

BEFORE THE
NORTH DAKOTA PUBLIC SERVICE COMMISSION

Montana-Dakota Utilities Co., a Division of MDU Resources Group, Inc.

Natural Gas Service Rate Increase Application

Case No. PU-15-90

DIRECT TESTIMONY
OF
VICTOR SCHOCK

ON BEHALF OF THE
NORTH DAKOTA PUBLIC SERVICE COMMISSION
ADVOCACY STAFF

August 7, 2015

1 Q: Provide your name and qualifications.

2 A: My name is Victor Schock. I am a Public Utility Analyst for the North Dakota
3 Public Service Commission (commission). I have 10 years of accounting
4 experience and one year of utility regulatory experience.

5 I received a Bachelor of Science Degree in Accounting from Dickinson State
6 University in 2007. I have testified before the commission on damage
7 prevention, advanced determination of prudence and certificate of public
8 convenience and necessity cases. Prior to my work with the commission I
9 completed hundreds of financial reviews of both public and private companies
10 as well as government entities in my work as a Credit & Collections Manager
11 with Unisys Corporation.

12
13 Q: What is the purpose of your testimony?

14 A: The commission has appointed me to advocacy staff (staff) in this
15 proceeding. As such, I will provide the commission with an analysis and
16 recommendation concerning various expense components of MDU's rate
17 increase request. My testimony will cover projected expenses including rate
18 base.

19
20 Q: Please summarize your testimony.

21 A: Advocacy Staff believes that projected test year expenses, as provided by
22 MDU, are overstated by a total of \$672,373. The specific adjustments making
23 up this total will be detailed in my testimony and the attached schedules. I
24 believe MDU's rate base estimate for 2015 is a reasonable projection.

25
26 Q: How did you analyze the expenses?

27 A: Individual expense items can vary greatly from year to year. Therefore, I
28 used a combination of averages, observable trends, and available backup
29 documentation in analyzing each of the expense projections for 2015. I also

1 took into account MDU's history of providing projections and the relative
2 accuracy of those projections.

3

4 Q: Is the income tax calculation used by MDU correct?

5 A: No. At the time MDU submitted the rate case, the North Dakota Legislature
6 had not finalized the tax structure for 2015. As a result, MDU's 2015 income
7 tax expense calculation was based on the state and federal income tax rates
8 for 2014.

9

10 The state and federal income tax factor used by MDU was 37.9445%, this
11 assumes federal income tax at 35% and state income tax at 4.53%. The
12 North Dakota Legislature approved a state income tax rate of 4.31%, which
13 when combined with the 35% federal rate, results in a tax factor for 2015 of
14 37.8015%. This results in the initial income tax expense projection being
15 reduced by \$12,757.

16

17 This expense should be further reduced as the other revenue and expense
18 items are adjusted. The current calculation is based on MDU's projected
19 revenues and expenses. It would be prudent to recalculate the income tax
20 expense based on what the commission finds to be just and reasonable
21 revenue and expenses in its final order.

22

23 Q: Is the labor expense projection provided by MDU reasonable?

24 A: No. The 2015 labor expense projection is based on the assumption that all
25 employees will receive a 3.5% increase in 2015. The backup data MDU
26 provided specifies that any increase would be effective beginning in May
27 2015 (Workpaper M-17). Therefore, the increase should be prorated to 7 of
28 12 months. This results in the labor expense projection being reduced by
29 \$143,000 as can be seen in Schedule VFS 3.

30

1 One could argue that by not allowing the full 3.5% increase into the test year
2 expense, the company would not recover its costs prospectively. However,
3 one could also argue that by putting interim rates into effect in April of 2015,
4 the company over-earned during April. MDU benefits from using a future test
5 year. The concept of a test year is eroded when annualizing test year
6 expenses.

7

8 Q: Do you agree with the methodology used to calculate benefits expense for
9 2015?

10 A: No. The projection for pension and post-retirement expense is based on an
11 actuarial study rather than actual costs. The actuarial study takes into
12 account, among other things, future projected earnings/losses in the pension
13 and post-retirement accounts. This is essentially a guess on the part of the
14 actuarial that exposes the ratepayers to stock market fluctuations from year to
15 year. Using an estimate based on historical figures and removing market
16 exposure is more stable and accurate over time. I suggest changing pension
17 expense to \$100,000 per year and post-retirement expense to \$15,000 per
18 year, which would result in a reduced 2015 expense of \$311,000. As a result
19 of implementing this more consistent approach, a regulatory asset/liability
20 would be created to reflect the difference between the market fluctuations and
21 the actual amounts expensed.

