

**Minnesota Public Utilities Commission**  
*Staff Briefing Papers*

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**Meeting Date:** **October 8, 2009** ..... **\*Agenda Item #** 6

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**Company:** Greater Minnesota Gas, Inc., a wholly owned subsidiary of Greater Minnesota Synergy, Inc. (Greater Minnesota Gas or GMG)

**Docket No.** G-022/GR-09-962  
In the Matter of the Application of Greater Minnesota Gas, Inc. for Authority to Increase Rates for Natural Gas Service in the State of Minnesota

**Issue:** Should this filing be accepted, the proposed rates suspended, this matter referred to the Office of Administrative Hearings, and interim rates set as requested by the Company?

**Staff:** Robert C. Harding ..... 651-201-2237  
Gerald Dasinger ..... 201-2235  
Shannon McIntyre ..... 201-2238  
Stuart Mitchell ..... 201-2242

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***Relevant Documents***

GMG – Application (Vols. I-IV) & Petition for Interim Rates ..... Aug. 21, 2009  
GMG – Supplemental Filing ..... Sep. 1, 2009  
OES – Comments ..... Sep. 14, 2009  
GMG – Reply comments ..... Sep. 18, 2009

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September 25, 2009



## ***Statement of the Issue***

Should this filing be accepted, the proposed rates suspended, this matter referred to the Office of Administrative Hearings, and interim rates set as requested by the Company?

## ***Introduction***

On August 21, 2009, Greater Minnesota Gas, Inc., a wholly owned subsidiary of Greater Minnesota Synergy, Inc. (Greater Minnesota Gas or GMG) filed a request for a general increase in its natural gas rates. GMG requested an increase of \$806,061, or approximately 16.3 percent, over existing rates (total revenue), based on a rate of return on common equity of 10.00%.

GMG	Present revenue		Proposed revenue including proposed increase	
Retail Rate Revenue	\$ 4,892,000	100%	\$ 5,698,000	100%
Less Cost of Purchased Gas	\$ 3,304,000	68%	\$ 3,304,000	58%
Non-gas Margin Revenue	\$ 1,588,000	32%	\$ 2,394,000	42%
Proposed Increase in Margin Revenue			<b>\$ 806,000</b>	
Rate Increase as a % of Retail Rate Revenue			<b>16.5%</b>	
Rate Increase as a % of Margin Revenue			<b>50.8%</b>	

Note: Retail rate revenue in this table does not include approximately \$54,000 in other retail revenue (i.e. activation fees and miscellaneous revenue). The numbers in this table are rounded to the nearest \$'000.

GMG proposed a test year that ends on December 31, 2009. In its proposed test year, GMG has approximately 3,700 customers and throughput of approximately .5 Bcf of gas.

GMG proposed an interim increase over present rates of approximately \$522,732 annually, or approximately 10.7 percent above present rates (or 10.57 percent above present gross revenues) based on a 10.0% rate of return on common equity. GMG requested interim rates be made effective October 20, 2009.

The basic issues at this stage of a rate case are whether to accept the filing, suspend the proposed rates, refer this matter to OAH for a contested case, and set interim rates subject to refund.

## ***Background***

On August 25, 2009, the Commission issued its notice requesting comments on whether GMG's filing complies with the filing requirements in Minn. Stat. § 216B.16, Minn. Rules, Parts 7825.3100 to 7825.4400 and Commission Orders. The Commission also asked for comments on whether this rate application should be referred to the Office of Administrative Hearings ("OAH") for a contested case proceeding.

On September 1, 2009, GMG submitted a supplemental filing in response to informal discussions with and an email from the Minnesota Department of Commerce-Office of Energy

Security (OES) regarding items OES considered missing or needing further clarification in GMG's application.

On September 14, 2009,<sup>1</sup> OES submitted comments recommending that with the clarifications submitted on September 1, GMG's "filing satisfies the filing requirements specified by Minnesota Statute §216B.16, Minnesota Rules parts 7825.3100 through 7825.4400 and part 7829.2400, Commission Policy Statements, and Commission Orders" and may be considered complete as to form. OES offered no conclusions regarding the merits of GMG's request. OES recommended the Commission refer this matter to the Office of Administrative Hearings for a contested case proceeding.

On September 18, 2009, GMG submitted its reply which described the Company's September 1 supplemental filing and the OES's September 14 comments. GMG agrees this case should be referred to the Office of Administration Hearings for a contested case proceeding but hopes its application will be handled efficiently without becoming a regulatory burden for GMG or its customers.

(In a related matter, on August 21, 2009, GMG submitted its petition in Docket No. G-022/M-09-983, for approval of a new base cost of gas to coincide with the implementation of interim rates, pursuant to Minn. Rules, Part 7825.2700, subpart 2. On September 20, 2009, the OES submitted comments recommending the Commission approve GMG's petition with the revised supporting schedules. This docket is on the Commission's agenda for this meeting.)

## **1. Prior general rate proceedings**

### **GMG's transition to a state rate regulated utility**

In September 2002, GMG notified the Department (now the OES) and the Commission that it would no longer qualify for an exemption from Commission rate regulation, under Minn. Stat. § 216B.16, subd. 12, because the Company had reached the 2,000 customer mark. Prior to this notification, GMG's rates were regulated and approved by the local governing bodies (i.e. the municipalities and townships) of the areas in which the Company provides service. GMG was the first exempt gas utility in Minnesota to come under Commission rate regulation after reaching the 2,000 customer level.

On January 24, 2003, GMG filed its rate schedules and tariff book and asked for authority to continue charging its existing rates until it filed its first general rate case.

On August 28, 2003, the Commission issued its Order [GMG to continue charging its current] Authorizing Rates, Requiring General Rate Case and Other Filings,<sup>2</sup> which required GMG to file a general rate case no later than February 2004.

