

Direct Testimony and Schedules
Charles A. Cloninger

Before the Minnesota Public Utilities Commission
State of Minnesota

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

Docket No. G007,011/GR-10-977

Exhibit _____

Company Background/Rate Case Overview

November 30, 2010

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1 **I. INTRODUCTION AND QUALIFICATIONS**

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A. My name is Charles A. Cloninger. My business address is Minnesota Energy Resources
4 Corporation (“MERC”), 2665 145th St., Rosemount, Minnesota 55068-0455.

5
6 Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?

7 A. I am the President of MERC. MERC is a wholly-owned subsidiary of Integrys Energy
8 Group, Inc. (“Integrys”).

9
10 Q. PLEASE SUMMARIZE YOUR QUALIFICATIONS AND EXPERIENCE.

11 A. I have over 29 years of experience within the utility industry. Previous to my position
12 here in Minnesota, I worked for Wisconsin Public Service Corporation, an electric and
13 gas utility in northeast Wisconsin. Over my career I’ve had experience at various levels
14 within the utility industry including field engineer, supervisor, regional manager, and
15 assistant vice president of operations and engineering. I have a Bachelor of Science
16 degree in Electrical Engineering from Michigan Technological University in Houghton,
17 Michigan, and am a Registered Professional Engineer in the State of Wisconsin.

18
19 Q. FOR WHOM ARE YOU PROVIDING TESTIMONY?

20 A. I am providing testimony on behalf of MERC.

1 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

2 A. I will provide a company background and rate case overview of MERC's rate case that is
3 based upon a 2011 proposed test year. In addition, I will briefly discuss MERC's petition
4 for interim rates.

5

1 **II. COMPANY BACKGROUND**

2 Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF MERC AND THE AREA IT
3 SERVES.

4 A. MERC is a corporation organized under the laws of the state of Delaware, authorized to
5 do business in Minnesota, with its principal office located in Rosemount, Minnesota.
6 MERC is a subsidiary of Integrys. MERC is a sister company to Wisconsin Public
7 Service Corporation, Upper Peninsula Power Company, Michigan Gas Utilities
8 Corporation, The Peoples Gas Light and Coke Company, and North Shore Gas Company,
9 which provide natural gas and electric service in the states of Wisconsin, Illinois and
10 Michigan.

11
12 As of December 31, 2009, MERC sold and/or distributed natural gas to approximately
13 209,000 customers in 51 counties and 165 communities throughout Minnesota. I have
14 attached as Exhibit _____ (CAC-1) to my testimony a map of MERC’s service territory.
15 On the map, the darker grey shade indicates areas served by MERC’s “Peoples Natural
16 Gas” jurisdiction (“MERC-PNG”), while the lighter grey shade indicates areas served by
17 MERC’s “Northern Minnesota Utilities” jurisdiction (“MERC-NMU”). MERC-PNG and
18 MERC-NMU are operating divisions of MERC. While these service areas were once
19 owned by separate utility companies a long time ago, they also were both owned and
20 operated by the same company for many years prior to MERC’s acquisition of them in
21 2006.

1 Q. WHAT WAS MERC’S GENERAL APPROACH TO DEVELOPING ITS LAST RATE
2 CASE?

3 A. MERC’s last rate case, Docket No. G-007, 011/GR-08-835, was MERC’s first rate case
4 following its acquisition of the Minnesota operations of Aquila, Inc. As a result, MERC
5 presented a straightforward rate request. In my testimony in that proceeding, I
6 mentioned, however, that MERC did have some additional and more complex issues that
7 would need to be addressed in future rate cases, such as rate consolidation between
8 MERC-PNG and MERC-NMU, and revenue decoupling.

9
10 Q. IS MERC PROPOSING TO ADDRESS SOME OF THESE ISSUES IN THIS RATE
11 CASE?

12 A. Yes. MERC is requesting approval of important changes such as rate area consolidation,
13 a consolidation of its four Purchased Gas Adjustment (“PGA”) areas into two areas,
14 revenue decoupling, and an uncollectibles expense tracking mechanism (“UETM”).
15 These requests are addressed in detail in the testimony of other witnesses. I will provide
16 a general introduction to each of these issues.

