

STATE OF NORTH DAKOTA
BEFORE THE PUBLIC SERVICE COMMISSION

Montana-Dakota Utilities Co., a
Division of MDU Resources Group, Inc.
Electric Rates Investigation

Case No. PU-399-
01-186

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

On September 7, 2001, the North Dakota Public Service Commission Staff [hereinafter "Staff"] issued a complaint, pursuant to N.D.C.C. ' 28-32-05, alleging that Montana-Dakota Utilities Co.'s [hereinafter "Montana-Dakota"] existing filed rates for providing electric service in North Dakota are unjust and unreasonable, on the claimed grounds that Montana-Dakota is recovering more revenue than necessary to earn a reasonable return on its investment used and useful in providing such service. The complaint alleged that Montana-Dakota's rates should be adjusted to reduce annual North Dakota electric revenues by \$9.155 million annually, and sought a decision by the Public Service Commission [hereinafter the "Commission"] requiring implementation of rates that would produce said revenue reduction. The complaint was served by mail on Montana-Dakota on September 20, 2001.

Montana-Dakota filed its answer to the complaint, pursuant to N.D.C.C. ' 28-32-05, on October 9, 2001, admitting the standard jurisdictional allegations but denying that its filed rates were unjust or unreasonable or that any excess electric revenues were being

earned for North Dakota service, and seeking a dismissal of the Staff=s complaint.

On November 21, 2001, the Commission issued a Notice of Hearing, Notice of Public Input Sessions, and Notice of Intervention Deadline, setting the public hearing in this matter for February 25, 2002, and scheduling informal public input sessions via interactive television on December 11, 2001, in Bismarck, Dickinson and Williston. The public input sessions were held at said time and places, and several members of the public made appearances in Dickinson.

Pursuant to the Notice of Hearing, the Commission held the public hearing at the State Capitol in Bismarck on February 25-26, 2002, on the following issues:

1. What is the value of Montana-Dakota=s property, used and useful for the service and convenience of the public in North Dakota?
2. What is Montana-Dakota=s rate of return on its property, used and useful for the service and convenience of the public in North Dakota?
3. What is a just and reasonable rate of return on Montana-Dakota=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 Montana-Dakota=s property, used and useful for the service and convenience of the public in North Dakota?
5. Are Montana-Dakota=s rate schedules designed in such a manner that they will result in a basis of charge to its customers that is just and reasonable without discrimination?

No person intervened or sought intervention in this matter and no members of the public appeared at the public hearing.

In its written rebuttal testimony submitted on February 11, 2002, the Staff updated its position using new financial information and reduced its initial complaint of excess earnings from \$9.155 million to \$7.327 million. At the public hearing, the Staff again amended its position, recommending instead that Montana-Dakota=s rates should be adjusted to reduce revenues by \$4.941 million annually.

Montana-Dakota took the position that its rates should not be adjusted. Although the evidence the Company presented showed an annual revenue deficiency of \$1.727 million, Montana-Dakota did not seek an increase in its rates to meet such deficiency.

FINDINGS OF FACT

Jurisdiction

1. Montana-Dakota is a Division of MDU Resources Group, Inc. and is a public utility providing both electric and natural gas services to customers in North Dakota, South Dakota, Montana and Wyoming.

Test Year

2. The appropriate test year to be used for determining Montana-Dakota=s rate base for this proceeding is 2001, adjusted for certain known and measurable changes projected for 2002.

Rate Base

3. Based upon the evidence received at the public hearing, the appropriate rate

base for Montana-Dakota=s North Dakota electric service is \$128,902,000, determined as follows:

<u>Projected 2002 (Thousands)</u>				
<u>Description</u>	<u>2001</u>	<u>Adjustments</u>	<u>Adjusted</u>	<u>Average</u>
Plant in Service	\$379,126	\$4,325	\$383,451	\$381,289
Less: Accumulated Depreciation	\$215,094	\$71	\$215,165	\$215,130
Construction Work in Progress	\$518	\$0	\$518	\$518
Net Plant in Service	\$164,550	\$4,254	\$168,804	\$166,677
Materials and Supplies	\$2,909	\$0	\$2,909	\$2,909
Fuel Stocks	\$1,255	\$0	\$1,255	\$1,255
Prepayments	\$99	\$15	\$114	\$107
Accumulated Deferred Income Taxes	(\$39,774)	(\$65)	(\$39,839)	(\$39,807)
Accumulated Deferred ITC=s	(\$2,229)	\$0	(\$2,229)	(\$2,229)
Customer Advances	(\$10)	\$0	(\$10)	(\$10)
Rate Base	\$126,800	\$4,204	\$131,004	\$128,902

Cost of Capital

4. Montana-Dakota=s present capital structure consists of long-term debt, preferred stock and common stock (common equity). The Commission finds that the present capital structure consists of 45.90% long-term debt, 5.23% preferred stock and 48.87% common equity and that said capital structure is just and reasonable for the determination of rates herein.

