

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

Appearances

Commissioners Randy Christmann, Julie Fedorchak, and Brian Kroshus.

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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 Advocacy Staff.

Illona Jeffcoat Sacco, General Counsel, Public Service Commission, 600 East Boulevard Ave., Dept. 408, Bismarck, ND 58505-0480, as Counsel for the Public Service Commission.

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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.

Petitions to Intervene were filed by the AARP and the Federal Executive Agencies. On November 14, 2017, the Petitions to Intervene of both AARP and the Federal Executive Agencies ("FEA") were granted.

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 (Advocacy 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 March 23, 2018 MDU provided the effects of the Federal Tax Cut and Jobs Act on its original request as part of the rebuttal testimony submitted by Mr. Travis Jacobson. The revenue deficiency was reduced to \$3,575,388.

On May 30-June 1, 2018, the rescheduled hearing was held in the Commission Hearing Room, State Capitol, 600 E. Boulevard Avenue, 12th Floor, Bismarck, North Dakota 58505.

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 provide natural gas distribution service to retail customers in North Dakota.

2. The parties dispute the following issues in this proceeding:

Implementation of the System Safety and Integrity Program (SSIP)
Recovery Mechanism, Rate 94;

Revenue Requirement Items:

- o Recovery for 2018 SSIP Projects
- o Incentive Compensation
- o Return on Equity
- 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

Miscellaneous Changes to Current Rates:

- o Insufficient Funds Charge
- o Monthly Gas Adjustment

Residential Basic Service Charge

SSIP RECOVERY MECHANISM

3. MDU has implemented a proactive pipeline replacement plan to enhance system safety and reliability, referred to as its System Safety and Integrity Program ("SSIP"). As part of its SSIP, MDU is proposing a structured replacement program targeting early-vintage steel pipe, early-vintage plastic pipe, low-pressure systems and the relocation of inside meters, all of which have been identified as higher safety risks by MDU's Distribution Integrity Management Plan ("DIMP"). To fund its SSIP plan, MDU has requested the implementation of a cost recovery mechanism, Rate 94. Implementation of a cost recovery mechanism for the SSIP will assist with avoiding costly rate cases and providing customers with more gradual rate increases over time.

4. The evidence established approximately twenty-five percent of MDU's entire natural gas system is over fifty years old. The depreciation study filed by the MDU indicated some of its existing natural gas facilities are in excess of 100 years old. The costs to replace the aging pipeline infrastructure will be substantial.

5. The evidence at the hearing demonstrated that replacement of an aging pipeline infrastructure is a problem gas utilities are facing nationwide. The vast majority of States have adopted specific rate recovery mechanisms for accelerating pipeline replacement.

6. MDU proposed the implementation of a cost recovery mechanism for its SSIP, Rate 94. Under Rate 94, MDU will make annual filings with the Commission identifying a portfolio of SSIP projects and their costs that the Company plans to undertake in the upcoming year. MDU would then true-up the actual costs of the SSIP projects the following year. Under Rate 94, MDU would not be permitted to recover any revenue for the SSIP projects until they were approved by the Commission. The revenue requirement for the SSIP projects would be allocated to the various rate classes, excluding the Minot Air Force Base and transmission level customers, based upon each class' respective allocation established in this rate case. The proposed Rate 94 recovery mechanism would be similar to the recovery mechanism in the North Dakota electric riders for environmental, renewable resources, and transmission projects.

7. Advocacy Staff and AARP expressed concerns regarding the recovery mechanism, claiming it did not have sufficient consumer protections. Advocacy Staff's expert testified to the requirements that an acceptable accelerated recovery mechanism should have, including a filing fee to assist Advocacy Staff to determine the prudence of the projects, a cap on the cost of yearly projects submitted, and a requirement that after a certain period the projects must be taken out of the recovery mechanism and put into base rates. MDU's witnesses testified the Company is agreeable to inclusion in Rate 94 of several of the consumer protection requirements identified by Advocacy Staff and AARP. Moreover, the requirement of Commission approval before MDU can recover any revenue on the SSIP projects mitigates Advocacy Staff and AARP's concerns regarding consumer protection. Advocacy Staff, AARP, and any other interested parties have the right to be party to the SSIP cases and express any concerns regarding the projects.

8. MDU's proposed SSIP program and recovery mechanism would promote a collaboration between the Commission, the Company, and other interested parties to assist in finding a solution to the growing problem of an aging gas infrastructure. MDU's proposal will create an open dialog between all interested parties to ensure the best practices are being utilized and funds being spent are targeting the appropriate projects.

