STATE OF NORTH DAKOTA

PUBLIC SERVICE COMMISSION

**Montana Dakota Utilities, Co., a Division of MDU Resources Group, Inc.
2017 Natural Gas Rate Increase Application** | **Case No. PU-17-295**

ADVOCACY STAFF'S POST-HEARING BRIEF

I. INTRODUCTION

[¶1] MDU seeks to increase its rates for natural gas service in North Dakota by $3,575,388, which constitutes a 3.3% increase over its current rates. In addition, MDU seeks to implement a SSIP mechanism to allow it to more easily increase rates in the future for nonspecific replacement and repair projects. Advocacy Staff ("Staff") opposes the size of MDU's proposed increase and opposes the SSIP mechanism.

II. RELEVANT FACTS

[¶2] The most relevant facts for the disputed areas will be discussed in the argument section below to avoid repetition.

III. APPLICABLE LAW AND ARGUMENT

[¶3] The areas primarily in dispute are the proposed SSIP mechanism, MDU's requested revenue requirement, and return on equity. Certain parties, including Staff, have reached a settlement agreement, which has been filed with the Commission. As an initial matter, Staff agrees the settlement is a reasonable resolution of the issues addressed therein, and requests the Commission adopt the settlement. However, Staff will address all issues in this brief in the event the settlement is not approved, and because the

189 PU-17-295 Filed 07/19/2018 Pages: 27
Advocacy Staff's Post-Hearing Brief
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settlement does not resolve every issue in the case. Similarly, Staff is filing a proposed order in the event the settlement is not accepted by the Commission.

[¶4] A public utility seeking to increase its rates can use a future test year, subject to various conditions. N.D.C.C. § 49-05-04.1. At any hearing to increase rates, "the burden to show that the increased rate or proposed change of rate, classification, rule, or practice is just and reasonable is upon the public utility applying for the increase." N.D.C.C. § 49-05-06.

[¶5] To ascertain just and reasonable rates and charges, the Commission "shall investigate and determine the value of the property . . . used and useful for the service and convenience of the public." N.D.C.C. § 49-06-01. The value of the property of a public utility, as determined by the commission for ratemaking purposes, is the money honestly and prudently invested therein by the utility." N.D.C.C. § 49-06-02. However, the value of public utility property for ratemaking purposes shall not include or be affected by goodwill value, going concern value, or franchise value in excess of payments made therefore. N.D.C.C. § 49-06-03. The Commission shall also "ascertain whether an advanced or fictitious cost price, or a price in excess of the fair market value of any commodity, machinery, equipment, material, or service has been paid or is being paid or charged, by the public utility," and if so, shall fix and allow only the reasonable and fair market price for such items, eliminating all such fictitious or excessive prices or values. N.D.C.C. § 49-06-04. The system of accounts used by natural gas distribution companies must conform to the uniform system of accounts set forth in title 18, Code of Federal Regulations, part 201, prescribed by the federal energy regulatory commission. N.D. Admin. Code § 69-09-05.1-03.

[¶6] "An investor-owned public utility, such as MDU, is entitled to earn revenue that will allow it to meet its expenses and earn a fair and reasonable rate of return for its investors." MDU v. Public Service Comm'n, 413 N.W.2d 308, 311 (1987). The Commission can only fix or establish new rates to be charged in the future and cannot engage in retroactive ratemaking. MDU v. Public Service Comm'n, 431 N.W.2d 276, 280 (1988). "In general, the governing principle for determining rates to be charged by a utility is the right of the public on one hand to be served at a reasonable charge, and the right of the Utility on the other to a fair return on the value of its property used in the service. After the value or rate base of the property used and useful in the public utility business is ascertained, next to be ascertained is the amount of the operating expenses as compared with the gross income, after which a conclusion can be drawn as to the rates necessary for a fair return on the property." Public Service Comm'n v. Montana-Dakota Utilities Co., 100 N.W.2d 140, 144 (N.D. 1959). "The anticipated patrons of the company under the present proposal cannot be burdened in order to provide for possible needs of other patrons in other communities some time in the future." Public Service Comm'n v. Montana-Dakota Utilities Co., 100 N.W.2d 140, 150 (N.D. 1959). Similarly, ratepayers should not be burdened to cover expenses that should be borne by shareholders and are undertaken for shareholder benefit.

[¶7] All rates and charges must be "just and reasonable" and any unjust or unreasonable rate or charge is prohibited and unlawful. N.D.C.C. § 49-04-02. All rules and regulations made by any public utility affecting or pertaining to its rates or services to the public shall be just and reasonable. N.D.C.C. § 49-04-17.

A. MDU's Requested SSIP Mechanism Should be Denied

[¶8] MDU's requested SSIP Mechanism has not been resolved by the settlement agreement. As part of its case, MDU is requesting the Commission authorize it to have a surcharge or rider type recovery mechanism to allow it to recover costs from customers for an accelerated replacement project of early vintage steel pipe and early vintage plastic pipe. The early vintage steel pipe pre-dates federal requirements, so MDU is not specifically aware of what the conditions are of that pipe in the ground or if it is potentially unsafe. With respect to the early vintage plastic pipe, certain vintage Aldyl-A pipe may have used a particular resin that makes it more susceptible to becoming brittle and cracking. MDU is not aware whether its Aldyl-A pipe has this resin, but it is possible given the pipe's age.

