Direct Testimony and Schedules
Valerie H. Grace

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 _____

Sales and Revenue Decoupling

November 30, 2010

TABLE OF CONTENTS

I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Valerie H. Grace. My business address is Integrys Business Support ("IBS"), 130 East Randolph Drive, Chicago, Illinois 60601.

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

A. I am Manager, Gas Regulatory Services in the Regulatory Affairs Department of Integrys Business Support, LLC ("IBS"). Both Minnesota Energy Resources Corporation ("MERC") and IBS are wholly-owned subsidiaries of Integrys.

Q. PLEASE SUMMARIZE YOUR QUALIFICATIONS AND EXPERIENCE.

A. In 1980, I graduated from Illinois State University with a Bachelor of Science Degree in Business Administration. In 1988, I received a Master of Management Degree from Northwestern University. I have been employed by IBS and three affiliated companies from September 1980 to the present. I have been employed in various positions and levels of responsibility including the Rates Department, the Office of the Chairman, the Executive Office of the Customer Relations Division, and the Gas Transportation Services and Strategic Development departments. I have been in my present position since February, 2007.

Q. FOR WHOM ARE YOU PROVIDING TESTIMONY?

A. I am providing testimony on behalf of MERC.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY REGULATORY AGENCY?

A. Yes, I have filed testimony or have testified before the Illinois Commerce Commission and the Michigan Public Service Commission for The Peoples Gas Light and Coke ("Peoples Gas") Company and North Shore Gas Company ("North Shore Gas"); and Michigan Gas Utilities Corporation, respectively. I have filed testimony or have testified in general rate increase and customer choice proceedings; annual reconciliation proceedings related to gas costs and decoupling; and the merger proceeding involving Peoples Energy Corporation ("PEC") and WPS Resources Corporation ("WPSR").

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

A. The purpose of my pre-filed direct testimony is to address the design for a primary decoupling mechanism for MERC, known as the Revenue Decoupling Mechanism ("RDM"), as well as an alternative decoupling mechanism, a Straight Fixed Variable ("SFV") rate design for applicable rate classes.

Q. ARE YOU SPONSORING ANY EXHIBITS IN CONNECTION WITH YOUR TESTIMONY IN THIS PROCEEDING?

A. I am sponsoring the following exhibits:

Exhibit _____ (VHG-1), Schedule 1, RDM Baseline

Exhibit _____ (VHG-1), Schedule 2, RDM Illustration

Exhibit _____ (VHG-1), Schedule 3, Proposed RDM Tariff

Exhibit _____ (VHG-1), Schedule 4, Fixed and Variable Cost Summary

Exhibit _____ (VHG-1), Schedule 5, Alternative Decoupling Proposal

Q. WERE THESE EXHIBITS PREPARED BY YOU OR UNDER YOUR DIRECTION AND SUPERVISION?

A. Yes, they were.

Q. PLEASE DESCRIBE EXHIBIT _____ (VHG-1), SCHEDULE 1, RDM BASELINE.

A. Exhibit _____ (VHG-1), Schedule 1, RDM Baseline, reflects, for each applicable rate group, the derivation of the baseline that would be used to determine annual adjustments under the RDM, assuming the distribution charges proposed in this proceeding.

Q. PLEASE DESCRIBE EXHIBIT _____ (VHG-1), SCHEDULE 2, RDM ILLUSTRATION.

A. Exhibit _____ (VHG-1), Schedule 2, RDM Illustration, reflects, for each applicable rate group, an illustration of the symmetrical operation of the RDM, assuming that per customer revenues would be 3% higher or lower than the baseline proposed in this proceeding.

Q. PLEASE DESCRIBE EXHIBIT _____ (VHG-1), SCHEDULE 3, PROPOSED RDM TARIFF.

A. Exhibit _____ (VHG-1), Schedule 3, Proposed RDM Tariff, provides the proposed tariff sheet provisions and calculations that would effectuate the RDM.

Q. PLEASE DESCRIBE EXHIBIT _____ (VHG-1), SCHEDULE 4, FIXED AND VARIABLE COST SUMMARY.

A. Exhibit _____ (VHG-1), Schedule 4, Fixed and Variable Cost Summary, reflects for the General Service - Residential and Small Commercial rate classes, a breakdown of the revenue requirement into fixed and variable cost classifications.

Q. PLEASE DESCRIBE EXHIBIT _____ (VHG-1), SCHEDULE 5, ALTERNATIVE DECOUPLING PROPOSAL.

A. Exhibit _____ (VHG-1), Schedule 5, Alternative Decoupling Proposal, reflects, for the General Service - Residential and Small Commercial rate classes, a proposed SFV rate design, which MERC believes is a feasible alternative approach for decoupling.

II. PRIMARY DECOUPLING PROPOSAL - RDM

Q. PLEASE DESCRIBE THE PURPOSE OF MERC'S PROPOSED RDM.

A. MERC's proposed RDM is a decoupling mechanism that will separate (or decouple) MERC's revenues from the volume of gas that it sells, thereby removing the financial disincentive to promote energy efficiency and allowing MERC the opportunity to earn its Commission approved revenue requirement. The RDM is a symmetrical true-up mechanism that will adjust for each applicable rate group, on a per customer basis, for sales volumes that are above or below the approved sales level for the rate group that is used to determine the volumetric distribution charges approved by the Commission. The symmetrical design of the RDM will result in a bill charge if the rate group's usage is below the approved sales level, and a bill credit if the rate group's usage is above the approved sales level.

