

**STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION**

Public Service Commission)
Montana-Dakota Utilities Co.)
2017 Natural Gas Rate Increase)
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Case No. PU-17-295

MONTANA-DAKOTA UTILITIES CO.'S POST-HEARING REPLY BRIEF

Montana-Dakota Utilities Co. ("MDU") submits the following Post-Hearing Reply Brief in support of its Application for a natural gas rate increase.

Following filing of its Post-Hearing Brief on June 22, 2018, MDU reached a Settlement Agreement with the North Dakota Advocacy Staff ("Advocacy Staff") and Intervenor Federal Executive Agencies ("FEA") referred to collectively as the "Settling Parties". See Docket # 188. The Settlement Agreement resolved all outstanding expense, revenue, rate base, return, and rate design issues in this case between MDU, Advocacy Staff, and FEA. The Settlement Agreement results in an annual revenue increase of \$2.5 million, representing an overall increase in rates of 2.30%. The parties to the settlement agreed upon a return on equity of 9.40 percent, which results in an overall rate of return of 7.236 percent. The Settling Parties agreed that all revenue increases for the residential customers will be collected through an increase to the fixed basic service charge, which amounts to a charge of \$0.6860 per day or \$20.87 per month. MDU requests the Commission adopt the Settlement Agreement in its entirety. MDU believes the Settlement Agreement will result in just and reasonable rates for the Company's gas service in North Dakota.

The settling parties did not reach an agreement on MDU's proposed System Safety and Integrity Program ("SSIP") cost recovery mechanism and agreed that the issue will be decided by the Commission in this case.

Intervenor AARP did not join in the Settlement Agreement due to its ongoing objection to MDU's use of a fixed basic service charge to recover all non-gas costs assigned to the residential class.

MDU's Reply Brief will address the remaining issues unresolved by the Settlement Agreement regarding adoption of the SSIP recovery mechanism and the fixed basic service charge. In the event the Commission declines to adopt the Settlement Agreement, MDU's Reply Brief also addresses issues raised by Advocacy Staff in its Brief regarding the revenue requirement. Concurrent with this Brief, MDU is filing two separate proposed Findings of Fact, Conclusions of Law, and Orders; one assuming the Commission adopts the Settlement Agreement and the other assuming the Commission rejects the Settlement Agreement.

I. MDU urges the Commission to adopt its proposed System Safety and Integrity Program recovery mechanism, Rate 94.

MDU has implemented its SSIP as a proactive pipeline replacement program to enhance system safety and reliability of its natural gas system. As part of its SSIP, MDU has identified a structured replacement program for Early Vintage Steel Pipe, Early Vintage Plastic Pipe, Low Pressure Systems and the relocation of inside meters, all of which are known for higher safety risks as identified by MDU's Distribution Integrity Management Plan ("DIMP"). To fund this replacement plan, MDU is requesting the implementation of a cost recovery mechanism, Rate 94, which allows the Company to proactively address aging infrastructure while potentially avoiding costly rate cases and

providing customers with more gradual rate increases over time. MDU's SSIP would bring all the interested parties together in an effort to develop cost-efficient solutions to these very pressing public safety concerns.

Advocacy Staff and AARP oppose MDU's SSIP program and the rate recovery mechanism, preferring a more reactive approach to pipeline safety and the replacement of aging infrastructure. Specifically, Advocacy Staff's chief objection to the SSIP is that MDU failed to present sufficient evidence that their system poses an imminent threat to the public. Tr. at p. 587:4-14. Advocacy Staff's expert witness, Karl Pavlovic, testified gas pipeline should only be replaced when a leak has been discovered. MDU believes the reactive approach of waiting for a leak or a serious safety risk to the public is no longer reasonable for dealing with its aging infrastructure. MDU's proactive approach is supported by the 2013 NARUC Resolution which encouraged State Regulatory Commissions to adopt rate recovery mechanisms that encourage replacing the most vulnerable pipelines as quickly as possible. See Ex. MDU-11. The NARUC Resolution recognized that companies need to be proactive in "replacing their aging pipelines through a risk-based approach focusing on prioritizing safety, asset replacement, and rate impact." Id.

