

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

Allen C. Hoberg, Director, 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 current rates result in excess revenue collections of \$9.155 million per year. Also on September 7, 2001, staff filed its testimony in support of its complaint.

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

On November 5, 2001, Commissioner Susan Wefald wrote to the parties regarding the applicability of handling off-system sales revenue through the fuel

adjustment clause and asking whether the Commission should consider incentives to encourage future off-system sales. On November 21, 2001, staff replied, asserting that no change in existing policy should be made, thereby excluding off-system sales profits from the fuel adjustment clause. Staff also provided information regarding a number of incentive plans used by other state commissions to encourage the selling of off-system sales. On December 3, 2001, MDU replied stating that any discussions of this issue 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 orally 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 of the public 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 asserting that rates do not need to be changed.

On February 11, 2002, staff's two witnesses filed rebuttal testimony reducing their 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 5, 2002, MDU filed Late Filed Exhibit 16 providing monthly on-peak prices for MAPP for the period 1998 through 2001, Late Filed Exhibit 17 providing details of changes in office supply expenses from 2000 to 2001, Late Filed Exhibit 18 an updated summary of insurance expense for 2001 and projected 2002, Late Filed Exhibit 19 providing information on corporate aircraft expense, and Late Filed Exhibit 20 providing details of the change in administrative and general salaries between 2000 and 2001.

On April 10, 2002, MDU filed an update to Late Filed Exhibit 20 to include administrative and general salaries for 1999.

On April 16, 2002, MDU submitted an affidavit of Terry L. Blinsky, Electric Bulk Power Marketing Coordinator for MDU, containing first quarter 2002 wholesale sales and sales for resale margin. MDU requested that this information be made part of the record. MDU also requested that Case No. PU-399-01-186 be held open temporarily for the purposes of settlement negotiations which MDU had initiated with the Commission Staff.

On April 18, 2002, Commission staff filed a response to the affidavit of Terry L. Blinsky stating no objection generally to the filing of the information except to the relevance and subject of paragraph 5 of affidavit.

On April 22, 2002, Commission staff filed a letter stating that it could not reach a settlement agreement with MDU.

The Commission, having reviewed the evidence in the record makes the following:

Findings of Fact

1. MDU is an investor owned 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, Public Service Commission Director of Accounting, 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. Except for the specific exceptions noted below, the parties do not dispute the:
 - 2002 test year for rate determination.
 - 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).

Test Year Rate Base

4. Diller presented historical rate base amounts reported by MDU and 2002 test year rate base levels for this proceeding. MDU agreed to Diller's test year value for rate base. The commission finds the following historical rate base levels and 2002 test year rate base:

<u>Description</u>	(Thousands)			
	Reported by MDU			2002
	1999	2000	2001	Test Year
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	\$134,869	\$133,667	\$126,800	\$128,902

5. The parties dispute the following issues:
- The return on common equity.
 - The overall cost of long-term debt.
 - The appropriate level of sales for resale margins.
 - The appropriate level of administrative and general expenses.

Return on Common Equity

6. The parties dispute the return on common equity (ROE) MDU should be allowed an opportunity to earn.
7. MDU's witness, Steven Gaske, asserted 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.
8. Staff's witness, Charles King, asserted that a return on equity of 11.7% is a fair and reasonable return to MDU's stockholders using a DCF calculation.
9. During cross-examination, Gaske reviewed the annual survey of returns on equity granted by other state commissions 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%.
10. Two primary areas of disagreement, resulting in different recommended rates of return on common equity, include:
- Flotation costs.
 - Comparable companies.

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's and staff's positions. Eliminating the flotation cost from Gaske's calculation reduces his recommended return on equity to 12.17%.
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 witness Gaske included a theoretical cost of issuing common equity based on a sampling of electric companies during 1996-2000. Gaske assumed flotation costs of 4.75% for new equity which he incorporated in his proposed return on equity.

14. Under cross-examination, Gaske provided no empirical data to show that disallowing flotation costs would hinder the issuance of stock. On the contrary, Gaske agreed that most regulatory commissions do not allow flotation costs.

15. Given that staff has provided evidence based on historical information, we find no need to rely on the theoretical information provided by MDU. In addition, Gaske admitted that most regulatory commissions do not allow flotation costs. The evidence indicates a negligible amount of flotation costs in the instant case. Therefore, the Commission will not include flotation costs in the determination of return on common equity.

