MINNESOTA PUBLIC UTILITIES COMMISSION

Staff Briefing Papers

Meeting Date	May 16, 2019		Agenda Item 3**
Company	Minnesota Energy Resources Corporation		
Docket No.	**G-011/M-18-182**		
	In the Matter of the Petition of Minnesota Energy Resources Corporation for the Approval of a Natural Gas Extension Project (NGEP) Cost Rider Surcharge for the Recovery of 2019 Rochester Project Costs.		
Issues	Should the Commission approve MERC's proposed Natural Gas Extension Project cost rider surcharge for the recovery of 2019 Rochester Project Costs with or without modification and/or clarification?		
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✓ **Relevant Documents**	**Date**
Minnesota Energy Resources Corporation – Initial Filing	February 28, 2018
Minnesota Energy Resources Corporation – Letter	April 16, 2018
Department of Commerce – Comments	May 29, 2018
Minnesota Energy Resources Corporation – Reply Comments	June 8, 2018
Department of Commerce – Response to Reply Comments	August 24, 2018
Minnesota Energy Resources Corporation – Additional Reply Comments	August 28, 2018

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

I. Statement of the Issues

Should the Commission approve MERC's proposed Natural Gas Extension Project cost rider surcharge for the recovery of 2019 Rochester Project Costs with or without modification and/or clarification?

II. Background

A. Docket G-011/M-15-895 – Initial Filing of the NGEP Rider

On October 26, 2015, in Docket No. 15-895, Minnesota Energy Resources Corporation (MERC or the Company) filed a petition for evaluation and approval of rider recovery for its Rochester Natural Gas Extension Project (Rochester Project or the Project) under the natural gas extension project (NGEP) statute.[1] MERC claimed that it has been short capacity to meet its current and future growth needs for the Rochester area.

On May 5, 2017, the Commission issued its Order approving the Rochester project, granting MERC's preapproval request to recover Phase II costs of up $44 million through a combination an NGEP Rider and base rates.[2] The Commission also granted MERC's preapproval request to recover additional interstate natural gas pipeline (i.e. Northern Natural Gas or NNG) transportation costs of $55 million to $60 million through MERC's NNG Purchased Gas Adjustment (PGA).[3]

B. Docket G-011/GR-17-563 – MERC's General Rate Case

In MERC's General Rate Case, Docket No. G-011/GR-17-563 (rate case), MERC and the Department agreed to include $19.4 million of Rochester Phase II project capital costs in base rates.

The estimated remaining Phase II Rochester project costs of $24.58 million[4] were expected to be incurred from 2019 through 2023; MERC is proposing to recover a portion of these costs in the current docket through its NGEP Rider. MERC expects to recover NNG's pipeline capacity costs associated with the 15,939 Dth/day of additional capacity through its PGA; see MERC's 2018/2019 demand entitlement petition (November 1, 2018), pending in Docket No. G-011/M-18-526.

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[1] Minn. Stat. § 216B.1638 (2015)

[2] *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 at 18 (Order Point 2) (May 5, 2017).

[3] Ibid., at 18 (Order Point 3) (May 5, 2017).

[4] The sum of $19.4 million plus $24.58 million equals $43.98 million which is just under the Commission preapproved Phase II amount of $44 million.

C. Docket G-011/M-18-182 (current docket)

On February 28, 2018, MERC filed its petition requesting a forecasted 2019 revenue deficiency of approximately $1.3 million, subject to a true-up filing. The Company also proposed a 2019 NGEP rate factor of $0.00150 per therm applicable to all customer classes (including transportation customers) to be effective January 1, 2019.

On April 16, 2018, MERC filed a letter regarding its communications with the Destination Medical Center Corporation (DMC or DMCC). The DMCC formally expressed its position that MERC projects within the DMC Development District boundaries are not eligible for the limited amount of public funding allocated to the DMCC project.

On May 29, 2018, the Department filed comments recommending that the Commission allow MERC to implement an NGEP rider surcharge effective January 1, 2019 at $0.00049 per therm. Additionally, the Department recommended that the Commission modify its order in Docket No. G-011/M-15-895 to no longer require MERC to submit an application to the DMC for all work conducted in the DMCC. However, the Department requests that MERC continue its conversations with the DMC to determine if its position regarding infrastructure funding changes.

On June 8, 2018, MERC replied to the Department, agreeing with most of the Department's recommendations. However, MERC disagrees with the Department's analysis of Minn. Stat. § 216B.1638 (NGEP Statute) that the 33 percent cap on cost recovery through the NEGP rider applies to the annual incremental revenue requirement. The Company argues that the 33 percent statutory cap applies to the entirety of Phase II costs, currently estimated at $44 million. MERC also disputed the Department's proposed treatment of Contributions-In-Aid-of-Construction (CIAC).

On August 24, 2018, the Department filed response comments withdrawing its proposed adjustment for CIAC and proposing that the NGEP rider surcharge be set at $0.00050 per therm, based on the Department's initial analysis of the NGEP Statute.

