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December 30, 2016

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VIA ELECTRONIC FILING

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 Seventh Place East, Suite 350
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Re: Reply of Minnesota Energy Resources Corporation to Exceptions to
Administrative Law Judge's Findings of Fact, Conclusions of Law and
Recommendations

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 Nos. G011/M-15-895
OAH Docket No. 68-2500-33191

Dear Mr. Wolf:

Enclosed, please find Minnesota Energy Resources Corporation's Reply to the
Exceptions of the Minnesota Office of the Attorney General – Residential Utilities and
Antitrust Division ("OAG") filed on December 20, 2016.

These documents have been filed via the e-docket system and served as specified by
the enclosed service list. Please contact me at mkrikava@briggs.com or (612) 977-8566 if
you have any questions regarding this filing.

Very truly yours,

/s/ Michael C. Krikava
Michael C. Krikava

Enclosure
Cc: Service List

**STATE OF MINNESOTA
BEFORE THE
MINNESOTA PUBLIC UTILITIES COMMISSION**

Beverly Jones Heydinger
Nancy Lange
Dan Lipschultz
Matthew Schuerger
John Tuma

Chair
Commissioner
Commissioner
Commissioner
Commissioner

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Energy Resources Corporation for Evaluation
and Approval of Rider Recovery for its
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**MINNESOTA ENERGY RESOURCES CORPORATION'S
REPLY TO THE EXCEPTIONS OF THE OFFICE OF THE MINNESOTA ATTORNEY
GENERAL**

December 30, 2016

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I. INTRODUCTION

Minnesota Energy Resources Corporation (“MERC” or the “Company”) respectfully submits to the Minnesota Public Utilities Commission (“Commission”) this Reply to the Exceptions of the Minnesota Office of the Attorney General – Residential Utilities and Antitrust Division (“OAG”) filed on December 20, 2016. In its Exceptions, the OAG effectively seeks complete repudiation of the Administrative Law Judge’s (“ALJ”) November 30, 2016, Findings of Fact, Conclusions of Law, and Recommendation (“ALJ Report”). The OAG’s repeated barrage on the accuracy and completeness of the ALJ Report is merely an attempt to re-argue the unsupported and erroneous positions presented in its testimony and post-hearing briefs. The OAG seeks to add, revise, or delete more than 70 of the ALJ’s Findings and completely rejects the ALJ’s Conclusions and Recommendations, all under the guise that the 94-page ALJ Report is somehow not thorough. Contrary to the OAG’s aspersions, the ALJ Report is a model of thoroughness and well-reasoned fact finding.

The ALJ simply did not agree with the OAG or accept the OAG’s positions. The ALJ Report appropriately reflects that disagreement and that the ALJ recognized that MERC satisfied its burden of establishing that the Rochester Project, as proposed, is a reasonable and prudent system addition under all of the circumstances.

The lengthy ALJ Report demonstrates the ALJ’s thorough review and understanding of the extensive record that was developed in this proceeding, a detailed consideration and understanding of the parties’ positions and thoughtful analysis of the complex issues of first impression. The ALJ fully considered the record evidence and positions of the parties, and upon weighing the evidence and law, properly recommended rejection of the OAG’s positions,

ultimately finding MERC had demonstrated by a preponderance of the evidence that the Rochester Project is necessary, reasonable, and prudent.¹

Further, there is nothing new in the OAG's Exceptions, as they amount only to a rehash of the same arguments that the ALJ found unpersuasive. MERC fully addressed the OAG's arguments in detail in the testimony and briefs submitted in this proceeding and the ALJ, after careful consideration, reasonably rejected the positions and arguments raised by the OAG. MERC submits this limited Reply to highlight a few areas of significance that support the ALJ's Conclusions and support rejection of the OAG's Exceptions. While it is ultimately the Commission's role to weigh the policy considerations in its determination of the issues presented in this proceeding, the ALJ Report reflects a meticulous balancing of those relevant policy considerations in light of the applicable law and the robust record evidence presented. Nothing raised in the OAG's Exceptions supports the OAG's position that the ALJ's Conclusions and Recommendations should be disregarded.

II. THE OAG'S CRITICISMS OF THE ALJ REPORT ARE WITHOUT MERIT

In its Exceptions, the OAG maintains that the ALJ Report should be given limited weight and that the Commission should perform an independent review of the full record because there is no Commission precedent or established rules or guidelines that are directly on point under the Natural Gas Extension Project Statute, Minn. Stat. § 216B.1638 ("NGEP Statute").² Such argument directly contradicts the OAG's prior position and the Commission's referral of this matter to the Office of Administrative Hearings ("OAH"). As discussed in the Commission's February 8, 2016, Notice of and Order for Hearing:

¹ ALJ Report at 92 (Conclusion 9).

² OAG Exceptions at 1.

The Commission finds that it cannot satisfactorily resolve all questions regarding the Rochester Project on the basis of MERC's filings. Evaluating the reasonableness and prudence of the project will involve factual determinations, policy decisions, and the first interpretation of a new statute. The development of a comprehensive, disciplined record by an administrative law judge will greatly aid the Commission's decision-making in this matter. The Commission will therefore refer MERC's petition to the OAH.³

Indeed, the OAG pushed for a contested case, stating:

MERC's request is unique, it involves the first ever interpretation of a new law, it involves factual issues that are traditionally resolved through a contested case, and reaching a final decision will require many determinations on complex issues of fact and policy. It would be a disservice to MERC's ratepayers to attempt to complete this case without the level of analysis and care that is available in a contested case.⁴

Now, after the ALJ, the Company, the Department, and other parties have committed significant time and resources to developing a comprehensive record on the relevant issues presented in this proceeding,⁵ the OAG seeks to disavow the ALJ's extensive Findings and thorough analysis. Given the evolution of the OAG's position, it is transparent that the OAG objects to the ALJ Report, not because the Report is incomplete or inadequate, but because the ALJ concluded that the OAG's positions and arguments were without merit.