22

23 The projection for 401k expense is based on a percentage of labor expense.
24 Since we would reduce the labor expense by \$143,000, this would also
25 reduce the 401k expense by an additional \$15,000. 401k expense also
26 includes an additional 1% of the labor value for profit sharing expense. Profits
27 are for the benefit of the company, not the ratepayer. Therefore, the ratepayer
28 should not be required to pay for such an expense. Removing the profit
29 sharing expense reduces this by \$86,000 as can be seen in Schedule VFS 4.

30

1 In total the 2015 benefits expense projection should be \$2,457,000 rather
2 than the projection provided by MDU of \$2,869,000 (a reduction of \$412,000).

3

4 Q: Do you agree with the insurance expense projection for 2015?

5 A: No. The self-insurance calculation did not take into account reimbursements
6 not yet received from the insurance company. Based on data request item
7 3.10 attachment A, this should be reduced from \$130,000 to \$62,627. This
8 would adjust the insurance expense projection down from \$577,000 to
9 \$509,627 as can be seen in Schedule VFS 5 (a reduction of \$67,373).

10

11 Q: Do you agree with the regulatory commission expense projection for 2015?

12 A: No. The rate case amortization projection assumes that the entire \$175,000
13 filing fee will be used by the commission for the current rate case. It also
14 includes an additional \$168,500 that will be used by MDU. A reasonable
15 projection would be that only \$25,000 of the filing fee will be used. This will
16 reduce the total cost by \$150,000, which is then amortized over three years.
17 This will reduce the 2015 projection by \$50,000 as can be seen in Schedule
18 VFS 6.

19

20 Q: Do you agree with MDU's rate base and depreciation expense projection for
21 2015?

22 A: Yes. While it is difficult to precisely predict these categories during a time of
23 rapid and unprecedented growth to the system, I feel that MDU has made
24 reasonable projections in these areas.

25

26 The estimated plant additions for 2015 are \$21,623,992. The actual plant
27 additions in 2014 were \$51,426,431, however \$22,377,110 of this was the
28 Heskett pipeline, and an additional \$4M was to build new offices in Williston
29 and Watford City. With those items removed, the 2015 projection represents
30 an approximately 15% reduction in annual plant additions when compared to

1 2014. This is a reasonable estimate based on the recent slowdown we have
2 seen in the oil boom in western North Dakota.

3

4 Due to the large plant additions in recent years and the estimated 2015
5 additions, the depreciation expense has increased significantly. This expense
6 was \$4.877M in 2013, grew to \$5.868M in 2014 and is projected to be
7 \$7.044M in 2015, which staff believes to be reasonable.

8

9 Q: Does this conclude your testimony?

10 A: Yes it does.

**MONTANA-DAKOTA UTILITIES CO.
NORTH DAKOTA PUBLIC SERVICE COMMISSION
DATA REQUEST
DATED APRIL 16, 2015
CASE NO. PU-15-90**

Question 3.10: Statement M

Page 27. Please explain how the Self Insurance expense is calculated, and why this item is increasing by 357% from 2014 to 2015.

Response:

Self Insurance expense was calculated by taking the 4 year average of the reserve activity (\$765,000) as shown on Attachment A, page 1 and allocating 43.4% to the Gas Utility and allocating that amount to North Dakota gas using Factor 27 – O&M Excluding Cost of Gas and A&G as shown on Statement Workpapers, page M-82.

Upon reviewing that worksheet and discussions with Accounting, it was determined that the method of expensing self-insurance has changed from past practice. The information provided was thought to be the expense portion but included additional activity related to insurance payments that are yet to be reimbursed from the applicable insurance company. Therefore, the average used above was overstated.

See Attachment A, page 2 for a restated average self-insurance expense estimate.

Summary of reserve activity by year
Account 2282

Year	Beginning Reserve	Claims/ Expenses paid by Heimsman	Settlements paid directly by MDU	Legal Fees & other costs paid directly by MDU	Reserve Adjustment	Ending Reserve
2010	(1,486,612.47)	153,479.74	631,907.99	164,728.27	(400,000.00)	(936,496.47)
2011	(936,496.47)	179,585.44	54,317.50	134,020.11		(568,573.42)
2012	(568,573.42)	242,623.62	130,000.00	18,837.69	(887,149.89)	(1,064,262.00)
2013	(1,064,262.00)	349,057.27	1,000,000.00	2,724.02	(1,642,963.80)	(1,355,444.51)
Average	(1,013,986.09)	231,186.52	454,056.37	80,077.52	(976,704.56)	(981,194.10)

Average expense 231,186.52 454,056.37 80,077.52 765,320.41 Total
self-insured

Note: the 2013 reserve adjustment is offset by the recording of an insurance receivable for the claims greater than \$500,000.
 Current receivable balance is \$946,127.00 (90.1432.99006)

**Montana-Dakota Utilities Co.
 Self Insurance Expense**

	<u>2010</u>	<u>2011 1/</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>5 Yr Avg</u>
Total Company	\$ 299,632	\$ 367,923	\$ 886,928	\$ 126,114	\$ 166,352	\$ 369,390

1/ A change in the method of determining self insurance expense was implemented in 2011.

