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A P P E A R A N C E S

MR. WILLIAM W. BINEK of  
Public Service Commission  
State capital  
Bismarck, North Dakota 58505-0480

FOR THE COMMISSION.

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FOR MONTANA-DAKOTA  
UTILITIES CO.

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1           (The following proceedings were had and made of  
2 record, Monday, October 7, 2002, commencing at 9:00  
3 a.m.)

4           MR. HOBERG: Let's begin. Let the record  
5 show it's approximately 9:00 a.m. on October 7,  
6 2002. This is the time and place scheduled in the  
7 Public Service Commission hearing room in the State  
8 capital in Bismarck, North Dakota, for the hearing  
9 in the matter of the application of Montana-Dakota  
10 Utilities for a natural gas rate increase.

11           In June of this year the Office of  
12 Administrative Hearings received a request from the  
13 Public Service Commission to provide an  
14 administrative law judge to preside in this matter.  
15 My name is Allen Hoberg, and I've been duly  
16 designated as the procedural hearing officer to  
17 preside today.

18           Let's start with the appearances of the  
19 parties for the record in this matter, beginning  
20 with the applicant, followed by the Commission  
21 staff. Will counsel please state their appearances?  
22 Mr. Pearce, please.

23           MR. PEARCE: Yes. Thank you. William P.  
24 Pearce of Pearce and Durick, in Bismarck, appearing  
25 on behalf of the applicant, Montana-Dakota Utilities



1 Company.

2 MR. HOBERG: And who do you have with you?

3 MR. PEARCE: With me to my left is Mr. Don  
4 Ball, manager of regulatory affairs for the company,  
5 and to his left is Mr. Douglas Schulz, who is an  
6 attorney with the company, also appearing for the  
7 company.

8 MR. HOBERG: Thank you. You have a number  
9 of witnesses today.

10 MR. PEARCE: Yes. We have nine witnesses  
11 altogether.

12 MR. HOBERG: Thank you, Mr. Pearce.  
13 Mr. Binek, please.

14 MR. BINEK: My name is William Binek. I'm  
15 counsel for the Public Service Commission. I'm  
16 representing the Commission advocacy staff in this  
17 proceeding. Seated to my right is Mr. Charles King,  
18 a Commission consultant, and to the right of  
19 Mr. King is Michael Majoros, another consultant.  
20 And at the end of the table is Patrick Fahn, a  
21 public utility analyst with the Public Service  
22 Commission.

23 MR. HOBERG: Thank you, Mr. Binek. Is  
24 there anyone else present today who may wish to give  
25 testimony, either for or against the application?



1     Anyone else present?  No one else present.

2                     Then, of course, to my left we have members  
3     of the Public Service Commission.  To my immediate  
4     left, Commissioner Leo Reinbold, and then Commission  
5     President, Susan Wefald, and Commissioner Tony  
6     Clark.

7                     And starting with Commissioner Reinbold,  
8     who has the natural gas portfolio, I'll ask for your  
9     opening comments, please.

10                    COMMISSIONER REINBOLD:  Thank you.  Good  
11     morning, and welcome.  It's good to see so much  
12     interest.  It's an interesting case.  We're here to  
13     determine what needs to be allowed and also what  
14     must be disallowed.  That's our job.  We're here to  
15     do that by being fair to all parties concerned and  
16     get done by Noon because everyone has a plane to  
17     catch.  Welcome.

18                    COMMISSIONER WEFALD:  On Wednesday?

19                    MR. HOBERG:  Thank you, Commissioner  
20     Reinbold.  Commissioner Wefald, please.

21                    COMMISSIONER WEFALD:  Good morning.  We  
22     know that this case is very important, both to the  
23     company and to the consumers of North Dakota, and  
24     we're looking forward to getting a good record.  
25     Thank you.



1 MR. HOBERG: Thank you, Commissioner  
2 Wefald. Commissioner Clark, please.

3 COMMISSIONER CLARK: Good morning. I look  
4 forward to hearing the testimony. Thank you.

5 MR. HOBERG: Thank you. Just for the  
6 record, our court reporter is Linda Gingery today.

7 Just a very brief summary of the  
8 application. It's set out very well in the notice  
9 of hearing. On April 12th of this year MDU filed an  
10 application to increase its rates for natural gas  
11 service by an amount sufficient to provide increased  
12 total annual revenue of \$2,844,132. And then the  
13 rest of the proposals are adequately set forth in  
14 the notice of hearing, and I won't go through the  
15 rest of those today.

16 But on June 5th of this year, the Public  
17 Service Commission issued a notice of hearing,  
18 notice of public input sessions and notice of  
19 intervention deadline. And the notice of hearing  
20 scheduled a hearing for today and, of course, that's  
21 why we're here.

22 It's my understanding there have been no  
23 petitions to intervene in this matter filed with the  
24 Commission. However, there were public input  
25 sessions held via interactive television on July



1 15th of this year at Noon, Central Daylight Time,  
2 and giving members of the public an opportunity to  
3 express their concerns. And those sessions were  
4 held at Bismarck State College, Dickinson State  
5 University, Minot State University, Lake Region  
6 State College, North Dakota State Hospital, and  
7 Williston State College.

8 The issues, according to the notice of  
9 hearing, to be considered in this matter include:

10 Number 1: What is the value of MDU's  
11 property, used and useful, for the service and  
12 convenience of the public of North Dakota?

13 Number 2: What is MDU's rate of return on  
14 this property, used and useful, for the service and  
15 convenience of the public of North Dakota?

16 Number 3: What is the just and reasonable  
17 rate of return on MDU's property, used and useful,  
18 for the service and convenience of the public in  
19 North Dakota?

20 Number 4: What rates and charges are  
21 necessary to provide a just and reasonable rate of  
22 return on MDU's property, used and useful, for the  
23 service and convenience of the public of North  
24 Dakota?

25 Number 5: Are MDU's rate schedules



1 designed in such a manner that they result in a  
2 basis of charge to its customers that is just and  
3 reasonable without discrimination?

4           Number 6: Any other relevant information  
5 or proposals concerning the proceeding.

6           The hearing procedure today will be as  
7 follows: I'll first call on the applicant to  
8 present its case for the granting of the  
9 application. And Mr. Pearce has stated that he has  
10 nine witnesses on behalf of the company today. Each  
11 witness called by the applicant will be subject to  
12 cross-examination by Commission staff and by the  
13 Commission. And following the direct examination  
14 then by Mr. Pearce, cross-examination by Commission  
15 staff and questions by the Commission, I'll allow  
16 such further questions of the witnesses as are  
17 necessary.

18           Upon completion of the applicant's case,  
19 I'll call on the Commission staff to present its  
20 case. And Mr. Binek has informed us that he has two  
21 witnesses. It will be the same procedure there;  
22 direct examination by Mr. Binek, cross-examination  
23 by Mr. Pearce, questions by the Commission staff,  
24 and then such further questions of the witnesses as  
25 are necessary.



1           I think probably most of the evidence  
2   that's being offered today has already been  
3   docketed. Probably some additional evidence, too.  
4   And that will be offered also, though, and the  
5   docket number indicated when it's offered. And  
6   we'll mark the exhibits consecutively, 1 through  
7   whatever, and also indicate the docket number for  
8   those that have already been docketed. If there are  
9   additional exhibits being offered, we need seven  
10  copies for the record today.

11           No decision will be reached on this matter  
12  today. The proceedings are being transcribed and  
13  tape-recorded and will be reviewed by the Commission  
14  later. And, thereafter, the Commission will issue  
15  findings of fact and conclusions of law and an order  
16  as to whether the application should be issued,  
17  denied, or as to other appropriate administrative  
18  action.

19           If the party doesn't agree with the final  
20  decision of the Public Service Commission, they may  
21  have appeal rights or other rights under North  
22  Dakota Century Code Chapter 28-32, which is known as  
23  The Administrative Agencies Practices Act, or under  
24  the Rules of Commission, North Dakota Administrative  
25  Code, Article 69-02.



1           The issues today are as I previously  
2       stated. The burden of proof is on the applicant to  
3       show by the preponderance of the evidence, also  
4       known as the greater weight of the evidence, that it  
5       is entitled to a grant of the application it seeks.

6           Any questions about the procedures today?  
7       Mr. Pearce?

8           MR. PEARCE: No, sir. Except to point out  
9       that we will have our rebuttal case basically to put  
10      on after the staff's case.

11          MR. HOBERG: Correct. Thank you. Yes,  
12      there will be a rebuttal case presented. Mr. Binek?

13          MR. BINEK: Nothing.

14          MR. HOBERG: Just one other housekeeping  
15      item. There was a trade secret protection  
16      application filed in this matter and an order  
17      issued, so I would appreciate it if counsel would  
18      keep me apprised of when something that needs trade  
19      secret protection is going to be dealt with and we  
20      can deal with it appropriately. All right.

21          Mr. Pearce, do you have an opening  
22      statement to make?

23          MR. PEARCE: Yes, I do. I've got a brief  
24      opening statement I'd like to read.

25          MR. HOBERG: Please proceed.



1           MR. PEARCE: This case is an application by  
2 Montana-Dakota Utilities Company seeking the  
3 Commission's approval of an increase in its  
4 residential and firm general service gas rates that  
5 would generate an additional \$2,844,132 in operating  
6 revenues, which is about a 4.1 percent overall  
7 increase. This increase is required to enable the  
8 company to continue to provide safe and reliable  
9 service to its approximately 83,500 customers in the  
10 state.

11           As the company's testimony in the case will  
12 show, the need for the increased revenue is driven  
13 by the necessity of meeting increases in the  
14 operating expenses of its gas distribution  
15 facilities in North Dakota. The company also needs  
16 an adequate permitted rate of return on the  
17 company's property devoted to gas distribution  
18 operations for it to be able to attract sufficient  
19 capital and maintain the quality, reliability and  
20 safety of its gas distribution services.

21           The last general rate increase was  
22 authorized by the Commission in November 1994, and  
23 it was a decrease in the gas rates as a result of a  
24 settlement that took effect in January 1999. This  
25 proceeding, of course, does not address the cost of



1 gas itself which the company acquires for  
2 distribution in its system. That's simply a  
3 pass-through component of the rates handled by the  
4 automatic adjustment procedures.

5 The list of company witnesses and the areas  
6 covered by their testimony will be summarized in the  
7 opening testimony of Mr. Wayne Fox, the company  
8 president.

9 One of the major components in the  
10 operating expense of the company is the depreciation  
11 expense allowance and that is a major factor in this  
12 case. The staff has done a curious thing not seen  
13 in the normal rate case proceeding. They have taken  
14 the depreciation study used in current rates and  
15 critiqued a very small portion of it, with the  
16 outcome being lower depreciation charges. This is  
17 not appropriate to base depreciation on a piecemeal  
18 critique of that study. We feel -- the company's  
19 position, as will be described by its witnesses, is  
20 it's premature at this point to make adjustments to  
21 the present depreciation rates which are based on a  
22 thorough depreciation study done by Stone & Webster  
23 in 1991. And they have been previously recognized  
24 by the Commission and applied in the previous rate  
25 case. The staff has not prepared a proper



1 depreciation study and no adjustment of the  
2 depreciation rates should be entertained by the  
3 Commission in this proceeding.

4           In addition, the question of the  
5 applicability of what's called FAS 143; that is,  
6 Financial Accounting Standard 143, will arise in the  
7 testimony that's already been filed in this case.  
8 This is a new financial accounting standard  
9 applicable to North Dakota's public utilities at the  
10 end of the year. FAS 143 will require companies to  
11 charge -- sorry -- to change the method of  
12 accounting for the expected retirement costs of an  
13 asset over the asset's useful life. FAS 143 is a  
14 very new and untested procedure at this point and  
15 the industry is currently engaged in a great deal of  
16 analysis and debate as to how and in what manner it  
17 should be implemented.

18           The implementation of 143 in North Dakota  
19 is not a matter which should be or reasonably can be  
20 addressed as an ancillary matter in a rate case  
21 involving a single utility company like  
22 Montana-Dakota operating in North Dakota. FAS 143  
23 is a much broader matter than the specific issues in  
24 a single company rate case and many decisions need  
25 to be made before it can be effectively implemented.



1 We feel this complex question can only be properly  
2 addressed in a generic rulemaking proceeding by this  
3 Commission, in which all the utilities operating in  
4 North Dakota may participate and present their views  
5 on the question. For this reason, our position is  
6 that the Commission should not address FAS 143 in  
7 this case, but should defer that issue to its proper  
8 place in a separate rulemaking proceeding that would  
9 involve all the other utilities in which questions  
10 relative to the implementation can be addressed in  
11 an appropriate setting.

12 With that background, MDU makes -- moves  
13 the Commission to defer any action on FAS 143 in  
14 this proceeding and set the matter, that accounting  
15 standard for a generic rulemaking proceeding at some  
16 appropriate point in the future.

17 With regard to the design of the proposed  
18 rates, the company has proposed changes to  
19 accomplish the objectives of providing a measure of  
20 stability during periods of admirable weather; being  
21 user-understandable for consumers, being simple to  
22 administer, and providing for enhanced fixed cost  
23 recovery.

24 We have also included an alternative  
25 proposal in the event the Commission finds the



1 primary proposal unacceptable. The company urges  
2 the Commission to accept the primary proposal as it  
3 provides the best fit with the objectives. However,  
4 should the Commission not adopt the primary  
5 proposal, the company urges the Commission to adopt  
6 the alternative proposal that will be discussed in  
7 the testimony.

8 MR. HOBERG: Thank you, Mr. Pearce.

9 Mr. Binek, do you have any opening to make,  
10 perhaps in response to the motion to defer in regard  
11 to FAS 143?

12 MR. BINEK: I'd like to make a couple  
13 comments.

14 First of all, I think it's appropriate to  
15 consider FAS 143 and its implications to MDU.  
16 Secondly, with regard to depreciation, depreciation  
17 is a major issue in this case. MDU would like to  
18 have the Commission defer any consideration on  
19 depreciation until it completes a depreciation study  
20 that I understand is presently in progress. The  
21 staff's position on that has been and continues to  
22 be that if a part of the case, and a very important  
23 part of the case, is not -- or should not be  
24 considered at this point, none of the case should be  
25 considered at this point.



1           There are other important issues in this  
2 case as well, such as the rate of return that the  
3 company should be allowed. We are far apart in our  
4 recommendations on that. The company is asking the  
5 Commission to allow a return on equity that is in  
6 excess of anything that we have seen, either in  
7 North Dakota or around the country for that matter.  
8 On the other hand, the recommendations of the  
9 Commission's consultants are in line with what is  
10 occurring not only in North Dakota, but across the  
11 country as well.

12           MDU's application is a bit curious because  
13 MDU's gas earnings have been very stable and are  
14 very reasonable at the present time. And it doesn't  
15 appear that MDU is in any need of any increase, but  
16 that will be determined by the Commission in this  
17 proceeding.

18           I think that's all I have.

19           MR. HOBERG: Thank you, Mr. Binek.

20           Mr. Pearce, I understand your motion to  
21 defer is a formal motion?

22           MR. PEARCE: Yes.

23           MR. HOBERG: And I would advise the  
24 Commission to take that under advisement and I don't  
25 know if a ruling on that is necessary right now, but



1 something to take under advisement as part of this  
2 proceeding. You don't expect a ruling?

3 MR. PEARCE: No, that's what we  
4 anticipated.

5 MR. HOBERG: All right. Thank you both.  
6 Would you like to call your first witness,  
7 please, Mr. Pearce?

8 MR. PEARCE: Thank you. I think I'm going  
9 to ask, just for convenience, the application and  
10 supporting statements are already filed, but in case  
11 they need to be referred to, I'd like to mark those  
12 as Exhibits 1 and 2, the two books.

13 MR. BINEK: Your Honor, the direct  
14 testimony is not shown as separate docket entries so  
15 perhaps they be should be identified separately as  
16 exhibits.

17 MR. HOBERG: That's what we're going to do,  
18 but the application, I believe, is marked as Exhibit  
19 1-Docket 3.

20 MR. PEARCE: Right.

21 MR. HOBERG: And what was the other  
22 document?

23 MR. PEARCE: Statements A through O. And  
24 that's going to be Exhibit 2 and it's also Docket 2.

25 MR. HOBERG: Is that all the direct?



1           MR. PEARCE: That's simply the application  
2 and statements. The direct will be, I believe,  
3 Exhibits 3, 4, 5, 6, 7, 8, 9, and 10. And it's the  
4 seven direct -- prefiled direct testimony. It's all  
5 in one, single book there, but I think that will  
6 have the next seven exhibit numbers.

7           MR. HOBERG: Let's go off the record.  
8           (Exhibits 1, 2, 3, 4, 5, 6, 7, 8, and 9  
9 were marked for identification.)

10           (Discussion off the record.)

11           MR. HOBERG: Okay. The packet that we have  
12 of all of the direct testimony of Montana-Dakota  
13 Utilities is marked on the outside as Docket No. 1,  
14 and the inside of each of the -- direct testimony of  
15 each of the witnesses will be marked consecutively  
16 as 3 through 9, and that's how we'll be referring to  
17 them during the presentations then.

18           Mr. Fox is the first witness?

19           MR. PEARCE: Yes, he is.

20           MR. HOBERG: Mr. Fox, please.

21           Please be seated. As you know, I'm  
22 required by law to tell all the witnesses at  
23 administrative proceedings that the maximum penalty  
24 for perjury in this state is a Class C felony,  
25 punishable by a maximum five years imprisonment,



1 \$5,000 fine, or both.

2 Mr. Fox, being advised of the penalty for  
3 perjury, do you promise to tell the truth in this  
4 matter? If so, answer I do.

5 THE WITNESS: I do.

6 MR. HOBERG: Thank you. Mr. Pearce,  
7 please.

8 C. WAYNE FOX,  
9 having been first duly sworn, was examined and  
10 testified as follows:

11 DIRECT EXAMINATION

12 BY MR. PEARCE:

13 Q. Would you please state your name and your  
14 business address?

15 A. My name is C. Wayne Fox. My business  
16 address is 400 North Fourth Street, Bismarck, North  
17 Dakota 58501.

18 Q. What is your position with Montana-Dakota  
19 Utilities Company?

20 A. I am president of Montana-Dakota Utilities,  
21 a division of MDU Resources Group, Incorporated.

22 Q. What are your duties and responsibilities  
23 with Montana-Dakota?

24 A. I have executive responsibility for the  
25 development, coordination and implementation of the



1 strategies and policies relative to all areas of  
2 operation.

3 Q. Would you please outline your educational  
4 and professional background?

5 A. In 1964 I received a Bachelor of Science  
6 degree in electrical engineering from Chicago  
7 Technical College, Chicago, Illinois. I received a  
8 Master of Arts degree in business administration  
9 from the University of Illinois, Springfield,  
10 Illinois in 1975. Upon graduating from college in  
11 1974, I joined the Illinois Commerce Commission, the  
12 state body regulating public utilities in Illinois,  
13 as an electrical engineer.

14 Upon termination of my employment with the  
15 Illinois Commerce Commission in June 1980, I was  
16 serving as manager of the public utilities division.  
17 In that capacity my duties included testifying in  
18 formal cases before the Commission, formulating and  
19 coordinating Commission policies on technical and  
20 administrative matters, processing formal and  
21 informal cases, and advising the Commission on  
22 matters related to the regulation of public  
23 utilities operating in the State of Illinois.

24 In June 1980 I joined Montana-Dakota as  
25 assistant treasurer, regulatory affairs, retaining



1 that position until May 1982 when I was elected  
2 assistant vice-president, regulatory affairs. In  
3 May 1985 I was promoted to vice-president,  
4 regulatory affairs. In May 1987 my duties were  
5 broadened to include the company's purchasing and  
6 general services activities. At that time my title  
7 was changed to vice-president, regulatory affairs  
8 and general services. I assumed my present position  
9 in August 2000.

10 I also have been involved with the  
11 activities of the Electric Power Research Institute,  
12 the Edison Electric Institute, and the American Gas  
13 Association.

14 Q. Have you testified before this Commission  
15 and other state regulatory bodies?

16 A. Yes. I have previously sponsored testimony  
17 before this Commission, the Montana Public Service  
18 Commission, the Wyoming Public Service Commission,  
19 Minnesota Public Utilities Commission, and South  
20 Dakota Public Utilities Commission. In addition,  
21 during my tenure with the Illinois Commerce  
22 Commission, I testified in a number of cases before  
23 that Commission.

24 Q. What is the purpose of your testimony?

25 A. The purpose of my testimony is to provide



1 an overview of our North Dakota natural gas  
2 operations, explain our request for a gas rate  
3 increase, and discuss the policies and reasons  
4 underlying the major aspects of the request. I will  
5 also identify the company witnesses in this  
6 proceeding.

7 Q. Would you provide a summary of Montana-  
8 Dakota's gas operations in North Dakota?

9 A. The North Dakota natural gas distribution  
10 system serves approximately 83,500 customers in 76  
11 communities. The customer mix is about 86.5  
12 percent residential, 13.3 percent firm commercial,  
13 with the small interruptible and large interruptible  
14 customers making up two-tenths percent of customers.  
15 In addition, gas is provided to the U.S. Air Force  
16 Base at Minot and a location in northeastern North  
17 Dakota. The residential, firm commercial, and small  
18 interruptible customers use natural gas primarily  
19 for space and water heating.

20 As such, Montana-Dakota's system has a low  
21 load factor with peak gas requirements occurring  
22 during the winter, with summer loads being small by  
23 comparison. The total annual gas used by North  
24 Dakota customers is 18.3 megadecatherms as projected  
25 for 2003 in this case. Consumption by customer



1 class is as follows: 43 percent residential, 31  
2 percent firm commercial, 8 percent small  
3 interruptible, 12 percent large interruptible, and 6  
4 percent U.S. Air Force.

5 Montana-Dakota's North Dakota gas service  
6 area is divided into two operating regions, with  
7 regional offices located in Bismarck and Dickinson.  
8 In addition, there are a number of district offices  
9 located in communities throughout the state. As of  
10 December 31, 2001 the company had 587 full and  
11 part-time employees who live and work throughout our  
12 North Dakota electric and gas service area.

13 Q. Mr. Fox, did you authorize the filing of  
14 the rate application in this proceeding?

15 A. Yes, I did.

16 Q. Why has Montana-Dakota filed this  
17 application for a gas rate increase?

18 A. Montana-Dakota is requesting an increase in  
19 general gas rates at this time because the current  
20 cost of providing natural gas service to our North  
21 Dakota customers is not adequately reflected in  
22 the -- excuse me -- is not accurately -- adequately  
23 reflected in currently authorized rates. It should  
24 be noted that this application does not include any  
25 cost changes related to the cost of gas which is



1 handled through the Commission authorized Purchased  
2 Gas Cost Adjustment tariff.

3 Q. Would you please explain the basic elements  
4 that make up the total costs of providing gas  
5 service and which of these elements is subject to  
6 regulation by this Commission?

7 A. Yes. The cost of providing natural gas  
8 service can be best broken down into two major  
9 categories. First, the cost of the gas delivered to  
10 the town border station where it leaves the  
11 interstate or intrastate pipeline and enters our  
12 distribution system. And, second, the cost of  
13 delivering the gas from the town border station  
14 through our distribution system to the individual  
15 customers. We call this portion distribution costs  
16 or non-gas costs.

17 Natural gas purchased from a producer or  
18 supplier is a commodity like wheat or corn and  
19 prices are not regulated. The charges for moving  
20 the gas to our distribution system on the pipeline  
21 system are regulated by the Federal Energy  
22 Regulatory Commission or other regulatory agencies.  
23 These two elements which we call, quote, unquote,  
24 gas costs, are passed on to our customers on a  
25 dollar-for-dollar basis as specified in the



1 Purchased Gas Cost Adjustment Tariff, and there is  
2 no profit made by Montana-Dakota. This portion  
3 currently comprises about 66 percent of a typical  
4 residential bill for gas services.

5 The distribution cost of our rate is  
6 regulated by this Commission and is the subject of  
7 this proceeding. This portion includes operation  
8 and maintenance expenses, depreciation, taxes, and a  
9 component for the opportunity to earn a return on  
10 the investment we have in facilities to provide  
11 natural gas service. The distribution costs are  
12 currently about 34 percent of a typical residential  
13 bill. The last time this portion of the rates  
14 increased was in 1994.

15 Q. What is the amount of the increase  
16 requested?

17 A. As will be fully explained by other company  
18 witnesses, the company is requesting an increase of  
19 \$2,844,132 based on a projected 2003 test year.

20 Q. How will the requested increase affect the  
21 various classes of customers?

22 A. The proposed percentage change in rates by  
23 customer class is as follows: Residential, 4.6  
24 percent change; firm general service, 4.6 percent;  
25 Air Force, zero; small interruptible, a negative 4.1



1 percent; large interruptible, zero, for a total  
2 increase of 4.1 percent.

3 Q. What are the primary reasons that Montana-  
4 Dakota needs an increase at this time?

5 A. The primary reasons are increased operating  
6 expenses, operation and maintenance costs,  
7 depreciation and taxes other than income and a  
8 higher required return on equity.

9 Q. When was the last general rate increase for  
10 Montana-Dakota?

11 A. Montana-Dakota's last gas -- I'm sorry.  
12 Montana-Dakota's gas rates were last increased in  
13 November 1994. The increase was \$565,000 annually  
14 and was authorized in case No. PU-399-94-297.

15 Q. Have the gas generates changed since that  
16 time?

17 A. Yes. In case number PU-399-96-325 the gas  
18 generates were decreased by \$800,000 or about 1.2  
19 percent as a result of a settlement accepted by the  
20 Commission with a lower rate becoming effective  
21 January 15, 1999.

22 Q. Would you please explain how Montana-Dakota  
23 has been able to hold the gas rates down since 1994?

24 A. From 1994 through 2001 the Consumer Price  
25 Index has risen almost 20 percent. In spite of this



1 increase, we have been able to hold the line on our  
2 gas rates by finding ways of operating our business  
3 more efficiently and taking advantage of new  
4 technology where it makes economic sense to do so.  
5 For example, we have created a customer service  
6 center in Bismarck representing a one-stop shop for  
7 our customers. And we have installed computers in  
8 our servicemen's trucks allowing them to receive  
9 orders electronically, resulting in savings of at  
10 least one hour per day. We continue to look for  
11 opportunities to reduce costs and increase  
12 efficiencies. However, we now find ourselves in a  
13 position where despite our efforts, our best  
14 efforts, we must seek rate relief.

15 Q. What policy changes are proposed by the  
16 company in this filing?

17 A. We are proposing a change in policy  
18 regarding service lines. Montana-Dakota is  
19 proposing to own all service lines on a prospective  
20 basis. Currently, Montana-Dakota owns the service  
21 lines in the communities designated as rate zone 2  
22 in its tariff. The customers currently own the  
23 services lines in the communities designated as rate  
24 zone 1. We are proposing that Montana-Dakota own  
25 and pay for, subject to appropriate extension policy



1 considerations or conditions, all new and  
2 replacement service lines on a prospective basis.  
3 This change will remove the distinction between rate  
4 zones 1 and 2 and will serve as a uniform policy on  
5 a statewide basis for all of our service areas. It  
6 will also align the ownership of the service line  
7 with the responsibility for ongoing testing and  
8 maintenance of the lines, which rests with  
9 Montana-Dakota and will avoid customer confusion and  
10 frustration in those instances when a replacement is  
11 necessary.

12 Q. Is Montana-Dakota proposing changes in its  
13 rate structure in this proceeding?

14 A. Yes. The proposed changes in the rate  
15 structure, which will be fully described by other  
16 witnesses, accomplish the objectives of providing a  
17 measure of stability for our customers, being simple  
18 to administer, and providing for enhanced fixed cost  
19 recovery.

20 I should note that our witnesses also  
21 present an alternative proposal in the event that  
22 the Commission finds the primary proposal to be  
23 unacceptable. The alternative proposal is fully  
24 described in the testimony of other witnesses. I  
25 would urge the Commission to accept the primary



1 proposal, as it provides the best fit with the  
2 objectives noted above.

3 Q. Will you please identify the other  
4 witnesses who will testify on behalf of Montana-  
5 Dakota in this proceeding?

6 A. Yes, I will. I should note at line 22,  
7 Mr. Pearce, that there's a correction. We should  
8 strike the word "electric" appearing in the last  
9 line thereof and substitute the words "natural gas."  
10 I will finish my answer.

11 In addition to myself --

12 MR. HOBERG: Mr. Fox, I'm sorry to  
13 interrupt you, but just for the court reporter's  
14 benefit, all the names, of course, are listed in the  
15 prefiled testimony. Please continue.

16 THE WITNESS: Stephen Gaske, President of  
17 Zinder Companies, Incorporated, will testify  
18 regarding the appropriate cost to common equity and  
19 overall cost of capital for Montana-Dakota's natural  
20 gas operations. Mr. Craig A. Keller,  
21 vice-president, controller and chief accounting  
22 officer for Montana-Dakota, will testify regarding  
23 the capital structure and overall debt and preferred  
24 equity costs. Ms. Rita A. Mulkern, regulatory  
25 analysis manager for Montana-Dakota, will testify



1 regarding the total revenue requirements necessary  
2 for Montana-Dakota's North Dakota gas operations.

3 Mr. Richard A. Espeland, vice-president,  
4 human resources for MDU Resources Group,  
5 Incorporated, will testify regarding the  
6 supplemental income security plan. Mr. Russell A.  
7 Feingold, managing director of Navigant Consulting,  
8 Inc., will testify regarding certain rate design  
9 policy matters. And Ms. Tamie A. Aberle, pricing  
10 and tariff manager for Montana-Dakota, will testify  
11 on the specific rate design proposals.

12 Q. (MR. PEARCE CONTINUING) Mr. Fox, are the  
13 rates requested in this proceeding just and  
14 reasonable?

15 A. Yes. In my opinion, the proposed rates are  
16 just and reasonable because they are reflective of  
17 the total cost being incurred by Montana-Dakota in  
18 providing gas service to its customers. The  
19 proposed rates will allow Montana-Dakota the  
20 opportunity to earn a just and reasonable return on  
21 its North Dakota gas operations.

22 Q. Does this complete your direct testimony?

23 A. Yes, it does.

24 Q. And to the best of your information and  
25 belief, does the testimony you have just given



1 coincide with the prefiled direct testimony that's  
2 marked as Exhibit A?

3 A. It does.

4 Q. Did you prepare that testimony originally?

5 A. I did.

6 MR. PEARCE: I'll offer Exhibit A at this  
7 time -- Exhibit 3. I have no further questions of  
8 this witness.

9 MR. HOBERG: Any objection to Exhibit 3,  
10 Mr. Binek?

11 MR. BINEK: No.

12 MR. HOBERG: Exhibit 3 is admitted.

13 Mr. Binek, do you have any questions on  
14 cross-examination?

15 MR. BINEK: Yes, I do.

16 CROSS-EXAMINATION

17 BY MR. BINEK:

18 Q. Good morning, Mr. Fox.

19 A. Morning.

20 Q. Does MDU calculate its earned return each  
21 year for its North Dakota gas operation?

22 A. We do.

23 Q. What was the company's earned return on its  
24 gas operations during each of the years 1998, 1999,  
25 2000, 2001?



1           A.    I don't know right offhand.  I can  
2    certainly provide that to you.  We've filed an  
3    annual report with the Commission each and every  
4    year.  I do know for 2003 without this rate  
5    increase, we would be a negative 4 percent.

6                   (Exhibit 10 was marked for identification.)

7           Q.    (MR. BINEK CONTINUING)  Mr. Fox, I show you  
8    what has been marked as Exhibit 10 and ask if you  
9    can identify that exhibit?  First of all, I guess I  
10   should ask if you've seen that previously?

11          A.    I have not.

12          Q.    Okay.  Do you recognize that as an exhibit  
13   that has been docketed in an MDU case by the Public  
14   Service Commission?

15          A.    I do not.

16                MR. HOBERG:  Mr. Pearce, did you get a  
17   copy?

18                MR. PEARCE:  No, I didn't.  I'm wondering  
19   what it is.

20          Q.    (MR. BINEK CONTINUING)  Can you identify  
21   what the exhibit is, please?

22          A.    It's a memorandum, internal memorandum, I  
23   believe, written by Mike Diller of the Commission  
24   staff, and it's written to Commissioners, Illona and  
25   Bill.  And --



1 Q. What is the date of that document?

2 A. September 3rd, 2002.

3 Q. Okay. And what does it refer to?

4 A. It refers to 2001 annual reports.

5 Q. And in that document there are a number of  
6 companies listed, including MDU Gas, and it shows  
7 returns on equity earned by utilities for the four  
8 years that I had asked you about; is that correct?

