

1 (The following proceedings were had and
2 made of record, Monday, October 8, 2002, commencing
3 at 9:00 a.m.)

4 MR. HOBERG: Let's go on the record. This
5 is day two of the hearing in the matter of the
6 application of Montana-Dakota Utilities Company for
7 a natural gas rate increase. Yesterday we
8 concluded -- almost concluded -- we did conclude the
9 direct examination of Montana-Dakota Utilities and
10 we're taking the direct testimony of the staff's
11 case, and we have concluded Mr. King and we're
12 almost, I think, done with Mr. Majoros.

13 Is there anything we should discuss
14 preliminarily before we finish the testimony of
15 Mr. Majoros today?

16 COMMISSIONER REINBOLD: I have to leave by
17 5:00 today.

18 MR. HOBERG: Hopefully, we're all able to
19 do that. All right. Then I think --

20 MR. BINEK: Just one point. Yesterday
21 Mr. Pearce or someone from MDU had indicated that
22 one of their witnesses needed to leave early.

23 MR. PEARCE: That's no longer the case.
24 I'm sorry. I forgot to mention that to you. We
25 have no constraints anymore.

1 and so I've got a few more questions on
2 depreciation.

3 Maybe we could just start first by if you
4 could answer this question. If we were -- if the
5 Commission was to adopt your position, how many
6 years would it take for the depreciation reserve to
7 straighten itself out?

8 A. I would -- to answer that -- I can't give a
9 precise answer to that question. But I would say if
10 you adopt what I'm recommending here, which is to
11 eliminate the negative net salvage from the
12 company's depreciation rates, which would reduce
13 those rates, and then amortize the positive net
14 salvage that they've experienced, including the gain
15 on the building over five years, that, combined with
16 normal plant growth, should start to resolve that
17 problem in about five years, I would think. Would
18 be well on its way to resolving itself.

19 Q. So in your mind this wouldn't be a fix that
20 would straighten itself out over one year's time, it
21 would take a number of years?

22 A. Yes.

23 Q. And you're guessing maybe five years?

24 A. I'm guessing five years for it to make a
25 significant dent. It will never resolve itself

1 entirely until, you know, all of the assets are
2 fully depreciated and that would generally be over
3 the average remaining life of these assets.

4 Q. The difference is so big between the
5 parties I was just wondering -- I mean, if the
6 Commission decided that it wanted to end up
7 somewhere in between, would it matter whether the
8 differences were resolved over five years' time or
9 10 years' time or 15 years?

10 A. No. What the Commission -- you know, the
11 Commission could also recalculate rates with new
12 service lives and calculate remaining life rates and
13 then that resolution would be probably longer than
14 five years.

15 Q. Can you tell me why depreciation is such a
16 big issue here philosophically? I mean, why does
17 the company care whether we use \$1 million worth of
18 depreciation expense or \$3 million of depreciation
19 expense? Forget about that expense is supposed to
20 match revenues, expense is supposed to match the
21 customers causing the cost, but philosophically, why
22 would the company care one way or the other?

23 A. Probably because it represents pure cash
24 flow to the company. The more depreciation that's
25 charged, the greater the free cash flow flowing into

1 the company. Any reduction to that amount is a
2 reduction in cash flow.

3 Q. Would there be any benefit if the state
4 were to go to, let's say, retail wheeling or some
5 kind of electric reform where it wasn't under rate-
6 of-return regulation, would it be beneficial to have
7 your plant assets depreciated more than is necessary
8 at that point in time or less than is necessary?

9 A. Well, at that point in time, I think that
10 if I were running the company, I'd want the correct
11 depreciation rates.

12 Q. You'd want the correct ones?

13 A. Yes.

14 Q. It wouldn't be beneficial in a competitive
15 environment --

16 A. No.

17 Q. -- to have your assets overly depreciated?

18 A. No, because in a competitive environment,
19 depreciation does not drive cash flow. It's only in
20 a regulated environment that depreciation drives
21 cash flow because it's built in as a component into
22 the price that's being charged to ratepayers. In a
23 competitive environment, depreciation is an after-
24 the-fact entry on the company's books. Prices are
25 set by the market in a competitive environment.

1 Q. Okay. So in your mind it's all about cash
2 flow?

3 A. In this case, yes, that is correct.

4 Q. Okay.

5 A. It's all about cash flow and the correct
6 theory and rates.

7 MR. DILLER: Right. I think that's all the
8 questions I have.

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

10 Mr. Binek, did you have some more questions
11 of Mr. Majoros?

12 MR. BINEK: Yes, just a few.

13 REDIRECT EXAMINATION

14 BY MR. BINEK:

15 Q. Mr. Majoros, should ratepayers have
16 benefited from the gain in the building sale?

17 A. Yes.

18 Q. How should that gain have been reflected in
19 depreciation?

20 A. Probably under the existing procedure
21 should have been reflected in depreciation as a
22 positive net salvage ratio in the structures and
23 improvements account.

24 Q. Was it, to your knowledge?

25 A. No, it was not.

1 Q. Okay. What salvage value did the company
2 apply to account 390, that's general plant
3 structures and improvements?

4 A. If you turn to my Exhibit MJM-4, page 2 of
5 2, which is common plant, general plant, the
6 building I think was included in account 390,
7 structures and improvements, and you can see that
8 that was depreciated using a negative 10 percent net
9 salvage ratio.

10 Q. What are the advantages or disadvantages of
11 extending the time period for correcting the
12 depreciation as you have proposed?

13 A. What are the advantages or disadvantages?

14 Q. Yeah.

15 A. To whom?

16 Q. For the ratepayers.

17 A. Well, I would say for the ratepayers the
18 advantages of going with my proposal is we get that
19 reserve situation resolved quicker rather than
20 later.

21 Q. Does it result in lower rates?

22 A. Yes.

23 MR. BINEK: I have no further questions.

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

25 Mr. Pearce, did you have some additional questions?

1 MR. PEARCE: No. No, I don't.

2 MR. HOBERG: Thank you, Mr. Pearce. Any
3 further questions then of Mr. Majoros at this time?

4 COMMISSIONER WEFALD: I have one.

5 MR. HOBERG: Commissioner Reinbold, please.

6 EXAMINATION

7 BY COMMISSIONER REINBOLD:

8 Q. Yes. Mr. Majoros, review for me again when
9 you say small interruptible customers are being
10 overcharged, how, when and why. You said that,
11 didn't you?

12 A. No, I think Mr. King said that.

13 Q. Oh, okay. I'm long behind in my notes.

14 A. One reason they're being overcharged is
15 probably too much depreciation is flowing into their
16 rates.

17 Q. Okay. I'll take that for now. And I
18 understand the term, but I want to hear you define
19 the phrase "cash flow," in your mind.

20 A. Cash flow?

21 Q. Yeah.

22 A. As I'm using it here it means cash flowing
23 from ratepayers into the company without any
24 corresponding cash outflow. Arrives at the
25 company -- if we talk about labor expense, cash

1 flows into the company from ratepayers, but there's
2 an offsetting cash outflow, so there's zero cash
3 flow impact of that being included in rates. But
4 with depreciation, cash flows in and there's no
5 corresponding cash flow out, so it's there, stays
6 there for the company's use for whatever it chooses.

7 Q. So then it becomes a balancing act?

8 A. Not in my mind, no.

9 COMMISSIONER REINBOLD: Okay. That's all I
10 have then.

11 MR. HOBERG: Thank you, Commissioner
12 Reinbold. Commissioner Wefald.

13 COMMISSIONER WEFALD: On -- well, I guess
14 this relates to whether I'll have a chance to ask a
15 question of staff after we hear the rebuttal of MDU.
16 If I won't have a chance, then I would ask now. But
17 if I will, then I would wait.

18 MR. HOBERG: Whether he's coming back on as
19 surrebuttal?

20 COMMISSIONER WEFALD: Yeah.

21 MR. HOBERG: Mr. Binek, do you intend to
22 call these witnesses, Mr. King and Mr. Majoros,
23 after the rebuttal of MDU?

24 MR. BINEK: It's going to depend on what
25 the rebuttal of MDU is. Ordinarily, we would not,

1 but if there's some new evidence that comes in, for
2 instance, we would probably want to rebut that.

3 COMMISSIONER WEFALD: Should I just ask my
4 question now?

5 MR. HOBERG: Well, Mr. Pearce, it sounded
6 like yesterday you were expecting them to be called
7 back on.

8 MR. PEARCE: No.

9 MR. HOBERG: You weren't. Oh.

10 MR. PEARCE: I certainly wasn't. I would
11 be quite surprised. In fact, I hope it won't just
12 go on forever and forever that we would have another
13 surrebuttal on the surrebuttal.

14 MR. HOBERG: Perhaps ask it now then.

15 COMMISSIONER WEFALD: Then I'll ask my
16 question now.

17 EXAMINATION

18 BY COMMISSIONER WEFALD:

19 Q. On page 17 of Mr. Jeter's testimony he
20 says --

21 COMMISSIONER REINBOLD: What page are you
22 on?

23 COMMISSIONER WEFALD: Page 17 of Mr. Jeter.
24 That's in this book here, in the rebuttal testimony.

25 Q. (COMMISSIONER WEFALD CONTINUING) The

1 paragraph starting with line 4, the question and
2 then it goes through line 12. "Included in this
3 discussion --

4 MR. HOBERG: Commissioner Wefald, excuse
5 me. He needs a chance to find it here.

6 Q. (COMMISSIONER WEFALD CONTINUING) It's in
7 the rebuttal testimony and exhibits. It says,
8 "Included in his discussion of salvage on page 12 of
9 his testimony at lines 1 through 2, Mr. Majoros
10 says, it appears that the company has not recorded
11 any net salvage at all for services; is that true?"

12 "No. I understand from company personnel
13 that the company has recorded 1.4 million of net
14 negative salvage for services during the years 1995
15 through 2001. Mr. Majoros took his data from a
16 report of retirement work in progress, which because
17 of the use of blanket work orders show services
18 combined with mains. That is apparently the reason
19 he concluded there was no net salvage applicable to
20 services."

21 Yesterday I remember that you said that
22 there was no net salvage applicable to services.
23 Did you get your information from this report of
24 retirement work in progress?

25 A. I got my information from the company's

1 response to my data request to provide all net
2 salvage for even back prior to 1995, and it may be
3 that they provided a blanket work order or this
4 retirement work in progress material in response to
5 that. But I can tell you that material clearly
6 shows various accounts on it and the one that is
7 strikingly missing is services. So for the company
8 to say that it has recorded 1.4 million of negative
9 net salvage for services, they haven't proven it to
10 me. At this point everything I have says they
11 didn't record any net salvage for services. And I'm
12 responding based upon the information they provided
13 me. Mr. Jeter makes this statement, but there's not
14 a document to support it in his testimony or
15 exhibits.

16 Q. When you requested the information from
17 MDU, what did you ask for? What did your data
18 request say?

19 A. My data request No. 21 referenced
20 statements A through F, G through L, N through O,
21 and those are the company statements. Question,
22 Please provide annual North Dakota gas utility gross
23 salvage and cost of removal by plant account
24 beginning in 1986 through 2003.

25 Response, Please see Attachment A. For the

1 years '86 through '94, the information is available
2 for the total company only. For the years 1995 to
3 2001 show both -- the years 1995 through 2001 show
4 both total company and as allocated to North Dakota.
5 Please see Statement O, pages 5 and 6, for salvage
6 and removal costs for projected 2002 and 2003.

