STATE OF MINNESOTA
BEFORE OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION

In the Matter of the Petition by Great Plains Natural Gas Co., a Division of Montana-Dakota Utilities Co., for Authority to Increase Natural Gas Rates in Minnesota	))))))	**MPUC Docket No. G004/GR-19-511** **OAH Docket No. 65-2500-36528**

PROPOSED FINDINGS OF FACT, CONCLUSIONS OF LAW AND RECOMMENDATION ON DISPUTED ISSUES OF GREAT PLAINS NATURAL GAS CO.

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In the Matter of the Petition by Great Plains Natural Gas Co., a Division of Montana-Dakota Utilities Co., for Authority to Increase Natural Gas Rates in Minnesota	MPUC Docket No. G004/GR-19-511 OAH Docket No. 65-2500-36528 **PROPOSED FINDINGS OF FACT, CONCLUSIONS OF LAW, AND RECOMMENDATION ON DISPUTED ISSUES**

Great Plains Natural Gas Co. ("Great Plains" or the "Company"), a Division of Montana-Dakota Utilities Co., respectfully submits these Proposed Findings of Fact and Conclusions of Law on Disputed Issues ("Proposed Findings") for the Administrative Law Judge ("ALJ") and the Minnesota Public Utilities Commission's ("Commission") consideration. Consistent with the direction provided by the ALJ at the March 10, 2020 contested case hearing, the Proposed Findings submitted herein focus on the issues in dispute between the parties. Stipulated Proposed Findings on uncontested issues were separately submitted by the Minnesota Department of Commerce, Division of Energy Resources ("Department") on April 15, 2020.

FINDINGS OF FACT

I. LEGAL STANDARD

1. In this proceeding, Great Plains has the burden to demonstrate that its proposed rate increase is just and reasonable by a preponderance of the evidence.[1] In determining just and reasonable rates for Great Plains, the Commission is required to "give due consideration to the public need for adequate, efficient, and reasonable service and to the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing the service . . . and to earn a fair and reasonable return upon the investment in such property."[2]

2. The Minnesota Supreme Court has concluded that "[i]n order to establish 'just and reasonable' retail rates, the MPUC must consider the right of the utility and its investors to a reasonable return, while at the same time establishing a rate for consumers which reflects the cost of service rendered plus a 'reasonable' profit for the utility."[3]

[1] Minn. Stat. § 216B.16, subd. 4.

[2] Minn. Stat. § 216B.16, subd. 6.

[3] *Northern States Power Co. v. Minnesota Public Utilities Comm'n*, 344 N.W.2d 374, 378 (Minn. 1984) (emphasis added).

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3. Minnesota law recognizes this principle when it defines a "fair and reasonable" rate of return as the rate which, when multiplied by the rate base, will give a utility a reasonable return on its total investment.[4] A fair return enables the utility to attract sufficient capital at reasonable terms. Minnesota law also requires that any doubt as to reasonableness must be resolved in favor of the consumer.[5]

II. COST OF CAPITAL

A. Cost of Common Equity

1. Introduction

4. In order to determine an appropriate overall rate of return for the Company, it is necessary to determine the amount of long-term debt, short-term debt and common equity needed by Great Plains to finance its operations.

5. The Department and the Company agree on the amount of long-term debt, short-term debt and common equity needed by Great Plains to finance its operations, which is based upon Great Plains' projected capital structure.[6] The Department and the Company disagree, however, on an appropriate return on common equity ("ROE") for the Company.

6. The record in this case shows that a ROE for Great Plains of 10.2 percent is required in order for Great Plains to be in a position to raise capital on reasonable terms, taking into consideration (1) the unique risk faced by Great Plains; (2) current market conditions and investor expectations; and (3) regulatory commission authorized ROEs and the proper application of the comparability standard.

2. Legal Framework

7. The United States Supreme Court provided guidelines regarding the level of ROE that will pass constitutional muster. In *Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia et al.,*[7] the Court concluded:

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[4] Minn. Stat. § 216B.16, subd. 6.

[5] Minn. Stat. § 216B.03.

[6] Great Plains' overall cost of capital is the average of the costs of long-term debt, short-term debt and common equity, weighted by the amount of each type of financing that Great Plains uses. Both the Department and the Company agree that Great Plains' projected capital structure should be adopted in this proceeding as follows:

Long-Term Debt	45.132%
Short-Term Debt	4.053%
Common Equity	50.815%

[7] 262 U.S. 679 (1923) ("Bluefield").

> 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.[[8]]

The Court elaborated on this requirement in *Federal Power Commission v. Hope Natural Gas Co.*[9] stating:

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[[10]]

8. Accordingly, the standards established by the Court, and adopted by the Commission,[11] require that:

a. The allowed rate of return should be comparable to that generally being made on investments and other business undertakings which are attended by corresponding risks and uncertainties;

b. The return should be sufficient to enable the utility to maintain its financial integrity; and

c. The return should be sufficient to attract new capital on reasonable terms.

3. Great Plains' Recommended ROE of 10.2 Percent is Reasonable and Supported by the Record Developed in this Proceeding.

9. In determining an appropriate ROE for the Company, Great Plains Witness Ms. Ann Bulkley calculated the cost of common equity capital for Great Plains' Minnesota natural gas distribution operations based on the Constant Growth Discounted Cash Flow ("DCF")[12] and

[8] *Id.* at p. 692.

[9] 320 U.S. 591 (1944) ("Hope").

[10] *Id.* at p. 603 (internal citations omitted).

[11] *See, e.g., In the Matter of the Request of Interstate Power Company for Authority to Change Its Rates for Gas Service in Minnesota,* Docket No. G-001/GR-95-406, Findings of Fact, Conclusions of Law, and Order at pp. 34-35 (February 29, 1996).

[12] The DCF model uses current dividend yield and the expected growth rate of dividends to determine what rate of return is sufficient to induce investment. The model relies primarily on dividend, stock prices, and growth rate inputs.

the Two-Stage DCF models of a group of proxy companies that have risks similar to those of Great Plains' Minnesota gas distribution operations.[13] The DCF approach is based on the theory that a stock's current price represents the present value of all expected future cash flows. In its most general form, the DCF model is expressed as follows:

$$P_0 = \frac{D_1}{(1+k)} + \frac{D_2}{(1+k)^2} + ... + \frac{D_\infty}{(1+k)^\infty}$$

[1] Where P_0 represents the current stock price, D1…D∞ are all expected future dividends, and k is the discount rate, or required ROE.[14]

10. Ms. Bulkley used other analytical approaches including the Capital Asset Pricing Model ("CAPM"), Bond Yield Risk Premium[15] and Expected Earnings analysis[16] to check the reasonableness of the results of the DCF models and inform her decision as to where Great Plains' ROE should fall within the range of returns produced by her DCF analyses.[17]

11. In determining an appropriate ROE for a utility, the Commission "has historically placed its heaviest reliance" on the DCF analytical model, with the CAPM and Bond Yield Risk Premium used as a check on the reasonableness of the DCF results.[18]

12. Because Great Plains is not a publicly traded company, in estimating the cost of equity for Great Plains, "it is necessary to establish a group of companies that is both publicly traded and comparable to Great Plains in certain fundamental business and financial respects to serve as its 'proxy' in the ROE estimation process."[19] Use of a proxy group "moderates the effects of unusual events that may be associated with any one company."[20] As Ms. Bulkley testified, "[t]he key consideration in determining the cost of equity is to ensure that the methodologies

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[13] Ex. GP-14, Direct Testimony of Ann Bulkley at 10 ("Bulkley Direct").

[14] Bulkley Direct at 52.

[15] The Risk Premium approach "is based on the fundamental principle that equity investors bear the residual risk associated with equity ownership and therefore require a premium over the return they would have earned as a bondholder. That is, because returns to equity holders have greater risk than returns to bondholders, equity investors must be compensated to bear that risk. Risk premium approaches, therefore, estimate the cost of equity as the sum of the equity risk premium and the yield on a particular class of bonds." *See* Bulkley Direct at 73.

[16] The Expected Earnings methodology "is a comparable earnings analysis that calculates the earnings that an investor expects to receive on the book value of a stock. The expected earnings analysis is a forward-looking estimate of investors' expected returns." Bulkley Direct at 77.

[17] Bulkley Direct at 5-8; Ex. GP-16, Rebuttal Testimony of Ann Bulkley at 8 ("Bulkley Rebuttal").

[18] *See In the Matter of a Petition by Great Plains Natural Gas Co., a Division of MDU Resources Group, Inc., for Authority to Increase Natural Gas Rates in Minnesota,* Docket No. G004/GR-15-879, Findings of Fact, Conclusions, and Order at 20 (September 6, 2016) ("Great Plains 2016 Rate Case Order").

[19] Bulkley Direct at 40.