### **2004 rate case**

On April 30, 2004, GMG submitted its first general rate case under Minn. Stat. § 216B.16. In its

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<sup>1</sup> The OES comments are dated September 11 but were not filed until September 14.

<sup>2</sup> In the Matter of Greater Minnesota Gas, Inc. Extending Service to More Than 2,000 Customers and Becoming Subject to Minn. Laws, Ch. 216B, Docket No. G-022/M-03-117

filing, GMG reported that the Company ... had an annual revenue deficiency of approximately \$528,000 but did not propose to increase its rates. Instead, GMG “proposed to use this first rate case as a vehicle for achieving compliance with the requirements of the Public Utilities Act and with the rules promulgated under that Act governing natural gas utilities.”

On April 13, 2005, the Commission issued its Order Setting Rates, Accepting And Adopting Administrative Law Judge’s Recommendation, And Requiring Compliance Filing:<sup>3</sup> (1) accepting and adopting the recommendation of the Administrative Law Judge,<sup>4</sup> and (2) finding that GMG had demonstrated a test-year revenue deficiency of \$513,167, based on an overall rate of return of 6.58%, a 72.5%/27.5% debt/equity ratio, a 5.28% cost of debt, and a 10.00% cost of equity.

### **2006 rate case**

On October 23, 2006, GMG filed its second general rate case and proposed to increase its rates for natural gas by approximately 7.1%, or \$336,500.<sup>5</sup> In its July 30, 2007 Order Setting Rates, Accepting And Adopting Administrative Law Judge's Recommendation, And Requiring Compliance Filing,<sup>6</sup> the Commission found that

the Company's revenue requirement has been properly determined and the Company's revised proposed increase in rates of \$317,157 is appropriate. The Commission concurs with the parties that all issues have been resolved within the zone of regulatory reasonableness, in a manner supported by substantial evidence, and on terms consistent with the public interest.

## **2. Other matters**

### **GMT financial difficulties**

In the audit report included in GMG’s filing, the auditor described financial difficulties at GMG’s affiliate, Great Minnesota Transmission (GMT)<sup>7</sup> as follows:

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<sup>3</sup> In the Matter of a Petition by Greater Minnesota Gas, Inc. for Authority to Establish Natural Gas Rates in Minnesota, Docket No. G-022/GR-04-667

<sup>4</sup> The Administrative Law Judge recommended the Commission accept and adopt the final recommendations of the Department of Commerce, in which the Company concurred. Those recommendations included requiring specified filings to bring the Company into regulatory compliance, setting guidelines for the Company’s next rate case, and permitting the Company to continue charging its existing rates until its next rate case.

<sup>5</sup> Although GMG projected a revenue deficiency of approximately \$1,150,058, the Company did not request to increase its rates to recover the full projected test year revenue deficiency. GMG instead requested to increase rates by approximately one-third of the reported revenue deficiency - \$336,500.

<sup>6</sup> In the Matter of the Application of Greater Minnesota Gas, Inc., a Wholly Owned Subsidiary of Greater Minnesota Synergy, Inc., for Authority to Increase Rates for Natural Gas Service in the State of Minnesota, Docket No. G-022/GR-06-1148

<sup>7</sup> Greater Minnesota Transmission, LLC (GMT) is an intrastate pipeline regulated by the Minnesota PUC under Minn. Stat. §216B.045. The pipeline is approximately 12 and 1/2 miles long and runs from the Northern Natural gas town border station near Coates, Minnesota to the Cannon Falls Energy Center in Canon Falls, Minnesota, a natural gas generating plant owned by Invenergy. The plant sells its electricity to Xcel Energy. Xcel purchases and transports the gas, and is GMT’s only customer. The Commission issued the route permit for the GMT pipeline on October 27, 2006 in Docket No. PL-6580/GP-06-931. The Commission approved the gas transportation contract

### **NOTE 13 - COMMITMENTS AND CONTINGENCIES**

During 2008, the GMT pipeline project was completed, but invoices from a project vendor totaling \$1,166,978 are currently in dispute. The disputed invoices are included in the accounts payable balance of \$2,599,840 as of December 31, 2008. The vendor has filed a mechanics lien against the GMT property and has filed suit against GMT for payment and unspecified damages. Management intends to defend its position. Since it is not possible to predict or determine the outcome of the litigation, there can be no assurance made that GMT will prevail. An unfavorable outcome could have an adverse impact on the Company's results of operations, liquidity and financial position.

Also relating to the GMT pipeline project, GMT is currently under going litigation proceedings with various land owners relating to easement rights relating to the property in which the pipeline was placed. The accounts payable balance of \$2,599,840 also includes \$333,000 relating to the future expected settlements. This amount has been estimated by Company management based on recent court settlements for similar land parcels.

#### **GMT foreclosure**

In 2009, GMT defaulted on the mortgage on its intrastate transmission pipeline assets, held by Premier Bank of Rochester MN and other Premier banks. The bank brought an action in District court to commence foreclosure proceedings and to have a receiver appointed. On June 4, 2009, the Dakota County District Court appointed John Sprangers, President of Planergy, Inc. as the receiver of GMT, pending the foreclosure actions. The Court found that GMT failed to make payments when due on its Notes held by Premier Bank, and was in default. The Receiver is charged with operating the pipeline property for the benefit of GMT and its creditors, which includes assuming the contractual rights and obligations necessary to run the pipeline. The ownership of the assets remains with GMT during the foreclosure proceedings.

Xcel is the only customer of GMT and has taken steps to protect its interests. Xcel initiated what is in essence an escrow action in Hennepin County District Court for its May 2009 payment due to GMT, because it got demands from both the bank and the pipeline for payment. Xcel's request was granted.

#### **GMS auditor's opinion letter**

In the audit report in GMG's filing, the auditor expressed reservations about whether GMG's parent company, Greater Minnesota Synergy (GMS), would be able to continue as a going concern without refinancing its operations.

