

27 P.U.R.4th 583

Re Montana-Dakota Utilities Company

(F-3241)

South Dakota Public Utilities Commission

December 28, 1978

APPLICATION by a gas company for authority to increase its rates and charges; granted with modifications.

P.U.R. Headnote and Classification

***584 EXPENSES**

s26 - Advertising expenditures - Gas company.

SD.P.U.C. 1978

Advertising expenditures of a gas company which were designed to enhance its image were disallowed as an operating expense for rate-making purposes. [5]

Re Montana-Dakota Utilities Co.

P.U.R. Headnote and Classification

EXPENSES

s46 - Contributions - Gas company.

SD.P.U.C. 1978

Various contributions and donations made by a gas company during its test year were disallowed as an operating expense where the activities of the organizations engaged in lobbying activities on behalf of the utility and other utilities may not have coincided with or reflected the interests of the utility's customers. [6]

Re Montana-Dakota Utilities Co.

P.U.R. Headnote and Classification

***583 EXPENSES**

s114 - Income tax expenses - Gas company.

SD.P.U.C. 1978

A gas company's federal income tax rate was calculated at the rate of 46 per cent since the tax rate reduction from 48 per cent to 46 per cent would become effective prior to the implementation of any new rates in the gas company's rate proceeding, and the reduction was a known and measurable change. [4]

Re Montana-Dakota Utilities Co.

P.U.R. Headnote and Classification

RETURN

s26.4 - Gas company.

SD.P.U.C. 1978

A 12.31 per cent rate of return on common stock equity was found to be fair and reasonable for a gas company. [9]

Re Montana-Dakota Utilities Co.

P.U.R. Headnote and Classification

RETURN

s35 - Inflation adjustment - Gas company.

SD.P.U.C. 1978

A gas company's proposed inflation adjustment which was derived by multiplying the operating and maintenance expenses of the utility by one-half of the cost of living index was rejected where the commission concluded that the utility had merely employed an arbitrary method and had proposed a totally speculative rate which would in effect allow an unsupported inflationary adjustment. [7]

Re Montana-Dakota Utilities Co.

P.U.R. Headnote and Classification

RETURN

s92 - Gas company.

SD.P.U.C. 1978

An overall rate of return of 9.55 per cent was found to be fair and reasonable for a gas company. [8]

Re Montana-Dakota Utilities Co.

P.U.R. Headnote and Classification

VALUATION

s25 - Date of valuation - Average rate base.

SD.P.U.C. 1978

An average rate base was adopted in determining the revenue requirements of a gas company where the commission concluded that the use of an average rate base fulfilled the principle of matching revenues received and expenses incurred during the test year. [1]

Re Montana-Dakota Utilities Co.

P.U.R. Headnote and Classification

VALUATION

s224 - Rate base determination - Construction work in progress.

SD.P.U.C. 1978

A gas company's claim for inclusion of its construction work in progress in its rate base was rejected where the commission concluded that the construction work should be excluded from the rate base since it was not used and useful to ratepayers and that the inclusion of construction work in progress would result in a mismatch of costs and benefits between present and future customers. [2]

Re Montana-Dakota Utilities Co.

P.U.R. Headnote and Classification

VALUATION

s293 - Rate base determination - Working capital allowance.

SD.P.U.C. 1978

A gas company was granted a working capital allowance to be included in its rate base upon a lead-lag study. [3]

Re Montana-Dakota Utilities Co.

Before P. K. Ecker, chairman, Norma Klinkel, vice chairman, and Charlotte Fischer (dissenting), commissioner.

By the COMMISSION:

On the fourteenth day of April, 1978, Montana-Dakota Utilities Company filed with this commission an application to increase its rates for retail gas service to customers in South Dakota. Montana-Dakota Utilities Company requests that the commission allow an increase of \$2,910,707 in additional annual revenues.

By orders entered on the tenth day of May, 1978, and the first day of August, 1978, the commission suspended Montana-Dakota Utilities Company's rate schedules and related tariff sheets which were proposed to become effective on the fifteenth day of May, 1978. ACORN, upon request, was granted intervention.

On the eleventh day of August, 1978, this commission entered its order for and notice of procedural schedule for disposition of Montana-Dakota Utilities Company's application. Hearings were conducted in Pierre, South Dakota, commencing on the twenty-seventh day of November, 1978, and concluding on the first day of December, 1978. Further, the commission conducted a consumer input hearing in Rapid City, South Dakota, on the fourth day of December, 1978, regarding Montana-Dakota Utilities Company's, hereinafter MDU, rate increase application.

The commission has carefully reviewed the entire record in this proceeding, including late-filed exhibits, and renders its decision regarding the application of Montana-Dakota Utilities Company for an increase in rates for gas service as follows:

Findings of Fact

I.

Average Versus Year-end Rate Base

***585 (A) Staff Position:**

[1] Staff recommends that, on the basis of staff witness Dupic's testimony, the average rate base approach be utilized in setting rates for Montana-Dakota Utilities Company since use of average rate base achieves the proper matching of operating income for the test period with the investment that produced that income. Staff opposes MDU's use of year-end rate base in that there is an inherent uncertainty in the matching adjustments proposed by MDU. Staff contends that the proper application of the matching principle would require adjustments of both expenses and revenues if a year-end rate base were used.

Staff recommends that average rate base be utilized because it is unlikely to burden either Montana-Dakota Utilities Company or consumers of Montana-Dakota Utilities Company in the long run and, additionally, use of average rate base is simpler to administer than year-end rate base since matching adjustments commensurate with use of the year-end rate base are often difficult, if not impossible, to properly make.

(B) MDU's Position

Montana-Dakota Utilities Company contends that since rates are made for the future, the investment at the date nearest the time when the rates are to be implemented is the investment which ought to be used in determining those rates. Montana-Dakota Utilities Company contends that if year-end rate base is not used, MDU will not receive its full revenue requirement and is not fully reimbursed for its costs over the life of the investment. Finally, company contends that use of an average rate base defeats the legitimate financial needs of MDU where a delay occurs regarding a final determination and implementation of new rates.

Commission Findings

The commission finds that staff's recommendation regarding use of average rate base is proper and will be adopted by the commission for the reasons contained in (A) above set forth. The commission finds that the use of an average rate base fulfills the principle of matching revenues received and the expenses incurred during the test year with the investment. The commission finds that use of the year-end rate base requires extensive adjustments which are speculative at best and, therefore, year-end rate base should not be utilized. Hence, MDU's year-end level adjustments are, accordingly, rejected.