One of the stated reasons for Advocacy Staff's opposition is its baseless argument that the scrutiny of the proposed SSIP projects will not be the same as that in a full rate case. See Advocacy Staff's Brief, at ¶ 9. Contrary to Advocacy Staff's assertion, there will be more scrutiny of the proposed SSIP projects than the scrutiny given to the Company's replacement projects in past rate cases. Advocacy Staff, AARP, and any other potential intervenors would have the right to be party to MDU's SSIP cases. MDU

witnesses testified they are not opposed to the imposition of filing fees under Rate 94, similar to electric rider cases, which would allow Advocacy Staff to retain experts to analyze the SSIP projects. The SSIP projects will be the sole issue in the filing, unlike in a typical rate case where there are numerous issues in dispute between the parties. Moreover, no rate recovery would occur until the projects are approved by the Commission. There is simply no factual basis for the assertion MDU's proposed SSIP projects will receive less scrutiny than a full rate case.

Advocacy Staff's opposition to the SSIP program is surprising considering its expert witness, Karl Pavlovic, testified he supported an accelerated recovery mechanism. Tr. at p. 576:14-17. Pavlovic testified there are two main purposes for the accelerated infrastructure replacement programs: 1) safety and reliability concerns; and 2) to accelerate infrastructure replacement cost recovery outside of a full rate case. Tr. at p. 573:14 – 574:4. Pavlovic stated that every accelerated infrastructure replacement program has an accelerated rate recovery mechanism. Tr. at p. 583:13-23. Pavlovic further testified that the Commission's adoption of MDU's SSIP program would accomplish the primary purpose of accelerating replacement of targeted infrastructure for safety and reliability purposes. Tr. at p. 574:5-10. In response to a question from Commissioner Christmann, Pavlovic expressly stated, "If you think that it's justified for [MDU] to undertake a replacement program, then this is a good way -- this is a good way to implement it through a recovery mechanism." Tr. at p. 595:6-14.

Pavlovic explained that under the right circumstances accelerated recovery mechanisms are appropriate and "can be very easily made acceptable". Tr. at p. 576:18-

23; Tr. at p. 582:11-17. Specifically, Pavlovic stated an acceptable accelerated recovery mechanism should have the following requirements:

- The company makes a filing with the Commission identifying the projects to be included for the next year;
- The company identifies the proposed costs of the projects;
- The company identifies the revenue requirement for the projects;
- The company makes a true-up filing demonstrating actual costs of the projects;
- There should be a cap on costs of projects under the program;
- There should be a requirement that after a certain period the investment should be taken out of the tracker and put into base rates; and
- A filing fee should be included to assist staff to determine the prudence of the projects.

Tr. at p. 578:12 – 579:16; p. 596:1-8. Pavlovic noted that Massachusetts, Maryland, and New Jersey have rate recovery mechanisms that contain the appropriate consumer-protection requirements. Tr. at p. 581:8-18.

AARP also opposes MDU's SSIP recovery mechanism calling it an anti-consumer surcharge and arguing it contains no consumer protections. AARP attempts to distinguish the 39 other States that have adopted an accelerated rate recovery mechanism by arguing those States have requirements for consumer protection, such as requirements to file rate cases or annual caps on the amount of the projects. See AARP Brief, at p. 10.

Contrary to the assertions made by Advocacy Staff and AARP, MDU is agreeable to inclusion in Rate 94 of several of the consumer protection requirements identified. Rate 94 already includes a number of the necessary consumer protection requirements identified by Pavlovic, including an annual filing identifying specific projects and proposed costs, and a true-up filing demonstrating the actual costs of the project. As explained by its witnesses, MDU has no objection to the Commission including further consumer protection requirements, including filing fees to assist Advocacy Staff to evaluate the projects, project spending caps, or requirements on the period of time to file rate cases.

MDU encourages the Commission to consider inclusion of these requirements to help alleviate the concerns.

Most importantly, the customers' interests are protected under Rate 94, as MDU cannot begin to recover any revenue for the proposed SSIP projects until they are approved by the Commission. Advocacy Staff, AARP, and any other interested party will have the right to be part of their case and express any concerns to the Commission if MDU's proposed SSIP projects are imprudent.