On August 28, 2019, MERC filed an additional reply to the Department's comments in support of its proposed rider surcharge of $0.00150 per therm.

III. Minn. Stat. § 216B.1638 - Natural Gas Extension Project Costs.

In 2015, the Legislature enacted the Natural Gas Extension Project Costs statute. In Subd. 3, of Minn. Stat. § 216B.1638, the Commission is required to approve a rider to recover the costs of a natural gas extension project if it determines that certain conditions have been met and the Commission may not approve a NGEP rider that allows for recovery of more than 33 percent of the costs of a natural gas extension project through this rider. In Subd. 4, of Section 1638, the Commission is directed to evaluate and report to the Legislature, once every three years, on the effectiveness of NGEP riders approved under this statute.

A complete copy of Minn. Stat. § 216B.1638 is attached to the briefing papers as Attachment A.

IV.Parties' Comments

A. MERC – Initial Filing

MERC has requested recovery of its 2019 costs related to the Rochester Project. Specifically, the Company is seeking approval of:

- An ongoing NGEP Rider;
- A 2019 forecasted revenue deficiency of approximately $1.3 million for MERC's projected 2019 investments related to the Rochester Project subject to future true up;
- A 2019 per-therm NGEP rate factor of $0.00150 per therm applicable to all customer classes to be effective January 1, 2019; and
- Proposed NGEP Rider tariff sheets.

The Company notes that in Docket G-011/M-15-895, the Commission granted MERC's requested preapproval to recover Phase II costs of up to $44 million through the combination of an NGEP rider and base rates.

B. MERC – April 16, 2018 Letter

In its letter, MERC discussed Ordering point 9 of the Commission's May 5, 2017 Order in Docket No. G-011/M-15-895, as reproduced here.

> a. If MERC undertakes projects within established Destination Medical Center development district boundaries, the Company shall petition the DMCC for funding.
>
> b. MERC shall, in its annual NGEP filing and in future AAA filings, provide a discussion and supporting data explaining all work performed within the Destination Medical Center development district boundaries, with the amount of DMCC funding applied for and received.

To comply with the Commission's order, MERC met with both the City of Rochester and DMCC representatives. In its letter,[5] MERC explained that:

> …the DMCC informed MERC that the projects for which it was seeking funding, while within the DMC development districts, would not qualify for DMC funding. At this meeting, MERC was advised that DMC funding is based upon priorities developed through a budgeting process that takes into account available funding and project approvals. At this time, funding is not available for general infrastructure development, particularly for projects that have not been specifically included in the DMC long-range plan. In addition, MERC was told that funding is designed for development of new projects that promote the DMC's goals, such as real estate and medical construction projects that have been

[5] MERC Letter filed April 16, page 1-2

> specifically approved. General infrastructure work, even if occurring within one of the DMC development districts, does not qualify for funding.

Additionally, the DMCC noted that funding was limited to the DMCC's stated goal of making Rochester a medical destination and that it was not intended to be a substitute for other public or private funds that are available to pay for basic infrastructure development. On March 15, 2018, the City of Rochester and the DMCC formally sent MERC a letter confirming its view that MERC does not qualify for DMC funding.

C. Department – Comments

1. 33 Percent Factor

The Department argues that MERC has not properly calculated the 33 percent rule – the statutory requirement that a utility only recover 33 percent of project costs in the NGEP rider. The Department's interpretation of the NGEP Statute is that MERC is only eligible to recover 33 percent of the *incremental revenue deficiency*, which would result in a cost recovery of approximately $439,955.

The Department also argues that MERC's interpretation of the statute conflicts with what MERC has previously stated in the 15-895 docket.[6]

> Phase II construction costs are estimated to be approximately $44 million. Pursuant to the NGEP Statute, MERC requests recovery of 33 percent of the *revenue deficiency* associated with MERC's Phase II costs through the rate rider, with the balance of Phase II costs recovered in future rate cases.
>
> [Department emphasis]

Additionally, the Department provided Table 9 of MERC's October 26, 2015 filing in Docket No. 15-895 to demonstrate that the Company's previous interpretation of the NGEP Statute differs from its interpretation in the current petition. This is reproduced as Table 1 of the briefing papers. Table 1 shows MERC's previous calculation of the 33% cap is based on the Rochester project's annual revenue deficiency amount.

[6] Department Comments, filed May 29, 2018, page 5 – originally quoted from MERC's October 26, 2015 filing in the 15-895 docket.

