company	Minnesota Energy Resources Corporation		
Docket No.	**G-011/M-20-420**		
	In the Matter of the Petition of Minnesota Energy Resources Corporation (MERC) for Approval of its Natural Gas Extension Project (NGEP) Rider True-up for 2019, Rider Revenue Deficiency for 2021, and Revised Surcharge Factors		
Issues	Should the Commission approve MERC's proposed 2021 Natural Gas Extension Project (NGEP) rider surcharge factors for the recovery of 2021 Rochester Project Costs with or without modification?		
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✓ **Relevant Documents**	**Date**
MERC Initial Filing	April 13, 2020
Minnesota Propane Association – Public Comment	June 30, 2020
Office of Attorney General – Letter	October 9, 2020
Department of Commerce – Comments (Trade Secret)	January 8, 2021
MERC – Reply Comments	January 22, 2021

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

Relevant Documents	Date
Department of Commerce – Response to Reply Comments	March 19, 2021
MERC – Reply Comments—Additional	March 29, 2021

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I. Statement of the Issues

Should the Commission approve MERC's proposed 2021 Natural Gas Extension Project (NGEP) rider surcharge factors for the recovery of 2021 Rochester Project Costs with or without modification?

II. Introduction

Minnesota Energy Resources Corporation (MERC or the Company) submitted the current petition requesting approval of its 2021 Natural Gas Extension Project (NGEP) rider (rate) factors which were designed to recover 33 percent, or $997,896, of its projected 2021 revenue deficiency of $3,023,928 for MERC's projected 2021 investments related to the Rochester NGEP.

The NGEP rate currently in effect of $0.00052 per therm is based on a revenue deficiency of $400,989, or 33 percent of a projected 2019 revenue deficiency of approximately $1.2 million.

After numerous rounds of comments, MERC and the Minnesota Department of Commerce, Division of Energy Resources (Department) have not agreed on the projected 2021 revenue deficiency.

Two disputed revenue requirement issues remain in this docket. First, the Department continues to propose that MERC true up its 2018 revenues from its base rates to account for offsetting revenues in the Rochester area. MERC contends that the Order in Docket No. G-011/GR-17-563[1] refers only to a true-up of differences between actual 2018 capital expenditures and estimated capital expenditures.

Second, MERC and the Department dispute the inclusion of a portion of MERC's actual incremental 2019 outside legal regulatory expense associated with the Rochester Project NGEP rider in the true-up reconciliation and 2021 forecast.

Regarding property tax expense, the Department concluded that MERC complied with the Commission's Order, in Docket No. G-011/M-19-608,[2] and detailed in Department Information Request No. 1. In addition, MERC agreed to the Department's request to provide project-area specific property tax data in future NGEP rider true-up filings.

Also, the surcharge rate for MERC's direct-connect customers is not an issue like it was in MERC's previous annual NGEP update, in docket 19-608. The Company and the Department agree with the Commission's decision regarding the allocation of the NGEP rider revenue

[1] FINDINGS OF FACT, CONCLUSIONS, AND ORDER, In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to Increase Rates for Natural Gas Service in Minnesota, DOCKET NO. G-011/GR-17-563 (December 26, 2018)

[2] ORDER APPROVING NGEP RIDER SURCHARGE WITH MODIFICATIONS, In the Matter of Minnesota Energy Resources Corporation's 2020 Rochester Natural Gas Extension Project Rider, Docket No. G-011/M-19-608 (September 21, 2020)

requirement to Direct Connect Customers. However, MERC disagrees with the Department's analysis of the bypass risk posed by direct connect customers.

III. Relevant Statute

Minnesota (Minn.) Statutes (Stat.), Section (§) 216B.1638, the Recovery of Natural Gas Extension Project Costs statute, was enacted in 2015. This section of law allows a utility to petition the Commission for a rider to recover, outside of a general rate case, the revenue deficiency from a natural gas extension project. The statute defines eligible natural gas extension projects and sets forth the information that must be contained in such a petition and establishes the scope and standards for review of the petition by the Commission. Among other requirements for Commission approval, such a rider must not be allowed to recover more than 33 percent of the costs of the natural gas extension project.

To date, only one public utility other than MERC has requested authorization to recover costs associated with natural gas extension projects under Section 1638 of Minn. Stat., Ch. 216B.

On December 31, 2019, CenterPoint Energy Resources Corp., d/b/a CenterPoint Energy Minnesota Gas (CenterPoint Energy) submitted its request for authority to recover costs for a project in the community of Nowthen in Anoka County, Minnesota. CenterPoint Energy asked to recover costs for this project either in its next rate case or through an NGEP Rider and to establish a 16-year New Area Surcharge to finance the remainder of the project costs. The Commission approved this project with cost recovery authorized mainly through new area surcharges and a very small $0.00001 per therm NGEP rider factor.[3]

IV. Background

A. Initial Filing of the NGEP Rider

In its May 5, 2017 ORDER APPROVING ROCHESTER PROJECT AND GRANTING RIDER RECOVERY WITH CONDITIONS,[4] the Commission found that the Rochester Phase II upgrades are a natural gas extension project within the meaning of Minn. Stat. § 216B.1638 and authorized MERC to recover up to 33 percent of its Phase II costs to upgrade the Rochester-area distribution system through an NGEP rider surcharge on all customers, with the remainder to be recovered through base rates.

Total Phase II recovery was capped at MERC's estimate of $44 million unless MERC can establish that the overruns are reasonable.

