Minnesota Public Utilities Commission
Staff Briefing Papers

Meeting Date: **April 23, 2015 .... Agenda Item #2**

Company: Minnesota Energy Resources Corporation (MERC or the Company)

Docket No. G-011/GR-13-617
In the Matter of a Petition by Minnesota Energy Resources Corporation (MERC) for Authority to Increase Natural Gas Rates in Minnesota

Issue: Should the Commission approve Minnesota Energy Resources Corporation's (MERC) proposed Incentive Compensation Refund Mechanism Compliance Filing to refund amounts included in test-year revenue requirement that were not paid out in a particular year?

Should the Commission approve MERC's proposed refund calculation modification of determining each customer's refund made in this docket or continue to support the Commission's previously approved method?

Staff: Bob Brill 651-201-2242
Sundra Bender 651-201-2247

Relevant Documents

G-007,011/GR-10-977
Commission – Findings of Fact, Conclusions of Law, and Order .... July 13, 2012
MERC – Compliance Filing .... September 21, 2012
PUC Staff – Briefing Papers .... December 13, 2012
Commission – Order .... December 21, 2012
MERC – Incentive Compensation Refund Mechanism Compliance Filing .... March 12, 2014

G-011/GR-13-617
MERC – Findings of Fact, Conclusions of Law, and Order .... October 28, 2014
MERC – Incentive Compensation Refund Mechanism Compliance Filing .... March 4, 2015
Department of Commerce (Department) Letter Comments ....March 17, 2015

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Table of Contents

Statement of the Issue

Should the Commission approve Minnesota Energy Resources Corporation's (MERC) proposed Incentive Compensation Refund Mechanism Compliance Filing to refund amounts included in test-year revenue requirement that were not paid out in a particular year?

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Introduction

In its July 13, 2012 Order in Docket No. 10-977, [1] Order Point 9[2] and its October 28, 2014 Order in Docket No. 13-617, Order Point 4, the Commission required MERC to refund any incentive compensation costs included in the test year revenue requirement[3] that were not paid out in a particular year.

MERC accounts for its annual unpaid incentive compensation amounts through its tracker and issues a customer refund only after the unpaid incentive compensation amounts,[4] when divided by the number of customers, exceeds $1 per customer.[5] In 2014, MERC's calculation resulted in a per customer refund amount of $1.80; MERC made its unpaid Incentive Compensation Refund Mechanism Compliance Filing.[6]

In Docket No. 10-977, the Commission directed MERC to calculate its unpaid incentive compensation customer refunds on a per Dth basis; a customer's refund would vary depending on its Dth usage. In its March 4, 2015 compliance filing in the current docket, MERC proposed a different calculation method to determine customer refunds by using a per customer basis. In this docket, each customer would receive a refund of $1.80.

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[1] The Commission adopted the findings, conclusions and recommendations of the Administrative Law Judge on this matter who recommended that the Commission retain the per-therm refund method established in Docket No. 10-977 for refunding unpaid incentive compensation amounts.

[2] Further, Order Point 9 required MERC to: a) make an annual compliance filing within sixty days after the incentive compensation awards are or would have been paid; and b) include in its compliance filing sufficient information to determine whether a refund is required and, if so, the amount of the refund; and c) use a per dekatherm (Dth) refund mechanism with any such refund.

[3] In Docket No. 13-617, MERC's test year incentive compensation was set at $1,231,630.

[4] MERC later clarified that $1 per customer refund threshold would be calculated by taking the cumulative unpaid incentive compensation and dividing the amount by its total number of customers. Further, MERC clarified that unpaid incentive compensation includes both non-executive and executive incentive compensation.

[5] In this docket, MERC reported unpaid incentive compensation of $387,200 and when divided by its number of customers (214,689) results in a per customer amount of $1.80.

[6] In 2013, MERC filed its unpaid incentive compensation filing, but the per customer amount resulted in $0.43 per customer amount which did not reach MERC's refund threshold.

MERC

On March 12, 2014,[7] MERC made its 2013 unpaid Incentive Compensation Refund Mechanism Compliance Filing. The filing reflected an unpaid incentive compensation amount, but when divided by the number of customers the result amounted to $0.43 per customer which was under the $1.00 per customer threshold that would initiate a customer refund. MERC did not issue a refund, but accumulated the amount not refunded.

2013 Unpaid Incentive Compensation Calculation

Incentive Compensation Amount authorized in Docket No. 10-977	$1,308,121
2013 Unpaid Incentive Compensation	$91,294
Approved annual average customer count	211,965
Amount per customer	$0.43
Threshold level per customer	$1.00

On March 4, 2015,[8] MERC filed its 2014 unpaid Incentive Compensation Refund Mechanism Compliance Filing. This filing reflected that MERC had accumulated $387,200[9] of unpaid incentive compensation, which calculated at $1.80 per customer which exceeded the $1.00 refund threshold requiring MERC to issue an unpaid incentive compensation refund to its customers.

2014 Unpaid Incentive Compensation Calculation

Incentive Compensation Amount authorized in Docket No. 13-617	$1,231,630
2013 Unpaid Incentive Compensation	$91,294
2014 Unpaid Incentive Compensation	$295,906
Cumulative Amount	$387,200
Approved annual average customer count	214,689
Amount per customer	$1.80
Threshold level per customer	$1.00

In its 2014 Incentive Compensation Refund Mechanism Compliance Filing, MERC sought Commission approval to modify the method for refunding back the unpaid incentive compensation amounts to its customers. MERC proposed to refund each customer the $1.80 flat

[7] Pursuant to the Commission's July 13, 2012 Order in Docket No. 10-977.
[8] Pursuant to the Commission's October 28, 2014 Order in Docket No. 13-617.
[9] Includes the 2013 and 2014 unpaid incentive compensation amounts.

amount, instead of the Commission approved refund method based on each customer's per Dth usage. Further, MERC proposed to refund the entire amount in a single month rather than spreading the refund over 12 months. MERC stated that given the small amount of the refund, its proposed approach is the simplest and least cost way to administer the refund.

