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April 27, 2020

The Honorable Ann C. O'Reilly
Administrative Law Judge
Office of Administrative Hearings
PO Box 64620
St. Paul, MN 55164-0620

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

Dear Judge O'Reilly:

Enclosed and filed herewith, find please find the Minnesota Department Of Commerce, Division of Energy Resources Proposed Findings on Disputed Issues.

Sincerely,

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Enclosure

|#4708449-v1

OAH Docket No. 65-2500-36528

BEFORE THE MINNESOTA OFFICE OF ADMINISTRATIVE HEARINGS
600 NORTH ROBERT STREET
ST. PAUL, MINNESOTA 55101

FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION
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Katie Sieben	Chair
Valerie Means	Commissioner
Matthew Schuerger	Commissioner
Joseph Sullivan	Commissioner
John Tuma	Commissioner

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. G-004/GR-19-511

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MINNESOTA DEPARTMENT OF COMMERCE, DIVISION OF ENERGY RESOURCES PROPOSED FINDINGS ON DISPUTED ISSUES

April 27, 2020

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I. INTRODUCTION

- The Minnesota Department of Commerce, Division of Energy Resources, Energy Regulation and Planning Unit (Department or DER) submits these Proposed Findings on Disputed Issues pertaining to the application for a general rate increase filed by Great Plains.

II. FINDINGS

1. Burden of Proof

- The Company bears the burden of showing that its proposed rates are reasonable.[1] Minnesota law requires that every rate established by the Commission must be just and reasonable, and that any doubt should be resolved in favor of the consumer:

> Every rate made, demanded, or received by a public utility . . . shall be just and reasonable. . . . Any doubt as to reasonableness should be resolved in favor of the consumer.[2]

- The Commission's role is both quasi-judicial and partially legislative, in determining just and reasonable rates in a rate proceeding:[3]

- The utility must prove the facts required to sustain its burden by a fair preponderance of the evidence.[4]

- "By merely showing that it has incurred, or may hypothetically incur, expenses, the utility does not necessarily meet its burden of demonstrating it is just and reasonable that the ratepayers bear the costs of those expenses."[5]

- The utility has at all times the burden of proving the proposed rate change.[6]

- ALJ Steve M. Mihalchick's 2015 *Monticello Prudency* report provided a detailed discussion of state law regarding a public utility's burden of proof.[7] Relying on

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[1] Minn. Stat. § 216B.16, subd. 4 (2018).
[2] Minn. Stat. § 216B.03 (2018).
[3] *In re Pet. of N. States Power Co. for Auth. to Change its Schedule of Rates for Elec. Serv. in Minn.*, 416 N.W.2d 719, 722-723 (Minn. 1987) (*In re N. States Power Co.*) (Court stated that "in the exercise of the statutorily imposed duty to determine whether the inclusion of the item generating the claimed cost is appropriate, or whether the ratepayers or the shareholders should sustain the burden generated by the claimed cost, the MPUC acts in both a quasi-judicial and a partially legislative capacity.")
[4] *In re N. States Power Co.*, 416 N.W.2d at 722 (Minn. 1987).
[5] *Id.* at 722–23.
[6] *Id.* at 725 (holding that a rebuttable presumption of reasonableness is not created by the utility).

longstanding Minnesota Supreme Court precedent,[8] ALJ Mihalchick correctly explained that state law does not give a public utility a presumption of reasonableness that must be overcome by other parties:

> In its 1985 rate case, Xcel argued that once it produced evidence on a particular issue, it had created a "'rebuttable presumption of reasonableness' that could only be overcome by competent evidence in rebuttal." As noted by the Minnesota Supreme Court, the Commission "rejected that contention" because "the company had at all times the burden of proving the proposed rate change." The Supreme Court agreed with the Commission, and stated:
>
> > If there ever existed in this state a presumption to be applied in ratemaking, enactment of Minn. Stat. § 216B.16, subd. 4 (1986) effectively removed any presumption, and placed on the petitioning utility the burden of proving the proposed rate is fair and reasonable[.]
>
> In Minnesota, a utility does not create a presumption of recovery merely by producing evidence. Minn. Stat. § 216B.16, subd. 4, places the burden of proof on the utility, and only on the utility.[9]

- To the extent that the Company did not satisfy its burden of demonstrating that its proposed recovery was reasonable, the Department recommended adjustments to Great Plains' request to conform to the requirement that rates must be fair and reasonable.

2. DISPUTED FINANCIAL ISSUES

A. Dues to Minnesota Utilities Investor Association and Edison Electric Institute

Disputed between DER and Great Plains: The DER recommended that the Commission disallow Great Plains' proposed test year expense of MUI dues. Ex. DER-6 at 7-10 (Byrne Direct); Ex. DER-14 at 6-10 (Byrne Surrebuttal); Ex. DER-21 (Byrne Summary); Ex. GP-21 at 21-22 and TRJ-1 at 3 (Jacobson Direct); Ex. GP-23 at 2-4 (Jacobson Rebuttal); Ex. GP-24 (Jacobson Summary).

(Footnote Continued from Previous Page)

[7] *In re Comm'n Investigation into Xcel Energy's Monticello Life Cycle Mgmt./Extended Power Uprate Project & Request for Recovery of Cost Overruns*, MPUC Docket No. E-002/CI-13-754, (*Monticello Prudency*), FINDINGS OF FACT, CONCLUSIONS OF LAW AND RECOMMENDATIONS at 34-36, (February 2, 2015) (MONTICELLO REPORT).

[8] *In re N. States Power Co.* 416 N.W.2d 719 (Minn. 1987).

[9] MONTICELLO REPORT at 35 (quoting *In re N. States Power Co.*, 416 N.W.2d at 725).

<u>Disputed</u> between OAG and Great Plains: The OAG recommended disallowance of both MUI dues and EEI dues. Ex. OAG-1 at 7-9 (Lebens Direct); Ex. OAG-2 at 7-9 (Lebens Surrebuttal); Ex OAG-3 (Lebens Summary).

- In the Company's Initial Filing,[10] Great Plains provided an itemized schedule of all industry dues paid in 2018 totaling $34,589, along with projections for each dues amount in 2019 totaling $41,872. The 2020 projected test-year amount was held at the 2019 total of $41,872.[11]

- The Company proposed a test-year expense for organizational dues to be paid to an organization called the "Minnesota Utility Investors Association" (MUI), whose name implied that the association focuses on investors, rather than utility operations,[12] and whose purpose, according to the Company, is to represent the interests of investors owning shares in utility companies operating in Minnesota, and whose principal objective is to enhance the voice and impact of utility shareholders in the development of federal, regional and state legislative and regulatory policy."[13]

- The MUI describes itself as "representing the interests of utility shareholders."[14] It sponsors member meetings, a statewide annual meeting, an annual Day at the Capitol which includes the MUI making appointments for members to meet their legislators, and tours of energy facilities. Past tours have included nuclear, wind, solar, coal, and hydro facilities but, no natural gas distribution system facility tours. Supporting membership-level members may bring to events a spouse or other guest for free. Tours included catered meals and transportation from around the state to annual meetings and the Day on the Capitol events.[15]

- Basic standards of utility regulation require that the amount and purpose of any organizational dues expense that a utility proposes ratepayers pay must be reasonable and in the best interests of the utility's ratepayers.[16]

- The Commission does not impose on customers the expense of dues when it has not been shown that customers receive any benefit from the organizations receiving the dues, as may

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[10] Ex. GP-2 (Vol. III, Statement C, Schedule C-2, page 20 of 27)(Sept. 27, 2019)(eDocket No. 20199-156151-04).
[11] Ex. DER-6 at 7 (Byrne Direct).
[12] *Id.* at 8.
[13] Ex. GP-21, TRJ-1 at 3 (Jacobson Direct); Ex. DER-6 at 4 (Byrne Direct) (emphasis added).
[14] Ex OAG-2 at 8-9 (Lebens Surrebuttal).
[15] Copies of the Association's webpages were included with Ms. Byrne's testimony at Ex. DER-6 at 8-9, ACB-3 (Byrne Direct).
[16] Ex. DER-14 at 8-9, ACB-S-1 (Byrne Surrebuttal) (STATEMENT OF POLICY ON ORGANIZATION DUES, (MPUC June 14, 1982) (This is one of eight policies on recurring rate case issues adopted to provide "advance guidance on the likely treatment of these issues."))

be the case when the organizations are lobbying or social in purpose, or where there is no connection between the expense and reasonable and reliable utility service.[17]

- A utility seeking recovery of dues expenses should include testimony explaining whether the primary purpose of the organization is educating and informing public utility employees about providing improved utility service; or training employees to become better qualified in providing improved utility service; or if membership in the organization is a necessary qualification for public utility employees to carry on their employment responsibilities; or if membership provides essential information to the utility.[18]

- With respect to the reasonableness of investor relations expenses generally, in some cases the Commission has allowed 50 percent recovery of the expenses that utilities proposed to be included in base rates, finding that these expenses, such as costs incurred for convening the utility's annual shareholders' meeting, maintaining shareholder records, and recruiting equity capital, benefit ratepayers in as much as they keep utility financing at a favorable cost.[19] In these cases, a portion of these typical investor relations costs, like the annual shareholders' meeting, benefit only shareholders. When the utility does 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.[20]

- The stated mission and activity of MUI do not align with the general regulatory principal that rate-recoverable expenses include only those that relate to utility operations of benefit to ratepayers. Specifically, the activities of MUI do not enhance or facilitate equity funding specifically for Great Plains. MUI is not responsible for shareholder record keeping, nor does it seek new investors to keep utility financing costs reasonable. MUI's mission instead is expressly to empower utility shareholders in the legislative and regulatory policy-making processes.[21] The Company's payments to MUI do not enhance utility employee knowledge or skills.[22] And, unlike officers and employees, shareholders have no duty to ratepayers or even to the utility, fiduciary or otherwise, and they are not required to use information and/or support provided by MUI in the best interest of ratepayers or the Company.