[20] Bulkley Direct at 40.

employed reasonably reflect investors' views of the financial markets in general, as well as the subject company (in the context of the proxy group), in particular."[21]

13. In the selection of her proxy group, Ms. Bulkley began with the group of 10 companies that Value Line classifies as Natural Gas Distribution Utilities and applied the following screening criteria to select companies that:

- pay consistent quarterly cash dividends, because companies that do not cannot be analyzed using the Constant Growth DCF model;
- have investment grade long-term issuer ratings from S&P and/or Moody's;
- are covered by at least two utility industry analysts;
- have positive long-term earnings growth forecasts from at least two utility industry equity analysts;
- derive more than 70.00 percent of their total operating income from regulated operations;
- derive more than 60.00 percent of regulated operating income from gas distribution operations; and
- were not parties to a merger or transformative transaction during the analytical periods relied on.[22]

14. Based on her screening criteria, Ms. Bulkley included the companies in Figure 1 below in her proxy group, determining that such companies "possess a set of operating and risk characteristics that are substantially comparable to the Company, and thus provide a reasonable basis to derive and estimate the appropriate ROE for Great Plains."[23]

Figure 1

Company	Ticker
Atmos Energy Corporation	ATO
New Jersey Resources Corporation	NJR
NiSource Inc.	NI
Northwest Natural Gas Company	NWN
ONE Gas, Inc.	OGS
South Jersey Industries, Inc.	SJI
Southwest Gas Corporation	SWX
Spire, Inc.	SR

[21] Bulkley Direct at 44.

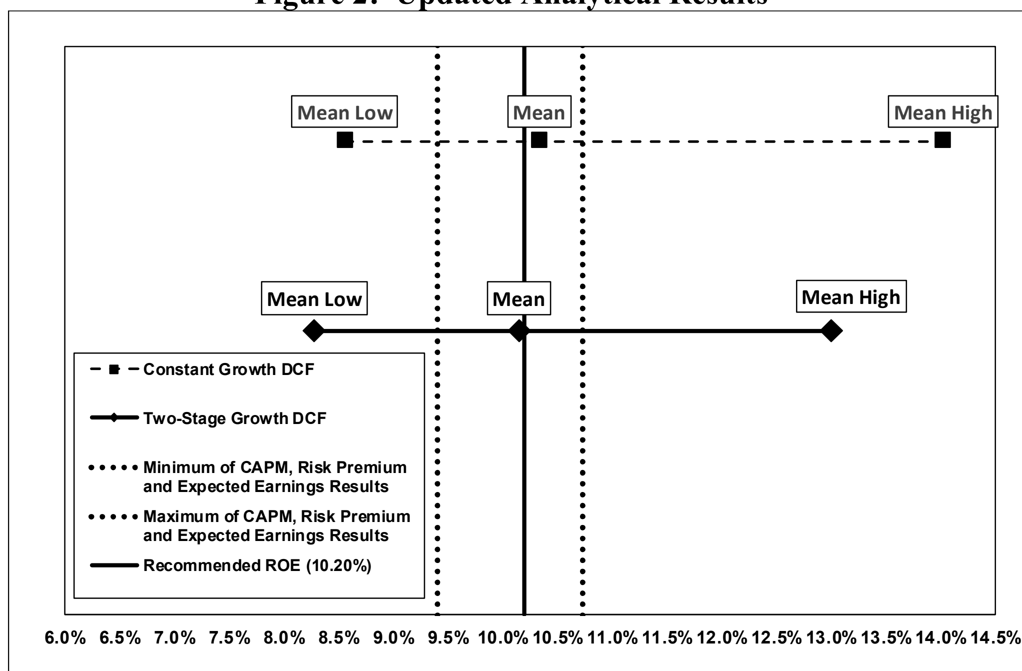
[22] Bulkley Direct at 42.

[23] Bulkley Direct at 40-41.

15. Ms. Bulkley's analyses includes results for three stock price averaging periods, 30 days, 90 days, and 180 days so as not to rely on data that could be biased by any short-term market events. The averaging periods used rely on historical data that are not consistent with the forward-looking market expectations. Therefore, the results of the Constant Growth DCF model using historical data may underestimate the forward-looking cost of equity. As a result, Ms. Bulkley placed more weight on the mean to mean-high results produced by her Constant Growth DCF model.[24] Multiple averaging periods in the analytical results as well as an understanding of how the assumptions used in the ROE models have been affected by market conditions over those averaging periods provides a more reasonable approach to estimating the investor-required return on equity.[25]

16. The results of Ms. Bulkley's cost of equity analyses are set forth in Figure 2 below:

Figure 2: Updated Analytical Results[26]



17. As the Commission has recognized, the analytical tools used to determine an appropriate ROE do "not formulaically dictate a particular ROE to be approved."[27] Instead, such analyses present a "range of reasonable returns on equity" from which the Commission determines an appropriate ROE based on the entire record.[28]

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[24] Bulkley Direct at 53.

[25] *See* Ex. GP-17, Testimony Summary of Ann Bulkley at 5 ("Bulkley Testimony Summary").

[26] Bulkley Rebuttal at 8, Figure 1.

[27] *See In the Matter of the Application of Otter Tail Power Company for Authority to Increase Rates for Electric Service in Minnesota,* Docket No. E-017/GR-15-1033, Findings of Fact, Conclusions and Order at 55 (May 1, 2017).

[28] *Id.*

18. As the Supreme Court in *Hope* explicitly recognized, "return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[29] Consistent with the standard established in *Hope,* the Courts have concluded that in determining an appropriate ROE a Commission must consider the risks of the target company relative to the proxy companies.[30]

19. In determining, where within the range of returns produced by her DCF analyses Great Plains' ROE should be set, Ms. Bulkley considered the Company's business and financial risk relative to the companies in her proxy group in establishing the range and recommended ROE. This was necessary notwithstanding the fact that the companies in her proxy group are generally comparable to Great Plains, because "each company is unique, and no two companies have the exact business and financial risk profiles. Accordingly . . . I have adjusted the results of my analysis either upwards or downwards within the reasonable range of results to account for any residual differences in risk."[31]

20. In determining an appropriate ROE for Great Plains, Ms. Bulkley testified that: "Great Plains has higher business risk than the proxy group on several factors that are important to investors. Specifically, the Company is substantially smaller than the average company in the proxy group, which supports an ROE above the proxy group mean. In addition, Great Plains has a high concentration of industrial customers, making the Company more vulnerable to changes in demand than the proxy group companies."[32]

21. While Ms. Bulkley did not make a specific adjustment to her recommended ROE for Great Plains based on these factors, she did "consider them in aggregate in determining where, within the range of results, the authorized ROE for Great Plains should be set."[33]

22. In addition, in recommending a 10.2 percent ROE for Great Plains, Ms. Bulkley considered (i) the importance of investors' actual return requirements and the critical role of judgment in selecting the appropriate ROE; (ii) the importance of providing a return comparable to returns on alternative investments with commensurate risk; (iii) the need for a return that supports Great Pains' ability to attract needed capital on reasonable terms; and (iv) the effect of current and expected capital market conditions.[34] Based on these considerations, Ms. Bulkley concluded that a ROE of 10.2 percent adequately reflects the unique risks faced by the Company and would result in a return sufficient to attract new capital on reasonable terms.

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[29] *Hope,* 320 U.S. 591 at 603.

[30] *See, e.g., Petal Gas* 496 F.3d 695 (D.C. Cir. 2007).

[31] Bulkley Direct at 5-6.

[32] Bulkley Rebuttal at 69.

[33] Bulkley Rebuttal at 69.

[34] Bulkley Rebuttal at 3-4.

23. The ALJ finds that record in this proceeding supports a range of returns from 9.75 percent of 10.25 percent and that within this range, a ROE of 10.20 percent is reasonable for Great Plains.

4. The Department's Recommended 8.82 ROE for Great Plains is Unreasonably Low and is Not Supported by the Record.

24. Relying on its Two-Growth DCF analysis, the Department recommended a ROE of 8.82 percent – the mean of Department witness Mr. Craig Addonizio's proposed range of 7.90 percent to 9.67 percent.[35]

25. The ALJ finds that the record in this case demonstrates that the Department's recommended 8.82 percent ROE is artificially low due to errors and omissions in the Department's DCF and CAPM analyses and failure to consider (1) the unique risk faced by Great Plains; (2) current market conditions and investor expectations; and (3) regulatory commission authorized ROEs and the proper application of the comparability standard.

26. The ALJ also finds that the Department's recommended ROE is inconsistent with Mr. Addonizio's use of the CAPM as a check on the reasonableness of his DCF results.[36] Mr. Addonizio's CAPM results reflected in his Surrebuttal Testimony produced "an estimated required rate of return on equity of 9.38 percent" for Great Plains,[37] which is 56 basis point higher than the mean Two-Growth DCF results. This is in direct contrast to Mr. Addonizio's Direct Testimony where his CAPM produced a required ROE of 8.90 percent and his recommended ROE based on his DCF analysis was 8.87 percent.[38] Rather than demonstrating the reasonableness of his DCF results, the CAPM results should have signaled that Mr. Addonizio's recommended return is not reasonable.

