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**

REPLY BRIEF OF GREAT PLAINS NATURAL GAS CO.

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TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. DISCUSSION 2

A. Return on Equity 2

1. The Department's Proxy Group Composition Improperly Biases the Results of its Cost of Equity Analyses. 3

2. The Fact that the Department's Recommended ROE for Great Plains is Below Nearly Every Authorized ROEs in the Last 10 Years Cannot be Ignored in Determining a Reasonable ROE for the Company. 6

3. The Unique Risks Faced by Great Plains Cannot be Ignored in Determining a Reasonable ROE for the Company. 8

4. Current Market Conditions Cannot be Ignored in Determining a Reasonable ROE for the Company. 11

5. The Department's Treatment of Growth Rates Improperly Biases the Results of its Cost of Equity Analyses. 14

6. The Department's CAPM Analysis Understates the Required ROE for Great Plains. 16

B. Incentive Compensation 18

C. Customer Charges for Great Plains' Residential and Small Firm General Service Classes. 20

III. CONCLUSION 23

I. INTRODUCTION

Great Plains Natural Gas Co. ("Great Plains" or the "Company"), a Division of Montana-Dakota Utilities Co., files this Reply Brief in response to the Initial Briefs filed by the Department of Commerce, Division of Energy Resources ("Department") and the Office of the Attorney General – Residential Utilities and Antitrust Division ("OAG"). In this Reply Brief, Great Plains addresses only select issues and certain arguments raised by the other parties that require response beyond that already provided in the Company's Initial Brief. Great Plains' decision not to address certain arguments set forth in the Department or OAG's Initial Briefs should not be viewed as agreement with, or acquiesce of, such arguments. Instead, the Company has already fully briefed the issues and, therefore, relies on its Initial Brief and the positions set forth therein, as well as on its Testimony and Exhibits.

As outlined below, Great Plains limits its response to addressing discrete arguments related to the (1) appropriate return on equity ("ROE") for the Company, (2) the Department's recommendation that the Commission require Great Plains to track incentive compensation paid and incurred for possible refund to customers on an annual basis; and (3) OAG's opposition to modest increases in the Basic Service Charges for Great Plains' Residential and Small Firm General Service classes. As discussed below and in the Company's Initial Brief, Great Plains' positions on these issues are consistent with Minnesota law and fully supported by the record of this proceeding. Therefore, the Company respectfully requests that the Administrative Law Judge ("ALJ"), and ultimately the Minnesota Public Utilities Commission ("Commission"), approve the Company's recommendations on these issues and other matters in dispute, all of which are fully addressed in Great Plains' Initial Brief.

II. DISCUSSION

A. Return on Equity

As is evident from the record established in this proceeding, the Department and the Company fundamentally disagree on an appropriate ROE for the Company. In fact, the Department devotes a significant portion of its Initial Brief outlining the methodological steps it followed in arriving at its initial recommended ROE of 8.87 percent and final recommended ROE of 8.82 percent.[1] The Department also critiques Great Plains' witness Ms. Ann Bulkley's analyses, citing certain methodological differences in conducting her costs of equity analyses and her consideration of factors the Department considers unnecessary or unreasonable.[2]

As the Commission has recognized, however, the analytical tools used to determine an appropriate ROE do "not formulaically dictate a particular ROE to be approved" by the Commission.[3] Instead, such analyses present a "range of reasonable returns on equity" from which the Commission determines an appropriate ROE based on the record.[4] In this respect, while it is easy to become mired in the analytical differences employed by the Department and Great Plains (both of which rely primarily on Discounted Cash Flow ("DCF") analyses), both the Department and Great Plains agree that the judgment of the experts is ultimately used to determine an appropriate ROE for Great Plains.[5]

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[1] Department Initial Brief at 32-59.

[2] *Id.* at 60-78.

[3] *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).

[4] *Id.*

[5] *See, e.g.,* Evidentiary Hearing Transcript at 61 (March 10, 2020) (Department Witness Mr. Craig Addonizio stating that "in applying the two-growth DCF, I would say we have to develop a proxy group, we have to define reasonable inputs, ***and that all requires informed judgment so it's not formulaic***.") (emphasis added); Ex. GP-14, Direct Testimony of Ann Bulkley at 44 ("Bulkley Direct") ("The required ROE is estimated by using one or more analytical techniques that rely on market-based data to quantify investor expectations regarding required equity

As discussed below and in Great Plains' Initial Brief, it is apparent from the Department's Initial Brief and Testimony submitted in this proceeding that in nearly every case where judgement is applied to the cost of equity analyses, the Department exercised such judgment in a manner that results in a lower cost of equity for Great Plains. Acceptance of the Department's recommended 8.82 percent ROE for Great Plains would truly be unprecedented and simply would not allow the Company to attract capital on reasonable terms – to the detriment of customers and the Company.

