



MDU Electric Operations

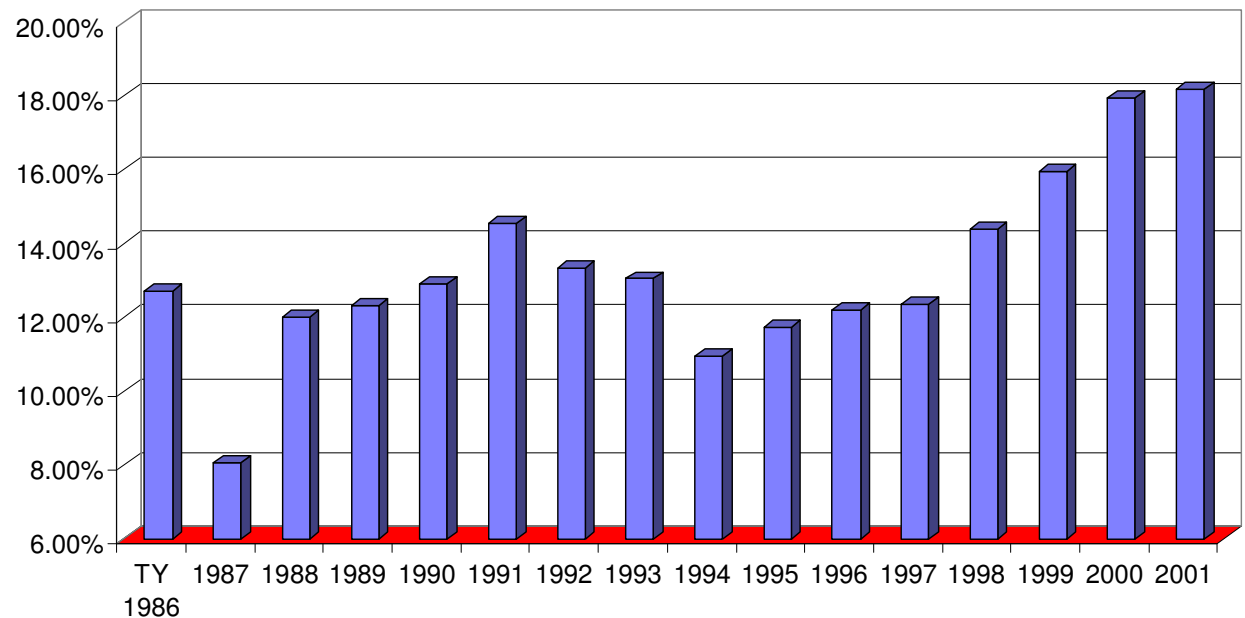
PSC Staff Presentation
Case No. PU-399-01-186
February 25, 2002

Brief History

n Last electric rate case was filed in 1986 resulting in a 6.37% rate increase.

n Recent earnings are too high for a regulated monopoly service provider.

Montana-Dakota Utilities Co.
North Dakota Electric Operations
Return on Equity





Test Year

- n Staff's direct testimony filed on September 7, 2001 utilized a 2000 historical test year plus additional off-system sales margins for an excess earnings position of \$9.155 million.
- n 2001 results were received January 30, 2002 yielding a return similar to that of 2000.
- n Staff rebuttal testimony gives consideration to the new 2001 test year information and MDU's testimony effectively moving the test year to 2002 and beyond. Staff reduced its original position to a finding of excess earnings of \$7.3 million.