The commission finds that utilization of the average rate base does not deprive MDU of receiving its full revenue requirement whatsoever because current and prospective conditions can be reflected by making adjustments for changes which are known and measurable as the commission has done in its decision and order herein. Finally, the commission notes that average rate base

has been adopted by this commission in all previous cases that have come before this commission and the MDU has presented no basis or justification for having the commission change its policy in regard thereto.

II.

Construction Work in Progress

(A) Staff Position:

[2] Staff recommends that no plant *586 that is not yet in service be included in rate base. Staff contends that present customers would be paying for plant they may never use or those customers may leave MDU's system and not receive the benefits of that plant if construction work in progress is included in rate base. Staff recommends that the more equitable method for compensating MDU's investors is for MDU to book AFUDC on CWIP. Staff feels that in this manner, MDU is fully compensated and the customers of MDU are fairly treated.

Staff further contends that when the time value of money is considered, consumers will be better off in both the short and long term if MDU utilizes the booking of AFUDC on construction work in progress as demonstrated by staff witness Dupic. Additionally, staff points out that the likelihood of MDU's customers receiving any benefit of a decrease in MDU's plant is exceedingly remote and, thus, this constitutes another reason construction work in progress should not be included in rate base.

Finally, staff points out that construction work in progress should be excluded from rate base because the facilities are not used and useful to the ratepayers. Further, inclusion of construction work in progress in rate base results in a mismatch of costs and benefits to consumers by imposing on present consumers costs which are more properly assessed consumers of the future who will actually benefit from the use of that plant. Staff also contends that inclusion of CWIP in rate base compounds the already existent inequities in light of ongoing curtailment and the consequent inability of customers to possibly utilize those facilities.

(B) MDU's Position:

Montana-Dakota Utilities Company contends that there is a need for partial inclusion in rate base of construction work in progress. Montana-Dakota Utilities Company contends that a major portion of construction work in progress at this time will be utilized to serve today's customers. Montana-Dakota Utilities Company states that construction work in progress should be included in rate base to meet the increasing usage of today's customers and to replace plant about to reach its full service life and be retired. Montana-Dakota Utilities Company claims that it is simply requesting inclusion of construction work in progress in order to have current customers pay the current carrying charges on plant under construction to be utilized for those customers' gas requirements.

Montana-Dakota Utilities Company contends that while the portion of earnings derived from AFUDC are included in the calculation of coverage ratios and earnings per share, those earnings are not available for paying MDU's bills. Montana-Dakota Utilities Company maintains that it will be required to borrow additional money in order to pay interest charges if construction work in progress is not included in its rate base. Montana-Dakota Utilities Company further contends that present construction work in progress benefits present customers to the extent of 50 per cent of such construction and that amount of construction work in progress should be properly included in MDU's rate base.

Commission Findings

The commission finds that staff's recommendation should be adopted for *587 the reasons contained in (A) above set forth. The commission finds that the rate increase allowed herein will provide MDU ample interest coverage to meet its financing requirements. The commission finds that construction work in progress should be excluded from rate base since it is not used and useful to ratepayers. The commission finds that inclusion of construction work in progress would result in a mismatch of costs and benefits between present and future customers. In particular, the commission is concerned about customers of MDU who, due to old age or other circumstance, would be charged for construction work in progress but would be unable to take advantage of purported future reduction in rates due to its inclusion in rate base at this time. The commission finds that

a portion of MDU's claimed CWIP, in light of ongoing curtailment, may not even be useful to customers which adds to the already existent inequities if CWIP were included.

The commission finds that MDU has not demonstrated that it is entitled to inclusion of construction work in progress in rate base because of its financial circumstances and that MDU has not presented any basis or justification for why this commission should change its previous policies regarding construction work in progress. The commission further finds that inclusion of construction work in progress in rate base is a more costly alternative to consumers than is the capitalization of AFUDC on construction work in progress.

Finally, the commission finds that MDU is fully and totally compensated for construction work in progress by taking AFUDC thereon. The commission finds that MDU's other arguments are without merit and that this commission's previous policies should not be changed regarding treatment of construction work in progress.

III.

Working Capital Allowance

(A) Staff Position:

[3] Staff recommends that MDU's rate base requirement for cash working capital be measured by an analysis of the flow of cash to and from MDU as related to the gas service rendered by MDU. Staff witness Peterson presented such a lead-lag study of MDU's working capital requirements. Staff contends that its lead-lag study is the only credible evidence in the record regarding the determination of an appropriate working capital allowance to be allowed to MDU and that staff witness Peterson's study should be utilized.

Finally, staff contends that MDU, without any supportive evidence, merely assumes that MDU obtains from its customers working funds which match exactly its total working capital requirements thereby justifying a zero working capital allowance. Staff contends that this is without any basis in fact and that staff's lead-lag study properly determines company's working capital in this proceeding.

(B) MDU's Position:

Montana-Dakota Utilities Company contends that no cash working capital allowance be charged to MDU thereby reducing its rate base. Montana-Dakota Utilities Company does not contend that its zero working capital allowance is justified on the basis of the evidence adduced before this commission, but rather only criticizes staff's lead-lag study. *588 Montana-Dakota Utilities Company contends that staff assumed use of forty days for gas service as being the appropriate lag time for receipt of revenues from MDU's customers without having conducted a study to support that determination. Montana-Dakota Utilities Company contends that if staff's recommendation is followed, MDU's cash flow will go down and MDU will be forced to borrow more money to finance operating and construction activities, thereby resulting in additional rate cases that MDU will have to file. Finally, MDU contends that a valid lead-lag study would be exceedingly expensive and should not be required by this commission.

Commission Findings

The commission finds that staff's recommendation regarding the working capital allowance to be provided MDU should be adopted for the reasons contained in (A) above set forth. The commission finds that MDU presented no evidence whatsoever to justify its zero working capital allowance however, the commission finds that staff utilized an appropriate lead-lag study upon which to base its working capital allowance. The commission finds that MDU's criticism thereof is without merit. The commission finds that on the basis of MDU's total failure to in any manner support its recommendation and on the basis of staff's lead-lag study, staff's recommendation is totally proper and should be adopted by the commission.

IV.

Federal Income Taxes

(A) Staff Position:

[4] Staff recommends that the federal income tax rate of 46 per cent should be utilized in this proceeding since it is a known and measurable change. Staff contends that this known change in federal income tax rates must be reflected in MDU's cost of service. The tax rate reduction from 48 per cent to 46 per cent will become effective on January 1, 1979, prior to implementation of any new rates in this proceeding. Further, staff contends that the vast majority of MDU's pro forma income tax liability is attributed exclusively to the recommended rate adjustments.

