MONTANA-DAKOTA UTILITIES CO.

A Division of MDU Resources Group, Inc.

Before the South Dakota Public Utilities Commission

Docket No. EL15-__

Direct Testimony
of
Travis R. Jacobson

Q. Would you please state your name and business address?

A. Yes. My name is Travis R. Jacobson and my business address is 400 North Fourth Street, Bismarck, North Dakota 58501.

Q. What is your position with Montana-Dakota Utilities Co.?

A. I am the Regulatory Analysis Manager for Montana-Dakota Utilities Co. (Montana-Dakota), a Division of MDU Resources Group, Inc.

Q. Would you please describe your duties as Regulatory Analysis Manager?

A. I am responsible for the preparation of cost of service studies, fuel cost adjustments, purchased gas cost adjustments and gas tracking adjustments in each of the jurisdictions in which Montana-Dakota operates.

Q. Would you please describe your education and professional background?

A. I graduated from Minot State University with a Bachelor of Science degree in Accounting and I am a Certified Public Accountant (CPA). I started my career with Montana-Dakota in 1999 as a financial analyst in the Financial Reporting area and during my tenure with the Company have held positions of increasing responsibility, including Supervisor, Financial Reporting & Planning and Manager, Financial Reporting & Planning before attaining my current position.

Q. Have you testified in other proceedings before regulatory bodies?

A. Yes. I have previously presented testimony before the Montana and Wyoming Public Service Commissions and have submitted written testimony in proceedings before the North Dakota Public Service Commission.

Q. Are you familiar with the books and records of Montana-Dakota and the manner in which they are kept?

A. Yes. Montana-Dakota's books and records are kept in accordance with the Federal Energy Regulatory Commission (FERC) Uniform System of Accounts.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to present the per books cost of service for the twelve months ended December 31, 2014, the pro forma cost of service reflecting known and measurable adjustments that will occur by December 2015 and the calculation of the revenue deficiency.

Q. What statements, schedules and exhibits are you sponsoring?

A. I am sponsoring Statements D through F, Statements H through M, Statements P through R as well as Exhibit No.___(TRJ-1), the calculation of the final revenue requirement, and Exhibit No. ___ (TRJ-2), the fuel and purchase power cost (fuel and power supply) adjustment tariff.

<u>Pro Forma Revenue Requirement</u>

Q. What were the results of South Dakota electric operations for the twelve months ended December 31, 2014?

A. Rule 20:10:13:96, Statement M, pages 1 and 2 show the per books income statement and rate base for total Company and South Dakota. As shown on page 1, South Dakota electric operations had a return on rate base of 8.352 percent for the twelve months ended December 31, 2014. The details for each line item, i.e. sales revenue, other revenue, etc., are included in the applicable Rule listed. Pages 3 through 5 list the pro forma adjustments to operating revenues, expenses and rate base. All adjustments were calculated on either a South Dakota specific basis or on a total Company basis and allocated to South Dakota, as indicated on the statement or schedule detailing each adjustment.

Q. How was the per books cost of service allocated to South Dakota?

A. The Company utilizes a jurisdictional accounting system that directly assigns and/or allocates every item of revenue, expense and rate base to the jurisdictions as part of the regular accounting process on a monthly basis. The allocation methods and procedures are the same as have previously been used in Commission proceedings and are based on the principle of assigning and/or allocating costs to the cost causer.

Q. What criteria were used to determine the pro forma adjustments?

A. The pro forma adjustments to operating revenue, expenses and rate base were based on known and measurable changes occurring by December 31, 2015, conform to past Commission practices and are listed on pages 3 through 5 of Rule 20:10:13:96. All of these adjustments are reasonably certain to occur and can be measured with reasonable accuracy, thus meeting the criteria of known and measurable.