27. In Minnesota Power's last rate case, the Commission concluded that "it is appropriate to establish an ROE toward the higher end of the DCF-supported results to adjust for the divergence between ROEs supported by the DCF models and the models the Commission has historically relied upon for confirmation of reasonableness—the CAPM and Bond Yield Plus Risk Premium models."[39] The Commission noted that it "is persuaded that an ROE supported by the two-growth DCF analyses in the record, but which is also reasonably positioned among the breadth of reasonable DCF, CAPM, and blended-analysis results, is justified in this case."[40] In the present case, the ALJ finds that the record does not support an 8.82 percent ROE for Great Plains.

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[35] Ex. DER-9, Surrebuttal Testimony of Craig Addonizio at 4 ("Addonizio Surrebuttal").

[36] Addonizio Surrebuttal at 33.

[37] Addonizio Surrebuttal at 5.

[38] Ex. DER-1, Direct Testimony of Craig Addonizio at 37 ("Addonizio Direct").

[39] *In the Matter of the Application of Minnesota Power for Authority to Increase Rates for Electric Service in Minnesota,* Docket No. E-015/GR-16-664, Findings of Fact, Conclusions, and Order at 61 (March 12, 2018).

[40] *Id.*

a. The Department Erroneously Applied its Income Screen in Selecting its Proxy Group.

28. In developing its proxy group for purposes of its DCF analyses, the Department applied a similar screening criteria to the criteria employed by Great Plains, by reviewing historical data to ensure that a company (a) is traded on one of the stock exchanges, (b) has a Standard and Poor's ("S&P") credit rating from BBB to A+, (c) derived more than 60 percent of its total operating income from regulated gas operations, and (d) is not currently be involved in a merger or acquisition.[41]

29. Based on the application of his screening criteria, Department Witness Mr. Craig Addonizio's proxy group includes five companies that are included in Ms. Bulkley's proxy group, but excludes New Jersey Resources ("NJR"), South Jersey Industries ("South Jersey") and NiSource, Inc. ("NiSource").[42] The record shows that Great Plains' DCF analyses are more reliable because the Department unreasonably excluded New Jersey Resources, South Jersey and NiSource from its proxy group, biasing the results of its DCF analyses downward.

30. As reflected in his Direct Testimony,[43] Mr. Addonizio screened companies for inclusion in his proxy group to ensure that they derived more than 60 percent of their total operating income from regulated gas operations based on his historical review of the data. This historical review resulted in Mr. Addonizio excluding South Jersey based on the percentage of operating income it generated from natural gas operations in 2017 and 2018.

31. Mr. Addonizio excluded NiSource and South Jersey due to his treatment of negative operating income for a business segment in the calculation of the percentage of total operating income from each of the business segments.[44] Rather than including the actual loss from a business segment as its contribution to net operating income, Mr. Addonizio reflected negative operating income for a segment using the absolute value.[45] This resulted in NiSource and South Jersey failing to satisfy Mr. Addonizio's income screen due to one-time financial events.

32. While South Jersey had business segments with negative operating income in 2017 and 2018 and NiSource had negative operating income for its regulated natural gas distribution operations in 2018, Mr. Addonizio failed to factor in that the losses were related to one-time financial events. Great Plains demonstrated that South Jersey only failed Mr. Addonizio's income screen because South Jersey had business segments with negative operating income in 2017 and 2018 due to one-time financial events – events that Great Plains demonstrated did not continue in 2019.

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[41] Addonizio Direct at 9-13.

[42] Addonizio Direct at 13.

[43] Addonizio Direct at 11-13.

[44] Bulkley Rebuttal at 19.

[45] Bulkley Rebuttal at 19.

33. To illustrate this point, Ms. Bulkley calculated the percentage of operating income derived from regulated natural gas distribution operations for South Jersey from 2010 through 2018 using Mr. Addonizio's methodology and showed that the only two years where the percentage was below 60 percent – 2017 and 2018 – correspond to the two years where the company incurred the impairment charge associated with its solar generation assets, which South Jersey has since divested.[46]

34. In response to Ms. Bulkley, Mr. Addonizio changed the intention of this screening criterion to include his own expectations about how the business operations for South Jersey might continue in the future suggesting that South Jersey's share of operating income from regulated operations has decreased even in the absence of impairments and concluded that this decrease may be indicative of a downward trend that could result in South Jersey's percentage of annual operating income from regulated gas operations dropping below 60 percent on a consistent basis in the future.[47] Mr. Addonizio concludes that "there are plausible scenarios under which [South Jersey's income derived from regulated gas operations] could remain under 60 percent in 2019 and beyond."[48]

35. The ALJ finds that Mr. Addonizio's speculation regarding whether South Jersey will continue to meet his income screen in the future is irrelevant as the goal of the screening criteria is to establish a company that is risk comparable to the subject company as of the time of the analysis. Using the market data for that group of companies is what informs the appropriate ROE. Since the data that is relied on in the ROE estimation models is recent market data for the existing proxy companies, the screening criteria reflect the known operations of those companies, which by necessity is a historical review. Further, his speculation is not support by the record.

36. On February 26, 2020, South Jersey issued 2019 Results and provided updated guidance for 2020.[49] In that report, South Jersey reported that the "loss on property, plant and equipment" – which includes the impairments in question – were reduced in 2019 to $10.745 million from the 2018 and 2017 levels of $105.280 million and $91.299 million, respectively.[50] South Jersey's Report was available before Mr. Addonizio filed his Surrebuttal Testimony on March 3, 2020, and further demonstrates that the magnitude of the impairment charges for 2018 and 2017 were in fact one-time financial events that did not carry over into 2019.

37. Based on the evidence in the record, the ALJ finds that South Jersey meets the screening threshold for operating income for natural gas operations used by Mr. Addonizio and should have been included in his proxy group. South Jersey's omission contributed to Mr. Addonizio's recommendation that the Commission approve an unreasonably low ROE of 8.82 percent for Great Plains.

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[46] Bulkley Rebuttal at 21-22.

[47] Addonizio Surrebuttal at 9.

[48] Addonizio Surrebuttal at 9.

[49] Ex. GP-35, SJI Reports 2019 Results; Updates 2020 Guidance.

[50] Ex. GP-35, SJI Reports 2019 Results; Updates 2020 Guidance at 11.

38. Mr. Addonizio's exclusion of NiSource from its proxy group is similarly based on his misapplication of his income screen. In particular, Mr. Addonizio indicated that NiSource derived negative operating income from its regulated natural gas distribution operations in 2018.[51] Thus, Mr. Addonizio calculated that NiSource only derived 39.2 percent of total operating income from natural gas distributions operations in 2018 – below his 60 percent income screen.[52]

39. The record shows that NiSource failed to meet Mr. Addonizio's income screen solely due a one-time financial event related to an accident resulting from over pressurized lines on the system of a NiSource subsidiary on September 13, 2018.[53] As Ms. Bulkley testified, "[s]imilar to South Jersey, the financial data for NiSource in 2018 was directly affected by a one-time event. However, Mr. Addonizio has used this outlier event to justify his exclusion of NiSource from the proxy group."[54]

40. To demonstrate that the financial data for NiSource in 2018 was directly affected by a one-time event, Ms. Bulkley provided the percentage of operating income derived from regulated natural gas distribution operations for NiSource from 2010 through 2018 using the absolute value method recommended by Mr. Addonizio.[55]

41. The only year where NiSource's percentage of "operating income from natural gas distribution operations was below 55 percent was 2018."[56] Therefore, the data shows that "2018 was an outlier year due the financial implications of a one-time event and is not indicative of the past or future operations of NiSource."[57]

42. Finally, Mr. Addonizio asserts that "[i]t may very well be the case that the looming uncertainty surrounding the final financial impact of the accident has caused investors to increase their required expected return for NI, which may introduce an upwards bias into an ROE analysis for Great Plains if NI is included in that analysis."[58] As Ms. Bulkley testified, however, "[t]he stock price for NiSource has been stable, prior to and following the incident at Columbia and therefore it is reasonable to include this company in the proxy group."[59] The ALJ finds that NiSource should have been included in Mr. Addonizio's proxy group.

43. The record shows that the exclusion of South Jersey and NiSource from the Department's proxy group significantly affected the results of its DCF analyses. As shown in Exhibit 2 of Ms. Bulkley's Testimony Summary, recalculating the results of the Two-Stage DCF

[51] Addonizio Direct at 49.

[52] Addonizio Direct at 49.

[53] Addonizio Direct at 50; Bulkley Rebuttal at 22-23.

[54] Bulkley Rebuttal at 23.

[55] Bulkley Rebuttal at 23-24.