Additionally, staff recommends that the increase in FICA taxes, which also becomes effective on January 1, 1979, should be reflected in this proceeding for the same reasons.

(B) MDU's Position:

Montana-Dakota Utilities Company contends that the 46 per cent tax rate should not be used since it is an isolated element of expense which is prospective and that other such elements, which MDU views to be known and which will occur after January 1, 1979, have not been considered in this proceeding. Montana-Dakota Utilities Company contends it is not good rate making to single out one known and measurable change and not others. Montana-Dakota Utilities Company cites its increase in labor costs effective January 1, 1979, as one example and staff's rejection of MDU's proposed inflation adjustment as another. Montana-Dakota Utilities Company did not present any evidence regarding its productivity, its unit costs, or other adjustments which may be proper or relevant in considering its labor costs.

Commission Findings

The commission finds that staff's *589 recommendation should be adopted for the reasons set forth in (A) above. The commission finds that the reduced federal income tax rate and the increased FICA tax rate are known and measurable and will become effective on the first day of January, 1979. The commission finds that recognition of such known and measurable changes is appropriate and should be recognized in this proceeding.

The commission finds the MDU's arguments to the contrary are without merit. Montana-Dakota Utilities Company fails to state or take into account the reasons and rationale for staff's rejection of MDU's inflation adjustment and, likewise, fails to take into account crucial considerations relating to increased labor costs effective January 1, 1979.

The commission finds that the recognition of the applicable tax rate is entirely appropriate in this proceeding, and that such recognition does not constitute recognition of only one element of expense as contended by MDU. Rather, the commission has in its decision and order today recognized all supported known and measurable changes.

V.

Advertising Contributions and Membership Accounts

(A) Staff Position:

[5][6] Staff contends that portions of MDU's claimed miscellaneous general expenses should be disallowed because those expenses are not necessary for the rendition of adequate, safe, and reliable gas service to South Dakota customers. Staff witness Rislov testified that certain of the organizations receiving contributions from MDU were engaged in lobbying activities on behalf of MDU and other utilities. Staff states that such activities may not coincide with, or reflect, the interests of MDU's customers. Accordingly, those customers should not be required to pay for those expenses through their rates.

Additionally, staff witness Rislov recommends disallowance of expenses relating to the enhancement of MDU's image. Staff contends that there may be no direct benefits to South Dakota consumers from such expenditures and that those expenditures are not legitimate expenditures which should be recovered by MDU from MDU's customers.

(B) MDU's Position:

Montana-Dakota Utilities Company witness Ball testified at hearing that such advertising, contribution, and membership expenditures should be allowed to be included in MDU's rates. Montana-Dakota Utilities Company did not address this position in its brief.

Commission Findings

The commission finds that staff witness Rislov's recommendation should be adopted for the reasons set forth in (A) above. The commission finds that the expenses involved are not germane or necessary to the rendition of adequate, safe, and reliable gas service. The commission finds that in certain instances, the expenses may, indeed, cause detriment to consumers since various positions MDU and other utilities advocate through lobbying activities may be adverse to consumers. The commission finds that such expenses cannot and should not be recovered through rates charged to MDU's retail customers.

**590 VI.*

Inflation Adjustment

(A) Staff Position:

[7] Staff witness Peterson testified that MDU's proposed inflation adjustment should not be allowed. Montana-Dakota Utilities Company's adjustment purports to account for the effects of inflation on operating and maintenance expenses and is derived by multiplying the operating and maintenance expenses not adjusted elsewhere by a one-half of a cost of living index. Staff contends that the index is a mix of the 1976 and 1977 United States city consumer price index, hereinafter CPI, and that the index is an inappropriate measure for reflecting changes in the cost of living. Staff points out that the CPI measures relative changes and the extent to which the price of a particular and specified market basket has changed during a relevant period of time. However, the market basket is not based at all upon the experience of utilities, but rather is based upon the experience of a specific population of urban wage and clerical workers for a particular bundle of goods and services.

Staff contends that if the effects of inflation on MDU's costs are known, MDU has the burden of identifying the significant increases and of establishing that those increases are known and measurable. If MDU meets that burden, staff states that the increase associated therewith would be recognized as a known and measurable change in the same manner as staff has recognized other known and measurable changes reflecting inflation such as increases in wages. However, staff contends that use of an inappropriate index applied across the board to operating and maintenance expenses not already recognized for change is mere speculation and is not appropriate for rate making.

Staff recommends that MDU identify those items which are subject to known price changes and support and justify those changes in its rate filings. Staff contends that to allow a speculative adjustment as proposed by MDU would raise a serious public policy question. Staff states that such allowance, without more justification for the adjustment, would simply lead to additional inflation which would not otherwise occur or exist. Staff contends that upon the showing made by MDU, MDU has clearly not justified its proposed adjustment and that the same should be disallowed.

(B) MDU's Position:

Montana-Dakota Utilities Company contends that an inflationary adjustment should be made to its cost of service. Montana-Dakota Utilities Company states that the adjustment applies an inflation factor to all operations and maintenance accounts which are not adjusted elsewhere in MDU's case. Montana-Dakota Utilities Company contends that its adjustment is a commonsense matter which will recognize, at least in part, the inflation MDU will incur in those expenses. Montana-Dakota Utilities Company

states that staff's requirement that MDU identify with specificity the increases it will incur and justify same is not realistic. Montana-Dakota Utilities Company maintains that it will in the future incur these additional expenses due to inflation and that its utilization of one-half of the CPI is conservative. Montana-Dakota Utilities Company maintains that the commission's failure to recognize an inflation adjustment would deprive MDU *591 of recognition of increased expenses MDU contends it will incur.

Commission Findings

The commission finds that staff's recommendation set forth in (A) above should be adopted for the reasons set forth therein. The commission finds that MDU's proposed adjustment is totally speculative and that, as a result, rates cannot and should not be based thereon. The commission finds that MDU has wholly failed to identify with any specificity increases in costs it contends it will incur due to inflation. Rather, MDU has merely employed an arbitrary method by utilizing the consumer price index and applying one-half of the rate thereof to its operating and maintenance expenses not adjusted elsewhere. The commission finds that the consumer price index has little, if anything, to do with the costs incurred by a utility. The commission further finds that utilization of such an index is wholly unwarranted and unjustified. The commission finds that MDU has had every opportunity in this proceeding to establish and justify any and all known and measurable changes it desires to so do. Montana-Dakota Utilities Company's proposed inflation adjustment does not even constitute a rational, let alone convincing, attempt.