7 And this material I got, here is the -- I
8 guess it's the retirement work order document that
9 Mr. Jeter is referring to. If you want to take a
10 look at it, you can see that it has account numbers
11 and accounts, but one account that is missing is
12 381. There has not been -- I mean, 380, services.
13 There has not been any net salvage recorded from
14 1995 through 2001 for services.

15 Q. Do you want to have that entered into the
16 record?

17 A. Sure. It will be the response to data
18 request 21. I have it here. I don't know if I have
19 all of it. I mean, I took the pages that I relied
20 on.

21 MR. HOBERG: Do you have a copy of that,
22 Mr. Binek?

23 MR. BINEK: We should have a copy.

24 MR. HOBERG: Let's go off the record.

25 (Discussion off the record.)

1 MR. HOBERG: Let's go back on the record.
2 We're going to mark the data request 21 as Exhibit
3 21 for the record. Did you have any further
4 questions, Commissioner Wefald?

5 COMMISSIONER WEFALD: No.

6 MR. HOBERG: Thank you. Any further
7 questions by the Commissioners of Mr. Majoros? Any
8 further questions by any of the parties of
9 Mr. Majoros? Thank you, Mr. Majoros.

10 MR. BINEK: Off the record, please.

11 (Exhibits 22, 23, 24, 25, 26, 27, 28, 29,
12 and 30 were marked for identification.)

13 MR. HOBERG: We're ready to go back on the
14 record. We're back from a short recess to mark
15 exhibits, and I believe we're at the point where
16 Montana-Dakota Utilities will call their rebuttal
17 witnesses, starting with Mr. Jeter; is that correct?

18 MR. PEARCE: Yes, it is.

19 MR. HOBERG: Okay. Please call your next
20 witness.

21 MR. PEARCE: I call John Jeter.

22 MR. HOBERG: Mr. Jeter, I don't think
23 you've been sworn yet.

24 THE WITNESS: No.

25 MR. HOBERG: Were you here yesterday --

1 well, let me give it today.

2 THE WITNESS: I was here. I heard it.

3 MR. HOBERG: But I should give it once at
4 the beginning of the day, just to refresh
5 everybody's recollection, and I'm required to do so
6 by law, anyway.

7 Let me tell all the witnesses again that
8 the maximum penalty for perjury in this state is a
9 Class C felony, punishable by a maximum five years
10 imprisonment, a \$5,000 fine, or both.

11 Mr. Jeter, being advised of the penalty for
12 perjury, do you promise to tell the truth in this
13 matter being heard? If so, answer I do.

14 THE WITNESS: I do.

15 MR. HOBERG: Thank you. Mr. Pearce,
16 please.

17 JOHN A. JETER,
18 having been first duly sworn, was examined and
19 testified as follows:

20 DIRECT EXAMINATION

21 BY MR. PEARCE:

22 Q. Would you please state your name and
23 business address?

24 A. John A. Jeter, 1304 South 185th Circle,
25 Omaha, Nebraska.

1 Q. What is your occupation?

2 A. I'm a certified public accountant and
3 self-employed consultant. I retired from full-time
4 association with Arthur Andersen & Company in 1991
5 after over 37 years with that firm.

6 Q. What is the nature of the work you
7 performed while you were there?

8 A. I was involved in examinations of financial
9 statements, and to a much lesser extent in design
10 and installing accounting systems. For many years I
11 performed other financial and accounting
12 consultation services for utility clients.

13 Q. Would you summarize your educational
14 background and professional experience, please?

15 A. I'm a graduate of the University of
16 Nebraska at Omaha, from which I obtained a Bachelor
17 of Science degree with distinction in accounting in
18 1954. I was admitted to the Arthur Andersen &
19 Company partnership in 1967. I'm a member of the
20 American Institute of Certified Public Accountants
21 and the Nebraska Society of Certified Public
22 Accountants. In 1994, I was elected to the Board of
23 Directors of Tucson Electric Power Company and
24 became a director of its parent company, UniSource
25 Energy Corporation, when it was formed. I retired

1 from the UniSource board and its subsidiary boards
2 in May 2001.

3 In 1991 I began consulting on my own with
4 utilities regarding accounting and regulatory
5 matters. As is true in this case, I have also
6 consulted in association with Zinder Companies,
7 Inc., a firm that provides economic and financial
8 consultation to regulated utilities.

9 Q. What experience have you personally had in
10 the utility field?

11 A. I have participated in or been responsible
12 for regular audits of financial statements,
13 registration statements filed with the Securities
14 and Exchange Commission, the SEC, for the sale of
15 securities, installations of property records and
16 information systems and a variety of other special
17 accounting services for regulated industry clients.
18 For many years before I retired from Arthur Andersen
19 I had regional responsibilities for its regulated
20 industries practice, and was a member of the
21 partnership team that established policies with
22 respect to issues facing clients in rate-regulated
23 industries.

24 I often taught at both training sessions
25 for Andersen personnel and in training sessions

1 Andersen offered for its clients and others. This
2 training ordinarily involved accounting issues, tax
3 issues, and various regulatory matters. In 1992, I
4 prepared a paper and presented it twice in a
5 tutorial sponsored by the Institute of Electrical
6 and Electronics Engineers, Inc. Power Engineering
7 Society. The title of my portion of the tutorial
8 was, quote, Accounting for Depreciation, Return, and
9 Income Taxes, unquote.

10 Q. Have you previously testified before any
11 regulatory agencies?

12 A. Yes. I've testified before the Federal
13 Energy Regulatory Commission, the FERC, and its
14 predecessor, the Federal Power Commission, the
15 National Energy Board in Canada, the Interstate
16 Commerce Commission, and regulatory agencies in
17 North Dakota and a number of other states, and the
18 province of Alberta, Canada. My testimony has
19 addressed depreciation, accounting for income taxes,
20 post retirement benefits other than pensions,
21 working capital, and various other topics related to
22 accounting and ratemaking issues. I have attached
23 Appendix A, which is a his of my testimony in
24 regulatory proceedings since the beginning of 1996.

25 Q. What is the purpose of your rebuttal

1 testimony in this proceeding?

2 A. I've been asked by Montana-Dakota
3 Utilities, paren, quote, Montana-Dakota, quote, or,
4 quote, the Company, unquote, to respond to the
5 direct testimony of Michael J. Majoros, Jr., on
6 behalf of the staff of the North Dakota Public
7 Service Commission regarding depreciation rates.

8 Q. I believe you are sponsoring Exhibits 22,
9 your testimony, with JAJ-2 attached, and also
10 Exhibits 29 and 30; is that right? Exhibit 29 we
11 just marked.

12 MR. PEARCE: That's actually a page from
13 Mr. Jeter's testimony. And Exhibit 30 is a summary
14 of negative salvage from Montana-Dakota Utilities.

15 MR. HOBERG: Exhibit 29 is a page from his
16 testimony?

17 MR. PEARCE: I believe that's what it is.

18 THE WITNESS: It's a new schedule that I
19 prepared.

20 MR. PEARCE: It's a schedule. I have my
21 little yellow thing on the wrong sheet. That didn't
22 make too much sense, did it?

23 MR. HOBERG: So are you offering --

24 MR. PEARCE: I'm not offering yet. I'm
25 just mentioning those are his exhibits; 22, 29 and

1 30.

2 Q. (MR. PEARCE CONTINUING) Will you please
3 summarize your conclusions?

4 A. Yes. The company is using the depreciation
5 rates included in Case No. PU-399-94-297 based on a
6 depreciation study completed in 1992. Currently,
7 Montana-Dakota has retained AUS Consulting to
8 complete another depreciation study by December 31,
9 2002. There should be no change in depreciation
10 rates until that study has been completed and the
11 appropriate review has taken place as Mr. Majoros
12 did not prepare a depreciation study, has not
13 presented -- has presented no evidence that the
14 depreciation rates should be changed at this time.
15 A proper depreciation study will involve reviewing
16 additions, retirements, transfers, balances,
17 salvage, removal costs, and accumulated depreciation
18 for the entire history of each account in gas plant
19 and common plant for Montana-Dakota's gas
20 distribution, none of which Mr. Majoros did.

21 Mr. Majoros' reference to cash flow as a
22 basis of setting depreciation rates is completely
23 incorrect and his use of the rough turnover
24 estimation procedures is not reliable and is not
25 used to measure depreciation rates when study data

1 is available, as it is in this case. His comments
2 regarding net salvage are largely his unsupported
3 opinions and are not based on any analysis of
4 Montana-Dakota facilities, experience, or
5 operations.

6 Q. Would you please describe the facilities
7 being depreciated by the company?

8 A. Montana-Dakota's facilities include gas
9 distribution properties in North Dakota that are
10 used to serve approximately 83,500 customers in 76
11 communities. In addition, there are common
12 facilities that are used in connection with the
13 electrical gas operations in North Dakota and other
14 states, the costs of which are directly assigned or
15 allocated to the North Dakota gas operations.

16 Q. On pages 5 through 9 of his testimony,
17 Mr. Majoros discusses a relationship between cash
18 flow and depreciation. Is this a normal type of
19 depreciation analysis?

20 A. No. Mr. Majoros states that depreciation
21 is not intended to finance additions on page 6,
22 lines 3 through 4, but then compares Montana-
23 Dakota's companywide depreciation expense with the
24 plant additions that were made during the years 1996
25 through 2001. It is well established that

1 depreciation is not intended to finance plant
2 additions and the relationship between the two is
3 largely meaningless for determining the appropriate
4 time period during which the company's plant should
5 be depreciated.

6 In spite of this, Mr. Majoros concluded at
7 lines 25 to 26 at page 6 of his testimony that the
8 company, quote, is financing all of its plant
9 additions from depreciation funds it collects from
10 ratepayers and still has a substantial amount of
11 additional cash for other matters, end quote. There
12 is no way he can support that conclusion, because he
13 is assuming incorrectly that there are no other
14 requirements for the cash flow.

15 Moreover, since depreciation is meant to
16 recover the existing investment, it is irrelevant
17 whether investors reinvest the recovered funds or,
18 instead, find other uses for the funds. The
19 appropriate depreciation rate is dictated by the
20 need to recover the invested capital during the life
21 of the facilities. By ignoring that fundamental
22 purpose of depreciation, Mr. Majoros is effectively
23 proposing that the depreciation rate should vary
24 from time to time depending on the amount of cash
25 the company is investing on projects deemed by

1 Mr. Majoros to be beneficial to ratepayers.
2 Presumably, in years when the company has, quote,
3 additional cash for other matters, unquote,
4 Mr. Majoros would reduce the depreciation rate.
5 Conversely, in years when the company needs to
6 undertake major investments in plant, Mr. Majoros
7 presumably would propose major increases in
8 depreciation rates so that the company will have
9 sufficient cash flow to fund all of its investments
10 without borrowing, retaining earnings, or issuing
11 common stock.

12 It is doubtful that Mr. Majoros really
13 means to revolutionize the concept of depreciation
14 so that customers' rates can be increased
15 dramatically to provide financing for new
16 investments. Nevertheless, that is the logical
17 corollary to the new, quote, cash-flow-needs,
18 unquote, standard for setting depreciation rates
19 that Mr. Majoros is advocating.

