BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE APPLICATION OF SOUTH DAKOTA INTRASTATE PIPELINE COMPANY FOR AUTHORITY TO INCREASE ITS NATURAL GAS RATES

STAFF MEMORANDUM SUPPORTING SETTLEMENT STIPULATION

DOCKET NG17-009

Commission Staff (Staff) submits this Memorandum in support of the Settlement Stipulation (Stipulation) of June 20, 2018, among Staff, South Dakota Intrastate Pipeline Company (SDIP or Company), Montana-Dakota Utilities Co. (MDU), and Ring-Neck Energy & Feed, LLC, dba Ringneck Energy, LLC (Ring-neck), (jointly, the Parties) in the above-captioned matter.

BACKGROUND

Upon expiration of the 25-year transportation agreement resulting from rate case NG92-005 and consistent with this agreement between the Company and MDU dated September 1, 1993, the Company is required to propose new rates to take effect September 1, 2018.

On June 1, 2017, the Company filed a letter of transmittal with the South Dakota Public Utilities Commission (Commission) requesting approval to increase rates for natural gas service to its customers. On June 29, 2017, the Company filed a confidential application for authority to increase its natural gas rates. This application was subsequently made public on August 8, 2017 and requested authority to increase annual revenues by approximately $1.8 million, or 80.9 percent.

After responding to several rounds of discovery from Staff, reconciling discrepancies with numbers provided, and recognizing some Staff concerns with proposed adjustments, SDIP filed supplemental testimonies and exhibits, revised statements, and supporting schedules on November 20, 2017. This revised filing saw a reduction in the requested increase of annual revenues to approximately $250 thousand, or an increase of 11.4 percent.

SDIP's proposed increase was based on a historical test year ended December 31, 2016, adjusted for what SDIP believed to be known and measurable changes, a 10.00% return on common equity, and an 8.91% overall rate of return on rate base.

The Commission officially noticed SDIP's filing on June 8, 2017, and set an intervention deadline of July 31, 2017. On June 22, 2017, MDU filed a Petition to Intervene. On July 6, 2017, the Commission issued an Order assessing a filing fee and granting intervention to MDU. On February 15, 2018, Ring-neck filed a Petition to Intervene. On March 2, 2018, the Commission granted intervention to Ring-neck.

Settlement discussions among the Parties commenced on February 21, 2018. After several discussions, the Parties arrived at a mutually acceptable resolution of the issues presented in SDIP's filing.

The Parties reached a comprehensive agreement on SDIP's overall revenue deficiency and other issues presented in this case including, but not limited to, rate design and tariff concerns due to Ring-neck being added to SDIP's system in the near future.

OVERVIEW OF SETTLEMENT

Staff based its revenue requirement determination on its comprehensive analysis of SDIP'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 SDIP's filed case.

The Parties' 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.

STAFF ANALYSIS OF SETTLEMENT

These settlement rates allow SDIP a reasonable opportunity to earn a return, and management fee in lieu of a return, that is adequate to enable it to continue providing safe, adequate, and reliable service to its customers.

Staff's determination of the settlement revenue requirement begins with Company test year costs for the twelve months ended December 31, 2016, and adjusts these test year results for known and measurable post-test year changes. Staff Exhibit___(PJS-1), Schedule 3 illustrates Staff's determination of SDIP's *pro forma* operating income under present rates, and Staff Exhibit___(PJS-1), Schedule 4 provides the calculation of SDIP's three-year levelized operating income. Staff Exhibit___(PJS-2), Schedule 2 illustrates Staff's calculation of SDIP's rate base, and Staff Exhibit___(PJS-1), Schedule 2 and Staff Exhibit___(PJS-2), Schedule 1 summarize the positions. Staff Exhibit___(PJS-1), Schedule 1 summarizes Staff's determination of SDIP's revenue deficiency and total revenue requirement.

Unless otherwise noted, all the changes discussed below are changes from the Company's supplemental filing.

