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**

INITIAL BRIEF OF GREAT PLAINS NATURAL GAS CO.

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I. INTRODUCTION

On September 27, 2019, Great Plains Natural Gas Co. ("Great Plains" or the "Company"), a Division of Montana-Dakota Utilities Co., filed a Petition seeking Minnesota Public Utility Commission ("Commission") authorization to increase natural gas rates for utility service to Great Plains' Minnesota customers by $2,860,839, representing a 12.0 percent increase in revenues. The purpose of the requested rate change was to produce additional revenues to meet Great Plains' cost of service for the test year ending December 31, 2020, and to more closely align customers' rates with costs.

Since Great Plains filed its last rate case in 2015,[1] several factors contributed to Great Plains' current revenue deficiency. The primary reason for the need for an increase in rates is Great Plains' increased capital investment in its Minnesota distribution system to improve system safety and reliability.[2] The additional investment has generally increased the Company's associated depreciation, taxes and operation and maintenance ("O&M") expenses.

Through the course of this proceeding, the Company, the Department of Commerce Division of Energy Resources ("Department") and the Office of the Attorney General – Residential Utilities and Antitrust Division ("OAG") have resolved most of the issues raised in this proceeding.[3] However, discrete issues remain in dispute—the most significant of which is the appropriate return on equity ("ROE") for the Company.

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[1] Great Plains' last natural gas rate case was filed in Docket No. G-004/GR-15-879 on September 30, 2015, with interim rates implemented on January 1, 2016 and final rates implemented on January 1, 2017.

[2] Ex. GP-10, Direct Testimony of Nicole Kivisto at 6 ("Kivisto Direct").

[3] The parties to this proceeding identified "undisputed" issues in their Joint Issue Matrix filed on March 30, 2020. A discussion of such undisputed issues will be set forth in Proposed Findings of Fact, Conclusions of Law and Recommendation on stipulated issues, which is being filed concurrently with this Brief. Great Plains will also submit Proposed Findings of Fact, Conclusions of Law and Recommendation on Disputed Issues on April 24, 2020.

The Company supported a ROE of 10.2 percent in this proceeding, while the Department recommends a ROE of 8.82 percent. This difference accounts for approximately $300,000 of the $363,308 in adjustments proposed by the Department in this proceeding.[4] The only other expense adjustment in dispute relates to the Department, OAG and the Company's disagreement over whether certain 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.

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. Finally, two discrete rate design issues remain unresolved: (1) the appropriate level of the Basic Service Charges for the Company's residential and small firm business customer classes; and (2) Great Plains' proposal to convert the monthly Basic Service Charge to a daily Charge.

As discussed below, Great Plains' positions on these remaining disputed 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 Commission, approve the Company's recommendations on the few remaining disputed matters for the reasons outlined below.

II. EXECUTIVE SUMMARY

Each application to change rates (rate case) stands on its own merits. While the Company has demonstrated that its current rates are not sufficient to cover the cost of providing service to its customers, the Department and OAG have taken positions that, if adopted, would

[4] The Department has determined a revenue deficiency for the Company of $2,486,378, which is $363,308 lower than the Company's filed case. *See* Ex. DER-15, Surrebuttal Testimony of Dale Lusti at 10 ("Lusti Surrebuttal").

deny Great Plains' recovery of costs that are known, measurable, and incurred in providing reliable gas service to customers.

The fundamental question that was definitively answered is whether Great Plains' cost of providing service to its Minnesota customers is adequately reflected in its currently authorized rates. Throughout the course of these proceedings, the Company has demonstrated by a preponderance of the evidence that it is not and that a rate increase of $2,818,293 is warranted, as its expenses have outstripped its revenues.[5] The Company has also demonstrated that its proposed rate design and revenue responsibility apportionment among customer classes is just and reasonable and appropriately reflects a gradual movement towards cost, without upsetting customer expectations. Finally, the record supports a fair and reasonable overall rate of return of 7.46 percent, with a return on common equity of 10.2 percent. The Department's proposed 8.82 percent return on common equity (resulting in an overall rate of return of 6.760 percent) would not allow the Company an opportunity to earn a reasonable return on its investment and access capital markets on reasonable terms.

III. LEGAL STANDARD

The legal standard for establishing rates for natural gas service in Minnesota is clear. In this proceeding, the Company has the burden to demonstrate that its proposed rate increase is just and reasonable by a preponderance of the evidence.[6] 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

[5] This amount represents Great Plains' calculated revenue deficiency based upon the changes agreed to by the Company throughout the course of this proceeding.

[6] Minn. Stat. § 216B.16, Subd. 4.

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."[7]

The Minnesota Supreme Court has stated 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."[8] The record in this proceeding shows that Great Plains has met its burden and demonstrated that its proposed rate increase and a ROE of 10.2 percent are just and reasonable.

IV. COST OF CAPITAL

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. The Department and the Company agree on the Company's 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' actual capital structure.[9] The Department and the Company disagree, however, on an appropriate return on common equity for the Company.

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[7] Minn. Stat. § 216B.16, Subd. 6.

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

[9] Great Plains' overall cost of capital is the average of the costs of long-term debt, short-term debt, preferred stock 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%

Great Plains demonstrated that return on common equity of 10.2 percent is required in order for Great Plains to be in a position to raise capital on reasonable terms, in part, due to the risks its faces because of its small relative to the size of the proxy companies and concentration of industrial customers in its service territory focused on agriculture or the production of ethanol. The Department recommends an 8.82 percent ROE through the Surrebuttal Testimony of Mr. Craig Addonizio filed on March 3, 2020—notwithstanding the extreme volatility present in the capital markets, the unique risks faced by Great Plains and the fact that a 8.82 percent ROE would be lower than nearly all the authorized ROEs in the United States for the past ten years. As discussed below, a 10.2 percent ROE is within the range of reasonable returns estimated for Great Plains in these proceedings and should be adopted.