Table 1: MERC's Previous Representation of How the 33 Percent Factor Affects NGEP Rider[7]

Line	Item	Description	2017	2018	2019
1	Rate Base	13-month average net plant value*	$3,702,535	$12,375,362	$19,626208
2	Rate of Return	Authorized in 2014 rate case	7.3048%	7.3048%	7.3048%
3	Gross Revenue Conversion Factor	Authorized in 2014 rate case	1.704	1.704	1.704
4	Return on Rate Base	Line 1 x Line 2 x Line 3	$ 456,990	$1,536,673	$2,443,120
5	Expenses	O&M, Depreciation Expense, Property Taxes	$ 10,849	$ 326,915	$ 768,304
6	Total Revenue Requirement	Line 4 plus Line 5	$ 467,840	$1,863,587	$3,211,424
7	Project Revenues	Projected Rochester sales growth x rates approved in 2014 rate case	$ 266,802	$ 552,987	$ 851,875
8	Revenue Deficiency	Line 6 minus Line 7	$ 201,038	$1,310,600	$2,359,549
9	Rider-Eligible Revenue Deficiency	Line 9 x 33%	$ 67,013	$ 436,867	$ 786,516

The Department therefore recommends, in the current petition, 33 percent cap be applied to MERC's projected revenue requirement for 2019 of $1,319,864, which results in the maximum amount eligible for cost recovery in the rider surcharge in 2019 to be $439,955.

2. Contingency Costs

The Rochester Project has an approved soft cap of approximately $44 million. The Department notes that MERC's filing includes a contingency factor of approximately 15 percent. The Department argues that including contingency costs in the NGEP Rider is inappropriate because, to the extent cost overruns occur, the Company bears responsibility to demonstrate that the costs were reasonable and prudent to warrant charging customers for higher costs.

Additionally, the Department expressed concerns with contingency costs' impacts on rate base.[8]

> …Since the Company earns a return on the rate base associated with the Rochester Project, if contingency costs are included in the NGEP Rider surcharge, the Company's ratepayers would essentially be forced to give MERC a loan for which the ratepayers pay not only interest but also a rate of return on costs that are, by definition, high…

The Department concludes that contingency costs are not reasonable to charge ratepayers at this time.

[7] Department Comments, filed May 29, 2018, page 5, appears in Department's Comments as Table 1

[8] Department Comments, filed May 29, 2018, page 6

3. Sales in the Surcharge Calculation

The Department proposed revisions to MERC's sales forecast, first noting the inclusion of the Michigan Taconite mine sales.[9]

> …the total sales number (877,001,389 therms) proposed by the Company in the instant docket is 16.46 percent higher than the MERC's proposed sales in the pending rate case (753,081,025). The Department analyzed this inconsistency in greater detail and concluded that the higher figure proposed in the NGEP filing includes Michigan Taconite mine sales. Since MERC has not shown that the Michigan Taconite mine would be subject to paying the NGEP, the Department recommends that these sales be removed in calculating the NGEP surcharge. Removing such sales would increase the NGEP surcharge, but should avoid an under-recovery of costs that can be avoided by correcting the calculation.
>
> [footnotes omitted]

Additionally, the Department stated that the Company properly accounts for sales growth in the Rochester area but fails to account for growth in other areas, which contradicts information MERC filed in its general rate case. In its August 30, 2017 Pre-Filed Forecasting Data, MERC's historical data demonstrates that sales in all regions have increased on a year-over-year basis. Further, the Department discussed the sales forecast in MERC's general rate case compared to the forecasting provided in this docket and made recommendations to adjust the forecast in the NGEP Rider.[10]

> …the Department notes that the Company's forecasts in the pending general rate case include projected sales increases through calendar year 2020…The Department notes that the forecasted sales values for 2019 (764,518,780 therms) included in the rate case, excluding Michigan sales, do not match the sales figures provided in this docket; in fact, the sales figures in this docket (754,945,735 therms) are 1.27 percent less than the forecasted 2019 sales figures in the general rate case…
>
> …the Department observed concerns with the Company's test-year sales projections and recommended an adjustment to MERC's total test-year sales. The Department recommended total 2018 test-year sales of 792,933,091 therms, which is 32,852,066 therms, or approximately 5.29 percent, greater than MERC's originally filed figure of 753,081,025 therms. Although the sales forecast in the general rate case is for the 2018 test year, it is possible to use the results of the Department's test-year sales forecast to estimate sales in 2019. Specifically, the Department recommends that the same upward adjustment, on a percentage basis of 5.29 percent, be applied to the Company's 2019 Minnesota jurisdictional sales estimate provided in its Pre-Filed Forecasting Data in Docket No. G-011/GR-

[9] Department Comments, filed May 29, 2018, page 8

[10] Id. page 8-9

> 17-563. When this adjustment is applied to 2019 Minnesota jurisdictional sales of 764,518,780 in MERC's pre-filed forecasting data, it results in estimated 2019 sales of 804,961,823 therms.

The Department recognizes that the rider is subject to a true-up, but argues that the sales forecast results in a surcharge that is unreasonably high. The Department recommends that the Commission require MERC to use the Department's calculation of 804,961,823 therms as discussed above. Alternatively, the Commission may decide to use MERC's pre-filed forecasting data figure of 764,518,780 from the Company's general rate case.

