

**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. G-011/M-15-895  
OAH Docket No. 68-2500-33101**

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

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**REPLY BRIEF  
OF THE OFFICE OF THE ATTORNEY GENERAL –  
RESIDENTIAL UTILITIES AND ANTITRUST DIVISION**

**October 25, 2016**

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**REPLY BRIEF OF THE OFFICE OF THE ATTORNEY GENERAL**

**INTRODUCTION**

The Office of the Attorney General – Residential Utilities and Antitrust Division (“OAG”) respectfully submits its Reply Brief regarding Minnesota Energy Resource Corporation’s (“MERC” or “the Company”) Petition for Evaluation and Approval of Rider Recovery for its Rochester Natural Gas Extension Project (“the Rochester Project” or “the Project”).

**I. MERC SHOULD NOT BE ALLOWED TO ESCAPE RIGOROUS SCRUTINY BY ATTEMPTING TO SHIFT THE BURDEN OF PROOF.**

In its Initial Brief, MERC argues for the first time that the burden of proof in this case should be shifted to other parties. According to the Company, a strict application of the Certificate of Need rules indicates that, “the burden falls squarely on other parties to introduce alternatives into the record.”<sup>1</sup> And, based on this construction, the Company apparently believes that the Commission is *required* to approve the Rochester Project, regardless of whether it is reasonable, because the OAG has not produced a detailed alternative pipeline bid from an interstate pipeline supplier. The Company is wrong.

**A. THE CERTIFICATE OF NEED RULES DO NOT APPLY BECAUSE THIS IS NOT A CERTIFICATE OF NEED PROCEEDING.**

At the outset, it is important to point out a basic, underlying fact that the Company is careful to avoid: this is not a Certificate of Need proceeding. MERC has not requested a

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<sup>1</sup> MERC Initial Brief, at 24.

Certificate of Need, this case was not filed as a Certificate of Need, and MERC made clear in its Initial Petition that it does not need a Certificate of Need to move forward with the Rochester Project.<sup>2</sup> So, while it is true that the burden of proof can sometimes be shifted in a Certificate of Need proceeding, MERC's argument is a red herring because this is not a Certificate of Need case.

This particular case does involve similar questions of need and reasonableness, and analysis of those questions can be informed by the factors outlined in the Certificate of Need rules. But that does not transform this proceeding into something it is not. The idea that consulting a list of factors for evaluating need and reasonableness would attach legal standards used for a different, specific type of proceeding is absurd.<sup>3</sup> The legal standards for obtaining a Certificate of Need should not be applied to a proceeding that is not a Certificate of Need—especially when it would involve shifting the burden of proof away from the utility seeking to make investments that will increase rates.<sup>4</sup>

**B. EVEN IF THE CERTIFICATE OF NEED RULES DID APPLY, MERC HAS NOT MET THE THRESHOLD FOR SHIFTING THE BURDEN OF PROOF.**

To the extent that the Commission accepted the concept of shifting the burden of proof away from MERC, the evidence in the record demonstrates that the Company has not met the threshold that would trigger a burden shift. According to MERC, the burden would shift to the OAG and other parties after MERC satisfied the burden of 1) “demonstrating need for the project by a preponderance of the evidence” and 2) “showing that the proposed project is a reasonable

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<sup>2</sup> Ex. 1, at 10 (Petition).

<sup>3</sup> It is worth pointing out that the MERC's primary legal citation for its burden shifting proposition is a single, unpublished decision from the Court of Appeals, which holds no precedential value. MERC Initial Brief, at 11, n. 34; Minn. Stat. § 481A.08.

<sup>4</sup> For example, Minnesota law requires the Commission to resolve all doubt about the reasonableness of rates in favor of the ratepayers. Minn. Stat. § 216B.03. Shifting the burden of proof away from the utility would not be resolving doubt in favor of ratepayers.

and prudent way to satisfy the articulated needs.”<sup>5</sup> As discussed at length in the OAG’s Initial Brief, and further in this Reply Brief, MERC has not satisfied either of these requirements.

When making its burden shifting arguments, the Company artfully sweeps away the fact there is extensive dispute about the level of need for additional natural gas capacity in the Rochester area. While all parties agree that there is some existing need for additional capacity, that is not the focus of the analysis. MERC argues that there is a need to provide 100,00 Dth/day of natural gas capacity in the Rochester region, and that is how its proposed project is sized. If the burden were ever going to shift, it could only happen after MERC has proven by a preponderance of the evidence that there is a need for 100,000 Dth/day of natural gas capacity in the Rochester area. As demonstrated in the OAG’s Initial Brief, MERC’s long-term peak demand forecast is significantly flawed and does not satisfy MERC’s burden of proof.

Furthermore, even if MERC did prove that its customers may demand 100,000 Dth/day of natural gas capacity in the 2040s, according to its own construction the Company would also have to prove that its proposal is a reasonable way to address that need.<sup>6</sup> As the OAG demonstrated at length in its Initial Brief, the Rochester Project is *not* a reasonable way to serve customers in the Rochester area. The Rochester Project would result in unreasonably large reserve margins, create equity problems among customer classes, and also lead to intergenerational equity problems. It is not reasonable to build out facilities more than two decades before they will be useful, when MERC received competitive bids that could do so in a more conservative, phased approach, at comparable cost. Even if MERC’s burden shifting argument were correct, the burden would only shift after MERC had demonstrated by a preponderance of the evidence that the Rochester Project was a reasonable way to address the

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<sup>5</sup> MERC Initial Brief, at 10.

<sup>6</sup> *Id.* at 10.

demonstrated need. The evidence in the record establishes that MERC has not satisfied this burden of proof.

**C. APPLYING MERC’S PROPOSED BURDEN OF PROOF WOULD RESULT IN BAD REGULATORY POLICY.**

The policy implications that would flow from MERC’s argument are troubling. According to MERC’s construction, once the Company conducts a long-term demand forecast, the Commission would be *legally required* to approve the Company’s proposal regardless of whether the size, timing, and cost are reasonable. Such a policy outcome is obviously unacceptable.

MERC is attempting to box the Commission in by insinuating that the Company must move forward with the Rochester Project, regardless of whether it is properly sized or overbuilt, because there is some need for new capacity and the Rochester Project is the only alternative that is fully designed and ready to move forward.<sup>7</sup> But that regulatory construct does not allow for any reasoned analysis or regulatory oversight. If MERC is right, then it does not matter whether the Commission or anyone else believes the Rochester Project is prudent or reasonable, because the Commission would be effectively required to approve anything the utility proposed.

A regulatory structure of that nature would be untenable. That is, perhaps, why natural gas utilities are not required to obtain a Certificate of Need for “system integrity and reliability”<sup>8</sup> projects like the Rochester Project. To do so would put an enormous and impossible burden on other parties to produce full blown engineering solutions and cost estimates. The burden shifting in Certificate of Need proceedings is functional because it is primarily used for selecting electric

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<sup>7</sup> This is not the first time in the record where the Company has warned of dire consequences if the Commission does not approve the Rochester Project in its entirety. MERC witness Ms. Lee suggested “partial approval” would be comparable to *holding the project hostage*, and testified that if the Commission did not approve the project in full (regardless of the concerns about the size, timing, and cost), the Company would inform the City of Rochester of limitations regarding service to its firm customers. Ex. 6, at 37–39 (Lee Rebuttal).