Finally, the commission finds that there is merit in staff's position that to allow such an unsupported inflationary adjustment will, in all likelihood, lead to additional inflation through the rates charged by MDU to MDU's retail customers which would not otherwise occur. The commission finds that this is clearly against the public interest and national policy and is clearly against every sound rate-making principle. The commission finds that MDU's proposed adjustment is without any credible support or justification, is totally speculative, and has no rational basis. As a result, the commission finds that the adjustment should be disallowed.

VII.

Rate Case Expense

The commission finds that staff's recommendations regarding proposed procedures and methods which MDU should utilize in booking regulatory expenses and in the allocation of those expenses in the future should be adopted. At the present time, the commission finds that there are insufficient safeguards regarding the booking and allocation of regulatory expenses to assure accuracy and fairness. The commission finds that staff's recommendation rectifies this shortcoming. Thus, the commission finds that MDU shall in all future proceedings before this commission implement staff's recommendation.

VIII.

Rate of Return

(A) Staff Position:

[8][9] Staff recommends an overall rate of return of 9.55 per cent on MDU's gas operations. This represents a return on common equity of 12.31 per cent for MDU's gas operations.

Staff witness Dr. Wilson explained how he arrived at staff's recommendation regarding a fair rate of return for MDU. Dr. Wilson explained that there are four principal types of securities issued by a utility; to wit, long-term debt, preferred stock, common stock, and *592 short-term debt. The costs of long-term debt, preferred stock, and short-term debt are rather clearly defined and there is no real dispute between MDU and staff in this regard.

However, there is a sharp dispute between MDU and staff regarding the equity return investors require in order to invest in MDU. Dr. Wilson testified that the fair rate of return reduces to the return available to investors from the purchase at the time of other securities of equal or comparable risk. Dr. Wilson arrived at his common equity cost for MDU by utilizing two tests, the comparable earnings analysis and the discounted-cash-flow approach. Under the comparable earnings analysis, a direct

observation is made of the actual earnings of other utilities and regulated enterprises and of unregulated firms. Dr. Wilson testified that the comparable earnings test has traditionally played a significant role in determining the fair earnings rate in the regulatory process. However, Dr. Wilson noted that there are limitations in the exclusive use of the test to determine a fair return. Dr. Wilson points out that actual earned rates of return by other regulated companies are not independent yardsticks since they are reflections of previous regulatory decisions. Moreover, actual returns set on a test-year basis may not reflect fully certain conditions which should be taken into consideration in setting prospective rates of return. Additionally, Dr. Wilson testified that a single criteria based simply on what other enterprises have earned would not be adequate since it would reflect earnings that are either excessive or inadequate.

In his comparable earnings test, Dr. Wilson utilized data relating to both comparable utilities and to unregulated companies. His data base for comparable utilities included data pertaining to 15 gas distribution companies, 89 independent utilities, and the largest operating subsidiaries of 11 electric utility holding companies. The electric utilities utilized by Dr. Wilson include electric only companies and combination gas and electric utilities such as MDU. Dr. Wilson's studies establish that those regulated utilities had average earnings on common equity in the 11 per cent to 12 per cent range over the 1970 to 1976 period.

In addition, Dr. Wilson examined data relating to unregulated companies in his comparable earnings analysis in order to provide boundaries within which to assess utility returns. Dr. Wilson stated that with proper adjustments for the lower utility risks, such data could help in establishing some guidelines. The return on common equity for all industries, both regulated and unregulated, was approximately 14 per cent for 1977, while earnings in the regulated sectors were in the 12 per cent range. Dr. Wilson noted that as to returns for unregulated industries, it is necessary to make an assessment of the risks facing the respective regulated and unregulated sectors. Dr. Wilson testified that the utility sector is generally a less risky business than the competitive, unregulated sector. Dr. Wilson pointed out that there has not been one business failure or bankruptcy in the past quarter century among major electric and gas utilities while such events have been numerous in most competitive industries. Moreover, Dr. Wilson notes that the dividends of shareholders in the utility industry have followed a remarkably stable upward path in recent decades while the unregulated sector has experienced far more frequent cyclical ***593** dividend reductions. Dr. Wilson also employed the beta coefficients analysis to establish the comparably stable low risk nature of utility common stock investments. Further, Dr. Wilson indicated that insofar as indices of safety, price stability, and earnings predictability are concerned, the utility industry ranks high in comparison to other sectors of the economy.

Dr. Wilson concluded that these measures of risk establish that the utility industry generally is less risky than the unregulated sector and accordingly the returns to the unregulated sector are higher to reflect those greater risks. Based upon the comparative studies conducted by Dr. Wilson, Dr. Wilson concluded that a return on common equity in excess of 12 per cent would not be required to attract capital or to fairly compensate the shareholders of MDU.

In addition to the comparable earnings studies performed by Dr. Wilson, Dr. Wilson employed a discounted-cash-flow study to analyze MDU's common equity return requirements. Dr. Wilson's DCF method is a generally accepted method measuring the required return on the firm's common equity capital. The basis of the DCF method is the principle that the maximum price that an investor will pay for a security is an amount equal to the present value of the dividends that he expects to receive over the years during which he holds the security and its resale price including capital gains when he sells it.

Since dividend and price values are known, Dr. Wilson states that the basic problem is to estimate the expected rate of dividend growth. The essence of this task is to determine the most probable projection of the rate of growth that is presently anticipated by investors. In his DCF analysis, Dr. Wilson stresses the importance of determining not the actual growth rate, but rather, the growth rate investors are expecting.

Dr. Wilson applied the DCF formula to larger groups of utility companies and arrived at an unadjusted cost of common equity capital of 11.94 per cent for gas utilities. By utilizing information from a large group of companies, rather than information relating solely to MDU, Dr. Wilson testified that he avoided certain pitfalls that might invalidate the use of the DCF method. Dr. Wilson pointed out that any individual company might well be affected by several factors, both favorable and unfavorable, that would not be of a nature upon which investors could or would rely. As a result, investors attempt to correct for distortions they might observe in a single company's performance by looking at other companies' data. Likewise, Dr. Wilson contends

that analysts should look to data on comparable companies for confirmation of their analysis and also to compensate for erratic past growth rates that might have been experienced by a single company. Dr. Wilson also utilized data for a large selection of electric utilities to make a statistical analysis to pinpoint those growth variables and time periods that best reflect the way and manner investors formulate their expectations about dividend growth in the future. Dr. Wilson concluded from these studies that investor expectations for the average growth in dividends for gas utilities common stock are in the 3 per cent to 4 per cent range. The results of Dr. Wilson's determinations indicate that the current cost of common equity capital for gas utilities is approximately 12 per cent.

