DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA
*****

IN THE MATTER OF THE APPLICATION OF MONTANA-DAKOTA UTILITIES CO., a Division of MDU Resources Group, Inc., for Authority to Establish Increased Rates for Electric Service in the State of Montana	)))))	REGULATORY DIVISION DOCKET NO. D2015.6.51

CROSS-INTERVENOR AND RESPONSE TESTIMONY

OF

KEVIN C. HIGGINS

ON BEHALF OF THE

MONTANA LARGE CUSTOMER GROUP

JANUARY 14, 2016

TABLE OF CONTENTS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Kevin C. Higgins. My business address is 215 South State Street, Suite 200, Salt Lake City, Utah, 84111.

Q. ARE YOU THE SAME KEVIN C. HIGGINS WHO PREVIOUSLY FILED DIRECT TESTIMONY IN THIS PROCEEDING ON BEHALF OF THE MONTANA LARGE CUSTOMER GROUP ("LCG")?

A. Yes, I am.

I. INTRODUCTION AND SUMMARY

Q. WHAT IS THE PURPOSE OF YOUR CROSS-INTERVENOR RESPONSE TESTIMONY?

A. My cross-intervenor response testimony responds to certain issues address in the direct testimony of Montana Consumer Counsel ("MCC") witnesses Albert E. Clark and John Wilson. Specifically, I identify MCC's adjustments that are conceptually additive to LCG's adjustments and I respond to Mr. Clark's decision not to challenge end-of-period rate base treatment for MDU's four major plant additions scheduled for 2015. I also respond to Mr. Clark's observation that the extension of bonus tax depreciation likely has significant implications for the revenue requirement in this case.

My testimony also responds to Mr. Wilson's testimony regarding MDU's proposed Environmental Cost Recovery Rider ("ECRR") and Transmission Cost Recovery Rider (TCRR").

Q. PLEASE SUMMARIZE THE CONCLUSIONS IN YOUR CROSS-INTERVENOR RESPONSE TESTIMONY.

A. Adding the MCC adjustments to LCG's direct case reduces MDU's revenue requirement by an *additional* $3,086,761 relative to LCG's direct filing case. Taken together, the joint LCG/MCC adjustments reduce MDU's revenue requirement by $12,404,766, resulting in a net revenue requirement *decrease* of $649,222. This change is inclusive of (i.e., net of) the fuel cost increase associated with my adjustment to the Thunder Spirit Wind Farm rate base and expenses presented in my direct testimony.

I disagree with MCC's decision not to challenge MDU's proposal to recover the costs of, and earn a return on, the four major 2015 plant additions measured on an end-of-period basis. As I explained in my direct testimony, using an end-of-period rate base and annualized expense for the four major plant additions is inconsistent with the Company's treatment of all other post-test-period plant additions in this case and overstates the Company's revenue requirement deficiency.

I agree with Mr. Clark's observation that the extension of bonus tax depreciation potentially has significant implication for the revenue requirement in this case.

I am also in complete agreement with Mr. Wilson's recommendations that the proposed ECRR and TCRR be rejected by the Commission.

II. RESPONSE TO MR. CLARK

Q. WHAT GENERAL TOPIC DOES MR. CLARK ADDRESS IN HIS TESTIMONY?

A. Mr. Clark presents MCC's proposed revenue requirement. In doing so, he makes numerous adjustments to MDU's proposal. Mr. Clark also incorporates the depreciation recommendations of MCC witness Jack Pous and the cost of capital recommendations of Mr. Wilson to present an overall revenue requirement recommendation from MCC.

Q. WHAT IS MCC'S PROPOSED REVENUE REQUIREMENT FOR MDU?

A. As presented on page 3 of MCC Exhibit AEC-1, MCC is proposing a revenue requirement increase of $3,767,053, which is a reduction of $7,988,491 relative to

MDU's filing. In comparison, LCG is recommending a revenue requirement increase of $2,437,539 relative to current base rates, inclusive of the fuel cost increase associated with my adjustment to the Thunder Spirit Wind Farm rate base and expenses

Q. WHAT ASPECTS OF MR. CLARK'S TESTIMONY ARE YOU ADDRESSING?

A. There are two distinct purposes to my discussion of Mr. Clark's testimony. My first purpose is to identify the amount of MCC's adjustments that is conceptually additive to LCG's adjustments. That is, without taking a position as to the merit of any MCC adjustment, I identify the revenue requirement impact of the LCG/MCC adjustments taken together, after netting out adjustments that are either duplicative or non-applicable in light of LCG's direct case.

