BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE APPLICATION OF MIDAMERICAN ENERGY COMPANY
FOR AUTHORITY TO INCREASE ITS NATURAL GAS RATES

STAFF MEMORANDUM SUPPORTING SETTLEMENT STIPULATION

DOCKET NG14-005

Commission Staff (Staff) submits this Memorandum in support of the Settlement Stipulation (Settlement) of June 3, 2015, between Staff and MidAmerican Energy Company (MidAmerican or Company) in the above-captioned matter.

BACKGROUND

MidAmerican's last Natural Gas Rate Increase docket was filed on April 2, 2004. On August 4, 2014, the Company filed an application with the South Dakota Public Utilities Commission (Commission) requesting approval to increase rates for natural gas service to its customers in its South Dakota retail service territory by approximately $2.8 million annually or approximately 3.5%. A typical residential natural gas customer using 61 therms per month would see an increase of $1.00 per month.

Some of the primary drivers as discussed throughout the testimony are increases from general inflation, an increase of more than 50% in rate base since the last rate case, rapid growth in the MidAmerican gas service territory, realignment and relocation of pipelines to accommodate roadway and infrastructure improvements to support the growth, retiring all vintage cast iron gas pipe system, replacement of older steel and plastic pipe, and investments in facilities and equipment used on the pipelines.

MidAmerican's proposed increase was based on a historical test year ended December 31, 2013, adjusted for what MidAmerican believed to be known and measurable changes, a 10.60% return on common equity, and a 7.545% overall rate of return on rate base.

The Commission officially noticed MidAmerican's filing on August 7, 2014, and set an intervention deadline of October 24, 2014. No petitions to intervene were filed. On August 27, 2014, the Commission issued an Order Assessing Filing Fee and Suspending Operation of Proposed Rates. On December 31, 2014, MidAmerican filed a Notice of Intent to Implement Interim Natural Gas Rates effective on and after February 1, 2015.

Settlement discussions between Staff and MidAmerican commenced on April 7, 2015. Thereafter Staff and MidAmerican (jointly, the Parties) held several settlement discussions in an effort to arrive at a mutually acceptable resolution of the issues presented in MidAmerican's filing. Ultimately, the Parties reached a comprehensive agreement on MidAmerican's overall revenue deficiency and other issues presented in this case including, but not limited to, class revenue responsibilities, rate design, and tariff concerns.

OVERVIEW OF SETTLEMENT

Staff based its revenue requirement determination on its comprehensive analysis of MidAmerican's filing and information obtained during discovery. Staff accepted some Company adjustments, made corrections where necessary, modified other adjustments, and rejected those that do not qualify as known and reasonably measurable. Lastly, Staff introduced new adjustments not reflected in MidAmerican's filed case.

Company and Staff positions were discussed thoroughly at the settlement conferences. As a result, some positions were modified and others were accepted where consensus was found. Ultimately, the Parties agreed on a comprehensive resolution of all issues. Staff believes the settlement is based on sound regulatory principles and avoids additional costly and unnecessary litigation.

The Parties agree MidAmerican's revenue deficiency is approximately $1,485,212, which results in an approximate 5.67% increase in retail distribution revenue[1]. This revenue requirement and supporting calculations described in this Memorandum and attachments depict Staff's positions regarding all components of MidAmerican's South Dakota jurisdictional revenue requirement.

STAFF OVERVIEW OF SETTLEMENT

Staff believes the settlement provides MidAmerican with an annual level of revenues relative to its current service costs that is fair, just and reasonable. These settlement rates allow MidAmerican a reasonable opportunity to earn a return adequate for it to continue the provision of safe, adequate, and reliable natural gas service to its South Dakota retail customers.

