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**BEFORE THE MINNESOTA OFFICE OF ADMINISTRATIVE HEARINGS  
600 North Robert Street  
St. Paul, Minnesota 55101**

**FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION  
121 7th Place East  
Suite 350  
St. Paul, Minnesota 55101-2147**

**MPUC Docket No. G011/GP-15-895  
OAH Docket No. 68-2500-33101**

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***In the Matter of the Application of Minnesota Energy Resource Corporation for  
Authority to Increase Rates for Natural Gas Utility Service in Minnesota***

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**EXCEPTIONS OF THE OFFICE OF THE MINNESOTA ATTORNEY GENERAL TO  
THE FINDINGS OF FACT, CONCLUSIONS AND RECOMMENDATION OF THE  
ADMINISTRATIVE LAW JUDGE**

**December 20, 2016**

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## **I. INTRODUCTION**

The Office of the Attorney General — Residential Utilities and Antitrust Division (“OAG”) respectfully submits its Exceptions to the Findings of Fact, Conclusions of Law, and Recommendation (“Report”) dated November 30, 2016. The OAG takes Exception to Recommendations of the Administrative Law Judge (“ALJ”), and to many of the Findings and Conclusions included in the Report.

In this case, the Minnesota Public Utilities Commission (“Commission”) initiated a contested case proceeding to generate findings on the reasonableness and prudence of a significant natural gas system integrity project in the Rochester area (“Rochester Project” or the “Project”) that was proposed by the Minnesota Energy Resources Corporation (“MERC” or the “Company”). The Company requested a finding from the Commission that recovery of costs under the newly-enacted Natural Gas Extension Project (“NGEP”) rider statute would be appropriate for the Rochester Project.

The Rochester Project is unusual in two ways. First, it is the first project to be considered under the NGEP rider statute. Second, it involves the type of long-term planning horizons that are not typically analyzed for natural gas system integrity projects in this state. The ALJ thus compiled the findings and conclusions contained in the Report without the benefit of Commission precedent or established rules or guidelines that are directly on point under the NGEP rider statute. As such, it is important for the Commission to thoroughly examine the record as well as the Report in its final determination in this issue of first impression.

The Commission should also be sure to carefully review the record because there are several areas in which the Report does not include relevant facts that are in the record. There are also several areas where the Report does not adequately describe fundamental aspects of the

OAG's position. For example, in many areas the Findings describe a position taken by the OAG in Direct Testimony and the Company's response in Rebuttal Testimony, but do not describe the OAG response in Surrebuttal or in briefing. Because they do not include the full arguments made by all parties, these sections of the Report give preference to those parties supporting the Rochester Project without providing a full accounting of the record. These concerns are amplified by the Project's distinction as an issue of first impression in front of the Commission because it could set a harmful precedent regarding the inclusion of future system integrity projects, which are normally recovered via the traditional rate case process, that would be detrimental to the public interest if adopted. These Exceptions will attempt to identify significant instances where this occurred and will provide findings and citations to the record as appropriate in order to allow the Commission to identify record evidence that was not completely described in the Report.

These Exceptions address only issues where specific comment is necessary, especially where the Report neglected to address fundamental parts of the OAG's position. The section numbering of these Exceptions is consistent with the ALJ's Report. The fact that the OAG does not address an issue in these Exceptions does not indicate a waiver; the OAG continues to support all of the positions as recommended in its Initial Brief and Reply Brief.

## **VIII. EVALUATION OF THE NEED, REASONABLENESS, AND PRUDENCE OF THE PROPOSED ROCHESTER PROJECT**

The OAG takes exception to the ALJ's Findings, Conclusions, and Recommendation regarding the reasonableness of and need for the Rochester Project. In particular, the OAG takes exception to the sections of the Report regarding the sales forecast, the RFP process, the reasonableness of the Precedent Agreement ("PA") and Phase II portions of the project, and on the ALJ's overall analysis of reasonableness.

**A. MERC’S FORECASTED NEED.**

Findings 67 through 80 describe the process that MERC used to create its long-term demand forecast. While the Findings are generally accurate, there are a few Findings that omit important, relevant facts that are in the record. To ensure that the Commission is provided with a complete record and a fair accounting of the arguments from all parties, the OAG recommends the following changes:

After 74: 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.<sup>1</sup> 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.”<sup>2</sup>

**1. The Department’s Analysis of MERC’s Forecasted Need.**

**d. Department’s Alternative Need Forecast.**

As above, some additional facts could be included in the Findings describing the Department’s analysis of MERC’s forecast. To ensure that the Commission is provided with a complete record and a fair accounting of the arguments from all parties, the OAG recommends the following changes:

111. Because of its concerns regarding the accuracy of MERC’s forecast, the Department conducted an alternative need forecast.<sup>3</sup> Mr. Heinen testified that “The ROCG (Rochester-Olmsted Council of Governments) forecast data did not anticipate growth at the level projected by the Company.”<sup>4</sup> MERC’s forecasted annual growth rate for Residential customer count of 2.26 percent is significantly greater than the highest average annual population growth rate of approximately 1.5 percent assumed by

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<sup>1</sup> Ex. 1, LCI Customer Forecast Model Attachment C10 (Petition).

<sup>2</sup> Ex. 311, Schedule JAU-SR-1, MERC’s Response to OAG 116 (Urban Amended Surrebuttal).

<sup>3</sup> Ex. 405 at 25 (Heinen Direct).

<sup>4</sup> Ex. 405 at 15 (Heinen Direct).

the ROCG for Olmsted County. The Department's forecast included its own alternative customer count forecast.<sup>5</sup>

In addition, the accuracy of Finding 113 could be improved as follows:

113. The Department's forecast results suggested an increase in retail customer counts of approximately 0.75 percent per year during the forecasting period. 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. The difference between the two forecasts was illustrated in Graph 4 in Mr. Heinen's Direct Testimony and is displayed below:<sup>6</sup>

**2. The OAG's critique of MERC's forecast and Design Day.**

**a. Historical Sales Growth.**

Findings 125 through 127 describe the OAG's concerns with MERC's forecast as it compares to historical sales growth, and the OAG's conclusion that it may not be reasonable to assume an annual growth rate of 1.5 percent for the next 25 years when the only available historical data demonstrates a growth rate of only 0.46 percent. In Findings 128 through 134, the Findings describe the counter-arguments of MERC and the Department to this historical sales data. The Findings do not, however, provide any description of the OAG's response to MERC and the Department.

In particular, the Findings describe MERC's argument that the historical data should be manipulated to exclude years that were warmer than average, and that doing so would produce a historical data set with a higher growth rate, but decline to describe the OAG's rebuttal to MERC's argument. To ensure that the Commission is provided with a complete record and a fair accounting of the arguments from all parties, the OAG recommends that the following Findings be inserted after Finding 133:

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<sup>5</sup> Ex. 405 at 25, AJH-14 (Heinen Direct).

<sup>6</sup> Ex. 405 at 27 (Heinen Direct).

133a. The OAG responded to MERC's concern by questioning the validity of the Company's proposal to ignore some years when considering historical data. While 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.<sup>7</sup>

133b. The OAG also suggested that MERC's method for measuring annual growth rates was not the most reasonable. To calculate its "average compound growth rate," MERC used only two figures: the sales from the first year in the time period, and the sales from the last year in the time period. The OAG suggested that relying on only two data points could be somewhat arbitrary. Instead, the OAG recommended that it would be more useful to rely upon "average annual percentage change," which would use the annual change in each year of a time series to produce an average result. For the 2007 to 2015 time series, for example, MERC's method would use only two data points (2007 and 2015), while the OAG's method would use nine data points (each year from 2007 to 2015). Because its method used more data points, the OAG suggested that it was less prone to arbitrarily choosing specific years, and as a result was less volatile.