My second purpose is to respond to Mr. Clark's decision not to challenge end-of-period rate base treatment for MDU's four major plant additions scheduled for 2015.

Q. WHAT IS THE OVERALL EFFECT OF COMBINING THE LCG AND MCC ADJUSTMENTS?

A. As I stated above, together the joint LCG/MCC adjustments reduce MDU's revenue requirement by $12,404,766, resulting in a revenue requirement *decrease* of $649,222. This change is inclusive of the fuel cost *increase* associated with my adjustment to the Thunder Spirit Wind Farm rate base and expenses presented in my direct testimony. An itemization of the combined revenue requirement adjustments is presented in Table KCH-1CR below. The adjustments are presented cumulatively in the sequence shown in the table. I note that the revenue requirement impact of each individual adjustment may be different if presented in a different sequence.

Table KCH-1CR

Summary of Revenue Requirement Impact of Combined LCG/MCC Adjustments

	Adjustment	Increase
MDU As-Filed Requested Increase		**$11,755,544**
LCG Adjustments		
Big Stone AQCS Project Adjustment	($2,584,324)	$9,171,220
Lewis & Clark MATS Project Adjustment	($496,564)	$8,674,656
Lewis & Clark - RICE Units Project Adjustment	($1,279,164)	$7,395,492
Thunder Spirit Wind Farm Adjustment	($1,855,463)	$5,540,029
Transmission Expense Adjustment	($984,337)	$4,555,692
Decommissioning Over-Recovery Amortization Adjustment	($673,239)	$3,882,453
Depreciation Update - Big Stone	($216,071)	$3,666,382
Generation Overhaul Expense Adjustment	($311,858)	$3,354,524
Capital Structure Adjustment	($366,063)	$2,988,461
Cost of Debt Adjustment	($71,657)	$2,916,804
Return on Equity Adjustment	($479,265)	$2,437,539
Total LCG Adjustments	($9,318,005)	
LCG Recommended Increase		$2,437,539

Note: The summary above does not include LCG's recommended adjustment to MDU's proposed recovery of deferred MCC and PSC Taxes.

	Adjustment	Increase
MCC Incremental Adjustments (i.e. Incremental to LCG Adjustments)		
Miscellaneous Revenues Adjustment	($10,791)	$2,426,748
MCC/MPSC Tax Rate Expense Adjustment	($5,581)	$2,421,167
Incremental Labor Expense Adjustment	($57,150)	$2,364,017
401(k) and Other Benefits Adjustment	($1,870)	$2,362,147
Uncollectible Expense Adjustment	($9,554)	$2,352,593
Postage Expense Adjustment	($1,318)	$2,351,275
Advertising Expense Adjustment	($2,848)	$2,348,427
Self-Insurance Expense Adjustment	($14,178)	$2,334,249
Heskett III O&M Expense Adjustment	($40,034)	$2,294,215
Company Use Expense Adjustment	($7,472)	$2,286,743
Regulatory Expense Adjustment	($37,750)	$2,248,993
Subcontract Labor Expense Adjustment	($652,107)	$1,596,887
Regional Market Expense Adjustment	($15,823)	$1,581,064
Depreciation Expense Adjustment (excl. Four Large Generation Projects)	($1,207,373)	$373,690
Post-TY Plant Plant Related Expense Adjustment (excl. Four Large Generation Projects)	($128,480)	$245,210
Depreciation Expense - Rate Base Adjustment (excl. Four Large Generation Projects)	$75,575	$320,785
Materials and Supplies Rate Base Adjustment	$53,304	$374,090
Fuel Stores Rate Base Adjustment	$7,742	$381,831
Prepaid InsuranceRate Base Adjustment	$1,698	$383,529
Injuries and Damages Rate Base Adjustment	($2,851)	$380,678
Post-TY Plant in Service Rate Base Adjustment (excl. Four Large Generation Projects)	($418,807)	($38,129)
Post-TY Plant Related Rate Base Adjustment (excl. Four Large Generation Projects)	$16,483	($21,646)
Incremental ROE Impact Applied to LCG Rate Base	($627,576)	($649,222)
Total MCC Adjustments	($3,086,761)	
Recommended Increase with Incremental MCC Adjustments		($649,222)

Q. WHAT ARE YOUR GENERAL OBSERVATIONS REGARDING THE INCREMENTAL IMPACT OF COMBINING THE LCG AND MCC ADJUSTMENTS?

A. Adding the MCC adjustments to LCG's direct case reduces MDU's revenue requirement by an additional $3,086,761 relative to LCG's direct filing case. Of this amount, $627,576 consists of an incremental reduction to revenue requirement attributable to MCC's lower recommended cost of capital (applied to the smaller rate base being proposed by LCG). An additional $1,131,799 (the combined expense and rate base impacts) is attributable to MCC's recommended depreciation expense adjustment (applied to all plant except the four major plant additions). Finally, approximately $1,327,387 is attributable to revenue, expense, and rate base adjustments proposed by Mr. Clark that are not addressed in my direct testimony or are larger in amount than the adjustment I recommended on an item we both addressed.

