ISSUE DATE: August 6, 1996

DOCKET NO. G-008/AI-96-254

ORDER APPROVING PETITION, AS MODIFIED AND CONDITIONED, AND GRANTING VARIANCES

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Joel Jacobs	Chair
Marshall Johnson	Commissioner
Dee Knaak	Commissioner
Don Storm	Commissioner

In the Matter of Minnegasco's Petition for Approval of Affiliated Interest Agreements

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PROCEDURAL HISTORY

On March 13, 1996, Minnegasco, a Division of NorAm Energy Corp., Minnegasco or the Company) filed a petition requesting approval of two affiliated interest agreements. The Company also requested variances to allow these agreements to become effective earlier than they would under the Minnesota Rules.

On April 11, 1996, the Minnesota Department of Public Service (the Department) filed its comments on Minnegasco's petition recommending approval of the Agreements and the requested variances.

On March 20, 1996, Minnegasco filed reply comments agreeing with the Department's comments.

On July 11, 1996, the Commission met to consider this matter.

FINDINGS AND CONCLUSIONS

Minnegasco requested approval of two affiliated interest agreements between Minnegasco and NorAm Damage Prevention, Inc. (NDP): 1) an Administrative Services Agreement (ASA) and 2) a Line Locating Agreement (LLA). Minnegasco also requested variances from Minnesota Rules to allow the contracts to become effective January 1, 1996 and March 30, 1996, respectively, rather than from the date that approval is granted.

This Order will consider these requests separately.

A. Administrative Services Agreement

1. Description

Under Minnegasco's ASA with NDP, Minnegasco is to provide certain administrative services such as information systems, human resources, finance, accounting, legal, and other similar administrative services to NDP. Under the agreement, Minnegasco invoices NDP monthly for its services and NDP is to pay for such services within 20 days of receipt. If payment is not received within 20 days, Minnegasco originally proposed that interest would accrue at the prime rate.

According to Minnegasco, the purpose of the ASA is to prevent cross-subsidization by using the CAM to separate costs between regulated and nonregulated operations.

In its reply comments, Minnegasco agreed with the Department to use an interest rate based on its authorized rate of return grossed up for taxes. Minnegasco would price its administrative services using its Cost Allocation Manual (CAM).

2. The Department's Recommendation

Based on its review, the Department has concluded that the ASA is reasonable and consistent with the public interest and recommended approval. The Department stated that Minnegasco will be calculating its cost for administrative services using its CAM. According to the Department, using the CAM to determine the price for Minnegasco's services will prevent subsidization of NDP's operations. The Department commented that because the ASA is new, a deeper analysis may be necessary in Minnegasco's next rate case.

The Department objected to one provision of the ASA regarding interest on overdue payments. Minnegasco proposed to use the prime rate for interest on overdue amounts. The Department recommended that the interest rate should be the same rate that ratepayers pay to Minnegasco - the rate of return grossed up for taxes. As previously noted, the Company has agreed to this modification.

3. Commission Analysis of the Administrative Service Agreement

The relevant rule that applies to affiliate interest agreements are contained in Minn. Rules, Part 7825.2200(B).

In accordance with this rule, Minnegasco provided the required information including a copy of the agreement, a history of contracts or agreements between the affiliates, a summary describing why the agreement is in the public interest, and discussion pertaining to competitive bidding. The provision requiring competitive bids does not apply to this agreement because Minnegasco is providing services, not purchasing them, under this agreement.

A further provision of Minn. Rules, Part 7825.2200(B) requires that a utility explain why its contract or agreement is in the public interest. The Commission is persuaded that the public interest will be adequately protected under this ASA because the Company will be using its

Cost Allocation Manual (CAM) to valuate Minnegasco's services and separate costs between regulated and nonregulated operations.[1] Furthermore, the propriety of this agreement can be reviewed in a subsequent rate proceeding.

Finally, regarding the interest Minnegasco will be allowed to charge on overdue amounts, the Department recommended that the interest rate should be the same rate that ratepayers pay to Minnegasco (the rate of return grossed up for taxes) rather than the prime rate as the Company originally proposed. Minnegasco has subsequently agreed to this modification, which the Commission finds reasonable.

B. Line Location Agreement

1. Minnegasco's Position

Minnegasco requested approval of a second affiliate interest agreement, a contract for line locating services between it and NDP, effective March 30, 1996. NDP, a wholly-owned subsidiary of NorAm Energy Corp., was organized to provide damage prevention and automated technology services to utilities.

Minnegasco explained that it is required to respond to requests for gas line locating within its service territory. In accordance with the proposed agreement, NDP would perform that function for Minnegasco. NDP's primary activity under the agreement would be to locate and mark Minnegasco's underground distribution facilities when requested by excavators.