9 A. It does.

10 Q. Do you have any reason to doubt the figures  
11 that are shown in that exhibit?

12 A. I do not.

13 Q. And would you accept the figures shown on  
14 that exhibit subject to check, subject to your own  
15 verification?

16 A. I would.

17 Q. What is the ROE shown for the year 1998 for  
18 MDU?

19 MR. HOBERG: I think we better have it  
20 offered and admitted before we testify.

21 MR. BINEK: I'm sorry. I will offer  
22 Exhibit 10.

23 MR. HOBERG: Any objection to Exhibit 10,  
24 Mr. Pearce?

25 MR. PEARCE: I guess I'm tempted to object



1 for lack of foundation since the witness who  
2 prepared it is not being offered, but given that  
3 Mr. Fox has indicated he would accept the numbers  
4 subject to verification, I don't have any objection.

5 MR. HOBERG: Okay. Exhibit 10 is admitted.  
6 Mr. Binek, please.

7 MR. BINEK: Thank you.

8 Q. (MR. BINEK CONTINUING) Now, Mr. Fox, would  
9 you -- for the year 1998 what is the ROE shown for  
10 MDU gas?

11 A. 14.55.

12 Q. And 1999?

13 A. 10.25.

14 Q. 2000?

15 A. 11.92.

16 Q. And 2001?

17 A. 11.90.

18 Q. And what is the four-year average?

19 A. 12.16.

20 Q. Okay. And it's your position that -- is it  
21 your position that an 11.9 return on equity is  
22 inadequate?

23 A. Dr. Gaske in this case has pointed out that  
24 because of the risk associated with our gas  
25 business, we should be earning considerably higher



1 than 11.9.

2 Q. So the earnings that you had in 2001, 11.9  
3 were inadequate; is that your testimony?

4 A. That's correct.

5 Q. And the four-year average of 12.16 is  
6 adequate; is that also your testimony?

7 A. Let me explain that. It's inadequate based  
8 upon Dr. Gaske's testimony in this case, but keep in  
9 mind, that we are dealing with 2002 and 2003 is just  
10 right around the corner and we know based upon our  
11 rates-of-return analysis that we will be earning a  
12 negative rate of return for 2003 without the  
13 proposed rate increase. In fact, in 2002 we will be  
14 at zero. So we've had a drastic change in the last  
15 two years.

16 Q. Will the 2002 return be influenced by the  
17 very mild winter we had last year?

18 A. This is normalized.

19 Q. Okay. And what is your predicted return  
20 for 2002 under normalized weather conditions?

21 A. I believe it's zero. We have witnesses  
22 here which can attest to that and subject to check.  
23 It's considerably lower than what you find here for  
24 2001.

25 Q. Is it true that you are predicting a



1 significant decline in your earned return between  
2 now and the end of 2003?

3 A. I am.

4 Q. Okay. On page 6 of your testimony you  
5 mentioned that the last gas rate increase was in  
6 1994, and that that was a relatively small increase,  
7 \$565,000. What did that amount to in percentage  
8 terms?

9 A. I don't recall.

10 Q. Okay. In 1999 you had a rate reduction of  
11 800,000. Do you know what the percentage reduction  
12 was then?

13 A. In my testimony I say about 1.2 percent.

14 Q. Okay.

15 MR. HOBERG: Mr. Binek, can you bring your  
16 microphone over closer? It's on, isn't it?

17 MR. BINEK: Yeah.

18 Q. (MR. BINEK CONTINUING) Earlier this year  
19 the Commission reduced your electric rates; isn't  
20 that correct?

21 A. It did.

22 Q. What is it about the gas business that  
23 causes it to require an increase when the electric  
24 side of your operations justify a rate decrease?

25 A. Well, they're really two different



1 businesses. Dr. Gaske, I think in his testimony  
2 laid out very well the reasons. You know, we're a  
3 small gas utility --

4 MR. HOBERG: I'm sorry. Mr. Fox, can you  
5 bring your microphone a little closer, too? They  
6 are having a little trouble hearing both you and  
7 Mr. Binek in the back.

8 MR. BINEK: We're both soft-spoken.

9 THE WITNESS: Can you now hear me better?

10 MR. HOBERG: Yes. We can hear you upfront.  
11 It's just having trouble back --

12 THE WITNESS: I'll try to do better. We  
13 also have competition for alternate fuels. And,  
14 thirdly, we have a rate design that's in effect  
15 right now that doesn't allow us to fully recover our  
16 fixed cost of operations. And so Dr. Gaske does a  
17 good job of looking at that and I happen to agree  
18 with what he said. He said, I think, in his  
19 testimony that because of the smallness, which means  
20 that, you know, small change in one of our expense  
21 items or whatever creates a big difference in  
22 whether we are able to earn a return or not, an  
23 adequate rate or return on our business. And he  
24 said that's worth 100 basis point in and of itself  
25 simply because we're that small.



1 Q. (MR. BINEK CONTINUING) You mentioned  
2 competition from alternate fuels. What competition  
3 do you face from alternate fuels?

4 A. Propane, coal, and --

5 Q. How --

6 A. Excuse me. Gas bypass.

7 Q. How much competition do you face from coal?

8 A. Well, I have a neighbor -- I'll be happy to  
9 supply some of that, but we do have some  
10 competition. In fact, I've got a residential  
11 customer in my neighborhood that uses coal.

12 Q. It's very, very minimal, isn't it?

13 A. It is from a residential standpoint, but  
14 keep in mind that folks like the larger customers,  
15 such as out here at the Tesoro -- did I say that  
16 correctly? Amoco --

17 COMMISSIONER WEFALD: Tesoro.

18 THE WITNESS: Tesoro is, in fact, looking  
19 at that very option, whether to burn coal or  
20 continue with gas, and we, in fact, have lost a  
21 portion of that gas load now to gas bypass.

22 Q. (MR. BINEK CONTINUING) Propane, aren't  
23 you, in fact, putting in -- extending your natural  
24 gas delivery systems in the Bismarck area out into  
25 areas previously served by propane?



1           A.    We are, but we're not picking up, you know,  
2 100 percent or even 90 percent of that.

3           Q.    But you are picking up a good majority of  
4 the customers out there that were previously on  
5 propane, aren't you?

6           A.    We're primarily picking up those customers  
7 who have yet not committed, picking up the new  
8 customers. We're hoping for a conversion rate  
9 around 60 percent on propane out there. Certainly  
10 not the 100 percent. So how pervasive it is, it's  
11 there and continues to be there.

12          Q.    Okay. So you had 100 percent of the  
13 customers out there using propane prior to extending  
14 your lines, now you're going to -- you're hoping to  
15 acquire 60 percent of those people presently using  
16 propane, is that --

17          A.    Or said another way, Mr. Binek, we will  
18 lose 40 percent of that load out there or not be  
19 able to --

20          Q.    Well, you're going to gain load out there  
21 that is presently served by propane, right?

22          A.    That's correct.

23          Q.    Okay.

24          A.    My statement is also correct, too.

25               MR. HOBERG: Mr. Binek, your question -- I



1 don't know that we sufficiently defined what "out  
2 there" means.

3 Q. (MR. BINEK CONTINUING) I'm thinking  
4 specifically about areas north of Bismarck where  
5 lines are being -- distribution lines are being  
6 extended by MDU gas.

7 A. For the record I would clarify. We do have  
8 a new project. We call it the northeast Bismarck  
9 project, where we are spending monies to provide gas  
10 service to customers in that area, that hopefully  
11 will have some growth, plus pick up some of the ones  
12 that are now using propane.

13 Q. Thank you.

14 MR. HOBERG: Thank you.

15 Q. (MR. BINEK CONTINUING) And the other  
16 competitive fuel is oil?

17 A. Could be. For the larger customers you  
18 have coal, oil, bypass, primarily.

19 Q. Okay. The bypass would be served by the  
20 Williston Basin Interstate Pipeline?

21 A. That's one bypass that I'm thinking about.  
22 They actually went to Williston Basin.

23 Q. Okay. And that's an MDU Resources company?

24 A. It is, but it's money out of my pocket.

25 Q. Sure. I understand that. Has inflation



1 accelerated since 1994?

2 A. Yes, it has.

3 Q. Do you have any basis for assuming that  
4 inflation will accelerate between now and the end of  
5 2003?

6 A. When you say accelerate, I'm not sure. We  
7 know we have inflationary pressures of probably  
8 three, three and a half percent per year.

9 Q. Will it get worse?

10 A. I have no idea.

11 Q. On page 7 of your testimony you state that  
12 you have so far avoided a rate increase by operating  
13 your business more efficiently and taking advantage  
14 of new technology. Have you suddenly lost the  
15 ability to operate more efficiently?

16 A. If I may, I'll go back in history a little  
17 bit. In 1994 we had our last rate increase  
18 application in here. Since that time, our  
19 employees -- we've had a decrease in our employees  
20 of over 30 percent. And that hasn't come about by  
21 huge layoffs. That came about by attrition and  
22 finding more efficient ways of doing things.  
23 Another statistic that I like to think about is --  
24 let me check my notes here, if I can find it real  
25 fast -- is that in 1994 one employee -- I'm sorry --



1 248 customers was being served by one employee. In  
2 2001 one employee was serving 370 customers. Just  
3 means that we've tried to find better ways of doing  
4 that.

5           And we continue to look for that, but I  
6 don't foresee us continuing that type of rapid  
7 growth in trying to achieve efficiencies that would  
8 mark that rate of serving more customers with less  
9 employees. In fact, we've kind of flattened in the  
10 last year or two. I think there is just so much  
11 that you can do. Although, I can tell you we have  
12 our employees out there looking for it. And that's  
13 where most of our ideas come from, is from our  
14 employees. And we have several programs that are  
15 geared to do that, to reward and provide some  
16 incentive for coming forth with ideas, and most of  
17 them are just recognition-type things.

18           Q. Have you exhausted all possible new  
19 technologies that might help you cut costs?

20           A. Again, probably not, but keep in mind,  
21 Mr. Binek, if I may -- can you still hear me all  
22 right?

23           MR. HOBERG: Yes.

24           THE WITNESS: -- is that we -- and, here  
25 again, to give you an example, we are small. And,



1 again, to give you an example of what that smallness  
2 can do for you, we had hoped to automate our meter  
3 reading across our entire service area, including  
4 that of North Dakota, but we find out with the  
5 sparseness of our operation and given that we serve  
6 very few so-called large towns, Bismarck, Billings,  
7 Montana being the largest ones, Rapid City, we  
8 certainly -- we could not commit the monies that  
9 would have been necessary to do that. So we went  
10 halfway. We decided to upgrade our semiautomatic  
11 ICON meter reading system to, again, accord new  
12 technology, but certainly not to the point where we  
13 would have liked to.

14           So it's looking, but it's -- you know, you  
15 look at all across that business venture, I don't  
16 see anything on the horizon other than what we've  
17 done today, such as the customer service center,  
18 automating and consolidating our meter reading. We  
19 do joint trenching. You know, we just keep looking  
20 under every little piece of dirt, so to speak, to  
21 try to figure out ways of doing it. But when you  
22 say "all," no, I wouldn't say all, but certainly we  
23 have come a long ways in the last five, six years.

24           Q. (MR. BINEK CONTINUING) As far as numbers  
25 of customers, have you been gaining in customer



1 count?

2 A. Not particularly.

3 Q. You have had some gains?

4 A. We have had some gains, but nothing  
5 materially. We grow about 1 percent or less per  
6 year in the gas business. Unless we take on a new  
7 project like northeast Bismarck, there isn't a lot  
8 of growth other than that.

9 Q. Could you explain what joint trenching is?

10 A. That means we get together with  
11 telecommunication companies, other utilities,  
12 anybody that's putting a hole in the ground and  
13 trenching it for a ways, we'd like to drop our  
14 underground facilities in there as well and that's  
15 worked out very well for us.

16 Q. So you're doing that right now?

17 A. We are doing that now.

18 Q. Are you doing that in northeast Bismarck as  
19 well?

20 A. We are wherever the opportunity comes  
21 along, especially with the telecommunications  
22 people, but that's slowed down, too.

23 Q. On page 7 of your testimony you propose a  
24 policy change with regard to the ownership of  
25 customer services. Does that policy change



1 influence your need for more revenue and, if so,  
2 how?

3 A. It does. We think we'll spend about --  
4 other witnesses have it. It's about \$500,000 a  
5 year, and that's included in this case.

6 Q. On page 8 you mention rate structure  
7 changes. Do those rate structure changes influence  
8 your need for more revenue and, if so, how?

9 A. It does not.

10 MR. BINEK: I have no further questions.

11 MR. HOBERG: Thank you, Mr. Binek.

12 Commissioner Reinbold, do you have any  
13 questions of Mr. Fox?

14 COMMISSIONER REINBOLD: A couple. Thank  
15 you.

16 EXAMINATION

17 BY COMMISSIONER REINBOLD:

18 Q. First of all, I want to get back to the  
19 residential customers burning coal in the City of  
20 Bismarck. Do you have any idea the numbers you're  
21 talking about, the number of households that are  
22 taking advantage --

23 A. It would be very small for the residential.  
24 I happened to use that. I kind of bristle at that  
25 every time I go by that person's home. That's the



1 reason I brought it up. But the coal, the  
2 competitive feature of that would be in the large  
3 customer list. And the reason for that, if the cost  
4 of gas goes up -- and primarily we're talking about  
5 the cost of gas that we don't control. We're  
6 talking about the wholesale. But if that would go  
7 up materially, then those folks start looking at  
8 different alternatives. The distribution portion of  
9 it doesn't have much influence on this.

10 Q. The reason I wanted to bring it up again is  
11 because it surprised me. I didn't know that  
12 happened.

13 MDU, you have gas operations in other  
14 states other than North Dakota. You have Montana?

15 A. Montana, South Dakota, and Wyoming.

16 Q. And are they in a similar calendar mode of  
17 applying for a rate increase, or don't you know?

18 A. Yes. In every state we are filing for a  
19 rate increase, either have or will. We filed in the  
20 State of Montana. We've already received an interim  
21 rate increase there. And we expect the process in  
22 Wyoming to go rather fast. The idea in most cases,  
23 and the other witnesses here will have a better feel  
24 for that, but we are hopeful of putting increases on  
25 the distribution site, increased rates in effect for



1 this heating season.

2 Q. You mentioned your customer service center  
3 and we've heard presentations on that. It's  
4 fascinating what you're doing. Can you elaborate a  
5 bit on what the customer service center does if  
6 somebody calls in?

7 A. Yes. Yes, I can. Am I close enough to  
8 this? A few years ago we decided to centralize what  
9 we call our customer service point. Historically,  
10 we would have a person located in each of our major  
11 areas talking to our customers, answering their  
12 inquiries, their questions. And we thought that we  
13 could consolidate that and still give personalized  
14 service to each customer by doing a couple things.  
15 One is when they call in, they would get a real  
16 person that would be able to meet their needs. And,  
17 secondly, through increased training, 8 to 10 weeks  
18 of training for each of these people, we thought  
19 that they would be able to handle particular  
20 questions, inquiries. In fact, they actually  
21 dispatch calls to our servicemen, that type of  
22 thing, in addition to that.

23 So we thought we could do that with a  
24 decreasing -- without decreasing our request time  
25 for service, decrease our customer acceptability. In



1 fact, I think it's enhanced our customer  
2 acceptability since we started that. There are a  
3 lot of things that have been very favorable about  
4 that and, plus, we've been able to save a  
5 considerable amount of money on an annual basis as a  
6 result of that.

7 Q. Better service and save money at the same  
8 time?

9 A. That's correct.

10 Q. You say when I call in or somebody calls  
11 in, you talk to a real person?

12 A. They do. I say that versus calling, as we  
13 sometimes do, call for help and we find that we have  
14 to punch one or two or three or four a couple of  
15 times in order to get someone to answer our  
16 questions and sometimes we never get someone to  
17 answer our questions. So we don't do things that  
18 way.

19 Q. Is there any way that you can take your  
20 experiences of talking with a real person and teach  
21 this to the telephone industry in the state?

22 A. Well, I didn't mention them by name, but  
23 you're right on track.

24 Q. I could. That's enough insults for now.  
25 Next.



1                   MR. HOBERG: Thank you, Commissioner  
2 Reinbold. Commissioner Wefald, please.

3   EXAMINATION  
4 BY COMMISSIONER WEFALD:

5           Q. You mentioned Tesoro Company. What impact  
6 does this one company have on the income of Montana-  
7 Dakota Utilities?

8           A. Well, we have a witness that would have it.  
9 Ms. Mulkern has that in her cost of service.

10          Q. Then I'll just wait and ask Ms. Mulkern.  
11 That's fine. And then each one percent -- we  
12 received this memo --

13                   MR. HOBERG: Exhibit 10.

14          Q. (COMMISSIONER WEFALD CONTINUING) Exhibit  
15 10 from staff. And it shows that 2001 11.9 percent  
16 rate of return. In your testimony you have said  
17 that you anticipate a rate of return of zero in  
18 2002; is that correct?

19          A. 2003. No, 2002. 2003 would be negative.

20          Q. So can you share with me the difference in  
21 income or the difference in expenses that would  
22 relate to a drop from 11.9 percent to zero?

23          A. I can, but I think what would be best,  
24 Commissioner, if you can wait for Ms. Mulkern to  
25 come. She has all the full facts in front of her.



1 Q. Okay. And then in your expansion into  
2 north Bismarck, how are costs recovered for that  
3 expansion, and are they included in your cost for  
4 2002 when you anticipate a rate of return to be  
5 zero?

6 A. Northeast Bismarck is included in this rate  
7 case.

8 Q. And what are the --

9 A. That's a 2003 test year.

10 Q. And that's a 2003 test year?

11 A. Mm-hmm.

12 Q. So what are the costs for that expansion,  
13 and how are they recovered?

14 A. Let's see, how are they recovered? They  
15 are included in this rate case so it would be  
16 recovered through the rates of all the folks,  
17 ratepayers in the State of North Dakota.

18 Q. Do you have an expansion tariff in place so  
19 that the customers in those areas pay the bulk of  
20 the expansion, or are the bulk of the expansion  
21 costs paid by all the ratepayers of the State of  
22 North Dakota?

23 A. There's a policy in place for that and,  
24 again, if I may, Ms. Aberle or Ms. Mulkern could  
25 answer specific questions on that.







1 FURTHER EXAMINATION

2 BY COMMISSIONER REINBOLD:

3 Q. One other question. Do you serve the  
4 University of Mary with natural gas?

5 A. Yes.

6 COMMISSIONER REINBOLD: You do. Thank you.

7 MR. HOBERG: Thank you, Commissioner  
8 Reinbold. Mr. Pearce, anything on redirect?

9 MR. PEARCE: No. I have no questions.

10 MR. HOBERG: Thank you. Mr. Binek,  
11 anything further?

12 MR. BINEK: No.

13 MR. HOBERG: Thank you, Mr. Fox.

14 Let's take about a -- let's be back at 10  
15 after 10:00, about a nine-minute recess. We'll  
16 start at 10 after 10:00.

17 (A recess was taken.)

18 MR. HOBERG: We're back on the record after  
19 a short recess. And I apologize. I neglected to  
20 ask for an appearance by Commission advisory staff,  
21 and at this time I will ask Ms. Jeffcoat-Sacco to  
22 make an appearance for Commission advisory staff.

23 MS. JEFFCOAT-SACCO: Commission advisory  
24 staff in this case is myself, Mike Diller, and Jerry  
25 Lein. And for purposes of this case, if there are



1 some questions of advisory staff during the hearing,  
2 I'd request that Mike be able to ask those, if  
3 that's acceptable.

4 MR. HOBERG: Any objection, Mr. Pearce?

5 MR. PEARCE: No, that's no problem.

6 MR. BINEK: No.

7 MR. HOBERG: Did you have any questions of  
8 the first witness?

9 MR. DILLER: I can ask the question I had  
10 of one of the other witnesses.

11 MR. HOBERG: Okay. Thank you,  
12 Ms. Jeffcoat-Sacco and Mr. Diller. You may not be  
13 asking questions, as I understand, of every witness,  
14 but you'll indicate to me if you have a question?

15 MR. DILLER: That's right.

16 MR. HOBERG: Okay. Thank you. Your next  
17 witness, please, Mr. Pearce.

18 MR. PEARCE: Thank you. Before I call the  
19 witness, I think there's one matter I'd like to  
20 clarify. I'm not quite sure what's the best way to  
21 do it. It turns out apparently there's a  
22 significant error in Exhibit 10. The 2001 MDU gas  
23 return does not correspond to the return that was  
24 actually filed with the Commission in the annual  
25 report. Apparently, it was mistranscribed when this



1 exhibit was made up, so I'm not quite sure what's  
2 the best way to do that. We can take judicial  
3 notice of the report that's on file with the  
4 Commission.

5 MR. HOBERG: This is on file in another  
6 matter?

7 MR. PEARCE: This is the annual report that  
8 the company has filed and I think Mr. Diller based  
9 his Exhibit 10 on. Perhaps maybe since he's now  
10 participating in the proceeding, he could simply  
11 clarify that there's apparently a transcription  
12 error made in preparing Exhibit 10.

13 MR. HOBERG: Is there an error, Mr. Diller?

14 MR. DILLER: Yes. I looked at MDU's annual  
15 report for its gas operation. It appears I picked  
16 up the 2000 number and put it in 2001. The actual  
17 earnings reported by MDU, I believe, is 1.6 percent  
18 for 2001, rather than 11.9.

19 MR. HOBERG: 1.6 percent. Why don't we  
20 just make that correction there? Is that  
21 sufficient, Mr. Pearce?

22 MR. PEARCE: Yes, that's fine. The report  
23 actually says 1.616, but 1.6 is fine.

24 MR. HOBERG: And then, of course, that  
25 would make a difference on the four average, too,



1 and make a difference on the average for all. For  
2 the purpose of this hearing are we mostly concerned  
3 about those four numbers from 1998 to 2001?

4 MR. PEARCE: That was the point of the  
5 exhibit, I think.

6 MR. HOBERG: Okay. Then that exhibit will  
7 be corrected as indicated. Thank you, Mr. Pearce.  
8 Your next witness, please.

9 MR. PEARCE: We'll call Dr. J. Stephen  
10 Gaske.

11 MR. HOBERG: Dr. Gaske's direct testimony  
12 does appear as Exhibit 4 in Docket No. 1.

13 Dr. Gaske, did you hear -- you can sit  
14 down.

15 THE WITNESS: I thought you'd swear me in.

16 MR. HOBERG: I am going to. You can sit  
17 down while you're doing it.

18 Dr. Gaske, did you hear the admonition I  
19 gave in regard to perjury?

20 THE WITNESS: Yes, I did.

21 MR. HOBERG: Being advised of the penalty  
22 for perjury, do you promise to tell the truth in  
23 this matter being heard? If so, answer I do.

24 THE WITNESS: I do.

25 MR. HOBERG: Thank you. Mr. Pearce,



1 please.

2 J. STEPHEN GASKE,  
3 being first duly sworn, was examined and testified  
4 as follows:

5 DIRECT EXAMINATION

6 BY MR. PEARCE:

7 Q. Dr. Gaske, have you prepared and had  
8 prefiled in this case prepared direct testimony of  
9 J. Stephen Gaske?

10 A. Yes.

11 Q. And if you were asked the same questions  
12 appearing in Exhibit 4, would your answers be the  
13 same today if you gave them live in this proceeding?

14 A. Yes.

15 Q. And to the best of your information and  
16 belief, is all the information contained in that  
17 testimony true and correct?

18 A. Yes.

19 MR. PEARCE: I will offer Exhibit 4 at this  
20 time and I'm not going to reread the testimony.

21 MR. HOBERG: Thank you, Mr. Pearce. Any  
22 objection to Exhibit 4?

23 MR. BINEK: No.

24 MR. HOBERG: Okay. Exhibit 4 is admitted.

25 Are you tendering the witness for --



1 MR. PEARCE: Yes.

2 MR. HOBERG: Okay. Thank you, Mr. Pearce.  
3 Mr. Binek, do you have any questions of Dr. Gaske?

4 MR. BINEK: Yes.

5 CROSS-EXAMINATION

6 BY MR. BINEK:

7 Q. Dr. Gaske, on page 2 of your initial  
8 testimony, and that is Exhibit 4, at lines 8 to 10,  
9 you state that you have filed cost of capital and  
10 capital structure issues in six states, including  
11 North Dakota.

12 Was your latest North Dakota appearance in  
13 Case No. PU-399-01-186, which was MDU's electric  
14 service rate case?

15 A. Yes.

16 Q. In that case did you argue for the  
17 inclusion of an upward adjustment in the return to  
18 equity to account for flotation costs?

19 A. Yes, I did.

20 MR. BINEK: Okay. Your Honor, at this time  
21 I would like to have Mr. Gaske refer to some  
22 findings in this case. Do you wish to have this  
23 marked as an exhibit or just --

24 MR. HOBERG: Let's take official notice of  
25 that. I don't think we need to mark it as an



1 exhibit.

2 MR. BINEK: I do have copies, if people  
3 would like copies.

4 MR. HOBERG: That may be a good idea to put  
5 copies out for us, please.

6 MR. HOBERG: And, again, for the record,  
7 that's Case No. PU-399-01-186. Mr. Binek, please.

8 Q. (MR. BINEK CONTINUING) Okay. I've handed  
9 you a copy of the decision that the Commission  
10 issued in that case. The decision is dated April  
11 24, 2002. And I would ask if you would please read  
12 paragraphs 14 and 15.

13 A. (Witness reviews document.)

14 MR. HOBERG: You don't want him to read  
15 them out loud, do you?

16 Q. (MR. BINEK CONTINUING) Yes, I would like  
17 to have you read them out loud.

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

23 "Given that staff has provided evidence  
24 based on historical information, we find no need to  
25 rely on the theoretical" --



1           MR. HOBERG: Dr. Gaske, I'm sorry. Can you  
2 speak up a little bit, please? We're having a  
3 little trouble.

4           THE WITNESS: "Given that staff has  
5 provided evidence based on historical information,  
6 we find no need to rely on the theoretical  
7 information provided by MDU. In addition, Gaske  
8 admitted that most regulatory commissions do not  
9 allow flotation costs. The evidence indicates a  
10 negligible amount of flotation costs in the instant  
11 case. Therefore, the Commission will not include  
12 flotation costs in the determination of return on  
13 common equity."

14          Q. (MR. BINEK CONTINUING) Thank you. Your  
15 flotation cost approach in this case is essentially  
16 the same as your approach in MDU's electric case  
17 that was decided on April 24th of 2002; isn't that  
18 correct?

19          A. Yes, it is.

20          Q. And it's also correct that the Public  
21 Service Commission rejected the inclusion of  
22 flotation costs in that case --

23          A. Yes, that's true.

24          Q. -- is that correct? And it's also true  
25 that most state public utility commissions have



1 rejected the inclusion of flotation costs in  
2 determining the cost of common equity; isn't that  
3 also correct?

4 A. Some have accepted it and some have  
5 rejected it.

6 Q. Most have rejected it; would you agree?

7 A. At this point, yes.

8 Q. Where in your direct or rebuttal testimony  
9 in this case do we find empirical data to show that  
10 disallowing flotation costs would hinder the  
11 issuance of stock?

12 A. I never make the claim that it hinders the  
13 issuance of stock. What I do say is that without  
14 the allowance, an issuance of stock will result in a  
15 confiscation of property of the existing investors.  
16 So that's a very different claim than the one that  
17 you've asked me about. I don't base my claim on  
18 empirical evidence that they will be unable to issue  
19 stock. They will be unable to issue the stock on  
20 reasonable terms.

21 Q. Aside from North Dakota, what were the  
22 other five states where you filed testimony on cost  
23 of capital?

24 A. Let's see. Montana, Wyoming, New York,  
25 South Dakota, and actually I've done it in Alaska.



1           Q.    In how many of those states did you  
2 recommend a flotation cost adjustment to the return  
3 on equity?

4           A.    All of them.

5           Q.    And how many of those states did the  
6 Commission accept your recommendation?

7           A.    Actually, I should add I've also testified  
8 on flotation cost adjustment in a property tax case  
9 in Wyoming and, in fact, testified on that on two  
10 occasions.

11          Q.    Okay.  But in utility cases you're talking  
12 about the previous ones you mentioned?

13          A.    In utility cases, most of those were  
14 settled or have not had a decision.  The Montana  
15 case they did not allow flotation costs.  In the  
16 Wyoming property tax case they did not allow it the  
17 first time, but the second time around I think I did  
18 a better job of explaining it and they did agree  
19 that a flotation cost adjustment was appropriate in  
20 order to be able to issue common stock on reasonable  
21 terms.  It's an appropriate part of the cost of  
22 capital.

23          Q.    Okay.  But that was not a utility case?

24          A.    No, it was not.  But my point is that  
25 Commissions have rejected this issue in the past and



1 then turned around and realized and understood the  
2 issue so that they did allow it. They changed their  
3 minds.

4 Q. What rates of return did the Commissions  
5 allow in gas -- let me go back. Were any of these  
6 cases that -- the utility cases that you talked  
7 about gas utility cases?

8 A. Yes.

9 Q. And how many of those were gas utility?

10 A. I probably -- I don't recall exactly, but  
11 maybe about five of them.

12 Q. What rates of return did the Commission  
13 allow in each of those gas distribution cases?

14 A. To my recollection, the only one that went  
15 to a decision was a Montana case and I believe it  
16 was 11.7, but I would have to check to tell you.

17 Q. Okay. None of them have --

18 A. It might -- it might have been higher than  
19 that. I don't recall.

20 Q. I'd like to have you turn to your Exhibit  
21 JSG-2.

22 COMMISSIONER REINBOLD: What page is that?

23 MR. BINEK: It's Exhibit JSG-2.

24 MR. HOBERG: Toward the end of Exhibit 4,  
25 his testimony, about two pages before the end.



1 Q. (MR. BINEK CONTINUING) On page 1 you  
2 provide a number of rates of annual change for  
3 prices and gross domestic product. They end in  
4 2001.

5 MR. HOBERG: I'm sorry. I misspoke. I was  
6 on page 8 when I said that. It's closer to about 10  
7 pages from the end, JSG-2.

8 THE WITNESS: I think you're on the right  
9 page.

10 COMMISSIONER CLARK: Schedule 1.

11 COMMISSIONER WEFALD: Is it in the rebuttal  
12 testimony or the original testimony?

13 THE WITNESS: Original testimony.

14 COMMISSIONER WEFALD: Thank you. That will  
15 help me find it.

16 MR. HOBERG: Schedule 1, where it says 1 of  
17 3 pages.

18 THE WITNESS: I think that's what he's  
19 referring to.

20 MR. HOBERG: Does everyone have it?

21 COMMISSIONER WEFALD: JSG-2, and which page  
22 of JSG-2 are we on?

23 MR. BINEK: Page 1 of 3.

24 COMMISSIONER WEFALD: Thank you.

25 MR. HOBERG: Mr. Binek, please.



1 MR. BINEK: It's Schedule 1, page 1 of 3.

2 Q. (MR. BINEK CONTINUING) Okay. On page 1  
3 you provide a number of rates of annual change for  
4 prices in gross domestic product. They end in 2001,  
5 which is now more than nine months ago. What has  
6 happened to these indicators since last December?

7 A. I believe in the early part of the year  
8 there was relatively rapid growth in the economy.  
9 And I believe it slowed down since then, and I don't  
10 know what's going on right now. I do know that  
11 right now there's a debate whether we're in or going  
12 into another recession, but we really won't know  
13 that until the quarter is out.

14 Q. What about consumer prices, what's  
15 happening there?

16 A. I don't have that information.

17 Q. On page 2 of that exhibit you show a number  
18 of interest rates, but your series end last January.  
19 Can you provide the latest interest rates and match  
20 these series?

21 A. Let's see. The last one I had was as of  
22 the end of July, the corporate average, which was  
23 7.38 in January, went down 11 basis points to 7.27  
24 percent. The A-rated public utilities, which has  
25 been 7.66 percent, went down to 7.31 percent. And



1 the Baa-rated utilities barely changed at all, went  
2 from 8.13 to 8.07 percent. Since that time I don't  
3 have the exact numbers. I believe the numbers have  
4 gone down some. That, I guess, brings you up  
5 another six more months.