20 Q. Is Mr. Majoros' assertion concerning
21 Montana-Dakota's source and uses of funds factually
22 accurate?

23 A. No. In addition to the fact that the
24 comparison he made is meaningless, the amounts used
25 are not comparable. The depreciation -- and I'm now

1 referring to his page 6. The depreciation in column
2 2 includes depreciation of common plant, but the
3 amounts for, quote, construction/acquisition (sic)
4 in column 3 do not include those for common plant.

5 Now, I'd like to insert here the fact that
6 yesterday Mr. Majoros put forth Exhibit 20, and
7 included in that exhibit is a schedule which is
8 entitled page 6 table expanded. That's the top page
9 of Exhibit 20. What he did there was to add the
10 common plant construction in column 5, which is why
11 it exceeds the amounts in column 3, and then show
12 the corrected incremental cash flow. He could
13 easily have left out columns 3 and 4 because they
14 are obviously -- well, 3 is correct, but column 4 he
15 could have left out because it's no longer correct
16 and I think he would agree with that.

17 But I wanted to point out that he has now
18 corrected that. During this 1996 to 2001 period
19 there were 28,000 -- \$28,064,555 of additions to
20 common plant. This changes the incremental cash
21 flow in his column 4 from \$28,473,000 to \$408,000.
22 Now, with his expanded schedule, he comes to
23 \$409,000. So we differ again by rounding
24 differently on that number by 1,000. The last year
25 in the column and in his original table in his

1 testimony was shown as 2002 and should have been
2 2001, and he carried that into his expanded table.
3 Mr. Majoros also -- excuse me. I've come to the
4 next question.

5 Q. Mr. Majoros also made an analysis using
6 just a North Dakota distribution and general plant
7 additions and depreciation expense amounts in his
8 Exhibit MJM-3. Is that any different?

9 A. No. It's also meaningless for similar
10 reasons. Once again, his conclusion is completely
11 incorrect. After observing that the depreciation
12 expense for the years '86 through 2001 exceeded the
13 plant additions by 4.5 million he says, paren, on
14 lines 8 and 9 on page 7, close paren, quote, It
15 seems that ratepayers rather than investors have
16 been financing the company's North Dakota plant
17 through excessive depreciation, end quote.
18 Interestingly, he asserts that there is, quote,
19 excessive depreciation, end quote, and has at this
20 point in his testimony mentioned no basis for that
21 other than the comparison of depreciation cash flows
22 and plant additions, which even he agrees are not
23 the basis for setting depreciation rates.

24 I'd like to insert here also based on his
25 Exhibit 20. Well, let me first explain. The next

1 paragraph of my testimony I was planning to strike
2 because it was incorrect. However, in Exhibit 20 he
3 revised the Exhibit MJM-3 and in revising it, it's
4 now incorrect. I said earlier that it was when it
5 wasn't and now he's revised it and now it is, in
6 fact, incorrect. And that's the third page in
7 Exhibit 20. He added depreciation of common plant
8 to the depreciation of distribution plant that was
9 originally in his exhibit and that shows in column
10 2, increased amount there. But he did not add the
11 common plant additions in column 3. Had he added
12 them, I think the schedule would not show what he
13 intended it to show.

14 For instance, in the first year, 1986, the
15 additions, including common plant, are \$2,699,841,
16 compared to the 1,945,514 of depreciation expense.
17 And, therefore, there would have been a negative
18 number in the fourth column of 754,327. I didn't go
19 through all of these to make that correction, but
20 the only other one I did was in '89 and it has the
21 same type of effect only more so.

22 COMMISSIONER WEFALD: Can you just repeat
23 for me again which document you were looking at?

24 THE WITNESS: All right. His Exhibit 20
25 that was entered yesterday, and it's the third page

1 of that, ma'am, if you just turn back into it. It's
2 several different things, and the third page is the
3 one I was referring to.

4 COMMISSIONER WEFALD: Thank you.

5 THE WITNESS: Yes. Now, that is supposedly
6 the same thing as his Exhibit MJM-3, which was
7 attached to his original testimony. And what he has
8 done, if you look at the two, you can see that he
9 has added amounts in column 2 each year so that the
10 total depreciation expense instead of being
11 \$33,405,083 as it was in his original exhibit is now
12 \$37 million.

13 MR. HOBERG: Mr. Jeter, are you still
14 wanting to strike that 15 through 21?

15 THE WITNESS: Yes. I would like to strike
16 it, because I was referring to his original exhibit
17 which was not inconsistent.

18 MR. HOBERG: Lines 15 through 21 on page 7
19 should be stricken and replaced with what you just
20 said?

21 THE WITNESS: With what I said, yes.

22 COMMISSIONER REINBOLD: What are the lines?

23 MR. HOBERG: 15 through 21 of page 7 of his
24 rebuttal.

25 THE WITNESS: It does not change anything.

1 I still think the exhibit is meaningless, but I had
2 called attention to something I thought was wrong
3 and I was wrong. It is incorrect in his new version
4 attached to part of Exhibit 20.

5 MR. HOBERG: Thank you. Please continue.

6 THE WITNESS: It is incorrect in his new
7 version attached to -- as part of Exhibit 20.

8 Q. (MR. PEARCE CONTINUING) On page 7, at
9 lines 12 to 13 of his testimony, Mr. Majoros states,
10 An excessive depreciation rate is one that produces
11 depreciation and expense more than necessary to
12 return a company's capital investment in an asset
13 over the life of the asset.

14 Do you agree with the statement?

15 A. No, because it's incomplete. The Federal
16 Energy Regulatory Commission in its Uniform System
17 of Accounts for natural gas companies, paren, also
18 used by this Commission for the gas companies
19 subject to its jurisdiction, close paren, defines
20 depreciation as:

21 The loss in service value not restored
22 by current maintenance, incurred in
23 connection with the consumption or
24 prospective retirement of gas plant in
25 the course of service from causes which

1 are known to be in current operations
2 and against which the utility is not
3 protected by insurance. Among the
4 causes to be given consideration are
5 wear and tear, decay, action of the
6 elements, inadequacy, obsolescence,
7 changes in the arts, changes in demand,
8 and requirements of public authorities,
9 and, in the case of natural gas
10 companies, the exhaustion of natural
11 resources.

12 The term "service value" is defined as the
13 difference between original cost and net salvage
14 value of gas plant. Since service value includes
15 net salvage in addition to capital investment,
16 Mr. Majoros omitted an important aspect of the
17 recovery of cost that is necessary through
18 depreciation provisions.

19 I'd like to also comment here about some of
20 the things that were said yesterday. The expense
21 provision for depreciation includes cost of removal
22 or salvage net and that means that they would either
23 be higher or lower depending on the estimates of
24 whether there's net cost of removal or negative
25 salvage or salvage itself. The reserve is there for

1 the retirement of the asset and for the cost of
2 removal or salvage as often happens. His comparison
3 is misleading because he's leaving out those aspects
4 of reserve for depreciation in his comparison.

5 Q. How would the omission of net salvage
6 affect his determination of excessive depreciation?

7 A. Well, his comparisons are not only
8 baseless, but they're also incorrect in that the
9 entire cost is not included in his thinking. If the
10 net salvage is negative and is estimated at 30
11 percent of the asset cost, he would be asserting
12 that since the depreciation expense exceeds current
13 additions, it is excessive. That is a wrong
14 comparison to start with, but, in addition, he would
15 be leaving out the fact that the expense would have
16 to be 130 percent of the amount necessary to recover
17 the investment in order to provide for the negative
18 salvage or cost of removal in excess of salvage.

19 Q. On page 7, line 16, through page 9, line 2,
20 Mr. Majoros quotes a U.S. Supreme Court decision in
21 1934 as a basis for his contention that excessive
22 depreciation results in the extraction of capital
23 contributions from ratepayers.

24 Would you please comment on that?

25 A. Yes. Mr. Majoros seems to have missed the

1 point of the Court's ruling. He refers to a cite of
2 this decision in the NARUC Depreciation Manual as
3 proof that it is still relevant law. The section in
4 which this term is cited is The Brief History of
5 Utility Regulation. Now, as an aside to that,
6 that's a nine-page chapter. It's the first chapter
7 of this book put out by the NARUC. The following
8 chapter is entitled, quote, Current Concepts of
9 Depreciation, end quote. So the chapter that he's
10 referring to is actually a history of what has
11 happened. Obviously, depreciation practices were
12 still in the development stage in 1934.

13 Now, I'll go back to the text here. The
14 NARUC text point out the fact that this decision
15 overruled a 1930 decision for depreciation on fair
16 value. That means a value that reflects changes
17 because of inflation, typically, over time. In
18 other words, at that time they were depreciating
19 plant using reproduction cost, new. In other words,
20 they were taking account of inflation over time and
21 then depreciating that inflated amount rather than
22 the original cost of the plant.

23 Now, since some of my comments about things
24 I've read are not necessarily believed by others,
25 I'd like to read into the record the information

1 that I was just talking about. And this is from
2 page 3 of this NARUC Depreciation Manual. And it's
3 the third full paragraph.

4 In 1930 the opinion of the Court had
5 changed and reflected the belief that depreciation
6 expense should be based upon present value rather
7 than original cost. United Railways and Electric
8 Company of Baltimore versus West, 280 U.S. 234,
9 1930. That opinion appears to have been overruled
10 in the 1934 decision, Lindheimer versus Illinois
11 Bell Telephone Company, 292 U.S. 151, 1934, wherein
12 the Court stated, The method is designed to spread
13 evenly over the service life of the property the
14 loss which is realized when a property is ultimately
15 retired from service. According to the principle of
16 this accounting practice, the loss is computed upon
17 the actual cost of property as entered upon the
18 books, less the expected salvage and the amount
19 charged each year is one year's pro rata share of
20 the total amount.

21 So this issue had to do with whether we
22 depreciate fair value of the property determined
23 using various indices to estimate the value of an
24 existing property that had been in existence for
25 some time and then depreciating that value, or if we

1 should use original cost. I frankly had not heard
2 of this case until this testimony was done. And the
3 case you hear of is discussed in the rest of my
4 written testimony. So I'll begin there.

5 Subsequent to the Hope Natural Gas Company
6 case decided by the Supreme Court in 1944, most
7 regulatory commissions stopped using the value
8 method for measuring the rate base investment and
9 switched instead to the original cost method of
10 measuring rate base. To that extent, I believe the
11 1934 decision cited by Mr. Majoros is consistent
12 with current regulatory practice, which generally
13 uses original cost rate base for ratemaking. I
14 believe the references in the decision to excessive
15 recovery of depreciation refer to the use of value
16 rather than cost in setting rates. That is
17 certainly not an issue in this case since neither
18 the rate base nor the depreciation amount is derived
19 from an estimate of the current value or replacement
20 cost of the plant.

21 Q. On page 9, lines 3 through 24, Mr. Majoros
22 shows the relationship of the accumulated
23 depreciation reserve to the plant in service and
24 concludes that the reserves are extraordinarily
25 high, to use his term, and that they suggest that

1 higher depreciation rates have been excessive.

2 Do you agree with this conclusion?

3 A. No. Without information about the average
4 age of the plant, prior retirements, et cetera, it
5 is not possible to tell at what level the
6 accumulated depreciation provisions the reserve
7 should be. Once more, Mr. Majoros has expressed his
8 opinion without benefit of any evidence to support
9 it.