4. Destination Medical Center

MERC is required to petition the DMCC to request funding for natural gas infrastructure for all work that occurs within the DMCC district. The Department reviewed MERC's attempts to gain funding from the DMCC.[11]

> The DMCC informed MERC that the projects for which it requested funding would likely not qualify for DMC funding. On April 16, 2018, MERC filed a Letter updating its progress regarding funding through the DMCC. As part of this Letter, the Company included a formal communication with the DMCC. In its Letter, MERC stated that it appears unlikely that funding through the DMCC is possible. According to the DMCC communication, it appears that the DMCC will deny the Company's cost recovery proposal. The Board concluded that funding is not available for general infrastructure projects, in particular for projects not specifically included in the DMC plan. In addition, the DMCC noted that funding is based on priorities developed within a comprehensive planning process and capital improvement plan. Further, the Board noted that the non-refundable cost of an application is $10,000.
>
> [footnotes omitted]

The Department requests that the Commission reconsider its May 5 Order in Docket No. 15-895. Ordering point 9a requires the Company to continue to petition the DMCC for funding for all projects within the DMCC district. However, given the DMCC's formally stated position and the low probability of a favorable outcome, the Department does not believe repeated requests for funding would be an efficient use of MERC's resources. Therefore, the Department recommends MERC continue to have conversations with the DMC to ascertain whether the DMC's position changes, but not specifically require MERC to apply for funding for projects within the DMCC.

5. Contribution-in-Aid-of-Construction

The Company's analysis suggests that the upgrades related to the Rochester Project were to the town border stations only and that new customers (paying CIAC) would not directly connect to the upgrades, therefore, there are no CIAC revenues to offset the total revenue requirement

[11] Department Comments, filed May 29, 2018, page 10-11

for the Rochester Project. The Department disagrees with this analysis, noting that any extensions in the Rochester area are predicated on the increased capacity resulting from the Rochester Project.

The Department acknowledges that this treatment of CIAC is different than the typical treatment of CIACs.[12]

> …Although CIAC-related revenues are generally considered as an offset to rate base for an individual extension, the NGEP statute acknowledges that extensions of service to these customers is entirely dependent upon MERC receiving the capacity expansion from the Rochester NGEP project.

The Department also acknowledges that no CIAC forecast is available at this time, but requests that the average CIAC from 2016 and 2017, $31,863, be include in the NGEP Rider. This amount would be used as an offset against actual amounts received in the Company's NGEP true-up filing.

D. MERC – Reply Comments

1. 33 Percent Factor

MERC responded to the Department's read of the May 5 Order in Docket 15-895 and the NGEP Statute.[13]

> …Indeed, the Commission's Order quotes the direct language of the statute, which expressly provides that the 33 percent cap applies to the 'costs of the natural gas extension project.' The Commission's Order also explicitly states that '[t]he Company plans to recover 33 percent *of Phase II costs* through an NGEP rider, with the balance to be recovered in future rates.' Nothing in the Commission's Order supports the Department's assertion that the Commission understood its approval to be limited to 33 percent of the annual incremental revenue requirements for the Rochester Project. Rather, all discussion in the Order regarding the statutory 33 percent cap supports MERC's interpretation in its Petition that the cap applies to overall projects costs.
>
> [footnotes omitted; MERC emphasis]

MERC also stated:[14]

> MERC provided an example in its initial Petition in Docket No. G-011/M-15-895 to illustrate how the NGEP Rider surcharge might be calculated and, as the Department points out, that calculation was based on 33 percent of the annual

[12] Department Comments, filed May 29, 2018, page 12

[13] MERC Reply Comments, filed June 8, 2018, page 3

[14] Id. page 3

> revenue requirement calculation. However, the Company was also clear that it would file a future petition for NGEP Rider recovery and, ultimately, MERC's calculation and application of the 33 percent statutory cap in this Petition is consistent with both the unambiguous language of the NGEP Rider Statute and the Commission's Order in Docket No. G-011/M-15-895.
>
> [footnote omitted]

The Company believes the calculations it used in its petition are correct and the NGEP should be approved as filed.

2. Contingency Costs

MERC accepted the Department's recommended adjustment to remove contingency costs "with the understanding that all actual capital and expense amounts incurred in 2019 will be subject to true-up through the rider true-up mechanism."[15]

3. Sales in the Surcharge Calculation

MERC agreed that forecasted sales approved in its rate case should account for the growth and correctly back out sales from Michigan Taconite mines. Alternatively, MERC agreed that the surcharge should be calculated using the 2019 sales presented in the Company's pre-filing in its general rate case. The final over- or under- recover amount is subject to true-up.

4. Destination Medical Center

MERC agrees with the Department's recommendation for the Commission to modify its order to not require MERC to submit applications for future work within the DMC development districts. The Company also agrees to maintain communications with the DMC to determine if the DMC's position on infrastructure funding changes.