5. The cost rate of Montana-Dakota=s \$16,500,000 in preferred stock was not

disputed in this proceeding, and the Commission finds that it is 4.63%.

6. Expert testimony on behalf of the Staff and on behalf of Montana-Dakota was presented pertaining to the determination of the cost of the Company's \$144,894,000 in long-term debt. The Commission finds that the yield-to-maturity methodology for calculating the cost of long-term debt best reflects the true effective cost of debt capital because it is based on actual amounts and the actual timing of cash flows, and notes that this methodology is required for ratemaking purposes in proceedings under the jurisdiction of the Federal Energy Regulatory Commission. Accordingly, the long-term debt cost rate of 9.22% for Montana-Dakota determined using the yield-to-maturity methodology is found to be appropriate.

7. Expert testimony on behalf of the Staff and on behalf of Montana-Dakota was presented pertaining to the determination of the cost of Montana-Dakota's \$154,250,000 in equity capital. The Commission finds, based on analysis of business, regulatory, financial and market risks faced by comparable utility companies, including both electric-only and combination (gas and electric) companies, and upon recognizing the necessary flotation cost adjustment testified to by Montana-Dakota's expert witness J. Stephen Gaske, that the appropriate cost of equity capital for Montana-Dakota is 12.75%.

8. Accordingly, the Commission finds that the overall rate of return on rate base which should be allowed for Montana-Dakota is 10.70%, determined as follows:

<u>Source of Capital</u>	<u>Percentage in Capital Structure</u>	<u>Cost Rate</u>	<u>Contribution to Overall Rate of Return</u>
Long-term Debt	45.90%	9.22%	4.23%
Preferred Stock	5.23%	4.63%	0.24%

Common Equity	48.87%	12.75%	6.23%
TOTAL:	100%		10.70%

Revenues from Sales for Resale (Wholesale Sales)

9. A major issue in this case is the level of margins on sales of electric power for resale, that is wholesale sales of power which Montana-Dakota makes to other retailers. The margins realized by the Company on such sales result from two factors: the actual Mwh of power sold and the price per Mwh paid by the purchaser. The evidence presented by Montana-Dakota showed that margins earned through wholesale electric power sales (Asales for resale margins@) during the 2001 test year, as well as during the original proposed 2000 test year, arose from anomalies in the wholesale electric market, including a scarcity of available generation and very high natural gas prices that would not recur in 2002 or in any foreseeable succeeding year. Montana-Dakota=s witness Terry Blinsky testified that the price per Mwh paid to the Company under a wholesale electric contract negotiated in March 2001, covering and setting prices for the 2001 summer peak season, was very favorable because the contract was negotiated at a time when market conditions projected abnormally high electric prices for the 2001 summer peak season. The undisputed expert testimony of Montana-Dakota witnesses Paul Wilkinson and Roger Schiffman showed that the natural gas market when this contract was entered into was very tight and prices were at a decade-high level, resulting in strong upward pressure on electric prices. The testimony of Blinsky, Schiffman

and Wilkinson showed that this situation will not recur in the foreseeable future, demonstrating that the large margins achieved by the Company under the 2001 contract will not be achievable in 2002. The Commission finds that the upper limit of the likely levels of wholesale sales margins in more normal market conditions would result from applying the current market estimated prices to the same level of Mwh sales as were made during 2001, as the Company did in its presentation, resulting in an estimated margin level of approximately \$6,430,000 for 2002. Accordingly, the Commission approves an amount of \$6,430,000 as the appropriate level of adjusted test-year wholesale sales margins for this proceeding.

Operating Expenses

10. The evidence shows that due to higher than normal temperatures and summer load peaks that occurred in 2000 and 2001 Montana-Dakota was unable to meet its reserve capacity obligations imposed by its membership in MAPP (Mid-Continent Area Power Pool) and that accordingly monetary penalties will be assessed in accordance with the MAPP rules and will be payable in 2002 and 2003. The Commission recognizes that the anomalous weather conditions giving rise to the penalty could not be fully foreseen, and determines that the cost that would have been incurred in securing the additional 16.9 megawatts of capacity required to meet the MAPP peak requirement during the summer of 2001, rather than the actual penalty, is the appropriate amount that should be allowed as an operating expense, since this is the actual cost that would have necessarily been incurred in order to avoid the imposition of a penalty. The evidence presented shows that the cost for additional capacity is approximately \$4,000 per megawatt month, so that the cost for the

additional 16.9 megawatts in capacity for four months would be approximately \$270,000 on a total Company basis, or \$186,000 for the portion allocated to North Dakota. The Commission accordingly finds that an amount of \$186,000 should be allowed in North Dakota operating expenses to account for this item.