- Based on the information provided by the Company and obtained independently, the Department witness, Ms. Byrne concluded in her direct testimony that Great Plains has not shown that it is reasonable for ratepayers to pay for its dues to the MUI. She recommended excluding the proposed $11,500 of organization dues from the Company's 2020 test-year expenses.[23]

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[17] *Id*.
[18] *Id*.
[19] Ex. DER-6 at 9-10 (Byrne Direct), Ex. DER-14 at 8 (Byrne Surrebuttal).
[20] *Id.*
[21] Ex. DER-6 at 9 (Byrne Direct).
[22] Ex. DER-21 (Byrne Summary).
[23] Ex. DER-6 at 10, ACB-3 (Byrne Direct).

- In rebuttal testimony, Great Plains offered two additional statements as support for Great Plains' proposed recovery of MUI dues expense: it stated that MUI focuses on legislation and regulatory policy that impacts utilities and utility customers, and that Great Plains' invoice from MUI indicated that 35 percent of the annual dues was related to lobbying and the Company excluded that amount from the Company's filing request of $11,500.

- Great Plains provided no documentation to support these statements, nor explain how MUI efforts devoted to "legislation and regulatory policy" differed from "lobbying" efforts.

- Ms. Byrne in surrebuttal testimony stated that, in light of the Company's rebuttal argument, she would have expected the Company to substantiate the reasonableness of the claimed expense by providing the invoice from MUI, or at the very least, the calculation showing the exclusion of the 35 percent lobbying expenses, but the Company provided neither.[24]

- MUI membership is completely optional for both utilities and shareholders and is open only to current shareholders.

- The Company did not show that any the activities of the MUI organization fall within the boundaries described in the Commission's Statement of Policy on Organizational Dues. MUI's work does not enhance employee knowledge or skills in providing safe and reliable utility service.[25]

- In his rebuttal testimony, Mr. Jacobson proposed that, at a minimum, Great Plains should be allowed to recover at least 50 percent of the dues it paid MUI, as a way to acknowledge customer benefits.[26] Great Plains' identification of customer benefits was limited to a statement that the MUI dues support efforts that have an impact on legislation and regulatory policy; however, as the Department noted, it is reasonably likely that such efforts are focused on shareholder, and not necessarily ratepayer, interests, and the Company introduced no evidence to show benefits to ratepayers. That an elective activity may impact on regulatory policy does not by itself demonstrate that it is reasonable for the utility to recover the expense from ratepayers.[27]

- Great Plains did not show that it is reasonable for ratepayers to pay for MUI dues. Great Plains did not substantiate that the requested amount is accurate or properly excludes stated lobbying costs.[28] The estimated financial impact of this recommendation reduces test-year

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[24] Ex. DER-14 at 7 (Byrne Surrebuttal).
[25] *Id.* at 9. In addition, the Commission stated in its policy that it does not impose on customers dues to organizations that have not been shown to provide customer benefit, "…as may be the case when the organizations are lobbying or social in purpose…." *Id*.
[26] Ex. GP-23 at 2-3 (Jacobson Rebuttal); Ex. DER-14 at 7 (Byrne Surrebuttal).
[27] Ex. DER-14 at 9 (Byrne Surrebuttal).
[28] Ex. DER-21 (Byrne Summary).

operations and maintenance (O&M) expenses (of which organizational dues expense is a part) by $11,500.[29]

B. Incentive Compensation

<u>Disputed</u> between DER and Great Plains: Great Plains opposes the Department's recommendation that the Company be required to file an annual incentive compensation report, or to refund to ratepayers incentive compensation the Company does not pay to employees. Ex. DER-22 (Lusti Summary); Ex. DER-7 at 8-12 (Lusti Direct); Ex. DER-15 at 4-7 (Lusti Surrebuttal); Ex. GP-21 at 18 (Jacobson Direct); Ex. GP-23 at 5-6 (Jacobson Rebuttal); Ex. GP-24 (Jacobson Summary).

- The incentive compensation expense issue has two parts: (1) the level of incentive compensation to be included in the test-year expenses, and (2) whether Great Plains should be required to file an annual report showing whether the incentive compensation was actually paid to employees under the program.

- The Department witness, Mr. Lusti, indicated that the Department's acceptance of the Company's proposed level of incentive compensation was premised on the filing of an annual incentive compensation report to determine whether refunds need to be made.[30]

- Since 1994 the Commission has required many investor-owned utilities, including Xcel Energy, Minnesota Power, and CenterPoint Energy to track payment of incentive compensation, file annual incentive compensation reports, and refund amounts not actually paid under their incentive compensation programs.[31]

- The Commission first adopted this policy in Xcel Energy's 1992 Electric Rate Case[32] and Xcel Energy continues to track, file an annual report, and refund unpaid incentive

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[29] Ex. DER-6, ACB-3 (Byrne Direct); Ex. DER-14 at 10 (Byrne Surrebuttal).

[30] Ex. DER-7 (Lusti Direct at 9). (Mr. Lusti testified: "Q: Do you agree that Great Plains included a reasonable amount of incentive compensation in the test year? A. Yes. *However,* since the Company's proposal is based upon all employees earning their individual 100 percent of target level incentive compensation, capped at 15 percent of salary, it is reasonable for the Company to 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. To determine the amount of actual incentive compensation paid that is recoverable from ratepayers, the Company should apply the 15 percent cap to each employee's salary.") (emphasis added).

[31] *Id.* at 10.

[32] *Id.* at 11 (*citing 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 (Xcel 1992 Rate Case)* Docket No. E002/GR-92-1185, ORDER AFTER RECONSIDERATION (January 14, 1994) page 25, Ordering Paragraphs 2 and 3.

compensation. Xcel Energy filed its most recent annual incentive compensation report, for 2018, on May 31, 2019.[33]

- Similarly, Minnesota Power (MP) tracks, files annual reports, and refunds unpaid annual incentive compensation. In MP's most recent rate case, the Commission ordered, "[t]he Company shall continue to provide customer refunds in the event that actual payouts are lower than the level approved in rates."[34] In accordance with the Commission order, on July 23, 2019, Minnesota Power filed its annual incentive compensation report for the period January 1, 2018 through December 31, 2018.[35]

- CenterPoint Energy also tracks annual incentive compensation, files reports, and is required to refund unpaid amounts. On April 15, 2019, CenterPoint Energy filed its most recent annual incentive compensation report[36] pursuant to the Commission's requirements in CenterPoint Energy rate cases.[37]

- Great Plains in the recent past has recovered from ratepayers amounts for incentive compensation that were not paid to employees. Department witness, Mr. Dale Lusti testified that in February 2016, the Department learned that Great Plains did not plan to pay its employees incentive compensation based on 2015 results.[38]

- In this instant Great Plains rate case, the Department concluded that, since the Company's proposed test-year incentive compensation expense was based upon *all* employees earning their *individual* 100 percent of target level incentive compensation, capped at 15 percent of salary, it is reasonable for the Company to refund to ratepayers the amount of incentive compensation that is approved and included in base rates but is not paid annually to employees under the program.

- The Department explained that, to determine the amount of actual incentive compensation paid that is recoverable from ratepayers, the Company should apply the 15 percent cap to each individual employee's salary (as is required of Xcel Energy, Minnesota Power, and CenterPoint Energy) and the Commission should require Great Plains to file an annual report on incentive compensation within 30 days after incentive compensation is normally

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[33] Ex. DER-7 at 11 (Lusti Direct) (*citing Northern States Power Co. Report on the Operation and Performance of its 2018 Incentive Compensation Plan*, Docket No. E,G002/M-19-375, *Annual Report and Refund Proposal*, (May 31, 2019).
[34] *Id*. at 11 (*citing In the Matter of the Application of Minnesota Power for Authority to Increase Rates for Electric Utility Service in Minnesota*, Docket No. E015/GR-16-664, (March 12, 2018) Order Point 22.
[35] *MP Compliance Filing-Incentive Compensation,* July 23, 2019.
[36] *CenterPoint Annual Incentive Compensation Compliance Filing*. April 15, 2019.
[37] Ex. DER-7 at 12 (Lusti Direct).
[38] *Id.* at 12 (*citing In the Matter of the Application of Great Plains Natural Gas Co., a Division of MDU Resources Group, Inc. for Authority to Increase Rates for Natural Gas Service in Minnesota* (Docket No. G004/GR-15-879), *Lusti Direct* at 4-5 (Feb 23, 2016).

scheduled for payout. The Department recommended that the report should include at a minimum the following:

A. A description of the incentive compensation plan;

B. The accounting of amounts of unpaid incentive compensation built into rates to be returned to ratepayers;

C. An evaluation of the incentive plan's success in meeting its stated goals, including the payout ratio;

D. A proposal for refund, if applicable; and

E. Identification of each performance indicator and its associated scorecard information, such as the measure, the goal for various attainment levels (threshold, target, maximum), its funding weight and the actual result achieved; and to report the overall plan payout percentage attained relative to the target goal of 100%.[39]

