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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

IN RE:)
)
NORTHWESTERN Corporation) **Docket No. NG11-**
d/b/a NorthWestern Energy)

PREFILED DIRECT TESTIMONY OF KENDALL G. KLIEWER
ON BEHALF OF NORTHWESTERN ENERGY

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Witness Information

Q. Please state your name and business address.

A. Kendall Kliewer, 3010 W. 69th Street, Sioux Falls, South Dakota, 57108.

1 **Q. By whom are you employed and in what capacity?**

2 **A.** I am the Vice President and Controller of NorthWestern Corporation (NWE or
3 NorthWestern).

4
5 **Q. Please summarize your educational and employment experiences.**

6 **A.** I have been the Chief Accountant of NorthWestern since November 2002, the
7 Controller since July 2004 and a Vice President since August 2006. My primary
8 responsibilities include, among other duties, overseeing compliance with financial
9 reporting requirements established by the Securities and Exchange Commission
10 (SEC) and other regulatory agencies, technical research with regard thereto,
11 reviewing NWE's financial statements, and implementing and overseeing
12 accounting policies and procedures. Previously, I was a Senior Manager at
13 KPMG, LLP in Lincoln, Nebraska. I was employed by KPMG from September
14 1996 through September 1998 and again from October 1999 through November
15 2002, when I joined NorthWestern. During my tenure at KPMG, I coordinated
16 financial statement audits, consulted clients on appropriate accounting practices
17 and SEC reporting requirements, assisted clients with the preparation and review
18 of various SEC filings, and planned and supervised audits. From September 1998
19 through October 1999, I was the Vice President – Regulatory Reporting
20 Accountant, of TierOne Bank in Lincoln, Nebraska, where I was responsible for the
21 preparation and review of various regulatory reports requiring a working knowledge
22 of regulatory accounting principles, generally accepted accounting principles and
23 income tax reporting requirements. I have a Bachelor of Science in Business
24 Administration from the University of Nebraska and am a certified public
25 accountant.

26
27 **Purpose of Testimony**

28 **Q. What is the purpose of your testimony?**

29 **A.** My testimony:

- 30 1. Provides background for significant accounting changes since the last rate
31 filing, Docket No. NG07-013;
32 2. Discusses our method of allocating shared administrative costs;

- 1 3. Presents a detailed explanation of various adjustments to the income
2 statement and rate base provided in this filing; and
3 4. Discusses stock-based compensation included in this filing.
4

5 **Significant Accounting Changes**

6
7 **Q. What significant accounting changes have occurred since Docket No.
8 NG07-013?**

9 **A.** NorthWestern has experienced two significant accounting changes as they relate
10 to our cost of service since the last rate filing. They consist of the following:

- 11 • Repairs tax benefit; and
12 • Post-retirement medical benefits.
13

14 **Repairs Tax Benefit**

15 On September 25, 2009, NorthWestern received a Consent Letter from the Internal
16 Revenue Service ("IRS") in response to NWE's request to change its method of
17 accounting for income tax purposes related to how deductible repair expenses are
18 calculated effective for the tax year 2008. This consent allows NWE to analyze its
19 capital expenditures on the books annually and deem a significant portion of those
20 expenditures as deductible ordinary and necessary business repair expenses in the
21 year they are incurred under Section 162 of the Internal Revenue Code. NWE has
22 flowed through these tax deductions for the benefit of retail customers in this filing.
23 Accordingly, the amount of repair deductions benefit being flowed through to
24 customers in this filing is \$300,650.
25

26 **Post-retirement Medical Benefits**

27 In 2009, NorthWestern amended its post-retirement medical plan to: (i) cap the
28 company contribution toward the premium cost for coverage; (ii) provide a company
29 contribution toward the premium cost for coverage to our South Dakota and
30 Nebraska retirees; and (iii) change eligibility provisions for the company contributions
31 from age 50 with 5 years of service to age 60 with 20 years of service for employees

1 terminating on or after January 1, 2011. Previously, only the Montana retirees
2 received a company contribution.