III. THE RECORD SUPPORTS THE NEED FOR THE ROCHESTER PROJECT

The OAG takes exception to the ALJ's Findings and Conclusions regarding the need for the Rochester Project, arguing that the ALJ Report did not provide a complete description of the

³ *In the Matter of a Petition by Minn. Energy Res. Corp. for Evaluation and Approval of Rider Recovery for Its Rochester Nat. Gas Extension Project*, Docket No. G011/M-15-895, NOTICE OF AND ORDER FOR HEARING at 4 (Feb. 8, 2016).

⁴ *In the Matter of a Petition by Minn. Energy Res. Corp. for Evaluation and Approval of Rider Recovery for Its Rochester Nat. Gas Extension Project*, Docket No. G011/M-15-895, Comments of the Office of the Attorney General at 8 (Nov. 25, 2015) (Document ID 201511-115963-01).

⁵ In addition a substantial initial Petition, Direct, Rebuttal, and Surrebuttal Testimony, and post-hearing Briefs, MERC provided considerable information and data through the discovery process, including responses to over 150 information requests.

OAG's responses to MERC and the Department's positions, that the ALJ Report omits relevant facts, and that the ALJ incorrectly applied low, medium, and high-growth scenario labels to the parties' recommendations, resulting in a "misapplication of legal standards."⁶ Contrary to the OAG's assertions, however, the ALJ Report reflects full consideration of the OAG's arguments, and rejection of those arguments based on consideration of all relevant record evidence.

With respect to the OAG's claims that the ALJ Report omits important, relevant facts, the additional "facts" the OAG proposes should be included do not accurately reflect the record evidence and should be rejected. For example, the OAG proposes an additional finding 74a regarding MERC's reliance on Moody's Analytics data as follows:

74a. MERC also stated that *the forecast for firm sales included the LCI Customer Forecast Model which included a GSP variable or Gross State Product variable.*⁷ The Company's sales forecaster stated that the forecast relied on economic and demographic variables produced by Moody's Analytics. In response to OAG information requests MERC state that the Moody's forecasts "presumably reflect some assumption about the impact of the DMC plan" but the Company "cannot determine the degree of that impact for any particular variable."⁸

However, this proposed additional finding does not accurately reflect the record evidence as MERC has clearly stated that its forecasted need was *not* impacted by the Large C&I customer model. As MERC discussed in detail in its Reply Brief:

The OAG also alleges that MERC's use of Moody's Analytics data incorporates impacts related to the DMC and, therefore, is inconsistent with the Company's statements that *a priori* information was used as a check on the reasonableness of its models. But MERC's Initial Petition was also clear about its use of data from Moody's Analytics. As shown on pages 77-78 of MERC's Initial Petition, only the Large C&I customer count

⁶ OAG Exceptions at 10; *see also* OAG Exceptions at 3-13.

⁷ Ex. 1, LCI Customer Forecast Model Attachment C 10 (Petition).

⁸ OAG Exceptions at 3 (Citing Ex. 311, Schedule JAU-SR-1, MERC's Response to OAG 116 (Urban Amended Surrebuttal)) (emphasis added).

model used an economic variable from Moody's (Gross Metro Product ("GMP")). The Residential and Small C&I models *did not use any Moody variables*, so no DMC impact was modeled. Since the Large C&I sales model is a total sales model, the Large C&I customer count model did not play a role in determining the growth rate of 1.5 percent.⁹ Thus, there was nothing about the Moody's data that influenced MERC's projected growth rate.¹⁰

The OAG also proposes to modify ALJ Finding 113 to delete language quoted directly from the Department witness's testimony. In particular, the OAG proposed the following change:

According to the Department, its customer count forecast is approximately ~~1.14 percent less~~ 60 percent less than the Company's projections of 1.89 percent.¹¹

Given that the finding is discussing the testimony and evidence "according to the Department," it is nonsensical that the OAG proposes to modify the language as directly quoted from the Department's testimony.¹²

It is unclear why the OAG proposes to recast the record with respect to MERC's and the Department's forecast analyses, except for an attempt at obfuscation. Because the proposed revisions would not accurately reflect the testimony and evidence, such changes are both unnecessary and unwarranted. The OAG's proposal to incorporate additional findings and revise existing findings should be rejected.

Similarly, the OAG's assertion that the ALJ Report does not fully reflect the OAG's rebuttal positions regarding the need for the Rochester Project is without merit. For example, the

⁹ Ex. 1 at 77-78 (Initial Filing – Rochester Project Rider Petition). The Interruptible and Transport models also used GMP but are not firm so these did not impact the 1.5 percent growth rate either.

¹⁰ MERC Reply Brief at 11-12.

¹¹ OAG Exceptions at 4.

¹² Ex. 405 at 27 (Heinen Direct) ("My forecast results suggested an increase in retail customer counts of approximately 0.75 percent per year in the forecasting period, which was approximately 1.14 percent less than the Company's projections of 1.89 percent.").

OAG argues the ALJ Report did not fully address the OAG's position taken in its Reply Brief that "[w]hile the Company argued that 2014 and 2015 should not be included because of unusual weather events, the OAG argued that it would not make sense to exclude data as a result of unusual data because the entire data set has been weather normalized."¹³ Contrary to the OAG's assertion, MERC did not take the position that 2014 and 2015 should be excluded because of unusual weather events but, instead, provided additional data points to illustrate the challenges of fully weather normalizing historical data. The ALJ fully addressed both MERC's and the OAG's positions regarding historic data in Findings 125 to 134, and rejected the OAG's position based on consideration of the relevant facts, as reflected in Finding 175:

The record also reflects that the average compound growth rate for sales from 2007-2014 was significantly higher, 2.28 percent, but fell to 0.27 percent for 2007-2015. The OAG focuses on the average growth rate from 2007-2015 to argue that MERC's forecast is too high, but fails to recognize that the unusually low number is likely caused in part by the El Niño effects in 2015.¹⁴ As explained by MERC witness, David Clabots, these differences in the average compound growth rates for 2007-2013, 2007-2014, and 2007-2015 reflect, at least in part, the challenges associated with fully weather normalizing historical sales under extreme weather situations.¹⁵ In addition, the swings in the data support MERC's projected growth rate of 1.5 percent rather than a lower rate as suggested by the OAG. MERC must be able to meet the actual demand on the coldest day, not the average demand over time.¹⁶

The OAG also claims that its arguments were not adequately addressed with respect to MERC's Residential Use-Per-Customer forecast, use of *a priori* information, and design day growth rate.¹⁷ These claims are without merit. The ALJ Report fully considered the OAG's

¹³ OAG Exceptions at 5 (Proposed Finding 133a) (citation omitted).

