BEFORE THE MINNESOTA OFFICE OF ADMINISTRATIVE HEARINGS
600 NORTH ROBERT STREET
ST. PAUL, MINNESOTA 55101

FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION
SUITE 350
121 SEVENTH PLACE EAST
ST. PAUL, MINNESOTA 55101-2147

Beverly Jones Heydinger	Chair
Nancy Lange	Commissioner
Dan Lipschultz	Commissioner
Matthew Schuerger	Commissioner
John Tuma	Commissioner

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	MPUC Docket No. G-011/M-15-895 OAH Docket No. 2500-33191

POST-HEARING REPLY BRIEF OF THE MINNESOTA DEPARTMENT OF COMMERCE, DIVISION OF ENERGY RESOURCES

Dated: October 25, 2016

/s/ Linda S. Jensen
LINDA S. JENSEN
Assistant Attorney General
Atty. Reg. No. 0189030

445 Minnesota Street, Suite 1800
St. Paul, MN 55101-2134
Telephone: (651) 757-1472
Fax: (651) 297-1235
linda.s.jensen@ag.state.mn.us

ATTORNEY FOR MINNESOTA
DEPARTMENT OF COMMERCE,
DIVISION OF ENERGY RESOURCES

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I. INTRODUCTION

The Minnesota Department of Commerce, Division of Energy Resources, Energy Regulation and Planning Unit (Department or DOC) respectfully submits this Post-Hearing Reply Brief to provide the Administrative Law Judge (ALJ) and the Minnesota Public Utilities Commission (Commission) with analysis of the facts and law pertaining to the Petition of Minnesota Energy Resources Corporation (MERC or the Company) for Evaluation and Approval of Rider Recovery for Its Rochester Natural Gas Extension Project.

II. ARGUMENT

1. THE PROJECT IS ELIGIBLE FOR COST RECOVERY THROUGH THE NATURAL GAS EXTENSION PROJECT (NGEP) RIDER.

Rochester and the surrounding area meet the definition in Minn. Stat. § 216B.1638 (2016)[1] of an "inadequately served area" (DOC Ex. 410 at 3 (Heinen Summary)), and the Rochester Project is NGEP rider eligible because the Rochester Area is capacity constrained (DOC Ex. 405 at 58-59 (Heinen Direct)) and is at increasing risk of an unreliable supply of firm natural gas. MERC's Initial Filing demonstrated that in January of 2014, during the "Polar Vortex" event that struck the region, after interrupting its interruptible and transport customers, MERC exceeded its total firm contracted capacity at Rochester TBS 1D. MERC Ex. 1 at 2 (Initial Filing); *see also* MERC Ex. 12 at 6-7 (Mead Direct). Plainly, the Rochester area is "inadequately served" with respect to natural gas capacity.

The Office of Attorney General (OAG) proposes that the Rochester area is not "inadequately served" based on an analysis in which it suggests that the phrase, "inadequately served area" may be determined to be ambiguous and the NGEP statute inapplicable. The OAG offers a two-step process for finding the phrase "inadequately served area" to be ambiguous. In

[1] The "NGEP statute."

the first step, OAG proposes that the ALJ find the statutory phrase "inadequately served area" to be synonymous with the phrase "underserved area." The OAG provides no citation to authority or any evidence or discussion to support this first step. In the second step, OAG proposes that the ALJ adopt a definition of "underserved area" used in an article on natural gas line extensions[2] in which the author urges that "residential, business, agricultural, and industrial energy consumers … switch from oil, propane, and other fuels to natural gas." The article advocates:

> Switching to natural gas also may have broader public benefits, such as a cleaner environment, more reliable service, and economic development. With natural gas prices presently far lower than oil and propane prices, large-scale switching to natural gas could create public benefits substantial enough to warrant governmental actions.… Overall, switching to natural gas has the potential to save energy consumers substantial sums of money and contribute to a cleaner and more robust economy.

