BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Dan Lipschultz	Commissioner
Matthew Schuerger	Commissioner
Katie J. Sieben	Commissioner
John A. Tuma	Commissioner

In the Matter of Minnesota Energy Resources Corporation's Request for Approval of a Gas Utility Infrastructure Cost Rider

ISSUE DATE: February 5, 2019

DOCKET NO. G-011/M-18-281

ORDER APPROVING GAS UTLITY INFRASTRUCTURE COST RIDER WITH MODIFICATIONS AND REQUIRING COMPLIANCE FILING

PROCEDURAL HISTORY

On April 13, 2018, Minnesota Energy Resources Corporation (MERC or the Company) filed a petition to establish a rider to recover gas utility infrastructure costs under Minn. Stat. § 216B.1635. Under MERC's proposal, the rider would begin operation in 2019, with a 2019 revenue requirement of approximately $3.64 million.

By July 27, two parties had filed comments on MERC's petition: the Minnesota Department of Commerce (Department) and the Office of the Attorney General – Residential Utilities and Antitrust Division (OAG).

The Department recommended granting MERC's petition with modifications and asked the Company to provide further information in reply comments. The OAG recommended that the Commission deny the request to establish a rider or, failing that, grant it with certain conditions intended to protect ratepayers.

On August 17, MERC filed reply comments responding to the Department and the OAG, and providing the additional information the Department had requested.

On December 6, 2018, the Commission met to consider the matter.

FINDINGS AND CONCLUSIONS

I. Summary of Commission Action

In this order, the Commission approves MERC's requested rider with modifications and requires the Company to make a compliance filing proposing a new rider rate factor and effective date based on the decisions described below.

II. Background

A. Statutory Background

Generally, a public utility may not change its rates without undergoing a general rate case in which the Commission comprehensively reviews the utility's costs and revenues. However, the Legislature has created exceptions to this general policy, allowing a utility to implement a rider with a rate-adjustment mechanism to expedite recovery of certain costs not reflected in the utility's base rates.

Minn. Stat. § 216B.1635 allows utilities to seek rider recovery of gas utility infrastructure costs (GUIC). GUIC are costs incurred in gas utility projects that are in-service but were not included in the utility's rate base in its most recent general rate case. "Gas utility projects" involve either (1) the replacement of natural gas facilities required by road construction or other public work by or on behalf of a government agency or (2) the replacement or modification of existing facilities required by a federal or state agency, including surveys, assessments, reassessment, and other work necessary to determine the need for replacement or modification of existing infrastructure.[1]

A utility seeking approval of a GUIC rider must file a petition, accompanied by a "gas infrastructure project plan report," at least 150 days before the rider is to be implemented.[2] The report and petition must list the projects and costs proposed for recovery, including, but not limited to:

- project description and scope, estimated costs, and in-service date;
- the government entity ordering or requiring the project and the purpose for which the project is undertaken;
- a description of the estimated costs and salvage value, if any, associated with the existing infrastructure replaced or modified as a result of the project;
- a comparison of the utility's estimated costs and the actual costs incurred, including a description of the utility's efforts to ensure that the costs of the facilities are reasonable and prudently incurred;
- calculations to establish that the rate adjustment is consistent with the terms of the rate schedule, including the proposed rate design and an explanation of why the proposed rate design is in the public interest;
- the magnitude and timing of any known future projects that the utility may seek to recover under the GUIC statute;
- the magnitude of the costs in relation to the utility's base revenue as approved by the Commission in the utility's most recent general rate case, exclusive of gas-purchase costs and transportation charges;
- the magnitude of the costs in relation to the utility's capital expenditures since its most recent general rate case; and

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[1] Minn. Stat. § 216B.1635, subd. 1(b), (c).

[2] *Id.*, subd. 2. The report "must be for a forecast period of one year." *Id.*

- the amount of time since the utility last filed a general rate case and the utility's reasons for seeking recovery outside of a general rate case.[3]

The Commission may approve a GUIC rider if the costs proposed for recovery through the rider are prudently incurred and achieve gas facility improvements at the lowest reasonable and prudent cost to ratepayers.[4] Costs eligible for rider recovery include not only the plant investment itself but also a rate of return on that investment, income taxes on the rate of return, incremental property taxes, incremental depreciation expense, and any incremental operation and maintenance (O&M) costs.[5]

B. MERC's Petition for Approval of a GUIC Rider

MERC's petition seeks to implement a GUIC rider to recover approximately $3.64 million related to the Company's projected 2019 gas utility infrastructure capital expenditures and incremental O&M expense, subject to true-up.