5. Contribution-in-Aid-of-Construction

MERC disagrees with the Department's analysis on CIAC.[16]

> …the statute defines 'contribution in aid of construction' to mean 'a monetary contribution, paid by a developer or local unit of government to a utility providing natural gas service to a community receiving that service as the result of a natural gas extension project, that reduces or offsets the difference between the total revenue requirement of the project and the revenue generated from the customers served by the project' …
>
> [footnotes omitted]

[15] MERC Reply Comments, filed June 8, 2018, page 4

[16] MERC Reply Comments, filed June 8, 2018, page 4

MERC argues that the CIACs that serve as a direct offset to revenue deficiency are those paid by a developer or a local government. The CIACs that MERC has collected thus far have been paid by individual customers for an extension of natural gas service. Therefore, MERC does not recommend adopting the Department's CIAC proposal.

E. Department – Response to Reply Comments

The Department acknowledged MERC's agreement on the issues relating to contingency costs, sales forecasting, and the DMCC. Overall, the Department recommends allowing MERC to implement an NGEP surcharge effective January 1, 2019 for NGEP costs to be incurred in 2019 and to set the rider surcharge at $0.00050 per therm. The remaining issues are discussed below.

1. 33 Percent Factor

The Department reiterated its interpretation of the NGEP Statute, stating that MERC appears to confuse the issue of a soft cap and cost recovery. Additionally, the Department quoted MERC's initial filing from Docket G-011/M-15-895.[17]

> [Paragraph] 1.6. Project Cost and Cost Recovery. Phase II construction costs are estimated to be approximately $44 million. Pursuant to the NGEP Statute, *MERC requests recovery of 33 percent of the revenue deficiency associated with MERC's Phase II costs through the rate rider,* with the balance of Phase II costs recovered in future rate cases.[18]
>
> [Department emphasis]

The Department also responded to MERC's assertion that it included different cost recovery examples in Docket 15-895, however, the Department notes that the examples are not included in the record of that proceeding.

The Department also provided additional context from the Commission's order, indicating that the intent was for MERC to recover 33 percent in the NGEP Rider and the remaining amount in base rates.[19]

> MERC may recover up to 33 percent of its cost to upgrade the Rochester-area distribution system through an NGEP rider surcharge on all customers, *with the remainder to be recovered through base rates*. Recovery will be capped at the Company's initial cost estimate of $44 million unless MERC can establish that the overruns are reasonable.

[17] Department Response to Reply Comments, filed August 24, 2018, page 4

[18] MERC's Initial Filing, Docket No. G-011/M-15-89, Page 4, October 26, 2015

[19] May 5, 2017 Order, Docket No G-011/M-15-895 on page 3.

[Department emphasis]

The Department maintains its position that only 33 percent of the NGEP incremental revenue requirement is eligible for recovery under the NGEP Statute; the remaining recovery would occur in a general rate case.

2. Contribution-in-Aid-of-Construction

The Department reviewed MERC's response and now agrees that CIACs, as defined by and in the context of projects covered by this statute, are limited only to amounts paid by a developer or a local unit of government. As a result, the Department withdrew its recommended adjustment.

F. MERC – Additional Reply Comments

MERC filed a brief response to the Department's *Response to Reply Comments.* The Company noted that the Department does not specifically oppose any costs as being imprudent, but rather, focuses on only allowing MERC to recover 33 percent of the incremental revenue requirement under the Department's read of the statute. MERC states that the Department's comments run counter to the legislative intent of the NGEP and that forcing the Company to recover some of the costs in the rider and the rest of the cost in base rates promotes more frequent rate case filings and results in unnecessary administrative and regulatory expense.

V. Staff Analysis

1. Resolved Issues

The Department and the Company have agreed to utilize either the sales forecast used in MERC's general rate case or, as an alternative, the sales forecast for 2019 in the Company's 2017 pre-rate case sales forecast filing. The comments and reply comments contemplating the use of the 2019 forecast pre-filing were submitted before the conclusion of MERC's rate case. Staff discussed the sales forecast with both the Company and Department; the parties agree that the 2019 sales forecast approved in the rate case, 764,518,780 therms, is the appropriate forecast for this rider surcharge.

MERC and the Department also agreed to remove contingency costs from the NGEP rider surcharge and to make no adjustments for CIAC.

Finally, the Parties agree that it would not be reasonable for MERC to continue to apply for DMC funding given the DMC's formally stated position. MERC will continue to maintain discussions with the DMC to determine if its position on funding MERC infrastructure projects changes.

2. Disputed Issue – 33 Percent Factor

a. Minn. Stat. § 216B.1638

MERC and the Department dispute the interpretation of the 33 percent factor in the NGEP Statute. The NGEP Statute, reproduced in full in Attachment A to the Staff Briefing Papers, states:

> The commission must not approve a rider under this section that allows a utility to recover more than 33 percent of the costs of a natural gas extension project.[20]

MERC's interpretation of this section of the statute focuses on the phrase "costs of a natural gas extension project." The Company argues that the Commission preapproved a soft cap of approximately $44 million; 33 percent of $44 million is approximately $14.52 million. Because the requested cost recovery is well below the 33 percent threshold, MERC proposes to recover its $1.3 million incremental revenue deficiency using a rider surcharge amount of $0.00150 per therm.