GMT has not filed its 2008 annual jurisdictional report, pursuant to Minn. Rules, parts 7825.4800 through 7825.5400, which was due on May 1, 2009.

### **3. Relevant pending docket**

Although GMG has several dockets pending before the Commission, staff believes the only matter that directly relates to this rate case is GMG's 2008 demand entitlement filing, in docket #08-1327. In that docket, OES recommended that the Commission

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between GMT and Xcel on December 26, 2006 in Docket No. PL-6580/M-06-1063, and a supplemental agreement on May 30, 2008 in Docket No. PL-6580/M-08-190.

“require Greater Minnesota to file a miscellaneous tariff filing, or testimony in its next general rate case, that: (1) addresses the issues that occurred on January 29, 2008, and (2) explains how Greater Minnesota intends to modify its tariffs to prevent this type of situation from occurring on a going-forward basis.”

In its response, GMG noted that construction-related heating requirements of a few commercial firm customers caused GMG’s consumption to exceed budgeted usage. GMG does not expect this to happen again. However, GMG also stated that

“... there may need to be revised tariff language to account for construction heat during the winter months for customers who are served under GMG firm tariff. ***Currently, there is no tariff for construction load vs. base load and [this issue] will be addressed in the next rate case.***” [emphasis added]

GMG did not address this issue in its application. Staff recommends the Commission require parties to address this issue in this proceeding.

### ***GMG's Application***

According to GMG’s witness (Kevin Alishouse)

“GMG’s calculated revenue deficiency of \$1,362,566 reflects a return on equity (ROE) of 10 percent, which is the ROE from GMG’s last general rate filing approved by the Commission in Docket No. G022/GR-06-1148. A 10 percent ROE is also consistent, and in fact slightly conservative, compared to recent Commission ROE awards for other utilities. GMG has not performed a separate, stand-alone ROE analysis, consistent with our past practices, but believes 10 percent is conservative and reasonable to use for the purpose of setting rates in this proceeding. The principal drivers behind the need for this rate increase are the recovery of:

- A reasonable rate of return on utility plant;
- A modest increase in operating expenses; and
- A portion of the balance of the unrecovered Operating Revenue Deficiency from the 2006 rate case which amounted to a total of \$509,197.

GMG is not requesting full recovery of the calculated deficiency at this time.

GMG believes it is not appropriate to increase rates to recover its full cost of service at this time. GMG proposes to increase rates by approximately \$806,061 or 16.3 percent above present rates to offset a portion of its revenue deficiency. This equates to an increase of roughly 50.8 percent in the non-gas portion of the customer bill. GMG recognizes the sensitivity of implementing rates to recover the full cost of service, which would result in a 27.5 percent increase in rates (or an 85.8 percent increase in the non-gas portion of the bill). Therefore, GMG seeks recovery of just under 60 percent of its full revenue deficiency. GMG believes this level will moderate the impact of the increase on customers, while still

addressing the most serious financial needs of the Company.”<sup>8</sup> [Alishouse, direct, p. 3]

## 1. Comparison of Authorized and Proposed Revenue Requirement

The following abbreviated schedule compares the revenue requirement approved in GMG’s 2006 rate case, Docket G-022/GR-06-1148, and the proposed revenue requirement in this docket.

	Authorized 2006 Rate Case- Docket G-022/GR-06-1148	Proposed 2009 Rate Case - Docket G-022/GR-09-962
Rate Base	\$6,806,033	\$11,739,015
Rate of Return	8.85%	9.53%
Return on Equity	10.00%	10.00%
Required Operating Income	\$602,334	\$1,118,863
Revenue	\$5,066,540	\$4,946,327
Expense	\$4,656,245	\$4,633,525
Operating Income	\$410,295	\$312,801
Income Deficiency	\$192,039	\$806,061
Conversion Factor	1.0000	1.6904
Revenue Deficiency	\$192,039	\$1,362,566

<sup>8</sup> According to Mr. Alishouse:

“GMG has been funding its growth opportunities and operating costs for the past fourteen years through a combination of operating revenues, bank debt and continued shareholder contributions, supplemented with a 6.7 percent (\$317,157) rate increase in 2006. ...”

“GMG has essentially completed its initial service territory build for natural gas, with a current customer base of approximately 3,500. With an extensive infrastructure network in place, GMG now focuses on gaining customers through a targeted in-fill effort. GMG also stands to benefit from customers coming on-system as rural housing developments, covered by development agreements, begin to recover from the new housing slump.”

GMG estimated customer growth at approximately 8 percent for the test year, which translates to 303 customer additions by December 31, 2009. Capital cost per addition is projected to be between \$800 to \$2,300 per customer, with an annual budget of \$425,000 for 2009. GMG expects to add customers at a significantly lower cost per customer than in the past as the majority of new customers will be added to GMG’s existing system.”  
[Alishouse, direct, pp. 2-3]

The proposed revenue deficiency (which is more than the proposed rate increase) of \$1,362,566 can be attributed to the following changes since rates were established in the 2006 rate case:

Unrecovered Deficiency from 2006 Case	\$192,039
Increase in Rate Base	\$436,569
Decrease in Net Income	\$97,721
Increase in Rate of Return	\$79,825
Increase in Conversion Factor	\$556,412
Total	<u>\$1,362,566</u>

As shown above, the factor that contributes most to the requested increase is the revenue conversion factor which grosses up the allowed increase to account for the income taxes on the increase. In the July 30, 2007 Order in GMG's last rate case, Docket No. G-022/GR-06-1148, ordering paragraph 3 stated:

The Commission will require GMG to provide testimony in its next rate case on the issue of who provided the funds that resulted in the NOL and whether the ratepayers or the shareholders should receive the benefit of the NOL in determining the revenue deficiency;

In this case, the Company stated in its testimony that the benefit from the Net Operating Loss (NOL) should go to the shareholders. GMG also included a calculation of the revenue conversion factor. Staff recommends that the Commission request that parties address the calculation of the revenue conversion factor and its relationship to the book taxable loss under present rates.