**b. MERC's Residential Use-Per-Customer Estimate.**

Findings 137 through 143 provide a description of the OAG's concerns regarding the assumptions in MERC's Residential Use-Per-Customer model. Findings 144 through 148 describe MERC's response to these concerns. As with the issue of historical sales growth, however, the Findings do not describe the OAG's rebuttal of MERC's argument. To ensure that the Commission is provided with a complete record and a fair accounting of the arguments from all parties, the OAG recommends that the following Findings be inserted after Finding 148:

148a. In response to MERC's argument, the OAG noted that the Company's arguments against a Residential time trend variable were inconsistent with the Company's decision to include a time-trend variable for its Small Commercial & Industrial class.

148b. The OAG also responded to the Company's argument that it would not be reasonable to add a time-trend variable in isolation

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<sup>7</sup> OAG Reply Brief at 13–14 (Oct. 25, 2016) (eDocket No. 201610-125991-01).

without making other changes to the model. The OAG pointed out that while the Company had presented this argument several times, it had never identified any changes that should be made along with a time trend variable.<sup>8</sup> The OAG also noted that its expert, Dr. Urban, did not blindly recommend including a time trend variable but did so only after reviewing the model in its entirety.<sup>9</sup>

**d. Use of A *Priori* Information.**

Findings 149 through 156 describe the OAG's concerns regarding the use of *a priori* information in MERC's sales forecast, and the Company's response, but the Findings do not provide a fully accurate description of the OAG's position regarding *a priori* information. The OAG recommends that the following Findings be inserted after Finding 151:

151a. In its Initial Brief, the OAG clarified the reason that it was concerned about the use of *a priori* information in the sales forecast. The OAG stated that the use of *a priori* information is significant because it represents a departure from historic growth based on the judgment of the sales forecaster. The OAG pointed out that it is essential to understand what *a priori* information was used, where it came from, and what impact it had on the forecast in order to determine whether the analyst's judgment was reasonable. The OAG stated that MERC's discussion regarding the *a priori* information had changed throughout the case and had not been transparent.

151b. In particular, the OAG noted that the Company's Initial Filing stated that the assumptions for the Residential and Small Commercial & Industrial forecast were "primarily based on the Mayo Clinic expansion, and the economic growth in the Rochester area,"<sup>10</sup> but the Company had later argued that it did not use *a priori* information in the forecast except to check its reasonableness. In light of this inconsistency, the OAG concluded that MERC's discussion regarding *a priori* information was not sufficiently transparent, and that it was not possible to determine what information had been used, how it was used, or whether it was reasonable to do so based on the evidence that MERC produced.<sup>11</sup>

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<sup>8</sup> OAG Reply Brief at 15 (Oct. 25, 2016) (eDocket No. 201610-125991-01).

<sup>9</sup> Ex. 314 at 2 (Urban Opening Statement).

<sup>10</sup> Ex. 1 at 77 (Petition).

<sup>11</sup> OAG Initial Brief at 26–29 (eDocket No. 201610-125643-02).

**e. Design Day Growth Rate**

Findings 157 through 166 describe the OAG's request that MERC re-run its forecast with several changes, the results of that forecast, and the Company's objections to the results. There are several problems with these Findings. First, Finding 163 should be modified to provide a more accurate description of how MERC handled several changes the OAG requested to the sales forecast, as follows:

163. To address its concern, MERC also made the modifications specified by the OAG with some changes while also updating the forecast tables to include 2015 weather normalized actual sales (rather than forecasted 2015). Specifically, MERC replaced the forecasted value for 2015 with weather normalized actual sales for 2015. When using the forecasted values, the annual growth rate from 2015 to 2016 was -0.6%; when the forecasted values are removed and 2015 weather normalized actuals are used, the annual growth rate from 2015 to 2016 was to 11.6%. Overall, the change proposed by MERC—which resulted in a 10-year average total retail sales growth rate of positive 1.1 percent.<sup>12</sup> MERC explained that it also ran the scenario with 2015 weather normalized sales to further demonstrate the significant impacts that changing forecast model variables in isolation can have.<sup>13</sup>

Second, as with many other areas in the Report, the Findings do describe the OAG's rebuttal to MERC's arguments. To ensure that the Commission is provided with a complete record and a fair accounting of the arguments from all parties, the OAG recommends that the following Findings be inserted after Finding 166:

166a. The OAG disagreed with MERC's suggestion that the forecast tables should be modified to include 2015 actual sales. The OAG pointed out that MERC was *not* suggesting that the forecast should be re-run with the benefit of additional data from 2015. Instead, the Company was suggesting that the results of a forecast should be removed and replaced with actuals. The OAG argued that replacing one value in a forecasted time series with historical data would be unreasonable and inconsistent. The OAG pointed out that the purpose of the analysis was to determine an

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<sup>12</sup> Ex. 11 at 13, DWC-S2 (Clabots Surrebuttal).

<sup>13</sup> *Id.* at 13.



average annual growth in a forecasted time series, and that replacing some forecasted values with actuals would not produce useful information because it would instead be a conglomeration of an actual and forecasted numbers. The OAG suggested that MERC's proposal was not consistent with standard forecasting practice.<sup>14</sup>

166b. The OAG also disagreed with MERC's suggestion that including a time trend variable would be changing a single variable in isolation. Dr. Urban testified that she did not blindly recommend a time trend variable in isolation, but only did so after reviewing the model in its entirety.<sup>15</sup> The OAG also pointed out that despite its concern that changing one variable in isolation would be unreasonable, MERC was recommending changing a single value in the forecast results that would also cause a different change in the average annual growth rates.

166c. The OAG also noted that even making the change that MERC suggested would produce a forecast significantly lower than MERC's initial forecast. If the forecasted results are removed and replaced with actuals as the Company suggests, the forecast produces an annual growth rate estimate of 1.1 percent—nearly thirty percent lower than what the Company used to justify its proposal.<sup>16</sup>

In addition, the Findings do not accurately state the conclusion that the OAG draws from the modified forecast results. The OAG recommends that the following Findings be inserted following Finding 166:

166a. The OAG did not suggest 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.<sup>17</sup> The OAG argued that this information demonstrated the magnitude of the problems with MERC's forecast, and suggested that it was evidence that the forecast was not a reasonable justification for the Company's proposed capital expenditures.

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<sup>14</sup> OAG Initial Brief at 33 (Oct. 11, 2016) (eDocket No. 201610-125583-01).

<sup>15</sup> Ex. 314 at 2 (Urban Opening Statement).

<sup>16</sup> OAG Initial Brief at 34 (Oct. 11, 2016) (eDocket No. 201610-125583-01).

<sup>17</sup> OAG Initial Brief at 34 (Oct. 11, 2016) (eDocket No. 201610-125583-01).