Profit Regulation Components

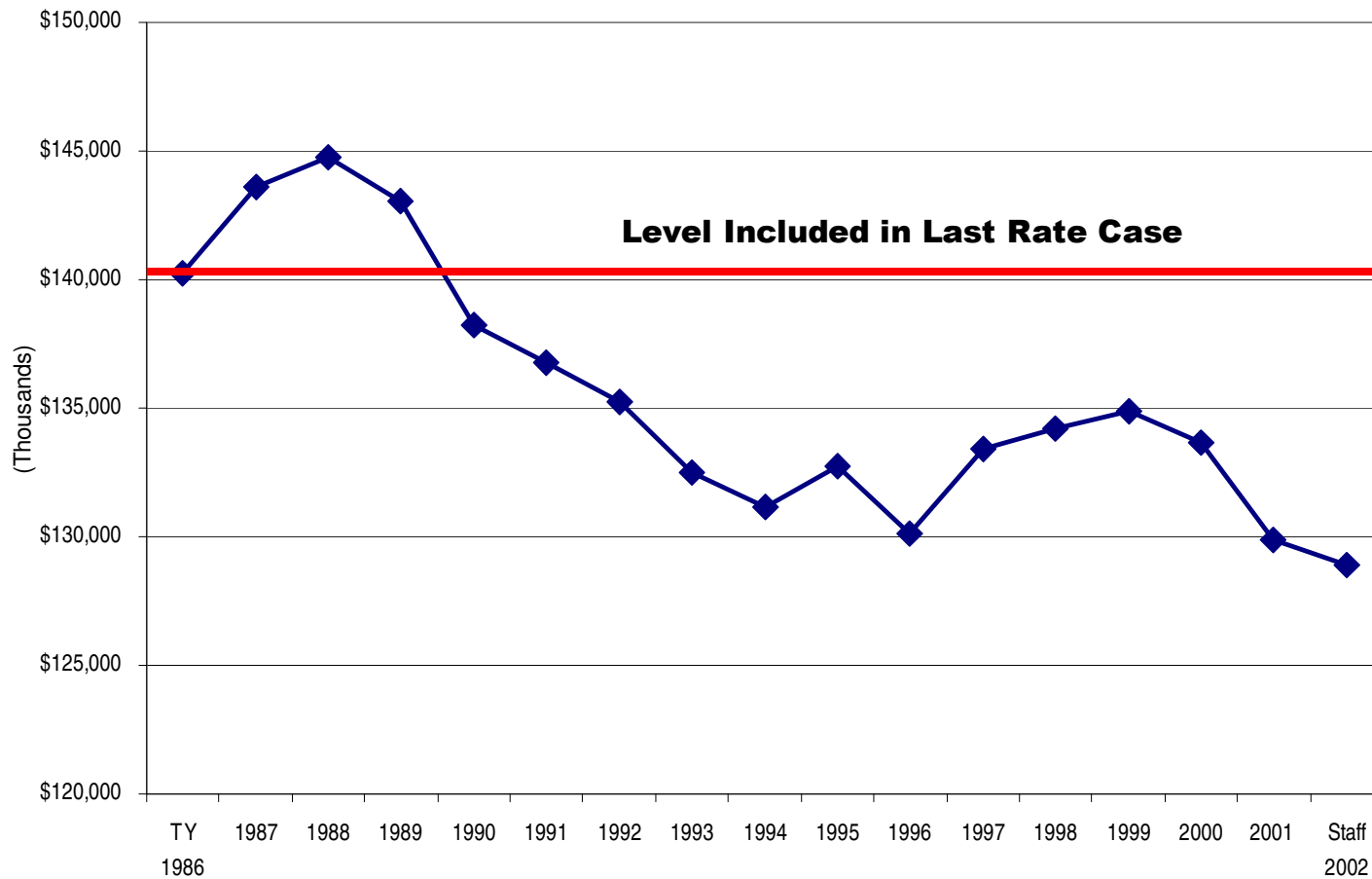
n Rate Base

n Rate of Return

n Net Regulated Income

Rate Base History

Investment in North Dakota Rate Base





Rate Base Summary

- n In rebuttal testimony, staff updated rate base for 2001 financial information and accepted all of MDU's adjustments to rate base for extraordinary capital costs.
- n In surrebuttal testimony, MDU accepted staff's rate base.