Staff also notes that the error discussed below under interim rates also applies to the requested final revenue deficiency. The corrected filed deficiency would be \$1,868,359.

In the base cost of gas filing, Docket No. G-022/MR-09-983, the Company used the actual 2008 demand costs in determining the new base cost. Staff is recommending in that docket that the demand costs be updated to reflect the demand costs for 2009 which is the test year. This change will increase the revenues and the cost of gas by \$28,731 with no change in net income. As described in the 09-983 docket, Staff has identified an error in the calculation of the commodity cost of gas. This reduces the cost by \$124,817. The sum of these adjustments reduces the overall cost of gas by \$96,086. The revised cost of gas and percentage increase in revenues is shown on Exhibit A. If the Commission accepts those recommendation, the schedules which include detailed revenue calculations, cost of gas and operating income will need to be revised. Staff suggests that the revised schedules be filed at the same time as the interim rate compliance filing.

## 2. Proposed Test Year Cost of Capital

GMG requested a return on equity of 10.00%, which is the same as the 10.00% rate of return on common equity that was allowed in GMG's last rate case in 2006. GMG's proposed test year cost of capital is shown below:

Type of Capital	Amount	% of Total	Cost	Weighted Cost
Long-Term Debt	\$ 8,735,376	53.89%	9.13%	4.92%
Common Equity	\$ 7,473,846	46.11%	10.00%	4.61%
Total	\$ 16,209,222	100.00%		9.53%

The testimony in GMG's filing does not address the test-year increase in the cost of debt to 9.13% (from GMG's actual 4.69% cost of debt in 2008, and the test-year 8.42% cost of debt from GMG's last rate case). It appears, however, that the cost of debt is a function of GMG's financing arrangements which are accomplished primarily through bank loans.

The testimony in GMG's filing also does not address the \$2 million increase in equity capital. There is, however, a one sentence note to the cost of capital schedules that indicates GMG expects (or would like) to receive \$2 million in new equity capital to "displace" debt. These loans are described in detail in the Company's financial statements.

Representatives of GMG and GMT have stated that to the best of their knowledge, there is no common financing between GMT and GMG. When asked specifically about cross-default obligations both indicated they were not aware of any but did not go so far as to say such obligations do not exist. Even if no specific cross-default obligations exist, it seems possible that the GMT financial situation could have some effect on GMG, given the common ownership.

## 3. Proposed Rate Design

### a. Class revenue apportionment

GMG proposed the following revenue increases by customer class.

	# of Customers	# of MCF	Current Revenue	Proposed Revenue	Proposed Increase	
					\$	%
<b>Firm Service</b> (includes demand and commodity cost of gas)						
Residential	3,396	339,600	\$3,610,645	\$4,201,549	\$590,904	16.4%
Small Commercial – up to 1,999 Ccf / year	208	17,472	\$188,958	\$220,158	\$31,200	16.5%

	# of Customers	# of MCF	Current Revenue	Proposed Revenue	Proposed Increase	
					\$	%
Commercial - 2,000 to 4,999 Ccf /year	35	15,785	\$156,859	\$188,415	\$31,556	20.1%
Medium Industrial – 5,000 to 9,999 Ccf /yr.	8	8,704	\$85,173	\$101,492	\$16,319	19.2%
Large Industrial – at least 10,000 Ccf per/yr.	6	54,871	\$455,812	\$505,276	\$49,464	10.9%
Total Firm Service	3,653	436,432	\$4,497,447	\$5,216,890	\$719,443	16.0%
<b><u>Interruptible Service</u></b> (includes commodity cost of gas)						
Agricultural	25	14,125	\$113,036	\$134,198	\$21,162	18.7%
Industrial	3	31,920	\$246,939	\$285,651	\$38,712	15.7%
Total Interruptible	28	46,045	\$359,975	\$419,849	\$59,874	16.6%
<b><u>Transportation Service</u></b> (does not include cost of gas)						
Firm (LSF)	1	21,451	\$32,131	\$56,928	\$24,797	77.2%
Interruptible (MS)	1	674	\$2,315	\$3,728	\$1,413	61.0%
Total Transport.	2	22,125	\$34,446	\$60,656	\$26,210	76.1%
<b>Total Gas Sales &amp; Transportation Revenue</b>	<b>3,683</b>	<b>504,602</b>	<b>\$4,891,868</b>	<b>\$5,697,395</b>	<b>\$805,527</b>	<b>16.5%</b>

### b. Monthly facility fees (customer charges) & per Ccf distribution charges

Monthly facility fees (customer charges) & per Ccf distribution charges	Current	Proposed	% Increase
<b><u>Firm Service</u></b>			
Residential			
Facility fee	\$ 8.00	\$ 10.00	25%
Distribution charge	\$ 0.2750	\$ 0.4250	55%
Small Commercial – up to 1,999 Ccf per year			
Facility fee	\$ 8.00	\$ 10.00	25%
Distribution charge	\$ 0.2750	\$ 0.4250	55%
Commercial - 2,000 to 4,999 Ccf per year			
Facility fee	\$ 25.00	\$ 40.00	60%
Distribution charge	\$ 0.2350	\$ 0.3950	68%

<b>Monthly facility fees (customer charges) &amp; per Ccf distribution charges</b>	<b>Current</b>	<b>Proposed</b>	<b>% Increase</b>
<b>Medium Industrial – 5,000 to 9,999 Ccf per year</b>			
Facility fee	\$ 75.00	\$ 100.00	33%
Distribution charge	\$ 0.2100	\$ 0.3750	79%
<b>Large Industrial – at least 10,000 Ccf per year</b>			
Facility fee	\$ 150.00	\$ 200.00	33%
Distribution charge	\$ 0.20	\$ 0.36	80%
<b><u>Interruptible Service</u></b>			
<b>Agricultural</b>			
Facility fee			
Oct. - Nov.	\$ 125.00	\$ 200.00	60%
Dec. - Sep.	\$ 12.50	\$ 20.00	60%
Distribution charge	\$ 0.12	\$ 0.23	92%
<b>Industrial</b>			
Facility fee	\$ 175.00	\$ 275.00	57%
Distribution charge	\$ 0.14	\$ 0.25	79%
<b><u>Transportation Service</u></b>			
<b>Firm (LSF) medium</b>			
Facility fee	\$ 75.00	\$ 100.00	33%
Distribution charge	\$ 0.21	\$ 0.38	79%
<b>Interruptible (MS) large</b>			
Facility fee	\$ 175.00	\$ 275.00	57%
Distribution charge	\$ 0.14	\$ 0.25	79%

Note: This table does not include negotiated contract rates for flexible rate/market rate customers.