### **3. Conclusions regarding MERC's forecast of its future capacity needs.**

The OAG also takes exception to the ALJ's conclusions regarding MERC's forecast. The ALJ incorrectly applies low-, medium-, and high-growth scenario labels to the parties' recommendations regarding reasonable growth projections, when none of the parties presented their projections in such a fashion. It appears that the ALJ did so because multiple projections are typically included in other proceedings involving long-term forecasts. It is important to recognize, however, that this matter has not followed the same procedures as other long-term forecasting cases. For example, the Company did not produce multiple forecasts and instead justifies its capital expenditure proposal on the results of a single forecast that it produced. In fact, the Company has the burden to show that its forecast is reasonable, period—not simply the most reasonable of the forecasts offered in the record.<sup>18</sup>

The discussion surrounding the long-term growth forecast, which is not typically conducted by natural gas utilities for the purposes of Commission approval, highlights one of the many examples where the Rochester project proves an ill-fit under the NGEPA statute. MERC has attempted to present an unprecedented, or at least exceedingly rare, growth forecast in this proceeding to justify a massive system integrity project as well as a long-term interstate natural gas capacity contract. Using the normal procedures for long-term forecasting may have required the Company to produce multiple forecasts, but that is not what happened in this case. The ALJ's attempt to force the facts in this record into a different framework is not appropriate, and those findings should be removed from the report. Specifically, Findings 169 and 170 should be deleted.

If the Commission would prefer to modify them to provide a more accurate statement of the law, the OAG provides the following suggestions:

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<sup>18</sup> ALJ Report at 30.

169. In similar types of proceedings where long term forecasts are used to make infrastructure decisions such as in Integrated Resource Plans or Certificate of Need filings, the forecast or need analysis typically includes: low growth, base growth, and high growth scenarios.<sup>19</sup> It should also be noted, however, that the Commission has considered and declined to adopt natural gas resource plans that would require a long term planning horizon to be approved by the Commission.<sup>20</sup> As such, there is no affirmative requirement here to fit the different proposed growth scenarios into specific low-, medium-, or high-growth scenarios nor is there Commission precedent that would encourage the type of long term forecasting for natural gas demand that the Company has provided in this case. The question here is whether the Company's proposed 1.5 percent annual growth rate is a reasonable basis upon which to rely for a \$100 million investment by MERC's ratepayers.

170. In this case, the Administrative Law Judge concludes that the record does not 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.~~ The OAG's projection of a more reasonable growth rate and its well-founded criticism of MERC's forecast demonstrates that the Company's forecast cannot be reasonably relied upon to project future growth 25 years into the future. Moreover, it was unreasonable, given the concerns raised by the OAG, for the Company to rely upon its flawed growth forecast when it designed the parameters of its RFP based on the results of the forecast. ~~that sales growth will be negative 0.092 percent is not reasonable for use as a low growth estimate of future Design Day growth.~~

In addition to these changes to correct a misapplication of legal standards, the OAG takes exception to the ALJ's conclusions regarding the forecasts in this case. Both the OAG and the Department raised significant concerns regarding the reasonableness of MERC's forecast. In light of those concerns, there is no basis for the ALJ's conclusion that the Company's forecast is reasonable. The OAG recommends that Findings 169 through 179 be removed, and replaced with the following Findings:

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<sup>19</sup> Ex. 407 at 6 (Heinen Direct).

<sup>20</sup> Ex. 311 at 10 (Urban Amended and Corrected Surrebuttal).

179a. Both the OAG and the Department have raised serious concerns regarding the forecast that MERC uses to justify the Rochester Project.

179b. First, the OAG and the Department agreed that MERC's customer count model was not reasonable and should be changed. In isolation, this change as calculated by the Department reduces MERC's forecast annual growth rate by one-third, from 1.5 percent to 1.0 percent.

179c. Second, the OAG identified that MERC's Residential Use-Per-Customer model assumed that residential use would be constant every year for the next 25 years or more. It is well known that the consumption of natural gas has been declining for decades. In light of this fact, it is not reasonable to assume that residential use-per-customer will remain constant for the next two or three decades.

179d. Third, the OAG questioned MERC's use of *a priori* information. While it may have been reasonable to use *a priori* information to inform or check the forecast in light of the context in the region, MERC was not transparent about what information it used, the source of that information, or the impact that the information had on the results of its forecast. Because it did not produce evidence of this nature, the Company did not demonstrate that its use of *a priori* information was reasonable.

179e. Fourth, the OAG and the Department both questioned whether it was reasonable for MERC to apply the results of a sales forecast, which measures total sales, to its Design Day, which measures peak demand rather than total sales. The Company did not provide any effective response to this concern.

179f. Fifth, there is some concern that the Company's proposed 1.5 percent growth rate is not consistent with historical growth rates. In particular, the historical growth rate in the Rochester area has been 0.46 percent since 2007. This concern is magnified by the relative lack of historical data, since MERC only has access to nine years of historical data. While MERC may have a reasonable explanation for the lack of historical data, the Company's reasoning does not change the fact that a forecast based on more historical data would likely be more reliable.

179g. The evidence in the record demonstrates that MERC's forecast is not reasonable. While no party disputes that MERC must obtain additional capacity to meet existing need, MERC's

forecast does not provide a reasonable basis to estimate the amount of need that will exist in the future.

There are specific reasons that many of the ALJ's findings in this section are incorrect. Finding 175 unreasonably suggests that it would be reasonable to exclude one year from the historical sales data because it is lower. But it is simply not reasonable to pick and choose among the data in such a fashion. The historical data in this case is already challenging because MERC has conducted a 25+ year forecast based on only 9 years of historical data, which would not normally be acceptable. To further dilute the sample only increases this problem. In addition, the ALJ's argument that one year of data should be excluded because of an El Nino event is unreasonable. That year's data has, for one, already been weather normalized to smooth out abnormalities. In addition to that concern, it would only be reasonable to remove data because of a specific weather abnormality if it is certain that such a weather event would never occur again. There is no information to support that conclusion in this record. It is possible, and perhaps even likely, that there will be warmer than average winters in the future, and that those winters will create downward pressure on MERC's sales in the Rochester region. Removing a single year's worth of data because it was a warm winter discounts the possibility of warmer winters in the future and is not sound from a forecasting perspective. For these reasons, Finding 175 should be deleted entirely.

Findings 177 and 178 should also be deleted. First, the Findings do not represent the conclusion that should be drawn from the modified forecast that the OAG asked MERC to produce. The OAG does not suggest that the Rochester area will see negative growth in the future. Instead, the conclusion that should be drawn is that correcting a few parts of MERC's forecast that are obviously problematic produces significantly lower results, and that this is a reason to view MERC's forecast with skepticism. The Findings miss this conclusion, and

instead attempts to shoehorn the modified forecast results into a low-, medium-, and high-forecast framework that was simply not applied in this case.

Second, the ALJ unreasonably accepts MERC's suggestion that, after conducting a forecast, one year of data from a forecasted time series should be replaced with actual data rather than the forecasted results. As described above, MERC's proposal is completely inappropriate from a forecasting perspective, and the ALJ's reliance on it is unreasonable.

Third, the ALJ relies on the growth rate for the entire MERC NNG PGA to support the reasonableness of MERC's forecast for the Rochester region. There is no evidence in this record to suggest that it is reasonable to justify the results of a forecast for one region with the results of a different, much larger region. In fact, MERC's decision to base the case on a Rochester-specific forecast is, itself, an indication that the analysis should be focused on the Rochester area, rather than the entire NNG PGA. Growth rates for one region should not be used to support growth rates for another, and no party recommended that it would be reasonable to do so. In light of these concerns, the OAG recommends that Findings 175, 177, and 178 be deleted entirely. To be consistent with these changes it would also be necessary to delete Findings 171 through 176.

