

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Montana-Dakota Utilities Co.
2000 Electric Operations
Annual Report

Case No. PU-399-01-186

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

April 2, 2002

Appearances

Commissioners: Susan E. Wefald, Leo M. Reinbold, Anthony T. Clark.

William W. Binek, Chief Counsel, Public Service Commission, State Capitol, 600 East Boulevard, Bismarck, ND 58505, appearing for the Public Service Commission advocacy Staff.

William P. Pearce, Attorney at Law, 314 E. Thayer Ave., PO Box 400, Bismarck, ND 58502-0400, appearing for Montana-Dakota Utilities Co.

Douglas W. Schultz, Senior Attorney, MDU Resources Group, Inc., PO Box 5650, Bismarck, ND 58506-5650, appearing for Montana-Dakota Utilities Co.

Patrick J. Fahn, Utility Analyst, State Capitol, 600 East Boulevard, Bismarck, ND 58505, appearing as advisory Staff for the Public Service Commission.

Allen C. Hoberg, Office of Administrative Hearings, 1707 North 9th Street - Lower Level, Bismarck, ND 58501-1882, presiding Administrative Law Judge.

Preliminary Statement

On September 7, 2001, the North Dakota Public Service Commission advocacy staff (staff) filed a complaint against Montana-Dakota Utilities Co. (MDU), a division of MDU Resources Group, Inc., alleging that MDU's rates result in excess revenue collections of \$9.155 million per year.

On September 19, 2001, the North Dakota Public Service Commission (Commission) found that staff's complaint states a *prima facie* case.

On November 5, 2001, Public Service Commissioner, Susan Wefald, solicited responses from the parties in the case regarding the applicability of handling off-system sales revenue through the fuel adjustment clause and whether the Commission should consider incentives to encourage future off-system sales. The staff's reply argued for no change in existing policy thereby excluding off-system sales profits from the fuel adjustment clause but provided a number of incentive plans used by other state commissions to encourage the selling of off-system sales. MDU's reply stated that any discussions should focus on the need for incentives and a proper balance of the risks and rewards.

On November 13, 2001, MDU filed a letter confirming the procedural schedule agreed to by MDU and staff.

On November 21, 2001, the Commission issued a Notice of Hearing and Notice of Public Input Session. The notice set forth the following issues for consideration in the proceeding:

1. What is the value of MDU's property, used and useful, for the service and convenience of the public in North Dakota?
2. What is MDU's rate of return on its property, used and useful, for the service and convenience in North Dakota?
3. What is a just and reasonable rate of return on MDU's property, used and useful, for the service and convenience of the public in North Dakota?
4. What rates and charges are necessary to provide a just and reasonable rate of return on MDU's property, used and useful, for the service and convenience of the public in North Dakota?
5. Are MDU's proposed rate schedules designed in such a manner that they result in a basis of charge to its customers that is just and reasonable without discrimination?
6. Other relevant information or proposals concerning the proceeding.

On December 11, 2001, the Commission conducted a Public Input Session via interactive videoconference, with hearing sites in Bismarck, Dickinson and Williston. The public input included concerns about escalating prices requiring the lowering of thermostats, a commendation for reliable service, questions concerning changes in company wide earnings and stock prices, concerns about the workability of investor owned utilities in conjunction with rural electric cooperatives and, general questions about deregulation and alternative forms of regulation. Staff and MDU responded to all questions.

On January 11, 2002, MDU's six witnesses filed direct testimony arguing that rates do not need to be changed.

On February 11, 2002, staff's two witnesses filed its rebuttal testimony reducing its initial complaint of excess earnings from \$9.155 million to \$7.327 million.

On February 19, 2002, MDU added four new witnesses and filed its surrebuttal testimony arguing that rates do not need to be changed.

On February 25 and 26, 2002, the Commission conducted a formal hearing as scheduled. No motions to intervene were filed. On March 5, 2002, MDU filed late-filed exhibits.

On March 7, 2002, the Commission held a working session to discuss the issues and clarify whether additional late filed exhibits or information were necessary.