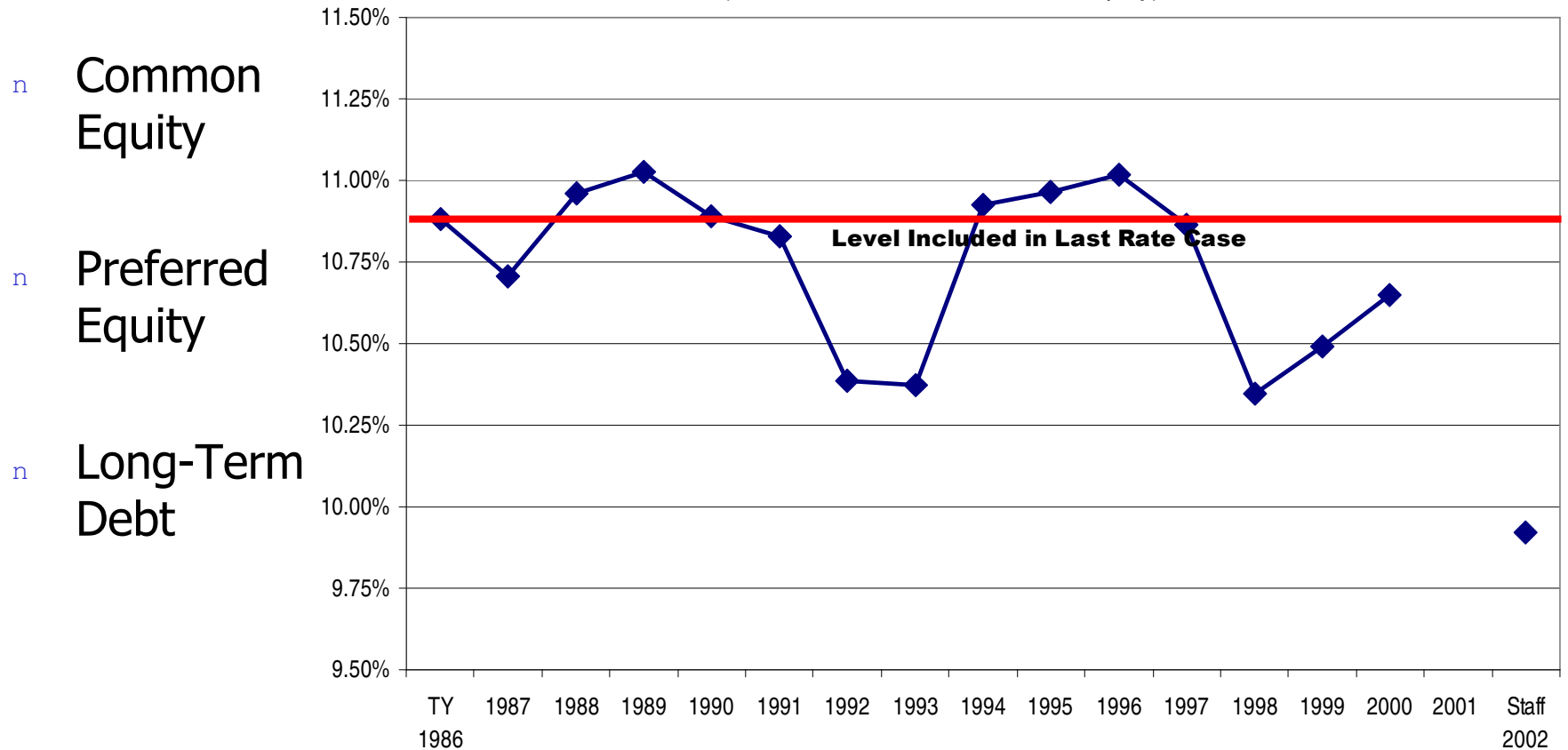
MDU and Staff Rate Base

<u>Description</u>	(Thousands)			
	<u>Beginning Balance</u>	<u>Adjustments</u>	<u>Ending Balance</u>	<u>Average Balance</u>
Plant in Service	\$379,126	\$4,325	\$383,451	\$381,289
Accum. Res. for Depreciation	215,094	71	215,165	215,130
Avg. Net Plant in Service	\$164,032	\$4,254	\$168,286	\$166,159
Constr. Work in Progress	518		518	518
Materials & Supplies	2,909		2,909	2,909
Fuel Stocks	1,255		1,255	1,255
Prepayments	99	15	114	107
Net Negative Salvage			0	-
Accum. Def. Income Taxes	(39,774)	(65)	(39,839)	(39,807)
Accum. Invest. Tax Credits	(2,229)		(2,229)	(2,229)
Customer Advances	(10)		(10)	(10)
Average Rate Base	\$126,800	\$4,204	\$131,004	\$128,902

Required Return on Investment

Cost of Capital Invested in North Dakota

(Assumes 12.71% Return on Equity)