[¶9] Under this basic background, MDU wants to accelerate replacement of a significant portion of its system and recover those replacement costs through a SSIP mechanism annually rather than through a rate case. Staff opposes this mechanism for numerous reasons as discussed at the hearing. First, Staff hopes the Commission observed through the hearing the benefit of examining issues in a rate case, including the inter-relatedness of issues, in order to arrive at an overall just and reasonable rate. By allowing a mechanism such as requested by MDU, the scrutiny available in a rate case will not be the same regardless of any additional protections placed on the mechanism.

[¶10] In addition, while MDU argues this mechanism is about safety, it has not shown safety will be improved or impacted by the mechanism. In fact, every example used by MDU to justify this mechanism relates to different circumstances and MDU has not identified a single safety incident related to early vintage steel or plastic pipe. Rather,

MDU uses these incidents as scare tactics to pressure the Commission into approving their requested mechanism. Instead, what the mechanism is really about is recovery—getting money for projects sooner, reducing risk on the shareholder, passing investment risk onto the customer, and earning a return without the necessity of a rate case. See Hearing Tr. at p. 175:2-6 (Mr. Darras agreeing that from an operational standpoint these projects could be done without the mechanism).

[¶11] Further, MDU does not even know if its early vintage steel pipe causes a danger and does not know whether its Aldyl-A pipe includes the resin that can make it susceptible to brittle cracking. As Staff's witness Dr. Pavlovic testified, before MDU is granted a mechanism that would dramatically shift how rates are recovered, it should at least determine whether and to what extent its expressed concerns actually exist on its system.

[¶12] Rather than learning its system and then determining if there is really an issue, MDU instead proposes to learn its system by replacing it. This approach puts customers at risk of replacing pipe that still has an extended useful life, is not in need of replacement, and passing that cost on to the customer sooner. In fact, certain efficiencies of Montana-Dakota's replacement program are lost in this process, making the projects less efficient and more costly as well, all while trying to recover those costs sooner. See *Hearing Tr.* at 175:10-176:5. What the evidence showed is that MDU has operated a safe system for decades. It will continue to operate a safe system regardless of whether the mechanism is approved, but it will just not be able to collect more money from customers sooner. Instead of granting this mechanism when it is unknown if any of these conditions actually exist or the system will be safer, MDU should continue to evaluate its routine

replacement projects for the presence of any concerns and be required to justify the project with something more than scare tactics and "everyone else is doing it" approach.

[¶13] In fact, not every jurisdiction is using these mechanisms, and even though several are, there is no information that safety has been improved. None of Montana Dakota's other jurisdictions—South Dakota, Montana, and Wyoming—presently have a similar mechanism even though all jurisdictions have aging infrastructure. While some of Montana Dakota's sister companies have mechanisms in other jurisdictions, there was no testimony that the systems in these jurisdictions are safer as a result.

[¶14] Under the law, the Commission has general jurisdiction over MDU, a gas utility engaged in the distribution of natural gas. N.D.C.C. § 49-02-01(5). Further, the Commission "by rule, may establish and enforce minimum safety standards for the design, construction, and operation of gas distribution facilities and intrastate pipeline facilities used for the distribution and intrastate transportation of" natural gas. N.D.C.C. § 49-02-01.2. Any such rules may not be more stringent than corresponding federal regulations applicable to interstate pipelines and related facilities. Id. If the Commission determines a pipeline facility is hazardous to life or property, it may issue an order requiring the operator of the facility to take corrective action. N.D.C.C. § 49-02-01.2. No evidence was presented that the Commission has ever determined a facility of MDU is hazardous to life or property.

[¶15] Further, every public utility, including MDU, must "furnish, provide, and maintain such service, instrumentalities, equipment, and facilities as shall promote the safety, health, comfort, and convenience of its patrons, employees, and the public, as shall be in all respects adequate, convenient, just and reasonable, and without any unjust

discrimination or preference." N.D.C.C. § 49-04-01. As part of ensuring safety, natural gas distributions pipelines "shall be designed, constructed, and operated to meet safety standards set forth in regulations of the United States department of transportation" of title 49, Code of Federal Regulations Parts 190-195, and 199. N.D. Admin. Code §§ 69-09-03-01 and -02.

[¶16] As can be seen, the law already requires MDU to provide a safe and reliable system. MDU has provided a safe and reliable system for decades, and testified it will continue to do so regardless of whether the SSIP mechanism is approved. Staff asserts the SSIP mechanism is not just and reasonable, and should not be granted for the reasons discussed above. Further, MDU is asking the Commission to approve a mechanism for a program that keeps changing and is difficult to determine what is fully encompassed in it. See *Hearing Tr.* at 175:23-176:5. This is a serious mechanism that would dramatically shift the landscape of how MDU rates are set and recovered. It involves up to $148 million for EVPP and up to $48.5 million for EVSP, all of which would be subject to MDU's proposed mechanism. *Hearing Tr.* at 183:18-184:12. Yet, MDU has not established a safety concern with its system that would justify increasing customer rates every year in a single-issue proceeding that does not include the full investigation and review of a rate case. MDU's attempt to accelerate recovery from ratepayers even though it already routinely seeks increases in its rates should be rejected.

