



Case No. PU-12-813
Michael J. Majoros, Jr.
Opening Statement
August 29, 2013

My name is Michael J. Majoros, Jr. I am the advocacy staff's witness on depreciation. I have testified before this Commission on several occasions, the last time in Case No. PU-07-776. I was the staff's revenue requirement witness in that case which included a discussion of depreciation. Depreciation was one of the primary issues in case No. PU-07-776.

The thrust of my direct and supplemental testimony in this case is to obtain the transparency and accountability North Dakota ratepayers deserve regarding the cash flow they provide to NSPM through depreciation charges.

Depreciation is a ratemaking mechanism used to transfer cash from ratepayers to a utility to pay for the investment it made in property plant and equipment. Depreciation is an after the fact return of capital, accomplished using a constant depreciation rate over the life of the property plant and equipment.

When a utility includes depreciation in its revenue requirement, it provides cash flow to the utility, since there it is a non-cash expense, i.e. a return of a previous expenditure. The higher the depreciation rate, the greater the cash flow. Yesterday, Mr. Tyson discussed investor expectations. He explained that cash flow is an important factor to investors, since the greater the cash flow the less the future dilution of stock prices.

I have prepared an example to show the difference between the Company's accrual basis return, which Ms. Heuer discussed, and its cash basis rates of return for 2011 and 2012. The cash basis rates of return far exceed the accrual basis returns. Depreciation is one of the primary contributors to this cash flow.

Getting back to depreciation rates, somewhere along the line, utilities were successful in increasing the depreciation rate to account for future cost of removal on the grounds of intergenerational equity. That is, current ratepayers should pay more now to protect future ratepayers from overpaying.

As a result, depreciation rates were increased to account for future costs and then increased again by using inflated future costs thus further increasing the cash transfer from ratepayers to the utility.

In 2002, the professional accounting community and the SEC expressed their displeasure with this practice. Normal companies are not allowed to include future cost estimates in current depreciation rates, inflated or otherwise. The professional accountants determined that it was folly to charge current periods for future costs that would not be incurred. Thus, if a company has a legal obligation to incur a future removal cost, it is required to capitalize that cost at its present value and charge it to expense over the life of the asset, just as any other capital expenditure.

Not only did professional accountants reaffirm that normal businesses were not allowed to include future cost estimates in current depreciation rates, it demonstrated its disdain for the practice by requiring regulated utilities to report the excess non-legal collections as regulatory liabilities. Specifically, as amounts owed to ratepayers if they were not spent on their intended purpose.

As a result of these GAAP changes, NSPM reported a \$432 million regulatory liability in its 2012 SEC form 10K, and its annual report to shareholders. NSPM owes its ratepayers \$432 million for cash it has collected for cost of removal that it has not incurred. That is, \$432 million over and above the actual money it has spent for cost of removal. The excess \$432 million is not in a bank account somewhere as is the case with the nuclear fund, instead, it went somewhere else, and we do not know where. It is part of the free cash flow embedded in ratemaking service rates as explained earlier.

The only thing ratepayers have by way of transparency and accountability is the regulatory liability reported in GAAP financial statements, but not in the reports to this Commission.

In Case No. PU-07-776, the staff and the Company reached an agreement which staff thought would provide such accountability and transparency. We believe the Company has failed to comply with the Case No. 07-776 stipulation.

So, the primary thrust of my current testimony is to obtain, by Commission recognition and Order, the transparency and accountability that North Dakota ratepayers deserve regarding the additional free cash flow they have provided to the Company for unincurred future costs.

Ms. Perkett's testimony concerns me as she asserts that NSPM reports the \$432 million regulatory liability in its GAAP financial statements as a result of the settlement in Case No. 07-776. That is not true. NSPM reports a \$432 million regulatory liability in its GAAP financial statements because the professional accounting community and the SEC recognize that NSPM owes that money back to its ratepayers. It has nothing to do with net versus gross plant.

So, my bottom line is that, given these facts, the least North Dakota ratepayers should be able to expect is that the Company identify the rates and amounts involved and properly report its regulatory liability to this Commission for further scrutiny.