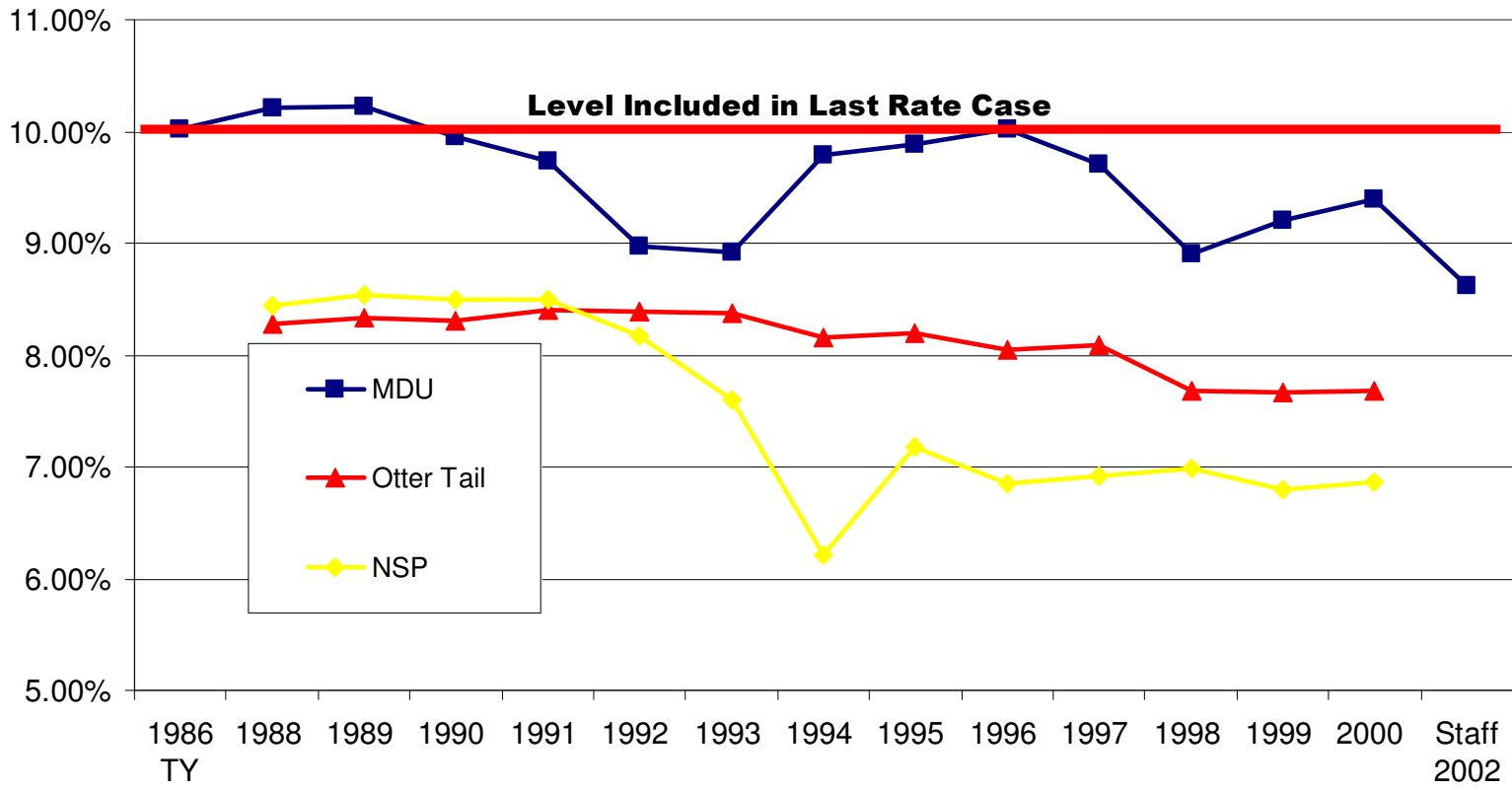


Cost of Capital Summary

	Staff		
	Capital		Weighted
<u>Description</u>	<u>Ratio</u>	<u>Cost</u>	<u>Cost</u>
Debt	45.90%	8.62%	3.96%
Preferred Stock	5.23%	4.63%	0.24%
Equity	48.87%	11.70%	5.72%
Total	100.00%		9.92%
	Montana-Dakota Utilities Co.		
	Capital		Weighted
<u>Description</u>	<u>Ratio</u>	<u>Cost</u>	<u>Cost</u>
Debt	45.90%	9.22%	4.23%
Preferred Stock	5.23%	4.63%	0.24%
Equity	48.87%	12.75%	6.23%
Total	100.00%		10.70%