Line Extensions at iv. The article "focuses on fuel switching from oil and propane to natural gas that requires gas-line extensions" (*id.* at 2), and specifically promotes "grow[th of] gas usage in *underserved areas* that currently have gas mains." *Id.* at 1 (emphasis added). For purposes of his analysis of fuel switching, the author of the *Line Extensions* article distinguishes unserved areas (which he defines as areas having no access to natural gas) from underserved areas, and defines the phrase "underserved area" as one that "may have main lines nearby but many households and businesses that consume other forms of energy." *Id.* at 3.

The *Line Extensions* article does not claim that the phrase "underserved area" is a technical term of art in the industry, or that it is anything other than a phrase coined for purposes

[2] Ken Costello, *Line Extensions for Natural Gas: Regulatory Considerations* at ii (Feb. 2013)(*Line Extensions*). Mr. Costello's article describes the author as a researcher at the National Regulatory Research Institute (NRRI) of Silver Spring Maryland. The article's publication pre-dates passage of the NGEP statute.

of the article's discussion of issues surrounding the switching of customers to natural gas by means of gas-line extensions. Further, there is nothing in the evidentiary record of this 15-895 docket that further illuminates the author's use of the term "underserved area" in the *Line Extensions* article.

There is no evidence in the record to suggest that the phrases, "underserved area" or "inadequately served area" are synonymous, or to support a conclusion that the NGEP statute's use of the phrase "inadequately served area," means an area that "may have main lines nearby but many households and businesses that consume other forms of energy." There appears to be no basis to conclude that the *Line Extensions* article's use of the phrase "underserved area" should be deemed a technical term of art assigned the proposed special meaning.

The Department recommends that, consistent with Minnesota law, the phrase should be accorded its plain meaning. When interpreting a statute, Minnesota courts first determine whether the statutory language is clear or ambiguous. *State v. Moua*, 874 N.W.2d 812, 816 (Minn. Ct. App. 2016). A statute's words and phrases are to be given their plain and ordinary meaning. Minn. Stat. § 645.16 (2016); *State v. Koenig*, 666 N.W.2d 366, 372 (Minn. 2003). Where a statute is unambiguous in its plain meaning, as it is here, "the legislature's intent is 'clearly manifested by [the] plain and unambiguous language' of the statute," and further statutory construction "is neither necessary nor permitted." *State by Beaulieu v. RSJ, Inc.*, 552 N.W.2d 695, 701 (Minn. 1996) (*quoting Ed Herman & Sons v. Russell*, 535 N.W.2d 803, 806 (Minn. 1995); *State v. Rick*, 835 N.W.2d 478, 482 (Minn. 2013) (citation omitted). A statute is considered ambiguous only "if it is *reasonably* susceptible to more than one interpretation." *Current Tech. Concepts, Inc. v. Irie Enters., Inc.*, 530 N.W.2d 539, 543 (Minn. 1995) (emphasis added).[3] Here, the OAG's proposed two-step process for finding ambiguity based on a claimed special, technical meaning is not reasonable.

The phrase "inadequately served area," appears to mean, simply, an area that is *not* adequately[4] served. In this case, the NGEP Rider treatment is appropriate because the Rochester Area is not adequately served; it is capacity constrained and is at increasing risk of an unreliable supply of firm natural gas.

According the phrase "inadequately served area," its plain meaning is consistent with other Minnesota utility regulation laws, in which the terms "adequate" and "inadequate" abound, and are given their ordinary meaning. For example, Minn. Stat. § 216B.17 subd. 1 provides that, on its own motion or upon a complaint that service is *inadequate*, the Commission may make such investigation as it deems necessary. Minn. Stat. § 216B.01 declares it to be in the public interest that public utilities be regulated in order to provide the retail consumers of natural gas and electric service in this state with "*adequate* … services at reasonable rates." (emphasis added). Minn Stat. § 216B.04 requires public utilities to "furnish safe, *adequate*, efficient, and reasonable service." Minn. Stat. § 216B.23 subd. 2 authorizes the Commission to require that utilities provide reasonable service in lieu of service found to be unreasonable, *inadequate*, or

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[3] If the language of a statute is ambiguous, courts may look to other indicia of legislative intent to ascertain its meaning, including the reason for the statute, former versions of the statute, and legislative history regarding the language at issue. *Dupey v. State*, 868 N.W.2d 36, 39 (Minn. 2015). "The object of all interpretation and construction of laws is to ascertain and effectuate the intention of the legislature." Minn. Stat. § 645.16 (2016). In undertaking statutory construction, the court must assume that "the legislature does not intend a result that is absurd, impossible of execution, or unreasonable." Minn. Stat. § 645.17(1) (2016).