<sup>8</sup> MERC Initial Brief, at 45.

generating alternatives, which involves use of computer modeling that is able to consider multiple alternatives and provide cost and benefit estimates. The OAG is not aware of any such technology that can produce bid alternatives or price estimates for interstate natural gas pipelines. Without technology of that nature, it is unclear that it would ever be possible for any party to “produce an alternative” at a similar level of detail and with reliable cost estimates, as MERC would require. Instead, the OAG has properly focused on whether the Rochester Project is reasonable compared to the size and timing produced from a reasonable peak demand forecast, and as compared to the results of the competitive bidding process that MERC conducted. Unfortunately, it is not.

The standard of review in this proceeding should be the one articulated in the Commission’s Notice of and Order for Hearing: “Are the Rochester Project investments prudent, reasonable, and necessary to provide service to MERC’s Rochester service area?” This standard echoes the legal requirement that all utility rates be just and reasonable. MERC’s proposal to apply the Certificate of Need burden shift in this case would subject ratepayers to the cost of any project, regardless of whether the size and timing are reasonable, simply because the utility demonstrated some level of existing need. Applying that standard would not result in just and reasonable rates.

## **II. OTHER PARTIES’ ANALYSIS OF RESERVE MARGINS IS UNSOUND.**

In their Initial Briefs, both the Department and MERC argue that the reserve margins that would result from the Rochester Project are reasonable, despite all evidence to the contrary.

### **A. THE RESERVE MARGIN ANALYSIS SHOULD FOCUS ON THE ROCHESTER AREA.**

As the explained in the OAG’s Initial Brief, one factor that can be used to evaluate the prudence and reasonableness of the Rochester Project is the reserve margin that will result from



MERC's proposal. MERC's discussion of reserve margins, however, relies on a limited and highly selective set of facts that conceals the true result.

Through the entirety of its Initial Brief, MERC did not once disclose the level of excess reserve margins that will result in the Rochester area. Instead, MERC focuses on the reserve margins for the entire NNG PGA.<sup>9</sup> But MERC has not proposed the Rochester Project because it needs to increase capacity for the entire PGA—MERC's Petition makes clear that the purpose of the Rochester Project is to increase capacity for the Rochester area. In fact MERC's Initial Petition *only* discusses reserve margins in the Rochester area.<sup>10</sup> The Petition does not mention NNG reserve margins even once, and *only* includes analysis of the reserve margins for the Rochester area.<sup>11</sup> Furthermore, in its Notice of and Order for Hearing, the Commission stated that the first issue in the case was: "Are the Rochester Project investments prudent, reasonable, and necessary to provide service to *MERC's Rochester service area . . .*."<sup>12</sup> The purpose of the Rochester Project, according to MERC, to "expand the capacity of MERC's natural gas distribution system in and around the city of Rochester."<sup>13</sup> While discussing reserve margins for the entire NNG system may have some relevance, it is not reasonable to shift away from the true focus of this case—the Rochester area.

MERC, though, manages to go through its entire Initial Brief without once mentioning the reserve margins that will result in the Rochester area. For example, MERC's Initial Brief does not disclose that the reserve margin in the Rochester area will be more than fifty percent when the Rochester Project is complete. In other words, MERC attempts to conceal the amount of overbuilding that would result from the Rochester Project by simply ignoring the facts of the

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<sup>9</sup> MERC Initial Brief, at 37.

<sup>10</sup> Ex. 1, at 24–25 (Petition).

<sup>11</sup> *Id.*

<sup>12</sup> Notice of and Order for Hearing, at 5.

<sup>13</sup> Ex. 1, at 1 (Petition).

case. For convenience, the reserve margin analysis included in MERC's Petition is reproduced here:<sup>14</sup>

**Table 6 – Rochester Area Forecasted Peak Day Capacity and Reserve Margins (Therms)**

Winter (eff. Nov. 1)	Peak Day Forecast (1.60%/Yr.)	TBS 1D Capacity	TBS 1B Capacity	New TBS Capacity	Total Capacity	Reserve Margin
2014/2015	599,690	367,070	184,620	0	551,690	-8.0%
2015/2016	609,290	367,070	184,620	0	551,690	-9.5%
2016/2017	619,030	367,070	184,620	0	551,690	-10.9%
2017/2018	628,940	472,070	184,620	0	656,690	4.4%
2018/2019	639,000	472,070	184,620	0	656,690	2.8%
2019/2020	649,230	407,070	184,620	410,000	1,001,690	54.3%
2020/2021	659,610	407,070	184,620	410,000	1,001,690	51.9%
2021/2022	670,170	407,070	184,620	410,000	1,001,690	49.5%
2022/2023	680,890	407,070	184,620	410,000	1,001,690	47.1%
2023/2024	691,780	407,070	184,620	410,000	1,001,690	44.8%
2024/2025	702,850	407,070	184,620	410,000	1,001,690	42.5%
2025/2026	714,100	407,070	0	594,620	1,001,690	40.3%

MERC's Initial Brief attempts to confuse the issue by focusing on reserve margins for the entire NNG system, but it is clear from MERC's Petition and the Commission's Notice of and Order for Hearing that the purpose of the Rochester Project was to deal with reserve margin issues in the Rochester area. That is the proper frame of analysis for this case.

**B. ANALYSIS OF RESERVE MARGINS SHOULD NOT INCLUDE CONSUMPTION BY INTERRUPTIBLE CUSTOMERS.**

The Department also provides questionable analysis of reserve margins. In its Initial Brief, the Department describes how Mr. Heinen modified his analysis of reserve margins in

<sup>14</sup> Ex. 1, at 24 (Petition). A table including further years of detail is included in the Direct Testimony of MERC witness Ms. Mead. Ex. 12, at 21, Table 1 (Mead Direct).

Surrebuttal to reduce reserve margins as a result of increased consumption he anticipates from Rochester Public Utilities.<sup>15</sup>

As pointed out in the OAG's Initial Brief, though, Mr. Heinen's proposal to reduce reserve margins by 20,000 Dth/day for anticipated interruptible transportation service from RPU is inconsistent with Mr. Heinen's other testimony in which he states that transportation service should not be included in peak demand planning.<sup>16</sup> Applying this standard, future consumption from RPU should not be included in analysis of reserve margins for the Rochester area (or the NNG system overall). The Department's analysis is also inconsistent with the way that MERC plans its system. During the evidentiary hearing, MERC witness Ms. Lee confirmed that the utility does not plan its system based on interruptible or transportation consumption.<sup>17</sup> To make it even more clear, in an information request Ms. Lee and Ms. Lyle confirmed in writing that "interruptible and transport volumes do not factor into MERC's peak-day planning and therefore do not directly affect MERC's planning for its Rochester Project."<sup>18</sup> The Department's proposal to reduce reserve margins to account for potential future transportation consumption ignores these facts from the record, and is not reasonable.

In addition, the Department's Initial Brief contains facts that are simply untrue and are clearly controverted by the record. Specifically, the Department claims that "[i]t is unclear how [Rochester Public Utilities] intends to procure service, but it announced recently that it plans to rebuild its Westside Energy Station and use natural gas as its fuel source."<sup>19</sup> This statement is simply incorrect. In a letter that RPU filed in this proceeding, RPU clearly states, "Overall, RPU anticipates that its firm natural gas usage from Minnesota Energy Resources will remain

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<sup>15</sup> Department Initial Brief, at 37–40.

<sup>16</sup> Ex. 405, at 9 (Heinen Direct).

<sup>17</sup> Tr. Evid. Hearing, Vol. 1, at 24 (Lee).

<sup>18</sup> Ex. 304, Schedule 32, at 3 (Urban Direct Schedules Public).

