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**

GREAT PLAINS NATURAL GAS CO.'S EXCEPTIONS TO THE ALJ'S FINDINGS OF FACT, CONCLUSIONS OF LAW AND RECOMMENDATION

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I. INTRODUCTION

Pursuant to the Minnesota Public Utilities Commission's ("Commission") July 2, 2020 Notice issued in this proceeding, Great Plains Natural Gas Co. ("Great Plains" or the "Company"), a Division of Montana-Dakota Utilities Co., respectfully files limited Exceptions to the Administrative Law Judge's ("ALJ") June 30, 2020 Findings of Fact, Conclusions of Law, and Recommendation ("Recommendation"). Initially, Great Plains greatly appreciates the work undertaken by the ALJ in preparing her Recommendation. The ALJ's Recommendation reflects a thorough, balanced and thoughtful review of the issues. Great Plains does, however, take exception to two discrete aspects of the Recommendation.

First, Great Plains believes the record developed in this proceeding supports the ALJ's recommended return on equity ("ROE") of 9.67%. The recommended return falls within the range of reasonable returns presented in the Department's and the Company's return analyses. Great Plains, however, disagrees with the ALJ's conclusion that the Department of Commerce's ("Department") Discounted Cash Flow ("DCF") analyses are "more reliable" than the DCF analyses presented by the Company. Second, Great Plains takes exception to the ALJ's recommendation that the Commission require Great Plains to track incentive compensation paid and incurred for possible refund to customers on an annual basis. Finally, Great Plains proposes a few minor clarifications/corrections to the Recommendation for the Commission's consideration.

II. EXCEPTIONS

A. Return on Equity

In her Recommendation, the ALJ determined that "due to the risks faced by GP and the average authorized ROEs for other natural gas companies throughout the country, it is reasonable and appropriate for the Commission to select the mean high ROE established in the DOC-DER

DCF analysis of 9.67 percent."[1] A ROE of 9.67% is supported by the DCF and collaborating return analyses presented by both the Department and the Company. A 9.67% ROE falls near the upper end of the Department's DCF analyses and near the mean of the Company's DCF analyses.[2] The record supports the adoption of the ALJ's recommended ROE.

Great Plains disagrees, however, with the ALJ's conclusions that "the DCF conducted by the DOC-DER is more reliable than that presented by the Company."[3] As the ALJ highlights in her Recommendation, the primary difference the DCF analyses performed by the Company and the Department centers around the composition of their respective proxy groups.[4] The Department's proxy group includes five companies that are included in Company's proxy group, but excludes New Jersey Resources ("NJR"), South Jersey Industries ("South Jersey") and NiSource, Inc. ("NiSource").[5] Great Plains believes that the ALJ erred in determining that the Department properly excluded South Jersey and NiSource from its proxy group.[6]

The Department excluded NiSource and South Jersey from its proxy group on the basis that they did not derive 60 percent of their operating income from regulated natural gas distribution operations.[7] The record in this proceeding, however, shows that these companies did not meet the income screen due to one-time financial events. With respect to South Jersey, the

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[1] Recommendation at Finding 284.

[2] *See* Recommendation at Findings 200 and 216. Company Witness Ms. Ann Bulkley concluded that "the range of reasonable ROE results for the proxy group companies is between 9.75 percent and 10.25 percent, and that the just and reasonable cost of equity for Great Plains is 10.20 percent." *See* Ex. GP-16, Rebuttal Testimony of Ann Bulkley at 73 ("Bulkley Rebuttal").

[3] Recommendation at Finding 258.

[4] Recommendation at Findings 258-263.

[5] Recommendation at Findings 190 and 192.

[6] The inclusion or exclusion of NJR from the proxy group has little effect on the overall DCF results.

[7] Recommendation at Finding 259.

record clearly demonstrates that in 2017 and 2018, its on-site energy production segment recorded impairment charges mainly associated with the solar generation assets that another business segment owned.[8] Great Plains demonstrated that such impairments did not continue in 2019.[9]

In particular, on February 26, 2020, South Jersey issued 2019 Results and provided updated guidance for 2020.[10] 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.[11] South Jersey's Report was available before the Department filed its Surrebuttal Testimony on March 3, 2020, and further demonstrates that the magnitude of the impairment charges for 2017 and 2018 were in fact one-time financial events.

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 the Department'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.[12] Simply, the Department's exclusion of South Jersey was improper and, as noted below, biased the results of its DCF analysis downward.

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[8] Bulkley Rebuttal at 20-21.

[9] *See* Ex. GP-35, SJI Reports 2019 Results; Updates 2020 Guidance at 11; *see also* Great Plains Initial Brief at 10-17.