REVENUE REQUIREMENT

9. MDU is seeking additional annual revenue of \$3,575,388, which constitutes a 3.3% increase over current rates. Advocacy Staff asserts an overall increase in revenue is warranted in the amount of \$867,496. Additional revenue of \$1,367,776 over current rates was found to be warranted.

2018 SSIP Replacement Projects

10. As part of its application, MDU requested recovery for certain pipeline replacement projects that would be completed during the 2018 test year. The 2018 replacement projects include replacing early vintage low-pressure steel mains and fittings in the communities of Gladstone, Fairview, New Salem, and Taylor, and replacement of early vintage Aldyl-A plastic pipe installed between 1971 and 1982 in the communities of Gladstone, Fairview, New Salem, Eldridge, Barlow, and Cleveland. The total cost of the 2018 replacement projects was estimated at \$5,553,154, with about \$800,000 of that total attributable to the replacement of Aldyl-A plastic pipe and material testing of the pipe removed.

11. MDU presented ample evidence regarding the need for the 2018 replacement projects and how the projects were selected. MDU introduced its updated SSIP Project Plan for 2018, which identified these projects were selected for replacement pursuant to the Pipeline and Hazardous Materials Safety Administration ("PHMSA") regulations and MDU's Distribution Integrity Management Program ("DIMP"). MDU presented evidence of its DIMP model, including risk scores for these projects, as part of its SSIP document. Based upon the results of the DIMP model and consultation with the MDU's numerous subject matter experts, the Company selected these projects for replacement in 2018. The 2018 replacement projects were determined to be necessary and prudent projects by the Company's operations team. Construction of the 2018 replacement projects is underway and completion of all projects is expected in 2018.

12. Pat Fahn, the Commission's Director of Public Utilities, also testified at the Hearing regarding the PHMSA regulations. Mr. Fahn testified PHMSA requires MDU to evaluate and rank the risks posed to its system and then to take the DIMP data and identify and implement measures to correct the risks posed to the system. Mr. Fahn confirmed MDU's procedures in identifying the 2018 replacement projects through its DIMP model as part of its SSIP program is consistent with the PHMSA requirements.

13. The testimony and evidence presented established the 2018 replacement projects identified through the appropriate procedures set forth by PHMSA regulations are necessary and the costs for the 2018 replacement projects are just and reasonable and should be included in the Company's rate base in this case.

Incentive Compensation

14. MDU's Application seeks recovery for incentive compensation or at-risk

compensation paid to all the Company's employees. The evidence presented at the hearing established incentive compensation provided by MDU is not bonus pay, but rather an integral part of the Company's total remuneration package provided to its employees and has been part of MDU's employee compensation package for over twenty years.

15. MDU's incentive compensation pay range and targets are similar to those of other comparable companies in the labor market. The 2017 American Gas Association Compensation Survey for the North Central Region showed thirteen of fifteen participating gas utilities also provided incentive compensation to all levels of the utility's employees, similar to MDU's incentive compensation. The AGA study also showed that inclusion of the incentive compensation was necessary to meet the market targets. MDU hires an independent third-party, Aon Hewitt, to review its Total Rewards compensation program, including incentive compensation and the results demonstrated MDU's incentive compensation plan is well designed and utilizes high quality and established external sources to ensure the program aligns well with other industries that compete for highly skilled employees.

16. There was no evidence presented to establish MDU's employee incentive compensation package was excessive, unwarranted or implemented in bad faith. Rather, the evidence showed that base salary compensation would need to be increased if incentive compensation was removed from the total remuneration package, which would result in an increase in base wages and cost increases for the Company and, ultimately, its customers.

17. There was no evidence supporting Advocacy Staff's arbitrary sixty percent reduction of MDU's incentive compensation. The decision regarding how best to compensate employees to attract and retain highly qualified individuals is a decision that is left to MDU's Management.

Return on Equity/Rate of Return

18. MDU seeks a return on equity (ROE) of 10.0 percent resulting with an overall rate of return of 7.542 percent. Advocacy 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. FEA requests a ROE of 9.10 percent. Each party presented an expert to substantiate their position.

19. The three expert witnesses presented varying calculations and methods used to reach their respective opinions as to the appropriate ROE. The determination of a fair rate of return on common equity is accomplished by using the current market cost of common equity in order to ensure that the return is adequate to attract capital and is commensurate with returns available on other investments of similar risk.

20. One factor that was consistent between the three experts is that they all selected essentially the same group of natural gas distribution proxy companies for

comparison. The evidence presented at the hearing established that three of the proxy companies had Commission determined ROEs within three months of the hearing in this case; Atmos Energy was awarded a ROE of 9.70 percent on May 3rd in Kentucky, and Spire Missouri and Missouri Gas Energy were both awarded ROEs of 9.80 percent in Missouri on February 21st. MDU is a smaller utility and faces greater business risks than the comparable proxy companies. The evidence presented at the hearing establishes that MDU should be entitled to a ROE higher than those larger companies in the proxy group.