In summary, the OAG recommends that Findings 169 through 179 be deleted entirely and replaced with new Findings 179a through 179g, as described above. If the Commission would prefer to modify some findings, rather than deleting all of them, the OAG recommends modifying Findings 169 and 170 as described above.

**B. REASONABLENESS OF MERC’S RFP PROCESS.**

**3. The OAG’s review of MERC’s RFP Process.**

As with other areas of the Report, there are several specific instances where the Findings do not fully describe the position of the OAG regarding its concerns with MERC’s RFP design, process, and selection. To ensure that the Commission is provided with a complete record and a fair accounting of the arguments from all parties, the OAG recommends the following changes:

After 215: 215a. In response to the argument that the size of the RFP ensured competition and negotiating power, which was made for the first time in MERC’s Rebuttal Testimony, the OAG argued that the resulting competing bids were “decidedly non-competitive” and that the mere presence of bids from multiple entities does not necessarily result in a competitive process.<sup>21</sup> In addition, the OAG suggested that an open-ended RFP, which would have accepted bids up to 100,000 Dth/day, would have allowed the Company to inject competition into the process while also allowing for bids for smaller or phased-in projects.<sup>22</sup> The OAG also noted that it was questionable that MERC did not provide this justification in its initial Petition and only raised it after criticisms were raised regarding the appropriateness of the RFP.<sup>23</sup>

After 219: 219a. In response to the assertion by MERC that it did consider the relative costs and benefits of an incremental approach and that a series of smaller projects would likely have been more expensive than the cost of the PA, the OAG responded by noting that a smaller project, such as one providing 17,500 Dth/day that was proposed by NNG, would provide a reserve margin in the area above 4 percent to the year 2026.<sup>24</sup> In addition, the OAG took issue with the Company’s claim that a renegotiation of the PA would be difficult, arguing that the risk borne by ratepayers outweighed any speculative difficulty the Company might have in renegotiating the agreement should the Commission deny the Project as-proposed.<sup>25</sup>

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<sup>21</sup> OAG Initial Brief at 38 (Oct. 11, 2016) (eDocket No. 201610-125583-01).

<sup>22</sup> *Id.* at 38–39.

<sup>23</sup> Ex. 19 at 6 (Sexton Rebuttal); Ex. 14 at 12 (Mead Rebuttal).

<sup>24</sup> Ex. 311 at 23 (Urban Amended and Corrected Surrebuttal (Public)).

<sup>25</sup> Ex. 311 at 23 (Urban Amended and Corrected Surrebuttal (Public)).

#### 4. Analysis of the RFP Process.

The OAG also takes exception to the ALJ's ultimate conclusions regarding the RFP. In light of the concerns raised by the OAG, MERC has failed to meet its burden to prove that the RFP was fair and reasonable. The OAG recommends the following changes to Findings 220 through 225:

220. The Administrative Law Judge finds that ~~a preponderance of the evidence shows~~ MERC's failed to demonstrate, by a preponderance of the evidence, that its RFP process was fair and reasonable.

221. First, the record does not ~~supports~~ MERC's decision to determine the size of the capacity requested in its RFP based on its projected need over 25 years. The OAG correctly pointed out that there is a significant amount of risk in any forecast, and that it was not reasonable for MERC to only request bids that satisfied its full long term demand forecast. In response, MERC argued that it was necessary to ~~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 in order to~~ entice companies other than NNG to provide bids. While two other companies provided bids that would have necessitated the construction of a brand-new, 80-mile pipeline, the record does not support a finding that these bids created a competitive environment or that ~~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 that allowed for more incremental capacity to meet MERC's projected Rochester area demand well into the 2020s, ~~only near term demand requirements~~ as suggested by the OAG, it would have been possible for MERC to receive bids for smaller or phased projects that it would have otherwise dismissed as non-conforming. Given 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, however, it is unclear just how much competition any competing bid could have fostered.

223. ~~Second, the record supports MERC's decision to negotiate a contract with NNG. NNG's bid was the lowest priced.~~<sup>26</sup>

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<sup>26</sup> ~~Ex. 19 at 5-6 (Sexton Rebuttal).~~



~~Therefore it was fair and reasonable for MERC to proceed with negotiations with NNG. while the OAG did not directly question whether MERC should have chosen to negotiate with NNG as opposed to other companies, the record the OAG produced demonstrates that the problems with the design of MERC's RFP should bear on the reasonableness of the Company's negotiation with NNG.~~

224. [delete]

225. [delete]

**C. REASONABLENESS OF THE ROCHESTER PROJECT: PA AND PHASE II.**

**c. The OAG's discussion of alternatives.**

Findings 276 through 284 summarize the OAG's discussion of alternatives. While this summary is generally accurate, it is short, and some of the nuance contained in the OAG's arguments has been lost in the reproduction. Rather than revising each Finding individually, the Commission may refer to the following citations in the record for greater detail on the discussion of alternatives presented by the OAG in testimony and in briefing.

- Phased Proposals (OAG Proposed Findings at 29–31; OAG Initial Brief at 49–55; OAG Reply Brief at 19–21, 24–28; Urban Amended and Corrected Direct at 22–24, 47–49; Urban Amended and Corrected Rebuttal at 8–16; Urban Amended and Corrected Surrebuttal at 8–11);
- Peak Shaving and Conservation (OAG Proposed Findings at 35–36; OAG Initial Brief at 64–67; OAG Reply Brief at 18–19; Urban Amended and Corrected Direct at 52–56; Urban Amended and Corrected Surrebuttal at 12–16).

**3. MERC's Response to the OAG.**

As with several other areas discussed above, there were places in the Report where the Findings did not describe the OAG's rebuttal to MERC's response on particular issues. The citations provided in the prior section on the phased proposals and peak shaving/conservation contain many of these such responses and the Commission may wish to refer to those references for detail on the OAG's responses. To ensure that the Commission is provided with a complete

record and a fair accounting of the arguments from all parties, the OAG recommends modifications as follows:

After 290: 290a. The OAG responded by noting that MERC had not presented its Initial Petition in terms of the entire NNG PGA, but had focused only on the Rochester area reserve margins. In fact, the OAG noted that the Initial Petition does not include any references to the reserve margins for the entire NNG PGA.<sup>27</sup> The OAG also noted that the Commission's Notice of and Order for Hearing specifically referred to the Rochester service area, rather than the entire NNG PGA.<sup>28</sup> Based on these facts, the OAG concluded that the true purpose of the Rochester Project was to increase natural gas capacity in the Rochester area, and that as a result the project should be evaluated on that basis rather than as compared to the entire NNG system.

After 295: 295a. In response to MERC's argument regarding the need for fixed prices, the OAG noted that MERC's position was inconsistent. The Company had disagreed with portions of the Department's request for cost caps because its own cost estimates were not a "firm or fixed price."<sup>29</sup> The OAG noted that it was not reasonable for MERC to discard some options from NNG because they did not have fixed prices when MERC was not offering fixed prices to ratepayers for its own costs.<sup>30</sup> In addition, the OAG noted that while the lack of price certainty may be one factor in deciding which project is best for ratepayers, it should not be the only reason to discard some options. The OAG also pointed out that MERC would have the opportunity and responsibility to review cost estimates from NNG and determine whether they are reasonable.

After 297: 297a. The OAG disagreed with MERC's analysis that a smaller project would cost more. The OAG pointed out that, rather than relying on the estimated cost of a smaller project produced by MERC, there was a better source of information in the record: the results of the competitive bidding process. The OAG correctly noted that several of the competitive bids would have produced phased or incremental proposals at significantly lower cost than the estimate created by MERC.<sup>31</sup>

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<sup>27</sup> Ex. 1, at 24–25 (Petition).

