BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Nancy Lange	Chair
Dan Lipschultz	Commissioner
Matthew Schuerger	Commissioner
Katie J. Sieben	Commissioner
John A. Tuma	Commissioner

In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to Increase Rates for Natural Gas Service in Minnesota

ISSUE DATE: December 26, 2018

DOCKET NO. G-011/GR-17-563

FINDINGS OF FACT, CONCLUSIONS, AND ORDER

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PROCEDURAL HISTORY

I. Initial Filings and Orders

On October 13, 2017, Minnesota Energy Resources Corporation (MERC, or the Company) filed this general rate case seeking an annual rate increase of $12,641,230 or 5.05%. The filing included a proposed interim-rate schedule.

On the same date, the Company filed a petition to establish a new base cost of energy for the period during which interim rates would be in effect; that petition was granted by order dated December 5, 2017.[1]

Also on December 5, the Commission issued three orders in this case:

- an order finding the rate-case filing substantially complete, suspending the proposed final rates, and authorizing MERC to treat 2016 as its "most recent fiscal year" and 2017 as its "projected fiscal year" for purposes of the proceeding;

- a notice and order for hearing referring the case to the Office of Administrative Hearings for contested-case proceedings; and

[1] *In the Matter of the Petition of Minnesota Energy Resources Corporation for Approval to Establish a New Base Cost of Gas for Interim Rates*, Docket No. G-011/MR-17-564, Order Setting New Base Cost of Gas for Interim Rate Period (December 5, 2017).

- an order setting interim rates for the period during which the rate case was being resolved.[2]

II. The Parties and Their Representatives

The following parties appeared in this case:

- MERC, represented by Elizabeth M. Brama, Kristin M. Stastny and Lauren E. Pockl, Briggs and Morgan, P.A.

- Minnesota Department of Commerce, Division of Energy Resources (the Department), represented by Peter E. Madsen and Katherine Hinderlie, Assistant Attorneys General.

- Office of the Minnesota Attorney General–Residential Utilities and Antitrust Division (OAG), represented by Ian Dobson and Joseph C. Meyer, Assistant Attorneys General.

- Encore Energy Services, Inc. (Encore), represented by Eric F. Swanson and Elizabeth H. Schmiesing, Winthrop & Weinstine, P.A.

- Super Large Gas Intervenors (SLGI),[3] represented by Andrew P. Moratzka, Sarah Johnson Phillips, Riley A. Conlin, Stoel Rives LLP

III. Proceedings Before the Administrative Law Judge

The Office of Administrative Hearings assigned Administrative Law Judge (ALJ) Eric L. Lipman to hear the case.

The parties filed direct,[4] rebuttal, and surrebuttal testimony prior to the opening of evidentiary hearings. The ALJ held evidentiary hearings in Saint Paul on July 10 and 11, 2018. After the hearings the parties filed initial briefs, reply briefs, and proposed findings of fact and conclusions of law.

The ALJ also held four public hearings in the case, on the dates and at the locations set forth below:

- Kahler Apache Hotel, Rochester—May 15, 2018 (afternoon)
- City Hall, Albert Lea—May 15, 2018 (evening)
- City Hall, Grand Rapids—May 16, 2018
- City Hall, Rosemount—May 17, 2018

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[2] MERC later filed a request to reduce its interim rates, which the Commission authorized in an Order Authorizing Interim-Rate Reduction on March 19, 2018.

[3] A consortium consisting of Hibbing Taconite Company, ArcelorMittal USA's Minorca Mine, Northshore Mining Company, United Taconite, LLC, the Minntac and Keetac Mines of United States Steel Corporation, and USG Interiors, Inc.

[4] MERC also filed supplemental direct testimony by leave of the ALJ.

IV. Public Comments

The Administrative Law Judge held four public hearings, where the Company, the Department, the OAG, and the Commission's staff were available to make presentations and field questions from members of the public.

All public comments are filed in the case record. Written comments submitted directly to the Commission are labeled "Public Comment," of which the Commission received four. The comments were variously critical of rate increases, rate design, or particular billing issues and practices of MERC.

V. Proceedings Before the Commission

On December 27, 2017, MERC filed a letter memorializing that it agreed to a date of December 26, 2018, for a final determination by the Commission, and that it waived relevant rights under Minn. Stat. § 216B.16, subd. 2, to accommodate the adjusted timeline.

On September 21, 2018 the Administrative Law Judge filed his Findings of Fact, Summary of Public Testimony, Conclusions of Law, and Recommendation (the ALJ's Report). The following parties filed exceptions to the ALJ's Report under Minn. Stat. § 14.61 and Minn. R. 7829.2700: the Company, the Department, the OAG, and Encore.

On November 5 and 8, 2018, the Commission heard oral argument from and asked questions of the parties. On November 8, 2018, the record closed under Minn. Stat. § 14.61, subd. 2.

Having examined the entire record in this case, and having heard the arguments of the parties, the Commission makes the following findings, conclusions, and order.

FINDINGS AND CONCLUSIONS

VI. The Ratemaking Process

A. The Substantive Legal Standard

The legal standard for utility rate changes is that the new rates must be just and reasonable.[5] The Minnesota Supreme Court has described the Commission's statutory mandate for determining whether proposed rates are just and reasonable as "broadly defined in terms of balancing the interests of the utility companies, their shareholders, and their customers," citing Minn. Stat. § 216B.16, subd. 6.[6] That statute is set forth in pertinent part below:

> The commission, in the exercise of its powers under this chapter to determine just and reasonable rates for public utilities, shall give due consideration to the public need for adequate, efficient, and reasonable service and to the need of the public utility for revenue

[5] Minn. Stat. § 216B.16, subds. 4, 5, and 6.

[6] *In re Interstate Power Co.*, 574 N.W.2d 408, 411 (Minn. 1998).

> sufficient to enable it to meet the cost of furnishing the service, including adequate provision for depreciation of its utility property used and useful in rendering service to the public, and to earn a fair and reasonable return upon the investment in such property.

B. The Commission's Role

While the Public Utilities Act provides baseline guidance on the ratemaking treatment of different kinds of utility costs, it generally makes only threshold determinations on rate recoverability, leaving to the Commission the tasks of determining (a) the accuracy and validity of claimed costs; (b) the prudence and reasonableness of claimed costs; and (c) the compatibility of claimed costs with the public interest.

In ratemaking, therefore, the Commission must decide a wide range of issues, ranging from the accuracy of the financial information provided by the utility, to the prudence and reasonableness of the underlying transactions and business judgments, to the proper distribution of the final revenue requirement among different customer classes.

These diverse issues require different analytical approaches, involve different burdens of proof, and require the Commission to exercise different functions and powers. In ratemaking the Commission acts in both quasi-judicial and quasi-legislative capacities: As a quasi-judicial body it engages in traditional fact-finding, and as a quasi-legislative body it applies its institutional expertise and judgment to resolve issues that turn on both factual findings and policy judgments. As the Supreme Court has explained,

> [I]n the exercise of the statutorily imposed duty to determine whether the inclusion of the item generating the claimed cost is appropriate, or whether the ratepayers or the shareholders should sustain the burden generated by the claimed cost, the MPUC acts in both a quasi-judicial and a partially legislative capacity. To state it differently, in evaluating the case, the accent is more on the inferences and conclusions to be drawn from the basic facts (i.e., the amount of the claimed costs) rather than on the reliability of the facts themselves. Thus, by merely showing that it has incurred, or may hypothetically incur, expenses, the utility does not necessarily meet its burden of demonstrating it is just and reasonable that the ratepayers bear the costs of those expenses.[7]

C. The Burden of Proof

Under the Public Utilities Act, utilities seeking a rate increase have the burden of proof to show that the proposed rate change is just and reasonable.[8] Any doubt as to reasonableness is to be resolved in favor of the consumer.[9]

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[7] *In re N. States Power Co.*, 416 N.W.2d 719, 722–23 (Minn. 1987) (citation omitted).

[8] Minn. Stat. § 216B.16, subd. 4.

[9] Minn. Stat. § 216B.03.

On purely factual issues, the Commission acts in its quasi-judicial capacity and weighs evidence in the same manner as a district court, requiring that facts be proved by a preponderance of the evidence. On issues involving policy judgments, the Commission acts in its quasi-legislative capacity, balancing competing interests and policy goals to arrive at the resolution most consistent with the broad public interest.

Utilities seeking rate changes must therefore prove not only that the facts they present are accurate, but that the costs they seek to recover are rate-recoverable, that the rate recovery mechanisms they propose are permissible, and that the rate design they advocate is equitable, under the "just and reasonable" standard set by statute. As the Court of Appeals explained, quoting the Supreme Court,

> A utility seeking to change its rates has the burden of proving by a preponderance of the evidence that its proposed rate change is just and reasonable. Minn. Stat. § 216B.16, subd. 4 (1986). "Preponderance of the evidence" is defined for ratemaking proceedings as "whether the evidence submitted, even if true, justifies the conclusion sought by the petitioning utility when considered together with the Commission's statutory responsibility to enforce the state's public policy that retail consumers of utility services shall be furnished such services at reasonable rates."[10]

VII. Rate Case Overview

MERC initially sought an annual rate increase of $12,641,230 or 5.05% to reflect the current cost of natural gas service to its customers. As initially proposed by the Company, on average, the proposed rate change would increase the bill for a typical residential gas customer by $3.50 per month or $42.05 annually. The impact on individual customers would be higher or lower depending on each individual customer's actual consumption. MERC also proposed new customer classifications for some commercial and industrial customers.

In its supplemental direct testimony, MERC provided testimony on the effects of the 2017 Federal Tax Act on its test year revenue requirements. MERC concluded that its test year revenue deficiency was reduced from $12,641,230 to $7,313,512.

The Company used a projected 2018 test year, based on data from fiscal years 2016 and 2017.

VIII. Summary of the Issues

Many initially contested issues were resolved in the course of evidentiary proceedings. The Administrative Law Judge found that the resolutions reached by the parties on most of these issues were reasonable and supported by record evidence; he recommended accepting them.[11] The Commission concurs.

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[10] *In re Minn. Power & Light Co.*, 435 N.W.2d 550, 554 (Minn. App. 1989) (citation omitted).

[11] ALJ's Report ¶¶ 27–38.

Other issues remained contested. The following issues either were contested or otherwise require discussion.

<u>Financial Issues</u>

- ***Actual Non-Fuel Operations and Maintenance (O&M)—***What amount of Non-Fuel Operations and Maintenance expense should the test year reflect?
- ***Uncollectible Expense (Bad Debt Expense)—***For this category of expenses, should the Company use actual expense amounts or a three-year average?
- ***Charitable Contributions Administrative Expense—***Should the test year include administrative expenses for the Company's charitable contributions?
- ***Late Payment Revenues – FERC Account 487—***For this category of revenues, should the Company use actual revenues amounts or a three-year average?
- ***2017 Federal Tax Act —***How should the effects of the Federal Tax Act be reflected in the test year?
- ***Property Tax Appeal—***In light of recent and pending litigation affecting the Company's property tax liability, should the Company be permitted to use a tracker mechanism to account for the difference between taxes paid and amounts recovered in base rates arising from property tax?
- ***Rate Case Expense—***How should rate case expenses be accounted for in the test year?
- ***Recovery of Rochester Expansion Costs Included in Rate Base—***Should MERC be required to true-up expenses that will be built into base rates for its Rochester area expansion using its Natural Gas Expansion Project rider?
- ***Office Building Depreciation—***How should the Company's rate base be adjusted to account for the retirement of an office building in this case, and should the Company be required to adopt a different depreciation accounting method for such assets going forward?
- ***Travel and Entertainment Expenses (Part of O&M Expense)—***What is the appropriate amount of these expenses in the test year?

<u>Cost-of-Capital Issues</u>

- ***Return on Equity—***What is a fair and reasonable rate of return on equity for this Company, on this record, at this time?

<u>Sales Forecasting and Class-Cost-of-Service-Study (CCOSS) Issues</u>

- ***CCOSS—***What action should the Commission take, if any, with respect to the Class Cost of Service Studies proposed in this case? What requirements, if any, should be established for future MERC rate cases?

Sales Forecast

- ***Sales Forecast*—**What action should the Commission take with regard to the Company's sales forecast?

Rate-Design Issues

- ***Interclass Revenue Apportionment*—**What percentage of the revenue requirement should be allocated to each customer class?
- ***Decoupling*—**Should the Commission authorize adjustments to the Company's decoupling program, including requiring an energy-savings threshold?

These issues are examined individually below, with issues on which the Commission declines to accept the ALJ's recommendation discussed in greater detail.

IX. The Administrative Law Judge's Report

The Administrative Law Judge's Report is well reasoned, comprehensive, and thorough. The ALJ held two days of formal evidentiary hearings and four public hearings. He reviewed the testimony of some 20 expert witnesses and related hearing exhibits. He reviewed the written comments submitted by members of the public.

The ALJ received and reviewed initial and reply post-hearing briefs from the parties, as well as their proposed findings of fact and conclusions of law. He made some 515 findings of fact and conclusions of law and made recommendations on stipulated, settled, and contested issues based on those findings and conclusions.

The Commission has itself examined the record, considered the report of the Administrative Law Judge, considered the exceptions to that report, and heard oral argument from the parties. Based on the entire record, the Commission concurs in most of the Administrative Law Judge's findings and conclusions. On some issues, however, the Commission reaches different conclusions, or adopts different reasoning, as delineated and explained below. And on a few issues it provides technical corrections and clarifications.