While Dr. Wilson believes that these results could generally be applied to MDU, he made additional studies in order to identify differences between *594 MDU and the industry generally. These studies included a regression analysis relating to dividend yields and growth rates to several variables for the 15 comparable companies utilized in Dr. Wilson's study. The variables included the common equity ratio. Dr. Wilson testified that these variables are indicative of relative risk among public utility common stocks and that these risk differences could affect the cost of capital. Dr. Wilson concluded on the basis of these studies that certain of the factors were significant for purposes of his analysis. However, the growth rate makes the largest contribution which establishes the propriety of utilizing the DCF principle.

On the basis of all of these studies, Dr. Wilson determined that the approximate cost of common equity capital for MDU in this proceeding is approximately 12.09 per cent for its gas utility operations. Dr. Wilson noted that market pressure was probably negligible for the purposes of this proceeding. Dr. Wilson then recommended that a premium price of 3 per cent above book value reflects sufficient margin for the new common stock at book value, after considering market pressure and expenses of issue, and that said percentage should be properly applied to the dividend yield component of the DCF calculation rather than to the total return required by the investors. This resulted in an increase in the return allowance of .22 per cent. Dr. Wilson testified that the additional rate allowance added to the cost of common equity capital for MDU should permit the common stock of the company to trade far enough above book value for new common stock to be sold for net proceeds at book value. Accordingly, Dr. Wilson's total cost of common equity for MDU is 12.31 per cent for MDU's gas utility service. Dr. Wilson notes that this will result in adequate coverage for MDU and provide MDU with a fair, just, and reasonable return.

Staff utilized the latest actual capital structure of MDU available in its determinations.

(B) MDU's Position:

Montana-Dakota Utilities Company's witnesses recommend that MDU be allowed 15.25 per cent on its common equity return. Montana-Dakota Utilities Company's president stated that it was his opinion that MDU's history of earnings was one of the reasons that MDU's common stock was selling at approximately 86 per cent of its book value on November 24, 1978. Company witness Monteau testified that the true marketability of the company's common stock was untested by the marketplace until April of 1978, at which time MDU issued 750,000 shares of common stock and received only 81 per cent of its book value in regard thereto. Mr. Monteau testified that it was his opinion that MDU be able to establish a solid record of adequate earnings, continue to expand its common equity base, gradually increase its dividend to the industry norm, and restore the market-to-book ratio of its common stock to the point where the common stock can be safely issued without dilution of either earnings or equity.

Montana-Dakota Utilities Company witness Paige testified that if MDU is allowed an inadequate return on equity, the free market will lower the price of the company's common stock to a price further below book value where the investor will still attain his required return on investment. Company witness Monteau points out that this will reduce *595 the value to the present holders of the stock in MDU.

President Schuchart testified that to maintain the company's capital structure of just over 50 per cent representing borrowed money and 50 per cent owner investment, the company will have to issue \$107 million in debt and look to internal generation and equity sales in about the same amount to provide funds for the next four years' construction. As a result, substantial amounts of common stock will have to be sold during this period. Montana-Dakota Utilities Company contends that unless an adequate return is earned by MDU, these new issues of stock will sell substantially below book value for the reasons stated by company witnesses Monteau and Paige.

Montana-Dakota Utilities Company witness Monteau testified that the earnings of MDU decreased for the twelve months ending December, 1977. Witness Monteau stated that the return earned on average common equity fell in 1977 to the lowest experienced since 1966 and was presently inadequate. He testified that investors' confidence in MDU is at an all-time low. He testified that this is particularly true as to MDU's operations in Montana and South Dakota. Witness Monteau stated that the purpose of utility regulation is to supplant forces of competition, but not force shareholders to subsidize the purchaser of energy.

Mr. Monteau testified that based upon his comparative earnings analysis and discounted-cash-flow model, the market-determined investor capitalization rate on equity for MDU is between 14.5 per cent and 15 per cent. He testified that MDU should be allowed the opportunity to earn the return set at the upper end of the range in order to afford MDU a chance of achieving earnings at the lower end of the range.

Montana-Dakota Utilities Company contends that a utility's earned return on average equity will be approximately two points below that which is allowed. Montana-Dakota Utilities Company maintains that witness Monteau established same in his studies of 16 combination utilities operating in the upper Midwest.

Montana-Dakota Utilities Company witness Monteau conducted a preliminary analysis of MDU. Witness Monteau concluded that MDU is presently earning a return which is simply inadequate. He proceeded with his cost of capital study toward a recommendation of fair rate of return which would enable MDU to restore its financial integrity, to attract debt capital on reasonable terms, to obtain additional common equity capital without dilution of its earnings or equity positions, and to properly compensate its investors for the risks assumed.

Montana-Dakota Utilities Company witness Monteau utilized three tests to determine his recommended return on common equity-the comparable earnings test, the DCF method, and a market appraisal analysis-the latter to verify the results of the two preceding tests. Mr. Monteau took a sample of primarily combination electric and gas utilities operating in the same states or states contiguous to the states in which MDU operates as well as a group of 22 large, highly rated industrial companies for his comparable earnings analysis. Witness Monteau concluded from his studies that the cost of common equity was at least 14.5 per cent without adjustment for the need to restore investor confidence.

Mr. Monteau also utilized a DCF analysis wherein he derived his growth rate estimates by analyzing the growth of all three variables in the DCF formula $*596$ over a number of periods adjusted for a number of specific factors which will impact upon it continuously in the future. Mr. Monteau determined an estimate of growth in each category. Mr. Monteau enumerated some 20 variables covering a vast range of values but did not provide the manner in establishing the weight to be given to each value. Mr. Monteau utilized the three-month period of December, 1977, to February, 1978, to arrive at his current yields for his 16 sample companies and for MDU. Mr. Monteau also utilized the market appraisal analysis in his determination of a proper equity return to verify his conclusions.

Montana-Dakota Utilities Company witness Paige reviewed MDU's financial history and set forth general discussion of market conditions for new long-term senior securities and common stock. Witness Paige offered evidence reflecting that the attrition in the return on equity averaged 200 basis points in 1976 and 1977 as between the allowed return and the actual earned return.

Montana-Dakota Utilities Company witness Paige described the capital markets in which MDU must operate. Mr. Paige presented his conclusions regarding what investors are charging for new capital in the present market for debt and equity and, thus, what MDU can expect to pay. Mr. Paige testified that his method is admittedly simplistic but that it is his opinion that that is the way investors make decisions as to price in the marketplace and that his method is therefore most reflective of the true cost of capital.

Both witnesses Monteau and Paige presented critiques of Dr. Wilson's analyses.