6 Q. Okay. So the interest rates generally have  
7 decreased; do you agree?

8 A. Yes. The Baa barely as much, but it's  
9 down.

10 Q. Do you know whether it's true that interest  
11 rates are now the lowest that they've been in  
12 decades?

13 MR. HOBERG: By "decades" you mean what,  
14 the last --

15 MR. BINEK: Last couple, three.

16 MR. HOBERG: Three decades.

17 THE WITNESS: It depends on what interest  
18 rate you're talking about. One of the things that  
19 has occurred in the past year is that investors have  
20 been very leery of investing in almost anything that  
21 has any risk at all attached to it. So they have  
22 been reluctant to be in common stocks or even risky  
23 bonds. The treasury bill rates are the lowest  
24 they've been in decades. The U.S. Treasury bond  
25 rates are also the lowest that they've been in



1 decades. However, if you look at the Baa public  
2 utility bonds, right now they're essentially higher  
3 than they were in 1999 or '98. Approximately where  
4 they were in '97. Higher than they were in '93.  
5 They're about where they've been for the last  
6 decade.

7           So to answer your question, depends on  
8 whether you're talking about extremely low-risk  
9 instruments. Those are low. Investors want those  
10 very badly right now because there's a great deal of  
11 uncertainty in the market and the economy, but your  
12 question is not true if you're talking about public  
13 utility bonds.

14           Q. (MR. BINEK CONTINUING) On page 3 of that  
15 same exhibit, you show average return on the book  
16 value of equity since 1977 up through 2001. What  
17 has happened to returns on equity during the past  
18 nine months?

19           A. I would imagine that they are pretty  
20 abysmal, but I don't know the numbers on that.

21           Q. Okay. On page 11 of your testimony you  
22 present the discounted cash flow formula. Is it  
23 true that the only difference between your  
24 presentation of this formula and that of Mr. King is  
25 that you increase the next year's dividend by a



1 factor of .625 and that Mr. King increases it by .5?

2 A. As far as the basic general formula, yes,  
3 that's correct.

4 Q. Is the principal reason for this difference  
5 your belief that Mr. King has failed to recognize  
6 the present value of future dividends and dividend  
7 increases?

8 A. I think that the best way to describe it is  
9 that he's neglected to pay any attention to the time  
10 value of money during the initial year.

11 Q. And that's present value, isn't it?

12 A. Well, the whole discounted cash flow model  
13 looks forward basically into an infinite period of  
14 time in the future and is based on discounted cash  
15 flow. The portion of the model that deals with that  
16 adjustment factor really is looking at the first  
17 year of an infinite number of years. That dividend  
18 tends to be the most valuable because it's one you  
19 get the soonest, and to the extent that you're  
20 getting it on a quarterly basis, the first one you  
21 get is more valuable than the second, more valuable  
22 than the third, et cetera, as long as the dividend  
23 doesn't change. And so I think the real difference  
24 between the two of us is a relatively small one. I  
25 recognize the time value of money and he doesn't.



1 Q. This really doesn't amount to much of  
2 anything as far as this case, does it?

3 A. No. That's why I was a little bit  
4 surprised that he put it in his rebuttal testimony.

5 Q. I recall an electric case we spent a lot of  
6 time on this issue for very little money.

7 A. Yeah. And I couldn't understand why he  
8 kept getting the math wrong and still does.

9 Q. Perhaps he might not think he's got it  
10 wrong.

11 A. It really goes -- it's not a real big  
12 dollar thing. It really goes to a question of  
13 whether you can do the math right.

14 Q. I think we'll let him respond to that one.

15 A. And that may be something -- well, I'll  
16 leave it at that.

17 Q. Please turn to page 5 of Schedule 2 of your  
18 Exhibit JSG-2.

19 COMMISSIONER WEFALD: Same book?

20 MR. HOBERG: Yes, same book.

21 COMMISSIONER REINBOLD: What page?

22 MR. BINEK: Page 5 of Schedule 2.

23 COMMISSIONER WEFALD: 5 of 9?

24 MR. BINEK: Of 2. Oh, 5 of 9, yes.

25 Q. (MR. BINEK CONTINUING) Is this the page on



1 which you developed the growth rates you use for  
2 your six proxy group companies?

3 A. These are the factors that I gave the most  
4 weight to, yes.

5 Q. The first column is Zacks five-year growth  
6 estimate, and the second column is your retention  
7 growth calculation; is that correct?

8 A. That's correct.

9 Q. Is it true that for five out of these six  
10 companies the Zacks forecast is higher than the  
11 retention growth forecast?

12 A. Yes.

13 Q. The third column is labeled "weighted  
14 average." Is that the weighting of two-thirds Zacks  
15 and one-third retention growth?

16 A. Yes.

17 Q. On what basis did you decide to make that  
18 weighting between the two growth estimates?

19 A. There were two factors that came into play.  
20 One is that I normally think of the retention growth  
21 rate as being sort of a baseline, relatively stable  
22 number that investors can look at as being a base  
23 level of growth throughout the life of the project  
24 or the company as long as they maintain that. The  
25 Zacks earnings growth estimates take into



1 consideration a lot of other ways that a company can  
2 grow other than by retaining earnings and  
3 reinvesting it to increase common equity just  
4 through retained earnings. So the Zacks earnings  
5 estimates which are put together by analysts and  
6 forecasts tend to include the other methods that  
7 companies can grow by. For these companies I think  
8 people who buy common stock place a fairly good  
9 amount of weight on those estimates and stock prices  
10 and dividend yields are dictated to a large extent  
11 by those analysts' estimates. So I tended to give  
12 them a little more weight.

13           The second reason I used that approach is  
14 that it somewhat mimics an approach that the Federal  
15 Energy Regulatory Commission actually requires  
16 almost as a generic approach where they give two-  
17 thirds weight to the Zacks earnings estimates and a  
18 one-third weight to the projected growth in the  
19 Gross National Product or Gross Domestic Product,  
20 rather than retention growth. So to my mind, it's a  
21 good way to put together a combination of the two  
22 that smooths out aberrations that may occur in one  
23 growth rate or the other and get a pretty good  
24 estimate of what investors reasonably expect over a  
25 long period of time.



1 Q. Isn't it true that two companies, Keyspan  
2 and Laclede Group, account for the highest  
3 observations?

4 A. Yes, highest observed growth rates.

5 Q. And those high growth rates for Keyspan and  
6 Laclede rates carry over to the next page, page 6,  
7 to yield the two highest rates of return; isn't that  
8 also correct?

9 A. Yes. Keyspan and Laclede also have the  
10 highest dividend yields.

11 Q. Did Mr. King include Keyspan in his  
12 comparable companies?

13 A. No, he did not.

14 Q. Do you know why Mr. King excluded Keyspan  
15 from his group of comparable companies?

16 A. He used different selection criteria than I  
17 did. Keyspan derives less than 75 percent of its  
18 earnings from utility operations or gas utility  
19 operations.

20 (Exhibit 11 was marked for identification.)

21 Q. (MR. BINEK CONTINUING) Would you please  
22 identify what has been marked as Document 11? I  
23 guess I also would like to say, would that be the  
24 cover page, index page, and page 27 of the 2001 form  
25 10-K for Keyspan Corporation?



1 A. Yes.

2 MR. BINEK: I would offer Exhibit 11.

3 MR. HOBERG: Any objection to Exhibit 11?

4 MR. PEARCE: No. Assuming it is what it  
5 purports to be, I have no objection.

6 MR. HOBERG: Exhibit 11 is admitted.

7 Q. (MR. BINEK CONTINUING) Mr. Gaske, I'd like  
8 to have you look at the first line of the first  
9 column on page 27. Could you tell me what the  
10 number there represents?

11 A. It's the gas distribution revenues of  
12 Keyspan during various years in the recent past.

13 Q. It shows gas distribution revenues in 2001?

14 A. Yes, it does.

15 Q. What is that number?

16 A. 3.6 million.

17 Q. Now, I'd like to have you drop down a few  
18 lines -- is the number billion?

19 A. Yes. The numbers are expressed in  
20 thousands of dollars, so, yes, \$3.6 billion.

21 Q. And now would you drop down a few lines and  
22 read the number for total revenue?

23 A. \$6.6 billion.

24 Q. Would you agree that gas distribution  
25 accounts for almost exactly one-half of Keyspan's



1 total revenue?

2 A. A little more than that, but, yes.  
3 Somewhere in the 50 percent range, 50 to 60.

4 Q. The other company with very high weighted  
5 growth rate on page 5 of Schedule 2 is Laclede? Or  
6 I think you refer to as Laclede?

7 A. Yes.

8 Q. Okay. Could you explain how Laclede could  
9 generate a 12 percent annual growth in earnings when  
10 its retention of earnings would allow it to increase  
11 by only 4.2 percent?

12 A. Laclede, at the time that I did my  
13 testimony, the most recent Value Line page for them  
14 indicates that it had recently formed a holding  
15 company and that Laclede was going to begin  
16 essentially starting up some new businesses and  
17 getting into some other new lines. The Value Line  
18 ultimate conclusion was that Laclede's expansion  
19 into unregulated industry boosts its long-term  
20 earnings prospects.

21 So although Laclede did not have much in  
22 the way of other investments and other lines of  
23 business, particularly unregulated ones at the time,  
24 and still doesn't have a whole lot, investors were  
25 clearly expecting that they would get into some



1 additional lines of business and that in the long  
2 run that they were going to boost their earnings'  
3 growth rate above the growth rate that would be  
4 sustained by book value growth.

5 Q. So Laclede's high return is related to  
6 unregulated activities; would that be correct?

7 A. Not the current required return of the  
8 company at the time. The high growth rate and  
9 perhaps the dividend yield was lower than it might  
10 otherwise have been because of that high expected  
11 growth rate, but at the time the company was  
12 primarily a distribution company.

13 Q. But the high return that you're showing is  
14 due to unregulated activities, isn't it?

15 A. They didn't have much in the way of  
16 unregulated activities at the time. The high growth  
17 rate is based on the expectation that in the future  
18 they're probably going to make more money than they  
19 can make on unregulated operations, but there's a  
20 very different question there, because the current  
21 return reflects to some degree unregulated  
22 operations in the future, but it primarily reflects  
23 what they have in place and what their current  
24 business is, what their prospects for that business  
25 are and the risks attached to it. So you can have



1 high growth expected in the future without  
2 necessarily having a lot of risky investments right  
3 now.

4 In addition, the -- I suspect that at one  
5 level it's probably good for the Laclede investors  
6 for the company to diversify into a few other lines  
7 of business to more or less diversify the company in  
8 case something happens with the gas distribution  
9 business.

10 Q. Didn't Mr. King produce as his Exhibit  
11 CWK-5 a Zacks report that showed Laclede's consensus  
12 growth at 4.25 percent?

13 A. Yes. Later in the year after I prepared my  
14 testimony the projected forecast for Laclede went  
15 down. I actually didn't look to see what happened  
16 with the other companies, but he did produce the  
17 Laclede one and it went down from 12 to 4.

18 Q. Turning to page 6 of your Schedule 2, would  
19 you agree with me that if you left out Keyspan and  
20 Laclede, the average return would be considerably  
21 less than the numbers you show there?

22 A. The average for -- if you left the two out,  
23 the average cost of capital would be -- instead of  
24 12.83, it would drop to 11.85. The median would  
25 drop from 12.51 to 12.4. So your median would drop



1 about 11 basis point. So, yes, it's a slightly  
2 lower number. Not a lot, but it's slightly lower.

3 Q. I'd like to have you turn to page 7 of  
4 Schedule 2, Exhibit JSG-2. Do we find again that  
5 Keyspan and Laclede generate by far the highest  
6 rates of return?

7 A. Laclede does. The Keyspan depends on your  
8 definition of "by far," but, yes, it is about 80  
9 basis point higher than the next one.

10 Q. Now, I'd like to turn to your primary DCF  
11 analysis. A discussion of that begins on page 20 of  
12 your testimony.

13 COMMISSIONER WEFALD: Which testimony is  
14 that -- the original testimony?

15 MR. BINEK: That's the original.

16 Q. (MR. BINEK CONTINUING) The growth rate  
17 that you use for this analysis as a range --

18 A. Could I ask you to wait for a moment?

19 Q. Sure.

20 A. Okay. Where was it that you were going?

21 Q. Okay. Page 20.

22 A. I'm there.

23 Q. Okay. The growth rate that you use for  
24 this analysis is a range, isn't it?

25 A. Yes.



1 Q. That range is presented on lines 14 and 15  
2 of page 21 as 6.75 percent to 7.75 percent; is that  
3 correct?

4 A. Yes.

5 Q. How did you arrive at that range?

6 A. I considered a variety of factors. I  
7 believe that natural gas is going to tend to become  
8 a more important fuel source in the future, at least  
9 in some places. I also looked at the data that you  
10 pointed me to earlier. If you go to Schedule 2 of  
11 Exhibit JSG-2 and page 4 of that schedule -- I'm  
12 sorry -- page 5 of that schedule at the back, when  
13 you put the -- when you just look at the Zacks data,  
14 you'll see that companies with projected growth  
15 rates above 7 percent or 7 percent above include  
16 every single company there, except WGL Resources.  
17 So the 7 percent number is towards the middle of  
18 that range, of the range that I adopted, 6.75 to  
19 7.75. There's one company that's below that range.  
20 Keyspan is just slightly above that range.  
21 Laclede's well above the range, but everybody else  
22 is grouped right in the middle. They're all in the  
23 7 percent range. I thought that that was a pretty  
24 good anchor.

25 The retention growth I usually think of as



1 being a base amount that a company can achieve and  
2 usually under most circumstances you would expect it  
3 to be able to do better than that. And the analysts  
4 in this case thought that the company should do  
5 better than that, but if you look at the weighted  
6 average in the last column, you'll see that you have  
7 several companies a little under that range. And,  
8 let's see, Keyspan at 7.5 and Laclede at 9.4. So I  
9 used -- essentially, after considering other factors  
10 other than the simple two-thirds/one-third objective  
11 approach, I felt that 6.75 to 7.75 really reflected  
12 what investors expected and you can see that from  
13 the Zacks forecast where virtually all of my  
14 companies are 7 percent or higher.

15 Q. Okay. Looking at the top range of 7.75  
16 percent, can you show me anywhere on pages 5, 6, and  
17 7 of Schedule 2 where you have developed an average  
18 growth for the six companies that is as high as  
19 7.75?

20 A. Now, the purpose of a range is to more or  
21 less put the company within some range around which  
22 you think on a normal basis these companies would  
23 be. The Zacks 7.6 percent obviously is well above  
24 the midpoint of that range. I was trying to  
25 establish about a 100 basis point range that would



1 be reflective overall of the group. So 7.6 would be  
2 well above the average in that range and the average  
3 for the weighted average would be toward the lower  
4 end of the range, but falls within the range.

5 So using those two numbers as anchors, you  
6 can go a little above 7.6 percent on the Zacks  
7 average earnings and get to 7.75. You can go a  
8 little below the 6.9 percent average and get to 6.75  
9 and that gave me a 100 basis point range.

10 Q. Again, looking -- I'll repeat the question  
11 and please answer the question. Looking at the top  
12 of the range, 7.75 percent, can you show me anywhere  
13 on these pages, 5, 6, and 7, where you developed an  
14 average growth for the six companies that is as high  
15 as 7.75 percent? Just yes or no.

16 A. There's no simple average that does that,  
17 no.

18 Q. Okay. At lines 19 through 21 of page 21  
19 you state that your range of 6.67 percent to 7.75  
20 percent is consistent with the retention growth for  
21 the six companies. Please turn to page 5 of  
22 Schedule 2 and read to me the average retention  
23 growth for the six companies.

24 A. Would you take me back to the first  
25 citation that you had?



1 Q. Page 5.

2 A. You were citing someplace --

3 MR. HOBERG: Page 21.

4 Q. (MR. BINEK CONTINUING) Pages 19 through  
5 21.

6 MR. HOBERG: Wasn't it line 19 through 21?

7 Q. (MR. BINEK CONTINUING) Lines 19 through 21  
8 of page 21. The average retention growth rate for  
9 the six companies.

10 COMMISSIONER WEFALD: Does it start out "in  
11 my opinion," is that the line?

12 THE WITNESS: Okay. I see what you are  
13 asking. Page 21, the last three lines.

14 Q. (MR. BINEK CONTINUING) Starting at line 13  
15 is the beginning of the paragraph.

16 A. But I believe you asked the question about  
17 the last sentence?

18 Q. Right.

19 A. And the last sentence says that, "This  
20 growth rate range is also consistent with the  
21 retention growth rates projected for these companies  
22 and their ability to grow by means other than  
23 retained earnings," which is what I was talking  
24 about earlier, that typically companies have the  
25 ability to grow by other means than retained



1 earnings and that allows them to generally achieve a  
2 slightly higher or somewhat higher growth rate than  
3 solely with book value growths.

4           You then asked me to turn to page 5 of  
5 Schedule 2 of Exhibit JSG-2 and reconcile the 5.5  
6 percent average shown there with what I said on page  
7 21. And the reconciliation is quite simply that  
8 it's -- if a company can have a base growth rate of  
9 about 5.5 percent, but investment analysts are  
10 projecting an average of 7.6 percent, it's  
11 consistent to think that 6.75 to 7.75 is consistent  
12 with the idea that book value forms sort of a base  
13 and the other methods that they can grow by,  
14 including investing in an unregulated operation,  
15 comes up with a higher rate of return.

16           Q. Over the long run how does a utility  
17 company do better than the retention growth?

18           A. There are several ways they can do that.  
19 One actually is contained in Mr. King's testimony.  
20 Mr. King has a growth rate component -- he calls it  
21 SV, issuing stock at above book value. If a company  
22 has some unregulated operations and those are doing  
23 reasonably well, it will have a book value -- or  
24 market value above book value and it's able to grow  
25 in that way. I believe Mr. King for his companies



1 estimated about 1 percent additional kicker to the  
2 growth rate from that. I'd have to go back and  
3 check his numbers, but it's something in that  
4 ballpark.

5 Another way that they can do that is by  
6 essentially borrowing to invest in new assets, that  
7 if those assets earn more than the cost of capital,  
8 it increases -- the market value of those assets  
9 exceed the book value and the company over time can  
10 generate retained earnings from these new  
11 unregulated assets and essentially build their  
12 equity ratio back up again and then repeat the  
13 process. And that's a very, very common thing, is  
14 that companies borrow because they find that they  
15 have a really good investment that will make them  
16 better off. They do so, they invest in it, and if  
17 it pays off well and it's making a 20-percent rate  
18 of return, and they borrowed the money at 8 percent,  
19 they get a big kick in their earnings per share.  
20 The stockholders get the difference between the 20  
21 percent the operation makes and the 8 percent that  
22 they borrowed at.

23 So those are a few of the ways and I think  
24 those are probably the primary ways. I could  
25 probably think of a few others that are less



1 important, but those are big ones. And my 5.5  
2 percent earnings retention growth rate, I should  
3 note, is a little bit different from Mr. King's book  
4 value growth rate in that I have not included the SV  
5 factor in the 5.5. I have assumed that the SV  
6 factor -- or actually I should call it a term  
7 because it's used as a term, it's an add-on to the  
8 retention growth rate -- is encompassed in the Zacks  
9 earnings forecast, which are higher, and that the  
10 other ways that a company can grow, including the SV  
11 term, are in the Zacks earnings growth estimate. So  
12 retention growth is sort of a baseline, but you can  
13 do all these other things. And clearly investors  
14 are expecting some of that to happen.

15 MR. HOBERG: Dr. Gaske, for the record,  
16 what is the SV factor?

17 THE WITNESS: It's the stock -- the  
18 percentage increases in the shares outstanding times  
19 the premium over book value that you are able to  
20 sell your stock at.

21 MR. HOBERG: Thank you.

22 THE WITNESS: And explained in fairly great  
23 detail in Mr. King's testimony.

24 (Exhibit 12 was marked for identification.)

25 Q. (MR. BINEK CONTINUING) I'd like to refer



1 you to page 23 of your testimony. On pages 6  
2 through 8 you describe data by Ibbotson Associates  
3 on returns to stocks, bonds and treasury bills since  
4 1926. I've handed you a response that Mr. King  
5 filed to MDU's September 6, 2002 data request,  
6 question 14. And this is marked as Exhibit 12.

7 Have you seen this response?

8 A. Yes, I have.

9 Q. In this response does Mr. King represent  
10 that he has supplied the yearly returns to an S&P  
11 composite index and S&P utility index, long-term  
12 corporate bonds and public utility bonds for every  
13 year from 1927 to 2001?

14 A. Yes.

15 MR. HOBERG: Isn't it 1928?

16 MR. BINEK: Or '28.

17 Q. (MR. BINEK CONTINUING) Now, would you look  
18 at the bottom of that sheet and identify what is  
19 reported on the last four lines?

20 A. A geometric mean return for the series and  
21 an arithmetic mean return for the series, a standard  
22 deviation, and a median.

23 Q. Are you familiar with those terms?

24 A. Yes, I am.

25 Q. Would you please describe your



1 understanding of the meaning of each of those terms?

2       A. The geometric mean tells you the average  
3 historical rate of return that occurred throughout  
4 the period, assuming compounding. And it's a very  
5 good indicator of your past historical return that  
6 you earned. The arithmetic mean is the average of  
7 the return earned each year, year by year. And it's  
8 a very good indicator of future expected return.

9               The standard deviation tells you how much  
10 variation there is in a particular series of  
11 numbers. And, in fact, what the standard deviation  
12 really tells you is that if you assume that the data  
13 have what is referred to in statistics as a normal  
14 distribution, it's a number that you can add to the  
15 mean, the arithmetic mean, plus or minus, to  
16 determine a range within which two-thirds of the  
17 observations fall or would be expected to fall. In  
18 this case I'm not entirely sure whether he had done  
19 this as a population mean or sample mean. Usually  
20 it's calculated as a sample mean, so I would presume  
21 that, but maybe we'd have to ask him which kind of  
22 mean he used or rather what kind of standard  
23 deviation he used.

24               And the last number, the median, is the  
25 number that half of the observations are above and



1 half are below.

2 Q. If the standard deviation is higher than  
3 the mean, what does that tell you about the  
4 statistical significance of the mean?

5 A. That there's a high probability that the  
6 mean of that particular series is zero, or at least  
7 -- let's say the standard deviation is exactly equal  
8 to the mean, then there's about a 16 percent chance  
9 that the real number would be zero or less.

10 Q. Please read the arithmetic means and the  
11 standard deviations of each of these series.

12 MR. HOBERG: I think we better have this  
13 thing offered first, Mr. Binek.

14 MR. BINEK: Oh, I'm sorry. I will offer.

15 MR. HOBERG: Any objection to Exhibit 12,  
16 Mr. Pearce?

17 MR. PEARCE: No. On the assumption that  
18 Mr. King prepared this from published data, I have  
19 no objection.

20 MR. HOBERG: Exhibit 12 is admitted.  
21 Mr. Binek, please.

22 Q. (MR. BINEK CONTINUING) Now, would you  
23 please read the arithmetic means and the standard  
24 deviations of each of these series?

25 A. 12.33 percent for the S&P composite, and



1 20.3 for the standard deviation. For the public  
2 utility index, 11.11 percent. And 22.65 percent for  
3 the standard deviation. The long-term corporate  
4 bonds, 6.06 percent, and the standard deviation,  
5 8.76 percent. The public utility bonds, 5.79  
6 percent. The standard deviation, 8.11 percent.

7 Q. If I buy a share in a company, what price  
8 do I pay, the market price of the share or the book  
9 value of the share?

10 A. You pay the market price.

11 Q. If the market price is twice the book  
12 value, I still have to pay the market price, don't  
13 I?

14 A. Yes, you do.

15 Q. If the company is earning 20 percent on its  
16 book value and I pay a market price twice that book  
17 value, what is my return?

18 A. I can't calculate that in my head.

19 Q. Would it be 10 percent?

20 A. If there's no growth. Yes, if the company  
21 paid out its dividend, everything they make.

22 Q. What, in general, do you believe to be the  
23 relationship between market price and book value of  
24 the average company in The Value Line Investment  
25 Survey that you cite on page 25 of your testimony?



1           A.    It's quite above book value.  I don't  
2 recall the composites at this time, but it's  
3 probably in the neighborhood of four or five.

4           Q.    Please turn to page 9 of Schedule 2 of your  
5 Exhibit JSG-2.  We keep going back to that sucker.

6                    COMMISSIONER WEFALD:  Would you repeat the  
7 number again, please?

8                    MR. BINEK:  It's JSG-2, Schedule 2, page 9.

9                    THE WITNESS:  Which page now?  I'm sorry.

10           Q.    (MR. BINEK CONTINUING)  Page 9.  There you  
11 show debt and equity -- are you there?  I'm sorry.

12           A.    Yes, I am.

13           Q.    There you show debt and equity ratios of  
14 your six proxy companies.  They are all quite close  
15 together except one.  Which is that one?

16           A.    Keyspan.

17           Q.    Keyspan has an equity ratio of only 38.84  
18 percent.  What effect would that have on the  
19 financial risk of that company?

20           A.    Other things being equal, that should raise  
21 what we referred to as the financial risk.  And  
22 Keyspan, if you look at page 2 of the same schedule,  
23 has an A plus and an A2 bond rating, which gives you  
24 a good idea of how investors view the financial  
25 risk.  It's pretty comparable.  Actually, it's the



1    only one that's identical to the first mortgage  
2    bonds of Montana-Dakota -- or MDU Resources that are  
3    secured by the public utility assets. So Montana-  
4    Dakota -- Montana-Dakota's bonds and Keyspan bonds  
5    have virtually the same rating so that the overall  
6    risk, that at least bond investors are looking at,  
7    is pretty much identical between the two.

8           Q.    On page 7 of Schedule 2, doesn't that show  
9    that Keyspan has the second highest DCF return of  
10   the six companies?

11          A.    Yes.

12          Q.    Do you think that the low equity ratio of  
13   Keyspan might have some influence on the equity risk  
14   perceived by investors?

15          A.    Well, two things interrelate in the sense  
16   that you can't -- when you look at the return on  
17   equity, you have to look at both the business risk  
18   of the company and its financial risk. And the two,  
19   in a sense, multiply against each other. So  
20   undoubtedly part of their rate of return is based on  
21   their high financial risk or -- and part of it is  
22   based on business risk. When you combine the two  
23   things, you come up with an overall risk assessment  
24   and, as I said, the bond rating agencies look at  
25   Keyspan as a whole as being almost identical to the



1 Montana-Dakota public utility assets. But both of  
2 them are rated -- have bond ratings below the  
3 average for that group, so I'm not surprised that  
4 Keyspan is above the average. Montana-Dakota  
5 Utilities do have low average bond rates for this  
6 group.

7 Q. I'd like to have you turn to page 32. On  
8 page 32 you list your costs of capital indications.  
9 What is the distinction between investor requirement  
10 and cost of capital?

11 A. The investor requirement is the return  
12 investors require on the sunk investment that's  
13 there. The cost of capital is what they require in  
14 order to be able to track new capital on reasonable  
15 terms.

16 Q. If we ignore flotation costs, we would  
17 focus on the first column; is that correct?

18 A. Yes.

19 Q. Now, I'd like to concentrate on the second  
20 stage retention growth. The number we see there was  
21 developed on page 6 of Schedule 2 of your exhibit;  
22 is that correct?

23 A. That's correct, yes.

24 Q. The growth component of that number was  
25 developed on page 5 of Schedule 2; is that also



1 correct?

2 A. Yes.

3 Q. Isn't it true that the retention growth  
4 that you used is not all retention growth, but only  
5 one-third retention growth, the other two-thirds  
6 being Zacks forecast?

7 A. Right, that's why I referred to it as a  
8 second stage retention growth, or it's a weighted  
9 average of Zacks and retention.

10 Q. If we developed a DCF using solely  
11 retention growth, would it consist of a growth  
12 factor of 5.5 shown on page 4 of Schedule 2 and a  
13 dividend yield of 5.14 percent developed on page 3  
14 of Schedule 2?

15 A. Mathematically that would be correct. It  
16 wouldn't mean anything because it wouldn't match up  
17 with investors' expectations.

18 Q. What would the DCF result be?

19 A. If you add 5.5 and 5.14, you get 10.64 and  
20 then, obviously, you would add the flotation cost  
21 adjustment.

22 Q. Okay. Thank you.

23 MR. BINEK: Can I take a moment, please?

24 MR. HOBERG: Yes.

25 (Exhibit 13 was marked for identification.)



1                   COMMISSIONER WEFALD:  What number is this  
2 exhibit?

3                   MR. HOBERG:  Exhibit 13.

4           Q.   (MR. BINEK CONTINUING)  Mr. Gaske, does  
5 this -- I've handed you what has been marked as  
6 Exhibit 13.  Do you recognize that exhibit?

7           A.   It appears to be an exhibit you showed me  
8 earlier this year.  I'm not positive it's the same  
9 one, but it looks to be almost identical.

10          Q.   And you see a reference of Exhibit 14 in  
11 the right-hand corner of that exhibit and below that  
12 a Docket No. 80 under case PU-399-01-186?

13          A.   Yes, I do.

14          Q.   Was that an MDU electric rate case?

15          A.   Yes.

16          Q.   And this was a document that was introduced  
17 in that case; is that correct?

18          A.   Yes.

19          Q.   Can you tell me what this document is?

20          A.   It looks to be a survey of rates of return  
21 that have been authorized -- or requested and  
22 authorized in past rate proceedings.  It also shows  
23 the dollar amount that the increase or decrease and  
24 other information about when these cases occurred.

25          Q.   Okay.  And would you agree that -- I'm



1 referring to the first page of this document in the  
2 introduction, that it says that the survey covers  
3 orders issued by state regulatory commissions during  
4 the period October 1, 2001 through September 30th,  
5 2001; is that correct?

6 A. I'm sorry. I missed where you were  
7 referring.

8 Q. It's in the first paragraph, about the  
9 third or fourth line down, it says that -- it  
10 indicates the period covered by the report is  
11 October 1, 2000 through September 30th, 2001?

12 A. Yes.

13 Q. Okay. And what is the date of this report?

14 A. It's dated December 15th, 2001.

15 Q. And it says that it's an annual survey?

16 A. Yes.

17 Q. So would it be safe to assume that this is  
18 the latest annual survey that has been put out by  
19 Public Utilities Reports?

20 A. That I don't know.

21 Q. Just assuming an annual survey issued  
22 December 15th of 2001.

23 A. Yeah, I would assume so. I don't know if  
24 it's some kind of a mutant average or something like  
25 that.



1 Q. Okay. But there's no exact science to this  
2 exhibit as far as use of it, but I'd like to explain  
3 to you, if you would look at the following pages,  
4 I've highlighted several cases and if you will look  
5 at those cases, they are all ones that were decided  
6 in the year 2001. I would also like to point out  
7 that under North Dakota, Roman numeral VII, in red  
8 highlight or red marker is Otter Tail Power Company  
9 Gas at 12 percent ROE, and I would ask that all of  
10 the parties acknowledge the fact that Otter Tail  
11 Power Company does not have a gas distribution  
12 company operating in North Dakota and so this is  
13 obviously an error. It's just a carryover from  
14 their electric case and the same reference is to  
15 their electric case, is just a mistake that they  
16 made. There are not all that many cases here. I'd  
17 like to have you start with the first case.

18 MR. BINEK: Yes. I was just getting to  
19 that. I would like to offer Exhibit 13.

20 MR. HOBERG: Any objection, Mr. Pearce?

21 MR. PEARCE: No. It's hearsay, but  
22 probably pretty reliable hearsay, so I won't object.

23 MR. HOBERG: Exhibit 13 is admitted.

24 Q. (MR. BINEK CONTINUING) Now, I would ask,  
25 would you please go through the highlighted cases



1 and just indicate for us the company name, the order  
2 date and the newly authorized rate of return on  
3 company equity, starting with Arizona, first of all?

4 MR. HOBERG: You want him to read these  
5 into the record?

6 MR. BINEK: He can or --

7 MR. HOBERG: Can't the document speak for  
8 itself?

9 MR. BINEK: That's fine. I have no problem  
10 with that.

11 Q. (MR. BINEK CONTINUING) I would like to  
12 have you just kind of peruse these different  
13 entries, though, and then I would -- the question I  
14 would have for you is, if you would agree with me  
15 that the ROE range for the majority of these cases  
16 range from 10.7 percent to 11.5 percent?

17 MR. HOBERG: Do you need a couple minutes  
18 to look at that, Dr. Gaske, or a couple seconds?

19 THE WITNESS: I don't see any that are  
20 below 11.7 -- or I'm sorry. I don't see any that  
21 are below 10.7. I do see a couple that are 12.25  
22 and 12.1 on the last page.

23 Q. (MR. BINEK CONTINUING) But my question is,  
24 would you agree that the majority of the cases range  
25 from 10.7 to 11.5?



1           A.    Well, if you start at the very bottom of  
2 the range and count upwards until you get to a  
3 majority, that's probably true.  If you start at the  
4 top and work your way down, you probably get another  
5 number.

