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 Transportation Rate	**Docket No. NG17-009**

SUPPLEMENTAL DIRECT TESTIMONY AND EXHIBITS OF WILLIAM MURPHY

ON BEHALF OF SOUTH DAKOTA INTRASTATE PIPELINE COMPANY

November 20, 2017

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DIRECT TESTIMONY OF WILLIAM MURPHY

I. INTRODUCTION AND SUMMARY

Q. Please state your name and business address.

A. My name is William Murphy. My business address is South Dakota Intrastate Pipeline Company, 1415 Airport Road, Pierre, SD, 57501.

Q. What is your occupation and by whom are you employed?

A. I am the President and CEO of South Dakota Intrastate Pipeline Company ("SDIPC").

Q. Did you offer direct testimony in this proceeding?

A. Yes, I did.

Q. On whose behalf are you testifying?

A. SDIPC.

Q. What is the purpose of your Supplemental Direct Testimony?

A. The purpose of my testimony is to provide an update to SDIPC's request for a rate increase and provide additional background and support for SDIPC's board fees.

II. UPDATED RATE INCREASE

Q. You previously testified that SDIPC incurred a loss for the 2016 test year. Please verify that is still the case based on SDIPC's updated financial information.

A. Yes, as explained in greater detail in the testimony of Lisa Murphy, as her supplemental testimony, SDIPC suffered a loss of $662,673, in the test year. This is a significant and substantial loss. Absent a change in rates, it is doubtful that SDIPC could sustain these losses and remain a viable business.

Q. Why have the figures changed?

A. Since its initial filing in this matter, and because of the present opportunity to file supplemental direct testimony, SDIPC has undertaken a significant review of its books and records to both respond to Staff's request to have updated financial results as well as provide a well-founded record by which the Commission can issue a decision. Our review included a thorough review of company transactions to ensure accuracy and appropriate classification of various costs. Unfortunately, as explained in greater detail in the testimony of Lisa Murphy, SDIPC's review revealed the necessity to make substantial changes. This work, which has required retention of a new accountant and consultants, has been very time intensive. Balancing this work with responding to Commission Staff's inquiries during discovery, has been difficult and our responses have, despite SDIPC's best efforts, required more time than anticipated. This has been due, in large part, to the fact that SDIPC has been operating under a long-term contract for 25 years and this is our first opportunity to fully participate in a regulatory review of our operations and adequacy of rates. In any event, SDIPC greatly appreciates all parties' patience in this proceeding and looks forward to additional discussions on a just and reasonable SDIPC revenue requirement.

Q. Would you please summarize your recommendations in this case?

A. I have three principle recommendations that summarize our amended request: First, I recommend the Commission approve a test-year revenue requirement of $2,444,080. Second, I recommend that the Commission adopt a rate design consisting of a monthly customer charge of $203,673.33, which represents the test-year revenue requirement divided by twelve. Finally, I recommend the Commission direct interested parties to meet and collaboratively develop a recommended decommissioning mechanism that will commence collection of monies to be solely used to pay for decommissioning costs and be managed to earn the highest interest possible while minimizing risk to principal.

The revenue requirement of $2,444,080 includes our projected increase in O&M expenses as well as a just and reasonable management fee. Our major investment in the pipeline will be fully depreciated at the end of the 25-year contract, as directed by the Commission. The management fee is designed and calculated consistent with past FERC decisions for utilities with no meaningful rate base.

Q. How does the revenue requirement in the supplemental testimony compare to the original SDIPC filing?

A. SDIPC's initial filing had a revenue requirement request of $3,968,876. This supplemental filing represents a reduction in requested revenues of approximately $1.5 million, which is a substantial reduction.

Q. What are the main reasons for the sizable decrease?

A. There are two main reasons. First, the pipeline depreciation expense of roughly $800,000 was removed. Second, we removed the specific rate request related to decommissioning of roughly $500,000. We are proposing parties collaboratively work together to develop a specific decommissioning rate mechanism to bring forward to the Commission for its consideration.

Q. By what percentage would SDIPC revenues increase under this supplement testimony?

A. Roughly 10.24 percent, which is very reasonable given how long SDIPC has operated without a rate increase. Furthermore, two key facts inform our current environment which must be taken into account in this proceeding. First, we are ending a 25-year contract. Costs for just about everything in conducting business has gone up including compliance with governmental regulations. Second, MDU's use of our pipeline has declined considerably from the minimum take-or-pay obligations that were in force in the early portion of our contract. When you take an essentially fixed cost system, and charge for that system with a through-put charge, if volumes decrease substantially, revenues will not be commensurate with costs. That is the situation we find us in. That is a key driver for why we are recommending a customer charge instead of a through-put charge. We have one customer and we have substantially fixed costs.