A. Cost of Common Equity Generally

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.,*[10] the Court concluded:

> 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.[11]

The Court elaborated on this requirement in *Federal Power Commission v. Hope Natural Gas Co.*[12] 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

[10] 262 U.S. 679 (1923) ("Bluefield").

[11] *Id.* at 692.

[12] 320 U.S. 591 (1944) ("Hope").

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.[13]

Accordingly, the standards established by the Court, and adopted by the Commission,[14] 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.

The Courts have concluded that consistent with the standard established in *Hope,* that in determining an appropriate ROE, a Commission must consider the risks of the target company relative to the proxy companies.[15] In this respect, the fundamental question to be answered is where within the range of returns established by both Great Plains and the Department's analyses should the return for Great Plains be placed based upon the risk Great Plains faces relative to the proxy companies.

B. Great Plains' Analysis Supports a 10.2 Percent ROE.

In determining an appropriate ROE, Great Plains Witness Ms. Ann Bulkley calculated the cost of common equity capital for Great Plains' Minnesota natural gas distribution operations

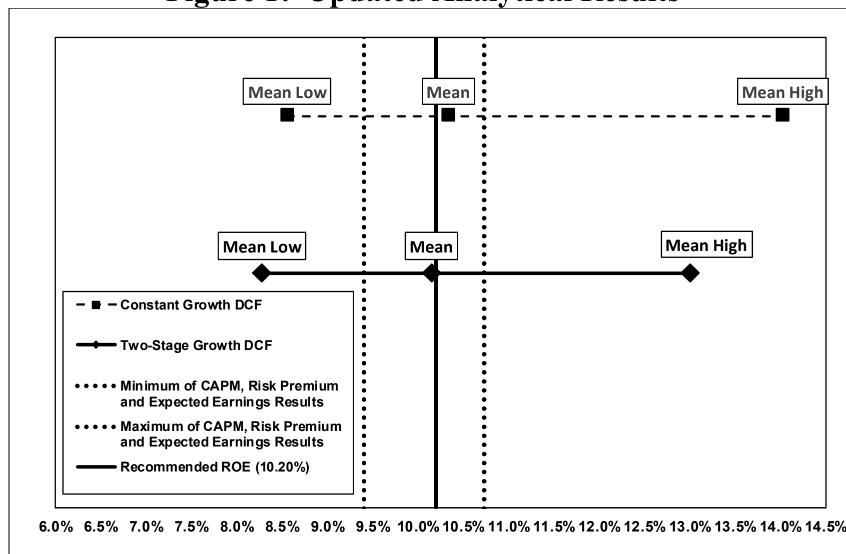
[13] *Id.* at 603 (internal citations omitted).

[14] *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).

[15] *See, e.g., Petal Gas Storage, L.L.C. v. Federal Energy Regulatory Commission*, 496 F.3d 695 (D.C. Cir. 2007) ("Petal Gas").

based on the Constant Growth Discounted Cash Flow ("DCF")[16] and the Two-Stage DCF models of a group of proxy companies that have risks similar to those of Great Plains' Minnesota gas distribution operations.[17] In addition, Ms. Bulkley used other analytical approaches including the Capital Asset Pricing Model ("CAPM"), Bond Yield Risk Premium[18] and Expected Earnings analysis[19] 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.[20] The results of Ms. Bulkley's analyses are illustrated in Figure 1 below:

Figure 1: Updated Analytical Results[21]



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[16] 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.

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

[18] Ms. Bulkley described the Risk Premium method as follows: "In general terms, this 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.

[19] 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.

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

[21] Bulkley Rebuttal at 8, Figure 1.

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.[22] Instead, such analyses present a "range of reasonable returns on equity" from which the Commission determines an appropriate ROE based on the record.[23] Consistent with this recognition, Ms. Bulkley explained because the Constant Growth and Two-Growth DCF models produced a wide range of results, she used the "CAPM, Risk Premium and Expected Earnings analyses to check the reasonableness of the results of the DCF models and to inform my decision as to where Great Plains' ROE falls."[24]

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 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 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]

Specifically, Ms. Bulkley appropriately 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

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[22] *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).

[23] *Id.*

[24] Bulkley Direct at 5.

[25] Bulkley Direct at 5-6.

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.[26] Based on these considerations, Ms. Bulkley demonstrated 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. According to Ms. Bulkley:

> Based on my updated ROE analyses, I conclude 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. Consistent with the recent conclusions of the Commission, my recommendation relies primarily on the results of the DCF models but also considers other analytical approaches such as the CAPM, Risk Premium and Expected Earnings analyses to check the reasonableness of the results of the DCF models and to inform my decision as to where Great Plains' ROE falls. In addition, my recommendation considers other factors in determining the appropriate ROE, including company specific risk factors, and the capital attraction standard.[[27]]

The 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.

C. The Department's Analyses underlying its Recommended 8.82 Percent ROE for Great Plains are Fundamentally Flawed.

Relying on its Two-Growth DCF analysis, the Department initially recommended a ROE of 8.87 percent – the mean of Mr. Addonizio's proposed range of 7.99 percent to 9.70 percent.[28] In his Surrebuttal Testimony, Mr. Addonizio updated his DCF analyses and revised his recommended 8.87 percent ROE downward to 8.82 percent—the mean of his new range of 7.90 percent to 9.67 percent.[29] The record in this case demonstrates that the Department's recommended 8.82 percent ROE is artificially low due to fundamental errors in the Department's

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[26] Bulkley Rebuttal at 3-4.

[27] Bulkley Rebuttal at 73.

[28] Ex. DER-1, Direct Testimony of Craig Addonizio at 27 ("Addonizio Direct").

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

DCF and CAPM analyses and the Department's 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. As discussed below, such errors and omissions include:

(1). Mr. Addonizio's improper exclusion of three companies in his proxy group, which if included in his DCF analyses, would have resulted in a mean ROE of 9.23 percent and a high result of 10.77 percent.[30]

(2). Mr. Addonizio's failure to consider how the results of his Two-Growth DCF model are being distorted by anomalous conditions in the capital markets and how such failure is compounded by Mr. Addonizio's reliance on 30-day average stock prices.