Q. Would you describe the pro forma adjustments to the income statement and rate base?

A. Yes. The adjustments to the income statement are summarized on Rule 20:10:13:96, page 3 and 4 and consist of adjustments to revenue, operation and maintenance expenses, depreciation expense, taxes other, and current and deferred income taxes. The adjustments to rate base are summarized on page 5 and include plant, accumulated reserve and associated additions and deductions. Each adjustment is discussed in detail below.

<u>Pro Forma Income Statement</u>

Q. What adjustments were made to operating revenues?

A. The adjustments to operating revenues are contained in Rule 20:10:13:85, Statement I. Adjustment No. 1 is the adjustment to reflect pro forma sales revenues as discussed by Ms. Tamie A. Aberle and is an increase in revenue of $334,215.

Adjustment No. 2 decreases revenue by $35,069 to reflect the elimination of sales for resale. Montana-Dakota is proposing to credit 85 percent of total wholesale sales margins through the fuel and power supply tracking adjustment. As such, the pro forma amount for the wholesale sales margin embedded within the calculation of the revenue requirement is zero.

Adjustment No. 3, shown on page 4, includes the adjustments to other operating revenues for a total reduction in revenue of $145,839. Basin Electric Power Cooperative (BEPC) is joining the Southwest Power Pool (SPP) in 2015 and the revenue received under the joint use facilities agreement will cease at that time. Therefore, joint use revenue was removed on a pro forma basis for a reduction in revenue of $143,149. Montana-Dakota is using a three year average of KVAR penalty as a representative level of KVAR revenue that is included as part of other revenue resulting in a reduction of $3,194. In addition, late payment revenue was increased to reflect the ratio of 2014 late payments to sales revenue applied to pro forma revenue for an increase of $504.

Q. What adjustments were made to operation and maintenance (O&M) expenses?

A. The adjustments to operation and maintenance expenses are contained in Rule 20:10:13:81, Statement H, Schedule H-1 and are summarized in Rule 20:10:13:80.

Fuel and purchased power is shown in Adjustment No. 4 on Rule 20:10:13:81, page 5. Fuel and purchased power costs have been restated to the pro forma level to reflect the inclusion of the Thunder Spirit wind facility and the RICE generating units located at the Lewis & Clark Station site as well as the Big Stone and Lewis & Clark environmental projects. The recently added Heskett III combustion turbine located in Mandan, North Dakota has been included in the generation re-dispatch as well as supplanting the capacity contract that expired in 2015. Finally, the fuel and purchased power costs reflect a re-dispatch to reflect normal outage schedules for all plants and current Midcontinent Independent System Operator, Inc. (MISO) market costs for energy.

Montana-Dakota is proposing to recover the reagent costs used in the emissions control equipment necessary to comply with the Federal Environmental Protection Agency's (EPA) Mercury and Air Toxics Standards (MATS) Rules in the fuel and purchased power adjustment mechanism. The use of reagents is further discussed in the testimony of Alan L. Welte. Reagent expenses will be incurred at Big Stone Station upon completion of its Air Quality Control System (AQCS) project and also be required at the Lewis & Clark Station and the RICE units, both located near Sidney, Montana as well as the Coyote Station, located near Beulah, North Dakota. Montana-Dakota's other generating facilities do not currently require the use of reagents to comply with the MATS rule. The quantity of reagents at the generating facilities will fluctuate directly in relation to the operation of the facilities, similar to fuel costs. The majority of these charges are new costs to the Company and the incurrence of these costs is necessary to meet newly implemented emissions rules.

Montana-Dakota is proposing to reclassify the existing reagent costs from other operation and maintenance expenses. Previously, reagent costs were a component of other O&M costs and this proposed change results in a shift in recovery from O&M to Fuel. Adjustment No. 16 reflects the removal of the reagent from the Other Production O&M.

Montana-Dakota is also proposing to recover the costs incurred to meet the capacity requirements and the additional cost of delivering natural gas to the Heskett III combustion turbine as part of the fuel and purchased power adjustment. As discussed in the testimony of Mr. Neigum, Heskett III serves as a capacity resource and, in part, replaces the WE Energies annual capacity contract. These costs will be allocated to South Dakota based on the twelve month integrated system peak demand factor.