3
4 NorthWestern also placed retirees into a risk pool that is separate from its active
5 employee population for determining premiums and fixed the company contribution
6 toward the total premium. The previous company contribution toward the total
7 premium was based on a complicated formula and varied by retiree and retirement
8 date. The company contribution for retirees going forward is fixed at \$250 (single) or
9 \$580 (two-party or family) coverage per year of completed service, capped at 25
10 years of service. The company contribution is provided until the retiree reaches the
11 age of 65. Our 2010 post-retirement medical benefit expenses included in cost of
12 service in this filing was \$115,971 as reflected on Schedule H-3, page 1 of 1.

13 14 **Allocated Shared Administrative Costs**

15
16 We have three regulatory jurisdictions consisting of Montana (including Colstrip Unit
17 #4), South Dakota and Nebraska. Our administrative costs are allocated between
18 jurisdictions by utilizing a 3-factor formula, consisting of gross plant, margin, and
19 labor. The 3-factor formula is updated annually in October through an internal
20 administrative allocation study. The 2010 jurisdictional allocation methodology is
21 attached as Exhibit KGK-1.

22
23 In addition, we utilize a 3-factor formula to allocate shared costs between South
24 Dakota electric and gas operations and Nebraska gas operations consisting of plant,
25 customers, and O&M labor expense per each of the electric and natural gas
26 segments of our business. The 2010 electric and natural gas allocation methodology
27 is attached as Exhibit KGK-2

28 29 **Normalization Adjustments**

30 **Q. What are your explanations of the various adjustments on Statement N**
31 **provided in this filing?**

1 A. I will address adjustments 3 through 12 and 17. Witness Decker has addressed
2 the remaining adjustments in his testimony.

3
4 **Adjustment #3 - Advertising Expense**

5 Consistent with prior ratemaking treatment, this adjustment was made to reflect the
6 removal of known and measurable promotional and institutional advertising expense
7 of \$22,203 originally recorded as a utility operating expense.

8
9 **Adjustment #4 - Association Dues**

10 Consistent with prior ratemaking treatment, this adjustment was made to reflect the
11 removal of the Utility Shareholders of South Dakota dues of \$12,896 originally
12 recorded as a utility operating expense.

13
14 **Adjustment #5 - Government Lobbying Related Costs**

15 Consistent with prior ratemaking treatment, this adjustment was made to reflect the
16 removal of \$6,066 of government related lobbying costs originally recorded as a
17 utility operating expense.

18
19 **Adjustment #6 - Economic Development**

20 NorthWestern actively seeks out partnerships with the communities we serve to
21 promote their towns to prospective employers and businesses or local businesses
22 that are looking to expand or relocate. Active, growing communities are essential to
23 keeping our state's overall economy healthy by providing employment opportunities
24 for our customers in the James River Valley. With business growth, there is the
25 added benefit of an expanded tax base for our communities, counties and local
26 school districts. One way NorthWestern is able to support its communities in
27 fostering economic growth is to provide financial support to local or area economic
28 development organizations. The adjustment for economic development in Schedule
29 H3 reflects the financial support NorthWestern provides to local, regional and state
30 supported economic development organizations. The adjustment in Schedule H3 for
31 economic development expenses reflects a 50/50 split between our natural gas
32 customers and shareholders. This is consistent with previous Commission decisions

1 regarding economic development related expenses for other South Dakota rate
2 regulated natural gas and electric utilities. With Commission approval of our
3 proposed treatment of economic development related expenses as part of this rate
4 case filing, NorthWestern will provide an annual report and budget to the
5 Commission for its review and approval by March 30th of each year, beginning on
6 March 30, 2012. While financial support for these groups has a role, it is important
7 to note that NorthWestern provides additional support through employee
8 participation on local economic development boards, regional economic
9 development organizations, and State of South Dakota led initiatives. NorthWestern
10 has staff specifically dedicated to fostering economic development in conjunction
11 with our community partners. Additionally, our area operations managers are key
12 company representatives in maintaining a local presence within our communities
13 and in working with them to promote economic development opportunities. Exhibit
14 KGK-4 provides detail for the 2010 expenditures and Statement H3 includes the
15 normalizing entry of \$3,160.