REVENUE REQUIREMENT

Rate Base

Working Capital – SDIP proposed four working capital adjustments: "Accounts Receivable", "Prepayments", "Accounts Payable", and "Accrued Property Tax". SDIP's supplemental filing included twelve-month averages for accounts receivable and prepayments and the average of the year-beginning and year-ending balances for accounts payable and accrued property tax.

The settlement incorporates standard cash working capital and tax collections available adjustments in lieu of the proposed accounts receivable, accounts payable, and accrued property tax adjustments. This ensures that not only is SDIP getting credit for the revenue lag in its billing, but customers are getting credit for the expense lead associated with all SDIP's expenses.

The settlement also reflects a more recent twelve-month average for prepayments. The net effect of these changes decreases rate base by approximately $74,000.

Plant In-Service – SDIP proposed two adjustments to plant in-service: "Fixed Assets – Office & Operations" and "Fixed Assets – Trucks and Equipment". SDIP's supplemental filing adjusted plant in service to include budgeted 2017 and 2018 office and operations equipment additions as well as one new pick-up truck and one new dump truck.

The settlement revises the Company's adjustment to reflect known and measurable changes including the retirement of three pick-up trucks, the addition of one pick-up truck purchased off lease, the addition of two new pickup trucks, the addition of a new dump truck, miscellaneous equipment additions, and office furniture/equipment retirements and additions. These adjustments to plant in service reduce rate base by approximately $101,000, excluding accumulated depreciation impacts which is discussed below.

Accumulated Depreciation – SDIP proposed an adjustment to accumulated depreciation based on its estimated depreciation expense for 2017 and 2018, accounting for the fully depreciated pipeline as of August 31, 2018.

The settlement revises this adjustment to reflect the actual accumulated depreciation balance as of August 31, 2018, based on known and measurable changes. These changes include reflecting the full accumulated depreciation associated with the pipeline, August 31, 2018 accumulated depreciation balances associated with existing plant, and August 31, 2018 accumulated depreciation balances associated with plant additions and retirements. The effect of this adjustment is a reduction to rate base of approximately $363,000.

<u>Operating Income</u>

Federal Income Tax – The Company proposed a combined federal and state income tax rate of 40 percent (35 percent federal, 5 percent state). The settlement adjusts this to remove the five percent state income tax, as the company is located in a state without a state income tax, and reduces the federal income tax to the 21 percent tax rate now applicable to Subchapter C corporations under the Federal Tax Cuts and Jobs Act. Staff does note that SDIP is set up as a Subchapter S corporation, where income is not taxed at the corporate level, but passed through and taxed at the individual, shareholder level. However, even though there is not a tax expense at the corporate level, pass-through entities have been permitted an income tax allowance, in this jurisdiction and other state and federal jurisdictions, on the income imputed to the corporation provided that the corporation, or shareholders, have an actual or potential income tax liability on that income. The result of this adjustment reduces

operating expenses by approximately $7,000, as compared with the use of a 40 percent tax rate on the settlement revenue requirement.

Depreciation Expense – The Company proposed in its supplemental filing to remove the test year depreciation expense associated with its pipeline, as the pipeline will be fully depreciated by August 31, 2018 when new rates take effect. The settlement accepts this adjustment and further adjusts depreciation expense to reflect the proforma depreciation expense as of August 31, 2018 resulting from other plant items that reached the end of their depreciation lives post-test year as well as the impact of proforma plant additions and retirements. The result of this adjustment reduces depreciation expense by approximately $5,000.

Rent Expense – The Company proposed in its supplemental filing a known and measurable adjustment to the test year for a $7,200 increase in rent expense at its office/shop in Pierre, South Dakota, which went into effect January 1, 2017. The settlement accepts this adjustment.