[3] Order, In the Matter of the Petition of CenterPoint Energy (CenterPoint) for Approval for Recovery of Natural Gas Extension Project Costs through a Rider or in the Alternative for Regulatory Asset Treatment and for a New Area Surcharge for the Nowthen Project, Docket No. G-008/M-19-840 (August 4, 2020)
[4] In the Matter of a Petition by Minnesota Energy Resources Corporation for Evaluation and Approval of Rider Recovery for Its Rochester Natural Gas Extension Project, Docket No. G-011/M-15-895

B. First Annual Request for NGEP Rider Recovery

MERC filed its first annual request for NGEP Rider recovery on February 28, 2018 in Docket No. G-011/M-18-182[5] (18-182 Docket). MERC proposed to recover a 2019 incremental revenue deficiency of approximately $1.3 million through the rider via an equal per therm surcharge applied to all customers (including transportation). The Department opposed MERC's interpretation of the NGEP Statute regarding the amount eligible for rider recovery and stated that the amount of the annual revenue deficiency eligible for rider recovery was 33 percent of the annual revenue requirements.

In its June 18, 2019, ORDER APPROVING NGEP RIDER SURCHARGE WITH MODIFICATIONS, in the 18-182 Docket, the Commission found that the 33% figure in the NGEP statute should apply to the annual incremental revenue requirement or revenue deficiency. The Commission also required MERC to remove contingency costs from its total cost projection and to modify the sales forecast for 2019 used to calculate the NGEP Rider rate.

On June 28, 2019, MERC filed, in 18-182 Docket and in Docket No. G-011/M-18-281[6] (18-281), an emergency request to suspend collection of the gas utility infrastructure cost (GUIC) rider and NGEP rider surcharges for direct connect customers. MERC argued that implementation of the GUIC and NGEP rider surcharges represented a significant rate increase to Direct Connect customers and risked these customers leaving MERC's system.

On August 26, 2019, the Commission, in Docket Nos. 18-182, 18-281, 19-282,[7] and 17-563,[8] issued its ORDER SUSPENDING GUIC RIDER SURCHARGE FOR DIRECT CONNECT CUSTOMERS, AND DECLINING TO REOPEN NGEP COST RIDER DOCKET. The Commission concurred with the Department and OAG that the NGEP statute requires application of the NGEP surcharge to all customers, and therefore, the Direct Connect customers must bear their share of the NGEP rider surcharge. The Commission stated, on p. 7 of its August 26, 2019 Order, "But because the NGEP surcharge of $0.00052 per therm is only one eighth the size of the GUIC surcharge, it is far from clear that a rider of this magnitude would have a substantive effect on a customer's choice to bypass MERC's system."

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[5] In the Matter of the Petition of Minnesota Energy Resources Corporation for Approval of a Natural Gas Extension Project (NGEP) Cost Rider Surcharge for the Recovery of 2019 Rochester Project Costs, Docket No. G-011/M-18-182

[6] In the Matter of Minnesota Energy Resources Corporation's Request for Approval of a Gas Utility Infrastructure Cost (GUIC) Rider, Docket No. G-011/M-18-281

[7] In the Matter of the Petition of Minnesota Energy Resources Corporation for Approval of 2020 Gas Utility Infrastructure Cost (GUIC) Rider Revenue Requirement and Revised Surcharge Factor, Docket No. G-011/M-19-282

[8] In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to Increase Rates for Natural Gas Service in Minnesota, Docket No. G-011/GR-17-563

C. Petition for MERC for Approval of 2021 NGEP Rider Revenue Deficiency and Revised Surcharge Factors, in this docket

On April 13, 2020, in this docket (20-420 Docket), MERC submitted its Petition requesting approval of recovery of a portion of its 2021 Rochester NGEP costs through MERC's 2021 NGEP Rider pursuant to Minn. Stat. § 216B.1638. MERC is requesting approval to implement updated NGEP surcharges by customer class effective January 1, 2021 to recover 33 percent of the annual 2021 Rochester Project revenue deficiency.

On October 9, 2020, OAG filed comments opposed MERC's proposal to charge the direct-connect customers one-thousandth of a penny per therm for the NGEP surcharge. This direct-connect issue is moot since the Commission issued its Order in docket 19-608.[9]

On January 8, 2021, the Department filed comments opposing MERC's request for approval of recovery. The Department also recommended adjustments to property tax, outside legal fees, weather normalization, 2018 and 2019 true-up, and revenue offsets, and developed an alternative proposal for the NGEP rider surcharge rates.

On January 22, 2021, MERC filed reply comments in support of its position for adjustments in property tax expense, legal regulatory fees, weather normalization, 2018 true-up adjustments, proposed rate design, and termination of 2021 NGEP Surcharge Rates.

On March 19, 2021, the Department filed response to reply comments to address MERC's argument of support for the above-listed issues. Several issues have been resolved, including MERC direct-connect customers, the sales forecast used to set rates, and the termination of 2021 NGEP surcharge rates at the end of the Rochester project. The Department also offered an alternative proposal in response the MERC's original proposal.

On March 29, 2021, MERC filed additional reply comments vigorously defending its interpretation of the statute in the areas of legal regulatory fees and the 2018 base rate revenue true-up. The Company also addressed weather normalization and property tax expense.