Q. WHY IS MERC PROPOSING A DECOUPLING MECHANISM?

A. I have been advised by counsel that in 2007, the Minnesota Legislature enacted Minn. Stat § 216B.2412, which defined decoupling as a "regulatory tool designed to separate a utility's revenue from changes in energy sales." Minn. Stat. § 216B.2412, subd. 1. The legislation directed the Commission to establish criteria and standards by which decoupling could be adopted by the state's regulated utilities. The legislation also required the Commission to allow one or more rate-regulated utilities to participate in a pilot program to "assess the merits of a rate-decoupling strategy to promote energy and conservation." Minn. Stat. § 216B.2412, subd. 3.

Q. HAS MERC INDICATED THAT IT WOULD PROPOSE A REVENUE DECOUPLING PILOT PROGRAM?

A. Yes. On June 19, 2009, the Commission issued its Order Establishing Criteria and Standards to be Utilized in Pilot Proposals for Revenue Decoupling, Docket No. E,G-999/CI-08-132. As part of that Order, the Commission asked utilities to file a non-binding notice of intent about their plans to file a decoupling pilot program by June 1, 2010. On May 27, 2010, MERC filed with the Commission its notice of intent to file a decoupling pilot program as part of this general rate case. This filing is prior to the Commission's December 30, 2011 deadline for the filing of decoupling pilot proposals.

Q. HAS THE COMMISSION APPROVED ANY DECOUPLING PILOT PROGRAMS?

A. Yes. On November 2, 2009, the Commission approved a partial decoupling pilot program for CenterPoint Energy ("CenterPoint") that grew out of a Stipulation among various parties to CenterPoint's general rate case.

Q. DOES MERC'S PROPOSED RDM ADHERE TO THE GUIDING STATUTE?

A. Yes. MERC's proposed RDM, which decouples revenues from changes in energy sales, removes the disincentive to promote energy efficiency and conservation. The RDM therefore will work in the same direction as the expanded energy conservation plans that MERC-PNG and MERC-NMU presented and had approved for the first phase of the energy conservation efforts envisioned in the Next Generation Energy Act "NGEA" of 2007.

Q. IS MERC'S PROPOSED RDM A PARTIAL OR FULL DECOUPLING MECHANISM?

A. MERC's proposed RDM is a full decoupling mechanism. Full decoupling means the mechanism would compute an adjustment for all changes in usage per customer above or below the sales level approved in MERC's most recent general rate case proceeding. Such usage changes could arise from customer energy efficiency and conservation efforts, increased customer usage, or weather variations. A partial decoupling mechanism is typically one that would compute adjustments for either conservation or weather related changes in customers' usage, but not both. In addition to removing the disincentive to promote energy efficiency, MERC's proposed RDM pilot as well as its proposed alternative decoupling mechanism will provide an opportunity for the Commission to evaluate and approve an alternative decoupling pilot program, as it assesses the merits of various types of decoupling.

Q. WHY IS MERC PROPOSING A FULL RATHER THAN A PARTIAL DECOUPLING MECHANISM?

A. Minn. Stat. § 216B.2412, subd. 1 directs the Commission to consider energy efficiency and weather among other factors when designing its criteria and standards for decoupling. A full decoupling mechanism, which would be symmetrical, would allow the Commission to assess the effects of both energy efficiency and weather that varies from the normal weather assumed for ratemaking purposes. A partial decoupling mechanism that would compute adjustments only for energy efficiency and conservation related usage changes would be asymmetrical and not provide as much value as a full

decoupling mechanism which considers other factors. A partial decoupling mechanism which considers only reduced usage would not fully align the interests of MERC and its customers, as it would not provide bill credits to customers if their usage is greater than the usage level approved by the Commission. A partial decoupling mechanism is also more complicated to compute, potentially administratively burdensome, and may cause disputes about the appropriate quantification of usage changes and affected sales volumes. MERC believes that a full decoupling mechanism, such as its proposed RDM, would be simpler to compute, align the interests of MERC and its customers, and would minimize debates related to quantifying sales levels or changes in usage.

Q. WOULD THE PROPOSED RDM OFFER ANY BENEFITS TO MERC AND ITS CUSTOMERS?

A. Yes, it would. The proposed RDM would fully decouple MERC's volumetric sales levels from its distribution revenues, thereby removing the disincentive to promote energy efficiency and allowing MERC the opportunity to earn its Commission approved revenue requirement. MERC's customers would benefit from any company sponsored energy efficiency programs and from bill credits that would arise from the symmetrical operation of the mechanism.

Q. CAN YOU CITE ANY SPECIFIC EXAMPLES WHERE CUSTOMERS HAVE BENEFITED FROM A FULL DECOUPLING PROGRAM SIMILAR TO MERC'S PROPOSED RDM?