¹⁴ Ex. 11 at 6 (Clabots Surrebuttal).

¹⁵ *Id.* at 6-7.

¹⁶ ALJ Report at 32.

¹⁷ *See* OAG Exceptions at 5-8.

arguments and positions and rejected those positions based on the record as a whole. MERC also notes that OAG's proposed additional finding 133b¹⁸ does not include any citation to the record. While this proposed additional finding does not alter the weight of the evidence and support for the ALJ's Conclusions and Recommendations with respect to the need for the Project, it does not include or reference any support in the record and should therefore be rejected.

With respect to the OAG's alternative forecast analysis, the OAG claims that the ALJ Report does not "accurately state the conclusion that the OAG draws from the modified forecast results."¹⁹ This non-sequitur attempts to draw a distinction where one simply does not exist. Ultimately, the OAG's position necessarily must be that its alternative forecast should be relied upon to support a finding that the Rochester Project is not necessary to provide natural gas service to MERC's customers.²⁰ To now argue that the ALJ misunderstood its position about the "use" of its alternative forecasting work is revisionist history in the extreme.

Even if the Commission concluded such distinction were somehow relevant to its evaluation, the ALJ Report reflects substantial justification for the conclusion that the OAG's alternative forecast work was unsupported in light of the record evidence and should not be given any weight. The ALJ correctly recognized that the OAG's attempts to rely upon its claim of a *negative* 0.092 percent growth rate lacked credibility and was unreliable.²¹

¹⁸ See OAG Exceptions at 5.

¹⁹ OAG Exceptions at 8.

²⁰ The OAG now argues that the ALJ Report inaccurately assumed that "the modified forecast results should be used. Instead, the OAG noted that the more important point is that there are significant concerns with MERC's forecast, and that when those concerns are addressed the resulting forecast is somewhere between 50 and 100 percent lower." OAG Exceptions at 8 (Proposed Finding 166a) (citation omitted).

²¹ ALJ Report at 32-33 (citations omitted).

177. The record does not support use of the negative 0.092 percent growth rate presented in the OAG's testimony. The Administrative Law Judge concludes that this estimate is not reasonable

Additionally, the OAG's assertion that "[t]he ALJ incorrectly applies low-, medium-, and higher-growth scenario labels to the parties' recommendations . . . when none of the parties presented their projections in such a fashion,"²² is simply wrong. As accurately reflected in the ALJ Report, both MERC and the Department discussed forecasted need in terms of low growth, base growth, and high growth scenarios.²³ The record is replete with references that MERC's forecast could be considered an "optimistic" or high-growth scenario, while the Department's forecast could properly be considered a "status quo" or "conservative" forecast.²⁴ At no time did the OAG object to this characterization or the discussion of the use of a range of forecasts.

Indeed, the OAG's argument in its Exceptions is explicitly contradicted by the Surrebuttal Testimony of Department witness Adam Heinen:

In integrated resource plans (IRP) and certificate of need (CON) filings, the forecast or need analyses typically include low-growth, base-growth, and high-growth scenarios. Generally, any of these forecasts, or results in between, are considered acceptable with the base case being the most likely scenario.²⁵

for purposes of projecting MERC's future need for several reasons. First, as noted above, MERC's Design Day in its NNG PGA area has grown an average of 1.33 percent per year from 2006/2007 to 2015/2016. In addition, the evidence in the record suggests that the DMC plan will lead to substantial growth in the Rochester area. Finally, as noted by MERC's expert, "[c]hanging variables in isolation, . . . , risks inconsistent and potentially skewed results." In fact, when MERC used the OAG's assumptions and updated the forecast tables to include 2015 weather normalized actual sales rather than forecasted 2015 sales, the average retail sales growth rate was positive 1.1 percent as opposed to negative 0.092 percent.

178. For these reasons, the forecast of negative 0.092 percent growth in sales is not reasonable for use in estimating growth in Design Day. It is critical that MERC have sufficient capacity to meet peak demand of firm customers on extremely cold days. In the view of the Administrative Law Judge, use of a negative 0.092 growth rate to estimate future Design Day growth would place MERC's customers at real risk of not having sufficient capacity if Design Day conditions occur.

²² OAG Exceptions at 9.

²³ See ALJ Report at 31-33.

²⁴ E.g., Ex. 407 at 3-6 (Heinen Surrebuttal).

²⁵ Ex. 407 at 6 (Heinen Surrebuttal).

And as discussed in MERC's briefs and reflected in the record, the parties to this proceeding, including the OAG, agreed that the Certificate of Need rules provide a useful framework for evaluating MERC's petition.²⁶ Given the OAG's agreement that the Certificate of Need procedures provide useful guidance for the analysis used to review and assess the need for the Rochester Project, it is curious that the OAG now objects to the parties' and the ALJ's assessment of the need for the Project based on a range of potential forecast scenarios.