[9] ORDER APPROVING NGEP RIDER SURCHARGE WITH MODIFICATIONS, In the Matter of Minnesota Energy Resources Corporation's 2020 Rochester Natural Gas Extension Project Rider, Docket No. G-011/M-19-608 (September 21, 2020)

V. Revenue Requirement

A. Background

1. MERC's Petition

MERC has requested approval of recovery of 33 percent of its annual 2021 Rochester NGEP costs through the NGEP Rider. Specifically, MERC is seeking approval of:

- An ongoing NGEP Rider;
- A 2021 forecasted revenue deficiency of approximately $3.0 million for MERC's projected 2021 investments related to the Rochester NGEP, with 33 percent ($997,896) to be recovered through the NGEP Rider, subject to future true-up;
- A true-up adjustment of $227,236 for the under-recovered 2019 NGEP revenue deficiency based on MERC's actual Rochester Project costs and actual NGEP Rider revenues, and to account for differences between the 2018 actual Rochester Project capital expenditures and MERC's capital estimates.
- NGEP Rider surcharge rates by customer class to be effective January 1, 2021; and
- Updated NGEP Rider tariff sheets.

MERC stated that:[10]

> This Petition seeks approval for the recovery of a portion of the costs incurred to construct the Rochester Project. The Rochester Project is designed to expand the capacity of MERC's natural gas distribution system in and around the City of Rochester to meet current and forecasted demand. MERC filed its first request for the establishment of an NGEP Rider and recovery of 2019 costs through an NGEP surcharge rate in Docket No. G011/M-18-182. The Commission issued its 2019 NGEP Rider Order in that docket on June 18, 2019. Through that proceeding, MERC and the Minnesota Department of Commerce, Division of Energy Resources (the 'Department') were able to reach resolution regarding a number of modifications to MERC's NGEP Rider.

2. Department Comments

The Department believes MERC's supporting information and calculation of its $997,896 revenue deficiency are generally reasonable but asked for additional information and proposed modifications with respect to offsetting revenues, outside regulatory legal expense, and weather normalization.

These three issues are discussed in the following sections of the briefing papers.

[10] MERC Petition, p. 2.

B. Resolved Revenue Requirement Issues

1. Allocation of Cost Recovery Among Customers and Proposed Method of Rider Recovery (Resolved in the 2020 Petition, Docket 19-608)

a. MERC Petition

MERC filed this Petition on April 13, 2020, before the proceeding for its 2020 Petition in docket G011/M-19-608 was completed. The order for the 19-608 docket was issued on September 21, 2020, and therefore the 2021 Petition did not incorporate the decisions from the docket 19-608 order. The main issue in this section was the tariff for direct connect customers in light of the prospect of a possible risk of bypass. In the order, the Commission approved applying the NGEP rider surcharge to all customers.[11]

b. Department Comments

In January 8, 2021 Comments, the Department noted that it was unaware of any changes in underlying data or assumptions used in last year's bypass analysis. Additional details of the Department's analysis in last year's petition may be found in its Comments.[12]

c. Staff Analysis

Staff concludes that this issue has not changed from last year's order, and that this issue is resolved.

2. Revenue Deficiency for 2021 Rider Recovery (Resolved)

a. MERC Petition

The statute defines the revenue deficiency as:

> The deficiency in funds that results when [1] projected revenues from customers receiving natural gas service as the result of a natural gas extension project, plus [2] any contribution in aid of construction paid by these customers, fall short of the total revenue requirement of the natural gas extension project.[13]

The calculation of revenue deficiency includes the following elements: 1) the currently authorized rate of return, 2) incremental income taxes, 3) incremental property taxes, 4)

[11] MERC Petition, p. 20.
[12] TRADE SECRET Comments of the Minnesota Department of Commerce, Division of Energy Resources Docket No. G-011/M-20-420, p. 8.
[13] Minn. Stat. § 216B.1638, subd. 1(f). The "total revenue requirement" of a project means "the total cost of extending and maintaining natural gas service to a currently unserved or inadequately served area."

incremental depreciation expenses, and 5) any incremental operation and maintenance expenses.[14]

The calculation of the revenue requirement uses the following factors: 1) the applicable tax rate from the Tax Cuts and Jobs Act, 2) 9.7 percent return on equity authorized in MERC's 2018 rate case, Docket No. G-011/GR-17-563, 3) prorated accumulated deferred income taxes ("ADIT") in compliance with Internal Revenue Service ("IRS") normalization rules with the tax gross-up factor of 1.402, and 4) a weighted average cost of capital of 6.6971 percent.[15]

MERC expects to recognize incremental sales growth in the Rochester area, as reflected in its forecast in Docket No. G-011/M-15-895, in the amount of $811,877 for 2021.[16] After subtracting for this marginal 2021 revenue, MERC's revenue deficiency for 2021 becomes $3,023,928. NGEP-eligible recovery of this deficiency at 33% is $977,896.

Next, MERC adjusts this revenue deficiency for a true-up adjustment of $227,236 related to the under-recovery of actual NGEP Rochester costs in 2018 and 2019. This brings the recovery amount to $1,225,132. This revenue deficiency was allocated across customer classes.

b. Department Comments

The Department notes that this treatment of depreciation and income taxes appears consistent with the Commission's September 21, 2020 Order, and the Department concludes that this approach is reasonable at this time.[17] A part of Operations and Maintenance (O&M) expenses and outside legal fees are discussed separately below.

Regarding property taxes, the Department argued that there should be a reduction to rate base to reflect the one-year timing difference in the payment of property taxes. The Department requested that MERC update its NGEP rider calculations to reflect the Commission's September 21, 2020 Order. In response to the Department's information request, MERC supplied a downward adjustment of $597,394 to base rates to reflect the property tax offset. The Department recommends the property tax offset to continue in future years.[18]

The Department also requested that MERC provide property-specific Rochester project property tax information, in accordance with the Commission's requirement in its September 21, 2020 Order.