10 Now, I'd like to comment here again that in
11 his discussions yesterday he mentioned the 70
12 percent ratio of one of the plant items depreciation
13 reserves to the plant cost itself. And I think we
14 need to understand what's in those depreciation
15 reserves in order to understand those ratios.
16 They're not used to separate. This book says over
17 and over that that shouldn't be done. And there are
18 very few situations in which regulatory bodies
19 actually look at the reserve for depreciation and
20 say that reserve is too much or too little and we're
21 going to correct that right away. It's done in the
22 telephone industry to some extent, but other than
23 that, it's practically not done at all.

24 The reserve has the provisions that have
25 been charged to expense for cost recovery and for

1 net salvage, whether it's positive or negative, in
2 it. Credits for salvage increase the reserve.
3 Plant cost retired is in the reserve as a negative
4 amount. In other words, we depreciate over the
5 years with the idea that when the plant is retired,
6 that depreciation reserve will equal the amount of
7 the cost of the plant and the two will offset. It
8 also has charges for the cost of removal because
9 when plant is retired and must be removed, then
10 those costs are charged to the depreciation reserve
11 also because they have been provided for in the
12 provision for depreciation and that goes into that
13 reserve.

14 Deciding whether reserve is too high or too
15 low is difficult. Mr. Majoros compared the reserve
16 for all distribution facilities which is impossible
17 to understand on its face because it includes a lot
18 of different kind of properties, a lot of different
19 existing ages of those properties, and a lot of
20 different lives of those properties. You need
21 analysis, but usually that's not done in modern
22 depreciation practices other than as a sort of test
23 of what's been done in more detail using curve
24 fitting techniques that are typically used in
25 determining depreciation rates.

1 Q. Are there others aspects of the level of
2 the depreciation reserves that should be considered?

3 A. Well, yes. The amount in the reserve
4 includes amounts that are set aside for the net
5 negative salvage, as well as the amounts needed to
6 recover original investment in the plant.
7 Obviously, that makes the percentage relationship of
8 the reserve to the plant amounts look larger than it
9 would if only the investment recovery portion of the
10 reserve were compared. More importantly, the larger
11 the reserve balance is, the lower the rate base is
12 and the lower revenue requirements for return and
13 income taxes are. In some cases the level of
14 reserve can also affect the levels of property taxes
15 paid, and reduce them if the reserve is higher.

16 Q. Could you quantify the effects of the lower
17 rate base?

18 A. Yes, I can do that roughly, and I want to
19 emphasize the word "roughly." The direct effect of
20 the lower rate base caused by larger depreciation
21 reserve balance is to lower the revenue requirement.
22 If it is assumed that depreciation has been less --
23 had been less by the amount of Mr. Majoros' proposed
24 annual adjustment of depreciation since rates were
25 set to be effective in late 1994, we would have

1 eight years, '95 through 2002, of Mr. Majoros'
2 \$2.172 million proposed depreciation expense
3 reduction accumulated in the reserve for
4 depreciation by the end of 2002. That would have
5 reduced the reserve by \$17,376,000 and increased the
6 rate base by the same amount.

7 The effect of an increase in rate base of
8 \$17,376,000 would be to increase the revenue
9 requirement. I've computed those amounts using
10 Montana-Dakota's proposed 11.044 percent rate of
11 return shown on Dr. Gaske's testimony and the 39.61
12 percent combined federal and state income tax rate
13 supplied to me by the company.

14 Q. And what are the effects on revenue
15 requirements using those assumptions that you
16 mentioned?

17 A. The revenue requirement avoided because of
18 the 17,376,000 is in the depreciation because that's
19 in the reserve is about 3.2 million annually, which
20 exceeds the 2.2 million annual depreciation
21 adjustment proposed by Mr. Majoros. This means that
22 there would be a greater reduction of revenue
23 requirement -- I said would. There will be a
24 greater reduction of the revenue requirement every
25 year from 2002 on by having the 17,376,000 in the

1 reserve, than Mr. Majoros' proposed reduction in
2 annual depreciation expense. In addition, the
3 revenue requirement reduction does not reduce the
4 amount of investment being recovered by Montana-
5 Dakota as Mr. Majoros' proposed depreciation expense
6 reduction would. The higher depreciation reserve
7 balances, resulting in a lower rate base, has
8 benefited Montana-Dakota's customers and continues
9 to be a benefit in terms of reducing the revenue
10 requirement.

11 Q. On page 10, lines 2 and 3, Mr. Majoros
12 states, according to the company, no specific
13 studies have been prepared regarding the adequacy of
14 the depreciation reserve or calculation of any
15 theoretical depreciation reserves.

16 Is that true and, if so, can you explain
17 why it is true?

18 A. I understand it is true, and it's certainly
19 appropriate. Theoretical depreciation reserves are
20 discussed in the NARUC text on depreciation, this
21 document, to which Mr. Majoros referred in his
22 testimony. On page 24 the author states, quote, If,
23 for example, depreciation rates have been prescribed
24 by regulatory authorities for an appreciable period
25 in the past, it would be inconsistent to deduct in

1 establishing a rate base a larger or smaller amount
2 than book depreciation reserve accumulated under the
3 prescribed rates, end quote.

4 The reason that the company has not done
5 studies of the adequacy of the depreciation reserves
6 or determined theoretical depreciation reserves is
7 that it's inappropriate. Adjustments of
8 depreciation are nearly always done on a prospective
9 basis based on the determination of changes in
10 average service lives or determinations of average
11 remaining service lives, more often remaining
12 service lives.

13 Q. On page 10 of his testimony Mr. Majoros
14 expresses his opinion that the 1991 depreciation
15 study by Stone & Webster included an extremely high
16 cost of removal factor for account 380, services.
17 Do you agree?

18 A. No. The 1991 depreciation study of Stone &
19 Webster included a review of account 380 additions
20 from 1936 through 1991 and related salvage data to
21 the extent that it was available. I'd like to
22 insert here some discussion, because I did not talk
23 about the level of net cost to remove or net
24 negative salvage that is in this case and I think
25 that it is more understandable if you start to think

1 about what's involved than it is if you just look at
2 those rates and say they're too high.

3 For instance, in salvage in the services
4 area, the service again is the line from the main in
5 the street to the home. They're typically a small-
6 diameter pipe. The installation -- and I think
7 there was an example of \$1,000 installation
8 yesterday, and I'd like you to think about what
9 happens when that is installed and then a period of
10 time of 35 years goes by and then it's taken out.
11 For whatever the reason, maybe it's replaced, maybe
12 it's taken out because the home is no longer
13 occupied, but for whatever the reason. It seems to
14 me that it probably would cost about the same amount
15 in terms of labor, time, and equipment, and so forth
16 to take that line out as it did to put it in in the
17 first place. However, in 35 years the cost of doing
18 that is going to have increased. I looked at the
19 Consumer Price Index, and in 1967 the Index was
20 32.9, in January. In January of 2002 the index was
21 at 177.1. So if the cost of doing these activities
22 has gone up by the inflation amount shown by the
23 Consumer Price Index, the cost would be over five
24 times as much.

25 So when an estimate of net cost of removal

1 is 140 percent of the original cost of the facility,
2 that may be pretty close to what's involved, but it
3 may also be short. It may actually cost more than
4 that. So I was accused of not having thought about
5 this or reacted to those salvage amounts. I didn't
6 look at the study in any detail at all, but I'm
7 certainly more willing to accept what people did in
8 an extremely detailed study than to just say offhand
9 those are wrong. And so I think that the amounts
10 that are there are reasonable, probably. Now, I
11 can't swear to that because I haven't done the work
12 that's necessary, but I would certainly wait until
13 somebody does the work in the current study to see
14 if those amounts are reasonable.

15 And I should mention the inflation during
16 that 35-year period that I talked about was greater
17 than normal. It amounted to 4.9 percent a year
18 because of very high years in the '70s and '80s that
19 we had some very high inflation, but even at 3
20 percent a year in 35 years, prices will go up 2.8
21 times so it's still something that has to be dealt
22 with when you're dealing with longer life
23 properties.

24 I'll continue with the rest of that answer.
25 I would rather rely on that study than Mr. Majoros'

1 reaction, which seems mainly to be based on the
2 effects of the salvage estimate rather than the
3 basis for it.

4 Q. On the same page 10 Mr. Majoros concludes
5 that the 36-year life for account 376, mains, and
6 the 34-year life for account 380, services, may be
7 excessive based on his experience in investigating
8 other gas depreciation rates.

9 Will you please comment?

10 A. Yes. Again, I would rely on Stone &
11 Webster's 1991 depreciation study. Mr. Majoros'
12 opinion may be based on his experience, but his
13 opinion was formed without any specific
14 determination of the proper life or any specific
15 basis for the life he would have led. The Stone &
16 Webster's study used data from 1936 through 1991 and
17 curve fitting techniques that resulted in the use of
18 the R3 Iowa Curve to determine the 34-year life for
19 the account 380, services. The study used data from
20 1944 to 1991 for account 376, mains, in the same
21 manner to determine an R5 curve fit and a 36-year
22 life.

23 The approach used by Stone & Webster for
24 these two accounts is widely used by depreciation
25 experts, including the FERC staff, to determine the

1 appropriate lives to use to depreciate gas utility
2 plant.

3 Q. On page 11, lines 1 through 15, Mr. Majoros
4 discusses the geometric mean turnover studies he
5 used to test service lives.

6 Will you please comment on that?

7 A. Yes. First, the use of the word "studies"
8 should not be interpreted to mean he did a
9 depreciation study. What he did is a very limited
10 review of certain data, with some unexplained
11 calculations. He said in the testimony that he used
12 the last five years of additions and retirements.
13 However, his Exhibit MJM-5 shows additions and
14 retirement for the period 1985 through 2001. In
15 addition, his exhibit labels certain of the data as
16 a three-year band and it appears not to be for any
17 three-year period. His schedules on Exhibit MJM-5,
18 pages 1 of 4 and 3 of 4, show average plant balances
19 in column b for each year based on the balances at
20 the beginning of the current year and the beginning
21 of the prior year, which means the average balances
22 are all shown for the wrong year. They are all
23 actually averages of the year previous to the one
24 shown.

25 The average plant balance additions and

1 retirement shown under the three-year band caption
2 are in each instance the sum of the current year and
3 the previous year amounts from columns b, c, and d.
4 Thus, they are not for three years and they use
5 those incorrect average balances from column b that
6 I discussed. Using the data for this 17-year period
7 Mr. Majoros computed a life estimate of 108.07 years
8 for account 376, mains, and a life of 68.53 years
9 for account 380, services. He does not explain how
10 the data for this 17-year period is reliable, nor
11 how the method he used works to determine the lives.

12 Now, I'd like to insert here a comment
13 based on the discussions yesterday in the hearing.
14 Exhibit 20 has comparisons of company and industry
15 averages and to put the lives that Mr. Majoros
16 determined in that methodology in context, I'd like
17 you to look at the second piece of paper in Exhibit
18 20, which is the statistics for lives that he
19 presented. And in that example taking mains, which
20 is account 376, the company life is shown as 36
21 years. The lives that he got averages from
22 statistics for gas plant, and I assume a rather wide
23 group in the United States are around the 50- to 55-
24 year lives. The minimum life was 10 and the maximum
25 life was 80.

