G-008/GR-93-1090 ORDER SETTING INTERIM RATES

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Marshall Johnson	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner

In the Matter of the Application of Minnegasco, a Division of Arkla, Inc., for Authority to Increase Its Rates for Natural Gas Service in the State of Minnesota

ISSUE DATE: January 31, 1994

DOCKET NO. G-008/GR-93-1090

ORDER SETTING INTERIM RATES

PROCEDURAL HISTORY

On November 5, 1993, Minnegasco (or the Company), a division of Arkla, Inc., filed a petition seeking a general rate increase of $22.7 million, or approximately 3.6 percent. Along with the rate increase petition, the Company filed a proposed interim rate schedule, to be effective January 4, 1993. The interim rate request, if allowed, would increase present revenues by $16.9 million, or approximately 2.7 percent.

On December 16, 1993, the Commission issued its ORDER FINDING FILING INCOMPLETE based on its December 9, 1993 review of the matter. In its Order, the Commission noted that the Company's December 9, 1993 filing was untimely filed for consideration on that day and that without the supplement its filing was incomplete. The Commission did not speculate on the effect of the supplemental filing and reserved review of that filing for a later date.

On January 26, 1994, the Commission issued its NOTICE AND ORDER FOR HEARING, in which the Commission referred the general rate case to the Office of Administrative Hearings for contested case proceedings. On the same day, the Commission also issued its ORDER ACCEPTING FILING AND SUSPENDING RATES in this proceeding. Under Minn. Stat. § 216B.16, subd. 3 (1992), if rates are suspended the Commission must set an interim rate schedule within 60 days of the Company's initial rate petition.

On January 13, 1994, the Commission met to consider this matter.

FINDINGS AND CONCLUSIONS

I. The Interim Rate Statute

Minn. Stat. § 216B.16, subd. 3 (1992) states in part 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; (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.

II. The Company Proposal

Minnegasco proposed an interim rate increase of $16.9 million, based on the following revenue deficiency calculation:

	(000)
Rate Base	$335,057
Rate of Return	10.01%
Required Operating Income	33,539
Operating Income	23,652
Income Deficiency	9,887
Revenue Conversion	1.7056
Revenue Deficiency	$16,863

III. The Company's Most Recent Rate Proceeding

Minnegasco's most recent general rate case rate increase was filed on July 2, 1992. In the Matter of the Petition of Minnegasco, a Division of Arlka, Inc., for Authority to Change Its Schedule of Rates and Charges for Natural Gas Service in Minnesota, Docket No. G-008/GR-92-400. The Commission issued its FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER in that matter on May 3, 1993. On July 19, 1993, the Commission issued its ORDER AFTER CONSIDERATION.

IV. Financial Issues

A. FASB 106 Costs

Minnegasco calculated FASB 106 costs for the 1994 test year including changes resulting from the Midwest acquisition and elimination of Nebraska and South Dakota operations. Included in Minnegasco's calculation of FASB 106 expense was the amortization of deferred costs that the Commission recently denied.[1] Because Minnegasco was not allowed to defer and amortize the FASB 106 costs, the test year expense is reduced by $443,771.

The revenue requirement for FASB 106 costs normally results in a rate base reduction. Rate base is reduced to recognize the difference between what a utility recovers in rates and the amount paid by the utility for postretirement benefits and for externally funding its obligation. Minnegasco is currently funding 100 percent of its FASB 106 obligation internally.

Minnegasco's calculation reflects the new level of proposed expense but does not reflect the amount that has already been recovered in current rates. The Commission does not accept Minnegasco's rate base calculation because it does not reflect the amount recovered since the last case. Minnegasco is receiving ratepayer supplied funds currently to pay its future employee benefit obligation. The amount of ratepayer supplied funds accumulates each year and should be recognized as a reduction to rate base.

The calculation of the rate base in Minnegasco's last case showed a balance of $(1,517,000) as of December 31, 1993. Using this as the beginning balance and Minnegasco's new expense calculation for the 1994 test year, the test year rate base amount is approximately $(2,093,000). The resulting adjustment to rate base for interim rates is $(1,013,873).