The critical component of MDU's proposed SSIP recovery mechanism is the collaboration between the Commission, the Company, and any other interested parties to share information and research on the best practices to address public safety and replacement of the Company's aging infrastructure. MDU's proposal will create an open dialog with all interested parties before these projects even begin construction to ensure the best practices are being utilized and ensure funds spent are targeting the appropriate projects. MDU's SSIP program was created to address the growing problem of aging infrastructure replacement, while working with other interested parties to ensure all funds are spent on necessary projects in a cost-efficient manner. Contrary to Advocacy Staff and AARP's assertions, MDU's SSIP plan is a superior procedure to address the safety concerns of an aging infrastructure, while ensuring the funds for such projects are appropriate. MDU urges the adoption of Rate 94 so the parties can start working together to formulate the solution to this growing problem.

II. The residential customer rate increase should be collected through an increase to the fixed basic service charge.

MDU's Application and the Settlement Agreement propose that all revenue increases for residential customers be collected through an increase to the fixed basic

service charge. In 2015, the Commission adopted MDU's proposal to recover residential customer's non-commodity costs through a fixed monthly charge, which is currently \$0.6443 per day. The rate increase agreed to in the Settlement Agreement would amount to an increase in the residential basic service charge of just over four cents, to \$0.6860 per day (\$20.87 per month). This results in an increase of \$1.27 per month for each customer that is in service for a full year. Advocacy Staff and FEA support the revenue increase being collected through the basic service charge as part of the Settlement Agreement.

AARP opposes the allocation of residential customers' revenue increase through the basic service charge arguing it would violate the principles of fairness and efficiency. AARP erroneously argues the basic service charge violates the principle of fairness because both low-use and high-use customers pay the same fixed charge. The evidence presented at the hearing established that the costs to serve the low-usage customer and the high-usage customer is essentially the same, as the system design and investment in distribution main required to serve each residential customer along with a typical service line, meter and regulator has the same average cost. Tr. at p. 500:1-501:4. MDU's proposal to allocate the revenue increase through a fixed basic service charge complies with the principle of fairness when the costs to provide natural gas to residential customers is the same.

AARP also erroneously argues the basic service charge violates the principle of efficiency, which requires that customers who consume more should pay more. AARP's Brief fails to acknowledge that, even with the current basic service charge, the majority of a customer's gas bill is calculated based upon the volumetric charge for cost of gas.

Jordan Hatzenbuhler testified that under MDU's current rate structure, a customer with average use will see approximately 60 percent of their bill remain volumetric, thus "maintaining the incentive for the customer to conserve or to achieve efficiencies that ultimately conserve your energy and the desired price signal of use less, pay less, use more, pay more." Tr. at p. 492:6-11. With the majority of a customer's bill being a volumetric charge, residential customers still have an incentive to conserve energy consumption and lower their costs. AARP's argument that MDU's basic service charge violates the principle of efficiency is without merit.

Finally, AARP contends the existing customer charge for residential customers exceeds the customer-related unit cost of service derived in the Company's CCOSS. AARP erroneously compared the \$18.13 per month the Company's initially filed as the customer-related cost per residential customer per month to the current monthly Basic Service Charge of \$19.60 per month. A valid comparison should also include the demand-related cost to serve residential customers of approximately \$5.67 per month cost per customer. In the absence of a demand charge, this cost must be collected either through an energy charge or through the fixed charge. As is supported in the record and was discussed in-depth at the hearing, these demand-related costs are fixed in nature, are currently recovered through the fixed charge on the customer bill as authorized in Case No. PU-15-90 and proposed to be recovered in that manner in this case.

The current fixed rate system for the residential class is simple for the customers to understand, mitigates the impacts of abnormal weather, and maintains the ability of customers to save money through conservation measures. The evidence presented at the hearing supports MDU's continued use of a straight fixed variable rate design to

recover all non-gas residential customer revenues through a fixed customer charge. Accordingly, MDU respectfully requests the Commission adopt its request to maintain the current rate design for the residential customer class and to allocate any rate increase to the class through the basic service charge component of the existing rate.