17
18 Q. WHY DOES MERC WANT TO CONSOLIDATE THE MERC-PNG AND MERC-
19 NMU SERVICE AREAS AND RATE SCHEDULES?

20 A. The MERC-PNG and MERC-NMU service areas are contiguous, are served by the same
21 company, and were for many years before MERC acquired them. The two areas have
22 been operating as one company since MERC took over ownership in 2006. The same
23 services and service levels are provided in the two areas, they are supported by the same

1 MERC staff, and served by the same call center. From an operations perspective MERC
2 is operating as a single utility. MERC is proposing distribution rate consolidation of the
3 current MERC-NMU and MERC-PNG rate areas into a single distribution rate area.
4 MERC's rate consolidation proposal is discussed in the testimony of Mr. Greg Walters
5 and Mr. Seth DeMerritt.

6
7 Q. HAVE SOME STEPS BEEN TAKEN TOWARD RATE CONSOLIDATION OF
8 MERC-PNG AND MERC-NMU?

9 A. Yes. In its last rate case, MERC proposed as part of its rate design that the customer
10 charges of MERC-PNG and MERC-NMU be set at the same level, and that the respective
11 distribution rates be moved closer together for each customer class, to facilitate a future
12 decision to fully consolidate the distribution rate schedules for MERC-PNG and MERC-
13 NMU. The Commission approved these requests.

14
15 Q. WHY DOES MERC PROPOSE TO CHANGE THE PGA AREAS FROM FOUR
16 AREAS TO TWO AREAS?

17 A. MERC's proposal is designed to more accurately reflect the cost of gas for its customers
18 served by different pipelines. The historic NMU PGA determines the cost of gas by
19 consolidating the cost of gas among the four pipelines that provide gas to MERC-NMU
20 customers. The historic PNG PGAs determine a separate cost of gas for each of the three
21 pipelines that provide gas to MERC-PNG customers. This results in MERC-PNG and
22 MERC-NMU customers paying a different cost of gas even when their gas comes from
23 the same pipeline. MERC's proposal is to consolidate the PGAs of MERC-NMU and

1 MERC-PNG, then employ two PGA areas, one for the northern pipelines that serve
2 Minnesota from Canada, and one for the customers served off the Northern Natural Gas
3 pipeline. MERC's proposed PGA area change is discussed in the testimony of Mr.
4 Shawn Gillespie.

5
6 Q. WHY IS MERC BRINGING ITS PGA PROPOSAL INTO THIS GENERAL RATE
7 CASE?

8 A. MERC believes that its proposed change is best evaluated in the context of the overall
9 look at a utility's rates that occurs during a general rate case. An issue in evaluating this
10 proposal for change in the structure of MERC's PGAs, in addition to its cost justification,
11 will be the impact on various groups of customers and their bills. This impact will be
12 easier to assess in the context of this case, as opposed to two separate proceedings.

13
14 Q. WHY IS MERC PROPOSING A DECOUPLING MECHANISM IN THIS CASE?

15 A. Today there is great concern at all levels of society and government regarding climate
16 change and the economic down-turn, thus increasing the risk of utilities not fully
17 recovering costs in the context of the traditional rate making process.

18
19 Past electric and gas rate cases assumed that a sales forecast based on historical data
20 would provide an appropriate projection upon which to base future rates. Additionally, it
21 would provide the utility with a reasonable opportunity to recover its costs and earn its
22 authorized rate of return. However, due to the concerns of government and society at
23 large regarding the impacts of global climate change, and the economic down-turn, the

1 past may no longer be a reliable predictor of future sales. Both government and society
2 seek changes to mitigate and reduce greenhouse gas emissions. The leading strategy is
3 an increased emphasis on energy efficiency and conservation, which is seen as the least
4 cost approach with the greatest potential to affect climate change.