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[14] Minn. Stat. § 216B.1638, subd. 3(d).

[15] In the Matter of the Petition of Minnesota Energy Resources Corporation for Approval of Natural Gas Extension Project (NGEP) Rider True-Up for 2019, Rider Revenue Deficiency for 2021, and Revised Surcharge Factors Docket No. G011/M-20-420, p. 17.

[16] MERC Petition, p. 16.

[17] Department Comments, pp. 13, 15.

[18] Department Comments, p. 12.

c. MERC Reply Comments

MERC responded to the Department's Information Request No. 1 by revising its 2019 NGEP true-up model so that it now conforms to the Commission's September 21, 2020 Order, in docket 19-608, even though the Company believed the rate base adjustment for property tax was inappropriate. Regarding the property-specific property tax estimates for 2019, MERC provided the Department with step by step explanation of its methodology. MERC also noted that the $597,394 reduction to base rates would also reduce revenue requirement by $18,510.[19]

d. Department Response Comments

The Department found MERC's additional commentary and analysis helpful in estimating 2021 property tax expense, and now believes that this updated method is consistent with MERC's previous estimates of forecasted property taxes.[20] This process resulted in a $115,522 increase in actual 2019 actual incremental property tax expense.

The Department requests MERC to continue to make consistent estimates of project-area specific property tax data, similar to that provided in in Attachment B of its Reply Comments.

The Department concluded that MERC's property tax method for 2021 is consistent with the Company's previous estimates. The Department also concludes that MERC complied with the Commission's docket 19-608 Order. The updated property tax cost estimates are used in the Department's alternate calculation.

e. Staff Analysis

Staff concludes the issue is resolved.

3. Termination of Rider Recovery, Renewal, and True-up (Resolved)

a. MERC Petition

MERC proposes that the implementation of the new NGEP surcharge rates effective January 1, 2021, including the 2018 and 2019 true-ups, continue to remain in effect into the future.[21] One of two things would happen: either the Commission authorizes a new NGEP Rider surcharge rate, or the completion of the NGEP at which time it would be added to rate base.

Project completion is expected to be at the end of 2021, with some restoration work in 2022. The Company proposes to preserve the original proration requirements embedded in the projected rates by adjusting the prorated ADIT with the 13-month average of the differences between projected and actual ADIT balances. As a special case, the proposed true-up cannot change the prorated Accumulated Deferred Income Taxes (ADIT) across customer classes.

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[19] MERC Reply Comments, pp. 2-3.

[20] Department Reply Comments, p. 2.

[21] MERC Petition, p. 39.

b. Department Comments

The Department concludes that the Company's proposal to terminate rider rates with the implementation of new NGEP Rider surcharges or interim rates in a future rate case proceeding is reasonable. This is the same termination method approved by the Commission in the last NGEP rider filing.[22]

c. MERC Reply Comments

MERC agrees that the Department's proposal is reasonable, as long as depreciation recovery and return of base rate are rolled into rates in the Company's future general rate case and that the NGEP rider is suspended with the implementation of interim rates in a future general rate case.[23]

d. Department Response Comments

The Department agrees with MERC's termination proposal regarding the 2021 NGEP surcharge rates.[24]

Additionally, the Department supports the recommendation to submit a compliance filing showing final surcharge rates to be effective at the end of the project and continuing until such a time that interim rates are implemented in a future rate case.

e. Staff Analysis

Staff concludes the issue is resolved.

4. Weather Normalization (Resolved)

a. MERC Petition

In this filing, MERC proposed to weather-normalize sales using 20-year weather data instead of 15-year data, which was used in the Company's 2020 NGEP filing.[25] MERC changed to the 20-year data to be consistent with the original Rochester docket and its 2017 rate case.

b. Department Comments

The Department agrees with the Company's decision to switch to 20-year data. However, it is concerned that the usage of 15-year data creates an inconsistent treatment of base sales and actual-adjusted sales.[26] In response to a Department information request, MERC provided

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[22] Department Comments, p. 18
[23] MERC Reply Comments, p. 21.
[24] Department Response Comments, pp. 10-11.
[25] MERC Petition, p. 37.
[26] Department Comments, pp. 19-20.

spreadsheets and calculations. However, the Department believes this data does not support the reasonableness of MERC's weather normalization process.

The Department also requested more information on MERC's regression methodology used in calculating its 20-year weather normalization data.

c. MERC Reply Comments

MERC notes that its prior use of 15-year weather data in the 2020 NGEP docket does not affect its 2021 revenue requirement or the 2019 true-up. The Company inadvertently used a 15-year instead of a 20-year normalization period for Rochester area sales growth based on actual weather-normalized sales through September 2019 and forecasted sales through December 2019. As a result, it updated the calculation of $626,362 for offsetting revenues. The difference between the 15 and 20-year basis is a nominal reduction of $869, meaning that ratepayers will not be charged.

Regarding weather normalization, MERC made no other changes in methodology between the 2020 and 2021 rider filings. The 2021 forecast uses more complete data compared to that of 2020. Another difference in methodology related to the implementation of MERC's new rate classes effective with final rates in 2019, making the calculation of offsetting revenues more accurate. Another factor improving accuracy in this filing is the change from annual customer counts in the 2020 offsetting revenue calculation to monthly customer counts for the 2019 true-up and the 2021 forecast.

