MONTANA-DAKOTA UTILITIES CO.

A Division of MDU Resources Group, Inc.

Before the Public Service Commission of North Dakota

Case No. PU-16-666

Rebuttal Testimony
of
Travis R. Jacobson

Q. Would you please state your name and business address?

A. Yes. My name is Travis R. Jacobson and my business address is 400 North Fourth Street, Bismarck, North Dakota 58501.

Q. What is your position with Montana-Dakota Utilities Co.?

A. I am the Regulatory Analysis Manager for Montana-Dakota Utilities Co. (Montana-Dakota), a Division of MDU Resources Group, Inc.

Q. Are you the same Travis R. Jacobson that previously offered direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my testimony is to address certain analysis and recommendations proposed by Mr. Richard A. Polich, Managing Director of GDS Associates, Inc. testifying on behalf of the North Dakota Public Service Commission Advocacy Staff, and Ms. Sara Cardwell, Public Utility Analyst with the North Dakota Public Service Commission, testifying on behalf of the North Dakota Public Service Commission Advocacy Staff.

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Prefiled Rebuttal Testimony of Travis R. Jacobson
Montana-Dakota Utilities Co., a Division of MDU Resources Group, Inc.
Tamie Aberle

Q. Based on Mr. Polich's testimony, does the resulting revenue requirement accurately reflect his recommended adjustments?

A. I was unable to reconcile Mr. Polich's recommended revenue requirement to the Company's revenue requirement, as originally requested in this Docket, based on the adjustments described in his testimony and presented in Exhibit No. PSC-3 of his testimony.

Therefore, the Company requested Mr. Polich's files to fully understand his adjustments and the impact each adjustment had on the revenue requirement. Based on the analysis of the Excel files received in response to Request No. MDU-1, I was able to reconcile to the Company's revenue requirement for 2017 based on the 2016 calendar year actual results as provided in Montana-Dakota's response to North Dakota Public Service Commission Data Response No. 1.1.

On page 32, line 2, Mr. Polich indicated he intended to reduce incentive compensation and bonuses by 60 percent or an adjustment of $1,313,132. Mr. Polich's Excel files have only one adjustment to operation and maintenance expenses with a total reduction $2,393,567. This is an overstatement of $1,080,435 compared to Mr. Polich's stated adjustment which misstates his revenue requirement. The total incentive compensation and bonuses requested by the Company and shown on Statement Workpapers, Statement K, page K-152 was $2,146,078 ($623,082 + $1,522,996).

Mr. Polich's adjustment shown in his testimony does not represent 60 percent of the Company's requested incentive compensation and, in fact, exceeds the Company's total incentive compensation request.

Mr. Polich has also recommended disallowance of a portion of the costs associated with the Lewis & Clark RICE unit but he has failed to properly remove the full amount indicated. Rate base has been understated because of this error which also misstates his revenue requirement.

Q. Please summarize Mr. Polich's recommendations you will address.

A. Mr. Polich recommended three rate base and income statement adjustments which I will address. The recommendations are as follows:

- Disallowance of the Company's proposal to recover decommissioning costs related to electric production facilities;
- Disallowance of losses on manufactured homes used to provide housing for employees in areas affected by the rapid expansion in oil development; and
- An adjustment to exclude 60 percent of the Company's request for employee bonus and incentive compensation that, as stated above, I believe is overstated.

Mr. Polich also recommended an adjustment to disallow a portion of the cost associated with the Lewis & Clark RICE unit, which will be addressed in the rebuttal testimonies of Mr. A. Welte and Mr. D. Neigum, and a reduction in the return on equity, which will be addressed by Dr. S. Gaske.

Q. Do you agree with Mr. Polich's testimony regarding the Company's proposal to recover decommissioning costs related to its generating units?

A. No. Mr. Polich has cited several reasons for recommending disallowance of the Company's proposal to recover the cost of decommissioning its generation facilities. His reasons are summarized as follows:

- The Company intends to use projected costs;
- Montana-Dakota proposed an inappropriate method of accounting; and
- Decommissioning provides little to no value to rate payers.