Finally, the Company is proposing to reflect the sales of Renewable Energy Credits (RECs) as a credit to customers through the fuel and purchased power adjustment clause. RECs are received based on generation from the Company's wind and waste heat production facilities.

The overall change in fuel and purchased power is a reduction of $305,792, largely reflecting reduced MISO purchases due to Thunder Spirit generation and the expiration of the capacity contract supplanted by the Heskett III combustion turbine. These reductions are partially offset by the inclusion of reagent costs.

Fuel costs associated with wholesale sales have been excluded from the pro forma fuel and purchased power costs as Montana-Dakota is proposing to include wholesale sales margin in the fuel and power supply tracking adjustment assuming a zero base.

Q. How were the pro forma labor and benefits developed?

A. The adjustment to labor is Adjustment No. 5. The pro forma labor was developed by applying the percentage increase in total Company labor costs to the actual 2014 South Dakota labor expense. Pro forma total Company labor costs were based on the application of an increase of 4.0 percent for union employees and 3.5 percent for nonunion employees effective in 2015. In addition, incentive compensation has been adjusted to reflect a three year average percentage of labor. This results in an overall increase in labor of $100,396 or 4.74 percent.

Benefits are shown on page 7 of Statement H. Adjustment No. 6 is an overall increase of $84,549 in benefits. Benefits expense consists of medical/dental insurance, pension expense, post-retirement, 401K, workers compensation, and other benefits (primarily disability insurance). Each of these items was adjusted individually using current information and applying the percentage increase to each type of benefit.

Medical and dental expense is increasing 4.1 percent. The increase is based on medical and dental premiums currently in effect during 2015. Pension expense is increasing 136.3 percent reflecting a decrease in the discount rate and lower than expected asset returns. The

Company continues to make contributions to the pension fund to minimize expense and maintain adequate pension funding. Post-retirement expense is increasing by 166 percent from 2014 levels. A decrease in the discount rate used in the actuarial study as well as lower than expected asset returns account for this increase in expense as well. 401(k) expense and Other Benefits are increasing consistent with the change in labor costs. Workers compensation expense is based on the ratio of 2014 workers compensation expense to 2014 labor expenses.

Adjustment No. 7, shown on page 8 of Statement H, reflects incremental employees, as well as the related benefits, necessary to continue to operate and maintain Montana-Dakota's electric production facilities. The Power Production Department is increasing its staff level by four employees in order to meet the increasing environmental regulations as well as assist in the day to day operations of the department as discussed by Mr. Welte. Additional employees are also included for the Glendive Turbine and the Diamond Willow and Cedar Hills wind facilities to alleviate staffing issues at those facilities. All employees have been or will be in place by the end of 2015. The increase in labor and associated benefits is $44,046 on an annual basis.

Q. Would you describe the other adjustments made to O&M expense?

A. Yes. Adjustment Nos. 8, 9 and 10 are related to production facilities placed in service during 2014 or expected to be placed in service during 2015. The Heskett III combustion turbine was placed in service in

August 2014. However, the final phase of the construction process involved a significant level of testing that extended to the end of 2014 resulting in the majority of the charges to the facility being covered under the contractor certification process and capitalized as a part of the construction cost. Therefore, Adjustment No. 8 reflects the expected annualized cost of operations for that unit as no per books costs were incurred. Adjustment No. 9 reflects the expenses related to the RICE unit located at the Lewis & Clark Station site and the MATS requirements discussed by Mr. Welte. Adjustment No. 10 reflects the annual costs of the Thunder Spirit wind facility including labor and benefits expense associated with two technicians, the maintenance contract and the annual easement payments as discussed by Mr. Neigum. The pro forma adjustment amounts for Adjustment No. 8, 9, and 10 are $17,967, $26,451 and $142,187, respectively.