(3). Mr. Addonizio's erroneous application of his own judgement in the selection of growth rates used in his Two-Stage DCF model.

(4). Mr. Addonizio's failure to follow Commission precedent and consider the differences in various risk factors between Great Plains and the companies in his proxy group that should be considered in setting a ROE for Great Plains.

(5). Mr. Addonizio's failure to consider recently authorized ROEs that show that his recommend ROE of 8.82 percent is below nearly all authorized ROEs for natural gas utilities from 2009 through 2019.

(6). Mr. Addonizio's arbitrary reduction in Great Plains' flotation costs.

Each error is discussed in turn below and further supports adoption of Great Plains' recommended 10.2 percent ROE in this proceeding.

1. Mr. Addonizio's Failure to Include South Jersey Industries and NiSource, Inc. in his Proxy Group Biased the Results of his DCF Analyses Downward.

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

[30] *See e.g.,* Ex. GP-17, Testimony Summary of Ann Bulkley at 9-10 ("Bulkley Testimony Summary").

Premium used as a check on the reasonableness of the DCF results.[31] The DCF model is based on the theory that a stock's current price represents the present value of all expected future cash flows.[32] 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."[33] Use of a proxy group "moderates the effects of unusual events that may be associated with any one company."[34] As Ms. Bulkley testified, "[t]he key consideration in determining the cost of equity is to ensure that the methodologies 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."[35]

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;

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[31] *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").

[32] Bulkley Direct at 52.

[33] Bulkley Direct at 40.

[34] Bulkley Direct at 40.

[35] Bulkley Direct at 44.

- 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.[36]

Based on the use of her screening criteria, Ms. Bulkley included the following companies 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":[37]

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

In developing its proxy group, the Department applied a similar screening criteria, which required that a company (a) be traded on one of the stock exchanges, (b) have a Standard and Poor's ("S&P") credit rating from BBB to A+, (c) derive more than 60 percent of its total operating income from regulated gas operations, and (d) not currently be involved in a merger or acquisition.[38] Based on the application of his screening criteria, Mr. Addonizio's proxy group includes five companies that are included in Ms. Bulkley's proxy group, but excludes New Jersey Resources, South Jersey Industries ("South Jersey") and NiSource, Inc. ("NiSource").[39]

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[36] Bulkley Direct at 42.

[37] Bulkley Direct at 40-41.

[38] Addonizio Direct at 9-13.

[39] Addonizio Direct at 13.

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.

Initially, Mr. Addonizio excluded NiSource and South Jersey from his proxy group on the basis that they did not derive 60 percent of their operating income from regulated natural gas distribution operations. Mr. Addonizio's conclusion is flawed as he failed to recognize that these companies did not meet his income screen due to one-time financial events unlikely to be repeated, which skewed his analysis.

As Ms. Bulkley explained:

> The basis for excluding NiSource and South Jersey is Mr. Addonizio's 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. Rather than including the actual loss from a business segment as its contribution to net operating income, Mr. Addonizio has reflected negative operating income for a segment using the absolute value. While I agree that investors are exposed to the risk of each business segment of a company, I disagree with Mr. Addonizio's use of the absolute value in the specific cases of South Jersey and NiSource.[[40]]

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. With respect to South Jersey, the record clearly demonstrates that in 2017 and 2018, the on-site energy production segment recorded impairment charges mainly associated with the solar generation assets that another business segment owned. As Ms. Bulkley testified:

> [I]n 2017, South Jersey realized that the fair value of its solar portfolio was well below the carrying value and thus was impaired. As a result, the company recorded a combined impairment charge for it solar facilities in 2017 of $71.3 million. In 2018, South Jersey entered into an agreement to sell the solar assets; however, the purchase price of the assets was lower than the carrying value of the

[40] Bulkley Rebuttal at 19.

> assets and thus, South Jersey recorded another impairment charge within the on-site energy production segment of $99.2 million. Therefore, the negative operating income associated with the on-site energy production segment was the result of impairment charges for the company's solar assets that South Jersey has since divested. Therefore, the negative operating income associated with the on-site energy production segment likely only affects the company's financial statements in 2017 and 2018.[[41]]

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.[42]

While Mr. Addonizio asserted that Ms. Bulkley's conclusion that the impairment charges would not have a large effect on South Jersey's financial statements in 2019 and beyond is "highly speculative,"[43] on February 26, 2020, South Jersey issued 2019 Results and provided updated guidance for 2020.[44] 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.[45] 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.

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[41] Bulkley Rebuttal at 20-21.

[42] Bulkley Rebuttal at 21-22.

[43] Addonizio Surrebuttal at 7.

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

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

Furthermore, "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."[46] Simply, 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.

Mr. Addonizio's exclusion of NiSource from its proxy group is similarly flawed. In particular, Mr. Addonizio indicated that NiSource derived negative operating income from its regulated natural gas distribution operations in 2018.[47] Thus, using the absolute value approach to calculate his operating income screen, 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.[48] However, NiSource failed to meet Mr. Addonizio'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.[49] 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."[50]

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

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[46] Bulkley Testimony Summary at 9.

[47] Addonizio Direct at 49.

[48] Addonizio Direct at 49.

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

[50] Bulkley Rebuttal at 23.

natural gas distribution operations for NiSource from 2010 through 2018 using the absolute value method recommended by Mr. Addonizio.[51] Importantly, the only year where NiSource's percentage of "operating income from natural gas distribution operations was below 55 percent was 2018."[52] 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."[53]

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."[54] 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."[55] Simply, NiSource should have been included in Mr. Addonizio's proxy group.

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

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[51] Bulkley Rebuttal at 23-24.

[52] Bulkley Rebuttal at 23.

[53] Bulkley Rebuttal at 23.

[54] Addonizio Surrebuttal at 12.

[55] Bulkley Testimony Summary at 10.

percent.[56] Great Plains' recommended ROE of 10.2% is comfortably within this range of reasonable returns.