16
17 **Adjustment #7 - Labor Expense**

18 Consistent with prior ratemaking treatment, actual base year labor allocated or
19 directly charged to South Dakota operations was increased 3 percent, or \$133,542,
20 which is consistent with the average range of recent annual salary adjustments to
21 employees.

22
23 **Adjustment #8 - Interest Synchronization**

24 Consistent with prior ratemaking treatment, this adjustment reflects the change in
25 Federal income taxes by using the interest synchronization method of computing the
26 interest deduction for income tax purposes. Under this method, interest in the
27 income tax calculation was set to be equal to the implied interest in our proposed
28 cost of capital included in this filing.

29
30 **Adjustment #9 - Depreciation Expense**

31 NorthWestern serves several ethanol plants under Contracts with Deviation that
32 have been approved by the SDPUC. The assets placed into service to serve each

1 plant are depreciated over the same life as the Contract with Deviation. In the first
2 quarter of 2011, it was discovered that the regulator station on the Prairie Ethanol
3 plant was incorrectly depreciating at a lower rate. In order to reflect the correct
4 depreciation for this asset, we added \$33,722 of depreciation expense into our test
5 year.

6
7 **Adjustment #11 - Aberdeen MGP Amortization**

8 In NG07-013, it was agreed through settlement that NWE would collect \$1,425,400
9 annually from customers to cover the costs of the MGP site in Aberdeen.
10 NorthWestern recorded expense of \$1,127,531 during 2010. Exhibit KGK-3 reflects
11 our cumulative costs and cumulative recoveries through December 31, 2010. As of
12 December 31, 2010, we have under collected costs of \$169,927. We currently
13 estimate our Aberdeen MGP related clean-up costs will be at least \$2,800,000 in
14 2011, \$4,200,000 in 2012, and \$3,300,000 in 2013. We have included an adjusting
15 entry of \$1,672,469, to increase the expense to \$2,800,000 in this filing.

16
17 **Adjustment #12 - Huron MGP Amortization**

18 This adjustment was made to remove the amortization of the refund of insurance
19 proceeds to customers as agreed to in NG07-013. These proceeds have been
20 refunded to customers in full.

21
22 **Adjustment #10 and #17 - Vertex and Power Plan software implementations**

23 An adjustment has been made to increase rate base for two software conversions
24 NorthWestern is undertaking in 2011. Vertex is a new customer information system
25 (CIS) with an expected go-live date of March 1, 2012. Power Plan is a fixed asset,
26 property tax, and income tax software designed specifically for utilities. The
27 expected go-live date for Power Plan is September 1, 2011. The South Dakota
28 natural gas share of these asset additions is estimated to be approximately
29 \$444,928. Also on Statement N, page 3 of 5, a normalizing entry of \$88,986 was
30 done to add one year of amortization expense for these two capital investments.

1 **Stock-Based Compensation**

2
3 **Q. Does this filing include stock-based compensation?**

4 **A.** Yes. South Dakota natural gas administrative and general expenses include stock-
5 based compensation costs of \$79,075.

6
7 **Q. How is stock-based compensation expense calculated?**

8 **A.** NWE accounts for stock-based compensation in accordance with Statement of
9 Financial Accounting Standards No. 123R, *Share-Based Payment* (SFAS No.
10 123R), which requires companies to recognize compensation expense for all
11 equity-based compensation awards issued to employees. Under SFAS No. 123R,
12 NWE recognizes expense over the period during which an employee is required to
13 provide service in exchange for the award. The expense is based on the fair value
14 of the shares issued as of the grant date.

15
16 **Q. Does this complete your testimony?**

17 **A.** Yes, it does.