On all other issues, the Commission accepts, adopts, and incorporates the ALJ's findings, conclusions, and recommendations.

FINANCIAL ISSUES

X. Actual Non-Fuel O&M

A. Introduction

MERC initially proposed using 2016 costs, adjusted for inflation and known and measurable changes, to calculate its test-year non-fuel O&M expenses but subsequently updated its proposal in response to the Department's recommendation to use 2017 actual O&M expenses, adjusted for one year of inflation, as well as for known and measurable changes. Although the Company concurred on using a single year to calculate most O&M expenses, the Company proposed using a three-year average (2015-2017) to calculate uncollectible expense and late payment revenues. As part of its test-year O&M expenses, the Company also requested to recover administrative costs for charitable contributions.

MERC ultimately proposed to reduce its O&M expenses by $1,087,180, which excludes the uncollectible expense amounts.[12]

The Department concurred with the Company's proposal, with the exception of the three-year average to calculate uncollectible expense and late payment revenues. The Department also opposed the Company's proposal to recover administrative costs related to charitable contributions.

The OAG opposed the Company's proposal to calculate uncollectible expense using a three-year average and to recover administrative costs related to charitable contributions.

Excluding the two disputed items (uncollectible expense and administrative costs for charitable contributions) from the O&M test-year expenses results in a reduction of $1,086,092. The Commission will therefore approve this O&M reduction and separately address uncollectible expense, late payment revenues, and administrative costs for charitable contributions.

B. Charitable Contributions Administrative Expense

1. Introduction

In addition to recovering 50% of its charitable contributions, MERC requested test-year recovery of $36,146 in administrative costs for its charitable contributions program. At issue is whether to include charitable giving administrative costs in the test year.

2. Positions of the Parties

a. MERC

MERC argued that the administrative costs are used to benefit ratepayers because the charitable contributions themselves benefit ratepayers' community. The Company further argued that because its charitable activity was required by a prior Commission order,[13] it should be permitted to recover the cost of administering the activity.

b. The Department and the OAG

The Department and the OAG opposed including these administrative costs in the test year. Both reasoned that the Commission has historically excluded these costs from recovery, and argued that the Commission's order approving MERC's merger was not a reason to treat MERC's

[12] The reduction also includes an adjustment for medical expenses and mapping expenses.

[13] *In the Matter of a Request for Approval of the Merger Agreement Between Integrys Energy Group, Inc. and Wisconsin Energy Corporation*, Docket No. G-011/PA-14-664, Order Approving Merger Subject to Conditions (June 25, 2015) (the Merger Approval Order).

charitable contribution administrative expenses differently from those of other Minnesota utilities.

3. The Recommendation of the Administrative Law Judge

The ALJ recommended that the Commission should either permit MERC to recover $36,152 in costs for disbursing charitable contributions, or instruct MERC that the Commission would no longer require the Company to make any charitable contributions – during the test year, or in any other year. The ALJ reasoned that this symmetry was required by case law governing rate setting.

4. Commission Action

The Commission respectfully disagrees with the ALJ, and will not allow charitable contribution administrative expenses to be included in the test year. As the Commission has previously reasoned, such expenses are too far removed from the necessity of providing utility service to be recovered in rates.[14] The Commission similarly finds no record in this case that supports a conclusion that these administrative expenses are, in fact, necessary to provide utility service.

Neither the Merger Approval Order nor other case law compel a different conclusion. It is apparent from the Merger Approval Order and the record in that case that MERC voluntarily committed to "maintain historic levels of community and charitable involvement," that the commitment was agreed to by the parties, and was an uncontested element of the merger issue presented for the Commission's consideration. The Commission concluded that the commitment to maintain historic levels of community and charitable involvement was in the public interest and adopted it.

The commitment offered by the Company was unqualified—there is no evidence it was offered or adopted subject to an understanding that ratepayers would be expected to bear the administrative expenses. Because the Commission disallows recovery of these costs with some consistency, had the commitment been offered on those terms the Commission (and the other parties) might have taken a different view of the proposal's effect on the merger's overall public-interest calculus. It would, after all, impose a cost on ratepayers they would otherwise not bear.

The Commission does not adopt the view that because this self-imposed condition was included as part of the Merger Approval Order that the Commission must reach a different conclusion now about whether charitable-giving administrative costs are a necessary part of providing utility service. It has not been established, for example, that the merger itself was necessary.

Nor will the Commission modify the Merger Approval Order to selectively remove a voluntary commitment that MERC made and that the Commission memorialized by adopting it.

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[14] *See* Minn. Stat. § 216B.16, subd. 6 (requiring the Commission to consider "to the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing the service. . . .").

The Commission found that MERC's "commitments and conditions will help protect ratepayers and MERC's employees from any potential adverse consequences of the merger."[15] The Commission will not now, because it accepted a freely-given commitment of charity from the Company, impose the adverse effect of charging ratepayers for administrative costs that otherwise would not have been imposed on them.

C. Uncollectible Expense (Bad Debt Expense)

To calculate its uncollectible expense, MERC proposed using a three-year average, updated to include data from 2015-2017 in response to the Department's recommendation that the Company use 2017 data to make its calculation (the Company originally proposed to use data from 2014-2016).

1. Positions of the Parties

c. MERC

MERC stated that its uncollectible expense has fluctuated over time, justifying use of a three-year average that better reflects the variation that occurs from year-to-year. MERC stated that because late payment revenues increase proportionally to the increase in uncollectible expense, a three-year average should be applied when calculating both of these costs.

d. The Department

The Department opposed the Company's proposal to calculate its uncollectible expense using a three-year average. The Department stated that using 2017 actual costs, adjusted for inflation, are the most up-to-date and consistent with the use of 2017 costs to calculate other O&M expenses. The Department agreed with MERC that uncollectible expense and late payment revenues are interrelated, justifying use of the same approach for both cost categories.

e. The OAG

The OAG recommended that MERC be required to use 2015 actual costs to calculate its uncollectible expense, claiming that recent years' costs are unjustifiably inflated. The OAG highlighted the fact that due to the Company's suspension or delay of collections in 2016, uncollectible expense was unrealistically higher for that year. The OAG stated that because the 2017 expense levels had not returned to earlier levels, prior to the delay or suspension, it is likely that suspensions or delays continued into 2017, rendering 2017 actual costs less reliable than 2015 actual costs.

2. The Recommendation of the Administrative Law Judge

The ALJ recommended use of 2017 actual data, finding that such costs are the most recent and reflect the Company's data showing that its uncollectible expense is on the rise. The ALJ also recommended using 2017 actual data to calculate both uncollectible expense and late payment revenues.

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[15] Merger Approval Order, at 4.

3. Commission Action

The Commission concurs with the Department and the ALJ that using 2017 actual data to calculate uncollectible expense is reasonable. Actual costs from 2015 are lower than any year since 2012 and arguably less likely to be an accurate reflection of the Company's uncollectible expense cost trend. The Commission will therefore apply the 2017 percentage of actual bad debt expense over tariffed revenues of 0.762068% to the approximate Commission approved test-year tariffed revenues, including the approximate approved revenue deficiency.

XI. Late Payment Revenues – FERC Account 487

Similar to the method used for calculating uncollectible expense, MERC proposed using a three-year average to calculate late payment revenues. Although the Department recommended using 2017 actual data, the Company stated that the 2017 data is an outlier but that it would incorporate that year's data into a three-year average (2015-2017). Based on its updated proposal, MERC reduced its revenue deficiency by $85,190 and separately increased its revenue deficiency by $128,133 due to the use of a higher percentage of uncollectible expense.

The following table shows the Company's most recent years of late payment revenues.

Late Payment Revenue – FERC Account 487	
Year	**$ Actual**
2017	998,853
2016	737,771
2015	543,945
2014	686,531
2013	543,529

MERC stated that using 2017 actual data is unreliable because data from that year is an outlier relative to other years and that using a three-year average levels the impact of the anomalous year and more reasonably reflects recent history. MERC also stated that a corresponding three-year average for late payment revenue appropriately reflects the interrelationship between uncollectible expense and late payment revenue

The Department initially supported a three-year average but ultimately recommended using 2017 actual revenues for calculating late payment revenues. The Department stated that this approach is consistent with the use of 2017 actual data for non-fuel O&M costs and includes the most current cost data available. The result of using 2017 actual revenues is a decrease in the Company's revenue deficiency of $323,853.

The ALJ recommended use of 2017 actual data, finding that such data are the most recent and consistent with the use of 2017 actual costs for calculating uncollectible expense.

The Commission concurs with the Department and the ALJ that it is reasonable to use 2017 actual data for calculating late payment revenues, which appear to be on the rise. The

Commission will therefore direct MERC to use actual 2017 late payment revenues, resulting in an increase of $323,853 in late payment revenues.

XII. 2017 Federal Tax Act

A. Introduction

A federal tax reform bill[16] (the Act) was signed into law approximately two months after MERC's initial filing, leading MERC to subsequently file a reduction to its current and deferred federal income tax expense reflecting both the lower federal corporate income tax rate of 21 percent (down from 35 percent) and the downward adjustment of the Gross Revenue Conversion Factor from 1.704 to 1.402. These changes reduced the Company's revenue deficiency by approximately $5.3 million.

The Act also affected the accounting of excess deferred income tax (EDIT), resulting in a rate base liability of $37.9 million. To comply with rules of the Internal Revenue Service (IRS), MERC used the average rate assumption method (ARAM) to reduce the EDIT reserve over the remaining regulatory lives of the assets that created the reserves. Under this method, MERC would reduce the remaining life of each item, beginning in the year in which regulatory depreciation exceeds tax depreciation.

Balances subject to the IRS's normalization rules are treated as protected EDIT; balances not subject to the IRS's normalization rules are treated as unprotected EDIT. MERC proposed an amortization period of 41 years for protected EDIT balances and an amortization period of 25 years for unprotected EDIT balances.

The Department concurred with MERC's updated calculations based on the lower income tax rate and lower Gross Revenue Conversion Factor; the Department also concurred with MERC's use of ARAM and its proposed amortization periods. The ALJ concurred with the parties on these issues.

The remaining EDIT issue between the parties is MERC's proposal to create a regulatory asset, or liability, to account for the amortization of EDIT reserves that are greater or less than what is authorized in final rates.

B. Positions of the Parties

MERC proposed to create a regulatory asset or liability to account for amortization of EDIT reserves that are greater or less than what is authorized in final rates. The Company stated that the deferred income tax effects on rates must be recorded in the period of enactment as either income tax expense or benefit, or as a regulatory asset or liability, with recovery from or refund to customers in the future. The Act resulted in changes to the amount and amortization of MERC's existing deferred tax balances. As a result, the Company proposed to create a regulatory asset or liability to account for the difference whether it is greater or less than what is authorized in final rates. Because it is not known whether the result would favor the Company or ratepayers, MERC stated that its proposal is reasonable.

[16] Pub. L. 115-97.

The Department opposed the proposal, stating that MERC should address this issue within a rate case once the effect is known and measurable, particularly in light of the fact that MERC intends to file its next rate case within two years.

C. The Recommendation of the Administrative Law Judge

The ALJ recommended that the Commission deny MERC's request to establish a regulatory asset, stating that denying the request better incentivizes accurate ratemaking and utility cost control.

D. Commission Action

The Commission concurs with the parties and the ALJ on MERC's updated filings to reflect the new 21 percent federal corporate income tax rate and the revised Gross Revenue Conversion Factor of 1.402. The Commission also concurs that $37.9 million is the reasonable amount to use for purposes of determining the correct EDIT for the test year. The Commission will also approve use of ARAM with an estimated 41-year amortization period for protected or plant-related EDIT balances and will approve use of a 25-year amortization period for unprotected EDIT balances.

As to MERC's proposal to create a regulatory asset, the Commission concurs with the Company that under the circumstances, it is reasonable to create a regulatory asset, or liability, to account for the amortization of EDIT reserves that are greater than or less that what is authorized in final rates. The Act significantly changed the Company's tax liabilities during the pendency of the test year, and as a result of the extraordinary circumstances and timing of the federal tax changes, the Commission will approve the creation of a regulatory asset.

XIII. Property Tax Appeal

A. Introduction

MERC challenged in state court its property tax obligations for tax years 2008–2017 as a result of increases in its property assessments. During the pendency of this rate case, tax disputes for years 2008–2012 were resolved by the courts. Following that outcome, the Minnesota Tax Court accepted a settlement between MERC and the Department of Revenue for tax years 2013–2017. Based on taxes paid for years 2008–2017, MERC estimated that it under-recovered approximately $2.85 million.

To address this issue, MERC proposed a tracker mechanism to account for tax amounts paid, minus amounts recovered through its appeals, with carrying charges applied to any over-or under-recovered amounts. The Company's proposed 2018 test year property tax expense is not disputed between the parties.

B. Positions of the Parties

1. MERC

As part of its proposal to use a property tax tracker, with carrying charges, to account for over-or under-recovered amounts, MERC stated that in future rate cases the Company would file data on the tracker balance, updates on the status of property tax litigation or other actions, and a proposal for refunding or collecting the tracker account balance.

MERC also stated that the final rate impact of tax appeal outcomes will not be known until after local taxing authorities make their final calculations. The Company stated that a tracker reasonably balances the interests of ratepayers and the Company by ensuring that any refunds owed to ratepayers will be paid with interest in a timely manner and that there will be a full and accurate accounting of many years of disputed property taxes.