[4] "Inadequate" means:

- "not adequate to fulfill a need or meet a requirement; insufficient" *Amer. Heritage® Dictionary, 5th Ed*, *https://ahdictionary.com/word/search.html?q=inadequate;*
- "not adequate, insufficient, not capable", *www.merriam-webster.com/dictionary/inadequate;*
- "not enough, or not good enough for a particular purpose," *www.macmillandictionary.com/us/dictionary/american/inadequate.*

otherwise unlawful. Minn. Stat. § 216B.098 subd. 2 requires utilities to provide *adequate* notice to customers. The terms "adequate" and "inadequate" are used no less than twenty-six times in Minn. Stats. Ch. 216B, where they appear to have their ordinary and plain meaning, and "inadequate" simply means "not adequate."

The OAG also argues that, if the phrase "inadequately served area" has its ordinary meaning, the law would be so broad as to apply to most natural gas utilities' projects, which, the OAG states, would be an absurd result that utterly departs from the purpose of the statute. OAG Initial Brief at 82. The OAG argues that it is necessary to construe the NGEP statute not to be unreasonable or absurd. *Id.* at 82-85.

The Department disagrees that such a result would be absurd. The use of riders to facilitate cost recovery—even large cost recoveries—between rate cases is not extraordinary, inherently unreasonable, or a substantial departure from past practice. Riders are frequently used in this way. For example, Minn. Stat. § 216B.1692 creates a special emissions reduction rider and Minn. Stat. § 216B.1695 authorizes use of that rider for recovery of investment in certain large projects that cost in excess of $10 million.

Furthermore, if the legislature had intended to limit use of the NGEP rider in the fashion proposed by the OAG—solely for line extensions to extend the utility's natural gas distribution plant to homes and businesses that are located near gas mains but burn oil, propane or other fuels—it could easily have said so. It did not. The NGEP statute makes no reference to an objective of replacing the use of other fuels with natural gas usage. The statute makes no reference to propane. It is not absurd or unreasonable to assign the phrase "inadequately served area," its ordinary meaning, where there is no indication in the record or the law that "inadequate service" refers exclusively to service that uses fuel other than natural gas.

In summary, the phrase "inadequately served area" in the NGEP statute should be given its plain meaning: an area that is not adequately served. Rochester and the surrounding area is an "inadequately served area" because it is capacity constrained (DOC Ex. 405 at 58-59 (Heinen Direct)) and is at increasing risk of an unreliable supply of firm natural gas. The Rochester Project is NGEP rider eligible.

2. THE DEPARTMENT'S EVALUATION OF MERC'S RFP PROCESS SHOWED THAT MERC'S REQUEST FOR PROPOSAL (RFP) PROCESS WAS REASONABLE.

The Department reviewed MERC's RFP process, and concluded that it was a reasonable, comprehensive gauge of the market and potential alternatives for obtaining interstate pipeline services to the Rochester TBSs. The Department concluded that MERC made reasonable efforts to address this issue through the timing of the process and by allowing other bidders the opportunity to provide competitive bids on the Project. Overall, the Department concluded that MERC had demonstrated its RFP process to be fair and reasonable, and that MERC had negotiated reasonable provisions for ratepayers. DOC Ex. 402 at 14-15 (Ryan Direct); DOC Ex. 404 at 3 (Ryan Surrebuttal); DOC Ex. 409 at 1 (Ryan Summary).