In a throughput world, it is understandable for MDU to advise us that they expect to significantly increase use of our pipeline. In a paradigm where you charge for the use of the pipeline, that would result in a "relatively" low throughput charge. If by happenstance, the volumes do not materialize, the revenues paid by MDU are much less than our Commission-approved revenue requirement. The regulatory game in a through-put paradigm is for SDIPC to under-forecast expected volumes and MDU to over-forecast volumes. The monthly customer charges disposes of the forecasting issue and allows SDIPC to collect the revenues deemed just and reasonable by the Commission.

Other mechanisms to achieve the same end could be a peak use charge—capacity charge, but it is still a method to achieve the same result. To allow SDIPC an opportunity to recover its costs.

Q. Does SDIPC anticipate any new customers coming on-line before the end of 2018?

A. No. But SDIPC has had discussions with an ethanol facility and has agreed, subject to Commission approval, to provide that facility with transportation service. The timing and volume of transportation service of that potential customer is not known with sufficient certainty to warrant an adjustment to SDIPC's present filing. It is simply too soon to tell if and when that facility will be up and running.

Q. If the timing and volume do become known with certainty, what does SDIPC propose?

A. SDIPC would initiate a subsequent rates filing prior to commencing service. Our subsequent filing will include a revised rate design such that rates charged to MDU and any new customers allocate our cost of service equitably among the customers. The Commission and interested parties will have an opportunity to participate in any filing and make their analysis and recommendations known to the Commission to be fully considered by the Commission in formulating its order.

III. BOARD FEES

Q. How many members currently serve on SDIPC Board of Directors?

A. There are presently seven board members.

Q. Has this number changed since 1992?

A. Yes. From 1992 to 2011, there were three members. Since 2012, there have been seven members.

Q. What are the qualifications to be on the board of directors?

A. To be on the board of directors of SDIPC (the "Board"), you must also be a shareholder.

Q. Does that imply that Board members lack experience in SDIPC's business?

A. Absolutely not. The current make-up of the Board, with representative ownership interest in SDIPC, is as follows:

William Murphy	26%
Karen Murphy	26%
Dan Murphy	11%
Leslie Murphy	11%
James Murphy	11%
Lisa Murphy	11%
Walter Woods	4%

By way of background, I am the father of James Murphy and Lisa Murphy. Karen Murphy is the mother of Dan Murphy and Leslie Murphy. Each of these individuals, including myself, have extensive experience in the business of constructing and operating pipelines.

In 1971, I founded Murphy Bros. Inc. ("MBI"), an oil and gas pipeline construction business with my brother, Michael Murphy. We grew that company from very humble beginnings to an international pipeline construction and operation business with over $500 million in annual revenues. During that time, Michael's wife, Karen Murphy, served as MBI's controller. Also during that time, Leslie Murphy served as an accountant for MBI and James Murphy served as head of construction. Lisa Murphy and Dan Murphy also held various roles working for MBI. For over 23 years, Lisa Murphy has been Chief Financial Officer for SDIPC. During her tenure in this role, she has been responsible for financial planning, record keeping, bookkeeping, payroll, insurance, complying with state and federal reporting periods and reporting all financial matters to the Board. In 2004, Dan Murphy co-founded Precision Pipeline in Eau Claire, Wisconsin, and quickly grew it to one of the premiere pipeline construction companies in the U.S. Precision Pipeline was then sold to Mastec, Inc. in 2009.

Walter Woods began his career in 1963 with ANR Pipeline Company ("ANRPC"), starting as a systems analyst in the planning department. Over his career at ANRPC, Walter Woods held various positions, retiring in 1989 as Director, Plant Management in a newly formed Power Production Group. In February of 1992, Walter Woods became an officer of SDIPC and was put in charge of SDIPC's pipeline project. In short, the Board is not made up of family members with little knowledge of the pipeline business. To the contrary, the Board is comprised of folks who have spent their careers in the pipeline business.

Q. What is the current compensation for each Board member?

A. The 2016 test year compensation for each Board member is set forth in the table below.

	Board Compensation	
William Murphy	131,040	
Karen Murphy	131,040	
Dan Murphy	55,440	
Leslie Barnet	55,440	
James Murphy	55,440	
Lisa Murphy	55,440	
Walter Woods	20,160	
Total	504,000	

Q. Do you believe this compensation reflects the expertise of the Board members, as set forth above?

A. Based on my long tenure of service in multiple companies in the pipeline construction and operation business, including MBI, I do.