<sup>19</sup> Department Initial Brief, at 18.

relatively constant for the next decade. However, RPU's use of interruptible transportation service is likely to increase dramatically in the coming years."<sup>20</sup> It is *not* "unclear how RPU intends to procure service." In fact, RPU has made very clear how it intends to procure service, and the Department has simply ignored it.

Dr. Urban pointed out RPU's intention in her Surrebuttal Testimony.<sup>21</sup> Mr. Heinen was cross examined during the evidentiary hearing, and agreed that RPU was planning to take primarily interruptible transportation service.<sup>22</sup> In fact, the Department actually *cites* to a document in which RPU clearly states that most of its new consumption will be interruptible service *in* the Initial Brief in which it claims that RPU's intentions are unclear.<sup>23</sup> These factual inconsistencies cast further doubt on the Department's reserve margin analysis.

Furthermore, the Department simply ignores that MERC has explicitly targeted both its peak demand forecast and the Rochester Project at a level of demand it forecasts for "retail sales." MERC witness Mr. Clabots testified in his Direct Testimony, the forecast was targeted at "retail sales," which *do not* include consumption from interruptible or transportation customers.<sup>24</sup> The table in which Mr. Clabots presents the Company's forecast growth rate of 1.5 percent makes very clear that the 1.5 percent growth rate is for Total Retail sales and does not include interruptible or transportation sales.<sup>25</sup> MERC's own analysis demonstrates that interruptible or transportation service was not, and should not be, part of MERC's peak demand planning.

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<sup>20</sup> Ex. 16, Schedule 1, at 2 (Mead Surrebuttal).

<sup>21</sup> Ex. 311, at 6–8 (Urban Amended Surrebuttal).

<sup>22</sup> Tr. Evid. Hearing, Vol. 2, at 30–38 (Heinen).

<sup>23</sup> Department Initial Brief, at 18 (citing to Ex. 407, at 16–17) (Heinen Surrebuttal) (*citing* Ex. 309/310, JAU-R-2 (Urban Rebuttal Schedules)).

<sup>24</sup> Ex. 9, at 3, 7, 8 (Clabots Direct).

<sup>25</sup> *Id.* at 8.

The lack of clarity in the Department's Initial Brief is problematic. On top of the fact that the entire concept of including interruptible transportation service in peak demand planning is inconsistent with the testimony of its own witnesses, MERC's witnesses, and the full record, the Department further obscures the issue by simply ignoring the facts in the record that do not support its analysis. The Department's proposal is inconsistent with its own testimony and analysis, and is unsound. The reserve margins that result from the Rochester Project should be judged based on sales growth to retail customers, and should not incorporate increased consumption from either interruptible or transportation customers who receive discounted rates in return for agreements that their consumption may be curtailed at times of peak demand.

**C. THE DEPARTMENT'S SUPPORT FOR COLLECTING \$64.7 MILLION IN EXCESS COSTS FROM RATEPAYERS IS UNACCEPTABLE.**

Both MERC and the Department attempt to justify the excess reserve margins by relying on analysis conducted by Mr. Heinen from the Department. Specifically, MERC cites Mr. Heinen's testimony that the excess capacity that will result from the Rochester Project "may cost approximately \$3 million" per year, which would amount to "2.5 percent of the total PGA costs."<sup>26</sup> MERC's reliance on Mr. Heinen's analysis is not a justification for the Project, though, because Mr. Heinen's conclusions themselves are unreasonable.

According to the Department's calculations, assuming Mr. Heinen's alternate growth forecast, the Rochester Project will lead to \$64.7 million in excess capacity costs over 22 years.<sup>27</sup> It appears that the Department has decided that it is, for some reason, acceptable to expose ratepayers to \$64.7 million in excess costs. The Department justified the excess costs in two ways. First, the Department argued that the excess costs were not significant because they would

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<sup>26</sup> MERC Initial Brief, at 37–38 (quoting Ex. 405, at 35–36 (Heinen Direct)).

<sup>27</sup> Department Initial Brief, at 32.

represent only 2.5 percent of the PGA.<sup>28</sup> Second, the Department argued that the excess costs were not significant because they were smaller than the excess costs of the Bison Project, which are already being collected from ratepayers.<sup>29</sup> Neither of these arguments justify the Department's conclusion that \$64.7 million in excess costs are reasonable.

First, the Department provides no explanation for why it would be acceptable to permit the PGA to increase by 2.5 percent because of costs that the Department knows are caused by excess capacity. Apparently, the Department believes that it is acceptable because 2.5 percent is a relatively small proportion. From the ratepayers' perspective, though, there does not appear to be any reason to accept a 2.5 percent increase in the PGA as a result of excess capacity, especially when there were alternative phased proposals in the record that could have avoided the excessive reserve margins in MERC's proposal.

Second, the Department argues that excess costs from the Rochester Project would be reasonable because ratepayers are already subjected to excess costs for another pipeline, the Bison Project.<sup>30</sup> This analysis is completely unreasonable. The fact that ratepayers are already stuck paying excess costs for one pipeline does not justify exposing them to excess costs for a different pipeline. It should always be the goal that ratepayers should not pay *any* excess costs, or at the very least that such costs should be minimized. Effective regulation should seek to minimize excess costs, not to justify them by pointing to other excess costs as some kind of comparative defense. The Bison example should be a reason for caution, not comfort, as the Commission considers MERC's proposal for the Rochester Project.

The idea that the excess reserves will cost *only* \$3 million a year is not a reasonable justification for either MERC or the Department. In fact, they expose one of the primary

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<sup>28</sup> *Id.* at 35.

<sup>29</sup> *Id.* at 36.

<sup>30</sup> *Id.*

problems with MERC's proposal: if approved, the Rochester Project would knowingly expose captive ratepayers to excess costs. MERC's attempt to avoid the issue, and the Department's inexplicable decision that \$64.7 million in excess costs is acceptable, do not change the fundamental facts of the case: the Rochester Project would result in massive reserve margins for which ratepayers should not be required to pay.

### **III. THE FORECASTS OF OTHER PARTIES DO NOT REASONABLY DEMONSTRATE A NEED TO PROVIDE 100,000 DTH/DAY OF CAPACITY IN THE ROCHESTER AREA.**

Collectively, both MERC and the Department argued in their initial Briefs that MERC's forecast was a reasonable justification for the Rochester Project. Their arguments are unreasonable.

#### **A. MERC'S USE OF HISTORICAL DATA IS UNREASONABLE.**

In its Initial Brief, MERC criticizes the OAG's analysis of historical data. As demonstrated in the OAG's Initial Brief, the historical growth rates for natural gas sales in the Rochester area has been 0.46 percent per year over the time period from 2007 to 2015.<sup>31</sup> While Dr. Urban believes that the average change per year of 0.46 percent is the appropriate measurement for this analysis, it is worth pointing that MERC also admits that the average compound growth over that time has been only 0.27 percent per year.<sup>32</sup>

But MERC also attempts to muddy the waters regarding historical growth rates. In its Brief, MERC suggests that it would be more appropriate to create specialized data sets to account for unusual weather conditions. For example, MERC suggests that the year 2014 should

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<sup>31</sup> OAG Initial Brief, at 21.

<sup>32</sup> MERC Initial Brief, at 15.

be excluded, because there was a polar vortex, and that 2015 should also be excluded because there was an El Niño weather event.<sup>33</sup>

MERC's suggestions make little sense, though, because the data in question has been weather normalized. In other words, the data has been adjusted to make sure that unusual weather does not unduly disrupt the results. It would not be appropriate to take out some years due to unusual weather, when the data has already been weather normalized to account for unusual weather. The weather normalized data demonstrates that the historical growth rate in the Rochester area has been 0.46 percent per year, or approximately one-third of MERC's estimated growth rate for the future.