B. MDU's Requested Revenue Increase is Not Supported.

[¶17] As an initial matter, Staff requests the Commission approve the settlement agreement. In the event the Commission does not approve the settlement, Staff is presenting its argument on the revenue requirement issues. As discussed at the hearing,

there are several areas of disagreement between MDU and Staff regarding the requested revenue increase. The areas surround incentive compensation, return on equity, the 2018 SSIP projects, inflation, vehicles and work equipment, private aircraft expenses, employee housing, advertising and dues, and amortization of the non-plant EDIT. As indicated above, MDU has the burden to show that its proposed rate is just and reasonable. MDU attempts to shift that burden in its brief.

[¶18] Upon requesting an increase in its rates, a public utility is required to provide the Commission with specific information and an application fee. N.D.C.C. § 49-05-04. Under MDU's argument, providing this information establishes its burden of proof. MDU's argument that it has established a prima facie case and therefore Staff has the burden is inaccurate. MDU's argument essentially is that if the number is reflected in its application and/or on its books, it has met its prima facie case, and then Staff must rebut the evidence. This would make the burden of proof meaningless and is contrary to the law. For instance, in MDU v. PSC, 413 N.W.2d 308, 314-15 (1987), the North Dakota Supreme Court evaluated whether the PSC inappropriately calculated MDU's A & G expenses because it did not accept proration of the booked expenses for the entire test year. The Supreme Court determined,

> While those A & G expenses may have been items carried on MDU's books, that fact does not, by itself, establish that those expenses were properly allocable to MDU and should be used to establish MDU's North Dakota gas rates. For example, some of those expenses may be attributable to salaries for MDU employees who perform work that is not related to MDU's North Dakota gas distribution. Without a breakdown and underlying analysis of those expenses, we cannot say that they should be used to establish MDU's North Dakota gas rates. Paetzke's qualifying statement reflects that his review did not entail that breakdown and analysis, and MDU did not present any other evidence to establish that breakdown.

> Pursuant to N.D.C.C. § 49-05-06, the public utility has the burden to establish that an increased rate or proposed change of rate is just and reasonable. Based on this record and under these circumstances, we agree with the PSC that MDU did not meet its burden to establish the reasonableness of the changes in the A & G expenses. We do not believe that Paetzke's data or the changes in the A & G expenses requested by MDU represent known and measurable changes sufficient to support MDU's request for consideration by the PSC in setting North Dakota gas rates.

Id. at 315. While MDU tries to shift the burden of proof to Staff, the evidence it has presented is only the basic evidence of what is required in the application. Without further breakdown or analysis, MDU has not met its prima facie burden. Simply saying something cost a certain amount is not enough to shift the burden to Staff.

[¶19] In its burden of proof argument, MDU argues that once it has established a prima facie case, the burden shifts to others to show that the costs incurred by the utility are unreasonable because of inefficiency or bad faith. MDU Brief at pp. 5-6. This argument, even if it were correct, does not show MDU met its initial burden of proof. Simply stating what something costs is not all that is required of MDU to meet its burden. Regardless, the evidence indicates Staff's objections are well-founded.

1. Incentive Compensation

[¶20] While "the overall employment compensation package between MDU and its employees is a matter left largely to the deference and judgment of management," MDU v. PSC, 413 N.W.2d at 316, who pays for the compensation is directly within the PSC's jurisdiction. Staff is not asserting MDU employees should be paid less or differently. Rather, Staff asserts that incentive compensation should not be borne entirely by ratepayers because the incentives upon which the compensation is based are not all for the benefit of the ratepayer. The evidence indicates that approximately six percent of

compensation is incentive compensation. The ratepayers are paying for all other compensation, and Staff agrees they should pay for some incentive compensation as well. But, the shareholders should be responsible for that portion of incentive compensation that seeks to increase the shareholders' return. Accordingly, Staff requests the Commission order that ratepayers only have to pay forty percent of incentive compensation, meaning ratepayers will be paying over 96 percent of total compensation. This is not asking the Commission to micromanage compensation, rather it is asking the Commission to properly allocate who pays for certain compensation based on who the incentive is designed to benefit. If the compensation benefits shareholders, they should share in that expense.

[¶21] The evidence indicates there are two different incentive compensation programs—one for executives and one for everybody else. The executive incentive compensation is based on earnings and return on invested capital. The other employees' incentive compensation is based on customer satisfaction and O & M expense goals. MDU is asking ratepayers to be responsible for all of this incentive compensation. For the executive incentive compensation, the criteria are all based on items that relate to a benefit to shareholders. For the other employees, both shareholders and ratepayers have an interest in the incentives based on the testimony of the witnesses, particularly Ms. Kivisto. Accordingly, the ratepayers and shareholders should both be responsible to pay for some of the incentive compensation. This is not infringing on management's discretion, it is attributing costs to the person/group they are designed to benefit.