MERC forecasts spending in both types of statutory "gas utility project" categories:

- Capital investment of approximately $5.3 million to replace natural gas facilities located in the public right-of-way; and
- Capital investment of approximately $7 million and incremental O&M expenses of approximately $3 million to comply with federal regulations requiring pipeline operators to validate the integrity of their natural gas distribution system to mitigate safety risks.

The first category includes costs incurred in relocating Company facilities to accommodate various public-works projects. Government entities ask for relocations according to their own planning timelines, and MERC generally does not learn of future right-of-way relocations with enough lead time to include specific projects in its forecasts. Its petition thus does not identify specific right-of-way relocation projects planned for 2019, and the $5.3 million projected capital investment is based on average annual spending on relocations in 2015–2017.

The second category includes costs associated with MERC's efforts to comply with regulations issued by the federal Pipeline and Hazardous Materials Safety Administration (PHMSA). PHMSA's rules require pipeline operators to implement transmission- and distribution-integrity-management programs (TIMP and DIMP) to assess and improve the safety, reliability, and integrity of their infrastructure.[6] MERC identified three new projects that fall under its DIMP program: (1) a stop-valve survey, (2) a sewer cross-bore survey, and (3) replacement of obsolete piping and stop valves.[7]

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[3] *Id.*, subds. 3, 4.

[4] *Id.*, subd. 5.

[5] *Id.*, subd. 4.

[6] *See* 49 C.F.R. pt. 192, subps. O (prescribing minimum requirements for TIMP), P (prescribing minimum requirements for DIMP).

[7] Petition, Ex. E (Gas Infrastructure Project Plan Report), at 1–4.

As with relocation costs, MERC used its historical spending in 2015–2017 as the basis for projecting 2019 capital investments. Although the Company only seeks rider recovery of DIMP investments, it used the historical average spending for both TIMP and DIMP as the basis for its projection. MERC explained that it did so because it has replaced most of its transmission lines with high-pressure distribution mains and plans to focus its integrity-management efforts on distribution-level facilities in 2019.

MERC proposes to recover its 2019 GUIC revenue requirement using a GUIC rate factor of $0.00415 per therm applicable to all customer classes. The Company estimates that a typical residential customer would pay an additional $3.60 per year under its proposal.

III. Recoverability of Requested Costs

A. Summary

The Department recommended that the Commission delay rider recovery of MERC's right-of-way relocation costs, arguing that the Company did not provide sufficient detail about its planned 2019 relocation projects. The OAG argued that MERC had not satisfied the requirements of the GUIC statute and recommended denying rider recovery or granting it with conditions.

For the reasons discussed below, the Commission finds that MERC has adequately supported its request for rider recovery of both right-of-way relocation costs and DIMP costs. Accordingly, the Commission will authorize the Company to recover these costs though a GUIC rider beginning in 2019.

B. Positions of the Parties

1. The Department

The Department argued that MERC's forecasted 2019 right-of-way relocation costs are not recoverable through the GUIC rider because the Company did not provide project-specific details such as a project descriptions, estimated costs, or in-service dates. The Department recommended that MERC be allowed to recover actual 2019 relocation costs in 2020 after they are incurred and specific project information is available.

2. The OAG

The OAG argued that MERC has not adequately supported its request for rider recovery for three main reasons.

First, it echoed the Department's concern that MERC was unable to provide specific project information for all its 2019 relocation costs.

Second, the OAG claimed that MERC's base rates include representative amounts of capital costs and O&M costs and argued that the Company had not provided enough information to confirm that the costs it seeks to recover through the GUIC rider are incremental to the costs already reflected in its rates—or the new rates that will result from its pending rate case.[8]

Finally, the OAG argued that MERC had not identified specific federal or state requirements that mandate its DIMP expenses. While MERC cited PHMSA rules that require natural gas distribution companies to develop and implement integrity-management programs, the OAG contended that the rules do not require utilities to take any specific steps.

