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SOUTH DAKOTA PUBLIC
UTILITIES COMMISSION

HAND DELIVERED
January 14, 1993

Gus Jacob
Public Utilities Commission
500 N. Capitol
Pierre, SD 57501

RE: SDIP - Docket NG92-005

Dear Gus:

Enclosed please find an original and 11 copies of Applicant's Reply Brief and Certificate of Service in the above matter for your files.

Sincerely,

JAMES ROBBENNOLT
Attorney at Law

JR/jml

Enclosures

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SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

UNITED STATES OF AMERICA

BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE APPLICATION OF THE SOUTH DAKOTA INTRASTATE PIPELINE COMPANY FOR APPROVAL OFINITIAL RATES AND TARIFFS.	))))	DOCKET NO. NG92-005 CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 14th day of January, 1993, he mailed a true and correct copy of the Applicant's Reply Brief to the following named persons at their last known post office addresses as follows:

Alan Dietrich
Northwestern Public Service
PO Box 1318
Huron, SD 57350-1318

Eugene Mayer
Riter, Mayer, Hofer & Riter
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Pierre, SD 57501

Douglas W. Schulz
Montana-Dakota Utilities Co.
400 N. 4th Street
Bismarck, ND 58501-4092

Warren May
Attorney at Law
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Pierre, SD 57501

Gus Jacob
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and that said mailing was by US mail, first class with postage thereon prepaid and mailed at the US Post Office in Pierre, South Dakota.

James Robbennolt

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BEFORE THE PUBLIC UTILITIES COMMISSION
STATE OF SOUTH DAKOTA

IN THE MATTER OF THE APPLICATION OF THE SOUTH DAKOTA INTRASTATE PIPELINE COMPANY FOR APPROVAL OF INITIAL RATES AND TARIFFS.	))))	DOCKET NO. NG92-005 REPLY BRIEF

At the time of the filing of Applicant's original Brief in this matter, Applicant furnished copies of several FERC opinions cited in its previously filed testimony for the benefit of the parties involved. Specifically, Applicant furnished copies of the Kern River Gas Transmission Company and Mojave Pipeline Company Orders, 50 FERC ¶61,069 (January 24, 1990) page 61,150, wherein the FERC approved a 25 year depreciation life with a 15 year levelized cost of service; Altamont Gas Transmission Company, 54 FERC ¶61,027 (January 1991) page 61,061, wherein the depreciation life of 25 years was found to be a reasonable estimate as well as a 15 year levelized cost of service; Green Canyon Pipeline Company, 47 FERC ¶61,310 (1989) Page 62,112, wherein a 20 year depreciation life was deemed to be appropriate; Iroquois Gas Transmission System, 52 FERC ¶61,091 (1990) Page 61,393, where the FERC specifically held that depreciation rates of major interstate pipelines on economic, or useful, lives are generally between 20 and 25 years, and Tennessee Gas Transmission System, 54 FERC ¶61,103 (1991) Page 61,364, wherein the FERC ruled on the Applicant's request that it be allowed to depreciate the project facilities over 20 years rather than 40 years, reaffirming the 20 year rate as previously discussed in the Iroquois decision.

SDIP recognizes that the decisions of the Federal Energy Regulatory Commission are not direct authority in support of any issue or contention with regard to the Commission; however, where the discussion and decision of the FERC is relevant and cogent, the Commission should be advised as to how the FERC dealt with the particular question as a matter of courtesy and illustration, as well as for guidance, if applicable.

RESPONSE TO THE BRIEF OF MONTANA-DAKOTA

It is the impression of the Applicant that the Initial Brief of Montana-Dakota Utilities Company essentially restates the testimony of its witnesses, Donald R. Ball, Montana-Dakota's regulatory affairs manager, and M.C. Miller, marketing manager, for Montana-Dakota Utilities. Attached to the filed direct testimony of Mr. Miller was Exhibit (MCM-1), page 2, which indicated that according to MDU's best estimates, the projected volume of gas which would be marketed along the route proposed by the Applicant in the first year would be 419,001 DK totally, and in the second year, total DK marketed would be 838,634. It is the position of the Applicant that Mr. Miller, who is more intimately acquainted with the marketing of natural gas than Mr. Ball who is more involved in ratemaking, is more qualified to prognosticate concerning the initial market volume for natural gas in Pierre, and up and down the pipeline, and that Exhibit (MCM-1) is more reflective of reality.