2. The Department's Recommended ROE Fails to Account for Current Volatility in Capital Markets.

As Ms. Bulkley testified in this proceeding, "the evaluation of market conditions is critically important in determining how the assumptions used in the ROE estimation models are being affected by market conditions and whether the results of the models are reasonable when placed in context with market conditions."[57] In the present case, market conditions have significantly affected the results of the models used to estimate the cost of equity for Great Plains. As Ms. Bulkley explained, "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."[58] Mr. Addonizio, however, does not appropriately consider such market conditions, in his recommendation that Great Plains' ROE should be set at the mean of his Two-Growth DCF analysis.

For instance, Mr. Addonizio's DCF analyses rely on 30-day average stock prices ending February 13, 2020, which was near the highest point in the Dow Jones Industrial Average.[59] Since that time, the market has experienced tremendous volatility. As Ms. Bulkley testified:

> In the last week of February the overall market, as measured by the Dow Jones Industrial Average declined 2,633 points, the VIX, which is a measure of the

[56] The results also include New Jersey Resources, which Great Plains believes 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.

[57] Bulkley Testimony Summary at 2.

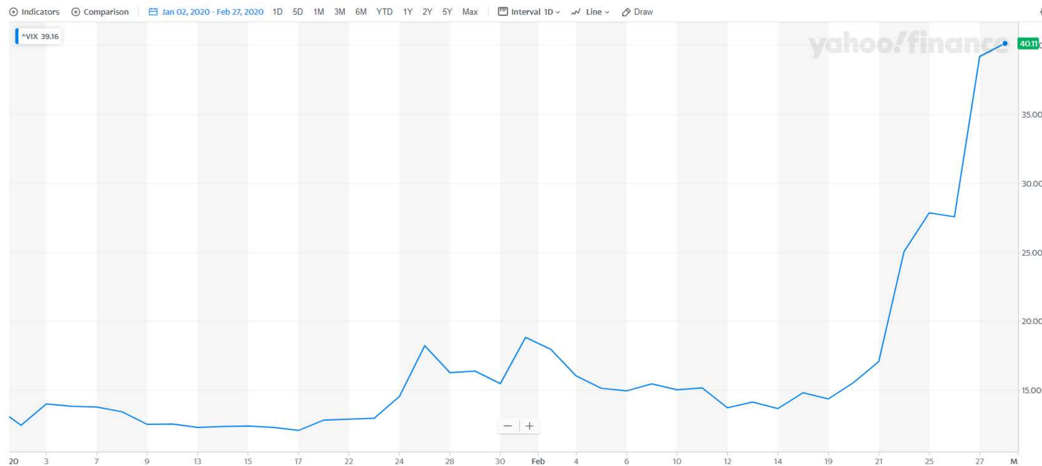
[58] Bulkley Testimony Summary at 3.

[59] Bulkley Testimony Summary at 3.

> market's uncertainty; a 'fear index' increased from below 20 in January of this year to over 40 by the end of February. Despite these significant changes in market conditions Mr. Addonizio's recommended ROE decreased. This result is counterintuitive and inconsistent with the significant and sudden change in risk to investors for holding equities.[[60]]

Ms. Bulkley illustrated this change in the VIX in Figure 2 below:

Figure 2- VIX January -February 2020

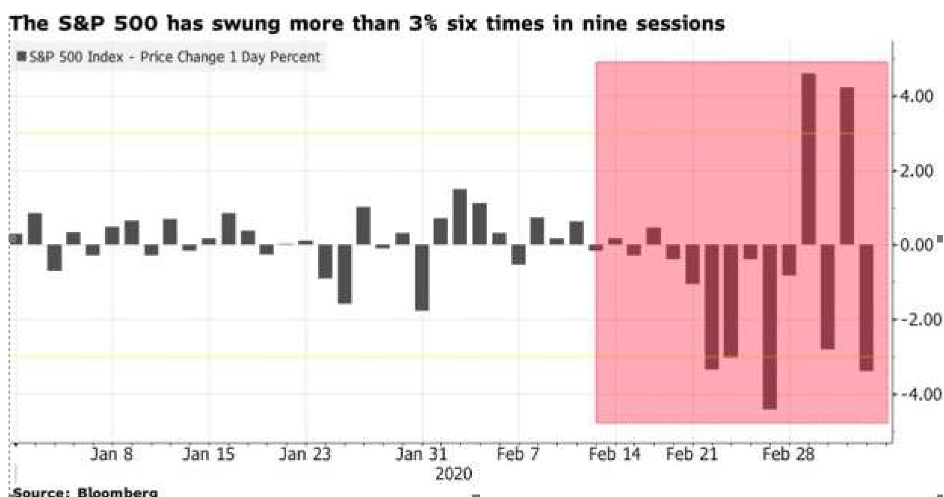


Ms. Bulkley further noted that the S&P 500 index from January 2020 through the first few trading days in March 2020 "demonstrates that the volatility in the S&P 500 was significantly lower when Mr. Addonizio filed his Direct Testimony . . . the S&P 500 has swung more than 3 percent six times in the nine sessions since the data that Mr. Addonizio relied on in his Surrebuttal Testimony."[61] The volatility of the S&P 500 index is illustrated in Figure 3 below:

[60] Bulkley Testimony Summary at 3.

[61] Bulkley Testimony Summary at 4.

Figure 3- S&P 500 Index - January – March 2020



As Ms. Bulkley testified, "[t]his dramatic change in market volatility is inconsistent with Mr. Addonizio's decision to lower his recommended ROE from his Direct to Surrebuttal Testimony."[62] 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 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."[63] For this reason, Ms. Bulkley's analysis 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."[64]

[62] Bulkley Testimony Summary at 4.

[63] Bulkley Testimony Summary at 4.

[64] 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).