Comparable Companies

16. Staff witness King used a DCF analysis to estimate the cost of common equity. King testified that if the utility can earn a return on its investment comparable to that required by enterprises of comparable risk, then it should have no difficulty in attracting capital and maintaining credit (comparable earnings test). For the comparable earnings test, King identified companies that have a bond rating of BBB or better from Standard & Poors and Baa or better from Moody's, companies of broadly comparable size, companies that have \$100 million or more in gross revenue, and companies whose market risk is driven by the earnings from providing regulated utility services, including retail electric service. King identified eight combination gas-and-electric companies and four electric-only companies with at least 85 percent of revenue generated by regulated activities. King testified that the comparison companies should be comprised of eight combination gas-and-electric companies since MDU is a combination gas and electric utility company. King used a "interest rate risk premium" check to test his DCF conclusions for reasonableness.

17. MDU witness Gaske used 12 companies including both electric-only and combination (gas and electric) companies for his DCF analysis. The 12 companies used met Gaske's threshold of 75 percent of revenue from regulated retail revenue. Gaske asserts that because this proceeding is about MDU's electric operations, the comparison group should also include electric only companies. 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. Staff asserts that the comparison companies should be comprised of combination gas and electric companies because MDU is a combination gas and electric utility company. Gaske asserts 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 the list of comparable companies should consist of companies with 85 percent or more of revenue from revenue generated by regulated activities. We find merit in MDU's assertion that electric-only companies should be used to determine the cost of equity capital that is devoted to providing regulated retail electric service in North Dakota. However, we find that MDU compromises this philosophy by including combination gas-and-electric companies in its calculation. We also find merit in staff's assertion that the list of comparable companies must consist of combination gas-and-electric companies since MDU is a combination company, however, the comparable companies should perhaps have the same relative proportions of electric-to-gas business as MDU.

21. We conclude that the list of comparable companies for this proceeding should consist of both electric-only and combination gas-and-electric companies with 85 percent or more of revenue from revenue generated by regulated activities. Accordingly, we find that a return on equity of 11.8% is a fair and reasonable return on equity to MDU's stockholders.

Weighted Cost of Long-Term Debt

22. The parties dispute the overall cost of long-term debt. MDU proposes a weighted cost of 9.22% whereas staff advocates a weighted cost of 8.62%.

23. 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.

24. MDU witness Gaske testified 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.

25. Staff witness King testified an accounting-based cost of debt calculation. 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. Using an accounting-based cost, staff asserts that MDU's cost of debt is 8.62%.

26. MDU asserts a "yield-to-maturity" cost of debt calculation is more appropriate. Gaske testified that the yield to maturity calculation gives consideration to the time value of money..

27. We find the "yield-to-maturity" cost of debt calculation is more appropriate as it gives consideration to the time value of money.

28. The Commission finds that an overall weighted cost of capital of 10.24% for MDU is just and reasonable as follows:

Description	Cost of Capital		
	Capital Ratio	Cost	Weighted Cost
Long-Term Debt	45.90%	9.22%	4.23%
Preferred Stock	5.23%	4.63%	0.24%
Common Equity	48.87%	11.80%	5.77%
TOTAL	100.00%		10.24%

Sales for Resale Margins

29. The parties dispute the appropriate level of sales for resale margins. MDU proposes using 2001 sales levels combined with futures prices as of January 2002. Staff advocates using a 3-year historical average.

30. Staff testified that using an average of sales for resale margins during the past three years results in 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.

31. The staff method of normalizing sales for resale margins is based on actual transactions that have occurred during the past 3 years and then averaged to result in a proxy for expected margins in the future.

32. MDU proposed using 2001 sales volumes and splitting the sales into off-peak and on-peak sales. The margins were 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. 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.

34. With respect to the demand side of the price equation, staff asserts that determining sales for resale margins based primarily on futures prices of the day is unreasonable.

35. MDU splits its margins calculation between off-peak and on-peak sales. Diller questioned the calculation in his rebuttal testimony because the off-peak sales margins portion reflects a net loss contribution to earnings of \$144,319. Blinsky testified that it is not MDU's common practice to sell below the incremental cost of fuel. Blinsky 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.

36. Diller stated in his rebuttal testimony that staff requested source data for Blinsky's off-peak prices. According to Diller's testimony, MDU replied that the 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.

37. MDU calculated on-peak margins by multiplying 2001 sales volumes by the futures prices listed by NYMEX on a particular day. Diller testified that futures are going to be less likely to predict actual electricity prices the further out you go. 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.