A. Yes. Two affiliate companies, Peoples Gas and North Shore Gas, implemented full decoupling mechanisms for their small residential and general service rate classes in May, 2008. Through September 2010, Peoples Gas and North Shore Gas have refunded net amounts of about $6.6 million and $2.5 million, respectively, due to the symmetrical nature of their full decoupling mechanisms.

Q. DO OTHER INTEGRYS UTILITIES CURRENTLY HAVE APPROVED REVENUE DECOUPLING MECHANISMS?

A. Yes, they do. In fact, of the six Integrys regulated utilities, MERC is the only utility that does not currently have an approved revenue decoupling mechanism. Specifically,

1. On February 5, 2008 in Docket No. 07-0241, the Illinois Commerce Commission approved a revenue decoupling mechanism for Integrys subsidiary North Shore Gas Company, an Illinois gas utility.

2. On February 5, 2008 in Docket No. 07-0242, the Illinois Commerce Commission approved a revenue decoupling mechanism for Integrys subsidiary The Peoples Gas Light and Coke Company, an Illinois gas utility.

3. On December 30, 2008 Docket No. 6690-UR-119, the Public Service Commission of Wisconsin approved a revenue decoupling mechanism for Integrys subsidiary Wisconsin Public Service Corporation, a Wisconsin combination gas and electric utility. Mechanisms were approved for both gas and electric service.

4. On December 16, 2009 Case No. U-15988, the Michigan Public Service Commission approved a revenue decoupling mechanism for Integrys subsidiary Upper Peninsula Power Company, a Michigan electric utility.

5. On July 1, 2010 Case No. U-15990, as modified on October 26, 2010, the Michigan Public Service Commission approved a revenue decoupling mechanism for Integrys subsidiary Michigan Gas Utilities Corporation, a Michigan gas utility.

Q. PLEASE IDENTIFY THE APPLICABLE RATE CLASSES FOR THE RDM.

A. RDM adjustments will be determined separately for two different rate groups. These two rate groups and the rate classes that will be included within each group are as follows:

1. General Service - Residential (MERC-NNG and MERC Consolidated)

2. General Service - Small Commercial & Industrial (MERC-NNG and MERC Consolidated)

These rate classes represent the rate class consolidation for delivery service proposed by MERC witness Mr. Gregory J. Walters. The RDM would be applicable to all customers served under these rate classes. Under present rates, the applicable rate groups and rate classes are as follows:

1. General Service - Residential (GS-1, GS-4, GS-5)

2. General Service - Small Commercial & Industrial (GS-1, GS-4, GS-5)

3. General Service - Residential (NMU)

4. General Service - Small Commercial & Industrial (NMU)

Under the proposed consolidated rate classes, the applicable rate groups and rate classes are as follows:

1. General Service – MERC-NNG Residential

2. General Service – MERC-NNG Small Commercial & Industrial

3. General Service – MERC Consolidated Residential

4. General Service – MERC-Consolidated Small Commercial & Industrial

This proposal satisfies the Commission's requirement that a revenue decoupling pilot program be implemented in more than one customer class. The RDM was not proposed for MERC's remaining rate classes which I understand are either more heterogeneous

with respect to usage, more affected by economic conditions, or subject to interruption under certain terms in MERC's tariff. MERC's alternative decoupling proposal would apply to the same customer classes as the proposed RDM, for the same reasons.

Q. PLEASE DESCRIBE HOW MERC'S PROPOSED RDM WILL OPERATE.

A. Distribution revenues are determined by multiplying volumetric distribution sales volumes times a distribution charge. MERC's proposed RDM will consider only changes in volumetric distribution revenues, exclusive of Conservation Cost Recovery Charge revenues, on a per customer basis. Adjustments under the RDM will be determined annually and will be calculated by taking the difference between: (1) baseline annual calendar year distribution revenues, exclusive of Conservation Cost Recovery Charge revenues, per customer for the rate group approved in MERC's most recent general rate case proceeding, and (2) actual annual calendar year distribution revenues, exclusive of Conservation Cost Recovery Charge revenues, per customer for the rate group. This difference will be multiplied by the average number of customers that were used to establish charges in the most recent general rate case proceeding to determine the dollar amount that will be collected from, or refunded to, customers. The amount will be recovered or refunded, on a per estimated therm basis, over a 12-month period. Each year after the initial year of the RDM, MERC would determine any over- or under-collection of the RDM and roll that amount into the determination of the RDM adjustment for the subsequent year. Exhibit _____ (VHG-1), Schedule 1 reflects MERC's proposed methodology for establishing the baseline for each rate group,

assuming the charges proposed in this proceeding.[1] Exhibit _____ (VHG-1), Schedule 2 illustrates the symmetrical operation of the RDM under two different scenarios assuming a change in distribution revenues of 3% from the baseline of each rate group. Page 1 reflects a refundable scenario resulting from an increase in distribution revenues per customer and Page 2 reflects a recoverable scenario resulting from a decrease in distribution revenues per customer. Columns A through C on both pages reflect the baselines derived in Exhibit _____ (VHG-1), Schedule 1. Columns D through I illustrate the calculation of the RDM adjustments.