- In rebuttal testimony, the Company disagreed with the Department's recommendation that the Company file an annual incentive compensation report. Mr. Jacobson said that in Great Plains' last rate case, incentive compensation was based on a three-year average of the incentive payments. He said that using the actual 2016, 2017 and 2018 payout percentages of 101.9, 113.2 and 95.1 percent of target, respectively, would produce an average of 103.4 percent of target. He implied that use of a 100 percent of target better matched the incentive compensation provided to employees with an appropriate and normalized level of expense, and thus the Company should not be required to file an annual report.[40]

- In response, Department indicated that an annual report is still needed because, unless required to do so, the Company has the ability not to pay incentive compensation in a given year. For example, the Company did not pay any incentive compensation for 2015 results.[41]

- Great Plains' failure to pay its employees any incentive compensation is similar to what led the Commission in 1994 to adopt its current reporting practice, and, according to Mr. Lusti, is what led the Department in this instant case to recommend that Great Plains be required similarly to report on its incentive compensation program.[42]

- During his cross examination, Mr. Lusti was told that in 2015, the reason the Company did not pay out incentive compensation was because the incentive compensation metrics were

[39] *Id*. at 9-10 (Lusti Direct); Ex. DER-15 at 4 (Lusti Surrebuttal).
[40] Ex. DER-15 at 5 (Lusti Surrebuttal).
[41] *Id.*
[42] *Id*. at 6-7 (Lusti Surrebuttal).

not met.[43] Mr. Lusti's view was that ratepayers, whose rates include an amount for incentive compensation, do not care why GP may not pay employees the incentive compensation amounts ratepayers pay to GP;[44] that incentive compensation not paid to employees should be refunded to customers, and that a report is the Commission's method for determining whether to require a refund.

- In rebuttal testimony, Mr. Jacobson characterized the Commission's practice of requiring annual incentive compensation reports as a "non-reciprocal, single-issue" rate making practice. Nothing in the Company's testimony, however, demonstrated a reason for the Commission in this rate case to abandon its practice, which the Commission evidently considers reasonable.[45]

- If an expense is authorized by the Commission as an approved test-year expense, a rate-regulated utility can build that cost into base rates and collect that expense from ratepayers until such time as the utility chooses to file a new rate case. It is not reasonable for ratepayers to pay rates premised on the award of annual employee incentive compensation that Great Plains does not actually award.[46]

- Incentive compensation included in rates but not paid to employees should be refunded to ratepayers, and an annual report is the Commission's method for determining whether a refund is appropriate, and in what amount.

C. Rate Case Expenses

<u>Disputed</u> between DER and Great Plains: Great Plains and the Department disagree whether Great Plains should track any over-recovery from ratepayers of rate case expenses, and apply that credit to the revenue requirement in its next rate case. Ex. GP -2 Statement Workpapers at C2-19; Ex. GP-21 at 23-24 (Jacobson Direct); Ex. GP-23 at 6 (Jacobson Rebuttal); Ex. DER-7 at 13-14 (Lusti Direct); Ex. DER-15 at 7-8 (Lusti Surrebuttal); Ex. DER-22 (Lusti Summary Statement).

- As to whether Great Plains should be required to track any over-recovery from rate payers of rate case expenses, and apply that credit to the revenue requirement in its next rate case, the Department witness said that building into rates a possible over-recovery is not reasonable, and the Commission's past practice, as seen in Great Plains' most recent past rate case,[47] has

[43] Tr. at 46. *See also* Department Initial Brief at 14 (it could be inferred that the Company may not have met its earnings requirement, thus incentive compensation was not earned.)
[44] Tr. at 46.
[45] *Id*. at 6 (Lusti Surrebuttal).
[46] *Id*. at 50.
[47] *In the Matter of the 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 point 8 (September 6, 2016).

been to require the utility to credit any over-recovery to future rate case revenue requirements.

- In Great Plains' last case, the Commission ordered:

> Great Plains shall use a four-year amortization period for its rate case expenses, and shall track any over-recovery for credit to the revenue requirement in its next rate case.

- Consistent with the Commission's past requirements, Great Plains should continue to be required to track any over-recovery from rate payers of rate case expenses, and to credit the excess amount it collects to the revenue requirement in Great Plains' next rate case.[48]

3. CAPITAL STRUCTURE

Return on Equity ("ROE")
Disputed between DER and Great Plains: The Department recommended an ROE of 8.82 percent.[49] Great Plains recommended an ROE of 10.20 percent.[50]

Flotation Costs
Disputed between DER and Great Plains: Great Plains proposed a flotation cost adjustment of 0.10 percent (ten basis points).[51] The Department recommended a flotation cost adjustment of 0.05 percent (five basis points).[52]

A. Return on Equity

1. Introduction

- As part of this proceeding, the Commission must determine what constitutes a fair overall rate of return (ROR), also called cost of capital, for Great Plains. ROR is calculated as the average of reasonable costs of long-term debt, short-term debt, and equity, weighted by the amount of each type of financing the Company uses.[53] In general, the cost of equity equals the return on equity ("ROE") that Great Plains must pay to induce equity investments in its regulated operations.

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[48] Ex. DER-7 at 14 (Lusti Direct); Ex. DER-15 at 8 (Lusti Surrebuttal); Ex. DER-22 (Lusti Summary Statement).
[49] Ex. DER-9 at 4 (Addonizio Surrebuttal).
[50] Ex. GP-16 at 8 (Bulkley Rebuttal).
[51] Ex. GP-14, AEB-2, Schedule 4 (Bulkley Direct).
[52] Ex. DER-1 at 32 (Addonizio Direct).
[53] DER-1 at 38-39 (Addonizio Direct).

- Great Plains witness Ms. Ann Bulkley provided testimony regarding the Company's proposed ROE, while Department witness Mr. Craig Addonizio provided DER's recommendations regarding a fair ROE.

2. ROE Principles

- The Commission must set rates that are just and reasonable.[54] The determination of reasonableness involves a balancing of consumer and utility interests. A reasonable rate enables a public utility not only to recover operating expenses, depreciation and taxes, but also to compete for funds in capital markets. Minnesota law recognizes this principle when it defines a "fair and reasonable" rate of return as the rate when multiplied by rate base that will give a utility a reasonable return on its total investment.[55] This means that a fair return is one that enables the utility to attract sufficient capital (induce investors) at reasonable terms.[56] However, Minnesota law requires that *any doubt* as to reasonableness should be resolved in favor of the consumer.[57] Accordingly, a ROR that provides the utility a greater return than is necessary to provide reliable service to consumers at reasonable rates would be excessive.

- The *Bluefield* decision holds that a utility's return must be reasonably sufficient to assure financial soundness and provide the utility adequate means to raise capital.[58] The Supreme Court reasoned that a utility had no right to large profits similar to those realized in speculative ventures, but that the utility's return:

> [S]hould be reasonably sufficient to assure confidence in the financial soundness . . . 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.[59]

  Hope reaffirmed and refined the *Bluefield* principles.[60] The *Hope* Court reiterated that utilities are only entitled to a return sufficient to cover operating expenses including services on debt and dividends on stock, assure confidence in the utility's ability to maintain credit worthiness, and attract capital. The Court added that a just and reasonable return should be similar to returns on investments in other businesses having a corresponding risk.[61]

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[54] Minn. Stat. § 216B.03 (2018).
[55] Minn. Stat. § 216B.16, subd. 6 (2018).
[56] Minn. Stat. § 216B.16, subd. 6 (2018).
[57] Minn. Stat. § 216B.03 (2018) (emphasis added).
[58] *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of W. Va.* (Bluefield), 262 U.S. 679 (1923).
[59] *Bluefield*, 262 U.S. at 693.
[60] *Fed. Power Comm'n v. Hope Natural Gas Co.* (Hope), 320 U.S. 591 (1944)
[61] *Hope*, 320 U.S. at 603.

- In addition, the Court has acknowledged that regulation must attempt to strike an equitable balance between investors and ratepayers. *Covington* recognized:

  > [S]tockholders are not the only persons whose rights or interests are to be considered. The rights of the public are not to be ignored. . . . The public cannot properly be subjected to unreasonable rates in order simply that stockholders may earn dividends.[62]

  The *Natural Gas Pipeline Company of America* decision reemphasized this point:

  > The consumer interest cannot be disregarded in determining what is a "just and reasonable" rate. Conceivably, a return to the company of the cost of service might not be "just and reasonable" to the public.[63]

  Accordingly, utilities are only entitled to a rate of return that allows the company to attract sufficient equity investment, or otherwise obtain the financing, necessary to provide adequate and efficient service to ratepayers at just and reasonable rates.

- As set forth in the *Bluefield* and *Hope* cases, the following economic guidelines should be employed to determine a fair ROE:

  - The rate of return should be sufficient to enable the regulated company to maintain its credit rating and financial integrity.
  - The rate of return should be sufficient to enable the utility to attract capital at reasonable terms.
  - The rate of return should be commensurate with returns being earned on other investments having equivalent risks.[64]

- Investors are faced with many investment opportunities in the financial markets. To attract investors, utilities must pay an equity return similar to the equity return that investors expect to earn on investments of comparable risk. When investors buy the common stock of a utility, they acquire the right to share any dividends that the company may declare in the future. To induce equity investors to provide capital (i.e., purchase shares of equity), expected future dividends must provide a rate of return that is at least equal to the best alternative investment opportunity with a similar level of risk.[65]

- The prospect of these dividends serves as an inducement to investors. Investors, however, do not know with certainty what dividends a company will pay in the future and

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[62] *Covington and Lexington Turnpike Road Co. v. Sanford* (Covington), 164 U.S. 578, 596 (1896).