Long-Term Debt

Cost of Debt Comparison



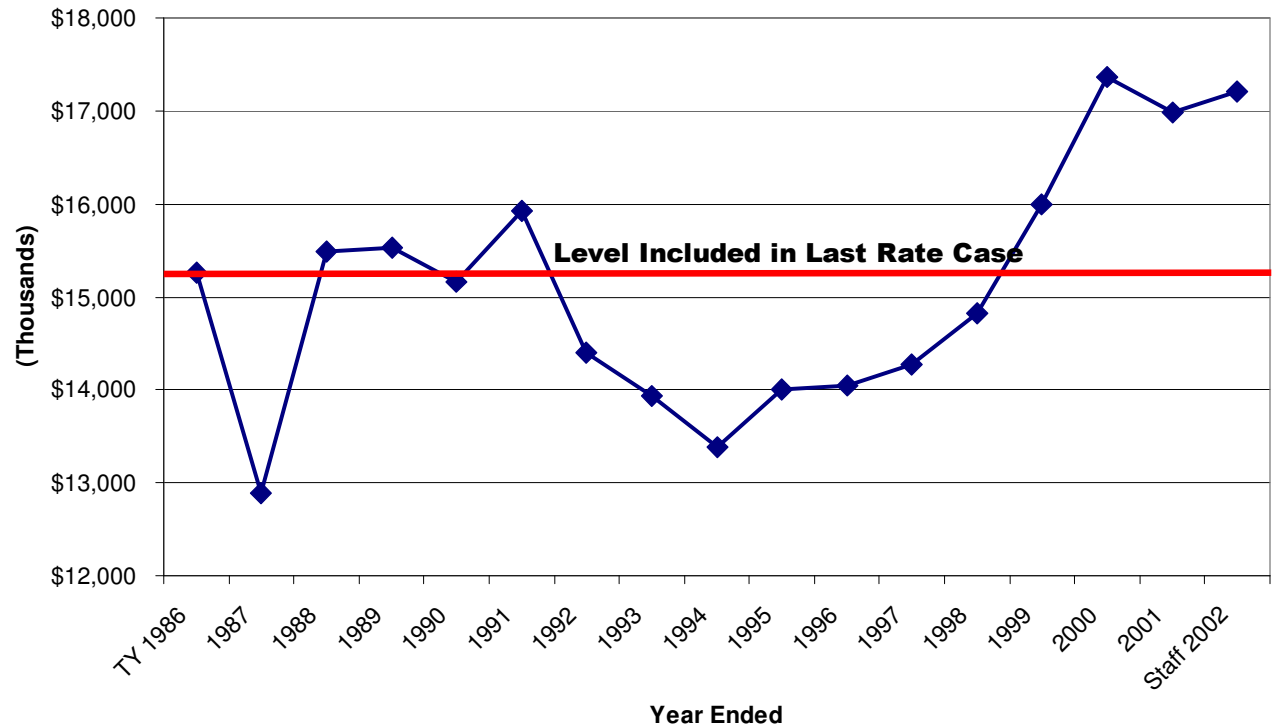
Net Regulated Income

n Revenues

n Expenses

n Net Income

Return Earned in North Dakota





Revenues

n Retail Sales

n Sales for Resale

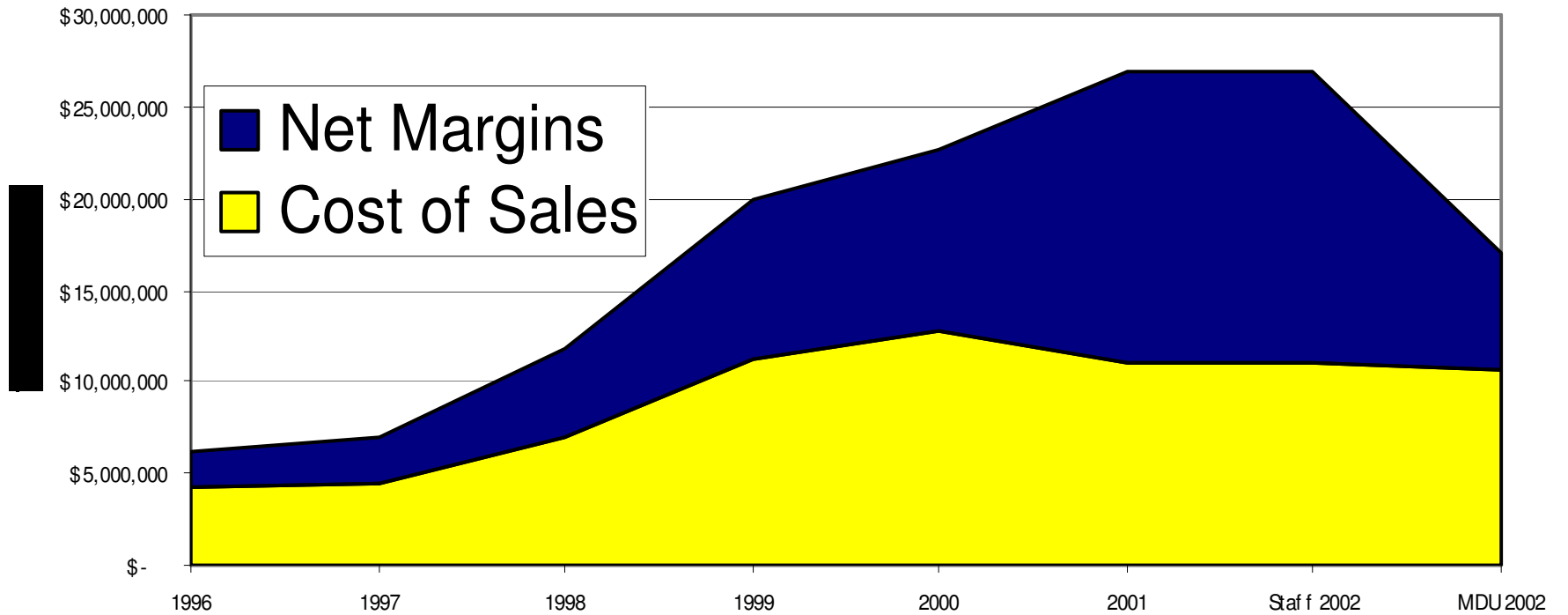
n Other Revenue



Retail Revenues

- n MDU does not calculate the impact of weather on retail sales.
- n North Dakota net margins (revenues less production expense) excluding off-system sales are \$1.1 million down in 2001 compared to 2000.
- n No adjustment.

Resale Margins





Why the Difference?

- n Staff relies on actual results
- n MDU relies on future projections



Factors Affecting Future Resale Margins

- n Futures Contracts
- n Natural Gas Prices
- n Droughts
- n National Economy
- n Manufacturing Industry
- n New Generation Capacity
- n Natural Gas Supplies



Factors Affecting Future Resale Margins (Continued, Page 2)

- n Weather
- n Natural Gas Transportation Rates
- n Incremental Operating Costs
- n Transactional Risks
- n Fuel Cost Differentials
- n Transmission Constraints
- n Generation Mix



Factors Affecting Future Resale Margins (Continued, Page 3)

- n Transmission Access
- n Market Power of Supplier
- n Institutional Inefficiencies
- n Regulation Uncertainties
- n Stranded Cost Exposure
- n Plant Outages
- n Incomplete Market Information



Factors Affecting Future Resale Margins (Continued, Page 4)

- n Nuclear Safety Regulations
- n Hedging Activities
- n Spark-Spreads
- n Conservation Programs
- n Gas Exploration Levels
- n Gas in Storage
- n Market Uncertainty



Proposal to Settle Resale Issue

- n The uncertainties of the future warrants the consideration of actual results as a proxy for future rates.
- n The resulting rates in this proceeding may be in effect for 15 years. Using an average of recent results will smooth out recent market fluctuations and provide for a normalized level going forward.
- n Staff suggests the commission consider using an average of sales margins during the past 3 years for purposes of rate design in this proceeding.