1 As I'll discuss later, Mr. Majoros has
2 adjusted his MJM-5, and he now finds that the life
3 should be 116 years. One hundred sixteen years
4 exceeds the maximum life of 80 years shown on his
5 schedule by quite a lot and I think is totally
6 meaningless in the context of depreciation rates for
7 this company.

8 Similarly, on the services the company is
9 using a 34-year life. The range for others is from
10 10.2 to 40 years. And the maximum life shown was 63
11 years. His revised determination is 74 years.
12 Again, substantially higher than any other company
13 has or is using. That's in the survey that he
14 produces numbers from.

15 I'm going back to the text now. In the
16 case of account 376, mains, the 1.167 million of
17 retirement for all of the years from 1985 through
18 2001 are only 6.2 percent of the balance at the
19 beginning of 1985, and a smaller percentage of the
20 1985 balance plus subsequent additions. In the
21 NARUC depreciation text mentioned by Mr. Majoros,
22 the turnover methods are discussed in Chapter 8.
23 The geometric mean turnover method he used is
24 described on page 81 as follows, quote, The
25 Asymptotic method and its simplified form, the

1 geometric mean method, are based on ratios of annual
2 additions and retirements. The latter method more
3 readily indicates trends, but is also prone to
4 producing results with considerable variability.
5 The simplicity of the turnover method and the ease
6 with which they may be applied explain their
7 popularity. Their use is restricted by the
8 assumptions of uniformity and their failure to
9 provide an indication of retirement dispersion.
10 These problems led to their replacement by the
11 Simulated Plant Record model.

12 Further, under the caption "limitations" on
13 page 92 of the same text, NARUC text, the following
14 summary statements about turnover methods are made.
15 Quote, All of the methods assumed uniformity of the
16 growth ratio and dispersion of retirement for each
17 vintage. A more reliable estimate may be made if
18 the property has experienced at least one life
19 cycle, roughly twice the average life, since, under
20 the consistency assumptions above, the property will
21 be at stability. Since utility property typically
22 does not meet the above consistency assumptions, the
23 method may produce considerable variations in life
24 indications. This is especially true for the
25 geometric mean method.

1 Now, if you think about applying that, this
2 document says that you need roughly twice the
3 average life of data. Twice of average life that he
4 determined would be 232 years, and I don't think we
5 have any data back to the 1700s.

6 The 1968 addition of the NARUC text stated
7 on page 138 -- now this is a long time ago, this
8 document. Turnover methods are currently used very
9 little because improved methods have been developed
10 for determining service lives from recorded data. I
11 do not believe Mr. Majoros' conclusions based on his
12 very rough analysis of this data should be given any
13 weight in determining the proper lives to use for
14 Montana-Dakota distribution facilities.

15 Q. Turning for a moment back to page 14, line
16 21, you said chapter 8. Did you mean chapter 7?

17 A. Excuse me. Chapter 7. I misspoke. I also
18 would like to insert here that during Mr. Majoros'
19 summary yesterday he mentioned that the Stone &
20 Webster study had talked about a turnover method and
21 he quoted a paragraph from page 4 of their report.
22 I'd like to quote it again and comment on it, if I
23 may.

24 I believe the quote was -- and this is from
25 page 4 of that document. The turnover testing is a

1 procedure in which the adjusted turnover period, the
2 number of years it takes an investment in plant to
3 be retired, is determined by aggregating additions
4 from the year 1991 backward until the total is equal
5 to the plant balance in that year and then adjusting
6 for the rate of growth in the account.

7 Now, keep in mind, they're talking there
8 about dealing with additions back through the years
9 from the time that they did their study until they
10 could account for all of the balance that was there
11 when they looked. I just mentioned he looked at
12 only 6.2 percent of the retirements in his study and
13 that the additions would have been something less
14 than 50 percent. So he did not do what Stone &
15 Webster said they did. They were both called
16 turnover methods, but his method is a much simpler
17 and less reliable method.

18 Q. On pages 11 -- sorry. On page 11, line 18,
19 through page 12, line 11 of his testimony,
20 Mr. Majoros discusses net salvage ratios and refers
21 to his Exhibit MJM-6. He concludes that the
22 company's net salvage recovery is vastly overstated.

23 Do you agree?

24 A. No. I believe the 1991 depreciation study
25 prepared by Stone & Webster is a much more reliable

1 source of information regarding net salvage than a
2 cursory look at the net salvage for all accounts
3 over a five-year period. By the way, Mr. Majoros
4 talked about that method being used in, I believe,
5 Pennsylvania and Kentucky. Which said another way
6 is that it's not used in the other 48 states, nor by
7 the FERC, nor by the FCC, nor by anybody else that
8 I'm aware of. It is a method that is bound to
9 charge the wrong customers for these items. The new
10 financial accounting standard is clearly aimed at
11 having the cost of removal spread over the life of
12 the facility so that the customers that have the
13 benefit of that facility are paying for it.
14 Spreading net cost of removal or salvage from a
15 previous five-year period doesn't accomplish that at
16 all and it is bound to be incorrect.

17 There's been several mentions of a gain on
18 the sale of a building. And I may cover that later
19 in the printed documents. I will. But it's been
20 mischaracterized as a gain several times, including
21 this morning again in cross. There was no gain on
22 the sale of the building. Salvage is the entire
23 amount realized from the sale of the property when
24 it's retired, not the gain on the sale. This
25 building was sold for book value. The salvage went

1 to the depreciation reserve and there it reduces
2 rates for customers because it's a reduction of the
3 rate base.

4 And in addition to that, it equaled the
5 amount that they needed because they sold it for
6 book value. So this using a five-year average and
7 including \$4.6 or 8 million in the future five years
8 based on that, is totally wrong. First of all, even
9 if that should be done that way, and it shouldn't,
10 but if it should be done, there's not going to be
11 another sale of a building likely in every five-year
12 period in the future, nor one-fifth of that amount
13 realized in any of the five years. It's just
14 absolutely wrong.

15 I want to make sure everybody understands
16 there was not a gain on the sale. There was nothing
17 that the customers are never going to realize. This
18 building was sold for its net cost. In other words,
19 its original cost less the depreciation that had
20 been accumulated on it from the time that it was
21 placed in service.

22 And I'm going to continue reading now from
23 my text. I also believe that the cost of removal
24 will tend to be paid near the end of the average
25 life of plant facilities and cannot be estimated

1 accurately using broad averages of short periods of
2 data as was done by Mr. Majoros. Mr. Majoros used
3 data without so much as questioning. The amounts by
4 year for natural gas vary from \$79,685 to \$440,703.
5 In addition, the amounts for common utility
6 facilities varied from 12,377 in 1997 to \$4,889,037
7 in 2001.

8 As I mentioned, I understand that the large
9 amount in 2001 involved the sale of an office
10 building for 4.6 million. The electric amounts
11 include an insurance recovery of about 1.8 million
12 and much of the other salvage during the period is
13 for vehicles and work equipment. These are
14 relatively short-life assets. The salvage very
15 often is trade-in value when work equipment is
16 traded in on new work equipment.

17 I will discuss the recommendation -- excuse
18 me. In summary, Mr. Majoros has very little basis
19 for his comment and for the effect of net negative
20 salvage he used in his final recommendation. I will
21 discuss that recommendation later in the testimony.

22 I do not understand Mr. Majoros' comments
23 about the recovery being overstated. I assume the
24 accounts being recovered are being recorded by the
25 company in the records. Perhaps he means that the

1 amounts being recovered are excessive, and I have
2 commented above about his complete lack of evidence
3 for that claim. He also states on page 12 of his
4 testimony that the company's, quote, ratepayers are
5 being penalized, end quote. The ratepayers will
6 receive full benefit of the amounts recorded by the
7 reduction in rate base as I described above.

8 MR. HOBERG: Perhaps this would be a good
9 time to take a 10-minute recess. I think we're
10 going to continue for a while. Let's take a
11 10-minute recess at this point.

12 (Recess was taken.)

13 (Exhibit 21 was marked for identification.)

14 MR. HOBERG: We're back from recess and,
15 we'll continue the examination of Mr. Jeter.

16 Mr. Pearce, please.

17 MR. BINEK: Your Honor, I just wanted to
18 mention that I passed out copies of Exhibit 21
19 during the break.

20 MR. HOBERG: Thank you, Mr. Binek. This is
21 the big one. It's the data request 21 and the
22 response, which is marked as Exhibit 21. Thank you.

23 COMMISSIONER REINBOLD: 21?

24 MR. HOBERG: 21, yes, Exhibit 21.

25 Mr. Pearce.

1 Q. (MR. PEARCE CONTINUING) Mr. Jeter,
2 included in Mr. Majoros's testimony in a discussion
3 of salvage he says, it appears that the company has
4 not recorded any net salvage at all for services.
5 Is that true?

6 A. No. I understand from company personnel
7 that the company has recorded 1.4 million of net
8 negative salvage for services during the years 1995
9 through 2001. Mr. Majoros took his data from a
10 report of retirement work in progress, RWIP, which
11 because of the use of blanket work orders shows
12 services combined with mains. That is apparently
13 the reason he concluded that there was no net
14 salvage applicable to services.

15 Now, earlier this morning this was
16 discussed again. And at the time that I wrote the
17 testimony, I had just been informed of that.
18 Subsequently, I asked for some data from the company
19 to explain that. And I should mention I think this
20 was an unfortunate thing. The response to the
21 original data request was misleading. I think there
22 was reason to believe looking at it that there were
23 no salvage amounts for services because they didn't
24 show there. And they were combined because of the
25 kind of blanket work order treatment the company

1 gives them.

2 But, in any event, there were actual net
3 cost of removal for services during the period
4 involved. And I have with Exhibit 30 summarized
5 several pages of data that I was given by the
6 company. Each of those pages is headed up services-
7 removal cost. And I have taken the total amount for
8 the year from each of those pages and summarized it
9 in the column called annual on the top page. And
10 you can see from that, that this totals up to
11 \$1,387,946.12 or 1.4 million. And the documents
12 that I got did not have monthly detail for all of
13 the months of the year, but on that top schedule I
14 summarized some of those just to get a feel for it.
15 The trouble is, those monthly amounts are not
16 necessarily representative in North Dakota because
17 they're for January and I doubt that there's a lot
18 of construction going on in this part of the world
19 in January, no more than necessary probably. But in
20 any case there were, in fact, a million-four of cost
21 of removal.

22 Now, I said in my testimony net negative
23 salvage. Looking at these schedules, there could
24 have been some positive salvage that's not accounted
25 for here. I doubt it because typically service

1 lines don't generate any material that can be sold
2 or used again. But that could be that there is some
3 actual salvage values that are not even in this more
4 detailed review.

5 Q. Mr. Majoros then guesses the company may be
6 recording cost of removal in connection with
7 services replaced as service transfer expense. Is
8 that what the company is doing?

9 A. No. As I mentioned above, the company has
10 informed me that the net salvage has been recorded
11 in the accumulated depreciation accounts, the
12 reserve.

13 Q. Then to the extent you relied on his
14 statements about account 380, services, his
15 conclusion is unsupported; is that right?

16 A. Yes.

17 Q. On page 12, lines 13 through 21,
18 Mr. Majoros discusses FAS No. 143 and the changes he
19 believes will be required for fiscal years beginning
20 after June 15th of 2002. Would you please summarize
21 the effects of FAS 143?