21. MDU's expert, Dr. Gaske, provided evidence that a risk premium is appropriate given the business risks faced by MDU due to its smaller size and slower customer growth.

21. The Commission finds that a ROE of 10.0 percent is appropriate in this case with a corresponding overall rate of return of 7.542 percent. This will assure confidence in the financial soundness of MDU and is adequate to attract capital and is commensurate with returns available on other investments of similar risk.

Inflation

22. MDU's Application seeks to apply a 2.2% inflation factor to certain miscellaneous expenses, including subcontract labor, materials, building rental, software maintenance, and all other miscellaneous O&M. The inflation factor was applied to a very small percentage of the total operating and maintenance expenses. MDU's 2.2% inflation factor was calculated by taking the average of six published inflation indexes and amounts to less than the approximately three percent annual increases for O&M expenses the Company has been experiencing since its last rate case.

23. In preparation of its Application, MDU prepared its 2018 future test year revenue requirement in a manner consistent with previous gas rate filings, which include reasonable estimates of inflation. MDU used actual known calculations of expenses when that calculation was available, but included a reasonable inflation rate on certain miscellaneous categories of smaller O&M expenses which would have been impossible to accurately predict for the future test year.

24. The Commission finds the use of a recognized inflation factor is a reasonable means of estimating cost increases for the broad categories of small expenses. The use of a recognized inflation factor in a rate case for a future test year is consistent with previous gas and electric rate filings before this Commission.

Vehicles and Work Equipment

25. The disagreements between Advocacy 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 is 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.

26. The one remaining issue in dispute involves a reduction to depreciation expense in the amount of \$38,488. The evidence presented at the hearing indicates that depreciation expense is included in clearing accounts and recorded in O&M expense as a part of a project in which vehicles and work expense is used. This was further supported at the hearing where MDU presented testimony establishing the depreciation expense included on the Company's income statement did not include the depreciation expense associated with vehicles and work and, therefore, it is inappropriate to accept Advocacy Staff's proposed reduction of \$38,488.

Private Aircraft

27. MDU's Application seeks to include in its rate base and expenses items related to the use of its corporate aircraft. MDU's corporate aircraft has been included in rates pursuant to earlier Commission decisions for decades. The evidence presented at the hearing established the corporate aircraft is used sparingly and only when justified by the cost savings compared to commercial travel. MDU introduced evidence through the testimony of Nicole Kivisto and corresponding documents identified as Requests for Corporate Aircraft Travel sheets filled out for each trip and approved by its CEO, which included a log of all travel, all passenger names, destinations, dates, business purposes of all trips, and a comparison of the costs between the corporate aircraft and alternative travel costs.

28. The evidence presented at the hearing established MDU's expenses for use of the corporate aircraft are just and reasonable. Advocacy Staff failed to present any evidence that MDU's use of the corporate aircraft was unreasonable or resulted in any extravagant or unnecessary costs. Rather, the actual evidence established the corporate aircraft was used only in circumstances when it provided a cost savings to the Company compared to the equivalent commercial air travel and associated costs. The record presented at the hearing does not support a finding that the Company's expenses incurred with the use of the corporate aircraft were unreasonable or an abuse of discretion. Based upon the evidence presented at the hearing, there exists no basis to encroach on management's determination to use the corporate aircraft.

Employee Housing

29. As part of its Application, MDU seeks to include \$774,487 in rate base for losses incurred on the sale of employee housing. MDU seeks to amortize the losses incurred over a twenty-year period in the amount of \$39,717 annually on its income statement.

30. During the Bakken oil boom, MDU was faced with a crisis regarding finding and retaining employees to work in Western North Dakota. When it reached the point that the Company could not find employees to provide safe and reliable service for its customers, MDU made the decision to purchase manufactured homes to house its employees in

Western North Dakota. When the housing market caught up following the peak of the Bakken boom, MDU sold the manufactured homes at a loss.

31. The acquisition of employee housing was required in order to provide safe and reliable service at a time when no other housing alternatives were available. The Company's proposal in this proceeding was based on the currently approved methodology employed in its North Dakota electric operations as the employee housing units requested in this proceeding are the same units requested in Case No. PU-16-666, the Company's most recent electric case. MDU also included gains on the sale of buildings in Western North Dakota as a rate base deduction along with an amortization of the gain over a twenty-year period.