Staff's determination of the settlement revenue requirement begins with the December 31, 2013, South Dakota retail test year costs. Staff then adjusted the December 31, 2013, test year results for known and measurable post-test year changes. Staff Exhibit___(EJP-1), Schedule 3 illustrates Staff's determination of MidAmerican's pro-forma operating income under present rates. Staff Exhibit___(EJP-2), Schedule 2 illustrates Staff's calculation of MidAmerican's South Dakota retail rate base, and Staff Exhibit___(EJP-1), Schedule 2 and Staff Exhibit___(EJP-2), Schedule 1 summarize the positions. Staff's calculation of MidAmerican's revenue deficiency and total revenue requirement are shown on Staff Exhibit___(EJP-1), Schedule 1.

The base revenue increase by rate schedule is shown on Staff Exhibit___(PJS-2), Schedule 1. Staff Exhibit___(PJS-2), Schedules 2-1 through 2-3 reflect the settlement base rates for each rate schedule. The comparison between present and settlement rates and resulting bill impacts for the Small Volume Firm (SVF) rate schedule is shown on Exhibit___(PJS-2), Schedule 3.

Unless otherwise noted, all of the changes discussed below are changes from the Company's filed position.

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[1] When including the PGA revenues of $56,028,766, the approximate increase is 1.81%.

RATE BASE

Average Rate Base – The Company proposed a test year average rate base based on an average of the 12 month-end account balances, January 31, 2013, through December 31, 2013. The settlement revises this to an average of the 13 month-end account balances, December 31, 2012, through December 31, 2013. This change had a net effect of increasing rate base by approximately $142,000.

Acquisition Adjustment – In accordance with the settlement in NG95-006, MidAmerican proposed this adjustment to remove 50% of rate base associated with the exchange of properties between MidAmerican and Minnegasco in 1993. The settlement accepts this adjustment with a slight modification to use a 13-month average ending December 31, 2013 versus the filed 12-month average. This revision decreases rate base by approximately $6,000.

Cast Iron Replacement – MidAmerican proposed an adjustment to reflect changes to plant in service, accumulated depreciation, and accumulated deferred income taxes (ADIT) associated with cast iron replacement projects completed during the test year and expected to be completed in 2014. This project completes a three-year program initiated in 2012 to eliminate all remaining cast iron systems. The decision to engage in such a program was based upon review as part of the Company's Distribution Integrity Management Plan (DIMP) and the Pipeline and Hazardous Materials Safety Administration (PHMA) Advisory issued in 2012 emphasizing the need for accelerated replacement of cast iron due to the higher risk for failure associated with these systems.

The settlement revises this adjustment to: 1) Reflect actual costs through March 31, 2015; 2) Reflect 13-month average rate base in lieu of 12-month average rate base; 3) Annualize accumulated deferred income taxes for projects placed in-service in 2013; and 4) Reflect bonus depreciation through 2014. The net effect of these changes reduces rate base by approximately $404,000.

Sales Growth 2013 – The Company proposed an adjustment to reflect the incremental changes in plant in service, accumulated depreciation, and ADIT associated with the increase in year-end customers over average customers. The settlement rejects this adjustment, reducing rate base by approximately $1,355,000.

Project in Service During Test Year – MidAmerican proposed to annualize changes to plant in service, accumulated depreciation, and ADIT associated with one project placed in service during the test year.

The settlement revises this adjustment to: 1) Reflect actual, final costs; 2) Reflect 13-month average rate base in lieu of 12-month average rate base; 3) Annualize accumulated deferred income taxes; and 4) Reflect bonus depreciation through 2014. The net effect of these changes increases rate base by approximately $21,000.

Projects in Service by 12/31/2014 – The Company proposed an adjustment to reflect changes to plant in service, accumulated depreciation, and ADIT associated with three projects placed in service post-test year.

The settlement revises this adjustment to: 1) Reflect actual costs through March 31, 2015; 2) Reflect 13-month average rate base in lieu of 12-month average rate base; and 3) Reflect bonus depreciation through 2014. The net effect of these changes reduces rate base by approximately $65,000.