22 A. Yes. I prepared Exhibit JAJ-2, a simple
23 example of the accounting changes involved. On the
24 exhibit -- and it probably would help if we look at
25 that together -- I have assumed a \$10,000 plant is

1 completed on January 1, 2001 and there is an
2 estimate of \$500 of cost of removal and no salvage
3 at the time of its estimated retirement on December
4 31, 2010.

5 COMMISSIONER WEFALD: I need some help with
6 where this exhibit is found.

7 THE WITNESS: It's attached to my
8 testimony.

9 MR. HOBERG: His rebuttal testimony, the
10 very last page.

11 THE WITNESS: The very last page. In that
12 section we --

13 COMMISSIONER WEFALD: TAA-5, is that the
14 one we are looking at?

15 MR. PEARCE: JAJ-2. You must be in the
16 wrong --

17 COMMISSIONER WEFALD: JAJ-2?

18 THE WITNESS: Yes.

19 COMMISSIONER WEFALD: Thank you.

20 THE WITNESS: The owner of the plant
21 applies a credit adjusted risk-free interest rate to
22 discount the cost of the removal obligation to its
23 present value of \$254.17. Now, I'm assuming those
24 things, and the assumptions are basically all shown
25 at the top of the exhibit.

1 COMMISSIONER WEFALD: Where is this \$254
2 figure?

3 THE WITNESS: It's at the right-hand side
4 of the top little section there, right below the 7
5 percent, and it was derived using the 7 percent.
6 That's the present value of \$500 10 years out using
7 a 7 percent discount rate. In other words, if you
8 invested \$250.17 at 7 percent, 10 years later you
9 would have the \$500.

10 Under existing accounting, as shown at the
11 top table on the exhibit, the depreciation expense
12 would reflect the \$500 of cost of removal as an
13 additional provision for depreciation of \$50 per
14 year and the total depreciation expense credited to
15 the reserve for depreciation would provide for the
16 retirement of the asset and the cost of removal.
17 The plant and reserve accounts would be zero at the
18 end of the life.

19 Now, you can see there I've labeled it
20 expense. That's the provision for depreciation that
21 goes to expense and is credited to the depreciation
22 reserve which increases the reserve. At the end of
23 the life -- and this assumes perfect estimation --
24 there would be \$1,000 of plant taken out of the
25 plant records and charged against the reserve, and

1 there would be payments of \$500 to remove that
2 facility. And the balance in the depreciation
3 reserve would therefore become zero and the balance
4 in the plant account would also be zero. That's
5 quite a lot simpler than what I'm going to tell you
6 about next.

7 Because under SFAS 143 the \$254.17 present
8 value of the estimated cost of removal would be
9 recorded on January 1, 2001 as a liability and as an
10 addition to plant. Now, you can see that in the
11 first line of that lower table where plant starts
12 out at \$10,254.17. Depreciation of the adjusted
13 plant would be \$1,025.42 per year instead of the
14 \$1,050 recorded under existing accounting rules.
15 Now, you can see that's a lesser amount, and the
16 reason it's smaller is that we're dealing with a
17 present value of that future payment that has to be
18 made and that's the amount that would be depreciated
19 and recovered through depreciation. In the
20 depreciation -- well, let me read on.

21 The present value of the liability that
22 would be set up offsetting that addition to plant
23 must be increased each year as the time for
24 settlement approaches. The accretion recorded to do
25 that is the discount rate times the beginning of the

1 year balance each year. On the exhibit that shows
2 up as \$17.79 in 2001 and increases each year until
3 2010 when it is \$32.71. Once again, the plant and
4 reserve accounts, as well as the liability accounts
5 all stand at zero at the end of 2010.

6 Now, let me take you through this again.
7 We depreciate that additional \$254 and, therefore,
8 at the end of 10 years, that's the amount that's in
9 plant and that's the amount we've provided for so
10 the reserve zeros out, and the cost of removal would
11 no longer be charged to the reserve because it's
12 already been taken care of on a present-value basis.
13 But in addition to that cost to be recognized, there
14 is the accretion each year, which is also an expense
15 that reduces the net income of the company. And
16 that accretion increases over time and takes care of
17 the total discount or \$254.83 during the life of the
18 facility. Then when the \$500 of cost of removal is
19 paid, that obligation is taken care of. Because the
20 amount at the end would be \$500 because of the
21 interest being added each year to raise it to that
22 level. In other words, the present value five years
23 out is greater than the present value 10 years
24 before the cost has to be paid.

25 Now, I think it's also important to note

1 that the total expense recorded under both of these
2 systems is \$10,500. And that's shown in the total
3 expense column of the second table to be \$10,500.
4 That's the sum of the depreciation expense of
5 \$1,025.42 each year and the accretion over in the
6 third to the last column. Therefore, that amount
7 changes each year and it increases over time, not a
8 particularly handy thing from a regulatory
9 standpoint in my estimation. But the total cost is
10 the same.

11 Now, Mr. Majoros said in his testimony, and
12 I'll talk about this a little bit, but he talked
13 about only paying the present value and not taking
14 care of inflation. The inflation is specifically
15 required under 143 and it is required, if you think
16 about it, because you have to pay the cost of
17 removal in whatever the dollar values are at the
18 time that the facilities are retired. So inflation
19 is part of the process, and it's taken into account
20 here without regard to this discounting. The
21 discounting must also be taken into account to cover
22 all of the cost. In other words, that's part of the
23 \$500 of cost of removal that I assumed in this case.

24 Q. (MR. PEARCE CONTINUING) Just one quick
25 question, Mr. Jeter. I think, if I heard correctly,

1 you may have misspoken. In the upper part where you
2 said the figure at the bottom of the plant
3 retirement comment, I think you said 1,000 as I
4 heard it. I think you meant 10,000?

5 A. Yes, definitely. It's the total cost of
6 the plant.

7 Q. Would you please comment on Mr. Majoros'
8 discussion of FAS 143?

9 A. Yes. The new accounting standard will
10 cause Montana-Dakota and other companies to change
11 their accounting for retirement obligations.
12 Mr. Majoros indicates that when companies do not
13 have the asset retirement obligations described in
14 FAS 143, quote, these costs will likely be expensed,
15 end quote. If a company does not have such costs, I
16 do not understand what it is that he would have
17 them -- expect them to expense. He mentioned
18 yesterday, if I understood it right, that the
19 principles of SFAS 143 are that you expense the
20 costs as they're incurred and, to the contrary, 143
21 is aimed directly at expensing the cost of retiring
22 facilities during their life, over their life. And
23 that's done as I attempted to show in the simple
24 example. In talking about this, he talked about
25 only the present value being recognized and that

1 would not recognize all of the cost.

2 In addition, his comments on lines 17 to 18
3 about measuring those costs at their present value,
4 not the future inflated value, suggests a
5 misconception. I don't know why, but he seems not
6 to believe that the full amount of those costs needs
7 to be recovered. The requirements of SFAS No. 143
8 are to estimate the future cash flow as expected to
9 be spent removing facilities retired and to discount
10 those amounts to present -- current present values.
11 The requirements -- the required computations
12 specifically include an adjustment for inflation.
13 That's covered in paragraph A20 of this document
14 called Statement of Financial Accounting Standards
15 No. 143.

16 Mr. Majoros is apparently mixing the
17 effects of inflation with the discount rate used to
18 discount the future cash flow to present values.

19 Q. Do you agree that GAAP does not control
20 ratemaking as he asserts on page 13, line 2?

21 A. Regulatory agencies are not required to
22 follow the specifics of each accounting standard.
23 Because of this, Statement of Financial Accounting
24 Standards No. 71, accounting for the effect of
25 certain types of regulation, provides for the

1 accounting necessary to reflect the effects of such
2 regulatory actions. However, I do not think that
3 anyone knows whether the FERC or the various state
4 regulatory agencies will follow this new accounting
5 in setting rates as he suggests will be done.
6 Frequently, these agencies have decided to retain
7 the accounting for ratemaking that they have been
8 using when the FASB publishes a new standard. I
9 believe that is something yet to be decided.

10 Q. Is FSA-143 relevant then in this
11 proceeding?

12 A. Well, I believe it is. And the Commission
13 could rule in this proceeding as to the method
14 Montana-Dakota should use in the future for
15 recording asset retirement obligations and the
16 related operating expenses and how such items should
17 be treated for ratemaking purposes. However, it is
18 possible that the Commission will prefer to deal
19 with the question in a ratemaking -- in a
20 rulemaking-type proceeding involving all of its
21 jurisdictional companies. If it is ultimately
22 decided that the provisions of SFAS No. 143 are to
23 be used for ratemaking, it is obvious that those
24 provisions are relevant. If existing practices are
25 retained, the company must still comply with SFAS

1 No. 143 and difference must be accounted for under
2 the provisions of SFAS No. 71.

3 Now, I should mention at this point that
4 this simple example that we went over doesn't begin
5 to recognize the complexities of applying this in
6 real life. The assumption, for instance, that this
7 is a plant that is built and the entire amount is
8 retired 10 years later doesn't apply to things like
9 mains and services and telephone poles, and so on.
10 Those things tend to be retired over a very long
11 period before and after their average lives. So the
12 computations involved -- and the document allows
13 shortcutting so that you may be able to make the
14 computations based on an average life even though
15 you know that the lives of individual items in a
16 group property will be very different. It does add
17 a great deal of complexity to accounting for these
18 items and I think it would add a great deal of
19 complexity to the ratemaking function to wade
20 through this kind of accounting each time a company
21 asks for a rate change or each time you asked a
22 company to change its rates.

23 And so I do think this is something that
24 really is better dealt with in a rulemaking
25 proceeding as the company has already asked to have

1 done rather than in a rate case. But it's relevant
2 because Mr. Majoros brought it into the case. I
3 responded to it only because he had talked about it.

4 Q. Would you please comment on Mr. Majoros'
5 recommendations concerning SFAS-143?

6 A. Yes. The cost of removal charged to
7 customers already includes the legal asset
8 retirement obligations defined in SFAS No. 143.
9 However, I believe the Commission may require the
10 company to provide for similar obligations that may
11 not meet that definition and those costs should also
12 be included in cost to service. I certainly do not
13 agree that, quote, The company's experience suggests
14 that it does not have any such obligations, end
15 quote, as Mr. Majoros states at the top of page 14.
16 The definition of a, quote, legal obligation,
17 unquote, in FSAS 143 is quite broad and includes
18 entity promises to a third party, which may include
19 the public at large, about its intention to perform
20 retirement activities. Paragraphs A2 and A3 of the
21 statement discuss that.

22 I do not agree with his comment on page 14
23 at lines 3 and 4 that, quote, the costs should be
24 measured at their net present value, unquote. My
25 Exhibit JAJ-2 shows why that shouldn't be done. If

1 rates are set based on the SFAS 143 procedures, the
2 company must be allowed to recover depreciation of
3 the present value of future net negative salaries
4 and the accretion of the liabilities for asset
5 retirement obligations. The sum of these two
6 elements of cost is equal to the undiscounted cost
7 of removal and both must be recovered to compensate
8 the company for costs it is required to pay when
9 costs are recorded as required under the provisions
10 of SFAS No. 143. Here again, Mr. Majoros seems to
11 be mixing the discounting and the effects of
12 inflation. I believe both should be taken into
13 account in setting rates.