**B. THE DEPARTMENT RELIES ON THE WRONG DATA FOR ITS ARGUMENT ON HISTORICAL GROWTH RATES.**

The Department also criticizes the OAG's use of historical data, but it relies upon data that is both incorrect and not part of the record in this proceeding. On pages 42 and 43 of its Initial Brief, the Department responds to Dr. Urban's concerns regarding the historical growth rates in the Rochester area. In its Initial Brief, the Department claims that the average historical growth rate is 1.20 percent.<sup>34</sup> As noted above, the average historical growth rate is actually 0.46 percent, and the average annual compound growth rate is 0.27 percent. The discrepancy is caused because the Department is simply using the wrong set of information.

It appears that the Department's confusion is related to an errata filing. Dr. Urban included a table of sales data in her direct testimony that she believed was weather normalized. After MERC pointed out in its Surrebuttal testimony that the data was not weather normalized, the OAG filed an errata to replace it with data that *was* weather normalized.<sup>35</sup> The correct,

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<sup>33</sup> *Id.*

<sup>34</sup> Department Initial Brief, at 43.

<sup>35</sup> Errata to Direct Testimony of Julie Urban (Sept. 2, 2016).



weather normalized data demonstrates that the historical growth rate was 0.46 percent from 2007 to 2015. The correct, weather-normalized data was produced by MERC.<sup>36</sup> In fact, MERC reproduced the data in Mr. Clabots' Surrebuttal Testimony and then relied on the correct data in its Initial Brief.<sup>37</sup> There is no dispute between the OAG and MERC as to what the correct data is. That data shows that the historical growth rate in the Rochester area is 0.46 percent.

The Department, however, cites to data that was not weather-normalized and was, in fact, never offered as evidence in this proceeding. The Department was served on the OAG's errata filing. The Department was present at the evidentiary hearing when Dr. Urban's Amended and Corrected Direct Testimony, which included the correct, weather normalized data, was offered and accepted by the Administrative Law Judge.<sup>38</sup> Despite this, the Department's Brief refers only to the incorrect, non-weather normalized data, which was neither offered nor accepted as evidence in this case.

It appears that the Department declined to review the errata filing, or Dr. Urban's Amended and Corrected Direct Testimony, or Mr. Clabots' Surrebuttal Testimony, and instead decided to make an argument based on evidence that is not in the record.

**C. A TIME TREND VARIABLE SHOULD BE INCLUDED FOR RESIDENTIAL CUSTOMERS.**

The OAG's Initial Brief explained that one of the problems with MERC's forecast is that it assumed a constant use-per-customer for residential customers, but used a time trend variable to account for changing use-per-customer for commercial and industrial customers.<sup>39</sup> MERC's Initial Brief, however, argues that it would be inappropriate to include a time trend variable

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<sup>36</sup> Ex. 300, at 29, Table 2 (Urban Amended and Corrected Direct).

<sup>37</sup> Ex. 11, at 6, Table 1 (Clabots Surrebuttal); MERC Initial Brief, at 15.

<sup>38</sup> Ex. 300 (Urban Direct).

<sup>39</sup> OAG Initial Brief, at 24–27.

because “the addition or modification of particular variables without corresponding adjustments to other variables in the model can yield inconsistent and unsound results.”<sup>40</sup>

MERC’s explanation does not bear up under even the most casual scrutiny. Despite the Company’s arguments, it has never attempted to identify a variable that must be adjusted when a time trend variable is added. Dr. Urban suggested adding a time trend variable in Direct Testimony, and the Company has had many opportunities to explain what “other variables” must be adjusted to account for it since the issue was raised.<sup>41</sup> It has not done so.

Another reason that MERC has been unable to identify other variables is that, contrary to the Company’s claim, Dr. Urban did not suggest adding the time trend variable in “isolation.” As Dr. Urban made clear in her opening statement, “[she] did not blindly request the inclusion of a trend variable into the use per customer model.”<sup>42</sup> Dr. Urban fully reviewed MERC’s forecasting model, including the use-per-customer model, and recommended that the models could be improved by including a time trend variable for residential customers.

The reason that Dr. Urban did so is that one of MERC’s core assumptions in the use-per-customer model was unreasonable. All of the evidence makes clear that residential use-per-customer has been declining steadily for decades.<sup>43</sup> But, despite this obvious trend, MERC’s model assumes that residential use-per-customer will be constant for the next 25 years. Dr. Urban determined that one way to correct this unreasonable assumption would be to include a time trend variable for the Residential class.

It does not even appear that MERC disputes the fact that residential use-per-customer has been declining—instead of trying to defend its assumption as reasonable, MERC’s Initial Brief

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<sup>40</sup> MERC Initial Brief, at 16.

<sup>41</sup> Ex. 300 (Urban Amended and Corrected Direct).

<sup>42</sup> Ex. 314, at 2 (Urban Opening Statement).

<sup>43</sup> Ex. 314, at 2 (Urban Opening Statement).

tries to muddle the issue by focusing on the technicalities of Dr. Urban's proposed correction. But, once again, the Company fails to recognize that it is actually using a time trend variable to modify use-per-customer for the Small C&I class,<sup>44</sup> the class most comparable to the Residential class.

And MERC also fails to acknowledge that, according to the Company's own calculation, the time trend variable was an extremely significant explanatory variable for the Residential class. As noted in the OAG's Initial Brief, the p-value measures the level of confidence as to whether an explanatory value is significant. And the p-value for the Residential time trend variable was 0.00—the highest possible level of significance.<sup>45</sup>

In making its argument against the time trend variable, MERC ignores all of these basic facts that are in the record. But MERC cannot simply sweep away the facts that are inconvenient for the Company. The record demonstrates that the time trend variable has the highest possible level of significance when included for residential customers. That means that MERC's model, which assumes that residential use-per-customer will remain constant for 25 years, is not reasonable.

**D. THE RECORD DEMONSTRATES THAT THE DEPARTMENT'S CLAIM THAT THE FORECASTS DO NOT ACCOUNT FOR THE DESTINATION MEDICAL CENTER ARE FALSE.**

Throughout its Initial Brief, the Department repeatedly defends the size of MERC's proposal for the Rochester Project by suggesting that the Company's forecast did not account for possible growth that could result from the Destination Medical Center ("DMC").

The Department's suggestion that MERC's forecast does not account for the DMC is simply incorrect. On page 17 of its Initial Brief, the Department claims that "[t]he Company's

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<sup>44</sup> Ex. 300, at 30 (Urban Amended and Corrected Direct).

<sup>45</sup> Ex. 304, JAU-14 (Urban Direct Schedules).

sales and demand projections generally assumed that the DMC would not exist in the future period.” Pages 27 through 30 of the OAG’s Initial Brief includes a lengthy refutation of the Department’s assumption that does not need to be repeated here. But it is important to note that MERC’s own description of how it conducted the forecast clearly demonstrates that the Department’s belief is erroneous.