Cash Working Capital – MidAmerican's proposed rate base included an allowance for cash working capital based on their lead-lag analysis. A lead-lag analysis examines the timing of the Company's receipt of service revenues from customers in relation to the Company's payment of expenses to vendors and employees. This analysis also includes a rate base deduction for tax collections which the Company receives in advance of turning the related payments over to the taxing authorities. Staff carefully examined MidAmerican's revenue lag and expense lead day determinations and used these calculations to make an adjustment to rate base with the following modifications:

1. Included a separate expense lead for vacation pay;
2. Included a separate expense lead for incentive compensation;
3. Revised the expense lead day for sales tax to remain consistent with past Staff practice; and
4. Revised expenses per day to incorporate into the lead-lag analysis the impacts of Staff's recommended adjustments to *pro forma* operating expenses.

These modifications decrease rate base by approximately $1,027,000.

Other Working Capital – The settlement reflects a more recent 13-month average for materials and supplies, prepayments, customer advances, customer deposits, accumulated provision for uncollectibles, and accumulated provision for injuries and damages. Staff concluded that due to the volatility of the balance in the fuel stocks account arising from changes in the price of gas and the quantity in storage given varying winter temperatures, the settlement could accept a five year, or 61-point average, for fuel stocks. The net effect of these changes decreases rate base by approximately $640,000.

Rate Case Expense—MidAmerican proposed to amortize projected rate case costs for NG14-005 of $349,000 over 5 years and to not include any of the costs in rate base. The settlement reflects a 5 year amortization of $82,307 in actual costs incurred as of May 26, 2015. Half of the rate case costs, or $41,154, is included in rate base, representing the average unamortized balance over the 5 year period. The company proposed the 5 year amortization period and staff accepted that period. Staff felt the 5 years helped to limit the impact the rate case expense would have on consumers' bills while still allowing the company to recoup those costs in a timely fashion. The net effect of these changes increases rate base by approximately $41,000.

OPERATING INCOME

Interest Synchronization – The settlement synchronizes the tax deduction for interest expense with the weighted cost of long-term debt and the historic test year rate base as adjusted for known and measurable changes.

Payroll Adjustment – The Company proposed this adjustment to annualize 2013 test year payroll and recognize the 2014 increases for union employees, based on contracts in place. The Company also proposed to adjust test year non-union payroll for actual increases experienced on January 1, 2014. These adjustments are accompanied by adjustments to increase the corresponding costs of payroll taxes and the Company 401(k) match. The settlement accepts these adjustments.

Weather Normalization - Staff analyzed MidAmerican's weather normalization adjustment, raising two issues. First, MidAmerican proposed a departure from the standard definition of heating degree days

(HDD), proposing that they be based upon a base of 55 degrees rather than the normal base of 65 degrees. Second, MidAmerican's statistical models were not actually measuring how usage responds to abnormal weather, but to how usage responds to normal weather patterns during the course of a year. MidAmerican addressed both of these concerns and submitted a revised weather normalization adjustment. The stipulation reflects this revised adjustment. The effect of this adjustment is an increase in gas service revenues of approximately $37,000.

Retirement Plan Costs – MidAmerican's annual retirement-related costs, including pensions, SERP and OPEB, vary significantly and largely unpredictably. Much of the volatility in the annual expense is attributable to market forces, to changes in the actuarial assumption relied on to calculate the annual expense, and to changes in the value of plan assets. In order to smooth the annual expense for ratemaking purposes, MidAmerican proposed to average the expense over a three-year period, 2012-2014. This expense averaging technique is similar to the way in which pension costs were treated by Staff and accepted by the Commission in Black Hills Power's recent rate proceeding. Staff accepted MidAmerican's expense adjustment, which reflects the three-year average expense for its retirement-related costs.

Depreciation on Rate Base Adjustments – MidAmerican proposed to increase depreciation expense for the depreciation associated with the rate base adjustments. The settlement revises this adjustment to reflect the changes agreed to for the rate base adjustments. This reduces depreciation expense by approximately $52,000.