Adjustment No. 11 shows the $255,790 reduction in transmission charges related to the joint use (facility charge) agreement between Montana-Dakota and BEPC as the contract expires during 2015. Adjustment No. 12 reflects the increase in transmission charges to replace the previously mentioned facility charge and charges incurred under the current WAPA transmission service agreement with transmission service in the SPP market. This expense is net of revenue credits expected to be provided by SPP. In addition, the transmission charges have been updated to reflect the current tariff under the MISO market. Mr. Neigum's testimony further supports these changes. Also included in this adjustment are ongoing annual maintenance costs of the production facilities which were not performed during 2014, primarily borescope inspections. The borescope inspections have been completed in 2015 and will continue to be done on an annual basis. The total increase in subcontract labor is $474,426 driven primarily by the increase in transmission service charges.

Adjustment No. 13 reflects the expenses associated with the Company's Big Stone and Coyote generating stations to reflect operations for 2015. The adjustment reflects major overhaul costs for Big Stone station as the Company normally performs major annual overhauls on a rotating basis. No major annual overhauls were scheduled in 2014 and, therefore, the costs are expected to continue on an annual basis in the future and are included in this adjustment.

The change to materials (Adjustment No. 14) reflects a reduction in materials as 2014 included large nonrecurring transmission project expenses. The net reduction in materials is $14,846.

Adjustment No. 15 reflects the increase in the per ton cost of sand, from $29.00 to $38.50, as well as the increased usage of sand in the fluidized bed at the Heskett Station II in the amount of $6,870. The increased usage is required to combat the increased level of clay received in the coal received at the plant.

As noted previously, Adjustment No. 16 reflects the removal of the reagent costs from the per books information as the Company is proposing to recover these variable costs through the fuel and purchased power adjustment mechanism as shown in Adjustment No. 4.

Vehicles and work equipment (Adjustment No. 17) reflects all expenses associated with the Company's vehicles and equipment, such as backhoes, including the costs of fuel, insurance, maintenance and depreciation expense. This adjustment reflects an increase in this account due primarily to the change in the depreciation component of the expense and it is calculated based on the pro forma plant and the proposed depreciation rates in Statement J. The depreciation component on these items is not charged to depreciation expense but rather is charged to a clearing account where it is then recorded in O&M expense as the vehicles or work equipment is used.

Communications represents charges for telephone and computer network expenses and shows a reduction of $4,982 as shown in Adjustment No. 18. Expenses are expected to decrease slightly due to lower telephone and SCADA expense, partially offset by increased cell phone charges.

Company consumption (Adjustment No. 19) is the expense for electric and natural gas consumption in Company buildings. The electric component is projected to increase in step with the projected revenue increase for an increase of $3,617. The natural gas component is expected to decrease $2,341 based on the decrease in normalized firm sales and average 2014 gas cost.

Postage is adjusted to show the increase in postage rates and is offset to reflect the number of customers utilizing the electronic billing function offered by Montana-Dakota through its recently implemented customer information system. The December 2014 customer count using the electronic billing has been annualized. Adjustment No. 20 is a net increase of $303.

Uncollectible accounts expense (Adjustment No. 21) is a decrease of $5,313 from per books based on the three year average of net write-offs to pro forma sales revenues, including the requested revenue increase. The per books uncollectible accounts expense is presented on a GAAP basis and is determined based on the average aged receivable balance outstanding as of December 31, 2014 accounting for the slightly higher expense level than net write offs.

Advertising expense (Adjustment No. 22) is shown on page 23. Pursuant to past Commission policy, general promotional advertising expenses have been eliminated. Informational and institutional advertising is adjusted to exclude advertising that is not applicable to South Dakota electric operations.