6           Q.    Okay.  Well, would you agree with this  
7 statement, that the majority of them range from 11  
8 to 11 and a half percent?  If you can't agree,  
9 that's fine.  The document does speak for itself.

10          A.    I only see five back in that time period  
11 were above 11.5.

12          Q.    Okay.  And there were several below 11?

13          A.    Yes.

14          Q.    Okay.  Would you also agree with me that,  
15 according to this report, the highest ROE given in  
16 2001 that was included in the survey was 12.25  
17 percent?

18          A.    Yes.

19          Q.    Would you agree that there have been  
20 relatively few gas rate cases reported so far in  
21 2002, reported by Public Utility Reports, if you  
22 know?

23          A.    I don't know.

24          Q.    Okay.  Are you familiar with a case  
25 entitled Re Yankee Gas Services Company, a case



1 decided by the Connecticut Department of Public  
2 Utility Control on January 30th, 2002 and reported  
3 at 215 PUR4th, 185?

4 A. No, I'm not.

5 MR. BINEK: At this point, I would just  
6 like to show a copy of the case. I don't believe it  
7 needs to be offered as an exhibit, unless MDU would  
8 like to have it as an exhibit. It just refers to  
9 the ROE in this particular case, and I would like to  
10 have Mr. Gaske look at it.

11 MR. PEARCE: Well, I certainly would object  
12 to it being offered as an exhibit. I don't think  
13 that the rate of return on a case last year in the  
14 Eastern Seaboard has any relevance whatsoever to the  
15 return and costs in this case. So it certainly  
16 isn't relevant to this proceeding.

17 MR. BINEK: The only purpose is to show  
18 what is happening from basically the end of 2001 in  
19 the PUR report, what is shown up in PUR since then,  
20 kind of showing a trend.

21 MR. PEARCE: Well, that's the issue. Why  
22 would that be relevant to this case?

23 MR. BINEK: I think it is relevant.

24 MR. HOBERG: Dr. Gaske said he's not  
25 familiar with that case. Is there a better witness



1 to offer this through?

2 MR. BINEK: No, I don't think so. It's a  
3 case that's been reported and it's not a big issue.

4 MR. HOBERG: Are you withdrawing?

5 MR. BINEK: Well, my first question is  
6 whether the Commission would like to have it offered  
7 as an exhibit? I have three cases. I'll offer them  
8 as exhibits and if that's the course you would like  
9 to pursue and, apparently, based on the objections  
10 that Mr. Pearce has indicated, that would be the way  
11 to go.

12 MR. HOBERG: Okay. So you have two more  
13 besides this one?

14 MR. BINEK: Two more cases, yes.

15 MR. HOBERG: Are they the same relevancy  
16 that you're proposing?

17 MR. BINEK: Right. They're different -- in  
18 different jurisdictions. They're cases that have  
19 been reported in the year 2002.

20 MR. HOBERG: Mr. Pearce?

21 MR. PEARCE: Well, I would object to any  
22 such case. I mean, if they're cases reported in  
23 some public forum, anybody can look at them, but  
24 they certainly have no relevance that I can see to  
25 the issues in this case.



1           MR. HOBERG: Why don't you state them, give  
2 us the cites of those on the record, please,  
3 Mr. Binek, and we can make them available on an  
4 official notice basis, if the Commission wishes to  
5 use them, if the Commission believes they're  
6 relevant.

7           MR. BINEK: That's fine with me.

8           MR. HOBERG: Give Mr. Pearce a copy and  
9 perhaps after he has a copy of those, he will be  
10 able to make some argument that the Commission  
11 shouldn't take official notice of those because  
12 they're not relevant. At this point in time, you  
13 know, I don't know what the Commission would do with  
14 those. Maybe nothing. So let's take official  
15 notice of those three and pass them out to the  
16 Commission as a possibility that the Commission may  
17 take official notice of those in actually making a  
18 decision.

19           MR. BINEK: Very good.

20           MR. HOBERG: Why don't you read each of  
21 them as you're passing them out, what the decision  
22 is?

23           MR. BINEK: The first case is entitled Re  
24 Yankee Gas Services Company. It's Docket No.  
25 01-05-19PH01, decided by the Connecticut Department



1 of Public Utility Control on January 30, 2002. And  
2 that is reported in Public Utility Reports 215  
3 PUR4th, 185.

4 The next case is Re Berkshire,  
5 B-e-r-k-s-h-i-r-e, Gas Company. It's Docket D.T.E.  
6 01-56, decided by the Massachusetts Department of  
7 Telecommunications and Energy, on January 31, 2002.  
8 And pages are eliminated at the bottom. That case  
9 is in 215 PUR4th, that's P-U-R, 361.

10 And the last case is a short one. Re  
11 Atlanta Gas Light Company, Docket No. 14311-U,  
12 decided by the Georgia Public Service Commission on  
13 April 29th, 2002. And that is reported in 217  
14 PUR4th, page 190.

15 MR. HOBERG: Mr. Binek, you're not offering  
16 these for any of the facts contained therein, just  
17 for the rulings in these matters?

18 MR. BINEK: The only purpose for these  
19 cases is to show the return on equity that has been  
20 authorized by these other public utility  
21 commissions.

22 MR. HOBERG: As part of their orders in  
23 those cases?

24 MR. BINEK: Pardon?

25 MR. HOBERG: As part of their orders in



1 those cases?

2 MR. BINEK: Yes.

3 MR. HOBERG: Mr. Pearce?

4 MR. PEARCE: Well, I just want to make sure  
5 that my objection stands as to any conceivable  
6 relevance of these. He is simply taking three  
7 decisions from other jurisdictions based on totally  
8 different facts and circumstances. I would hope the  
9 Commission would not -- I'm sure they do not simply  
10 come to their decision by copying the results from  
11 other unrelated cases, so I don't think it will have  
12 any undue influence, but certainly it has no  
13 conceivable bearing on this case. We don't even  
14 know if these are all the decisions from that year.  
15 Even if they were, they certainly wouldn't be  
16 relevant.

17 MR. HOBERG: Thank you, Mr. Pearce.

18 Okay. Mr. Binek, do you have any further  
19 questions of Dr. Gaske?

20 Q. (MR. BINEK CONTINUING) I'd like to focus  
21 on some areas where you apparently agree with  
22 Mr. King. And this basically is in your rebuttal  
23 testimony, I believe.

24 MR. BINEK: That testimony hasn't been  
25 marked yet, has it?



1           MR. PEARCE: I didn't realize you were  
2 asking from rebuttal testimony. That isn't in the  
3 record, so we have to wait.

4           MR. BINEK: Okay. We'll wait. We'll cover  
5 it afterwards.

6           MR. HOBERG: You're bringing Dr. Gaske back  
7 on as rebuttal?

8           MR. PEARCE: Yes.

9           MR. BINEK: Okay. In the past we've kind  
10 of run these altogether. So that's fine. We'll  
11 cover him after he gives his rebuttal.

12          MR. HOBERG: I think that will be better.  
13 It will follow more clearly.

14          MR. BINEK: I have no further questions  
15 then.

16          MR. HOBERG: Thank you, Mr. Binek.

17          Commissioner Reinbold, did you have any  
18 questions of Dr. Gaske?

19          COMMISSIONER REINBOLD: Not at this time.  
20 Thank you.

21          MR. HOBERG: Thank you, Commissioner  
22 Reinbold. Commissioner Wefald, please.

23          COMMISSIONER WEFALD: None at this time,  
24 either.

25          MR. HOBERG: Thank you. Commissioner



1 Clark, please.

2 COMMISSIONER CLARK: I did have a couple.

3 EXAMINATION

4 BY COMMISSIONER CLARK:

5 Q. On page 28 of your testimony --

6 COMMISSIONER REINBOLD: What page?

7 COMMISSIONER CLARK: Page 28, lines 18 and

8 19.

9 Q. (COMMISSIONER CLARK CONTINUING) In this  
10 section you are discussing some of the business  
11 risks that you feel are faced by MDU.

12 A. Yes.

13 Q. You make a statement -- this follows up on  
14 previous testimony earlier this morning talking  
15 about the direct competition from propane heating  
16 oil. I think coal was used as another example of  
17 competition that MDU faces. Wouldn't raising rates  
18 be a strange action in response to direct  
19 competition?

20 A. Definitely not, under the circumstances.  
21 If you have direct competition, you will lose  
22 business, if it's really powerful direct  
23 competition. Currently, Montana-Dakota is able to  
24 maintain its business. If it has to maintain its  
25 rates at a level that it can't recover its costs, it



1 actually should try to go out of business and let  
2 the competitors have the business. So in a very  
3 short- run context, usually in markets you see that  
4 if there's a lot of competition, people are forced  
5 to lower their rates and the one who lowers his  
6 rates far enough that he can't recover his costs  
7 anymore, he goes out of business.

8           In Montana-Dakota's case I don't think that  
9 the competition at this point in time is so severe  
10 that they would go out of business, but if they were  
11 not allowed by this Commission to charge rates that  
12 would recover their costs, they should think about  
13 getting out of the business. Just as in a  
14 competitive market, if competition is the regulator  
15 that forces the rates to be below cost, a  
16 competitive company would after some time exit the  
17 market.

18           Q. Well, I'm asking because it seems  
19 counterintuitive that if you're facing competition  
20 and you've got potentially some customers who are on  
21 the edge, could potentially switch to another, in  
22 this case, heating source, that an increase in the  
23 rates would cause potentially some of those  
24 customers to switch over, and wouldn't that in the  
25 end, in fact, just increase the risk that MDU faces?



1     Wouldn't the better response be to find savings  
2     somewhere else, if you are, in fact, facing that  
3     competition?

4           A.     Well, I think as Mr. Fox testified earlier,  
5     they have tried to find as many savings as possible.  
6     What really happens with natural gas is that the  
7     cost of the commodity drives the attractiveness to a  
8     great deal -- great extent, also.  So that's  
9     probably a bigger problem for Montana-Dakota in  
10    terms of whether they increase the distribution  
11    charge by 4 percent or whether the suppliers to the  
12    company, whether the natural gas markets are selling  
13    gas at \$2 or whether it's at \$4.  That's where they  
14    really have to be concerned about such competition.  
15    And right now they can compete.  If the price of  
16    natural gas is driven upwards in the \$4- and  
17    \$5-range, you may see people shutting off their gas  
18    service at a fairly rapid rate.

19           Q.     Another question on that same page, talking  
20    about kind of the general business climate and risks  
21    that MDU faces.  On lines 10 through 12 there's a  
22    sentence there, On a practical level, MDU's  
23    relatively small natural gas distribution operations  
24    are heavily dependent on a relatively undiversified  
25    local economy.



1           Could you just expound on that a little  
2 bit?

3           A.   Well, you have in their service territory  
4 some mining operations, refining operations, a lot  
5 of farming and farming-related operations, and they  
6 face some risk that some of these kind of  
7 operations, manufacturing-type things -- I shouldn't  
8 call it manufacturing, but processing foods and  
9 things like that, could shut down and they'd lose  
10 that business, but, to my mind, a much bigger risk  
11 for them is the fact that if operations like that  
12 shut down around here, the people who work at those  
13 plants and local economies will suffer and people  
14 will migrate out of the towns and Montana-Dakota  
15 will be sitting there with gas distribution mains in  
16 place and yet because of, you know, events in the  
17 local economy, they're at risk.

18           And people who serve larger cities have a  
19 much smaller risk in that regard. Most large cities  
20 have many, many different kinds of businesses and  
21 industries that support the population and when one  
22 leaves, usually others are able to expand to take up  
23 the slack. I don't see that in the towns that  
24 Montana-Dakota serves.

25           Q.   I guess I've -- the reason I ask is, I've



1 always heard that North Dakota's economy, which  
2 would be true of economies of states like ours, is  
3 typically more resistant to booms and peaks and  
4 valleys. That, in fact, larger states more kind of  
5 dynamic economies are much more likely to have the  
6 peaks and valleys. And that's what we've seen  
7 certainly in this latest recession. We seem to be a  
8 little bit more recession proof. We seem to be a  
9 little bit less prone to the booms when times are  
10 good as well.

11 How does that fit with the comments in  
12 there?

13 A. As far as short-run booms and busts, I  
14 think you probably are pretty insulated from that  
15 because of a lot of agricultural-related things, but  
16 agriculture booms and busts a little bit. To the  
17 extent more energy production occurs in the state,  
18 you'll probably be more subject to booms and busts  
19 in the energy business.

20 On a longer-term basis, and Montana-Dakota  
21 has to think about longer-term basis, their plant is  
22 there for many, many years. They put it in and it  
23 will stay there for 30 years or something like that.  
24 As businesses shut down and people migrate out of  
25 towns, or just the natural change of people's desire



1 to, say, move to the big cities or whatnot, they can  
2 leave the towns, but Montana-Dakota's facilities are  
3 still there. They still have to try to recover  
4 their costs. To the extent you get some major  
5 employers that shut down for whatever reason, it's  
6 not a guarantee that the people will stay here or  
7 that the people will be able to pay their bills or  
8 things like that.

9           So even if you're resistant to short run  
10 year-to-year fluctuations in boom and bust cycles or  
11 even on two- or three-year cycles, on a longer run  
12 cycle, which really is very important to MDU because  
13 it has a lot of fixed costs, they have to worry  
14 about the big employers in this area, will they shut  
15 down and really dramatically change the economics of  
16 their business.

17           COMMISSIONER CLARK: That's all I have  
18 right now. Thank you.

19           MR. HOBERG: Thank you, Commissioner Clark.

20           Mr. Pearce, any further questions of  
21 Dr. Gaske?

22           MR. PEARCE: Just one short question,  
23 really.

24

25



1 REDIRECT EXAMINATION

2 BY MR. PEARCE:

3 Q. Dr. Gaske, there was some discussion on  
4 your cross-examination about Exhibit 13, which was a  
5 PUR report of decisions ending at a point in 2001.  
6 Would it surprise you that the cost of equity  
7 capital that you derived for Montana-Dakota for the  
8 2003 projected year would be different from and  
9 perhaps more than any of the cases which the last  
10 report here seems to end in June of 2001 in this  
11 Exhibit 13?

12 A. No. No. In the last year the stock market  
13 has gone down considerably in general. Investors'  
14 risk aversions have increased and we've seen some  
15 fairly remarkable things happen in the financial  
16 markets and not all of them very good for investors.

17 Q. And the cost of capital is essentially  
18 unique to each entity, isn't it, depending on the  
19 circumstances and the business and the risk, and so  
20 on?

21 A. Yes.

22 MR. PEARCE: I have nothing else.

23 MR. HOBERG: Thank you, Mr. Pearce.

24 Mr. Binek, anything further of Dr. Gaske?

25 MR. BINEK: No.







1 People just don't want to be in equities right now.

2 Q. That's the part I don't understand. Why  
3 would that go up? Why would it just be a certain  
4 amount greater than what you can get on a short-term  
5 money note, let's say? I mean, I don't understand  
6 your conclusion that that would go way up, if I'm  
7 only able to return -- get a return of a very small  
8 amount on a very short-term equity. Why wouldn't I  
9 be pleased if it was 5 percent more, and I could  
10 know that it's going to be even 5 percent more,  
11 let's say 8 percent rather than 3 percent, or I  
12 guess even right now many times in money market it's  
13 1 percent? So why wouldn't I be pleased if I could  
14 get 6 percent?

15 A. The overall return might go up or it might  
16 go down some that you require on your common  
17 equities, but they won't go down nearly as much as  
18 on safer investments. But investors view the market  
19 as very risky. If you say -- you think of it in  
20 terms of a common equity has five units more risk  
21 than a bond, if the market is very risky, that extra  
22 five units of risk will be very valuable. If people  
23 are very uncertain about the market, they don't --  
24 they're going to want a very high return to take the  
25 five units of extra risk.



1           If the economy is doing very well, things  
2   are very stable and people are very confident about  
3   the future, the price of risk, what they're willing  
4   to spend for -- or what they require for that extra  
5   five units of risk will be much lower. So you ask,  
6   you know, why don't they want 5 percent more than  
7   what they can get on bonds? Over time what they  
8   require will go up, the extra amount they require  
9   will go up and down. Right now we're in a period  
10  where people don't want to own common stocks. They  
11  think they're too risky and they do want to own  
12  bonds and short-term government bonds and short-term  
13  debt.

14           So the extra units of risk, let's say the  
15  five extra units of risk, those become very valuable  
16  or very expensive, they just aren't going to buy  
17  unless they think they are going to get a very good  
18  premium over what they can get on the bonds. So the  
19  premiums go up and down over time.

20           COMMISSIONER WEFALD: Thank you for that  
21  analysis.

22           THE WITNESS: Hopefully, your experiences  
23  have been better than mine in the market, but it has  
24  been a risky year or a very discouraging year.

25           MR. HOBERG: Thank you. Commissioner



1 Clark.

2 FURTHER EXAMINATION

3 BY COMMISSIONER CLARK:

4 Q. I do have a question on that. Is it that  
5 investors want to get out of the stock market,  
6 period, or does it require maybe a little bit more  
7 granular analysis, and that is that certain sectors  
8 are just horrendous? For instance, telecom is one  
9 of them. Fortunately, we can't invest in the  
10 telecom market because we are prevented by state law  
11 from doing that. Are certain stocks more attractive  
12 because of that, for example, potentially kind of  
13 old-fashioned utility companies that are regulated?

14 A. The utility companies are probably more  
15 attractive, much more attractive now than, say, a  
16 telecom stock. A lot of people wanted to buy  
17 telecom stocks two years ago. But relative to  
18 bonds, utilities are less attractive, so the premium  
19 that people require on utilities is, I think, higher  
20 now and has gone up over the last year. So some  
21 people selling telecom will buy utilities. Some  
22 people who have utilities will sell the utilities  
23 and buy bonds. But if you look at bonds versus  
24 utilities, I think that spread is increased.  
25 Utilities versus telecom, that spread has really



1 increased. Nobody wants the telecom stock right  
2 now. So all across the board, from the very safest  
3 to the very riskiest investment, I think everything  
4 is spread out.

5 Q. Would it follow then when the stock market  
6 get on a roll like it did for the past 10 years or  
7 so prior to the last few we've had, that utility  
8 regulated ROEs should go down then because it's  
9 easier to attract capital?

10 A. The spreads over bond yields should go  
11 down, but you can have a very good market, but the  
12 interest rates are very high. You can -- so it  
13 really depends on a lot more factors.

14 Q. I'm just wondering if then the argument  
15 would be, well, all the peer companies are doing so  
16 well, we need to increase our rate of return now to  
17 attract capital vis-a-vis the rest of the market?

18 A. Well, that one depends on -- yeah, how much  
19 the individual companies are willing to invest. But  
20 it really is a good question about -- people are  
21 afraid to invest in almost anything. So the  
22 measure, at least that I try to look at is, what  
23 kind of spread versus the bond yield, because those  
24 are much easier to determine than the equity  
25 returns.



1                   COMMISSIONER CLARK: That's all I have.

2                   Thanks.

3                   MR. HOBERG: Thank you. Any further  
4                   questions of Dr. Gaske? Thank you, Dr. Gaske. Take  
5                   an hour recess here, luncheon recess?

6                   COMMISSIONER WEFALD: Can you tell me,  
7                   please, the order of witnesses that are going to be  
8                   followed for this average?

9                   MR. HOBERG: I believe they're in exactly  
10                  the same order as listed in the direct testimony, is  
11                  that correct, Mr. Pearce?

12                  MR. PEARCE: Yes, it is.

13                  COMMISSIONER WEFALD: And then we'll go  
14                  through and then the rebuttal will happen in the  
15                  same order by those people following?

16                  MR. HOBERG: Then it will be Mr. Binek's  
17                  presentation of his witnesses after the direct of  
18                  MDU and then followed by the rebuttal.

19                  COMMISSIONER WEFALD: That's a little  
20                  unusual, but -- because then what happens you  
21                  have -- well --

22                  MR. HOBERG: I don't think it's unusual. I  
23                  think that's the practice we followed in the past.

24                  COMMISSIONER WEFALD: But the thing is,  
25                  there's a lot of information that has been agreed



1 upon by the parties by the time we get to the  
2 rebuttal. So we're going to have to cover things  
3 that perhaps aren't that important because the  
4 case -- they have agreed on a bunch of things as  
5 they have gone along.

6 MR. HOBERG: Well, I would assume those  
7 things we've agreed upon you're not going to be  
8 spending much time on, correct?

9 MR. PEARCE: No. The rebuttal only touches  
10 on points on which there's disagreement still. So  
11 the rebuttal -- anything that's been agreed to won't  
12 be testified to on rebuttal.

13 COMMISSIONER WEFALD: Okay.

14 MR. HOBERG: Is that the order you  
15 expected, Mr. Binek?

16 MR. BINEK: Well, we have done both ways  
17 where we've gone with questioning on both the direct  
18 and rebuttal testimony initially, and that was  
19 what -- kind of the mode I was in. It doesn't  
20 matter to me which way we do it, and this seems to  
21 be set up to do it the long way.

22 MR. HOBERG: The long way? I don't know  
23 that it's necessarily longer, as long as the parties  
24 understand that things that, you know, there's no  
25 disagreement about, you don't have to spend any time



1 on really.

2 MR. BINEK: Hopefully, it will work out  
3 that way.

4 MR. HOBERG: I think it's sort of six of  
5 one and half-dozen of the other, unless you --

6 MR. BINEK: It's fine to do it that way.

7 MR. HOBERG: Perhaps we'll reflect on that  
8 over the break.

9 MR. PEARCE: It seemed like it was the  
10 usual judicial procedure; plaintiff, defendant, and  
11 then plaintiff's redirect, is really the mode we are  
12 following, I think.

13 MR. HOBERG: That's what I thought, too.  
14 All right. Let's take a one-hour lunch.

15 (Lunch recess was taken.)

16 MR. HOBERG: Okay. We're back on the  
17 record after a luncheon recess. And just to kind of  
18 rehash maybe the concerns about the procedure today  
19 in regard to direct and rebuttal, I think everybody  
20 is basically pulling in the same direction and maybe  
21 to provide a little bit of consistency and some  
22 guidance, it seems like except for perhaps the first  
23 witness, Mr. Fox, who you wanted to highlight the  
24 direct especially, you're offering the direct, but  
25 you're not really asking many questions.



1 MR. PEARCE: Right.

2 MR. HOBERG: And maybe that will be the  
3 procedure for the whole rest of the direct. It can  
4 go relatively quickly, except for the PSC's case,  
5 but if you do really have -- if your questions are  
6 more along the lines of something for the rebuttal,  
7 perhaps you should save them for that, but there may  
8 be some questions to highlight or to ask something  
9 that somebody neglected to cover in the rebuttal,  
10 but, basically, I think the direct should go  
11 relatively quickly, at least for MDU's case, and the  
12 rebuttal will be where more of the questions are,  
13 but I think we'll get to the same place we would  
14 have if we had just forgot about the direct and went  
15 right to the rebuttal. I think that was a time  
16 where there was pretty much agreement in another  
17 case where we could just move right to the rebuttal,  
18 but that isn't the situation here, as I read it,  
19 anyway.

20 So we'll proceed with the direct and then  
21 perhaps move relatively quickly to the rebuttal,  
22 except for perhaps Mr. Binek's case. Is that clear?  
23 I maybe didn't make it very clear. I hope I did.

24 Mr. Pearce, do you want to proceed, please?

25 MR. PEARCE: Yes. I'll call Craig Keller.



1           MR. HOBERG: Mr. Keller, were you here  
2 earlier when I gave the admonition in regard to  
3 perjury?

4           THE WITNESS: Yes.

5           MR. HOBERG: Being advised of the penalty  
6 for perjury, do you promise to tell the truth in  
7 this matter being heard? If so, answer I do.

8           THE WITNESS: Yes, I do.

9           MR. HOBERG: Thank you. Mr. Pearce,  
10 please.

11                           CRAIG A. KELLER,  
12 having been first duly sworn, was examined and  
13 testified as follows:

14   DIRECT EXAMINATION

15 BY MR. PEARCE:

16       Q. Mr. Keller, in connection with this case  
17 have you prepared or had prepared under your  
18 direction and control direct testimony of Craig A.  
19 Keller, CPA?

20       A. Yes, I have.

21       Q. And if I were to ask you the questions that  
22 are in that prepared, prefiled testimony today,  
23 would your answers be the same as appear in there?

24       A. Yes, they would be.

25       Q. And to the best of your information and



1 belief, all of your answers contain accurate and  
2 correct information?

3 A. Yes, they do.

4 MR. PEARCE: I will offer the direct  
5 testimony of Mr. Keller. I think it would be  
6 Exhibit 14.

7 MR. HOBERG: Exhibit 5.

8 MR. PEARCE: I'm sorry. Exhibit 5. I have  
9 no further direct questions.

10 MR. HOBERG: Thank you, Mr. Pearce. Any  
11 objections to Exhibit 5?

12 MR. BINEK: No.

13 MR. HOBERG: Exhibit 5 is admitted.

14 Mr. Binek, do you have any questions of  
15 Mr. Keller on direct?

16 MR. BINEK: Yes.

17 CROSS-EXAMINATION

18 BY MR. BINEK:

19 Q. Mr. Keller, would you please turn to your  
20 Statement A?

21 COMMISSIONER WEFALD: Where do we find  
22 that?

23 MR. PEARCE: Exhibit 2.

24 MR. HOBERG: There's a document entitled  
25 Statements A through O. Is that what you're



1 referring to, Mr. Binek?

2 MR. BINEK: Yes.

3 COMMISSIONER WEFALD: And this is  
4 Statement F?

5 MR. BINEK: Statement A.

6 Q. (MR. BINEK CONTINUING) The first two pages  
7 of Statement A present a balance sheet that is  
8 labeled MDU Utilities Co. The remaining 27 pages  
9 are of notes on the balance sheet; is that correct?

10 A. Yes.

11 Q. Those 27 pages are not headed MDU Utilities  
12 Co., but rather MDU Resources, Inc.; is that  
13 correct? Am I correct that the notes pertain to a  
14 different balance sheet than Statement A?

15 A. I believe the balance sheet is the -- the  
16 balance sheet of Montana-Dakota is not the  
17 consolidated balance sheet, whereas the statements  
18 would be the consolidated -- the statements that are  
19 in our consolidated balance sheet of MDU Resources  
20 Group.

21 Q. Do all the notes on pages 3 through 27  
22 apply as well to the first two pages of Statement A?

23 A. They would apply to the Statement A. They  
24 may also apply to -- there will be information that  
25 will apply to some of the subsidiaries of MDU



1 Resources Group as well.

2 (Exhibit 14 was marked for identification.)

3 MR. BINEK: This will be Exhibit 14.

4 Q. (MR. BINEK CONTINUING) Now, I've handed  
5 you a document that's been marked as Exhibit 14.  
6 Can you identify that exhibit?

7 A. It says \$150 million secured medium-term  
8 notes, MDU Resources Group, Inc.

9 Q. I'm sorry. Could you speak up a little  
10 bit?

11 A. It's the prospectus for \$150 million  
12 secured medium-term notes, MDU Resources Group, Inc.

13 Q. Okay. And does this prospectus cover the  
14 \$133.5 million in long-term debt that you list on  
15 page 1 of Statement F?

16 A. I believe it applies to a portion of that.  
17 I don't believe it applies to the entire. It would  
18 apply to the debt that was issued under this  
19 prospectus or under this here arrangement, financial  
20 instrument.

21 Q. Could you repeat your answer?

22 A. I said I believe it applies to the debt on  
23 this schedule of the \$133 million that was issued  
24 under this financing instrument. So there is -- I  
25 believe there's also some debt that we have



1 outstanding that was not issued as part of this here  
2 prospectus here.

3 MR. BINEK: Okay. At this time I would  
4 offer Exhibit 14.

5 MR. HOBERG: Any objection to Exhibit 14?

6 MR. PEARCE: No.

7 MR. HOBERG: Exhibit 14 is admitted.

8 Q. (MR. BINEK CONTINUING) Who issued this  
9 prospectus?

10 A. MDU Resources Group, Inc.

11 Q. I'd like to have you turn to page 2 of the  
12 prospectus under the section titled "The Company."  
13 What company is described there?

14 A. It refers to the company as being MDU  
15 Resources Group, Inc.

16 Q. Does the company that -- the term "the  
17 company" include all subsidiaries under Centennial  
18 Energy Holdings?

19 A. I do not believe so. This states it's for  
20 the company's first mortgage bonds that are -- would  
21 be issued under our mortgage indenture, so that  
22 would apply only to MDU Resources and Montana-Dakota  
23 Utilities. It's on the first page, the very front  
24 of the prospectus, if you look on the very front of  
25 the prospectus. If you read the very first



1 sentence, it says, MDU Resources Group intends from  
2 time to time to offer up to \$150 million aggregate  
3 principal amount of its secured medium-term notes as  
4 an additional series of the Company's first mortgage  
5 bonds having maturities ranging from 9 months to 35  
6 years.

7 The only company that's able to issue notes  
8 under our mortgage indenture is Montana-Dakota  
9 Utilities or the utility.

10 Q. Lower down on that page of this, and I'm  
11 referring to page 3 now, is a section titled "Use of  
12 Proceeds." Would you please read that section?

13 A. "Unless otherwise set forth in a prospectus  
14 supplement, the net proceeds from the sale of the  
15 notes will be used to retire certain of the  
16 company's outstanding senior securities, including  
17 the refunding of outstanding first mortgage bonds,  
18 and for other general corporate purposes."

19 Q. Where in that section is there any specific  
20 reference to MDU Utilities Company or MDU Utilities  
21 Co.?

22 A. It doesn't state anything in this right  
23 here.

24 Q. Were those retired senior notes issued in  
25 the name of MDU Utilities Company or in the name of



1 the parent company, MDU Resources?

2 A. Well, they are one and the same. MDU is  
3 not a separate -- Montana-Dakota is not a separate  
4 corporation. So I believe all our debt is issued in  
5 the name of our legal entity, which would be MDU  
6 Resources Group, Inc.

7 Q. Where in this prospectus do we find a  
8 statement that the proceeds from the sale will be  
9 used only for MDU Utilities Company?

10 A. Well, I believe when it's saying -- refers  
11 to the company, it's talking about the company, MDU  
12 Resources Group, which is that legal entity only,  
13 and I think if we go down here --

14 MR. PEARCE: Could I just ask that we be  
15 careful for the record. I mean, there is no MDU  
16 Utilities Company. It's Montana-Dakota Utilities  
17 Company or MDU Resources Group, and I think we may  
18 be getting confused if we keep referring to MDU  
19 Utilities Company, which doesn't exist.

20 MR. HOBERG: Thank you, Mr. Pearce.

21 THE WITNESS: I guess when it refers to the  
22 company, it's talking about the legal entity, MDU  
23 Resources Group, and that is the same as Montana-  
24 Dakota. They're one legal entity. So when it  
25 refers to that, you know, I believe what it's



1 stating is that it is for the company, Montana-  
2 Dakota, MDU Resources Group, which is the same legal  
3 entity.

4 MR. BINEK: I have no further questions.

5 MR. HOBERG: Thank you, Mr. Binek.

6 Commissioner Reinbold, do you have any  
7 questions?

8 COMMISSIONER REINBOLD: No.

9 MR. HOBERG: Thank you. Commissioner  
10 Wefald?

11 COMMISSIONER WEFALD: I have none.

12 MR. HOBERG: Thank you. Commissioner  
13 Clark?

14 COMMISSIONER CLARK: None at this time.  
15 Thank you.

16 MR. HOBERG: Mr. Pearce, do you have any  
17 further questions of Mr. Keller?

18 MR. PEARCE: No.

19 MR. HOBERG: Thank you, Mr. Keller.

20 Mr. Keller, do you have the exhibit that was handed  
21 to you that was marked? Thanks.

22 Your next witness, please, Mr. Pearce.

23 MR. PEARCE: I'll call Rita A. Mulkern.

24 MR. HOBERG: Ms. Mulkern, did you hear the  
25 admonition I gave earlier in regard to perjury?



1 THE WITNESS: Yes, I did.

2 MR. HOBERG: Being advised of the penalty  
3 for perjury, do you promise to tell the truth in  
4 this matter being heard? If so, answer I do.

5 THE WITNESS: I do.

6 MR. HOBERG: Mr. Pearce, please.

7 RITA A. MULKERN,  
8 having been first duly sworn, was examined and  
9 testified as follows:

10 DIRECT EXAMINATION

11 BY MR. PEARCE:

12 Q. Ms. Mulkern, did you prepare direct  
13 testimony and have it prefiled in this case?

14 A. Yes, I did.

15 Q. And if I were to ask you the same questions  
16 today, would your responses be the same as in that  
17 prefiled testimony?