Utilities Expense – The Company proposed an adjustment in its supplemental filing to increase utilities expense to a projected average of 2017 and 2018 expense based on four percent inflation each year. During the discovery process, SDIP revealed that test year employee cell phone expense of $19,831 consisted of costs for two cell phones on a separate plan for William Murphy and most of the costs for three cell phones on a separate plan for Lisa Murphy. Staff obtained a $8,771 quote from AT&T which consolidated the lines into one account and removed the extra cell phone for William Murphy and two extra cell phones for Lisa Murphy. Thus, Staff's adjustment reduces operating expenses by $11,060, or an approximate $13,000 reduction from SDIP's proposed adjustment in its supplemental filing.

Training Expense – The Company proposed an adjustment in its supplemental filing to increase training expense to an amount representing the average of training expense for the years 2014 through 2016 plus one-seventh of the cost of the integrity management training, which occurred in 2017 and only occurs once every seven years. Staff agrees with this adjustment and only makes a slight revision to include the actual cost of the most recent training for each of the annual trainings. This adjustment increases operating expenses by approximately $500.

Professional Services – Office Expense – SDIP proposed in its supplemental filing to increase test year Professional Services – Office Expense by first removing fees that are included under Professional Services – Rate Case Expense and then adding back approximately $20,000 in estimated ongoing legal fees. This settlement provides for a reduction to the test year to remove the fees that are included for recovery under the Professional Services – Rate Case Expense adjustment. Staff did not accept the increase of approximately $20,000 in estimated ongoing legal fees. SDIP was unable to provide Staff any known and measurable justification to warrant the addition of these ongoing legal fees. The result of this adjustment reduces Professional Services – Office Expense by approximately $3,000.

Operations Expense – In its supplemental filing SDIP proposed to combine the three expense categories of Operations Expense, Property Tax Expense, and Office Expense and make it one adjustment named Operations Expense.

For the Operations Expense portion, the company took a 3-year average of expenses from 2014-2016 to get a 2017 estimate, then took a 3-year average of 2015-2017 expenses to get a 2018 estimate, and lastly SDIP took the average of the 2017 and 2018 estimates to come up with its adjusted Operations Expense.

For the Property tax section, SDIP used actual 2017 Property taxes for its 2017 number, then SDIP took the average of 2016 and 2017 Property Taxes for its 2018 estimate, and lastly SDIP took the average of its 2017 and 2018 Property tax numbers to come up with its adjusted Property Tax Expense.

For the Office Expense portion, the company inflated the test year amount by 4% to get the 2017 estimate, then SDIP inflated the 2017 number by another 4% to get the 2018 estimate, and finally SDIP took the average of the 2017 and 2018 estimates to arrive at its adjusted Office expense.

All three of these adjustments to the expense categories resulted in SDIP proposing to increase test year total Operations Expense, Property Tax Expense, and Office Expense by approximately $22,000.

This settlement reflects a 5-year average of Operations Expense from the years 2012-2016, Actual 2017 Property Tax expense, and a 5-year average of Office Expense from the years 2012-2016. Staff chose a 5-year average as that time frame is wide enough to capture both the highs and lows of the expenses, giving a more representative look at what average expenses are year over year compared to a shorter time frame. Staff chose 2012-2016 to ensure actual historical data as 2017 data for most accounts was not available at the time settlement negotiations took place. The result of this adjustment increases Operations Expense by approximately $19,000, reduces Property Tax Expense by approximately $24,000, and reduces Office Expense by approximately $7,000. On a total net adjustment basis, the result of this adjustment reduces the total Operations Expense adjustment by approximately $12,000.

Integrity Management Expense – The Company proposed an adjustment in its supplemental filing to decrease integrity management expense to an amount representing one-sixth of the cost of its most recent integrity management plan cost (rounded down to $50,000). Staff's adjustment applies one-seventh of the most recent plan cost, as code requires the assessment is done on a seven-year rotation and SDIP has been performing this assessment every seven years. However, Staff's adjustment does include annual recovery for the $7,000 cost of the cathodic survey, which needs to be performed on an annual basis. This adjustment decreases operating expenses by approximately $2,000.