Q. Would you explain why you are including institutional advertising expenses?

A. Montana-Dakota is seeking to include institutional advertising that benefits customers and serves the public interest. As a corporate citizen, Montana-Dakota needs to be active in the communities that it serves. Montana-Dakota's motto is "In the community to serve" and one of the ways to demonstrate being a strong community member is to advertise the Company and what it does for the communities. Communities expect nothing less and advertising in the local newspapers, on television, in school yearbooks, programs, etc., is a necessary part of being active in the community. This advertising benefits the community and the customers in that community, thus serving the public interest.

Q. Would you please continue with your explanation of adjustments to operation and maintenance expenses?

Insurance expense (Adjustment No. 23) reflects the expense at current levels for 2015 and represents an increase of $13,258. Insurance expense was adjusted to reflect current levels and self-insurance expense was adjusted to reflect a five year average of claims and related expenses incurred.

Adjustment No. 24, software maintenance, reflects an increase in software expenses reflecting an increase in maintenance contracts as well as implementation of new systems for an increase of $2,924.

Industry dues (Adjustment No. 25) reflects the pro forma level of industry dues and is a decrease of $25,102. Rule 20:10:13:81, Statement H, page 26 shows those dues that are directly assigned or allocated to

South Dakota and appropriately included in the pro forma expense level.

Rent expense was updated to reflect an additional office lease for General Office operations entered into in late 2014. Adjustment No. 26 is a net increase of $1,941.

Annual easements were reduced to reflect the payment of both the 2013 and 2014 Cedar Hills and Diamond Willow wind facilities annual lease payments which were expensed in 2014. The reduction of $6,348 in Adjustment No. 27 reflects pro forma annual expenses equivalent to one year's lease expense.

Regulatory Commission Expense (Adjustment No. 28) reflects the expenses to be incurred in this filing, amortized over a five-year period, and a three year average of ongoing regulatory commission expenses. The adjustment is an increase of $90,552.

Adjustment No. 29 reflects a three-year average of the regional market expense assessed by MISO with an increase of $8,503.

The items adjusted individually above represent approximately 98 percent of total South Dakota electric O&M, as shown on page 31. The remaining items, which make up approximately 2 percent of other O&M, are assumed to remain flat.

Q. What adjustments were made to depreciation expense?

A. The adjustment to depreciation expense is contained in Rule 20:10:13:86, Statement J. Adjustment No. 30 restates annual depreciation expense to the average pro forma level of plant in service with proposed depreciation rates from a 2014 study prepared by AUS Consultants and further discussed by Mr. Robinson. The depreciation rates are shown on Statement J, pages 3 through 7.

In addition, the Company is proposing three additional items to be included in depreciation expense; specifically the amortization of the costs of decommissioning retired power plants, the amortization of the costs associated with deferred generation cost, and the amortization of costs associated with the decommissioning of the Company's existing generating units.

The amortization of the costs of decommissioning retired power plants is shown on Rule 20:10:13:69, Statement F, page 7. Montana-Dakota recovered the costs of decommissioning of certain retired plants based on an estimate of costs. Upon completion of the decommissioning, the actual costs were less than the estimate and Montana-Dakota is returning that amount to customers over a ten year period, with the unamortized amount a credit to the rate base.

The deferred generation costs are shown on Rule 20:10:13:69, Statement F, page 6. The deferred generation costs, described in Mr. Skabo's testimony, are made up of the costs incurred by Montana-Dakota in its efforts to acquire generation resources in the Gascoyne project, the Milton R. Young III project and the Big Stone II project. The Company received a deferred accounting from this Commission (Order in Docket No. EL09-25), dated February 11, 2010, allowing deferral of the costs associated with these projects until disposition of its next general rate case. The total deferred generation costs totaled about $14.5 million of which $814,359 were allocated to South Dakota. These costs are amortized over ten years, with the unamortized amount in rate base.

Finally, substantial costs will be incurred to decommission the Company's existing generation fleet upon retirement. Montana-Dakota has contracted with outside consultants to prepare a cost study for the expected decommissioning cost for each power plant and the Company proposes to recover the identified costs over the remaining life of each power plant. The total costs will be collected based on an amortization rather than a percentage of the plant balance to better match the cost and prevent over collection as a result of increases in plant value. The pro forma annual cost included in this filing is $136,083.