18 A. Yes, they would.

19 Q. If you will look at Exhibit 6, I believe it  
20 would be, is that your prefiled testimony?

21 A. Yes, it is.

22 Q. And to the best of your information and  
23 belief, is the information contained in that exhibit  
24 true and correct?

25 A. Yes, it is.







1 return?

2 A. I guess I really can't answer that one.

3 Q. Okay. I'd like to now have you turn to  
4 Statement I, page 2 of 6.

5 MR. HOBERG: Exhibit 2, the blue book here.

6 Q. (MR. BINEK CONTINUING) Do you have it?

7 A. Yes, I do.

8 Q. Would you please read that paragraph for  
9 the record?

10 A. "See pages 3 through 5 for Montana-Dakota  
11 depreciation rates as set forth in a study performed  
12 by Stone & Webster Management Consultants, Inc., as  
13 of December 31, 1992 for gas and common plant. See  
14 page 6 for internally developed rates as of December  
15 31, 2001 for computer equipment and network  
16 equipment."

17 Q. Now would you please turn to page 5 of  
18 Statement I?

19 A. (Witness complies.)

20 Q. Did your internal studies result in  
21 substantial increases to certain depreciation rates?

22 A. Excuse me. Could you clarify that?

23 Q. Well, you listed depreciation rates there.  
24 Did these internal studies that you've performed  
25 result in any substantial increases to any of those



1 depreciation rates?

2 A. I believe that these accounts were ones  
3 that were not included in the Stone & Webster study  
4 and that's why they were developed internally. So  
5 they have not changed.

6 Q. Okay. I'd like to have you turn to page 4  
7 of 6. Is that the Stone & Webster study?

8 A. Yes, it is.

9 Q. Is there an account 391 on that page?

10 A. There is an account 391, office furniture  
11 and equipment.

12 Q. Is that where computer equipment is  
13 supposed to be?

14 A. No. Computer equipment is contained in  
15 various subaccounts under the 391. That account  
16 would be just for office furniture and equipment.

17 Q. Did you do a complete depreciation study as  
18 of December 31, 2001 or only a piecemeal study of  
19 general and common plant?

20 A. Can you repeat the question again?

21 Q. Did you do a complete depreciation study as  
22 of December 31, 2001, or did you only do a piecemeal  
23 study of general and common plant?

24 A. We did not do a depreciation study as of  
25 December 2001, and these depreciation rates set







1 Q. Okay. In your work with MDU have you  
2 testified in other cases before the PSC?

3 A. I have testified before this Commission and  
4 Commissions in Montana and South Dakota and Wyoming.

5 Q. Okay. I was going to ask about the other  
6 states, but you answered before I asked.

7 COMMISSIONER REINBOLD: I have no further  
8 questions. Thank you.

9 MR. HOBERG: Thank you, Commissioner  
10 Reinbold. Commissioner Wefald, please.

11 EXAMINATION

12 BY COMMISSIONER WEFALD:

13 Q. Ms. Mulkern, I'm going to ask you the  
14 questions I had asked Mr. Fox because I've been  
15 referred to you for those questions. And so I asked  
16 him, each 1 percent of each -- I have to get out my  
17 notes before me.

18 Each 1 percent of the rates of return, how  
19 many dollars does that represent? So, for example,  
20 on Exhibit No. 10 where it showed that MDU Gas,  
21 let's say in the year 2000, had 11.12 percent and  
22 then it dropped in the year 2001 to 1.6 percent,  
23 what does each one percent represent, how many  
24 dollars?

25 MR. HOBERG: Do you have Exhibit 10?



1 THE WITNESS: No, I don't.

2 Q. (COMMISSIONER WEFALD CONTINUING) It  
3 probably is a different dollar number each year.

4 A. Yes, I guess in -- I guess to try to  
5 clarify, in 2001 we had a rate of return on equity  
6 of 1.6 percent. And we're saying in 2003 we're  
7 going to need \$2.84 million. So, basically, to  
8 bring us up from 1.6 up to a 13.25, we would need  
9 2.8 million. That's approximate.

10 Q. The 1.6 return on equity is in the year  
11 2001. And the 13.25, you would like that in the  
12 year 2002?

13 A. The 13.25 is the equity return that we have  
14 requested in this case for 2003.

15 Q. Yes. So did you say that it would take 2.8  
16 million to bring you that number in 2003?

17 A. That's right.

18 Q. So what would it take to bring you to that  
19 number in 2002? Is it a different number?

20 A. Yes. I can give you that. It would take  
21 \$2.2 million to bring -- for 2002 to achieve a 13.25  
22 percent return on equity.

23 Q. Okay. Thank you. Then you had answered a  
24 question from Mr. Binek, but I needed you to show me  
25 where that information can be found. The expansion



1 into north Bismarck, how the costs were recovered  
2 from expansion, are they included in your costs for  
3 2002 when you anticipate the rate of return to be  
4 zero or the return on equity to be zero?

5 A. The costs for the northeast Bismarck  
6 expansion are -- in the rate case are the same costs  
7 as for any other new customer. The customers in  
8 northeast Bismarck will be paying a contribution for  
9 any costs over the extension policy, and according  
10 to that, they would give a contribution. So the  
11 costs in the case are the same as for any other new  
12 customer. And, also, the volumes associated with  
13 those new customers are also included in the case.  
14 Did I not answer your question?

15 Q. So you gave a dollar figure earlier to how  
16 much money. You said something had been returned in  
17 discovery. Can you just share that with me, because  
18 I haven't seen those discovery?

19 A. It's included in the discovery response  
20 dated July 25, and it is response No. 2.

21 Q. And do we have that in the materials that  
22 have been shared with the Commission?

23 A. We provided copies to the Commission.

24 Q. Where would I find that?

25 MR. HOBERG: Mr. Binek, do you have copies



1 of those data responses?

2 MR. BINEK: We should have copies of them.

3 Q. (COMMISSIONER WEFALD CONTINUING) But I  
4 wondered whether they had been provided to the  
5 Commissioners as part of your case.

6 A. They were not part of the case that was  
7 filed initially, but they were provided as -- detail  
8 provided as a data request. We did give a copy --  
9 sent a copy, I believe, to the Commission.

10 Q. All right. So I would go back into the  
11 record for that.

12 MR. BINEK: Those are not a part of the  
13 record, Commissioner. Data requests are not a part  
14 of the record.

15 COMMISSIONER WEFALD: She told me she sent  
16 a copy to the Commission so I'm assuming she sent a  
17 copy to us. Is that wrong?

18 MR. BINEK: To the Commission staff.

19 COMMISSIONER WEFALD: Then we don't see  
20 that.

21 Q. (COMMISSIONER WEFALD CONTINUING) So I'm  
22 asking, is that information confidential, or is it  
23 available to the Commissioners?

24 A. It's available to the Commissioners.

25 Q. Where would I find it?



1           A.    If someone could provide a copy of the data  
2 request response.

3           MR. HOBERG:  Well, you have all of those,  
4 Mr. Binek.  Do you make those available to the  
5 Commissioners?

6           MR. BINEK:  We can make those available to  
7 the Commissioners.  The consultant -- they were data  
8 requests that were made by the consultants.

9           COMMISSIONER WEFALD:  I would like to see  
10 it, just that one.

11          MR. HOBERG:  Just the one.

12          MR. BINEK:  Pat said he could find it.  Do  
13 you want that to be an exhibit in the record, or  
14 what?

15          COMMISSIONER WEFALD:  I would prefer if  
16 Ms. Mulkern can just tell me the answer, but she's  
17 referring me to this exhibit, to this data request,  
18 so I would just like to have the information.

19          MR. HOBERG:  Ms. Mulkern, do you recall the  
20 question?  Can you give the response without looking  
21 at the exhibit?

22          THE WITNESS:  If someone would provide me  
23 with a copy of the data request responses, I can do  
24 that.

25          MR. HOBERG:  Okay.







1           A.    There were various reasons.  One of the  
2 main ones was the operation and maintenance  
3 expenses.

4           Q.    That would account for how much of that?

5           A.    About \$770,000, or the difference in  
6 increase in operation maintenance expenses from 2000  
7 to 2001.

8           COMMISSIONER WEFALD:  Are you referring to  
9 a specific statement?

10          THE WITNESS:  Not one that is included in  
11 the filing.

12          Q.    (COMMISSIONER CLARK CONTINUING)  So  
13 \$770,000 out of -- what would the total be?

14          A.    That was the increase from --

15          Q.    So that would account -- 770,000 would  
16 increase the rest.  Out of how much of an increase  
17 in expenses?

18          A.    Out of 12.2 million.

19          Q.    Okay.  So we've got a ways to go there.  
20 What's some of the other?

21          A.    Others would be --

22          Q.    I'm just trying to get at what was, you  
23 know, so different about that year as opposed to the  
24 other years previous to it, the other three years  
25 previous.



1           A.    There would be a difference in sales  
2 volumes between the two years that would have  
3 contributed, and then some of the other reasons  
4 we've given in the case that we filed, increases in  
5 depreciation and taxes other than income.

6           Q.    Is there, you know, like one document that  
7 I can go to somewhere in the testimony or the file  
8 exhibits that's going to kind of break that down for  
9 me real easily?

10          A.    One place you can look is in the annual  
11 report to the Commission that we file. There is a  
12 comparison in that report each year comparing to the  
13 previous year, so if you look in the report for 2001  
14 there will be a comparison to the year 2002 in  
15 there.

16          Q.    Let's go to the 770,000 for operating and  
17 maintenance. Could you break that down a little for  
18 me?

19          A.    One of the increases would be, of course,  
20 due to labor expense.

21                    COMMISSIONER CLARK:  Maybe I should do  
22 this:  Will Ms. Mulkern be available later on after  
23 staff?

24          Q.    (COMMISSIONER CLARK CONTINUING)  I assume  
25 you'll be part of the rebuttal.







1 rate base then?

2 A. That's right. That's also the capital  
3 addition for the plant.

4 MR. DILLER: Okay. Thank you.

5 MR. HOBERG: Thank you, Mr. Diller.

6 Anything further then of Ms. Mulkern at this time?

7 Thank you, Ms. Mulkern.

8 Mr. Pearce, witness No. 7.

9 MR. PEARCE: I'll call Richard Espeland.

10 MR. HOBERG: I guess it's not witness 7.

11 Exhibit 7 is his testimony. Witness 5.

12 Mr. Espeland, did you hear the admonition I  
13 gave earlier in regard to perjury?

14 THE WITNESS: Yes, I did.

15 MR. HOBERG: Being advised of the penalty  
16 for perjury, do you promise to tell the truth in  
17 this matter being heard? If so, answer I do.

18 THE WITNESS: Yes, I do.

19 MR. HOBERG: Mr. Pearce, please.

20 RICHARD A. ESPELAND,

21 having been first duly sworn, was examined and

22 testified as follows:

23 THE WITNESS: If I don't speak up loud  
24 enough, please tell me to try and force it out a  
25 little bit more.



## 1 DIRECT EXAMINATION

2 BY MR. PEARCE:

3 Q. Mr. Espeland, in the course of this case,  
4 did you prepare and have filed with the Commission  
5 direct testimony of Richard A. Espeland?

6 A. Yes, I did.

7 Q. Okay. And looking at Exhibit 7, if you  
8 will, is that the same testimony from you that was  
9 prefiled?

10 A. That's correct.

11 Q. And if I were to ask you the same  
12 questions, would you give the same answers today?

13 A. Yes, I would.

14 Q. And to the best of your information and  
15 belief, is all the information contained in your  
16 testimony true and correct?

17 A. It is correct.

18 MR. PEARCE: I'll offer Exhibit 7. At this  
19 time I have no questions.

20 MR. HOBERG: Any objection to Exhibit 7?

21 MR. BINEK: No.

22 MR. HOBERG: Exhibit 7 is admitted. Thank  
23 you, Mr. Pearce.24 Mr. Binek, do you have any questions of  
25 Mr. Espeland?



1 MR. BINEK: Yes, I do have some questions.

2 CROSS-EXAMINATION

3 BY MR. BINEK:

4 Q. Mr. Espeland, you will agree that the costs  
5 of this plan have never been included in rates in  
6 North Dakota, wouldn't you?

7 A. That's correct.

8 Q. Why do you contend that the cost should now  
9 be borne by ratepayers?

10 A. When the program was implemented in 1982,  
11 it was not as common as they are today. It was more  
12 of a visionary plan. And today it's extremely  
13 common practice for these type of supplemental  
14 retirement plans to be in place. And it's  
15 appropriate for them to be in the rate base because  
16 it's part of doing business for those types of  
17 positions, as part of their total compensation  
18 program when you look at all of their compensation  
19 and benefits.

20 Q. Are you saying or suggesting that MDU's  
21 shareholders do not benefit from the efforts of  
22 these employees?

23 A. Both shareholders and customers benefit  
24 from these employees.

25 Q. But you're asking the ratepayers to pay



1 these costs, aren't you?

2 A. I think it's appropriate for the ratepayers  
3 to pay their portion of the cost for those  
4 employees, for the value they receive from those  
5 employees.

6 Q. But aren't you asking that the entire cost  
7 be on the ratepayers?

8 A. Yes.

9 Q. So you believe that the ratepayers are the  
10 only ones who benefit?

11 A. I think the ratepayers are the ones that  
12 have direct benefit from efficient, safe, reliable  
13 service. But, obviously, the stockholders of MDU  
14 Resources also benefits by a company that provides  
15 good services and a good rate of return and good  
16 customer service.

17 Q. Isn't one of the primary responsibilities  
18 of key employees is to make a profit for the company  
19 that in turn provides a dividend to shareholders?

20 A. That's correct.

21 Q. Your testimony in this case is essentially  
22 the same as it was in the MDU electric case that we  
23 heard a few months ago, isn't it?

24 A. That's correct. Yes, it is.

25 Q. Earlier I made reference to the findings of



1 fact, conclusions of law and order in the  
2 Commission's decision. In that case, which is  
3 PU-399-01-186, that decision issued on April 24,  
4 2002, and the Commission has taken -- I believe has  
5 taken administrative notice of that decision.

6 Do you recognize the document that I've  
7 just handed you as a copy of that order?

8 A. I recognize it as what you referred to. I  
9 have not seen it previously.

10 Q. Would you please read paragraphs 66 and 67?

11 A. Paragraph 66, "Staff objects to including  
12 SISP in ratemaking expense. Diller testified that  
13 while the plan has been in effect since 1982, the  
14 company has never sought rate recovery in any  
15 subsequent electric or gas rate case. Staff opposes  
16 spending a million dollars a year on the benefit for  
17 a few employees. In addition to SISP, employees  
18 that are allowed to participate in SISP are paid  
19 very well, minimum of 75 to 80,000 per year, and  
20 participate in all other benefits offered to regular  
21 employees such as health insurance, life insurance,  
22 401(k) participation, profit-sharing plans,  
23 incentive plans, defined benefit plans, Social  
24 Security, and discounted gas and electric service  
25 for those living in MDU's service territory."



1           Paragraph 67, "Diller testified that MDU's  
2 plan lacks symmetry and pointed out that the SISP  
3 benefits are heavily weighted in favor of the high-  
4 end salaried employees participating in the plan.  
5 For instance, an employee making \$50,000 a year  
6 would receive a monthly SISP benefit of \$1,330 per  
7 month, compared to a monthly benefit of \$30,000 for  
8 an employee making \$600,000 a year. In the case of  
9 a low-end employee, the monthly benefit calculates  
10 to be 2.66 percent of annual salary, compared to the  
11 high-end employee who would receive a monthly  
12 benefit of 5 percent of annual salary. Diller noted  
13 that only 27 employees of MDU's gas and electric  
14 employees are considered to be key employees."

15           Q. Is there anything factually incorrect in  
16 this description of Mr. Diller's testimony?

17           A. His facts and his math is correct to the  
18 extent it goes, yes.

19           Q. Okay. The number of employees, does that  
20 differ, the number of employees covered for this  
21 company, or is it the same employees basically  
22 covered?

23           A. Same basic group.

24           Q. And you read the description of benefits  
25 that these employees receive. Is that still true,



1 that they receive the same benefits that were  
2 described in the Commission's order in the electric  
3 case?

4 A. That's correct. Receive the same benefits.

5 Q. Isn't it true that even if this Commission  
6 doesn't allow the cost of this plan to be recovered  
7 in rates, the shareholders can continue to provide  
8 the benefit at shareholder expense? They can  
9 continue the plan just as it is right now, right?

10 A. Certainly they can and they may, because  
11 it's a competitive benefit that you need to attract  
12 and retain qualified people to run those operations  
13 and provide the service.

14 Q. What are the income ranges of the employees  
15 covered by this plan?

16 A. Montana-Dakota's range would be  
17 approximately \$75,000 to its president, around  
18 250,000 to 300,000.

19 Q. Does Montana include SISP as a cost to  
20 ratepayers?

21 A. I would defer to the regulatory staff on  
22 that, but I do not believe so.

23 Q. Does Wyoming include SISP as a cost to  
24 ratepayers?

25 A. The same answer. I would defer, but I



1 don't believe so.

2 Q. Same question for South Dakota?

3 A. And I don't believe so. I defer. At least  
4 I'm consistent.

5 Q. And as we've noted earlier, the North  
6 Dakota Commission has not included?

7 A. Not to this point.

8 Q. And, again, your testimony in this case and  
9 the position of Montana-Dakota Utilities Company is  
10 basically the same as it was in the electric rate  
11 case; isn't that correct?

12 A. That's correct. I provided a bit more  
13 information in my rebuttal testimony, but the basic  
14 facts remain the same.

15 Q. The electric case, a portion of that  
16 decision has been appealed by Montana-Dakota  
17 Utilities Company to the District Court. Isn't it  
18 true that the decision the Commission made on SISP,  
19 on the SISP issue, was not appealed?

20 A. I believe that is correct.

21 MR. BINEK: At this time, and I think  
22 administrative notice does this, but I just want to  
23 make certain that the findings of fact, conclusions  
24 of law and order in that electric proceeding would  
25 be incorporated into and made a part of this



1 proceeding.

2 MR. HOBERG: Yes, official notice would  
3 include that.

4 MR. BINEK: I have no further questions for  
5 this witness.

6 MR. HOBERG: Thank you, Mr. Binek.

7 Commissioner Reinbold, do you have any  
8 questions?

9 COMMISSIONER REINBOLD: I think I do, a  
10 couple of them.

11 EXAMINATION

12 BY COMMISSIONER REINBOLD:

13 Q. A good deal of the questions and the  
14 answers were relative to the electric case that was  
15 before us and the parallel. How can it be that the  
16 electric and the gas case benefits and circumstances  
17 are practically the same even though MDU has some  
18 areas of the state that are only gas and some that  
19 are only electricity? How do you account for the  
20 perfect parallel?

21 A. I'm not sure there's a perfect parallel,  
22 but the management group are similar and common.  
23 The amount of time they spend in the respective  
24 areas are allocated out based on where they spend  
25 their time, as would these costs. So we believe,



1 you know, as a group of costs and group of employees  
2 and it's allocated out based on where they do their  
3 work. Some may be full electric and some may be  
4 full gas, and others are split.

5 Q. Maybe some are just -- is the company  
6 something like Melroe? Is that a parallel in  
7 management and management salaries, and so on, to  
8 MDU? Do you know anything about Melroe here?

9 A. That keeps changing, but it's similar for  
10 the Bobcat division, so to some extent, but more  
11 Ingersoll-Rand would be a parallel to MDU Resources  
12 at a corporate level, but we don't pay those kind of  
13 salaries or benefits.

14 Q. And say a few words about MDU employee  
15 retention. How does MDU do? And compare it to  
16 whatever you want to compare it to. That's a pretty  
17 broad question. Take a shot at it.

18 A. I think retention is one of our goals,  
19 because if you want safe, reliable service, you need  
20 people that know history and what's been going on in  
21 the past, as well as how it all works. So retention  
22 is a goal and I think we've been very successful at  
23 that, providing a great place to work, providing  
24 competitive pay and benefits to the extent we're  
25 allowed to, and having them motivated by what they



1 do, providing a public service. There's a lot of  
2 motivation in that. And so I think we are a  
3 desirable place to work.

4 Q. So that's one of your goals you say?

5 A. Oh, absolutely.

6 Q. Getting back to the allocation of time and  
7 effort and salary because of the natural gas and the  
8 electric services, is it conceivable that, for  
9 example, somebody like Don Ball would be working 85  
10 percent in natural gas and 5 percent in electricity?

11 A. Currently, I suppose his current time is  
12 spent more on the gas side than electric side  
13 because of the rate case, but I think over time that  
14 would not necessarily be true, but Mr. Ball would  
15 know better how he allocates his time.

16 Q. Just a curiosity on my part because we do  
17 see him a great deal. And nobody was going to catch  
18 on the fact that I don't add up to 100 percent here.

19 MR. HOBERG: Where's the other 10 percent?

20 THE WITNESS: We consider that overtime and  
21 extra effort.

22 COMMISSIONER REINBOLD: I guess that's all  
23 my questions. Thank you.

24 MR. HOBERG: Thank you, Commissioner  
25 Reinbold. Commissioner Wefald, please.



1 EXAMINATION

2 BY COMMISSIONER WEFALD:

3 Q. How many dollars is the company requesting

4 in this case for SISP?

5 A. For the gas case I believe it's between 250

6 and \$260,000 per year for 2002 and 2003.

7 Q. Where would I find this information? Where

8 would I find that dollar number?

9 A. I'm going to defer in part to Rita and

10 Tamie, but I found it someplace.

11 Q. Just take your time.

12 A. I believe it's in Statement N, as in

13 November, page 8 of 23.

14 Q. Thank you. Page 8 of 23. It shows zero

15 for the year 2001?

16 A. That's correct.

17 Q. And that's because nothing was allowed by

18 the Commission?

19 A. Right. It has not been included

20 previously.

21 Q. And so then you showed in 2002 a number and

22 then 265,000 in 2003?

23 A. Right.

24 COMMISSIONER REINBOLD: Okay. Thank you.

25 MR. HOBERG: Thank you. Any further



1 questions, Commissioner Wefald?

2 COMMISSIONER WEFALD: No.

3 MR. HOBERG: Thank you. Commissioner  
4 Clark, please.

5 COMMISSIONER CLARK: I have no questions.  
6 Thank you.

7 MR. HOBERG: Thank you. Mr. Pearce, any  
8 further questions of Mr. Espeland?

9 MR. PEARCE: Just a couple.

10 REDIRECT EXAMINATION

11 BY MR. PEARCE:

12 Q. Mr. Espeland, I think you've already  
13 alluded to this indirectly, but it is true, isn't  
14 it, that all of the SISP costs is not assigned to  
15 all of the utility operations?

16 A. Oh, absolutely. Only the portion that  
17 would apply directly to the utility.

18 Q. So SISP is applied to other operations?

19 A. Yes.

20 Q. Now, the meter fact that Montana-Dakota  
21 Utilities didn't appeal the SISP decision doesn't  
22 mean that you've changed your mind, does it, on the  
23 value of SISP?

24 A. Has not changed my mind at all.

25 Q. And all of the ratepayers benefit from all



1 of the compensation given to or provided for  
2 employees, don't they?

3 A. That's correct.

4 MR. PEARCE: That's all I have.

5 MR. HOBERG: Thank you, Mr. Pearce.

6 Anything further then of Mr. Espeland?

7 MR. BINEK: No.

8 MR. HOBERG: Thank you, Mr. Espeland.

9 THE WITNESS: Thank you very much.

10 MR. HOBERG: And your next witness, please,  
11 Mr. Pearce.

12 MR. PEARCE: Call Mr. Russell Feingold.

13 MR. HOBERG: Mr. Feingold, were you here  
14 earlier when I gave the admonition in regard to  
15 perjury?

16 THE WITNESS: Yes, I was.

17 MR. HOBERG: Being advised of the penalty  
18 for perjury, do you promise to tell the truth in  
19 this matter being heard? If so, respond I do.

20 THE WITNESS: I do.

21 MR. HOBERG: Thank you. Mr. Pearce,  
22 please.

23 RUSSELL A. FEINGOLD,  
24 having been first duly sworn, was examined and  
25 testified as follows:



## 1 DIRECT EXAMINATION

2 BY MR. PEARCE:

3 Q. Mr. Feingold, you were retained in this  
4 proceeding by the applicant as an expert outside  
5 consultant; is that right?

6 A. That's right.

7 Q. And did you prepare or have prepared under  
8 your direction and control direct testimony  
9 consisting of answers and questions that was  
10 prefiled in this case?

11 A. Yes, that's correct.

12 Q. Looking at Exhibit 8, if you would, does  
13 that contain -- is that a copy of your prefiled  
14 direct testimony?

15 A. Yes, it is.

16 Q. Do you have any corrections that need to be  
17 made in your prefiled testimony?

18 A. No, I don't.

19 Q. To the best of your information and belief,  
20 is the information in that testimony, Exhibit 8,  
21 true and correct?

22 A. Yes, it is.

23 MR. PEARCE: I'll offer Exhibit 8. I have  
24 no direct questions.

25 MR. HOBERG: Thank you. Any objection to



1 Exhibit 8?

2 MR. BINEK: No objection.

3 MR. HOBERG: Exhibit 8 is admitted.

4 Mr. Binek, do you have any questions of  
5 Mr. Feingold on direct, please?

6 MR. BINEK: Yes.

7 CROSS-EXAMINATION

8 BY MR. BINEK:

9 Q. Mr. Feingold, on page 5 at lines 15 through  
10 18 you discuss the wider acceptance of three-part  
11 rates for gas distribution service. Do you see that  
12 reference in your testimony?

13 A. Yes, I do.

14 COMMISSIONER REINBOLD: What number?

15 MR. BINEK: Lines 15 through 18 on page 5.

16 COMMISSIONER REINBOLD: Thank you.

17 Q. (MR. BINEK CONTINUING) Would you describe  
18 these rates?

19 A. Yes. These rates generally consist of  
20 tariffs that include a rate structure with multipart  
21 components of rates. Typically, there's a -- for  
22 gas companies a commodity charge, which would be  
23 charged on a variable basis, and then there would be  
24 fixed charges, in some cases a demand charge or a  
25 capacity charge and then a customer or monthly



1 service charge.

2 Q. I take it you believe that these are  
3 preferable to the two-part rates now in use by MDU  
4 in North Dakota; is that correct?

5 A. They are preferable from a strict cost  
6 recovery perspective. I think I allude in my  
7 testimony to the fact that in some cases for smaller  
8 customers you may not be able to apply a three-part  
9 rate as easily as you would to a larger customer.

10 Q. Why haven't you proposed these rates for  
11 MDU?

12 A. Well, I think you'd have to ask MDU's  
13 company witness, but I can give you my perspective  
14 from the standpoint of someone who is commenting on  
15 the tariffs. And I believe that with regard to the  
16 smaller customers, i.e., the residential customers,  
17 there is not metering capability at this point to  
18 fairly apply a three-part rate to the smallest  
19 customer served on the system. In lieu of that,  
20 though, one of the proposals that the company is  
21 making is to try to recover a greater component of  
22 fixed costs from fixed charges, which is why the  
23 company has proposed the monthly service charge  
24 proposal it has.

25 Q. If you were to propose three-part rates, to



1 what types of customers would they apply?

2 A. Well, if I look at other utilities in North  
3 America, typically the ones that have three-part  
4 rates applied to them first and foremost are larger,  
5 more sophisticated customers where the economics  
6 permit the use of daily demand metering technology  
7 or equipment to be able to fairly assess at least  
8 the demand or capacity component of the charges.

9 Q. Do you recommend that this Commission  
10 direct its gas utilities to develop three-part gas  
11 rates?

12 A. I think it's something that's worthwhile  
13 looking at in the future. I think in response to a  
14 data request that was asked of me by staff I alluded  
15 to the fact that in Connecticut, for example, the  
16 Commission in Connecticut has actually looked at and  
17 has approved three-part tariffs for midsize general  
18 service type customers.

19 Q. Much of your testimony is devoted to  
20 supporting the company's proposed increases in  
21 customer charges; is that correct?

22 A. Yes. Although, I would say more generally  
23 it's to recognize the fact that fixed costs should  
24 be recovered from stable or fixed components of the  
25 tariff.



1 Q. Are you familiar with similar proposals in  
2 other states?

3 A. In other states served by the applicant?

4 Q. By the applicant or in other states in  
5 general.

6 A. Yes.

7 Q. In both cases?

8 A. Yes.

9 Q. Have these proposals encountered much  
10 opposition?

11 A. Well, I'm not sure how you define "much  
12 opposition." Certainly, from my perspective,  
13 they're eminently reasonable. And in some cases  
14 there has been a disproportionate amount of movement  
15 toward cost-based fixed charges.

16 Q. Where there has been opposition, from whom  
17 has the opposition been expressed?

18 A. The opposition has been expressed primarily  
19 from consumer advocates, entities that are  
20 representing smaller, perhaps lower income  
21 customers, because their contention is that perhaps  
22 those customers would be experiencing a larger  
23 increase than would be warranted at that point in  
24 time.

25 Q. Have Commissions generally supported



1 efforts to double or triple customer charges as  
2 Montana-Dakota Utilities proposes in this case?

3 A. Well, I think, first, in the case of  
4 Montana-Dakota the proposal is to move from a \$6.50  
5 per month charge to \$11.70, which is 39 cents per  
6 day as proposed. I don't think I've seen tripling  
7 of proposals as you are suggesting.

8 Q. What about the large customer?

9 A. What about large customers?

10 Q. Have their rates more than doubled or  
11 proposed charges, customer charges more than  
12 doubled?

13 A. Yes. However, it's a very different  
14 situation with larger customers because the revenues  
15 or the billings that are associated with the fixed  
16 monthly charge is a much larger -- smaller  
17 percentage of the customer's total bill, so they  
18 don't see it in the same way that a smaller customer  
19 would necessarily --

20 Q. But would you agree --

21 A. -- so it is more acceptable to Commissions,  
22 in my experience.

23 Q. I'd like to have you turn to page 8 of your  
24 testimony, lines 18 to 19. There you mentioned  
25 FERC's straight fixed-variable rate design for



1 interstate pipelines. Would you please describe  
2 that rate design?

3 A. Yes. Essentially, the FERC fixed-variable  
4 rate design is a -- I characterize it as a cost  
5 classification and allocation method that recovers  
6 fixed costs through a capacity or demand charge and  
7 variable costs through a commodity charge.

8 Q. Isn't the fixed part of that rate design  
9 tied to the maximum volume throughput of the  
10 customer and not to the customer's existence as a  
11 pipeline user?

12 A. Yes. And rightly so because pipelines  
13 don't serve hundreds of thousands of customers as an  
14 LDC does so they don't tend to classify and treat  
15 those costs in the same way that an LDC does.

16 Q. Would you agree that the appropriate  
17 analogy to FERC's fixed charges at the distribution  
18 level would be to a demand charge such as you  
19 discussed earlier and not to current customer  
20 charge?

21 A. From a strict rate design point of view, I  
22 would agree with you, but we have to recognize that  
23 some of the costs that are captured in the  
24 pipeline's capacity charge are costs that are  
25 appropriately recovered in the monthly customer



1 charge for an LDC.

2 Q. From page 12 on in your testimony you  
3 discuss the alternative distribution delivery  
4 stabilization mechanism which the company is  
5 proposing as an alternative to increasing customer  
6 charges. Just to refresh the Commission's memory,  
7 would you please provide a brief description of this  
8 mechanism?

9 A. Yes. The distribution delivery  
10 stabilization mechanism or more appropriately, the  
11 acronym DDSM, is a proposal that essentially adjusts  
12 the company's non-gas costs or a distribution margin  
13 to reflect changes in consumption as a result of  
14 changes in weather patterns.

15 Q. Do other utilities in other states have  
16 weather normalization adjustment mechanisms?

17 A. Yes.

18 Q. Are you familiar with these adjustments?

19 A. Yes, I am.

20 Q. Can you describe some of those mechanisms?

21 A. I'm not sure what aspect you're actually  
22 looking for me to describe beyond the general  
23 description I just gave you, which is essentially  
24 defining how all of the other mechanisms that I'm  
25 familiar with operate generally and what -- their



1 structure to accommodate.

2 Q. Do those mechanisms typically have a year's  
3 delay in the pass-through of the effect to warmer or  
4 colder weather?