In contrast, Mr. Addonizio relies on a 30-day average of stock prices, on the basis that "such long-term historical prices may result in biased dividend yields that reflect irrelevant information."[65] As Ms. Bulkley testified, however:

> Stock market performance over the last three weeks highlights that short-term market conditions may well not adhere to the strongest form of the Efficient Market Hypothesis that Mr. Addonizio relies on to support his criticism of my methodology. As discussed in my Direct and Rebuttal Testimony, and supported by recent market events, I continue to believe that consideration of 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.[[66]]

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. Mr. Addonizio's recommendation that Great Plains' ROE be set at the mean of his Two-Stage DCF model ignores the current market environment. The record is clear that market conditions have changed drastically since Mr. Addonizio filed his Direct Testimony in January 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.

While 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 conditions that existed on February 13, 2020, will continue to exist during the period that Great Plain's rates will be in effect.[67] Recent market conditions have shown this assumption is not

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[65] Addonizio Direct at 52.

[66] Bulkley Testimony Summary at 5.

[67] *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

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. This is consistent with the approach employed by Ms. Bulkley.

3. Mr. Addonizio's Decision to Remove Growth Rates prior to Applying the Statistical Test used in the Two-Stage DCF Model Biases the Results.

In addition to improperly excluding comparable companies from its proxy group, the results of Mr. Addonizio's DCF models are further distorted by his exclusion of Value Line's projected earnings growth rate for Northwest Natural Holding Company ("Northwest Natural"). Mr. Addonizio removed the earnings growth rate from his analysis citing that the growth rate is an outlier.[68] As Ms. Bulkley explained, however:

> 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.[[69]]

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."[70] Mr. Addonizio's decision to remove growth rates prior to applying the statistical test used in the Two-Stage DCF model biases the results of the analysis.

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current market data will not produce reasonable estimates of the cost of equity during the period that Great Plains' rates will be in effect.").

[68] Addonizio Direct at 28-29.

[69] Bulkley Testimony Summary at 11.

[70] Bulkley Testimony Summary at 11.

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."[71] Making the appropriate changes to Mr. Addonizio's Two-Stage DCF analysis—such as including the Value Line growth rate for Northwest Natural and relying Ms. Bulkley's proxy group—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.

4. The Department's Recommended ROE Fails to Appropriately Account for the Risk faced by Great Plains Faces Relative to the Companies in its Proxy Group.

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."[72] 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.[73] With this recognition, 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

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[71] Bulkley Testimony Summary at 11-12.

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

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

> 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.[[74]]

While Ms. Bulkley did not make a specific adjustment to her recommended ROE for Great Plains based on these factors, she did appropriately "consider them in aggregate in determining where, within the range of results, the authorized ROE for Great Plains should be set."[75]

In contrast, Mr. Addonizio essentially dismissed the risks faced by Great Plains due to its small size, concertation of large customers and customer demographics. Instead, Mr. Addonizio contended that he "included a lengthy discussion regarding the differences in risk between Great Plains and the proxy companies, and concluded that it was neither necessary nor appropriate to adjust my ROE recommendation to account for any such differences."[76] However, at hearing Mr. Addonizio indicated that he did not evaluate the risks faced by Great Plains relative to his proxy group:

> Q. Would you agree that each of these companies listed have natural gas distribution operations substantially larger than Great Plains in operations?
>
> A. I believe that's true, yes.
>
> Q. In reviewing the companies in your proxy group, did you evaluate whether the companies have a high concentration of industrial customers relative to Great Plains' customer demographics?
>
> A. I reviewed the testimony Ms. Bulkley presented on that issue, but I did not review any other.
>
> Q. Did you evaluate whether the industrial companies served by companies in your proxy group are concentrated in a single industry, like agriculture?
>
> A. I did not.[[77]]

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[74] Bulkley Rebuttal Testimony at 69.

[75] Bulkley Rebuttal Testimony at 69.

[76] Addonizio Surrebuttal at 66.

[77] Evidentiary Hearing Transcript at 62-63 (March 10, 2020).

In fact, Mr. Addonizio stated, "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."[78] Mr. Addonizio ignored such risks despite the fact that the Commission 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.

For example, 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. [[79]]

While Mr. Addonizio indicated his belief that the Commission's decision was in error,[80] there is no basis to ignore the risk faced by Great Plains in settling on the mean ROE generated by his DCF analysis.

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

[79] *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.

[80] Evidentiary Hearing Transcript at 66 (March 10, 2020) ("Those decisions can offer guidance on how to proceed in subsequent cases, however, I continue -- I disagree with the Commission's decision at the time that it was reasonable to reflect those individual risk characteristics of the utility in that case versus the proxy member, the proxy group members in that case.").

Indeed, 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] Here, the mean advocated for by Mr. Addonizio is not "the best measure of the return" in light of the record evidence.

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."[82] In this respect, even if Mr. Addonizio's DCF analyses did not suffer from inherent biases previously discussed, due to the risks faced by Great Plains there is simply no basis to set Great Plains' ROE at the mean of his Two-Growth DCF range of 7.9 percent to 9.67 percent.

5. The Department Failed to Appropriately Consider recently Authorized ROEs in Recommending that Great Plains' ROE be set at the mean of Two-Stage DCF results.

As noted above, 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. In fact, Mr. Addonizio notes that one of the economic guidelines he used in determining the cost of equity for Great Plains was the comparable return standard.[83] However, the only comparison developed by Mr. Addonizio is the use of a proxy group to

[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.

[83] Addonizio Direct at 4.