## *Staff Analysis*

### **1. Should this filing be accepted, and if so, as of what date?**

#### **a. Completeness**

##### **i. Compliance with rules and statutes**

Staff reviewed this filing under Minn. Stat. § 216B.16 and Minn. Rules 7825.3100 through 7825.4400. Staff agrees with the Department's analysis and believes the Company's August 21, 2009 filing substantially complies with these requirements with the exception of the items noted in the Department's comments. Those items were supplied by GMG on September 1 in a supplemental filing.

##### **ii. Compliance with prior Commission Orders**

Staff believes the Company has made a good faith effort to comply with and respond to the orders issued in the Company's last general rate case, as well as certain other orders that have a bearing on GMG's application in this case. However, it does not appear that GMG has addressed the peak-day send-out issue caused by construction-related heating load on January 29, 2008 as requested by OES in OES's comments in docket #08-1327. GMG stated in its comments in that docket that it would address this issue in this rate case, perhaps by proposing "revised tariff language to account for construction heat during the winter months for customers who are served under GMG's firm tariff." The Commission may want to consider requiring parties to address this issue in this rate case.

#### **b. Date of acceptance**

In its September 11 comments, the OES stated that in response to a verbal request, GMG submitted a supplemental filing on September 1 that information that was either missing from or was necessary to explain GMG's August 21 filing.

If the Commission agrees with the OES, then this case should be accepted as substantially complete as of the original filing date of August 21, 2009.

Alternatively, the Commission could find that GMG's filing was not substantially complete until the information requested by the Department was incorporated into the record of this proceeding on September 1. Under this alternative September 1 would be considered the correct date because that is the date GMG formally submitted this information into the record of this case.

(The acceptance date is significant because it marks the start of the ten-month rate case clock, pursuant to Minn. Stat. § 216B.16, subd. 2, and the start of the sixty-day time period during which the Commission must order an interim rate schedule into effect, pursuant to Minn. Stat. § 216B.16, subd. 3.)

#### **2. If this filing is accepted, should the proposed rates be suspended, pursuant to Minn. Stat. § 216B.16, subd. 2?**

The Commission needs to suspend proposed final rates during a rate case while the Company's filing is investigated, and parties are in litigation. The statute provides for interim rates during the suspension period. These rates are subject to refund.

#### **3. If this filing is accepted, should this matter be referred to the Office of Administrative Hearings ("OAH") for a contested case?**

OES recommended the Commission refer this matter to OAH for a contested case proceeding because GMG's request presents issues of material fact that need to be resolved. The Commission is required to refer a rate case to OAH for a contested case proceeding unless the Commission finds that all significant issues can be resolved to its satisfaction, pursuant to Minn. Stat. § 216B.16, subd. 2(b). Staff does not believe the Commission can make such a finding absent a fully developed record and recommends setting this matter for contested case.

The statutory deadline for the Commission to issue its order in this matter is ten months from the date the Commission accepts this filing as substantially complete, pursuant to Minn. Stat. § 216B.16, subd. 2(a). If this case is accepted as substantially complete as of August 21 then the Commission's deadline for issuing an order would be June 21, 2010. If the case is accepted as of September 1, then the ten month deadline would fall on July 1, 2010.

To ensure the Commission has sufficient time to consider this matter and issue its order within the ten month statutory deadline, staff recommends the Commission request the ALJ to schedule a prehearing conference, and to submit his or her report and recommendation within eight months of the acceptance date of this filing (e.g., by April 21, 2010 if this case is accepted as of August 21, 2009).

Staff recognizes that parties may be challenged to complete their work, i.e. discovery, pre-filed testimony, evidentiary hearings, and briefings, in time for the ALJ to have a full month between the date the last reply brief is filed and the date the Commission expects to receive the ALJ's report. Therefore, staff recommends the ALJ set the procedural schedule, and consider requests for time extension, with these constraints in mind, so that if extra time or extensions are granted at the beginning of the case, that time can be made up in the briefing schedule.

#### **4. If this filing is accepted, should interim rates be set as requested by the Company?**

For interim rates, GMG proposed an increase over present rates of approximately \$522,732 annually, or approximately 10.7 percent above present rates (or 10.57 percent above present gross revenues) based on a 10.0% rate of return on common equity. GMG proposed to collect interim rates as an equal percentage increase to all of its non-gas cost rates, i.e. the customer facility fees and distribution charges, and to show this increase as a single line item on customer bills. GMG requested interim rates be made effective October 20, 2009.

##### **a. Interim rate statute**

Minn. Stat. § 216B.16, subd. 3, states in part that:

(a) Notwithstanding any order of suspension of a proposed increase in rates, the commission shall order an interim rate schedule into effect not later than 60 days after the initial filing date. The Commission shall order the interim rate schedule ex parte without a public hearing. ... [and]

(b) Unless the Commission finds that exigent circumstances exist, the interim rate schedule shall be calculated using the proposed test year cost of capital, rate base, and expenses, except that it shall include: (1) a rate of return on common equity for the utility equal to that authorized by the commission in the utility's most recent rate proceeding; (2) rate base or expense items the same in nature and kind as those allowed by a currently effective order of the commission in the utility's most recent rate proceeding; and (3) no change in the existing rate design. . . .