5 A. There are some distribution utilities in  
6 North America that do have that feature, yes.

7 Q. Do most of them?

8 A. Most of them do not.

9 MR. BINEK: I have no further questions.

10 MR. HOBERG: Thank you, Mr. Binek.

11 Commissioner Reinbold, do you have any  
12 questions of Mr. Feingold?

13 COMMISSIONER REINBOLD: Just a couple of  
14 questions.

15 EXAMINATION

16 BY COMMISSIONER REINBOLD:

17 Q. Have you been to North Dakota before this  
18 hearing?

19 A. Yes, I have, but have not testified before.

20 Q. Okay. Have you ever been to Mandan, North  
21 Dakota?

22 A. Yes, I was, and I think I was lost when I  
23 was driving.

24 Q. Okay. I don't have any real -- well, I've  
25 got a couple questions here just to make sure you



1 earn your money. RAFFCOSNCIFERCDDSMWNADSANUADZCK.

2 What did I just say?

3 A. You mentioned every acronym that's in my  
4 testimony.

5 Q. Do you believe what I said to be an  
6 acronym?

7 A. It's a pretty long one, but, yes, I do.

8 Q. Quite technically it's not an acronym,  
9 unless it sounds like it might be a word and I can't  
10 imagine any of these being a word.

11 COMMISSIONER REINBOLD: That's all the  
12 questions I have at this time, but stay loose.

13 THE WITNESS: Okay. Thank you.

14 MR. HOBERG: Thank you, Commissioner  
15 Reinbold. Commissioner Wefald, please.

16 EXAMINATION

17 BY COMMISSIONER WEFALD:

18 Q. On page 9 of your testimony -- I have  
19 trouble seeing the lines. I think it's 18 through  
20 20 on page 9.

21 A. Yes.

22 Q. The proposed basic service charge increases  
23 will also ensure recovery by the company of a  
24 greater portion of its fixed costs of providing  
25 service.



1           If the higher customer charges were put in  
2 place, what proportion of the -- what proportion of  
3 the amount of income that MDU wishes to recover  
4 would be recovered by the basic service charge?

5           A.   I think the way that I could answer that,  
6 Commissioner, is if you turn to page 10 of my  
7 testimony --

8           Q.   Okay.

9           A.   -- lines 20 through 23, I try to quantify,  
10 I think, the question that you posed, and that is if  
11 the monthly basic service charges were increased,  
12 and I focused on the residential and general  
13 service customers, I talk about the amount of fixed  
14 costs that would be recovered. So, for example --  
15 well, on page 10 in particular I say that there's  
16 still roughly \$1.5 million of remaining  
17 customer-related costs and 3.3 million of fixed  
18 demand-related costs represented by 25 percent, so  
19 we're saying that roughly 75 percent of the fixed  
20 costs for the residential and general are recovered  
21 through the customer charge or monthly service  
22 charge.

23          Q.   That being the case, would MDU have a  
24 greater opportunity to overreturn from those  
25 customer -- let's say the residential customer



1 group?

2       A. I don't believe so. And the reason I say  
3 that is because the costs that would be recovered in  
4 those basic monthly service charges represent the  
5 non-gas cost margin that would be established as a  
6 result of this rate proceeding. So under the  
7 assumption that that set number of dollars that  
8 represents distribution margin is what the company  
9 requires to have the opportunity to earn a fair rate  
10 of return, it's entirely appropriate to recover  
11 those in the fixed charges of those classes, but it  
12 doesn't in any way suggest that there would be the  
13 opportunity for overrecovery because of the way that  
14 they are being recovered through those charges.

15       Q. Why wouldn't there be an opportunity for  
16 overrecovery? Because in some years even with the  
17 present -- even with the present rate structure, if  
18 you have a really good year where it's cold and  
19 you're selling a lot of natural gas, then you're  
20 able to recover more income, and so why wouldn't  
21 that just be exacerbated then? I know you're going  
22 to be decreasing the cost of the natural gas to some  
23 extent for those customers, but still if you have a  
24 year where you're selling more than the normal, just  
25 explain that to me, why that would be there.



1           A.    Certainly.  I mean, if we recognize that  
2   the monthly service charges are applied on a  
3   customer's bill by essentially a monthly charge, so,  
4   in other words, if you have a \$10-per-month monthly  
5   customer charge, whether you use zero decatherms of  
6   gas or 10 decatherms of gas in a particular month,  
7   you will be charged \$10 because that reflects the  
8   recognition that the company incurs fixed costs that  
9   don't change whether the customer uses zero gas or  
10  10 units of gas.  Okay.  So if it's a colder than  
11  normal year versus a warmer than normal year, it  
12  will not impact that \$10-per-month charge applied to  
13  the number of customers served by the utility.  In  
14  fact, it takes weather-sensitivity away from the  
15  utility business and instead of exacerbating,  
16  actually ameliorates the situation that you talk  
17  about with swings because of weather and that's one  
18  of the main reasons that this is being proposed.

19           Q.    Are you the person to ask questions about  
20  how the rate design was done to establish that this  
21  is the correct amount of the residential gas service  
22  charge?

23           A.    Well, I think the best person to ask that  
24  would be the next witness, Mrs. Aberle, but what I  
25  can answer here is that in reviewing the company's



1 embedded cost-of-service study, I was convinced that  
2 the numbers that came out of that study formed the  
3 basis for evaluating what rate level should we set  
4 in this case, so I'm comfortable with that  
5 connection. But I think she can talk to it in more  
6 detail.

7 Q. But it all depends on the assumptions that  
8 are put into that gas cost-of-service study as to  
9 which things are given to which customer group,  
10 correct?

11 A. That's correct, but I would venture to say  
12 based on my review of Mr. King's testimony, that  
13 with regard to the customer-related costs that form  
14 the basis for the monthly service charges, staff and  
15 the company are really not that far apart. It's a  
16 matter of how far do you go and how fast to get to  
17 cost-based rates.

18 COMMISSIONER WEFALD: Thank you.

19 MR. HOBERG: Thank you, Commissioner  
20 Wefald. Commissioner Clark, please.

21 COMMISSIONER CLARK: I have no questions.  
22 Thank you.

23 MR. HOBERG: Any further questions then of  
24 Mr. Feingold? No further questions. Thank you,  
25 Mr. Feingold.



1 THE WITNESS: Thank you.

2 MR. HOBERG: You have one more witness on  
3 direct?

4 MR. PEARCE: Yes. I'll call Tamie Aberle.

5 MR. HOBERG: Ms. Aberle, were you here  
6 earlier when I gave the admonition in regard to  
7 perjury?

8 THE WITNESS: I was.

9 MR. HOBERG: Being advised of the penalty  
10 for perjury, do you promise to tell the truth in  
11 this matter being heard? If so, answer I do.

12 THE WITNESS: I do.

13 MR. HOBERG: Mr. Pearce, please.

14 TAMIE ABERLE,  
15 being first duly sworn, was examined and testified  
16 as follows:

17 DIRECT EXAMINATION

18 BY MR. PEARCE:

19 Q. Did you prepare the direct testimony of  
20 Tamie Aberle that's been prefiled in this case?

21 A. I did.

22 Q. Looking at Exhibit 9, is that a copy of  
23 your testimony as prefiled?

24 A. Yes, it is.

25 Q. And if I were to ask the same questions,



1 would you give the same answers as are in that  
2 testimony?

3 A. Yes, I would.

4 Q. And to the best of your information and  
5 belief, is all of the information contained therein  
6 true and correct?

7 A. Yes.

8 MR. PEARCE: I will offer Exhibit 9 at this  
9 time, and I have no further questions on direct.

10 MR. HOBERG: Any objection to Exhibit 9,  
11 Mr. Binek?

12 MR. BINEK: No.

13 MR. HOBERG: Exhibit 9 is admitted. Thank  
14 you, Mr. Pearce. Mr. Binek, any questions of  
15 Ms. Aberle?

16 MR. BINEK: Just a few.

17 CROSS-EXAMINATION

18 BY MR. BINEK:

19 Q. Concerning your proposed distribution and  
20 delivery stabilization mechanism that you discuss on  
21 page 12 of your testimony, do I understand this  
22 mechanism is being proposed only as an alternative  
23 to the dramatic increases in customer charges?

24 A. It is our secondary proposal in lieu of the  
25 increased customer service charges that we have



1 proposed.

2 Q. Okay. So does this then mean that if the  
3 company get the customer charge increase it is  
4 seeking in this case, the DDSM proposal is  
5 withdrawn?

6 A. Correct.

7 Q. What if the company get no rate increase  
8 whatever or even a rate reduction, what happens to  
9 the DDSM proposal?

10 A. I'm sorry. I believe I might have  
11 misspoken on your earlier question. I was speaking  
12 of the increase in the basic service charges, not  
13 the overall revenue increase. Our DDSM proposal  
14 would apply regardless of the increase or decrease  
15 in the overall rates, if we were not to receive the  
16 basic service charges that we proposed.

17 Q. Okay. But if you got the basic service  
18 charges, then you're not seeking the DDSM?

19 A. Correct.

20 MR. BINEK: That's all I have for right  
21 now.

22 MR. HOBERG: Thank you, Mr. Binek.

23 Commissioner Reinbold, do you have any  
24 questions?

25 COMMISSIONER REINBOLD: None at this time.



1 Thank you.

2 MR. HOBERG: Thank you. Commissioner  
3 Wefald, please.

4 COMMISSIONER WEFALD: No, I have no  
5 questions at this time.

6 MR. HOBERG: Thank you. Commissioner  
7 Clark?

8 COMMISSIONER CLARK: None. Thank you.

9 MR. HOBERG: Anything further then of this  
10 witness at this time?

11 MR. PEARCE: Nothing.

12 MR. HOBERG: Thank you, Ms. Aberle.

13 Let's take a 10-minute recess at this  
14 point.

15 MR. BINEK: Could we take a little bit  
16 longer time? I wasn't anticipating that my  
17 witnesses would be going up this soon.

18 MR. HOBERG: Fifteen minutes?

19 MR. BINEK: I think 15 minutes.

20 MR. HOBERG: Okay. We'll be back at 25 to  
21 3:00, please.

22 (Recess was taken.)

23 (Exhibits 15-48, 16 and 17 were marked for  
24 identification.)

25 MR. HOBERG: We are back on the record



1 after a fairly short recess.

2 Before we begin the direct -- or the  
3 presentation of the State's case, we perhaps have  
4 some unfinished business. We have a couple of  
5 exhibits from MDU, is that correct, Mr. Pearce?

6 MR. PEARCE: Yes. I don't believe that I  
7 formally offered Exhibits 1 and 2. That's the  
8 application and the book of statements. I'll offer  
9 them at this time.

10 MR. HOBERG: Mr. Binek, any objection to 1  
11 and 2?

12 MR. BINEK: No.

13 MR. HOBERG: Okay. Exhibits 1 and 2 are  
14 admitted. Thank you. Mr. Binek, please.

15 MR. BINEK: Thank you. I'll call Charles  
16 King.

17 MR. HOBERG: Mr. King, did you hear the  
18 admonition I gave in regard to perjury earlier?

19 THE WITNESS: Yes, I did.

20 MR. HOBERG: Being advised of the penalty  
21 for perjury, do you promise to tell the truth in  
22 this matter being heard? If so, answer I do.

23 THE WITNESS: Yes, I do.

24 MR. HOBERG: Thank you. Mr. Binek, please.

25







1           A.    Yes.  I appeared in MDU's electric case  
2 earlier this year and last year in Xcel's gas case.

3           Q.    Let's see.  Mr. King, I show you what has  
4 been marked as Exhibit 15-48.  And can you identify  
5 that exhibit?

6           A.    That's my testimony.  I believe my exhibits  
7 are attached to it.  Yes.

8           Q.    And was this testimony prepared by you or  
9 at your direction?

10          A.    Yes, it was.

11          Q.    Are there any corrections that need to be  
12 made to your testimony?

13          A.    No, there are not.

14          Q.    And if I ask you the same questions today  
15 that are in your testimony, would your answers to  
16 those questions be the same as stated in your  
17 prefiled testimony?

18          A.    Yes, they would.

19          Q.    You also have before you Exhibits 16 and  
20 17.  Would you identify those exhibits?

21          A.    One of them is a month-by-month statement  
22 of MDU's working capital, and the other one is an  
23 exhibit from the earlier MDU case, the electric case  
24 of earlier this year, and -- which shows the  
25 respective revenue sources for a number of



1 utilities.

2 MR. BINEK: Okay. At this time I will  
3 offer Exhibits 15, 16, and 17.

4 MR. HOBERG: Mr. Pearce, any objection to  
5 any of those exhibits?

6 MR. PEARCE: No.

7 MR. HOBERG: Exhibits 15, 16, and 17 are  
8 admitted.

9 MR. BINEK: Thank you.

10 Q. (MR. BINEK CONTINUING) At this time,  
11 Mr. King, I would like to ask you to give a summary  
12 of your testimony and also any rebuttal that you --  
13 or any responses that you might have to the rebuttal  
14 testimony that has been filed by Montana-Dakota  
15 Utilities in this case.

16 A. Certainly. In the interest of time, I  
17 don't think I will go through in detail the portions  
18 of my testimony principally relating to rate design  
19 where I don't think there is any disagreement  
20 between us and the company. Unfortunately, most of  
21 my rate-of-return testimony there is disagreement.

22 The testimony overall deals with four  
23 subjects; the rate of return, cost allocation; that  
24 is, classed cost allocation, rate design, and,  
25 finally, the DDSM proposal. The cost -- I'm sorry.



1 Cost-of-capital testimony in turn has three parts.  
2 One is capital structure. The other is cost of the  
3 debt, and the other is cost of equity, and we don't  
4 seem to agree with MDU on any of them.

5           With regard to capital structure, there are  
6 two disagreements. One is that I include short-term  
7 debt and the company does not. And the other one is  
8 I used a historical 2001 capital structure and the  
9 company does a projected 2003 capital structure.

10           With regard to short-term debt, the reason  
11 for including short-term debt is that portions of  
12 the rate base are financed by short-term debt. If  
13 short-term debt were used for things totally out of  
14 rate base, such as expenses, then maybe we could  
15 exclude it, but, obviously, when you have elements  
16 that are in the rate base that vary throughout the  
17 year, why the company has to use short-term debt to  
18 finance that. And that's why I have my exhibit --  
19 what is it -- 16 or 15? I didn't write it down.  
20 Sixteen, and this is taken from the company's  
21 Statement E.

22           And it's -- unfortunately, it is four of  
23 the five items that make up working capital. I did  
24 not -- I neglected to put in DSM expenses, but it  
25 wouldn't detract from what the exhibit shows, which



1 is throughout the year there is significant  
2 variation in the amount of working capital. And  
3 when you have that kind of variation, it's necessary  
4 to finance it through short-term debt. So I suggest  
5 that contrary to what the company says, it does not  
6 finance its working capital with long-term debt and  
7 equity, that there is an element of short-term debt.  
8 To be sure, it is a small amount. And you will find  
9 in my capital structure a relatively small amount of  
10 short-term debt.

11 As regards the forecast capital structure,  
12 the company's position in this case is considerably  
13 different than it was in the electric case. In the  
14 electric case the company accepted a historical end-  
15 of-year 2000, in that case 2000 capital structure.  
16 In this case the company wants a forecast capital  
17 structure. And I think it's mid -- it's the average  
18 for the year 2003. Now, the reason one uses future  
19 test years is to capture exogenous effects or  
20 outside effects, such as inflation, and in this  
21 case, the necessary expansion of the system into the  
22 northern suburbs of Bismarck.

23 These are things that are objectively  
24 determined. They are reasonably knowable. They are  
25 reasonably objectively analyzed. The capital



1 structure of the company is a creation of its own  
2 management. If the company says that its capital  
3 structure is going to change, there is no way of  
4 determining that, in fact, it will change in that  
5 manner. For this reason, most Commissions use  
6 historical -- recent, but historical capital  
7 structures, unless the company can articulate why  
8 the capital structure will change. Otherwise, you  
9 invite the company to engage in gaming of the  
10 regulatory system by projecting a capital structure  
11 usually with more equity than debt so that the  
12 overcomposite becomes more expensive. And I don't  
13 think the company should be permitted to do that in  
14 this case.

15           The debt cost we have a significant  
16 difference in. The company is proposing that the  
17 debt be limited to first mortgage bonds with a cost  
18 of 9.302 percent. I have proposed that we use a  
19 parent company's debt cost, which includes 6.167  
20 percent. If -- I don't know if you want to look it  
21 up, but if you would want to look it up, Statement  
22 A, which is the company's balance sheet.

23           MR. HOBERG: In Exhibit 2.

24           THE WITNESS: Statement A in Exhibit 2.

25 And earlier I asked Mr. Keller -- we asked



1 Mr. Keller whether the first two pages were for MDU  
2 Utilities Company. He answered yes. And if the  
3 subsequent pages pertain to MDU Resources Group, and  
4 the answer to that was yes. If you turn to page 11  
5 of the Statement A, you'll find a list of long-term  
6 debt. That list does not begin to match the list  
7 that Mr. Keller has presented in Statement F, which  
8 is where he proposes his debt costs. The only debt  
9 that he shows is the secured medium-term notes,  
10 Series A, and then pollution control refunding  
11 revenue bonds. These are merely a portion of the  
12 parent company's total debt. Not included are --  
13 and he has about 133,000 of first mortgage bonds.  
14 Not included are senior notes, \$405,000 -- million  
15 dollars. Commercial paper, \$219 million. Revolving  
16 line of credit, \$25 million. Term credit agreements  
17 of \$11 million and pollution control note  
18 obligations of \$11 million -- I'm sorry -- \$2.5  
19 million. The company has reflected only a portion  
20 of its total debt.

21 Now, in rebuttal Mr. Keller has said that  
22 that doesn't -- other debt doesn't pertain to MDU  
23 Utilities, but you heard a few minutes ago that MDU  
24 Utilities Company isn't really a company. It's  
25 simply a division of the larger company. The larger



1 company is the entity that generates the debt, that  
2 raises the debt and distributes it to the  
3 subsidiaries. What the company has sought to do  
4 here is to build a firewall between the debt it  
5 wants to assign to the regulated piece and the debt  
6 it wants to assign to the unregulated piece. And,  
7 surprise, the debt it wants to assign to the  
8 regulated piece is 9 percent, and the debt it wants  
9 to assign to the unregulated piece ranges all the  
10 way down to 2 percent. And it should not be allowed  
11 to gain the system this way, by pretending that some  
12 debt pertains to the utility operations and other  
13 debt pertains to the non-utility operations.

14           Mr. Keller will tell you that that's how  
15 the debt instruments are written. Of course,  
16 they're written that way because that was how they  
17 were intended to be written so that they would  
18 appear that there is a distinction between debt  
19 raised for the utility and debt raised for the non-  
20 utility. Truth is, debt is all fungible. It could  
21 be spent anyplace the company chose to spend it.  
22 For that reason I have used the blended rate, debt  
23 rate of the entire company, meaning MDU Resources,  
24 as the debt cost. And it makes a very, very  
25 significant difference in the result. The debt



1 cost -- let me get my notes here -- again, is 9.3,  
2 if you use the company's first mortgage bonds as it  
3 proposes. It's 6.2 or 6.167, if you use the parent  
4 company's blended debt, which I developed in an  
5 exhibit to my testimony.

6 Now, equity, I have to kind of go through  
7 and tick off the items where Dr. Gaske and I  
8 disagree. The reality is we agree on a lot of  
9 things, specifically the formula for discounting  
10 cash flow, but, first of all, Dr. Gaske wants to  
11 include flotation costs. We're doing this all over  
12 again. In the electric case I demonstrated, and I  
13 simply repeat it in this docket, that if you include  
14 flotation costs, they come to .1 percent of the cost  
15 of the value of the total equity of the company.  
16 And I'm game to include that as a component of  
17 capital costs, but it would be lost in the rounding.  
18 Dr. Gaske seems to believe that it is appropriate to  
19 assign the incremental cost of flotation relative to  
20 the newly-issued stock and take that percentage and  
21 apply it to the entirety of equity. And this is a  
22 gross overcompensation of the company, and in the  
23 last case the Commission explicitly agreed with me.  
24 Now, selection of comparison companies,  
25 Dr. Gaske point out correctly that in the Xcel



1 case -- I'm sorry -- in the last case. Two things,  
2 he points out in the Xcel case that I used a much  
3 different and smaller group of companies and I used  
4 both gas companies and combination companies. And  
5 the answer is I didn't really pick those companies.  
6 In that case I was rebutting Dr. Olson, who had made  
7 the pick. And rather than fight with Dr. Olson over  
8 the pick, I accepted his listing.

9           In the last MDU case, the electric company  
10 case, I took some purely electric companies and some  
11 combination companies, and I argued that the  
12 combination companies were more representative of  
13 MDU's electric service. And I was going to do what  
14 Dr. Gaske suggests, which is include full gas  
15 companies and combination companies until I looked  
16 at what has now been marked Exhibit 17, which is an  
17 exhibit that I entered into -- in the MDU case. And  
18 it shows the proper portion of the revenue of each  
19 of these companies. The companies in boldface are  
20 the ones I wound up selecting. If you look at those  
21 companies and look at the electric revenue and then  
22 look at the gas revenue, what you'll see is in every  
23 case the electric revenue is a multiple of the gas  
24 revenue. And as a consequence, while one can say  
25 that the investors might view these companies as



1 electric companies that also provide gas service, it  
2 doesn't work the other way around. No one views  
3 these companies as gas companies that also provide  
4 electric service, which is why I did not include  
5 these companies in my comparison group this time.  
6 Instead, I included purely gas companies.

7           Now, the other -- well, let's go through  
8 what I did that I don't think Dr. Gaske and I  
9 disagree with on. I used the DCF formula and I did  
10 two -- three versions of it. First, is the so-  
11 called classic version, which Dr. Gaske has another  
12 name for, and we also used pretty much the same  
13 sources; Zacks for the future forecast of earnings  
14 growth. And then we did the same development of  
15 dividend yield. We had the silly little  
16 disagreement over whether the growth factor for next  
17 year's dividend should be .5 -- or .5g, g being the  
18 growth factor, or .625g. And Dr. Gaske says that I  
19 don't reflect the time value of money. And he's  
20 right. I didn't. I just took half a year and said,  
21 all right, that's the probable time the next  
22 dividend increase will occur so we take one-half of  
23 growth, which seems logical.

24           Now, if I were to include the time value of  
25 money, I would probably reduce that .5. Why?



1 Because a dividend increase six months from now is  
2 worth less than a dividend increase right now. So I  
3 would have to take -- I would have to reduce that .5  
4 by some factor reflecting half a year's loss in  
5 value because of the time value of money. So  
6 instead of increasing it as Dr. Gaske has done, I  
7 would have reduced the factor. But, again, we're  
8 talking about peanuts here in terms of impact on the  
9 total results.

10 The other thing I did was similar to  
11 Dr. Gaske's formula. I took the retention rate of  
12 the respective companies as determined by their  
13 dividend payout ratio or their earnings retention  
14 ratio times Value Line's forecast of their future  
15 return to book equity. And unlike Dr. Gaske, I  
16 added a piece for the probable or the likely  
17 increase in value that one would get from selling --  
18 or companies would get from selling stock at greater  
19 than book value, which would enhance the book value  
20 of the shares. And I developed an internal  
21 retention growth estimate. And then I used -- I did  
22 get out the history of earnings gross and I  
23 developed that, and I think Dr. Gaske and I both  
24 agree that that probably isn't worth a whole lot.

25 I then developed what I regarded as the



1 composite rates of return for each of the 11  
2 companies that I picked, as opposed to I think five  
3 or six that he used. And that was a judgment call,  
4 and Dr. Gaske is very unhappy with what I did there.  
5 But if you look at it, you will see what I have done  
6 in each case is taken the classic DCF return, which  
7 is probably the best estimator, and then turned and  
8 looked at the retention growth method. If the  
9 retention growth looks like it's totally out of  
10 whack with the forecast, and in some cases they are,  
11 simply no way that the company could be growing as  
12 fast or as slowly as the investor survey shows, I  
13 modified that classic DCF in the direction of the  
14 retention growth. And I came up with 11 estimates  
15 of the overall rate of return.

16           Then when I got those 11 estimates, I went  
17 through a little analysis of whether MDU is more or  
18 less risky than those 11 companies. And I  
19 determined a couple things. One is MDU has  
20 relatively high equity proportion in its capital  
21 structure, which saves it from a lot of financial  
22 risk that the other companies have. It was about  
23 equal to the best or the highest of the equity  
24 ratios. I don't pretend that that is the predictor  
25 of relative risk, but it is an element of relative



1 risk. Another element of relative risk is how much  
2 nonregulated activity the company has. In general,  
3 it's accepted that unregulated activities are  
4 riskier than regulated activities. Why? If your  
5 earnings are short, you come into a Commission like  
6 this and you get an increase in your rates. You  
7 have monopoly power. There is never a question that  
8 you're going to collect the money if the Commission  
9 let's you do it because you are a monopoly. That's  
10 not true of any unregulated activities. By  
11 definition, unregulated activities simply don't have  
12 the degree of security, the low-risk properties that  
13 regulated activities have.

14           There are a couple of other reasons I  
15 didn't mention in my testimony I probably ought to  
16 bring up now. Earlier in the day we heard from  
17 Mr. Fox that MDU was facing competition from propane  
18 and oil. Now, I live in Washington, D.C., and have  
19 done a lot of cases involving Washington Gas Light  
20 Company and so I'm familiar with competition there.  
21 There was no mention of competition from  
22 electricity. In Washington, D.C., the -- about  
23 two-thirds or three-quarters of the entire  
24 commercial load has been lost by the gas industry or  
25 the gas company to the electric company. And the



1 reason is that's a warmer climate. In Washington  
2 the climate is warm enough that you can build a  
3 compressor in an air-conditioning system that also  
4 heats. You can't do that in this climate. It would  
5 be ruinously expensive. Residentially you can sell  
6 people a heat pump. Heat pumps simply don't work in  
7 North Dakota. You freeze to death, along with  
8 paying an astronomical electric bill. So the  
9 relative degree of competition for gas in North  
10 Dakota, I submit, is considerably less than it is  
11 elsewhere in the country.

12           There's another difference. In Washington  
13 and even in Spades and Atlanta there is a much more  
14 active competitive supplier business. In Atlanta,  
15 the other company I'm familiar with, the Commission  
16 decided to totally restructure the gas industry.  
17 That no one -- the utility would no longer buy gas  
18 on behalf of its customers. It would have instead  
19 merchants would come in and you would be a customer  
20 of the ABC Gas Company, which would buy your gas and  
21 pay Atlanta Gas Light to deliver it to your house.  
22 So that from 600,000 customers, Atlanta Gas Light  
23 went to 11 customers.

24           That sounded like a wonderful idea, except  
25 that one of them with a nice Georgian name of



1 Peachtree Energy went bust and left Atlanta Gas  
2 Light hanging for quite a few million dollars, just  
3 stiffed them flat, and the company suffered a very  
4 significant loss. And Washington Gas Light has a  
5 similar problem. They've lost about two-thirds of  
6 their commercial load to competitive suppliers.  
7 Now, they still use WGL as their delivery to  
8 customers. One of the problems is that they haven't  
9 got the transportation capacity locked up that WGL  
10 had. And there's a great fear that if we have a  
11 cold winter, these people aren't going to be able to  
12 get the gas into Washington. Those are risks that  
13 larger companies have that MDU doesn't have because  
14 MDU does not seem to have anything like the active  
15 competition for the gas supply business that you get  
16 in bigger places.

17           So I think that is an important difference  
18 between MDU -- those two, the degree of competition  
19 and the effect of suppliers, is an important reason  
20 why MDU is probably less risky than the average  
21 utility, in addition to the point that I make in my  
22 testimony. Dr. Gaske says that MDU has the risk  
23 characteristics of a small company. Well, he's  
24 comparing apples and oranges. He's comparing the  
25 gas distribution business of a large company with



1 the risk properties of a small company, a small  
2 stand-alone company. What we're trying to find is  
3 not that. We're trying to find the risk  
4 characteristics of the gas operations of a large  
5 company. A large company gives you the security of  
6 financial strength and also diversification of  
7 financial resources. You remember where all those  
8 extra sources of debt came from, which a small  
9 company doesn't have and small companies indeed are  
10 more risky, but only when they are stand-alone  
11 operations. Principally, because their sources of  
12 financing and the support they can put behind that  
13 financing in terms of business is much less.

14 Well, all this comes together on page 34 of  
15 my testimony where I present my composite cost of  
16 capital and that is -- there I take the proportion  
17 of the capital structure, the cost elements, and the  
18 weighted costs. I've come up with 10.5 percent as a  
19 cost of equity, which is halfway between the average  
20 cost of equity of my 11 companies and the lowest  
21 cost of equity within that category, that group of  
22 11 companies, reflecting the fact that MDU is less  
23 risky than the average for the 11. That's 10.5 and  
24 then you get the weighted cost in the final column,  
25 overall return to capital is 7.98.



1           Now, the rest of my testimony deals with  
2 capital structure. The only area where I think I  
3 seem to hear disagreement from the company pertains  
4 to the cost of service study. Where Ms. Aberle says  
5 that customers cause most or half the cost or a  
6 third of the cost, I believe is their position, of  
7 the mains system. And I take exception to that.

8           And the reason is that the main system may  
9 be driven by the addition or -- well, never the  
10 subtraction, but always the addition of customers,  
11 but only out in the margins. Indeed, they're  
12 putting more mains out in north Bismarck, but you  
13 heard testimony earlier that they only add 1 percent  
14 more customers every year, so that's a negligible  
15 impact on the cost of mains. Most of the cost of  
16 the mains is what you call an embedded cost. It's  
17 there. It's been there for centuries -- I mean, for  
18 decades. And it's not going to be affected by any  
19 increase or decrease in the number of customers.  
20 It's not going to be affected by any increase or  
21 decrease in the amount of gas that goes through it.  
22 It will be impacted by the maximum amount of gas  
23 that goes through in any one day, but we reflect  
24 that. We recognize that in allocating a portion of  
25 the main's cost to throughput as among the various



1 classes of customers.

2           My -- when you can't find causation and  
3 that's the case with mains. They are simply there,  
4 what I would call an institutional cost. They're  
5 not caused by anything. They're there. When you  
6 can't find causation, then maybe you should look to  
7 value of service as an allocator. And value of  
8 service is measured by the amount of gas delivered  
9 to each of the three or four various categories of  
10 customers, which is what I have done in the  
11 alternative calculation that I have presented. And  
12 it does change the results some, but not a whole  
13 lot. We both agree that the small interruptible  
14 customers are being overcharged. We don't agree  
15 quite about what to do about it. The company would  
16 reduce their rates while increasing everybody else's  
17 rates.

18           I went through a number of previous  
19 Commission decisions, not just with MDU, but with  
20 all the other gas companies and also electric  
21 companies, and it appears to have been this  
22 Commission's policy over the years that when there  
23 is a rate increase, everybody ought to bear a little  
24 of the pain. And if you want to even out  
25 differences among the classes, you might change the



1 percentage increase, but everybody get some  
2 increase. And what I have seen is a number of cases  
3 where the overcharged class got half the increase  
4 that the undercharged class got. And that's what I  
5 proposed in this case. If you increase rates,  
6 increase everybody but the small interruptible  
7 customers and then give them half the increase you  
8 get for the rest.

9           The other rate design issue deals with this  
10 matter of customer charge increases. What the  
11 company and I agree on is that we should get rid of  
12 the declining block commodity rate and take the  
13 revenues you get from those high early blocks and  
14 put that in the customer charge. So even if we do  
15 nothing whatever in terms of overall revenue  
16 recovery, we would be increasing the customer charge  
17 as the company wishes. And then I agree that  
18 probably if we're going to have a rate increase, we  
19 might flow more of that increase into the customer  
20 charge than into the commodity charge. But nothing  
21 like the enormous increases in the customer charge  
22 that the company has proposed.

23           If we have a rate decrease, which is what  
24 staff is recommending, I would recommend that that  
25 decrease come entirely out of the customer charge --



1 I beg your pardon -- out of the commodity charge and  
2 the customer charge be left untouched. Well,  
3 actually they would be increased because we're  
4 flattening the rates, but the revenue recovered from  
5 the customer charge plus the early block pieces  
6 would not be reduced. We would flow all the  
7 reductions into the commodity charge.

8           On the DDSM, I don't even know whether  
9 there's a proposal still, but if it is, I think it's  
10 one that should be rejected because of the year's  
11 deferral. It could really backfire big time and get  
12 us all in a great deal of trouble, because if you  
13 had a warm winter and you tallied up a whole lot of  
14 money that you ought to collect from ratepayers  
15 because you didn't pay very much last winter and  
16 this winter it's colder than all get-out and  
17 everybody is paying enormous gas bills, both because  
18 of the amount of gas they're using and because the  
19 price of gas usually goes up when you have a cold  
20 winter and then on top of that you hit them with a  
21 DDSM charge, it will be very, very unpopular.