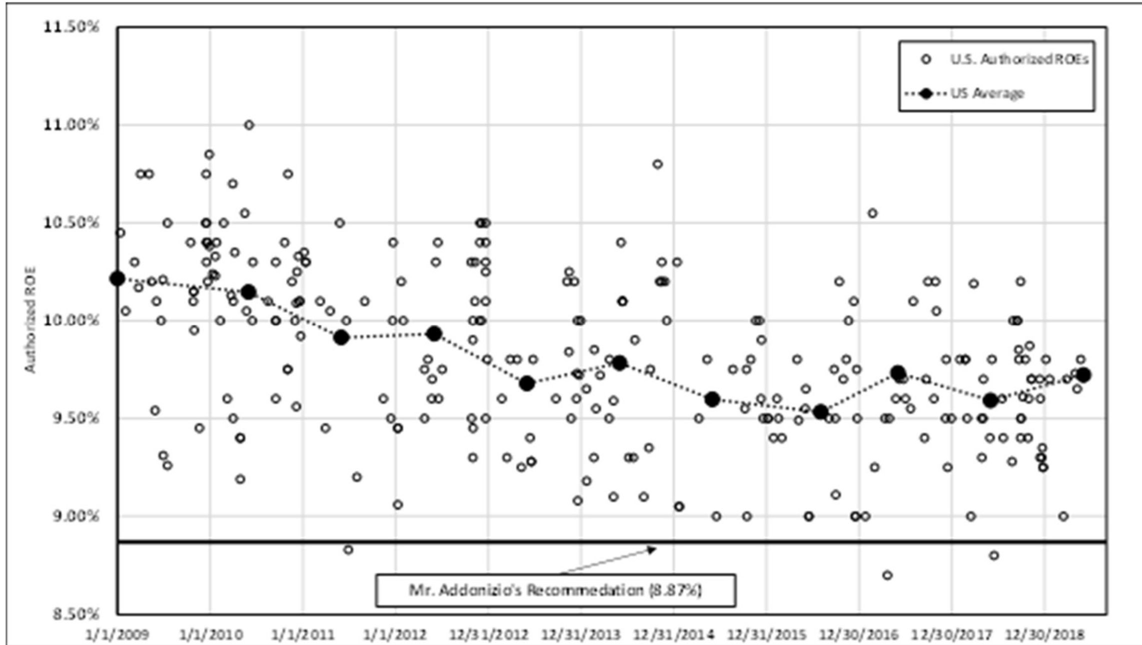
develop the results of his DCF and CAPM models. As noted above, Mr. Addonizio did not consider (1) the unique risks faced by Great Plains vis-a-vis the companies in his proxy group; or (2) market conditions that effect his analyses. Therefore, it is not surprising that Mr. Addonizio also failed to consider the fact that his recommended ROE of 8.82 percent 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.

In contrast, consistent with this Commission's recognition of the *Hope* and *Bluefield* comparable return standard, in arriving at her recommended ROE for Great Plains, Ms. Bulkley appropriately considered (1) recently authorized ROEs; and (2) how her recommended return compares with the returns available to investors for investments in other companies with comparable risk. As part of this analysis, Ms. Bulkley demonstrated how Mr. Addonizio's recommended ROE of 8.87% compares with recently authorized ROEs. As shown in Figure 4 below, Mr. Addonizio's recommendation is below nearly all authorized ROEs for natural gas utilities from 2009 through 2019.[85]

[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.

Figure 4- Summary of Recently Authorized ROEs.



Ms. Bulkley also demonstrated 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. As Ms. Bulkley stated: "Taken together, the Company's proposed common equity ratio of 50.815 percent and Mr. Addonizio's recommended ROE of 8.82 percent, results in a WROE of only 4.51 percent. Considering recently authorized returns, the average WROE for 2019 was 5.11 percent."[86] Mr. Addonizio's recommended WROE of 4.51 percent is significantly below the WROE for 2019 for natural gas utilities. As Ms. Bulkley notes, "[g]iven that Mr. Addonizio and I both support the Company's proposed 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, this would require an authorized ROE of at least 10.07 percent."[87]

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

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

While Mr. Addonizio asserted that recently authorized ROEs are not relevant to his analysis,[88] Ms. Bulkley demonstrated that, in addition to considering the comparability of returns, investors and credit rating agencies use recently authorized ROEs as a measure of the supportiveness of regulation in a jurisdiction. Specifically, Ms. Bulkley highlighted 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.[89] For these reasons, "Moody's 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."[90] Mr. Addonizio's suggestion that that a credit rating downgrade for ALLETE, Inc. is not relevant because it is an electric company is without merit.[91] As Ms. Bulkley explained, "[t]he relevant fact in this downgrade was that the return was below the average authorized ROEs at the time. Mr. Addonizio's revised, lower recommendation in this proceeding is 90 basis points below the average authorized ROE in 2019."[92]

The simple fact that Mr. Addonizio's DCF analyses resulted in an extraordinarily low mean ROE of 8.82 percent should have signaled to Mr. Addonizio that his recommended ROE for Great Plains does not meet the comparable return standard. Adoption of Mr. Addonizio's recommendation would place Great Plains at a disadvantage vis-à-vis nearly every other gas utility in competition for investor capital. Mr. Addonizio's recommended ROE of 8.82 percent simply does not meet the *Hope* and *Bluefield* standards or investor expectations.

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[88] Addonizio Direct at 67-73; Addonizio Surrebuttal at 72-73.

[89] Bulkley Rebuttal at 14-15.

[90] Bulkley Rebuttal at 15.

[91] Addonizio Surrebuttal at 73.

[92] Bulkley Testimony Summary at 8.

6. The Department's Flotation Cost Adjustment is Artificially Low.

Ms. Bulkley and Mr. Addonizio agree that the investor return requirement that is estimated by a DCF analysis needs to be adjusted for flotation costs in order reflect significant costs associated with issuing new common equity.[93] As the Commission has concluded:

> It is clear that raising equity capital involves substantial costs. If these costs are not factored into the cost of equity, or an equivalent adjustment made, the amount of equity available for Company use would be overstated and its ability to earn its authorized rate of return impaired. In effect, the Company would be granted a lower rate of return than the one officially set by the Commission. A flotation cost adjustment is therefore just and reasonable.[[94]]

Mr. Addonizio, however, has taken the position in this proceeding 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.[95] As a result, Mr. Addonizio divided the flotation cost estimate of 3.68 percent by two to arrive at a flotation cost estimate of 1.84 percent, stating, "I conservatively assume that half of Great Plains' equity was obtained via means that incurred flotation costs and half was obtained via means that did not."[96] Mr. Addonizio's proposed adjustment is unsupported. As Ms. Bulkley demonstrated, Mr. Addonizio has incorrectly 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.[97]

First, Mr. Addonizio failed to provide support for his conclusion that adjusting the flotation cost percentage by 50 percent is reasonable, as Mr. Addonizio asserts. It is by its nature

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

[94] *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).