Resale Settlement Calculation

<u>Description</u>	<u>Total</u>
1999 Resale Margins	\$ 8,772,849
2000 Resale Margins	9,918,345
2001 Resale Margins	15,937,892
Add-back Demand Penalties	457,836
Total	<u>\$ 35,086,922</u>
3 Year Average	\$ 11,695,641
2001 Resale Margins	15,937,892
Total Company Adjustment	\$ (4,242,252)
N.D. Share	66%
N.D.Adjustment	<u>\$ (2,799,886)</u>



Expense Issues Remaining

- n Demand Penalty – The penalties for non-compliance with MAPP reserve requirements should not be included as a ratemaking expense. However, can agree that the cost of securing additional capacity for compliance should be included in the cost of service.
- n A & G Costs – Requires a closer look.

Administrative & General Expenses

Total Company (Thousands)							
<u>Account Description</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>MDU</u>
Salaries	\$3,990	\$4,116	\$4,070	\$4,118	\$4,181	\$5,024	\$5,024
Office Supplies	1,883	1,903	1,812	2,112	2,122	2,906	2,906
Outside Services	545	521	558	687	677	653	653
Property Insurance	238	216	202	200	244	344	590
Injuries & Damanges	748	694	639	639	576	474	474
Employee Pen. and Ben.	5,796	4,384	4,410	3,484	2,451	2,415	3,883
Regulatory Commission	125	60	59	66	161	3	3
General Advertising	5	13	18	18	116	195	195
Misc General	789	725	862	830	1,094	978	978
Rents	55	50	35	38	40	124	124
Maintenance of Gen Plant	600	606	627	654	692	772	772
Total A & G Expense	\$14,774	\$13,288	\$13,292	\$12,846	\$12,354	\$13,888	\$15,602
Percent Change		<u>-10.1%</u>	<u>0.0%</u>	<u>-3.4%</u>	<u>-3.8%</u>	<u>12.4%</u>	<u>12.3%</u>



Remaining A & G Issues

- n Office Supplies
- n Insurance Expense
- n Pensions & Benefits
 - n Pension Expense
 - n FAS 106
 - n SISP



Office Supplies Expense

n Automobile Service

n **Bank Charges**

n Books & Subscriptions

n Building Service

n **Communications**

n Office Equipment

n **Computer Infrastructure**

n Membership Fees

n Office Supplies

n Legal Department
Expenses

n Postage and Printing

n Meals, Travel and
Incidental Expenses

n **Corporate Aircraft**



Office Supplies Summary

- n Office supplies expenses are controllable expenditures.
- n MDU's surrebuttal testimony does not provide an analytical approach to quantifying future estimated costs.
- n Staff's position remains unchanged.



Insurance Expense

- n Property Insurance

- n Cost of insurance or reserve accruals to protect against losses to property.

- n Injuries and Damages

- n Cost of insurance or reserve accruals to protect against damage claims of employees or others not covered by insurance.



Insurance Expense Summary

- n MDU's surrebuttal testimony does not include a review of all insurance expenditures and is inconclusive.
- n Staff's position remains unchanged.



Pension and Post Retirement

- n MDU's surrebuttal testimony does not include a review of all employee pension and benefits expenditures and is inconclusive.
- n Staff's position remains unchanged.



SISP

- n Double pension for “key employees”
- n Enron debacle
- n Front page principle
- n Beneficiaries
- n Mergers and Acquisitions

- n Staff’s position remains unchanged

Summary of Net Regulated Income Adjustments

<u>Description</u>	<u>Amount</u>	<u>Account</u>	
Reduce Sales for Resale Margins	(\$2,800)	Revenue	
3 Year Amortization of AVS Maint.	(635)	Production	
Eliminate Demand Penalties	(316)	Production	
Add Additional Capacity	186	Production	
Eliminate Schedule F Revenues	370	Transmission	
Energy Share & Lignite Council Dues	33	A & G	
Normalize Office Supplies Expense	(447)	A & G	
Depreciation for Plant Additions	77	Depreciation	
Adjust Income Tax Expense	(852)	Income Tax Expense	
Reduce Net Regulated Income	(\$1,216)		