MERC’s Initial Brief admits that the Company included consideration of the DMC in its forecast. The Company’s Initial Brief states that the Company’s forecasts were developed using “*a priori* information [accounting for] the growth that will be created, to some degree, by the expansion of the Mayo Clinic and the DMC initiative.”<sup>46</sup> The Company argues that, “Under the circumstances of this proceeding, it is reasonable for MERC to consider the Mayo Clinic’s expansion plans and plans related to the DMC project in determining an appropriate forecast given the unprecedented nature of the DMC initiative and anticipated growth that is expected to result in the Rochester area.”<sup>47</sup> To be clear, the Department has repeatedly argued that MERC’s unreasonably high forecast may be justified because it did not account for the DMC, while MERC has continually argued that it was reasonable for its forecast to account for the DMC. Those positions are fully inconsistent, and it is far more likely that MERC is accurately representing the manner in which *it* conducted *its* forecast. According to MERC, it was “reasonable for MERC to consider the Mayo Clinic’s expansion plans and plans related to the DMC project in determining an appropriate forecast.”<sup>48</sup> As with several other concerns addressed in this Reply Brief, the Department’s Initial Brief simply ignores these facts in making the arguments in its Brief.

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<sup>46</sup> MERC Initial Brief, at 17.

<sup>47</sup> *Id.* at 18.

<sup>48</sup> *Id.*

**IV. THE RECORD DOES NOT SUPPORT THE CONCLUSION THAT MERC'S PROPOSAL FOR THE ROCHESTER PROJECT IS THE MOST REASONABLE AND PRUDENT WAY TO SERVE CUSTOMERS.**

In its Initial Brief, MERC argues that it has proven that the Rochester Project is a prudent and reasonable way to provide service to customers in the Rochester area. Similarly, the Department concluded that MERC had acted reasonably and selected the lowest cost option for the Rochester Project. Neither of these conclusions are supported by a thorough review of all of the evidence in the record.

**A. MERC'S INITIAL BRIEF DOES NOT ADDRESS ALL OF THE FACTS IN THE RECORD.**

Following its attempt to shift the burden of proof to other parties, MERC argues that it has demonstrated that the Rochester Project is the most reasonable and prudent way to address need in the Rochester area. MERC's argument, however, does not contain a full consideration of all the facts in the record.

**1. MERC's Initial Brief Confirms That The Company Considered Conservation And Peak Shaving As "All Or Nothing" Options.**

MERC first argues that the "only viable alternative" to address the needs of Rochester customers was to add interstate pipeline capacity.<sup>49</sup> MERC's argument in this section, though, serve only to confirm the fact that, to the extent they were considered at all, MERC treated alternatives such as increased conservation or peak-shaving facilities as "all or nothing" options. MERC's Initial Brief points out that its witnesses discarded peak-shaving possibilities because they "determined that such facilities would [not] solve MERC's capacity need in the Rochester area."<sup>50</sup> But, as discussed in the OAG's Initial Brief, it is not reasonable to dismiss either conservation or peak shaving alternatives because they do not "solve" the need in the Rochester

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<sup>49</sup> MERC Initial Brief, at 22–24.

<sup>50</sup> *Id.* at 24.

area. It is obvious that neither solution could completely eliminate all possibility that additional natural gas will be demanded in the Rochester area in the future. But that is, just as obviously, not the point.

The point is that both conservation and peak-shaving, alone or in concert, could mitigate the need to add natural gas capacity in the future *and* the cost of doing so. At the very least, they could increase the flexibility of options available to MERC. MERC has provided no indication that it actually performed analysis to study the costs and benefits of increasing conservation or peak-shaving, much less a comparison of those costs to the full cost of the Rochester Project. That is a fundamental flaw in MERC's analysis, and is evidence that the Company has not acted prudently and reasonably in selecting the Rochester Project.

**2. MERC's Initial Brief Demonstrates A Concerning Lack Of Transparency Because It Does Not Contain Any Discussion Of Pipeline Alternatives.**

After summarily dismissing conservation and peak shaving concepts, MERC argues that its evaluation of the responses to the RFP was reasonable.<sup>51</sup> MERC's "discussion" comprises only one and a half pages of briefing. In its Initial Brief, MERC provides essentially *no information* about the details of alternative bids that it received in response to the RFP, no information about the cost estimates for those bids, no information about the methods it used to analyze the bids, and no comparative analysis of the costs and benefits of the different bids. In a later section, MERC once again compares the costs of the Amended Precedent Agreement to its "good faith" estimate of the cost for incremental upgrades, rather than the actual cost estimates provided by NNG in a competitive bid response.<sup>52</sup> At no point does the Company present a

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<sup>51</sup> *Id.* at 29–30.

<sup>52</sup> *Id.* at 32–33.

comprehensive analysis of the costs and benefits of the different options it received in response to the competitive bidding process.

This is not the type of transparency that is necessary to demonstrate that MERC has acted prudently and reasonably. MERC should be providing the Commission with a full discussion of the competitive bid responses it received, and a full analysis of the costs and benefits of each response. Instead, MERC attempts to skate by without providing a full analysis to the Commission, and then shift the burden of proof to other parties.

**3. MERC's Initial Brief Ignores The Warnings The Company Received From NNG Suggesting That A Phased Approach Was Most Appropriate.**

As described in the OAG's Initial Brief, NNG's response to the RFP included multiple sections in which NNG carefully explained to MERC that proceeding with a phased approach would provide significant benefits to customers. It is important to recognize that NNG informed MERC that a phased-in construction alternative would [HIGHLY SENSITIVE TRADE SECRET BEGINS

[HIGHLY SENSITIVE TRADE SECRET ENDS]<sup>58</sup> All of these warnings were provided to MERC by NNG in its response to the RFP. MERC has never acknowledged or explained these statements from NNG,

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<sup>58</sup> Further details of NNG's discussion are included in the OAG's Initial Brief at pages 49–51.

or why it chose to design a project with such significant up-front costs in the face of these warnings from its experienced interstate gas supplier.

MERC does, however, attempt to conflate the Amended Precedent Agreement with a phased-in proposal by arguing that it contains elements of phasing that make it comparable to the phased-in proposals presented by NNG.<sup>59</sup> While it is true that the Amended Precedent Agreement will proceed in two steps, those steps do not obtain the benefits of phasing that could have been obtained from NNG's phased-in proposals. NNG's proposals were beneficial because they reduced the forecasting risk and risk of overbuilding placed on ratepayers. The phased-in proposals allowed MERC to address existing and near-term growth in demand, without obligating ratepayers to fund facilities in anticipation of significant growth in future demand. And NNG's phased-in proposals provided MERC the option to further increase capacity to the extent that MERC's forecasted level of growth did materialize. While the Amended Precedent Agreement may have two "parts," it is not comparable to NNG's phased approach because it does not provide the same type of benefits. Both "parts" of the Amended Precedent Agreement would be completed by 2019, which indicates that its "phasing" will have no positive impact on excess reserve margins, equity issues for sales customers, or intergenerational inequities, and will provide no protection from forecasting risk. MERC's attempt to conflate the two issues is disingenuous.

**B. THE DEPARTMENT'S ANALYSIS OF MERC'S DECISION-MAKING IS INCOMPLETE.**

The Department concludes, based on the analysis conducted by Mr. Ryan and Mr. Heinen, that MERC's decision making process was reasonable,<sup>60</sup> and that MERC's proposal for

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<sup>59</sup> MERC Initial Brief, at 34–35.

<sup>60</sup> Department Initial Brief, at 76–77.



the size of the Rochester Project is reasonable.<sup>61</sup> The Department's conclusions are not supported by the evidence in the record.