Sales Growth – The Company proposed an adjustment to estimate the increased revenue that would result from the increase in year-end customers over average customers. The settlement rejects this adjustment, reducing operating revenue by approximately $392,000.

Acquisition Adjustment – In accordance with the settlement in NG95-006, MidAmerican proposed this adjustment to remove 50% of the amortization expense associated with the exchange of properties between MidAmerican and Minnegasco in 1993. However, this adjustment is not consistent with the mechanics used in prior rate cases, as the settlement in NG95-006 also states that MidAmerican is to retain the tax benefits attributable to the exchange of the properties. Thus, this settlement contains adjustments consistent with past cases and retains tax benefits with MidAmerican. This Staff adjustment increases federal income tax expense by approximately $67,000.

Rate Case Expense—MidAmerican proposed to amortize projected rate case costs for NG14-005 of $349,000 over a 5 year period. The settlement reflects a 5 year amortization of $82,307 in actual costs incurred as of May 26, 2015. The company proposed the 5 year amortization period and staff accepted that period. Staff felt the 5 years helped to limit the impact the rate case expense would have on consumers' bills while still allowing the company to recoup those costs in a timely fashion. The net effect of these changes is a reduction in operating expenses by approximately $53,000.

Late Payment Charges – This Company-proposed adjustment eliminates test year late payment revenue in lieu of using actual payment collection days in the cash working capital calculation, where, per statute, a 20-day period is used. This is consistent with past ratemaking treatment, and the settlement accepts this adjustment.

Long-term Incentive Partnership (LTIP) Costs – The Company's LTIP plan is intended to compensate selected participants for the Company achieving financial performance goals. Consistent with the

Commission's prior treatment of incentive compensation plans that are driven by achieving financial performance goals, MidAmerican proposed an adjustment to eliminate its LTIP expense for ratemaking purposes. The Commission Staff accepted this adjustment.

Energy Efficiency Costs and Revenues – The Company's filing included a pro forma adjustment to remove from the revenue requirement all revenues and operation expense amounts relating to energy efficiency programs as these costs and related recoveries are accounted for in a separate rider. The settlement accepts this adjustment.

PGA Costs and Revenues—MidAmerican proposed to remove PGA costs of approximately $56,029,000 and revenues of approximately $56,029,000 from the test year. This settlement accepts this adjustment.

Economic Development—MidAmerican proposed to remove all economic development expenses over the $50,000 recovery approved in its economic development plan. The Company did not propose any changes to its economic development plan from the plan currently in place, which is a 50/50 split of economic development costs up to $100,000; therefore MidAmerican is eligible for $50,000 in recovery. The effect of this adjustment reduces operating income by approximately $52,000. This settlement accepts this adjustment.

Out-of-Period Income Tax Adjustment – The Company's 2013 income tax expense included certain tax adjustments recorded in 2013 that were related to amounts reflected on the Company's 2012 tax return. Since these adjustments relate to 2012 transactions, they are not appropriate to include in the test year that underlies the Company's rate filing in this case. The Commission Staff's revenue requirement analysis reflects the same out-of-period tax adjustment that was included in the Company's original filing. Staff accepts this adjustment.

Association Dues—Staff proposed an adjustment to the association dues expense included in the test year. The settlement removes association dues costs which do not provide for the provision of safe, adequate, and reliable electric service for South Dakota ratepayers. The effect of this adjustment reduces operation expenses by approximately $25,000.

Bad Debt Expense – MidAmerican proposed an adjustment to increase bad debt expenses based on 0.30% of the proposed revenue deficiency. The settlement adjusts bad debt expense based on a five year uncollectible rate average applied to retail revenues. The net effect of this change increases operating expense by approximately $13,000.