MERC stated that until the refund is issued, the $387,300 cumulative unpaid incentive compensation amount will remain in a regulatory liability account.

Department

The Department reviewed MERC's Incentive Compensation Refund Mechanism Compliance Filing and MERC's proposal to modify the Commission directed refunding methodology[10] to its customers. The Department concluded that it is reasonable to refund each customer the proposed $1.80 flat amount instead of using the Commission approved method of calculating refunds on a per Dth basis.

PUC Staff Comment

PUC staff believes that the Department recommended that the Commission approve MERC's modified refund proposal; to refund each customer a $1.80 flat amount. PUC staff does not necessarily disagree with the Department, but staff does have the following concerns.

Should the Commission approve Minnesota Energy Resources Corporation's (MERC) proposed Incentive Compensation Refund Mechanism Compliance Filing to refund amounts included in test-year revenue requirement that were not paid out in a particular year?

PUC staff agrees with the Department that the Commission should approve MERC's unpaid incentive compensation amount of $387,200. PUC staff believes that the Commission may wish to consider MERC's modified refund proposal made in this docket as opposed to the Commission's approved method reflected in Docket No. 10-977.

Should the Commission approve MERC's proposed refund calculation modification of determining each customer's refund made in this docket or continue to support the Commission's previously approved Dth usage method?

PUC staff believes that there are a number of methods and numerous variations for any method that could be used to calculate each customer's unpaid incentive compensation refund amount. In Docket No. 10-977, after much discussion between all the parties, the Commission directed MERC to calculate customer refunds based on its Dth usage. In this docket, MERC has proposed to modify the Commission approved refund method to a method that would simply

[10] In Docket No. 10-977, the Commission's Order, Order Point 9, directed MERC to issue unpaid incentive compensation refunds on a per Dth basis. In this docket, MERC is proposing to modify its refund calculation from the Docket No. 10-977 basis to a per customer calculation.

take the unpaid incentive compensation amount and divide the amount by its total number of customers, i.e. every customer would receive the same refund amount.

PUC staff realizes that MERC's modified refund proposal is probably the simplest and least cost approach and is further supported by a relatively low unpaid incentive compensation amount. But, PUC staff questions the fairness of MERC's refund proposal over MERC's wide customer base.[11] In this docket, MERC is proposing to refund each customer $1.80 without giving any consideration to the customer's size or Dth usage.

PUC staff believes that MERC's proposed approach could have an adverse impact on a larger customer with sufficient Dth usage by reducing the customer's refund, see the following example:

Assume a large volume customer with annual usage of 500,000 Dth during 2014. Under MERC's proposed modified approach this customer would receive a $1.80 refund.[12] By using the refund calculation method approved by the Commission, which assumes that each customer's refund is calculated based on Dths used, the same customer would receive a $2,810 refund; see the following calculation.

Refund Calculation using Commission Approved method

Unpaid Incentive Compensation amount	$387,200
Adjusted Sales Forecast for 13-617 in Dth	68,962,551
Refund Factor	$0.00562
Large Volume Customer's Usage	500,000
Calculated Refund	$2,810

There are many pros and cons to each refund method, but as illustrated above, a large volume customer example would receive $2,810 as an unpaid incentive compensation refund under the Commission approved calculation method, as opposed to $1.80 under MERC's proposed method. PUC staff estimates that any customer with Dth usage over 320 Dth would receive a smaller refund if MERC's modified proposal is adopted as opposed to the Commission approved method.

PUC staff believes that it would be difficult to determine how much incentive compensation amounts are collected through the customer charge versus the volumetric factors. MERC's class cost of service uses a series of allocation factors which functionalizes the costs into multiple categories, primarily distribution, procurement services, and individual account classifications, and then further allocates into customer classes, such as residential.

[11] Over 50% of MERC's annual throughput is derived from a small group of large industrial customers.
[12] See the above calculation.

In MERC's rate design, the cost of service is allocated between the customer charge and volumetric factors. Because of this process, PUC staff believes that the test period level of incentive compensation is collected from MERC's customers through both its customer charge and its volumetric factors. In order to assure fair and equal refunds for all customers, MERC would have to first allocate its unpaid incentive compensation amount into portions for each of the customer charge and the volumetric charge. But, this process would add a level of complexity and cause MERC to incur unnecessary costs to issuing a refund that was not anticipated by the Commission. Therefore, the Commission will need to decide which refund calculation method is the proper way to distribute unpaid incentive compensation amounts.

In addition to MERC's proposed change in calculating the customer's unpaid incentive compensation refund, MERC has proposed to issue the refund in one month as opposed to using a twelve month period. PUC staff is unaware of any reference in Docket Nos. 10-977 and 13-617 that required MERC to use a twelve month refund period. PUC staff agrees with the Department's recommendation that a one month period is reasonable.

Decision Alternatives

1. Approve MERC's unpaid incentive compensation amount of $387,200.

2. Approve MERC's modified refund proposal to issue the unpaid incentive compensation refund based on MERC's calculation of taking the unpaid incentive compensation amount and dividing by the number of customers to calculate each customer's refund of $1.80.

3. Do not approve MERC's modified refund proposal and require MERC to calculate its per customer refund based on the Commission July 13, 2012 Order requiring each customer's refund to be calculated based on each customer's Dth usage.

4. Modify its original July 13, 2012 Order methodology to some other refund method calculation.