In summary, as MERC states,

> . . . 2019 offsetting revenue true-up and 2021 forecasted offsetting revenues as proposed reflect the most accurate actual 2019 offsetting revenues and forecasted 2021 offsetting revenues associated with Rochester area sales and customer growth. These calculations are inclusive of actual weather-normalized 2019 sales based on a 20-year normal weather assumption and actual and forecasted sales and customer counts for each current rate classification.[27]

In response to the Department's request to identify which regression method the Company used, MERC explains that it uses the ratio method for the 2021 NGEP weather normalization forecast, just as it has done for its rate filings.[28] The regression method finds the line that best fits a set of temperature observations. The ratio method, on the other hand, multiplies weather-sensitive sales by the ratio of normal 20-year HDD65 temperatures to actual HDD65 temperatures, and then adds back in baseload sales, which are unaffected by weather.

d. Department Response Comments

[27] MERC Reply Comments, p. 11.

[28] MERC Reply Comments, p. 11.

The Department reviewed MERC's response and concludes that normal weather was appropriately applied in the NGEP rider.[29]

As for regressions and ratios, the Department has no objection to ratios. However, the forecast is performed by regression analysis whereas the historic weather normalization was computed with ratio analysis. The Department believe there may be a difference in results due to the difference in methodologies.

The Department recommends MERC provide the following in its next NGEP Rider Petition: 1) Any, and all, data necessary to verify the normal and actual weather used to calculated weather normalized sales in the Company's current NGEP Rider and prior NGEP Rider filings; and 2) Historic annual customer count data since 2014, by customer class, for the Rochester Area to verify MERC's weather normalized sales estimates for the rider.

The Department noted that MERC was asked to provide in supplemental comments or a compliance filing updated NGEP rider surcharge rates based on actual weather-normalized sales when the data becomes available.

e. MERC Additional Reply Comments

MERC agrees to provide the information requested by the Department, as described above.[30]

f. Staff Analysis

Staff concludes that the parties have resolved the issue of weather normalization methodologies.

C. Disputed Issue: 2018 and 2019 True-up Reconciliation

1. MERC Petition

In this filing, in addition to submitting a proposed 2021 NGEP revenue deficiency for recovery, MERC is submitting its first true-up reconciliation for the Rochester Project NGEP Rider for calendar year 2019.[31] Based on a rider surcharge factor of $0.00052 per therm applicable to all customer classes, MERC's authorized 2019 NGEP Rider revenue deficiency for recovery through the NGEP Rider surcharge was $400,989 – 33 percent of the total project revenue deficiency of $1,215,118. The true-up reconciles the difference between actual Rider surcharge revenue earned and 33 percent of actual expenses for 2019.

MERC has calculated an under recovery of $(227,236), which includes the 2018 and 2019 true-up reconciliation and actual NGEP Rider surcharge revenues collected through December 2019. This true-up includes incremental depreciation expense through the end of 2019, property tax expense, O&M expense, and return on incremental base rate, which is the difference between

[29] Department Response Comments, pp. 7-8.
[30] MERC Additional Reply Comments, pp. 5-6.
[31] MERC Petition, p. 30.

the authorized rate base in Docket No. G-011/GR-17-563 and actual rate base through 2019. Thus, return on incremental rate base is only return on the difference.

In a similar fashion, incremental depreciation expense is calculated as the difference between budget and actual. Budgeted depreciation expense for 2019 was forecasted at rates approved on planned additions to plant. Actual 2019 depreciation expense was calculated on actual additions to plant at the most-recently applied rates.[32]

2. Department Comments

Pursuant to the Commission's September 21, 2020 Order and in response to the Department's information request No. 1, MERC updated its under-recovered balance to $205,542 from $227,236.[33]

The Department also recommended a large unfavorable adjustment to 2018 rate base of $2,350,510. This difference is due to MERC's inclusion of $11,382,768 in 2018 rate base instead of the actual rate base of $9,032,258. This means MERC overstated 2018 rate base by this difference. Three specific items make up this proposed adjustment—the true-up of 2018 depreciation expenses, the true-up of property tax expenses, and the Rochester Project rate base.

First, MERC calculated a $4,468 difference between depreciation expense included in base rates and actual 2018 depreciation authorized in docket 17-442. The Department found that this amount accounts for the difference between forecasted and actual depreciation.

Second, regarding property tax expense, the Department found a similar result as with depreciation between forecast and actual expense based on plant in service. The true-up showed an under-recovery of $56,574.

The third adjustment pertains to Rochester rate base, which MERC, unlike depreciation and property tax, chose not to true-up. The Company claimed that it could start with the 2017 rate case value and adjust it through 2019 for asset removals. The Commission's ordering point from the 2017 rate case clearly states that the true-up adjustments requested for 2018 should have been requested in the 2019 NGEP Rider filing. Late requests for true-up adjustments would therefore result in a decrease in the NGEP rider surcharge to ratepayers. The Department is unclear if a strict interpretation is called for.

Nevertheless, the Department is unclear if a 2018 true-up is reasonable or not. Also, it is unclear whether MERC's true-up methodology for rate base is reasonable. It is not consistent with the treatment of depreciation and property tax. However, the Department noted that in MERC's 2020 NGEP rider filing in docket 19-608, the actual rate base for 2018 was $9,032,258; yet the $11,382,768 in Rochester rate base was included in base rates, a $2,350,510 difference. The Commission weighed in on the danger of over-recovery of Rochester Project costs in its

[32] MERC Petition, p. 32.