In summary, nothing in the OAG's Exceptions support modification of the ALJ's Findings or Conclusions with respect to the need for the Rochester Project. The ALJ Report fully and accurately reflects the facts and analysis on the record and the arguments and positions of the parties with respect to need. The ALJ reasonably concluded, upon consideration of all relevant facts and arguments that:

the record supports the Department's estimate of 1.0 percent as a base growth projection in Design Day growth and MERC's forecast of 1.5 percent as a high-growth projection in Design Day growth.²⁷ The OAG's projection that sales growth will be negative 0.092 percent is not reasonable for use as a low-growth estimate of future Design Day growth.²⁸

As recognized by the OAG in its November 25, 2015, Comments in this proceeding:

Some of the central issues in the case, including sales growth forecasting and need analysis, involve factual situations that the Commission typically resolves using contested case proceedings, including sworn testimony, cross examination of witnesses, and recommendations by an administrative law judge. The

²⁶ MERC Initial Post-Hearing Brief at 24 (citing Evidentiary Hearing Transcript, Vol. 1 at 170:12-21 (Urban) (acknowledging that the certificate of need procedures are analogous to the current proceeding and provide "useful guidance" on how to implement the NGEPS Statute)); Ex. 300 at 6 (Amended and Corrected Urban Direct) ("While MERC does not need to obtain a CN for the Rochester Project, the CN process can still provide useful guidance on what analysis will be useful in this case.").

²⁷ See Ex. 407 at 29-30 (Heinen Direct); Ex. 12 at 21 (Mead Direct).

²⁸ ALJ Report at 31 (Finding 170) (citing Ex. 311 at 3 (Urban Amended Surrebuttal)).

Commission handles those issues with a contested case for good reasons: they require expert analysis that is extremely technical.”²⁹

In this case, the ALJ fully weighed the technical analysis and testimony from three experts and, based on careful review of the evidence presented, made a well-reasoned and well-supported Conclusion and Recommendation regarding the need for the Rochester Project. Nothing raised by the OAG in its Exceptions supports modification of those Conclusions and Recommendations.

IV. THE RECORD SUPPORTS THE REASONABLENESS OF THE ROCHESTER PROJECT

A. The Request for Proposal (“RFP”) Process

The OAG also takes exception to the ALJ’s Findings and Conclusions regarding MERC’s Request for Proposal (“RFP”) design, process, and selection, arguing that the ALJ Report did not provide a complete description of the OAG’s responses to MERC and the Department’s positions.³⁰ Once again, contrary to the OAG’s assertions, the ALJ Report fully reflects the OAG’s arguments and responses and rejects them based on the record evidence taken as a whole. The OAG’s Exceptions raise no relevant facts or arguments not already addressed in the ALJ Report or that would support a rejection of the ALJ’s thorough and well-supported Findings, Conclusions, and Recommendations with respect to MERC’s RFP process.

First, with respect to the OAG’s proposed additional Finding 215a regarding the size of MERC’s RFP, the ALJ Report already fully reflects the OAG’s positions regarding the competitiveness of MERC’s RFP process.³¹ Based on consideration of the relevant facts and

²⁹ *In the Matter of a Petition by Minn. Energy Res. Corp. for Evaluation and Approval of Rider Recovery for Its Rochester Nat. Gas Extension Project*, Docket No. G011/M-15-895, Comments of the Office of the Attorney General at 4-5 (Nov. 25, 2015) (Document ID 201511-115963-01).

³⁰ OAG Exceptions at 14-16.

³¹ ALJ Report at 38-39 (Findings 210-212).

issues, the ALJ rejected the OAG's arguments. The ALJ Report reflects consideration and rejection of the arguments urged by the OAG in its Exceptions with respect to the size of the RFP:

221. First, the record supports MERC's decision to determine the size of the capacity requested in its RFP based on its projected need over 25 years. By requesting bids for 100,000 Dth/day, the project was designed to meet MERC's forecasted Design Day needs to 2042 and was large enough to entice companies other than NNG to provide bids. The results show that the 100,000 Dth/day capacity size put pressure on NNG to provide a competitive bid.

222. If MERC had issued an RFP for more incremental capacity to meet only near-term demand requirements as suggested by the OAG, the quantity would not have been sufficient to make it economic for any company other than NNG to submit a bid given the significant barrier to entry created by the 80-mile pipeline construction requirement for new entrants.³²

Additionally, in Finding 225 the ALJ notes "the OAG's suggestion that MERC should have issued an RFP for a smaller project (i.e. less than 45,000 Dth/day of new capacity) really raises the question of whether a smaller project is a better alternative than the PA. That issue is also addressed in the next section."³³ The Report goes on to provide significant additional Findings and Conclusions regarding alternatives to the Rochester Project; ultimately rejecting the OAG's arguments regarding smaller project alternatives.³⁴

The OAG also argues that MERC's position that the size of the RFP ensured competition and negotiating power should be given little or no weight because, according to the OAG, it was raised "for the first time in MERC's Rebuttal Testimony."³⁵ Such a claim is irrelevant and, in any event, false as MERC provided a detailed discussion of the RFP process and the need to

³² ALJ Report at 40-41 (citing Ex. 19 at 5-6 (Sexton Rebuttal)).

³³ ALJ Report at 41 (Finding 225).

³⁴ ALJ Report at 66 (Findings 322-324); *see generally* ALJ Report at 41-67.

³⁵ OAG Exceptions at 14 (Proposed Finding 215a).

create a competitive bidding environment in the Direct Testimony of MERC witnesses Timothy Sexton and Sarah Mead.³⁶ As discussed in MERC's Reply Brief, this issue was discussed extensively in the Direct Testimony of Department witness Michael Ryan:

This argument is baseless both because the OAG failed to offer any evidence into the record that would contradict the record evidence demonstrating the substantial value and benefit obtained through the competitive RFP process and because it is axiomatic that the purpose of an RFP is to foster a competitive environment and solicit competitive bids. As Department witness Michael Ryan recognized in Direct Testimony, "While other pipelines may have difficulty serving Rochester, MERC made reasonable efforts to address this issue through the timing of the process and allowing other bidders the opportunity to provide competitive bids on the Project."³⁷

The OAG's argument that MERC's RFP process did not create competition is without merit and the ALJ reasonably rejected such a position in light of the record evidence.