[63] *Fed. Power Comm'n v. Natural Gas Pipeline Co. of Am.*, 315 U.S. 575, 607 (1942) (Black, J., concurring).

[64] DER-1 at 4 (Addonizio Direct).

[65] DER-1 at 5 (Addonizio Direct).

they recognize that there is a risk that future dividends will be lower than expected. They also understand that dividends may be higher than expected.[66]

3. The Department's 8.82 Percent Recommended ROE is Reasonable

a. The Department's Decision to Rely on Discounted Cash Flow ("DCF") Analysis was Reasonable

- The Discounted Cash Flow model provides a mechanism for evaluating the likely expectations of investors. The DCF model, assuming constant growth of dividends over time, is reflected in the following formula:

  > The expected (required) rate of return on equity = the expected dividend yield + the expected growth rate in dividends.

  While the cost of equity cannot be observed directly, with estimates of a stock's expected dividend yield (in one year) and its dividend growth rate, the cost of equity can be estimated.[67] The Discounted Cash Flow model further postulates that an investor's expected future dividends are as follows:

  > The current price of a stock = the present value of all expected future dividends, discounted by the appropriate rate of return.

  The DCF model, applied to companies with comparable risk, is a reasonable market-oriented method for determining a fair ROE for Great Plains. It uses current, relevant information to determine a reasonable ROE that will provide the Company a reasonable opportunity to compete sufficiently and fairly in the capital markets.[68]

- Additionally, DCF "analysis is the most widely accepted model and one that has been used consistently as a starting point for establishing the cost of equity in public utility cases before the Commission."[69] DCF analysis estimates a company's present value based on projections of how much money it will generate in the future.

- Great Plains cannot be analyzed directly with a DCF analysis because it is not publicly traded on any of the stock exchanges. When an entity's stock is not publicly traded, there are a few alternative ways to conduct a DCF analysis.

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[66] *Id.* at 5.
[67] DER-1 at 6-7 (Addonizio Direct).
[68] *Id.* at 6.
[69] *In re N. States Power Co., a Minn. Corp. & Wholly Owned Subsidiary of Xcel Energy Inc., for Auth. to Increase Rates for Nat. Gas Serv. in Minn.*, Docket No. G-002/GR-06-1429, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER at 28 (2007 NSP Rate Case Order) (Sept. 10, 2007).

- Department witness Mr. Addonizio chose to perform a DCF analysis on a group of companies with investment risks comparable to the risks of Great Plains because it is a well-accepted financial principal that companies with similar investment risks are expected to have similar costs of equity.[70] Mr. Addonizio chose a group of companies that have business risks similar to Great Plains by applying the following screens:

    1) Are listed on the Compustat Research Insight data base; and
        a) Have an Standard Industrial Classification code of 4924 (natural gas distribution);
        b) Are traded on a stock exchange;
        c) Have a Standard & Poor's ("S&P") credit ratings within the range of BBB to A+;

    2) Received an average of at least 60 percent of their operating income from natural gas distribution during the most recent three years for which data is available; and

    3) In addition to the four companies that were listed by Compustat and met the above credit and income screens, Mr. Addonizio added one company, Southwest Gas Holdings, Inc., classified by Value Line as a natural gas company, which also met the credit rating and income requirements.[71]

- Mr. Addonizio's screening process resulted in the following proxy group (DER Proxy Group):[72]

Company	Ticker
Atmos Energy Corporation	ATO
Northwest Natural Holding Company	NWN
ONE Gas, Inc.	OGS
Spire Inc.	SR
Southwest Gas Holdings, Inc.	SWX

Source: Ex. DER-1, CMA-2 (Addonizio Direct)

- After identifying a proxy group, Mr. Addonizio used the constant growth DCF model and the two-growth DCF model to estimate Great Plains' cost of equity. Under the DCF methodology, cost of equity (the required rate of return) is equal to the expected dividend yield plus the expected growth rate of dividends.[73]

[70] Ex. DER-1 at 8-9 (Addonizio Direct).
[71] *Id.* at 10-12.
[72] *Id.* at 13.
[73] Department Initial Brief at 37.

- For the first DCF component, the expected dividend yield, Mr. Addonizio determined the expected dividend yield for each company in the DER Proxy Group using its current stock price, which is directly observable, and its most recent dividend, which also is directly observable. The DCF model assumes that dividends are paid once per year. The dividend yield is calculated as the expected annual dividend in the next year divided by the current stock price, and thus requires an estimate of each company's annual dividend to be paid one year from now.[74]

- As to his calculation of the share price in the current period, Mr. Addonizio testified that recent prices must be used since the current price per share incorporates all relevant publicly available information. Share prices, however, can be volatile in the short run. For these reasons, it is desirable to use an average share price of a period of time long enough to avoid short-term aberrations in the capital market, but not too long in order to ensure that the measure of price used to calculate the expected dividend yield appropriately reflects all relevant publicly available information.[75] To balance these competing pressures, for purposes of calculating each company's expected dividend yield, Mr. Addonizio calculated share price as the average of the closing price over the 30 trading days ending on December 9, 2019.[76] In his surrebuttal testimony, Mr. Addonizio updated the expected dividend yield for companies in his proxy group by using the most recently available 30 trading days ending on February 12, 2020.[77]

- For the second DCF component, the expected dividend growth rate for each company in the DER 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.[78] Further, and consistent with financial studies and literature, Mr. Addonizio used projected earnings-per-share growth rates, rather than dividend-per-share or book-value-per-share, since the long-run sustainable growth in dividends is solely driven from earnings growth.[79]

- As part of this process, Mr. Addonizio also performed a high-level review of all the projected earnings growth rates to identify any unreasonably high or low values.[80] Mr. Addonizio identified one unreasonable growth rate: Value Line's 27.0 percent five-year growth rate for Northwest Natural Holding Company.[81] Mr. Addonizio reasonably concluded that Value Line's 27.0 percent growth rate was inappropriate to include in the

[74] Ex. DER-1 at 22 (Addonizio Direct).
[75] *Id.* at 23.
[76] *Id.*
[77] Ex. DER-9, CMA-S-7 (Addonizio Surrebuttal).
[78] Ex. DER-1 at 14 (Addonizio Direct).
[79] *Id.* at 15-16.
[80] Ex. DER-9 at 30 (Addonizio Surrebuttal).
[81] *Id.* at 31.

DCF analyses because it was more than five times higher than the other two estimates for Northwest Natural and three times higher than the next highest single estimate for any of the other proxy companies.[82]

- Upon further investigation, Mr. Addonizio determined that this earnings growth estimate was caused by Northwest Natural's decision to write off a poorly performing asset in 2017, coupled with stable earnings in 2016, 2017, and 2018.[83] Mr. Addonizio explained that the other earnings growth rates for Northwest Natural appear to account for this balance sheet change, as shown in Figure 1, and provide a more accurate estimate of the company's future earnings.[84]

- Mr. Addonizio also addressed Spire Inc.'s estimated earnings growth rate. Mr. Addonizio reasonably concluded that any concerns regarding Yahoo!'s estimated earnings for the company were mooted by a subsequent upwards adjustment.[85]

- Mr. Addonizio also performed a second set of DCF analyses that used two growth rates for each company. The two-growth DCF uses one growth rate for the first five years, and then a second, sustainable growth rate for year six and beyond. The two-growth DCF model accounts for situations where the short-term projected earnings growth rates may not be expected to continue in the long run because the short-term rate may be unusually low or unusually high, relative to the company's historical averages, industry averages, or relative to the economy as a whole.[86] Unusually low or high growth rates may result in unreasonably low or high estimates of the cost of equity. Mr. Addonizio, for the short-term growth rate, used the five-year projected earnings growth rates that he used in the constant growth DCF analysis from Zacks, Value Line, and Thomson.[87]

- For the long-term growth rates, Mr. Addonizo first determined the likelihood for each company in the DER Proxy Group that its five-year project growth rate is sustainable. Growth rates may be considered unsustainable if they are unusually low or unusually high relative to the industry. To make this assessment, Mr. Addonizio calculated the average growth rate for the DER Proxy Group and the standard deviation of the growth estimates. He determined that any growth rate that was lower than one standard deviation below the proxy group's average may not be sustainable and, similarly, any

[82] Ex. DER-9 at 31 (Addonizio Surrebuttal).
[83] *Id.* at 18.
[84] Ex. DER-1 at 21-22 (Addonizio Direct) ("Zacks and Thomson reported expected earnings growth rates of 5.00 percent and 3.75 percent, respectively. . . . [I]t seems clear that both Zacks and Thomson removed the impact of [Northwest Natural's] write down of the Gill Ranch Facility from their forecasts.").
[85] Ex. DER-9 at 35 (Addonizio Surrebuttal).
[86] Ex. DER-1 at 24 (Addonizio Direct).
[87] *Id.* at 26.

growth rate that is higher than one standard deviation above the proxy group's average growth rate may not be sustainable.[88]

- As part of his two-growth DCF analyses, Mr. Addonizio again performed a high-level review of his inputs. While the two-growth DCF model is intended to mitigate the effect of unsustainable growth rates, it is not robust against extreme outliers. In this instance, including Value Line's 27.0 percent growth estimate would have unreasonably inflated the group's average and its standard deviation, resulting in a much higher and much wider range of ROEs considered to be sustainable.[89] Inclusion of Value Line's 27.0 percent growth estimate would have dramatically increased the recommended ROE for Great Plains from 8.82 percent to 10.26 percent, before adjusting for flotation costs.[90]