2. The Department

The Department opposed MERC's proposal to use a tracker and instead recommended that the Company be required to refund the approximately $2 million awarded the Company as a result of its property tax appeal for years 2008–2012. The Department recommended that the refund be amortized over two years, consistent with the Company's rate case expenses and its practice of filing rate cases every two years.

The Department stated that this amount is known and measurable during the 2018 test year and should therefore be refunded to ratepayers. Timely refunds to customers, the Department noted, increases the likelihood that refunds are issued to the customers who paid those costs. Further, the Department stated that waiting for the outcome of the pending appeal of tax years 2013–2017 could unnecessarily delay refunds that are now owed.

C. The Recommendation of the Administrative Law Judge

The Administrative Law Judge recommended that the Commission authorize MERC to establish a tracker to account for the difference between taxes paid and the amounts recovered in base rates. The ALJ recognized that the use of a tracker in a rate case is unusual but concluded that the exceptional circumstances of this case—the longstanding dispute with taxing authorities—justify its use. The ALJ found that MERC did not cause any tax overpayments and that the recent settlement for tax years 2013–2017 means that a final and complete accounting is imminent.

D. Commission Action

The Commission concurs with the ALJ's recommendation to authorize MERC to establish a tracker account for tax years 2008–2017. As the ALJ found, MERC is not responsible for any overpayments, and in fact, actively sought to adjust its tax liabilities, ultimately benefitting ratepayers. Further, MERC's recent settlement of its 2013–2017 property tax dispute alleviates the concern over a potentially prolonged appeal that could indefinitely delay possible refunds.

For these reasons, the Commission will require MERC to establish a tracker to account for actual Minnesota property tax expenses paid each year, less the amounts approved for recovery in base rates, ensuring that tax refunds are tracked as they are received from local taxing authorities and netted against expenses. Carrying charges should be applied to the tracker balance at MERC's approved weighted cost of debt. In subsequent general rate cases, if relevant, MERC must include testimony regarding the balance in the tracker account, Company actions taken regarding property taxes, and a proposal on how to refund or collect the balance in the tracker.

XIV. Rate Case Expense

A. Introduction

Among the costs utilities may include in their test year are reasonable, prudently incurred expenses of conducting a rate case.

The Commission tries to set a rate-case expense cost-recovery or amortization period that will coincide with the time between rate cases. It is important for these two time periods to match as closely as possible, to ensure that the utility recovers its authorized rate case costs without over-recovering them. Setting the cost recovery period can be challenging, however, since individual utilities, not the Commission, generally control the timing and frequency of rate case filings.

MERC has forecasted a total test-year rate case expense of $2,270,000, which includes the costs of expert witnesses, legal expenses, satisfying information requests, publishing required notices, among other costs. At issue is what rate case expenses to include in the test year.

B. Positions of the Parties

1. The Company

The Company initially proposed to recover $2,174,675 of its test year rate case expense over a two-year period. MERC arrived at that amount by adjusting the total test year expense to recover only the percentage attributable to the regulated portion of its business (100% of most expenses, 87.7% of state agency and administrative law judge fees). As MERC explained,

> MERC allocated a portion of state agency and Administrative Law Judge costs between its regulated and non-regulated business in recognition that those agencies may spend some amount of time reviewing the allocation of costs between MERC's regulated and non-regulated businesses.[17]

MERC asserts that increased capital expenditure activity will result in short periods between rate cases, justifying the two-year amortization. The Company proposed that if it does not file a rate case in 2020, it would defer rate-case-amortization revenue collected and use it to offset rates set in its next rate case.

2. The OAG

The OAG views the proposed $2,174,675 expense to be unusually large, particularly in light of the rate case expense amounts approved by the Commission in MERC's 2014 and 2016 test-year

[17] MERC's Initial Brief, at 38.

rate cases. Instead, the OAG recommended that the Commission use an average of the last three rate case expense amounts.

The OAG further recommended adjusting the amount by applying the 87.7% allocation factor to all of MERC's rate case expenses. The OAG argued, and in exceptions asserted that even the ALJ apparently recognized, that at least some portion of all rate case expenses could be attributed to MERC's non-regulated businesses, so it was appropriate to apply the same allocator to all the expenses in this category.

The OAG's recommendation would result in a rate case expense of $1,660,728.

C. The Recommendation of the Administrative Law Judge

The ALJ agreed with MERC and recommended that the Commission allow the Company to recover rate case expenses in the amount of $2,174,675, amortized over a two-year period. The ALJ rejected the OAG's recommendation that 12.3% of all ratemaking expenses should be allocated to MERC's non-regulated business.

D. Commission Action

The Commission will require MERC to apply the 87.7% allocator to state agency and ALJ fees to remove the pro-rata share of MERC's non-utility business ServiceChoice, as proposed by MERC. MERC appropriately recognized that the non-regulated businesses impose direct costs on the state agencies responsible for conducting and reviewing the rate case proceedings, and that passing those costs to ratepayers would be inappropriate. Reducing these rate case expenses using the percentage allocator is the most reasonable outcome in this case. Any connection of the non-regulated business to the remaining rate-case-expense categories, however, is speculative and not supported by this record. Accordingly, the Commission will not require that an allocator be applied to them.

The Commission is not persuaded that averaging the test-year costs with previous years' costs is warranted in this case. Averaging test-year expenses with prior years can be a useful regulatory tool to prevent unusual expense fluctuations from becoming the basis of unreasonable rates; but, because it departs from the preferred foundation of test-year expense amounts, it is most appropriately applied when it is established that a test year value is likely to be anomalous. Here, the record does not provide enough of a basis to satisfy the Commission that the 2018 test year expense amount is the anomalous value.

In adopting the above reasoning, the Commission takes no position on the substance of paragraphs 318 and 319 of the ALJ's Report. Those paragraphs reflect broad statements of policy that are not necessary to determine the appropriate test-year expense amount, and concern subjects of significance that were not directly at issue or thoroughly litigated in this proceeding.

The Commission will allow MERC to recover the identified rate case expenses using a two-year amortization period, and will accept MERC's proposal to defer revenue collected associated with the rate case expense amortization after the end of the two period until the next rate case is filed and propose a rate offset of the amount collected in that rate case. This will protect ratepayers in the event MERC does not seek to adjust its rates as soon as anticipated.

XV. Recovery of Rochester Expansion Costs Included in Rate Base

A. Introduction

MERC's initial filing used a projected test year based in part on actual 2017 data through September, 2017, and projected 2017 data for the remainder of the year. The parties have agreed to update MERC's rate base—the net value of MERC's assets—to reflect actual 2017 data for the entire year. The update has the effect of reducing MERC's test year rate base, which in turn lowers MERC's revenue deficiency.

However, the adjusted capital costs included projected 2018 capital additions of $13.7 million for an infrastructure expansion in the Rochester area (the Rochester Project). Approved by the Commission in 2017, the Rochester Project is to be built in phases from 2017 through 2023.[18] The Commission also granted preapproval to recover up to $44 million in Phase II costs through the combination of a Natural Gas Expansion Project (NGEP) rider, and in base rates.[19]

At issue are the projected test-year expenses for the Rochester Project. If the projection overestimates the expenses that are actually incurred during the test year, ratepayers would be paying for plant that had not been placed in useful service, and the overestimate would be built into MERC's base rates until the Company's next rate case. But because a portion of project expenses are authorized to be recovered in the NGEP rider, there is an opportunity to ensure that, on net, rates are trued-up through the rider mechanism if the capital expenditures on the project fall below the projected amount in the test year.

The question the Commission faces is whether to require a true up for these expenses in this circumstance.

B. Positions of the Parties

MERC and the Department addressed the possibility of Rochester Project NGEP true-up in their recommended decision option filings.[20] The Department recommended that the true-up be required, and MERC preferred that the Commission take no action, but recommended a clarification to the requirement if the Commission were to adopt it.

C. The Recommendation of the Administrative Law Judge

This issue, as articulated above, did not arise during proceedings before the ALJ. The ALJ did not address this issue directly, though the ALJ did recommend that the Commission adopt the

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[18] *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, Order Approving Rochester Project and Granting Rider Recovery with Conditions (May 5, 2017).

[19] Id., at 18, ¶2 (preapproving recovery, subject to review in future rate proceedings for reasonableness and prudence of departures from individual-item estimated costs). *See also* Minn. Stat. § 216B.1638 (authorizing NGEP riders to recover costs of certain natural gas infrastructure projects).

[20] MERC Preferred and Additional Decision Options (filed November 5, 2018); [Department] Preferred Decision Options (filed November 6, 2018).

parties' agreement to update MERC's rate base and depreciation expense amounts to reflect actual 2017 data.

D. Commission Action

When calculating rates using a projected rather than a historical test year, projections and forecasts of test year costs are necessary. Where rates are not subject to revision until the next general rate proceeding, the reliability and accuracy of forecasts are critical to ensure that rates are just and reasonable. MERC's test year includes a projection of one year of capital expenses for a significant, multi-year, multi-phase infrastructure project. But MERC is also authorized to recover a portion of those project costs through a rider, a mechanism that allows rate adjustments outside of a rate case.

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.

XVI. Office Building Depreciation

A. Introduction

At the end of 2017, MERC moved staff out of a building it owned in Rosemount (the Old Rosemount Building), and into a new facility. The Old Rosemount Building has since been demolished, and the parties agree that the test year should reflect that this asset is no longer in service. At issue is the amount by which to adjust MERC's rate base to appropriately reflect the retirement of the building from useful service.

B. Positions of the Parties

1. The Company

According to MERC, the Company has used one method of accounting for the Old Rosemount Building throughout its life: group depreciation. Generally, depreciation accounting is a way of recognizing the cost of an asset over a reasonable approximation of its useful life.[21] Group depreciation operates by depreciating all assets in the group over a time period, and at a rate, determined by the average life of the assets in the group.

MERC calculated the remaining value, and therefore the rate base reduction for removal of the Old Rosemount Building, using the same group-depreciation method. Doing so resulted in removal of $1.73 million from the group's asset and accumulated depreciation accounts.

[21] *See* Minn. R. 7825.0500 defining "Depreciation" and "Depreciation accounting."

Removing the same amount from both accounts results in no net change to the Company's rate base, net of accumulated depreciation.

2. The Department and the OAG

The Department and the OAG recommended a different calculation, which would reduce rate base by $1,107,671. They argued chiefly that MERC's accounting method would leave a substantial portion of the cost of the building on its books, and it was unreasonable for ratepayers to continue to pay for a building that was no longer used and useful. According to the Department, MERC's choice of group accounting resulted in an undepreciated balance of $1.1 million out of the $1.7 million book value for the Old Rosemount Building.

The Department further contended that group depreciation was inappropriate for an asset of this nature—an entire building. It argued that group depreciation was intended for assets the nature of which, because they are so numerous and of relatively little value individually, accounting for them individually would be impractical or unreasonable.

C. The Recommendation of the Administrative Law Judge

The ALJ concluded that the most appropriate result in this rate case is to carry-through the group accounting methodology upon retirement of the headquarters building.

Accordingly, the ALJ recommended approving MERC's proposed accounting for the old Rosemount building. This would result in a downward adjustment in MERC's test year depreciation expense of $40,941. But the ALJ also recommended that the Commission require MERC to propose, in its next rate case, depreciation practices that would treat large assets like office buildings separately.

D. Commission Action

The Commission agrees with the ALJ's recommendation, and so will authorize MERC to reduce the asset and depreciation reserve accounts as the Company has proposed. In this case, MERC has computed the asset's depreciation according to an accepted accounting practice that has been reviewed by regulators and approved by the Commission as recently as May 4, 2018.[22] As MERC pointed out, "the group depreciation method is designed to be fair and balanced so long as it is applied in a consistent manner over time." To selectively apply the adjustment advanced by the Department and OAG for ratemaking purposes in this case would seem to require applying an inconsistent accounting method, and would be an inappropriate result after MERC reasonably relied on tacit acceptance of the group-accounting method throughout the building's useful life.

However, the Commission agrees that the Department and OAG have raised an important issue about whether using group accounting is an appropriate accounting practice for large assets like office buildings. The Commission will require MERC, in the earlier of its next (1) rate case or (2) depreciation filing, to propose accounting practices and adjustments that would separately

[22] *In the Matter of the Petition of Minnesota Energy Resources Corporation for Approval of its 2017 Five-Year Review of Depreciation Certification*, Docket No. G-011/D-17-442, Order (May 4, 2018).

depreciate these assets, or to explain why no change from its current accounting practice is warranted or appropriate.

XVII. Travel and Entertainment Expenses

A. Introduction

A public utility's travel, entertainment, and related employee expenses may be subject to rate recovery if the Commission concludes that they are reasonable and necessary for the provision of utility service.[23] Additionally, itemization of travel, entertainment, and related employee expenses "must include the date of the expense, the amount of the expense, the vendor name, and the business purpose of the expense."[24]

At issue is the appropriate amount to include in the test year for this category of expenses.

B. Positions of the Parties

1. The OAG

The OAG recommended reducing the Company's claimed employee expenses in these categories. A portion of this amount MERC agreed to, but still contested between them were $12,078 for items because the itemization did not include a vendor name.

2. The Company

MERC requested $256,356 in Travel and Entertainment Expenses for the test year after agreeing to some of the OAG's proposed reductions. However, MERC contended that the $12,078 in expenses that the OAG sought to exclude were properly included. It argued that expenses lacking vendor information were generally paid to employees as reimbursement either for mileage for the use of the employee's vehicle or for travel expense report items for which the vendor information is not captured.