1. The Department's Proxy Group Composition Improperly Biases the Results of its Cost of Equity Analyses.

The Department's exercise of judgment to the detriment of a just and reasonable ROE for Great Plains is most apparent in the composition of its proxy group. In particular, Department witness Mr. Craig Addonizio's application of his income screen to exclude South Jersey Industries ("South Jersey") and NiSource, Inc. ("NiSource") from the Department's proxy group has materially contributed to the low returns produced by his DCF analyses. As Great Plains demonstrated through the testimony of Ms. Bulkley and in its Initial Brief, the exclusion of South Jersey and NiSource was improper, which is evidenced by the Department's changing rationale to justify their exclusion.

As reflected in his Direct Testimony,[6] 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. In response to Mr. Addonizio's

returns, adjusted for certain incremental costs and risks. ***Informed judgment is then applied*** to determine where the company's cost of equity falls within the range of results.") (emphasis added).

[6] Ex. DER-1, Direct Testimony of Craig Addonizio at 11-13 ("Addonizio Direct").

application of his income screen, 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.[7]

In rebuttal 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***, stating:

> It is worth noting that SJI's share of operating income from regulated operations has decreased even in the absence of impairments. In 2016, SJI's operating income totals were not impacted by the impairments at its On-Site Energy Production Unit. Yet, SJI's percentage of operating income was only 64.40 percent. This is more than 6 percentage points lower than the lowest percentage during 2010-2015. It is more than 15 percentage points lower than the average during that six-year stretch (79.49 percent). Ex. DER-9, CMA-S-13 (Addonizio Surrebuttal). While it is not appropriate to draw strong conclusions from one year of data, this decrease is consistent with the growth in SJI's Wholesale Energy Operations unit. This decrease may be indicative of a downward trend in the relative size of SJI's regulated gas operations versus its other business segments. If SJI's Wholesale Energy Operations unit sustains this growth, it could result in SJI's percentage of annual operating income from regulated gas operations dropping below 60 percent on a consistent basis in the future.[[8]]

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."[9] Mr. Addonizio has never applied this approach to screen a proxy group in the past, nor did he apply such a criterion to any other proxy company. Therefore, Mr. Addonizio's change in the

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[7] On February 26, 2020, South Jersey issued 2019 Results and provided updated guidance for 2020. 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. 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. *See* Ex. GP-35, SJI Reports 2019 Results; Updates 2020 Guidance at 11; *see also* Great Plains Initial Brief at 10-17.

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

[9] Addonizio Surrebuttal at 9.

application of his income screen in his Surrebuttal Testimony can only be viewed as an attempt to eliminate a company that has historically been in nearly all natural gas proxy groups used by the Department in prior cases,[10] simply to lower the resulting ROE for Great Plains.

Similarly, Great Plains showed that NiSource failed to meet Mr. Addonizio's income screen solely due to the financial cost of an accident caused by over pressurized lines on the system of a NiSource subsidiary on September 13, 2018.[11] As Ms. Bulkley testified, "[s]imilar to South Jersey, the financial data for NiSource in 2018 was directly affected by a one-time event."[12] The Department does not carefully consider these one-time events which results in the improper exclusion of South Jersey and NiSource from the Department's proxy group. Furthermore, the Department's inclusion of the one-time events for NiSource and South Jersey in the determination of the proxy group stands at odds with the Department's decision to remove the earnings growth rate for Northwest Natural Holding Company, which also included the effect of a one-time financial event from the calculation of the Constant and Two-Growth DCF models.

In its Initial Brief, the Department contends that "Ms. Bulkley's conclusion about South Jersey Industries' future performance is highly speculative" and "the appropriate and reasonable treatment is to exclude it from the proxy group."[13] Mr. Addonizio, however, engaged in speculation; not Ms. Bulkley. As noted above, when faced with evidence that his historical review of income generated by South Jersey failed to factor in one-time financial events in 2017

[10] Bulkley Rebuttal at 29-30.

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

[12] Bulkley Rebuttal at 23.