For these reasons, the OAG recommended against approving the rider. However, if the Commission decides to approve a GUIC rider, the OAG would recommend making two changes to avoid potential overrecovery.

First, the OAG recommended recalculating the amount of relocation-project capital costs based on a five-year average, rather than the three-year average MERC used in its petition. This longer averaging period would result in rider-eligible capital costs of $4.4 million rather than the $5.3 million MERC has proposed.

Second, the OAG recommended that MERC's proposed true-up mechanism include a cap such that MERC would not be permitted to true up to actual costs that exceed its initial estimate, unless the Company can prove that it was reasonable and prudent to incur the excess costs.

3. MERC

MERC maintained that all the projects for which it seeks rider recovery are different from the projects included in the 2018 revenue requirement currently under review in its rate case, and that the requested costs are therefore incremental as required by the statute. The Company did, however, agree with the OAG that depreciation expense associated with replaced assets should not be recovered through the rider and proposed to account for it in the annual true-up.

MERC contended that the OAG's argument that the Company's DIMP initiatives were not "required" by federal or state agencies was based on a too-restrictive reading of the GUIC statute and a misunderstanding of utilities' obligation to follow federal and state safety guidance. According to MERC, the fact that agency guidance may not identify specific steps to be taken does not mean that it does not require any action from utilities; it means that each utility must proactively work to identify and address potential threats to the safety of its system.

With respect to its 2019 right-of-way relocation projects, MERC reiterated that it is unable to identify every relocation project in advance and argued that, through the annual true-up process, the Company will be able to ensure that all estimated relocation costs recovered through the rider are actually incurred. MERC argued that interpreting the statute to require detailed project-by-project information for relocation costs would make timely recovery of these costs impossible, contrary to the purpose of the GUIC statute.

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[8] *See generally In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to Increase Rates for Natural Gas Service in Minnesota*, Docket No. G-011/GR-17-563. The Commission issued its *Findings of Fact, Conclusions, and Order* on December 26, 2018. A petition for reconsideration of that order is currently pending.

For similar reasons, MERC opposed the Department's recommendation to delay rider recovery of right-of-way relocation costs until the year after they are incurred. And the Company argued that the OAG's proposal to base rider recovery of relocation costs on a five-year average rather than a three-year average was unreasonable because relocation costs have been increasing in recent years.

Finally, MERC opposed the OAG's recommendation to cap the rider true-up based on the Company's initial estimate. MERC stated that its annual true-up filing would allow it to demonstrate that the actual costs of rider-eligible projects were prudently incurred and give parties and the Commission an opportunity to review those costs.

C. Commission Action

The Commission agrees with MERC that the costs it seeks to recover through its proposed GUIC rider are incremental; required by federal, state, or local agencies; and supported by sufficient detail to meet the information requirements of the GUIC statute. Accordingly, the Commission will authorize the Company to recover the capital and O&M costs identified in its petition though a GUIC rider, beginning in 2019.

Both the capital costs and the O&M costs derive from new projects that are not currently reflected in the Company's base rates or the rates that will flow from the pending rate case; the costs are therefore incremental as required by the GUIC statute. Moreover, the Commission agrees with MERC that its efforts to comply with federal DIMP regulations, or with state guidance pursuant to federal safety regulations, meets the definition of a "gas utility project" under the statute.

Both the Department and the OAG expressed concern that MERC did not provide sufficient detail about its right-of-way relocation costs. This concern is misplaced. The GUIC statute anticipates the use of estimated costs.[9] As MERC has explained, it generally is not informed of future right-of-way relocation work with enough lead time to include specific projects in its forecasts. Therefore, MERC's petition relies on historic spending to support its requested amount. This amount will be trued up annually to actual costs, eliminating any possibility that forecasting will result in overrecovery.

The OAG supported the true-up concept but argued that MERC should not be allowed to correct for underestimation unless it can demonstrate that it was necessary and prudent to exceed an estimate. However, the Commission finds this condition unnecessary, since MERC already has the obligation to demonstrate the reasonableness and prudence of all costs actually spent at the time of the true-up.[10]

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[9] *See* Minn. Stat. § 216B.1635, subds. 2 (providing that the gas-infrastructure-project-plan report accompanying a rider petition "must be for a forecast period of one year"), 4(2)(iv) (requiring that the petition include "a comparison of the utility's estimated costs included in the gas infrastructure project plan and the actual costs incurred").