[¶22] In MDU v. PSC, 413 N.W.2d 308, 316 (N.D.1987), the supreme court cited Central Maine Power Co. v. Public Utilities Comm'n, 405 A.2d 153 (Me. 1979, *cert*

denied, 447 U.S. 911 (1980). In that case, the Supreme Court of Maine indicated that it has "clearly held" that it is within a Commission's regulatory powers to review issues relating to employee compensation. 405 A.2d at 179 (citing Casco Bay Lines v. Public Utilities Comm., 390 A.2d 483, 492-94 (Me. 1978). In Casco Bay, the Maine Supreme Court recognized that certain pension expenses were not supportable because the utility failed to meet its burden of proof. 390 A.2d at 493. The court noted:

> The staff, of course, is not required to introduce any direct evidence in a rate case proceeding for the burden of proof is upon the utility to demonstrate that its proposed rate increase is just and reasonable. If the staff chooses not to present a case-in-chief, the Commission is not bound to accept the uncontradicted testimony of the utility but is free to weigh the evidence, determine the credibility of the utility's experts, and draw its own independent conclusion.

Id. (internal citations omitted). This rationale applies in this case as well and dispels MDU's burden of proof argument.

[¶23] Further, in Casco Bay, the Maine Supreme Court removed from the rates sought, the cost for its vice president to commute to work each day. Id. at 493-94. In doing so, the Maine Supreme Court affirmed the Commission's determination that ratepayers should not be charged because the employee chooses to live ten miles from work. Id. at 494. Likewise, in this case, ratepayers should not have to pay for incentive compensation the Company chooses to be steered toward increasing shareholder earnings. That is a cost that should be borne by shareholders under any just and reasonable standard. Based on the hearing testimony, sixty percent is a reasonable and supported reduction to MDU's incentive compensation in this case.

[¶24] MDU argues sixty percent is an arbitrary number. Staff disagrees, and asserts assigning 100% to ratepayers is more arbitrary and indefensible as a majority of

the incentive compensation is designed to incentivize employees for the shareholders' benefit. There is no evidence to support that 100% of incentive compensation is for ratepayer benefit. Therefore, if the Commission were to follow MDU's request, the decision would arbitrarily attribute expenses to the ratepayers that are designed to benefit shareholders. In reviewing the case law, it appears to be generally recognized that "[r]atemaking is not an exact science and often calls for estimations and predictions. The Commission and the utilities might overestimate in one area and underestimate in another." Casco Bay, 390 A.2d at 494. The nature of the incentives, and the dual interests for both ratepayers and shareholders involved, does not result in a situation capable of determining exactly what percentage of the incentives is for shareholder versus ratepayer benefit. Therefore, an estimation is necessary. Certainly, 100% paid by the ratepayers is inaccurate because the executive incentive compensation is wholly for shareholder benefit and the other employees' incentives are mixed between shareholders and ratepayers. Therefore, sixty percent is a more supportable estimate, and should be adopted by the Commission.

2. Return on Equity

[¶25] "The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally." Bluefield Waterworks & Imp. Co. v. Public Service Comm'n, 43 S.Ct. 675, 679 (1923). Staff asserts the evidence at

hearing established a return on equity between 9.23 up to 9.50 percent, with an overall return of between 7.15 to 7.29 percent is appropriate.

[¶26] The Commission heard three witnesses testify about the return on equity at the hearing—Stephen Gaske, Marlon Griffing, and Michael Gorman. These witnesses relied on much of the same information, and the primary areas of disagreement were whether a small size adjustment should be used, application of a flotation cost factor, and whether Dr. Gaske's self-created gas utility risk premium should be applied. With respect to the small size adjustment, it is interesting to note that MDU seems to argue that its BBB+ credit rating justifies the small size adjustment. This argument is interesting as the credit rating is based on the entirety of its parent company, MDU Resources, Inc. The evidence at hearing showed it was not the utility division that resulted in a BBB+ rating, but the other companies under the entirety of the MDU Resources' umbrella. Put simply, MDU picks and chooses when it wants the Commission to consider its parent company's information and when it does not. The only consistent factor in its choice is it always picks whichever position will allow it to request higher rates.

[¶27] The Commission should not take the bait. Montana Dakota is integrated into a large parent company that shares employees, shares technology, and shares various other functions to increase the performance of the overall parent company. Montana Dakota is not separable from MDU Resources, Inc., when considering an appropriate return and its attempts to separate itself only where it results in greater recovery should be rejected. <u>See</u> *Propriety of Considering Capital Structure of Utility's Parent Company or Subsidiary in Setting Utility's Rate of Return*, 80 A.L.R.4th 280, §2 ("The general view in all jurisdictions is that state and federal utility regulatory commissions may consider a

parent corporation's capital structure in setting an appropriate rate of return for a utility subsidiary").