B. Consideration of Alternatives

Similarly, the OAG's claims that the ALJ Report does not reflect a fair accounting of all of its arguments regarding the relative costs and benefits of alternatives are also without merit.³⁸ The ALJ Report reflects a thorough and detailed consideration and ultimately a rejection of all of the arguments the OAG claims in its Exceptions were not adequately considered.

1. The ALJ's Alternatives Analysis Was Complete

The OAG acknowledges that the ALJ's description of the OAG's arguments with respect to alternatives is generally accurate. But the OAG goes on to complain that the Findings are "short, and some of the nuance contained in the OAG's arguments has been lost in the

³⁶ Ex. 17 at 11, 15, 41, 42-43 (Sexton Direct). MERC's RFP process properly "exerts downward pressure on barriers to entry, in turn making for a more robust environment for the development of competitive bid alternatives." *Id.* at 42:22-23; *see also* Ex. 12 at 9-10 (Mead Direct).

³⁷ MERC Reply Brief at 18-19 (citing Ex. 402 at 14-15 (Ryan Direct)).

³⁸ *Compare* OAG Exceptions at 14, *with* ALJ Report at 41-67.

reproduction.”³⁹ The purpose of the ALJ Report is not to mechanically restate the entirety of the parties’ briefs and testimony. Rather, the ALJ Report does an able job of summarizing the facts and positions and makes reasoned judgments on those facts and positions. Ultimately, there is nothing new in the OAG’s Exceptions.

The OAG’s ultimate conclusion that “several of the competitive bids would have produced phased or incremental proposals at significantly lower cost than the estimate created by MERC”⁴⁰ was fully debunked in the ALJ Report. As reflected in ALJ Finding 252, “MERC’s expert, Mr. Sexton, estimated that limiting expansion capacity to 30,000 Dth/day (instead of the proposed 45,000 Dth/day) would cost \$1 million *more* on an NPV basis than the cost of the PA.”⁴¹ Based on the evidence in the record, the ALJ concluded “a smaller project in the range of 30,000 Dth/day would likely cost more than the PA.”⁴² By any measure, paying more money for less capacity is not a good deal for MERC’s customers.

While it may seem anomalous that a *smaller* project would *cost more*, this result was thoroughly explained on the record as being a function of the fact that many of the costs of a pipeline project are fixed and unavoidable, making it more cost-effective to build a larger project over which to spread the costs.⁴³ Additionally, as reflected in the ALJ Report, the evidence

³⁹ OAG Exceptions at 16.

⁴⁰ OAG Exceptions at 17 (Proposed Finding 297a).

⁴¹ ALJ Report at 51-52 (Finding 252) (finding that the Department agreed that a smaller expansion would be more costly on an NPV basis (citing Ex. 405 at 35, AJH-19 (Heinen Direct)).

⁴² ALJ Report at 66 (Finding 324).

⁴³ Ex. 17 at 18-20 (Sexton Direct) (discussing types of costs that must be incurred in a pipeline project regardless of the size of the project); *See also* Ex. 17 at 24-25 (Sexton Direct); Ex. 13 at 7-8 (Mead Rebuttal); Ex. 16 at 12-13 (Mead Surrebuttal).

demonstrates that a future incremental upgrade would result in significant additional costs and unacceptable risk to MERC ratepayers.⁴⁴

The record was quite clear. MERC's leverage over NNG lay in the fact that NNG carried the risk that its entire Rochester position could be supplanted by a competing bidder. That leverage resulted in a much better deal than MERC could have negotiated if it had accepted a smaller or incremental proposal.

[I]t is a near certainty that costs of a later incremental capacity expansion negotiated in a non-competitive environment with Northern would result in higher costs than will be paid for this growth capacity in the current transaction.⁴⁵

And even the OAG acknowledged that selecting any of the phased approaches that would have allowed MERC the flexibility to forego the second phase would have exposed MERC to uncapped costs,⁴⁶ which clearly would have occurred in an uncompetitive environment during the second phase.⁴⁷

In weighing the record evidence and positions of the parties, the ALJ reached the eminently reasonable conclusion that the record demonstrates both the Precedent Agreement with NNG and the Phase II distribution upgrades are necessary, reasonable, and prudent.⁴⁸ In

⁴⁴ ALJ Report at 52 (Finding 253) (Citing Ex. 405 at 35 (Heinen Direct)); ALJ Report at 66 (Finding 324) ("Also, a smaller project in the range of 30,000 Dth/day would likely cost more than the PA because MERC would not be able to generate bids for a project that size from suppliers other than NNG. The significant cost barriers to entry in the Rochester market gives NNG a significant, if not overwhelming, competitive advantage on a smaller project.") (citations omitted).

⁴⁵ Ex. 28 at 3 (Sexton Opening Statement).

⁴⁶ Evidentiary Hearing Transcript, Vol. 1 at 175:19-176:1 (Urban) ("Q. ... Would you agree with me that under the Northern package of bids as proposed, ... that would allow MERC to stop and not implement the second phase came with the price risk that the second phase would be at actual costs at the time incurred? A. Yes."). See also Ex. 28 at 4 (Sexton Opening Statement); Evidentiary Hearing Transcript, Vol. 1 at 129-130 (Mead).

⁴⁷ Ex. 28 at 3 (Sexton Opening Statement).

⁴⁸ ALJ Report at 67 (Findings 326-327).

reaching this conclusion, upon weighing the evidence, relevant policy considerations, and arguments of the parties, the ALJ determined

neither a phased option nor a smaller project is more reasonable than the PA. . . . [A] phased project or smaller project would expose MERC's customers to a significant risk that they would pay much more for capacity over the next 25 years than under the PA.⁴⁹

Additionally, the ALJ concluded "the record demonstrates that conservation and peak shaving are not viable alternatives to the PA for addressing the current and future capacity needs in the Rochester Area."⁵⁰ Such conclusions are fully supported by the record and consideration of the competing policy concerns identified by the parties.