5
6 Revenue decoupling, which separates revenues from changes in energy sales, removes
7 the disincentive to promote energy efficiency and conservation that is a consequence of
8 the way rates are set under traditional rate regulation. The RDM therefore will work in
9 the same direction as the expanded energy conservation plans that MERC-PNG and
10 MERC-NMU presented and had approved for the first phase of the energy conservation
11 efforts envisioned in the Next Generation Energy Act “NGEA” of 2007.

12
13 MERC’s revenue decoupling proposal, and its alternative Straight Fixed Variable
14 (“SFV”) rate proposal, are discussed in the testimony of Ms. Valerie Grace.

15
16 Q. IS MERC ALSO PROPOSING A TRACKING MECHANISM FOR BAD DEBT?

17 A. Yes, in the volatile economic times that we have experienced in recent years, it has
18 become difficult to accurately estimate expected bad debt levels for a utility’s projected
19 test year. MERC’s proposed Uncollectible Expense True-up Mechanism (“UETM”)
20 mechanism would track bad debt expense and provide for a recovery of actual costs
21 incurred, while having a mechanism in place to provide an incentive for MERC to
22 appropriately pursue bad debt recoveries from its customers. MERC’s UTEM proposal is
23 discussed in the testimony of Mr. Seth DeMerritt.

1 **III. RATE CASE OVERVIEW**

2 Q. PLEASE EXPLAIN, GENERALLY, WHY BASE RATE RELIEF IS SOUGHT AT
3 THIS TIME.

4 A. First, the historical 2009 test year study indicates that MERC had a revenue deficiency of
5 \$359,098. MERC’s analysis of its projected 2011 test year indicates a much larger
6 revenue deficiency totaling \$15,165,309, or 5.18% of total revenues. The specific revenue
7 deficiencies of MERC-PNG and MERC-NMU are presented in the testimony of Mr. Seth
8 S. DeMerritt on the revenue requirements.

9
10 Second, from the 2009 historical year to the 2011 proposed test year, MERC will
11 experience a margin revenue decrease of 0.94%.

12
13 Third, general inflation, not including “Known and Measurable” (“K&M”) items, has
14 increased Operations and Maintenance (“O&M”) expenses at a rate of 5.38%. The
15 combination of a decreasing margin and increased expenses will not provide MERC with
16 a reasonable opportunity to earn its rate of return while maintaining the safe reliable
17 operation of the distribution system.

18
19 Fourth, MERC has identified K&M changes from 2009 to 2011 which will impact
20 MERC’s 2011 costs to provide service. These items include:

- 21 1. Increased costs from Vertex (formerly known as “Alliance Data Systems”, or
22 “ADS”) under its contract to provide MERC’s third-party customer service
23 functions (call center, dispatch, billing, payment processing, etc.),
24
25 2. Increased Costs associated with Benefits,
26

- 1 3. Increased Costs associated with System Implementation and Upgrades,
- 2
- 3 4. Increased Costs associated with Credit Facilities,
- 4
- 5 5. Decreased Costs associated with a net reduction in Employee Headcount,
- 6
- 7 6. Decreased Costs associated with Acquisition Expenses,
- 8
- 9 7. Decreased Costs associated with Restructuring Expenses,
- 10
- 11 8. Decreased Costs associated with Advertising Expenses,
- 12
- 13 9. Decreased Costs associated with Organizational Dues,
- 14
- 15 10. Decreased Costs associated with Charitable Contributions, and
- 16
- 17 11. Decreased Costs associated with Economic Development.
- 18

19 Fifth, MERC has included in the test year its 2011 approved Conservation Improvement
20 Plan (“CIP”) expenses.

21

22 Lastly, MERC has a right to a reasonable opportunity to earn its authorized Return on
23 Equity (“ROE”) for its operations. MERC’s currently authorized rates will not provide
24 sufficient revenue to provide MERC a reasonable opportunity to earn its authorized ROE.
25 There are no significant cost reductions that can be made without jeopardizing service
26 quality, service reliability, and safety to the public or MERC’s employees. Without rate
27 relief, MERC would be faced with the unacceptable prospect of implementing cost
28 cutting measures which would degrade its ability to provide long-term quality, safe and
29 reliable service to its customers. MERC, therefore, believes it is necessary, just and
30 reasonable to request and obtain rate relief.