Minnegasco argued that the line locating agreement (LLA) is in the public interest because NDP offers an accurate, reliable line locating service at a reduced cost. The Company stated that its costs are reduced by using NDP rather than Minnegasco's own employees. The Company explained that NDP offers reduced pricing to Minnegasco for locating lines because it can also locate other utilities' lines at the same time. Efficiency savings for locating multiple utility facilities will be reflected in NDP's pricing structure. Second, third, and forth-tier pricing will apply depending on how many different locates are performed at the same time.

Minnegasco did not solicit bids from other locating services because NDP was able to demonstrate, in the pilot agreement, that it could perform the service reliably, economically and in compliance with Minnegasco's safety standards. Moreover, according to the Company, NDP is the only line locating service that can electronically receive, dispatch, and archive locate request information from the Gopher State One Call Center. NDP also has the capability in its vehicles to use this electronic mapping data to perform its locating service. Minnegasco noted that NDP's ability in that regard fits well with Minnegasco's decision to convert its mapping of facilities to electronic files. Furthermore, the Company noted, NDP's pricing structure guarantees at least second tier pricing to Minnegasco and in any event the

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[1] Minnegasco's CAM is a fully distributed cost allocation system which has been approved by the Commission.

prudency of costs are subject to regulatory review in a rate case.

2. The Department's Recommendation

The Department noted that Minnegasco has provided the necessary information required by Minn. Rules, Part 7825.2200(B).

The Department stated that the LLA between Minnegasco and NDP will provide savings and advanced automated technology as benefits to Minnegasco ratepayers. The Department noted that Minnegasco supplied proprietary information that support its stated cost savings. For these reasons, the Department found that Minnegasco's LLA with NDP is in the public interest and should be approved. The Department noted that further review of Minnegasco's affiliated interest agreements should be done in Minnegasco's next rate case.

Regarding the competitive bidding provision of Minn. Rules, Part 7825.2200(B)(5), the Department noted that Minnegasco submitted no information on competitive bidding, but accepted the Company's explanation that the competitive bid provisions did not apply because NDP is the only provider in Minnegasco's service territory that can provide the necessary multiple line locating capability, at peak periods, with the paperless feature, and also meet Minnegasco's safety requirements.

3. Commission Analysis of the Line Location Agreement

Minnesota's provisions in favor of competitive bidding when contracting with an affiliated interest serve an important purpose: to avoid improper cost assignment and the recovery of costs that exceed what is necessary in the provision of utility service. Without competitive bidding, it cannot be determined whether contract terms and prices are representative of an arms-length agreement.

Minn. Rules, Part 7825.2200 B(5) requires a utility to explain its competitive bidding proposals or explain its decision to not seek competitive bids.

Minnegasco's explanation for not seeking competitive bids (i.e. that NDP is the only provider in the Company's service territory that can provide the necessary multiple line locating capability at peak periods with the paperless feature) is insufficient. Since the Company (in conjunction with other utilities) is seeking competitive bids from several other line locator service providers for line location service to its Stearns County service territory, it would appear that NDP may not be the only line locating company that could conceivably meet Minnegasco's line location needs.

To expedite this matter consistent with the competitive bidding requirement, then, the Commission will approve Minnegasco's petition subject to Minnegasco conducting competitive bids for its line locating service. To confirm compliance with this requirement and provide for review of this process, as necessary, the Commission will direct the Company to make a compliance filing describing the results of its competitive bidding process, including a summary of the terms of the proposals receive, including the name of each bidder or representative of a bidding group and a copy of each proposal received, and any action taken by the Company as a result of the bids it received.

D. Nonregulated Business Start-up Costs

According to Minnegasco, NDP was incorporated in August 1995. A pilot project with Minnegasco was conducted to determine whether NDP would be able to perform the line locating service for Minnegasco. In support of NDP's ability to perform according to Minnegasco's requirements, Minnegasco explained that it prefers the paperless process offered by NDP. Minnegasco is also transferring all of its mapping to electronic files. This will facilitate the paperless process offered by NDP.

In light of Minnegasco's expressed preference for NDP's paperless process and the coordination between Minnegasco and NDP in developing its business with a pilot project, the Commission has concerns whether NDP's startup costs were properly accounted for. The Commission cannot rely on the CAM alone to assure that startup costs were properly accounted for because the CAM separates costs between Minnegasco's regulated and nonregulated operations on an on-going basis. The CAM does not address startup costs of an affiliate.

The Commission believes that a review of startup activities and associated accounting of these activities at this time, in advance of the Company's next rate case, should help to verify that the accounting has been done properly and allow for timely accounting changes, should the appropriateness of such changes be indicated.

The Commission will direct Minnegasco to make a compliance filing regarding its startup activities on behalf of NDP and its accounting for those activities. As part of its compliance filing, the Company will respond to questions included in Ordering Paragraph 4 of this Order. The Company is encouraged to respond to the questions in detail suitable to the purpose of the Commission's review, as described above.

