MINNESOTA DEPARTMENT OF COMMERCE

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December 21, 2016

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101

RE: **Additional Response Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. G011/M-16-655

Dear Mr. Wolf:

On November 23, 2016, Minnesota Energy Resources Corporation (MERC or the Company) provided Additional Reply Comments *In the Matter of the Petition of Minnesota Energy Resources Corporation for Approval of Recovery of Natural Gas Extension Project Costs through the Natural Gas Extension Project (NGEP) Rider and a 25-Year New Area Surcharge (NAS) for the Esko Project* in the above referenced docket.

The Minnesota Department of Commerce, Division of Energy Resources (Department) supports utility efforts to expand natural gas service to previously un-served areas, and commends MERC for its efforts. In supporting these efforts, the Department notes that the Minnesota Public Utilities Commission (Commission) has discretion in determining the recovery method for costs associated with extending service to new areas. That is, the Commission has the discretion to decide the circumstances under which recovery should occur solely through an NAS or whether an additional extraordinary rate recovery mechanism (an NGEP Rider) is needed, so that the project will go forward. The Commission's guidance will be helpful in this regard, given that, in the Esko Project, MERC has not provided factual evidence of a threshold amount of an NAS that, once met, would require socialization of recovery of the remaining costs through an NGEP Rider. That is, the Company has not yet provided support to justify approval of the Petition as proposed. Since such issues have not been brought before the Commission previously, the following highlights the facts in this proceeding for the Commission to consider.

I. USE OF NGEP IN CONJUNCTION WITH NAS

While MERC has indicated its agreement that the Commission has the discretion to choose the recovery method that is in the public interest, MERC's Additional Reply Comments did not add any arguments to support the use of the NGEP Rider in conjunction with an NAS in the case of the Esko Project. Cost-based rates require that customers causing the costs be charged those costs. The purpose of the NAS is to ensure that the costs incurred in excess of a cost-effective project be collected from the new customers, who are typically much better off with natural gas service, even when paying for such costs, compared to their existing options. In addition, the NGEP Rider provides the Commission with another tool should it wish to facilitate further natural gas service expansions than would occur under an NAS. Under that assumption, careful consideration should be made in determining at what point a proposed extension is not feasible if an NAS is the sole mechanism to recover excess costs.

As noted in the Department's Comments, an NAS requires the Company and its shareholders to accept the monetary risk of an insufficient number of customers signing up during the term of the NAS (*i.e.*, insufficient customer sign-ups mean the full revenue requirements of the project are not recovered, at least during the NAS period). Allowing use of the NGEP Rider in addition to an NAS substantially reduces that risk by shifting more costs to existing customers. While use of the NGEP and NAS together may be reasonable and necessary for projects that would not otherwise occur, this increase in risk for ratepayers should only be done after careful consideration and with supporting factual information.

II. PROJECT FEASIBILITY

MERC indicated in its Additional Reply Comments that the Esko Project would not go forward absent Commission approval of the use of both the NAS and NGEP Rider. Aside from this statement, the record does not contain the facts needed for the Commission to determine that the following NAS surcharges are not sufficient to enable the Esko Project to proceed:

Rate Class	Estimated Cost Per Month
Residential	$29.21
Small C&I	$55.35
Large C&I	$138.38
Small Vol. Interruptible	$507.39
Large Vol. Interruptible	$568.90

However, the comparison in the record of the NAS surcharges above to costs of alternative fuel sources indicates that consumers in Esko would be much better off with natural gas service even including the temporary surcharges.[1]

In its Additional Reply Comments, the Company continued to emphasize that the maximum New Area Surcharge residential customers will accept is approximately $25 per month. MERC did not provide a factual basis for this statement, but said:

> MERC conducts significant customer outreach and engages in discussions with relevant local government officials before proceeding with potential new area growth and expansion projects. This outreach includes discussions with prospective customers regarding their interest in conversion to natural gas service, the use of consumer surveys to gauge participation, and

[1] October 3, 2016 Department Comments, pg. 11, Table 4: Residential Natural Gas and Propane Comparison.

> an evaluation of alternative fuel costs to develop a reasonable set of assumptions regarding the likely number of customers who would convert at any particular surcharge rate. MERC and its affiliated utilities have significant experience and expertise with expansion projects and the factors that are likely to impact participation.[2]

However, MERC did not provide outreach or survey data to support its statement regarding an NAS threshold. While the Company stated that it conducts an evaluation of alternative fuel costs, MERC did not provide this information to support its Petition. The Company claimed that the Department's analysis in Comments was flawed due to the analysis only including propane[3] and not the full mix of heating fuel sources in the area;[4] however, MERC unfortunately provided no analysis of the cost of alternative fuel sources to show what customers are currently paying.

Complicating matters, the Company revised its own numbers for the Esko NAS model by assuming lower participation by residents and businesses in Esko due to the higher surcharge rates. When preparing its initial Comments, the Department requested alternative surcharge information for the option of a 30-year NAS with no NGEP Rider recovery along with other options. MERC's analysis at that time did not indicate that participation estimates would change as the NAS surcharge changed. While the Department understands that participation rates are dependent on each prospective customer's cost-benefit analysis, it is unfortunate that MERC did not provide information about costs of alternative fuel sources, as noted above. Such information would have been helpful to enable the Commission to ascertain whether or at what point establishing an NAS alone is sufficient for project viability.

While forecasting decisions by potential customers may be difficult, there should be a reasonable basis for the Commission's decisions, to allow for consideration of how to use ratemaking tools. Given the goal of supporting cost-effective extensions of natural gas service to Minnesotans with fair rates, the Department recommends that the Commission carefully consider the point at which to go beyond use of an NAS to require customers who are not located in a new area to pay for the costs of extending service to an area that is not cost effective under current rates.

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[2] MERC Additional Reply Comments, pg. 5.
[3] October 3, 2016 Department Comments, pg. 11, Table 4: Residential Natural Gas and Propane Comparison.
[4] MERC Additional Reply Comments, pg. 5-6.

III. CONCLUSION

Extending cost-effective natural gas service to previously unserved areas, under fair rates, is an important policy goal in Minnesota. However, MERC did not show that an NAS alone is insufficient to make the Esko Project feasible, without charging ratepayers outside of Esko for the costs of the extension. Since such issues are new for the Commission, the Commission should have a reasonable foundation to determine what portion of the project costs, if any, must be recovered from MERC's existing ratepayers in order for the Esko Project to proceed. Given the costs of alternative fuels in this record, a 30-year NAS should be approved for the Esko Project, with no recovery through an NGEP Rider, as indicated on page 12 of the Department's October 3, 2016 Comments. If the Commission chooses to rely on the NGEP and the NAS, the Department requests that the Commission provide guidance for future proceedings on when to go beyond use of an NAS and require use of an NGEP.

The Department is available to answer any questions that the Commission may have in this matter.

Sincerely,

/s/ MICHAEL RYAN
Rates Analyst

MR/lt

CERTIFICATE OF SERVICE

I, Marcella Emeott, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, email, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

MINNESTA DEPARTMENT OF COMMERCE

COMMENTS

DOCKET NO. G011/M-16-655

DATED DECEMBER 21ST, 2016

/s/Marcella Emeott

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