[33] Department Comments, p. 17

rate case Order. The Department, therefore, concluded that a true-up of the 2018 rate base over-collection is necessary.

3. MERC Reply Comments

MERC does not object to the Department's proposal to include under-collected offsetting revenues in the true-up calculation for 2019. However, the Company disagrees with the Department's recommendation for a true-up to 2018 revenues.[34]

As for 2018 adjustments, MERC argues that it has included adjustments to account for the differences in actual 2018 Rochester Project capital expenditures through its 2019 NGEP rider true-up. As indicated in its Petition and response to information request No. 4 in this docket, MERC has already trued-up 2018 depreciation and property tax expenses against what was authorized in docket 17-563.

MERC also contends it has already trued-up rate base to 2018 actuals in both its 2020 NGEP rider, in docket 19-608, and in the 2019 true-up. MERC therefore believes that the Department's alternative proposal inappropriately amounts to a double reduction.

In its rate case, with a 2018 test-year, in docket 17-563, MERC already included any forecast versus actual differences in base rates, in accordance with the Commission's Order:

> Because recovery for the Rochester Project is authorized both in base rates and through the NGEP rider, there is a ready mechanism to ensure just and reasonable rates overall even if base rates turn out to be based on an overestimate of actual Project costs. The Commission will therefore require that MERC include any difference between the 2018 actual Rochester Project capital expenditures and MERC's capital estimates used in this docket in its upcoming NGEP Rider as a true-up with MERC's NGEP rider true-up calculation. The true up will ensure that an overestimate of projected costs built into base rates can be corrected-for. This will protect ratepayers if the Rochester Project capital expenses do not meet projected test-year amounts.[35]

MERC also agreed to true-up for 2018 Rochester Project costs within its 2019 true-up to be filed in 2020. In addition, MERC calculated the 2020 NGEP revenue requirement based on 2018 actuals.[36] Thus, 2018 actuals served as the basis for MERC's true-up to the 2020 NGEP.

MERC disputes the Department's claim on timing of the 2018 true-up. The Commission's Order on December 26, 2018 anticipated that the 2018 capital expenditure would occur as part of

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[34] MERC Reply Comments, p. 12.
[35] *In the Matter of the Application of Minn. Energy Res. Corp. for Auth. to Increase Rates for Nat. Gas Serv. in Minn.*, Docket No. G-011/GR-17-563, FINDINGS OF FACT, CONCLUSIONS, AND ORDER at 18 (Dec. 26, 2018).
[36] MERC Reply Comments, p. 14.

MERC's NGEP rider true-up calculation.[37] Accordingly, the Petition filed in this docket on April 13, 2020 was the first opportunity to file a NGEP rider true-up.

Regarding the Department's proposed rate base adjustment, MERC

> … has included a true-up for rate base to reflect the difference between the amount of Rochester Project costs included in rate base in the Company's authorized base rates and actual 2018 Rochester Project rate base additions. Indeed, MERC's rate base adjustment is for the identical amount the Department has proposed is appropriate. As a result, the Department's recommended adjustment would result in a second, duplicate reduction and is therefore unnecessary.[38]

In addition, plant balances are accumulative, meaning that the 2019 actual investments are already included in the 2019 NGEP and 2021 NGEP rider.

MERC presents the following table to show how it has already accounted for the adjustments recommended by the Department and the Department's recommendation is duplicative:[39]

MERC's As Filed 2019 Actual NGEP Rate Base	$7,046,094
2019 NGEP Rate Base Without 2018 Rate Base True Up	$9,396,604
Difference: Resulting Reduction to Rate Base	$2,350,510 (matches to Department recommended rate base reduction)
Revenue Requirement Impact	$72,830 reduction to 2019 revenue requirement (matches to Department recommended adjustment)

No further adjustments are necessary to reflect the 2018 true-up to rate base.

Regarding 2018 offsetting revenue, MERC argues that there is no requirement to true-up 2018 revenues from its base rates to account for offsetting revenues. While MERC has correctly included an offset for incremental revenues according to the statute, the requirement does not apply to base rates.[40]

4. Department Response Comments

On the base rate adjustment issue, the Department agrees with the position detailed in MERC's Reply Comments and no longer recommends its base rate adjustment.[41]

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[37] MERC Reply Comments, p. 15.
[38] MERC Reply Comments, p. 16.
[39] MERC Reply Comments, p. 16-17.
[40] MERC Reply Comments, pp. 18-19.
[41] Department Response Comments, pp. 7-8.

On offsetting revenues, the Department acknowledges that MERC is correct that the Commission's Order Point 13 in the 2017 Rate Case "does not explicitly require MERC to true-up 2018 actual Rochester revenues."

However, the Department believes MERC's interpretation is unreasonably narrow and ignores the discussion of the capital true-up included in the Order. The body of the Order describes a 'ready mechanism' which can correct for project overestimates becoming part of base rates. This ready mechanism is the NGEP rider true-up, which can protect rate payers from the risk of overpaying. Thus, one can infer that the Commission intended to true up both actual revenues and costs to estimates included in the 2017 Rate Case test year.[42]

5. MERC Additional Reply Comments

MERC reiterates that the Commission's Order Point 13 is clear and unambiguous. The Company states that the order ". . . limits the required NGEP rider true-up to 'any difference between the 2018 actual Rochester Project capital expenditures and MERC's capital estimates used in this docket. MERC also claims that the Department shifted its position by arguing intent in its Response Comments. The Company also points out in the Commission's Order language at least five explicit references to "capital expenditures" and no references to trueing up for revenues or sales.[43]

MERC continues to defend against the Department's claim of Commission intent and its use of the 'ready mechanism' argument. The Department had the opportunity to propose new language in the 2017 rate case, docket 17-563, but did not do so. The NGEP rider is unique because of its focus on the addition of natural gas lines. It cannot be compared to other common riders because they do not involve the extension of utility service to new areas.[44]

6. Staff Analysis

The base rate adjustment issue has been resolved by the parties. The remaining issue of offsetting revenues remains in dispute.