C. The Recommendation of the Administrative Law Judge

The ALJ concluded that a number of expense reductions were appropriate. The ALJ recommended the Commission require the following reductions: the $3,098 reduction agreed to between MERC and the OAG, and $849 in costs relating to service for customers in Michigan.

The ALJ recommended that the Commission allow the test year to include $12,078 in employee reimbursements. He reasoned that the Commission recently addressed travel and entertainment expenses lacking vendor information in a rate proceeding for another utility and reached a similar conclusion.[25]

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[23] Minn. Stat. § 216B.16, subd. 17(a).

[24] Minn. Stat. § 216B.16, subd. 17(b).

[25] *See In the Matter of the Application of Minnesota Power for Authority to Increase Rates for Electric Service in Minnesota*, Docket No. E-015/GR-16-664, Findings of Fact, Conclusions, and Order, at 38–40 (March 12, 2018).

D. Commission Action

The Commission agrees with and will adopt the ALJ's recommendation that the test year include the $12,078 in disputed employee expenses.

The Commission has previously reasoned that similar reimbursed travel expenses could be included in the test year despite lacking vendor information. The utility in that case had at least a reasonable explanation for not reporting the information—because it was not captured based on a good faith interpretation of the meaning of "vendor" that permitted them not to capture and record more detailed information for that subset of expenses—the Commission found that, *based on the record in that case*, the utility had provided a "satisfactory" explanation for its absence and that there was enough information to support the expenses' inclusion in the test year.[26]

However, the Commission also recognized that the statute requires the vendor information. The Commission expressly found that the vendor information should have been included, and did not adopt the rationale offered by the utility in that case as being an excuse from the mandate of the statute.[27]

Because here there is no dispute that the business purpose for these expenses is legitimate, and because there is at least what this Commission considers, at this time and in light of the relevant circumstances, to be a satisfactory justification for not reporting vendor information plainly required by statute, the Commission will, in this case, allow MERC to include in its test year this limited subset of employee expenses.

COST OF CAPITAL ISSUES

Utilities meet their capital needs by issuing stock, known as equity, and by incurring long-term and short-term debt; these three components make up a utility's capital structure. Generally, equity is the most expensive form of financing, followed by long-term debt and then short-term debt. The percentage of the capital structure made up of each of these components therefore has a substantial impact on costs and rates, as does the cost determined for each component during the ratemaking process.

In this case, the only contested cost-of-capital issue is the cost of equity. The parties that addressed cost-of-capital issues—the Company, the Department, and the OAG—take the same position on capital structure, the cost of long-term debt, and the cost of short-term debt.

The Commission will address the issues of capital structure and the cost of each of its components below.

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[26] *Id*.

[27] *Id*. at 40.

XVIII. Capital Structure

MERC is wholly owned by Integrys Holding, which is itself a subsidiary of WEC Energy Group, Inc., an electric- and natural-gas-delivery company serving some 4.4 million customers in Minnesota, Wisconsin, Illinois, and Michigan. MERC therefore has no capital structure of its own and must be assigned a hypothetical capital structure for ratemaking purposes.

The Company stated that more planned capital expenditures have increased MERC's total capital needs, but that its proposed proportions of equity, long-term debt, and short-term debt would remain relatively stable. It proposed the following capital structure:[28]

Long-Term Debt	39.16%
Short-Term Debt	9.94%
Common Equity	50.90%

The Department and the OAG reviewed the proposed capital structure and concluded it was reasonable in light of capital structures approved for the Company, and the most recently reported capital structures for the companies in the parties' respective proxy groups. The OAG also further reasoned that despite a proposed increase in the ratio of short-term debt, the capital structure was nevertheless reasonable overall because it resulted in a reasonable weighted average cost of debt. No one opposed the Company's proposal.

The Administrative Law Judge examined the proposal, found it reasonable, and recommended adopting it. The Commission concurs and adopts the proposed capital structure.

XIX. Cost of Long- and Short-Term Debt

The Company proposed a cost of long-term debt of 3.58%, and a cost of short-term debt of 3.60%, based on the Company's 13-month average costs ending December 31, 2018. The Department concluded that the Company had used a reasonable method to calculate the cost of long-term and short-term debt and that both costs were reasonable, given current market conditions and compared with the Company's past debt costs. The OAG expressed concern about the proposed mix of long- and short-term debt but ultimately concluded that the proposed weighted average cost of debt was reasonable.

The ALJ agreed that the proposed cost of long- and short-term debt, and the resulting weighted cost of debt, were reasonable and recommended that the Commission approve them.

The Commission concurs, and adopts a cost of long-term debt of 3.58%, and a cost of short-term debt of 3.60%.

[28] The table reflects the capital structure proposed by MERC in Supplemental Direct testimony, after it adjusted the ratios in light of the 2017 Federal Tax Act.

XX. Cost of Equity

A. Introduction

In determining just and reasonable rates, the Commission is required to

> give due consideration to the public need for adequate, efficient, and reasonable service and to the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing service, including adequate provision for depreciation of its utility property used and useful in rendering service to the public, *and to earn a fair and reasonable return upon the investment in such property.*[29]

One of the critical components of that fair and reasonable return upon investment is the return on common equity, which—together with debt—finances utility infrastructure. The Commission must set rates at a level that permits stockholders an opportunity to earn a fair and reasonable return on their investment and permits the utility to continue to attract investment. In short, the Commission must determine a reasonable cost of equity and factor that cost into rates.

The analysis would normally begin by examining the price of the utility's stock, but MERC is a wholly owned subsidiary of WEC Energy Group and therefore has no publicly traded common stock. Its cost of common equity—essential to determining overall rate of return and the final revenue requirement—must therefore be inferred from market data for companies that present similar investment risks.

B. The Analytical Tools

MERC, the Department, and the OAG conducted cost-of-equity studies and based their analysis on comparison groups of utilities they considered similar enough to MERC to serve as proxies in determining the Company's cost of equity. All three used the Discounted Cash Flow (DCF) analytical model, on which this Commission has historically placed its heaviest reliance.

The Company, the Department, and the OAG also performed a Capital Asset Pricing Model (CAPM) analysis. The Company also conducted an analysis using the Bond Yield Plus Risk Premium Model, which the Commission has historically relied on less heavily, considering the model prone to producing volatile and unreliable outcomes.

The DCF model uses the current dividend yield and the expected growth rate of dividends to determine what rate of return is sufficient to induce investment. The model is derived from a formula used by investors to assess the attractiveness of investment opportunities using three inputs—dividends, stock prices, and growth rates. DCF modeling can be performed using constant, "two-growth,"[30] and multistage dividend-growth assumptions.

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[29] Minn. Stat. § 216B.16, subd. 6 (emphasis added).

[30] A two-growth model assumes that dividends grow at one rate for a short time, and then grow at a second, sustainable rate in perpetuity.

The CAPM model estimates the required return on an investment by determining the rate of return on a risk-free, interest-bearing investment; adding a risk premium determined by subtracting the risk-free rate of return from the total return on all market equities; and multiplying the remainder by beta, a measure of the investment's volatility compared with the volatility of the market as a whole.

The Bond Yield Plus Risk Premium Model determines the cost of equity by adding to the risk-free rate a premium reflecting the greater returns required by equity holders.

C. The Contents of the Record

The Department pre-filed direct, rebuttal, and surrebuttal testimony of Dr. Eilon Amit on this issue, but on July 6 notified the ALJ that it would not offer Dr. Amit's rebuttal or surrebuttal testimony. Dr. Amit's direct testimony was adopted by the Department's new witness on this issue, but the Department did not recommend the rate of return advocated for in Dr. Amit's direct testimony, at least in part because it was based on outdated market information that would normally be updated in rebuttal and surrebuttal.

As the ALJ recognized, even though the ALJ's prehearing order contemplates withdrawal of testimony,[31] the Department's decision not to sponsor Dr. Amit's testimony created an "odd circumstance."[32] MERC's argument at the prehearing conference that it is "atypical" to withdraw key testimony on a central issue in the case is well taken.[33] The Department's decision not to offer updated testimony or make an ultimate recommendation on a critical rate-setting issue is an unusual development that the parties, the ALJ, and now the Commission, have grappled with.

At hearing, MERC offered Dr. Amit's prefiled rebuttal and surrebuttal testimony as evidence of what positions the Company and others in the proceeding were responding to. The testimony, which had been prefiled by a party subject to the ALJ's order,[34] became documents marked as exhibits and admitted into the record by the ALJ. They are unquestionably part of the record before the Commission. The Commission therefore considers them as part of the record, and weighs their probative value in light of all the available facts.

In particular among the relevant facts, though these written submissions were ultimately not sponsored by the party that initially procured them, Dr. Amit is a respected expert who has testified on rate of return issues in cases for over 30 years.[35] Whether or not the documents are credible evidence of the data underlying Dr. Amit's calculations, they are evidence of calculations and analytical methods that other parties, and the ALJ, considered credible enough to regard seriously.

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[31] First Prehearing Order, at 6 (December 22, 2017).

[32] Transcript of July 10, 2018 Hearing, at 17.

[33] Transcript of July 9, 2018 Prehearing Conference, at 24.

[34] First Prehearing Order (December 22, 2017).

[35] *See* "Professional Background and Education," DOC Attachment EA-1 to Amit Direct (the testimony of Dr. Amit that was not withdrawn by the Department).

The Commission is obliged to "give probative effect to evidence which possesses probative value commonly accepted by reasonable prudent persons in the conduct of their affairs,"[36] and the Commission may "utilize [its] experience, technical competence, and specialized knowledge in the evaluation of the evidence in the hearing record."[37]

The Commission is ultimately not persuaded by the efforts of the Department's witness to cast doubt on Ann Bulkley's recreation of Dr. Amit's calculations. The Commission, having reviewed the contents of the record and, under the circumstances, considers the documentation of Dr. Amit's professional opinion, and in particular, the analytical method and calculations that gave rise to his ROE recommendation—whether or not the Department's witness adopted his testimony—to have at least some probative value as it pertains to the analysis of an appropriate cost of equity for the Company.

D. The Positions of the Parties

1. The Company

The Company proposed a return on equity of 10.30%, based on constant growth and two-growth DCF models of an eight-utility proxy group, along with CAPM and Bond Yield Plus Risk Premium analyses.

The Company's chosen proxy group started with companies classified by Value Line as "natural gas distribution utilities," and then screened out companies based on seven screening criteria. The Company then further screened the proxy group by eliminating ROE results of less than 7.0%. Finally, the Company excluded one proxy member, South Jersey Industries, because of a large pending transaction. In the Company's final analyses, the proxy group comprised: Atmos Energy Corporation; New Jersey Resources Corporation; NiSource, Inc.; Northwest Natural Gas Company; ONE Gas, Inc.; Southwest Gas Corporation; and Spire, Inc.

The Company also advocated for factoring in and adjusting for business risks, economic factors and other factors specific to the Company, including company size and customer concentration, the Company's capital expenditure plan, forecasts of rising interest rates, and recent-average approved Returns on Equity (ROEs) in other rate-setting proceedings. According to the Company, these relevant factors distinguish MERC and justify a high ROE relative to the companies in the proxy group.

2. The OAG

The OAG proposed a return on equity of 9.11%, based on two DCF analyses (constant growth and two-stage), a CAPM analysis, and a dividend yield analysis.

The OAG challenged the Company's proxy groups and execution of the financial models. In the OAG's view, the proxy groups used by the Company and the Department included two

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[36] Minn. Stat. § 14.60, subd. 1.

[37] Minn. Stat. § 14.60, subd 4.

companies that have a significant amount of non-regulated business that make them inappropriate to include. In the end, the OAG conducted analyses using two proxy groups: one similar to the Company's, and one that excluded New Jersey Resources Corporation and NiSource, Inc.

And among the criticisms the OAG offered of the Company's financial modeling, it argued that the Company used too-long trading periods, substituted industry analyst judgments with their own, failed to appropriately adjust for unique events, and made other assumptions that the OAG argued are unreasonable.

3. The Department

The Department argued that MERC did not carry its burden to establish that its financial analyses were reasonable, and disputed that MERC is riskier than the companies in the proxy group. Ultimately, the Department did not recommend a specific ROE.

In lieu of an ROE recommendation, the Department proposed a methodology for setting an appropriate return on equity. The Department recommended using the same proxy group the Company used for its DCF analyses, and recommended relying primarily on DCF modeling, using CAPM as a check for reasonableness.

E. The Recommendation of the Administrative Law Judge

The ALJ determined that the best methodological approach would be to apply two-growth DCF modeling to the most recent market data in the record, using MERC's and the Department's proxy group, and then to add an adjustment to account for flotation costs.[38] This led the ALJ to recommend that the Commission set the ROE at 10.33%, the mean value resulting from MERC's calculation using Dr. Amit's two-growth DCF model and May 2018 pricing data.

F. Commission Action

Setting the cost of equity is a fact-intensive and record-specific judgment. The Commission must ultimately establish a reasonable rate of return that is supported by the evidence in the record considered in its entirety.[39] The diversity of analytical methods in the record in this case do not lead to wildly disparate conclusions or recommendations. The Commission believes that the record evidence in this case, including the broad diversity of modeling and expert testimony, establishes a range of reasonable costs of equity, within which the Commission must identify one value.

The record does not formulaically dictate a particular ROE to be approved. Instead, the record presents a range of reasonable returns on equity that the Commission has carefully evaluated based on the analyses and arguments in the record. As such, the Commission will set the Company's authorized ROE in light of the record as a whole.