- As part of his surrebuttal analysis, Mr. Addonizio updated the stock prices he used when calculating dividend yields and the dividend amounts for companies that changed their dividends. Mr. Addonizio also updated the growth estimates for some of the companies in the DER Proxy Group based on new Zacks Investment Research and Thomson First Call data. Mr. Addonizio further noted that Value Line did not release new information in the period between his direct and surrebuttal analyses.[91]

- Based on this updated information, Mr. Addonizio's Table 2 from his surrebuttal testimony shows his final DCF analysis for the DER Proxy Group:[92]

Model	Mean Low ROE	Mean Avg. ROE	Mean High ROE
Constant Growth DCF	7.95%	8.79%	9.67%
Two-Growth DCF	7.90%	8.82%	9.67%

Ex. DER-9, CMA-S-2 through CMA-S-5 (Addonizio Surrebuttal)

b. The Department's Decision to Check its DCF Analysis with the Capital Asset Price Modeling ("CAPM") was Reasonable

- Mr. Addonizio checked the reasonableness of his constant growth DCF and two-growth DCF analyses by using the Capital Asset Pricing Model. 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). The required rate of return on the stock is calculated as the sum of the stock's

[88] *Id.* at 26-27.
[89] *Id.* at 28.
[90] *Id.* at 28.
[91] Ex. DER-9 at 3-4 (Addonizio Surrebuttal).
[92] *Id.*

beta multiplied by the market risk premium, and the rate of return on a riskless asset.[93] While CAPM is theoretically sound, its use raises some difficult issues, including challenges determining the appropriate beta, the appropriate riskless asset, and the appropriate estimate of the required return on the market portfolio.

- The first input into the CAPM formula ($k = r_f + beta\ (k_m - r_f)$) is the rate of return on a riskless asset (r_f). A 30-year U.S. Treasury bond generally is considered to be devoid of default risk. It also better matches the equity investor's stock holding period (as opposed to a 90-day bond). However, investing in a 30-year treasury bond would subject an investor to investment risk associated with foregone investment opportunities because his or her cash is tied up in previously made investments.[94] As a compromise between the risks associated with short-term and long-term treasuries, Mr. Addonizio reasonably used the yield on 20-year U.S. Treasury bonds as the risk-free rate. Additionally, he reasonably used the average yield over the 30 trading days to eliminate any bias that may be introduced from day-to-day volatility.[95]

- The second input into the CAPM formula ($k = r_f + beta\ (k_m - r_f)$) is the market rate of return (k_m). To determine the market rate of return, it is necessary to select a market portfolio. Once a market portfolio is selected, the required return on that portfolio can be estimated. In this case, Mr. Addonizio used the S&P 500, a common choice for CAPM analyses, as a proxy for the market portfolio. State Street Global Advisors manages an exchange-traded fund (ETF) designed to mimic the S&P 500 Index, and reports an estimated 3-5 year earnings growth rate for the holdings of the ETF that it calculates using equity analysts' earnings estimates for the companies included in the ETF.[96] Mr. Addonizio used this earnings growth estimate as the estimate of the growth rate for the market portfolio, which was 10.75 percent as of January 1, 2020.

- The CAPM also requires a dividend yield. The dividend yield for the S&P 500 as of January 1, 2020, was 1.77 percent. Similar to the dividend yields used in his DCF analysis, Mr. Addonizio applied a half years' worth of growth to this dividend yield, resulting in a dividend yield of 1.87 percent. Thus, the required rate of return on the S&P 500 is 1.87 percent + 10.73 percent = 12.62 percent. Mr. Addonizio used this return as the market rate of return (k_m).[97]

- The third input into the CAPM formula ($k = r_f + beta\ (k_m - r_f)$) is the estimated beta for the target company. Mr. Addonizio reasonably relied on the beta estimate provided by Value Line for each of the companies in the DER Proxy Group. An average of these betas produced a beta figure of 0.64 for Great Plains.[98]

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93 Ex. DER-1 at 33-34 (Addonizio Direct).
94 *Id.* at 35.
95 *Id.* at 36.
96 *Id.* at 36-37.
97 *Id.* at 37.
98 *Id.*

- As part of his surrebuttal analysis, Mr. Addonizio updated his CAPM analyses with more current estimates of the risk-free rate and the rate of return on the market portfolio.[99] With this more current data, Mr. Addonizio re-ran his CAPM analyses using the process described above. With these updated data, Mr. Addonizio's CAPM analysis resulted in an estimated required rate of return on equity of 9.38 percent.[100] This result falls within the ROE range Mr. Addonizio developed with his DCF analysis. Accordingly, this updated CAPM analysis confirmed the reasonableness of Mr. Addonizio's DCF-derived recommendation.[101]

- The ALJ finds that the Department reasonably relied on DCF analyses, the Commission's preferred analytical tool, to recommend an appropriate ROE for Great Plains. In conducting his DCF analyses, Mr. Addonizio took reasonable steps to ensure that companies and growth rates that were not representative of Great Plains were excluded from the proxy group modeling. On this basis, Mr. Addonizio recommended an ROE of 8.82 percent.[102] The ALJ further finds that the Department took reasonable steps to check the reasonableness of its DCF analyses. Mr. Addonizio used CAPM, a theoretically sound analytical approach, to determine whether his DCF analyses had produced a sound result.[103] On this basis, Mr. Addonizio demonstrated that his ROE recommendation was reasonable because it fell within the range of results produced by his CAPM analysis. Overall, the ALJ finds that Mr. Addonizio's recommended ROE of 8.82 percent is reasonable and should be adopted by the Commission.

4. Great Plains' 10.2 Percent Recommended ROE is Not Reasonable and is Not Supported by the Record

a. Great Plains' DCF Analyses Relied on Flawed Inputs

- Like Mr. Addonizio, Ms. Bulkley developed a proxy group for her DCF analyses.[104] In its review, the Department identified two problems with Ms. Bulkley's proxy group screening process. First, Ms. Bulkley allowed operating losses in non-regulated operating segments to make income from regulated operating segments appear disproportionately large.[105] The Department recommended that Great Plains use the absolute values of each segment's operating income or loss to calculate the total company amount, as well as the percentages attributable to each segment, to avoid this distortion.[106] Applying this adjustment, the Department recommended exclusion of two

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[99] Ex. DER-9 at 4-5 (Addonizio Surrebuttal).
[100] Ex. DER-9, CMA-S-8 (Addonizio Surrebuttal).
[101] *Id.* at 5.
[102] *Id.* at 80.
[103] *Id.* at 5.
[104] Ex. GP-14 at 42 (Bulkley Direct).
[105] *Id.* at 45-46.
[106] *Id.* at 47; Ex. GP-14 at 43 (Bulkley Direct).

companies that Ms. Bulkley included in her proxy group: South Jersey Industries, Inc. ("South Jersey") and NiSource, Inc. ("NiSource").[107]

- In response, Ms. Bulkley argued that it was inappropriate to exclude South Jersey and NiSource from the proxy group due to one-time events that caused the companies to miss the required income threshold.[108] Mr. Addonizio responded that it was speculative to conclude that South Jersey and NiSource would exceed the 60 percent income threshold in the future given that South Jersey's share of operating income from regulated operations had decreased even in the absence of the impairments cited by Ms. Bulkley as one-time events[109] and significant uncertainty continues to surround NiSource following a natural gas explosion.[110] Mr. Addonizio further argued that the relevant question is not whether the companies are likely to exceed the income threshold in the future, but rather whether the companies met the income screens articulated by the analysts.[111]

- The ALJ finds that it is not reasonable to include South Jersey and NiSource in Great Plains' proxy group given that both companies failed the screens employed by Ms. Bulkley and Mr. Addonizio by not meeting the required 60 percent income threshold.

- Second, the Department recommended that Great Plains exclude New Jersey Resources Corporation from its proxy group because S&P withdrew all of its credit ratings on May 24, 2019.[112] In response, Ms. Bulkley argued that New Jersey Resources should be included in the proxy group because New Jersey Natural Gas, a utility subsidiary of New Jersey Resources Corporation, has an investment grade credit rating from Moody's.[113]

- Mr. Addonizio reasoned that Moody's credit rating for New Jersey Natural was irrelevant because it was not an issuer-level credit rating. Issuer-level credit ratings are based on an entity's ability to "honor senior unsecured debt and debt like obligations."[114] In contrast, Moody's investment grade credit rating for New Jersey Natural Gas (NJNG) is based on its ability to pay secured debt.[115] Mr. Addonizio explained why this difference between secured and unsecured debt matters:

> Secured debt has a higher claim priority than unsecured debt; accordingly, it is less risky than unsecured debt and results in higher credit ratings. . . . Ms. Bulkley is taking a credit rating . . . based on NJNG's ability to pay

[107] Ex. DER-1 at 47 (Addonizio Direct).
[108] Ex. GP-16 at 19-25 (Bulkley Rebuttal).
[109] Ex. DER-9 at 9 (Addonizio Surrebuttal).
[110] *Id.* at 11-12; Ex. DER-1 at 50 (Addonizio Direct);
[111] *Id.;* Ex. DER-9 at 10 (Addonizio Surrebuttal).
[112] Ex. DER-1 at 50 (Addonizio Direct).
[113] Ex. GP-16 at 27-28 (Bulkley Rebuttal); Ex. DER-9 at 22 (Addonizio Surrebuttal).
[114] *Id.* at 23 (quoting MOODY'S INVESTOR SERVICE, RATING SYMBOLS AND DEFINITIONS 9 (2020), available at https://perma.cc/FB7Z-Z866).
[115] Ex. DER-9, CMA-S-19 at 2 (Addonizio Surrebuttal).