31

1 Q. PLEASE IDENTIFY THE MERC WITNESSES, AND INDICATE THE SUBJECTS
2 THEY WILL ADDRESS IN THEIR DIRECT TESTIMONY.

3 A. Mr. Seth S. DeMerritt presents:

- 4 1. The MERC-PNG and MERC-NMU 2009 historical year, 2010 projected year, and
5 2011 proposed test year information,
6
- 7 2. CIP expenses and calculation of MERC's proposed Conservation Cost Recovery
8 Charge factor,
9
- 10 3. Lead/Lag Study in support of MERC's request for cash working capital,
11
- 12 4. Interim Rate deficiency proposal,
13
- 14 5. Consolidation of Sales, Customers, Additional Meters, and Daily Firm Capacity
15 Nominations, and
16
- 17 6. Proposal for an UETM.
18

19 Mr. Shawn Gillespie presents MERC's proposal for change in its PGA areas.

20

21 Ms. Valerie H. Grace presents MERC's decoupling proposal and alternative SFV
22 proposal.

23

24 Ms. Joylyn Hoffman Malueg presents MERC's class cost of service studies.

25

26 Mr. Harry W. Johns presents MERC's 2011 sales forecast, and supporting information on
27 the development of 20 year weather normalization for use in the sales forecast.

28

29 Mrs. Tracy L. Kupsh presents testimony regarding cost allocation procedures and factors
30 from Integrys Business Support, LLC ("IBS").

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Mr. David G. Kult presents testimony regarding service and main extensions, winter construction charges, abnormal construction charges, charges assessed for materials in situations where tampering has occurred, and the farm tap inspection program.

Ms. Lisa J. Gast presents MERC's capital structure and cost of capital.

Mr. Paul R. Moul presents MERC's requested ROE.

Ms. Christine M. Phillips presents testimony regarding MERC's benefits costs.

Mr. Greg J. Walters presents testimony regarding gas rate design, including rate area consolidation, the Company's Gas Affordability Program, other requested tariff changes, telemetry installation, and cost allocations related to MERC's appliance services company.

Mr. John R. Wilde presents testimony regarding various tax issues.

Q. WHAT IS THE AMOUNT OF RATE RELIEF MERC IS SEEKING IN THIS PROCEEDING?

A. MERC's study for the proposed test year ending December 31, 2011 indicates a need for an annual base rate increase of \$15,165,309, or 5.18% of total revenues. These increases are based on an authorized ROE of 11.25%. MERC is also requesting that these increased revenues be recovered through the rate design proposed by Mr. Greg Walters

1 that reflects consolidation of the MERC-PNG and MERC-NMU rate areas, and the
2 consolidation of MERC's four PGA areas into two areas.

3
4 The rates sponsored by Mr. Greg J. Walters are designed to produce the requested
5 revenue requirement and to move toward the MERC goal of a rate design where each rate
6 schedule will, consistent with cost-of-service studies, return the overall allowed rate of
7 return.