[56] Bulkley Rebuttal at 23.

[57] Bulkley Rebuttal at 23.

[58] Addonizio Surrebuttal at 12.

[59] Bulkley Testimony Summary at 10.

model using data through February 13, 2020, the same date relied on by Mr. Addonizio, and the growth rates relied on by Mr. Addonizio, and including South Jersey and NiSource in the Department's proxy group, results in a mean ROE of 9.23 percent and a high result of 10.77 percent.[60] Great Plains' recommended ROE of 10.2% is comfortably within this range of reasonable returns.

b. The Department Failed to Consider the Impact Current Market Conditions had on its ROE Analyses.

44. The purpose of the ROE analyses conducted by Great Plains and the Department is to set the ROE for the forward-looking period that rates will be in effect and, therefore, "it is critical that short-term market volatility that has unduly influenced the results of the ROE estimation models not be relied on so heavily as to understate or overstate the return on equity for a more stabilized forward-looking period."[61] For this reason, Great Plains' analyses include results for three stock price averaging periods, 30-days, 90-days, and 180 days "so as not to rely on data that could be biased by any short-term market events."[62]

45. As Great Plains Witness Ms. Bulkley testified, market conditions have significantly affected the results of the models used to estimate the cost of equity for Great Plains, as "there has been very significant volatility in both the prices of utility stocks and the yields on Treasury bonds that have affected the results of the models overall, and in very significant ways over the short time periods between the filings in this rate proceeding and since Mr. Addonizio and I have prepared our responsive analyses."[63]

46. The record in this proceeding shows that Mr. Addonizio did not appropriately account for such market conditions in his recommendation that Great Plains' ROE should be set at the mean of his Two-Growth DCF analysis.

47. Mr. Addonizio's DCF analyses rely on 30-day average stock prices ending February 13, 2020, which the record shows was near the highest point in the Dow Jones Industrial Average.[64] Since that time, the market has experienced tremendous volatility.

48. The record shows that in the last week of February the overall market, as measured by the Dow Jones Industrial Average declined 2,633 points and the "fear index" (referred to as the

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[60] The results also include New Jersey Resources, which Great Plains showed the Department also improperly excluded from its proxy group. However, the omission of New Jersey Resources did not bias the Department's DCF analyses downward and does not impact the ALJ's finding that a 10.2 percent ROE is supported by the record.

[61] Bulkley Testimony Summary at 4.

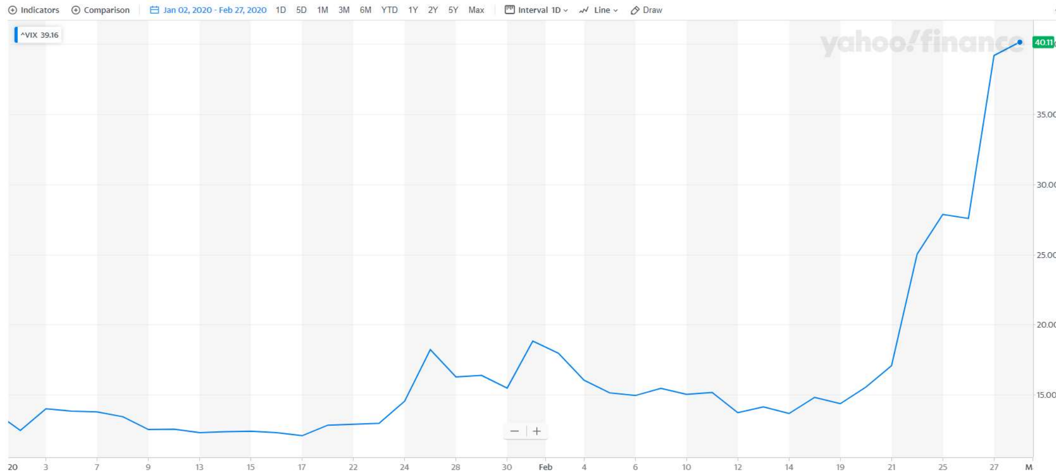
[62] Bulkley Testimony Summary at 4. *See also* Bulkley Direct at 57 (noting that she calculated her DCF analyses using 30-, 90- and 180-day stock price averaging periods to (a) ensure that the ROE is not skewed by anomalous events that may affect stock prices on any given trading day; and (b) ensure that the stock prices used are reasonably representative of expected capital market conditions over the long-term).

[63] Bulkley Testimony Summary at 3.

[64] Bulkley Testimony Summary at 3.

"VIX") increased from below 20 in January 2020 to over 40 by the end of February 2020.[65] This change is illustrated in Figure 3 below:

Figure 3- VIX January -February 2020

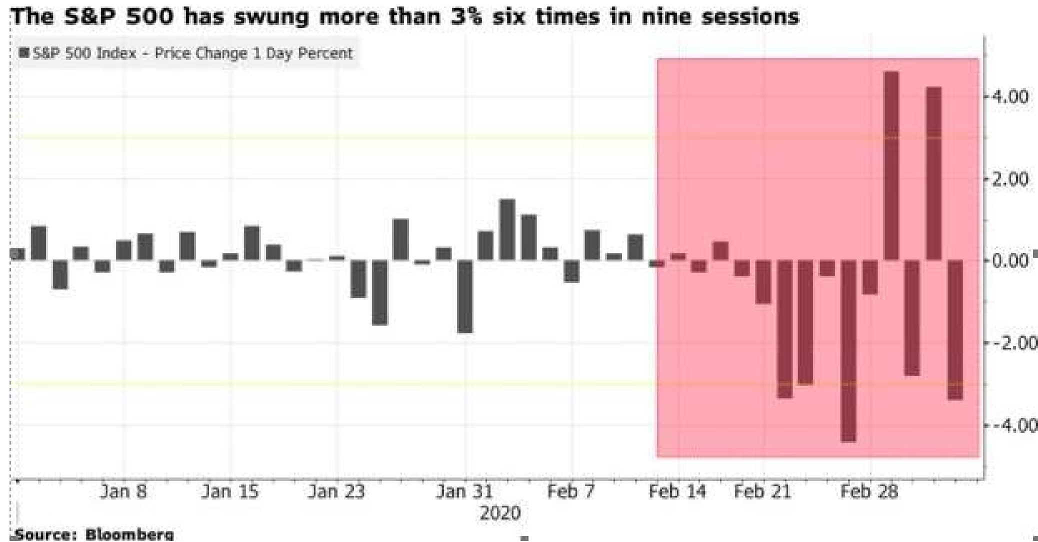


49. Ms. Bulkley further testified that the S&P 500 index from January 2020 through the first few trading days in March 2020 "demonstrates that the volatility in the S&P 500 was significantly lower when Mr. Addonizio filed his Direct Testimony . . . the S&P 500 has swung more than 3 percent six times in the nine sessions since the data that Mr. Addonizio relied on in his Surrebuttal Testimony."[66] The volatility of the S&P 500 index is illustrated in Figure 4 below:

[65] Bulkley Testimony Summary at 3.

[66] Bulkley Testimony Summary at 4.

Figure 4- S&P 500 Index - January – March 2020



50. While the Department asserts markets are rational and that if investors expected the price of utility stocks to decline they would not continue to hold these assets,[67] the increased volatility is proof of irrational behavior in the market.

51. The record is clear that market conditions have changed drastically since Mr. Addonizio filed his Direct Testimony in January 2020, using market data through December 9, 2019, and his Surrebuttal Testimony, which relies on market data through February 13, 2020. Despite these significant changes in market conditions, Mr. Addonizio's recommended ROE decreased from 8.87 percent to 8.82 percent in his Surrebuttal Testimony.

52. While the ALJ agrees that it is not appropriate to rely solely on the recent market volatility to estimate the ROE for Great Plains, it provides a useful check on assumptions that market conditions that existed on February 13, 2020, will continue to exist during the period that Great Plains' rates will be in effect as posited by the Department.[68] Mr. Addonizio's use of only a 30-day average of data ending on February 13, 2020, when utility stock prices were near their highest levels further depresses the dividend yield in the DCF model and understates the DCF results.

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[67] Addonizio Surrebuttal at 39-40.

[68] *See* Bulkley Rebuttal at 45 ("[I]t is important to review current and prospective market conditions and determine if current market conditions are expected to exist during the period that Great Plains' rates will be in effect. If prospective market conditions are expected to be different than current market conditions, the ROE model based on current market data will not produce reasonable estimates of the cost of equity during the period that Great Plains' rates will be in effect.").

53. Accordingly, the ALJ finds that Mr. Addonizio's recommendation that Great Plains' ROE be set at the mean of his 30-day average Two-Stage DCF model ignores the current market environment and is not supported by the record in this proceeding.

c. The Department's Erroneous Assumption Regarding Growth Rates Undermines its DCF Results.