[95] Addonizio Direct at 31.

[96] Addonizio Direct at 32.

[97] Bulley Rebuttal at 66-68.

arbitrary. Second, Ms. Bulkley explained that Great Plains' ultimate parent, MDU Resources Group, Inc., incurred costs associated with the equity issued via DRIPs.[98] In this respect, "Mr. Addonizio has incorrectly assumed that equity issued through dividend reinvestment programs ('DRIPs') and shares issued to employees through compensation programs are issued at zero cost."[99] While Ms. Bulkley agrees "that the costs incurred by the Company through ongoing equity ownership programs can be less than the costs of new public issuances, it is not correct to assume that the equity issuances from other sources do not result in any costs."[100] Simply, the Department's recommendation to reduce the flotation cost adjustment by 50 percent is not reasonable and should be rejected by the Commission.

V. REVENUE AND EXPENSE ITEMS

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. 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. As discussed below, 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 as single-issue ratemaking.

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[98] Bulkley Rebuttal at 67.

[99] Bulkley Rebuttal at 66.

[100] Bulkley Rebuttal at 66.

A. Industry Dues

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.[101] OAG recommended a 100% disallowance of MUI and EEI dues and recommends a corresponding reduction in the 2020 test year expense of $11,964.[102] 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.[103] The OAG and Department's positions should be rejected.

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, directly and indirectly, affects utility customers.[104] 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.[105] The removal of lobbying expenses ensures that only membership expenses that benefit customers are included in rates.

As Great Plains Witness Mr. Travis Jacobson testified, the Department acknowledged "that the Commission has allowed 50 percent of Investor Relations expenses and, 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."[106] In particular, the Department cited five Commission

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

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

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

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

[105] Jacobson Rebuttal at 3.

[106] Jacobson Rebuttal at 3.

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."[107] At a minimum, 50% of Great Plains MUI membership costs should be recoverable in rates as an expense that benefits Great Plains' customers.

With respect to EEI dues of $464, Great Plains addressed OAG concern that payment of dues to an organization ostensibly for electric utilities benefits Great Plains natural gas customers.[108] As noted in Mr. Jacobson's testimony, while the dues were paid to EEI, they were related to EEI's affiliate Utility Solid Waste Activities Group ("USWAG").[109] As Mr. Jacobson testified, "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 in a number of ways specifically for its natural gas operations."[110] There is simply nothing in the record that supports denial of recovery of such costs that clearly benefit customers by addressing solid and hazardous waste issues affecting the utility industry broadly.

B. Incentive Compensation and Rate Case Expense Tracking

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.[111] The Company and Department also agree that Great Plains' rate case

[107] Byrne Direct at 10.

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

[109] Jacobson Rebuttal at 3.

[110] Jacobson Rebuttal at 3.

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

expense amount of $592,555 is reasonable.[112] Notwithstanding this agreement, 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 Commission and included in base rates that are not paid out to employees under the program;"[113] and (2) "track any over-recovery of rate case expenses for credit to the revenue requirement in its next rate case."[114] The Department's recommendations should be rejected as (1) impermissible single-issue ratemaking; and (2) prejudicial to Great Plains' ability to recover the costs of providing service to customers due to the asymmetrical design proposed by the Department.

Initially, it is a bedrock principle of utility ratemaking that single-issue ratemaking should be avoided. This is because many expenses go up in the period between rate cases and some expenses may go down. Notwithstanding this fact, such expense levels 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—not simply select costs and revenues***. There is a sound reason for this policy.

As Mr. Jacobson testified, most, if not all, other expenses will have changed in future periods and it is not appropriate to select a one item and only adjust it to the detriment of the Company.[115] With respect to incentive compensation, Mr. Jacobson explained:

> Each year the Company's expenses vary from the projected level of expense with a general trend of increasing costs, for instance labor costs will likely increase about the same time rates from this proceeding are approved. Mr. Lusti's recommendation is a non reciprocal, single issue rate making proposal that should be rejected. Under Mr. Lusti's recommendation, Great Plains would be required to refund incentive expense amounts less than target; however, Mr. Lusti does not

[112] Lusti Direct at 14 ("I do not challenge the Company's estimate of the current costs of this proceeding.").

[113] Lusti Direct at 9.

[114] Lusti Direct at 14.

[115] Jacobson Rebuttal at 5.

> suggest that Great Plains may collect when incentive expenses are above target. Nor does he suggest that Great Plains be able to track increases in expenses, such as labor increases, and recover them in future periods.[[116]]

Tracking one expense item in an asymmetrical manner to provide for refunds ignores the fact that any amount of incentive compensation or rate case expense included in rates, but not paid in a year, is almost certainly offset by increases in other expenses.[117] As Mr. Lusti confirmed 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.[118] In this respect, the Department's tracking proposal by design prejudices Great Plains' ability to recover its costs of providing service.

With respect to rate case expense, for instance, the Department's proposal would require Great Plains to refund rate case expense if it stays out of a rate 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.[119] Similarly, the manner in which the asymmetrical incentive compensation expense tracking proposed by the Department can lead to unjust and unreasonable results can be illustrated through a simple example below. The example 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.

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[116] Jacobson Rebuttal at 5.

[117] 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.

[118] 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).

[119] 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.

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, under the Department's proposal, 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; under the Department's proposal, 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 under Mr. Lusti's proposal Great Plains would have refunded $10,000 to customers. This is a patently unjust and unreasonable outcome and illustrates the prejudicial nature of the Department's proposal.