The OAG states that the Department did not analyze "either the RFP or the RFP responses." OAG Initial Brief at 47, 49.[5] This statement is incorrect. As discussed in the Department's Initial Brief at 66 to 77, the Department carefully analyzed the RFP, and while the Department did not independently analyze each bid received in response, it is a mischaracterization to state that no analysis was done.

[5] Further, it appears that the OAG's disagreement regarding the size of the project led to this effort to discredit the Department's RFP review. OAG Initial Brief at 48 (OAG argues, "Mr. Ryan did not consider whether MERC's proposal is the proper size—the single most important factor in the reasonableness of the project.")

The Department evaluated MERC's RFP process to assess whether the RFP was inclusive of all potential responding parties, and whether the participating parties were held to a fair process. The Department reviewed the results of the RFP to determine whether MERC had selected the lowest cost option, and ensured there were reasonable provisions in the resulting contract to protect ratepayers. DOC Ex. 402 at 6 (Ryan Direct).

A. The Department Appropriately Evaluated MERC's RFP Process and Determined that the Request Was Inclusive of All Potential Parties and the Participating Parties Were Held to a Fair Process in the RFP.

The Department's witness, Mr. Ryan, based on his years of experience and training in working with natural gas RFPs, assessed the MERC RFP process. The Department concluded that MERC's RFP solicitation was reasonably inclusive of potential parties. The Department also reviewed the RFP and concluded that the participating parties were held to a fair process in the RFP. DOC Ex. 402 at 3-8 (Ryan Direct).

B. The Department Evaluated the Responses to the RFP and Determined that MERC Selected the Lowest Cost Option.

The Department reviewed the RFP responses and MERC's internal review[6] of the competitive bid process. DOC Ex. 402 at 9-10 (Ryan Direct) (*citing* DOC Ex. 403 at MR-6 and MR-1 (Ryan Highly Sensitive Trade Secret Direct) (MERC's Highly Sensitive Trade Secret Responses to OAG IR No. 132 and DOC IR No. 38)). The Department concluded that the weights MERC assigned in MERC's baseline summary document of the RFP results were reasonable, and that the information and weights to each category appeared reasonable. DOC Ex. 402 at 10 (Ryan Direct). The Department also reviewed the evaluation prepared by

[6] MERC's internal review was a high level summary of the pricing provided by suppliers along with other non-quantitative aspects that were factored into the Company's decision.[6] All categories were weighted with Project cost holding the majority of the weight. DOC Ex. 402 at 10 (Ryan Direct).

Mr. Sexton and concluded that Mr. Sexton's assumptions and additional cost component calculations were accurate. The Department was able to tie Mr. Sexton's statements to the responses provided by the bidding parties and confirmed the calculations. DOC Ex. 402 at 11 (Ryan Direct).

The Department determined that MERC's position, that Northern Natural Gas's (NNG's) Proposal 3.0 was the most competitive bid, was reasonable. DOC Ex. 402 at 11 (Ryan Direct). While the final amended negotiated transaction with NNG (which included the phased approach) increased the total cost of the Project in nominal dollars as a result of delaying Phase 1 of the Project, the delay resulted in an increased capital cost of less than 5 percent. DOC Ex. 402 at 12 (Ryan Direct) (*citing* MERC Ex. 12 at 15 (Mead Direct)). Mr. Ryan stated that these capital cost increases did not have a material impact on the results of the RFP process and NNG would still have prevailed relative to the other bids even with these increased cost. DOC Ex. 402 at 12 (Ryan Direct).

C. Summary

The Department analyzed the RFP and responses to the RFP. Based on his analysis, Mr. Ryan generally concurred with Mr. Sexton's Direct Testimony regarding the RFP conducted by MERC. The RFP process was a comprehensive gauge of the market and the potential alternatives for interstate pipeline services to the Rochester town border stations (TBSs). While other pipelines may have difficulty serving Rochester, MERC made reasonable efforts to address this issue through the timing of the process and by allowing other bidders the opportunity to provide bids on the Project. DOC Ex. 402 at 14-15 (Ryan Direct). MERC selected the lowest cost option. The Department continues to recommend that the Commission find that MERC's RFP process was fair and reasonable, and that MERC negotiated reasonable provisions for ratepayers in Rochester and elsewhere in MERC's system. DOC Ex. 402 at 14 (Ryan Direct); DOC Ex. 404 at 3 (Ryan Surrebuttal); DOC Ex. 409 at 1 (Ryan Summary).