> secured debt and treating it like a credit rating . . . based on the ability to pay unsecured debt. This results an overstatement of NJNG's creditworthiness.[116]

The difference between ratings on unsecured and secured debt alone is enough to render Moody's credit rating for New Jersey Natural Gas meaningless in the context of this proceeding. However, Moody's credit rating for New Jersey Natural Gas may be even less relevant than the unsecured/secured distinction implies because neither Ms. Bulkley nor Mr. Addonizio could determine whether the rating applied beyond a specific debt issuance by New Jersey Natural Gas made in conjunction with the New Jersey Economic Development Authority.[117]

- The ALJ finds that it is unreasonable to include New Jersey Resources Corporation in the proxy group because it lacks an issuer level credit rating itself. The ALJ further find that is unreasonable to rely on New Jersey Natural Gas's Moody's credit rating as a basis for including New Jersey Resources Corporation in the proxy given that this credit rating is not an issuer level rating and is not directly applicable to New Jersey Resources Corporation. For these reasons, the ALJ recommends that New Jersey Resources Corporation be excluded from the proxy group.

- Another issue that arose in relation to the DCF proxy groups was the stock price averaging period used to estimate divided yields. Basic financial theory holds that current stock prices fully reflect all publicly available information. Mr. Addonizio explained that the use of long-term historical prices may result in dividend yields that reflect irrelevant information. Under this principle, Ms. Bulkley's use of prices over the 90- and 180-trading-day periods to calculate her dividend yields was unreasonable.[118] Ms. Bulkley's mean constant growth DCF ROE estimates calculated using 90- and 180-trading-day average dividend yields (9.88 percent and 9.97 percent) are seven basis points and sixteen basis points higher, respectively, than her mean ROE estimate based on a 30-trading-day average dividend yield (9.81 percent).[119]

- An additional issue relating to the DCF proxy groups was the use of Value Line's estimated growth rate for Northwest Natural. In contrast to Mr. Addonizio, Ms. Bulkley chose to use Value Line's 27.0 percent growth rate for Northwest Natural as part of her DCF analyses.[120] Mr. Addonzio noted that Value Line's 27.0 percent earnings growth rate is five times higher than any other estimate for Northwest Natural and three times higher than the next highest single estimate for any other proxy company.[121] Mr. Addonizio also testified that this earnings growth estimate was caused by Northwest

[116] Ex. DER-9 at 25 (Addonizio Surrebuttal).
[117] *Id.* at 25-26.
[118] Ex. GP-14 at 52 (Bulkley Direct).
[119] Ex. GP-14, AEB-2, Schedule 2 (Bulkley Direct).
[120] *Id.*, Schedule 5.
[121] *Id.* at 31.

Natural's decision to write off a poorly performing asset in 2017, coupled with stable earnings in 2016, 2017, and 2018.[122] The ALJ finds that the 27.0 percent growth rate is inflated, unrepresentative of Value Line's assessment of Northwest Natural's expected earnings growth, and is not suitable for use in a DCF analysis.

- The ALJ further finds that Ms. Bulkley's two-growth DCF analyses suffered from the same defects as her constant growth DCF analyses. First, Ms. Bulkley used 90- and 180-day averaging periods for the proxy companies' stock prices that reflect out-of-date, irrelevant information. Second, Ms. Bulkley included Value Line's 27.0 percent earnings growth rate estimate for Northwest Natural.[123] For these reasons, Ms. Bulkley's two-growth DCF analysis results in an unreasonable ROE range.

b. Great Plains' CAPM Analyses Relied on a Flawed Input

- As part of her CAPM analyses, Ms. Bulkley used forecasted bond yields to determine the risk-free rate.[124] Mr. Addonizio objected to this decision. He reasoned that long-term interest rates, including yields on Treasury bonds, are determined by market forces. In this way, current bond yields already reflect investor expectations about future economic and financial conditions.[125] Since current bond yields reflect expected future developments, any changes to bond yields in the future will necessarily reflect unanticipated developments that cause investors to adjust their expectations.[126] Forecasted bond yields suffer from the fact that it is challenging to forecast unanticipated future events. Moreover, if these future developments were anticipated, then current bond yields would already reflect these anticipated changes. Accordingly, the ALJ finds that long-term forecasted bond yields are subject to too much uncertainty to be relied upon and the ROE estimates produced with them should be given little to no weight.[127]

- Mr. Addonizio concluded that Ms. Bulkley's estimate of the required market return and choice of beta for Great Plains appeared reasonable.[128] Mr. Addonizio, however, did note that Ms. Bulkley's CAPM analyses produced a required market return estimate of 13.90 percent in contrast to Mr. Addonizio's own estimate of 12.92 percent – even though they both used similar approaches and relied on respected datasets.[129]

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[122] Ex. DER-9 at 18 (Addonizio Surrebuttal).
[123] Ex. DER-1 at 53 (Addonizio Direct).
[124] Ex. GP-14 at 66-67 (Bulkley Direct).
[125] Ex. DER-1 at 56 (Addonizio Direct).
[126] *Id.*
[127] *Id.* at 56-57.
[128] Ex. GP-14 at 68-69 (Bulkley Direct).
[129] Ex. DER-1 at 57-58 (Addonizio Direct).

c. Bond Yield Plus Risk Premium Analysis is Not Theoretically Sound

- The Bond Yield Plus Risk Premium approach, employed by Ms. Bulkley, treats ROE as a sum of a bond yield plus an equity risk premium. Ms. Bulkley used historical data, going back to 1992, to estimate the historical relationship between the equity risk premium for gas utilities and the yield on 30-year U.S. Treasuries. She then derived an estimate of the current equity risk premium by applying that historical relationship to current 30-year Treasury yields, as well as two forecasts of 30-year Treasury yields.[130]

- Mr. Addonizio explained that Bond Yield Plus Risk Premium analysis is not a theoretically sound way to determine Great Plains' ROE because it is backward looking, rather than forward-looking.[131] The Bond Yield model assumes that the relationship between the equity risk premium for gas distribution utilities and treasury yields does not depend on investors adjusting their expectations depending on different economic and financial conditions such as changing federal monetary and fiscal policies.[132] The ALJ finds that it is unreasonable to use Bond Yield analysis to determine ROE because it ignores all other economic and financial conditions that may affect investors' expectations and return requirements.

- Ms. Bulkley also used forecasted interest rates in her Bond Yield Plus Risk Premium analysis. Mr. Addonizio explained that these forecasted interest rates are subject to too much uncertainty to produce an ROE that can be reasonably relied upon and are inferior to current interest rates as predictors of future interest rates. Actual bond yields already reflect investor expectations about the future.[133] The ALJ finds that it is unreasonable to rely on forecasts that depend on the occurrence of unanticipated and currently unknowable events.

d. The Expected Earnings Methodology is Not Theoretically Sound

- Ms. Bulkley also employed the Expected Earnings methodology to estimate Great Plains' ROE.[134] The Expected Earnings methodology is an accounting-based methodology, not a market-based one. It estimates a rate of return on the book value of a company's equity. However, Mr. Addonizio explained, investors cannot purchase shares of common stock at their book value. Investors must pay the current market value for shares.[135]

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[130] Ex. DER-1 at 58-59 (Addonizio Direct); Ex. DER-9 at 57 (Addonizio Surrebuttal).
[131] Ex. GP-14 at 73-77 (Bulkley Direct).
[132] Ex. DER-1 at 59 (Addonizio Direct).
[133] Ex. DER-1 at 60-61 (Addonizio Direct).
[134] Ex. GP-14 at 77-79 (Bulkley Direct).
[135] Ex. DER-1 at 60-61 (Addonizio Direct).

- The Federal Energy Regulatory Commission ("FERC") has similarly determined that the Expected Earnings Methodology is inappropriate for determining ROE. FERC explained, "The Expected Earnings methodology provides an accounting-based approach that uses investment analyst estimates of return . . . on book value[.]"[136] FERC concluded:

> 201. In particular, we find that the record does not support departing from our traditional use of market-based approaches to determine base ROE. Under the market-based approach, the Commission sets a utility's ROE to equal the estimated return that investors would require in order to purchase stock in the utility at its current market price. In *Hope*, the Supreme Court explained that "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks."
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> . . . .
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> 202. The return on book value is also not indicative of what return an investor requires to invest in the utility's equity or what return an investor receives on the equity investment, because those returns are determined with respect to the current market price that an investor must pay in order to invest in the equity.[137]

  In this way, FERC reasoned that it would be illogical to set ROE based on book value when actual equity investment must be made at the company's current market price.

- In response, Ms. Bulkley cited a passage from NEW REGULATORY FINANCE discussing Dr. Roger A. Morin's Comparable Earnings methodology.[138] Mr. Addonizo explained that Comparable Earnings and Expected Earnings Methodologies are not comparable to each other. Dr. Morin's Comparable Earnings methodology requires that the target utility's proxy group not include other utility companies. In contrast, Ms. Bulkley's proxy group exclusively contained gas distribution utilities.[139] Accordingly, it is unreasonable to extend the arguments supporting Dr. Morin's Comparable Earnings to Ms. Bulkley's Expected Earnings approach because Ms. Bulkley did not use the same inputs as Dr. Morin.