Montana-Dakota Utilities Company contends that staff's approach is improper and that this commission should utilize the recommendations made by MDU's witnesses Schuchart, Monteau, and Paige.

Montana-Dakota Utilities Company utilized a projected capital structure based upon estimates in arriving at its return recommendation.

Commission Findings

The commission finds that staff's rate of return recommendation should be adopted for the reasons set forth in (A) above. The commission finds that Dr. Wilson has utilized exhaustive and detailed studies in his determination of an appropriate and fair return for MDU on common equity. The commission finds that Dr. Wilson's comparable earnings analysis is sound and that Dr. Wilson's discounted-cash-flow methodology is equally sound. The commission finds that MDU has failed to establish that any of Dr. Wilson's studies, or any conclusions based thereon, are in any manner erroneous or improper. Rather, the commission finds that MDU merely makes bald assertions without substantiation.

The commission finds that staff's recommendation provides a fair, just, and reasonable return to MDU. The commission finds that MDU's recommendation is excessive and is unjustified on the basis of the evidence before this commission.

The commission finds that MDU's witnesses utilized very selective data in their analysis and that the same is not reflective and cannot be properly utilized in determining a fair return. The commission finds that, for example, MDU witness Monteau utilizes a very select group of companies in his comparable earnings analysis which does not provide *597 the appropriate basis for determining a fair return. Further, Mr. Monteau attempts to equate gas utility returns which should be allowed to those returns earned by highly profitable unregulated firms in the competitive sector of the economy. The commission finds that such a determination is erroneous and cannot be utilized as a basis for setting a fair rate of return. Additionally, Mr. Monteau does not in any manner explain or present the background regarding the exercise of his judgment in his DCF analysis. Rather, Mr. Monteau appears to merely set forth a hodgepodge of considerations, none of which have much empirical validity absent thorough explanation.

Finally, the commission finds that MDU's witness Paige's general and simplistic assertions are of little assistance in a true attempt to determine a fair return. This commission will not establish fair returns on the basis of such vague generalizations, but rather will utilize extensive and fully supported analyses. The commission finds that staff's recommendation is based on such analyses and, in the commission's judgment, that recommendation should be adopted herein.

IX.

Unsuccessful Well Drilling Costs

(A) Staff Position:

Staff contends that MDU's claim for an amortization of its pre-1974 unsuccessful well drilling costs should not be permitted. Staff witness Towers testified that the costs have already been written off by MDU in response to an FPC (now FERC) directive to write them off to expense in one year. Montana-Dakota Utilities Company charged same as an operating expense against income in 1973 and 1974, prior to statewide regulation of gas and electric utilities by the South Dakota Public Utilities Commission. Either of these factors would be sufficient to warrant rejection of the proposed amortization in staff's view. However, together, rejection of the amortization is totally justified and warranted.

Staff points out that since the expenses were written off in prior years for financial reporting purposes, such write-offs clearly establish that the costs were deemed to be applicable to utility operations prior to the test year in this proceeding. Montana-Dakota Utilities Company took the tax benefits associated with those write-offs at the time thereof. Staff further points out that the Federal Energy Regulatory Commission does not allow those costs to be included for rate-making purposes. Staff concludes that this constitutes retroactive rate making and is without justification whatsoever.

(B) MDU's Position:

Montana-Dakota Utilities Company contended at hearing that MDU should be permitted to amortize its pre-1974 unsuccessful well drilling costs. Montana-Dakota Utilities Company does not address this position in its brief.

Commission Findings

The commission finds that the amortization requested by MDU for its pre-1974 unsuccessful well drilling costs should be disallowed for the reasons set forth in (A) above. The commission finds that MDU has already written off the entire amount in prior years. Further, the commission finds that the applicable *598 time frame occurred before this commission even assumed jurisdiction over MDU for rate-making purposes. Further, the commission finds that MDU also enjoyed the tax benefits associated with those write-offs at the time they were taken. Finally, the commission finds that MUD's proposal constitutes retroactive rate making and that the same shall not be permitted by this commission on this or any other issue in this proceeding.

X.

Volume of Gas in Storage

(A) Staff Position:

Staff recommends that MDU's adjustment to reflect an increase in the volume of gas in storage not be allowed. Staff maintains that gas storage volumes reflect the average volume of gas in storage during 1977 in staff's presentation. Staff contends that MDU's proposed adjustment does not represent a known change in its average investment in gas in underground storage. Staff points out that both the quantity MDU projects will be added to storage and the cost of that gas which MDU contends should be added to investment are mere conjecture. As a result, staff maintains that MDU's adjustment should not be allowed in this proceeding.

(B) MDU's Position:

Montana-Dakota Utilities Company contended at hearing that the adjustment to increase by \$2.8 million its volume of gas in storage be allowed by this commission. Montana-Dakota Utilities Company does not address this position in its brief.

Commission Findings

The commission finds that staff's recommendation should be adopted for the reasons set forth in (A) above. The commission finds that MDU has not even attempted to establish its entitlement to the proposed adjustment. The commission further finds that the adjustment does not constitute a known and measurable change by any stretch of the imagination. The commission finds that allowance of MUD's adjustment would inflate the rates charged to consumers without any justification therefor. While MDU concedes its adjustment is conjecture, the commission so finds and accordingly disallows same.

XI.

Purchased Gas Adjustment Clause

(A) Staff Position:

Staff states that the issue regarding MDU's purchased gas adjustment clause relates to, for rate-making purposes, whether it is necessary to forecast purchased gas costs as proposed by MDU or whether it is sufficient and appropriate to base the treatment for same on MDU's recent actual experience as recommended by commission staff witness Brown.

Montana-Dakota Utilities Company utilized estimates for its purchased gas costs. However, staff contends that such estimates are speculative and their use is unnecessary in light of the existence of MDU's purchased gas adjustment clause. Staff points out that to the extent that MDU's experienced purchased gas expense increases above the base rate, MDU will be fully compensated by the operation of its purchased gas adjustment *599 clause. Accordingly, staff revised the base cost and made the appropriate adjustment to the purchased gas adjustment clause revenues relating thereto.

Staff also recommends that procedures outlined in relevant FERC orders regarding a gas surcharge should be implemented and deferred accounting relating thereto utilized. Staff also recommends that MDU be allowed to recover its carrying costs in regard thereto.

(B) MDU's Position:

Montana-Dakota Utilities Company contended at hearing that utilization of its proposed estimates of purchased gas costs was appropriate. However, Montana-Dakota Utilities Company would concur in staff's recommendation regarding utilization of FERC procedures and deferred accounting.