Public Awareness Expense – SDIP proposed in its supplemental filing to increase test year Public Awareness expenses by first inflating the test year by 10% to get their 2017 estimate, then again inflating 2017 by 10% to get their 2018 estimate, and finally taking the average of the 2017 and 2018 estimates to come up with their adjusted Public Awareness Expense. This settlement reflects the removal of approximately $3,000 in Public Awareness expenses that Staff determined do not provide for the provision of safe, adequate, and reliable service for SDIP's ratepayers. Reasons for each disallowance are found on Staff Exhibit EJP-1 Schedule 4. The result of this adjustment reduces Public Awareness Expense by approximately $3,000.

Employee Benefits Expense – The Company proposed an adjustment in its supplemental filing to increase benefits expense to correspond with the increase to payroll expense, as all employees but one contribute to a level to receive the four percent employer match to their 401k plan. Staff's adjustment allows for this increase and updates the other components of employee benefits expense, dental insurance and 401k plan costs, to actual 2017 costs. The net effect of this adjustment is an approximate $3,000 increase to operating expenses.

Property Tax – See Operations Expense above.

Insurance Expense – SDIP proposed in its supplemental filing to increase test year Insurance expense by first using the actual 2017 insurance expense, then inflating the 2017 Expense by 4% to get a 2018 estimate, and finally taking the average of the 2017 and 2018 numbers to come up with an adjusted insurance expense. This settlement uses the actual 2017 Insurance Expense for the adjusted amount. The result of this adjustment increases insurance Expense by approximately $14,000.

Pipeline Safety Tax – The Company proposed an adjustment in its supplemental filing to increase pipeline safety tax expense to the average of actual 2017 pipeline safety tax expense and projected 2018 pipeline safety tax expense, assuming four percent inflation. Staff's adjustment accepts the update to actual 2017 expense but does not accept any further inflationary increases. The result of this adjustment is an approximate $1,000 reduction to operating expenses.

Payroll Expense – The Company proposed an adjustment in its supplemental filing to increase payroll to the average of projected 2017 and 2018 expense assuming four percent pay raises and a need for approximately $14,000 in temporary summer help in 2018. Staff's adjustment made a series of modifications to this methodology:

1. Staff's adjustment provides recovery of salaries effective September 1, 2017 plus a three percent known and measurable increase effective September 1, 2018 pursuant to Element 7 of the Settlement Stipulation.
2. Staff's adjustment captures the 2018 Social Security wage base limit of $128,400 when computing increases to FICA.
3. Staff's adjustment does not provide an increase on the unemployment taxes component of payroll, as each employee is already above the wages limit for which state and federal unemployment tax is computed.
4. Staff's adjustment does not provide an allowance for temporary summer help in 2018, as SDIP did not need summer help in 2016 or 2017.
5. Staff's adjustment incorporates a five-year average for the bonuses component, as the test year included the Company's 2016 bonus payment and its 2015 bonus payment, paid in 2016.

These adjustments increase operating expenses by approximately $12,000.

Interest Synchronization – Staff proposed an adjustment to synchronize 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. This adjustment reduces operating expenses by approximately $1,000.

Directors Fees – In docket NG92-005, SDIP was allowed recovery of Directors Stipend and Directors Expense at $3,000 and $7,000, respectively. During the 25 years that have followed, the board has grown from three members to seven, and the total fees has increased to $504,000. SDIP attempts to justify these costs with the fact the executive board members need to personally guarantee bank loans and lines of credit and with a study which shows a median board cost for “small cap” utility companies of approximately $750,000.

Staff does not believe this study is relevant, as the companies compared in this study all have total assets in the billions and customer counts in the hundreds of thousands. However, Staff does acknowledge the uniqueness of SDIP and that there are not perfect comparables to use in this case.