**1. The Department Did Not Conduct A Complete Analysis Of The RFP Responses.**

The Department's analysis is incomplete because no analyst for the Department conducted a thorough review of the responses to the RFP (or, the alternatives that were available to meet demand) compared to the need for the Project. Mr. Heinen provided analysis and testimony regarding the forecast for growth in the Rochester area, but Mr. Heinen confirmed that it was not his responsibility to perform a detailed analysis of either the RFP or the responses to the RFP.<sup>62</sup> On the other hand, Mr. Ryan testified that it was his responsibility to review MERC's RFP and the responses, but later confirmed that he did not do any independent analysis on the RFP responses and that his conclusions about the RFP did not "address[] the size and timing of the project."<sup>63</sup>

The result is a gap in the analysis. The Department's witness who analyzed the appropriate size of the Project did not analyze the RFP or the responses; and the Department's witness who analyzed the RFP did not analyze the appropriate size of the Project *or* conduct any independent analysis of the RFP responses. No witness for the Department conducted an independent review of MERC's options. In contrast, Dr. Urban did review the RFP alternatives and concluded that some of the options that MERC discarded could have provided significant value to ratepayers. Instead, the Department reviewed the single sheet of paper MERC produced

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<sup>61</sup> *Id.* at 44.

<sup>62</sup> Tr. Evid. Hearing, Vol. 2, at 46–47 (Heinen).

<sup>63</sup> Tr. Evid. Hearing, Vol. 1, at 213 (Ryan); Ex. 409 (Ryan Opening Statement).

to support their analysis of the RFP responses, and concluded that MERC had selected the lowest cost option.<sup>64</sup> But even *that* conclusion is not supported by the record.

**2. The Department's Claim That MERC Selected The Lowest Cost Option Is Simply Wrong.**

In its Initial Brief, the Department states that MERC selected the lowest cost option for the Rochester Project.<sup>65</sup> That conclusion is not supported by the facts in the record. As discussed in the OAG's Initial Brief, during the evidentiary hearing Mr. Ryan agreed that the lowest cost bid included in MERC's single page of analysis was actually [HIGHLY SENSITIVE TRADE SECRET BEGINS]

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<sup>64</sup> MERC Initial Brief, at 72.

<sup>65</sup> *Id.* at 72.

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[HIGHLY

SENSITIVE TRADE SECRET ENDS].

The Department's conclusion that Proposal 3.0 was the lowest cost project is simply wrong, and it continues to be wrong even after accounting for the additional benefits MERC was able to negotiate from the base proposal. It remains unclear why Mr. Ryan concludes that MERC chose the least cost option when the only documents MERC has provided lead to a different conclusion, or why the Department has continued to take that position in its Brief after the errors were exposed during the evidentiary hearing.

**3. The Department's Analysis Does Not Include Any Consideration For The Special Value Provided By Phased Options.**

On top of that, it is clear that the Department's conclusion regarding the reasonableness of MERC's proposal does not account for any concerns about the timing of when capacity should be added to the system to meet any growth in demand. One significant advantage of a phased proposal is that it would spread out the costs of adding capacity. This would reduce the rate shock from a single large build-out, reduce reserve margins, expose ratepayers to less forecasting risk, and more closely tie the costs of adding capacity to the time periods and customers where it may be useful. And, on top of that, a phased proposal has the potential of being significantly less expensive—if growth turns out to be less than forecasted, a phased proposal could allow the utility to forego future upgrades that are not needed. If growth occurs as the Company expects and further upgrades are needed, a phased proposal would provide that

option; if they are not needed, then ratepayers would not be exposed to unnecessary costs as a result of building based on uncertain long-term forecasts.

In fact, the “first phase” of the phased proposals would be *significantly* less than the project that MERC has proposed. The cost for the first phase of Phased Proposals 2.3, 4.1, and 4.2 would be [HIGHLY SENSITIVE TRADE SECRET BEGINS]

[HIGHLY SENSITIVE TRADE SECRET ENDS] To be clear, that means that the Phased Proposals could have reduced costs to ratepayers by [HIGHLY SENSITIVE TRADE SECRET BEGINS] [HIGHLY SENSITIVE TRADE SECRET ENDS] if MERC’s growth projections do not pan out, while still providing options to add further capacity if the projections do materialize.

The Department tries to wave away the phased options by stating that the Amended Precedent Agreement offered a “phased approach.”<sup>69</sup> But, as discussed above, the Amended Precedent Agreement does not provide the unique benefits the NNG phased proposals could have provided. The Department’s analysis does not incorporate any consideration of these possible benefits—instead, the Department focuses only on the “cost,” and then inexplicably recommends approval of a project that is not even the lowest cost option on the record. This analysis is obviously incomplete.

#### **4. The Department’s Analysis Of The Cost Of Phased Or Incremental Proposals Is Unsound.**

In addition to these problems, the analysis the Department conducted on the cost of phased or incremental proposals is unmoored from the facts in the record. In its Brief, the Department supported MERC’s decision to proceed with a fully up-front project rather than a

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<sup>69</sup> Department Initial Brief, at 73.

phased or incremental project because of a “good faith” estimate of the cost of an incremental or phased project provided by MERC.<sup>70</sup> According to the Department, the good faith estimate produced by MERC demonstrates that adding an incremental capacity of 30,000 Dth/day would create a Net Present Value cost of \$1 million more than the Amended Precedent Agreement, which proposes to add 45,000 Dth/day.<sup>71</sup> Based on this fact, the Department concludes that MERC’s decision to negotiate from Proposal 3.0 and select an up-front project was the “lowest cost” option.

But it is entirely unreasonable to rely on “good faith” cost estimates of providing incremental or phased capacity that are produced by MERC’s consultants, when the record already contains a number of phased proposals that are the result of a competitive bidding process. As discussed in the OAG’s Initial Brief, the “good faith” estimates that MERC provided are completely unreasonable when compared to the cost of the proposals that resulted from the RFP process. MERC’s good faith estimate proposes that it would cost [HIGHLY SENSITIVE TRADE SECRET BEGINS] [HIGHLY SENSITIVE TRADE SECRET ENDS] to provide 45,000 Dth/day in an incremental manner.<sup>72</sup> That figure is absurd when compared to Phased Proposal 4.2, which estimates a cost of [HIGHLY SENSITIVE TRADE SECRET BEGINS]

[HIGHLY SENSITIVE TRADE SECRET ENDS].<sup>73</sup> Mr. Sexton’s “good faith” estimate of providing 35,000 Dth/day in an incremental manner is [HIGHLY SENSITIVE TRADE SECRET BEGINS] [HIGHLY SENSITIVE TRADE SECRET

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<sup>70</sup> *Id.* at 34–35.

<sup>71</sup> *Id.* at 35.

<sup>72</sup> Ex. 22, at 17 (Sexton Rebuttal Schedules HSTS).

<sup>73</sup> Ex. 303, at 24 (Urban Amended and Corrected HSTS Direct). Other bids had similar cost estimates.

ENDS].<sup>74</sup> But MERC received phased proposals with an up-front cost estimate *far* lower than Mr. Sexton’s approach. For example, Phased Proposal 4.2 would have added 17,669 Dth/day (more than enough to resolve supply problems for more than a decade assuming MERC’s forecast is correct) for an up-front cost of [HIGHLY SENSITIVE TRADE SECRET BEGINS] [HIGHLY SENSITIVE TRADE SECRET ENDS].<sup>75</sup> Phased Proposal 4.2 could then have provided an additional 27,331 Dth/day, for a total of 45,000 Dth/day, with a deferred cost estimate of [HIGHLY SENSITIVE TRADE SECRET BEGINS] [HIGHLY SENSITIVE TRADE SECRET ENDS].<sup>76</sup> In other words, the total cost, [HIGHLY SENSITIVE TRADE SECRET BEGINS] [HIGHLY SENSITIVE TRADE SECRET ENDS], of providing 45,000 Dth/day in a phased proposal is [HIGHLY SENSITIVE TRADE SECRET BEGINS] [HIGHLY SENSITIVE TRADE SECRET ENDS] *less* than Mr. Sexton’s “good faith” estimate of providing 30,000 Dth/day. While Mr. Sexton’s “good faith estimate” may seem useful in a vacuum, when compared against the facts actually in the record it makes no sense.