First, it is important to understand the concept of depreciation to determine whether decommissioning is appropriate. Depreciation is defined by the Federal Energy Regulatory Commission ("FERC")[1] as follows:

> 'Depreciation,' as applied to depreciable plant, means the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of electric plant in the course of service from causes which are known to be in

[1] Title 18 of the Code of Federal Regulations ("CFR") Part 101, Definition 12.

> current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities.

Based on the FERC definition, the prospective retirement is a consideration. By their nature, all prospective retirements are based on projected costs. Montana-Dakota retained outside professionals to determine the appropriate level of costs to include in its request for decommissioning costs related to generating facilities.

Regarding the appropriateness of the Company's accounting methods, decommissioning costs recovered through the amortization proposed in this proceeding have been shown to reduce rate base (Statement K, page 47). Mr. Polich has misinterpreted the Company's accounting treatment of decommissioning costs. His misunderstanding is further shown in his response to the Company's request MDU-7 where he stated, "The accounting treatment for this is very straight forward because revenues with no associated expenses will usually increase profits…" Montana-Dakota's recovery of decommissioning costs do result in additional revenue but are offset by an equal amount of expense. Additionally, rate base is credited through the recording of a liability on the balance sheet in a like amount simultaneously with the recording of the expense.

A lower rate base results in a reduced revenue requirement necessary to be recovered from North Dakota rate payers. Mr.

Polich noted that the Company does not intend to credit the decommissioning costs collected with interest. The Company's proposal gives customers the full benefit of the overall rate of return as collections are a credit to rate base. Certainly, the overall rate of return is much more advantageous to rate payers than an interest only component.

Mr. Polich further clarified his references to improper accounting in response to Montana-Dakota's data request MDU-8. In that response, he has compared the Company's decommissioning with that of nuclear generating units. The accounting treatment as described by Mr. Polich likely does conform to the regulations required by the Nuclear Regulatory Commission; however, Montana-Dakota does not operate nuclear generating units and the Company's proposal is appropriate for its generating facilities.

Mr. Polich noted that Montana customers had overpaid their estimated share of decommissioning costs. This is true, however, one of the primary reasons for the overcollection of decommissioning costs in Montana was due to the method of recovery. In Montana, beginning in about 1987, decommissioning was included as a component of depreciation expressed as a percentage to be applied to the gross plant balance. The magnitude of capital investment within each generating facility increased over time and the amount of decommissioning costs recovered followed the gross investment balance. However, the estimated cost of decommissioning didn't increase at the same pace. It is important to note that Montana customers realized a reduced rate base and a corresponding reduction to their revenue requirement which is inaccurately portrayed in Mr. Polich's exhibit PSC-6.

Ironically, this overcollection was the primary reason for the Company's proposal to develop an amortization which will remain constant rather than increase with the level of plant. The amortization is proposed to be trued up with each general rate case filed by the Company as noted in my Direct Testimony at page 31.

Finally, Mr. Polich indicated decommissioning provides little to no value to rate payers. By reducing or delaying recovery of decommissioning costs, an intergenerational subsidy has been created. Current customers pay less than the true cost while future customers inherit higher rates relative to the service received. The true value to current rate payers is the full cost of recovery for the asset used "in connection with the consumption or prospective retirement of electric plant in the course of service" as noted in the FERC definition. Again, the reduced recovery in the short term leads to a higher rate base and, ultimately, a higher revenue requirement in the long term.

Q. Do you agree with Mr. Polich's recommendation to disallow the Company's proposal to recover decommissioning costs related to its generating units?

No. Mr. Polich has misunderstood the Company's proposal and ignores the importance of matching the true cost of service provided with the recovery of the costs associated with providing the service. Mr. Polich's recommendation to disallow decommissioning costs is flawed and should be rejected.

Q. Mr. Polich has recommended disallowance of losses on manufactured homes. Do you agree with his recommendation?

A. No. It appears Mr. Polich does not understand the environment in which the Company operated in and the importance of the manufactured homes in order for Montana-Dakota to provide safe and reliable service in areas impacted by the rapid expansion in oil development. Montana-Dakota didn't begin purchasing manufactured homes until it had exhausted other options and was unable to maintain staffing levels required to perform the work in the affected areas. While Mr. Polich points to prior oil boom/bust cycles, he seems to lack an appreciation of the circumstances which forced the Company into purchasing manufactured homes.