<sup>28</sup> Notice of and Order for Hearing, at 5.

<sup>29</sup> Ex. 8, at 3 (Lyle Rebuttal).

<sup>30</sup> OAG Initial Brief at 60 (Oct. 11, 2016) (eDocket No. 201610-125583-01).

<sup>31</sup> Ex. 22, at 17 (Sexton Rebuttal Schedules HSTS).

After 302: 302a. In response to these concerns from the Department and MERC, the OAG noted that the phased proposals produced by NNG would have actually provided MERC with the opportunity to obtain the full 100,000 Dth/day produced by its long term demand forecast. Because the phased proposals provided this option, the OAG argued that it did not fail to consider the risk of increased growth as suggested by the other parties. The phased options provided the additional benefit of not requiring ratepayers to pay for the full capacity additions in the event that they were not necessary.

## **5. Analysis of Need and Reasonableness of the Rochester Project.**

The OAG takes exception to the ALJ's conclusions regarding the need and reasonableness for the Rochester Project contained in Findings 314 through 328. In general, the ALJ discounts the risk that growth will not materialize as the Company hopes. MERC faces no risk if this happens. All of the risk will be placed on ratepayers, because the Rochester Project, if approved, will be paid for by ratepayers (and not the Company's shareholders) regardless of whether the growth occurs. MERC's plan is founded on the assumption that its long-term demand forecast is so accurate that it will support investments intended for customers that may exist 20, 30, or 40 years in the future. The facts in the record do not support this assumption, especially in light of the phased proposals that would have allowed MERC to meet short- and mid-term requirements, provided the option for additional capacity in the future, and protected ratepayers in the event that growth does not materialize as the Company predicts. The ALJ's findings do not give appropriate consideration for these facts.

In a footnote, the ALJ discussed the weight her recommendation placed on policy considerations "such as keeping rates lower in the short-term or promoting generational equity" where the Commission could reasonably find that "a phased approach may be more reasonable than the PA."<sup>32</sup> The full text of that footnote is reproduced below:

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<sup>32</sup> ALJ Report at fn. 429.

Given that this is the first case under the new NGEPA 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 the long run costs. Under such an analysis, the record could support the conclusion that a phased approach may be more reasonable than the PA. Absent specific direction for the Commission as to these policy considerations, 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 as discussed above.

The OAG urges the Commission to consider these policy implications as it determines the prudence and reasonableness of the Rochester Project as-proposed. Approval of such a large project that has been proposed in reliance of a much longer-term forecast than is typical in other natural gas proceedings places a significant amount of risk on current ratepayers on the wager that future ratepayers will need the capacity that is being built today. As the ALJ notes, there is record support that a phased approach is more reasonable than the all-in approach embodied in the Company's PA. The Company has requested assurance from regulators that the Project is reasonable, but the record simply does not support such a conclusion, especially when the important policy considerations raised by the ALJ are also taken into consideration.

The Commission should also carefully review the record in regard to the ALJ's assertion that a phased project would reduce short-term costs but create the possibility for increased long-term costs. The evidence actually in the record establishes that several phased proposals were cost-comparative to the PA that MERC negotiated. These proposals would have been less expensive in the short-term, and would *not* have been more expensive in the long-term as suggested by the ALJ. The ALJ chose not to include any cost figures in her Findings, so the Commission should refer to the record itself for this information, which is included in Schedule 5

of Dr. Urban's Highly Sensitive Trade Secret Direct Testimony, and is addressed in pages 49 through 63 of the OAG's Initial Brief.

For these reasons, the OAG recommends the following modifications to the following Findings:

314. The Administrative Law Judge finds that the record does not support a finding demonstrates that the Rochester Project is necessary, reasonable, and prudent to provide service to MERC's customers in the Rochester area.

315. [delete]

316. [delete]

317. [delete]

318. ~~While~~ The reserve margins resulting from the PA are relatively large when looking at the Rochester area alone, up to 54.9 percent, and will persist at high levels until at least 2040, when they are estimated to be at 15 percent using the Company's sales forecast.<sup>33</sup> They are even larger when using the forecast provided by the Department or the after modifications recommended by the OAG. the reserve margins for MERC's system as a whole are much smaller

319. [delete]

320. ~~Given Despite~~ the uneven nature of capacity additions and the time it takes to plan for new capacity additions, ~~the Administrative Law Judge concludes that~~ the reserve margins resulting from the PA are not reasonable, even under the circumstances especially given the DMC initiative wherein the Rochester area experiences significant load growth over the next two to three decades.

321. In addition, to the extent excess capacity exists in the near term, MERC stated that it can seek to sell excess capacity on the capacity release market. Given that NNG currently has no excess capacity on its system in the Rochester area, MERC argued that it should have strong demand for any excess capacity. But the Department noted that revenue generated by capacity release sales is "typically small compared to the original purchase price of the capacity."<sup>34</sup> The OAG also suggested that the basic theories of supply and demand indicate that the cost on the

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<sup>33</sup> Ex. 12 at 21 (Mead Direct).

<sup>34</sup> Ex. 405 at 47 (Heinen Direct).

capacity release market are likely to drop in light of the excessive supply that would result from the Rochester Project, further reducing the Company's ability to recoup costs.<sup>35</sup> As such, it is not likely that the company would be able to fully recoup the costs associated with the unused, excess capacity, which are costs that will be borne by MERC's ratepayers.

323. ~~[delete] and replace with 323a.~~

323a. The facts in the record demonstrate that MERC was provided several phased proposals that could have provided the Company with the option to obtain the full amount of capacity it seeks if growth materializes as it projects, while also protecting ratepayers from excess costs if growth does not materialize. The phased proposals would also have improved intergenerational inequity, and reduced the excess reserve margins that would lead to intra-class inequity with interruptible and transportation customers.

324. ~~In addition, many of the phased proposals had operational issues as discussed above. Also, a MERC argued that~~ 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. ~~But this argument also assumes that the demand would eventually increase by 30,000 Dth/day, thus potentially requiring additional upgrades to accommodate a higher supply from an interstate gas pipeline. Even under the Company's sales forecast, a 30,000 Dth/day increase to the Design Day demand would not occur until the late-2030s.<sup>36</sup>~~

325. ~~The Administrative Law Judge finds that t~~The record demonstrates that MERC did not sufficiently consider conservation and peak shaving are not viable as alternatives to the PA for addressing the current and future capacity needs in the Rochester area. While it is likely that neither conservation nor peak shaving could completely resolve all future demand in the Rochester area, either or both alternative may have been able to reduce the amount of demand in a cost-effective manner. MERC did not provide sufficient testimony or evidence to demonstrate that it considered the possibility to control the size of the project using these alternatives, and MERC should provide additional detail about such options in future relevant filings.

326. ~~For these reasons, the Administrative Law Judge concludes that record demonstrates MERC did not meet its burden of proof to show that~~

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<sup>35</sup> OAG Initial Brief at 108 (Oct. 11, 2016) (eDocket No. 201610-125583-01).