## **b. Effective date for interim rates**

If the Commission accepts GMG's filing as substantially complete as of August 21, 2009 (the original filing date), and suspends the proposed final rates, then the Commission must order interim rates into effect within sixty days, i.e. no later than October 20, 2009, pursuant to Minn. Stat. § 216B.16, subd. 3.

Alternatively, if the Commission adopts September 1, 2009, the date of GMG's supplemental filing, as the date GMG completed its application, then interim rates do not need to be ordered into effect until October 31, 2009, i.e. sixty days from the date this filing was put into proper form and was deemed substantially complete.

Another alternative would be for the Commission to accept this filing as of September 1, 2009 but allow GMG to put interim rates into effect on October 20, 2009. Staff does not believe the interim rate statute prohibits the Commission from ordering interim rates in advance of the sixty day time frame suggested by the statute. However, staff believes allowing interim rates to go into effect early sets a bad precedent and sends the wrong message by creating an incentive that encourages the submission of poorly developed and incorrect initial general rate filings. Authorizing interim rates to go into effect earlier than sixty days encourages this behavior because companies will count on getting interim rates into effect on the date they originally asked for if they agree to supplement their filing and agree to a delay in the start of the ten-month rate case clock.

GMG's billing system can accommodate an October 20 or October 31 effective date for implementing interim rates.

## **c. Financial matters**

What increase should be approved for interim rates?

### Background

GMG proposed an interim rate increase of \$522,732 or about 10.6% of total test year interim retail revenues of \$4,946,327. The test year is calendar year 2009.

In past rate cases the Company classified a portion of the cost of mains as holdout. These were mains that had less than the Company's standard for the number of customers served per mile of main. Previously GMG excluded that portion of the cost of the mains from rate base. In this rate case, GMG included all the cost of those mains in rate base. However, for interim rates, the cost of holdout mains were excluded from rate base as well as the related depreciation reserve and deferred taxes. GMG also excluded cash working capital from rate base. Interim operating income is higher because of the excluded depreciation expense and related deferred taxes from the holdout mains.

Staff notes that there is an error in the calculation of operating income related to deferred income taxes. The deferred income taxes at issue result from the difference between depreciation expense for calculating taxable income for income taxes and depreciation expense used to

calculate book income. Depreciation for income taxes is calculated using an accelerated method and for books depreciation is calculated using the straight line method. In the early years of the life of an asset, the tax depreciation is greater than the book depreciation as is the case for GMG. The result is a deferred tax expense. GMG included the deferred taxes as a benefit, increasing net income rather than reducing income.

Because the item was included backwards, the correction is twice the original amount of \$121,936. The correction reduces the book operating income from \$330,791 to \$86,919. Including that income in the interim revenue deficiency calculation changes the interim revenue deficiency from \$522,732 to \$766,604. The change increases the proposed interim rate percentage increase from 10.90% to 15.98% of corrected revenues from sales.

Minn. Stat. § 216B.16 subd 5 states in relevant part:

In no event shall the rates exceed the level of rates requested by the public utility.

Staff has been advised by counsel that this statute applies to final rates and not to interim rates. Based on that, the Commission has the option of approving an interim rate increase of \$766,604 rather than the requested amount of \$522,732. Staff has discussed the error with the Company and has been advised that the Company wants the corrected deficiency of \$766,604 to be the interim rate increase.

#### **d. Cost of capital**

Minn. Stat. § 216B.16, Subd. 3 (b) reads as follows:

Unless the commission finds that exigent circumstances exist, the interim rate schedule shall be calculated using the proposed test year cost of capital, rate base, and expenses, except that it shall include: (1) a rate of return on common equity for the utility equal to that authorized by the commission in the utility's most recent rate proceeding; ...

GMG proposed to use the following capital structure and cost rates for interim and final rates:

<b>Type of Capital</b>	<b>Amount</b>	<b>% of Total</b>	<b>Cost</b>	<b>Weighted Cost</b>
Long-Term Debt	\$ 8,735,376	53.89%	9.13%	4.92%
Common Equity	\$ 7,473,846	46.11%	10.00%	4.61%
<b>Total</b>	<b>\$ 16,209,222</b>	<b>100.00%</b>		<b>9.53%</b>

In GMG's last general rate case (docket 06-1148), the Commission authorized the following capital structure and component costs in the calculation of GMG's final rates:

Type of Capital	Amount	% of Total	Cost	Weighted Cost
Long-Term Debt	\$ 10,206,658	73.03%	8.42%	6.15%
Common Equity	\$ 3,770,060	26.97%	10.00%	2.70%
Total	\$ 13,976,718	100.00%		8.85%

As noted above, the determination of the rate of return for interim rates is directed by the interim rate statute. Staff believes the Company's proposal follows the statutory requirement to use the rate of return on common equity from the utility's most recent rate proceeding.

#### e. Rate design

GMG proposed to apply the interim rate increase to all of its retail gas customers. GMG proposed to collect this interim rate increase through a uniform increase on all customers total bills before the addition of the monthly purchased gas adjustment and sales taxes, i.e. on the customer charge (facility fee) plus the distribution charge plus the base cost of gas. GMG proposed to implement this increase on a prorated basis for service rendered on and after October 20, 2009. GMG also proposed to put the increase on customer bills as a separate line item labeled interim rate adjustment.

Staff believes GMG's proposal to apply the same percentage rate increase to all customer bills as a separate line item prorated to a common effective date conforms to the interim rate statute<sup>9</sup> and the Commission's interim rates policy statement.<sup>10</sup> The proposed interim rate tariff sheets included in the interim rate petition correspond to the Company's proposal for implementing interim rates.

Staff believes GMG should include in its interim rate compliance filing sample customer bills that show the interim rate adjustment as it will appear on customer bills.