The Commission, having reviewed the evidence in the record and submittals in support thereof, makes the following:

Findings of Fact

1. MDU is a utility company operating as a division of MDU Resources Group, Inc. MDU provides retail electric service to approximately 70,000 customers in North Dakota.
2. Advocacy staff witness Mike Diller testified that the commission should continue to use rate of return regulation as it has in the past. Diller identified the primary components of rate of return regulation as rate base, cost of capital and net regulated income. He explained how the components are used to determine if MDU's rates should be adjusted and provided the Commission with worksheets for use in its deliberations.
3. Many of the issues in this proceeding were resolved between the parties through the filing of direct, rebuttal and surrebuttal testimony, as well as oral testimony at the hearing. Except for the specific exceptions noted below, the parties do not dispute the:
 - Jurisdictional cost of service study.
 - Test year rate base.
 - Capital structure.
 - Cost of preferred equity.
 - Test year revenues (except for sales for resale margins).
 - Test year expenses (except for administrative and general expenses).

4. Diller presented historical rate base amounts reported by MDU and test year rate base levels for this proceeding. MDU did not object to any of Diller's historical representations. Through surrebuttal testimony, MDU agreed to Diller's test year value for rate base. The commission finds that the following schedule accurately depicts North Dakota's historical rate base levels as well as a reasonable test year rate base as agreed to by advocacy staff and MDU.

<u>Description</u>	(Thousands)			
	Reported by MDU			2002
	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>Test Year</u>
Plant in Service	\$366,890	\$375,347	\$379,126	\$381,289
Accum. Res. for Depreciation	193,286	202,071	215,094	215,130
Avg. Net Plant in Service	\$173,604	\$173,276	\$164,032	\$166,159
Constr. Work in Progress	2,572	850	518	518
Materials & Supplies	3,252	3,202	2,909	2,909
Fuel Stocks	1,192	1,277	1,255	1,255
Prepayments	265	209	99	107
Net Negative Salvage				
Accum. Def. Income Taxes	(42,124)	(41,564)	(39,774)	(39,807)
Accum. Invest. Tax Credits	(3,583)	(3,074)	(2,229)	(2,229)
Customer Advances	(309)	(509)	(10)	(10)
Average Rate Base	<u>\$134,869</u>	<u>\$133,667</u>	<u>\$126,800</u>	<u>\$128,902</u>

5. The parties disputed the following issues:

- The return on common equity (ROE) MDU should be allowed. MDU proposes an ROE of 12.75%. Staff recommends an ROE of 11.7%.
- The overall cost of long-term debt. MDU proposes a weighted cost of 9.22% whereas staff advocates a weighted cost of 8.62%.
- The appropriate level of sales for resale margins. MDU proposes using 2001 sales levels combined with futures prices. Staff advocates using a 3-year historical average.
- The appropriate level of administrative and general expenses. MDU proposes a 12.3% increase compared to 2001 levels. Staff proposes a 4.6% reduction compared to 2001 levels.

Return on Common Equity

6. MDU's witness, Steven Gaske, argued that a return on equity of 12.75% is a fair and reasonable return to MDU's stockholders using a Discounted Cash Flow (DCF) calculation.

7. Staff's witness, Charles King, argued that a return on equity of 11.7% is a fair and reasonable return to MDU's stockholders using a DCF calculation.

8. During cross-examination, Gaske reviewed the annual survey of returns on equity granted by other state agencies as reported in the Public Utilities Reports for the year ended September 30, 2001. After reviewing the reports, Gaske noted that of the 45 companies listed, eleven companies were granted returns on equity higher than 11.7% and only three companies were granted returns on equity that were equal to or higher than 12.75%.

9. There were other differences in opinion but the primary areas of disagreement resulting in different recommended rates of return on common equity include:

- Flotation costs.
- Comparable companies.

10. Gaske argued strenuously about the value of using .625 rather than .5 for the dividend growth rate contained in the DCF formula. Both Gaske and King agreed that the difference was immaterial to the ROE calculation.

Flotation Costs

11. Flotation costs are the costs associated with issuing new common equity capital and make up approximately 58 basis points of difference between MDU and staff's position (Tr. p. 199). Eliminating the flotation cost from Gaske's calculation reduces his recommended return on equity of 12.75% to 12.17%, which is only 7 basis points different than King's electric only DCF returns of 12.1%.

