

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 PROPOSED FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER**

_____, 2018

Appearances

Commissioners Randy Christmann, Julie Fedorchak, and Brian Kroshus.

Paul R. Sanderson, Evenson Sanderson, PC, 1100 College Dr., Suite 5, Bismarck, ND, 58501, as Counsel for Montana-Dakota Utilities Co.

Mitchell D. Armstrong, Special Assistant Attorney General, 122 East Broadway Avenue, Bismarck, North Dakota 58502, and John M. Schuh, Special Assistant Attorney General, 600 East Boulevard Ave., Dept. 408, Bismarck, ND 58505-0480, as Counsel for the Public Service Commission.

Andrew J. Unsicker, Maj, USAF, AFLOA/JACE-ULFSC, 139 Barnes Drive, Suite 1, Tyndall Air Force Base, FL 32403, as Counsel for the Federal Executive Agencies.

John B. Coffman, John B. Coffman, LLC, 871 Tuxedo Blvd., St. Louis, MO 63119-2044, as Counsel for AARP.

Patrick J. Ward, Office of Administrative Hearings, 2911 North 14th Street, Suite 303, Bismarck, ND 58503, as Procedural Hearing Officer.

Preliminary Statement

On July 21, 2017, Montana-Dakota Utilities Co., a Division of MDU Resources Group, Inc. (MDU) filed an application to increase rates for natural gas service to provide additional annual revenue of \$5.9 million or a 5.4% increase in 2018 test year annual revenue at current rates.

On September 6, 2017, the Commission approved MDU's request for an interim rate increase of \$4.6 million, 4.2% over current rates, which became effective for service

on and after September 19, 2017. MDU must refund interim rate amounts in excess of final rates approved by the Commission, including interest.

By Notice issued September 22, 2017, the Commissioner scheduled a formal hearing to begin February 28, 2018.

On January 16, 2018, MDU filed a Motion for Continuance asking the Commission to continue the hearing to permit investigation of the impact of the 2017 federal tax changes on this proceeding.

Also on January 16, 2018, Commission Advocacy Staff (Staff) filed a response to MDU's motion, agreeing with and joining the motion, and asking that the rate suspension under N.D.C.C. § 49-05-06 be extended to August 31, 2018.

On February 14, 2018, the Commission issued a Notice of Continued Public Hearing. The Commission agreed to continue the February 28, 2018, hearing to May 30, 2018 and extended the rate suspension to August 31, 2018. The Notice identified the following issues for hearing:

1. What rates and charges are necessary to provide a just and reasonable rate of return on MDU's property, used and useful, for the service and convenience of the public in North Dakota?
2. Are MDU's proposed rate schedules designed in such a manner that they result in a basis of charge to its customers that is just and reasonable without discrimination?

On February 27, 2018, the Commission granted MDU's petition to reduce interim rates to conform to the federal Tax Cut & Jobs Act. The interim increase in annual revenue was reduced to \$2.7 million.

On May 30-June 1, 2018, the hearing was held as scheduled.

Having allowed all interested persons an opportunity to be heard and having heard, reviewed, and considered all testimony and evidence presented, the Commission makes the following findings of fact:

Findings of Fact

1. Montana-Dakota Utilities Co. is a division of MDU Resources Group, Inc. currently registered with the North Dakota Secretary of State and authorized to do business in North Dakota as a foreign corporation. MDU is doing business in North Dakota as a public utility company.

2. MDU provides natural gas distribution service in four states, including North Dakota, Montana, South Dakota, and Wyoming. MDU's parent company is MDU Resources Group, Inc., which includes other utility companies in several states as well as other businesses.

3. Staff and MDU dispute the following issues:

- Implementation of the System Safety and Integrity Program (SSIP) mechanism for payment of SSIP projects;
- Revenue Requirement Items:
 - o Incentive Compensation
 - o Return on Equity
 - o Recovery for 2018 SSIP Projects
 - o Inflation
 - o Vehicles and Work Equipment
 - o Private Aircraft
 - o Employee Housing
 - o Advertising and Dues
 - o Amortization of Non-Plant Excess Deferred Income Taxes (EDIT)
- Miscellaneous Changes to Current Rates:
 - o Insufficient Funds Charge
 - o Adjustment to the Monthly Gas Adjustment

SSIP ADJUSTMENT MECHANISM

4. MDU requests the implementation/approval of its SSIP, which includes a mechanism for annual recovery of costs for replacement and repair projects related to certain Early Vintage Steel Pipe and Early Vintage Plastic Pipe. The mechanism for recovery (Rate 94) was attached to the Direct Testimony of Stephanie Bosch included in Exhibit MDU-1, and outlines the requested parameters for the recovery mechanism. At the hearing, MDU indicated it would be willing to include various other conditions on the mechanism as ordered by the Commission.