Allocation to Gas Utility	Corporate Overhead Factor	43.40%
Allocation to North Dakota - Gas	Factor 27	39.065037%
	Total	<u><u>62,627</u></u>

Montana-Dakota Utilities Co.
North Dakota Gas Utility
Revenue Deficiency Calculation and Rate Base
(000's)

Schedule VFS 1

Line	Description	2012	2013	2014	2015			Staff Test Year
					MDU Test Year	Staff Adj.	Adj Ref	
<i>Revenue Deficiency:</i>								
1	Average Rate Base (Line 19)	\$52,202	\$60,895	\$90,160	\$114,487	\$0		\$114,487
2	Cost of Capital	8.273%	7.655%	7.800%	7.588%	-0.683%	1/	6.904%
3	Return Required (L.1*2)	\$4,319	\$4,661	\$7,032	\$8,687	(\$782)		\$7,905
4	Return Earned (L. 27)	3,804	3,435	6,838	6,016	1,039		7,055
5	Return Deficiency (L.3-4)	\$515	\$1,226	\$194	\$2,671	(\$1,821)		\$850
6	Tax Coefficient (State & Fed)	61.65%	62.06%	62.06%	62.06%	0.14%		62.20%
7	Revenue Deficiency (L. 5/6)	\$835	\$1,976	\$313	\$4,304	(\$2,937)		\$1,367
<i>Average Rate Base:</i>								
8	Plants in Service & CWIP	\$134,747	\$151,718	\$191,927	\$224,536	\$0		\$224,536
9	Accum. Res. for Depr.	69,690	73,336	77,487	82,913	0		82,913
10	Net Plant in Service (L.8-9)	\$65,057	\$78,382	\$114,440	\$141,623	\$0		\$141,623
11	Materials & Supplies	1,891	2,362	2,478	2,463	0		2,463
12	Fuel Stock/Gas IRP/Other	35	45	46	46	0		46
13	Prepayments	149	166	185	188	0		188
14	Unamortized Loss on Debt	598	629	659	623	0		623
15	Gain on Sales		0	(171)	(335)	0		(335)
16	Accum. Def. Income Taxes	(11,027)	(13,201)	(17,345)	(21,390)	0		(21,390)
17	Accum. Invest. Tax Credits	(3)	0	0	0	0		0
18	Customer Advances	(4,498)	(7,488)	(10,132)	(8,731)	0		(8,731)
19	Average Rate Base	\$52,202	\$60,895	\$90,160	\$114,487	\$0		\$114,487
<i>Net Operating Income:</i>								
20	Operating Revenues	\$84,849	\$110,797	\$140,007	\$131,559	\$ 987	2/	\$132,546
21	Cost of Gas	58,003	81,268	103,658	94,834	0		94,834
22	Operation and Maintenance	16,620	18,572	19,375	20,049	(672)	3/	19,377
23	Depreciation	3,723	4,877	5,868	7,044	0		7,044
24	Taxes Other Than Income	1,599	1,617	1,638	1,864	0		1,864
25	NOI before IT (L20-21-22-23-24)	\$ 4,904	\$ 4,463	\$ 9,468	\$ 7,768	\$ 1,659		\$ 9,427
26	Income Tax Expense (L. 35)	1,100	1,028	2,630	1,752	620		2,372
27	Net Operating Income (L. 25-26)	\$ 3,804	\$ 3,435	\$ 6,838	\$ 6,016	\$ 1,039		\$ 7,055
<i>Tax Calculation:</i>								
28	NOI b4 Inc. Taxes (L. 25)	\$ 4,904	\$ 4,463	\$ 9,468	\$ 7,768	\$ 1,659		\$ 9,427
29	Rate Base (L. 19)	\$52,202	\$60,895	\$90,160	\$114,487	0		\$114,487
30	Weighted Cost of Debt	2.833%	2.510%	2.547%	2.579%	0		2.579%
31	Interest Deduction (L. 29*30)	\$1,479	\$1,528	\$2,296	\$2,953	0		\$2,953
32	Other Tax Adjustments	(\$557)	(\$225)	(\$240)	(\$198)	0		(\$198)
33	Taxable Income (L. 28-31+32)	\$ 2,869	\$ 2,710	\$ 6,932	\$ 4,617	\$ 1,659		\$ 6,276
34	Combined Tax Rate	38.35%	37.94%	37.94%	37.94%	0.14%		37.80%
35	Income Tax Expense (L. 33*34)	\$ 1,100	\$ 1,028	\$ 2,630	\$ 1,752	\$ 620		\$ 2,372

1/ Per Staff Schedule ALR 1.
2/ Per Staff Schedule MRD 1 & 2, combined.
3/ Per Staff Schedule VFS 2.