Continuing in Statement J, the increase to depreciation expense shown in Adjustment No. 30 is an increase of $394,992 which reflects the inclusion of plant additions, except as detailed below, annualizing the 2014 ending plant balances, application of the proposed deprecation rates and the return/recovery associated with the Company's power production facilities.

Adjustment No. 31 is the annual depreciation expense for the large generation projects and is shown on page 8. The depreciation rates for Big Stone and L&C are consistent with the previously mentioned study and the Thunder Spirit wind farm and the RICE units located at Lewis & Clark Station are based on industry based life estimates.

Q. What adjustments were made to taxes other than income?

A. The adjustments to taxes other than income are contained in Rule 20:10:13:94, Statement L. Adjustment No. 32 restates ad valorem taxes to the pro forma level of plant in service based on the 2014 ratio of ad valorem taxes to plant. The net result is an increase of $75,900.

The adjustment to payroll taxes (Adjustment No. 33) is an increase of $7,087 based on the ratio of payroll taxes to labor expense for 2014 applied to pro forma labor expense.

Adjustment No. 34 restates the South Dakota Gross Receipt Tax to the pro forma level of revenue, excluding other operating revenue not generated in South Dakota, and is an increase of $728.

Electric production taxes were restated in Adjustment No. 35 to reflect the pro forma load resources included in Adjustment No. 5, including the Thunder Spirit wind facility that is subject to recent North Dakota legislation exempting wind production facilities from property tax and replacing it with production taxes. The net change is an increase of $21,488.

Q. What adjustments were made to income taxes?

A. The adjustments to income taxes are contained in Rule 20:10:13:88, Statement K. The adjustment to interest expense (Adjustment No. 36) is shown on page 8. Interest is deductible for tax purposes and interest expense is calculated on the pro forma rate base using the weighted cost of debt and debt ratio from Statement G. The resulting interest expense is an increase of $437,112 from the per books level.

The adjustment for tax depreciation and deferred taxes on the pro forma plant additions, including the large generation projects (Adjustment No. 37) is shown on page 9.

The current income tax expense on all of the pro forma adjustments to operating revenues and expenses are calculated on page 10 in Adjustment No. 38.

The production tax credit (PTC) related to energy produced at the Company's wind generating facilities was adjusted to reflect a credit of 2.3 cents per kWh of production for a total increase in the federal income tax credit of $489,867. Adjustment No. 39, page 11, is based on the re-dispatch of the existing wind facilities and also includes the Thunder Spirit wind facility based on an expected capacity factor of 45.2 percent. Per books 2014 included the utilization of 2013 PTCs which were offset by lower deferred income taxes resulting in no change in net income tax.

The closing/filing and prior period adjustments in the current income tax accrual and in the deferred taxes are eliminated in Adjustment No. 40. Adjusted current and deferred income taxes match those calculated for South Dakota and conform to past Commission practices.

Pro Forma Rate Base

Q. How was the rate base developed?

A. The pro forma rate base is based on the average 2014 rate base and reflects known and measurable adjustments that will occur within twelve months beyond December 31, 2014. The resulting rate base is stated on an average basis, except as noted below. The pro forma adjustments to rate base are summarized on Rule 20:10:13:96, Statement M, page 5.

Adjustment A, shown in Rule 20:10:13:54, Statement D, page 2, annualizes the December 31, 2014 ending balance and includes known and measurable plant additions that will be in service by December 31, 2015. The pro forma adjustment of $2,342,468 includes additions to production, transmission, distribution, general and common plant.