<sup>36</sup> Ex. 12 at 21 (Mead Direct). From the table provided in Ms. Mead's testimony, if one assumes that 30,000 Dth/day is added to the existing total Rochester area capacity of 55,169, it would equal roughly 85,000 Dth/day, which is the forecasted Design Day for 2038/2039. *Id.*

the PA is necessary, reasonable, and prudent by a preponderance of the evidence, provided that MERC actively and aggressively seeks to sell any excess capacity on the capacity release market. This is the first case under the new NGEPA statute and it is reasonable for the Commission to conclude that policy considerations such as protecting ratepayers from forecasting risk and promoting generational equity are important, and MERC's argument that a phased project would have resulted in increased long term costs is not supported by the facts in the record. The record thus supports a conclusion that a phased approach is more reasonable than the PA.

327. In addition, given the link between the proposed size of the Project and the engineering of the Phase II system upgrades, the record also does not support the need and reasonableness of the Phase II distribution upgrades. While the record does support additional capacity in the Rochester area and distribution-level solutions to meet the increased capacity, the current proposal for Phase II upgrades is inextricably tied to the unreasonably high growth estimate and the unreasonably long term horizon upon which that estimate is applied. As such, the Company should design future engineering upgrades to allow it to deliver safe and reliable natural gas now and into the future at a more reasonable level than its Rochester Project envisions. If, as the Company argues, the same type of distribution enhancements would be required under either the PA or a phased approach, then the Company must produce evidence to provide its claim. The Phase II distribution system upgrades are needed to address operational and efficiency issues on MERC's distribution system in the Rochester area. Phase II involves reconstruction of the TBSs that serve Rochester and construction of transmission infrastructure necessary to move additional capacity into the Rochester area.

328. In summary, the Administrative Law Judge concludes that MERC has not demonstrated that the Rochester Project is prudent, reasonable, and necessary to provide reliable service to MERC's Rochester service area subject to the conditions set forth in the Recommendations section below.

## **IX. THE OAG'S USED AND USEFUL RECOMMENDATION.**

While the OAG recommends that the Commission deny MERC's request for an advanced determination of prudence for the Rochester Project, the OAG also presented an alternative. If the Commission determines that the Rochester Project is necessary to meet short-term demand, the Commission could determine that only a portion of the project is necessary in order to

accomplish that goal, and that the remainder of the project is not yet used and useful.<sup>37</sup> This outcome would allow the Rochester Project to move forward, protect ratepayers from costs related to excess capacity until those costs become useful, and improve intergenerational equity.

The OAG takes exception to the ALJ's Findings related to this recommendation. The ALJ concluded that the OAG's recommendation was not supported by the law because the used and useful section of the statute is included in the rate case statute, Minn. Stat. § 216B.16, rather than the NGEPS Statute, Minn. Stat. § 216B.1638. That distinction is not legally sound. Costs recovered through the NGEPS Statute, like all other costs recovered by utilities, must be reasonable and necessary for the provision of utility service. The used and useful standard is derived from this requirement, and the application of that standard is not limited to costs that are recovered through base rates only. The fact that MERC requests some costs from a rider rather than through base rates should not remove protections that are intended to make sure that ratepayers pay only for costs that are necessary for the provision of utility service.

Findings 335 through 338 should be deleted, regardless of the Commission's determination on other issues, as they are inaccurate description of the law. Including them in a Commission order, even by reference, could lead other utilities to request recovery of costs that are not used and useful merely because they are recovered through a rider rather than base rates. That interpretation is not a correct statement of Minnesota law and should not be included in the Commission's decision in this case. The OAG recommends the following changes to the ALJ's Report:

335. [deleted]

336. [deleted]

337. [deleted]

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<sup>37</sup> Ex. 300 at 57–58 (Urban Amended and Corrected Direct).



338. [deleted]

338a. In general, ratepayers should not be required to pay for utility investments that are not used and useful. The fact that some costs are recovered through a rider, rather than base rates, does not change this fundamental aspect of utility regulation in Minnesota. If the Commission determines that the Rochester Project must go forward to meet short-term demands, but is also concerned that the Project may be unreasonably large, the OAG's alternative recommendation may provide an appropriate solution.

## **X. COST RECOVERY AND RATE DESIGN.**

### **A. NGEPR RIDER ELIGIBILITY.**

The OAG takes exception to the ALJ's recommendations regarding NGEPR rider eligibility of the Rochester Project. The OAG provided extensive analysis in its brief regarding the ambiguity of the statutory terms "unserved or inadequately served areas" and their definitions. In particular, these terms are ambiguous because, as technical terms of art, they are required to be interpreted under their special meaning.<sup>38</sup> The technical meaning of these terms refers to areas that are not currently served by natural gas or an area where many households and businesses consume other forms of energy, even if gas mains are nearby.<sup>39</sup> This technical understanding comports with the statutory definition as well—an unserved area contains "potential end-use customers" while an underserved area contains "existing [and/]or potential end-use customers."<sup>40</sup> The Company, the Department, and the ALJ apply this definition far too broadly, which could lead to unintended consequences.

The OAG's Initial Brief provides a discussion of the unintended, absurd results that could occur under other parties' application of the statute, results that could cause serious harm to the

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<sup>38</sup> OAG Initial Brief at 80 (Oct. 11, 2016) (eDocket No. 201610-125583-01).

<sup>39</sup> *Id.* at 81–82.

<sup>40</sup> Minn. Stat. § 216B.1638, subd. 1(h).

public interest if utilities began to seek NGEPR rider recovery for system integrity projects.<sup>41</sup>

Apart from safety-related infrastructure projects, which can be recovered via a separate rider, it is difficult to identify a typical capital project performed by a natural gas utility that the utility could *not* argue falls under the interpretation advanced by MERC. The ability to recover up to 33 percent of system integrity project costs outside of the traditional rate case process would represent a significant change to the regulatory system if approved.

Finally, given the ambiguity previously discussed, the OAG analyzed the NGEPR rider statute and the related legislative history under the eight criteria provided by the Legislature to determine legislative intent.<sup>42</sup> Because this analysis demonstrates that the Legislature intended something very different than MERC proposed, the OAG recommends the following changes and additions to Findings 359:

359. Based on its view that the NGEPR statute is ambiguous, the OAG looked to the statute's legislative history, policy goals, and the statute's structure to determine the legislature's intent as to the applicability of the Rochester Project to the NGEPR statute. The OAG maintained that the legislative history indicates that the legislature intended the NGEPR rider to be used "to promote the expansion of natural gas service in Minnesota to communities where it otherwise is uneconomical to extend service."<sup>43</sup> The OAG argued that the legislative history shows that the NGEPR statute was intended to encourage extension of gas service to new customers, not for infrastructure to serve existing customers.<sup>44</sup>

359a. The OAG argued that the NGEPR rider statute fits into the state's broader policy goal to encourage the expansion of natural gas service to areas where it had been uneconomical to serve. The OAG provided figures that demonstrated the impact that two policies—the new area surcharge and the NGEPR rider statute—had on increasing the pool of potential natural gas customers.<sup>45</sup> Through this analysis the OAG argued that the NGEPR rider statute fits in with decades of public policy designed to promote the extension of natural gas service and that the propane

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<sup>41</sup> OAG Initial Brief at 82–84 (Oct. 11, 2016) (eDocket No. 201610-125583-01)..

<sup>42</sup> *Id.* at 85–99.

<sup>43</sup> OAG Initial Brief at 86 (Oct. 11, 2016) (eDocket No. 201610-125583-01).

<sup>44</sup> *Id.* at 86–99.

<sup>45</sup> *Id.* at 87–90.

shortage and frigid winter of 2013–14 prompted action to incrementally increase the pool of potential natural gas customers.