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[38] Flotation costs are the expenses of issuing common stock.

[39] *See In re:App. of Minn. Power for Auth. to Increase Rates for Elec. Serv. in Minn.*, 838 N.W.2d 747, 760 (2013) (describing the substantial evidence test, and citing *Reserve Min. Co. v. Herbst*, 171 N.W.2d 712, 825 (1977)).

Not all models are equally probative, and not every application of the same model is equally probative. The Commission examines the results of every model introduced into the record in every case. In this case, the Commission agrees with the ALJ that the DCF model is the best in the record for determining return on equity. The Commission finds that the transparency and objectivity of the DCF model make it the strongest, most credible model, and that the most reasonable way to proceed is to use its results as a baseline and to use the results of other models to check, inform, and refine those results.

The DCF model calls for fewer subjective judgments than the CAPM and Risk Premium models—in fact, two of its three inputs, dividends and market equity prices, are uncontested, publicly reported facts, and the third input, projected growth rates, generally come from a limited number of recognized professional resources.

The CAPM and Risk Premium methods, on the other hand, require expert judgment at nearly every turn—determining the term of the risk-free, interest-bearing investment used as a benchmark, determining the time frame for calculating growth rates, determining the beta that represents market volatility, determining the historical periods over which to measure returns. Almost none of these inputs are simple matters of fact and public record.

The Commission has considered and weighed the relevant factors, which include, but are not limited to the relative objectivity, transparency, reliability, rigor, and timeliness of the analytical models in the record, and their inputs; the composition and representative nature of the proxy groups proposed in each analysis; the ROEs that the parties recommended based on their modeling results; and the Company's approved capital structure and costs of obtaining equity investment.

Most importantly, the approved ROE must adequately assure a fair and reasonable return in light of the Company's risk profile and costs of obtaining equity investment. In light of the relevant factors, the Commission will approve a cost of equity of 9.70%.

The Commission finds a 9.70% ROE to be reasonable and appropriate based on the two-growth DCF modeling done by the parties and by Dr. Amit. The value lies virtually at the midpoint of the DCF-based recommendations of the OAG and MERC, and comfortably between the mean-growth-rate and high-growth-rate two-growth DCF results calculated by both MERC and the OAG in surrebuttal testimony.

The reasonableness of 9.70% is amply supported by the other analytical approaches and contextual data in the record, which could support ROEs in a range from near 8% to near 11%, in the context of an equity-cost "directional trend line" that the ALJ recognized.[40] And, 9.70% is within a few basis points of Dr. Amit's updated mean-growth-rate two-growth DCF calculations and ROE recommendation.[41]

[40] ALJ's Report, at 24.

[41] As recreated by Ann Bulkley; *see* MERC Exhibit 43, at 2, and ALJ Report at 23.

The Commission finds, based on its experience, technical competence, and specialized knowledge in the evaluation of the evidence in the hearing record, that an ROE of 9.70% is sufficient to establish just and reasonable rates, while adequately assuring a fair and reasonable return in light of the Company's unique risk profile, capital structure, and costs of obtaining equity investment.

XXI. Final Capital Structure and Overall Cost of Capital

The final capital structure and overall cost of capital resulting from the decisions made in this order are as follows:

Component	Ratio	Cost	Weighted Cost
Long-Term Debt	39.16%	3.58%	1.4019%
Short-Term Debt	9.94%	3.60%	0.3578%
Common Equity	50.90%	9.70%	4.9373%
Total	100.00%		6.6971%

SALES FORECASTING AND CLASS COST OF SERVICE ISSUES

XXII. Rate Design and Class Cost of Service Introduction

A. Rate Design and Customer Classification

The preceding sections established MERC's revenue requirement based on a 2018 test year. The following sections will address how MERC may recover the revenue requirement from its ratepayers. This process of rate design requires the Commission to exercise policy judgment because there are many ways to set rates to enable a utility to recover appropriate revenues.

In designing rates, the Commission considers a variety of factors, including:

- Equity, justice, and reasonableness, and avoidance of discrimination, unreasonable preference, and unreasonable prejudice;[42]
- Continuity with prior rates to avoid rate shock;
- Revenue stability;
- Economic efficiency;
- Encouragement of energy conservation;[43]
- Customers' ability to pay;[44]
- Ease of understanding and administration; and
- Cost of service.

Estimating the cost to serve any given customer is challenging because a utility will incur different costs to serve different customers, and will incur many costs that benefit multiple

[42] Minn. Stat. §§ 216B.01, .03.

[43] Minn. Stat. §§ 216B.03, .2401, 216C.05.

[44] Minn. Stat. § 216B.16, subd. 15.

customers. Because similar types of customers tend to impose similar types of costs on the system, utilities simplify their analysis by first dividing customers into classes—for example, distinguishing residential customers from commercial or industrial customers. Utilities then attempt to determine the amount of revenues they should recover from each customer class.

To aid this analysis, the Commission directs utilities to conduct a class-cost-of-service study (CCOSS). Minn. R. 7825.3400(C) directs a utility to file:

> A cost-of-service study by customer class of service, by geographic area, or other categorization as deemed appropriate for the change in rates requested, showing revenues, costs, and profitability for each class of service, geographic area, or other appropriate category, identifying the procedures and underlying rationale for cost and revenue allocations. Such study is appropriate whenever a utility proposes a change in rates which results in a material change in its rate structure.

B. Class Cost of Service Studies

According to the *Electric Utility Cost Allocation Manual* of the National Association of Regulatory Utility Commissions (*NARUC Manual*), performing a CCOSS involves three steps. First, costs are grouped according to their function (generation/production, transmission, distribution, customer service/facilities, administrative). Second, costs are classified based on how they are incurred. Third, costs are allocated to the various customer classes.[45]

Functionalization. The utility separates costs according to function, including production, transmission, distribution, storage, customer service, and administrative/general. Cost figures are based on the utility's accounts kept in compliance with FERC's uniform system of accounts. The production function refers to power production from the utility's generating units. The transmission function refers to the assets and costs associated with interconnecting the utility's system to load centers. The distribution function refers to the system that connects the customer to the transmission system.

Classification. The cost of a function might be classified as related to energy, demand, or customers. Energy–related costs increase as customers' consumption of energy increases. Demand–related costs increase as the rate at which customers consume energy increases, especially during periods of peak demand. Customer–related costs increase as the number of customer accounts increases.

Allocation. The various costs are allocated to each customer class.

[45] *Electric Utility Cost Allocation Manual*, National Association of Regulatory Utility Commissioners, at 18-23 (January 1992).

C. MERC's Cost Studies

MERC filed four cost studies in this rate case, as directed by the Commission in the Company's last rate case, including: the zero-intercept, the minimum size, the basic system, and the average and excess.

The basic system method reflects the premise that only costs that can be traced back to individual customers—such as the costs of service lines, meters, billing, and collection—should be classified as customer costs. The rest of the distribution plant is a shared asset built to deliver the maximum amount of energy demanded by the customers—and these costs should be classified as capacity costs.

In contrast, the Minimum System method reflects the premise that a utility builds out its distribution plant to serve each customer regardless of the amount of demand that customer puts on the system, and thus some portion of the plant should be regarded as customer-related. MERC identifies two types of minimum system cost studies: a minimum size study and a zero-intercept study. The minimum-size and zero-intercept methods are, in other words, different versions of the minimum system approach.

A minimum size study estimates the cost a utility would have incurred to build its distribution system at some minimal capacity, and assigns this amount to customer costs. To use this method, a utility first calculates the length of pipe it has in its distribution system. Then it identifies a distribution pipe of "minimum practical size," meaning the pipe with the smallest diameter that fairly represents what is actually installed within a utility's distribution system. The utility calculates the average cost per foot to buy and install this small-diameter pipe, and then multiplies this by the length of pipe in the utility's distribution system. The result is designated the customer cost; the remainder of the cost of the distribution system is designated capacity cost.

In the minimum size study, however, parties may disagree about the magnitude of the "minimum practical size" pipe to use for the study, which may affect the study's results. Also, because even a minimum system will have some capacity for delivering gas, a Minimum Size study will inevitably misidentify some capacity-related costs as customer costs.

In contrast, a zero-intercept study avoids these disputes. Recognizing that larger capacity pipes cost more to buy and install than smaller pipes, a zero-intercept study calculates (using ordinary-least-squares regression analysis) the relationship between pipe cost and pipe capacity. Based on this relationship, the study estimates the cost of installing a hypothetical pipe with zero capacity. Costs associated with building a distribution system with no capacity are regarded as customer costs. All additional costs of the distribution plant are presumed to be caused by the need to provide capacity, and are therefore regarded as capacity costs.

While a zero-intercept study has advantages over a minimum size study, it also has the disadvantages of being more burdensome to generate and of requiring more data. One additional perspective is provided by the average-and-excess method.

Each of these studies allocates capacity cost among customer classes based on each class's share of total gas consumption during the utility's coincident peak demand, and reflects the idea that a utility designs and builds its system to have sufficient capacity to meet the needs of all its firm customers during periods of peak demand, no matter how brief that period is. In practice, this dynamic causes residential consumers to bear a larger share of these costs relative to the amount of gas consumed than do industrial customers.

The average-and-excess method ameliorates this dynamic. This method characterizes all distribution-system costs as capacity costs, but rejects the premise that these costs should be allocated purely on the basis of coincident peak demand. Instead, the average-and-excess method allocates some costs based on each class's average level of usage, reflected by each class's energy consumption or average demand. And it allocates the rest based on peak demand—but the peak demand of each customer class, regardless of when that peak occurs (non-coincident peak demand). This has the effect of assigning lower costs to residential customers, and more to industrial customers, than would occur under other cost study methods.

D. Positions of the Parties

1. MERC

MERC stated that because a minimum-size study can over-assign customer costs, it should be used only as a check on the results of the zero-intercept study, noting that the results of the two studies should be comparable. MERC maintained that the basic system study and the average-and-excess study do not recognize that the Company's investment in distribution mains is driven by demand *and customer* considerations; gas mains are installed to meet both average and peak demand. Further, MERC maintained that allocating costs according to the basic system study would eliminate the price discounts available to interruptible service customers and heightens the risk that they would leave MERC's system if their rates were reallocated under this method.

The Company recommended that the Commission use the results of its zero-intercept study, with a correction recommended by the Department to include all quantities of distribution mains currently installed by the utility in the calculation of the portions of the distribution mains to be classified as customer- and demand-related costs, as a basis for setting rates.

MERC also recommended that in its next rate case filing that the Commission require the Company to file only one cost study and produce additional studies as requested by parties, if those studies "are clearly defined, supported, and consistent, including a detailed explanation and justification for any deviation from previously made requests."

2. The Department

The Department recommended that the Commission use MERC's zero-intercept method, with two modifications, as a basis for revenue apportionment.

The Department explained that the four cost studies MERC filed differ in the way they classify distribution mains—FERC Account No. 376. The zero-intercept study classifies distribution mains between demand- and customer-related costs. The minimum-size study classifies distribution mains between demand- and customer-related costs on the basis of the minimum-size method. The basic system study classifies distribution mains as 100 percent demand-related costs. Similarly, the average-and-excess study classifies distribution mains as 100 percent demand-related costs but allocates those costs on the basis of an energy-weighted method.

The Department concurred with MERC that the basic system and average-and-excess studies incorrectly classify distribution mains as 100 percent demand-related. Treating demand as the only factor driving a utility's investment in distribution mains incorrectly assumes that there is no delivery or service function of the natural gas system.

The Department countered the OAG's position that because some distribution main costs are incurred solely to meet peak demand, it is reasonable to classify all distribution main costs as 100 percent demand-related.

The Department recommended that MERC make the following two modifications to its zero-intercept cost study: (1) include all quantities of distribution mains currently installed by the utility in the calculation of the portions of the distribution mains to be classified as customer- and demand-related costs; and, (2) use the zero-intercept values for plastic ($9.787 per foot) and steel ($16.185 per foot), instead of setting the zero-intercept value of steel at $9.787 per foot, in the calculation of the portions of the distribution mains to be classified as customer- and demand-related costs.

MERC agreed on making the first change but stated that the second change would not produce a more accurate estimate of cost causation. Even if the Commission were to apply both of the Department's recommended changes, however, MERC stated that those changes would not be significant enough to justify modifying its proposed revenue apportionment.

3. The OAG

The OAG recommended that the Commission consider multiple cost studies when setting rates, explaining that there are two primary reasons for considering multiple cost studies. First, is the recognition that cost studies are not perfect models, and second is that different cost studies can more accurately describe different parts of the distribution system.

The OAG acknowledged that the zero-intercept study is superior to the minimum-size method because the minimum system created by the minimum-size method contains some capacity, which should be classified as capacity-related (but is not). Rather than assuming that distribution mains have a customer-related component, the basic system method classifies costs as customer-related only if they are tied directly to a specific customer. Because distribution mains are built to serve all customers, and not a specific customer, they are classified as capacity-related, while the meters and service lines are classified as customer-related.

The OAG asserted that the average-and-excess method recognizes that distribution mains are not always operating at peak capacity, and that therefore the mains are built to serve customers at both peak and average loads. For that reason, the average-and-excess method classifies the distribution mains as entirely capacity-related, and then allocates the cost as part capacity-related and part commodity-related based on a commodity weighting factor.

In addition to recognizing that distribution mains are built to serve more than average demand, the average-and-excess method mitigates concerns that allocating based solely on peak demand would overstate the importance of capacity.