As stated at the bottom of page 2 of the Montana-Dakota Initial Brief and the top of page 3, naturally, if the volumes are higher than those projected by Mr. Ball in the initial phases of the project, SDIP, as well as any distributor of natural gas along the pipeline, would receive higher compensation based upon actual throughput.

The Commission is referred to the Applicant's original testimony in its application supporting the proposition that volume in the system the first year would be 400,000 cf of natural gas, as well as the testimony of Terry Szklarski (HT 54 lines 24, 25 and HT page 65, line 1).

Based upon the above discussion and the Initial Brief at pages 5-7, SDIP believes the Commission should approve the minimum take provision and the associated minimum quantities as proposed by SDIP. The Commission should also be mindful of the fact that FERC's new policy under Order Nos. 636, et al., strongly advocates Straight Fixed Variable (SFV) rate design. Under SFV, the FERC allows the pipeline to include all non-gas fixed costs in its demand rate. What SDIP is proposing here is very similar to the FERC's new policy, except that SDIP will be exposed to much greater losses in its early years of operation under its minimum take proposal.

STAFF'S INITIAL BRIEF

In response to the Initial Brief of the Staff, SDIP would offer the following: Filing 92-005 is a rate filing concerned only with the transmission costs of SDIP as it constructs and operates the pipeline as envisioned. The attention of the Commission would more properly be directed toward the municipal distribution rate to be charged by the eventual distributors of the natural gas when and after those filings are made. SDIP would initially respectfully submit to the Commission that the Staff's concern with distribution of risk between SDIP and any potential distributors as to the rate at which SDIP would be authorized to transmit natural gas pursuant to the application, is not, at this time, properly before the Commission. There have been no applications for authority filed with the Commission to distribute the gas to be transported by SDIP in any of the municipalities along the route. The chief concern of the Commission, it is respectfully submitted, should be the reasonableness of the transportation rate proposed by SDIP based upon the anticipated cost of service to be incurred by SDIP to transport the gas from Brown County to its Hughes County terminus. If the transportation rate finally decided upon by the Commission in this case does not allow for the profitable operation of distributors up and down the line, the issue will be moot since the line will not be built unless there are customers for competitively priced natural gas as proposed in the application. The reasonableness of the proposed transportation rate as reflected in the documents filed by SDIP should be the main concern of the Commission at this time.

As to the depreciation arguments put forth by the Staff in their Initial Brief, SDIP would initially point out that the entire argument from the Staff relies upon its citation of PUC Docket F-3445. SDIP has cited the Commission to several FERC decisions allowing for depreciation at a more accelerated rate than that apparently adopted as part of the settlement of Docket No. F-3445.

To put Staff's recommendation into perspective, it is helpful to look back in time to see what circumstances were like when MDU built its combination distribution/transmission system. Back in the late 50's and early 60's, gas was plentiful. No one ever contemplated the gas shortage of the late seventies and early eighties. At the time, MDU built its facilities, it was willing to agree to a longer depreciation life. At that time, the bankers were not concerned about not receiving payment of the debt that they financed. Interest rates were low. There were no companies in bankruptcy. It was a completely different environment than that which exists today.

Granted, Staff refers to the year 1982 as the time when MDU's rates were evaluated, and it was decided by the company to retain the existing depreciation rates. At that time, MDU's facilities were probably 30 to 40 percent depreciated. It therefore anticipated another 20 to 25 years of operation, and so on that basis, spreading the remaining amount to be depreciated over an additional 20 to 25 years was reasonable. The question before the Commission in regard to Docket #F-3445 is: "What would MDU have done if it was building a brand new transmission system in 1982?" SDIP believes MDU would have been faced with a situation similar to SDIP, and MDU would have advocated a shorter depreciation life, just as SDIP is doing in this proceeding.

As pointed out in previous documents filed by SDIP, the Staff's reliance upon Docket No. F-3445 is somewhat inappropriate. Apparently, the depreciation rate being decided in that docket was a depreciation rate for an existing distribution system and not a transmission system; the docket deals with MDU which is a mature, established company, wherein in this case, the Commission is dealing with a brand new entity, both in terms of type of energy dealt with as well as market; in Docket No. F-3445 MDU, an established company, was not faced with the same financing obligations with which SDIP, a brand new company, will be dealing.

The significance of the fact that we are dealing with an entirely new source of energy in a virtually untried and untapped market cannot be overemphasized. For purposes of depreciation lives, SDIP does not ignore the physical life of the pipeline; however, the economic life of the system is of increasing importance presently as it affects the Applicant's ability to secure financing and other aspects of the project as stated in the Applicant's original Brief.