2. *The ALJ's Policy Recommendation Was Correct*

The OAG cites to a footnote in an effort to overcome the lack of record support for its positions. In that footnote, the ALJ states:

Given that this is the first case under the new NGEP statute, the Administrative Law Judge recognizes that the Commission may conclude that policy considerations such as keeping rates lower in the short term or promoting generational equity should be given greater weight than long run costs. Under such an analysis, the record could support the conclusion that a phased approach may be more reasonable than the PA.⁵¹

Despite the fact that the record is clear that taking a smaller or phased project would result in higher costs and unacceptable ratepayer risk, the OAG urges the Commission to find that such policy considerations warrant rejection of the Rochester Project.

MERC agrees with the ALJ that it is the Commission's role to weigh the policy considerations in its determination of the issues presented in this proceeding based on the record.

⁴⁹ ALJ Report at 66 (Finding 323) (citing Ex. 28 at 2-3 (Sexton Opening Statement); Ex. 13 at 14-21 (Mead Rebuttal); Ex. 405 at 34-37 (Heinen Direct); Ex. 407 at 5-6 (Heinen Surrebuttal)).

⁵⁰ ALJ Report at 67 (Finding 325) (citation omitted).

⁵¹ OAG Exceptions at 18-19; ALJ Report at 67, note 429.

But that policy analysis by the Commission does not occur in a vacuum or without regard to the record. To the contrary, in addressing the policy issues raised by this proceeding, the Commission should be guided by the thorough record that was developed here, including the incontrovertible evidence that a smaller or phased approach would have cost more and would expose ratepayers to unacceptable risk.

MERC respectfully suggests that the ALJ Report reflects a careful balancing of the relevant policy considerations in light of the applicable law and the record evidence presented. As the ALJ noted in the same footnote relied upon by the OAG, “the Administrative Law Judge’s conclusions are based on consideration of the competing policy concerns identified by the parties and the record as a whole.”⁵²

The OAG raises no factual or policy considerations that would support rejection of the Project. Further, even if the Commission concludes additional weight should be given to keeping rates lower in the short term and promoting generational equity, such balancing would still not support rejection of the Precedent Agreement and denial of the Rochester Project as proposed. This is an important point, as the record evidence supports the conclusion that a smaller project would have cost *more* and would have subjected ratepayers to additional *risk*. Far from “promoting generational equity,” denying the Rochester Project now would put current ratepayers at risk of supply shortages⁵³ and would subject future ratepayers to higher costs with little leverage to negotiate with NNG or other pipeline service providers.⁵⁴ In other words, if the OAG’s position is followed, both current and future ratepayers would be harmed.

⁵² ALJ Report at 67, note 429.

⁵³ Under current conditions, MERC is operating with a negative 9.5 percent reserve margin in Rochester and has been extremely fortunate not to have had a design day situation that would challenge the ability to meet firm customers’ natural gas needs. *See* Evidentiary Hearing Transcript, Vol. 1 at 103:22-24 (Mead).

⁵⁴ *See* Ex. 28 at 3 (Sexton Opening Statement):

3. *Safe, Adequate, and Reliable Service is Needed in Rochester Now*

Finally, denial of the Project, as recommended by the OAG, would have significant adverse effects on MERC's ability to provide adequate, safe, and reliable natural gas service to customers in the Rochester area as MERC is currently operating with a negative reserve margin. The OAG's recommendation to reject the Project and require the Company to start over to identify a new set of potential smaller alternatives would expose MERC's customers to significant risk that they will not have adequate and reliable natural gas service while also exposing ratepayers to substantial and unjustified risk of having to pay significantly greater costs for future capacity upgrades.

As demonstrated on the record, in the absence of the competitive environment created by the RFP, NNG would have a substantial incentive to charge MERC a significantly higher price under a take-it-or-leave-it contract. MERC and its customers would effectively be held hostage by the incumbent pipeline to proceed with the deal, regardless of the cost, or else face the possibility of having inadequate gas supply to meet firm customer demand. The OAG acknowledged that pursuant to NNG's FERC tariffs, NNG had no obligation give MERC a good deal and could have imposed maximum rates and other onerous terms.⁵⁵ It was clearly the competitive pressure of the RFP process that brought NNG to the table with competitive terms

[I]f MERC followed an incremental approach, the risk associated with higher future costs with respect to the acquisition of a second or later increment of capacity would likely once again put MERC in a position of negotiating with Northern as a sole supplier. This is due to the fact that this second or later smaller capacity increment would be unlikely to have sufficient scale to foster competitive third party proposals. In such an uncompetitive environment, Northern would have no incentive to offer discounted services or favorable contract terms.

⁵⁵ Evidentiary Hearing Transcript, Vol. 1 at 175:3-12 (Urban) (admitting that NNG had the legal right to tell MERC "take my max rates, take it or leave it" but that NNG did not do so and, in fact, provided significant concessions).

that the Department's witness Michael Ryan found to be both reasonable⁵⁶ and resulting in an impressive list of benefits to MERC's customers.⁵⁷

As summarized in MERC's Reply Brief, which the ALJ found to be persuasive:

The record demonstrates MERC's process for selecting the Rochester Project was reasonable. MERC involved stakeholders from the beginning stages;⁵⁸ evaluated potential alternatives to adding additional interstate capacity; successfully designed an RFP to foster competitive bids and pressure the incumbent pipeline, NNG, to sharpen its pencil;⁵⁹ designed an outcome with NNG that was both cost-effective and incorporated multiple additional benefits such as being able to serve Rochester at multiple points, using the least amount of pipeline, and capping the reservation price of NNG capacity;⁶⁰ and negotiated an agreement with NNG that provides additional benefits and cost savings to MERC customers, including MERC customers outside the Rochester area.⁶¹