The Department’s decision to rely on estimates created by the Company’s consultant, months after the Petition was filed, when there were competitive bid proposals available in the record, strains any claim to reasonableness. The Department does not provide any detail about the other bids in its Initial Brief. It is clear that neither Mr. Heinen nor Mr. Ryan conducted any independent analysis of the RFP responses.<sup>77</sup> Mr. Heinen actually admitted during the evidentiary hearing that he did not know whether the “good faith” estimates he was relying on

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<sup>74</sup> Ex. 22, at 18 (Sexton HSTS Rebuttal Schedules).

<sup>75</sup> Ex. 306, Schedule 5, at 38–40 (Urban HSTS Direct Schedules).

<sup>76</sup> *Id.*

<sup>77</sup> Tr. Evid. Hearing, Vol. 1, at 213 (Ryan); Ex. 409 (Ryan Opening Statement); Tr. Evid. Hearing, Vol. 2, at 46–47 (Heinen).

were higher or lower than the competitive bid estimates.<sup>78</sup> And, yet, the Department concludes that Mr. Sexton's estimates justify MERC's proposal for the project. The Department's decision to base its analysis on Mr. Sexton's "good faith" estimates, rather than the results of the competitive bidding process, is fundamentally unreasonable.

**5. The Department's Suggestion That Excess Costs For The Rochester Project Are Comparable To The Costs Of Insurance Is Not Based On Any Evidence In The Record.**

In its Initial Brief, the Department for the first time claims that the excess costs that would result from the Rochester Project are somehow comparable to the costs of insurance. Specifically, the Department states, "Any excess costs associated with the Project as proposed by MERC are relatively small on an annual basis and are comparable to insurance against the potential costs of future system upgrades."<sup>79</sup> It is important to recognize that the Department provides no citation or reference for this statement. The reason that the Department provides no citation is that there is none. The Department's claim that the excess costs of the Rochester Project are comparable to "insurance against the potential costs of future system upgrades" is an invented fact. There is no plausible support for the Department's statement anywhere in the record.

In fact, the record supports the opposite conclusion. The Department, presumably, is referring to the estimate \$64 million in excess capacity costs that it estimates would result from the Rochester Project.<sup>80</sup> But it makes no sense to claim that \$64 million in excess costs is somehow comparable to the costs of a phased proposal. The record demonstrates that the cost of phased proposals is actually comparable to the cost of the Amended Precedent Agreement.<sup>81</sup>

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<sup>78</sup> Tr. Evid. Hearing, Vol. 2, at 51 (Heinen).

<sup>79</sup> Department Initial Brief, at 36.

<sup>80</sup> *Id.* at 32.

<sup>81</sup> OAG Initial Brief, at 54; *see also* Ex. 306, Schedule 5, at 38 (Urban HSTS Direct Schedules).

Instead of relying on a careful analysis of the facts in the record, the Department is attempting to support its recommendation with uncited and unsupportable claims.<sup>82</sup>

## **V. OTHER FUNDS AVAILABLE TO COVER THE PROJECT COSTS.**

In its Notice of and Order for Hearing, the Commission asked parties to investigate “what other funds may be available to cover the project costs.”<sup>83</sup> Much of this conversation has focused on whether the Rochester Project should receive funding through the state’s infrastructure aid program for DMC construction. But it is also important to consider whether other customers should contribute specifically to the costs.

### **A. FUNDING FROM THE PUBLIC INFRASTRUCTURE AID STATUTE.**

In its Initial Brief, the Department provided a discussion of whether the Rochester Project would be eligible for public infrastructure aid under Minnesota Statutes section 469.47. This statute provides that state infrastructure aid is available for construction projects in the Rochester area under certain conditions.<sup>84</sup> The Department concluded that the Rochester Project was not eligible, because the Rochester Project will not take place in the Destination Medical Center “development district.”<sup>85</sup>

According to the statutory scheme, the “development district” is a “geographic area in the city identified in the DMCC development plan.”<sup>86</sup> The Department correctly notes that the development district outlined in the DMCC’s Plan is in downtown Rochester and not near the area where MERC proposes to construct the Rochester Project. That means, according to the Department, that the Rochester Project is not eligible for state infrastructure aid.

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<sup>82</sup> If, instead, the Department is referring to some form of actual insurance, the claim makes even less sense, as the matter of insurance has never been an issue in this case.

<sup>83</sup> Notice of and Order for Hearing, at 5 (Feb. 8, 2016).

<sup>84</sup> Minn. Stat. § 469.47, subd. 3.

<sup>85</sup> Department Initial Brief, at 86.

<sup>86</sup> Minn. Stat. § 469.40, subd. 5.



It is possible, however, that things could have worked out differently. For example, as Dr. Urban pointed out, there are provisions in the DMC Plan that would allow the DMC Corporation board to amend the DMC Development District to include a new area.<sup>87</sup> The DMC Plan states, “From time to time, the DMCC and City may consider expanding the DMC Development District to support the execution of specific projects or strategies that are outside of the current boundaries.”<sup>88</sup> The Plan goes on to provide a list of criteria that would be used to judge a request for amendment.<sup>89</sup> If MERC believes that the Rochester Project is necessary for the success of the DMC development plan, then MERC should have provided a thorough and detailed request for amendment to the DMC governing organizations. Instead, a review of MERC’s application to the DMC demonstrates that the Company’s request for an amendment was a single paragraph of general explanation about the purpose of the Rochester Project.<sup>90</sup> If MERC had more vigorously pursued an amendment, it is possible that the outcome could have been different.<sup>91</sup>

In addition, it is possible that the DMC Plan could have been designed differently if MERC had involved the DMC organizations in the early stages of the Rochester Project. According to the record, the first time that MERC formally contacted the DMC about the Rochester Project was via an email on February 15, 2016.<sup>92</sup> During the evidentiary hearing, Ms. Lee confirmed that, while some people involved with the DMC may have been aware of the Rochester Project, she could not recall any instances in which the Company sought the input of

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<sup>87</sup> Ex. 300, at 68 (Urban Amended and Corrected Direct).

<sup>88</sup> DMC Plan, at 8. Ex. 300, at 68 (Urban Amended and Corrected Direct). Dr. Urban incorporated the voluminous DMC Plan by citation, as it was not practicable to include a copy with her testimony.

<sup>89</sup> *Id.*

<sup>90</sup> Ex. 5, Schedule ASL-3, at 3.

<sup>91</sup> It is important to consider MERC’s incentives regarding the possibility of outside funding. As Dr. Urban pointed out, “It is not clear that MERC has a financial interest in obtaining alternate funding, because that could impact the amount of investments on which the Company earns a rate of return in the future.” Ex. 300, at 68 (Urban Amended and Corrected Direct).

<sup>92</sup> Ex. 304, Schedule JAU-18 (Urban Direct Schedules).

the DMC before it filed its Petition with the Commission.<sup>93</sup> And, necessarily, that means that MERC also did not seek the input of the DMC before it decided which type of project to pursue.