[13] Department Initial Brief at 37. The Department also states that South Jersey's share of income from regulated operations has decreased "even in the absence of impairments cited by Ms. Bulkley as one-time events." *Id.* The Department fails, however, to respond to Ms. Bulkley's statement that "while Mr. Addonizio suggests in his Surrebuttal testimony, that SJI's share of operating income from regulated operations has declined over time, he recognizes that the operating income for the time period in question did exceed the 60 percent threshold and was currently at 64.40 percent." *See* Ex. GP-17, Testimony Summary of Ann Bulkley at 9 ("Bulkley Testimony Summary").

and 2018, Mr. Addonizio speculated regarding whether South Jersey would meet his income screen in the future. Similarly, with respect to NiSource, the Department indicated that due to the "uncertainty surrounding NiSource, the reasonable approach is exclude the company from the proxy group."[14] The Department refers to such decisions as the "conservative approach of excluding questionable companies" to ensure that "no bias will be introduced to the results of the analyses."[15]

As Great Plains demonstrated in its Initial Brief, the Department's decision to exclude South Jersey and NiSource from its proxy group based on Mr. Addonizio's "conservative approach" biases the DCF results downward[16] to a point where the Department's recommended ROE for Great Plains is below nearly every return authorized for a natural gas company from 2009-2019.[17] As explained below, however, the Department dismisses such facts to support its unreasonably low return results, which have not been shown to allow Great Plains "to earn a fair and reasonable return upon [its] investment" as required by Minn. Stat. § 216B.16, subd. 6.

2. The Fact that the Department's Recommended ROE for Great Plains is Below Nearly Every Authorized ROEs in the Last 10 Years Cannot be Ignored in Determining a Reasonable ROE for the Company.

In its Initial Brief, the Department continues to discount the fact that its recommended ROE for Great Plains is below nearly ever return authorized in the last ten years, characterizing Ms. Bulkley's argument as asserting that "Mr. Addonizio's recommendation was inadequate

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[14] Department Initial Brief at 62.

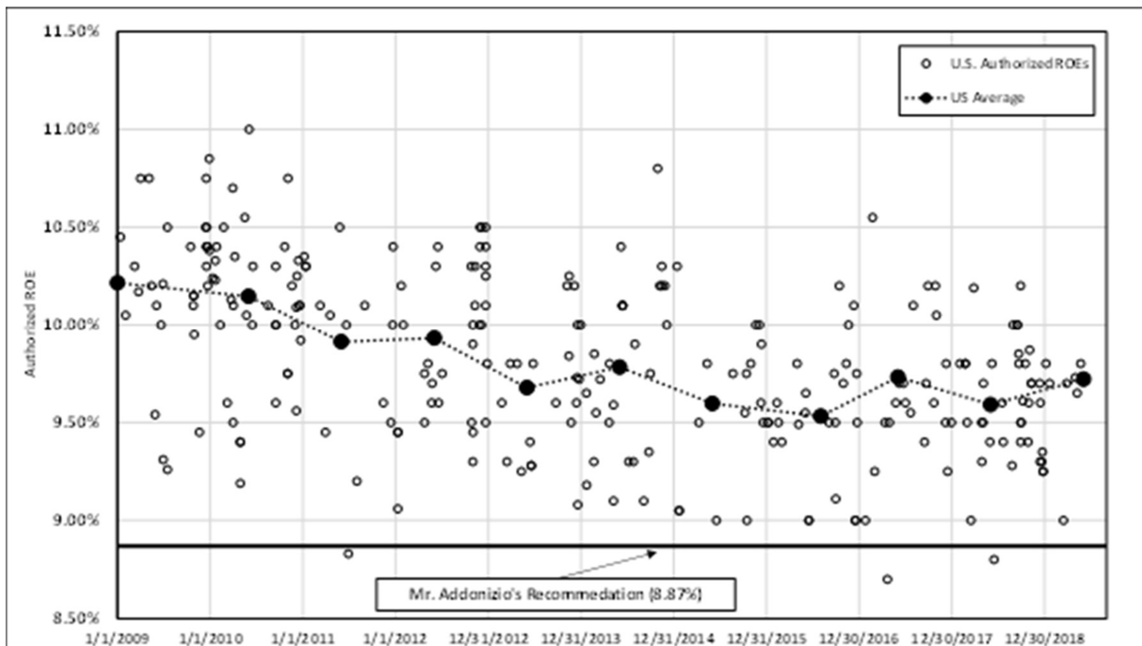
[15] *See, e.g.,* Department Initial Brief at 37 and 61-62.