Q. HAVE YOU PROVIDED TARIFF LANGUAGE FOR THE RDM?

A. Yes. The proposed RDM tariff is provided as Exhibit _____ (VHG-1), Schedule 3.

Q. WHY IS IT NECESSARY TO DETERMINE THE RDM ON A PER CUSTOMER BASIS?

A. It is necessary to determine the RDM on a per customer basis to filter out any changes (increase or decrease) in the number of customers that would differ from those levels supporting the revenues approved by the Commission in a general rate case proceeding. Doing so will not only isolate the changes in usage and related distribution revenues for the number of customers that were used to determine the revenues approved in a general rate case proceeding; it will recognize the additional costs incurred by MERC to provide service to new customers. These costs include the addition of new services and meters as

[1] Exhibit _____ (VHG-1) depicts calculations based on MERC's present non-consolidated rate structure. Because the RDM is calculated based on MERC's total residential and total small commercial customer base, the results would be identical under MERC's proposed consolidated rate structure.

well as other expenses to serve new customers joining the system. This approach will allow MERC to continue to recover the cost of connecting new customers. Moreover, it will also prevent MERC from recovering revenues for load losses associated with customers leaving the system.

Q. WHY DOES MERC PROPOSE TWO DIFFERENT RATE GROUPS RATHER THAN INDIVIDUAL RATE CLASSES TO CALCULATE RDM ADJUSTMENTS?

A. Each rate group includes rate classes that have identical distribution charges. MERC proposes to calculate the RDM adjustment for two rate groups rather than individual rate classes to simplify the calculation of adjustments for, and the operation of, the RDM.

Q. HOW WOULD THE RDM BE IMPLEMENTED EACH YEAR?

A. MERC will file its RDM adjustments with the Commission by March 31 of each year requesting refund or recoveries of any amounts arising from the previous calendar year. MERC proposes that the RDM adjustments will become effective the following day on April 1, and bill over a 12-month period. This would allow the adjustments to be implemented on a regular annual cycle, and allow each succeeding annual period to consider any over/under recovery from the prior year in setting the new adjustment. In the event any portions of the proposed RDM adjustments are modified by the Commission, the adjustments will be adjusted either by changing the RDM adjustment factor for the remaining months of the refund period, or as specified in the Commission's order.

Q. HOW WOULD THE RDM BE EVALUATED DURING THE PILOT PERIOD?

A. Each year MERC will submit an evaluation plan to the Commission which conforms to the Commission's Revenue Decoupling Criteria and Standards in Docket No. E,G-999/CI-08-132, and includes the adjustments described above. This report will include the following information, as specified by the Commission: total adjustments by class, total adjustment charges collected, number of customer complaints, whether the pilot program has stabilized revenues for the customer classes and how any such stabilization has impacted MERC's risk profile, a comparison of how revenues under traditional regulation would have differed from those collected under the RDM pilot program, whether MERC is meeting the energy efficiency savings goals in its Conservation Improvement Plans, whether the RDM pilot program has influenced achievement of those goals, any problems encountered, and suggested improvements for the future. MERC would also submit an annual evaluation report addressing the above issues for its alternative decoupling proposal.

Q. HOW WILL MERC'S PROPOSED AND ALTERNATIVE RDM IMPACT MERC'S COST OF CAPITAL?

A. Neither RDM proposal will impact MERC's cost of capital. Please refer to the testimony of Mr. Paul Moul, which describes how MERC's requested return on equity was derived. As explained by Mr. Moul, all companies included in the comparison group have some form of revenue decoupling, and the impact of decoupling has been considered in Mr. Moul's recommended return on equity.

Q. WHAT IS THE PROPOSED PILOT PERIOD FOR THE RDM?

A. MERC proposes that RDM adjustments be calculated for three calendar years plus any partial calendar year that the RDM becomes effective. A partial year would arise if the distribution charges approved by the Commission in this proceeding become effective within a calendar year. In this case, initial RDM adjustments will be determined based on actual data beginning with the first day of the month following the Commission's order. MERC's alternative decoupling proposal requires no adjustments, and if approved, MERC proposes that it be in place as a pilot program for the same time period described above.

Q. HOW WOULD RDM ADJUSTMENTS BE SHOWN ON CUSTOMERS' BILLS?

A. RDM adjustments will be shown as a separate line item on customers' bills. RDM adjustments will not be combined with any other charges as revenues arising from the RDM will be reconciled annually with any under or over-billings being recovered in a subsequent RDM adjustment. RDM adjustments will also not affect any other charges or adjustments in MERC's tariff.

Q. PLEASE DESCRIBE HOW THE RDM WOULD WORK IN CONCERT WITH ANY AUTOMATIC RECOVERY MECHANISM OR FINANCIAL INCENTIVE?

A. MERC has a purchased gas adjustment mechanism that would not be affected by the proposed RDM because gas costs are not part of the distribution and customer charges set in general rate cases for gas utilities. Therefore, gas costs are not included in any RDM calculation.