The Department opposes this interpretation of the NGEP Statute. The Department argues that MERC's proposed interpretation would allow the Company to recover more than 33 percent of the costs of a natural gas extension project, which the statutory language explicitly states the Commission must not approve. The Department's position is that the "33 percent of cost should be calculated on an annual basis, as originally proposed by MERC. …"[21]

Staff notes that the soft cap applied is based on a forecasted cost estimate. Carried to its conclusion, MERC's proposal would allow it to recover 33 percent of Phase II costs, approximately $14.52 million, in the beginning years of the project. Towards the end of the project, after the $14.52 preapproved soft cap for recovery has been reached, the Company would cease recovery under the NGEP Statute and could use a rate case to recover the remaining Phase II costs. There are two concerns the Commission may wish to address when considering MERC's proposal. First, as the Department notes, the NGEP Statute prohibits a utility from recovering more than 33 percent of costs in the NGEP rider. In 2019, and likely in the first couple of years of the project, the Company would be recovering 100% of its NGEP costs in the rider. Only after $14.52 million of Phase II costs are recovered will MERC be required to recover the remaining costs in a general rate case. This creates a potential for intergenerational inequity (front-loading) as ratepayers in 2019 would pay more than what is required by statute in a rider, whereas customers in the latter half of the project would not bear responsibility for their "share" of costs until MERC files a rate case. Secondly, the Parties discuss the potential for costs to exceed the soft cap but there is no discussion as to the implications of project costs falling short of the estimated $44 million. In the event project costs are lower than projected, MERC would have recovered more than 33 percent of project costs until a refund can be ordered and issued.

[20] Minn. Stat. § 216B.1638, subd. 3(c)

[21] Department Comments, filed May 29, 2018, page 4

Conversely, the Department's proposal allows the Company to recover 33 percent of the incremental (annual) revenue requirement. As costs are incurred and forecasts are adjusted, ratepayers will only be charged for 33 percent of the Phase II costs at any time, thereby eliminating concerns of intergenerational inequity. As long as the costs are reasonable and prudent, MERC will continue to recover 33 percent of its NGEP costs through the life of the NGEP Rider. The remaining unrecovered costs, if found to be reasonable and prudent could be recovered through a general rate case.

b. Commission's Order in Docket G-011/M-15-895

The Commission's May 5, 2017 Order in Docket 15-895 stated:

> MERC may recover up to 33 percent of its cost to upgrade the Rochester-area distribution system through an NGEP rider surcharge on all customers, with the remainder to be recovered through base rates. Recovery will be capped at the Company's initial cost estimate of $44 million unless MERC can establish that the overruns are reasonable.

MERC states that this order, in addition to statute previously discussed, does not specifically state that the Company is to recover 33 percent of incremental revenue requirement as proposed by the Department. MERC believes its proposal fits within the intent of the statute and the Commission's prior decision.

The Department noted that throughout the record in the 15-895 docket, the Company's calculations applied the 33 percent factor to the annual incremental revenue requirement. An example of this is provided in Table 1 on page 6 of these Staff Briefing Papers. The Department also provided an excerpt of the same May 5 Order from Docket 15-895.[22]

> MERC seeks to recover a portion of the project's costs under the NGEP statute, which allows rider recovery of *one third of the revenue deficiency* from an eligible natural gas extension project. The remaining costs would be recovered through base rates or the Company's purchased-gas-adjustment rider.
>
> [Department emphasis]

MERC and the Department appear to arrive at different conclusions of intent from the Commission's May 5 Order in Docket 15-895. No party has requested a reopening of, or proposed any modifications to, the existing order but the Commission may wish to consider explicitly stating whether the intent of the May 5 Order was for MERC to recover 33 percent of annual incremental revenue requirement or 33 percent of the preapproved project cost.

[22] PUC Order, May 5, 2017, Page 1

c. Bill Impacts

In MERC's initial petition in Docket 15-895, the Company provided an estimated residential customer bill impact, reproduced in these Staff Briefing Papers as Table 2[23]

Table 2 – Rochester Project Total Cost Impact on Residential Customers

Year	Residential Average Annual Revenue Deficiency Cost	Residential Average Annual Capacity Payment	Total
2017	$ 0.23	$ 2.64	$ 2.87
2018	$ 1.51	$ 15.69	$ 17.20
2019	$ 2.72	$ 18.20	$ 20.92
2020	$ 3.29	$ 31.04	$ 34.33
2021	$ 3.97	$ 30.87	$ 34.84
2022	$ 4.53	$ 30.57	$ 35.10
2023	$ 4.67	$ 30.26	$ 34.93
2024	$ 3.97	$ 29.83	$ 33.80
2025	$ 3.30	$ 29.63	$ 32.93

The residential rate impact of the proposed rider surcharge is as follows:

Table 3 – Comparison of bill impact for MERC and Department proposals

MERC		Department	
Per Therm	Annual (867 therms)	Per Therm	Annual (867 therms)
$ 0.00150	$ 1.30	$ 0.00050	$ 0.43

Additionally, in Docket No. G-011/M-18-526, MERC proposed a significant demand entitlement change, amounting to $0.01974 per therm.[24]

Table 4 – MERC Demand Entitlement Filing

Attachment 8

MINNESOTA ENERGY RESOURCES - NNG

Change in Costs due to November 1, 2018 Change in Entitlement Levels and Related Demand Costs

Costs Assigned In Demand	Contract	2017/18 Entitlements	2018/19 Entitlements	Entitlement Change	Months	2018/19 Rate	2017/18 Total Annual Cost	2018/19 Total Annual Cost	Total Annual Cost Change
TF12B (Max Rate) Winter	112495	49,219	46,506	(2,713)	5	$10.2300	$2,517,552	$2,378,782	($138,770)
TF12B (Max Rate) Summer	112495	49,219	46,506	(2,713)	7	$5.6830	$1,957,981	$1,850,055	($107,926)
TF12V (Max Rate)	112495	30,290	33,003	2,713	12	$9.0926	$3,304,978	$3,600,997	$296,019
TF5 (Max Rate)	112495	36,275	36,275	0	5	$15.1530	$2,748,375	$2,748,375	$0
TF12B (Discount-Winter)	112495	5,200	5,200	0	12	$7.4951	$467,694	$467,694	$0
TFX12 (Max Rate)	112486	10,822	16,261	5,439	12	$9.6288	$1,250,434	$1,878,887	$628,453
TFX Apr (Max Rate)	112486	2,000	2,000	0	1	$5.6830	$11,366	$11,366	$0
TFX Oct (Max Rate)	112486	2,000	2,000	0	1	$5.6830	$11,366	$11,366	$0
TFX5 (Max Rate)	112486	82,688	77,688	(5,000)	5	$15.1530	$6,264,856	$5,886,031	($378,825)
TFX5 (Discount)	112486	1,800	1,800	0	5	$10.0320	$90,288	$90,288	$0
TFX12 (Rochester)	112486	0	10,500	10,500	12	$37.1175	$0	$4,676,805	$4,676,805
TFX12 (Discount)	111866	1,283	1,283	0	12	$4.8640	$74,886	$74,886	$0
TFX12 (Discount)	111866	8,271	8,271	0	12	$5.4720	$543,107	$543,107	$0
TFX12 (Discount)	111866	11,921	11,921	0	12	$7.6025	$1,087,553	$1,087,553	$0
TFX5 (Discount)	111866	379	379	0	5	$4.8640	$9,217	$9,217	$0
TFX5 (Discount)	111866	2,445	2,445	0	5	$5.4720	$66,895	$66,895	$0
TFX5 (Discount)	111866	22,189	22,189	0	5	$15.1392	$1,679,619	$1,679,619	$0
Windom		2,500	2,500	0	12	$0.0000	$0	$0	$0
Northwestern Energy		1,035	1,035	0	12	$8.3382	$103,560	$103,560	$0
Total Demand Cost							$22,189,728	$27,165,484	$4,975,755

[23] As filed in MERC's Initial Petition in Docket No G-011/M-15-895, page 35 (Table 13)

[24] MERC Initial Filing in Docket G-011/M-18-526, Attachment 4, pg. 2 of 2; and Attachment 8

If the same average (867 therms) is applied, the annual commodity cost for an average residential ratepayer would be $17.11.

These related filings and bill impacts appear to be consistent with MERC's overall proposal and estimate of the NGEP Rider for Phase II project costs as shown in Table 2. The Commission approved a soft cap of these costs, subject to a prudence review and true-up, of $44 million. Commodity costs will continue to be reviewed in the Company's annual filings. The only dispute between the Department and MERC is with the timing and mechanism by which to recover costs.

VI.Decision Options

1. Approve MERC's petition for a NGEP rider surcharge with or without one or more of the following modifications and/or clarifications:

33 Percent Factor

2. Allow MERC to recover a forecasted 2019 revenue deficiency of approximately $1.3 million, subject to a true-up filing, using a rider surcharge factor of $0.00150 per therm applicable to all customer classes. (MERC) or

3. Allow MERC to recover a forecasted 2019 revenue deficiency of approximately $439,955, subject to a true-up filing, using a rider surcharge factor of $0.00050 per therm applicable to all customer classes. (Department)

Contingency Costs

4. Require MERC to remove contingency costs from its total cost projection. (MERC, Department)

Sales in the Surcharge Calculation

5. Require MERC to use MERC's 2019 sales forecast from the Company's pre-filed sales forecast data, in Docket No. G-011/GR-17-563, resulting in a 2019 sales forecast of 764,518,780 therms. (MERC, Department confirmed agreement on April 30, 2019) or