359b. The OAG argued that the legislative history, which included testimony from a representative of MERC and a statement from a sponsor of the bill, demonstrated that the discussion amongst lawmakers and experts at the time was confined to a very specific scenario in search of a very specific outcome.<sup>46</sup> That scenario arose when propane dependent communities sought the extension of natural gas service via a new area surcharge, but the revenue associated with that mechanism was not enough to cover the revenue deficiency caused by the project cost. A MERC representative testified that the Company had fielded calls from 25 towns and townships, but did not mention the Rochester area.

359c. The OAG argued that the structure of the NGEPS statute supports the narrower interpretation of the statute it favored.<sup>47</sup> In particular, the statute’s 33 percent cap on the amount that is able to be recovered from all ratepayers reflects the amount that a potential new area “falls short” of being economical, even with a new area surcharge. The OAG argued that, by allowing all ratepayers to pay up to 33 percent of an extension project’s costs, the Legislature balanced the obligation of the new area to pay its share of project costs (via the new area surcharge) with its desire to promote the extension of natural gas service to a wider range of potential customers.<sup>48</sup>

The OAG also takes exception to Findings contained in the Report’s analysis of NGEPS rider eligibility. In particular, the Findings regarding the proper interpretation of the statutory language are not supported by the record. In addition, the Findings do not describe the absurd policy implications of approving MERC’s proposed interpretation of the NGEPS rider statute. Findings 360 to 369 should be modified as follows:

360. In analyzing whether the Rochester Project is eligible under the NGEPS statute, the starting place is the plain language of the statute. When the words of a statute are clear in their application to a particular case, the plain meaning of the law must not be disregarded.<sup>49</sup> “Technical words and phrases . . . are construed according to such special meaning or their definition.”<sup>50</sup>

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<sup>46</sup> Id. at 90–92.

<sup>47</sup> Id. at 92–97.

<sup>48</sup> Id. at 94.

<sup>49</sup> Minn. Stat. § 645.16 (2016); *ILHC of Eagan, LLC v. County of Dakota*, 693 N.W.2d 412, 419 (Minn. 2005).

<sup>50</sup> Minn. Stat. § 645.08 (2016).

361. Here, the statutory language is clear and unambiguous has a technical meaning and a broad interpretation of the phrase “unserved or inadequately served area” leads to an absurd result.

362. The legislature defined the applicable terms. The term “natural gas extension project” means “the construction of new 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.”<sup>51</sup> The OAG demonstrated that, using the technical terms common to the natural gas industry, “existing or potential end-use customers” does not include customers in areas that are predominately served by natural gas, such as the Rochester area, but rather such areas where the extension of natural gas service was previously uneconomical, even with a new area surcharge. Hence, the meaning of the term “unserved or underserved” in the Natural Gas Extension Project statute should be understood in the context of natural gas extension policy, not a broad, plain language interpretation of the statutory language.

363. Under this interpretation, tThe Rochester Project clearly fits does not align ~~within~~ these definitions.

364. ~~The Rochester area is an “inadequately served area” because the area lacks “adequate natural gas pipeline infrastructure to meet the demand of existing or potential end use customers.”<sup>470</sup> Currently, “in situations of very high demand, MERC’s existing low pressure distribution system in Rochester cannot distribute all of the gas supply available in the southern portion of the system to the northern portion of the system where it is needed.”<sup>52</sup> Although MERC’s distribution system is constrained, the area has been served by MERC and its predecessors for over 80 years.<sup>53</sup> The Rochester Project is thus a “system integrity and reliability project,” which “can be considered similar to other infrastructure projects included in rate base and recovered through base rates.”<sup>54</sup> As a system integrity project and not an extension project, the Rochester Project is not eligible for recovery under the NGEP statute, and cannot reliably serve existing and future customers in the Rochester area.<sup>55</sup>~~

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<sup>51</sup> Minn. Stat. § 216B.1638, subd. 1(e), (i) (2016).

<sup>52</sup> ~~Ex. 5 at 11 (Lee Direct).~~

<sup>53</sup> OAG Initial Brief at 78 (Oct. 11, 2016) (eDocket No. 201610-125583-01).

<sup>54</sup> ~~Ex. 5 at 23 (Lee Direct).~~

<sup>55</sup> ~~Ex. 1 at 2 (Petition); Ex. 12 at 6–7 (Mead); Ex. 5 at 10–11 (Lee); Ex. 405 at 38, 59 (Heinen Direct).~~

~~365. In addition, the Project meets the definition of a “natural gas extension project” because the Project will undertake construction of “upgrades to existing natural gas facilities necessary to serve” this “inadequately served area[.]”~~

366. ~~Because~~ Although the legislature defined these terms ~~and the language is clear as applied to this situation, their technical meaning and the context under which they are applied—that is, to natural gas extension policy—requires an analysis under the~~ there is no need to resort to canons of statutory construction in order to understand the intent of the Legislature or the legislative history.

367. ~~In addition, even if it were appropriate to consider canons of statutory construction, t~~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, while the NRRI publication cited by the OAG does not include the phrase “inadequately served” area, ~~While the article does provide a definition of “underserved” area, the term “underserved” area which is not~~ 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 comports with to the legislature’s express intent and to statements made by legislators and a representative of the Company during a hearing on the bill.<sup>56</sup> 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.”<sup>57</sup> 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 under scenarios where there may be a small number of existing customers, but where many other households and businesses consume other forms of energy.<sup>58</sup>

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<sup>56</sup> See OAG Initial Brief at 91–92 (Oct. 11, 2016) (eDocket No. 201610-125583-01) (citing statements made by a co-author of the bill explaining the rationale of the bill:

[T]he current process analyzes if there is a revenue deficiency or not and then allows the option of having a New Area Surcharge added on to help cover the deficiency. If that is not enough to cover the deficiency, the project does not go forward. So what we’re proposing . . . is to, in order to cover that deficiency, to allow the current, existing member base to pay part of the cost of the expansion . . . up to 33 percent of the project cost, to help cover the deficiency in order to move natural gas usage forward in Minnesota.).

<sup>57</sup> Minn. Stat. § 216B.1638, subd. 1(i) (2016).

<sup>58</sup> See OAG Initial Brief at 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)).

368a. In addition, the OAG raised reasonable concerns regarding the policy implication of approving MERC's interpretation of the NGEPS statute. MERC stated in the record that the Rochester Project is comparable to other, standard system integrity projects.<sup>59</sup> The OAG argued that allowing the Rochester Project to be recovered through the NGEPS Rider would set a precedent allowing all system integrity projects from all natural gas utilities to flow through the rider. The OAG argued that such an interpretation would be a dramatic regulatory change in Minnesota that the legislature did not intend.<sup>60</sup>

369. For these reasons, the Administrative Law Judge concludes the Rochester Project is not a natural gas extension project ~~which is~~ and is thus not eligible for recovery of costs through a NGEPS rider.

## CONCLUSIONS OF LAW

The OAG takes exception to several of the ALJ's Conclusions of Law, in particular the Conclusions concerning the eligibility of the Rochester Project under the NGEPS rider statute. As described above, the OAG thoroughly briefed this issue<sup>61</sup> and demonstrated that there is ambiguity in the statute that requires an investigation of legislative intent. The result of this analysis shows that the legislature never intended for system integrity projects like the Rochester Project to be eligible for NGEPS rider recovery and that allowing MERC to proceed with its project under this interpretation could result in a significant change to the regulatory structure in Minnesota that was not envisioned by the Legislature. For those reasons, the OAG recommends modifications or additions as follows:

6. A "natural gas extension project" is defined as "the construction of new infrastructure or upgrades to existing natural gas facilities necessary to serve currently unserved or inadequately served areas."<sup>62</sup> The phrase "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."<sup>63</sup> As technical terms, "unserved

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<sup>59</sup> OAG Initial Brief at 23 (Oct. 11, 2016) (eDocket No. 201610-125583-01).