11. An adjustment to reflect a three-year amortization of major maintenance expenses at the Antelope Valley Unit II generating station resulting from Montana-Dakota's long-term power purchase contract with Basin Electric Cooperative was not disputed between the parties. This amount, which is found to be proper by the Commission, equates to an annual expense reduction of \$920,000 on a Company system-wide basis as applied to the 2001 test period.

12. An adjustment to reflect an annual loss in revenues of \$563,000 resulting from Montana-Dakota's participation in the Midwest Independent System Operator Inc. (MISO) regional transmission organization (RTO), pursuant to FERC order No. 2000, was not disputed between the parties. The inclusion of this revenue reduction is found to be proper by the Commission.

13. The adjustment proposed by Montana-Dakota to labor costs to reflect actual wage increases experienced for 2001 and 2002, was not disputed by the Staff, and the Commission finds the amounts proposed by the Company to be proper and allowable as proper operating expenses.

14. Montana-Dakota introduced evidence showing that its pension and post-retirement benefit costs will increase substantially in 2002, from the 2001 test year amounts, in an amount of \$241,000 applicable to North Dakota operations, due to the decline in asset returns from the abnormally high returns received in recent years and the

decline in discount rates to reflect current long-term interest rates, both of which result in increased pension and benefit costs. The Commission finds this adjustment to be appropriate and accordingly allows this item of \$241,000 as an operating expense increase.

15. Montana-Dakota introduced evidence showing that the portion of the annual cost of its Supplemental Income Security Program (SISP) allocable to North Dakota electric operations is \$683,000. The SISP program is a supplemental pension benefit designed to attract and retain key employees. The Company has not previously sought to include the cost as a recoverable item of operating expense. The Commission finds that such plans are common in the industry and that the SISP program is beneficial to Montana-Dakota customers and serves the public interest by helping to insure a high-quality management of the Company. Accordingly, the Commission finds this adjustment to be appropriate and allows this item of \$683,000 as an operating expense.

16. The evidence shows that Montana-Dakota's insurance expense has increased and that such increases were exacerbated as a result of the terrorist attack upon the United States on September 11, 2001. The record in this case reflects that insurance expenses for 2002 have increased by the amount of \$155,000, and accordingly the Commission finds this adjustment to be appropriate and allows this item of \$155,000 as an increase in operating expense to reflect actual current prevailing conditions.

17. The adjustment proposed by Montana-Dakota to include approximately \$33,000 in contributions to Energy Share of North Dakota and the Lignite Energy Council as allowable operating expenses was not disputed by the Staff. The Commission finds such contributions to be proper and in the public interest and accordingly allows this item as an operating expense.

18. The evidence offered by the Staff noted what it deemed to be an abnormally high level of office supplies expense in 2001, and accordingly Staff proposed using a figure representing a 5% increase over the 2000 level, rather than the actual 2001 level, resulting in a proposed disallowance of \$678,000 in 2001 expenses. The evidence presented by Montana-Dakota, however, showed that the 2001 increase resulted from costs associated with a corporate aircraft, increased costs for computer infrastructure and telephone expense, as well as some reclassification of fees from other accounts, all of which will be continuing costs on a year-to-year basis, rather than one-time increases experienced only in 2001. The Commission finds that these will be annual costs and accordingly no adjustment from actual 2001 levels should be made.

19. Based on the above Findings of Fact and the resolution of certain matters as discussed above, the Commission finds that there is no basis to support a revenue reduction in Montana-Dakota's electric operations at this time. In fact, there exists a revenue deficiency, but, as Montana-Dakota has not sought a rate increase, none is appropriate in this proceeding.

CONCLUSIONS OF LAW

1. The Commission has jurisdiction over the parties to and the subject matter of this proceeding.

2. The Staff bears the burden of proof in this proceeding to demonstrate that a preponderance of the evidence shows that Montana-Dakota's North Dakota electric rates now in effect produce revenues that are excessive and therefore are not just and reasonable.

3. The preponderance of the evidence demonstrates that the current Montana-

Dakota electric rates in effect in North Dakota are just and reasonable, and do not produce revenues that are excessive.

4. The complaint herein should accordingly be dismissed, with prejudice.

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

ORDER

The complaint herein is hereby in all things dismissed, with prejudice.

Bismarck, North Dakota. April _____, 2002.

PUBLIC SERVICE COMMISSION

Susan E. Wefald, President

Leo M. Reinbold, Commissioner

Anthony T. Clark, Commissioner