Additionally, MERC has approval to track and recover Conservation Improvement Program ("CIP") costs, including a financial incentive, which are recovered through a Conservation Cost Recovery Charge ("CCRC"), which is imbedded in the base volumetric distribution rate; and a Conservation Cost Recovery Adjustment ("CCRA"), which is a separate line item on customer bills, and is therefore not imbedded in the base volumetric distribution rate. MERC's proposed RDM would exclude the CCRC revenues and CCRA revenues from the RDM calculations. Further, any changes to the CCRC or CCRA require specific Commission approval. MERC proposes than any adjustments to the calibration of the CIP financial incentive be reviewed in future CIP financial incentive proceedings.

Finally, MERC's Gas Affordability Program and its proposed Uncollectibles Expense Tracking Mechanism are or would be implemented, respectively, through a line item separate from the distribution charge on customers' bills. As a result, the proposed RDM adjustments would not be calculated based upon these items.

MERC's proposed RDM therefore assures that no double recovery would occur due to implementation of the RDM tariff.

III - ALTERNATIVE DECOUPLING PROPOSAL – MONTHLY SERVICE CHARGE

Q. WHY IS MERC PRESENTING AN ALTERNATIVE DECOUPLING PROPOSAL?

A. MERC believes that a variant of the Straight Fixed Variable ("SFV") rate design, or a flat monthly "Service Charge" to recover fixed costs, is a feasible alternative to decouple rates. The SFV rate design directly remedies the issue that causes the need for revenue decoupling: failure to assign all fixed costs of utility service to the fixed customer charge, and to assess only variable costs of service through the distribution charge.

Q. WHAT IS A SFV RATE AND WHY IS MERC MAKING SUCH A PROPOSAL?

A. A SFV rate would assign all fixed costs to fixed charges and all variable costs to variable charges. As about 92% of MERC's costs for its Residential rate group is fixed, and 90% of MERC's costs for its Small Commercial rate group is fixed, MERC believes that its proposed Service Charges, which would assign all costs to flat fixed monthly charges is appropriate. This is akin to the symmetrical decoupling mechanism described above because changes in per customer usage would not provide a disincentive for MERC to promote energy efficiency nor significantly affect MERC's recovery of its Commission-approved revenue requirement. Exhibit _____ (VHG-1), Schedule 4, Fixed and Variable Cost Summary, shows the derivation of the fixed and variable cost percentages cited above.

Q. PLEASE DESCRIBE THE PROPOSED ALTERNATIVE MONTHLY SERVICE CHARGES.

A. Exhibit _____ (VHG-1), Schedule 5, Alternative Decoupling Mechanism, shows the derivation of MERC's proposed alternative monthly Service Charges for its Residential and Small Commercial rate groups. For its Residential and Small Commercial rate groups, the proposed monthly Service Charges are $24.25 and $29.60, respectively (line 5). These charges are derived by taking the rate group revenues that would arise from the base rate design proposals made by Mr. Walters for General Service - Residential and Small Commercial rate classes, less any amounts arising from the CCRC, and dividing the resulting amount by the annual number of customers for each rate group. For the General Service – Residential rate group, the proposed Service Charge is based on the revenues arising from Mr. Walters' proposed rate design, rather than the full cost of service, because Mr. Walters, while proposing to move the General Service - Residential rate group closer to cost, does not set rates at the full cost of service. If the General Service - Residential rate group was set at cost, the monthly Service Charge would be higher at $25.68, as derived and shown on Exhibit _____ (VHG-1), Schedule 5, line 10.

Q. WOULD THE PROPOSED MONTHLY SERVICE CHARGE OFFER ANY BENEFITS TO MERC AND ITS CUSTOMERS?

A. Yes, it would. Like its proposed RDM, MERC's proposed monthly Service Charge would completely decouple MERC's volumetric sales levels from its rates for its residential and small commercial rate classes, thereby removing the disincentive for MERC to invest in energy efficiency and allowing MERC the opportunity to earn its Commission approved revenue requirement. It also eliminates the need for any computed adjustments, reconciliations or filings with the Commission. Note that for the

General Service – Residential rate group, an annual bill of $291.00 ($24.25 x 12), which would result from the proposed monthly Service Charge is equivalent to an annual bill of $291.00 that would result from the monthly customer charge proposed by Mr. Walters and the RDM baseline shown in Exhibit _____ (VHG-1), Schedule 1, column E, line 6 ($9.50 x 12 + $177.00), but without any adjustments that would need to be computed, reconciled and filed with the Commission. Similarly, for the General Service – Small Commercial rate group, an annual bill of $355.20 ($29.60 x 12), which would result from the proposed monthly Service Charge is equivalent to an annual bill of $355.25 that would result from the monthly customer charge proposed by Mr. Walters and the RDM baseline shown in Exhibit _____ (VHG-1), Schedule 1, column E, line 12 ($14.50 x 12 + $181.25), but again without any adjustments that would need to be computed, reconciled and filed with the Commission. The Service Charge offers a simple rate design and would essentially provide equal monthly billing for a customer's bill. This would be especially beneficial to customers during the winter period when gas usage, gas prices and resulting bills are typically at their highest. A monthly Service Charge would also send the appropriate price signal to customers about the fixed cost nature of the distribution service provided by MERC. The gas cost portion of the customers' bill, which is the largest bill component, will continue to send the proper price signal about the market driven nature of gas costs. Finally, a fixed flat Service Charge would be similar to flat charges that customers have become accustomed to paying for internet, telephone, cable and waste removal services.