If the Commission were to reject the Precedent Agreement with NNG and require MERC to submit an alternative proposal, MERC would need to attempt to renegotiate with NNG under a scenario where there would be no non-incumbent third party service providers to create competition. In other words, "[i]f MERC... issued an RFP that only supported near-term demand requirements, the quantity would not... [be] sufficient to enable third-party service providers to submit proposals that had any realistic chance of clearing the significant barrier to entry created by the required 80-mile pipeline construction requirement."⁶² A smaller project

⁵⁶ On reviewing the RFP process, the Department concluded that "MERC's RFP process was fair and reasonable," and that MERC's evaluation criteria and "weights to each category appeared reasonable. Overall, the driving component was cost and the summary data confirms the decision made by MERC." Ex. 402 at 10, 14 (Ryan Direct).

⁵⁷ Ex. 402 at 10, 14 (Ryan Direct).

⁵⁸ Ex. 24 at 1 (Lee Opening Statement).

⁵⁹ Ex. 28 at 2 (Sexton Opening Statement); Ex. 402 at 14-15 (Ryan Direct).

⁶⁰ Ex. 402 at 12 (Ryan Direct).

⁶¹ MERC Reply Brief at 16-17 (citing Ex. 402 at 14 (Ryan Direct)).

⁶² Ex. 19 at 5 (Sexton Rebuttal).

simply would not provide the economics for a non-incumbent service provider given the 80-mile distance such provider would need to overcome to reach the Rochester area. The record evidence demonstrates such a scenario would result in significant additional cost for MERC's ratepayers for significantly less value received.

The record in this proceeding and consideration of various policy concerns supports approval of the Rochester Project as the best available alternative. Nothing raised in the OAG's Exceptions supports a different conclusion and therefore, the Commission should adopt the Findings, Conclusions, and Recommendations of the ALJ regarding the reasonableness and prudence of the Rochester Project.

V. THE USED AND USEFUL STANDARD DOES NOT APPLY

The OAG has also taken exception to the ALJ's conclusion regarding the non-applicability of the "used and useful" standard to this proceeding.⁶³ Contrary to the OAG's position that the used and useful standard should be applied here, the ALJ's analysis, rationale, and conclusion regarding the applicability of the "used and useful" standard are fully supported by the law and Commission precedent. As discussed in the ALJ Report:

336. The "used and useful" standard referred to by the OAG is found in Minn. Stat. § 216B.16, the statute governing rate cases.

337. The Commission's review of the Rochester Project is under a separate statute, Minn. Stat. § 216B.1638, the NGEPS statute. The standard provided in that statute is whether the project costs are "reasonable and prudently incurred" to extend natural gas service to an unserved or inadequately served area.⁶⁴ There is no requirement that capacity be limited to that necessary to serve a given area for a limited period of time as suggested by the OAG.

338. Because the OAG's recommendation would impose a standard not found in the plain language of the NGEPS statute, the

⁶³ OAG Exceptions at 22-24.

⁶⁴ Minn. Stat. § 216B.1638, subd. 3.

Administrative Law Judge recommends that the Commission not adopt the OAG's alternative recommendation.⁶⁵

The ALJ's conclusion is also consistent with Commission precedent. For example, in Docket No. G002/M-93-773, Northern States Power Company requested recovery of a prorated portion of the acquisition adjustment it incurred in its purchase of the Viking Gas Transmission Company.⁶⁶ In that case, the OAG argued that the proposed cost failed the used and useful standard and should not be recovered.⁶⁷ Disagreeing with the OAG's position, the ALJ found:

[T]he correct standard to apply is the prudence and reasonableness of the expense. This standard is distinguishable from the used and useful analysis applied in the determination of rate base treatment. The used and useful approach is designed to protect utilities from the imposition of confiscatory rates. It is not designed to preclude amortization of a prudent, reasonable expense which benefits ratepayers.⁶⁸

The Commission agreed with the ALJ and was similarly not persuaded by the OAG's used and useful argument, stating that the utility was not seeking asset recovery through rate base treatment, but rather was seeking recovery of an amortization of the premium paid – a situation that called for a “prudence and reasonableness analysis.”⁶⁹

As evidenced by Commission precedent and the language of Section 216B.16, the used and useful standard does not apply here as the OAG suggests. The used and useful standard is applied to determine whether a utility's property should be included in rate base, not in a

⁶⁵ ALJ Report at 68.

⁶⁶ *In the Matter of a Petition by N. States Power Co. to Recovery the Acquisition Premium Associated with Its Purchase of the Viking Gas Trans. Co.*, Docket No. G002/M-93-773, ORDER DENYING PETITION FOR RECOVERY OF ACQUISITION PREMIUM THROUGH THE PGA (Nov. 21, 1994).

⁶⁷ *Id.* at 5.

⁶⁸ *Id.* at 4.

⁶⁹ *Id.* at 6.

proceeding to determine the prudence of a capacity addition.⁷⁰ The relevant standard for the Commission's consideration is whether the Project is reasonable and prudent, and the record in this case demonstrates that it is. As discussed in the Rebuttal Testimony of Amber Lee,

[T]he question before the Commission is whether the proposed Project costs are prudent. If so, they should be approved. If not, the Project should be denied. Holding a portion of the Project hostage is inconsistent with the need to provide the Rochester area with sufficient capacity to meet current and future needs.⁷¹

VI. THE PROJECT QUALIFIES FOR THE NGEPR RIDER

Finally, the OAG takes exception to the ALJ's Conclusions and Recommendation regarding the Rochester Project's eligibility for recovery under the NGEPR Statute, arguing that the NGEPR Statute is ambiguous, requiring consideration of the canons of statutory construction.⁷² Such argument is without merit and, indeed, as the ALJ pointed out, is based on the OAG conflating terms and ignoring the express wording of the statute.⁷³ The ALJ Report reflects a full consideration and rejection of the OAG's arguments regarding interpretation of the NGEPR Statute and application to the Rochester Project.