5. Staff and AARP oppose the requested mechanism, regardless of any conditions. Staff asserts MDU has and is obligated to provide a safe system regardless of the recovery mechanism. Further, Staff asserts there has been no showing the SSIP mechanism will result in increased safety. Rather, Staff asserts the mechanism will only allow MDU quicker recovery from ratepayers and will shift investment risk to ratepayers. Staff further asserts that replacement of the system in order to learn what is in the system is inefficient. Instead, Staff argues MDU should learn its system better in order to determine and evaluate what replacement projects are reasonable and prudent, and should recover those through traditional ratemaking procedures.

6. The Commission finds the requested SSIP mechanism has not been shown to be just and reasonable. MDU has, and is required by law to, operate a safe and reliable system. Implementing a mechanism of this type without first knowing whether and to what extent the potential problems exist on the system is premature. Rather, MDU should learn its system and determine if the EVSP and EVPP on its system actually has the issues it claims are safety concerns. Further, replacing the system without first learning what is on the system is imprudent. MDU regularly appears before the Commission requesting rate increases, and this traditional ratemaking process provides for a full review of MDU's rates, including the inter-relatedness of rate issues. Allowing MDU to recover costs through this mechanism based on a significantly fluid "plan" would result in single issue ratemaking that will increase ratepayers' costs every year without as much investigation and review as a traditional rate case. Further, there has been no showing that there is an actual safety risk with MDU's system as it relates to EVSP or EVPP. As a result, we find that such a departure from the traditional ratemaking process to allow for recovery of these projects between rate cases through the SSIP mechanism is unwarranted.

REVENUE REQUIREMENT ITEMS

7. After revision due to the passage of the Tax Cuts & Jobs Act, MDU is seeking additional annual revenue of \$3,575,388, which constitutes a 3.3% increase over current rates. Staff asserts an increase is warranted in the amount of \$867,496. There were some minor adjustments by the parties during the hearing, which altered these number.

1. Incentive Compensation

8. MDU seeks full recovery of incentive compensation from ratepayers. Staff asserts ratepayers should be responsible for 40% of incentive compensation. MDU's incentive compensation program is part of its overall Total Rewards package. Incentive compensation accounts for approximately six percent of total compensation. Base compensation is paid for entirely by ratepayers. There are essentially two different incentive compensation programs—one for executives and one for all other employees. For the executives, the incentive compensation is based on earnings and return on invested capital. For the other employees, the incentives are based on customer satisfaction and O & M expense goals.

9. The executive incentives wholly benefit the shareholders by increasing earnings and return. The ratepayers should not have to pay incentive compensation based on incentives that wholly benefit the shareholders. The other employee incentives benefit both the shareholders and the ratepayers. Requiring ratepayers to pay for incentive compensation that is designed to benefit shareholders is not just and reasonable. We find that Staff's recommendation of a 60/40 split between the shareholders and ratepayers for incentive compensation is just and reasonable and more

closely aligns with the reality of the incentives upon which the incentive compensation is based.

2. Return on Equity/Rate of Return

10. MDU seeks a return on equity (ROE) of 10 percent resulting with an overall rate of return of 7.542 percent. Staff asserts a reasonable ROE is between 9.23 and 9.5 percent, resulting in a corresponding overall rate of return between 7.15 and 7.29 percent.

11. The primary areas of disagreement between the parties regarding ROE were whether a small size adjustment should be used, application of a flotation cost factor, and whether a gas utility risk premium should be applied. We find a small size adjustment is not appropriate in MDU's circumstance. MDU's credit rating is that of its parent company, MDU Resources Group, Inc. The evidence reflects the utility division does not bring the parent company's credit rating down. Further, by being part of the parent company, MDU is able to share various employees, technologies, and other functions. For purposes of market factors affecting an appropriate ROE, MDU cannot be separated from its parent company.

12. We also find that a flotation cost factor is appropriate. However, we are convinced Dr. Griffing's application of the flotation cost factor is more appropriate than Dr. Gaske's for the reasons explained by Dr. Griffing at the hearing.

13. We also find it is not appropriate to apply a gas utility risk premium as testified to by Dr. Gaske based on its subjective application, as well as its failure to account for the broader association of MDU with its parent company.

14. We find that a ROE of 9.23 percent is appropriate in this case with a corresponding overall rate of return of 7.15 percent. This will assure confidence in the financial soundness of MDU and should be adequate under efficient and economical management, for MDU to support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

3. 2018 SSIP Replacement Projects

15. As part of its application, MDU requested recovery for certain projects it anticipated in its 2018 test year. These projects were part of its SSIP, and 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 estimated to be \$5,553,154. By the time of the hearing, the projects were 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. The estimated cost of the projects remained \$5,553,154.