Q. PLEASE DESCRIBE HOW THE ALTERNATIVE MONTHLY SERVICE CHARGE WOULD WORK IN CONCERT WITH ANY AUTOMATIC RECOVERY MECHANISM OR FINANCIAL INCENTIVE?

A. Because the alternative monthly service charge has no after the fact true-up mechanism, and because the alternative monthly service charge has been adjusted for CCRC revenues, no double recovery of any costs would occur due to implementation of the alternative monthly service charge.

Q. IS MERC PROPOSING A CAP OR A COLLAR FOR ITS PRIMARY OR ALTERNATIVE DECOUPLING PROPOSALS?

A. No. Under MERC's primary RDM proposal, any adjustments would simply true-up customers' bills to distribution revenue per customer levels that have been approved by the Commission. A cap or a collar would both not fully remove the disincentive for MERC to support energy efficiency and may result in MERC recovering a lesser revenue requirement than that approved by the Commission. A cap or collar would also not allow customers to fully receive the benefit of decoupling, such as those enjoyed by Peoples Gas and North Shore Gas customers, if customer usage greatly exceeds the baseline approved by the Commission. Under MERC's alternative decoupling proposal, a cap or collar would not apply since the monthly Service Charge would be a fixed, flat amount.

Q. HOW WILL MERC MEASURE, MAINTAIN AND REPORT ASPECTS OF ITS SERVICE QUALITY UNDER ITS DECOUPLING PROPOSALS?

A. In accordance with the Commission's August 26, 2010 order in Docket No. G-999/CI-09-409, commencing May 1, 2011, MERC must annually report statistics regarding certain gas utility quality standards. MERC proposes to include phone answer times, gas emergency response times, missed appointments for service installations, times to reconnect service, and the number of customers disconnected for non-payment in these reports. Further, MERC agrees to continue to provide this information during the duration of the decoupling program.

IV - CONCLUSION

Q. DOES MERC'S PROPOSALS CONFORM TO THE STATUTE AND THE COMMISSION'S CRITERIA AND STANDARDS?

A. Yes. MERC's primary and alternative decoupling proposals have been designed to conform to the statue as well as the Commission's Revenue Decoupling Criteria and Standards.

Q. DO YOU BELIEVE THAT MERC'S PROPOSALS ARE REASONABLE APPROACHES TO DECOUPLING?

A. Yes. I believe that MERC's proposals are reasonable and properly align the interests of the Company and its customers.

Q. DOES THIS COMPLETE YOUR PRE-FILED DIRECT TESTIMONY?

A. Yes, it does.

Minnesota Energy Resources Corporation
RDM Baseline Assuming Proposed Rates
Projected Calendar Year 2011

Ln	Rate Class	Illustrative Baseline - Proposed Rates: Test Year Sales Therms [A]	Proposed Distribution Charges Less CCRC [B]	Proposed Distribution Revenues Less CCRC Revenues [C]	Customers Avg Monthly [D]	Distribution Revenues Per Customer [E] [C] / [D]
1	General Service - Residential					
2	MERC-PNG-NNG	131,441,161	$ 0.19980	$ 26,261,944	145,331	
3	MERC-PNG-Viking	3,058,391	$ 0.19980	$ 611,067	3,914	
4	MERC-PNG-GLGT	4,306,465	$ 0.19980	$ 860,432	5,149	
5	MERC-NMU	29,404,396	$ 0.19980	$ 5,874,998	35,481	
6	Total Residential	168,210,413		$ 33,608,441	189,875	$ 177.00
7	General Service - Small Commercial and Industrial					
8	MERC-PNG-NNG	5,906,382	$ 0.18763	$ 1,108,214	6,181	
9	MERC-PNG-Viking	241,553	$ 0.18763	$ 45,323	302	
10	MERC-PNG-GLGT	470,404	$ 0.18763	$ 88,262	439	
11	MERC-NMU	2,280,453	$ 0.18763	$ 427,881	2,290	
12	Total Small C&I	8,898,792		$ 1,669,680	9,212	$ 181.25

Minnesota Energy Resources Corporation
RDM Illustration Assuming Proposed Rates
Illustration - Assuming an Increase in Distribution Revenues Per Customer