[16] As Great Plains demonstrated in its Initial Brief, 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 Mr. Addonizio, and the growth rates relied on by Mr. Addonizio for Northwest Natural Gas, 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.

[17] Great Plains Initial Brief at 25-28.

because it was lower than the ROEs approved ***for some other gas utilities in the United States***."[18] As Great Plains demonstrated in its Initial Brief, the Department's recommended return is not simply lower than "some other gas utilities," Mr. Addonizio's recommendation is below nearly every authorized ROE for natural gas utilities from 2009 through 2019.[19] This fact is plainly illustrated in Figure 1 below.

Figure 1- Summary of Recently Authorized ROEs.



In the face of such facts, citing the Commission decision in Otter Tail Power Company's 2017-rate case, the Department asserts that "state commissions sometimes account for other factors when determining a utility's authorized ROE that are not applicable to other utilities."[20] Great Plains generally agrees with this statement, but notes that the Department has ignored all other risk factors unique to Great Plains in this proceeding.

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[18] Department Initial Brief at 46 (emphasis added).

[19] Bulkley Rebuttal at 10-16.

[20] Department Initial Brief at 48.

Furthermore, the Department's notion is in direct conflict with the consideration of the credit rating agencies. As the Company noted in its Initial Brief,[21] 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. In its decision to downgrade ALLETE, Moody's considered the company's various ratemaking mechanisms such as riders and a forward test year; however, the additional ratemaking mechanism were not enough to offset the negative effect of the rate case outcome. Thus, credit rating agencies are considering both the authorized ROE and the business risks of a company in the determination of a credit rating.

The Department's argument that in recommending a 10.2 percent ROE for Great Plains, Ms. Bulkley inappropriately considered (1) the unique risk faced by Great Plains due to its size, customer demographics and industrial load; (2) current market conditions and investor expectations;[22] and (3) regulatory commission authorized ROEs and the proper application of the comparability standard is incorrect and inconsistent with the process employed by the credit rating agencies. As Great Plains demonstrated in its Initial Brief,[23] the Department's decision to disregard such relevant factors undermines its entire analysis and results in its recommended 8.82 percent ROE, which would most likely be viewed negatively by the credit rating agencies.

3. The Unique Risks Faced by Great Plains Cannot be Ignored in Determining a Reasonable ROE for the Company.

In determining where within the range of returns produced by her DCF analyses Great Plains' ROE should be set, Ms. Bulkley appropriately considered the Company's business and financial risk relative to the companies in her proxy group in establishing the range and

[21] Great Plains Initial Brief at 28.

[22] Department Initial Brief at 46-49, 72-78.

[23] Great Plains Initial Brief at 17-21, 22-28.

recommended ROE.[24] 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 selected a proxy group with similar, but not the same risk profiles; and 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."[25]

While the Department states in its Initial Brief that "Mr. Addonizio included a lengthy discussion regarding the differences in risk between Great Plains and the proxy companies,"[26] Mr. Addonizio unequivocally stated at hearing "I don't think it's reasonable to consider the relative risk of Great Plains versus the proxy group members, that was the purpose of the screening process."[27] The Department doubles down on its position in its Initial Brief, stating that "size and customer mix are not relevant considerations."[28] The Department's position is squarely inconsistent with Commission precedent.

In the very Otter Tail decision cited by the Department in its Initial Brief for the proposition that "state commissions sometimes account for other factors when determining a utility's authorized ROE that are not applicable to other utilities,"[29] the Commission found that the higher business risks faced by Otter Tail (which included small size and customer demographics) relative to the proxy group companies supported a return above the mean DCF results. Specifically, the Commission concluded:

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[24] *Id.* at 22-25.

[25] Bulkley Direct at 5-6.

[26] Department Initial Brief at 74.

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

[28] Department Initial Brief at 76.

[29] *Id.* at 48.

> 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.[[30]]

In this respect, despite the fact DCF analyses do not formulaically dictate a particular ROE for Great Plains, Mr. Addonizio treated his DCF results as a mathematical formula and recommended the mean average of such results without considering how his own judgment has biased the results.

As Ms. Bulkley appropriately concluded, "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."[31] In this respect, even if Mr. Addonizio's DCF analyses could be relied on, the record in this proceeding shows that due to the risks faced by Great Plains there is simply no basis to set Great Plains' ROE at 8.82 percent – the mean of his Two-Growth DCF range of 7.9 percent to 9.67 percent.