12. Staff's position included a review of floatation costs actually incurred during the past five years. King found that the actual costs were immaterial and lost in the rounding when applied to the return required on common equity. As a result, staff did not include any flotation costs in its return on equity calculation.

13. Rather than using actual expenditures, MDU's witness Gaske argued for the inclusion of a theoretical cost of issuing common equity based on a sampling of electric companies during 1996-2000. Gaske's assumed flotation cost of 4.75% for new equity is then used to inflate the estimated return on equity. Essentially, Gaske's position includes enough flotation costs that MDU could reissue all of its common equity annually at the expense of ratepayers.

14. Gaske argued that the courts have had fundamental tests requiring that rates must be sufficient to attract capital in reasonable terms (Tr. p. 173). Yet, under cross-examination, Gaske could not provide any data supporting the notion that disallowing flotation costs would hinder the issuance of stock (Tr. p 209). To the contrary, Gaske agreed that most regulatory commissions do not allow flotation costs (Tr. p. 210).

15. Staff's witness Diller indicated that an average rate base has been declining since MDU's last 1986 test year. . Therefore, MDU's North Dakota electric operation

requires little or no common stock issuances. We agree with staff's position that flotation costs be disallowed.

Comparable Companies

16. Staff's witness King used a DCF analysis to estimate the cost of common equity. Based on certain criteria, King identified 8 comparable combination (gas and electric) utility companies' dividends and growth estimates for estimating the return required on MDU's common equity. King used a "interest rate risk premium" check to test his DCF conclusions for reasonableness.

17. Using a different set of criteria, MDU's witness Gaske utilized 12 companies including both electric only and combination companies for his DCF analysis. The different criteria resulted in Gaske discarding four combination companies identified by King and adding others. Gaske used a risk premium approach known as the Ibbotson & Singfield study and also the "alternative equity investment approach" to test his DCF conclusions for reasonableness.

18. Much discussion ensued as to which group provides the best estimate for MDU's cost of common equity capital. Essentially, staff argued that the comparison companies should be comprised of combination gas and electric companies because MDU is a combination gas and electric utility company. Gaske argued that because this proceeding is about MDU's electric operations, the comparison group should also include electric only companies.

19. Montana-Dakota Utilities Co. is a division of Montana-Dakota Resources Group, Inc. As such, any common stock issuance or dividend paid is done so by Montana-Dakota Resources Group, Inc., a combination gas and electric company.

20. We find that staff's proposed return on equity of 11.7% is a fair and reasonable return on equity to MDU's stockholders.