For the purposes of settlement, Staff’s adjustment uses a comparison of South Dakota electric cooperatives, as they are located in the same state as SDIP, are similarly an energy utility, and have similar sized boards. Thus, for the stipend component of the adjustment, Staff uses the average total board stipend for the largest four electric cooperatives in the state. And for the directors expense piece, Staff’s adjustment inflates the $7,000 provided in NG92-005 for 25 years and prorates it to the new board membership of seven.

These adjustments decrease directors fees by over two-thirds, reducing operating expenses by approximately $339,000.

South Dakota Use Tax – Staff proposed an adjustment to remove use tax costs from the test year associated with late payments, penalty, and interest, as these payments are not representative of normal business operations. This adjustment reduces operating expenses by approximately $13,000.

Miscellaneous Bank Penalty/Interest – Staff proposed an adjustment to remove other miscellaneous penalty and interest payments, as these payments are not representative of normal business operations. This adjustment reduces operating expenses by approximately $13,000.

Office Expense – See Operations Expense above.

Donations Expense – Staff proposed an adjustment to remove all Donations Expense from the test year which do not provide for the provision of safe, adequate, and reliable service for SDIP’s ratepayers. The result of this adjustment reduces Donation Expense by approximately $8,000.

Unemployment Taxes Penalty – Staff proposed an adjustment to remove an unemployment taxes penalty, as this payment is not representative of normal business operations. This adjustment reduces operating expenses by approximately $200.

Vehicle Leases and Loans Expense – Staff proposed an adjustment to 1) remove the lease payment expense included in the test year associated with a pick-up truck SDIP purchased and is now included in rate base, as the lease payment is no longer an expense, 2) remove the loan payment associated with another pick-up that is included in rate base as the Company recovers a return on and a return of the pick-up included in rate base, and 3) adjust the lease payment expense for SDIP’s Bobcat to the known

proforma amount. The result of these adjustments reduces operating expenses by approximately $17,000.

Fixed Assets – Office & Operations Expense – SDIP's test year included "Fixed Assets – Office & Operations Expense", consisting of expenses related to office and operations items retained for more than a year. SDIP used these accounts to differentiate these items from supplies and items used every day and included in the operations expense and office expense accounts. Going forward, SDIP will not be using the expense accounts "Fixed Assets Operations" or "Fixed Assets Office". Instead, items exceeding the capitalization threshold of $2,500 will be capitalized and depreciated and items under the capitalization threshold will be reflected in the "office expense" or "operations expense" accounts.

To reflect the revised accounting procedures going forward, Staff proposed an adjustment based on the 2017 actual expenses and excluded capitalized items. This should be representative of costs going forward for similar expenses. This adjustment decreases operating expenses by approximately $7,000.

Cost of Capital and Rate of Return

Capital Structure – In its supplemental filing, SDIP proposed a capital structure consisting of 17.88% debt and 82.12% equity. The Company derived the debt component based on the estimated debt associated with its proposed truck additions and assigned the remaining rate base balance as equity.

The settlement applies a similar approach to the derivation of the debt and equity components. However, the level of debt compared to the remaining rate base increases substantially once all pro forma outstanding debt as of August 31, 2018 is accounted for. This results in a capital structure of 50.30 percent debt and 49.70 percent equity.

Cost of Debt – In its supplemental filing, SDIP assumed a 3.9 percent cost of debt as that was the rate most recently obtained for a new truck loan. The settlement applies a cost of debt of 4.47 percent based on the annual cost of proforma debt compared to the principal outstanding as of August 31, 2018.

Cost of Equity – SDIP proposed a cost of equity of 10.0 percent. The settlement accepts this cost of equity as reasonable for this company in consideration of its size and risks. Staff agrees with SDIP that given the very small impact the cost of equity has on the revenue requirement in this case, it does not make sense for Staff to hire a cost of equity witness or litigate this issue. Furthermore, a 10.0 percent cost of equity is in line with the benchmark the Commission used in the past for small telephone companies in switched access rate cases. It was used a proxy given the widely varying capital structures and year-to-year material changes that made individual determinations problematic, and the cost of any attempt to perfect this substitute cost of equity exceeded the short-term value of doing so.