Mr. Polich suggested the Company could have rented manufactured homes and indicated that "MDU should have known that the housing stock would catch up with demand…". Montana-

Dakota was fully aware housing would catch up with demand; however, its obligation to provide safe and reliable service as a public utility was severely impacted because rental units were not available or were too expensive relative to Montana-Dakota's salary structure. This is contrary to Mr. Polich's statements but one must only look to published articles about the region. I have included examples below.

A Bloomberg.com article published February 20, 2013 had the following headline "Oil Boom Forces Employers to Be Landlords in North Dakota" and went on to say:

"To house a commercial lender and a residential loan processor, McKenzie County Bank in Watford City purchased two, 1,800-square-feet townhouses for about $200,000 each, said Patten, the bank's president.

"It's either we purchase these, or we didn't have any employees to fill the holes," said Patten….”; and

"The city government has raised wages 10 percent a year for the past two years and topped it with at least a $350 a month housing allowance for all its 200 employees. Williston also invested in apartment buildings which will have units for about 45 employees."

An article published in August 2011 by Governing.com had this to say in regards to housing:

"The biggest struggle in the region, though, is the shortage of housing. When people in other parts of the country talk about a "housing shortage," they don't mean it literally. There are usually still plenty of available places for residents making decent money. But when people in western North Dakota discuss the housing shortage, they're serious. There's literally no place to sleep."

These are but two examples which point to the fact the Company had few options regarding housing and acted in a prudent and responsible manner.

Mr. Polich was asked to provide supporting documentation regarding the availability and cost for rental units and suitable locations corresponding to the time frame which the Company acquired housing units. Mr. Polich's response to data request MDU-9 did not provide any rental costs or suitable locations relative to the time frame requested. However, he did provide information for two companies that specialize in temporary housing. I contacted both companies and found that the rental units are generally travel trailers or campers.

Not only are campers not well suited for North Dakota's harsh environment, there are delivery and set up charges, do not include lot rental fees nor do the companies search to acquire a location, additional fees apply for electric or sewage hook up charges, and the rental units require additional charges for winterizing. Finally, the companies charge additional charges to pick up the campers upon termination of the rental agreement.

Generally the campers are designed for multiple workers rather than family units. Montana-Dakota has always been a long-term employer, unlike oil and gas exploration companies, and has found that the lack of family housing hampers recruiting.

Mr. Polich's recommendation to disallow losses on manufactured homes used to provide housing for employees in areas affected by the rapid oil expansion should be rejected.

The Company has also requested to include a gain on the sale of Company office buildings in Williston and Watford City. The Company realized a significant gain on each building, largely due to the same factors mentioned above. Both the gain on these buildings and the loss on employee housing were presented on Statement L, Schedule L-1, page 20. However, Mr. Polich chose to exclude only the loss on employee housing.

Q. Please describe Mr. Polich's recommendation to disallow 60 percent of the Company's request for employee bonuses and incentives?

A. As discussed in the rebuttal testimony of Ms. A. Jones, Montana-Dakota applies a Total Rewards philosophy to determine the appropriate level of employee compensation. As noted in my earlier discussion regarding the shortage of housing, compensation has become increasingly competitive in the economic environment in which the Company operates today. The Company's approach to compensation includes an important component, incentive or bonus pay. Ms. Jones referred to this component as "pay-at-risk". The reason I note that it is important is that it allows the Company to remain competitive and yet places responsibility with employees to ensure they must perform at an acceptable level before any incentive is awarded.

Mr. Polich has recommended the Company's request for incentive compensation be reduced by 60 percent. His rationale for the reduction is a reference to Case No. PU-10-124.

Q. Do you agree with Mr. Polich's recommendation to exclude 60 percent of Montana-Dakota's requested incentive compensation?

A. No, I do not. First, the Settlement Agreement dated March 11, 2011 and approved by the Commission on June 8, 2011, specifically states "the Agreement does not establish any principle or precedent, nor adopt or recommend any specific type or amount of expense or rate base." Second, while the exclusion was required to be included in the next interim request, the exclusion was never identified by any of the parties to the settlement in development of the final revenue requirement that was approved by the Commission. Mr. Polich's reliance on the Settlement in Case No. PU-10-124 is misplaced and he has provided no evidence to support a 60 percent reduction. His recommendation should be ignored.

