MONTANA-DAKOTA UTILITIES CO.

A Division of MDU Resources Group, Inc.

Before the South Dakota Public Utilities Commission

Docket No. NG15-___

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.

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 and Exhibit No.___(TRJ-1).

Pro Forma Revenue Requirement

Q. What were the results of South Dakota gas 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 gas operations had a return on rate base of 6.809 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. Page 3 and 4 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, 2014, conform to past Commission practices and are listed on pages 3 and 4 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 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 4 and include plant, accumulated reserve and associated additions and deductions. Each adjustment is discussed in detail below.

Pro Forma Income Statement

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 restates the per books consumption at current rates, adjusted to reflect an annual gas cost for 2015, exclusive of the surcharge adjustment, and eliminates the unbilled revenue, margin sharing credit and reserve for refund, decreasing revenue by $5,990,966.

Adjustment No. 2 decreases revenues by $4,828,375 to reflect the effect of normal weather on sales and transportation volumes, as weather was 6.3 percent colder than normal in 2014.

Adjustment No. 3 includes the adjustments to other operating revenues. The pro forma adjustment consists of the adjustment of rent to reflect current rental revenue, late payment revenue based on the three year average ratio of late payment revenues to sales and transportation revenue applied to pro forma revenue and a three year average of penalty revenue.

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

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

The adjustment to the cost of gas (Adjustment No. 4) is shown on Rule 20:10:13:81, page 3, and adjusts the cost of gas to reflect the pro forma dk sales and an annual 2015 gas cost level. The pro forma cost of gas per dk was derived by calculating annual demand charges and commodity cost of gas and applying those costs to the April 2015 purchased gas cost adjustment billing determinants. The distribution loss factor of 1.00 percent represents the current loss factor.

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 $236,286 or 4.55 percent.

Benefits are shown on page 5. Adjustment No. 6 is an overall increase of $181,799 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. Similar to pension expense, 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 and applied to pro forma labor expense.

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

A. Yes. Vehicles and work equipment (Adjustment No. 7) reflects all expenses associated with the Company's vehicles and equipment, such as backhoes, including the costs of fuel, insurance, maintenance and depreciation expense. Adjustment No. 7 reflects an increase in this account due to the change in the plant balances. It is calculated based on the pro forma plant and the 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.

Subcontract Labor (Adjustment No. 8) is an increase of $116,688 to reflect normal expense as 2014 expense was lower than normal.

Materials (Adjustment No. 9) is an increase of $15,048 and is due to lower than normal expense in 2014, net of a non-recurring expense.

Software Maintenance expense (Adjustment No. 10) is increasing by $8,158 due to an increase in software fees and fixed network expenses.

Office expense (Adjustment No. 11) is an increase of $3,589 due to lower than normal expenses in 2014 and expenses associated with the purchase of a new copier in 2014.

Communication expense (Adjustment No. 12) is a decrease of $1,481 to exclude expense not applicable to South Dakota, net of increased communication costs.

Rent expense (Adjustment No. 13) is a decrease of $19,536 to reflect one-fifth of a five year lease recorded in 2014, net of increased expense for additional office space.

Company consumption (Adjustment No. 14) is the expense for electric and natural gas consumption in Company buildings. The electric component is projected to remain flat. The natural gas component is expected to decrease $13,338 based on the decrease in normalized firm sales revenues associated with the pro forma cost of gas.

Uncollectible accounts expense (Adjustment No. 15) is a decrease of $97,134 based on the three year average ratio of net write-offs to revenues applied to pro forma sales and transportation revenues.

Postage expense (Adjustment No. 16) is an increase of $402 reflecting an increase in postage costs net of a reduction in postage annualizing the number of customers that are paying bills electronically.

Advertising expense (Adjustment No. 17) is shown on page 16. 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 gas 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. 18) reflects the expense at current levels for 2015 and represents an increase of $43,234. Self-insurance expense was adjusted to reflect a five year average of claims and related expenses incurred.