Furthermore, the Department's recommended ROE is also inconsistent Mr. Addonizio's claim that he used his Capital Asset Pricing Model ("CAPM") as a check on the reasonableness of his DCF results.[32] In particular, Mr. Addonizio's CAPM results reflected in his Surrebuttal

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[30] 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).

[31] Bulkley Rebuttal at 71.

[32] Department Initial Brief at 48.

Testimony produced "an estimated required rate of return on equity of 9.38 percent,"[33] which is 56 basis point higher than the mean Two-Growth 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.[34] Rather than demonstrating the reasonableness of his DCF results, the CAPM results should have signaled that Mr. Addonizio's recommended return is not reasonable.

Importantly, 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."[35] 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."[36] In the present case, there is simply no support for an 8.82 percent ROE for Great Plains.

4. Current Market Conditions Cannot be Ignored in Determining a Reasonable ROE for the Company.

In its Initial Brief, the Department argues that Ms. Bulkley's use of 90- and 180-Tading-Day Periods is unreasonable because the "use of long-term historical process may result in dividend yields that reflect irrelevant information."[37] In support of Mr. Addonizio's reliance on 30-trading-day average, the Department alleges that "[b]asic financial theory holds that current

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[33] Addonizio Surrebuttal at 5.

[34] Addonizio Direct at 37.

[35] *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).

[36] *Id.*

[37] Department Initial Brief at 65.

stock prices fully reflect all publicly available information."[38] Again, however, Mr. Addonizio discounts the fact that market conditions have significantly affected the results of the models used to estimate the cost of equity for Great Plains.

As Ms. Bulkley testified in this proceeding, "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."[39] As Great Plains demonstrated in its Initial Brief,[40] the volatility in the current market cannot be disputed.[41] While the Department asserts that markets are rational and that if investors expected the price of utility stocks to decline they would not continue to hold these assets,[42] the increased volatility is proof of irrational behavior in the market. Mr. Addonizio's recommendation that Great Plains' ROE should be set at the mean of his Two-Growth DCF analysis ignores these unprecedented conditions and again evidences that he continues to exercise his judgment in a manner that biases the results of his analyses.

The record shows that Mr. Addonizio's use of 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.[43] While Great Plains has acknowledged 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 Mr. Addonizio's assumption that market

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[38] *Id.*

[39] Bulkley Testimony Summary at 3.

[40] Great Plains Initial Brief at 17-21.

[41] Bulkley Testimony Summary at 3.

[42] Department Initial Brief at 45.

[43] Great Plains Initial Brief at 20.

conditions that existed on February 13, 2020, will continue to exist during the period that Great Plain's rates will be in effect.[44] Indeed, in its Initial Brief, the Department states:

> First, market conditions and investor attitudes towards risk change over time. Even if a utility's authorized ROE was set exactly equal to the required ROE demanded by equity investors at the time the authorized ROE was set, if market conditions (e.g., interest rates) or investors' level of risk-tolerance have changed, then the authorized ROE will no longer be equal to investors' required ROE. For this reason, ***ROEs authorized even just a few months ago should be viewed with caution***.[[45]]

The same is true for market data used in the DCF model. A lot has changed since Mr. Addonizio estimated his Two Growth model in his Surrebuttal Testimony. Given the volatility in the current market, Mr. Addonizio's reliance on 30-day average of data ending February 13, 2020 "should be viewed with caution."

The record developed in this proceeding shows that in recommending that Great Plains' ROE be set at the mean of his Two-Stage DCF model, Mr. Addonizio ignores the current market environment. Recent market conditions have shown this assumption is not reasonable and highlights the importance of considering current and prospective market conditions when determining where among the range of results Great Plains' authorized ROE should fall.[46] This is consistent with the approach employed by Ms. Bulkley in recommending a 10.2 percent ROE for Great Plains.

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[44] *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.").

[45] Department Initial Brief at 47-48. Emphasis added.

[46] The Department further alleges that "Ms. Bulkley asserted that utility valuations should be expected to fall in the future as a result. On this basis, Ms. Bulkley concluded that the DCF model, which uses stock prices as an input, is overstating the cost of equity for utilities." *Id.* at 75. This does not accurately characterize Ms. Bulkley's conclusion. The current high valuations result in the DCF ***understating*** the cost of equity. *See* Bulkley Testimony Summary at 4.