Q. WHICH ITEMS ARE ADJUSTED BY BOTH YOU AND MR. CLARK?

A. Mr. Clark and I make identical recommendations regarding the preferred ratemaking treatment for the $6.7 million in decommissioning costs that MDU has over-recovered from Montana customers. We both propose to use a five-year amortization period to credit this over-recovery back to customers rather than the ten-year period proposed by MDU. This adjustment reduces the Montana revenue deficiency by $673,239 relative to MDU's filed case, and is counted only once in the combined LCG/MCC adjustments complied in Table KCH-1CR.

In addition, both Mr. Clark and I address MDU's proposed adjustments to transmission expense (which MDU labels "subcontract labor expense"). In its filing, MDU replaced its 2014 test period transmission expense with a hybrid of projected end-of-period (*i.e.*, annualized) 2015 expenses and projected 2016 costs. In my direct testimony, I recommend an adjustment that replaces MDU's 2015/2016 hybrid approach with 2015 calendar year pro forma transmission expense as a known and measurable change to the 2014 historical test year presented by MDU. In contrast, Mr. Clark proposes to reject the Company's transmission expense adjustment in its entirety. My adjustment reduces the Montana revenue requirement by $984,337 relative to MDU's proposal, whereas Mr. Clark's adjustment reduces it by $1,636,444. In Table KCH-1CR, I show the difference between these two amounts ($652,107) as the incremental effect of combining the LCG and MCC adjustments.

Q. WHAT MCC ADJUSTMENTS DID YOU EXCLUDE FROM THE COMBINED REVENUE REQUIREMENT IMPACT BECAUSE THE ADJUSTMENTS ARE NOT APPLICABLE IN LIGHT OF LCG'S DIRECT FILING?

A. I excluded two of MCC's adjustments in light of LCG's direct filing. First, I excluded the effects of MCC's depreciation expense adjustments on the four 2015 major plant additions because the large majority of the revenue requirement change associated with this adjustment (in this proceeding) only applies if an end-of-period rate base treatment is accepted for these plants. MDU proposed such an end-of-period treatment and MCC did not challenge the Company's proposal. However, I recommend rejecting the end-of-period rate base treatment for these four plant additions in favor of an average-of-period rate base. If an average-of-period rate base is used, as I recommend, then the large majority of MCC's depreciation expense adjustment for the four major plant additions is not additive to the LCG revenue requirement reduction. Therefore, I do not include this item in the combined LCG/MCC revenue requirement tally.

Second, I excluded the impact of MCC's proposed Lewis & Clark – RICE O&M expense adjustment. I have already removed the vast majority of the MDU's annualized O&M expenses for the Lewis & Clark capital additions because this investment was not scheduled to be commercially operational until 11 months after the conclusion of the historical test period and, to account for this fact, I substituted the projected *actual* 2015 O&M expenses for this project in place of MDU's projected *annualized* 2015 expenses. Therefore, only a small fraction (~1/12) of MCC's adjustment would be incremental the adjustment I recommended in my direct testimony. For simplicity, I have elected to exclude this O&M adjustment in its entirety.

Q. ARE YOU OPPOSING ANY OF THE ADJUSTMENTS RECOMMENDED BY MR. CLARK?

A. No. Based on my review of his direct testimony and exhibits, it appears to me that Mr. Clark has prepared a careful and well-reasoned basis for his adjustments. Therefore, I am not opposing any of his adjustments.

Q. ARE YOU FORMALLY INCORPORATING ANY OF MR. CLARK'S ADJUSTMENTS INTO LCG'S PROPOSED REVENUE REQUIREMENT?

A. No, not at this time. However, by removing duplicative or non-applicable adjustments, Table KCH-1CR will hopefully aid the Commission and parties in analyzing the recommendations in this case by summarizing the impact of a combined LCG/MCC revenue requirement.