Adjustment B, shown on page 10, is South Dakota's allocated portion of the following large generation projects:

- Big Stone AQCS environmental project
- Lewis & Clark MATS environmental project
- RICE Units located at L&C Station site
- Thunder Spirit Wind Project

These production investments total $19,644,271 and have been annualized to reflect the plant additions as if they were in service the entire year. Each generation project is discussed in more detail in the testimony of Mr. Welte and Mr. Neigum. All related adjustments were also annualized, including the energy generated and associated fuel and purchased power costs and the related production tax credits associated with wind generation.

Adjustment C, shown in Rule 20:10:13:64, Statement E, page 2, increases the average reserve for depreciation on the per books plant by $1,102,389 to restate the reserve to the average pro forma level in order to match the average pro forma plant levels.

Adjustment D, shown in Rule 20:10:13:86, Statement J page 8, shows the increase in the average reserve for depreciation related to the large generation projects in the amount of the annual depreciation of $839,032.

The working capital and other additions and deductions are adjusted and included in Rule 20:10:13:68, Statement F. Materials and supplies are restated to a thirteen-month average balance, with actual balances through January 31, 2015, in Adjustment E, for a decrease of $58,080.

Coal and fuel oil stores are restated to a thirteen-month average balance in Adjustment F and reflect a decrease of $3,604. The pro forma balance reflects actuals through January 31, 2015 with the remaining months of 2015 based on 2014 actuals.

Prepaid insurance is restated to a thirteen-month average balance in Adjustment G with actual balances through January 31, 2015 and is an increase of $37,894.

The average net unamortized loss on reacquired debt balances and the associated deferred income taxes as of December 31, 2015 is included as Adjustment H.

The unamortized balance of the deferred generation costs at December 31, 2015 and the associated deferred income taxes is included as Adjustment I and in increase to rate base of $773,641.

The accumulated amortization balance for decommissioning of existing power plants as of December 31, 2015 and the associated deferred income taxes is included as Adjustment J and is a reduction to rate base of $68,042.

Finally, Adjustment K shows the remaining balance related to the unamortized decommissioning costs on retired plants as of December 31, 2015 and the associated deferred income taxes and is a reduction to rate base of $37,798.

Unamortized rate case expense from this docket, reflecting 2015 activity, and the associated deferred income taxes are included as Adjustment L.

The adjustments to accumulated deferred income taxes are summarized on Rule 20:10:13:88, Statement K, pages 9 and 17.

Adjustment M is the increase to deferred taxes necessary to extend the average accumulated deferred tax balance to match the pro forma plant and accumulated reserve balances. The adjustment also includes the deferred taxes associated with the unamortized loss on debt

(Adjustment H), deferred generation costs (Adjustment I), accumulated amortization of decommission of existing power plants (Adjustment J), decommissioning of retired power plants (Adjustment K), and unamortized rate case expense (Adjustment L), along with customer advances (Adjustment N) and the amortization of the full normalization adjustment for 2014 as shown in Statement K on page 16.

Adjustment O, page 9, shows the deferred tax associated with the large generation projects. The Big Stone and L&C environmental projects qualify for accelerated depreciation and expenditures prior to January 1, 2015 qualify for bonus tax depreciation. The increase to deferred income taxes associated with the large generation projects is $1,335,041.

Customer advances for construction (Adjustment N) are restated to a thirteen-month average balance as of December 31, 2014. There were no refunds related to plant placed in-service prior to January 1, 2015, The net change is an increase of $1,143 as shown on Rule 20:10:13:69, Statement F, page 10.

These are all of the pro forma adjustments to revenue, expense and rate base.

Q. What is the additional revenue requirement calculated on Exhibit No.____(TRJ-1)?

A. Exhibit No.____(TRJ-1), which is identical to Rule 20:10:13:96, Statement M, page 8, shows the calculation of the revenue deficiency of $2,655,643 based on the pro forma operating income and rate base and using the overall rate of return of 7.588 percent from Rule 20:10:13:72, Statement G, page 1.

