

**BEFORE THE
NORTH DAKOTA PUBLIC SERVICE COMMISSION**

***In the Matter of the Application of Montana-Dakota Utilities Co.
for Authority to Establish an Electric Generation Resource
Recovery Rider for Heskett III***

***Case No. PU-14-108
Case No. PU-14-109***

DIRECT TESTIMONY

OF

MIKE DILLER

ON BEHALF OF THE

**NORTH DAKOTA PUBLIC SERVICE COMMISSION
ADVOCACY STAFF**

May 28, 2014

1 Q: Provide your name and position at the North Dakota Public Service
2 Commission (commission).

3 A: My name is Mike Diller and I am the Director of Economic Regulation.

4
5 Q: What kind of work do you provide to the commission?

6 A: I am a utility analyst and provide direction to a small staff.

7
8 Q: Provide a summary of your educational background and public utility
9 regulatory experience.

10 A: I have about 29 years of public utility regulatory experience including
11 service to both the Oklahoma Corporation Commission and the North
12 Dakota Public Service Commission. I received a Bachelor of Science
13 Degree in Accounting from Oklahoma Christian University in Edmond,
14 Oklahoma in 1981. I am a Certified Public Accountant and I am a member
15 of the American Institute of Certified Public Accountants.

16
17 Q: Have you previously provided testimony to the commission?

18 A: Yes. I have testified before the commission on acquisition proposals, rate
19 cases, settlement offers, advance determination of prudence requests and
20 rule changes.

21
22 Q: What is the purpose of your testimony?

23 A: The purpose of my testimony is to support the Settlement Agreement
24 (Settlement) between the North Dakota Public Service Commission
25 Advocacy Staff (staff) and Montana-Dakota Utilities Co. (MDU) as filed on
26 May 20, 2014. The Settlement provides a tariff for cost recovery of the
27 new Heskett III generation facility in Mandan, if and when needed; a 2014
28 excess earnings sharing plan; a fixed charge rate design instead of a
29 volumetric charge; and a plan for cost recovery of the natural gas line
30 serving the generation facility.

31

1 Q: What should the commission be concerned with in this proceeding?

2 A: The issue stated in the Notice of Hearing reads “whether the proposed
3 generation resource cost recovery rider and proposed initial rate increases
4 should be approved.” The commission already provided MDU with an
5 Advance Determination of Prudence for Heskett III and therefore the
6 decision to build the unit has already been vetted and approved. The cost
7 of the project is under-budget making it hard to argue against cost
8 recovery. Nevertheless, I reviewed the work order and some of the
9 supporting invoices noting no exceptions and agree with MDU’s cost
10 projections to completion.

11

12 Q: MDU has been in an over-earnings position since its last rate increase in
13 2010. Therefore, why should MDU be able to increase its rates further
14 through a generation rider?

15 A: The short answer is increased expenses and investments related not only
16 to Heskett III but also for infrastructure improvements and expansions to
17 meet the North Dakota economic boom. That said, the Settlement
18 recognizes that recent earnings levels have been more than sufficient and
19 delays the use of the rider until earnings dictate otherwise.

20

21 Q: Won’t the increase in customers and new revenues from North Dakota’s
22 economic boom pay for the increased expenses and investment?

23 A: There is a lag between invested capital and associated revenues but to
24 what degree is difficult to predict. To be frank, the economic development
25 in North Dakota is so dramatic that predicting long-term earnings for
26 MDU’s electric operations is difficult.

27

28 In its original application filed February 27, 2014, MDU estimated earnings
29 on equity for 2014 of 7.67% absent any new generation rider revenues. In
30 its amended application on May 9, 2014, MDU removed the gas pipeline

1 from the rider and updated other project costs improving its 2014 earnings
2 projections to 8.25%, absent any new generation rider revenues. After
3 updating revenue projections for 2014, to account for the unusually cold
4 weather in 2014 year to date, MDU expects to earn above 10% without
5 any additional revenues and assuming a normal summer. As you can
6 see, just from the filings in this case, MDU operates in a dynamic and ever
7 changing world where projected earnings can change quickly.

8
9 The Settlement recognizes the higher than normal sales in 2014 by
10 delaying implementation of the rider until needed. In addition, the
11 Settlement provides for a refund in 2015 if earnings are above 10.75% on
12 invested equity for 2014. A refund is not expected at this time but a
13 warmer than normal summer could bring this aspect of the Settlement into
14 play.

15

16 Q: What value does the Settlement provide to ratepayers?

17 A: In the event over-earnings occur in 2014, the earnings sharing agreement
18 captures 50% of earnings above 10.75% on MDU's invested equity back
19 to January 1, 2014. Absent an agreement, any over-earnings prior to
20 Settlement adoption would be considered retroactive ratemaking and
21 therefore not available to ratepayers.