		Illustrative Baseline - Proposed Rates			Illustrative Actual - Increase in Revenue Per Customer					
Ln	Rate Class	Proposed Distribution Revenues Less CCRC Revenues [A]	Customers Avg Monthly [B]	Proposed Distribution Revenues Less CCRC Revenues Per Customer [C] [A] / [B]	Actual Distribution Revenues Less CCRC Revenues [D]	Customers Avg Monthly [E]	Actual Distribution Revenues Less CCRC Revenues Per Customer [F] [D] / [E]	RDM Recoveries (Refunds) [G] {[C] - [F]} x [B]	Estimated 12-month Therms [H]	RDM Charge (Refund) Therm [I] [G] / [H]
1	General Service - Residential									
2	MERC-PNG-NNG	$ 26,261,944	145,331.00		$ 27,049,802	145,331.00				
3	MERC-PNG-Viking	$ 611,067	3,914.00		$ 629,399	3,914.00				
4	MERC-PNG-GLGT	$ 860,432	5,149.00		$ 886,245	5,149.00				
5	MERC-NMU	$ 5,874,998	35,481.00		$ 6,051,248	35,481.00				
6	Total Residential	$ 33,608,441	189,875.00	$ 177.00	$ 34,616,694	189,875.00	$ 182.31	$ (1,008,236.25)	138,806,017	$ (0.00730)
7	General Service - Small Commercial									
8	MERC-PNG-NNG	$ 1,108,214	6,181.00		$ 1,141,460	6,181.00				
9	MERC-PNG-Viking	$ 45,323	302.00		$ 46,683	302.00				
10	MERC-PNG-GLGT	$ 88,262	439.00		$ 90,910	439.00				
11	MERC-NMU	$ 427,881	2,290.00		$ 440,717	2,290.00				
12	Total Small Commercial	$ 1,669,680	9,212.00	$ 181.25	$ 1,719,770	9,212.00	$ 186.69	$ (50,113.28)	8,898,792	$ (0.00560)
13	Total RDM Recovery (Refund)							$ (1,058,349.53)		

Minnesota Energy Resources Corporation
RDM Illustration Assuming Proposed Rates
Illustration - Assuming a Decrease in Distribution Revenues Per Customer

Ln	Rate Class	Illustrative Baseline - Proposed Rates: Proposed Distribution Revenues Less CCRC Revenues [A]	Customers Avg Monthly [B]	Proposed Distribution Revenues Less CCRC Revenues Per Customer [C] = [A] / [B]	Illustrative Actual - Decrease in Revenue Per Customer: Actual Distribution Revenues Less CCRC Revenues [D]	Customers Avg Monthly [E]	Actual Distribution Revenues Less CCRC Revenues Per Customer [F] = [D] / [E]	RDM Recoveries (Refunds) [G] = {[C] - [F]} x [B]	Estimated 12-month Therms [H]	RDM Charge (Refund) Therm [I] = [G] / [H]
1	General Service - Residential									
2	MERC-PNG-NNG	$ 26,261,944	145,331.00		$ 25,474,086	145,331.00				
3	MERC-PNG-Viking	$ 611,067	3,914.00		$ 592,735	3,914.00				
4	MERC-PNG-GLGT	$ 860,432	5,149.00		$ 834,619	5,149.00				
5	MERC-NMU	$ 5,874,998	35,481.00		$ 5,698,748	35,481.00				
6	Total Residential	$ 33,608,441	189,875.00	$ 177.00	$ 32,600,188	189,875.00	$ 171.69	$ 1,008,236.25	138,806,017	$ 0.00730
7	General Service - Small Commercial									
8	MERC-PNG-NNG	$ 1,108,214	6,181.00		$ 1,074,968	6,181.00				
9	MERC-PNG-Viking	$ 45,323	302.00		$ 43,963	302.00				
10	MERC-PNG-GLGT	$ 88,262	439.00		$ 85,614	439.00				
11	MERC-NMU	$ 427,881	2,290.00		$ 415,045	2,290.00				
12	Total Small Commercial	$ 1,669,680	9,212.00	$ 181.25	$ 1,619,590	9,212.00	$ 175.81	$ 50,113.28	8,898,792	$ 0.00560
13	Total RDM Recovery (Refund)							$ 1,058,349.53		

REVENUE DECOUPLING MECHANISM – RDM

1. Purpose

The purpose of the Revenue Decoupling Mechanism (RDM) is to: (a) reduce the financial discencentive for the Minnesota Energy Resources Corporation to promote energy efficiency and conservation and (b) promote distribution revenue symmetry by breaking the link between sales volumes and distribution revenues.

2. Applicability

The RDM shall apply to all customers served under the Small Volume General Service rate schedules, specifically all Residential and Small Commercial & Industrial customers.

3. Definitions

As used in the RDM, the terms below are defined to mean:

Actual Margin (AM) shall mean that dollar amount of distribution revenues, excluding revenues arising from the CCRC and adjustments under the RDM, which were billed for each applicable Rate Schedule Group in the Calendar Year.

Actual Customers (AC) shall mean the number of customers in each applicable Rate Schedule Group in the Calendar Year.

Billing Period shall mean the 12-month period succeeding the Calendar Year for which the RDM is billed.

Conservation Cost Recovery Charge (CCRC) shall mean the Conservation Cost Recovery Charge imbedded in base volumetric distribution rates.

Factor V (V) shall mean the sales volumes, in therms, projected to be delivered by the Company to customers in each applicable Rate Schedule Group for the Billing Period.

Calendar Year shall mean the Calendar Year that ended as of the most recent December 31.

Rate Case Customers (RCC) shall mean the number of customers that underlie the distribution rates approved by the Commission in the Company's most recent rate proceeding for each applicable Rate Schedule Group.

Rate Case Margin (RCM) shall mean the dollar amount of distribution revenues arising from the test year sales volumes and distribution charges approved by the Commission in the Company's most recent rate proceeding for each applicable Rate Schedule Group, less any revenues arising from the CCRC.

Rate Schedule Group shall mean the rate schedule group approved by the Commission in Docket No. G007,011/GR-10-977 for the purposes of determining a RDM adjustment.