22           If you're going to have a weather  
23 normalization program -- I think they're not a bad  
24 idea. More and more states are using them. -- they  
25 have to be maybe not real-time, but they have to be



1 concurrent. The warm weather charges that you want  
2 to collect from customers have to flow to customers  
3 during the warm weather and the cold weather charges  
4 that you would to subtract from their customer bills  
5 have to be during the cold weather. Otherwise, you  
6 are losing the effects, the beneficial effects on  
7 ratepayers, which is to even out their year-to-year  
8 gas charges.

9 I think I've said quite enough so I'm going  
10 to shut up right now. Thank you very much.

11 MR. BINEK: At this point I tender the  
12 witness for cross-examination.

13 MR. HOBERG: Thank you, Mr. Binek.  
14 Mr. Pearce, if you have any questions.

15 MR. PEARCE: Yes, I do have several.

16 CROSS-EXAMINATION

17 BY MR. PEARCE:

18 Q. This is just a minor point, but turning to  
19 page 2 of your testimony, Mr. King, line 23 and line  
20 27, I suppose you mean gas there. You have electric  
21 operation there in both cases.

22 A. Oh, dear. I'm sorry. That part of my  
23 testimony I had simply taken and listed from the  
24 earlier.

25 MR. HOBERG: So you would agree that should



1 be gas?

2 THE WITNESS: Yes, it should be gas.

3 Q. (MR. PEARCE CONTINUING) One of the  
4 downsides of word processing, isn't it?

5 A. That's right.

6 Q. Exhibit 17, I think, was just introduced  
7 and it's electric and gas utilities percent  
8 regulated revenue?

9 A. Yeah.

10 Q. I think you said you introduced that in the  
11 electric case. Dr. Gaske tells me that he  
12 introduced that as part of his testimony in the  
13 electric case. It's not critical, but maybe --

14 A. Well, I don't care who introduced it. I  
15 thought it was mine, but welcome -- nonetheless, it  
16 shows what it shows.

17 Q. Right. We'll both accept that as true.  
18 Now, turning to page 28 in your testimony through  
19 29, I just wanted to clarify a point. It's your  
20 testimony that by your understanding Dr. Gaske's  
21 1.625g factor there is based on his assumption that  
22 the first dividend would be received three months  
23 from the date of purchase; is that right?

24 A. Well, that's how I calculated it, but  
25 Dr. Gaske says that isn't so and I'll let him



1 explain why it isn't so.

2 Q. Now, have you -- Dr. Gaske's prefiled  
3 testimony, rebuttal testimony is in the record,  
4 although it hasn't been introduced as an exhibit. I  
5 think you said you had read it; is that right?

6 A. Yes.

7 Q. If I could just show you one page, although  
8 it's not an exhibit yet, but just to make sure we  
9 are on the same wavelength. I'm looking at his  
10 JSG-4, page 2 of 3 on Schedule 3. It has the -- I  
11 believe what's the classic DCF formula. I just  
12 wanted to confirm that we agree that that's the --

13 A. I think it is, yes.

14 Q. Okay. Now, turning back to page 20 of your  
15 prefiled testimony, and this is the testimony right  
16 after your table 7 at the bottom of the page. You  
17 say -- in fact, it's the last line of that page,  
18 line 22. For example, there are no examples of  
19 level or declining earnings in the Value Line  
20 forecasts. I'm going to show you --

21 (Exhibit 18 was marked for identification.)

22 Q. (MR. PEARCE CONTINUING) Exhibit 18 is a  
23 packet of six pages, and before I identify it  
24 further, could I ask you -- well, let me back up.

25 Which issue of Value Line did you use for



1 your analysis? Do you have that there?

2 A. Mine are all dated June 21.

3 Q. Of 2002?

4 A. Yeah.

5 Q. Okay. Now, looking at what's been marked  
6 as Exhibit 18, it is -- and I'll tell you what it  
7 is, is sheets from Value Line for six companies of  
8 that same date. Would you agree that's what it  
9 appears to be?

10 A. Yeah. None of them are the six companies  
11 that I was analyzing.

12 Q. Right. Right. No.

13 A. Or the 11 companies.

14 Q. You make in your testimony a very broad  
15 statement about Value Line. I just wanted to lead  
16 you over to some other companies that were not in  
17 your testimony.

18 A. Well, I didn't mean to imply that they  
19 never, ever predict declining earnings. I was  
20 talking about among the 11 companies that I was  
21 looking at.

22 Q. Okay. Just to go through this, looking at  
23 these companies, and I realize this is very fine  
24 print for a person of my age, but looking at the  
25 third line there, earnings per share, and then down



1 toward the bottom is return on common equity, I  
2 think. Would you agree if you have a chance to look  
3 at each of these six sheets, that there is, in fact,  
4 declining earnings and earnings per share from  
5 2000 -- between 2000 and 2001 and, in fact, out  
6 through the 2005, 2007 period?

7 A. Oh, sure, for these companies. These are  
8 in the oil business. I don't know what Holly Corp  
9 is. Crude oil. We're looking at oil companies for  
10 some reason.

11 Q. I believe they're all energy companies.

12 A. Tesoro is one of them.

13 Q. Right.

14 MR. HOBERG: Are you offering Exhibit 18,  
15 Mr. Pearce?

16 MR. PEARCE: Yes.

17 MR. HOBERG: Any objection to 18,  
18 Mr. Binek?

19 MR. BINEK: Well, the only objection I  
20 would have is based on the comments that Mr. King  
21 has made, that none of the companies that he's  
22 talking about are included here, and so I guess I  
23 would question the relevance of this.

24 MR. HOBERG: What is the relevancy,  
25 Mr. Pearce?







1 that subject.

2 Q. Would it surprise you if I directed you to  
3 a window in this room and directed you to look to  
4 the northwest and see a brand-new huge church  
5 building which is being heated and cooled by 120  
6 wells 160 feet deep in the parking lot?

7 A. Goodness.

8 Q. Doing it very efficiently. A young  
9 entrepreneur, who was a well driller, got it started  
10 and he's worked this type of work as far away as  
11 South Carolina. So it may not work everywhere, but  
12 it does work over at our church. It's very  
13 expensive and it will be expensive for a long time,  
14 but it does work.

15 A. I hope you're comfortable at Christmastime.

16 COMMISSIONER REINBOLD: That's all I have  
17 for now.

18 MR. HOBERG: Thank you, Commissioner  
19 Reinbold. Commissioner Wefald, please.

20 COMMISSIONER WEFALD: Yes, I have a few  
21 questions.

22 EXAMINATION

23 BY COMMISSIONER WEFALD:

24 Q. On page 34. I understand there's a  
25 disagreement between the company and the staff about



1 whether short-term debt should be included and as  
2 you've said, it's only 2.78 percent that you've  
3 included in your calculations.

4 A. That's right.

5 Q. And you're asserting -- my first question  
6 is, are you asserting that short-term debt should be  
7 included?

8 A. Yes.

9 Q. Because you have information on the record  
10 and where is that that shows that they're using  
11 short-term debt?

12 A. Well, you never know. You can't trace the  
13 source of money from where they get it to where they  
14 use it because it all goes in effect into the bank  
15 account and then back out again. But the  
16 proposition is that when you have expenses that  
17 fluctuate -- or capital costs or expenses that  
18 fluctuate, particularly capital costs fluctuate  
19 month to month, the normal way of financing those  
20 would be through short-term debt. Now, they are  
21 high in June and low in January and where are you  
22 going to get the money to cover those, you go to the  
23 bank and borrow it.

24 Now, in fairness, MDU does not use much  
25 short-term debt. And the reason is that the company



1 generates a lot of internal cash primarily from  
2 excessive depreciation charges, but that's what  
3 Mr. Majoros is going to talk about. But they do use  
4 some, and this is what I reflect here. And the  
5 reason I put in this exhibit is to show that there's  
6 significant variation from month to month in the  
7 working capital.

8 Q. How did you come up with this?

9 A. It's from the company's own -- well, the  
10 numbers are presented up in the front. Let me find  
11 the table for you. It's page 5.

12 Q. Yes.

13 A. Table 1.

14 Q. But I just wondered how you were able to  
15 determine it was \$9,639,000 --

16 A. That I think I got from there --

17 Q. -- if you said it's hard to trace?

18 A. Oh, you can determine how much short-term  
19 debt there is. What you can't do is determine where  
20 they spent it. That's what I meant is hard to  
21 trace. I believe I got that -- here it is. Look at  
22 my Exhibit CWK-1, which is attached to my  
23 testimony.

24 Q. Okay.

25 A. Go to the last page of that exhibit and



1 there at the bottom you'll see the 9 million and  
2 you'll see the 4.542 percent. That's the source of  
3 those numbers. And this is a company data response.

4 Q. All right. And on page 43 of your  
5 testimony you talk about penalties for failure to  
6 interrupt should be increased, on line 11.

7 A. Yes.

8 Q. Do you have any recommendations about that?

9 A. Well, I was going to recommend the  
10 company's proposal be accepted. And it's the  
11 company's judgment as to what it takes to make  
12 interruptible customers interrupt, but if they don't  
13 interrupt, you could have a disaster. You can have  
14 the pipeline suddenly unable to deliver gas to the  
15 city gate and everybody goes cold. So if -- and the  
16 company isn't planning. They don't make the  
17 commitment to the pipelines. They don't build their  
18 own main structure to handle the interruptible  
19 customers' loads at the peak day. The assumption is  
20 when it really gets high gas demand, phone them up,  
21 have them cut off. They don't cut off, the company  
22 can be in trouble.

23 Q. Right.

24 A. So I think it's very important that there  
25 be sufficient pricing to persuade those customers



1 they better interrupt.

2 Q. Well, what I was wondering is, it says  
3 here, penalties for failure to interrupt should be  
4 increased since the company apparently believes that  
5 the current penalties are not sufficient. So did  
6 the company present what you feel is a sufficient  
7 penalty then to --

8 A. Well, I really do have to defer to the  
9 company. I guess I accepted their judgment in that  
10 regard. Maybe I'm naive, but in this regard I --

11 Q. You're not disputing what they're  
12 proposing?

13 A. I'm not disputing their judgment on that.  
14 But I think if you want to know what is the basis of  
15 the exact amount of increase, you better ask  
16 Ms. Aberle.

17 Q. All right. Then my next question was page  
18 44. This is under the question, have you calculated  
19 the increased customer charges that would result  
20 from eliminating declining block rates. It's my  
21 understanding that you think that we should be  
22 eliminating the declining block rates. And so is it  
23 your recommendation that this size increase that is  
24 reflected in paragraphs 19 through 23 is what should  
25 be put in place for customers?



1           A.    Well, what I did in my Exhibit CWK-8 was  
2    calculate the revenue that is recovered in the high  
3    initial blocks of the present rate structure.  And  
4    then I divided that by the number of customer bills  
5    and got the amount of increase you would need in the  
6    monthly customer charges in order to recapture that  
7    same money in the customer charges instead of in the  
8    initial declining block rates.  And that's the  
9    numbers you see here.  This is a totally revenue  
10   neutral proposal.

11          Q.    Right.  I see.  This doesn't reflect any  
12   increase that the company may want?

13          A.    No increase, right.

14          Q.    This is just what would occur if you  
15   eliminated the declining block rate?

16          A.    Right.

17          Q.    So then this would be the minimal amount --  
18   this would be the bottom amount that we would be  
19   looking at --

20          A.    Yeah.

21          Q.    -- for a customer rate increase before  
22   you'd --

23          A.    Yeah.

24          Q.    -- project any -- if you were going to do  
25   any increase for their rate case?



1           A.    Right.  What I'm suggesting is, even if you  
2  reduce rates, you ought to keep these customer  
3  charges, because I am sympathetic to the company's  
4  desire to capture somewhat more fixed costs in the  
5  customer charge.  So I think if you were to reduce  
6  the rates, it would be inappropriate to reduce the  
7  customer charge.  Reductions ought to come out of  
8  the commodities.

9           Q.    Even in this situation for the large  
10 customer who goes from \$17 to \$45, which is a  
11 triple increase?

12          A.    It's a big increase, but it is, as I  
13 believe an earlier witness pointed out, those  
14 customers use so much gas that this is small  
15 potatoes in terms of their total bill.

16          Q.    All right.  And then on page 45, the  
17 question is, are there any other proposals the  
18 company has made that you believe the Commission  
19 should consider regardless of the change in overall  
20 revenues, and your answer is on lines 12 through 19.  
21 I recommend the Commission consider the company's  
22 proposal to convert the basic service customer  
23 charge from a monthly charge to a daily charge.  And  
24 then you go on and then you say.  My only concern is  
25 whether it might be accepted by the average customer



1 as a reasonable way of charging for service.

2 To me it would be very confusing as a  
3 customer to not know every month, not to have the  
4 same amount each month on my bill for my customer  
5 charge.

6 A. Yeah, and I'm sympathetic to that. I think  
7 that's a legitimate concern and that's why I put  
8 that sentence in there. I guess I'm tossing the  
9 ball back to you as to whether you think that is  
10 something that will go down with the average  
11 customer.

12 Q. Because, otherwise, you might have one rate  
13 that would be there for the 28-day month, another  
14 one for the 30-day month and another for the 31?

15 A. You get a lower customer charge in  
16 February, right. But I think the virtue from the  
17 company's standpoint is it gives them a little more  
18 flexibility as to when they send their meter readers  
19 out. Now, it's got to be -- I guess I don't know  
20 whether they bill by the calendar month or whether  
21 they bill -- each customer get from a certain day to  
22 a certain day, but whatever it is, they're locked  
23 into pretty much a 30-, 31-day interval and this  
24 would permit them to alter the interval, if they had  
25 to.



1           Also, we put in a data request asking how  
2 many customers did they have that had partial month  
3 bills in a given year, and it was a huge number. I  
4 don't know why, but it was -- I was surprised by how  
5 big it was. And it's one of the reasons that I sort  
6 of gave a backhanded endorsement to this proposal.  
7 But it's certainly not something that I would insist  
8 on.

9           Q.    When you say -- what do you mean by a  
10 partial month bill?

11          A.    What we asked was in any given -- I don't  
12 have the data response with me. They had said they  
13 had a lot of customers who came -- who got on and  
14 off during the year. And the consequence of signing  
15 on for a part of a month instead of the full 30  
16 days, they had 20 days or 10 days or whatever. And  
17 I said, all right, well, how big a deal is that?  
18 How often does that occur? And it was in the  
19 thousands. It was quite remarkable that it was as  
20 much as it was. Evidently, there must be a lot of  
21 customers who simply turn off gas service in the  
22 course of the year and disconnect. And then  
23 reconnect later. It could be vacation homes or  
24 people who decide they don't need gas in the summer  
25 because they don't need the heat in the summer and



1 they cancel gas service. You have to ask the  
2 company why it's so large, but it was a large  
3 number. And this would facilitate dealing with that  
4 problem.

5 Q. I will ask the company a few more questions  
6 about this, but then does it also -- in your  
7 understanding of this does it reflect -- let's say  
8 the company read my meter on January 15 and then  
9 they didn't get around to reading my meter again  
10 until the 20th of February. So then there might  
11 be -- would I get a 30-something day --

12 A. Thirty-five-day month, it's possible.

13 Q. And then the next I get a 25-day one if  
14 they went back and did it again on the 15th again of  
15 the next month?

16 A. If you're like me, you write your bills  
17 once a month when you get paid, and customers could  
18 really get messed up if they started changing the --  
19 if they got out of the monthly cycle of billing,  
20 which this would permit them to do. So maybe that's  
21 a good reason not to permit this change.

22 COMMISSIONER WEFALD: Who would be the MDU  
23 person I would ask these questions of just so I can  
24 understand it better?

25 MR. HOBERG: Mr. Pearce?



1           MR. PEARCE: I suppose probably  
2 Mrs. Aberle.

3           MR. HOBERG: Tamie Aberle.

4           COMMISSIONER WEFALD: I do have some  
5 questions about that so I will ask Ms. Aberle.

6           Q. (COMMISSIONER WEFALD CONTINUING) All  
7 right. And then, now, this is a bigger, broader  
8 question.

9           A. I like big, broad questions. I give big,  
10 broad answers.

11          Q. So now let's say a hypothetical utility has  
12 divisions and one of them makes -- one of these 11  
13 divisions that they have and only one is a utility  
14 division, but it's still a -- it's a company with  
15 many subsidiaries, and one is the utilities and one  
16 of those divisions makes bad business decisions and  
17 starts to go into a -- close to a bankruptcy  
18 situation. So within the -- it's my understanding  
19 what happens sometimes then is that the bond rating  
20 of the whole company can get lowered and then a  
21 Commission has to worry about what are the --  
22 whether the riskiness of their bond rating at that  
23 time is going to be passed on to their customers.

24           When you're talking about looking at bonds  
25 for the whole group of MDU companies, all of these



1 divisions, if I accept your premise that the bonds  
2 are good for everyone and it's the whole, big  
3 company that has a bond rating and not just one  
4 division, am I setting myself up in the future then  
5 to set precedents that if they make a bad decision  
6 with one of their divisions, that I'm going to need  
7 to accept that bond rating for the utility company  
8 as well?

9 A. Well, you have exactly that situation with  
10 your telephone company.

11 Q. Right.

12 A. And it's a difficult problem. US West was  
13 a thoroughly successful company, but it got bought  
14 by this Qwest outfit, which has gone south, and it's  
15 junk bond status. And your question is, okay, what  
16 are you going to do about assigning a bond yield  
17 cost to US West?

18 Q. Well, and I don't have to worry about that  
19 because under price cap, but let's say there's a  
20 hypothetical company that's in the same situation,  
21 but we know that that's reality in some cases today.  
22 And so what I'm concerned about is your --

23 A. Well, what I would say is that if the  
24 utility piece of it is a -- is profitable and would  
25 support an adequate bond rating, then for -- but the



1 rest of the company caused it to go south, I think  
2 you would have to impute a bond cost that reflected  
3 the utility's performance. Fortunately, for MDU  
4 Resources that's not an issue, because not only is  
5 the utility profitable, but the parent company is  
6 also profitable.

7           But I think your concern is a very  
8 legitimate one, that if the non-utility activities  
9 of the company soured the bond ratings such that  
10 there were astronomically high debt costs, is it  
11 fair to ratepayers to pass those debt costs through  
12 to them? And I would say no, because that is a  
13 result of -- it's in a way analogous to why we don't  
14 use MDU's equity costs because its equity cost is  
15 seriously influenced by its nonregulated activities.  
16 If you could demonstrate that the bond -- the debt  
17 cost is influenced adversely by the nonregulated  
18 activities, then I think it's appropriate to impute  
19 a different debt cost. Fortunately, I don't think  
20 that's an issue here because it's clear that the  
21 company seems to have a good debt rating.

22           COMMISSIONER WEFALD: Thank you.

23           MR. HOBERG: Thank you, Commissioner  
24 Wefald. Commission Clark, please.

25           COMMISSIONER CLARK: I have none. Thank



1 you.

2 MR. HOBERG: Thank you. Any further  
3 questions of Mr. King? Mr. Binek?

4 MR. BINEK: Just one.

5 REDIRECT EXAMINATION

6 BY MR. BINEK:

7 Q. I guess I would like a little bit of  
8 clarification about this heat pump business. When  
9 you were making reference to the use of heat pumps,  
10 you were -- I'm assuming you were thinking about a  
11 unit that does both heating and air conditioning,  
12 kind of a stand-alone unit, versus something that  
13 draws heat off of groundwater?

14 A. Yeah.

15 Q. Is that correct?

16 A. Mr. Majoros can testify about heat pumps.  
17 He has one in his house and he says he hates it.

18 Q. Okay. But there are different kinds of  
19 heat pumps?

20 A. Yes. Essentially, it's an air-conditioner  
21 that works two ways, and it only works as an  
22 air-conditioner in the reverse direction down, I'm  
23 told, to about 45 degrees Fahrenheit. If it get  
24 colder than that, you have to supplement with  
25 resistance, electric resistance heating, which is



1 why it becomes very expensive if you have a cold  
2 climate, because up here you would have that  
3 resistance heating on all the time and that scarfs  
4 up an incredible amount of electricity.

5 Q. These are the kinds of units that we often  
6 see in motels; isn't that right?

7 A. Yeah.

8 MR. BINEK: Okay. No further questions.

9 MR. HOBERG: Thank you, Mr. Binek.

10 Mr. Diller, any questions? Okay. Anything further  
11 then of Mr. King? Thank you, Mr. King.

12 Let's take a short break and then we can  
13 perhaps take Mr. Majoros and finish off the day that  
14 way. Let's be back at -- a five- to seven-minute  
15 recess.

16 (Recess was taken.)

17 (Exhibits 19 and 20 were marked for  
18 identification.)

19 MR. HOBERG: We're back from a short  
20 recess. And, Mr. Binek, you were ready to call your  
21 next witness.

22 MR. BINEK: Yes. I will call Michael  
23 Majoros.

24 MR. HOBERG: Mr. Majoros, you were here  
25 earlier when I gave the admonition regarding



1 perjury; is that correct?

2 THE WITNESS: Yes, sir.

3 MR. HOBERG: Being advised of the penalty  
4 for perjury, do you promise to tell the truth in  
5 this matter being heard? If so, answer I do.

6 THE WITNESS: I do.

7 MR. HOBERG: Thank you. Mr. Binek, please.

8 MR. BINEK: Thank you.

9 MICHAEL J. MAJOROS, JR.,  
10 having been first duly sworn, was examined and  
11 testified as follows:

12 DIRECT EXAMINATION

13 BY MR. BINEK:

14 Q. Would you state your full name for the  
15 record, please.

16 A. Yes. My name is Michael J. Majoros, Jr.

17 Q. What is your occupation, Mr. Majoros?

18 A. I'm vice-president of the economic  
19 consulting firm of Snavelly King Majoros O'Connor and  
20 Lee, Incorporated.

21 Q. And how long have you been at that firm?

22 A. Approximately 22 years.

23 Q. What is your educational background?

24 A. My educational background is in accounting.  
25 I've passed the CPA exam, taken courses in the MBA



1 program at George Washington University, and have  
2 taken several continuing education courses.

3 Q. And you have testified in a number of state  
4 commission utility rate cases?

5 A. Yes, sir.

6 Q. You have before you documents Exhibit  
7 19-49, I think it is, and Exhibit 20. Could you  
8 please identify those two exhibits?

9 A. Yes. Exhibit 19-49 consists of my  
10 testimony, my Appendix A, which is a summary of my  
11 qualifications and experience, and my Exhibits MJM-1  
12 through MJM 12.

13 Q. And what is Exhibit 20?

14 A. Exhibit 20 is a packet of exhibits I  
15 prepared in response to primarily Mr. Jeter's  
16 rebuttal to me.

17 MR. BINEK: At this time I would offer  
18 Exhibits 19 and 20.

19 MR. HOBERG: Mr. Pearce, any objections to  
20 Exhibit 19?

21 MR. PEARCE: No.

22 MR. HOBERG: How about 20?

23 MR. PEARCE: No.

24 MR. HOBERG: Exhibits 19 and 20 are  
25 admitted.



1 Q. (MR. BINEK CONTINUING) I should have  
2 asked, if I were to ask you the same questions today  
3 that are in your testimony, would your answers be  
4 the same?

5 A. Yes, sir.

6 Q. Are there any errors in your testimony that  
7 need to be corrected?

8 A. I noted a couple of typos, but the one that  
9 I would like to correct is on page 5, line 5.  
10 There's a range of years in that sentence, 1996 to  
11 2000. I'd like to change that to 2003.

12 Q. Any other corrections?

13 A. No. No, sir.

14 Q. At this time I would ask that you please  
15 provide a summary of your testimony and also provide  
16 any response that you may have to rebuttal testimony  
17 that has been filed by Montana-Dakota Utilities in  
18 response to your direct testimony.

19 A. Okay. The objective of my testimony is to  
20 recommend the appropriate jurisdictional revenue  
21 requirements for the North Dakota gas division of  
22 Montana-Dakota Utilities, Incorporated. I've  
23 attempted to recognize the legitimate needs of the  
24 company to recover its costs, but at the same time  
25 I've attempted to ameliorate any added burden on



1 ratepayers from excessive recoveries. Ms. Mulkern  
2 proposes a \$2.8-million base rate increase using an  
3 11.44 percent rate of return. I recommend a \$1.4-  
4 million base rate decrease using Mr. King's  
5 recommended 7.98 percent rate of return. My  
6 adjustments are summarized at page 3 of my  
7 testimony.

8 I propose to reduce the Company's  
9 depreciation rates. I propose to eliminate bonuses  
10 and commissions from the company's costs and hold  
11 the 2003 labor cost levels equal to the 2002 levels.  
12 I propose to eliminate the SISP from benefits  
13 expense. I propose a five-year rather than three-  
14 year rate case amortization period. And I propose  
15 to eliminate the general inflation from other  
16 unadjusted operation and maintenance expenses.

17 At pages 4 to 7 of my testimony I've  
18 included certain financial analyses. At the top of  
19 page 4 of my testimony I demonstrate that the  
20 company's gross margins declined from 2001 to 2003.  
21 The decline is caused by major increases to  
22 operation and maintenance expenses, excluding the  
23 cost of gas. Increased O&M expenses is a major  
24 driver in this rate case. From 1996 to 2003 O&M  
25 expenses, excluding the cost of gas, increased at a



1 compound rate of 2.5 percent. And that is shown on  
2 my Exhibit MJM-2. However, that 2.5 percent is  
3 slightly misleading because from 2000 to 2003 the  
4 expense is actually ratcheted up and continued on  
5 from there. The compound growth rate from 2000 to  
6 2003 is actually 5.7 percent, which, in my opinion,  
7 is unreasonable.

8 I am also recommending a change in  
9 depreciation rates. Since depreciation produces  
10 cash flow for this company, I conducted certain cash  
11 flow analyses. Although depreciation is not  
12 intended to finance capital additions, some equate  
13 it to additions as if that was its intent. As I  
14 stated in my testimony, the purpose of depreciation  
15 is not to finance plant additions. Nevertheless,  
16 I've determined that this company's depreciation  
17 seems to always produce more than sufficient cash  
18 flow to cover its additions.

19 At page 6 of my testimony I've included a  
20 table of -- comparing annual depreciation cash flow  
21 to annual construction additions at the total  
22 company level for the years 1996 to 2002. Mr. Jeter  
23 challenged this table so I've provided an expanded  
24 table, which is the first page of Exhibit 20. Even  
25 with the revisions --



1           COMMISSIONER WEFALD:  Where is Exhibit 20,  
2  please?

3           MR. HOBERG:  That's the one that was just  
4  introduced, that separate one.

5           COMMISSIONER WEFALD:  Thank you.

6           THE WITNESS:  Even with Mr. Jeter's  
7  changes, at the total company level since 1996 this  
8  company's depreciation expense has exceeded its  
9  capital additions by \$409,000.  I also -- Mr. Jeter  
10  also challenged my Exhibit MJM-3, where I compared  
11  the gas utility only depreciation expense to  
12  additions.  Mr. Jeter claimed that I failed to  
13  include common plant depreciation expense in column  
14  2.  Consequently, on the third page of Exhibit 20  
15  I've made the adjustment in accordance with  
16  Mr. Jeter's testimony.  And what this demonstrates  
17  is that since 1986 this company's gas company North  
18  Dakota depreciation expense has exceeded the  
19  additions to gas plants in North Dakota by \$8.2  
20  million.  In my opinion, this has resulted from  
21  excessive depreciation rates which have been charged  
22  to ratepayers.

23           At page 7 of my testimony I cite and quote  
24  from what I consider to be a landmark U.S. Supreme  
25  Court decision on the subject of depreciation.



1 COMMISSIONER WEFALD: That's where?

2 THE WITNESS: Page 7 of my direct  
3 testimony.

4 COMMISSIONER WEFALD: Page 7. Thank you.

5 THE WITNESS: In that case, which is known  
6 as Lindheimer v. Illinois Bell, the Court equated  
7 excessive depreciation to the extraction of capital  
8 contributions from ratepayers. And it clearly  
9 stated in the beginning of the second paragraph,  
10 Confiscation being the issue, the company has the  
11 burden of making a convincing showing that the  
12 amounts it has charged to operating expenses for  
13 depreciation have not been excessive. This morning  
14 I heard the word "confiscation" from Mr. Gaske, and  
15 I understand the company in this case has the burden  
16 of proof. And my testimony states that their  
17 depreciation expense is excessive, and I provided my  
18 reasons for making that claim.

19 Here's how I arrived at that conclusion.  
20 First, I reviewed this company's depreciation  
21 reserve levels and that's accumulated depreciation.  
22 I have testified or been involved in more than 80  
23 proceedings on the subject of public utilities  
24 depreciation. Based on my experience, if you refer  
25 to page 9 of my testimony, the 70.7 percent reserve



1 ratio for the distribution plant is very, very high.  
2 And it suggests that prior depreciation rates may  
3 have been excessive. I asked the company if it  
4 conducted any studies to measure the adequacy of  
5 that reserve and it has not. The company's current  
6 depreciation rates are based upon an 11-year-old  
7 study conducted by Stone & Webster, which does not  
8 exist anymore, at least Stone & Webster doesn't, to  
9 the best of my knowledge.

10 That was the next place I looked. I've  
11 included as MJM-4 to my testimony the first few  
12 pages from that Stone & Webster study. These are  
13 also included in the company's Statement I, if I  
14 could refer you to those pages. Two things caught  
15 my eye in reviewing this. The first thing that  
16 caught my eye was the negative 140 percent net  
17 salvage ratio for services. That is shown in about  
18 the fourth column. It says estimated retirement  
19 costs percent amount.

20 COMMISSIONER WEFALD: Will you just show me  
21 what you're looking at?

22 THE WITNESS: I'm looking at Exhibit MJM-4,  
23 page 1 of 2.

24 COMMISSIONER WEFALD: MJM. Thank you.

25 THE WITNESS: About halfway down -- well, a



1 third of the way down the page, account 380, the  
2 second number in that line is negative 140. And  
3 that's a very, very high negative net salvage ratio.  
4 That also suggested to me the possibility the  
5 current depreciation rates are excessive.

6           The next thing that caught my eye, if you  
7 come over three columns, the column that starts with  
8 the number 39 and then goes to 36, those are average  
9 service lives. The average service life for  
10 distribution mains, which is the single largest  
11 account on the company's books, is 36 years. If you  
12 put a circle around that, and then coming down the  
13 page, the average service life for services, which  
14 is the second largest account, is 34 years. Based  
15 on my experience with gas companies, those are very,  
16 very short lives. Short lives equate to high  
17 depreciation rates. If they're too short, the  
18 resulting depreciation rates are excessive.

19           Consequently, I conducted certain tests of  
20 those lives based upon the information available to  
21 me. These are called geometric mean turnover  
22 analyses. They're included as Exhibit MJM-5. And  
23 these two analyses would indicate that overall the  
24 average service life for mains is in the 108-year  
25 range and the average service life for services is



1 in the 69-year range. Mr. Jeter, through a data  
2 request, identified certain discrepancies in my  
3 calculations. So I redid the GMT studies. They're  
4 included again with Exhibit 20. And when I make the  
5 adjustments identified in the company's data  
6 request, the corrected GMT studies would support  
7 lives for mains of 116 years and lives for services  
8 of 74 years.

9 At this point I'm pretty convinced that the  
10 company's depreciation rates are excessive. I  
11 conducted one more analysis based upon the company's  
12 data request to me. This, I must admit, was after I  
13 had filed the direct testimony. It's contained on  
14 page 2 of Exhibit 20. And here I've compared the  
15 company's current average service lives to industry  
16 statistics.

17 COMMISSIONER WEFALD: You're on which page?

18 THE WITNESS: Second page of 20.

19 COMMISSIONER WEFALD: The second page?

20 THE WITNESS: Yes. And I obtained these  
21 statistics from the AGA/EEI. They are proprietary  
22 and confidential so I've only summarized them here.  
23 But if you look at, again, mains, the company's  
24 average service life is 36 and you look across that  
25 line and it's basically much lower than the industry



1 averages. And services is about five to six years  
2 lower than the industry averages. Given all that, I  
3 mean, I could have recommended longer lives, but I  
4 did not because there's a bigger issue in  
5 depreciation.

6 As I indicated, I'd like you now to go back  
7 to 4, Exhibit MJM-4. On that first page you can see  
8 at the bottom of the page where it says total  
9 depreciable plant, the first column is, of course,  
10 the description of the plant accounts. The next  
11 column is plant balance, and the next column is the  
12 cost of removal or the negative net salvage that's  
13 incorporated in the current depreciation rates. And  
14 that happens to be \$46.5 million. Now, that's the  
15 total estimates back at that time. That, again, is  
16 about almost 50 percent of the total plant balance.  
17 What that means is, that in calculating those rates,  
18 those depreciation rates, an additional 50 percent  
19 was added to the plant balance in order to collect  
20 150 percent of the plant balance.