22

23 Q: Why can't the commission capture over-earnings prior to adoption of the
24 Settlement?

25 A: Aside from the legal argument that the commission does not have the right
26 to recover money collected under approved tariffs, retroactive ratemaking
27 would remove the inherent incentive for utility companies to control costs
28 and become more efficient. Further, retroactive ratemaking for the benefit
29 of ratepayers in over-earnings situations would, in all fairness, dictate
30 retroactive ratemaking for the benefit of utilities in under-earning

1 situations. The built in lag within the regulatory process is the primary
2 surrogate for free market competition. There are clear legal and
3 philosophical reasons for not practicing or attempting to practice
4 retroactive ratemaking.

5

6 Q: Isn't a return on equity of 10.75% too high given today's market
7 conditions?

8 A: Staff did not conduct a cost of capital study for MDU's electric operation in
9 this proceeding. However, based on recent rate case applications and
10 commission decisions, 10.75% appears to be on the higher end of the fair
11 and reasonable spectrum. For instance, the commission recently
12 approved a 10.0% return on equity for MDU's gas operations and it
13 recently approved a range of returns on equity for NSP's electric
14 operations of 9.75% to 10.25% for 2013 through 2016.

15

16 Q: If a 10.75% return on equity is on the high side, why did you accept its
17 inclusion in the Settlement?

18 A: Returns authorized for electric utilities are generally higher than gas
19 utilities, all things being equal. In my opinion, this is due in large part to
20 the additional risks associated with owning electric generation and
21 transmission assets. In my opinion, the return on equity for MDU's electric
22 operations should be a little higher than for its gas operations.

23

24 Beyond risk profiles, many other factors may influence the minds of
25 commissioners beyond a purely economic basis when authorizing a return
26 on equity, including: frequency of rate filings; cooperation and openness
27 with the commission; rate competitiveness; community interest;
28 management's ability to make hard decisions to generate efficiencies etc.

29

1 Q: If projected earnings in 2014 deteriorate because of a cool summer or for
2 some other reason and MDU applies to utilize the rider, what would staff
3 recommend?

4 A: Staff has agreed to the first year cost estimates of Heskett III in the
5 Settlement. However, staff's recommendation would be based on a
6 number of metrics including sales and margin growth; investments actually
7 made in 2014 and planned in 2015; expense growth; updated cost of
8 capital etc. As the commission moves further into the use of riders, it
9 becomes more necessary to conduct financial reviews as part of the
10 ongoing rider process. To a large degree, riders are taking the place of
11 rate increase applications.

12

13 Q: What if MDU only needs one-half of the full Heskett III generation rider to
14 effectuate reasonable earnings in the future?

15 A: The Settlement does not inhibit MDU and staff from negotiating further
16 and agreeing to something other than a full rider in the future.

17

18 Q: What if the commission approves the use of the rider in the future and
19 earnings levels become too high, what would staff recommend?

20 A: The annual rider filings are to be coordinated with the Company's annual
21 reports to the commission so that earnings levels can be considered each
22 year before authorizing a new rate.

23

24 Q: While MDU has agreed to withdraw its use of the rider, the Settlement has
25 a very aggressive time table for approving a rider should deficient
26 earnings start to occur. How can the staff and the commission be
27 expected to meet the 30 day time period?

28 A: MDU has agreed to keep staff informed of any changing conditions that
29 might cause a need for the rider. The idea behind keeping staff informed
30 is more than a quick phone call or email. Instead, we envision active

1 sharing of information including crucial assumptions, evaluations and
2 supporting documentation as proof. Absent close communication and
3 cooperation, a 30 day window is not doable. When crafting the
4 Settlement, the parties agreed that a strict adherence to 30 days may not
5 be achievable given the space of time between commission meetings but
6 the idea is to get it done as quickly as possible.

7

8 Q: Why does the Settlement change the mode of cost recovery from a
9 volumetric charge to a fixed charge?

10 A: Riders approved by the commission in the past have used volumetric
11 charges so MDU's application included the traditional approach to riders.
12 It became evident early on in staff's evaluation that this type of investment
13 should be assigned on a fixed charge basis. The unit is not expected to
14 run more than 1% of the time through 2020. It is primarily a fixed cost unit
15 placed into service primarily to meet peak load requirements. As such,
16 the associated costs should be assigned on a demand basis and not on a
17 volumetric basis. Therefore, the Settlement more accurately assigns cost
18 on a demand basis to the customers with metered demand and to the
19 customer charge for customers without demand meters.

20

21 Q: What are your thoughts on the pipeline recovery proposal?

22 A: If the pipeline can be more fully utilized while maintaining firm service to
23 Heskett III, then costs will be more widely allocated and better for MDU's
24 electric customers. From an operational standpoint, it makes more sense
25 for MDU's gas operations to own and operate it.

26

27 Q: Does this conclude your testimony?

28 A: Yes it does.