[¶28] Similarly, the Commission should not accept Dr. Gaske's gas utility risk premium analysis. Dr. Gaske has testified nearly thirty times for Montana Dakota. The company continues to hire him for a reason—he provides testimony for a higher return. In this case, his return is much higher than Dr. Griffing's and Mr. Gorman's despite the similar methodology. Further, his testimony does not move with the markets like the other witnesses. This is because it is already high. His application of a gas utility risk premium and small size adjustment should be rejected. There is no basis to apply these unless the goal is to get a higher return.

[¶29] The only remaining significant difference between the experts was application of a flotation cost adjustment. Dr. Gaske and Dr. Griffing applied a flotation cost adjustment, and Mr. Gorman did not. The end result of the flotation cost adjustment is a difference of 11 or 12 basis points in Dr. Griffing and Mr. Gorman's testimony, and essentially makes up the difference between these two witnesses. There was also a difference in how the flotation cost factor was applied between Dr. Gaske and Dr. Griffing. Dr. Gaske applied the flotation cost factor to the growth-rate term which is incorrect as explained in Dr. Griffing's testimony, and resulted in a 21 basis point difference between them. PSC Ex. 23 at pp. 14-15; Griffing Hearing Testimony. Again, this indicates an appropriate return on equity is less than Dr. Gaske testified. Accordingly, Staff requests the Commission establish a reasonable return on equity between 9.23 and 9.50 percent, resulting in a corresponding overall return between 7.15 and 7.29 percent depending on what ROE is selected.

3. 2018 SSIP Replacement Projects

[¶30] MDU also contests Staff's request that the Commission disallow the 2018 SSIP projects. MDU misstates Staff's position on this issue. While MDU implores the Commission that it wants to work together with it on the SSIP projects and mechanism, MDU's approach to misstate Staff's position, withhold information unless specifically requested, and to seek every opportunity to request a higher return from ratepayers for shareholder items should at least cause the Commission some concern about MDU's request for the SSIP projects and mechanism. As an example, MDU now questions Dr. Pavlovic's credentials. Yet, it stipulated to the admission of his testimony, and never pressed him about his credentials at the hearing. Certainly, if it had objected to his testimony for lack of expertise or questioned his credentials at the hearing, more information would have been obtained from him. This example (similar to the private airplane documents produced at the hearing), which is also one of Staff's concerns about implementing the SSIP recovery mechanism.

[¶31] Regardless, the Commission heard Dr. Pavlovic testify at the hearing, and it is clear he has significant experience and history in this subject matter. Simply because his bachelor's and master's degrees are in philosophy does not mean he is not an expert in any other area. This approach is indeed unique for another reason as well. While questioning his credentials on one hand, MDU relies on his testimony in other areas. MDU cannot pick and choose whether Dr. Pavlovic is an expert. Either Dr. Pavlovic is a qualified expert or he is not. His CV, which is Attachment A to PSC Ex. 20, lists his qualifications including at least forty-five cases in which he has been engaged in for regulatory issues similar to those areas he provided testimony in this case.

[¶32] Regardless, Dr. Pavlovic's testimony and the other testimony establishes the 2018 SSIP projects should not be included in rate base. In order to fully evaluate this issue, one must look at the timeline of how the 2018 projects evolved. As indicated in Dr. Pavlovic's initial pre-filed and hearing testimony, originally the 2018 projects were identified as low-pressure system replacements in New Salem, Taylor, Bismarck and Mandan; and Aldyl-A replacements in Barlow, Cleveland and Eldridge. The cost of these projects was projected at $5,553,154 (resulting in a revenue requirement of $386,787). There was no SSIP plan at the time of the original testimony, and the actual plan is dated January 4, 2018, and was first submitted in the rebuttal testimony of Patrick Darras on March 23, 2018. MDU-3 (PCD-2).

[¶33] In that "plan" and at the hearing, MDU testified the 2018 projects are now replacement of early vintage plastic pipe in Barlow, Cleveland, Eldridge, Fairview, Gladstone, and New Salem; and replacement of early vintage steel pipe in Fairview, Gladstone, New Salem, and Taylor. <u>But, the cost of the projects remains the same</u>. So, while the projects have changed, the cost has not. MDU has not identified, and Staff has not found, anywhere where MDU has identified the cost figures (other than the total cost) for either the originally designated projects or the present projects. Yet, even though the projects have changed, the requested costs to recover remained the same. Staff has not been able to identify how the costs are calculated and somehow remain the same even though the projects have changed. The cost for these projects should absolutely not be approved unless MDU can identify somewhere in the evidence that it has actually conducted a cost analysis for the originally designated 2018 projects and the new 2018

projects. Absent a showing of this, MDU has not met its burden that the costs are justified or based on anything.

[¶34] In sum, the SSIP plan has been a moving target; the current plan was not even created until March 19, 2018; and the plan has no end date (MDU-3, PCD-2). Yet, the cost MDU seeks to recover for the 2018 projects has not changed since the application even though the projects have changed. When questioned about the projects at the hearing, Mr. Darras indicated part of the replacement projects is identifying what is in the ground. In addition, the plan itself calls for a study, yet MDU is seeking to recover the costs of the 2018 projects without even performing the study. As Mr. Darras testified:

> Q. Okay. And on page 9 of PCD-2[], at least for the early vintage plastic pipe replacement, it indicates that a study will be performed on the projects; is that correct?
>
> A. That's correct.
>
> Q. Has there been a study performed on the projects proposed for 2018?
>
> A. Has it been performed? No, it has not. It's in the works.
>
> Q. Okay. But you've already signed the contracts, you've already agreed to go forward with them, but you haven't performed the study that's identified in the plan?
>
> A. Correct. The study itself, I would say, is even fluid based on information that we're getting back.