6. Require MERC to use the sales forecast that is based on the Department's analysis of 2018 forecasted and actual sales and then applied to 2019 to project 2019 sales from MERC's pre-filed sales forecast data, in Docket No. G-011/GR-17-563, resulting in a 2019 sales forecast of 804,961,823 therms. (Initial Department proposal)

Destination Medical Center

7. Reopen the Commission's May 5, 2017 Order in Docket G-011/M-15-895 and modify Ordering Paragraph 9a to no longer require MERC to apply for Destination Medical Center funding for projects within the DMCC boundaries. (MERC, Department) or

8. Approve the request for MERC to discontinue applying for Destination Medical Center funding for projects within the DMCC boundaries as previously ordered in Docket G-011/M-15-895 by modifying that requirement in this order. (Staff provided alternative)

Contribution-in-Aid-of-Construction

9. Require MERC to use the average 2016 and 2017 CIAC revenues, $31,863, as an offset to the NGEP revenue deficiency. (Department initial recommendation, later withdrawn)

MINN. STAT. § 216B.1638. RECOVERY OF NATURAL GAS EXTENSION PROJECT COSTS.

Subdivision 1. **Definitions**. (a) For the purposes of this section, the terms defined in this subdivision have the meanings given them.

(b) "Contribution in aid of construction" means a monetary contribution, paid by a developer or local unit of government to a utility providing natural gas service to a community receiving that service as the result of a natural gas extension project, that reduces or offsets the difference between the total revenue requirement of the project and the revenue generated from the customers served by the project.

(c) "Developer" means a developer of the project or a person that owns or will own the property served by the project.

(d) "Local unit of government" means a city, county, township, commission, district, authority, or other political subdivision or instrumentality of this state.

(e) "Natural gas extension project" or "project" means the construction of new infrastructure or upgrades to existing natural gas facilities necessary to serve currently unserved or inadequately served areas.

(f) "Revenue deficiency" means the deficiency in funds that results when projected revenues from customers receiving natural gas service as the result of a natural gas extension project, plus any contributions in aid of construction paid by these customers, fall short of the total revenue requirement of the natural gas extension project.

(g) "Total revenue requirement" means the total cost of extending and maintaining natural gas service to a currently unserved or inadequately served area.

(h) "Transport customer" means a customer for whom a natural gas utility transports gas the customer has purchased from another natural gas supplier.

(i) "Unserved or inadequately served area" means an area in this state lacking adequate natural gas pipeline infrastructure to meet the demand of existing or potential end-use customers.

Subd. 2. **Filing**. (a) A public utility may petition the commission outside of a general rate case for a rider that shall include all of the utility's customers, including transport customers, to recover the revenue deficiency from a natural gas extension project.

(b) The petition shall include:

(1) a description of the natural gas extension project, including the number and location of new customers to be served and the distance over which natural gas will be distributed to serve the unserved or inadequately served area;

(2) the project's construction schedule;

(3) the proposed project budget;

(4) the amount of any contributions in aid of construction;

(5) a description of efforts made by the public utility to offset the revenue deficiency through contributions in aid to construction;

(6) the amount of the revenue deficiency, and how recovery of the revenue deficiency will be allocated among industrial, commercial, residential, and transport customers;

(7) the proposed method to be used to recover the revenue deficiency from each customer class, such as a flat fee, a volumetric charge, or another form of recovery;

(8) the proposed termination date of the rider to recover the revenue deficiency; and

(9) a description of benefits to the public utility's existing natural gas customers that will accrue from the natural gas extension project.

Subd. 3. **Review; approval**. (a) The commission shall allow opportunity for comment on the petition.

(b) The commission shall approve a public utility's petition for a rider to recover the costs of a natural gas extension project if it determines that:

(1) the project is designed to extend natural gas service to an unserved or inadequately served area; and

(2) project costs are reasonable and prudently incurred.

(c) The commission must not approve a rider under this section that allows a utility to recover more than 33 percent of the costs of a natural gas extension project.

(d) The revenue deficiency from a natural gas extension project recoverable through a rider under this section must include the currently authorized rate of return, incremental income taxes, incremental property taxes, incremental depreciation expenses, and any incremental operation and maintenance costs.

Subd. 4. **Commission authority; order**. The commission may issue orders necessary to implement and administer this section.

Subd. 5. **Implementation**. Nothing in this section commits a public utility to implement a project approved by the commission. The public utility seeking to provide natural gas service shall notify the commission whether it intends to proceed with the project as approved by the commission.

Subd. 6. **Evaluation and report**. By January 15, 2017, and every three years thereafter, the commission shall report to the chairs and ranking minority members of the senate and house of representatives committees having jurisdiction over energy policy:

(1) the number of public utilities and projects proposed and approved under this section;

(2) the total cost of each project;

(3) rate impacts of the cost recovery mechanism; and

(4) an assessment of the effectiveness of the cost recovery mechanism in realizing increased natural gas service to unserved or inadequately served areas from natural gas extension projects.