5. The Department's Treatment of Growth Rates Improperly Biases the Results of its Cost of Equity Analyses.

As evidenced by the Initial Briefs filed by the Company and the Department, there is significant disagreement as to whether Mr. Addonizio's exclusion of Value Line's projected earnings growth rate for Northwest Natural Holding Company ("Northwest Natural") from his DCF model was appropriate.[47] As the Department notes in its Initial Brief, for the expected dividend growth rate for each company in its proxy group, "Mr. Addonizio relied on the expected earnings growth rates provided by three respected and widely-used investment research services, Zacks Investment Research (Zacks), Value Line, and Thomson First Call (Thomson). Specifically, he used the three projected earnings growth rates (lowest, average and highest) provided by Zacks, Value Line, and Thomson."[48]

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.[49] At the same time, Mr. Addonizio inconsistently included the extremely low growth rate for another company in his proxy group, Spire, Inc. Again, Mr. Addonizio's exercised his judgement in a manner that biased the results of his analysis downwards. As Ms. Bulkley explained:

> The Two-Stage DCF model that has consistently been applied by this Commission includes its own statistical outlier test, which removes outlier growth rates, high and low, from the long-term growth stage of the model. Mr. Addonizio's decision to remove the Northwest Natural Value Line growth rate affects the calculation of the average and standard deviation for the proxy group in the Two-Stage DCF model. Not only does this affect the results for Northwest Natural, but it biases the remainder of the analysis because it alters the standard deviation by which all other growth rates in the model are measured.[[50]]

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[47] *See* Great Plains Initial Brief at 21-22.

[48] Department Initial Brief at 39.

[49] *Id.* at 40-41.

[50] Bulkley Testimony Summary at 11.

In this respect, "[b]y including this outlier test in the model, the Commission's methodology eliminates the introduction of bias by any analyst in the selection of growth rates and allows for the market expectations to be evaluated without undue influence from the analyst."[51] Mr. Addonizio's decision to remove Northwest Natural growth rates prior to applying the statistical test used in the Two-Stage DCF model because they are too high biases the results of the analysis.

The Department's Initial Brief also highlights additional subjectivity applied by Mr. Addonizio in using his judgement with respect to growth rates. In particular, the Department asserts:

> Additionally, Ms. Bulkley's rebuttal testimony argued that Mr. Addonizio should have excluded Spire Inc.'s 2.37 percent earnings growth rate from Yahoo! ("SR" in Figure 5) as unreasonably low. In response, Mr. Addonizio's surrebuttal testimony first explained that the magnitude of the year-to-year changes in Spire's earnings was significantly smaller than the year-to-year changes that impacted Value Line's calculation of NWN's growth rate. Mr. Addonizio second explained that Ms. Bulkley's concern was mooted by updated financial information that resulted in an upwards adjustment to Spire Inc.'s estimated growth rate.[[52]]

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 Direct Testimony is the exact subjectivity the Commission tried to remove from the DCF model by developing the Two-Growth outlier test. 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.[53] If analysts are simply allowed to exclude or include growth rates for companies based on the analyst's subjective determination of whether the

[51] *Id.* at 11.

[52] Department Initial Brief at 41-42.

[53] Bulkley Rebuttal at 34.

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. Simply, Mr. Addonizio's removal of Northwest Natural's growth rate in this case is inappropriate and would establish a poor precedent for future cases.

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."[54] Accordingly, 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.

6. The Department's CAPM Analysis Understates the Required ROE for Great Plains.

In its Initial Brief, the Department states that "Mr. Addonizio checked the reasonableness of his constant growth DCF and Two-Growth DCF analyses by using the Capital Asset Pricing Model (CAPM). CAPM's basic premise is that any company-specific risk can be diversified away by investors. Therefore, the only risk that matters is the stock's systematic risk, which is measured by beta (market risk premium)."[55] Setting aside the fact that Mr. Addonizio recommends an 8.82 percent ROE for Great Plains, which is 56 basis points below the required return of 9.38 percent produced by his CAPM analysis, the Department's CAPM analysis

[54] Bulkley Testimony Summary at 11-12.

[55] Department Initial Brief at 51.

similarly understates the cost of equity required by Great Plains. Mr. Addonizio's beta calculation contributes to this problem because he fails to ensure that the historical Beta calculation is not unduly influenced by the period following the implementation of the Tax Cuts and Jobs Act ("TCJA"). As Ms. Bulkley testified, the "TCJA has reduced utility revenues due to the lower federal income taxes, the end of bonus depreciation, and the requirement to return excess Accumulated Deferred Income Taxes ('ADIT'). This change . . . has led to weaker credit metrics and negative ratings actions for some utilities."[56]

Mr. Addonizio's use of Value Line betas, which are calculated using five years of data, do not appropriately account for the TCJA's impact on utilities' stock performance relative to the S&P 500 Index as Value Line's betas are artificially low, and therefore produce artificially low CAPM results.[57] While the Department purports to show in its Initial Brief that the Beta has been declining over a longer time period and therefore the 5-year Beta is reasonable,[58] Ms. Bulkley refuted such demonstration.