C. Variances

Minn. Rules, Part 7825.2100 provides in relevant part:

> A public utility, prior to entering into a contract or agreement, or making any modifications or revisions to existing contracts or agreements with an affiliated interest, where the total consideration for such contract agreement is in excess of $10,000...shall petition for and receive approval from the commission by formal written order

Minnegasco did not secure approval from the Commission for these two affiliated interest agreements prior to the parties' signing them and thereby "entering in to a contract or agreement" within the meaning of the rule. The Company has not, therefore, complied with the rule.

However, Minn. Rules, Part 7829.3200 provides that a variance may be granted from the requirements of a rule when the following criteria are fulfilled: enforcement of the rule would impose an excessive burden upon the applicant or others affected by the rule; granting the variance would not adversely affect the public interest; and granting the variance would not conflict with standards imposed by law.

In this case, the conditions for granting a variance are met:

- First, enforcement of the rule requiring Commission approval prior to entering into the affiliate transactions in question wold impose an excessive burden upon the Company when compared with the benefit to the Company of being able to finalize, prior to submitting them to the Commission for approval, the positions of the parties to such agreements by securing their signatures on contracts. The danger identified by the Company was that filing an unsigned contract creates the risk that either party could withdraw from the agreement or attempt to change its terms.

- Second, granting the variance will not damage the public interest.

- Third, a variance would not conflict with standards imposed by law. The statute relating to effective dates for affiliated interest statutes (Minn. Stat. § 216B.48) does not serve the identical purpose of the rule. Unlike the rule, the statute does not prohibit parties from signing such contracts before receiving Commission approval to do so, but provides that the agreements will not be "valid or effective" (and hence not enforceable) by either party prior to Commission approval. The requested variance does not interfere with that provision. Accordingly, the Commission concludes that the rule should be varied.

D. Summary of Commission Action

Based on the foregoing analysis, the Commission will approve 1) Minnegasco's administrative services agreement (ASA), as modified with respect to the interest rate issue, and 2) the line locating agreement (LLA) subject to the Company conducting competitive bids for that service. The Company will report the results of the bidding process as specified in Ordering Paragraph 3.

With respect to the non-regulated business costs issue discussed in Section D of this Order, Minnegasco will be required to make a compliance filing on that subject. The Company's filing should be in adequate detail to allow the Commission to determine whether Minnegasco has properly accounted for NDP's startup costs. Part of the report will consist of the Company's response to the questions listed in Ordering Paragraph 4.

Finally, due the variances granted with respect to Minn. Rules, Part 7825.2100, the ASA and LLA agreements are deemed effective on January 1, and March 30, 1996, respectively.

ORDER

1. Minnegasco's agreement with its affiliate, NDP, for the provision of administrative services is approved, effective January 1, 1996, modified as noted above with respect to interest on overdue payments.

2. Minnegasco's agreement with its affiliate, NDP, for the purchase of line location services is approved, effective March 31, 1996, subject to Minnegasco conducting competitive bids for the line locating service.

3. Within 15 days after completing the competitive bidding process required by Ordering Paragraph 2, Minnegasco shall make a compliance filing describing the results of its competitive bidding process, including 1) a summary of the terms of the proposals received, 2) the name of each bidder or representative of a bidding group, 3) a copy of each proposal received, and 4) a report of any action taken by the Company in response to the bids received.

4. Within 15 days of this Order, Minnegasco shall make a compliance filing regarding the startup costs of NDP, Minnegasco's affiliate, and the Company's accounting of such costs in detail suitable to the purpose of the Commission's review as described above in this Order. As part of its report and in a manner consistent with the Commission's expressed goal, the Company shall respond to the following questions:

    a. Describe the technology and other assets that are used in the performance of NDP's line locating service. For assets acquired in excess of $500, when were these assets acquired and from whom? What percentage of 12-31-95 assets were acquired from Minnegasco?

    b. What business development activities did NorAm and Minnegasco management contribute to NDP's business plan? Identify which management employees were involved in the planning of this business. For each of these employees, what percentage of their compensation was included in Minnegasco's 1995 regulated cost of operations?

    c. Are any of NDP's employees, current or past, formerly Minnegasco employees? If so, identify them by name and title. When did they transfer from Minnegasco to NDP?

d. Explain what technology Minnegasco purchased or developed in 1994 and 1995 that allows it to conduct its line locating service as it presently does and/or that allows NDP to perform line locating service for Minnegasco.

e. Explain the approach that Minnegasco and NDP used to properly assign costs between them with regard to vehicles and facilities. What training is required of NDP's line locating personnel? Were all of these costs assigned to NDP? If not, explain.

f. Provide a monthly summary of affiliate transactions between Minnegasco and NDP that shows monthly totals to and (from) Minnegasco. The period should start when NDP was conceived and organized prior to it being formally incorporated. Prior to incorporation, the affiliate transactions would presumably be with NorAm.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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