The OAG advocated a weighted average approach to the cost studies by assigning a 50-percent weight to the results of the zero-intercept study, a 25-percent weight to the results of the basic system study, and a 25-percent weight to the results of the average-and-excess study.

E. The Recommendation of the Administrative Law Judge

The ALJ concurred with MERC and the Department that regardless of whether MERC's recommended revised cost study, or the Department's recommended revised cost study, is relied upon by the Commission, the apportionment of revenue responsibility that MERC proposes to make as a result of these studies is reasonable.

The ALJ found that the cost study as revised by the Department (so as to reflect all of the distribution mains installed by the utility, and weighted cost averages of the different types of distribution mains), is a better estimate of costs. He was persuaded by the Department's demonstration that the weighted average cost of a hypothetical "zero-inch" system (with plastic and steel distribution mains) had a lower total per-foot cost than projected by the Company. The Department checked its results against those of the minimum size study to verify that the estimate produced by its revised zero-intercept study was less than the per-foot cost of the minimum system study.

The ALJ also concurred with MERC that it is reasonable to limit the number of studies MERC must file in its next rate case, finding that it is reasonable to limit those filings to one cost study and a minimum-size classification calculation, without the added burden of submitting a complete minimum-size study. But the ALJ disagreed with MERC's proposal to only conduct other studies that are "clearly defined, supported, and consistent, including a detailed explanation and justification for any deviation from previously made requests," stating that a better approach is for the Commission to detail the initial filing requirements for the next rate case and allow an intervening party to request two additional cost studies.

The ALJ also noted that if more than two studies are requested, or if a request is not clearly defined, MERC may ask the ALJ to limit the requests under Minn. R. 1400.6700, subp. 4, which protects parties from discovery requests that place undue burdens and expense upon them.

F. Commission Action

The Commission is persuaded that consideration of multiple cost studies is informative for purposes of considering cost and non-cost factors when setting rates. The Commission will therefore adopt the ALJ's recommendation as modified, acknowledging that the Commission will consider MERC's recommended zero-intercept model, the Department's recommended zero-intercept model, and the OAG's blended approach, on a qualitative basis, in making its determination on class revenue apportionment.

The Commission will also adopt the ALJ's recommended future filing requirements, consistent with the following. MERC must file:

a. One cost study in future rate cases; and
b. If MERC elects to file a zero-intercept cost study, MERC must also comply with (a), by filing a minimum-size classification in lieu of a full-blown minimum-size study.

Intervening parties have the option to request additional cost studies; if more than two studies are requested, or if a request is not clearly defined, MERC may seek protection from the Administrative Law Judge under Minn. R. 1400.6700, subp. 4.

XXIII. Sales Forecast and Firm Class 1 and Firm Class 2 Customer Class Proposal

A. Introduction

MERC developed its sales forecast using regression models with monthly historical data from January 2007 to December 2016. The regression models included economic and demographic variables, heating degree days with a base of 65 degrees Fahrenheit, binary variables, and time-trend variables. The Company applied its forecast methods at the revenue class level within each of MERC's Purchased Gas Adjustment systems: MERC-NNG, MERC Consolidated, and MERC-Albert Lea. MERC's forecast showed its overall test-year weather-normalized sales to be 753,081,025 therms.

MERC applied its forecasts to existing customer classes, although it proposed to reclassify customer classes as part of this rate case and subsequently applied its forecasts to those new classes accordingly. MERC's existing customer classification includes firm and interruptible customers. Firm customer classes include: Residential, General Service Small Commercial and Industrial (C&I), and General Service Large C&I. The Company's interruptible customer classes include Small Volume Interruptible, Large Volume Interruptible, and Super Large Volume Interruptible.

MERC's proposed reclassification would include Firm classes 1 through 5, and Interruptible classes 1 through 5. MERC also proposed to: consolidate its Interruptible and Joint Transportation customer classes into Firm/Interruptible classes 1 through 5; create six Farm Tap customer classes (all firm sales); create three Agricultural Grain Dryer customer classes (sales or transport); and create two Power Generating Unit customer classes (sales or transport).

The Department identified several issues with MERC's proposed sales forecast, including the use of variables in the forecasting models, the use of historical normal weather for the Residential class instead of actual weather, and misclassification of customers between the Small Commercial C&I class and the Large Commercial C&I class. The Department developed an alternative forecast in response to these issues, but the alternative sales forecast reflected an error in MERC's data that was filed during record development. Correcting that error showed that the

Department's alternative forecast would reduce the Company's revenues, resulting in an increase in the Company's revenue requirement of approximately $3.8 million.

MERC subsequently corrected its initial sales forecast as well, using updated data on the classification of General Service Small C&I and Large C&I customers, resulting in an increase to its revenue deficiency of $220,902. MERC recommended using its updated forecast for the purpose of determining its revenue requirement, but the Department disagreed, stating that the Company's initial sales forecast should be used, and only for the purpose of setting rates.

B. Positions of the Parties

1. MERC

MERC's forecast, as initially filed and subsequently revised, as applied to existing customer classes is shown in the table below.

MERC Forecast (Existing Customer Classes)		
Rate Class	Test-Year 2018 (Therms)	Corrected Test-Year 2018 (Therms)
Residential	183,783,848	
C&I General Service Rate		
Small General Service	9,089,669	8,374,639
Large General Service	92,408,923	93,123,953
Total C&I General Service	101,498,592	101,498,592
Interruptible & Joint		
Interruptible	36,544,892	
Joint	404,285	
Total Interruptible & Joint	36,949,177	
Transportation	430,849,408	
Total MERC-Minnesota	753,081,025	753,081,025

In response to the Department's proposed alternative forecast, the Company reclassified customers in both the Small C&I General Service class (Small C&I class) and the Large C&I General Service class (Large C&I class) and recalculated the revenues assigned to those classes. As part of that reclassification, the Company skewed the allocation of sales toward the Large C&I class, which has no upper usage limit, by first deriving the average usage of customers in the Small C&I class.

The Small C&I class includes customers who use 1,500 therm or less on an annual basis. The Company determined the average usage for the Small C&I class for the time period between February 2016 and January 2017 by calculating the usage of all customers, regardless of class, whose usage was less than 1,500 therms. Based on its calculations, MERC estimated that the average usage for the Small C&I class is 850 therms annually. The Company then calculated the C&I Large class usage as the difference between the total usage for both classes and the amount estimated for the Small C&I class. MERC stated that 2017 usage data produces the most recent and accurate customer classification information available.

The table below shows the forecast as initially filed with the newly proposed customer classes, and shows by comparison, the results of its customer reclassification.

	MERC's Initial Filing (ALJ's Finding)	MERC's Updated Sales Forecast Reflecting Customer Re-classifications (MERC's position)
Rate Class	Test Year 2018 Initial Sales (therms)	Test Year 2018 Corrected Sales (therms)
Residential	181,526,150	181,526,150
Residential Farm Tap	2,257,698	2,257,698
Class 1	**8,807,698**	**8,092,667**
Class 1 Farm Tap	275,134	275,134
Class 1 Ag	234,889	234,889
Class 2 - Firm	**85,386,635**	**86,097,472**
Class 2 Farm Tap	3,043,620	3,043,620
Class 2 Ag	2,024,493	2,024,493
Class 2 – Int	16,204,200	16,204,200
Class 3 – Firm	**3,963,107**	**3,967,301**
Class 3 Ag	1,604,084	1,604,084
Class 3 - Interr	72,383,283	72,383,283
Class 4 – Interr	24,708,678	24,708,678
Class 5 - Interr	291,114,105	291,114,105
Power Generating 1	165,757	165,757
Power Generating 2	40,225,718	40,225,718
FLEX & Transport for Resale	19,155,776	19,155,776
Total	753,081,025	753,081,025

2. The Department

As an initial matter, the Department opposed the Company's proposal to increase the revenue requirement by $220,902 based on the adjustment made to reflect the reclassification between the Small C&I class and the Large C&I class. Instead, the Department recommended using the Company's initial sales forecast to set rates, which resolves doubt about the reasonableness of rates in favor of the ratepayer.

The Department disputed the reasonableness of the Company's calculation that the average usage of customers who used 1,500 therms or less annually is 850 therms for the time period between February 2016 and January 2017.

The Department stated that MERC's adjustment is not, in fact, based on all customers who used 1,500 therms or less annually because the number of customers included in the calculation was too low compared to the total customer count in the Small C&I class. The Department also stated that the 850-therm figure is based on actual data that is not weather-normalized, further reducing the reliability of the Company's calculation.

As a result, the Department stated that the Company's calculations are not accurate and reliable for purposes of increasing the Company's revenue deficiency by $220,902. The Department recommended that the Company's forecast in its initial filing, without the reclassification, be used to set rates.

The Department also recommended that MERC be required, at least six months prior to filing its next rate case or in any proceeding requiring a forecast, to work with the Department on the following:

- Whether MERC's forecasting models have appropriate signs on the independent variables chosen by MERC;
- Use of actual weighted Heating Degree Days;
- Not using predicted residential customer counts as an independent variable in the Small C&I customer count model;
- Any misallocation or "ad hoc adjustments" of customer classifications between the Small C&I class (a decoupled class) and the Large C&I class (a non-decoupled class);
- Any issues in the Transportation models; and
- Data integrity issues identified in this case, including misallocation of customers in the Small C&I class and Large C&I class and the lack of availability of historical data to correct the misallocation issue.

C. The Recommendation of the Administrative Law Judge

The ALJ found that MERC's sales forecast is reasonable for the purpose of setting rates. He concluded that any doubt as to the reasonableness of rates should be resolved in favor of ratepayers.

The ALJ also recommended that beginning at least six months before MERC files its next rate case, MERC and the Department should work on the forecasting-related issues listed above.

D. Commission Action

The Commission concurs with the Administrative Law Judge that resolving doubts about the reasonableness of the sales forecast in favor of ratepayers is the most equitable result and required by statute, and the Commission will therefore adopt the sales forecast recommended by the ALJ, as shown in column 2 in the table above.

The Commission will also adopt the ALJ's recommended reporting requirements described above.

Finally, the Commission will require MERC to file an annual compliance filing by March 31st of each year that:

- details the number of customers reassigned to different customer classes, their original class and the class to which they were moved;
- identifies the number of customers with usage falling within the 10-percent usage band that did not warrant reassignment;
- contains a description summarizing customer complaints regarding class reassignments; and
- addresses MERC's compliance with Minnesota Rules, part 7820.4000.

RATE DESIGN ISSUES

XXIV. Class Revenue Apportionment

A. Introduction

After the Commission establishes a utility's revenue requirement, the Commission designs rates to provide the utility with a reasonable opportunity to recover these costs. The next step in this process is to establish the share of MERC's revenue requirement to be recovered from each class of customers served by the utility.

In making this apportionment, the Commission considers the totality of the evidence in the record, in light of non-cost concerns such as: equity, justice, and reasonableness and the avoidance of discrimination, unreasonable preference, and unreasonable prejudice; continuity with prior rates to avoid rate shock; revenue stability; economic efficiency; encouragement of energy conservation; customers' ability to pay; ease of understanding and administration; and cost of service.[46]

MERC currently provides several types of service including: sales and transportation service; firm and interruptible service; joint service; and market rate service.

MERC's sales include procurement of both wholesale quantities of natural gas and interstate transportation service to MERC's city gates, which is resold and delivered to natural gas customers through its distribution system.

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[46] Minn. Stat. §§ 216B.01, .03, .2401, 216C.05, 216B.16, subd. 15.

Transportation service customers acquire their own gas supplies and arrange pipeline transportation of these supplies to MERC's town border stations. MERC then delivers gas shipments to transportation customers through its distribution system.

A limited number of mainline customers, such as certain Super Large Volume customers and taconite facilities, are directly connected to the interstate gas pipeline and do not utilize MERC's gas distribution system. To these customers, MERC provides only odorizing services. Sales and transportation customers can take either firm or interruptible service. Firm service is typically not subject to curtailment and is priced to include the costs of providing reliable shipments. Customers receiving interruptible service have discounted rates, subject to curtailment as necessary to maintain system reliability for the firm service customers.

As part of this rate case, MERC proposed creating new customer classes and reassigning existing customers into those classes. MERC's existing firm classes include Residential service class, the Small C&I General Service class and the Large C&I General Service class. The Company's three interruptible classes include Small Volume Interruptible, Large Volume Interruptible, and Super Large Volume Interruptible.

In its initial filing, MERC proposed the following new customer classes: (a) Firm Classes 1 through 5; (b) Interruptible Classes 1 through 5; (c) Consolidation of its Interruptible and Joint transportation classes into Firm/Interruptible Classes 1 through 5; (d) 6 Farm Tap classes, all of which receive firm service; (e) 3 Agricultural Grain Dryer classes (sales or transport); and, (f) 2 Electric Generation Unit classes (sales or transport).

B. Positions of the Parties

1. MERC

In developing its revenue apportionment proposal, MERC aimed to balance the recovery of costs imposed by each class while limiting bill impacts to any one class, using the results of its zero-intercept study as a starting point. The following table shows the Company's proposed revenue apportionment.

			Revenues ($000s)		Increase	
Customer Class	Number of Customers	Sales – Therms (000s)	Current	Proposed	(000s)	%
Residential	210,331	183,784	$68,043	$71,686	$3,643	5.35%
Firm Sales	22,128	101,499	$26,196	$24,008	($2,188)	(8.35%)
Interruptible Sales	444	54,240	$3,836	$4,036	$200	5.21%
Transport	187	417,725	$9,111	$12,198	$3,087	33.88%
Total	233,090	757,248	$107,186	111,928	$4,742	4.42%

(These revenue numbers exclude the cost of gas.)