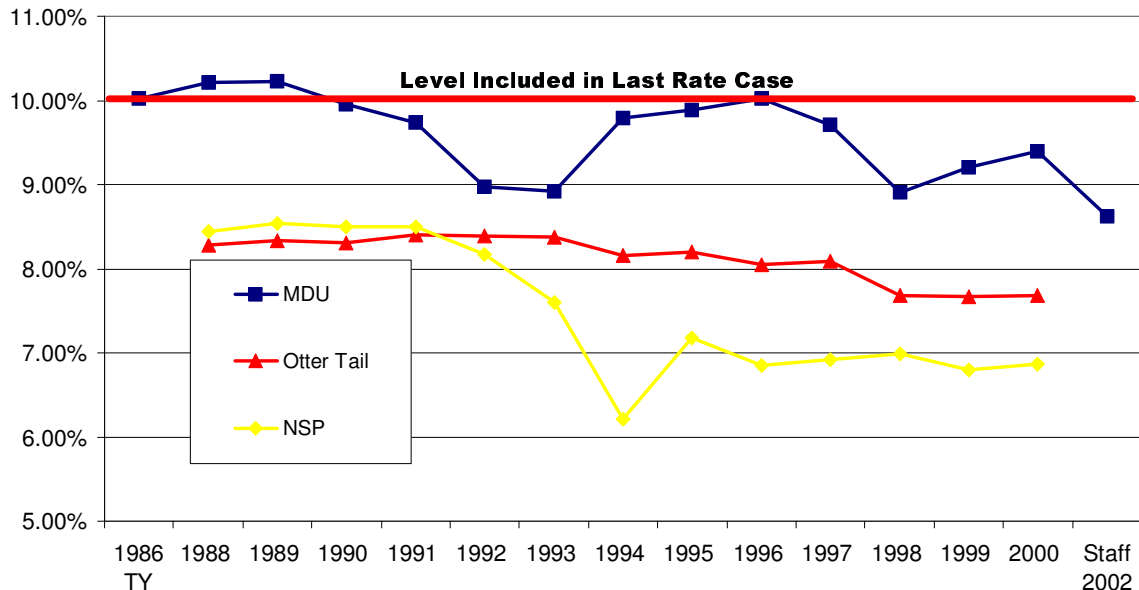
Weighted Cost of Long-Term Debt

21. Diller testified that MDU's reported cost of debt since 1988 remains significantly higher than the cost reported by the other two investor owned electric companies operating in North Dakota.

22. MDU's witness Gaske suggests in his surrebuttal testimony (Ex. 7 p.3) that differences in the cost of debt are due to timing of financing needs and therefore are often explained by the vintage of the debt obligations.

23. For 13 years, little progress has been made by MDU to bring its costs down to a level competitive with the other investor owned electric companies operating in North Dakota. The cost of debt as reported by the investor owned electric companies and included in Diller's testimony follows:

Cost of Debt Comparison



24. According to Diller, a one-percentage point reduction in weighted cost of debt lowers the annual revenue requirements from MDU's North Dakota customers by about \$700,000. (Ex. 1 p. 20)

25. Staff argued for an accounting-based cost of debt calculation through its witness, King. King recommended that debt issuance and redemption costs be amortized over the life of the debt issues, which results in MDU recovering all of its costs. According to King, the Commission utilized an accounting-based cost of debt calculation in Northern States Power Company's last rate case application. Using an accounting-based cost, staff argued that MDU's cost of debt is 8.62%.

26. MDU argued for a "yield-to-maturity" cost of debt calculation. Gaske argued that the yield to maturity calculation gives consideration to the time value of money. Accordingly, the yield to maturity calculation results in a higher cost of debt or 9.22%.

27. The time value of money has not been considered with respect to other expenses included in the test year. Neither party presented any evidence regarding the allowance of cash working capital. Diller testified in his direct testimony that cash working capital is a calculated level of cash needed to pay ongoing expenses and that because revenues are often collected in advance of expenses, it can be a source of cost free capital. Diller's direct testimony states that the Commission's practice with MDU has been to disallow cash working capital absent a lead-lag study. His testimony

states that past Commission decisions have resulted in reducing rate bases of Otter Tail Power Company and Northern States Power Company for cash working capital and that its inclusion typically has benefited North Dakota ratepayers in other cases. We find that absent a lead-lag study, it is unwarranted and unfair to include the time value of money for issuance and redemption costs.

Cost of Capital Summary

28. Advocacy staff through its witness King, presented a capitalization structure and cost of preferred equity for this proceeding. Through its testimony, MDU adopted King's capitalization structure and cost of preferred equity.

29. King argued for an overall cost of capital of 9.92%, as follows:

<u>Description</u>	<u>Staff</u>		
	<u>Capital Ratio</u>	<u>Cost</u>	<u>Weighted 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%

30. We agree with staff's cost of capital.

Sales for Resale Margins

31. Staff argued for using an average of sales for resale margins during the past three years for a normalized level of \$11,695,641 on a total company basis. Diller's resale settlement calculation, offered at the hearing, shows that staff has reduced 2001 sales for resale margins by \$2.8 million on a North Dakota basis for the 2002 test year.

32. MDU argued for using 2001 sales volumes but splits the sales into either off-peak or on-peak sales. The margins are then calculated by multiplying the off-peak sales by an estimated price and the on-peak sales by futures prices quoted by the NYMEX Cinergy Hub.

33. Staff's method of normalizing sales for resale margins is based on actual transactions that have occurred during the past 3 years and then averaged for a proxy of expected margins in the future.