Mains Maintenance Expense – During a review of MidAmerican's actual test year expenses in Statement H and prior and post years' expenses supplied in response to data requests, Staff discovered a substantial increase in the Mains Maintenance account, Account 887, when comparing the test year expense of $1,188,475 with prior- and post-test year expenses in this account. The Company indicated that there were 2013 test year costs incurred for a gas main and services pressure retest project that would not be ongoing. Staff and MidAmerican concluded a five year average of costs in this account would be more representative of normal. The settlement adjusts test year expense to the 2010 through 2014 average expense in this account, thus reducing operating expense by approximately $413,000.

Performance Incentive Plan (PIP) Costs – In addition to its LTIP, the Company offers the PIP, which is an incentive compensation program for non-union employees. MidAmerican's claimed revenue requirement included $412,040 for test year PIP expenses. The Commission Staff reduced for ratemaking purposes the test year PIP expense by 10 percent, or $41,204, to exclude that portion of PIP payments made for achieving financial goals.

Miscellaneous Fees and Charges – The Company proposed to increase fees for customer-requested turn-on or turn-off service after normal working hours and reconnects following disconnects, as these fees have been in place since 1999; however, there wasn't a proposed adjustment for the additional revenue these increased fees would generate. Along with reducing the amount of the fee increases (see below) to avoid customer rate shock, the settlement adjusts operating income to account for these increased revenues. The effect of the adjustment increases revenue by approximately $26,000.

	Current	**Proposed**	**Settlement**
Customer Requested Turn On/Off After Hours	55.00	88.00	65.00
Customer Requested Turn On/Off Sundays & Holidays	75.00	169.00	90.00
Reconnection After Disconnection Regular Working Hours	35.00	49.00	35.00
Reconnection After Disconnection After Hours and Saturdays	55.00	103.00	75.00
Reconnection After Disconnection Sundays and Holidays	75.00	185.00	100.00

Monthly Metered Transportation (MMT) Switching and Scheduling Fees – MidAmerican's filing proposed increased switching and administrative fees and decreased scheduling fees under the Monthly Metered Transportation schedule. Although Staff agrees with the calculations used and does not object to the proposed fees, it was discovered that no accompanying adjustments were made to revenues for the switching and scheduling fee changes. The settlement provides for these adjustments and decreases operating revenue by approximately $2,000.

Kansas Property Tax Removal – During settlement, MidAmerican proposed to remove Kansas property taxes from the test year. These taxes are imposed by the State of Kansas on gas in storage under contracts between MidAmerican and Northern Natural Gas Company. As ad valorem tax is includible in the purchased gas adjustment under SDCL 49-34A-25 and these charges are a direct continuation of interstate pipeline charges, MidAmerican will propose in a future filing to include these Kansas property taxes in the purchased gas adjustment. The settlement accepts this adjustment which reduces operating expense by approximately $59,000.

COST OF CAPITAL AND RATE OF RETURN

MidAmerican's initial gas filing requested a 7.545 percent overall rate of return using a capital structure of 49.210 percent debt and 50.790 percent common equity, based on a 12 month average ending May 31, 2014. The embedded cost of debt associated with this capital structure was 4.391 percent, and the requested rate of return on equity was 10.60 percent. Staff's analysis initially challenged all three components of the overall rate of return: (1) embedded cost of debt, (2) the capital structure, and (3) the required return on equity.

[Begin Confidential] [redacted]

[redacted]

[redacted] **[End Confidential]**, the settlement overall rate of return is 6.92 percent.

RATE DESIGN ISSUES

The Parties agree in principle on all issues regarding rate design and the class revenue distribution. The settlement position reached between Staff and MidAmerican is discussed below.

Class Cost Allocation/Spread of the Increase – The Commission Staff did not raise significant issues with the way in which MidAmerican conducted its class cost of service study. That study indicated that the transportation customers in the Medium and Large rate classes should receive a larger-than-average percentage increase. To promote rate moderation and to avoid rate shock, Staff recommended that no class or subclass receive a revenue decrease and no class or subclass receive an increase greater than 1.5 times the overall percentage increase for all classes. The Company offered a proposal reflecting these guidelines, which Staff accepted. As a result, revenue responsibility for the typical residential customer rate schedule (Small – SVF) increases by 5.34 percent. Revenue responsibility for the large transportation rate schedule (Large – LT) increases by 8.46 percent. The overall increase reflected in the settlement is 5.67 percent.