Overall Rate of Return – The Company's proposed overall rate of return in its supplemental filing was 8.91 percent. Based on a capital structure of 50.30 percent debt and 49.70 percent equity, a cost of debt of 4.47 percent, and a cost of equity of 10.0 percent, the settlement overall rate of return is 7.22 percent.

Professional Services – Rate Case Expense

SDIP proposed in its supplemental filing to include an adjustment for estimated Rate Case Expense to be amortized and collected over a two-year period. SDIP proposed this expense be recovered through a tariff rider-type mechanism where a separate rate is developed for Rate Case Expense and then after two years that Rate Case Expense rate is then removed from the tariff. This settlement: 1) reflects the inclusion of actual Rate Case expense through June 15, 2018 and an additional estimate for expenses related to finalizing the rate case; 2) an amortization period of five years for Rate Case Expense; 3) the rate case rate base ROR recovery. Recovery of rate case expense will cease upon the conclusion of the five-year amortization period.

While Staff acknowledges the amount of Rate Case expense in this case is extraordinarily high even before consideration of the relatively small amount of input data and the presence of only one current customer and one future customer and two tariff rates, Staff also understands SDIP does not have the same internal resources, i.e. attorneys and accountants, as the other utility companies in South Dakota and therefore must retain outside help for many aspects of the rate case filing.

Staff believes rate case expense was higher than expected in this case for a number of reasons. SDIP has almost no experience filing a rate case in South Dakota prior to this filing which in turn caused SDIP to file a complete redo of its filing part-way through the process in November. SDIP also revised its entire accounting system in this filing to better align with the FERC System of Accounts. This revision caused slower processing time as SDIP was familiarizing itself with its system. This complete revision should not need to take place in a future filing which should reduce future rate case expense lower. Staff also asked and received responses to 14 rounds of data requests which included 235 questions, some of which had multiple parts. Delays in the 10-day response time ordered by the Commission for the data request process and incomplete answers which required additional follow-up questions and phone calls, additionally required more time by both SDIP and Staff than was expected. In a future filing it is reasonable to expect delays to be minimal and answers to be more thorough given SDIP's familiarity with the process for a rate case docket. Rate case expense for this docket is $502,028.

The result of this adjustment increases Professional Services – Rate Case Expense by approximately $100,406 in expense and $18,123 in rate case rate base ROR recovery for a total increase in the revenue requirement of $118,529 per year over the five-year amortization period.

Levelized Revenue Requirement

Given the large amount of rate case expense relative to the size of the Company's revenue requirement, one of Staff's top priorities was to create a mechanism to keep the Company's revenue requirement consistent with inflationary cost increases and lessen the possibility of successive rate case filings. The Settlement incorporates a levelized operating income found in Staff Exhibit___(PJS-1), Schedule 4. This method increases most of SDIP's operating expenses by two and a half percent per year over a three-year period and calculates a discounted average. This discounted average is then used in the calculation of the revenue requirement versus the *pro forma* operating income calculated in Staff Exhibit___(PJS-1), Schedule 3.

The use of this levelized revenue requirement comes with a three-year moratorium, as agreed in the Settlement Stipulation. This means the earliest effective date for the next rate increase would be September 1, 2021. This levelized operating income calculation increases the revenue requirement by approximately $40,000.

Management Fee

SDIP proposed to include a management fee since the Company's major investment, its pipeline, will be fully depreciated by the time new rates go into effect, leaving a very minimal rate base on which to earn a return. In its supplemental filing, the Company calculated this management fee based on the FERC Tarpon case where FERC authorized a management fee "in light of the fact that Tarpon's investment in its transmission plant [was] fully depreciated." Such a fee compensates a company's "owners for the risks of continuing to operate the pipeline and to provide incentive for efficient operations."[1] SDIP's proposed management fee based on the FERC method was approximately $102,000.