16. There has been no explanation how the proposed costs of the projects remain the same even though the projects have changed. Further, the prudence of the projects has not been demonstrated as MDU has not sought to identify whether the projects actually need replacement, but rather is replacing and repairing the projects in order to determine whether they needed replacement or repair. The evidence shows there are more prudent measures to evaluate and learn what is on MDU's system instead of wholesale replacement and repair. MDU has failed to prove that assessing these costs to customers is just and reasonable.

4. Inflation

17. MDU seeks to include an inflation adjustment of 2.2% on various O & M expenses. MDU based its 2.2% inflation adjustment based on six published sources. Staff seeks a disallowance of this inflation adjustment. Staff seeks to exclude \$166,188, which includes subcontract labor (\$37,569), materials (\$33,623), building rental (\$21,057), software maintenance (\$10,835), and all other miscellaneous O & M (\$63,104).

18. MDU has not established an inflation adjustment is appropriate. The hearing in this case occurred after five months of 2018 had passed. There was no evidence that the areas for which an inflation adjustment is sought have actually resulted in a cost increase. While MDU is allowed to use a test year, there should have been some evidence that this requested adjustment was being realized given nearly half the future test year had already passed at the time of the hearing. Further, the items such as building rental appear to be items in which any cost increases would be reflecting in agreements or leases or where inflation pursuant to the published sources would not apply.

19. Applying an across the board inflation adjustment where there are better methods of establishing any cost increases with more accuracy is not just and reasonable. From the evidence, we are convinced that if the cost were actually being incurred, or were greater than 2.2%, MDU would have presented such evidence. It is not just and reasonable to ask ratepayers to be responsible for the requested inflation adjustment sought by MDU.

5. Vehicles and Work Equipment

20. The disagreements between Staff and MDU relating to vehicles and work equipment have mostly been resolved based on the evidence. Staff and MDU now agree, and the evidence supports, that the appropriate reduction to capital additions in the amount of \$1,304,151 that would result in a rate base reduction of \$652,076. Further, while there was some disagreement about the method used, the parties agreed, and the evidence supported, a reduction to vehicles and work equipment expense as a component of O & M in the amount of \$24,041.

21. One adjustment remains disputed, and that is a reduction to depreciation expense in the amount of \$38,488. MDU contends this reduction should not be adopted because the depreciation expense on its income statement did not include the depreciation expense associated with vehicles and work equipment. Mr. Mugrace indicated he believe he appropriately applied the reduction, but would consider any information MDU could provide to show it was an error. No information has been provided to establish an error in Mr. Mugrace's reduction. Therefore, the Commission finds the depreciation expense was appropriately reduced by \$38,488 as testified by Mr. Mugrace.

6. Private Aircraft

22. MDU seeks to include in its rate base and expenses items related to the use of its corporate aircraft. Staff requested removal of \$446,796 for the expenses related to the aircraft and other expenses in the amount of \$169,840. For the rate base, Staff requested removal of \$786,586.

23. MDU has not shown that it is just and reasonable to recover the aircraft expenses from ratepayers, or that its aircraft should be included in rate base. There has been no showing that the aircraft is economical or necessary to provide natural gas distribution services. Rather, the evidence indicates the aircraft is used for the convenience of MDU, by its choice. It is not just and reasonable for ratepayers to be responsible to pay for items used for the convenience of MDU when those items are not economical.

7. Employee Housing

24. MDU seeks to include \$774,487 (annual amortization of \$39,717) in rate base for losses incurred on the sale of employee housing. Staff seeks disallowance of this entire amount.

25. Prior to its last natural gas rate case in 2015, MDU purchased certain housing units as a result of a housing shortage associated with the Bakken oil boom. MDU did not include those housing units in rate base during its last rate case. MDU then sold the housing units for a significant loss, \$774,487 of which is what it seeks to include in rate base in this case.

26. The evidence reflects MDU is including these items in rate base in bad faith, and recovery is otherwise not just and reasonable. Although the units were purchased prior to the last rate case, MDU did not include them in rate base at that time. It was only after it incurred a significant loss on the sale of these units that it attempted to include them in its rate base. Further, its attempt to include them in rate base at this time is not just and reasonable as the housing units are no longer used and useful. The Commission disallows MDU's request to include this loss on employee housing in rate base.

8. Advertising/Dues

27. MDU seeks to recover certain expenses for advertising and dues expenses from ratepayers. Staff's testimony requested a reduction in the advertising expense by 50% and \$6,844 removed from dues.