B. Manufactured Gas Plant (MGP) Cleanup Costs

Minnegasco proposed an interim and test year expense of $4,615,000 for MGP cleanup costs compared to the stipulated $3.6 million expense approved in the last case. The Commission will approve a $3.6 million expense level with no rate base adjustment for interim rates for the following reasons.

First, MGP cleanup costs have been a very difficult cost for Minnegasco to estimate and as a result Minnegasco has over recovered for this expense. Minnegasco, in its last case, estimated MGP cleanup costs for the test year of $5,060,000. Its actual expenses were approximately $658,000. This variance between estimated and actual expenditures for MGP cleanup was explained by Minnegasco to be due to certain cleanup delays beyond Minnegasco's control.

Also included in Minnegasco's authorized expense level of $3.6 million was amortization of 1992 costs which Minnegasco was allowed to defer. Minnegasco over-estimated 1992 costs by approximately $700,000. The 1992 estimated costs of $2.5 million were used to establish the annual amortization of $500,000 that

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[1] In the Matter of the Petition of Minnegasco, a Division of Arkla, Inc., for Authority to Increase Rates for Natural Gas Service in Minnesota, Docket No. G-008/GR-92-400, ORDER REJECTING ACCOUNTING TREATMENT IN COMPLIANCE FILINGS (December 29, 1993).

is included in the $3.6 million level of recovery. Finally, because this type of expense has been difficult for Minnegasco to estimate and control, the Commission will continue the existing level of rate recovery for interim rates.

In addition, the stipulated MGP cost established in the last case was intended to recover less than the full amount of that expense. Minnegasco originally proposed approximately $5 million for full recovery of MGP costs and other parties recommended a 50/50 sharing. By stipulating to a $3.6 million level of expense, it appears that the parties intended less than full recovery. To continue the $3.6 million level of recovery for interim rates would be consistent with what was adopted in the last case.

The 1992 deferred and unamortized costs equal $1,050,000 as of December 1993. This amount was calculated based on the corrected 1992 deferred costs of $1.8 million and 18 months of amortization from July 1992 to December 1993. The 1994 amortization will continue at $500,000 per year.

C. Rate Case Expenses

Minnegasco proposed to recover $1,721,000 of rate case expenses over two years for an annual expense of $861,000. Unamortized rate case expenses from Minnegasco's and Midwest's last two cases were also included in the proposed $861,000. For rate base, Minnegasco proposed to include the average unamortized balance of $761,000.

The Commission will adjust the expense level by $14,000 to remove the deferred costs disallowed in accordance with the Commission's recent accounting order.[2] The rate base amount of $761,000 will also be removed for interim rates because there was no rate base amount included for setting rates in Minnegasco's last case.

D. Cash Working Capital (CWC) - Late Payment Revenue

Minnegasco included in its calculation of cash working capital the extended due date for commercial/industrial customers. The extended due date was approved in Minnegasco's last rate case but the parties stipulated to use zero days for setting the revenue requirement. Minnegasco had originally proposed a 4.4 day impact and the Department recommended a 2.2 day impact to calculate the cash working capital requirement for the extended payment policy.

For interim rates Minnegasco used the Department's recommendation of 2.2 days from the last case thus increasing rate base by $3,520,000. For purposes of setting interim rates, the Commission will require that the stipulated number of days (zero) continue to be used to calculate cash working capital for commercial/industrial customers.

[2] See footnote 1.

E. Vacation Accrual

Minnegasco included in its interim rate proposal an adjustment to reflect a change in accounting for vacation. Similar to rate case expenses, Minnegasco had deferred the vacation accrual to coincide with the start of interim rates in the last case. The Commission disallowed deferral in the December 29, 1993 Order and the resulting adjustment for interim rates is a reduction of rate base of $(14,000). The Commission will adjust interim rates to reflect the Commission's earlier Order.

F. Conservation Improvement Program (CIP) Expenses

Minnegasco's calculation of expense and rate base for CIP expenditures reflected a deferral similar to the vacation accrual and rate case expenses. The Commission's decision to disallow deferral in the December 29, 1993 Order results in an adjustment which increases expense by $215,000 and rate base by 191,000. The Commission will adjust for this in interim rates.