3. THE ROCHESTER PROJECT IS PRUDENT AND REASONABLE.

A. MERC Can Mitigate Cost Increases Caused by Increased Capacity Costs.

Although the Department concluded that the Project is reasonable, and the excess capacity costs are not significant, the Department also concluded that, because capacity costs are typically recovered through the demand portion of the purchased gas adjustment (PGA) and it would be expected that MERC's firm customers would pay for the costs of excess capacity, MERC should take all reasonable steps to mitigate cost increases where possible. DOC Ex. 405 at 46, 59 (Heinen Direct); DOC Ex. 410 at 6 (Heinen Summary).

As noted in the Department's Initial Post Hearing Brief at 55-58, various methods exist to mitigate capacity costs for sales customers, including long-term capacity release contracts, assessment of the cost of capacity to interruptible customers, movement of customers to firm service, and potential sales of supplies to electric generation customers. DOC Ex. 405 at 47-48, 59 (Heinen Direct); DOC Ex. 410 at 6 (Heinen Summary). Because MERC has procured 100 percent of the incremental capacity associated with the Project in the Rochester Area, any party, including Rochester Public Utilities (RPU), wishing to use additional capacity in the Rochester Area should be required to pay for the capacity costs associated with the Project. DOC Ex. 410 at 6-7 (Heinen Summary). MERC should be proactive in finding potential purchasers of firm capacity from the electric industry as natural gas becomes a more attractive generation source. DOC Ex. 405 at 59-60 (Heinen Direct). Calculations in the Heinen Surrebuttal indicate that MERC's procurement of excess capacity may reduce, or mitigate, excess capacity costs from between $5 million (under MERC's estimate) and $15 million (under the Department's preferred case estimate) through 2040. DOC Ex. 410 at 7 (Heinen Summary).

The Company agreed to explore the capacity release market and to review its tariff books to determine whether changes should be made to facilitate the movement of customers from interruptible to firm service. DOC Ex. 410 at 6 (Heinen Summary). MERC agreed with the Department that "transport customers should be charged at a level that appropriately reflects the benefits they will receive as a result of the overall project" and committed to "make every effort to obtain the best available contract terms for release of excess capacity." 1 Tr. at 20.

The OAG mischaracterizes the Department's position as one in which the provision of service to interruptible and transportation customers is used to establish need for the project. OAG Initial Brief at 68-72. It implies that the Heinen Surrebuttal discussion of reserve margins pertained to planning for peak demand. *Id.* at 70. OAG takes issue with this so-called Department position, arguing it would be "unreasonable to justify" the Rochester Project based on "expected increase in consumption by interruptible or transportation customers." *Id*. at 71.