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

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

[12] Bulkley Rebuttal at 21-22.

Similarly, NiSource failed to meet Department's income screen solely due to the financial cost of a significant event that occurred as a result of over pressurized lines on the system of a NiSource subsidiary on September 13, 2018.[13] This resulted in negative operating income from its regulated natural gas distribution operations in 2018.[14] Thus, using the absolute value approach to calculate its operating income screen,[15] the Department determined that NiSource only derived 39.2 percent of total operating income from natural gas distributions operations in 2018—below its 60 percent income screen.[16] However, NiSource failed to meet the Department's income screen solely due to the financial cost of a significant one-time event. 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."[17]

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 the Department.[18] Importantly, the only year where NiSource's percentage of "operating income from natural gas distribution operations was below 55 percent

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[13] Ex. DER-1, Direct Testimony of Craig Addonizio at 50 ("Addonizio Direct"); Bulkley Rebuttal at 22-23.

[14] Addonizio Direct at 49.

[15] As the ALJ states in her Recommendation, "[t]he record establishes that, due to losses in the non-regulated segments of these business, the operating income for the regulated segments of these companies appear disproportionately large. To counteract this distortion, the DOC-DER recommended that GP use the absolute values of each segment's operating income or loss to calculate the total company amount, as well as the percentages attributable to each segment, to avoid this distortion." Recommendation at Finding 259.

[16] Addonizio Direct at 49.

[17] Bulkley Rebuttal at 23.

[18] Bulkley Rebuttal at 23-24.

was 2018."[19] 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."[20] Simply, NiSource should have been included in the Department's proxy group.

While the ALJ concluded in her Recommendation that the relevant inquiry is "whether the companies meet the income screens articulated by the analysts at the time of the analysis,"[21] it is still necessary to examine the basis for excluding a company based anomalous results that impact a company in a single year. This is because the purpose of the ROE analyses is to set the ROE for the forward-looking period that rates will be in effect.[22]

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 model using data through February 13, 2020 (the same date relied on by the Department, including the growth rates relied on by the Department for Northwest Natural Gas),[23] but 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.[24] While the ALJ's recommended ROE of 9.67% is comfortably within the range or returns produced, had the Department properly comprised its proxy group, a higher ROE would

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[19] Bulkley Rebuttal at 23.

[20] Bulkley Rebuttal at 23.

[21] Recommendation at Finding 260.

[22] *See e.g.,* Ex. GP-17, Testimony Summary of Ann Bulkley at 4 ("Bulkley Testimony Summary").

[23] As noted in her Recommendation at Finding 263, the ALJ concluded that Great Plains' use of "inflated" growth rates for Northwest Natural Gas made Great Plains' DCF analysis less reliable than the Department's analysis. As noted, however, use of the Department's growth rates in this analysis results in a range of returns up to 10.77%.

[24] The results also include NJR, which Great Plains believes the Department also improperly excluded from its proxy group. However, the omission of NJR did not bias the Department's DCF analyses downward.

be warranted and supported by the record in this proceeding – including Great Plains' recommended ROE of 10.2%.

B. Incentive Compensation

The Company, the Department and the ALJ 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.[25] The ALJ recommends, however, "that the Commission require the Company to file an annual report identifying the amount of incentive compensation actually paid out each year, along with the other information recommended by the DOC-DER. Upon review of the annual report, the Commission can then determine whether a refund to ratepayers."[26] The primary basis for the ALJ's recommendation is 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.[27] Adoption of the ALJ's recommendation, however, would (1) sanction impermissible single-issue ratemaking; and (2) prejudice Great Plains' ability to recover the costs of providing service to customers due to the asymmetrical design.

First, the record developed in this proceeding showed how the tracking mechanism proposed by the Department and adopted by the ALJ 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 resulting from this rate case are in effect, rather than focusing on

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[25] Recommendation at Findings 112-113.

[26] Recommendation at Finding 113.

[27] Recommendation at Findings 105-108.

a single year;[28] 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.[29]

The manner in which the asymmetrical incentive compensation expense tracking recommended by the ALJ can lead to unjust and unreasonable results can be illustrated through a simple example below, which shows 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 rate 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.

First, assume that the Commission approves the Company's test-year incentive compensation expense of $261,892 and that the rates established in this case remain in effect for three years. If, during the first year rates are in effect, Great Plains pays $251,892 in incentive compensation, if the ALJ's recommendation is adopted, Great Plains would be required to refund $10,000 to customers. If, during the second year rates are in effect, Great Plains pays $10,000 more in incentive compensation than the amount included in rates; Great Plains would not recover such costs from customers.