38. In its April 16, 2002 filing, MDU witness Blinsky states that the level of wholesale sales for the period January 1, 2002 through March 31, 2002 was 226,353 Mwh as compared to 260,830 Mwh sold in the first quarter of 2001. Blinsky further states that the level of sales for resale margins for the period January 1, 2002 through March 31, 2002 was \$1,618,840 as compared to the \$4,126,072 sales for resale margin for the first quarter of 2001.

39. Staff has shown, based on historical evidence, that MDU has made significant margins in its sales for resale. MDU has attempted to predict reduced sales for resale margins through estimates of future sales and future prices.

40. The Commission finds a high degree of uncertainty associated with predictions that are affected by one or more of at least 28 factors and the large number of combinations of those factors that are outside MDU or Commission control. These factors can change dramatically as evidenced by the change in prices of natural gas in recent years. We find that using the average of sales for resale during 1999, 2000, and 2001 is the most appropriate decision at this time.

Administrative and General Expenses

41. The parties dispute 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.
42. 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.
43. Staff presented evidence at the hearing that MDU's A&G expenses had been declining since 1996 until the year ended 2000. MDU reported a 12.4% increase in A&G expenses in 2001 and MDU now asserts that a 12.3% increase for 2002 is justified.
44. Staff asserted that MDU's 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.
45. Four general areas of concern were identified with respect to A&G expenses including MDU's projection of A&G salaries, office supplies expense, insurance expense and pensions and benefits.

A&G Salaries

46. Staff noted a significant increase in the salaries account of A&G expenses from 2000 to 2001. Staff did not originally take exception to the expense level because staff assumed that the difference was due to different levels of salary capitalization from one year to the next. Under cross-examination, MDU witness 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. 20. Late Filed Exhibit No. 20 discloses that a significant portion of the difference resulted from the payment of higher bonuses and commissions. The bonuses and commissions are \$635,765 higher on a total electric company basis, more than double the year 2000 level. At the request of the Commission, MDU updated Late Filed Exhibit 20 to include 1999 data.
47. We find that 2001 A&G salaries expense level is significantly higher than previous years because the bonuses and commissions component of A&G salaries is significantly higher. We find that this level of bonuses and commission is unreasonable and should not be included in the 2002 test year. Therefore we find that an appropriate level of bonuses and commissions for the 2002 test year is an average of that expense for years 1999, 2000, and 2001.

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. Diller provided an exhibit showing office supplies expense for the years 1996 through 2001. Diller testified that normal office supplies expense is approximately \$1.8 million to \$2.1 million annually, but that actual expenditures for 2001 were reported to be \$2.9 million. Staff proposed adding 5% to actual 2000 expenses, resulting in a 2002 test year level of \$2.228 million.

50. MDU asserted that its reported level of office supplies expense in 2001 is a reasonable expense level for 2002.

51. Staff's position is that the expenditures included in office supplies expense are controllable. Staff testified that it is unreasonable to assume that one extremely high cost year is representative of future expense levels.

52. Staff asserted 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 attributes a substantial part of the increase to its new corporate aircraft and that MDU did not quantify the savings attributable to acquiring the aircraft.

53. The Commission agrees that office supply expenses are controllable by MDU. We find that 2001 office supply expense level is significantly higher than previous years and there is no evidence that the significantly higher year is representative of a reasonable test year expense level. The Commission finds that an fair and reasonable level of office supply expenses for the 2002 test year is an average of the office supply expenses for years 1999, 2000, and 2001.

Insurance Expense

54. MDU proposes an increase in North Dakota insurance expense of \$155,383 to reflect higher 2002 premiums. MDU testified that the events on September 11, 2001, resulted in increased insurance costs and that the higher costs are reflected in the 2002 premiums.

55. Staff asserts that MDU's testimony did not include a review of all insurance expenditures and that MDU's evidence is inconclusive.

56. MDU Late Filed Exhibit 18 identifies the premiums that are expected to cause year 2002 increases.

57. The Commission finds that MDU's projected insurance expenses are reasonable for the 2002 test year.

Pensions & Benefits

58. 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

59. MDU witness Ball proposes an adjustment to pension expense and post retirement expense. Staff testified that it asked for source data related to the adjustments but the actuarial information was not provided. MDU offered to let Diller review the actuarial study on a confidential basis.