[10] If anything, putting extra conditions on trueing up an under-recovery seems likely to encourage overestimating costs to ensure that actual spending comes in below the estimate. This in turn would put an extra cost burden on ratepayers during the time the rates based on the estimate are in effect.

Finally, the Commission finds MERC's use of a three-year average of relocation costs reasonable both because these costs have been trending higher in recent years and because any overestimation can be corrected for in the true-up.

For the foregoing reasons, the Commission will allow MERC to recover the capital and O&M costs identified in its petition though a GUIC rider beginning in 2019.

IV. Rate of Return

A. The Issue

The GUIC statute allows utilities to recover a rate of return on rider investments and provides that the rate "shall be at the level approved by the commission in the public utility's last general rate case, unless the commission determines that a different rate of return is in the public interest."[11]

MERC proposed to recover a 6.8842% rate of return on GUIC investments, the same overall rate of return authorized in the Company's last general rate case.[12]

The Department recommended that the rate of return for the GUIC rider be set to the 6.6971% rate authorized in MERC's pending rate case.[13] And the OAG recommended that the rate be set at 3.6%, the cost of long-term debt authorized in the pending rate case, arguing that this rate would better reflect the lower risk of recovering costs through a rider as compared to base rates.

MERC agreed with the Department that it was appropriate to use the most current information about the Company's risk profile to set a rate of return for the rider, and proposed to do so through the true-up. MERC opposed the OAG's recommendation to use its long-term debt rate, arguing that the rate would not sufficiently compensate its shareholders for their investment in GUIC projects.

B. Commission Action

The Commission will set the rate of return for the GUIC rider equal to the 6.6971% overall rate of return authorized in MERC's pending general rate case.

The OAG contends that the cost of long-term debt would better reflect the risk associated with investments being recovered through a rider. However, MERC's GUIC investments are financed through a mix of equity and debt financing. The Commission therefore concludes that MERC's

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[11] Minn. Stat. § 216B.1635, subd. 6.

[12] *See In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to Increase Rates for Natural Gas Service in Minnesota*, Docket No. G-011/GR-15-736, Findings of Fact, Conclusions, and Order, at 29 (October 31, 2016).

[13] *See In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to Increase Rates for Natural Gas Service in Minnesota*, Docket No. G-011/GR-17-563, Findings of Fact, Conclusions, and Order, at 28 (December 26, 2018).

overall rate of return, which reflects a mixture of equity and debt risk, is the most reasonable rate for its GUIC rider.

V. Carrying Charge

MERC proposes to collect a carrying charge on the average monthly tracker balance—which reflects the difference between GUIC-related costs and revenues collected—at the rate of 1/12 of the Company's currently authorized cost of short-term debt.

The Department disagreed with MERC's proposal to collect a carrying charge, arguing that the purpose of such a charge is to compensate the Company for the time value of money and that, since the GUIC rider already provides accelerated recovery of GUIC investments, a carrying charge is not justified.

The Commission agrees that the need for a carrying charge has not been demonstrated on this record and therefore will not authorize MERC to collect a carrying charge on the average monthly GUIC tracker balance.

VI. Rider Rate Factor

MERC calculated a per-therm GUIC rider rate factor of $0.00415 by dividing its proposed 2019 GUIC revenue requirement by total forecast 2019 sales. The rate factor is the same for all customer classes and assumes an effective date of January 1, 2019

A. Rate Design

The Department recommended that the Commission consider varying the per-therm charge by class according to the nongas revenue allocation approved in MERC's pending rate case. The Department argued that this allocation would better reflect the fact that GUIC investments are distribution-related rather than energy-related.

MERC, however, argued that its proposal to use a flat charge for all customer classes was reasonable, both because it would make the administration of the rider less burdensome, and because it would recognize that all customer classes benefit from being able to use GUIC investments. The Commission agrees and will approve MERC's proposed rate design.

B. Recovery Period

MERC calculated the rate factor assuming an effective date of January 1. If a January 1 effective date is not possible, the Company recommended that the GUIC rate factor be recalculated to recover the 2019 revenue requirement over the remaining months of the year to align the timing of cost recovery with the projects' in-service dates.