Industry dues (Adjustment No. 19) reflects the pro forma level of industry dues and is a decrease of $4,980. Page 18 shows those dues that are directly assigned or allocated to South Dakota and appropriately included in the pro forma expense level.

Regulatory Commission Expense (Adjustment No. 20) reflects the expenses to be incurred in this filing, along with the remaining balance of expenses from Docket No. NG-12-008, amortized over a five-year period, and a three year average of ongoing regulatory commission expenses. The adjustment is an increase of $44,178.

The items adjusted individually above represent approximately 97 percent of total South Dakota gas O&M, as shown on page 20. The remaining items, which make up approximately 3 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. 21 restates annual depreciation expense to the average pro forma level of plant in service. The depreciation rates are shown on Statement J, page 7 and reflect the depreciation rates pursuant to the Stipulation approved by this Commission in Docket No. NG12-008.

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. 22 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 $25,440.

The adjustment to payroll taxes (Adjustment No. 23) is an increase of $16,878 based on the ratio of payroll taxes to labor expense for 2014 applied to pro forma labor expense.

Adjustment No. 24 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 a decrease of $1,380.

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. 25) 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 a decrease of $94,269 from the per books level.

The adjustments for net tax depreciation and deferred taxes on the pro forma plant additions (Adjustment No. 26) are shown on page 9. The calculation of net tax depreciation and the resulting deferred taxes on the plant additions are shown on page 17.

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. 27.

The closing/filing and prior period adjustments in the current income tax accrual and in the deferred taxes are eliminated in Adjustment No. 28. Adjusted current and deferred income taxes match those calculated for South Dakota and conform to past Commission practices.

<u>**Pro Forma Rate Base**</u>

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. The pro forma adjustments to rate base are summarized on Rule 20:10:13:96, Statement M, page 4. Adjustment A is the known and measurable plant additions that will be in service by December 31, 2015. The increase of $3,760,375 includes additions to distribution, general and common plant and the net additions are shown on Rule 20:10:13:54, Statement D, pages 1 through 5. Rule 20:10:13:56, Statement D, Schedule D-2, pages 2 through 5 contain the detailed plant additions of $6,017,656

Adjustment B, shown in Rule 20:10:13:64, Statement E page 2, increases the average reserve for depreciation on the per books plant by $2,352,689 to restate the reserve to the average pro forma level in order to match the average pro forma plant levels.

The working capital adjustments are included in Rule 20:10:13:68, Statement F. Materials and supplies are restated to a thirteen-month average balance, with actual balances through March 31, 2015, in Adjustment C, for an increase of $46,796.

Insurance expense is restated to a thirteen-month average balance in Adjustment D with actual balances through March 31, 2015 and balances for April through December 2015 based on the pro forma insurance expense and is an increase of $72,601.

The adjustment to the average net unamortized loss on reacquired debt balances and the associated deferred income taxes to reflect 2015 activity is included as Adjustment E.

The unamortized rate case expense from this docket and the remaining balance from Docket No. NG12-008 reflecting 2015 activity and the associated deferred income taxes are included as Adjustment F.

The adjustments to accumulated deferred income taxes are summarized on Rule 20:10:13:88, Statement K, page 16.

The deferred taxes associated with the unamortized loss on debt (Adjustment E) and rate case expense (Adjustment F) represent the accumulated deferred income taxes associated with the items included in working capital in Statement F.

Adjustment H is the increase in deferred taxes necessary to extend the average accumulated deferred tax balance to match the pro forma plant and accumulated reserve balances.

Adjustment I is the decrease to deferred taxes to reflect the amortization of the full normalization adjustment for 2014.

Customer advances for construction (Adjustment G) are restated to a thirteen-month average balance, with actual balances through March 31, 2015 and is an increase of $73,637 as shown on Rule 20:10:13:69 Statement F, Schedule F-1, page 6.

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 7, shows the calculation of the revenue deficiency of $1,532,999 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.

Q. Does this complete your direct testimony?

A. Yes, it does.