60. Diller concluded that both the pension expense and post retirement expense adjustments proposed by MDU do not include a review of all employee pension and benefits expenditures and are therefore inconclusive. Staff proposed using 2001 expense levels as a reasonable level for the 2002 test year.

61. Ball testified that MDU has no knowledge of known changes to pension and post retirement expenses other than the 2002 actuarial studies. Ball asserted 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 testified 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.

62. Staff did not further dispute the increases for 2002 related to pension and post retirement expenses or whether said expenses are real and are currently being booked.

63. The Commission finds that the upward adjustment to 2001 expense of \$179,000 for pension expense and \$62,000 for post retirement expenses is reasonable for the 2002 test year.

Supplemental Security Income Plan (SISP)

64. MDU proposed to include expenses associated with SISP. MDU witness Richard Espeland testified that SISP is a supplemental pension benefit that is necessary to

attract, retain and provide equitable benefits for key employees. MDU asserts that various changes in federal regulations, Social security benefits, and employment practices have adversely affected MDU key employees. MDU points out that defined benefit pension plans, that in the past could include benefits in consideration of up to \$225,000 of salary, have been limited to \$200,000. 401(k) plan regulations limit employee contributions limiting the percentage of income a key employee can contribute as compared to a lower salaried employee. MDU also testified that the Social security covered wage base has not kept pace with the general wage inflation and benefits provided at higher income levels are significantly less than at lower income levels. In general, MDU asserts that the more traditional plans benefit the low paid employees more than the high paid employees on a percentage of income basis and SISP enables MDU's key employees to benefit on a more comparable basis when considering benefits as a percentage of income.

65. Diller characterized SISP as a double pension for MDU's few key employees and compared it to the Enron debacle and the payments Enron made to key employees. Diller noted that one of the Congressmen in the recent Enron hearings stated that payments to key employees looked like management taking care of itself. Diller observed that Enron provided a warning to all of us, especially to managers of companies.

66. Staff objects to including SISP in ratemaking expense. Diller testified 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. Staff opposes spending a million dollars a year for the benefit of a few employees. In addition to SISP, employees that are allowed to participate in SISP are paid very well (minimum of \$75,000 to \$80,000 per year) and participate in all the other benefits offered to regular employees such as health insurance, life insurance, 401k participation, profit sharing plans, incentive plans, defined benefit plans, social security and discounted gas and electric service for those living in MDU's service territory.

67. Diller testified 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.

68. The Commission concludes it is inappropriate for ratepayers to bear this expense. The Commission finds that SISP expenses should not be included in ratemaking expense.

Earnings

69. The Commission finds the following historical summary of reported revenue and expenses, and the reasonable test year revenue and expenses, as follows:

Description	(Thousands)				
	Reported by MDU				Test Year
	1999	2000	2001	Adjustments	
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	(205)	8,763
Total O & M Expense	\$56,232	\$57,233	\$61,191	(\$600)	\$60,591
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	(\$1,075)	\$6,879
Net Regulated Income	\$15,999	\$17,366	\$16,982	(\$1,201)	\$15,781
<i>Income Tax Calculation:</i>					
Net Income Before Taxes	\$22,318	\$24,116	\$24,937		\$22,660
Less Interest Deduction:					
Rate Base	\$134,869	\$133,667	\$126,800		\$128,902
Weighted Cost of Debt	4.93%	4.74%	3.96%		4.23%
Calculated Interest Deduction	\$6,644	\$6,332	\$5,017		\$5,456
Other Tax Adjustments	\$281	(\$743)	\$163		\$163
Taxable Income	\$15,955	\$17,041	\$20,083		\$17,368
Combined Tax Rate	39.61%	39.61%	39.61%		39.61%
Income Tax Expense	\$6,319	\$6,750	\$7,955		\$6,879

70. The Commission finds MDU's 2002 test year excess revenue of \$4,273,000, as follows:

<u>Description</u>	(Thousands)
	<u>Test Year</u>
Average Rate Base	\$128,902
ROR Required (11.8% ROE)	10.24%
Return Required	\$13,201
Return Earned	\$15,781
Return (Excess)	(\$2,580)
Tax Factor	1.656
Revenue (Excess)	<u>(\$4,273)</u>

From the foregoing Findings of Fact, the Commission makes its:

Conclusions of Law

1. The Commission has jurisdiction over the parties in and the subject matter of this proceeding.
2. MDU is entitled to rates and charges necessary 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 \$4.273 million per year.