This is a strawman argument against a position that is not the Department's, and it safely can be disregarded by the ALJ. The Department's Surrebuttal discussion of interruptible and transportation customers simply addressed the reserve margin issue; it was not directly related to establishing need. As noted above, the Department's Direct Testimony concluded that the Project is reasonable, and the excess capacity costs were not significant. Based on its reserve margin analysis and its analysis of incremental capacity alternatives, the Department specifically concluded in its Direct Testimony that the size of MERC's proposed Project was reasonable. DOC Ex. 405 at 36 (Heinen Direct); DOC Ex. 406 at 1-3 (Heinen Rebuttal). The Department's position in Direct was that excess capacity costs associated with the Project as proposed by MERC were relatively small on an annual basis and were comparable to insurance against the potential costs of future system upgrades, and further, that there were methods by which MERC could mitigate those costs of excess capacity. DOC Ex. 405 at 36-37 (Heinen Direct). The Department's Surrebuttal Testimony did not modify its position that the proposed project was reasonable, but merely updated its excess capacity analysis (DOC Ex. 407 at 16 (Heinen Surrebuttal)) and concluded that expected usage by RPU, coupled with the fact that MERC had acquired 100 percent of incremental capacity in the Rochester Area, would likely result in a diminution of excess capacity related to the proposed Project. DOC Ex. 407 at 16 (Heinen Surrebuttal). That is, because MERC has obtained 100 percent of the incremental capacity in the Rochester Area, no other supply of natural gas capacity exists, and all customers, including new transportation customers in the area, should pay their fair share for the capacity costs of the Project. DOC Ex. 410 at 5 (Heinen Summary); Department Initial Brief at 60-65. In Surrebuttal, the Department explained that MERC should be able to obtain near full or full rate recovery in the capacity release market because the third-party marketers with which transportation customers contract can buy only from MERC capacity deliverable in the Rochester Area. As a result, if MERC correctly negotiates capacity releases, these transportation customers will pay for capacity costs. DOC Ex. 407 at 13 (Heinen Surrebuttal); DOC Ex. 410 at 5-6 (Heinen Summary).

MERC agreed that the Commission should require MERC to provide data for each capacity release associated with the Rochester Area over the most recent gas year in its future AAA filings and in the annual rider recovery filing in this 15-895 docket. The Department anticipates reviewing the releases to determine if the terms of the capacity release were reasonable based on market conditions. DOC Ex. 407 at 14 (Heinen Surrebuttal); 1 Tr. at 20.[7]

B. The Commission Should Establish, for Purposes of Rider Recovery, a Soft Cost Cap.

Although the Commission deferred a decision on the accuracy of MERC's revenue-deficiency calculation until the Company seeks approval of an NGEP rider to recover the specific revenue deficiency, MERC has the burden in this docket to show the prudency and reasonableness of the estimated costs, given MERC's stated intention to seek recovery in the future. The Department recommends that the Commission find that the estimated costs of the project, as proposed, are reasonable and prudent; establish, for purposes of rider recovery, a soft cost cap for this Project of $44,006,607[8] ((DOC Ex. 405 at 59 (Heinen Direct); DOC Ex. 410 at 3 (Heinen Summary); DOC Ex. 407 at 15 (Heinen Surrebuttal); Evidentiary 2 Tr. at 10:24 to 11:2 (Heinen)); and, find that the reasonableness and prudency of any costs in excess of $44,006,607 including the contingency factor can be considered when MERC proposes to recover the costs in base rates. DOC Ex.405 at 43 (Heinen Direct); DOC Ex. 407 at 7 and 10 (Heinen Surrebuttal).

The OAG appears to argue against a finding in this docket of reasonableness and prudency; it bases this argument, in part, on a concern that in a future proceeding, denial of any requested recovery may "be much more challenging." This concern is overstated. The

[7] Further, all MERC customers, including interruptible customers, need to pay their fair share, as suggested by the NGEP statute. Expanding the capacity of NNG's system makes it less likely, all else equal, that interruptible customers will be interrupted. The Department's recommendation that MERC appropriately assess the cost of capacity to interruptible customers and take steps to move interruptible customers to firm service, will prevent these customers from avoiding paying their share of costs to expand the capacity to the Rochester Area to the harm of other ratepayers. DOC Ex. 405 at 50 (Heinen Direct).

[8] This figure is inclusive of a 20 percent contingency factor. DOC Ex. 410 at 3 (Heinen Summary).

procedure employed in this docket is the same employed in other similar dockets in which rider treatment is allowed by a specific statute.