As noted in the testimony of witness Szklarski, the source of the gas to be transported through the proposed system will be obtained from the Northern Border Pipeline. Much of the gas transported through Northern Border originates in Canada, and necessarily so for economic reasons. As stated in the FERC decision in Iroquois, supra, this is a significant factor in determining the depreciable life of the pipeline. This fact cannot be overlooked in determining what distributors of the gas transported by SDIP will realistically have to deal with for the life of the project. Staff's implication at page 3, first full paragraph of their Initial Brief, that the project has a broad range of supply sources and core vs. incremental customers is unsupported in the record. In fact, the exact opposite is true since the proposed project will be totally dependent upon the Northern Border Pipeline for a source of natural gas.

If the Commission finds that after the project is actually in operation that the 20 year depreciation rate is in error or allows too high a return on the investment of the applicant, the rate can always be adjusted to a more appropriate depreciation life. At least for the first ten years of the existence of the project, with a totally new project such as this, a shorter depreciation life is justified. If the depreciation rate for natural gas service after the initial ten year service are found to be unjustifiably high, based upon volume and consumption, the Commission always has the power to reconsider the depreciation rate and to re-establish it at a level which, based upon ten years experience, is more appropriate. If nothing else, the Commission should establish, initially, a 20 year depreciation life, and, once a ten year track record has been established for the system, the Commission could re-address the issue and make adjustments as the Commission sees fit.

Staff refers to the 20 year depreciation life as a "plugged" number. Applicant strenuously objects to the characterization as used by Staff. The 20 year depreciation life has been in SDIP's rate proposal since the initial day it was filed. There has never been any attempt by SDIP to avoid the issue or to bury it in the filing. It is SDIP's position that the 20 year depreciation life is absolutely necessary to get this brand new, untried, untested, natural gas delivery system from the drawing board to reality, and if experience demonstrates that the depreciation life is unwarranted by actual experience, then the depreciation rate can be adjusted at such time as that determination is made.

Finally, Staff refers again in its Conclusion to its Initial Brief, that they are concerned about the nature of the "pie" available to distributors from the proposed project. It is submitted by SDIP that the concern of the Commission in this case, NG92-005, is solely the proper transportation rate to be accorded to SDIP and that the market place will determine whether there is a profit that can be made by the distributors of the product transported by SDIP once the transportation rate herein has been determined.

It is respectfully submitted that the cash flow of a given natural gas utility is determined by the volume of gas transported through the pipeline multiplied by the transportation rate authorized by the Public Utilities Commission after consideration of the testimony and exhibits of the Applicant and other interested parties. The transportation rate is determined by the cost of service as demonstrated by the evidence presented to the Commission. The cost of service consists of the costs of the project plus the expense of operating it once it is installed. SDIP submits that the methodology utilized by Mr. Szklarski and Mr. Woods conforms to acceptable rate making practices as has been demonstrated by the FERC opinions which have been furnished to the Commission and to the parties.

INTEREST ON SHORT TERM LOANS

Applicant has not included interest on short term loans ... "to finance fluctuating cash flow needs." , but as a legitimate cost of operating the pipeline system during the early years of operation. SDIP anticipates that there will be no return to the stockholders for five or six years, but it must, at least, be able to cover its out of pocket costs. Applicant has not included a return to the stockholders as part of its out of pocket cost calculations.

The interest on short-term debt is clearly an anticipated cost, just as is interest on the long-term debt, and it should be included in the development of the initial transportation rate to make the pipeline project feasible from an investor's viewpoint. If SDIP were paying a return to the stockholders and incurring debt for fluctuating cash flow at the same time, then the Staff's objections might have merit. This clearly <u>is not</u> the case. The stockholders of SDIP do not anticipate any return on equity for the first five or six years and should not be further penalized by having to absorb interest associated with short-term debt.

As SDIP has stated many times, this is a long term project, and SDIP's stockholders will not realize a return for many years. It is obvious that there is a considerable <u>"risk"</u> of loss in the early years of operation; the loss is <u>real</u> and it <u>will</u> occur. The loss must be covered by short-term debt to cover out of pocket costs, and the interest on those costs is an operating expense, just as interest on long-term debt is an operating expense.

CONCLUSION

Based upon the foregoing, SDIP respectfully requests that the Public Utilities Commission award the rate requested by SDIP, i.e., $2.4204/Mcf.

DATED this 14th day of January, 1993.

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