Using Atmos Energy as an example, Ms. Bulkley showed through the figure below that historically Beta has not been in gradual decline, but has rather been cyclical and that the historical average Beta is within a reasonable range of the 10-year beta relied on in her CAPM analysis.[59] Therefore, relying on a longer-term average Beta is a better representation of the future than the five year Beta relied upon by Mr. Addonizio.

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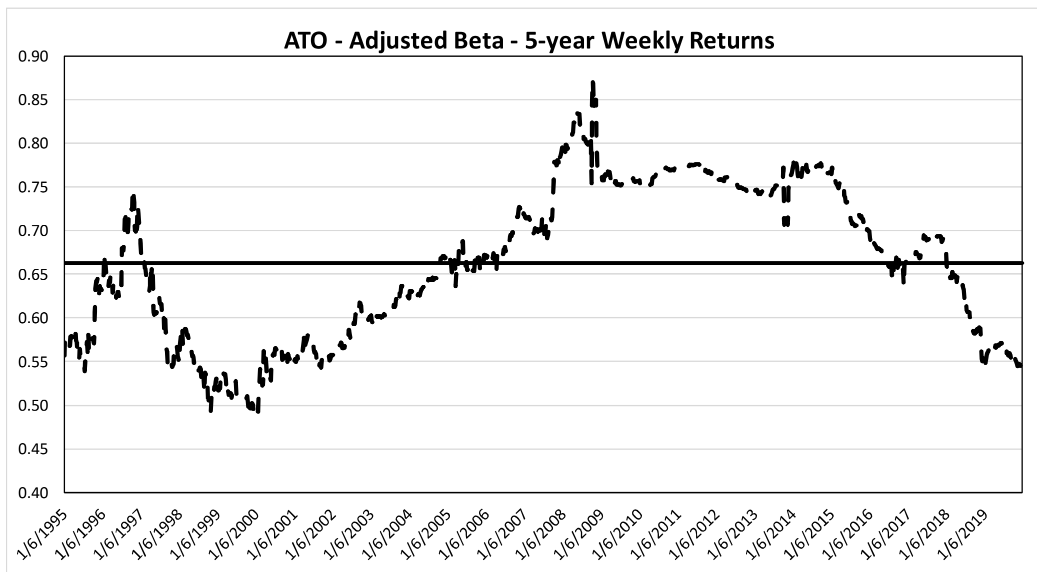
[56] Bulkley Direct at 34.

[57] Buckley Rebuttal at 54-57.

[58] Department Initial Brief at 58.

[59] Bulkley Testimony Summary at 12-13.

Beta for Atmos Energy



As Ms. Bulkley testified, had Mr. Addonizio relied "on a Beta calculation that is more representative of the long-term relationship between utilities and the market results in an ROE estimate of 9.90 percent excluding flotation costs. This result falls within the range of 9.75 percent to 10.25 percent that I recommend in my Direct Testimony and is more consistent with my recommendation of 10.20 percent than Mr. Addonizio's recommendation of 8.87 percent."[60] Thus, Ms. Bulkley recommended that "the Commission place greater weight on this revised analysis because it is internally consistent and more appropriately reflects investor expected return requirements than the estimate developed by Mr. Addonizio's CAPM analysis."[61]

B. Incentive Compensation

The Department recommended that the Commission require Great Plains to file an annual report and "refund to ratepayers all incentive compensation amounts approved by the Commission and included in base rates that are not paid out to employees under the program."[62]

[60] Bulkley Testimony Summary at 13.

[61] Bulkley Testimony Summary at 13.

[62] Ex. DER-7, Direct Testimony of Dale Lusti at 9 ("Lusti Direct").

In its Initial Brief, the Department supports its proposal primarily 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.[63] However, 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.

First, it should be noted that it appears that there are more utilities in Minnesota that are not required to track incentive compensation paid for potential refund—including Great Plains, notwithstanding the fact that 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 in not applicable here.[64]

More importantly, however, 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 resulting from this rate case are in effect, rather than focusing on a single year;[65] 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.[66]

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[63] Department Initial Brief at 10-12.