34. Staff's approach of using a three-year average gives consideration to the long time spans that typically occur between rate cases whereas MDU's approach focuses on the current market prices of the day. Under cross-examination, Diller asserted that

this proceeding is not just about setting rates for the next 6 months but instead for 2002 and beyond. MDU's last rate increase application was filed in 1986.

35. Under cross-examination, Diller was asked about the use of a three-year average (Tr. p. 52) to which he responded that the selected period was arbitrary. Diller further stated that the Commission could use a different length of time for averaging past results. Diller's rebuttal attachment MRD-1 depicts sales margins that have been growing for the past six years.

36. Diller identified 28 factors affecting future resale margins from the testimony of MDU's ten witnesses. One of the factors listed by Diller includes "new generation capacity." If price is determined by supply and demand principles discussed in this case, new electric supplies to meet new demand are critical to the long-term pricing of electricity. According to MDU's representation, the Mid-American Power Pool (MAPP) forecasts excess capacity in the future. However, Exhibit 11 entered by Commissioner Wefald shows that the North American Electric Reliability Council suggests that the MAPP capacity is inadequate for the time period of 2001-2010. This indicates that the experts can't agree on the critical element of the supply side of the price equation, and therefore, to assume that everything has changed and supply is now plentiful would be a huge step of faith.

37. With respect to the demand side of the price equation, staff agreed that the economy is somewhat confused at the moment but argued that fixing sales margins for potentially the next 15 years based primarily on futures prices of the day is unreasonable. MDU, on the other hand, would have the Commission believe that the sky is falling.

38. Turning to MDU's margins calculation, MDU splits its calculation between off-peak and on-peak sales. Diller questioned the calculation in his rebuttal testimony (Ex. 2, p. 10) because the off-peak sales margins portion reflects a net loss contribution to earnings of \$144,319. Blinsky responded in his surrebuttal testimony that it is not MDU's common practice to sell below the incremental cost of fuel. He further asserted that his calculation uses average fuel costs and that during off-peak periods the off-system sales typically come from a specific unit. The inference being that MDU's off-peak margins are understated and the on-peak margins are overstated but, as a whole, the calculation is fair.

39. Diller stated in his rebuttal testimony (Ex. 2, p. 11) that staff requested source data for Blinsky's off-peak prices. According to Diller's testimony, MDU replied that off-peak prices are estimates based on recent experience. Diller continued in his rebuttal testimony that without the source data and some historical perspective, staff is unable to conclude anything from MDU's sales for resale margins calculation. We find that no evidence has been offered through direct, surrebuttal or through oral testimony to support MDU's sales price estimate for off-peak sales. Accordingly, MDU's off-peak margins portion of the calculation is suspect and baseless.

40. After cross-examination, MDU witness, Donald Ball, agreed to provide Late Filed Exhibit No. 16 showing the off-peak prices for MAPP for the past four years. We find that MDU's estimates for off-peak margins prices appear to be understated in comparison to the actual MAPP prices.

41. The remaining on-peak margins are calculated by multiplying 2001 sales volumes by the futures prices listed by NYMEX on a particular day. Diller testified that the futures prices may be pretty accurate a few months out but that the further out you go the less accurate futures are going to be as far as what actual prices may end up being. Gaske testified that the futures prices are the best estimate of what electricity will cost in the future and that the futures prices consider all the factors that affect the price of electricity.

42. We find that futures prices is one of the tools that may be used to estimate the future cost of electricity, but it is only one of several tools that may and should be employed. Both staff and MDU pointed out numerous factors that may affect the future price of electricity. We agree with staff that a long-term view of future margin levels should be taken and that a 3-year average for this proceeding is reasonable.

Administrative and General Expenses

43. The administrative and general (A&G) expense category includes a number of accounts including salaries, office supplies, outside services, property insurance, injuries and damages, employee pensions and benefits, regulatory Commission expenses, general advertising, miscellaneous general, rents and the maintenance of general plant.

44. Staff presented evidence at the hearing in its PowerPoint presentation that MDU's A&G expenses had been declining since 1996 until the year ended 2001. The company reported a 12.4% increase in A&G expenses in 2001 and MDU now argues in this case that it needs another 12.3% increase for 2002.