The Commission will require MERC to calculate a new GUIC rider rate factor based on a full 12 months of sales to help smooth the increase to customer rates as a result of the new rider.[14] Any resulting under-recovery of 2019 GUIC costs can be addressed in a future rider proceeding.

VII. Performance Metrics

The OAG recommended that, if the GUIC rider is approved, MERC be required to implement performance metrics to ensure that gas distribution improvements are achieved at the lowest reasonable cost to ratepayers. The OAG recommended that the Commission consider developing performance metrics for integrity-management programs applicable to MERC and to gas utilities generally. It provided the following potential metrics for discussion purposes:

Desired Regulatory Outcome	Potential Performance Metric
Safety/reliability	• Leak rate by pipe material • Causes of leaks/incidents • Quantification of system risk • Quantification of reduction to system risk
Cost-effectiveness	• Integrity-management budget • Unit cost by pipe material • Comparison of budgeted costs to actual costs • Quantification of cost savings from reduced leaks

MERC pointed out potential difficulties with some of the OAG's suggested performance metrics. For example, the Company stated that it was not clear how to directly quantify overall system risk or reductions to system risk. MERC also stated that it already complies with federal regulations requiring it to report the total number of leaks eliminated or repaired, categorized by cause. And the Company noted that the Commission has not established performance metrics for other utilities' GUIC riders.

The Commission shares the OAG's commitment to ensuring that GUIC investments are achieved at the lowest reasonable cost to ratepayers.[15] However, the Commission is not persuaded that now is the right time to open a broad inquiry into DIMP performance metrics. Furthermore, the annual rider true-up process will provide the Commission, the OAG, and other stakeholders an additional opportunity to ensure that GUIC investments are prudent and cost-effective. The Commission will therefore decline to adopt performance metrics for MERC's GUIC rider at this time.

[14] The Commission notes that other adjustments to the GUIC rider rate factor will need to be made as a result of this order. These adjustments will also need to be reflected in the compliance filing discussed below.

[15] *Cf.* Minn. Stat. § 216B.1635, subd. 5 (providing that rider costs should "[be] prudently incurred and achieve gas facility improvements at the lowest reasonable and prudent cost to ratepayers").

VIII. Compliance Filing; Customer Notice

Having determined that MERC's petition should be approved with the above modifications, the Commission will require the Company to make a compliance filing within ten days of the date of this order that includes the following:

- Revised tariff language,
- A calculation of the authorized GUIC revenue requirement,
- A new GUIC rider rate factor,
- A new proposed effective date for the rider and a plan for implementing the new rate factor, and
- A revised customer bill message and a bill insert explaining the change in rates.

The Commission will require MERC to work with the Commission's Consumer Affairs Office and Commission staff to develop the bill insert.

ORDER

1. MERC is hereby authorized to establish a GUIC rider and begin cost recovery in 2019 of the following costs:

    - Approximately $5.3 million in capital investment to relocate natural gas facilities for public works and right-of-way projects;
    - Approximately $7 million in capital costs to replace obsolete materials;
    - Approximately $2 million in O&M costs for its stop-valve survey; and
    - Approximately $1 million in O&M costs for its sewer cross-bore survey.

2. The rate of return for the GUIC rider shall be the overall rate of return authorized in MERC's pending rate case, Docket No. G-011/GR-17-536.

3. The GUIC rider rate factor shall be uniform across all customer classes and shall be based on 12 months of sales.

4. MERC shall make a compliance filing within ten days of the date of this order that includes the following:

    - Revised tariff language,
    - A calculation of the authorized GUIC revenue requirement,
    - A new GUIC rider rate factor,
    - A new proposed effective date for the rider and a plan for implementing the new rate factor, and
    - A revised customer bill message and a bill insert explaining the change in rates.

5. MERC shall work with the Commission's Consumer Affairs Office and Commission staff to develop a bill insert for inclusion with customers' first bills incorporating a GUIC rider rate factor.

6. Comments on MERC's compliance filing shall be due within ten days of the date of the compliance filing.

7. This order shall become effective immediately.

BY ORDER OF THE COMMISSION

Daniel P. Wolf

Daniel P. Wolf
Executive Secretary

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