[136] Opinion No. 569, *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. System Operator, Inc.*, 169 F.E.R.C. ¶ 61,129, 61,301 (slip op., para. 172) (2019), available at www.ferc.gov/whats-new/comm-meet/2019/112119/E-11.pdf.
[137] *Id.* ¶ 61,329-330 (slip op., paras. 200-201) (citing *Fed. Power Comm'n, vs. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944)).
[138] Ex. GP-16 at 64-66 (Bulkley Rebuttal); ROGER A. MORIN, NEW REGULATORY FINANCE (Pub. Utils. Rep., Inc. 2006).
[139] MORIN, NEW REGULATORY FINANCE at 383.

- Expected Earnings analysis is fundamentally different from Comparable Earnings analysis. None of Dr. Morin's arguments in favor of the Comparable Earnings methodology can reasonably be applied to Ms. Bulkley's Expected Earnings analysis. Moreover, Ms. Bulkley's Expected Earnings analysis is subject to the circularity problem that Dr. Morin described in his textbook because Ms. Bulkley included other utilities in her proxy group.[140] Further, as Dr. Morin makes clear, investors cannot invest at book value, and thus, book-based rates of return are not representative of the returns available to investors, as Mr. Addonizio's direct testimony described and as FERC Opinion 569 concluded.[141] For these reasons, the ALJ finds that Ms. Bulkley's Expected Earnings analysis should be given no weight.

e. Great Plains' Consideration of Qualitative Risks Was Unreasonable

- Ms. Bulkley also used qualitative analysis to make adjustments to her recommended ROE for Great Plains. Ms. Bulkley specifically considered Great Plains' size, customer concentration, capital expenditures, and regulatory environment.[142] Based on these risk factors, Ms. Bulkley made unspecified upward adjustments to the Great Plains' proposed ROE.[143]

- First, Ms. Bulkley asserted that Great Plains is riskier than the proxy group companies because of its size.[144] Mr. Addonizio explained that while smaller businesses, particularly in the competitive market, may experience a "size effect" as described by Ms. Bulkley, it may not necessarily apply to rate regulated utilities.[145] The size effect theory further remains a matter of debate.[146] According to Cass Business School Finance Professor Mario Levis:

  > [I]t is fair to say that, after almost 20 years of its discovery, the underlying logic and sometimes the practical significance of the so-called 'size effect' still remains a matter of debate.[147]

  Public utilities like Great Plains also benefit from regulatory support and monopoly service territories that lessen the impact of market volatility.[148] As a result, utilities may be less impacted to the extent that a size effect exists.[149]

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[140] *Id.*
[141] MORIN, NEW REGULATORY FINANCE at 393; Ex. DER-9 at 62-63 (Addonizio Surrebuttal).
[142] Ex. GP-14 at 80-106 (Bulkley Direct).
[143] *Id.* at 92-93; Ex. DER-9 at 65 (Addonizio Surrebuttal).
[144] Ex. GP-14 at 80-85 (Bulkley Direct).
[145] Ex. DER-1 at 66 (Addonizio Direct).
[146] *Id.* at 65-67.
[147] Ex. DER-1, CMA-22 at 2 (Addonizio Direct) (Mario Levis, *The Record on Small Companies: A Review of the Evidence*, 2 J. OF ASSET MGMT. 368, 369 (2002)).
[148] Ex. DER-1 at 65-68 (Addonizio Direct); DER-9 at 65-66 (Addonizio Surrebuttal).
[149] Ex. DER-1 at 67 (Addonizio Direct).

- Second, Ms. Bulkley concluded that Great Plains is subject to greater risk than other companies in her proxy group because of its reliance on commercial and industrial customers.[150] In response, Mr. Addonizio explained that this conclusion is inconsistent with Ms. Bulkley's proxy group, which included four other companies with industrial and commercial delivery percentages greater than sixty percent. Mr. Addonizio also noted that Ms. Bulkley relied on a study that excluded regulated utilities.[151]

- Third, Ms. Bulkley testified that interest rates on government bonds have been driven lower as a result of market uncertainty.[152] She further stated that this decrease in interest rates has caused a decrease in the cost of capital for utilities, which in turn has caused utility valuations (i.e., stock prices) to increase above historical levels. 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.[153]

- In response, Mr. Addonizio explained that Ms. Bulkley's conclusion is inconsistent with financial theory. A reasonable investor will not hold an investment that he or she believes will perform poorly in the future.[154] If investors expect the price of a stock to fall, they are likely to sell the stock, bidding the price of the stock down until it reaches a point at which the expected return meets investors' required return. If investors expect interest rates to rise in the future, and also expect that rise to negatively impact the price of their stock holdings, they will bid the price of their stock holdings down until its expected return matches its required return.[155] In this way, market uncertainty is already fully reflected in stock prices.

- Fourth, Ms. Bulkley found that Great Plains is not riskier than the proxy group for her last two factors, capital expenditures and regulatory support.[156] Mr. Addonizio argued that it is unreasonable to make unspecified upward ROE adjustments on this basis.[157] To buttress its position that qualitative risk factors should be considered, Great Plains also relied on the Commission's May 2017 Order addressing Otter Tail Power Company's ROE.[158]

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[150] Ex. GP-14 at 85-87 (Bulkley Direct); Ex. DER-1 at 68 (Addonizio Direct).
[151] Ex. DER-1 at 69 (Addonizio Direct).
[152] Ex. GP-14 at 17-40 (Bulkley Direct).
[153] Ex. DER-1 at 69-70 (Addonizio Direct).
[154] *Id.* at 70.
[155] *Id.*
[156] *Id.* at 64.
[157] *Id.* at 65.
[158] Great Plains Initial Brief at 24. *In re Appl. of Otter Tail Power Co. for Auth. to Increase Rates for Elec. Serv. in Minn.*, MPUC Docket No. E-017/GR-15-1033, FINDINGS OF FACT, CONCLUSIONS AND ORDER at 55 (May 1, 2017).

- However, in Great Plains' last rate case, the Commission reasoned that such adjustments are subjective and undermine the DCF analysis:

> The Company adjusted its DCF results upward to reflect business risks it said were unique to the Company, setting it apart from the companies in its proxy group: its small size, a lack of geographic diversity in its service area, a lack of economic diversity in its service area, and a lack of diversity in its customer base. The Commission concurs with the Department and the ALJ that these risks—together with all company-specific strengths—have been subsumed into the mix of characteristics of the companies in the proxy groups and that adjusting for isolated, company-specific characteristics cutting only in favor of a higher return would improperly skew the DCF analysis.
>
> The proxy groups used in this case were carefully vetted, using objective criteria such as credit ratings and percentage of revenues drawn from specific business lines, to ensure their overall comparability to Great Plains. Making additional adjustments at this point for the characteristics cited by the Company would be likely to result in double-counting.[159]

  As a result, the Commission concluded:

> In short, it would disrupt the workings and compromise the results of the DCF model by inserting subjective judgments at a stage that is designed to be free of them.[160]

- Consistent with the Commission's order in Great Plains' last rate case, the ALJ finds that it is unreasonable to make adjustments to the DCF analysis-derived ROE based on qualitative analyses. The ALJ further finds that the upward adjustments reflected in Great Plains' proposed ROE are unreasonable because it is unclear exactly what adjustments were made, how the qualitative risk factor analysis is relevant, and whether the qualitative risk factor analysis supports such changes.

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[159] *In re Pet. by Great Plains Nat. Gas Co., a Div. of MDU Res. Grp., Inc., for Auth. to Increase Nat. Gas Rates in Minn.*, Docket No. G-004/GR-15-879, FINDINGS OF FACT, CONCLUSIONS, AND ORDER at 24 (Sept. 6, 2016).

[160] *Id.; see also* CenterPoint 2016 Rate Case at 42-43 (accepting the ALJ's recommendation to reject CenterPoint's ROE adjustment based on company size and current economic conditions); *In re Appl. of Minn. Energy Res. Corp. for Auth. to Increase Rates for Nat. Gas Serv. in Minn.*, MPUC Docket No. G-011/GR-15-736, FINDINGS OF FACT, CONCLUSIONS, AND ORDER at 26 (Oct. 31, 2016) (rejecting the use of company-specific risk factors).

f. Great Plains' Weighted ROE Recommendation is Unreasonable

- Weighted ROE is the product of a company's equity ratio and its authorized ROE.[161] Utilities, Great Plains included, have a great deal of control over their capital structure, and therefore their weighted ROE is in large part a function of their own choices related to the mix of debt and equity with which they choose to finance themselves. Ms. Bulkley calculated that Great Plains would need an authorized ROE of 10.07 percent in order to achieve an average weighted ROE of 5.11 percent, the average weighted ROE for other gas utilities in 2019.[162]

- Mr. Addonizio noted that a 10.07 percent authorized ROE would be significantly higher than the overwhelming majority of ROEs authorized during the last two years.[163] He explained that the reason it would need to be so high is that Great Plains has intentionally chosen to use a lower equity ratio than other gas utilities (i.e., by placing greater reliance on short- and long-term debt).[164] The ALJ finds that it would be unreasonable to award Great Plains a higher ROE simply because the Company has chosen to use a lower equity ratio than other gas utilities.[165]

- The ALJ finds that Great Plains' recommended ROE of 10.20 percent is unreasonable because the Company relied on DCF analyses that included flawed inputs and assumptions. The ALJ further finds that Great Plains' use of the Bond Yield Plus Risk Premium approach and Expected Earnings Methodology were unreasonable because these methodologies are theoretically flawed and Ms. Bulkley used unreasonable inputs. Finally, the ALJ finds that Great Plains' use of qualitative analyses was unreasonable because it is inconsistent with the Commission's order in the Company's last rate case, Great Plains' risk factor analysis is unsupported by the record, and the Company failed to directly connect this analysis to its adjustments.

