

State of North Dakota
Before the North Dakota Public Service Commission

In the Matter of
Application and Notice of Change in Natural Gas Rates of
MONTANA-DAKOTA UTILITIES CO.
Case No. PU-17-295

**Surrebuttal Testimony of
Scott J. Rubin**

on Behalf of
AARP

May 4, 2018

1 **Q. Please state your name.**

2 A. My name is Scott J. Rubin. On December 18, 2017, I submitted direct testimony in this
3 case on behalf of AARP.

4 **Q. What is the purpose of your surrebuttal testimony?**

5 A. I have been asked by AARP to review the rebuttal testimony submitted by Montana-
6 Dakota Utilities Company ("MDU" or "Company") and to respond concerning issues I
7 addressed in my direct testimony. In particular, I will respond to portions of the rebuttal
8 testimonies submitted by MDU witnesses Hatzenbuhler and Bosch. I also will briefly
9 mention Mr. Darras's rebuttal testimony.

10 **Q. Have you reviewed the rebuttal testimony of Jordan Hatzenbuhler?**

11 A. Yes.

12 **Q. On page 4 of his rebuttal, Mr. Hatzenbuhler states that the cost relationship
13 between different sizes of gas mains remains fairly constant over time. Is this
14 relevant for conducting a minimum-system analysis?**

15 A. No. As I explained in my direct testimony, a minimum-system analysis for a gas utility
16 should recognize the costs when they were incurred; that is the historical cost. Over time
17 different sizes of main are replaced at different points in time, leading to some very old
18 pipe remaining in place that is significantly less expensive than newer pipe. If mains of
19 different size are not replaced in equal percentages, then the result could be (and often is)
20 that the oldest pipe on the system is very small mains serving primarily residential
21 customers, while the newer pipe on the system consists of large mains needed to meet the
22 demands of larger customers.

1 That is, using Mr. Hatzenbuhler's example, if the 2-inch main from 1950 (at a cost
2 of \$1 per foot) is still in service, but the 12-in main was replaced recently and cost \$100
3 per foot, the relevant relationship is the \$1 compared to \$100 because those are the costs
4 that are proposed to be included in customers' rates.

5 **Q. Is that the case with the Company's mains?**

6 A. Yes. According to the Company's depreciation study, as of the end of 2015 MDU had
7 steel distribution mains in service that dated from 1916. MDU Exhibit EMR-1, p. 4-3.
8 On that same page, the Company's depreciation expert, Mr. Robinson, states: "While
9 portions of this property class (bare steel) were originally installed during earlier years,
10 coated and wrapped steel has continue[d] to be installed for higher pressure and larger
11 size requirements." In other words, the very old mains that remain in service are smaller
12 mains serving low-pressure customers with low demands. Newer steel mains are larger
13 in size and are designed to serve the higher pressures required by higher-demand
14 customers.

15 **Q. On page 5 of his rebuttal testimony, Mr. Hatzenbuhler cites to the NARUC rate**
16 **design manual for electric utilities. Do you agree with his use of that manual for**
17 **conducting a cost-of-service study for a natural gas distribution utility?**

18 A. No, I do not. NARUC has a separate manual for natural gas rate design, and that is the
19 source I discussed in my direct testimony.

1 **Q. If one were to rely on the NARUC electric manual in this case, is there other**
2 **information that is important for the Commission to consider?**

3 A. Yes. Mr. Hatzenbuhler cited to one sentence from page 95 of the electric manual. If he
4 had continued, he would have found the following discussion on the same page that is
5 directly related to the concerns I expressed in my direct testimony; specifically, that a
6 minimum-sized system has significant demand-serving capability that MDU failed to
7 consider in its analysis:

8 Cost analysts disagree on how much of the demand costs should be
9 allocated to customers when the minimum-size distribution method is used
10 to classify distribution plant. When using this distribution method, the
11 analyst must be aware that the minimum-size distribution equipment has a
12 certain load-carrying capability, which can be viewed as a demand-related
13 cost.

14 When allocating distribution costs determined by the minimum-
15 size method, some cost analysts will argue that some customer classes can
16 receive a disproportionate share of demand costs. Their rationale is that
17 customers are allocated a share of distribution costs classified as demand-
18 related. Then those customers receive a second layer of demand costs that
19 have been mislabeled as customer costs because the minimum-size
20 method was used to classify those costs.

21 *NARUC Electric Utility Cost Allocation Manual* (Jan. 1992), p. 95.

22 **Q. If one were to rely on sources from other utility industries, are there industries**
23 **other than the electric industry that could provide guidance for gas distribution**
24 **utilities?**

25 A. Yes. The distribution of water arguably has much more in common with the distribution
26 of natural gas than does the electric utility industry. Like gas distribution, water
27 distribution involves introducing the product at a source and transporting it via a network
28 of underground pipes to end-use customers. Water and gas utilities both have meters,

1 service pipes, distribution mains, valves, and pressure regulators (though in water,
2 regulators are called pumps to increase pressure or pressure-reducing valves to decrease
3 pressure).