45. Staff argued at the hearing that MDU's surrebuttal testimony does not provide an analytical approach to quantifying future estimated costs and therefore the A&G expense increase sponsored by MDU should be rejected.

46. Staff noted a significant increase in the salaries account of A&G expenses. According to Diller's testimony, no exception was taken to the expense level as staff assumed that the difference was due to different levels of salary capitalization from one year to the next. Under cross-examination, Ball was not sure why A&G salaries increased so much but thought it had to do with the capitalization differences as well. Through cross-examination, Ball agreed to research the difference and file Late Filed Exhibit No. 19. Late Filed Exhibit No. 19 discloses that most of the difference resulted from the payment of higher bonuses and commissions (\$635,765 on a total electric company basis). Staff did not make an adjustment to salaries expense, as this

information was not known until after the hearing. The bonus and commission increase from \$581,509 to \$1,217,274 appears unreasonable.

47. Staff identified three general areas of concern with respect to A&G expenses including MDU's projection of office supplies expense, insurance expense and pensions and benefits.

Office Supplies Expense

48. The office supplies expense category includes such expenditures as automobile services, bank charges, books and subscriptions, building service, communications, office equipment, computer infrastructure, membership fees, office supplies, legal department expenses, postage and printing, travel and incidental expenses and corporate aircraft expenses.

49. In rebuttal testimony, Diller shows that annual office supplies expense normally runs around \$1.8 million to \$2.1 million but that actual expenditures for 2001 were reported to be \$2.9 million. MDU argued that the new level established in 2001 is a reasonable expense level for 2002. On the other hand, staff inflated actual 2000 expenses by 5% to include a more normal level of \$2.228 million for the test year.

50. Staff's position is that the types of expenditures included in office supplies expense are controllable expenditures. Staff noted that MDU is not all that different from the Commission. Diller stated, for example, that there are some years when the commission spends a lot of money on computer software and hardware upgrades, but there are also years when that is not the case because of budgetary constraints. To assume that one extremely high cost year is representative of future expense levels is unreasonable. Further, Diller compared the Commission in this proceeding to the legislature when it appropriates a certain level of funds to the Commission. Controllable costs can be controlled and the Commission should order a reasonable and normal level of office supplies expense.

51. Staff argued that MDU did not use an analytical approach to quantifying future estimated costs. Instead, MDU relied on the expenditure level of one high cost year (2001). Staff highlighted its concerns by pointing out that MDU explained that a substantial part of the increase is attributable to its new corporate aircraft. Yet, no attempt was made or has been made to quantify savings attributable to acquiring the aircraft.

52. Through cross-examination, Ball agreed to submit Late Filed Exhibit No. 17 depicting office supply expenses by various accounts for Commission consideration.

Insurance Expense

53. MDU argued for an increase in North Dakota insurance expense of \$155,383 to reflect higher 2002 premiums. MDU argued that the events on September 11 resulted

in increased insurance costs and that the higher costs are reflected in the 2002 premiums.

54. Staff argued that MDU's testimony did not include a review of all insurance expenditures and that it is inconclusive.

55. As a result of staff's position and cross-examination, Ball agreed to submit Late Filed Exhibit No. 18 to show which premiums are causing the increase in expenditures for 2002.

Pensions & Benefits

56. Staff identified two areas of concern regarding MDU's proposed cost of pensions and benefits, as follows:

- Pension Expense and Post Retirement Expense (FAS 106)
- Supplemental Income Security Plan (SISP)

Pension and Post Retirement Expense

57 MDU's witness Ball argued for an adjustment to pension expense and post retirement expense in his direct testimony. In rebuttal testimony, staff argued that it asked for source data related to the adjustments but that the actuarial information was not provided. In surrebuttal testimony, MDU offered to let Diller review the actuarial study on a confidential basis.

58. Diller concluded at the hearing that both the pension expense and post retirement expense adjustments argued for by MDU does not include a review of all employee pension and benefits expenditures and is inconclusive. Staff made no adjustment to 2001 expense levels.