54. As previously noted, in general, the DCF model uses current dividend yield and the expected growth rate of dividends to determine what rate of return is sufficient to induce investment. The model relies primarily on dividend, stock prices, and growth rate inputs. If any input is flawed, the results of the model can be skewed.

55. For the expected dividend growth rate for each company in its proxy group, Mr. Addonizio relied on the three projected earnings growth rates (lowest, average and highest) provided by Zacks Investment Research, Value Line, and Thomson First Call.[69] Mr. Addonizio determined, however, that Value Line's growth estimate for Northwest Natural was unreasonably high and removed it from his analysis, determining that it would unreasonably affect the ROE calculations.[70]

56. The record in this proceeding shows that Mr. Addonizio's DCF model results are skewed by his exclusion of Value Line's projected earnings growth rate for Northwest Natural on the basis that the growth rate is an outlier.[71]

57. The Two-Stage DCF model relied on by the Commission already includes its own statistical outlier test, which removes outlier growth rates, high and low, from the long-term growth stage of the model. In particular, the Two-Growth DCF model identifies unsustainable earnings growth estimates and applies a more reasonable growth rate in the second stage of the model.[72] Therefore, Mr. Addonizio's decision to remove the Northwest Natural Value Line growth rate improperly affects the calculation of the average and standard deviation for the proxy group in the Two-Stage DCF model. In addition to affecting the results for Northwest Natural, the record shows that it biases the analysis because it alters the standard deviation by which all other growth rates in the model are measured.[73]

58. Ms. Bulkley pointed out that Mr. Addonizio initially included the extremely low growth rate for another company in his proxy group, Spire, Inc. Ms. Bulkley noted that Spire has a projected earnings growth rate from Yahoo! Finance of 2.37 percent compared to the 5.50 percent earnings growth rates reported for Spire by Zacks and Value Line.[74] Mr. Addonizio subjectively determined that Yahoo! Finance's growth rate for Spire was not comparable to Value Line's

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[69] Addonizio Direct at 14-16.

[70] Addonizio Surrebuttal at 31.

[71] Addonizio Direct at 28-29.

[72] Bulkley Rebuttal at 34.

[73] Bulkley Testimony Summary at 11.

[74] Bulkley Rebuttal at 34.

growth rate for Northwest Natural in terms of being an outlier.[75] Mr. Addonizio did not consider how this low growth rate for Spire would affect the results of the models. Therefore, by isolating only one growth rate even though two growth rates were affected by one-time events, Mr. Addonizio added subjectivity to his analysis and biased the results.[76]

59. The ALJ finds that if analysts are simply allowed to exclude or include growth rates for companies based on the analyst's subjective determination of whether the growth rate is an outlier, analysts could start reviewing all growth rates for inclusion or exclusion, undermining the objectivity built into the Commission's model. Mr. Addonizio's removal of Northwest Natural's growth rate in this case biases the results of his analysis and would establish a poor precedent for future cases.

60. As shown in Exhibit No. (AEB-3), Schedule 9 of Ms. Bulkley's Rebuttal Testimony, using the proxy group that includes New Jersey Resources, NiSource and South Jersey as recommended by Ms. Bulkley and allowing the Two-Stage DCF model to function as it was designed, "Mr. Addonizio's mean Two-Stage DCF result increases to 10.19 percent. Including flotation costs, which this Commission has historically considered appropriate in the authorized ROE, the mean result of Mr. Addonizio's Two-Stage DCF would be 10.29 percent."[77]

61. The ALJ finds that making the appropriate changes to Mr. Addonizio's Two-Stage DCF analysis results in a range of ROE results that are consistent with the range of 9.75 percent to 10.25 percent supported by Great Plains in this proceeding.

d. The Department Failed to Consider the Risks Faced by Great Plains Relative to the Companies in its Proxy Group.

62. The record in this proceeding shows that Great Plains is small relative to the size of the proxy companies used in the DCF analyses. The record further shows that in addition to its small size, Great Plains has risk related to the concentration of industrial customers in its service territory focused on agriculture or the production of ethanol, creating risk if a large load customer were to go out of business or relocate its operations.[78]

63. In making his ROE recommendation, Mr. Addonizio concluded that it was unreasonable to consider the relative risk of Great Plains versus the proxy group members in recommending a ROE for Great Plains.[79] The ALJ finds that Mr. Addonizio's decision is contrary to Commission precedent.

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[75] Addonizio Surrebuttal at 33.

[76] Bulkley Rebuttal at 33. While the Yahoo! Growth rate for Spire increased to a normal level by the time Mr. Addonizio filed his Surrebuttal Testimony, the judgement Mr. Addonizio applied to include Spire's low growth rate in his Direct Testimony is the exact subjectivity the Commission tried to remove from the DCF model by developing the Two-Growth outlier test.

[77] Bulkley Testimony Summary at 11-12.

[78] Bulkley Direct at 80-89; Bulkley Rebuttal at 68-71; Bulkley Testimony Summary at 2.

[79] Evidentiary Hearing Transcript at 60 (March 10, 2020).

64. The Commission only recently determined that it is necessary to account for differences in investment risk between the proxy group and the utility for which the return is being set. In its May 2017 Order addressing Otter Tail Power Company's ROE, the Commission found that the higher business risks faced by Otter Tail (which included small size, equity price volatility, low institutional ownership, and trading volume) relative to the proxy group companies supported a return above the mean DCF results. The Commission stated:

> The record in this case establishes a compelling basis for selecting an ROE above the mean average within the DCF range, given Otter Tail's unique characteristics and circumstances relative to other utilities in the proxy group. These factors include the company's relatively smaller size, geographically diffuse customer base, and the scope of the Company's planned infrastructure investments. The Commission has also considered Otter Tail's recognized [sic] the Company's performance in completing major infrastructure projects substantially under budget, its history of providing reliable service with stable rates, and its record of effectively serving the needs of its customers, as measured by multiple customer-satisfaction metrics.[[80]]

65. In other contexts, the Commission has determined that while the "midpoint is relevant evidence, of course, and can serve as a useful touchstone" it is "not invariably the best measure of the return required to permit a utility to attract capital at reasonable rates, to maintain its credit rating and financial integrity, and to provide returns commensurate with those earned on other investments with equivalent risks."[81] The ALJ finds that the mean advocated for by Mr. Addonizio is not "the best measure of the return" for Great Plains in light of the record evidence.

66. The record shows that it is reasonable and appropriate for the Commission to consider differences in business and investment risk between Great Plains and the proxy group companies, and to select an authorized ROE for Great Plains that is above the mean results for the proxy group of gas distribution companies.[82]

67. Due to the risks faced by Great Plains the record does not support setting Great Plains' ROE at 8.82 percent -- the mean of Mr. Addonizio's Two-Growth DCF range of 7.9 percent to 9.67 percent – even if the analyses producing this range did not suffer from the flaws identified herein.

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[80] *In the Matter of the Application of Otter Tail Power Company for Authority to Increase Rates for Electric Service in Minnesota*, Docket No. E-017/GR-15-1033, Findings of Fact, Conclusions and Order at 55 (May 1, 2017) (Emphasis added).

[81] *See, e.g., In the Matter of the Application of Interstate Power and Light Company for Authority to Increase Rates for Electric Service in Minnesota,* Docket No. E-001/GR-10-276, Findings of Fact, Conclusions, and Order at p. 10 (August 12, 2011).

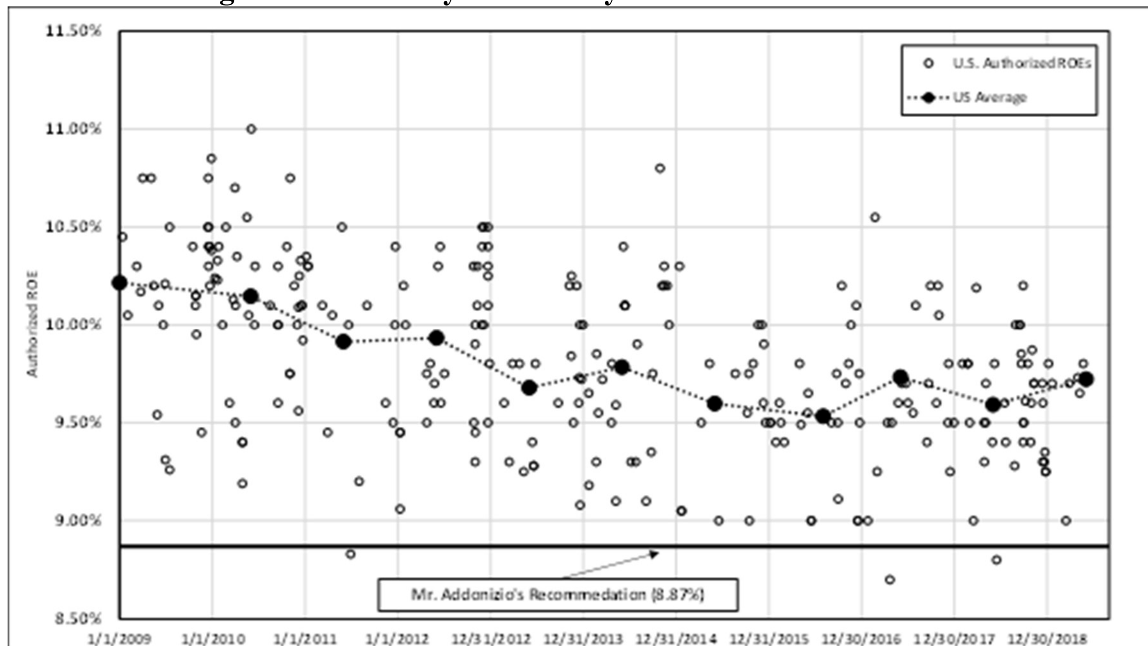
[82] Bulkley Rebuttal at 71.

e. The Department Failed to Adequately Consider Recently Authorized ROEs in Recommending a ROE for Great Plains.