### 5. Administrative and Compliance Issues

The Commission's practice in most rate cases has been to require: a) notice to municipalities and counties of the proposed rate change, b) public hearings at locations within the company's

<sup>9</sup> According to Minn. Stat. § 216B.16, subd. 3, "... Unless the commission finds that exigent circumstances exist, the interim rate schedule ..... shall include: ..... (3) no change in the existing rate design."

<sup>10</sup> The Commission's April 14, 1982 Statement of Policy on Interim Rates, states: "The Commission interprets that "no change in the existing rate design" applies to both the allocation of revenue responsibility among customer classes (or product and service categories) and the structure of the individual rates. Accordingly, interim rates should consist of the existing rate schedules with an interim rate adjustment equal to the overall requested interim increase percentage. This procedure will assure that consumption decisions will be made on the same basis as under existing rates and will allow refunds, if necessary, to be made across-the-board to all customers such that the final rates are prospective only. ... The interim rate adjustment should be shown as a separate item on the customer's bill, if practical." [Statement, pp. 1 & 2]

service area, and c) notice of evidentiary and public hearings.

The decision alternatives contain ordering language that is very similar to the language used in notice and orders for hearing in previous general rate proceedings, e.g. Great Plains' 2002 rate case.<sup>11</sup> Staff recommends that this language be incorporated into the Commission's decisions in this docket. General rate case notice requirements can be found in Minn. Stat. § 216B.16, subd. 1, and Minn. Rules, Part 7829.2400, subparts 3 and 7.<sup>12</sup>

The Commission's practice has also been to require interim rate compliance filings. These filings typically include tariff sheets with supporting documents, and a Commission-approved notice to customers of the interim rate increase. Companies are also required to keep records of their sales and collections to support any potential interim rate refund obligation. The decision alternatives contain language typical of the language used in previous Commission Orders authorizing interim rates.

Staff recommends the Commission require all of the administrative and compliance related items listed in the decision alternatives.

## *Decision Alternatives*

### **1. Acceptance**

- A. Accept this filing as being in proper form and substantially complete as of August 21, 2009, or
- B. Accept this filing as being in proper form and substantially complete as of September 1, 2009, or
- C. Reject this filing as not being in proper form and/or not being substantially complete.

If this filing is accepted, then the Commission will also need to decide the following:

### **2. Suspension of Proposed Final Rates**

- A. Suspend the proposed final rates until the Commission makes its final determination in this matter.

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<sup>11</sup> *Notice and Order for Hearing, In the Matter of a Petition by Great Plains Natural Gas Company, a Division of MDU Resources Group, Inc., for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-004/GR-02-1682, November 19, 2002, See Ordering Paragraphs 3, 4 and 5.

<sup>12</sup> Staff also recommends the Commission require GMG to send a copy of the Commission's notice and order for hearing to all local governing bodies in its service area. This notification will ensure that these entities can make an appearance at the prehearing conference or make arrangements to intervene in this case if they are interested.. This notification is in addition to the notice required by Minn. Stat. § 216B.16, Subd. 1, and Minn. Rule 7829.2400, subp. 3, and is consistent with past Commission practice.

### **3. Referral of this Matter to the Office of Administrative Hearings for a Contested Case Proceeding**

- A. Refer this matter to the Office of Administrative Hearings for a contested case proceeding, and request the ALJ's report within eight months of the date of the Commission's acceptance of this filing (e.g. on or before April 21, 2010 if the case is accepted as of August 21, 2010) and
- B. Issues requiring development of a complete record in this case.
  - 1. The standard rate case issues.<sup>13</sup>
  - 2. Whether there is a need for revised tariff language to account for construction heat during the winter months for customers who are served under GMG's firm tariff.
  - 3. The calculation of the revenue conversion factor and its relationship to the book taxable loss under present rates.
  - 4. Any other issue identified by the Commission.

### **4. Effective Date of Interim Rates**

If the proposed final rates are suspended, the Commission is required to set interim rates as of a certain effective date.

- A. For service rendered on and after October 20, 2009 (sixty days after GMG's August 21, 2009 filing date). or
- B. For service rendered on and after October 31, 2009 (sixty days after GMG submitted its September 1, 2009 supplemental filing).

### **5. Interim Rates (Financial Matters)**

- A. Approve an annual interim rate increase of \$522,732, or approximately 10.9% of corrected revenues from sales, as filed. or
- B. Approve an annual interim rate increase of \$766,604, or approximately 15.98% of corrected revenues from sales, as calculated by PUC staff.

### **6. Interim Rates (Capital Structure & Cost of Capital)**

- A. Approve GMG's proposed capital structure and cost of capital including its proposed

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<sup>13</sup> The standard rate case issues are: 1) Is the test year revenue increase sought by the Company reasonable or will it result in unreasonable and excessive earnings by the Company?, 2) Is the rate design proposed by the Company reasonable?, and 3) Are the Company's proposed capital structure and return on equity reasonable? *Notice and Order for Hearing, In the Matter of the Application of Minnegasco, a Division of NorAm Energy Company, for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-008/GR-95-700, p. 3 (October 4, 1995)

rate of return on common equity of 10.00% for the calculation of interim rates.

## 7. Interim Rates (Rate Design)

- A. Approve GMG's proposed apportionment of the interim rate increase, i.e. the interim rate increase will be implemented as a uniform percentage increase on all customer bills, the increase will be applied to each customer's total bill before the inclusion of the monthly purchased gas adjustment and sales taxes, the interim rate increase will be prorated to the effective date for service rendered on and after the effective date, and the interim increase will appear on the customer's bill as a separate, easily identifiable line item. and
- B. Interim rates compliance filing - Require GMG to include in its interim rate tariff compliance filing sample customer bills that show the interim rate adjustment as this adjustment will appear on customer bills.