14 One thing I'd like to add right here. We
15 haven't talked about the rate base effects, but,
16 obviously, if additions are made to plant to set up
17 the obligation, you would probably need to consider
18 whether or not those additions are included in rate
19 base and whether that obligation is an offset. I
20 think theoretically that would be the proper
21 approach, but there are other ways that could be
22 considered. In any event, I did not talk about the
23 rate base treatment, but it would have an impact
24 because of that growing obligation and the straight
25 line depreciation on the other side. So it's

1 something to be considered.

2 I do not know how the five-year rolling
3 average expensing approach Mr. Majoros recommends on
4 lines 4 to 9 of page 14 works. However, as I
5 explained above, if the Commission elects to follow
6 the provisions of SFAS 143 in setting rates, the
7 costs that need to be recovered are the depreciation
8 present value of the asset retirement obligation,
9 plus the accretion applicable to the present value
10 obligation. That accretion must be expensed each
11 year to adjust the net present value of the
12 obligation to the new current level. The
13 depreciation would be the same each year for any
14 specific obligation, but the accretion would
15 increase over time. Consequently, it would be
16 appropriate to use -- or it could be appropriate to
17 use a projected average amount over several years in
18 order to allow the recovery of the total of the two
19 parts required to be recorded under the provisions
20 of SFAS No. 143.

21 If the Commission elects to continue to
22 follow the practices it currently follows, then the
23 differences between the two methods should be
24 recorded as a regulatory asset or liability. The
25 differences would be between, one, the recovery of

1 the estimated net salvage on the existing basis and,
2 two, the expensing of depreciation of the
3 capitalized present value of the asset retirement
4 obligation, plus the accretion that must be recorded
5 under the provisions of SFAS No. 143 beginning in
6 2003. In the long term, the amounts allowed would
7 be the same, but the timing of the expense would be
8 different under SFAS No. 143 for what -- from what
9 it has been under Generally Accepted Accounting
10 Principles.

11 In other words, like so often has happened
12 in the past for deferred income taxes and other
13 items that have been handled differently for
14 regulation, there would be an adjustment made on the
15 books to recognize the difference caused by
16 ratemaking not being exactly in agreement with the
17 other General Accepted Accounting Principles.

18 Q. Is there any basis for the depreciation
19 recommendation shown on Mr. Majoros's Exhibit MJM-7?

20 A. No. Mr. Majoros has ignored the previous
21 depreciation study with regard to negative net
22 salvage and has also reduced the recommended
23 provision for depreciation for 2003 by \$848,000
24 based on a five-year average of salvage value he
25 obtained from the company. A review of the data

1 shown on his Exhibit MJM-6 makes it clear that this
2 five-year summary is not reliable for the use he
3 made of it. If this is the five-year average he
4 recommended on page 14, lines 4 to 8, I strongly
5 disagree with his recommendation. As discussed
6 earlier, there are large amounts included in the
7 exhibit which are not recurring, such as the four-
8 million-six sale of the office building and should
9 not be included in any case. That transaction is
10 unlikely to be repeated every five years. Because
11 of this and other problems with this approach, it
12 should not be considered.

13 Now, I have prepared a schedule that might
14 help understand how that \$848 amount was worked into
15 his depreciation recommendation, and this is Exhibit
16 29. Most of this exhibit comes from Mr. Majoros'
17 Exhibit MJM-7, which is near the back of his
18 testimony. The column A just shows the average
19 plant. And if you look at the bottom of page 1 of
20 MJM-7, you can see that it totals to 68 million --
21 excuse me. I'm in the wrong column. The average
22 balance is 68,870 -- excuse me -- 68,787,446. And
23 I've taken the very detailed schedule and summarized
24 it to show distribution and general separate from
25 common. And the common facilities have to be

1 summarized from his schedule and that's done in note
2 2 at the bottom, that the schedule shows
3 5,381,000.03, and 1,768,000 separately on the
4 schedule. So you must summarize those to get to the
5 total, and then there's a little bit of amortization
6 other in that plant and that's \$299.

7 Similarly, on the second page of his
8 exhibit, the annual depreciation for the year 2001
9 that he recommended is shown and it's been
10 summarized in much the same manner. The 1,291,000
11 is the top line on his exhibit and then I've
12 combined numbers to arrive at the general and the
13 common plant and then the \$7 of amortization plant
14 is added and that agrees with his 2,079,802.

15 Then for the year 2003 on his Schedule
16 MJM-7, page 3 of 3, this is what was being discussed
17 yesterday with some confusion about how we got from
18 where we are to where he recommends. I've again
19 summarized from his schedule and here his numbers
20 are much more summarized, but the total depreciation
21 at that stage of his 2003 recommendation is
22 1,937,000 as shown at the bottom of column C. More
23 importantly, the annual salvage which he determined
24 on his MGM-6, which is the exhibit just ahead of the
25 one we've been looking at, is \$848,010. He arrived

1 at that by adding to the natural gas plant about 50
2 percent of the common plant to come to a total five
3 years that he attributed to natural gas of
4 4,240,000. And, again, this includes that
5 four-million-six sale of a building, but at this
6 stage only to the extent of about 50 percent,
7 because he has allocated part of it to electric and
8 part of it to natural gas.

9 And I've taken his computation and broken
10 it down. In that four-million-two is included the
11 1,444,000 of natural gas plant and when you divide
12 that by five years, it's \$288,898. And I've taken
13 that up to show in total for distribution in general
14 of \$289,000. That reduces the provision for
15 depreciation in his recommendation. And you can see
16 that happening between columns C and E. Then the
17 rest of that 848,000 is common facilities. And he
18 would have us deduct \$559,000 of salvage with
19 respect to common properties which have a
20 depreciation provision of \$440,000 so that the
21 provision for common properties would end up being a
22 negative \$119,000 in a year. But that all adds into
23 the total that he did recommend of \$1,089,000, and
24 that is shown as the very last figure on page 3 of 3
25 of MJM-7.

1 Now, I just thought it would help to run
2 through those numbers. I apologize for the details,
3 but I think that it does help understand what it is
4 that's being proposed.

5 Mr. Majoros -- now, some of this will be a
6 bit repetitive. Mr. Majoros also allocated the
7 common property amounts between electric and gas
8 utilities based on the salvage amounts for each of
9 them separately, which is not the basis used by
10 Montana- Dakota for the allocation of common plant
11 costs. I think it overstates somewhat the amounts
12 attributed to natural gas based on information I've
13 received from the company, but I can't quantify that
14 for you. In any case, he did not support his
15 allocation, other than to say that it was allocated
16 based on the amounts of salvage.

17 The net result of Mr. Majoros' adjustments
18 would be a 2,172,000 reduction in the amount allowed
19 for depreciation to an amount of 1,089,000. His
20 proposed adjustment would be over 71 percent of the
21 amount currently being recorded by the company. The
22 proposed adjustment is not supported by any evidence
23 and should not be approved. On page 14, lines 16 to
24 17, Mr. Majoros states that these adjusted rates,
25 quote, are still excessive because they're based on

1 lives that are too short. They are conservative
2 from the ratepayers' perspective, end quote.

3 I do not believe that what Mr. Majoros
4 means by -- excuse me. I do not understand what
5 Mr. Majoros means by conservative, but, in my
6 opinion, his proposed rates are not conservative
7 from any standpoint. Any further reduction would
8 make them even less conservative. With the net
9 salvage adjustment he made, the overall average rate
10 he is proposing is 1.58 percent. It cannot be
11 considered conservative in any way. It is almost
12 certainly inadequate.

13 Q. Would you please summarize your testimony?

14 A. Yes. No adjustments in depreciation rates
15 should be entertained until the current depreciation
16 study is completed and an appropriate review has
17 taken place. Current rates are based on a
18 comprehensive study prepared in 1991 and used again
19 in 1994. Mr. Majoros has not done a depreciation
20 study and has no basis for suggesting the changes in
21 depreciation rates he is proposing. His review of
22 the depreciation rates currently in effect is
23 entirely superficial and contains many errors.
24 Thus, the depreciation rate should not be changed
25 based on Mr. Majoros' proposal.

1 Q. Mr. Jeter, did you prepare Exhibits 29 and
2 30?

3 A. Yes, I did. Well, Exhibit 30 has
4 information I received from the company. I prepared
5 the summary.

6 Q. Right. The first page?

7 A. Yes.

8 MR. PEARCE: I will offer Exhibits 22, 29,
9 and 30 at this time.

10 MR. HOBERG: Any objection?

11 MR. BINEK: Well, I do have an objection to
12 Exhibit 30. According to testimony of the witness,
13 the response to the data request that was submitted
14 to the consultant was misleading. And may I ask a
15 question of the witness?

16 MR. HOBERG: Yes.

17 BY MR. BINEK: Is it correct that the
18 information was never provided to Mr. Majoros?

19 THE WITNESS: Well, first, I'd like to say
20 I don't think it was intentionally misleading. I
21 think it just happened to be because of the way
22 those schedules were prepared. I think the company
23 probably thought that he had all the information he
24 needed. However, he didn't, and it was
25 understandable, in my opinion, that he didn't

1 realize that that was there. However, I mentioned
2 it in my testimony so he has been aware of it since
3 my testimony has been filed.

4 MR. BINEK: But that information was never
5 provided to him, was it, to your knowledge?

6 THE WITNESS: Not to my knowledge. Could
7 have been. I don't know.

8 MR. BINEK: I will object to --

9 MR. PEARCE: What's the basis for the
10 objection? That doesn't go to admissibility.

11 MR. BINEK: The information that this
12 exhibit relates to is based on information that was
13 requested by the Commission consultant and was never
14 provided to him in the response to his request.

15 MR. HOBERG: You're not saying it's not
16 relevant now?

17 MR. BINEK: I'm just saying that it has
18 been brought into this proceeding at this time
19 without having previously been provided to us, even
20 though the information contained in it was
21 requested.

22 MR. HOBERG: Mr. Pearce.

23 MR. PEARCE: Well, it's certainly relevant.
24 That doesn't go to the question of relevancy. As
25 Mr. Jeter pointed out, his rebuttal testimony does

1 state that there was, in fact, a million-four in net
2 salvage in the services account so that would have
3 given Mr. Majoros, I would think, the opportunity to
4 request a data basis for that statement.

5 MR. HOBERG: Okay. Well, I think it's
6 something that's certainly relevant and helpful to
7 the Commission to have at this point. Do you need
8 some chance to respond further to that then,
9 Mr. Binek?

10 MR. BINEK: May I ask the witness another
11 question?

12 MR. HOBERG: You may.

13 MR. BINEK: Does this information change
14 Exhibit MJM-6?

15 THE WITNESS: I don't think it would.

16 MR. BINEK: Thank you. I will withdraw the
17 objection.

18 MR. HOBERG: Okay. Thank you. I'll admit
19 Exhibits 22, 29, and 30 then. Does that conclude
20 the questions of Mr. Jeter?

21 MR. PEARCE: Yes, it does.

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

23 Mr. Binek, did you have some questions of
24 Mr. Jeter?

25 MR. BINEK: Yes.

1 CROSS-EXAMINATION

2 BY MR. BINEK:

3 Q. Mr. Jeter, on page 3 of your testimony you
4 state that you've testified before the FERC, the ICC
5 and a number of state regulatory commissions on
6 depreciation and a number of other accounting
7 issues. Have you ever sponsored a full depreciation
8 study?