In this docket, the prudency of the estimated expenses is to be evaluated, and in a subsequent proceeding the Commission will consider rate recovery, and in that proceeding, the Commission will determine whether the utility has met its burden to show the reasonableness of recovering particular costs from ratepayers. This was the same process used, for example, in *In the Matter of Otter Tail Power Company's Request for Approval of its Environmental Upgrades Cost Recovery Rider for the Big Stone Plant*, Docket No. E-017/M-13-648. There, the project and particular costs were reviewed for prudency and reasonableness under a then-newly amended law, Minn. Stat. § 216B.1692 subd. 1(b). This review followed an earlier contested case proceeding in Docket No. E017/M-10-1082, which had been conducted consistent with Minn. Stat. § 216B.1695, in which the project and its *estimated* costs had received an "advance determination of prudence." In its Order dated December 18, 2013 in Docket 13-648, the Commission adopted the recommendations of the Department and allowed rider recovery for only a portion of the company's requested recovery. Order at 1 (excluding rider recovery for a baghouse and activated carbon injection (ACI) system costing in excess of $40 million).

The Commission has tools with which it can assess the reasonableness of particular costs in a subsequent proceeding. The ALJ's finding of prudency or imprudency in this proceeding need not be colored by speculation that the Commission might inadequately conduct its future review of Rochester Project costs.

C. Size Is the Only Relevant Similarity between the Rochester Project and the MERC 2008 Bison Contract.

In 2008, MERC sought to diversify its supply of natural gas on its system and increase reliability, and entered into a contract that allowed MERC to procure gas priced off of the

Colorado Interstate Gas (CIG) index price; at the time MERC decided to enter into the contract, the delivered cost of gas under the contract, including the commodity cost, was the least-cost option available to MERC.[9] Events occurring to gas markets beginning on July 1, 2008, however, caused the contract not to be as advantageous for MERC's customers as MERC had initially contemplated. Because the prudency or imprudency of actions of a regulated utility are assessed based on the situation that exists at the time costs are incurred, and are not based on hindsight, the Department recommended that the Bison contract was not unreasonable when entered into by MERC in 2008.[10] The Department further observed that "when total price is considered, the Bison Contract did not harm ratepayers and was prudently incurred at the time."[11] The Commission agreed, adopted the Department's recommendations, and approved MERC's recovery of costs of the Bison contract as recommended by the Department.[12]

Mr. Heinen explained at trial that the only relevance of the Bison contract to the present docket was that a comparison of the relative level of costs of the two situations helps put the Rochester Project capacity costs in perspective, by comparing those costs to another project that MERC ratepayers are already being assessed.[13] The two costs are similar in amount, ($38 per year for Bison and $32 per year for the Rochester Project), as Mr. Heinen explained in his Direct Testimony:

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[9] MPUC Dockets M-10-1166 and M-10-1168, Comments of the Department dated Nov. 15, 2011 at 2, 3 (Nov. 15 Comments); 2 Tr. 54-55.

[10] Nov. 15 Comments at 3, 4; 2 Tr. 55. The Department further recommended that, to ensure that all customers, including transportation and interruptible customers, paid a fair share of costs, the cost recovery by MERC should be through the commodity portion of the PGA, not the demand portion. Nov. 15 Comments at 9.

[11] Nov. 15 Comments at 4.

[12] MPUC Dockets M-10-1166 and M-10-1168, Order, January 21, 2015 at 2, and at Ordering Paras. 6 and 7.

[13] 2 Tr. at 55.

> For additional perspective, MERC-NNG ratepayers have been assessed the Bison Pipeline contract since November 2010, which is recovered through the commodity portion of the PGA and has only been used at levels far below the full contracted capacity to deliver supplies to MERC ratepayers. In the Company's Response to DOC IR No. 36, MERC stated that the average costs of the Bison Contract for Residential customers is $38.09 per year, while total capacity costs for the Rochester project will reach $32.16 per year for Residential customers. The excess capacity costs for this project are embedded in the $32.16 figure, so, for comparative purposes, the excess costs of the not fully used Bison Contract, which ratepayers have been assessed for several years, are likely greater than the potential excess capacity costs associated with the Rochester project.

DOC Ex. 405 at 36 and AJH-20 and AJH-21 (Heinen Direct).