- For these reasons, Ms. Bulkley's recommended ROE has not been shown to be reasonable and, thus, must be rejected.

5. ALJ Return on Equity Recommendation

- The ALJ concludes that the Department's ROE analysis and recommendation of an ROE of 8.82 percent (with flotation costs) is reasonable and that Great Plains did not demonstrate the reasonableness of its proposed ROE of 10.20 percent (with flotation costs). The ALJ also finds that the Proxy Group of the Department was reasonable while the Company's Proxy Group was flawed by the inclusion of unrepresentative companies

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[161] Ex. GP-16 at 13 (Bulkley Rebuttal).
[162] *Id.* at 13.
[163] *Id.* at 12.
[164] Ex. DER-1 at 41-42 (Addonizio Direct).
[165] Ex. DER-9 at 72-73 (Addonizio Surrebuttal).

and inputs. For these reasons, the ALJ does not recommend Ms. Bulkley's proposed ROE.

B. Flotation Costs

- The Department and Great Plains agree that ROE estimates derived using DCF analyses must be adjusted for flotation costs. Flotation costs are the costs of issuing new shares of common stock. Due to issuance costs, the price paid by an investor for a new share is higher than the price received by the company issuing the new share. As a result, the company must earn a higher percentage return on its stock issuance proceeds than investors require on their investments in order to meet investor's required rate of return.[166] However, not all equity issuances incur flotation costs. For example, shares issued through employee compensation programs and dividend reinvestment programs often do not incur flotation costs.[167]

- Mr. Addonizio reviewed the Company's flotation cost calculations. Great Plains provided an estimate of the flotation cost percentage on equity issued through underwriters based on two equity issuances by MDU Resources, but it did not account for equity issued through processes that did not incur flotation costs. The Company estimated that its flotation costs for the two equity issuances were 3.68 percent. However, this number is likely inflated because it does not account for equity issuances that did not incur flotation costs.[168] Mr. Addonizio adjusted Great Plains' estimated flotation costs of 3.68 percent to account for this inflation by conservatively assuming that half of Great Plains' equity was obtained by means that did not incur flotation costs. Mr. Addonizio reasoned this adjustment allows the Company to recover some flotation costs while reducing the risk of over or double recovery.

- In her rebuttal testimony, Ms. Bulkley acknowledged that equity issuances via means other than public issuances are less expensive.[169] However, she failed to document MDU Resources Group's actual expenses relating to non-public equity issuances. Ms. Bulkley stated only that MDU Resources Group paid the costs of investing employee dividends.[170] Given Great Plains' inability or unwillingness to provide any meaningful information regarding the flotation costs it has incurred on equity issuances via means other than public offerings, Ms. Bulkley's recommended flotation cost adjustment is unsupported. Ms. Bulkley's recommended flotation cost adjustment also is likely overstated given her acknowledgment that other sources of equity are usually less expensive. It is unreasonable to allow the Company to recover fully costs that it cannot meaningfully estimate.[171]

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[166] Ex. DER-1 at 29 (Addonizio Direct).
[167] *Id.* at 31.
[168] *Id.*
[169] Ex. GP-16 at 67 (Bulkley Rebuttal); DER-9 at 64 (Addonizio Surrebuttal).
[170] Ex. GP-16 at 66-68 (Bulkley Rebuttal).
[171] Ex. DER-9 at 64 (Addonizio Surrebuttal).

- Based on his review, Mr. Addonizio recommended that flotation costs be set at 1.84 percent.[172] This recommendation allows Great Plains to recover some flotation costs, which it has undoubtedly incurred, while also placing a reasonable limit on its recovery of those costs in response to its lack of support for those costs.[173]

- The ALJ finds that it is unreasonable for Great Plains to recover costs that it cannot meaningfully estimate; particularly, given that the Company acknowledged that it has incurred nonpublic equity issuance expenses and that those issuances are less expensive than public equity issuances.[174] The ALJ further finds that the 1.84 percent flotation cost adjustment recommended by Mr. Addonizio is reasonable in recognition that Great Plains likely has incurred some flotation costs even if the exact amount has not been shown.

4. Rate Design and Apportionment of Revenue Responsibility

Basic Customer Service Charge Increases

<u>**Resolved**</u> **between DER and Great Plains**: Great Plains and the Department agreed that the Company's proposed increases to the basic customer charges for the residential and general firm class customers were reasonable.

The OAG opposed increasing the Residential and Small-Business Basic Customer Service Charges.

Basic Customer Charge Application

<u>**Dispute**</u> **between DER and Great Plains:** Great Plains and the Department disagree about whether it is reasonable to apply the basic customer charge on a daily basis.

A. Basic Customer Service Charges

1. Residential and Firm Customer Basic Customer Charges

- Great Plains proposed to increase the basic customer charge for the residential class by $1.50 a month, the small firm general class by $4.50 a month, and the large firm general service class by $6.50 a month.[175] The Company reasoned that these increases would move the residential and firm classes' basic customer charges closer to cost while not resulting in the rate shock that would accompany an increase in the basic customer charge

[172] Ex. DER-1 at 32 (Addonizio Direct).
[173] Ex. DER-9 at 65 (Addonizio Surrebuttal).
[174] Ex. GP-16 at 67 (Bulkley Rebuttal) ("Internal sources of equity, including dividend reinvestment and/ or employee stock option plans, are . . . typically less expensive[.]" (quoting ROGER A. MORIN, NEW REGULATORY FINANCE 334 (Pub. Util. Reps. 2006)).
[175] Ex. GP-25 at 18-20 (Hatzenbuhler Direct); Ex. DER-4 at 46 (Zajicek Direct).

fully to cost.[176] The Department evaluated Great Plains' proposal and determined that it would reduce intra-class subsidies by moving the majority of classes, including the residential and firm customer classes, closer to the costs identified in the CCOSS.[177] On this basis, Mr. Zajicek concluded the Company's proposed increases to the residential and general firm customer classes' basic customer charges were reasonable.

- Additionally, Great Plains and the Department responded to OAG witness Mr. Lebens' argument that the residential and small business classes' basic customer service charge should remain unchanged. The OAG articulated three reasons why the basic customer charge should not be increased: (1) it discourages conservation; (2) it disproportionately impacts low-usage users; and (3) it is inconsistent with monopoly regulation principles.[178]

- The Department disagreed with each of these reasons. First, not increasing the customer charge would have marginal impact on conservation because the corresponding increase in volumetric charge would be small and natural gas is an inelastic commodity.[179] Second, the customer charge disproportionately impacts low-usage users, as suggested by Mr. Lebens, precisely because it is designed to ensure that low-usage customers pay their fair share of fixed service costs. DER further concluded that a basic customer charge that accurately reflects fixed costs may benefit low-income customers because these customers may use slightly more energy on average than other customers due to older housing and other circumstances.[180] Third, monopoly regulation is intended to prevent utilities from asserting monopoly power. It is not intended to unreasonably restrict how utilities collect payment. Moreover, fixed delivery charges are used by a variety of competitive market firms, such as furniture stores, hardware stores, and grocery stores, to collect fixed expenses. In Great Plains' case, the basic customer charge is intended to recover the fixed expenses associated with connecting the customer's premise to safe, reliable service regardless of the amount of natural gas consumed.[181] For these reasons, the Department rejected Mr. Lebens' arguments and recommended that the Commission approve Great Plains' proposed increases to the residential and general service customer classes.[182]

- Accordingly, the ALJ finds that Great Plains' proposal to increase the basic customer charge for the residential class by $1.50 a month, the small firm general class by $4.50 a month, and the large firm general service class by $6.50 a month is reasonable because it would reduce intra-class subsidies while avoiding rate shock for customers.

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[176] Ex. GP-25 at 20 (Hatzenbuhler Direct).
[177] Ex. DER-4 at 51 (Zajicek Direct).
[178] Ex. OAG-1 at 3 (Lebens Direct).
[179] Ex. DER-8 at 2-3, 5-6 (Zajicek Rebuttal).
[180] *Id.* at 8-9.
[181] *Id.* 8 at 6-8.
[182] *Id.* at 9.

2. Basic Customer Charge Application Method Change

- Great Plains proposed that its basic service charge be applied on a daily basis. The charge currently is applied on a monthly basis.[183] Mr. Zajicek testified that this proposal is inconsistent with the principle that rates should be understandable and easy to administer because it would increase the complexity of customer bills.[184] Mr. Zajicek concluded that a monthly charge is simpler for customers to understand. He further testified that both daily and monthly application of the charge produce almost exactly the same financial results for Great Plains. To that end, Mr. Zajicek found that the Company appears to have chosen a set monthly rate and simply divided it by the total number of days in the year to identify its daily rate.[185] On this basis, the ALJ finds that Great Plains' proposal is unreasonable because it produces marginal benefits and needlessly risks customer confusion.

[183] Great Plains Initial Brief at 40-41 (citing Ex. GP-32 at 3 (Bosch Rebuttal)).
[184] Ex. DER-4 at 50-51 (Zajicek Direct).
[185] *Id.*

CERTIFICATE OF SERVICE

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

STATE OF MINNESOTA)
) ss.
COUNTY OF RAMSEY)

I, Ann Kirlin, hereby state that on April 27, 2020, I filed by electronic eDockets the attached Minnesota Department Of Commerce, Division of Energy Resources Proposed Findings on Disputed Issues, and eServed or sent by US Mail, as noted, to all parties on the attached service list.

See attached service list.

/s/ Ann Kirlin
ANN KIRLIN

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