During the third and final year rates are in effect, assume that Great Plains pays $261,892 in incentive compensation – the exact authorized amount in rates. In such a scenario, the amount of incentive compensation paid by Great Plains is 100% of the amount included in rates during the period of time rates established in the proceeding are in effect, yet if the ALJ's recommendation is adopted, Great Plains would have refunded $10,000 to customers. These

[28] *See* Great Plains Initial Brief at 34-35.

[29] 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) (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).

flaws illustrate the precise problem with tracking a single expense for possible refunds on an annual basis, while ignoring the multi-year period rates are likely to be in effect and the fact that expenses inevitably increase between rate proceedings. This is the reason why single-issue ratemaking is disfavored as generally contrary to sound regulatory principles.

Finally, adoption of the ALJ's recommendation to track incentive compensation expense is inconsistent with the Commission's treatment of such expense in the Company's last rate case. In particular, in Great Plains' most recent gas rate case incentive compensation expense was based on a three-year average of the incentive payments.[30] In the present case, Great Plains showed 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 in this proceeding.[31] 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.[32] 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.

III. MINOR CORRECTIONS

In reviewing the ALJ's Recommendation, Great Plains believes that a small number of Findings/Conclusions require clarification or correction. Accordingly, Great Plains submits the

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[30] Ex. GP-23, Rebuttal Testimony of Travis Jacobson at 5 ("Jacobson Rebuttal").

[31] Jacobson Rebuttal at 5.

[32] Jacobson Rebuttal at 5.

following proposed revisions to the Summary of Recommendation, Findings 1, 356 and 396 and Recommendation 8 for the Commission's consideration:[33]

Summary of Recommendation (p 4):

> Finally, the Judge recommends that the Company's proposed Conservation Improvement Program (CIP) expense of $566,621 be used as the basis for its Conservation Cost Recovery Charge ~~Adjustment~~ (CCRC~~A~~) rate and that any changes to the Conservation Cost Recovery Adjustment (CCRA) factor should be determined in the Company's next annual CIP tracker and financial incentive proceeding, rather than in the instant rate case.

Finding 1

> GP is a division of Montana-Dakota Utilities Co. ~~mpany~~ (MDU). MDU, ~~is~~ a subsidiary of MDU Resources Group, Inc., is an investor-owned company headquartered in Bismarck, North Dakota. GP has a general office in Fergus Falls, Minnesota, and a district office in Marshall, Minnesota. The Company operates as both a local distribution company and a transporter of natural gas to industrial, commercial, and residential customers in 18 Minnesota communities.

Finding 356

> Finally, the Commission should require the Company to perform an improved minimum-size CCOSS using per-foot replacement costs for each type and size of installed distribution pipes, and file such a study in the next general rate case, as recommended by the DOC-DER.

Finding 396[34]

Class	% Responsibility
Residential	~~15.71%~~ 44.46%
Firm General	~~12.53%~~ 33.38%

[33] With respect to the Company's proposed changes to its extension policies, the ALJ notes that Department supports such changes in Finding 369. However, the ALJ does not provide a recommendation on whether such changes should be approved. Great Plains believes this was inadvertent.

[34] The class responsibility percentages provided above represent the class responsibilities resulting from the class revenues reflecting the base cost of gas update submitted in Docket No. GR-19-512 on July 8, 2020 and the allocation of the ALJ revenue requirement (as submitted on July 8, 2020 in Docket No. GR-19-511) in the same manner as Great Plains' original allocation of the revenue increase. The percentages provided in the ALJ's recommendations at Finding 396 did not accurately reflect the class percentage responsibility set forth in Exhibit DER-12 at 8 (Zajicek Surrebuttal) as referenced in footnote 698 of the ALJ report.

Interruptible Grain Drying	~~12.23%~~ 3.24%
Small Interruptible Gas Sales	~~2.53%~~ 6.57%
Small Interruptible Gas Transport	~~16.15%~~ 0.51%
Large Interruptible Gas Sales	~~0.44%~~ 4.59%
Large Interruptible Gas Transport	~~6.04%~~ 7.25%

Recommendation 8

> Use the Company's proposed CIP expense of $566,621 as the basis for its CCRC~~A~~ rate and require that any changes to the CCRA factor be determined in the Company's next annual CIP tracker and financial incentive proceeding.

IV. CONCLUSION

For all of the reasons set forth above, and in its Initial and Reply Briefs, testimony and exhibits, Great Plains' positions on the issues discussed above are fully supported by the record in this proceeding and by sound public policy and are consistent with Minnesota law. The Company respectfully requests that the Commission adopt the ALJ's Recommendation except as provided above.

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Respectfully submitted,

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