MERC stated that the substantially larger increase to the Transportation class is a result of the Company's proposal to charge firm customers in this class at the firm distribution rate, instead of the daily firm capacity rate. In other words, the increase to this class would not apply to Transportation customers who do not purchase firm service. Customers in the Transportation class are MERC's largest customers, and the Company stated that many non-firm customers in this class are extremely price-sensitive because they can bypass MERC's system to obtain natural gas supply from other sources.

MERC also compared test-year operating revenue under present and proposed rates by type of charge – including minimum demand, energy by block, gross receipts, automatic adjustments, and other charge categories within each rate schedule and within each customer class. It also compared the amount of revenue generated by each rate component under the current and proposed monthly fixed charges, demand charges, and per therm rates for each rate class.

2. The Department

The Department recommended approval of MERC's revenue apportionment proposal, updated to reflect the Company's February 2018 reassignment of customers into their respective classes. In its support of MERC's proposal, the Department recognized the importance of the various types of service the Company provides, including sales and transportation; firm and interruptible; joint service; and market rate service. The Department stated that rates should be designed to keep the Company indifferent as to whether customers take transportation or sales service, which is available as either firm or interruptible service.

3. The OAG

The OAG recommended a different revenue apportionment than proposed by MERC, one that applies a blended approach by considering the results of all cost studies and non-cost factors. The OAG's proposal weighs the zero-intercept method most heavily in determining cost causation.

The OAG emphasized that all cost studies are imprecise and that a blended approach more reasonably balances cost and non-cost factors. For example, the OAG stated that the zero-intercept method inaccurately classifies the cost of new mains when they are installed for reasons other than connecting customers in new areas. Such costs should be classified as 100 percent capacity-related instead of partially customer-related.

Further, the OAG stated that cost causation is not an objective fact, and that all models are subject to limitations and biases, justifying consideration of multiple models to ensure a broader understanding of cost causation. The OAG also recommended that the Commission meaningfully weigh the following non-cost factors: ability to pay; historical continuity; ease of administration; customer acceptance; ability to pass along costs; ability to bypass the utility; and tax deductibility of utility expense.

The OAG stated that its proposed changes in revenue responsibility are reasonable and proportional when considering its cost of service analysis. For example, an increase of more than 130% over current rates would be required to bring the Transportation class to its cost. The OAG also noted the relevance of non-cost factors in proposing an increase to the Firm Sales and Interruptible Sales classes, even though their rates are above cost. The OAG claimed that if the Company's cost of service is increasing, and the cost of serving any one class has not decreased, it is generally equitable for all classes to share some portion of a rate increase, particularly in light of the OAG's modest proposal of a quarter-percent increase for the firm sales classes.

The OAG asserted that MERC and the Department did not sufficiently weigh non-cost factors, which favor a lower rate increase for the Residential class. Unlike other classes, the Residential class is unable to pass costs on to others and does not have the advantage of claiming tax deductions for energy usage. The OAG also highlighted the importance of historical continuity through moderation of rate increases across classes. The OAG stated that its proposed revenue apportionment reflects the most comprehensive cost-of-service analysis in the record, and most faithfully applies the Commission approved non-cost factors, as shown in the table below.

	MERC's Proposed Change in Apportionment from Current Revenues	OAG's Initial Proposal for Change in Apportionment from Current Revenues	OAG's Revised Proposal for Change in Apportionment from Current Revenue
Residential	5.35 percent	7.82 percent	2.93 percent
Firm Sales	(8.35 percent)	0.68 percent	0.26 percent
Interruptible Sales	5.21 percent	1.11 percent	0.42 percent
Transport	33.88 percent	77.92 percent	29.23 percent

Neither MERC nor the Department supported the OAG's proposed revenue apportionment, contending that it does not accurately reflect cost causation and is based on flawed cost studies that fail to recognize that MERC's investment in distribution mains is driven by both demand and customer factors.

C. The Recommendation of the Administrative Law Judge

The ALJ recommended that the Company's proposed revenue apportionment be adopted by the Commission, finding that the OAG's proposed revenue apportionment, based on blended results of all four studies, is less closely connected to cost causation.

D. Commission Action

The Commission is convinced that the OAG's proposed revenue apportionment reasonably balances the cost and non-cost factors that the Commission must consider. In this case, the overall revenue increase is considerably lower than initially proposed due to adjustments made by MERC to reflect changes under the Federal Tax Act; those reductions ameliorate the total impact of the rate increase. The OAG's proposed revenue apportionment is shown in the table below:

	Current Revenue (excluding gas) ($)	OAG's Proposed Revenue (excluding gas) ($)	Percent of Revenue Requirement (excluding gas) (%)
Residential	68,043,217	70,038,600	62.5
Firm Sales	26,187,473	26,254,563	23.5
Interruptible Sales	3,843,986	3,860,043	3.5
Transport	9,111,319	11,774,733	10.5
Total	107,185,995	111,927,939	100%

Compared to MERC's proposal, the increase to the Residential class would be measurably smaller, but that reduction is balanced with changes to other classes. Applying an increase of approximately one quarter of one percent to the firm sales classes, which would otherwise experience a significant eight-percent rate decrease under the Company's proposal, is a reasonable application of non-cost factors. As the OAG asserted, it is equitable to assign some portion of the rate increase across customer classes. Further, the OAG's proposal reduces the extent of the Company's proposed increase to the interruptible classes, a recognition that these customers are highly price-sensitive and could obtain service elsewhere if their costs become excessive.

On balance, the OAG's revenue apportionment proposal is reasonable, and the Commission will approve it, along with the OAG's proposed exceptions to the ALJ's Report on revenue apportionment (new OAG findings 15 to 30). The Commission will reject Finding 399 of the ALJ's Report.

XXV. Revenue Decoupling

A. Introduction

Revenue decoupling is a mechanism used to true-up rates to allow the Company to recover revenues if the collective usage of customer classes drops below a set base amount. Decoupling is designed to reduce a utility's disincentives to promote energy efficiency by separating a utility's earnings from overall reductions in energy sales.

MERC's current revenue decoupling program is operating as a pilot program, as approved by the Commission in the Company's 2010 rate case.[47] Under the program, adjustments are calculated for all changes in usage per customer above or below approved rate-case sales levels.

The parties agreed that as part of MERC's decoupling program, the Company would remove the Small C&I General Service customers from the program and require MERC to provide, when the Company files its next rate case, an updated analysis on the customer impact of extending its

[47] *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-15-376, Findings of Fact, Conclusions, and Order (October 31, 2016).

revenue decoupling program to all customer classes with 50 or more customers. In furtherance of their agreement, the parties concurred on the Department's recommended modifications to Finding 469 of the ALJ's Report, as well as recommended new Findings, as shown below:

> [New Finding]. The Department concluded that contrary to MERC's arguments a majority of MERC's non-residential customer classes have significant throughput incentives and that, for example, MERC's disincentive for encouraging a C&I FIRM Class 3 customer to participate in the Company's CIP ($167) is several times higher than MERC's disincentive for encouraging a residential customer to participate in its CIP ($53).
>
> [New Finding]. The Department discovered late in the discovery process that a significant portion of MERC's C&I customers are misclassified. For example, based on the Department's review of data provided by MERC, it appears that approximately 24 percent of the Company's Large C&I class customers should have been classified as Small C&I customers. Until this misclassification is rectified, the Department concluded that the appropriate revenue-per-customer baseline needed to calculate deferrals for MERC's C&I customers could not be calculated and the Department recommended that until the Company's next rate case, MERC's RDM should be restricted to its residential customer class.
>
> 469. ~~The Department's analyst, Christopher Davis, agreed. He~~ The Department also recommended ~~that the General Service Small C&I class be removed from MERC's decoupling program and~~ that the Company submit an updated analysis of potential expansion of the RDM to all of MERC's customer classes with 50 or more customers when MERC files its next rate case.

The parties also agreed to the following:

- require MERC to include the General Service Small C&I class in future annual revenue decoupling reports in the analysis of how the revenue decoupling mechanism would have impacted non-decoupled classes;
- Approve the agreement between MERC and the Department for continuation of the 10 percent symmetrical cap on surcharges and refunds within the revenue decoupling program; and
- Adopt an implementation date of January 1, 2019 for all modifications adopted herein to MERC's revenue decoupling program

The remaining dispute among the parties is the Department's recommendation that the Commission establish an energy savings threshold.

B. Positions of the Parties

1. The Department

The Department proposed that the Commission require MERC to achieve a first-year energy savings threshold of 365,000 dekatherms (Dth) before surcharging customers, stating that the Company's 2017 energy savings are significantly lower than 2014 energy savings when measured as a percentage of retail sales. The Department recommended that the savings threshold be based on first-year energy savings, which is lower than the lowest energy savings achieved in the past five years – MERC's lowest first-year energy savings was 369,068 Dth.

The Department stated that fluctuations in the Company's energy savings since 2010 warrant establishing an additional incentive to encourage more effective promotion of, and participation in, the Company's energy savings programs. As part of the Department's proposal, the Company would be required to achieve the energy savings threshold or forego making an upward rate adjustment in the following year.

2. MERC

MERC opposed establishing an energy savings threshold, stating that smaller utilities, such as MERC, have wider annual variations in energy savings achievement. The Company also stated that there are numerous factors, other than the Company's promotion of energy conservation, that affect energy savings levels and that tying its decoupling program to an energy savings threshold could be administratively challenging.

C. The Recommendation of the Administrative Law Judge

The ALJ recommended that the Commission not impose an energy savings threshold as recommended by the Department. The ALJ found that such a condition could unreasonably reduce the Company's earnings and does not effectively balance the Commission's authority to encourage energy conservation and its authority to set just and reasonable rates.

D. Commission Action

The Commission is not convinced that the proposed energy savings threshold would necessarily be an effective tool for further incentivizing MERC to promote energy conservation or otherwise increase customer participation. Although MERC is reasonably likely to achieve the proposed energy savings threshold, it is possible that for reasons outside the Company's control, energy savings could fluctuate and reach a level beneath that threshold. As a result, the Commission will not adopt the Department's proposed energy savings threshold. However, the Commission is not persuaded by the ALJ's reasoning regarding the potential harm to the utility's earnings and will therefore not adopt Findings 465 and 466 in the ALJ's Report.

The Commission will take the following steps:

- Approve the removal of General Service Small C&I customers from MERC's revenue decoupling program and require MERC to provide for an updated analysis of the impact on customers of extending its revenue decoupling program to all of MERC's customer classes with 50 or more customers, when MERC files its next rate case.

- Adopt the Department's modification to ALJ Finding 469, as shown above.
- Adopt the Department's proposed findings pertaining to revenue decoupling, as shown above.
- Require MERC to include the General Service Small C&I class in future annual revenue decoupling reports in the analysis of how the revenue decoupling mechanism would have impacted non-decoupled classes.
- Approve the agreement between MERC and the Department for continuation of the 10 percent symmetrical cap on surcharges and refunds within the revenue decoupling program.
- Adopt an implementation date of January 1, 2019 for all modifications adopted herein to MERC's revenue decoupling program.

FINANCIAL SCHEDULES

XXVI. Gross Revenue Deficiency

Revenue Deficiency - Minnesota Jurisdiction
Test Year Ending December 31, 2018

Description	MERC - MN
Average Rate Base	$ 284,298,225
Rate of Return	6.6971%
Required Operating Income	$ 19,039,736
Operating Income	$ 16,828,156
Income Deficiency	$ 2,211,580
Gross Revenue Conversion Factor	1.4020
Gross Revenue Deficiency	$ 3,100,635

XXVII. Rate Base Summary

Rate Base Summary - Minnesota Jurisdiction
Test Year Ending December 31, 2018

Description	MERC-MN
PLANT IN SERVICE	
Energy	$ 1,643,129
Transmission	$ 10,652,571
Distribution	$ 525,995,993
Customer	$ 11,653,533
Total Plant In Service	$ 549,945,226
RESERVE FOR DEPRECIATION	
Energy	$ 350,365
Transmission	$ 3,159,001
Distribution	$ 190,259,139
Customer	$ 2,484,888
Total Reserve For Depreciation	$ 196,253,393
NET PLANT IN SERVICE	
Energy	$ 1,292,764
Transmission	$ 7,493,570
Distribution	$ 335,736,854
Customer	$ 9,168,645
Total Net Plant In Service	$ 353,691,833
Construction Work in Progress	$ 6,531,691
LESS: Customer Advances	$ 36,180
LESS: Plant Deferred Income Taxes	$ 79,540,740
Working Capital:	
Cash Working Capital	$ (5,908,337)
Deferred Taxes Other than Plant	$ 32,734,598
Non-Utility Adjustment	$ 284,632
Plant Adjustment	$ -
Subtotal	$ 27,110,893
Materials and Supplies	$ 230,597
Gas Storage Inventory	$ 6,062,327
Prepayments	$ 951,103
Regulatory Assets/Liabilities	$ (30,703,299)
Subtotal	$ (23,459,272)
TOTAL AVERAGE RATE BASE	$ 284,298,225

XXVIII. Operating Income Summary

Operating Income Summary - Minnesota Jurisdiction
Test Year Ending December 31, 2018

Description	MERC-MN
UTILITY OPERATING REVENUES	
Retail Revenue	$ 246,812,754
Late Payment Revenue	$ 998,853
Other Operating Revenue	$ 360,000
Total Operating Revenues	$ 248,171,607
UTILITY EXPENSES	
Purchased Cost of Gas	$ 139,405,857
Other Production	$ 1,406,597
Gas Supply	$ 776,953
Transmission	$ 53,776
Distribution	$ 18,712,706
Customer Accounting	$ 10,345,915
Customer Service & Information	$ 1,159,264
Administrative & General	$ 15,517,088
Total Operating Expenses	$ 187,378,156
Amortizations	$ 13,355,051
Depreciation	$ 13,691,467
Taxes Other than Income Taxes	$ 12,973,419
Other Interest Expense	$ -
Total Depreciation & Other Taxes	$ 40,019,937
Federal Income Tax	$ 2,828,895
State Income Tax (MN & MI)	$ 938,629
Interest Synch/25 year amortization	$ 177,834
Total Income Taxes	$ 3,945,358
Total Expenses	$ 231,343,451
Net Income	$ 16,828,156

ORDER

1. MERC is entitled to increase its Minnesota jurisdictional revenues by $3,100,635 to produce total gross revenue of $251,272,242 in the test year ending December 31, 2018.