59. Ball argued that MDU does not have any knowledge of other known changes to pension and post retirement expenses other than the 2002 actuarial studies. Ball argued that the increase is attributable to low investment returns in recent years and the use of a lower discount rate for future years. He further argued that the increases for 2002 are real and currently being booked and that more increases are expected through 2005. MDU's case includes an upward adjustment to 2001 expense of \$179,000 for pension expense and \$62,000 for post retirement expenses.

Supplemental Security Income Plan (SISP)

60. MDU argued for the inclusion of expenses associated with SISP whereas staff argued strenuously against its inclusion in ratemaking expense.

61. MDU included the SISP adjustment in its direct testimony. In direct testimony, Ball argued that the plan provides a supplemental pension benefit to key employees.

Ball further argued that the benefit is necessary to attract and retain high quality staff in a number of key positions within the company.

62. Diller argued through rebuttal testimony that while the plan has been in effect since 1982, the company has never sought rate recovery in any subsequent electric or gas rate case.

63. Diller argued in his rebuttal testimony that MDU's plan lacks symmetry and pointed out that the SISP benefits are heavily weighted in favor of the high-end salaried employees participating in the plan. For instance, an employee making \$50,000 a year would receive a monthly SISP benefit of \$1,330 compared to a monthly benefit of \$30,000 for the employee making \$600,000 a year. In the case of the low-end employee, the monthly benefit calculates to be 2.66% of annual salary compared to the high-end employee who would receive a monthly benefit of 5% of annual salary. Diller noted that only 27 employees of MDU's gas and electric employees are considered to be key employees.

64. MDU's witness Richard Espeland argued in surrebuttal testimony that defined benefit and pension plans and social security are limited as to the maximum benefits a company can pay to its employees. Therefore, the more traditional plans benefit the low paid employees more than the high paid employees on a percentage of income basis. Espeland argued that the SISP enables MDU's key employees to benefit on a more comparable basis when considering benefits as a percentage of income.

65. Espeland indicated that the key employees participating in the plan include officers, directors and senior managers who have the vision to adequately plan for the future and implement appropriate strategies.

66. At the hearing, Diller responded further to the idea of including SISP in ratemaking expense. Diller characterized SISP as a double pension for MDU's few key employees and talked about the Enron debacle and the payments it made to key employees. Diller observed that one of the Congressmen in the Enron hearings stated that the payments to key employees looked like management taking care of itself. Diller observed that Enron provided a warning to all of us, especially managers of companies.

67. Diller opposed spending a million dollars a year for the benefit of a few employees. In addition to SISP, these key employees are paid very well (minimum of \$75,000 to \$80,000 per year according to Espeland) and participate in all the other benefits offered to regular employees such as health insurance, life insurance, 401k participation, profit sharing plans, incentive plants, defined benefit plans, social security and discounted gas and electric service for those living in MDU's service territory.

68. At the hearing, Espeland testified that the plan includes 27 active participants, but that there are also 34 inactive vested participants for a total of 61 current and past employees. Of these, Espeland testified that only 20 are in a pay status. Espeland

further testified that prior employees were not fully funded and that the company has only set aside 20% to 30% of the total liability.

Net Regulated Income

69. Diller presented a historical summary of reported earnings and staff's recommended test year earnings, as follows:

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

70. Staff concluded its direct oral testimony with a calculation of MDU's annual excess earnings, as follows:

	(Thousands)			
	Reported			
Description	1999	2000	2001	Test Year
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)

Conclusions of Law

1. The Commission has jurisdiction over the parties and the subject matter in this proceeding.
2. MDU is entitled to a rate level adequate to provide it an opportunity to earn a reasonable rate of return on its North Dakota electric property, used and useful, for the service and convenience of the public in North Dakota.
3. MDU's existing electric rates yield excess revenues of \$4.941 million per year.

From the foregoing Findings of Fact and Conclusions of Law, the Commission makes its:

Order

The Commission orders:

1. MDU shall file revised tariff sheets, reflecting an across the board rate reduction to produce a total annual rate revenue decrease of \$4.941 million.
2. The rate reduction is to be effective within 30 days of this order.

PUBLIC SERVICE COMMISSION

Anthony T. Clark
Commissioner

Susan E. Wefald
President

Leo M. Reinbold
Commissioner