68. One of the standards established by the Supreme Court in *Hope* and *Bluefield* is that the return authorized must be consistent with the returns of other companies with similar or comparable risk.[83] In recommending that the Commission set a ROE for Great Plains at 8.82 percent, Mr. Addonizio failed to consider the fact that his recommended ROE is lower than nearly all authorized ROEs for natural gas utilities from 2009 through 2019.[84] Thus, Mr. Addonizio failed to ensure that his recommended ROE is consistent with the returns of other companies with similar or comparable risk as required the Courts.

69. The record shows how Mr. Addonizio's initial recommended ROE of 8.87% compares with recently authorized ROEs. As shown in Figure 5 below, Mr. Addonizio's recommendation is below nearly all authorized ROEs for natural gas utilities from 2009 through 2019.[85]

Figure 5- Summary of Recently Authorized ROEs.



70. Mr. Addonizio's recommended ROE of 8.82 percent in his Surrebuttal Testimony is a further outlier.

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[83] Addonizio Direct at 4.

[84] The three lowest authorized ROEs for a natural gas utility in the U.S. between 2009 and 2019 were 8.70 percent for National Fuel Gas Corp on April 20, 2017, 8.80 percent for Central Hudson Gas and Electric Corp. on June 14, 2018, and 8.83 percent for Yankee Gas Company on June 29, 2011. Bulkley Rebuttal at 12.

[85] Bulkley Rebuttal at 10-16.

71. The record further shows how Mr. Addonizio's recommended ROE of 8.82 percent compares to recently authorized returns on a weighted basis ("WROE"), taking into consideration the authorized equity ratios. Based on the Company's proposed common equity ratio of 50.815 percent (which is not disputed by the Department), Mr. Addonizio's recommended ROE of 8.82 percent results in a WROE of only 4.51 percent, while the average WROE for 2019 was 5.11 for recently authorized returns.[86] Mr. Addonizio's recommended WROE of 4.51 percent is significantly below the WROE for 2019 for natural gas utilities.

72. In light of Great Plains' common equity ratio of 50.815 percent, in order for the Company to achieve a WROE equal to the average for 2019 of 5.11 percent, an authorized ROE of at least 10.07 percent would be required.[87]

73. In addition to considering the comparability of returns, the record shows that investors and credit rating agencies use recently authorized ROEs as a measure of the supportiveness of regulation in a jurisdiction. This is evidenced by the fact that ALLETE, Inc. (parent to Minnesota Power) experienced a downgrade in April 2019 based, in part, on a below average authorized ROE of 9.25 percent.[88]

74. Moody's Investor Services "concluded that while Minnesota Power has access to ratemaking mechanisms such as a forward test year and various riders, the ratemaking mechanisms are offset by the rate case outcome, which indicates a less than supportive regulatory relationship between Minnesota Power and the Minnesota Public Utilities Commission."[89] This downgrade was the result of an authorized return below the average authorized ROEs at the time. Mr. Addonizio's recommended ROE of 8.82 percent in this proceeding is 90 basis points below the average authorized ROE for natural gas distribution companies in 2019.[90]

75. Accordingly, the ALJ concludes that Mr. Addonizio's recommended ROE for Great Plains does not meet the comparable return standard and would place Great Plains at a disadvantage vis-à-vis nearly every other gas utility in competition for investor capital.

f. The Department's Reduction in Great Plains' Estimated Flotation Costs is Not Supported.

76. The Department and the Company agree that the investor return requirement that is estimated by a DCF analysis needs to be adjusted for flotation costs in order reflect significant

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[86] Bulkley Testimony Summary at 7; Bulkley Rebuttal at 13.

[87] Bulkley Testimony Summary at 7; Bulkley Rebuttal at 13.

[88] Bulkley Rebuttal at 14-15.

[89] Bulkley Rebuttal at 15.

[90] Bulkley Testimony Summary at 8.

costs associated with issuing new common equity.[91] Inclusion of a flotation cost adjustment is consistent with Commission precedent.[92]

77. The Department asserts that not all equity issuances incur flotation costs and estimates that half of Great Plains' equity was obtained via process that did not incur flotation costs.[93] As a result, the Department divided the flotation cost estimate of 3.68 percent by two to arrive at a flotation cost estimate of 1.84 percent.[94] Great Plains proposed flotation cost adjustment equates to 0.10 percent (ten basis points). The Department's recommend flotation cost adjustment equates to 0.05 percent (five basis points).[95]

78. The Department's proposed adjustment is not supported by the record developed in this proceeding. In making the adjustment, the Department erroneously assumed that (1) half of Great Plains' equity is derived from alternative sources of equity such as dividend reinvestment programs ("DRIPs") and shares issued to employees via compensation plans; and (2) the alternative sources of equity do not result in the Company incurring costs.[96]

79. The record shows that Great Plains' ultimate parent, MDU Resources Group, Inc., incurred costs associated with the equity issued via DRIPs.[97] In light of such facts, the ALJ finds that the Department's recommendation to reduce the flotation cost adjustment by 50 percent is not supported.

B. ALJ's Recommendation on Rate of Return

80. Consideration of the DCF and corroborating analyses conducted by the Company and the Department can reasonably inform the determination of the appropriate ROE for Great Plains in this proceeding. However, expert judgment is necessary to determine where Great Plains' ROE should be set within range of reasonable returns produced by the quantitative analyses.

81. The Company's proposed 10.2 percent ROE falls within the Company's range of reasonable returns resulting from its DCF analyses and is within the range of returns that would have been produced by the Department's DCF analyses if the Department had not relied on inputs that bias the results downward or considered the risks faced by the Company in the current market environment.

82. Based on the record in these proceedings, the ALJ finds that a ROE for Great Plains of 10.2 percent is reasonable and appropriate taking into consideration (1) the unique risk faced by

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[91] Bulkley Rebuttal at 66; Addonizio Direct at 32.

[92] *See generally In the Matter of a Petition by Minn. Energy Resources Corporation for Authority to Increase Natural Gas Rates in Minn.,* Docket No. G-011/GR-13-617, Findings of Fact, Conclusions, and Order at 40 (Oct. 28, 2014).

[93] Addonizio Direct at 31.

[94] Addonizio Direct at 32.

[95] Addonizio Direct at 32.

[96] Bulley Rebuttal at 66-68.

[97] Bulley Rebuttal at 66-67.

Great Plains; (2) current market conditions and investor expectations; and (3) regulatory commission authorized ROEs and the proper application of the comparability standard.

III. REVENUE AND EXPENSE ISSUES

83. There is disagreement between the Company, the Department and OAG on discrete revenue and expense issues. Among the few issues that remain unresolved are whether dues paid for Great Plains' membership in the Minnesota Utility Investors, Inc. ("MUI") and Edison Electric Institute ("EEI") totaling $11,964 should be included in rates and recovered from customers.

84. Great Plains and the Department also disagree regarding whether it is appropriate to require Great Plains to track incentive compensation paid and rate case expense incurred for possible refund to customers in future years.

85. For the reasons set forth below, the ALJ finds that the record supports Great Plains' inclusion of industry dues in rates and the rejection of the Department's proposal to track incentive compensation and rate case expense.

A. Industry Dues

86. Great Plains included $41,872 in test-year expenses related to dues for its membership in various organizations, including $11,964 in expense related to membership in MUI and EEI.[98] OAG recommended a 100% disallowance of MUI and EEI dues and recommends a corresponding reduction in the 2020 test year expense of $11,964.[99] The Department opposes inclusion of MUI dues in the 2020 test year expense and, therefore, recommends a reduction in the 2020 test year expense of $11,500.[100]

87. The ALJ finds that the recovery of MUI dues is appropriate because the record shows that Great Plains' membership benefits customers. MUI focuses on legislation and regulatory policy that affects utilities and utility customers.[101] Recognizing that MUI is engaged in other activities that are arguably focused on utility shareholders, Great Plains removed 35 percent of the MUI annual dues related to lobbying from the Company's test-year due expense.[102] The removal of lobbying expenses ensures that only membership expenses that benefit customers are included in rates.