Staff believes the issue of offsetting revenues is a matter of interpretation of the intent of the Commission in its Order Point 13 in the 2017 Rate Case. It appears to Staff that MERC and the Department both have strong points. The parties' positions on the issue reveal a significant lack of consensus surrounding the implications of Order Point 13. Additionally, the meaning and application of the concept of a 'ready mechanism' remain central to the concept of just and reasonable rates.

If the Commission decides it supports MERC's position it may want to find that Order Point 13 narrowly defines 'ready mechanism' and limit the required NGEP rider true-up to 'any difference between the actual and estimated 2018 Rochester Project capital expenditures.'

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[42] Department Response Comments, pp. 9-10.
[43] MERC additional Reply Comments, p. 2.
[44] MERC additional Reply Comments, p. 3.

Alternatively, the Commission may want to decide it supports the Department's position and interpret Order Point 13 to allow the Commission to require MERC to use the 'ready mechanism' of the NGEP to include offsetting revenue in the NGEP rider true-up.

D. Disputed Issue: 2019 Outside Legal Regulatory Expense

1. MERC Petition

In this filing, MERC notes that the NGEP statute authorizes rider recovery for any incremental Operations and Maintenance (O&M) expenses associated with the Rochester Projects in the true-up reconciliation.[45] MERC includes $40,632 of outside legal costs related to filings, regulatory proceedings, discovery, and approval of its 2019 NGEP Rider in Docket No. G-011/M-18-182. MERC believes these expenses are incremental to this project, and thus reasonable and consistent with the statute. To date, MERC has not requested recovery of such expenses in unique filings such as the NGEP Rochester Rider, although it has included legal expenses in routine regulatory filings.

2. Department Comments

The Department concludes for three reasons that it is inappropriate to include legal fees in the 2021 NGEP Rider surcharge because they are already included in base rates and are not true incremental costs.[46] First, through numerous communications, the Commission expected annual NGEP filings to occur in a routine fashion. Second, since the NEGP Order was issued 5 months before MERC's 2017 general rate case, MERC could have incorporated additional NGEP legal expenses in the rate case. Lastly, it is likely that these legal fees are related to cost recovery proposals that contradicted MERC's original Rochester NGEP petition that the Commission relied upon to approve the project. Approval of such fees would encourage utilities to make inappropriate filings in the hope of recovering future legal fees.

3. MERC Reply Comments

MERC continues to argue that the inclusion of outside legal fees for filings, regulatory proceedings, discovery, and approval of the Company's 2019 rider in Docket 18-182.[47] These costs are not only reasonable and prudent, they were in fact unforeseeable at the time of the Company's filing of its last rate case in Docket 17-563. The key qualification is whether these fees fall into the category of "any incremental operation and maintenance costs". MERC could not have known the complexity of the NGEP filings at that time. Although the Company filed for the recovery of routine legal fees in past rate cases, it has not included adjustments for unique filings such as the current NGEP project.

MERC counters the Department's assertion that the Company would be able to recover a windfall of outside legal fees in this case and into the future. These expenses fall outside a rate case test year, and therefore do not become part of base rates. In addition, outside legal fees

[45] MERC Petition, p. 34.

[46] Department Comments, p. 14.

[47] MERC Reply Comments, pp. 4-7.

are part of incremental O&M expenses, and therefore are subject to the 33 percent limit for recovery, according to the NGEP statute. Thus, MERC would only collect $13,408 of its $40,632 outside legal fees in the 2021 NGEP rider. Given the 33 percent recovery limitation, it is not possible to over-recover these costs.

4. Department Response Comments

The Department reviewed the Company's Reply Comments and continues to question whether the outside legal fees are reasonable and prudent.[48] The Department claims that MERC has provided no support for its position that the fees are directly related to NGEP. It also suggests that if these fees get into base rates, and if the fees are lower in the future, then MERC would be able to keep the difference between the amount in base rate and future lower actual legal fees. The Department concludes that MERC's attempt to recover outside legal fees is unreasonable since the Company can already recover legal fees embedded in base rates.

5. MERC Additional Reply Comments

MERC continues to emphasize the new nature of the Rochester NGEP.[49] The associated legal fees were for a project not seen previously. How could MERC forecast such fees without some kind of experience? By definition, the NGEP legal fees are incremental.

Also, since legal fees, as part of O&M expenses, MERC believes they should be subject to the 33 percent limitation while MERC bears the remaining 67 percent of cost. Accordingly, it has every incentive to minimize these fees.

6. Staff Analysis

Staff notes that MERC and the Department have strongly felt positions on the issue of outside legal fees. Yet, the Commission's decision must be grounded in a just and reasonable application of the NGEP statute. On the one hand, MERC claims the fees are incremental to the project and had no foreknowledge of what these fees would amount to when it initiated its Rochester NGEP. On the other hand, the Department claims MERC has not presented sufficient evidence to validate the nature of these fees for NGEP rider recovery.

[48] Department Response Comments, pp. 3-6.