2. The Commission accepts, adopts, and incorporates the findings, conclusions, and recommendations of the Administrative Law Judge, except as set forth herein.

3. The Commission adopts a capital structure comprising 50.90% common equity, 39.16% long-term debt, and 9.94% short-term debt.

4. The Commission adopts a cost of long-term debt of 3.58%.

5. The Commission adopts a cost of short-term debt of 3.60%.

6. The Commission adopts a cost of equity of 9.7%.

7. The Commission approves a test year non-fuel O&M reduction of $1,086,092.

8. MERC shall apply the 2017 percentage of actual bad debt expense over tariffed revenues of 0.762068% to the approximate Commission approved test-year tariffed revenues including the approximate approved revenue deficiency.

9. MERC must use actual 2017 late payment revenues, resulting in an increase of $323,853 in late payment revenues.

10. MERC shall not include charitable contribution administrative expenses in the test year.

11. The Commission hereby takes the following steps:

    - approves the update to reflect the new 21% federal corporate income tax rate and the revised Gross Revenue Conversion Factor of 1.402.
    - determines that $37.9 million, based on one year of amortization and a 13-month average is the reasonable amount to use for purposes of determining the correct excess deferred income tax (EDIT) amount for the test year.
    - approves the use of ARAM, with an estimated 41-year amortization period for protected or plant-related EDIT balances.
    - approves the use of a 25-year amortization period for unprotected EDIT balances.
    - approves the creation of a regulatory asset (or a regulatory liability) to account for the amortization of EDIT reserves that are greater than (or less than) what is authorized in final rates.

12. As pertains to MERC's test year rate-case expense, MERC shall

    a. Allocate 100 percent of the cost of capital expert, legal expenses and newspaper notices to its regulated business;

    b. Allocate 87.7 percent of state agency fees and ALJ fees to remove the pro-rata share for MERC's non-utility business ServiceChoice; and

    c. Amortize rate case expense over a two year period commencing January 1, 2018 and defer revenue collected associated with the rate case expense amortization after the end of the two period until the next rate case is filed and propose a rate offset of the amount collected in that rate case.

13. MERC shall include any difference between the 2018 actual Rochester capital expenditures and MERC's capital estimates used in this docket (17-563) in its upcoming NGEP Rider (18-182) as a true-up with MERC's NGEP rider true-up calculation.

14. To account for its Old Rosemount Building, MERC shall reduce rate base by $1.7 million with a corresponding $1.7 million adjustment to accumulated depreciation and a downward adjustment to depreciation expense in the amount of $40,941 to remove the annual depreciation expense from the test year.

15. In either its next rate case or its next depreciation filing, whichever comes first, MERC shall propose a set of depreciation practices and adjustments for the separate depreciation of large assets, like office buildings or to provide explanation why no such modification from the Company's depreciation practices is warranted or appropriate.

16. MERC is authorized to recover its requested Travel and Entertainment expense of $256,356 for the 2018 test-year.

17. MERC must establish a tracker to account for actual Minnesota property tax expense paid each year, less the amounts approved for recovery in base rates, ensuring that tax refunds are tracked as they are received from local taxing authorities and netted against expenses. Carrying charges should be applied to the tracker balance at MERC's approved weighted cost of debt. In subsequent general rate cases, if relevant, MERC must include testimony regarding the balance in the tracker account, Company actions taken regarding property taxes, and a proposal on how to refund or collect the balance in the tracker.

18. The Commission adopts the ALJ's recommendation to approve MERC's sales forecast, excluding the adjustment for MERC's February 2018 customer count. The Commission approves MERC's initially-filed sales forecast as reasonable for the limited purpose of setting rates.

19. The Commission adopts the reporting requirement recommendations in ALJ Report ¶ 502, p. 82 and ¶ 233, p. 38.

20. Cash working capital shall be recalculated to reflect the Commission approved outcomes in this proceeding.

21. MERC's proposed CCRC factor of $0.02953 and its current practice of combining the CCRC factor and its distribution rate into one billing rate are approved.

22. MERC shall update its CIP tracker carrying charge based on the approved short-term cost of debt in this docket.

23. Within 30 days, MERC shall submit a compliance filing detailing the amount of incentive compensation ultimately included in the Commission approved 2018 test-year.

24. The Gas Affordability Program (GAP) Surcharge shall to be reinstated to fund the GAP. MERC shall submit a compliance filing using the sales forecast determined in this proceeding to calculate the GAP factor.

25. The Commission finds that MERC has substantially complied with the reporting requirements of the Commission's Order Approving Merger Subject to Conditions in Docket No. G011/PA-14-664.

26. The Commission hereby amends the Order Approving Merger Subject to Conditions in Docket No. G011/PA-14-664 to remove Order Point 10 requiring review of MERC's low income programs in future rate cases.

27. MERC shall provide the following information in a compliance filing:

    a. the business case, design plans, and implementation plan for extension of Improved Customer Experience (ICE) to other WEC legacy utilities within 90-days of completion of the exploration project;

    b. a detailed discussion of costs and benefits to MERC of the roll-out to other utilities;

    c. a discussion of any work avoided by the WEC legacy utilities due to initial development of the ICE customer platform for legacy Integrys utilities;

    d. a discussion of the extent to which the allocations of costs (according the WEC affiliated interest agreement – AIA) captures the costs and benefits to the participating utilities;

    e. a cost recovery proposal to return all appropriate amounts to MERC customers, if, following the roll out to MERC's affiliates, the AIA itself does not ensure that MERC ratepayers do not pay a disproportionate share of ICE;

28. MERC shall confirm any decision on roll-out of ICE to WEC legacy utilities within 30 days of that decision, by submission of a compliance filing that reflects both the decision and the rationale.

29. In its next rate case, MERC shall file detailed information regarding the status of the Mapping Project and associated costs, including:

    (1) a full discussion of both phases of the Mapping Project;

    (2) the status of the Mapping Project;

    (3) the actual costs by year and the reasons for variances from forecasted amounts beginning with 2016;

    (4) the projected costs in the test year and how determined;

    (5) the actual and projected costs and how determined for the year immediately before the test year;

    (6) the portion of that year's costs performed by external contractors by year; and

    (7) any other evidence to support MERC's Mapping Project costs.

30. The Commission hereby takes the following steps:

    - adopts the ALJ's recommendation on cost studies, as modified, acknowledging that the Commission will consider MERC's recommended zero-intercept model, the Department's recommended zero-intercept model, and the OAG's blended approach, on a qualitative basis, in making its determination on class revenue apportionment.

    - adopts the ALJ's cost study future filing requirement recommendations subject to modifications, subject to requiring MERC to file one cost study in future rate cases, and if MERC elects to file a zero-intercept cost study to file a minimum-size classification in lieu of a full-blown minimum-size cost study.

- provides that intervening parties may request additional cost studies; if more than two studies are requested, or if a request is not clearly defined, MERC may seek protection from the Administrative Law Judge under Minn. R. 1400.6700, subp. 4 (2017).

31. The Commission rejects the ALJ’s revenue apportionment recommendation in Finding 399, and approves the OAG’s proposed class revenue apportionment and proposed exceptions to the ALJ’s report and recommendation.

32. The Commission hereby takes the following steps:

- approves the removal of General Service Small C&I customers from MERC’s revenue decoupling program and require MERC to provide for an updated analysis of the impact on customers of extending its revenue decoupling program to all of MERC’s customer classes with 50 or more customers, when MERC files its next rate case.
- adopts the Department’s modification to ALJ Finding 469.
- adopts MERC’s clarification to ALJ Finding 88.
- adopts MERC’s correction to ALJ Finding 134.
- adopts the Department’s proposed findings pertaining to revenue decoupling.
- requires MERC to include the General Service Small C&I class in future annual revenue decoupling reports in the analysis of how the revenue decoupling mechanism would have impacted non-decoupled classes.
- approves the agreement between MERC and the Department for continuation of the 10 percent symmetrical cap on surcharges and refunds within the revenue decoupling program.
- adopts an implementation date of January 1, 2019 for all modifications adopted herein to MERC’s revenue decoupling program.
- declines to adopt the Department’s recommendation to implement an energy savings threshold in this rate case.
- declines to adopt ALJ findings 465 and 466.

33. In future rate cases MERC shall:

a. show all revenues by FERC Account, with a breakout of the types of revenues included in each account; provide an explanation for why any revenue amount is excluded from the test year; and provide the last five years of actual revenues by type, plus related test-year amounts for that same period.

b. provide a schedule showing all allocated services to and from MERC and all other subsidiaries for five years of actuals and related test-year amounts during that five-year period. MERC should also include a brief description of each type of service or cost in the agreed upon format.

c. provide its rate base information by including beginning-of-year rate base and end-of-year rate base and 13 month rate base information and then calculating average rate base, to allow parties to better understand how MERC's rate base was calculated and to be able to tie out actual rate base amounts.

34. The Commission adopts MERC's proposed clarification to ALJ Finding 189.

35. MERC shall reduce its rate base by $1.03 million. This is based on MERC's Supplemental Direct Testimony rate base in which it updated the 2017 balances, updated for the loss of bonus depreciation, and incorporated a federal tax rate of 21 percent.

36. MERC shall reduce its revenue deficiency by $55,101 to reflect a recalculation of depreciation expense and a three year average of plant retirements.

37. MERC shall provide separately the retirements included in the test year rate base. MERC should provide actual retirements for the most recent five years to assist parties in evaluating whether the retirements MERC has included in rate base are reasonable.

38. MERC shall reduce rate base by $5,007,595 and a corresponding reduction of $524,724 to depreciation expense.

39. By March 31st of each year, MERC shall submit an annual compliance filing that:

    a. details the number of customers reassigned to different customer classes, their original class and the class to which they were moved;

    b. identifies the number of customers with usage falling within the 10-percent usage band that did not warrant reassignment;

    c. contains a description summarizing customer complaints regarding class reassignments; and

    d. addresses MERC's compliance with Minnesota Rules, part 7820.4000.

40. The Commission approves MERC's latest 5-year farm tap inspection program report.

41. MERC shall continue its farm tap inspection program and submit information about the program in its next rate case. MERC shall also:

    a. continue to send farm-tap safety and information brochures to new farm tap customers before they take service and to all existing farm customers annually.
    b. continue to file annual reports on its farm tap inspection program on or before April 1 of each year.

    c. Within 90 days of the end of each five-year inspection cycle, and in each general rate case, file with the Commission, the Department, and the Minnesota Office of Pipeline Safety a five-year report including cumulative results of the inspection program and any recommendations for future improvements.

42. MERC shall continue to address the reporting requirements of Docket No. 07-1188 in future general rate cases for Winter Construction Costs.

43. MERC shall continue to address the reporting requirements of Docket No. 90-563 in future general rate cases for abnormal construction costs and the collection of CIAC.

44. Within 30 days, MERC shall make the following compliance filings:

    a. Revised schedules of rates and charges reflecting the revenue requirement and the rate design decisions herein, along with the proposed effective date, and including the following information:

        i. Breakdown of Total Operating Revenues by type;

        ii. Schedules showing all billing determinants for the retail sales (and sale for resale) of natural gas. These schedules shall include but not be limited to:

            1. Total revenue by customer class;

            2. Total number of customers, the customer charge and total customer charge revenue by customer class; and

            3. For each customer class, the total number of commodity and demand related billing units, the per unit of commodity and demand cost of gas, the non-gas margin, and the total commodity and demand related sales revenues.

        iii. Revised tariff sheets incorporating authorized rate design decisions;

        iv. Proposed customer notices explaining the final rates, the monthly basic service charges, and any and all changes to rate design and customer billing.

    b. A revised base cost of gas, supporting schedules, and revised fuel adjustment tariffs to be in effect on the date final rates are implemented.

    c. A summary listing of all other rate riders and charges in effect, and continuing, after the date final rates are implemented.

45. MERC shall file a schedule detailing the CIP tracker balance at the beginning of interim rates, the revenues (CCRC and CIP Adjustment Factor) and costs recorded during the period of interim rates, and the CIP tracker balance at the time final rates become effective.

46. If final authorized rates are lower than interim rates, MERC shall file a proposal to make refunds of interim rates, including interest to affected customers.

47. Comments on all compliance filings may be filed within 30 days of the date they are filed. However, comments are not necessary on MERC's proposed customer notice.

This order shall become effective immediately.

BY ORDER OF THE COMMISSION

Michelle Rebholz for

Daniel P. Wolf
Executive Secretary

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