G. Summary of Staff's Recommended Adjustments

The following is a summary of the adjustments made by the Commission in Minnegasco's interim rate increase:

	Rate Base (000)	Operating Income (000)
FASB 106	(1,014)	444
MGP Investigation	(736)	1,015
Rate Case Expenses	(761)	14
Cash Working Capital	(3,520)	-
Vacation Accrual	(14)	-
CIP	191	(215)
TOTAL ADJUSTMENTS	$(5,854)	$1,258

H. Impact of Adjustments

Due to the adjustments listed above, the interim rate increase for Minnegasco will be $14.6 million or approximately 2.3 percent of test year revenues.

V. Interim Rate of Return

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

Type of Capital	Ratio	Cost	Weighted Cost
Long Term Debt	50.20%	8.53%	4.28%
Common Equity	49.80%	11.50%	5.73%
Total	100.00%		10.01%
	=======		=======

The following capital structure and cost rates were part of the settlement agreement adopted by the Commission in Minnegasco's 1992 rate case:

Type of Capital	Ratio	Cost	Cost
Long Term Debt	48.34%	9.24%	4.47%
Common Equity	51.66%	11.50%	5.94%
Total	100.00%		10.41%
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For final rates, Minnegasco requested a return on common equity of 12.00 percent and an overall rate of return of 10.26 percent.

A. Rate of Return on Common Equity

For interim rate purposes, the determination of rate of return is directed by Minn. Stat. § 216B.16, subd. 3, which states in part that, absent exigent circumstances:

> the interim rate schedule shall be calculated using the proposed test year cost of capital, ... 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;

The rate of return on common equity of 11.50 percent proposed by Minnegasco for interim rates is the rate employed in the settlement agreement adopted by the Commission in Minnegasco's last rate case, Docket No. G-008/GR-92-400.

B. Capital Structure

Minn. Stat. § 216B.16, subd. 3 requires that, absent exigent circumstances, the Commission use the Company's proposed test year cost of capital in setting interim rates.

Although Minnegasco, as a division of Arkla, is not a legal entity, it maintains a capital structure on its books and records separate from Arkla. Minnegasco's equity capital consists of the amount of common stock, additional paid-in capital and retained earnings at the date of the merger with Arkla, Inc., adjusted for any income earned and dividends paid to Arkla since that date. All of the Company's long-term debt securities are payable to Arkla. The Company's proposed capital structure is based on the separate record keeping and does not reflect Arkla's capital structure.

The equity ratio proposed by the Company is slightly lower than the 51.66 percent authorized in the last rate case and does not appear to be abnormal for a gas distribution company. However, the estimated test year capital structure for Arkla has a much lower equity ratio and a different mix of financing rates:

Type of Capital	Ratio	Cost	Cost
Long Term Debt	69.82%	9.56%	6.67%
Short Term Debt	.71%	5.80%	0.04%
Preferred Stock	5.14%	6.00%	0.31%
Common Equity	24.33%	11.50%	2.80%
Total	100.00%		9.82%
	=======		=======

Because Minnegasco's capital is supplied by Arkla and has a much greater percent of equity financing, there is reason to question the appropriateness of the proposed capital structure. However, since the proposed capital structure is similar to that used in the settlement agreement, it would appear to be reasonable for interim rates.[3]

VI. Interim Rate Design

A. Minnegasco's Rate Design Proposals

Minnegasco proposed to collect a different percentage increase in each of its three rate areas: 2.4 percent in the Minnegasco-Minnesota rate area; 5 percent in the Midwest Gas-Northern rate area; and 7.1 percent in the Midwest Gas-Viking rate area. In

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[3] In its August 31, 1992 ORDER SETTING INTERIM RATES, the Commission indicated that the capital structure would be fully examined in the rate making process and determined with final rates. In adopting the settlement, the Commission did not fully address the capital structure as an independent issue. However, in its May 3, 1993, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER, the Commission stated it has serious concerns regarding a number of the settled issues, including Minnegasco's capital structure. As stated in the NOTICE AND ORDER FOR HEARING, Minnegasco's rate of return will be fully addressed in this rate case. NOTICE AND ORDER at page 3.

the alternative, the Company proposed a 2.7 percent increase from each customer class in each rate area.