Q. Will you now address the recommendations of Ms. S. Cardwell?

A. Yes. Ms. Cardwell has recommended several changes to the Company's proposed Fuel and Purchased Power Adjustment (FPPA) Rate 58 as follows:

- Remove the Base amount of Fuel and Purchased Power costs;
- Eliminate monthly tariff changes and provide the information in an alternative manner;
- Exclude MISO Schedule 24 charges from the Fuel & Purchased Power costs; and
- True-up under and over collected balances monthly rather than annually.

The Company does not oppose Ms. Cardwell's recommendations to remove the base fuel or to eliminate the monthly tariff changes and has agreed to work with the Commission staff to provide information in an efficient and effective manner. The base fuel is presented to show the change; however, customers are currently billed the total cost of fuel.

The Company does not support Ms. Cardwell's recommendation to remove Schedule 24 from its FPPA. As noted in North Dakota Public Service Commission Response No. 1.18, originally the Company recorded MISO Schedule 24 - Administrative Allocation charges to FERC Account 555 and the costs were recovered through the FCA. Subsequently, the FERC required market administration costs be recorded in Account 575 - Regional Market Expense. In the last rate case (Case No. PU-10-124), the FPPA tariff was modified to include Account 575.

As described in the rebuttal testimony or Mr. D. Neigum, the market administration costs under MISO Schedule 24 are not MISO administrative costs but the costs associated with operating each load balancing authority and the costs are assessed based on the volume of customer load and generation within the MISO market. Under the Company's proposal, revenue received is included in the Transmission Cost Adjustment as it represents revenue received by the Company acting as a load balance authority and charges are included in the FPPA as the charges represent a component of the cost of power delivered to customers. Therefore, neither are included in base rates.

Ms. Cardwell noted the Minnesota Public Utilities Commission has determined MISO Schedule 24 charges should be included as a part of the utilities' base rates. However, the Company requested approval to include MISO Schedule 24 in Case No. PU-10-124. The North Dakota Public Service Commission granted that request and Montana-Dakota has been including that charge in the FPPA since that decision was rendered.

As noted, MISO Schedule 24 is charged on a volumetric basis and is a cost of participating in the MISO market similar to the other energy charges which the Company pays in the MISO market. If the Commission ultimately approves removal of MISO Schedule 24 from the FPPA it would require an adjustment to Montana-Dakota's base rates to recover the MISO Schedule 24 charges.

Finally, Ms. Cardwell has recommended the Company true-up under and over collected balances monthly rather than annually. The Company's current method was also approved in Case No. PU-10-124 and has not presented any problems and has not harmed customers. Ms. Cardwell's support for the change is to be consistent with Otter Tail and Xcel and she does not see that a monthly true-up adversely impacts the costs to customers. The Company does not believe its current method adversely impacts the costs to customers and may potentially allow for offsetting adjustments during volatile market conditions. However, the Company is open to further conversation to understand the administrative impact of a monthly true-up relative to the current method.

Q. Do you have further issues to address regarding the testimony of Mr. Polich or Ms. Cardwell?

A. No, I have no further issues. To summarize, Mr. Polich has recommended the disallowance of decommissioning costs and recovery of the loss on employee housing. As demonstrated, each of these costs is prudent and has been incurred in the delivery of safe and reliable service and each disallowance should be rejected. Mr. Polich's recommendation to remove 60 percent of the Company's proposed incentive has not been supported and should be rejected in its entirety.

Ms. Cardwell's recommendation to remove MISO Schedule 24 from the FPPA and include it in the Company's base rates should be rejected. The Company's current method reflects the correct cost of energy received through the MISO market, has not harmed customers and has been approved by this Commission. The

Company has agreed to, or is willing to discuss in more detail, Ms. Cardwell's remaining recommendations regarding the presentation of the Fuel & Purchased Power Cost Adjustment.

Q. Does this conclude your testimony?

A. Yes.