Finally, the Department's reliance on the Commission's decision in a 1994 Northern States Power Company ("NSP") rate case decision to support it proposal to track Great Plains' incentive compensation expense is misplaced. In particular, Mr. Lusti testifies that "Great Plains' decision in late 2015 not to pay its employees any incentive compensation that year is similar to what the Commission considered in its January 14, 1994 ORDER AFTER RECONSIDERATION in Docket No. E002/GR-92-1185," which required NSP to "record for future refund all incentive compensation payments earned under the terms of the plan and recoverable in rates under this Order but not paid."[120] This case is clearly distinguishable from the facts in this case.

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[120] Lusti Surrebuttal at 6.

The Commission's decision in the NSP case was specifically tied to NSP's decision to withhold paying incentive compensation earned under its plan. In particular, the Commission stated:

> In the original Order, the Commission expressed strong disapproval of the ***Company's retention of the right not to make incentive payments earned under the plan***. The Commission continues to view this as an inappropriate transfer of risk from shareholders to ratepayers and as inconsistent with the test year concept on which rates are based. The Commission will therefore require the Company to record all earned but unpaid incentive compensation recoverable in rates under this Order for future return to ratepayers.[[121]]

The same concerns are not implicated in the present case as Mr. Lusti mistakenly assumes that in 2015 Great Plains achieved the incentive compensation metrics under its plan, but a decision was nevertheless made to forego paying the incentive.

As Mr. Lusti noted at hearing, however, he does not know why incentive compensation was not paid in 2015, and notwithstanding the Commission's decision with respect to NSP upon which he relies, has concluded it does not matter why it was not paid.[122] It does matter as evidenced by the Commission's decision and concern with incentive compensation "earned but unpaid." Further, unlike in the NSP rate case, there is no dispute regarding whether the inclusion of incentive compensation amount of $261,892 is reasonable.

Finally, the Department's proposal 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.[123] However, the percentage of incentive

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[121] *In the Matter of the Application of Northern States Power Company for Authority to Increase its Rates for Electric Service in the State of Minnesota,* Docket No. E-002/GR-92-1185, Order After Reconsideration at 7-8 (January 24, 1994) (Emphasis added).

[122] Evidentiary Hearing Transcript at 46 (March 10, 2020).

[123] Jacobson Rebuttal at 5.

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.[124] 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.[125]

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 and not supported by the record in this case. Further, as explained above, the Department's proposal to track rate case expense suffers from the same infirmities as it seeks to track a single expense item to the exclusion of all other expenses that invariably change over time.

VI. RATE DESIGN

The Parties have successfully worked together to resolve 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. As discussed below, 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.

In the present case, 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. In particular, Great Plains proposed modest

[124] Jacobson Rebuttal at 5.

[125] Jacobson Rebuttal at 5.

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.[126] The Department supports the Company's proposed changes.[127]

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").[128] The Company's proposal appropriately mitigates rate shock by not implementing a fully compensatory fixed charge at this time.[129] Increasing customer charges closer to the level of fixed costs as proposed by Great Plains promotes equity by eliminating intra-class subsidies. As the Commission explained:

> 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.[[130]]

Notwithstanding these principles, 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.[131] The record shows that the OAG's concerns do not merit rejection of Great Plains' proposed customer charges.

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

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

[128] Hatzenbuhler Direct at 19-21.

[129] Hatzenbuhler Direct at 20.

[130] *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).

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

Initially, the OAG's position fails to adequately recognize 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. 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."[132] 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."[133] As Department Witness Mr. Michael Zajicek correctly observed, "I do not believe the change is significant enough to impact customers' energy conservation behavior."[134]

With respect to OAG's argument that the change impacts low usage customers disproportionately, as Mr. Hatzenbuhler notes, this is intentional as such customers do not pay the full cost of receiving natural gas service and are already subsidized by other customers.[135] This point is echoed by Mr. Zajicek, who states:

> 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.[[136]]

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[132] 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").

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

[134] Zajicek Rebuttal at 2.

[135] 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.

[136] Zajicek Rebuttal at 8-9.

Further, 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 impact low-income customers in any material way.[137]

Finally, it should be noted 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] 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. Great Plains proposed changes should be approved.

B. Great Plains' Proposal to Convert from a Monthly Charge to a Daily Charge is Reasonable, Supported by the Record and Should be Adopted.

In conjunction with its proposed increases in monthly Basic Service Charges, for the Service Charges applicable to the Residential and Firm General Service classes, Great Plains proposed to convert the monthly charge to a daily charge. The Department opposed the Company's proposal asserting that it would "increase the complexity of customers' bills and make them less understandable."[139] As demonstrated by the Company, however, charging such fixed costs on a daily basis "provides an awareness and alignment to how customers are billed

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[137] *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).

[138] Hatzenbuhler Testimony Summary at 7.

[139] Zajicek Surrebuttal at 5.

today. Customers are billed monthly, but those billing periods can and do vary from month to month."[140]

Furthermore, it should be acknowledged that "[t]he overall revenue to be collected under the Basic Service Charge revenue will be the same whether billed through a monthly or daily application of the rate component as noted by Mr. Zajicek, but the Company believes the daily application does provides that better alignment and awareness to how customers' meters are read and billed today."[141] As is apparent, there is no undue complexity; instead, 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. Great Plains' proposal is supported by the record and should be approved.

VII. CONCLUSION

The Commission is charged with setting reasonable rates and allowing utility companies to earn a fair rate of return. Through these proceedings, the Company, Department and OAG all worked hard to develop the record and limit the number of issues remaining in dispute. With respect to the remaining issues in dispute, Great Plains has demonstrated that its positions on the issues reflect both consistency with Commission precedent and, more important, fairness to both ratepayers and the Company. The positions Great Plains advanced in this case are wholly supported by the facts, law, and sound regulatory policy and appropriately balance the interests of customers with Great Plains' right to earn a fair rate of return. Based on the foregoing, the ALJ should recommend the adoption of Great Plains' positions on the contested issues in this proceeding as discussed above.

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

[141] Bosch Rebuttal at 4.

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Respectfully submitted,

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