Commission Findings

The commission finds that staff witness Brown's recommendation should be adopted for the reasons set forth in (A) above. The commission finds that MDU will be made whole by the operation of its purchased gas adjustment clause and that, as a result thereof, utilization of MDU's recent actual experience should be utilized in establishing the base cost of purchased gas in MDU's proposed purchased gas adjustment clause. The commission finds that utilization of estimates should be avoided in order that MDU customers shall only compensate MDU for the costs actually incurred by MDU. The commission finds that since the purchased gas adjustment clause has been allowed by this commission herein, MDU has no justifiable criticism whatsoever for utilization of recent actual data.

The commission finds that this is a minimal protection which should be extended to consumers and, in light of MDU's total ability to recover all of its purchased gas costs within a reasonably short period of time, it is proper.

Additionally, this commission has recently, in Docket F-3293, permitted implementation of rate schedules by MDU to recover all of MDU's increases in purchased gas resulting from enactment and implementation of the Natural Gas Policy Act of 1978. This commission's approval will permit MDU to recover a 30 per cent increase in the wholesale cost of purchased gas. It should be noted that this increase is over and above the increase allowed by this commission in MDU's base rates for gas service. Montana-Dakota Utilities Company can have no complaint regarding the establishment of the base rate to be utilized in its purchased gas adjustment clause herein in light of the above.

Further, the commission finds that adoption of a procedure analogous to the procedure outlined in the relevant FERC orders whereby a gas surcharge is established on the basis of current costs and the difference between actual costs and the cost recovered by the surcharge are accumulated in an unrecovered gas cost account for subsequent recovery from or refund to customers. The commission finds that by deferring the revenue, cost differences, revenues and expenses will be matched and a source of significant earnings distortions will be eliminated. In addition to accounting for the out-of-pocket costs of purchased gas, the commission finds that the PGA should be revised to account for the monthly carrying charges on the unrecovered gas cost balance calculated at *600 the rate of return of 9.55 per cent which is the most recent allowed by the commission.

Finally, the commission finds that MDU and commission staff should establish the exact method for implementing the PGA as above set forth on the basis of monthly revenues billed in conjunction with actual costs incurred for that month.

XII.

Gas Sales Curtailment

(A) Staff Position:

Staff recommends, as does MDU, utilization of the 60 per cent curtailment level for Priority IV sales to MDU's industrial customers which was implemented on July 1, 1978, and continues through June 30, 1979.

In order that the industrial customers of MDU may better utilize their remaining volumes of gas, staff recommends that the commission, staff, and MDU initiate and conduct communications with those Priority IV South Dakota industrial customers to

insure that the customers are fully aware of their options under MDU's curtailment plan and to ascertain whether grouping can be achieved with this commission's assistance for the mutual benefit of the Priority IV users and for MDU's other South Dakota customers. Staff believes that if this is achieved, the benefits of additional sales should be reflected as a further adjustment to MDU's South Dakota cost of gas service.

As for the 80 per cent curtailment level to commence on the first day of July, 1979, staff notes that that 80 per cent curtailment is not a fact since MDU's Federal Energy Regulatory Commission curtailment plan does not require MDU to effect the curtailment of any specific level. Further, staff points out that even if it assumed that an 80 per cent curtailment will materialize, the effects on MDU's South Dakota cost of service during the year ended June 30, 1980, should be far less than the change between 1977 and the 60 per cent curtailment. The decline in sales, combined with normal growth in sales to existing and new South Dakota customers, should provide for a negligible effect on MDU's earnings as a result of the 80 per cent curtailment.

Finally, staff recommends that MDU's request for a surcharge relating to the 60 per cent level of curtailments commencing on the first day of July, 1978, be disallowed in that it is retroactive rate making and MDU fails to set forth other considerations which may establish the impropriety of such a surcharge. Staff contends that on either of these grounds, MDU's surcharge should be disallowed.

(B) MDU's Position:

Montana-Dakota Utilities Company concurs that the 60 per cent curtailment level should be utilized in this proceeding. However, MDU further contends that it should be provided a surcharge reflecting the 60 per cent curtailment level from July 1, 1978, until the date the rates established in this proceeding are implemented. Montana-Dakota Utilities Company suggests that this will allow MDU to recover the loss associated therewith from July 1, 1978.

Montana-Dakota Utilities Company also recommends that on or after July 1, 1979, MDU should be permitted to immediately file a tariff reflecting the increased curtailment level of 80 per cent. Montana-Dakota Utilities Company *601 contends that this would be a simple mechanism that would serve to recognize the curtailment losses.

Montana-Dakota Utilities Company states that it is MDU's position that this commission has previously allowed for such a filing in the last MDU gas proceeding and that it is proper to do so in this proceeding.

Commission Findings

The commission finds that staff's recommendation should be adopted for the reasons set forth in (A) above. The commission finds that recognition of the 60 per cent curtailment level in this proceeding is proper.

However, the commission finds that MDU's requested surcharge constitutes retroactive rate making which this commission shall not permit. Montana-Dakota Utilities Company's contention that this commission has provided a comparable surcharge in previous proceedings is without merit in that the commission's August, 1977, order recognized only a 20 per cent curtailment level although a 40 per cent curtailment level was in effect on July 1, 1977. As a result of this commission's rehearing, the commission subsequently recognized the 40 per cent curtailment level. Here, the commission is recognizing in its decision and order herein the 60 per cent curtailment level which was effective on July 1, 1978, and no adjustments or surcharges are appropriate as a result thereof.

The commission finds that MDU's requested approval in this proceeding of a tariff it is purportedly to file with this commission on or after July 1, 1979, is rejected. The commission finds that it shall consider any such filing at that time, but that for the purposes of this proceeding, the test year would be meaningless were the commission to allow for a 30-month extension of the test period which relates to a curtailment level which is speculative as to the effects of same upon MDU.

Finally, the commission notes that the 80 per cent curtailment of Priority IV sales to commence on the first day of July, 1979, and the effects thereof cannot be determined at this time with any accuracy whatsoever. The effects of the 80 per cent curtailment are speculative. Further, the commission, commission staff, and MDU have at this time no information regarding increases in

sales to existing or new customers which would serve to offset the losses, in whole or in part, resulting from implementation of the 80 per cent curtailment level.

On each of the above bases, the commission finds that staff's recommendation should be adopted.

XIII.

AFUDC Rate

The commission finds that staff witness Brown's testimony regarding the AFUDC rate and her recommendations in relation thereto should be adopted for future proceedings. The commission finds that MDU must establish and demonstrate that the costs of compensating bank balances are actually, prudently, and necessarily incurred. The commission further finds that if the average compensating balance required to be maintained during the period in question is not significant after adjustment for float, or should MDU fail to establish and demonstrate that the costs are actually, prudently, and necessarily incurred, those costs may properly be excluded in future filings.

