

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

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

2 A. Yes. My name is Travis R. Jacobson and my business address is
3 400 North Fourth Street, Bismarck, North Dakota 58501.

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

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

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

9 A. Yes, I am.

10 **Q. What is the purpose of your rebuttal testimony?**

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

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

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

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

15 On page 32, line 2, Mr. Polich indicated he intended to reduce
16 incentive compensation and bonuses by 60 percent or an adjustment
17 of \$1,313,132. Mr. Polich's Excel files have only one adjustment to
18 operation and maintenance expenses with a total reduction
19 \$2,393,567. This is an overstatement of \$1,080,435 compared to
20 Mr. Polich's stated adjustment which misstates his revenue
21 requirement. The total incentive compensation and bonuses
22 requested by the Company and shown on Statement Workpapers,
23 Statement K, page K-152 was \$2,146,078 (\$623,082 + \$1,522,996).

1 Mr. Polich's adjustment shown in his testimony does not represent
2 60 percent of the Company's requested incentive compensation and,
3 in fact, exceeds the Company's total incentive compensation
4 request.

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

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

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

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

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

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

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

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

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

21 'Depreciation,' as applied to depreciable plant, means the loss in
22 service value not restored by current maintenance, incurred in
23 connection with the consumption or prospective retirement of electric
24 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.

1 current operation and against which the utility is not protected by
2 insurance. Among the causes to be given consideration are wear
3 and tear, decay, action of the elements, inadequacy, obsolescence,
4 changes in the art, changes in demand and requirements of public
5 authorities.
6

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

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

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

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

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

15 Mr. Polich noted that Montana customers had overpaid their
16 estimated share of decommissioning costs. This is true, however,
17 one of the primary reasons for the overcollection of decommissioning
18 costs in Montana was due to the method of recovery. In Montana,
19 beginning in about 1987, decommissioning was included as a
20 component of depreciation expressed as a percentage to be applied
21 to the gross plant balance. The magnitude of capital investment
22 within each generating facility increased over time and the amount of
23 decommissioning costs recovered followed the gross investment

1 balance. However, the estimated cost of decommissioning didn't
2 increase at the same pace. It is important to note that Montana
3 customers realized a reduced rate base and a corresponding
4 reduction to their revenue requirement which is inaccurately
5 portrayed in Mr. Polich's exhibit PSC-6.

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

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

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

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

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

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

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

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

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

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

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

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

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

22 "The biggest struggle in the region, though, is the shortage of
23 housing. When people in other parts of the country talk about a
24 "housing shortage," they don't mean it literally. There are usually still
25 plenty of available places for residents making decent money. But
26 when people in western North Dakota discuss the housing shortage,
27 they're serious. There's literally no place to sleep."
28

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

4 Mr. Polich was asked to provide supporting documentation
5 regarding the availability and cost for rental units and suitable
6 locations corresponding to the time frame which the Company
7 acquired housing units. Mr. Polich's response to data request MDU-
8 9 did not provide any rental costs or suitable locations relative to the
9 time frame requested. However, he did provide information for two
10 companies that specialize in temporary housing. I contacted both
11 companies and found that the rental units are generally travel trailers
12 or campers.

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

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

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

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

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

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

1 ensure they must perform at an acceptable level before any incentive
2 is awarded.

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

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

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

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

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

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

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

14 The Company does not support Ms. Cardwell's recommendation to
15 remove Schedule 24 from its FPPA. As noted in North Dakota Public
16 Service Commission Response No. 1.18, originally the Company recorded
17 MISO Schedule 24 - Administrative Allocation charges to FERC Account
18 555 and the costs were recovered through the FCA. Subsequently, the
19 FERC required market administration costs be recorded in Account 575 -
20 Regional Market Expense. In the last rate case (Case No. PU-10-124), the
21 FPPA tariff was modified to include Account 575.

22 As described in the rebuttal testimony of Mr. D. Neigum, the market
23 administration costs under MISO Schedule 24 are not MISO administrative

1 costs but the costs associated with operating each load balancing authority
2 and the costs are assessed based on the volume of customer load and
3 generation within the MISO market. Under the Company's proposal,
4 revenue received is included in the Transmission Cost Adjustment as it
5 represents revenue received by the Company acting as a load balance
6 authority and charges are included in the FPPA as the charges represent a
7 component of the cost of power delivered to customers. Therefore, neither
8 are included in base rates.

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

15 As noted, MISO Schedule 24 is charged on a volumetric basis and is a
16 cost of participating in the MISO market similar to the other energy charges
17 which the Company pays in the MISO market. If the Commission ultimately
18 approves removal of MISO Schedule 24 from the FPPA it would require an
19 adjustment to Montana-Dakota's base rates to recover the MISO Schedule
20 24 charges.

21 Finally, Ms. Cardwell has recommended the Company true-up under
22 and over collected balances monthly rather than annually. The Company's
23 current method was also approved in Case No. PU-10-124 and has not

1 presented any problems and has not harmed customers. Ms. Cardwell's
2 support for the change is to be consistent with Otter Tail and Xcel and she
3 does not see that a monthly true-up adversely impacts the costs to
4 customers. The Company does not believe its current method adversely
5 impacts the costs to customers and may potentially allow for offsetting
6 adjustments during volatile market conditions. However, the Company is
7 open to further conversation to understand the administrative impact of a
8 monthly true-up relative to the current method.

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

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

19 Ms. Cardwell's recommendation to remove MISO Schedule
20 24 from the FPPA and include it in the Company's base rates should
21 be rejected. The Company's current method reflects the correct cost
22 of energy received through the MISO market, has not harmed
23 customers and has been approved by this Commission. The

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

4 **Q. Does this conclude your testimony?**

5 A. Yes.