The DMC Plan was published in December, 2014.<sup>94</sup> Mr. Heinen notes that MERC contacted the Department about the Rochester Project in October 22, 2014.<sup>95</sup> That means that MERC was considering how to move forward with the Rochester Project at a time when it could have discussed the “development district” with the DMC governing bodies *before* the DMC Plan was finalized. If MERC had been proactive, it is possible that the DMC Plan could have made allowances for the Rochester Project and made it eligible for public infrastructure funding.

While it appears that the Rochester Project is not eligible for DMC infrastructure aid at this time, that does not mean that MERC’s approach was reasonable. Strong, early engagement with the DMC governing bodies may have allowed MERC to have input on the design of the DMC Plan. And, if MERC truly believes that the Rochester Project is necessary for the DMC project to succeed, MERC could have presented a stronger request for amendment of the DMC in its request for funding. As it is, ratepayers will not have the benefit of any state infrastructure aid.

## **B. CONTRIBUTIONS IN AID OF CONSTRUCTION.**

State infrastructure aid from the DMC statutes is not the only possible source of contributions. In a normal situation, if a new customer wanted to join MERC’s system but MERC did not have sufficient capacity to serve them, it would be reasonable to require that customer to contribute to the costs of acquiring more capacity. Because that new customer caused the cost of the new capacity, that cost would be assigned to them. Contributions of this nature are sometimes called Contributions in Aid of Construction (“CIACs”). For example,

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<sup>93</sup> Tr. Evid. Hearing, Vol. 1, at 31–32 (Lee).

<sup>94</sup> DMC Plan, at 1.

<sup>95</sup> Ex. 405, at 4 (Heinen Direct).

during one of the public hearings, MERC representatives disclosed that one of its customers may be interested in constructing a clean room, which would require significantly more energy than normal construction.<sup>96</sup> Ms. Lee stated that if a new customer wanted to construct a clean room, the that customer “would pay to upgrade their systems, upgrade [MERC’s] systems, and [] receive that special amount of service or their special requirements.”<sup>97</sup> Ms. Lee concluded that the new customer would “still be paying that contribution in the future.”<sup>98</sup> In other words, the new customer would have to contribute to costs if its service was not economical.<sup>99</sup>

Contrary to Ms. Lee’s assertion, though, MERC’s vision for the Rochester Project flips this on the head. It is extremely unlikely that any new customer would be required to contribute to obtaining new capacity, even if their needs are extremely large, because MERC proposes to acquire that capacity *before* it is requested by any potential new customers. Because MERC believes that there will be significant growth, MERC is seeking to add the capacity that may be required by large customers in the future, before it is actually needed. This changes the normal process for obtaining CIACs. If adding a new customer required MERC to obtain additional capacity, it would be reasonable for MERC to ask that new customer to contribute to the costs of doing so. Because MERC has proposed to obtain the capacity before it is requested, though, new customers would not have to contribute—the capacity will already be available. Effectively, no customer, no matter how large, will ever be asked for to provide a CIAC for new capacity, because MERC is proposing to make sure that capacity is available before it is needed.

To provide another example, the Department has repeatedly suggested that its proposed 50/50 split of Phase II costs would take place “after assignment of costs to Rochester Public

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<sup>96</sup> Transcript of July 12, 2016 Public Hearing in Rochester – 1 p m., at 50–51, 56, 60.

<sup>97</sup> Transcript of July 12, 2016 Public Hearing in Rochester – 1 p m., at 78–79.

<sup>98</sup> *Id.*

<sup>99</sup> For a thorough discussion of economical service, *see* OAG Initial Brief, at 78–99.

Utilities.”<sup>100</sup> Apparently, the Department believes that the fact that Rochester Public Utilities may require significant natural gas capacity in the future would justify directly assigning some costs of that capacity.<sup>101</sup> The Department’s suggestion makes sense from a cost causation standpoint—if a single customer is the reason that MERC must obtain a significant amount of additional capacity, it is economically reasonable and equitable for that customer to cover the costs. Unfortunately, it appears that this principle could not be applied to the Rochester Project because MERC is proposing to construct the capacity in anticipation that customers will request it in the future. If or when RPU needs additional capacity, it would be unlikely to provide a CIAC under existing policies because, according to MERC’s plan, the capacity will already be there.

As a result, it appears that MERC has designed the Rochester Project in such a way that it will be challenging to obtain CIACs from customers, even if they have significant consumption requirements. This is yet one more reason that the Rochester Project is not a reasonable solution to the demand situation in the Rochester area.

## **VI. THE ROCHESTER PROJECT IS NOT ELIGIBLE FOR COST RECOVERY UNDER THE NATURAL GAS EXTENSION PROJECT RIDER STATUTE.**

In its Initial Brief, the Department claims that all parties in this case agree that the Rochester Project is eligible for cost recovery under the Natural Gas Extension Project (“NGEP”) Rider Statute, Minnesota Statutes section 216B.1638.<sup>102</sup> The Department’s claim is not true.

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<sup>100</sup> Ex. 400, at 4 (Peirce Direct); Ex. 401, at 5 (Peirce Surrebuttal); Department Initial Brief, at 80–81.

<sup>101</sup> When pressed to further explain its proposal to assign costs to RPU, the Department was unable to provide sufficient details for the OAG to take a position on the matter. *See* Tr. Evid. Hearing, Vol. 1, at 203–204 (Peirce); Tr. Evid. Hearing, Vol. 2, at 17–19 (Heinen).

<sup>102</sup> Department Initial Brief, at 45.

The OAG's Initial Brief explains that permitting the Rochester Project to be recovered through an NGEF Rider would not be consistent with the Legislature's intent.<sup>103</sup> The Department's cursory analysis of NGEF Rider eligibility does not address the absurdity that would result from permitting a natural gas utility to recover one-third of all system integrity and reliability costs through a rider. The Department also fails to account for the legal requirement that technical terms in Minnesota statutes must be construed according to their special meaning. As demonstrated in the OAG's Initial Brief, a more comprehensive and searching analysis reaches a different result. The Rochester Project, if it is approved, is not eligible for recovery through an NGEF Rider.

### CONCLUSION

The Rochester Project, as designed and proposed by MERC, is not prudent, reasonable, and necessary to serve customers in the Rochester Area. MERC has not demonstrated by a preponderance of the evidence that its representation of the level of need is reasonable, or that its proposal to address that need is reasonable. As a result, the Commission should deny MERC's request for pre-approval of the Rochester Project, and direct the Company to develop a new plan to provide service to customers in the Rochester area.

In the alternative, if the Commission approves the Rochester Project, the Commission should take steps to protect ratepayers from excessive costs. The Commission could do so by finding that a portion of the Rochester Project, either related to the exceedingly large level of reserve margins or the excess costs as compared to the competitive bids that could have provided service through a phased proposal, is not used and useful because it is not reasonably necessary to meet the demand of existing customers.

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<sup>103</sup> OAG Initial Brief, at 78–99.

Regarding MERC's proposal for cost recovery and cost allocations, if the Rochester Project is approved the Commission should find 1) that the Rochester Project is not eligible for recovery through the NGEPRider; 2) that MERC's proposal to recover the Phase II distribution costs from all customers is reasonable; 3) that MERC must work with parties to ensure that costs for the NNG upgrades are shared by all customers in a manner commensurate with the benefits received; and 4) that the costs of the Project should be capped based on the cost estimates provided in this proceeding.

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Respectfully submitted,

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