Q. WHAT IS YOUR ASSESSMENT OF MCC'S RATEMAKING TREATMENT OF THE FOUR MAJOR PLANT ADDITIONS?

A. I disagree with MCC's decision not to challenge MDU's proposal to recover the costs of, and earn a return on, the four major 2015 plant additions measured on an end-of-period basis. The four projects are the Big Stone Air Quality Control System ("AQCS") environmental project, the Lewis & Clark Mercury and Air Toxic Standards ("MATS") environmental project, the Reciprocating Internal Combustion Engine ("RICE") Units located at the Lewis & Clark Station site, and the Thunder Spirit Wind Farm.

As I explained in my direct testimony, using an end-of-period rate base for the four major plant additions overstates the Company's revenue requirement deficiency. Although Mr. Clark carefully evaluates the timing implications of post-test year plant additions and expense for items *other than* the four major plant additions – and adheres to a rigorous average-of-period rate base treatment for these other items – he does not apply the same standard to the four major plant additions. Rather than recommending a ratemaking treatment for the four major plant additions that is consistent with his treatment of other post-test period plant additions, Mr. Clark accepts MDU's mismatched timing treatment for the four major items. Allowing this mismatch results in an overstatement of MDU's revenue requirement.

Q. PLEASE EXPLAIN WHY ALLOWING THIS MISMATCH OVERSTATES MDU'S REVENUE REQUIREMENT.

A. A return on any investment is paid as a function of the amount of time the invested capital has been deployed. The *average* amount of MDU's plant-in-service for these four major capital additions during 2015 is only $3.19 million, not $99.1 million, which is the projected value *only on the last day of the year*. In seeking to earn a return on the last-day value of $99.1 million as if this amount of investment had been in service for the entirety of 2015, MDU is overstating its actual investment in plant in service *during the 2015 post-test-year period* – which is properly measured over a full 12 months, not just on the last day of the year. By overstating its actual investment in plant in service during the 2015 post-test-year period, MDU *understates* its test period rate of return and consequently *overstates* its revenue requirement deficiency. MCC's acceptance of this treatment incorporates the overstatement of MDU's revenue requirement deficiency as it pertains to the four major plant additions.

Q. DOES MR. CLARK EXPRESS ANY CONCERN REGARDING MDU'S PROPOSED RATEMAKING TREATMENT FOR THE FOUR MAJOR PLANT ADDITIONS?

A. Yes. Mr. Clark acknowledges the different treatment proposed for these investments when he states:

> These projects are distinguishable from all of the other Company claimed post-test year plant additions because of their magnitude in dollars and the fact that the Company proposes to annualize them into rate base and expense as opposed to using an average rate base as is proposed for all other post-test year plant additions.[1]

Mr. Clark then goes on to comment on the fact that the scheduled in-service date for the Thunder Spirit Wind Farm is at the very end of the one-year period following the close of the historical test period:

> The latest information that I have received from MDU is that the in-service date is scheduled for December 31, 2015 which, of course, is the last day of the allowable one year adjustment period after the close of the historical test year. This is the second time that I can recall where a wind farm (Diamond Willow) was scheduled to be in-service on the last day of the adjustment period. At that time I stated generally that if it went into service on schedule it should be allowed. If not, the Commission could disallow it from rate base. Alternatively, if it came into service relatively quickly after the close of the allowed adjustment period, the Commission could still include it in rate base, and thus rates, as a public policy matter. I feel the same way about Thunder Spirit.[2]

---

[1] Direct Testimony of Albert E. Clark, p. 23.
[2] *Id*., p. 24.

Mr. Clark notes a similar concern regarding the timing of the Big Stone project when he states that, "It would not take much in the way of delays (weather or other unforeseen construction problems) to move this project beyond the limit of the adjustment period." [3]

In response to these timing concerns, Mr. Clark presents the ratemaking treatment of each of the four major plant additions as coming down to a determination of whether the revenue requirement increment for each project is included in rates using its (maximum) end-of-2015 rate base and annualized expense *or* entirely excluded from rates:

> Individually I am not proposing to exclude any of them at this time. If, however, any of them ultimately fail to be in-service during the allowable adjustment period set forth in the Commission rules, any of them could properly be excluded by the Commission.[4]

But the choice before the Commission is not limited to this "all or nothing" proposition. The Commission should also consider the third option I am recommending, which is to include the four major plant additions on an average-of-period basis, consistent with all other post-test-period plant. I believe this is the preferred ratemaking treatment for these items.