Hearing Tr. at p. 175:10-25.

[¶35] Staff asserts that if Montana Dakota does not know what is in the ground, the just and reasonable approach is to figure that out first before engaging in wholesale replacement. For all we know, MDU is in the process of replacing pipe that could

function properly and safely for many more years, and it is asking customers to pay for that replacement. Staff further asserts that if the projects change, it is unlikely that the cost of the projects remains the same. This is not a just, reasonable, or prudent approach.

4. Inflation

[¶36] MDU also seeks to include an inflation adjustment of 2.2% on various O & M expenses. MDU justifies this by arguing an inflation factor has always been granted and the rate case is based on a test year. As the proceedings developed in this case, the Commission will see that Staff has agreed to certain increases in expenses that are known and measurable. MDU's requested inflation adjustment is based on a 2018 test year. At the time of the hearing, it was already five months into 2018. MDU did not identify even a single instance of an actual cost increase or a general cost increase into 2018 that supported an across the board 2.2% inflation adjustment. Merely because a future test year is allowed, does not mean actual known and measurable expenses, or the lack of them, can just be ignored. This is supported by the North Dakota Supreme Court's discussion in Montana-Dakota Utilities Co. v. Public Service Comm'n, 413 N.W.2d at 314-15.

[¶37] In support of its position, MDU cites South Dakota Pub. Utils. Comm'n v. Otter Tail Power Co., 291 N.W.2d 291 (S.D. 1980). In that case, the South Dakota Supreme Court evaluated a similar inflation methodology by Otter Tail Power as MDU is seeking in this case. The South Dakota Supreme Court held:

> While it is not clear that OTP would experience an inflation rate comparable to fluctuations in the Wholesale Price Index, we agree with the trial court that to disallow any inflation adjustment is unrealistic and unwarranted. Proving an adjustment for inflation as to operating costs is at best elusive, complicated and fraught with uncertainty.

> The PUC acknowledges that OTP will sustain increased operating costs due to inflation. We agree with the trial court that in the absence of any guidelines set forth by the PUC for the development of an inflation adjustment by investor-owned utilities, or to adopt an inflation adjustment on its own, it appears that a failure to recognize these increased costs, as presented by OTP, was an arbitrary decision. There are likely more accurate methods of proof; the trial court was correct in vacating the disallowance and remanding the issue to the PUC to determine a reasonable inflation adjust procedure and allowance.

291 N.W.2d at 296.

[¶38] As recognized by the South Dakota Supreme Court, inflation is a difficult item to predict. However, even where a test year is used, it is appropriate to consider what becomes known and measurable. MDU has failed to establish that it has actually experienced any such cost increases that nearly correlate with the requested inflation adjustment. For instance, one of the items that MDU seeks a 2.2% inflation adjustment is for building rental. Yet, it has not provided any lease or other document showing rent will increase. It is unclear to Staff how building rental would be subject to an inflation adjustment as these would be terms covered by a lease or other agreement that should show what, if any, increases will occur. This same analysis would apply to many of the items MDU is seeking to increase by a straight 2.2% across the board. As Mr. Mugrace explained, a more appropriate method to address inflation would be to evaluate the trends, rather than apply an across the board inflation adjustment that is not warranted and will not likely be realized, yet ratepayers will have to pay.

[¶39] While an inflation adjustment may be appropriate, it is not appropriate to use what has been recognized as an inadequate method of proof when known and measurable information should be or becomes available. Staff requests MDU's requested inflation adjustment be denied.

5. Vehicles

[¶40] Based on the testimony at hearing and MDU's brief, it appears the remaining disputed item related to vehicles is an adjustment to depreciation expense in the amount of $38,488. While MDU does not disagree with Mr. Mugrace's testimony (or the results of it anyway) with respect to the other reductions for vehicles and work equipment, Mr. Jacobson testified the depreciation expense included on the Company's income statement did not include the depreciation expense associated with vehicles and work, and therefore, Mr. Mugrace's reduction of $38,488 was improper. As Mr. Mugrace indicated, he could not determine what Mr. Jacobson's alleged error was. Mr. Mugrace offered to consider the alleged error if it was shown to him. However, MDU does not indicate how Mr. Mugrace made any error, and therefore, Staff requests the Commission adopt Mr. Mugrace's reduction for vehicle and work equipment.

6. Private Aircraft

[¶41] With respect to the private aircraft, there are two different issues – rate base issues and expense issues. For the expenses, Mr. Mugrace removed $446,796 for the expenses related to the aircraft and other expenses in the amount of $169,840. PSC-24 at pp. 47-49. For the rate base issues, Mr. Mugrace removed the allocated costs related to aircraft equipment in the amount of $786,586. Id. at p. 56. MDU asserted the aircraft is used when multiple employees are traveling to one location thus reducing the number of commercial fares. It asserted this reduced lodging costs, meal costs, and time traveling. Id. at 61. Mr. Mugrace recommended removal of these amounts because they are more expensive than commercial flights.