8

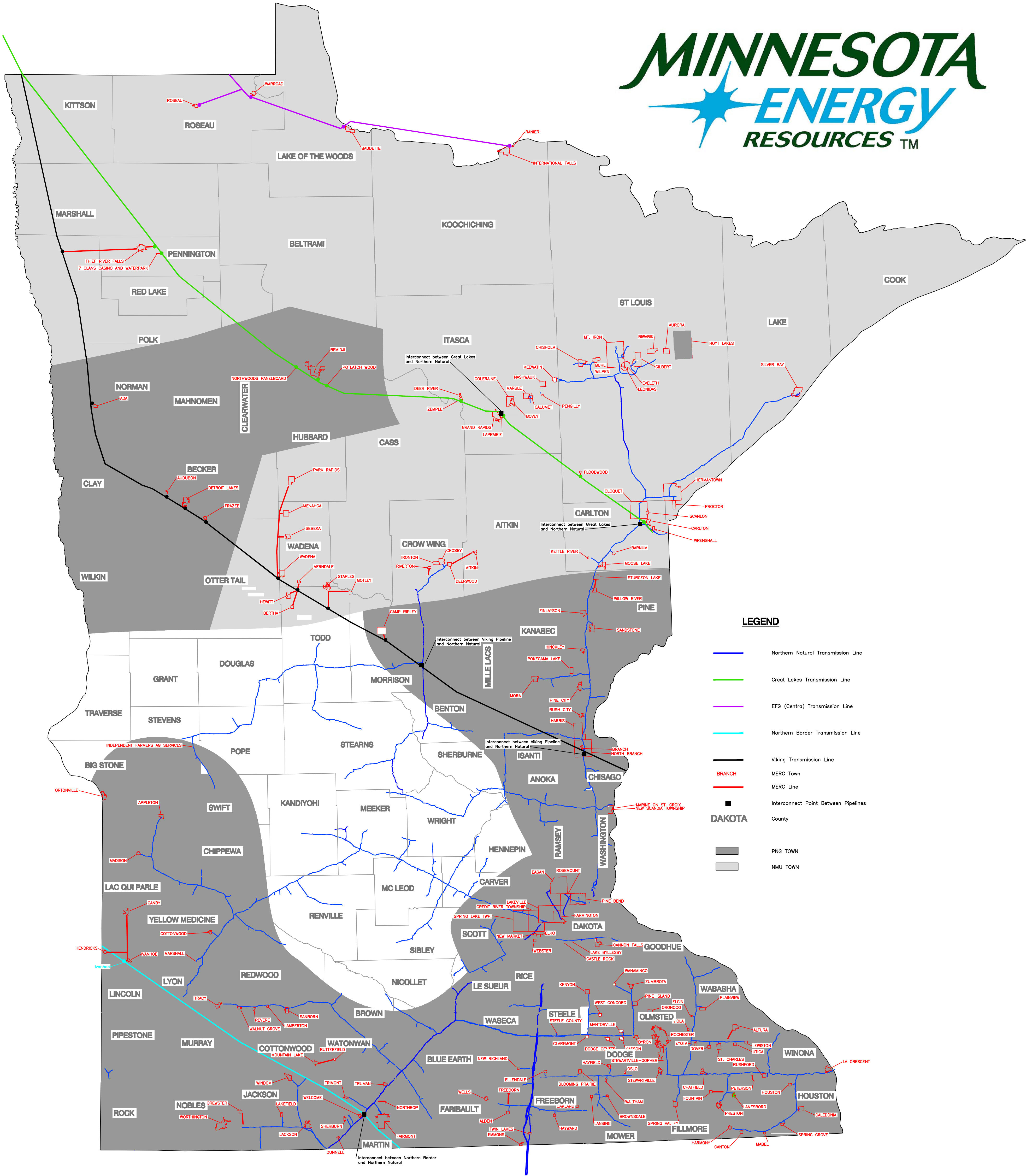
1 **IV. CONCLUSION**

2 Q. DO YOU HAVE ANY REMARKS IN CONNECTION WITH MERC'S INTERIM
3 RATE RELIEF REQUEST?

4 A. Yes, I do. Also in this filing MERC petitions for interim rate relief. If MERC is not
5 granted an interim rate increase, it will not have a reasonable opportunity to recover its
6 prudently incurred costs of providing natural gas service to its customers, and will be
7 severely harmed by being deprived of the opportunity to earn a reasonable rate of return
8 for 2011.

9
10 Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY AT THIS TIME?

11 A. Yes, it does.



LEGEND

- Northern Natural Transmission Line
- Great Lakes Transmission Line
- EFG (Centra) Transmission Line
- Northern Border Transmission Line
- Viking Transmission Line
- MERC Town
- MERC Line
- Interconnect Point Between Pipelines
- DAKOTA**
- PNG TOWN
- NMU TOWN