Q. Please provide an overview of the annual commitment required by each Board member.

A. Each year, the full Board has quarterly meetings. But I meet with Karen on a more regular basis to discuss various aspects of SDIPC's operations. Also, and as a benefit of being a family-owned business, Board members have the opportunity to more frequently communicate at various times during the year.

Q. Please explain why compensation for you and Karen Murphy is higher than for other Board members.

A. As the Executive Board members, Karen and I are responsible for personally guaranteeing any bank loan or line of credit. The current list of loans and line of credits we have personally guaranteed is set forth in Exhibit (WM-SD-1) attached to this testimony.

Q. Were there any other financial commitments provided by you or other Board members at the outset of SDIPC's operations?

A. Yes. Murphy family members contributed approximately $3,459,000 for purposes of constructing the pipeline. This amount, or roughly $1,729,500, was split equally between my family and my brother's family. This amount, along with a loan for $11,200,000 from Mutual of Omaha Bank, was used to construct the pipe and fund initial operations. One of the requirements of that loan was to require that an additional roughly $745,000 (which constituted the annual repayment obligation) be held in reserve until SDIPC was able to post four consecutive quarters of net profit. SDIPC was able to do so, and ultimately paid off the loan. But the $3,459,000 contribution was never included in the calculation of our initial rate.

Q. How have obligations for Board members changed since SDIPC started providing service?

A. When SDIPC began service and for the first 20 years of service, the duties and concerns of the Board were not focused as much on financial performance and revenues because the contract with MDU included guaranteed minimum revenues given the minimum purchase obligations pursuant to the Transportation Agreement between SDIPC and its sole customer, MDU. When the minimum purchase requirements were no longer in force, the financial pressures on SDIPC increased significantly as the throughput volumes were much less than the minimum take and hence, revenues decreased significantly. In addition, the trend in regulatory requirements is one of increased security and safety responsibilities on both the federal and state level. Therefore, the current Board has oversight of SDIPC that faces substantially greater business risk and regulatory requirements than the Board scope of years past. And the low throughput volume has detrimentally impacted SDIPC's ability to meet expenses and recent history shows the revenues were fall short of expenditures.

Q. Has compensation for Board service changed since SDIPC started providing service?

A. Yes, compensation has increased commensurate with risk borne personally by the Executive members, as well as the efforts the Board has undertaken in its oversight of SDIPC, including substantially greater business risk and regulatory requirements.

Q. What evidence do you have that current Board fees are indeed commensurate with risk?

A. It is very difficult to find information or studies that have been done on SDIPC's size and industry. Nonetheless, I believe a helpful study is one prepared by Steven Hall & Partners, which is attached to this testimony as Exhibit (WM-SD-2). That study, which examined non-employee director compensation for a variety of company sizes and industry sectors, including utilities, determined utility board compensation increased over the 2009 - 2014 period by 26% (more than any other sector analyzed in the study), and that for the year 2014, average board compensation per director was $250,000. The study further found that, for small cap utility companies, total median board cost was $755,351 for the year 2014, which is significantly higher than SDIP's 2016 total board expense. And while these small cap utility companies may have higher revenues and serve broader footprints, I believe that, given their larger size, it is fair to assume their executive board members are not personally guaranteeing obligations of their respective companies.

Q. Do you have any other comments regarding risk borne by SDIPC shareholders?

A. Yes. As noted in the Commission's Order Approving Revenue Requirement dated March 25, 1993, in Docket NG92-005, SDIPC requested, but was not allowed to recover, approximately $450,600 in interest expense on short term debt. The Commission found "Ratepayers do not participate in the profits of SDIPC, and therefore they should not bear the burden of short term losses. Such risks should be shouldered by SDIPC's stockholders." Furthermore, as noted in the direct testimony of Gordon Woods, SDIPC has incurred, and not recovered, over $1 million since 2002 to prepare and implement the SDIPC Integrity Management Plan. Exhibit (GW-1). Finally, as discussed above, the

Murphy family personally invested $3,459,000 at the outset of SDIPC's operations to get the pipeline constructed, operational, and managed effectively. SDIPC's Board members take seriously their obligation to manage and run the pipeline in a cost-effective, safe, and reliable manner. Given SDIPC's size, industry experience of SDIPC's Board members, unique risks taken on by the Board members, and efforts to manage SDIPC's assets, the Board needs fair and just compensation.

Q. Based on all of these factors, do you believe the Board compensation is fair and just?

A. I do. The compensation reflects what I believe is just and reasonable to ensure our pipeline operates in a safe, efficient, and reliable manner for the benefit of our customer, MDU.

Q. Does this conclude your direct testimony?

A. Yes.