[¶42] In response to Mr. Mugrace's testimony, MDU contended he did not consider that Montana Dakota is a part of a publicly traded company, with aircraft supporting associated functions, including debt and equity analyst meetings and board of director meetings. MDU-5 at p. 11. MDU also complained that there should be an offset for what commercial air travel would have cost. Id. MDU further asserted some of the reductions were duplicative because they were already removed by Mr. Mugrace in dealing with other areas, such as incentive compensation. Id.

[¶43] In response, Mr. Mugrace indicated the company has not provided any information related to the breakdown of costs related to the aircraft expenses or as related to the use of the aircraft. PSC-25 at p. 10. He also asserted the company had not explained how the use of the aircraft benefits ratepayers. Id. He concluded, "[u]ntil such time as the Company can provide this information, my recommendation to remove $446,796 related to aircraft costs remain the same. This also holds true to my removal of aircraft revenues of $462,280." Id. His response related to the expenses was similar. Id. at pp. 10-11.

[¶44] At the hearing, MDU came up with new reasons why it claimed the aircraft expenses and rate base items should remain. Ms. Kivisto testified it was used to fly people to staff the customer service center. Further, at the tail end of the hearing, MDU offered five aircraft travel request forms. MDU-17. These forms certainly do not cover all of the air travel as the amounts of them are much less than claimed by MDU. Further, this was the first time any of this information was referenced by MDU even though Mr. Mugrace's direct testimony was filed in December 2017. MDU has failed to support its claim for aircraft expenses and inclusion of any aircraft in rate base.

[¶45] The justifications for use of the aircraft have been shifting. In its testimony, MDU claimed the aircraft was used for debt and equity meetings. At the hearing, MDU testified it was used to fly staff to the customer service centers. Further, despite the fact that this issue was challenged, the forms for the flights were not provided until rebuttal when all other experts had already testified. Even then, only a select few forms were provided. MDU should not be allowed to pick and choose a few of the forms and use those to justify complete inclusion of its private aircraft expenses in rate base and full recovery of the expenses. It appears the information exists, but only a select few forms were provided for the Commission's review. Further, the stated use of the aircraft in the pre-filed testimony is not related to services to provide natural gas distribution to customers. Overall, the use of the private aircraft and inclusion of it in rate base and expenses for O & M has not been supported, and should be denied. Similar to the Casco Bay analysis described above, customers should not have to pay for MDU's choice to use private aircraft for its employees' convenience when it has not been shown whether that choice is economical or necessary to provide natural gas distribution services.

7. Employee Housing

[¶46] If there is one item that summarizes the overreaching in this case, MDU's request related to employee housing is it. Before its last rate natural gas rate case, MDU bought certain employee housing units in response to housing issues associated with the Bakken oil boom. PSC-46; *Hearing Tr.* at 269:5-8. In its last rate natural gas rate case, MDU did not include these costs, which should itself exclude them at this time. Ultimately, MDU sold the housing units for a significant loss following its last rate case. *Hearing Tr.* at 269:20-270:1. At that time, it decided to attempt to recover the loss from

its ratepayers. MDU then also included a gain on the sale of an office building in Watford City. Mr. Jacobson testified this gain would not normally be included for the ratepayers' benefit. Yet, in this case, MDU included the gain. The reason is obvious. The gain was much less than the loss on housing, which MDU wanted to recover from ratepayers. MDU asserts this approach was approved by the Commission in its recent electric case (PU-16-666). However, as can be seen in Exhibit PSC-47, there is nowhere in the Commission's order or the settlement agreement that approved MDU's treatment of the housing expense.

[¶47] The evidence reflects these losses would not normally pass to ratepayers, MDU did not include the expense in its last rate case even though the purchase of the housing units had already been incurred, and only decided to include the expense when significant losses were incurred. As Mr. Mugrace testified, this is an out-of-period adjustment. Staff requests the housing unit loss be disallowed as it is not just and reasonable. Further, bad faith is evident as well given the history for these units as it is clear if they would have been sold for a gain, these issues would have never been brought to the Commission's attention. Even if the housing is allowed, the housing should not be included in rate base (where the company will earn a return) because the housing is no longer used and useful.

8. Advertising/Dues

[¶48] Section 69-09-01-29, N.D. Admin. Code, discusses what types of advertising expenses can be recovered for ratemaking purposes. "[I]nstitutional, promotional, or political advertising shall be excluded from operating expenses in the cost of service determination for ratemaking purposes." N.D. Admin. Code § 69-09-01-

02(2). Subsection (1), N.D. Admin. Code § 69-09-01-29 defines institutional, political, and promotional advertising. The rule demonstrates that advertising expense to preserve or present the corporations' image, to influence public opinion for legislation or electoral matters, or to encourage selecting the services of the utility is not recoverable. Other advertising "may be included as operating expenses in the cost of service determination for ratemaking purposes" if the expenditures are "reasonable." Id. at (3). Staff recommends removing at least $67,051 (half of the requested amount) from advertising expenses as testified to by Mr. Mugrace.