4 **Q. Does the water utility industry have a cost-of-service manual?**

5 A. Yes. The American Water Works Association ("AWWA") publishes an in-depth
6 ratemaking manual that includes several chapters addressing cost-of-service studies and
7 rate design. The AWWA manual is prepared by ratemaking experts who represent
8 different perspectives, including investor-owned utilities, government-owned utilities,
9 and consumer interests. I served on the editorial committee for the fifth edition of that
10 manual which was published in 2000. Last year, AWWA published the seventh edition
11 which bears the title: *Manual M1: Principles of Water Rates, Fees, and Charges*.

12 **Q. Does the water industry's ratemaking manual address the use of a minimum system
13 analysis and its relation to fixed customer charges?**

14 A. Yes. On page 152 of the new edition of the AWWA manual, it states:

15 An approach that may be useful in establishing a cost basis for readiness-
16 to-serve costs is referred to as the minimum system analysis. This analysis
17 considers that there is a minimum system in place to meet minimum
18 service requirements regardless of use. The minimum needs are defined by
19 determining the minimum size a system would be designed to meet
20 minimum or average service needs (e.g., 4-in. service) not considering
21 sizing for peak-day capacity needs or fire protection. The percentage of
22 the distribution system related to meeting the minimum system needs
23 would be applied to distribution-related costs and would be collected in
24 the fixed charges. Incremental system sizing related to sizing the system to
25 meet peak-day needs and fire flow requirements may also be considered
26 for inclusion in the fixed charges. ... The requirement to recover costs
27 without regard to the volume of sales is real, but it does not necessarily
28 suggest that fixed charges should represent a large portion of total revenue
29 requirements, nor that the rate structure should match the cost structure of
30 a utility. The use of a water system is reflected in both potential and

1 average usage patterns, so a continued reliance on volumetric charges to
2 recover fixed costs has value from an equity perspective.

3 The extent to which a strategy of large service charges is employed
4 is frequently limited as a result of concerns over impacts on affordability
5 for smaller-volume customers.

6 AWWA, Manual M1: *Principles of Water Rates, Fees, and Charges* (7th ed. 2017),
7 p. 152 (emphases added).

8 **Q. On page 9 of his rebuttal testimony, Mr. Hatzenbuhler states that the cost of serving**
9 **a residential customer does not vary "with usage or an individual customer's peak**
10 **demand on the system." Is he correct?**

11 A. No, he is not correct. Mr. Hatzenbuhler takes a very short-term view of costs that are
12 "fixed" or "variable." In fact, the Company's own cost-of-service study recognizes that
13 the residential class incurs significant demand-related costs. Specifically, on page 1 of
14 Exhibit JRH-3 (Revised Statement M), the Company shows that \$6.8 million of its \$27.0
15 million distribution cost to serve the residential class is related to serving customer
16 demand or energy requirements. That is, 25% of the cost of serving residential customers
17 is incurred to serve customers' peak demands and energy requirements. It is not credible
18 for Mr. Hatzenbuhler to state that the cost to serve residential customers does not vary
19 with demand or energy usage when his own cost study shows that exactly the opposite is
20 true. Moreover, as I explained in my direct testimony, there is significant diversity of
21 demand and energy usage within the residential class, so it is neither reasonable nor
22 proper to assume that each customer contributes the same amount to demand- and
23 energy-related costs. But that is precisely the effect of Mr. Hatzenbuhler's assertion that
24 the cost to serve each residential customer is exactly the same as the cost to serve every
25 other residential customer.

1 **Q. On page 10 of his rebuttal, Mr. Hatzenbuhler asserts that collecting some of the**
2 **residential cost of service through a per-therm charge "would be to take a step**
3 **backwards in the evolution of the rate design for the Residential rate class." Is he**
4 **correct?**

5 A. No, he is not correct. MDU is one of the very few natural gas utilities that has
6 experimented with a distribution rate design that charges each residential customer a flat
7 rate. MDU is truly an outlier in this regard. Most other gas utilities continue to have per-
8 therm charges that collect a substantial portion of demand- and energy-related
9 distribution costs. I have testified in gas and electric utility rate cases throughout North
10 America, and MDU is the only utility I have seen that collects 100% of its residential
11 distribution costs through a fixed customer charge.

12 Indeed, in my experience, the true evolution in gas rate design is occurring in
13 utilities like Peoples Natural Gas and North Shore Gas (both in the greater Chicago area),
14 which have recognized that customers who do not use natural gas for space-heating
15 require significantly lower fixed costs and therefore should pay lower customer charges
16 (as well as different per-therm charges) than heating customers. That is, in my
17 experience, the next step in residential rate design is to move in exactly the opposite
18 direction from what MDU proposes; specifically to segment the residential customer
19 class to better collect demand-related costs from the customers who cause those costs to
20 be incurred by having higher winter (peak period) gas usage.