***602 XIV.**

MDU's Financial Position

Montana-Dakota Utilities Company contends that its recent earnings history has not been the best and that, as a result, this commission should change its rate-making precedents and principles and use those advocated by MDU.

The commission does not agree. Montana-Dakota Utilities Company's financial situation has greatly improved during the last twelve months which is the primary reason this commission did not allow MDU any interim relief in this proceeding. Montana-Dakota Utilities Company appears to desire to have this commission be responsible for MDU's entire utility operations. This simply cannot be done. Further, MDU would have this commission set excessive rates to cover any and every conceivable adverse or extraordinary economic condition which may occur in the future. This commission finds that such a contention is absurd. This commission has already recognized all supported known and measurable changes herein which will affect MDU's South Dakota operations. The commission has established in this proceeding just and reasonable rates which will provide MDU the opportunity to earn its allowed rate of return. This is what MDU is entitled to and is the burden MDU's customers must bear, regardless of the magnitude of hardship this creates for those customers. However, for MDU to then request this commission to set rates in order to basically guarantee MDU against any risk, real or imagined, which may, however remotely, exist in the future is tantamount to requesting this commission to abrogate its obligation and responsibility to set just and reasonable rates. The commission cannot and will not so abrogate its duties to either MDU or to the public.

MDU's request is hereby expressly rejected.

XV.

Rates under Bond Subject to Refund

Due to the pending litigation in the South Dakota supreme court in the case entitled Re Otter Tail Power Co., Docket F-3052, relating to a comparable inflation adjustment as that proposed by MDU wherein the circuit court, sixth judicial circuit, county of Hughes, state of South Dakota, reversed the commission and entered its order in regard thereto which is subject to said supreme court appeal, the commission finds that the revenues associated with the inflation adjustment in this proceeding should be implemented by Montana-Dakota Utilities Company under bond subject to refund with interest, said interest to be set at two percentage points above the prime rate of interest on the date of this order. The commission finds that said refunds with interest shall be made to MDU customers forthwith should the commission prevail in the aforementioned litigation or in any future litigation relating to the inflation adjustment arising out of this proceeding.

Conclusions of Law

I.

That the commission has jurisdiction over the parties and the subject matter of this proceeding.

*603 II.

That the commission's decision and order herein determines just and reasonable rates.

III.

That the implementation of the rates associated with the inflation adjustment is unjustified, unwarranted, and unreasonable but, in light of the aforementioned litigation, is properly implemented under bond subject to refund at this time, with said refunds with interest to MDU customers to be forthcoming should the commission prevail in said litigation.

FISCHER, commissioner, dissenting:

I am humored by the twisted logic the majority has applied to the end result of their decision in this case as it applies to the financial integrity and proved needs of the company. Without the recent circuit court's decision involving this commission and Montana-Dakota Utilities Company the majority would continue their blatant disregard for the absolute undeniable facts that Montana-Dakota Utilities is not and has not in the last three years been able to even come close to recovering their just and reasonable costs in South Dakota as allowed and provided in our statutes and previous commission decisions.

The majority seems to think that those who differ with their views demand the company be guaranteed every possible dollar of expenses and of return. However, the case is such that a reasonable opportunity must be provided to recover the costs rather than to have confiscation occur, as can be seen by the last three years' historical results of MDU's financial picture associated with its South Dakota operations.

The irritation exhibited by the majority's language and capricious and arbitrary treatment of fundamental facts clearly indicate a last-ditch effort to take from the company its services without reasonable compensation. After three years of this thought the courts and legislature certainly will make corrections which will regrettably result in the loss of this body's discretion. However, when that discretion is so abused as can be seen by this commission's past and present actions, what else can one expect? Indeed such abuses cannot long be suffered. A balance between the user and provider of the utility services must be struck. There is no free lunch. Continuation of such views can only lead to higher consumer costs when faced with a utility company in financial trouble.

The majority can indeed applaud itself in getting the best deal possible for the consumer *for the moment*. However, it should not fail to in the future take credit for consumer price increase ramifications resultant from a financially weak company. It takes a great deal more dollars to bring a company back to stability than it does to maintain an ongoing sound and reasonably financially secure image.

Specifically, the majority has mistakenly treated the issues of working capital allowance, inflation adjustment, the gas sales curtailment, the Knife River Coal Company, rate of return, and the labor increase expenses for 1979. Excepting rate of return, the company's position on these matters should be adopted as justified and reasonable, wholly supported on the record, and clearly recognizable components of sound regulation which contribute to the *604 overall end result of this company's needs and to a reasonable opportunity of achieving those needs.

The majority's rate of return allowances for both the gas and electric cost of equity should be adjusted upward by 1.5 percentiles in order to account for the errors of Dr. Wilson's computations and judgment. Dr. Wilson's fundamental error in the compatibility tests is that he compares earned returns to arrive at this company's allowed return with minor insignificant additions. The evidence shows companies earn 2 percentiles on the average below that allowed. To make a reasonable and sound comparison, this fact must be recognized. Specifically, our records show that Dr. Wilson's recommendations over the last three years in regard to this company have been drastically in error to which the authorized return on equity was not close to being sufficient

to allow MDU a reasonable opportunity to achieve an earned return on equity which was equal to its cost of equity. *There is no guarantee implicitly or explicitly suggested here. The allowed must be such that a reasonable opportunity be provided to earn the cost of equity.*

The majority adopts Dr. Wilson consistently without notice or recognition to his blatantly downward circularity analysis of reasonable return. By continuing such, the majority effectively has endorsed confiscating the company's legal right to an opportunity to earn the cost of equity capital.

Finally, a great deal has been said regarding President Carter's price guidelines to check inflation and our nation's financial situation. The idea is that the increased rates requested here are inflationary and should be held to a certain amount. I find this argument frivolous, irrelevant, and immaterial to the case; and specifically, the facts at hand regarding this company and those statutes of South Dakota directing me as a regulator in dealing with the rate increase request. If the majority would rid itself of its blinders and recognize the principal reason why we have these guidelines, it would simply suggest the federal government put its house in order and check the federal budgetary deficits.

I find great folly in such suggestions that we apply Carter's guidelines, considering specifically the financially conservative nature this company has been operating over the past three years in South Dakota. If the majority were to prevail in their views regarding MDU and its operations, I suggest maybe the company sell its South Dakota portion to staff. Staff appears to know how to make ends meet. However, it should be recognize that Dr. Wilson may not be interested, considering the lucrative nature of his consultant business!

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