

Memorandum

To: Commissioners Wefald, Clark and Reinbold
From: Mike Diller
Date: May 16, 2001
Re: **Contract for Case No. PU-399-01-186**

Importance of Case

In its 1999 annual report to the commission, Montana-Dakota Utilities Co. (MDU) reported earnings of 15.94% on its equity invested in North Dakota. For the year ended 2000, MDU reported earnings of 17.95%. Staff has recently testified that an 11.3% return on equity is fair and reasonable for setting Northern States Power Company's (NSP) natural gas rates. Using 11.3% as a surrogate in this case, MDU's 2000 reported earnings are more than \$6 million too high.

Bid Proposals and Recommendation

The commission does not have a cost of capital expert on staff. Therefore, the staff requested bid proposals from potential service providers to determine the cost of capital for MDU's electric operations. The staff received four proposals ranging in price from \$15,579 to \$68,000. Because of the quality of the Snavely King proposal and the price difference between it and the next lowest bidder, further analysis of the proposals is not necessary. The staff recommends entering into a contract with Snavely King. Please note that the contract requires that \$10,000 worth of work be completed this biennium with the remainder to occur after July 1, 2001—see later section on Budgetary Constraints.

Appoint Staff

Staff recommends that Bill Binek and Mike Diller be appointed as ratepayer advocacy staff per attached motion. We are not making a recommendation regarding the appointment of commission advisors until staff workloads can be more fully analyzed.

ROE Settlement Proposal Rejected

Staff's offer to stipulate to a 12% return on equity in this case was rejected by MDU. Even though the staff is recommending a return on equity of 11.3% in NSP's gas rate increase application, staff offered to stipulate to a 12% return on equity in this case because of the cost of hiring an expert

witness and the inability to recover such costs from MDU. Under current law, the commission is unable to bill the utility causing the cost of regulation if the commission initiates the investigation. Only when a utility requests a rate increase can the costs of regulation be passed on to the respective company. Because of this law, hiring an expert must come out of the commission's general fund budget--even though no such funding was appropriated to the commission.

Budgetary Constraints

It is important to understand the financial position of the commission prior to entering into this agreement. Staff has spent considerable time and effort analyzing and projecting general fund expenditures. Prior to entering into this agreement, we believe the commission will end the biennium with about \$13,000 left in general fund dollars, which is not much given our \$3.57 million general fund budget.

Entering into this contract will necessitate deferring delivery of certain products and services. As you know, deferring costs now will only aggravate our already under-funded budget for the next biennium. As you recall, the legislature restored the Weights and Measures inspector position for the next biennium but did not restore travel and other operating expenses to do the job. Entering into this contract will leave about a \$3,000 cushion for the next 46 days of the biennium.

Alternative Proposal

While staff is willing to accept the risk, the commission may not be willing to cut the budget this close. In such a case, the staff is willing to pursue additional funds through the Emergency Commission as soon as possible. An alternative motion to secure additional funding through the Emergency Commission is also attached.