88. As Great Plains Witness Mr. Travis Jacobson testified, the Department acknowledged "that the Commission has allowed 50 percent of Investor Relations expenses and,

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[98] Ex. GP-2, Statement C - Operating Income, Schedule C-2, page 20

[99] Ex. OAG-1, Direct Testimony of Brian Lebens at 7 ("Lebens Direct").

[100] Ex. DER-6, Direct Testimony of Angela Byrne at 7-10 ("Byrne Direct").

[101] Ex. GP-23, Rebuttal Testimony of Travis Jacobson at 2-3 ("Jacobson Rebuttal").

[102] Jacobson Rebuttal at 3.

at a minimum, Great Plains should be allowed to recover at least 50 percent of the dues to as a way to acknowledge customer benefits."[103]

89. In particular, the Department cited five Commission decisions where the Commission allowed 50% recovery of similar costs, stating, "when the litigating utility did not provide a detailed breakdown of the individual costs within the Investor Relations category, the Commission has denied 50 percent of recovery as a way to acknowledge shareholder benefit."[104] The ALJ finds that these decisions provide further support for the determination that Great Plains' recovery of MUI dues is appropriate.

90. With respect to EEI dues of $464, Great Plains addressed OAG's chief concern that payment of dues to an organization ostensibly for electric utilities benefits Great Plains' natural gas customers.[105] As noted in Mr. Jacobson's Rebuttal Testimony, while the dues were paid to EEI, they were related to EEI's Utility Solid Waste Activities Group ("USWAG").[106]

91. USWAG is an informal consortium of utility companies and other organizations, including the American Gas Association, and is responsible for addressing solid and hazardous waste issues on behalf of the utility industry and is utilized by Great Plains for its natural gas operations.[107] Customers derive clear benefits from Great Plains' membership at a reasonable and modest cost.

92. The ALJ finds that the record supports the Company's proposed industry dues, which the record shows benefit customers. As such, the ALJ finds that the (1) Department's proposed adjustment to decrease test year compensation expense by $11,500; and (2) OAG's proposed adjustment to decrease test year compensation expense by $11,964, are not supported.

B. Incentive Compensation and Rate Case Expense Tracking

93. The Company and Department agree that Great Plains' test-year level of incentive compensation amount of $261,892 (based on a 100 percent target level capped at 15 percent of salary) is reasonable.[108] The Company and Department also agree that Great Plains' rate case expense amount of $592,555 is reasonable.[109]

94. The Department has proposed that the Commission require Great Plains to (1) file an annual report and "refund to ratepayers all incentive compensation amounts approved by the

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[103] Jacobson Rebuttal at 3.

[104] Byrne Direct at 10.

[105] Ex. OAG-2, Surrebuttal Testimony of Brian Lebens at 7-8 ("Lebens Surrebuttal").

[106] Jacobson Rebuttal at 3.

[107] Jacobson Rebuttal at 3.

[108] Ex. DER-7, Direct Testimony of Dale Lusti at 8 ("Lusti Direct").

[109] Lusti Direct at 14.

Commission and included in base rates that are not paid out to employees under the program;"[110] and (2) "track any over-recovery of rate case expenses for credit to the revenue requirement in its next rate case."[111]

95. The ALJ finds that the Department's recommendations are unreasonable as they would (1) constitute impermissible single-issue ratemaking; and (2) prejudice Great Plains' ability to recover the costs of providing service to customers due to the asymmetrical design proposed by the Department.

1. Incentive Compensation

96. It is a bedrock principle of utility ratemaking that single-issue ratemaking should be avoided. This is because some expenses go up and some down in the period between rate cases. Such expense levels, however, are not adjusted until the next rate case, which determines whether the new proposed level of rates is reasonable on a going forward basis based upon all costs and revenues.

97. Acceptance of the Department's recommendation that the Commission require Great Plain to track incentive compensation expense would result in Great Plains being required to refund incentive expense amounts less than target; however, Great Plains would not be permitted to surcharge customers when incentive expenses paid are above target.[112]

98. Because Great Plains' expenses generally increase over time,[113] tracking one expense item in an asymmetrical manner to provide for refunds ignores the fact that any amount of incentive compensation expense included in rates, but not paid in a year, is almost certainly offset by increases in other expenses.[114]

99. The ALJ finds that it is not appropriate to select a one item and only adjust it to the detriment of the Company if expenses go down,[115] particularly where the record shows that each year the Company's expenses vary from the projected level of expenses with a general trend of increasing costs.

100. Great Plains showed how the tracking mechanism proposed by the Department could prevent Great Plains from recovering its costs of providing service to customers by determining any refund liability on an annual basis, without considering (1) the amount of incentive compensation expense included in rates that was paid over the entire period rates

[110] Lusti Direct at 9.

[111] Lusti Direct at 14.

[112] Jacobson Rebuttal at 5.

[113] Evidentiary Hearing Transcript at 44 (March 10, 2020) (acknowledging that public utilities' costs of providing service generally increases over time and that each of Great Plains last few rate cases have resulted in a rate increase).

[114] Jacobson Rebuttal at 6.

[115] Jacobson Rebuttal at 5.

resulting from this rate case are in effect, rather than focusing on a single year;[116] or (2) whether any amount of incentive compensation expense not paid was offset by increases in other expenses, which history has shown has always been the case.[117]

101. The Department's proposal to track incentive compensation expense is also inconsistent with the Commission's treatment of such expenses in the Company's last rate case where incentive compensation expense was based on a three-year average of the incentive payments made by the Company.[118] The record in this case shows that the percentage of incentive compensation paid in 2016, 2017, and 2018 were 101.9, 113.2 and 95.1 percent of target, respectively, which produced an average of 103.4 percent of target.[119] Great Plains' use of a 100 percent target in this proceeding is reasonable and lower than the three-year average of incentive compensation actually paid.[120]

102. While the Department supports its tracking proposal on the basis that the Commission requires Northern States Power Company, Minnesota Power and CenterPoint Energy to track and potentially refund incentive compensation included in rates but not paid on an annual basis,[121] the fact that the Commission required a few select companies to track incentive compensation expense does not mean that it appropriate to require Great Plains to do the same.

103. The ALJ observes that there appears to be more utilities in Minnesota that do not have such a requirement – including Great Plains, even though it completed its last rate case in late 2016. Further, as demonstrated in Great Plains' Initial Brief, the Commission's rationale for imposing such a requirement on NSP has not been shown to be applicable here.

104. Accordingly, the ALJ finds that based on the record developed in this proceeding there is no basis to require Great Plains to track incentive compensation expense; it is inconsistent with the treatment of such expenses in Great Plains' last rate case and not supported by the record in this case.

2. Rate Case Expense

105. The Company's Petition included an adjustment for rate case expenses necessary to prepare and file its initial Petition, including consultant and legal fees, administrative costs and

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[116] Great Plains provided a simple example to illustrate that the total amount paid in incentive compensation may be more than (or equal to) the amount of expense included in rates over the period in which rates are in effect, yet Great Plains could be required to provide refunds in the single year where Great Plains did not pay the full amount because it was not earned under the plan metrics. *See* Great Plains Initial Brief at 34-35.

[117] As Department witness Mr. Dale Lusti acknowledged at hearing, Great Plains' expenses generally increase over time as evidenced by the fact that Great Plains' recent rate cases have all resulted in rate increases. *See* Evidentiary Hearing Transcript at 44 (March 10, 2020).

[118] Jacobson Rebuttal at 5.

[119] Jacobson Rebuttal at 5.

[120] Jacobson Rebuttal at 5.

[121] Lusti Direct at 11.

billings from the ALJ, the Department and the Commission.[122] Importantly, no party challenges the Company's estimate of the rate case expenses expected to be incurred in this proceeding.

106. The Department, however, proposes that the Commission require Great Plains to track any over-recovery of rate case expenses for credit to the revenue requirement in its next rate case.[123]

107. The Department's proposal suffers from the same flaws as its proposal to track incentive compensation: (1) it constitutes single issue ratemaking,[124] and (2) is unduly prejudicial as it would require Great Plains to refund rate case expense if it stays out of a case for more than the four year amortization period, but would not allow Great Plains to recover unamortized costs if it files a rate case sooner.

108. For these reasons, the ALJ finds that the Department's recommendation that Great Plains track rate case expense for possible refund is not supported by the record.

IV. RATE DESIGN

109. The Parties have resolved all but two discrete rate design issues. The only issues in dispute are the (1) appropriate level of Basic Service Charges for Great Plains' Residential and Small Firm General Service classes; and (2) Great Plains' proposal to convert the monthly Basic Service Charges applicable to the Residential and Firm General Service classes from a monthly charge to a daily charge.