## 8. Administrative & Compliance Issues

- A. In the Notice and Order for Hearing, require the following:
- This Order will be served on the Company, which shall mail copies of the Order to all municipalities, counties, and local governing bodies in its Minnesota service area.
  - Public Hearings shall be held in this matter at locations within the service area of the Company.
  - The Company shall give the following notices of the evidentiary and public hearings:
    1. Individual written notice to each customer, which may be in the form of a bill insert, and shall be served at least ten days before the first day of hearings.
    2. Written notice to the governing bodies of all municipalities, counties, and local governing bodies in the area affected and to all parties in the Company's last two rate cases. These notices shall be mailed at least ten days before the first day of hearings.
    3. Display advertisements in legal newspapers of affected counties and other newspapers of general circulation within the Company's Minnesota service area. These advertisements shall appear at least ten days before the first day of hearings. They shall include the heading **RATE INCREASE NOTICE**, which shall appear in bold face type no smaller than 30 points.

4. The Company shall submit proposed notices for Commission approval prior to publication or service.

B. In the Order Setting Interim Rates require the following:

- Require GMG to update its financial schedules to reflect the change in the base cost of gas at the time it files the interim rate compliance filing.
- Order the Company to file within twenty days interim rate tariff sheets and supporting documentation reflecting the decisions herein. The Company's filing should also include the notice to customers, approved by the Executive Secretary, regarding the rate change under the interim rate schedule.
- Order the Company to keep such records of sales and collections under interim rates as would be necessary to compute a potential refund. Any refund should be made within 120 days of the effective date of the Commission's final order in a manner approved by the Commission.
- Order the Company to include with each customer's first bill under the interim rate schedule a notice of the rate change, approved by the Executive Secretary. Upon completion of this task, the Company shall certify this fact to the Commission.
- Require GMG to maintain records of CIP costs and collection through the interim period so that it can be ascertained that recoveries dedicated to CIP are properly recorded as CIP.

C. Do not require these items.

## **9. Approval of Notices and Customer Bill Inserts**

- A. Delegate authority to approve notices and bill inserts to the Commission's Executive Secretary for the duration of this proceeding, or
- B. Do not delegate authority to the Commission's Executive Secretary.

### ***Concluding Comment & Recommendation***

If the Commission accepts this filing as complete, the Commission should also suspend the proposed rates, set this matter for contested case hearing, and request the ALJ's report within eight months of the date of acceptance. With respect to rate design issues, staff recommends the Commission approve GMG's proposal for interim rates.

Staff also recommends all of the administrative and compliance items listed under alternative 7(A) & 7(B) and recommends the Commission delegate to the Commission's Executive Secretary authority to approve proposed notices and customer bill inserts for the duration of this proceeding.

Staff also recommends accepting this filing as of September 1, 2009, which is the date of GMG's supplemental filing that completed GMG's application. Staff notes, however, that the OES did not request a delay in the acceptance of GMG's filing or the start of the ten-month timetable.

Staff recommends alternatives 1(A or B), 2(A), 3(A, B-1, B-2 and B-3), 4(A or B), 5(A or B), 6(A), 7(A and B), 8(A and B), and 9(A).

The date, time, and location of the public hearings is typically discussed and decided around the time of the pre-hearing conference by the Administrative Law Judge in consultation with the Company, parties, and the Commission. A formal Commission decision on this point is not needed for the purpose of issuing Commission orders at this time. However, in the interest of planning a schedule for this proceeding, staff's recommendation would be for the ALJ to hold one evening public hearing in New Prague at the same location that was used in the last rate case if that location is available.<sup>14</sup>

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<sup>14</sup> In the 2006 rate case, one public hearing was held in the evening in New Prague. Approximately six members of the public attended and provided public comment and testimony. The ALJ received one public comments letter.

In the 2004 rate case, public hearings were held in Mankato Township (afternoon) and St. Peter (evening). No members of the public attended either hearing. No written comments were received by the ALJ or the Commission's Consumer Affairs Office that pertained to the 2004 rate case.

In the 2003 transition to Commission rate regulation proceeding, there were at least two public hearings. One was held in Mankato Township however only a few members of the public attended and no one testified. The other hearing was held in Lanesburgh Township and a reasonable number of people attended, provided comments and asked questions. Lanesburgh Township is very close to New Prague.

Exhibit A

Greater Minnesota Gas, Inc.  
Docket Nos. G-022/GR-09-962 & G-022/MR-09-983  
Cost Of Purchased Gas

Base Cost of Gas Effective with Implementation of Interim Rates  
All Customer Sales Rate Classes

	<u>MCF</u>	<u>x Months</u>	<u>x Tariff Rate</u>	<u>Equals</u>	<u>Rate/MCF</u>
TFX - 7	300	7	\$ 5.6830	\$ 11,934	\$0.02735
TFX - 5	4,244	5	\$ 15.1530	321,547	\$0.73676
TFX - 3	300	3	\$ 15.1530	13,638	\$0.03125
SMS Demand	50	7	\$ 2.1800	763	\$0.00175
	1,300	8	\$ 2.1800	22,672	\$0.05195
Demand Cost of Gas				\$ 0,554	\$0.84905
Current Commodity Cost of Gas/CCF % of Total		88%		<u>\$ 2,837,027</u>	<u>\$5.88013</u>
Total Cost of Gas/CCF				<u>\$ 3,207,581</u>	<u>\$6.72918</u>
Rate Case Firm Sales Volume MCF				436,432	
Rate Case Sales Volume MCF				482,477	
Revenues at Present Rates - customer charge (Schedule C-1)				\$ 393,159	
Revenues at Present Rates - distribution charge (Schedule C-1)				\$ 1,195,043	
Cost of Gas				\$ 3,207,581	
Total Revenues from Sales				\$ 4,795,783	
Final Increase Requested				\$ 806,061	
Increase as a percentage of Revenue from Sales				16.81%	
Revised Interim Increase Requested				\$ 766,604	
Increase as a percentage of Revenue from Sales				15.98%	