The settlement uses the FERC method as the basis for the management fee. However, based on Staff's research, the FERC method appears to be used for much larger pipelines (in size, length, and investment level) than SDIP and in most cases these pipelines are subsidiaries of other pipelines and thus have other significant assets than just one pipeline. Given SDIP's size and commensurate risks, the FERC method of applying a ten percent factor does not result in an appropriate level of management fee. In addition, the FERC method uses the Company's current cost of capital in the calculations. SDIP's cost of capital can be quite volatile based on even small investments. Therefore, Staff believes it is not an appropriate input to the management fee formula in this case.

The settlement management fee is derived by taking the average historical rate base associated with the pipeline investment and multiplying it by a compensation percentage of 10 percent in lieu of the Company's cost of capital, and applying a 20 percent compensation factor in lieu of the FERC 10 percent factor to account for the Company's small size. Finally, Staff includes the incremental gross receipts tax associated with the management fee. Staff believes this method results in a just and reasonable management fee commensurate with SDIP's risks. The management fee included in the settlement revenue requirement is approximately $138,000.

Revenue Excess

As shown on Exhibit___(PJS-1), Schedule 1, Staff's determination of the adjusted average rate base is $318,639. Multiplying the adjusted average rate base by the settlement rate of return of 7.22%, results in a required operating income of $23,006. When compared to the operating income with present rates, the income excess is $422,989, and after applying the gross revenue conversation actor to subtract additional income taxes made necessary by the decrease, the revenue excess is $535,429. Adding the gross receipts tax amount of $(573) to the revenue excess results in a total base rate revenue excess of $536,002, or a revenue requirement of $1,657,842, prior to considering the management fee and rate case expense.

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[1] See 57 FERC ¶ 61,371 page 33, attached to SDIP witness Dr. Marc Hellman's testimony as Exhibit (MH-D-1).

Adding the management fee results in a total revenue excess of $397,883, or a revenue requirement of $1,795,961, which is a decrease of approximately 18% compared to current revenues. The annual rate case expense recovery included for the first five years, September 1, 2018 through August 31, 2023, results in a total revenue excess of $279,354, or a revenue requirement of $1,914,490, which is a decrease of approximately 13% compared to current revenues.

RATE DESIGN ISSUES

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

Firm Service

MDU is the sole firm customer of SDIP. MDU will be billed a flat monthly fee allowing SDIP to recover the revenue requirement determined in this case. Effective September 1, 2018, the flat monthly fee for firm service is $159,540.83 per month. If SDIP has not filed an application for a rate increase to be effective prior to August 31, 2023, MDU will be billed a flat monthly fee for firm service of $149,663.42 per month.

The flat monthly fee guarantees SDIP will recover the revenue requirement determined in this case and reduces a significant amount of risk for the Company. While this rate design is unusual, Staff agrees it is appropriate in this specific case given the number of fixed costs and the limited ability of the Company to cut costs to control for other cost increases.

To provide some context compared to the current per dekatherm rate charged to MDU, the test year revenues were $2,193,844. Dividing this by twelve results in a $182,820 average monthly charge. While MDU's bill varied month to month over the last 25 years, it is evident that on average, MDU's monthly bill has been greatly reduced as a result of this settlement.

Interruptible Service

Ring-neck plans to be operational in November 2018. Therefore, Staff believes it is an utmost necessity to determine in this case how this new customer would be treated. Without resolving this issue in this rate case, it is unlikely all the necessary steps would be able to be taken to serve Ring-neck by its anticipated operational date. The settlement further helps to ensure operational deadlines can be met as even waiting for a hearing to conclude puts Ring-neck's timeline in jeopardy.

The Parties agree Ring-neck will be served pursuant to the interruptible tariff attached to this stipulation. The interruptible rate in effect from September 1, 2018, through August 31, 2023, will be $0.3365 per dk. If SDIP has not filed an application for a rate increase to be effective prior to August 31, 2023, the interruptible rate in effect beginning September 1, 2023, will be $0.3157 per dk.