III. Advocacy Staff failed to present sufficient evidence to support its assertion that MDU's revenue requirement is not just and reasonable.

MDU requests the Commission adopt the Settlement Agreement in its entirety. However, in the event the Commission does not accept the Settlement Agreement, MDU is compelled to address a number of issues raised by Advocacy Staff in its Post-Hearing Brief related to the revenue requirement.

While Advocacy Staff does not agree, the law in North Dakota regarding the burden of proof is clear, when the party with the burden of proof establishes a prima facie case, the burden of going forward with the evidence shifts to the opposing party and the party will prevail unless the opposing party offers "proof to the contrary." See e.g., Van Sickle v. Van Sickle, 2005 ND 69, ¶ 27, 694 N.W.2d 212; State v. Clayton, 2016 ND 131, ¶ 10, 881 N.W.2d 239. Advocacy Staff argues in its Brief that MDU failed to meet its prima facie burden, yet it fails to identify any specific areas in which MDU failed to present sufficient documents and testimony to meet its prima facie burden. The evidence presented by MDU in its Application, prefiled testimony, exhibits and testimony at the hearing established a prima facie case supporting its claimed revenue requirement.

On the other hand, Advocacy Staff failed to present any actual evidence supporting its claimed disallowances of MDU's revenue requirements. Advocacy Staff relies solely upon the testimony of its expert, Dante Mugrace, to support its claimed disallowances. However, arguments and baseless assertions by Mugrace do not constitute "evidence"

that this Commission should rely on to support its decision regarding MDU's revenue requirement.

Nowhere was this lack of evidence more apparent than in Mugrace's testimony regarding the disallowance of MDU's aircraft expense. Mugrace recommended the Commission disallow all of MDU's aircraft expense. During the hearing, Mugrace was asked whether he had any evidence of MDU using the aircraft imprudently:

Q. Are you aware, Mr. Mugrace, of any time where the -- where the Company's using the airplane improperly?

A. I have not noticed that.

Tr. at pg. 770:11-14. Rather, Mugrace's opinion is that MDU employees should be using busses or trains to travel to meetings because he does and it is cheap. Tr. at pg. 769:2-8. Mugrace presented no evidence establishing MDU's use of the corporate aircraft was imprudent or more costly than alternative means of travel. Mugrace's unfounded personal opinions cannot be the basis upon which this Commission decides the revenue requirement issues.

The error in Mugrace's opinions was also evident in his testimony regarding MDU's advertising expenses. Mugrace testified the Commission should disallow an arbitrary fifty percent of MDU's advertising simply because he could not understand the workpapers. Mugrace specifically testified, "I can't understand the work papers. They're confusing. . . . So barring this confusion, I'm just taking a 50-50 split and have the Company recover 50 percent of that advertising expense." Tr. at pg. 751:22-752:3. Mugrace testified the fifty percent reduction was based upon his own confusion and he did not take the time to review MDU's supporting documents or seek clarification of the advertising expense:

Q. You've identified some advertising that you agree should not be included, correct?

A. Well, it's -- there's general ledger balances, it says promotional advertising, it has explanations, some of this stuff doesn't appear to be advertising. But instead of going crazy and looking through ten documents, ten pages of documents, the only way I can estimate that it's a reasonable balance is just share it 50-50.

Q. And why do you view that as a reasonable balance?

A. Because some of this stuff, I just can't understand it. It's confusing.

Q. Did you attempt to gather information to understand it more fully?

A. At that point I did not, no. I should have.

Tr. at pg. 752:4-19; 774:16-22. The legal basis for disallowing MDU's revenue requirement cannot be because Advocacy Staff's expert does not understand the information and does not take the time to review ten pages of data or seek clarification.

Advocacy Staff is also seeking a sixty percent reduction to MDU's employee incentive compensation based upon the recommendation of Mugrace. However, when questioned regarding how he arrived at the sixty percent reduction, Mugrace confirmed he simply took the number from Advocacy Staff because it argued for a sixty percent reduction in a 2010 electric utility rate case. Tr. at pg. 757:24 – 758:9. Mugrace actually testified MDU's incentive compensation plan was reasonable. Tr. at pg. 779:1-6. Advocacy Staff and Mugrace have no evidentiary basis to support their arbitrary sixty percent reduction.