The OAG mischaracterizes the Bison contract as one involving "unreasonable costs," and implied that a thorough investigation could have been conducted (but was not). OAG Initial Brief at 75. In making this argument, the OAG fails to acknowledge that the Commission did, in fact, investigate those costs in the 10-1166 and 10-1168 Demand Entitlement dockets, determined that the Bison contract was not unreasonable, and approved recovery from ratepayers of costs associated with it.[14]

While a comparison of the similar sizes of the cost recoveries relating to the Bison contract and the Rochester Project is informative of how the Commission may evaluate such costs, the similarity of the two situations need not be overstated. The Department recommends that the ALJ disregard inaccurate characterizations of the Bison contract.

D. Several Factual Observations in Initial Briefing Are Immaterial and Should Be Disregarded by the ALJ.

First, with respect to the reserve margins, the relevant concern is what the total system reserve margin is. The OAG Initial Brief at page 9 discusses a reserve margin in the Rochester Area, and at page 10 appears to confuse total system with local area reserve margins. This

[14] Dockets M-10-1166 and M-10-1168, Order, January 21, 2015.

discussion is not helpful to the analysis. Reserve margins need to be evaluated and addressed on a total system basis.

Second, at page 10, the OAG Initial Brief discusses the reserve margin in the Rochester Area and appears to imply that the amount of that reserve margin is excessive because it is “ten times” greater than the “industry standard.” Whether a given amount of reserve margin in a particular situation corresponds with overall industry averages is not particularly helpful to analysis of the potential reserve margins in this docket; by its nature, natural gas capacity cannot be acquired in graduated amounts; it is acquired in increments that should not only address immediate needs, but include reasonable reserves for the future.

Third, forecasting in regulated utilities involves planning for peak demand. The OAG Initial Brief at page 13 urges the ALJ to consider planning for non-peak demand, implying that such planning is relevant. It is not.

Fourth, the OAG Initial Brief accurately summarizes on page 21 weather normalized calendar sales data for 2007 to 2015. It should be noted, however, that the summary is skewed due to selection of the start and stop dates of the summary. In the final year, 2015, a year of unusually warm weather, the percentage of change in sales was a negative 12.77 percent change, which very significantly affects the overall average change of 0.46 percent. Without the 2015 year skewing the average, a more reasonable growth of 0.75 percent would be the average, which is the growth calculated by Mr. Heinen. DOC Ex. 405 at 27 (Heinen Direct).

Fifth, at page 30 the OAG Initial Brief characterizes Mr. Heinen’s testimony on the Company’s consideration of the Destination Medical Center (DMC) as contradictory. This assertion is not correct. Mr. Heinen was very clear about the methodology used by MERC. Mr. Heinen accurately explained that MERC’s sales and demand projections did not *explicitly* account for potential growth associated with the DMC. MERC's sales and demand projections generally assumed that the DMC would not exist in the future period because the projections relied upon historical data, without adjustments in the forecasting period, to estimate future sales and load. DOC Ex. 405 at 11 (Heinen Direct) (*citing* MERC Ex. 9 at 13 (Clabots Direct)). Mr. Heinen specifically clarified that the impacts of the DMC nevertheless would "be *implicit* because the Company included regional demographic and economic factors when it estimated and forecast sales for certain rate classes." DOC Ex. 405 at 11 (Heinen Direct) (emphasis added). Mr. Heinen's description is an accurate statement about how the DMC figures into MERC's Sales and demand projections, and there is no inconsistency between his Direct and Surrebuttal Testimony on this topic.

III. CONCLUSION

The Department respectfully requests a recommendation from the Administrative Law Judge and an Order from the Commission consistent with the analyses, and recommendations as addressed in the Department's testimony and with its Initial and Reply Briefs.

Dated: October 25, 2016

Respectfully submitted,

/s/ Linda S. Jensen

LINDA S. JENSEN
Assistant Attorney General
Atty. Reg. No. 0189030

445 Minnesota Street, Suite 1800
St. Paul, MN 55101-2134
Telephone: (651) 757-1472
Fax: (651) 297-1235
linda.s.jensen@ag.state.mn.us

ATTORNEY FOR MINNESOTA
DEPARTMENT OF COMMERCE,
DIVISION OF ENERGY RESOURCES