REVENUE DECOUPLING MECHANISM – RDM

Reconciliation Adjustment (RA) shall mean dollar amounts due the Company (+RA) or the customers (-RA) arising from RDM adjustments that were under-billed or over-billed to each Rate Schedule Group in the Calendar Year.

4. Determination of Adjustment

There shall be a separate per therm adjustment amount determined under the RDM for each applicable Rate Schedule Group and such amount shall be determined as follows:

$$\frac{[(RCM / RCC) - (AM / AC)] \times RCC}{V} + \frac{RA}{V}$$

Where:

RCM = Rate Case Margin for the Calendar Year.
RCC = Rate Case Customers for the Calendar Year.
AM = Actual Margin for the Calendar Year.
AC = Number of Actual Customers for the Calendar Year.
V = Factor V for the Billing Period.
RA = Reconciliation Adjustment as defined in Section 3.

5. Reports

No later than March 1 of the calendar year following the Commission's approval for the RDM, and then no later than March 1 of each succeeding year until the RDM terminates, the Company shall file annually with the Commission a report that specifies the RDM adjustments to be effective for each Rate Schedule Group for the Billing Period. The initial report shall reflect a Calendar Year that begins on the first day of the month succeeding the implementation of final rates approved by the Commission in Docket No. G007,011/GR-10-977 until December 31 of that year, and then for a full Calendar year for each succeeding year. The report shall include work papers and data supporting the calculations in Section 4 of the RDM. Adjustments shall be effective with bills rendered on or after March 1 of the Billing Period and shall continue for 12 months. The report will also include an evaluation plan with information required by the Commission's Revenue Decoupling Criteria and Standards in Docket No. E,G-999/CI-08-132.

In the event any portions of the proposed RDM adjustments are modified by the Commission, the adjustments shall be adjusted in accordance with the Commission's order.

The Company shall record in its best estimate of the amounts to be recognized under the RDM so as to reflect in its books and records a fair representation of the impact of the RDM in actual earnings. Such estimates shall be adjusted if necessary, upon filing RDM calculations with the Commission and again upon final Commission approval.

6. Pilot Period

RDM adjustments shall be determined for three Calendar Years and for any partial Calendar Year in which the RDM becomes effective. The Company may request

REVENUE DECOUPLING MECHANISM – RDM

approval from the Commission to extend the RDM beyond the pilot period.

Minnesota Energy Resources Corporation
Fixed and Variable Cost Summary
Residential and Small Commericial Rate Classes

Line No.		General Service - Residential			General Service - Small Commercial			Notes
		NNG	Consolidated	Total	NNG	Consolidated	Total	
1	**Revenue Requirement**							
2	Transmission/Distribution Fixed	$48,034,375	$8,589,817	$56,624,192	$2,302,613	$783,688	$3,086,301	CCOSS: Informational Requirement No. 12, Schedule 22, Line 52, Column [F], pages 1, 4, 2, 5, respectively, from left to right
3	Transmission/Distribution Variable	$3,218,546	$519,006	$3,737,552	$196,456	$66,891	$263,347	CCOSS: Informational Requirement No. 12, Schedule 22, Line 52, Column [E], pages 1, 4, 2, 5, respectively, from left to right
4	Gas Supply Acquisition	$974,616	$156,926	$1,131,542	$56,223	$19,549	$75,772	CCOSS: Informational Requirement No. 12, Schedule 22, Line 52, Column [C], pages 1, 4, 2, 5, respectively, from left to right
5	Total	$52,227,537	$9,265,749	$61,493,286	$2,555,292	$870,128	$3,425,420	Sum Lines 2, 3 and 4
6	**Fixed and Variable Cost %**							
7	Fixed Costs	92%	93%	92%	90%	90%	90%	Line 2 / Line 5
8	Variable Costs	8%	7%	8%	10%	10%	10%	(Line 3 + Line 4) / Line 5
9	Total Costs	100%	100%	100%	100%	100%	100%	Line 7 + Line 8

Minnesota Energy Resources Corporation
Alternative Decoupling Proposal
Proposed Monthly Service Charge
General Service - Residential and Small Commercial

Line No.		GS Residential	GS Small Commercial	Notes
		[D]	[D]	[E]
1	**Monthly Service Charge Proposed**			
2	Revenue @ Proposed Rates	$58,228,170	$3,429,855	Rate Design Schedule 10
3	Less CCRC Revenues	($2,973,960)	($157,331)	
4	Annual Customers	189,875	9,212	
5	**Proposed Monthly Service Charge**	**$ 24.25**	**$ 29.60**	(Line 2 + Line 3) / Line 4
6	**Monthly Service Charge @ Cost**			
7	Revenue Requirement From COSS	$61,493,286	$3,425,420	CCOSS: Informational Requirement No. 12, Schedule 22, Line 52, Columns [F] + [E] + [C], pages 1 + 4 for GS Residential, and pages 2 + 5 for GS Small Commercial
8	Less CCRC Revenues	($2,973,960)	($157,331)	
9	Annual Customers	189,875	9,211	
10	**Monthly Service Charge @ Cost**	**$ 25.68**	**$ 29.57**	(Line 7 + Line 8) / Line 9