32. The Commission finds inclusion of MDU's losses incurred on the sale of the manufactured homes is just and reasonable and were a necessary business decision made in order to attract and retain operational employees in the local region in a difficult business climate.

Advertising/Dues

33. Advocacy Staff seeks a disallowance of 50 percent of MDU's advertising expense (\$67,051) and a certain portion of the Company's dues expense (\$6,844).

34. The evidence presented at the hearing established the prudence of the advertising and dues expenses. MDU's Application did not seek any expenses for promotions, charitable donations or gifts. Rather the advertising and dues were important to the Company and served legitimate company interests. Advocacy Staff's expert is not in a better position than MDU's management to determine the reasonableness and prudence of which industry organizations MDU should belong. Advocacy Staff failed to establish MDU's legitimate advertising and dues expenses were unreasonable or imprudent.

Non-Plant EDIT Amortization

35. 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 ten years is just and reasonable. This will allow MDU a reasonable recovery while normalizing the level between rate case proceedings.

MISCELLANEOUS ITEMS

36. The parties agreed to various changes to proposed tariff language and compliance. 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."

37. MDU requested a returned check charge in the amount of \$40, which is an increase from \$15. The Commission finds the increase of the returned check charge to \$40 would be consistent with MDU's charge for electric service and is just and reasonable.

38. MDU also proposed to change its filing threshold for its monthly cost of gas adjustment to 25 cents, instead of 10 cents. The change does not impact the amount of gas cost customers are responsible to pay, will not impact the deferred account as the deferred account amortization is currently established on an annual basis and eases the Company's administrative burden. The Commission finds the increase in the monthly filing threshold for its cost of gas adjustment to 25 cents is just and reasonable.

REVENUE ALLOCATION & RATE DESIGN

39. All the parties in the case agreed that MDU's proposed revenue allocation is reasonable and should be adopted.

40. MDU's Application proposes all revenue increases for residential customers be collected through an increase to the fixed basic service charge. Advocacy Staff and FEA support the revenue increase being collected through the basic service charge. AARP opposes any increase to the basic service charge and contends any rate increase should be recovered through the creation of a new volumetric charge.

40. 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 required to serve each residential customer with a typical service line, meter and regulator has the same average cost. Even with the current basic service charge, the majority of a residential customer's gas bill is calculated based upon the volumetric charge for cost of gas. 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. The Commission finds that recovery of all distribution or non-gas costs assigned to the Residential class through a fixed charge rate will not significantly discourage conservation.

41. In 2015, the Commission adopted MDU's proposal to recover residential customer's non-commodity costs through a fixed monthly charge. 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 fixed monthly charge implemented by Montana-Dakota in its last proceeding has achieved positive results. The numerous benefits of recovering non-commodity costs through a fixed monthly charge for Residential

customers outweigh the concerns expressed by AARP.

42. The changes in the Basic Service Charge applicable to other customer classes as proposed by MDU were not disputed by other parties and should be adopted.

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 rates 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. "Used and useful" requires North Dakota ratepayers to have received a tangible and quantifiable benefit. In a utility rate case, the rate base should be adjusted to include facilities in imminent or present use at the end of the test year.
5. The Commission concludes MDU's request to implement Rate 94, the SSIP Adjustment Mechanism, is just and reasonable. The Commission orders MDU to file a revised Rate 94 consistent with the revisions outlined in this Order.
6. The Commission concludes the revenue requirement recommended by MDU as adjusted for the change in vehicles and work equipment is supported by the evidence in this proceeding and is just and reasonable.
7. The Commission concludes MDU's request to increase its returned check charge to \$40 is just and reasonable.
8. The Commission concludes it is just and reasonable to increase the threshold to change the monthly gas adjustment to twenty-five cents.

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, as revised in this Order, is granted.
2. MDU may implement a rate increase for service rendered sufficient to produce a total annual revenue increase of an amount of \$3,575,388 as adjusted to reflect the adjustment to vehicles and work equipment provided in Mr. Jacobson's rebuttal testimony. MDU shall submit a compliance filing incorporating the adjustments identified in this Order.
3. MDU shall increase its returned check charge to \$40.
4. MDU shall increase its threshold for filing a change in its monthly gas adjustment to twenty-five cents.
5. Montana-Dakota shall file, for Commission approval, compliance rate schedules consistent with this Order.
6. Within ninety (90) days of the Commission's approval of the Company's refund plan, Montana-Dakota shall issue refunds to customers to reflect the difference in annual revenues collected under the interim increase and the effective date of the compliance rates approved by the Commission.

PUBLIC SERVICE COMMISSION

Randy Christmann
Chairman

Julie Fedorchak
Commissioner

Brian Kroshus
Commissioner