[¶49] The advertising expenses are detailed in MDU-1 (Workpapers pages 126 through 136). MDU argues that Mr. Jacobson explained the company was not seeking any expenses for charitable donations or gifts. MDU Br. at p. 27. However, this does not address the issue because MDU's workpapers identify numerous advertising expenses that are institutional or promotional in nature regardless of whether they are charitable donations or gifts. In fact, almost all of the advertising expenses in the workpapers are excludable as institutional or promotional advertising. *Hearing Tr.* at 271:14-23 (Mr. Jacobson agreeing the advertising expenses were necessary to retain a strong community focus and attract business). In the workpapers, the following advertising expenses appear to be recoverable:

- P. 126 - $17,013.59 – Call Before You Dig
- P. 130 - $33,457.60 – Louie & Sniffy Safety
- P. 132 - $3,110.40 – Call Before You Dig.

All other advertising expenses appear to fall under institutional or promotional advertising (or are otherwise unexplained) which is not recoverable per N.D. Admin. Code § 69-09-01-29.

[¶50] The same analysis should apply to the Company's request to recover certain dues. The ratepayers should not be responsible for dues paid by MDU that do not relate to ratepayers and only seek to promote MDU. Mr. Mugrace recommended reducing dues by $6,844 but recommended adding back in $160 for the Cavalier Chamber of Commerce. In actuality, the amount probably should have been more. MDU's dues expenses are included in the workpapers at pages 137-145, and appear to indicate dues primarily for promotional or institutional purposes rather than for entities related to providing natural gas distribution services. Staff requests the Commission reduce MDU's dues expenses by at least $6,844.

9. Non-Plant EDIT Amortization

[¶51] Another disagreement between Staff and MDU is how the company is proposing to account for non-plant excess deferred income tax (Non-plant EDIT). Staff requests the amortization be three years instead of the proposed ten years by MDU. PSC-25 at pp. 15-16. A shorter amortization period will allow a reasonable recovery while normalizing the level between rate case proceedings. Id. at 16. Allowing the company to recover a return over ten years is excessive and unnecessary. Staff requests the Commission require the non-plant EDIT to be amortized over three years.

C. Staff's Other Recommendations Should be Accepted.

[¶52] In addition to the items above, Staff requests the Commission include the changes addressed in Sara Cardwell's and Victor Schock's respective testimony

regarding tariff language and compliance. From the pre-filed testimony, it appears only two of the issues are disputed by MDU: (1) the returned check charge and (2) the Company's request to change its monthly gas adjustment unless the change is at least 25 cents.

[¶53] With respect to the returned check charge, as the Commission heard at the hearing, the request to increase the charge from $15 to $40 is not cost based. Rather, MDU seeks to penalize a person in hopes of it acting as a deterrent. No evidence was presented that such an increase is likely to be effective as a deterrent, and regardless, the fact that the proposed charge is not cost based would make it inconsistent with ratemaking principles. Further, issuing a bad check is a crime, and any penalty should be left to the proper authorities rather than MDU. See N.D.C.C. § 6-08-16. Staff requests MDU's request to increase its bad check charge be denied.

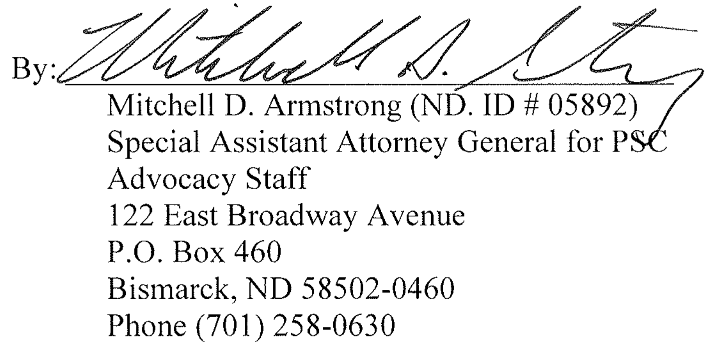
[¶54] Staff also requests MDU's proposal to not have to change its monthly gas adjustment unless the change is at least 25 cents be rejected. First, in order to determine if the adjustment is triggered, MDU necessarily has to perform the work to determine the amount. Therefore, the only remaining issue is going through the process of the true-up. As Ms. Cardwell/Mr. Schock testified, there have been significant true-ups over the years and increasing the trigger could cause significant increases in the Company's annual true-up to customers. Keeping the trigger at ten cents keeps customer rates more accurate, and therefore, Staff requests this proposal be denied.

[¶55] Staff requests the Commission adopt the agreed upon changes as shown in the proposed findings filed herewith.

IV. CONCLUSION

[¶56] For the foregoing reasons, Advocacy Staff requests the Commission enter an order consistent with the above and *Advocacy Staff's Proposed Findings of Fact, Conclusions of Law, and Order* filed herewith.

Dated this 19th day of July, 2018.

By: 

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