Rate Design – MidAmerican's initial proposal called for the discontinuance of Small Seasonal Service (SSS) and Large Seasonal Service (LSS) rates, the consolidation of Small Volume Interruptible (SVI) and Large Volume Interruptible (LVI) rates into one interruptible rate, and the corresponding consolidation of rates.

Although Staff generally agreed with these proposed changes, revisions were needed to promote rate moderation and avoid rate shock, as discussed above regarding the spread of the increase. Thus, the Company decided to forego these tariff changes for settlement purposes.

However, the settlement does support MidAmerican's proposed monthly metering charges with four different classes based on the size and capacity of the meter. During the test year, MidAmerican had 38 different meter sizes in service in its South Dakota jurisdiction with four natural price breaks where the price of the next larger meter was significantly higher. This natural break in meter charge classes seems logical to keep small volume customers from subsidizing larger volume customers. Given test year figures, approximately 85,784 out of the 86,694 Small Volume Firm (SVF) customers, or 99%, will see no increase in their flat monthly fee.

OTHER ISSUES

Interval Metering Charge – Presently, MidAmerican transportation customers requiring telemetry have the option of reimbursing the Company up front for the entire cost of a transportation meter or installing a meter at their own expense per MidAmerican specifications before service can be initiated. This proposed change will allow the Company to collect a monthly fee in lieu of an upfront fee when the new telemetry meters are installed. Staff generally agrees with this approach, but noticed during discovery a couple errors in the calculation of this monthly charge. Thus, the settlement revises the monthly fee from $57.54 to $42.00 to 1) reflect a return on rate base calculated on average rate base (half the cost of the meter) over a ten year useful life versus the initial rate base amount based on the entire cost of the meter and 2) calculate property taxes based on the revised average rate base.

Rate Moratorium – The Parties agree that MidAmerican shall not file any rate application for an increase in base rates which would go into effect prior to February 1, 2018 subject to the occurrence of various extraordinary events.

Implementation of Rates – The tariffs shown on Exhibit 1 attached to the Stipulation are proposed to be implemented for service rendered on or after July 1, 2015. Customer bills will be prorated so that usage prior to that date is billed at the previous rates and usage on and after that date is billed at the new rates.

Interim Rate Refund – Interim rates were implemented on February 1, 2015. Approval of the Settlement will authorize a rate increase less than the interim rate level. The Company agrees to refund customers the difference between interim rates and new rates established by the settlement for usage during the period February 1, 2015, through June 30, 2015. As part of the refund, MidAmerican will include interest, calculated by applying a 7% annual interest to the average refund balance for each month that interim revenues were collected. The Company will file a separate proposal for the interim rate refund.

Depreciation Rate Study Commitment – Through discovery Staff reviewed the depreciation rate changes that have been implemented by the Company based on periodic engineering studies performed either by the Company or its consultants. Many of these depreciation rate changes were made between rate case filings with the Commission.

The annual depreciation expense allowances that are reflected in the Company's financial reports are affected by any changes in the accrual rates derived from the engineering studies commissioned by the Company and these expense allowances represent significant components of its gas and electric revenue requirements. Moreover, the ratemaking allowances for depreciation expense represent the recovery of plant investment from ratepayer contributions that are recognized in rate base determinations in subsequent rate cases by deducting amounts then reflected in the Company's financial reports as accumulated depreciation. Because of the significance of depreciation rate accruals rate changes between rate cases, Staff proposed that MidAmerican advise the Commission of the results of any depreciation studies conducted of its gas and electric utility plant. This commitment is incorporated in the NG14-005 and EL14-072 Settlement Stipulations.

RECOMMENDATION

Staff recommends the Commission approve the Settlement for the reasons stated above.