110. As discussed below, the ALJ finds that the record supports approval of Great Plains' proposed Basic Service Charges for Great Plains' Residential and Small Firm General Service classes and conversion of such charges to a daily rate.

A. Customer Charge Level – Residential and Small Firm General Service Classes.

111. The Company proposed increasing the amount of fixed charges recovered under the Company's Basic Service Charges for the various customer classes to move toward a more compensatory fixed charge rate. Great Plains proposed increases to the monthly Basic Service Charges for residential customers from $7.50 to $9.00 and the small firm general service customer charge from $23.00 to $27.50.[125] The Department supports the Company's proposed increases.[126]

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[122] *See* Ex. GP-3, Statement Workpapers at C2-22.

[123] Lusti Direct at 14.

[124] As Mr. Jacobson testified with respect to rate case expense, "[d]uring the course of the four-year amortization period it is likely all expenses will change and it is not appropriate to select only one expense and require the Company to track it." Jacobson Rebuttal at 6.

[125] Ex. GP-25, Direct Testimony of Jordan Hatzenbuhler at 20 ("Hatzenbuhler Direct").

[126] Ex. DER-8, Rebuttal Testimony of Michael Zajicek at 1-8 ("Zajicek Rebuttal").

112. The basis for the increased amounts Great Plains proposes to be collected though the Basic Service Charges is the customer component identified in the class cost of service study ("CCOSS").[127] Increasing customer charges closer to the level of fixed costs as proposed by Great Plains promotes equity by eliminating intra-class subsidies and is consistent with Commission precedent.[128] The ALJ further finds that the Company's proposal appropriately mitigates rate shock by not implementing a fully compensatory fixed charge at this time.[129]

113. OAG opposes any increases in the Basic Service Charges for residential and small firm business customers on the basis that the increases would discourage energy conservation, be inconsistent with the intent of monopoly rate regulation, and disproportionally affect low-usage customers.[130] The record shows that the OAG's concerns do not merit rejection of Great Plains' proposed customer charges.

114. Intra-class rate design is a zero sum game. Since the same total revenue requirement must be collected from a particular customer class, the lower the fixed customer charge is set, the higher the volumetric charge must be set and vice versa.

115. As Great Plains Witness Mr. Jordan Hatzenbuhler explained the "increased basic service charge would not discourage energy conservation because . . . the percentage of revenue collected via the basic service charge under current rates and percentage of revenue to be collected via the basic service charge under the proposed rates is the same."[131] In both cases, "17% of total revenues for the residential class is expected to be collected through the basic service charge. As such, the increase to $9.00 per month does not discourage efficiency or conservation efforts."[132] As Department Witness Mr. Michael Zajicek correctly observed, "I do not believe the change is significant enough to impact customers' energy conservation behavior."[133]

116. With respect to OAG's argument that the change impacts low usage customers disproportionately, this is intentional as such customers do not pay the full cost of receiving natural

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[127] Hatzenbuhler Direct at 19-21.

[128] *In the Matter of an Application by Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Natural Gas Service in the State of Minnesota,* Docket No. G-002/GR-04-1511, Order Accepting and Modifying Settlement and Requiring Compliance Filings at p. 7 (August 11, 2005) (stating that "Customer charges play an important role in the rate structure. They reduce utilities' capital costs by ensuring baseline levels of revenue, thereby reducing consumers' rates. They help mitigate rate volatility between seasons by recovering some fixed costs during the low-usage, summer months. They promote equity by ensuring that the rate structure does not shift the full system-costs imposed by low-usage and seasonal customers to normal-usage, high-usage, and year-round customers.").

[129] Hatzenbuhler Direct at 20.

[130] Lebens Direct at 7-9; Lebens Surrebuttal at 2-7.

[131] Ex. GP-27, Testimony Summary of Jordan Hatzenbuhler at 6 ("Hatzenbuhler Testimony Summary"); Ex. GP-26, Rebuttal Testimony of Jordan Hatzenbuhler at 5-6 ("Hatzenbuhler Rebuttal").

[132] Hatzenbuhler Testimony Summary at 6; Hatzenbuhler Rebuttal at 6.

[133] Zajicek Rebuttal at 2.

gas service and are already subsidized by other customers.[134] In this respect, while an increase in the customer charge will increase the rate of low-usage customers more than high-usage customers, a lower customer charge increases intra-class subsidies.[135] Furthermore, in accepting past customer charge increases, the Commission acknowledged that "customer charges constitute just a fraction of customers' bills"—mitigating any affect that the modest increases proposed by the Company would negatively affect low-income customers in any material way.[136]

117. In accepting an increase to the Basic Service Charges for Great Plains' Residential and Small Firm General Service Classes in Great Plains' last rate case, the Commission stated:

> The Commission is not persuaded by the OAG's arguments for leaving the customer charges unchanged. The Commission acknowledges that the Legislature directs the Commission to design rates to promote conservation to the maximum reasonable extent. But the Commission concurs with Great Plains and the Department that a choice to recover the full amount of the revenue increase from only the distribution charge, with no additional contribution coming from the customer charge, would unreasonably burden customers with relatively high consumption.[[137]]

118. In the present case, the ALJ finds that Great Plains demonstrated that residential and small firm customers do not pay the full cost of receiving natural gas service and continue to be subsidized by other customers. The modest increase proposed by the Company will not discourage energy conservation or disproportionally affect low-use customers.

119. Finally, it is worth noting that all four of the other regulated gas distribution utility companies serving Minnesota customers have monthly residential fixed charges ranging from $8.50 to $9.50 per month.[138] Great Plains' proposed residential customer change of $9.00 is comfortably within this range, while its current charge of $7.50 is an outlier.

120. The ALJ finds that the record in this proceeding demonstrates that modestly increasing customer charges Residential and Small Firm General Service classes closer to the level of fixed costs does not adversely affect customers and promotes equity by eliminating intra-class subsidies.

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[134] Hatzenbuhler Testimony Summary at 7 (stating that "just because an increase to the basic service charge inherently disproportionately impacts low-usage customers, it doesn't mean it's a bad result or outcome. It is in fact intentional, and a necessary move to keep intra-class subsidies in check."). *See also,* Hatzenbuhler Rebuttal at 8.

[135] Zajicek Rebuttal at 8-9.

[136] *See, e.g., In the Matter of an Application by CenterPoint Energy for Authority to Increase Natural Gas Rates in Minnesota,* MPUC Docket No. G-008/GR-08-1075, Findings of Fact, Conclusions of Law, and Order at p. 57 (January 10, 2010).

[137] *See In the Matter of a Petition by Great Plains Natural Gas Co., a Division of MDU Resources Group, Inc., for Authority to Increase Natural Gas Rates in Minnesota,* Docket No. G004/GR-15-879, Findings of Fact, Conclusions, and Order at 38 (September 6, 2016)

[138] Hatzenbuhler Testimony Summary at 7.

B. Great Plains' Daily Rate Proposal

121. Great Plains proposed to convert the monthly customer charge to a daily charge for the Service Charges applicable to the Residential and Firm General Service classes. The Department opposed the Company's proposal asserting that it would "increase the complexity of customers' bills and make them less understandable."[139]

122. As demonstrated by the Company, however, charging such fixed costs on a daily basis "provides an awareness and alignment to how customers are billed today. Customers are billed monthly, but those billing periods can and do vary from month to month."[140]

123. In this respect, the record shows that there is no undue complexity associated with Great Plains' proposal. The ALJ finds that Great Plains' proposal would provide customers with additional information in a transparent manner regarding the components that make up the cost of providing natural gas to consumers.[141]

CONCLUSIONS OF LAW AND RECOMMENDATION

1. The Minnesota Public Utilities Commission and the Administrative Law Judge have jurisdiction over the subject matter of this proceeding pursuant to Minn. Stat. Chapter 216B and Section 14.50.

2. Any of the foregoing Findings that should be treated as Conclusions are hereby adopted as Conclusions.

Based on the foregoing Findings and Conclusions, IT IS RECOMMENDED that the Minnesota Public Utilities Commission find and conclude that:

1. Great Plains is entitled to increase gross annual revenues in the manner and in the amount consistent with the terms of this Order.

2. The concepts set forth in these Findings and Conclusions should govern the mathematical and computational aspects of the Findings and Conclusions. Any computations found to be in conflict with the concepts expressed should be adjusted to conform to the concepts expressed in the body of this Report.

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[139] Ex. DER-12, Surrebuttal Testimony of Michael Zajicek at 5 ("Zajicek Surrebuttal").

[140] Ex. GP-32, Rebuttal Testimony of Stephanie Bosch at 3 ("Bosch Rebuttal").

[141] Bosch Rebuttal at 4.

3. Great Plains shall make further compliance filings regarding rates and charges, rate design decisions, and tariff language as ordered by the Commission.

Dated:

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Ann O'Reilly
Administrative Law Judge