The Parties agree to a revenue sharing mechanism associated with the interruptible service. Under traditional rate making, Staff first determines the revenue requirement and then allocates the revenue requirement among customer classes. Given Ring-neck is not yet operational and therefore no historical

data exists regarding Ring-neck volumes and additional costs associated with serving Ring-neck, traditional class cost allocation is difficult. While Staff does advocate revisiting the rate design process in the Company's next rate case once historical information is available, Staff believes the revenue sharing mechanism agreed to in this settlement provides a balance between appropriately allocating costs while recognizing that certain costs and volumes are unknown at this time.

The revenues associated with Ring-neck's interruptible usage will be shared between SDIP and MDU, with the credits due to MDU reducing MDU's bill for firm transportation service. The agreed upon sharing mechanism is as follows:

- 1st 2,000 dk/day: 10% retained by SDIP and 90% credited to MDU.
- Next 2,000 dk/day: 5% retained by SDIP and 95% credited to MDU.
- Over 4,000 dk/day credited 100% to MDU.

The revenue sharing mechanism ensures MDU's customers are compensated for costs which are included in MDU's bill, but which should be partially paid for by Ring-neck. This arrangement also guarantees SDIP does not receive a significant windfall above its actual cost of service by serving an additional customer. Ultimately, Staff believes the sharing mechanism results in just and reasonable rates for both customers, and the Company.

One significant cost SDIP claims it will incur by serving Ring-neck is added insurance costs. This is reasonable given the increase in volumes that will flow through SDIP's pipeline. However, the cost increase is not a known and measurable change. Therefore, the Parties agree to a revenue guarantee that will be imposed should the annual revenue received by SDIP under the interruptible revenue sharing mechanism be insufficient to cover the increased insurance costs. SDIP will submit a compliance filing by October 1st each year detailing the actual increase in annual general and excess insurance costs. Ring-neck's bill will be subject to true-up if the interruptible revenue sharing mechanism does not allow SDIP to recover these costs. Staff or Ring-neck can request a docket be opened should there be issues that arise with the claimed increased insurance costs.

In addition to the revenue received from sharing mechanism associated with the interruptible rate, Ring-neck will be charged $2,000 per month by SDIP for ancillary services. Such services will be agreed upon by SDIP and Ring-neck pursuant to a service agreement. While Staff is not convinced that all of these services will result in costs above those included in the revenue requirement, Staff does believe there are unknown cost increases, in addition to the insurance discussed above, that will arise as a result of serving Ring-neck. This charge should appropriately cover any such costs that arise and allows SDIP a small additional management fee for serving Ring-neck which Staff was agreeable to for settlement purposes given the unknown costs.

SDIP's tariff also addresses the connection fee Ring-neck will pay regarding all upfront construction costs incurred to extend service.

Refer to Exhibit BAM-6 for an illustration of the settlement rate design under varying interruptible usage levels.

OTHER ISSUES

Decommissioning

Although SDIP initially requested a sizeable adjustment to depreciation expense for the retirement obligation of removing its pipeline, in its supplemental filing, SDIP instead proposed the Commission open a docket and direct the Parties to investigate and develop a decommissioning fund. Staff believes the Company has not provided sufficient justification for the necessity and requirement of full removal of the pipeline upon retirement nor the costs associated with doing so. Therefore, Staff does not recommend such a docket be opened at this time. Furthermore, such an issue is likely to require expert testimony and is a topic that should be addressed in a general rate case. The settlement does not include any decommissioning expenses in the cost of service nor does it include an agreement to open another proceeding on this matter. SDIP has agreed that if it desires to recover costs associated with the potential future decommissioning, dismantling, and removal of the pipeline, this issue will be addressed as part of a future rate case filing.

RECOMMENDATION

For the reasons stated above, Staff recommends the Commission grant the Joint Motion for Approval of Settlement Stipulation and adopt the Stipulation without modification.