28. MDU's workpapers (pp. 126 through 137) and testimony reflect that much of the advertising is institutional or promotional advertising, which must be excluded from operating expenses for ratemaking purposes. In reviewing the workpapers, it appears \$53,581.59 of advertising related to safety issues (Call Before You Dig and Louie & Sniffy Safety). These advertising expenses are not excluded. However, the remaining advertising expenses are coded as institutional or promotional advertising (or otherwise not explained). Accordingly, we find that advertising expenses in the amount of \$53,581.59 may be included as operating expenses in this case.

29. Similarly, the dues sought to be recovered by MDU appear to be related primarily to institutional or promotional dues. Staff has recommended removal of \$6,844, but agreed \$160 for the Cavalier Chamber of Commerce should be allowed instead of removed, resulting in removal of \$6,684. The Commission finds the dues removed by Staff are appropriately removed as they relate to items not necessary for provision of natural gas distribution services. It is not just and reasonable for customers to pay dues that are intended to preserve or promote MDU's corporate image or to encourage selection of its services.

9. Non-Plant EDIT Amortization

30. MDU proposes to amortize its non-plant EDIT over ten years. Staff requests the amortization period be three years. The Commission finds amortization of non-plant EDIT over three years is just and reasonable. This will allow MDU a reasonable recovery while normalizing the level between rate case proceedings. Allowing amortization over ten years will unjustly and unreasonably allow a greater recovery over a longer period, resulting in an unjust and unreasonable return.

MISCELLANEOUS ITEMS

31. In the testimony of Victor Schock and Sara Cardwell, they recommended various changes to proposed tariff language and compliance. MDU agreed with those changes and the Commission finds they are supported. We find the agreed upon changes are appropriate. Those changes are:

- Rate 74 paragraphs 2 and 3 under Metering Requirements;
- Rate 100 Section III paragraph 4 - Access to Customer's Premises;
- Rate 100 Section IV paragraph 2 - Customer's Equipment;
- Rate 100 Section V paragraph 10(c) and (d) - Billing Adjustments; and

- Rate 100 General Provisions page 15 – remove “and materials at retail prices.”

However, there were two areas of disagreement.

32. MDU requested a returned check charge in the amount of \$40, which is an increase from \$15. MDU attempts to support this increase as a deterrent. The Commission finds a returned check charge in the amount of \$40 is not just and reasonable. There has been no evidence presented that the increased charge will actually act as a deterrent, and the Commission finds the unlawfulness of issuing a check with insufficient funds should be deterrent enough. Further, the returned check charge is not supported by any additional cost to MDU, and therefore, is not allowed.

33. MDU also proposed to not have to change its monthly gas adjustment unless the change is at least 25 cents, instead of 10 cents. We find the calculation has to be performed regardless of the threshold amount and leaving the threshold at 10 cents keeps customer rates more accurate.

From the foregoing Findings of Fact the Commission makes the following conclusions of law:

Conclusions of Law

1. The Commission has jurisdiction over this proceeding.
2. MDU has the burden to establish that an increased rate or proposed change of rate is just and reasonable and not in violation of any of the provisions of N.D.C.C. title 49.
3. An investor-owned utility is entitled to earnings sufficient to pay its expenses and provide a fair and reasonable return to its investors.
4. To establish the just and reasonable rate of a public utility, the Commission is required to determine the value of the property of a public utility used and useful for the service and convenience of the North Dakota public.
5. “Used and useful” requires North Dakota ratepayers to have received a tangible and quantifiable benefit.
6. It is not just and reasonable for ratepayers to pay for expenses that primarily benefit an electric utility’s shareholders.
7. The Commission concludes MDU’s request to implement Rate 94, the SSIP Adjustment Mechanism, is not just and reasonable.

8. The Commission concludes the revenue requirement recommended by Staff is just and reasonable.

9. The Commission concludes MDU's request to increase its returned check charge to \$40 is not just and reasonable.

10. The Commission concludes it is just and reasonable to continue to have a ten-cent threshold to change its monthly gas adjustment.

From the Findings of Fact and Conclusions of Law, the Commission makes the following order:

Order

The Commission orders:

1. MDU's request to implement Rate 94, the SSIP Adjustment Mechanism, is denied.

2. MDU may implement a rate increase for service rendered sufficient to produce a total annual revenue increase of an amount of \$867,496 plus any adjustments acknowledged by Mr. Mugrace's testimony. MDU must submit detailed compliance filings reflecting the removal of the revenue requirement items identified above and incorporating the agreed upon adjustments.

3. MDU's returned check charge shall remain \$15.

4. MDU shall continue to use a ten-cent threshold for its monthly gas adjustment.

5. MDU shall file revised tariff sheets for the Commission's approval consistent with the foregoing findings of fact and conclusions of law.

PUBLIC SERVICE COMMISSION

Brian Kroshus
Commissioner

Randy Christmann
Chairman

Julie Fedorchak
Commissioner