Minn. Stat. § 216B.16, subd. 3 (1992) states that unless the Commission finds exigent circumstances exist, "the interim rate schedule shall be calculated using ..... no changes in the existing rate design." The Commission has interpreted the statute in past cases to mean that the statute applies to both the allocation of revenue responsibility among customer classes and the structure of individual rates.

In past cases, this has meant that all customers in all customer classes get the same percentage increase for interim rates unless exigent circumstances are found that warrant something else. Minnegasco does not claim there are exigent circumstances that warrant adopting its proposal, but argued that its proposal to charge three different percentage increases would keep its three rate areas separate and unconsolidated as was appropriate until the Commission authorized consolidation of the three areas.

The Commission finds that Minnegasco's three rate areas can be maintained separate and unconsolidated until final determination is made at the end of this case without recourse to the Company's proposal to authorize different levels of rate increases for interim rates. Accordingly, the Commission will approve the alternative proposal which is fully consistent with the statute and past Commission practice. As a consequence, the Company will increase interim rates in equal proportion for all customers regardless of rate area.

B. Implementation Method

Minnegasco has requested authority to implement interim rates on bills rendered on or after the effective date of those rates. According to the Company, a non-prorated increase would be easier to put through on the Company's computer system and would allow Minnegasco to achieve some administrative cost savings.

The Commission's practice has usually been to require companies to implement interim rates and final rates on a prorated basis using the effective date of the increase. The Commission's practice of requiring prorating is based on considerations of fairness. In general, the Commission has felt that rate payers should not benefit or be harmed by their place in a company's billing cycle. This argument applies in a rate case for the implementation of interim and final rates and when refunds are required retroactive to the date interim rates went into effect.

In several recent gas rate cases, companies have been allowed to implement rates so that the interim or final rates are collected for all bills rendered on or after the effective date without any prorating because of unusual circumstances specific to the particular case. Often the unusual circumstance is some kind of delay in the implementation of the interim rate or the new rate.

There are no similar circumstances in this case to warrant allowing Minnegasco to implement interim rates in this manner.

In these circumstances, the Commission will proceed in the customary manner and allow interim rates to go into effect for all services rendered on or after the effective date of the increase. In this case, that date is February 1, 1994.

VII. Interim Tariff Sheets and Notice to Customers: Compliance Filings

The Company will be required to file revised interim tariff sheets within seven days of this Order and include a staff-approved notice of the rate change under the interim rate schedule that will be included with each customer's first bill.[4] In addition, after the Company has provided notice to its customers as described herein, the Company shall certify its action to the Commission. The Commission will review the adequacy of these filings in due course.

VIII. Commission Action

Based on the findings and conclusions above, the Commission will authorize an interim revenue increase of $14.6 million or approximately 2.3 percent of revenues under current rates, for Minnegasco. The interim rate schedule will be effective on February 1, 1994.

Interim rates are collected subject to refund in the event the interim rate level exceeds the final rate level allowed in the general rate case. Minn. Stat. § 216B.16, subd. 3 (1992).

ORDER

1. Minnegasco is authorized to collect $14.6 million in additional annual revenues, or approximately 2.3 percent of revenues under current rates. The interim rate schedule will be effective for service rendered on or after February 1, 1994.

2. Within 7 days of this Order, the Company shall file with the Commission and the Department of Public Service interim tariff sheets and supporting documentation reflecting the decisions herein. The Company's filing shall include a proposed notice to customers, approved by the Executive Secretary, regarding the rate change under the interim rate schedule.

[4] In anticipation of this requirement, the Company filed revised interim tariff sheets on January 20, 1994.

3. The Company shall keep such records of sales and collections under interim rates as will be necessary to compute a potential refund. Any refund shall be made within 120 days of the effective date of the Commission's final Order in a manner approved by the Commission.

4. The Company shall 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.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)