Q. WHAT DOES MR. CLARK OBSERVE WITH RESPECT TO BONUS TAX DEPRECIATION?

A. Mr. Clark correctly notes that MDU's proposed revenue requirement would change if it were to reflect an extension of bonus tax depreciation.[5] In all likelihood, the change would be a potentially material reduction in revenue requirement. At the time MDU made its filing, bonus tax depreciation had not yet been extended to 2015. However, the

---

[3] *Id.*, p. 25.
[4] *Id.*, p. 27.
[5] *Id.*

Protecting Americans from Tax Hike ("PATH") Act of 2015 was signed into law on December 18, 2015. This legislation extends bonus tax depreciation for property acquired and placed in service during 2015 through 2019.

Q. WHAT IS BONUS TAX DEPRECIATION?

A. Bonus tax depreciation refers to a greatly accelerated tax deduction for depreciation that has been permitted pursuant to several statutes signed into law to stimulate the economy starting in the 2000s. Until the passage of the PATH Act of 2015, 50 percent bonus tax depreciation was scheduled to end on December 31, 2014, except under certain circumstances for qualified property placed in service through December 31, 2015.

Q. HOW DOES BONUS TAX DEPRECIATION IMPACT RATEMAKING FOR REGULATED UTILITIES?

A. Bonus tax depreciation is a form of accelerated tax depreciation. Regulatory authorities have long recognized that utility depreciation for tax purposes differs from utility book depreciation used in ratemaking. The timing difference between tax depreciation and book depreciation is recognized through the recording of accumulated deferred income tax ("ADIT"). Generally, the tax benefits of accelerated depreciation are not passed through *directly* to ratepayers, but rather certain indirect benefits are recognized through the determination of rate base. According to the conventions of income tax normalization, the benefit of a utility's ADIT is viewed as a source of zero-cost capital to the utility as part of the ratemaking process. Consequently, the ADIT that results from accelerated tax depreciation is booked as a credit against rate base, thereby reducing revenue requirements for customers.

Even though bonus tax depreciation affects rates through the same mechanics as standard accelerated depreciation, its impact is more dramatic than standard accelerated depreciation in the years immediately following the placement of the qualifying plant into service. This is because bonus tax depreciation causes a much greater increase in ADIT, which, in turn, produces a much greater impact on the overall cost of capital for any given amount of new plant in service. This, in turn, reduces the revenue requirement relative to what it would have been if bonus tax depreciation were not applicable.

Q. WHY IS THE EXTENSION OF BONUS TAX DEPRECIATION RELEVANT FOR THIS PROCEEDING?

A. Currently, MDU's rate case has been filed under the assumption that bonus tax depreciation would not be available after 2014. Since it is now known that bonus tax depreciation continues to apply during and beyond the post-test-year period in this case, it is necessary to properly reflect the ratemaking impact of this tax change which effectively reduces MDU's rate base for plant added in 2015. I note that I expect bonus tax depreciation to have a larger impact on the revenue requirement of MDU's filed case than on the revenue requirement of LCG's filed case, since in LCG's case I have significantly adjusted the rate base recognized for the four major 2015 plant additions.

Q. HOW SHOULD THE EXTENSION OF BONUS TAX DEPRECIATION BE REFLECTED IN THIS CASE?

A. Properly, MDU should reflect the impact of the extension of bonus tax depreciation in its rebuttal filing. If the Company fails to make such an update, I recommend that the Commission require such an update be made in either a supplemental filing or in a compliance filing in conjunction with the final disposition of the issues in this case.

III. RESPONSE TO MR. WILSON

Q. WHAT IS MR. WILSON'S RESPONSE TO MDU'S PROPOSED ENVIRONMENTAL COST RECOVERY RIDER AND TRANSMISSION COST RECOVERY RIDER?

A. Mr. Wilson describes the proposed ECRR and TCRR tariffs as examples of piecemeal ratemaking that could impose efficiency disincentives. He also warns that these mechanisms could result in potentially perverse rate adjustments that cause overall revenues to diverge from overall costs to a greater extent than would occur without these rate adjustment riders. Mr. Wilson concludes that the proposed ECRR and TCRR should be rejected by the Commission.[6]

Q. WHAT IS YOUR RESPONSE TO MR. WILSON'S DISCUSSION OF THIS PROPOSAL?

A. I am in complete agreement with Mr. Wilson's recommendation that these proposed mechanisms be rejected.

Q. DOES THIS CONCLUDE YOUR CROSS-INTERVENOR RESPONSE TESTIMONY?

A. Yes, it does.

---

[6] Direct Testimony of John Wilson, pp. 76-77.