<sup>60</sup> Id. at 83.

<sup>61</sup> *See id.* at 78–99.

<sup>62</sup> Minn. Stat. § 216B.1638, subd. 1(e).

<sup>63</sup> Minn. Stat. § 216B.1638, subd. 1(i).

or inadequately served area” must be constructed according to their special meaning.<sup>64</sup>

6a. In particular, interpreting “unserved or inadequately served area” to apply to a system integrity project designed “improve the operation and efficiency of MERC’s distribution system”<sup>65</sup> would result in such a broad range of eligible projects that it is likely that the vast majority of natural gas utilities’ capital projects would be eligible for recovery outside of a rate case via the NGEPR rider.

6b. Moreover, an examination of legislative intent<sup>66</sup> demonstrates that the Legislature enacted the NGEPR rider statute for a very specific purpose: to increase the scope of potential natural gas customers following a very cold winter where communities across the state faced high propane prices following a supply shortage. The rider statute was intended to reach communities for which the extension of service would continue to be uneconomical, even with policies such as a New Area Surcharge, by allowing the utility to socialize up to 33 percent of the project costs across all ratepayers. Such a construct demonstrates the balancing performed by the Legislature to extend natural gas service to unserved or inadequately served communities while balancing the equity interests of the utility’s ratepayers as a whole.

...

9. MERC has not shown by a preponderance of the evidence that the Rochester Project is necessary, reasonable, and prudent.

10. MERC has not shown by a preponderance of the evidence that the Rochester Project is a natural gas extension project within the meaning of Minn. Stat. § 216B.1638.

11. MERC has not demonstrated by a preponderance of the evidence that the Rochester Project meets the requirements for authorization of a NGEPR rider for recovery of up to 33 percent of Project costs pursuant to Minn. Stat. § 216B.1638. ~~MERC’s recovery of its expenses for Phase II of the Project are properly subject to a soft cap of approximately \$44 million.~~

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<sup>64</sup> Minn. Stat. § 645.08, subd. 1.

<sup>65</sup> Ex. 5 at 10 (Lee Direct).

<sup>66</sup> See, e.g. OAG Initial Brief at 85–99 (Oct. 11, 2016) (eDocket No. 201610-125583-01) (analyzing legislative intent across the eight criteria set forth by the Legislature in Minnesota Statutes section 645.16 and demonstrating that the Legislature did not intend for projects like the Rochester Project to be eligible for NGEPR rider recovery).

If the Commission approves the Rochester Project (Finding 9), then it should include a cap on costs (Finding 11) and find that recovery from all customers is reasonable (Finding 12).

## RECOMMENDATIONS

The OAG also takes exception to several of the ALJ's Recommendations and recommends the following changes:

1. Finding the Rochester area is constrained ~~and MERC's Rochester Project is, but that MERC has failed to demonstrate that the Rochester Project~~ is prudent, reasonable, and necessary to provide natural gas service to MERC's Rochester service area.

~~2. Authorizing rider recovery of up to 33 percent of the Phase II costs pursuant to the NGEPA statute from all of MERC's customers.~~

~~3. Limiting total recovery of Phase II costs to MERC's estimate of \$44,006,607, unless MERC can show that any costs above the initial estimate are due to unforeseen or extraordinary circumstances and the additional costs are otherwise reasonable and prudent.~~

~~4. Authorizing costs incurred under the PA for additional capacity through the commodity portion of the NNG PGA from all of MERC's firm and interruptible sales customers.~~

~~5.2.~~ Requiring MERC to reasonably pursue mitigation of costs for sales customers for any instance where the acquisition of additional firm capacity from an interstate pipeline causes significant excess capacity including, but not limited to: making every effort to obtain the best available terms for long-term and short-term release of excess capacity; encouraging the movement of customers to firm service; and utilizing excess capacity to avoid purchasing other more expensive capacity to serve other parts of the applicable PGA area ~~MERC NNG PGA.~~

~~6.3.~~ Requiring MERC to provide, in future AAA filings ~~and in the annual rider recovery filing in this docket~~, specific data for each capacity release associated with the Rochester area over the most recent gas year.

~~7.4.~~ Requiring MERC to petition the DMCC for state infrastructure aid if future work by the Company occurs within the development district, and report annually on the results of any applications made to the DMCC and the amount of any state aid received in AAA filings or in another annual filing determined by the Commission.



8. 5. Requiring MERC to provide a detailed analysis in its next general rate case regarding its existing interruptible and transportation rates and whether the rate structures and design for these classes are appropriate given the increased capacity associated with the proposed Project.

6. Finding that system integrity projects that are designed to serve areas that are already predominately served by natural gas, such as the Rochester Project, are not eligible for recovery under the NGEP rider statute because these areas are not “unserved or inadequately served” areas.

Dated: December 20, 2016

Respectfully submitted,

LORI SWANSON  
Attorney General  
State of Minnesota

*s/ Joseph A. Dammel*

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*s/ Ryan P. Barlow*

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ATTORNEYS FOR OFFICE OF THE  
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LORI SWANSON  
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# STATE OF MINNESOTA

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December 20, 2016

The Honorable Jeanne M. Cochran  
Administrative Law Judge  
Office of Administrative Hearings  
600 North Robert Street  
P.O. Box 64620  
St. Paul, MN 55164-0620

**Re:** *In the Matter of the Petition of Minnesota Energy Resources Corporation for Evaluation and Approval of Rider Recovery for its Rochester Natural Gas Extension Project.*  
**MPUC Docket No. G-011/GP-15-895**  
**OAH Docket No.68-2500-33191**

Dear Judge Cochran:

Enclosed and e-filed in the above-referenced matter please find the Office of the Attorney General – Residential Utilities and Antitrust Division’s Exceptions to the Findings of Fact, Conclusions and Recommendation of the Administrative Law Judge.

By copy of this letter all parties have been served. An Affidavit of Service is also enclosed.

Sincerely,

*s/ Ryan Barlow*

RYAN P. BARLOW  
Assistant Attorney General

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(651) 296-9663 (Fax)

Enclosure

## AFFIDAVIT OF SERVICE

**Re: *In the Matter of the Petition of Minnesota Energy Resources Corporation for Evaluation and Approval of Rider Recovery for its Rochester Natural Gas Extension Project.***

**MPUC Docket No. G-011/GP-15-895**

**OAH Docket No.68-2500-33191**

STATE OF MINNESOTA    )  
  ) ss.  
COUNTY OF RAMSEY    )

I hereby state that on December 20, 2016, I filed with eDockets the Office of the Attorney General – Residential Utilities and Antitrust Division’s *Exceptions to the Findings of Fact, Conclusions and Recommendation of the Administrative Law Judge* and served the same upon all parties listed on the attached service list by email, and/or United States Mail with postage prepaid, and deposited the same in a U.S. Post Office mail receptacle in the City of St. Paul, Minnesota.

*s/ Judy Sigal*

Judy Sigal

Subscribed and sworn to before me  
this 20<sup>th</sup> day of December, 2016.

*s/ Patricia Jotblad*

Notary Public

My Commission expires: January 31, 2020.

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
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First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
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