Net Regulated Income Statement

Description	(Thousands)				
	Reported by MDU			Adjustments	Test Year
	1999	2000	2001		
Sales for Resale	\$13,265	\$15,034	\$17,687	(\$2,800)	\$14,887
All Other Revenues	80,657	81,929	84,415	0	84,415
Total Revenues	\$93,922	\$96,963	\$102,102	(\$2,800)	\$99,302
Production Expense	\$37,160	\$38,365	\$40,671	(\$765)	\$39,906
Transmission Expense	3,667	3,567	3,915	370	4,285
Distribution Expense	4,586	4,660	5,010	0	5,010
Customer Accounts	2,162	2,113	2,233	0	2,233
Customer Service & Info.	96	105	113	0	113
Sales Expense	258	269	281	0	281
Administration & General	8,303	8,154	8,968	(414)	8,554
Total O & M Expense	\$56,232	\$57,233	\$61,191	(\$809)	\$60,382
Depreciation	\$11,436	\$11,803	\$11,955	\$77	\$12,032
Taxes Other Than Income	\$3,936	\$3,811	\$4,019	\$0	\$4,019
Income Tax Expense	\$6,319	\$6,750	\$7,955	(\$852)	\$7,103
Net Regulated Income	\$15,999	\$17,366	\$16,982	(\$1,216)	\$15,766
<i>Income Tax Calculation:</i>					
Net Income Before Taxes	\$22,318	\$24,116	\$24,937		\$22,869
Less Interest Deduction:					
Rate Base	\$134,869	\$133,667	\$126,800		\$128,902
Weighted Cost of Debt	4.93%	4.74%	3.96%		3.96%
Calculated Interest Deduction	\$6,644	\$6,332	\$5,017		\$5,101
Other Tax Adjustments	\$281	(\$743)	\$163		\$163
Taxable Income	\$15,955	\$17,041	\$20,083		\$17,931
Combined Tax Rate	39.61%	39.61%	39.61%		39.61%
Income Tax Expense	\$6,319	\$6,750	\$7,955		\$7,103



Staff Revenue Excess Calculation

	(Thousands)			
	Reported			
<u>Description</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>Test Year</u>
Average Rate Base	\$134,869	\$133,667	\$126,800	\$128,902
ROR Required (11.7% ROE)	10.07%	10.20%	9.92%	9.92%
Return Required	\$13,575	\$13,627	\$12,574	\$12,783
Return Earned	\$15,999	\$17,366	\$16,982	\$15,766
Return (Excess)	(\$2,424)	(\$3,738)	(\$4,408)	(\$2,984)
Tax Factor	1.656	1.656	1.656	1.656
Revenue (Excess)	(\$4,014)	(\$6,191)	(\$7,300)	(\$4,941)

Worksheet for Commission (1 of 2)

	(Thousands)			
	Reported			
<u>Description</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>Test Year</u>
Average Rate Base	\$134,869	\$133,667	\$126,800	\$128,902
ROR Required (11.7% ROE)	10.07%	10.20%	9.92%	
Return Required	\$13,575	\$13,627	\$12,574	
Return Earned	\$15,999	\$17,366	\$16,982	
Return (Excess)	(\$2,424)	(\$3,738)	(\$4,408)	
Tax Factor	1.656	1.656	1.656	1.656
Revenue (Excess)	(\$4,014)	(\$6,191)	(\$7,300)	
	Cost of Capital			
Long-Term Debt	\$144,894	45.90%		
Preferred Stock	16,500	5.23%	4.63%	0.24%
Common Equity	154,250	48.87%		
TOTAL	\$315,644	100.00%		

Worksheet for Commission (2 of 2)

Description	(Thousands)				
	Reported by MDU			Adjustments	Test Year
	1999	2000	2001		
Sales for Resale	\$13,265	\$15,034	\$17,687		
All Other Revenues	80,657	81,929	84,415	0	84,415
Total Revenues	\$93,922	\$96,963	\$102,102		
Production Expense	\$37,160	\$38,365	\$40,671	(\$765)	\$39,906
Transmission Expense	3,667	3,567	3,915	370	4,285
Distribution Expense	4,586	4,660	5,010	0	5,010
Customer Accounts	2,162	2,113	2,233	0	2,233
Customer Service & Info.	96	105	113	0	113
Sales Expense	258	269	281	0	281
Administration & General	8,303	8,154	8,968		
Total O & M Expense	\$56,232	\$57,233	\$61,191		
Depreciation	\$11,436	\$11,803	\$11,955	\$77	\$12,032
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