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September 10, 2014

VIA E-FILING AND ELECTRONIC MAIL

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

Re: **Reply to Supplemental Letter of the Minnesota Department of Commerce, Division of Energy Resources**
In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to Increase Rates for Natural Gas Service in Minnesota
MPUC Docket No. G-011/GR-13-617
OAH Docket No. 8-2500-31126

Dear Dr. Haar:

Minnesota Energy Resources Corporation ("MERC" or the "Company") submits this Letter in response to the letter filed in this docket by the Department of Commerce, Division of Energy Resources ("Department") on September 8, 2014. On August 25, 2014, MERC submitted its Compliance Filing in response to the Minnesota Public Utilities Commission's ("Commission") August 13, 2014, Notice of Schedule and Request for MERC to File Schedules Reflecting the ALJ's Recommendations, which were filed on August 12, 2014. On August 28, 2014, the Department filed a Letter agreeing with MERC's revised financial schedules incorporating the ALJ's recommendations, except for the cost of gas adjustment.[1] On September 8, 2014, the Department submitted a Supplemental Letter concluding that MERC's income statement adjustment for Conservation Improvement Program ("CIP") revenue was inconsistent with the ALJ's recommendations.

At the core of the issue is the appropriate mechanism for the recovery of MERC's 2014 CIP expense, and MERC has requested clarification of the ALJ's recommendation on this issue in our Request for Clarification and Exceptions filed on August 25, 2014. The ALJ recommended, in Finding 581, "setting the CIP revenue equal to the CIP expense so that final rates include CIP revenue and CIP costs of $9,396,422." Further, the ALJ recommended, in Finding 582, that the Conservation Cost Recovery Charge ("CCRC") should be added to the Conservation Cost Recovery Adjustment "(CCRA") on January 1, 2015, or with implementation of final rates, whichever occurs later. The Department's interpretation would have MERC

[1] MERC is in agreement with the Department's proposed cost of gas adjustment.

continue to collect a portion of CIP expense through the CCRC in Distribution Rates and collect the remainder through the CCRA. MERC respectfully disagrees with the Department's conclusion and believes it is inconsistent with the ALJ's recommendation that the CCRC be added to CCRA, because under the Department's interpretation, the CCRC would continue to be collected through Distribution Rates.

Attached to this letter as Attachment A is a table summarizing the three alternative options raised for addressing MERC's test year CIP expense. Option 1 is the Department's interpretation of the ALJ's recommendation, which, as explained above, would allocate recovery of CIP expense between the CCRC and CCRA. Option 2 is MERC's original position, under which recovery of all of test-year CIP expense would occur through the CCRC. Option 3 reflects MERC's understanding of the ALJ's recommendation. Under this option, CCRC would be set to zero and all recovery of CIP expense would occur through the CCRA factor.

Contrary to the Department's interpretation, MERC believes it is the clear intent of the ALJ to recommend that MERC's CCRC be set to $0.00000 and that recovery of CIP expense flow through the CCRA rather than Distribution Rates. As stated in ALJ Finding 577 "In this way, CIP expense would move from the Distribution Rate to the final approved CIP Rate on the customer's bill." Further, the ALJ concluded, in Finding 580, that "reflecting the appropriate charges as part of the final approved CIP rate will increase transparency in ratemaking and potentially reduce future audit costs and rate case expenses." Allowing all cost recovery for CIP expense to flow through the CCRA would simplify cost recovery and would be more transparent for MERC customers in reviewing their bills. MERC believes the ALJ's intention was clear that the CCRC should be set to $0.00000 and that recovery of CIP expense flow through the CCRA rather than Distribution Rates. Through this approach, as recognized by the ALJ in Finding 578, the CCRA would be adjusted between rate cases to address any significant under-recoveries or refund any over-recoveries. MERC therefore disagrees with the Department's interpretation and requests that the Commission adopt the ALJ's recommendations with respect to CIP expense, as further clarified in MERC's August 25, 2014 Clarifications and Exceptions.

Ultimately, if the Commission determines that the Department's recommended approach is preferable to allow for a gradual transition from recovery through the CCRC in Distribution Rates to recovery through the CCRA true-up mechanism, MERC would find that approach acceptable as long as the Company is permitted to fully recover all CIP expenses through either the CCRA or CCRC. If the Commission chooses to approve partial recovery via the CCRC and partial recovery via the CCRA, as suggested by the Department, MERC requests that the Commission also address whether, in any future rate case filing, MERC would be expected to transition CIP expenditure recovery entirely to the CCRA or continue to recover some portion through the CCRC.

Please contact me at 612-340-2881 if you have any questions regarding this matter.

Sincerely yours,

/s/ Michael J. Ahern___

Michael J. Ahern

cc: Service List

Minnesota Energy Resources Corporation
Calculation of Proposed CCRC Factor for 2014 Test Year

Line No.	Description	Option 1	Option 2	Option 3
1	Base Rate CIP Expense	$ 5,638,332	$ 9,396,422	$ -
2	Sales (Minnesota only)	689,625,513	689,625,513	689,625,513
3	Opt-out customers	305,799,314	305,799,314	305,799,314
4	CCRC applicable Sales	383,826,199	383,826,199	383,826,199
5	Calculated CCRC Factor ($/therm)	$ 0.01469	$ 0.02448	$ -
6	CCRA Increase at January 1st or Final Rate Implementation	$ 0.00979	$ -	$ 0.02448
7	Total CIP Expense collection (CCRC + CCRA)	$ 9,396,422	$ 9,396,422	$ 9,396,422

Option 1: DOC interpretation of ALJ Report
Option 2: MERC original Position
Option 3: MERC interpretation of ALJ report