21 **Q. Have you reviewed the rebuttal testimony submitted by Stephanie Bosch?**

22 A. Yes.

1 **Q. On page 5 of her rebuttal, Ms. Bosch states, "The Company believes that a returned**
2 **check charge set at cost would not provide that deterrent." Do you agree with her?**

3 A. No, I do not agree with her and I do not know the basis for her "belief." Ms. Bosch does
4 not cite to any information showing that a \$40 returned check charge would deter the
5 writing of bad checks, but that a cost-based charge of \$15 would not provide such a
6 deterrent.

7 I strongly disagree with Ms. Bosch. She seems to assume that customers make a
8 conscious decision to write a bad check and that a fee can deter that behavior. In fact,
9 many customers who have a payment dishonored do not know why it happened, as a visit
10 to almost any bank branch will confirm. I cannot count the number of times I have been
11 in line at a bank and a customer is asking a teller to explain why a payment was
12 dishonored. It often is the result of a timing difference between when funds are deemed
13 to be "available" by the bank and when the check was presented for payment, or the fact
14 that the bank charged the customer a fee without first notifying the customer.

15 Indeed, this is a source of great concern within the consumer protection industry.
16 See, for example, the National Consumer Law Center's ("NCLC") web site dealing with
17 banking practices for charging overdraft fees when a customer issues a dishonored
18 payment, at <https://www.nclc.org/issues/overdraft-loans.html>.

19 Moreover, as NCLC documents, a fee from a payee is hardly the only cost
20 incurred when a consumer issues a dishonored payment. The bank fees can be \$30 or
21 more in addition to whatever fee the payee charges for having to process a dishonored
22 payment. Thus, Ms. Bosch's undocumented "belief" about the need for a further deterrent

1 is completely unwarranted. With a cost-based fee of \$15 from MDU and a bank fee that
2 might be \$30 or more, a customer issuing a dishonored payment could easily end up
3 paying a penalty equal to 50% or more of his/her utility bill. In my opinion, no further
4 deterrent is needed.

5 **Q. On pages 6-8 and in Exhibit SB-1, Ms. Bosch discusses the allocation of costs under**
6 **the Company's proposed System Safety and Integrity Program ("SSIP") rider.**
7 **How do you respond?**

8 A. First, I would again emphasize that I recommended rejecting the proposed SSIP rider
9 because it is much too broad. Riders are basically single-issue ratemaking which fast
10 track utility spending without normal Commission review. Further, there is no
11 opportunity for the Commission to consider offsetting cost reductions. Neither Ms.
12 Bosch nor Mr. Darras addressed that fundamental problem with MDU's proposal. In fact,
13 Mr. Darras did not even mention the fact that I testified against adopting the SSIP
14 surcharge, let alone attempt to respond to the concerns I raised.

15 If, however, the Commission approves some type of SSIP (which I recommend
16 against), I pointed out in my direct testimony that the Company's proposed tariff
17 language would result in the residential class bearing a disproportionate amount of the
18 costs. Ms. Bosch has now clarified the Company's position and shows that costs would
19 be allocated among customer classes in proportion to each class's distribution revenues.
20 That is, each customer's distribution bill would be increased by the same percentage.

1 With her clarification of this point, we no longer have a disagreement about the
2 appropriate method to allocate costs under a SSIP rider, if the Commission approves such
3 a rider. We still disagree, however, about the scope and need for such a rider.

4 **Q. You mentioned that Mr. Darras did not acknowledge your testimony concerning the**
5 **merits of the SSIP. Have you reviewed his entire testimony?**

6 A. Yes.

7 **Q. Does his discussion of SSIP issues in response to Staff's testimony address your**
8 **concerns?**

9 A. No, it does not. I had two major concerns with the Company's proposal. First, it was
10 extremely broad in scope, including the use of undefined terms such as "operational" that
11 could be used to include nearly any expenditure in the special rider. Second, even if that
12 concern were addressed, a rider for safety-related spending should be limited to new
13 safety requirements; that is, requirements that were not known and could not be planned
14 for as part of the test year in a rate case.

15 From my reading of Mr. Darras's rebuttal testimony, he has not addressed either
16 of these concerns. In fact, in his testimony he acknowledges that some of the safety
17 issues he contemplates including in the proposed surcharge have been known for many
18 years (such as the problems with bare steel and Aldyl-A plastic pipe) and that many other
19 utilities already are addressing them. That is, these are existing requirements that the
20 Company has known about for many years. There is no reason that spending on this type
21 of program could not have been included in this rate case as an ongoing project.

1 As I discussed in my direct testimony, the fact that the Company has chosen to
2 defer the start of the program until after the rate case does not justify a separate surcharge
3 for the program. Many things change between cases -- some costs increase while others
4 decrease -- and spending on known safety concerns should be treated the same way as
5 any other expenditure.

6 **Q. Does anything in the Company's rebuttal submission cause you to change any of**
7 **your conclusions and recommendations?**

8 A. No.

9 **Q. Does this conclude your surrebuttal testimony?**

10 A. Yes, it does.