The OAG's initial conclusion that the NGEPR statutory definition of "unserved or inadequately served area" is ambiguous and requires application of a National Regulatory Research Institute ("NRRI") definition is clearly contradicted by the plain language of the NGEPR Statute itself. As the ALJ found:

362. The legislature defined the applicable terms. The term "natural gas extension project" means "the construction of new

⁷⁰ See *In the Matter of the Application of Peoples Nat. Gas Co. for Auth. to Increase Rates for Gas Util. Serv. in Minn.*, Docket No. G011/GR-82-65, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER at 23 (Jan. 29, 1983) ("The used and useful standard comes from M.S. § 216B.16, subd. 6, and clearly relates to the determination of the rate base and overall revenue requirements.").

⁷¹ Ex. 6 at 38 (Lee Rebuttal).

⁷² OAG Exceptions at 24-29.

⁷³ ALJ Report at 72-73.

infrastructure or upgrades to existing natural gas facilities necessary to serve currently unserved or inadequately served areas.” Further, the legislature expressly provided that “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.”⁷⁴

If the legislature had intended to define “unserved or inadequately served area” consistent with the NRRI language, as the OAG suggests, it could have done so. Instead, the legislature adopted a clear and broad definition of the term “unserved or inadequately served area,” which goes well beyond the OAG’s made up definition. The language of the statute is clear and further inquiry into legislative intent would be unreasonable and inappropriate.

Under Minn. Stat. § 645.16, “[w]hen the words of a law in their application to an existing situation are clear and free from all ambiguity, the letter of the law shall not be disregarded under the pretext of pursuing the spirit.” “The objective of statutory interpretation is to ascertain and effectuate the Legislature’s intent. *If the Legislature’s intent is clear from the statute’s plain and unambiguous language, then [a court] interpret[s] the statute according to its plain meaning without resorting to the canons of statutory construction.*”⁷⁵ “Because the legislature defined these terms and the language is clear as applied to this situation, there is no need to resort to canons of statutory construction or the legislative history.”⁷⁶

Additionally, as the ALJ concluded,

367. In addition, even if it were appropriate to consider canons of statutory construction, the publication referenced by the OAG does not support the OAG’s claim that the term “inadequately served” is a technical term with a special meaning. In fact, the NRRI publication cited by the OAG does not include the phrase

⁷⁴ ALJ Report at 72 (citing Minn. Stat. § 216.1638, subd. 1(e), (i)).

⁷⁵ *State v. Rick*, 835 N.W.2d 478, 482 (Minn. 2013) (citation omitted) (emphasis added).

⁷⁶ ALJ Report at 72 (Finding 366) (citing Minn. Stat. § 645.16 (“When the words of a law in their application to an existing situation are clear and free from all ambiguity, the letter of the law shall not be disregarded under the pretext of pursuing the spirit.”)).

“inadequately served” area.⁷⁷ While the article does provide a definition of “underserved” area, the term “underserved” area is not synonymous with “inadequately served” as the definition provided by the legislature demonstrates.

368. Moreover, the OAG’s suggestion that the NGEP statute only applies to infrastructure designed to extend service to new customers is contrary to the legislature’s express intent. The legislature specifically provided that an “inadequately served area” includes “an area lacking adequate natural gas pipeline infrastructure to meet the demand of *existing* or potential end-use customers.”⁷⁸ Thus, the legislature expressly included projects, like the Rochester Project, that provide infrastructure to meet the demand of existing customers, as well as future customers.⁷⁹

When considering the plain meaning of the statutorily defined term “unserved or inadequately served area,” as a factual matter, the ALJ correctly concluded that MERC had demonstrated that the Rochester area is an area in this state lacking adequate natural gas pipeline infrastructure to meet the demand of existing or potential end use customers. Neither the OAG nor any other party has questioned that fact or presented any evidence contrary to such a finding.

VII. CONCLUSION

The ALJ fully considered the voluminous record in this matter and the ALJ Report reflects careful and thorough consideration of that record in support of Findings, Conclusions, and Recommendations. Based on the foregoing, the record in this proceeding, and its Initial and Reply Briefs, MERC respectfully requests that the Commission adopt the ALJ Report in its entirety and reject the Exceptions of the OAG.

⁷⁷ OAG Initial Br. at 81-82 (Oct. 11, 2016) (eDocket No. 201610-125583-01) (citing Ken Costello, Nat’l Regulatory Research Inst., *Line Extensions for Natural Gas: Regulatory Considerations* 3 (Feb. 2013)).

⁷⁸ Minn. Stat. § 216B.1638, subd. 1(i).

⁷⁹ ALJ Report at 72-73 and n. 477 (“While there is no need to consult the legislative history for the reasons discussed above, to the extent the Commission disagrees, the Administrative Law Judge notes that there is a letter in the record from Rep. Garofalo dated October 17, 2016, discussing his recollection of the legislature’s intent. Rep. Garofalo has a different view of the legislative history than the OAG. *See* Letter from Rep. Pat Garofalo (Oct. 25, 2016) (eDocket No. 201610-125988-02)”).

Dated: December 30, 2016

Respectfully submitted,

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Minnesota Energy Resources Corporation

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. G011/M-15-895
OAH Docket No. 68-2500-33191

CERTIFICATE OF SERVICE

I, Kristin M. Stastny, hereby certify that on the 30th of December, 2016, on behalf of Minnesota Energy Resources Corporation (MERC), I electronically filed a true and correct copy of the enclosed Reply to the Exceptions of the Office of the Minnesota Attorney General on www.edockets.state.mn.us. Said documents were also served via U.S. mail and electronic service as designated on the attached service list.

Dated this 30th day of December, 2016.

/s/ Kristin M. Stastny
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