[64] Great Plains Initial Brief at 35-36.

[65] 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.

[66] 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) (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).

These 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. Accordingly, 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[67] and not supported by the record in this case.

C. Customer Charges for Great Plains' Residential and Small Firm General Service Classes.

The Department and Great Plains' Initial Briefs fully demonstrate that 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 customers from $23.00 to $27.50 is just and reasonable.[68] Nothing in OAG's Initial Brief refutes such demonstration. Great Plains nevertheless takes this opportunity to respond to OAG's suggestion that the Commission's approval of an increase in the Basic Service Charges in Great Plains' last rate case in some manner precludes an increase in the present case.

In particular, in its Initial Brief OAG asserts, "neither Great Plains nor the Department has shown that increasing the residential or small-business customer charge would result in a charge that is more just and reasonable than the current one."[69] According to OAG, "[i]n Great Plains' last rate case, the Company sought to increase its residential customer charge from $6.50 to $9 and its small-business customer charge from $20 to $25. The Commission, however, only allowed the Company to increase the charges in proportion to the increase in its overall revenue

[67] Great Plains Initial Brief at 36-37.

[68] *Id.* at 37-40; Department Initial Brief at 103-104.

[69] OAG Initial Brief at 10.

requirement."[70] OAG asserts that "[i]mplicit in this decision was a finding that these customer charges were just and reasonable."[71] OAG's reliance on the Commission's decision in Great Plains' last rate case is misplaced.

In accepting an increase to the Basic Service Charges for Great Plains' Residential and Small Firm General Service Classes in the 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.[[72]]

In the present case, Great Plains demonstrated that low-use residential and small firm customers do not pay their share of the fixed cost of receiving natural gas service and continue to be subsidized by other customers within those classes.[73] This point was also made by Department witness Mr. Michael Zajicek, who testified:

> While it is accurate to state that an increase in the customer charge will increase the rate of low-usage customers more than high-usage customers, it misses important context. Specifically, as explained above, a lower customer charge increases intra-class subsidies; meaning, that low-usage customers are not paying their share of costs. An increase to the customer charge may impact low usage customers more, but this is because they have been paying less than they should have compared to other customers.[[74]]

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[70] *Id.* at 12.

[71] *Id.*

[72] *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)

[73] Ex. GP-27, Testimony Summary of Jordan Hatzenbuhler at 7 ("Hatzenbuhler Testimony Summary") (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,* Ex. GP-26, Rebuttal Testimony of Jordan Hatzenbuhler at 8 ("Hatzenbuhler Rebuttal").

[74] Ex. DER-8, Rebuttal Testimony of Michael Zajicek at 8-9 ("Zajicek Rebuttal").

Simply, 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.

Finally, OAG cites Minn. Stat. § 216B.16, Subd. 15 in support of its position that the Commission "must also consider ability to pay as a factor in setting rates."[75] Initially, Minn. Stat. § 216B.16, Subd. 15 pertains to the Commission's authority to establish "low income affordability programs."[76] Consistent with the statutory mandate, Great Plains has established a Gas Affordability Program or GAP. More importantly, however, Great Plains established in its Initial Brief that 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.[77]

Lower income customers are not unreasonably impacted by a modest increase in the Basic Service Charge. As the Commission has stated, "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.[78] The record in this proceeding demonstrates that modestly increasing customer charges Residential and Small

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[75] OAG Initial Brief at 11.

[76] In particular, Minn. Stat. § 216B.16, Subd. 15 (a) provides that "the commission must consider ability to pay as a factor in setting utility rates and may establish affordability programs for low-income residential ratepayers in order to ensure affordable, reliable, and continuous service to low-income utility customers. A public utility serving low-income residential ratepayers who use natural gas for heating must file an affordability program with the commission."

[77] Great Plains Initial Brief at 39. As 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." 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").

[78] *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 57 (January 10, 2010).

Firm General Service classes closer to the level of fixed costs does not adversely affect customers and promotes equity by eliminating intra-class subsidies. Accordingly, Great Plains' proposed changes should be approved.

III. CONCLUSION

For all of the reasons set forth above, and in its Initial Brief, Testimony and exhibits, Great Plains' positions on the remaining disputed issues 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 ALJ and Commission approve the Company's recommendations on the disputed matters in this proceeding.

Dated: April 24, 2020

Respectfully submitted,

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