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

Order

The Commission orders:

1. MDU shall implement an across the board rate reduction sufficient to produce a total annual rate revenue decrease of \$4.273 million. MDU shall file revised tariff sheets reflecting the rate reduction to be effective for electric service rendered on and after May 8, 2002.

2. The April 16, 2002, request by MDU that the affidavit of Terry L. Blinsky be made part of the record in this proceeding is granted.

PUBLIC SERVICE COMMISSION

Anthony T. Clark
Commissioner

Susan E. Wefald
President

Leo M. Reinbold
Commissioner

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

**Montana-Dakota Utilities Co.,
a Division of MDU Resources Group, Inc
2000 Electric Operations
Annual Report**

Case No. PU-399-01-186

**Concurring Opinion
Commissioner Susan E. Wefald**

April 24, 2002

This case is a result of a staff investigation into Montana Dakota Utilities (MDU) electric utility rates due to the high earnings that MDU is experiencing in its electric operations. This order will provide opportunities for MDU to achieve 11.8% return on equity, and the 5.06% rate reduction is fair to customers of MDU.

In this case the Commission examined both the income and expenses of MDU electric operations. The rate reduction in this case is a result of determining a reasonable level of income and expenses.

Over the past several years, MDU has sold large amounts of electricity to other utilities. These sales to other utilities have provided MDU with increased profits in the past few years. MDU argued in this case that in the future they will not have as much income from off system sales as they have had in the past few years. There is a lot of uncertainty with making predictions regarding future revenues and future sales.

The Commission also took a close look at the Administrative and General Expenses of MDU and decreased expenses in that area by \$205,000. The Commission allowed increases in some subareas that were justified (such as insurance costs that have risen since September 11, 2001) but did not allow expenses (for example, the Supplemental Security Income Plan) and reduced expenses in other areas (such as Office Supply Expenses).

Commissioner Susan E. Wefald

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

**Montana-Dakota Utilities Co.,
a Division of MDU Resources Group, Inc.
2000 Electric Operations
Annual Report**

Case No. PU-399-01-186

**Concurring Opinion
Commissioner Anthony T. Clark**

April 24, 2002

There were a number of issues to decide in this case in order to get to the bottom line, but the biggest ticket item in dispute was how to handle the large profits reaped by MDU from the sale of excess power to other markets. To address this, the two sides presented essentially two different regulatory paradigms.

MDU asks the Commission to keep rates the same, ignoring the historic profit levels they have made for a number of years. Instead, they ask the Commission to base rates on a futures market that their witnesses said indicated lower profits from excess sales.

Staff asked the Commission to base its decision on historic rates and profits. By using the historic numbers, in this case a three-year average of MDU profits from sales, staff justifies a cut in rates.

I find more merit in staff's argument. It relies on the one sure thing we do know, actual profits and experience in the marketplace. Unfortunately, the futures market has proven to be a less than reliable predictor of what actually occurs at any given time. MDU witnesses even testified to this fact.

MDU witnesses were in the difficult position of making two contradictory arguments. They indicated that no one could have predicted the markets that have given MDU the ability to earn excess profits in recent years. At the same time, MDU asks the Commission to predict future markets with absolute clarity. This is an untenable position.

We simply cannot predict with certainty where prices will go in the next few years. What will happen with transmission constraints? Will Congress permit Yucca Mountain to be the nuclear waste repository? Will the weather be cold or warm in the

next few years? Will new government policies encourage or discourage the production of energy? What will happen with the economy? Will future environmental regulations help one particular fuel source over another? To accurately predict the future price of wholesale electricity, we would have to know the answers to all these questions plus many, many more.

Out of the two models advocated and made part of the record, I find the staff approach more reasonable. It depends on the most accurate, current data available. Additionally, staff made the test year even more fair by averaging the past three years profits, so as to mitigate any one year anomalies.

Might excess power pool sales dry up for MDU? Yes, they might. In which case, MDU might return to the Commission and ask for an increase at some future date.

Might MDU make even more excess power pool sales in the next few years? Yes, that might happen too. In that case, staff will likely file for another rate reduction at some point.

Might excess power sales simply be volatile? That's certainly a possibility as well. In which case ratepayers and shareholders may alternately benefit for short periods of time.

Rates are always subject to change. The job of utility commissions is to be fair and reasonable to both consumers and regulated industries. In this case, based on the record, I believe we have clearly done that.

Anthony T. Clark, Commissioner