With respect to MDU's at-risk pay or incentive compensation, the focus of the Commission's inquiry should be the reasonableness of the result of MDU's total compensation, regardless of the method used to calculate the compensation (base salary plus incentive compensation). The evidence established MDU hired an outside auditing firm, Aon Hewitt, to prepare an analysis of total employee cash compensation for each program participant and then compares the results with recent surveys of gas industry

compensation for similar positions. MDU presented evidence that its total employee cash compensation was within the comparable levels reported in the gas industry survey.

A continuous theme throughout Advocacy Staff's Brief and arguments is its assertion that certain expenses are unreasonable and should be disallowed because they were incurred for shareholder benefit. Advocacy Staff failed to present any evidence that the benefits of MDU's incentive compensation plan were mutually exclusive between customers and shareholders. Contrary to Advocacy Staff's assertions, Travis Jacobson explained how MDU's incentive compensation benefits MDU's customers and ratepayers, by having employees focus on customer service and generating increased savings in operations and maintenance which directly benefits the customers. Tr. at pg. 246:5-247:9. The actual evidence at the hearing established incentive plans benefit both customers and shareholders, because as productivity rises, more attention is paid to cost control and more focus is given to customer service.

Mugrace's testimony seeking disallowance of MDU's inflation increase on certain expenses was also flawed. Mugrace argued he did not believe the inflation increase was "known and measurable, so I took it out." Tr. at pg. 746:4-8. However, Mugrace admitted that it would be acceptable for MDU to trend historical expenses and apply that rate to a future test year. Tr. at pg. 781:24-782:8. Despite his testimony indicating the use of historical trends would be acceptable, he rejected MDU's evidence establishing the specific expenses have increased approximately three percent per year over the last three years since the last rate case. See MDU Ex. 1, Kivisto Testimony, pg. 12. Mugrace's requested disallowance of MDU's 2.2% inflation factor which is less than the

approximately three percent annual increases for O&M expenses the Company had been experiencing since the last rate case, is without merit.

Finally, Mugrace proposes a disallowance of all \$5.4 million of projected costs for the 2018 replacement projects because they were identified as SSIP projects. Tr. at pg. 791:18-792:6. Mugrace confirmed the only reasons these infrastructure repair and replacement costs were identified for disallowance is because they were identified as SSIP projects. Id. Mugrace had no objection to the 2017 repair and replacement projects that were not specifically identified as SSIP projects. Moreover, Mugrace recognized the doctrine of imminent use mandates that projects intended to be completed during the test year should be considered used and useful for determining rate base. Tr. at pg. 793:11-21. Advocacy Staff failed to present any evidence that these 2018 replacement projects were not reasonable and prudent. Mugrace's proposed disallowance of the 2018 replacement projects on the basis they are identified as SSIP projects lacks merit and should not form the basis for this Commission's decision.

The Commission's decision should be based upon competent, admissible evidence presented at the hearing. The confusion and baseless personal opinions of Advocacy Staff's expert is not evidence and should not form the basis of the Commission's decision. The record reflects that Advocacy Staff failed to present competent evidence to support its claims that MDU's revenue requirement should be disallowed.

CONCLUSION

For the reasons set forth in this Brief, MDU respectfully requests the Commission adopt the Settlement Agreement in its entirety, as it will result in just and reasonable rates for the Company's gas service in North Dakota. MDU requests the Commission approve the proposal that all revenue increases for residential customers be collected through an increase to the current fixed basic service charge.

In addition, MDU requests the Commission approve the adoption of Rate 94 which will allow a cost recovery mechanism for the Company's pipeline replacement plan. MDU's SSIP, including the rate recovery mechanism, will allow the Company to proactively address its aging infrastructure while potentially avoiding costly rate cases and providing customers with more gradual rate increases over time. MDU's SSIP would bring all the interested parties together in an effort to develop cost-efficient solutions to these pressing public safety concerns. MDU urges adoption of the SSIP program and rate recovery mechanism so the Commission and parties can start working together to formulate the solution to this growing public safety concern.

Dated this 1st day of August, 2018.

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