Electric Fuel and Purchased Power Adjustment Cost Tracking

Q. Would you describe the proposed fuel and purchased power adjustment presented in this filing?

A. Yes. Montana-Dakota is proposing to replace the existing Fuel Clause Rate 58 with a similar adjustment called the Fuel and Purchased Power Adjustment Rate 58 (FPPA). A number of differences are proposed, including:

- A four month average of costs and sales rather than a three month average.
- Recovering reagent costs through this mechanism rather than other O&M.
- Similarly, demand costs and the pipeline transmission and reservation charges are included in the FPPA.
- Reflect the sale of RECs as a credit to customers.
- Reflect 85 percent of wholesale margins as a credit to customers.
- Finally, the implementation of a deferred account with an annual surcharge.

The change to a four month average of fuel and purchased power costs and sales, rather than three, will likely smooth the monthly adjustments and should reduce the over and under collection of costs throughout the year.

As discussed previously, Montana-Dakota is proposing to include reagent charges in the fuel and purchased power adjustment. The quantity of reagents at the generating facilities will fluctuate directly in relation to the operation of the facilities, similar to fuel costs. The majority of these charges are new costs to the Company and the incurrence of these costs is necessary to meet newly mandated emissions rules. Previously, reagent costs were a component of other O&M costs and this proposed change results in a shift in recovery from O&M to fuel. Correspondingly, Adjustment No. 16 on Rule 20:10:13:81, Statement H, page 17 reflects the removal of the reagent costs from Other Production O&M.

Montana-Dakota incurs demand or capacity charges to ensure adequate capacity is available in order to meet its customer's energy needs. Capacity is obtained through bilateral contracts, such as the recently expired contract with We Energies, the MISO market, and specific customer agreements, such as DSM programs and customer owned generation resources. Demand charges have not previously been included in the fuel clause adjustment as they were traditionally long term agreements, such as the 20 year AVS II contract that expired in 2006. Today, demand or capacity agreements mentioned above are short term in nature and it is more appropriate to include these in the FPPA instead of the cost of service so that changes, both increases and decreases, can be passed on to customers in a timely manner without filing a general rate case.

Mr. Neigum's testimony discusses the addition of the Heskett III combustion turbine. Montana-Dakota's electric power production incurs gas transmission and reservation charges in connection with the delivery of natural gas used in the turbine. All charges are properly recorded in Account 547. Both capacity and pipeline transmission charges are necessary components of delivering electricity to the Company's customers and are therefore appropriately recovered through the FPPA.

Another proposed change is to credit 85 percent of all wholesale margins through the fuel and power cost tracking adjustment. The Company has been a net purchaser of energy since the expiration of the AVS II contract with BEPC and has had no sales for resale on a year-to-date basis through May 2015. Therefore, the 2014 per books sales for resale revenue and fuel cost was removed from the computation of the revenue requirement in this filing. This change provides customers will receive a share of future sales and, at the same time, provides an incentive to the Company to maintain its low cost generation.

Renewable Energy Credits or RECs are received based on the generation from the Cedar Hills, Diamond Willow, and Thunder Spirit wind farms and the waste heat unit at Glen Ullin. The Company markets these certificates and proposes to reflect the sale proceeds as a credit to customers as an offset to the fuel costs.

Finally, Montana-Dakota proposes a Deferred Fuel Cost Account with an annual true up, similar to its purchased gas cost adjustment. Each month Montana-Dakota will track the difference between costs recovered and actual costs, with the difference placed in a deferred account. Effective July 1 each year, Montana-Dakota will true-up the balance in that account using a surcharge adjustment that will be recovered from or credited to customers over the subsequent twelve months based on projected sales during that same period. The Company will apply a carrying charge or credit to the deferred account balance each month at a rate equal to the three-month Treasury Bill as published by the Federal Reserve Board. As noted earlier, the process defined in this tariff is similar to the Purchased Gas Cost Adjustment Rate 88.

Exhibit No. ___(TRJ-2) is the proposed Rate 58 tariff, also included in Appendix B.

Q. Does this complete your direct testimony?

A. Yes, it does.