MONTANA-DAKOTA UTILITIES CO.
SUMMARY OF EXPENSE ADJUSTMENTS
GAS UTILITY - NORTH DAKOTA
2013-2015

Schedule VFS 2

	2015 projected MDU	2015 projected Staff	Staff Adjustment
Labor Expense	\$10,167,000	\$10,024,000	\$143,000
Benefits Expense			
Pension Expense	182,000	100,000	82,000
Post-Retirement Expense	244,000	15,000	229,000
401K	1,188,000	1,087,000	101,000
Insurance Expense	577,000	509,627	67,373
Regulatory Commission Expense	206,000	156,000	50,000
 Total Expense Reduction			 <u><u>\$672,373</u></u>

MONTANA-DAKOTA UTILITIES CO.
LABOR EXPENSE
GAS UTILITY - NORTH DAKOTA
2013-2015
(*000s)

Schedule VFS 3

	2013	2014	2015 projected MDU	2015 projected Staff	Staff Adjustment
Other Gas Supply	\$81	\$186	\$84	\$83	\$1
Distribution	6,095	6,046	6,308	6,219	89
Customer Accounts	1,620	1,608	1,677	1,653	24
Customer Service	110	129	114	112	2
Sales	101	87	104	103	1
A&G	1,816	1,900	1,880	1,853	27
Total Labor Expense	\$9,823	\$9,956	\$10,167	\$10,024	\$143

MONTANA-DAKOTA UTILITIES CO.
BENEFITS EXPENSE
GAS UTILITY - NORTH DAKOTA
2013-2015
(*000s)

Schedule VFS 4

	2013	2014	2015 projected MDU	2015 projected Staff	Staff Adjustment
Medical/Dental	\$891	\$1,179	\$1,190	\$1,190	\$0
Pension Expense	206	68	182	100	82
Post-retirement	11	(58)	244	15	229
401K	1,078	944	1,188	1,087	101
Workers compensation	32	29	33	33	0
Other benefits	31	30	32	32	0
Total Benefits Expense	\$2,249	\$2,192	\$2,869	\$2,457	\$412

MONTANA-DAKOTA UTILITIES CO.
INSURANCE EXPENSE
GAS UTILITY - NORTH DAKOTA
2013-2015
(*000s)

Schedule VFS 5

	2013	2014	2015 projected MDU	2015 projected Staff	Staff Adjustment
Director's & Officer's Liability Insurance	\$27	\$33	\$32	\$32	\$0
Excess Liability					
Fiduciary & Employee Benefits Liability	10	10	10	10	0
Public Liab. & Property Ins. Damage of Others	208	227	228	228	0
All Risk	182	174	176	176	0
Blanket Crime	1	1	1	1	0
Self Insurance	22	28	130	63	67
Total Insurance Expense	\$450	\$473	\$577	\$510	\$67

MONTANA-DAKOTA UTILITIES CO.
REGULATORY COMMISSION EXPENSE
GAS UTILITY - NORTH DAKOTA
2013-2015
(*000s)

Schedule VFS 6

	2013	2014	2015 projected MDU	2015 projected Staff	Staff Adjustment
Rate Case Amortization	\$0	\$101	\$114	\$64	\$50
Non-Recurring Filing Fee	21	1	0	0	0
Recurring Level of Expense	1	9	1	1	0
Manufactured Gas Plant Amortization	91	91	91	91	0
Regulatory Commission Expense	<u>\$113</u>	<u>\$202</u>	<u>\$206</u>	<u>\$156</u>	<u>\$50</u>

2015 Expense Detail

	2015 projected MDU	2015 projected Staff	Staff Adjustment
PSC (filing fee/expert testimony)	\$175,000	\$25,000	\$150,000
MDU Expense Estimate			
Fed ex	500	500	0
Legal	25,000	25,000	0
Transcript	10,000	10,000	0
Direct Testimony	50,000	50,000	0
Data Requests	15,000	15,000	0
Rebuttal Testimony	40,000	40,000	0
Hearing	28,000	28,000	0
Total Regulatory Expense	<u>\$343,500</u>	<u>\$193,500</u>	<u>\$150,000</u>
3 year ammortization of expense	<u>\$114,500</u>	<u>\$64,500</u>	<u>\$50,000</u>