21 So -- and that might be reasonable. I did  
22 some more investigation. And what I discovered --  
23 I'm going to point you again back to that 140  
24 percent for services, because that is a huge rate,  
25 and the resulting depreciation rate of 8.22 percent



1 is the highest rate I think I've personally seen for  
2 a gas service account. It's way -- very much higher  
3 than normal. So I asked for the company's actual  
4 net salvage data and what I discovered is shown on  
5 my Exhibit MJM-6. And what that shows --

6 COMMISSIONER WEFALD: Just one moment,  
7 please.

8 COMMISSIONER REINBOLD: What are we looking  
9 for?

10 COMMISSIONER WEFALD: MJM-6.

11 THE WITNESS: MJM-6. What that shows is  
12 that on the gas side, the total net salvage for the  
13 years 1997 through 2001 was 1.4 million.

14 COMMISSIONER WEFALD: Where do you see  
15 that?

16 THE WITNESS: Where it says total under net  
17 salvage, natural gas.

18 COMMISSIONER WEFALD: Okay.

19 THE WITNESS: But what's really extremely  
20 interesting about that number is it's positive and  
21 the company is collecting for negative net salvage  
22 to the tune of about \$2,000,000 a year in its  
23 current depreciation rates. Furthermore, in doing  
24 this investigation, I discovered that there  
25 apparently was a sale of a building in 2001 which



1 produced about 4.9 million, a 4.9-million gain that  
2 was a common plant. And the company included that  
3 also as positive salvage.

4 Now, Mr. Jeter wrote many, many, many pages  
5 of testimony rebutting me, but he never addressed  
6 this threshold issue, which is that the company's  
7 current depreciation rates are charging ratepayers  
8 about \$2,000,000 a year for negative net salvage  
9 when the company normally experiences positive net  
10 salvage. And that difference is, in my opinion,  
11 even with the lives which I know are much too short,  
12 but that overcollection is what produces the  
13 excessive depreciation reserve levels.

14 I talked in my testimony about a certain  
15 new accounting requirement, Generally Accepted  
16 Accounting Principle. First of all, the acronym for  
17 that is GAAP, G-A-A-P. And I readily admit that  
18 GAAP does not control ratemaking. But what I find  
19 interesting about SFAS No. 143 are the principles  
20 which underlie it, and I believe they make sense and  
21 I'm just recommending to you to consider those  
22 principles. The principles are fundamental. Before  
23 you include any cost in today's cost for some future  
24 potential expenditure relating to the removal of a  
25 plant or mass property plant, you have to establish



1 a legal obligation to incur that cost. Otherwise,  
2 that cost will just be expensed as incurred, rather  
3 than used to inflate depreciation rates.

4 Now, Mr. Jeter has included a lot of  
5 testimony about how to implement FAS 143, but he  
6 failed to focus again on the fundamental issue,  
7 which is does this company have asset retirement  
8 obligations, those legal retirements. And the  
9 answer is based upon all of the responses that were  
10 submitted to me is, the best answer is they don't  
11 know, but I think the most likely answer is no,  
12 based on what I'm finding out in other states and in  
13 other proceedings. The natural gas industry does  
14 not have asset retirement obligations for  
15 distribution plant. And if they do, they're rare.  
16 There are some unique circumstances involved.

17 So what's going to happen as this company  
18 is subject to SFAS No. 143, just like all companies  
19 in the country, regulated and unregulated. And  
20 what's going to happen is that on their nonregulated  
21 books when SFAS No. 143 is implemented, all of that  
22 excess depreciation which is included in the  
23 distribution plant reserve reflected by that 70  
24 percent is going to be pulled out of that reserve  
25 and treated as a regulatory liability to ratepayers.



1 So the company has said they are going to do -- they  
2 recently embarked on a new depreciation study. I  
3 don't know how that's going to be treated there. My  
4 suspicion is, you know, if I were involved in that  
5 study, I'd say for ratemaking purposes, perhaps you  
6 ought to use the remaining life method which will  
7 amortize that excess back to ratepayers over the  
8 remaining life of the existing investment.

9           But what I've done for the purposes of this  
10 rate case, since clearly their current depreciation  
11 rates are excessive as a result of this negative net  
12 salvage is, I've merely eliminated from the existing  
13 depreciation rates. I haven't changed any of the  
14 lives or anything like that. I've just stripped out  
15 the negative net salvage and said let's collect  
16 that, the average of that on sort of a normalized  
17 expense basis. This is a procedure that is used in  
18 Pennsylvania regularly. It's been recently approved  
19 in two cases in Kentucky. In my opinion, it is  
20 consistent with the likely result.

21           COMMISSIONER REINBOLD: With what?

22           THE WITNESS: It is consistent with the  
23 likely result of the implementation of SFAS No. 143,  
24 combined with another statement of accounting policy  
25 on property plant and equipment. It keeps the



1 company whole. It keeps ratepayers whole and it  
2 removes this excessive recovery from current  
3 depreciation rates. I talked a lot about  
4 depreciation because, of course, it's the biggest  
5 adjustment in my testimony.

6 I'm also recommending the elimination of  
7 wages and bonuses. I'm recommending the elimination  
8 of the supplemental security income plan. I'm  
9 recommending a five-year rather than three-year rate  
10 case amortization period, and the disallowance of  
11 inflation to other O&M expenses.

12 That concludes my summary.

13 MR. HOBERG: Mr. Binek, did you have some  
14 questions?

15 MR. BINEK: Yes. I just have a  
16 clarification concerning the statement about  
17 elimination of wages and bonuses.

18 Q. (MR. BINEK CONTINUING) When you talk about  
19 the elimination of wages and bonuses, what -- is it  
20 your recommendation that the -- you eliminate the  
21 2003 increases as an expense in this proceeding?  
22 You're not telling the company that they can't give  
23 raises or bonuses, if they want to, it just should  
24 not be charged to the ratepayers?

25 A. That's correct. Elimination from the rate



1 case.

2 Q. Right.

3 MR. BINEK: Okay. At this time I'll tender  
4 the witness for cross-examination.

5 MR. HOBERG: Thank you, Mr. Binek.  
6 Mr. Pearce, please.

7 MR. PEARCE: Thank you.

8 CROSS-EXAMINATION

9 BY MR. PEARCE:

10 Q. Mr. Majoros, I may have misheard. I was a  
11 little alarmed when you said elimination of wages.  
12 I don't assume you mean all wages to employees  
13 should be taken out of the rate case?

14 A. Not all.

15 Q. Now, to clarify a point that may be  
16 misleading, you talked about the Lindheimer,  
17 Illinois Bell case and cited the Court's reference  
18 to confiscation being the issue. What the Court is  
19 talking about, isn't it, is that Illinois Bell  
20 alleged that its property was being confiscated by  
21 exceptionally low rates? It isn't a matter of the  
22 other side claiming that the depreciation rates were  
23 confiscatory?

24 A. Well, I believe you're probably correct,  
25 but the words stand on their own.



1           Q.    Yeah.  It's sort of a pejorative word.  I  
2    just didn't want it to be taken out of context.

3           A.    But I heard that word this morning.  That's  
4    the only reason I brought it up.

5           Q.    Turning to your Exhibit 20, and this is  
6    page 1 of 4 of MJM-5, which is your geometric mean  
7    turnover analysis for the mains account.  You  
8    described your technique using the geometric mean  
9    for a life estimate there and, of course, a  
10   geometric mean uses a product of two ratios there,  
11   doesn't it?  You take the square root, of course,  
12   the usual way the geometric mean is done.  That  
13   technique means -- now, for example, if you --  
14   looking at, say, 1996, for example, if you  
15   substituted; that is, interchanged columns C and D,  
16   the additions and retirements, you'd have the same  
17   result, right, because they both appear as  
18   numerators in effect in that calculation so it  
19   doesn't matter how you take them?  In other words,  
20   you would get the same lifetime if you had single-  
21   year retirements of 119 -- I mean, single-year  
22   additions of 119,000 and single-year retirements of  
23   1,096,000, you interchange columns C and D, is what  
24   I'm saying and you get the same number?

25          A.    Yes.



1           Q.    You referred to Stone & Webster as  
2 nonexistent. Now, you're not suggesting, are you,  
3 that they were not in their day a highly reputable  
4 and very large company?

5           A.    I just -- when I talk about them, I'd like  
6 to be looking at their study. Yeah, they were a  
7 large company in their day.

8           Q.    For whatever reason, I believe they have,  
9 in fact, disbanded or disappeared. You have not  
10 done an actual depreciation study, a full study  
11 comparable to their 1991 study, have you?

12          A.    You know, I'm not really sure of everything  
13 they did in that study. I know what they said they  
14 did. I've tested the lives of the two largest  
15 accounts in the company's books, and if I could  
16 refer you to the Stone & Webster study, I have it  
17 here before me. I'll just refer you to page 4. I  
18 used the geometric mean turnover approach to test  
19 that. And in the Stone & Webster study they say in  
20 the second paragraph, quote, The turnover testing is  
21 a procedure in which the adjusted turnover period,  
22 i.e., the number of years it takes an investment in  
23 plant to be retired, is determined by aggregating  
24 additions from the year 1991 backward until the  
25 total is equal to the plant balance in that year and



1 then adjusting for the rate of growth in the  
2 account.

3 So, you know, turnover method is not new.  
4 Other firms have used it. And I'm not recommending  
5 any changes in service lives.

6 Q. You're not suggesting the way you  
7 characterized it a moment ago that Stone & Webster  
8 didn't actually do what they said they did?

9 A. Well, I don't know how they arrived at the  
10 negative 140 percent for services and you can't tell  
11 from that study.

12 MR. PEARCE: Okay. I don't have any other  
13 questions.

14 MR. HOBERG: Thank you, Mr. Pearce.

15 Commissioner Reinbold, did you have any  
16 questions in there?

17 COMMISSIONER REINBOLD: Just a couple.  
18 Thanks.

19 EXAMINATION

20 BY COMMISSIONER REINBOLD:

21 Q. I lost track of something here. The 1991  
22 Stone & Webster survey, what was the point that you  
23 were making about that?

24 A. Well, the first point is it's 11 years old.  
25 The second point -- the point I just made was, they



1     apparently employed one of the very procedures that  
2     I've used here to test lives in that study. And the  
3     reason I bring that up is because Mr. Jeter and now  
4     Mr. Pearce have sort of implied that I haven't done  
5     any kind of complete study, whether it's -- you  
6     know, given the level of available data, the use of  
7     the geometric mean turnover approach is as  
8     legitimate as any other approach.

9           Q.    Okay. Turning to your reference to selling  
10    a building, can you flesh that out a little bit?

11           A.    Yes. There apparently was a building sold  
12    in 2001 and it produced a gain of about \$5 million.  
13    And the company debited cash, put that money in cash  
14    and credited it to accumulated depreciation. Now,  
15    if that building was included in rate base, which I  
16    imagine it probably was, that gain probably ought to  
17    be shared with ratepayers. By using the company's  
18    approach here, you would not have known about it  
19    until I found it.

20           Q.    I understand now.

21                    COMMISSIONER REINBOLD: That's all.

22                    MR. HOBERG: Thank you, Commissioner  
23    Reinbold. Commissioner Wefald, please.

24                    COMMISSIONER WEFALD: Yes.

25



1 EXAMINATION

2 BY COMMISSIONER WEFALD:

3 Q. On page 5 of your testimony you say the  
4 compound growth rate from 2000 to 2003 is 5.7  
5 percent and you have a chart, an exhibit that  
6 reflects that. I think it's Exhibit MJM-2.

7 A. That's correct.

8 Q. Okay. What specifically do you think is  
9 driving this?

10 A. I think that commissions and bonuses and  
11 the SISP and the imputation of inflation in year  
12 2003 are driving this.

13 Q. On page 10, why are the company's  
14 depreciation reserves so high? I need to have you  
15 help me with this. It's negative 140 percent factor  
16 on line 8, which means that the current depreciation  
17 rates for service was substantially increased to  
18 recover not only the existing investment, but also  
19 another 140 percent for future costs of removal?

20 A. That's correct.

21 Q. So I just need an example here. When they  
22 put in a gas main, the current depreciation rate  
23 is -- according to your understanding, it doesn't  
24 recover not only the existing investment to the  
25 main, but another 140 percent for future cost of



1 removal of the main?

2 A. Here I'm talking about services, which --

3 Q. Services.

4 A. -- is from the main to the house. And if  
5 it costs \$1,000 to put that service in, its  
6 depreciation rates were designed to collect \$2,400,  
7 which was the original cost plus another 140 percent  
8 for future cost of removal.

9 Q. What do you -- if you have looked at other  
10 depreciation studies, what would you say would be a  
11 more normal future cost of removal?

12 A. Well, typically, that number is driven,  
13 based from my experience, is typically driven by  
14 some internal cost allocation policy in which the  
15 cost of removal is -- you know, they have to  
16 figure -- when they go out and replace a main and a  
17 service, they have to figure out how much of that  
18 cost they want to assign to cost of removal. So  
19 they come up with an allocation factor, which  
20 results in that allocation.

21 I explained in my testimony here about  
22 Elizabethtown Gas. This was just, you know, within  
23 the last two months where I went out and watched a  
24 typical main replacement project for that company.  
25 And what I discovered in watching and observing that



1 project, was that the replacement of an existing  
2 service, first of all, is very rare. It's a --

3 Q. You mean the part from the main to the  
4 home?

5 A. Right.

6 Q. That's the service?

7 A. That's the service. Because what they do  
8 is, they'll have a main running down a street and  
9 want to replace that main. They will trench a  
10 couple of feet away and a lot of times they will  
11 keep that existing service. They may insert  
12 something into it to maintain, but it's rare that it  
13 actually gets removed. So the replacement cost is  
14 just the cost for disconnecting from the original  
15 main and then extending another tap over here.

16 So, in my opinion, that cost is really a  
17 replacement cost and probably ought to be  
18 capitalized to the new main or something like that.  
19 So it's difficult to answer your question about what  
20 is a typical removal cost. It depends on how a  
21 given company allocates that cost. What's important  
22 to understand about this particular company is they  
23 don't record any cost of removal at all for  
24 services. They're collecting 140 percent, but not  
25 recording any cost of removal, as difficult as that



1 is to believe.

2 Q. They're not reflecting any cost of removal  
3 where?

4 A. No cost of removal in their books and  
5 records. I went through their summary tables and I  
6 can see some cost of removal for mains. I could  
7 see -- I was looking for account 380, services, and  
8 it's not there. They're not recording any -- as big  
9 as that number is, you would think that that would  
10 certainly be one of their recurring costs of  
11 removal, they would record it, and it's not there.

12 Q. So does that suggest to you that they're  
13 not having any --

14 A. I don't think they do.

15 Q. -- costs of removal?

16 A. I speculated in my testimony and Mr. Jeter  
17 took, you know, a shot at me, but what I found out  
18 in the Elizabethtown Gas case is that for years and  
19 years and years that company and probably most gas  
20 companies, the people in the fields never recorded  
21 costs of removal. They treated everything as a  
22 service transfer expense and just expensed it.

23 Q. All right. Now I want to go -- all right.  
24 Now, I want to understand MJM-4.

25 A. Yes.



1 Q. You said another --

2 COMMISSIONER REINBOLD: What page is it on?

3 COMMISSIONER WEFALD: MJM-4. It's in the  
4 back of his testimony here. Page 1 of 2.

5 COMMISSIONER REINBOLD: Okay.

6 Q. (COMMISSIONER WEFALD CONTINUING) Now, on  
7 this one you said another 50 percent was added to  
8 the total depreciation plant.

9 A. Yes.

10 Q. That's down at the bottom.

11 A. Yes.

12 Q. I need you to lead me through that again.

13 A. First, the third column is plant balance.

14 Q. Right.

15 A. Okay. I always go back to services because  
16 it's the best example of this.

17 Q. It shows a negative in front of that 46.  
18 What is it, 46 million?

19 A. That's at the bottom. I was trying to lead  
20 you to how I got to that number.

21 Q. Okay.

22 A. So if we look at services, the plant  
23 balance is \$200,727,046.

24 Q. All right.

25 A. The company applied a negative 140 percent



1 salvage ratio to that to come up with an estimated  
2 future negative -- future cost of removal of  
3 \$28,101,844. It added that amount to the plant  
4 balance to arrive at something called the estimated  
5 service value, which is \$48,174,590.

6 Q. Where is that number?

7 A. That is under a column titled estimated  
8 service value.

9 Q. All right.

10 A. Okay. It then divided that estimate  
11 service value over the estimated remaining life of  
12 21.8 years. That's about the third from the last  
13 column.

14 Q. Yes.

15 A. To come up with an annual accrual amount of  
16 1.6 million, which in turn produced an annual  
17 depreciation rate of 8.22 percent, which is then  
18 applied every year to calculate depreciation expense  
19 and, in fact, the company applied that rate to  
20 services in this case and, of course, the plant  
21 balance -- this was the 1989 -- 1991 plant balance.  
22 That has increased, I believe, substantially. So in  
23 this case, the recovery is more than that.

24 So, anyway, going back to that column where  
25 they've applied the 140 percent, they also applied



1 negative 40 to mains and then they have some  
2 positives offsetting it, but the sum of all those  
3 positives and negatives sums to negative 46,495,732,  
4 which, again, you can see has been added to the  
5 plant balance to arrive at that estimated service  
6 value, which is then being depreciated.

7 Q. All right. Thank you. All right. Then go  
8 to MJM-6.

9 A. Yes.

10 Q. Now, you made the point and I just -- is  
11 this what you said, that MDU is charging customers  
12 negative net salvage when the company has a positive  
13 salvage value?

14 A. Yes.

15 Q. So the \$2,733,666, tell me about that  
16 number again.

17 A. What I've done there is you'll notice I've  
18 separated the plant into electric, natural gas and  
19 common utility.

20 Q. Yes.

21 A. The common utility I didn't know exactly  
22 how to allocate that back to the electric and  
23 natural gas, so what I did was allocate that 5.5  
24 million back to electric and gas based upon the  
25 totals right above that, you know, the 1.412 and the



1 1.44. The sale of the building is included in that  
2 common utility plant column. I mean, the gain on  
3 the sale of the building.

4 Q. The sale of the building is included in  
5 which column?

6 A. Common utility. It's the first big number  
7 on that, over in the right-hand column, the 4.889  
8 million.

9 Q. I'm somehow missing that.

10 A. All the way to the right.

11 Q. All the way to the right. I'm seeing the  
12 number -- am I looking at the correct number under  
13 common utility, 5,529,260?

14 A. Right. At the top of that column.

15 Q. All right.

16 A. That's the gain on the sale of the  
17 building.

18 Q. Oh, that 4,889,037?

19 A. Yes.

20 Q. Okay. Then I need you to go to MJM-1.

21 A. Okay.

22 Q. And this gives -- page 2 of 4.

23 A. Yes.

24 Q. This goes over the numbers. You're  
25 contrasting your numbers to the company's numbers



1 and its income statement?

2 A. Yes.

3 Q. And at the present time, let's skip over  
4 the operating revenues --

5 A. Okay.

6 Q. -- because those are the same?

7 A. Yes.

8 Q. And then you go down to the operation  
9 expense, and there isn't a difference in your cost  
10 of gas, there's a slight difference in your other  
11 O&M?

12 A. Yes.

13 Q. But the big difference then comes when you  
14 get to depreciation?

15 A. Yes.

16 Q. And the company is projecting in 2001, 2002  
17 and 2003 over \$3 million, but let's use the 2003  
18 figure because that's the one you're looking at  
19 also.

20 A. Mm-hmm.

21 Q. Is that correct, \$3,261,000?

22 A. Yes.

23 Q. And you're projecting \$1,089,000?

24 A. Yes.

25 Q. So you're right. This is a big ticket



1 item. So I need to have you tell me how did you  
2 come to that \$1,089,000 versus the \$3,261,000.  
3 Where would I see what you've done to make the  
4 difference here?

5 A. It's in my Exhibit MJM-7.

6 Q. All right.

7 A. Page 1 of that exhibit is the company's  
8 current depreciation rates without the negative --  
9 without the net salvage built in. I've stripped  
10 out, you know, the 140 percent and those numbers we  
11 were looking at in that column.

12 Q. You've stripped out all of that or only the  
13 one for the services?

14 A. All of them.

15 Q. You stripped out all of them?

16 A. Yes.

17 Q. Did the company show any cost for some of  
18 those, to remove some of those?

19 A. Yes. They have costs to remove some, but  
20 overall the cost has been positive as shown on  
21 Exhibit MGM-6.

22 Q. And that's because of the building being  
23 added in?

24 A. No. The building is separate. That's in  
25 common utility. The natural -- on the natural gas



1 side, for the last five years, setting aside common,  
2 setting aside electric, the actual net salvage  
3 experience for the company has been positive every  
4 year.

5 Q. All right. So those positive numbers mean  
6 that there's a positive -- that it is a positive  
7 cash flow, doesn't mean that its cost -- when the  
8 first one says 440,703 --

9 A. Mm-hmm.

10 Q. -- in 2001, that means that that's a  
11 positive number, there were no costs that the  
12 company incurred?

13 A. That is a net positive number. Net pluses  
14 and minuses.

15 Q. So they had some costs, they had some money  
16 that they showed from what? Income from what?

17 A. I don't know. Probably is some reuse  
18 involved in that. Let me see. It seems like the  
19 company is obtaining a fair amount of positive  
20 salvage on underground conductor and devices, which,  
21 you know, I don't know if they are selling them or  
22 reusing them. So that's one source. I'm sorry.  
23 I'm looking at the records.

24 Q. Okay. Take your time.

25 A. I was having a disconnect there. What the



1 heck is going on? There's a positive salvage on  
2 mains. I'm just looking at 2001.

3 Q. That means they will sell gas mains?

4 A. I don't know. I don't know what the source  
5 is. Power operated equipment could be reused.  
6 Bottom line, I don't know all of these things. I do  
7 know that it's been positive, net positive.

8 Q. All right. And so you added up those net  
9 salvages on the natural gas and it came to  
10 1,444,452?

11 A. Yes.

12 Q. And is that what you subtracted then  
13 from -- then we still have a different number from  
14 their 2003, 3,261,000 and your 1,089,000. What's  
15 the number?

16 A. I stripped out the negative salvage -- all  
17 the salvage ratios from the depreciation rates  
18 themselves. And in distribution plant that resulted  
19 in a 2.37 percent composite depreciation rate rather  
20 than the company's existing depreciation rate. The  
21 next thing -- so I applied the rates without the net  
22 salvage allowances to the plant balances, which is  
23 the way it's done in the rate case, and then to that  
24 total I subtracted the average positive salvage that  
25 the company has experienced in the last five years,



1 including the gain on the sale of the building. If  
2 the company had regularly experienced negative net  
3 salvage, I would have added, you know, one-fifth of  
4 that amount to the annual depreciation expense.

5 And, again, the average net salvage is  
6 \$848,010 shown at the bottom of MJM-6, page 1.

7 Q. Right. And then you did what with the sale  
8 of the building?

9 A. I included that in that average annual  
10 experience amount.

11 Q. Over five years?

12 A. Yes.

13 Q. To give the ratepayers a credit --

14 A. Yes.

15 Q. -- for that? And that's how you came up  
16 with the Snavelly King \$1,089,000?

17 A. Well, the Snavelly King \$1,089,000 is shown  
18 ultimately on Exhibit MJM-7, page 3.

19 Q. All right.

20 A. Up above it says company proposal, 2003.  
21 Those numbers show the application of the company's  
22 depreciation rates to plant balances of the sum  
23 \$3,261,000 that they're proposing. And below shows  
24 the application of the depreciation rates without  
25 the net salvage built into them to the same plant



1 balances. That sums to \$1,937,000, from which I  
2 subtracted the average annual net salvage of  
3 \$848,000 to arrive at my recommended \$1,089,000.

4 Q. Thank you. Now, the current income taxes,  
5 we haven't heard anything about that and yet I  
6 notice that that's also a substantial difference in  
7 the amount.

8 A. Are we --

9 Q. Page 2 of 4 of MGM-1.

10 A. Yes. Current income taxes, I've used the  
11 same procedure as the company to calculate that  
12 amount and that amount -- that calculation is shown  
13 on page 3 of 4 of Exhibit MJM-1.

14 Q. And your calculation shows 500 -- a charge  
15 of 529,000; is that what the negative --

16 A. That's a negative current income tax  
17 expense. And the reason for that has something to  
18 do with the deferred fuel lag, I think, the lag and  
19 the recovery of deferred gas expense resulting from  
20 the PGA.

21 Q. Help me interpret the negative number. I'm  
22 sorry. I'm having trouble with that. The negative  
23 number means that just -- is that something they  
24 will pay or they won't pay? I see a positive number  
25 of 4,322,000 in current income taxes that they are



1 going to pay in 2001. Does that mean they are  
2 actually going to pay 4,322,000 in 2001? I'm  
3 looking at MJM-1, page 2 of 4.

4 A. I don't know. My suspicion is they didn't  
5 pay that --

6 Q. All right.

7 A. -- as a result of all kinds of timing  
8 differences.

9 Q. But the next number means that they would  
10 have a credit of \$3,067,000, is that what that  
11 negative -- is that what the parentheses mean?

12 A. Yes. And it has to do -- again, it has to  
13 do with the interrelationship of the PGA and  
14 deferred fuel balance.

15 Q. And the next number means that they would  
16 also have a credit of \$1,961,000?

17 A. That's what -- yes.

18 Q. So the number that you're showing as a  
19 credit of \$529,000 is actually less of a credit than  
20 what the company is showing to the ratepayers?

21 A. Yes, because I'm showing more income than  
22 they are so I have less of a tax credit than they  
23 do.

24 Q. You're showing more income than they are?

25 A. Net income before taxes.



1                   COMMISSIONER REINBOLD: Mr. Hearing  
2 Examiner, if we are not going to finish off this  
3 witness tonight, let's wait until morning.

4                   MR. HOBERG: I think perhaps we're close.

5                   COMMISSIONER REINBOLD: Are we close?

6                   MR. HOBERG: Well, we only have  
7 Commissioner Wefald, Commissioner Clark and perhaps  
8 not very many questions. Mr. Diller has a couple.

9                   COMMISSIONER REINBOLD: Okay. You're the  
10 Hearing Examiner.

11                  MR. HOBERG: I think maybe, if we can,  
12 finish it off in just a few minutes.

13                  Q. (COMMISSIONER WEFALD CONTINUING) If I can  
14 just understand that number, then I'm done. All  
15 right?

16                  A. The negative current tax number. Every  
17 time I come to North Dakota I get one of these.

18                  Q. Maybe Mike Diller can explain it to me, but  
19 I better ask you. Why you're showing that it should  
20 be a smaller credit for the customers than the  
21 company does?

22                  A. Because my net income before taxes, what I  
23 estimate for 2003, is higher than the company's.  
24 That's one reason why my recommendation is for less  
25 of an increase. I'm recommending a decrease.



1 Q. All right.

2 A. So the more net income before taxes that  
3 you estimate, the less current taxes -- no. The  
4 more current taxes you would have. And we're  
5 dealing with negative numbers here because I'm  
6 estimating more net income. I'm estimating more  
7 current taxes, which is less of a credit than the  
8 company.

9 COMMISSIONER WEFALD: All right. Thank  
10 you.

11 MR. HOBERG: Thank you, Commissioner  
12 Wefald. Commissioner Clark, please.

13 COMMISSIONER CLARK: Just a couple  
14 questions.

15 EXAMINATION

16 BY COMMISSIONER CLARK:

17 Q. The 140 ratio, maybe you mentioned this,  
18 but I'm not sure that I picked it up. Now that I  
19 understand the math better, again, how is that  
20 arrived at for, you know -- and I know you didn't  
21 have access to the information that the consulting  
22 firm that did it back in the early '90s. But  
23 typically how would that be figured and what input  
24 would go into figuring that 140?

25 A. Typically, the way it's done is, in the



1 depreciation studies that I've been involved in,  
2 there are typically tables that show annual  
3 retirements by year, then gross salvage by year, and  
4 cost of removal by year. And the net of those gross  
5 salvage and cost-of-removal numbers are related to  
6 the retirements to arrive at these ratios.

7           Now, there's all kind of problems with that  
8 approach to the analysis, but that's the way it's  
9 typically done, or has been typically done. I look  
10 through the Stone & Webster study and I don't see  
11 any of those kind of analysis, so I don't know --  
12 you know, I do know that in that study it said to  
13 the extent such data, net salvage data was  
14 available. I think it's quite possible that it was  
15 an off-the-top-of-the-head estimate because the  
16 company doesn't record any net salvage for services.

17           Q. So your recommendation is because it's a  
18 positive number, it should just be sort of zeroed  
19 out?

20           A. No. I'm recommending we abandon the  
21 procedure entirely and take -- because the new  
22 thinking in the accounting profession is that if you  
23 don't have a legal obligation to incur that kind of  
24 cost on a long-life asset, you probably should  
25 expense it or perhaps, in my opinion, capitalize it



1 to the replacement. Most of these things -- in this  
2 we're dealing with mass property plant here. We're  
3 not dealing with power plants or nuclear plants.  
4 We're dealing with services and mains that get  
5 turned over all the time. There's constant  
6 activity. They have blanket work orders to do this  
7 kind of work. And that to me looks a heck of a lot  
8 more like an annual operating expense than something  
9 you should treat as a capital cost to inflate  
10 depreciation rates. On the other hand, you treat it  
11 as a replacement cost and capitalize it.

12 Q. Now, that is starting to get into the point  
13 about the AROs or asset retirement obligations and  
14 that gets into the SFAS No. 143. Okay. Let's  
15 assume that in college I was reading about the Civil  
16 War --

17 A. Yeah.

18 Q. -- as opposed to GAAP. Can you give me  
19 some examples of, you know, in a concrete way what  
20 this ARO means? I understand it is talking about  
21 incurring legal obligations. But what -- kind of  
22 lay out a couple of examples of what would be an  
23 actual obligation.

24 A. I think that one that pops in is the  
25 retirement to remove a nuclear plant and that's



1 going to cost some money. So what -- and there may  
2 be a legal requirement to remove any kind of  
3 electrical plant, although I'm not sure.

4 COMMISSIONER WEFALD: Or gas plant.

5 THE WITNESS: Maybe a gas plant,  
6 manufactured gas plant or something like that. But  
7 if there is, what this thinking says, if there's an  
8 obligation -- normally when you buy a gas -- say,  
9 you buy a manufactured gas plant and it costs  
10 \$1,000, you debit gas plant, that's plant in  
11 service, and you credit a liability, long-term debt  
12 or cash or something, but you have something. So  
13 the cost of that plant is \$1,000. The rationale  
14 that underlies FAS 143 is that if you have a legal  
15 obligation to then remove that plant, say you  
16 estimate it would cost you \$200 to remove it and you  
17 have a legal obligation to do that, then that is  
18 part of the cost of the plant so it gets capitalized  
19 as \$1,200. But you don't do that unless you have a  
20 legal obligation to incur that cost. If you don't  
21 have a legal obligation to incur that cost, and this  
22 is just replaced as normal things do, you probably  
23 would expense that cost.

24 COMMISSIONER CLARK: Okay. That's all I  
25 have right now. Thank you.



1 MR. HOBERG: Thank you, Commissioner Clark.

2 Mr. Diller, do you have some questions?

3 MR. DILLER: I hesitate to ask a question.

4 Commissioner Reinbold looks like he's ready to

5 leave.

6 COMMISSIONER WEFALD: We could maybe wait

7 until tomorrow morning.

8 MR. DILLER: I don't have that much. It's

9 real general.

10 MR. HOBERG: Any further questions then of

11 Mr. Majoros?

12 COMMISSIONER WEFALD: I don't want

13 Mr. Diller to not ask questions.

14 MR. BINEK: I'm going to have a couple of

15 short questions. I mean, they shouldn't take but a

16 couple minutes.

17 MR. HOBERG: Is yours pretty short,

18 Mr. Diller?

19 MR. DILLER: Yes, it is.

20 MR. HOBERG: Commissioner Reinbold?

21 COMMISSIONER REINBOLD: You're the Hearing

22 Examiner.

23 MR. PEARCE: I have one question, if I may,

24 at some point, too.

25 MR. HOBERG: So we have four questions left



1 of Mr. Majoros. He's going to be back tomorrow,  
2 isn't he? Let's recess tonight and finish in the  
3 morning.

4 (Recessed at 5:04 p.m., the same day.)

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