[49] MERC Additional Reply Comments, pp. 4-5.

VI. Department's Alternate Proposal

In its March 19, 2021 Response Comments, the Department put forth an alternative proposal which summarizes its proposed adjustments in issues discussed in this docket. Table BP-1 below summarizes the adjustments leading to MERC's and the Department's recovery amounts. The first adjustment for the September 21 Order followed through as an update to MERC's original Petition from the Commission's decision in Docket 19-608.

The difference between MERC's adjusted proposal and the Department's alternative proposal is in the treatment of outside legal fees. Specifically, the NGEP statute allows MERC to recover only 33 percent of the $40,632 of legal fees, meaning that the difference in the two proposals is $13,409.

Table BP-1: NGEP 2019 True-up Revenue Over/(Under) Recovery Determination	
2019 Revenue Deficiency	$1,117,442
33% for allowed recovery	$368,756
2019 surcharge revenue collected	$141,520
Over/(under) recovery	$(227,236)
Adjustment for September 21 Order issued after original Petition was filed	$21,694
Over/(under) recovery per MERC	$(205,542)
Disallowed legal fees per DOC: $40,632 * 33% =	$13,409
Over/(under) recovery: DOC alternative	$(192,133)

Next, Table BP-2 below shows the summary of the NGEP Rider 2021 Forecast as recommended by the Department. This table also included the 2018 and 2019 true-ups proposed by the Department. The total 2021 Revenue Deficiency ties into table BP-3 on the next page.

Table BP-2: NGEP Rider 2021 Forecast Revenue Requirement on NGEP[50]		
Total Revenue Requirement	$	3,739,082
Less offsets		
Offsetting Project Revenue	$	811,877
Offsetting Revenue 2018 True-up	$	1,117,546
Offsetting Revenue 2019 True-up	$	(318,548)
2021 Annual Deficiency	$	2,128,207
33% of Annual Revenue Deficiency	$	702,308
2019 NGEP True-up: over/(under) recovery	$	(192,133)
Total 2021 Revenue Deficiency, including 2019 True-up	$	894,441

[50] Department Response Comments, Attachment A-1

Table BP-3 shows the annual average customer impact by customer class of the Department's alternative proposal for the NGEP Rider 2021 Forecast.

Table BP-3: Department NGEP Surcharge and Revenue Apportionment and Bill Impact, Inclusive of 2021 Sales Revenue True Up[51]

Customer Class	Apportionment of Revenue Responsibility	Therm Sales 2019	Rate per Therm	Customer Count	$ Customer (per year)
Residential	$559,026	191,313,373	$0.00292	218,327	$2.56
Class 1-2 Firm	$171,631	117,522,457	$0.00146	23,482	$7.31
Class 3-4 Firm	$1,112	4,764,220	$0.00023	26	$42.15
Class 1-2 Interruptible, Grain Dryer, and Class 1 Generation	$38,562	26,404,942	$0.00146	513	$75.15
Class 3-4 Interruptible and Grain Dryer	$33,365	142,912,053	$0.00023	211	$155.78
Class 5, Transport for Resale, and Class 2 Generation	$32,947	141,124,573	$0.00023	26	$1,248.41
Direct Connect	$57,798	247,567,358	$0.00023	8	$7,117.56
Total	$894,441	871,608,976		235,340	

The table MERC proposed in its petition was produced before the Commission decided the direct-connect surcharge issue in Docket 19-608, and thus is not directly comparable.

[51] Department Response Comments, Table R-3, p. 13.

VII. Decision Alternatives

MERC's proposed 2021 Natural Gas Extension Project (NGEP)

1) Approve an ongoing NGEP Rider without modification. OR

2) Approve an ongoing NGEP Rider with modification. (Department, MERC)

True-up of 2018 Revenues

3) Require MERC to true-up for 2018 revenues from base rates to account for offsetting revenues in the Rochester area. (Department), OR

4) Authorized MERC to only true-up for the differences between actual 2018 capital expenditures and capital expenditure estimates. (MERC)

2019 outside legal regulatory expenses associated with the Rochester NGEP rider.

5) Authorize MERC to include Rochester NGEP legal fees in incremental Operations and Maintenance (O&M) expense. (MERC), OR

6) Do not allow Rochester NGEP legal fees to be included in incremental Operations and Maintenance (O&M) expense. (DOC)

Depreciation, property tax, and income tax as part of Revenue Deficiency for 2021 Rider Recovery

7) Approve the inclusion as resolved by the parties. (MERC, DOC) OR

8) Do not approve the inclusion as resolved by the parties.

Weather normalization methodology

9) Require MERC to provide in a compliance filing updated NGEP rider surcharge rates based on actual weather-normalized sales when the data becomes available. (MERC, DOC) OR

10) Do not require a compliance filing.

Termination of Rider Recovery, Renewal, and True-up

11) Approve MERC's termination proposal regarding the 2021 NGEP surcharge rates. (MERC, DOC) OR

12) Do not approve MERC's termination proposal regarding the 2021 NEGP surcharge rates.

Compliance filing at termination of the Rochester NGEP

13) Submit a compliance filing showing final surcharge rates to be effective at the end of the project and continuing until such a time interim rates are implemented in a future rate case. (MERC, DOC) OR

14) Do not require a compliance filing.

Compliance filing

15) Require MERC to submit a compliance filing within 10 days of the Commission issuing its order with updated NGEP rider revenue requirement calculations, rider factor calculations and tariff pages.

16) Do not require a compliance filing.