9 A. No. Not the kind of study that was done in
10 this case. I have in natural gas pipelines cases
11 where the natural resource declines were involved
12 and that was basically a unit of reduction approach,
13 but I have not done a statistical curve-fitting type
14 of studies.

15 Q. Okay. Thank you.

16 MR. BINEK: I guess could we go off the
17 record for just a moment?

18 MR. HOBERG: Let's go off the record,
19 please.

20 (Discussion off the record.)

21 MR. HOBERG: Back on the record.

22 Q. (MR. BINEK CONTINUING) Mr. Jeter, on page
23 4 you state that AUS Consulting is due to make a
24 complete depreciation study by December 31, 2002.
25 What is the purpose of that study?

1 A. Well, that information was given to me by
2 the company, obviously. My assumption is that it
3 would be a complete update of the depreciation work
4 done in 1991. And, by the way, I don't know that
5 there's any reason to expect very much change since
6 1991. There may be, but I don't know of any reason.

7 Q. Why wasn't a depreciation study done prior
8 to the filing of this rate case?

9 A. I don't know. You'd have to ask one of the
10 company witnesses.

11 Q. Okay. If that new depreciation confirms
12 Mr. Majoros's suspicion that MDU's depreciation
13 rates are too high by approximately \$2 million, is
14 it MDU's intention to file for a rate reduction?

15 A. I also don't know that, but I do think that
16 could be answered by one of MDU's subsequent
17 witnesses.

18 Q. Would you agree that if depreciation rates
19 are significantly changed as a result of the study,
20 those changes, whether up or down, should be
21 reflected in rates?

22 A. Yes. I think the rate change should
23 coincide with the changes in the depreciation being
24 recorded by the company.

25 Q. So, basically, by deferring this study

1 until December 31, 2002, MDU will be asking this
2 Commission to conduct two rate cases in the space of
3 six months; is that correct?

4 A. If the decision were made to reflect those
5 new depreciation results, assuming they change the
6 amounts -- I guess I should say assuming they change
7 the amounts significantly, then there might be a
8 need to review that study and then adjust rates for
9 the company to reflect whatever change that made in
10 the cost of service, but that would obviously be
11 somewhat limited compared to a full-blown rate
12 proceeding, I would think.

13 Q. Please turn to page 6 of your testimony and
14 read the sentence beginning on line 1.

15 A. By ignoring that fundamental purpose of
16 depreciation, Mr. Majoros is effectively proposing
17 that the depreciation rate should vary from time to
18 time depending upon the amount of cash the company
19 is investing in projects deemed by Mr. Majoros to be
20 beneficial to ratepayers.

21 Q. Where in his testimony does Mr. Majoros
22 make this proposal?

23 A. I think this is just a corollary to what
24 he's saying. He has talked a great deal about cash
25 flow. But he's not mentioned the fact that the cash

1 requirement for plant comes when the plant is built
2 or purchased. And that's a cash flow that's already
3 taken place. The cash flows for depreciation are
4 the recovery of those amounts over the life of the
5 plant. And some of that cash may be required to pay
6 off debt that was incurred when the plant was built.
7 That hasn't been mentioned. But that's one of the
8 things that must be done.

9 To the extent that the facilities have been
10 built with equity funds, retained earnings, or newly
11 acquired equity, those investors also require the
12 recovery of their funds. Now, they may recover the
13 funds from one plant facility, reinvest it in the
14 company through retained earnings and invest it in
15 another facility, but that's the way that works.
16 And to suggest that the cash flow from depreciation
17 is just free and there's nothing else to do with it
18 isn't correct.

19 And I think the thrust of what he was
20 saying -- although, he said at the beginning it's
21 not the way you set depreciation rates, you don't
22 make these cash flow comparisons, but then he
23 proceeded to make the comparison and suggest that
24 the customers are spending all of the money that's
25 being spent for facilities. That's not the case.

1 And I don't think he made that case and, therefore,
2 you have to kind of assume that he's suggesting some
3 new change in approach. That's all that whole top
4 of that page is talking about.

5 Q. Would you please turn to page 6 of
6 Mr. Majoros's testimony and read the question at the
7 top of the page?

8 A. Is depreciation intended to finance plant
9 addition?

10 Q. What is the first word of Mr. Majoros'
11 answer?

12 A. No. Now, I just mentioned that he said
13 that.

14 Q. On page 8, at lines 17 through 20, you
15 accuse Mr. Majoros of ignoring net salvage as a
16 component of depreciation. Where in his testimony
17 did Mr. Majoros assert that net salvage should be
18 ignored?

19 A. Well, he took it out. The net salvage that
20 was being recorded as a result of the 1991 study was
21 removed from his computations of depreciation, as I
22 understand it.

23 Q. What do you think the 848,000 is?

24 A. Well, four-million-six of it divided by 2,
25 roughly, is the sale of the building, which really

1 doesn't have a lot to do with the salvage and the
2 net salvage on services and mains. And it seems to
3 me that if one proposes to take a five-year snapshot
4 and divide that by five and use that over the next
5 five years, then you must think that that is going
6 to be repeated in the next five years. Otherwise,
7 you're not doing something that makes any sense at
8 all.

9 Q. But is that net salvage?

10 A. I don't think it's going to be repeated in
11 the next five years.

12 Q. Is the number that Mr. Majoros used net
13 salvage?

14 A. It is, but it's not salvage in the sense of
15 a depreciation study reflecting the salvage
16 applicable to the facilities involved over the life
17 of the facilities. It gets away from the whole
18 concept of depreciation and the concept under the
19 new Financial Accounting Standard in 143, which is
20 clearly not to recognize this thing based on some
21 average of some short period. It's to recognize
22 them based on the life of the facility and the
23 expected cost at the end of its life to remove those
24 properties or the expected credit in the event that
25 there is, in fact, positive salvage.

1 Q. In fact, does Mr. Majoros include net
2 salvage in his final depreciation recommendation
3 only as positive rather than negative salvage?

4 A. Yes. Well, he included net salvage and it
5 was positive. I mean, because of the period he
6 selected and some of the extraneous items included
7 in that period.

8 Q. On page 9 you take issue with Mr. Majoros'
9 observation that the Supreme Court found that
10 excessive depreciation resulted in extraction of
11 capital contributions from ratepayers. Is it
12 possible to have excessive depreciation of the
13 original cost of an asset or group of assets?

14 A. I have to know what you mean by
15 "excessive."

16 Q. How would you define excessive
17 depreciation?

18 A. Well, if you mean is it possible to have
19 estimates of the life of a facility that turn out to
20 be wrong and turn out to be wrong because they're
21 too short, then some would say that would generate
22 an excessive amount of depreciation expense in the
23 ratemaking situation revenues to cover that expense.

24 But the excess depreciation in that
25 situation, and this is assumptions that -- we say

1 the life is going to be 20 years and then we
2 discover after the plant has been in service for 10
3 years, that it's going to be 15 or 25. If it's
4 going to be 25, then you could say that was
5 excessive. It may not have been. The life used
6 during that first period might be exactly right in
7 terms of the best estimate you could get, but when
8 you get better estimates of what the life is, you
9 should adjust. And the typical method of adjusting
10 depreciation is over the remaining life of the
11 facility.

12 Q. If a utility depreciates a category of
13 plant on the basis of 140 percent negative net
14 salvage when the negative net salvage is, in fact,
15 only 15 percent, would that constitute excessive
16 depreciation?

17 A. It might if you accept your assumption.
18 Those are both assumptions. One of them is an
19 estimate made by somebody using judgment and
20 historical facts, and so forth, and the other is
21 just an assumption of 15 percent being the right
22 answer. If that 15 percent were to be the amount
23 determined in a new depreciation study, then I would
24 say that you could say that that had been excessive,
25 but only based on saying we made a wrong estimate in

1 the past, not based on the fact that we know more
2 now and we're adjusting our estimate. So there's a
3 fine line between whether it's really excessive or
4 it's excessive relative to what you would be
5 thinking it should be in the future.

6 Q. On page 11 of your testimony you purport to
7 demonstrate that since 1995 the depreciation which
8 Mr. Majoros claims to be excessive would by now have
9 paid for itself in the form of rate base deductions;
10 is that correct?

11 A. In effect, that's a short way of saying it,
12 I guess.

13 Q. Did you quantify your rate base deduction
14 by multiplying Mr. Majoros' \$2.172 million
15 depreciation expense adjustment by the eight years
16 that have transpired between 1995 and 2002?

17 A. Yes.

18 Q. Mr. Majoros' correction is to eliminate the
19 negative salvage and to amortize positive salvage
20 over five years; isn't that correct?

21 A. That's my understanding, yes.

22 Q. What makes you believe that Mr. Majoros'
23 adjustment, if applied in 1995, would have amounted
24 to 2.172 million?

25 A. Well, I emphasized the word "rough" when I

1 started on this. I did not attempt to go back and
2 figure out what Mr. Majoros' adjustment would have
3 been had he made it in '95. I think that's clear
4 from the way I described it. But I would admit that
5 had he made a similar adjustment back in 1995, it
6 probably would have been somewhat less because there
7 was less plant at that time. I think. Now, I did
8 not do that. This is very rough. It's an example
9 more than anything.

10 Q. Well, Mr. Majoros would not have included
11 the \$848,000 in positive salvage because it didn't
12 occur until 2001; isn't that correct?

13 A. I don't know what the positive salvage or
14 negative salvage would have been or what five-year
15 period he would have chosen.

16 Q. MDU's gas distribution plant was a smaller
17 total amount in 1995; would you agree?

18 A. Yes. And I already said that would have an
19 impact. I did not calculate it.

20 Q. And so the elimination of negative net
21 salvage would have been a correspondingly smaller
22 amount, wouldn't it?

23 A. Probably. I don't know. I haven't looked
24 at it.

25 Q. Wouldn't the result have been a rate base

1 offset somewhat smaller than the 17.376 million that
2 you ponder on line 4, page 11?

3 A. It might very well have been, yes.

4 Q. On page 12 of your testimony you argue that
5 it would be inappropriate to calculate theoretical
6 depreciation reserves to determine whether a reserve
7 excess or deficiency exists. Are you familiar with
8 the term "remaining life depreciation"?

9 A. Yes.

10 Q. Would you please describe what that term
11 means?

12 A. It involves determining the life of the
13 facility, an estimate of the age of all of the
14 facilities, and thereby arriving at a remaining
15 number of years that you would expect those
16 facilities to exist before they're retired. And
17 then converting that to a rate using the total cost
18 of the facility less the depreciation reserve as of
19 the same day.

20 Q. Does MDU use remaining life depreciation?

21 A. Yes. It's my understanding that that's
22 been done based on what I've read in the 1999 -- '91
23 study.

24 Q. Doesn't remaining life depreciation
25 effectively amortize any reserve excess or

1 deficiency over the remaining life of each category
2 of plant?

3 A. Yes. That's why most depreciation studies
4 don't include trying to figure out what a
5 theoretical reserve will be. It's taken care of
6 over the remaining life in any event.

7 Q. Earlier you discussed R3 Iowa curves. Do
8 you know what a generation arrangement is?

9 A. Yes. I don't know that I could describe
10 it. I've read quite a little bit about it.

11 Q. How do you calculate an average remaining
12 life?

13 A. Well, it's calculated based on the
14 retirement dispersion that is determined using the
15 curves after having determined from the existing
16 data about plant what is the best fit. In other
17 words, the Iowa curves are based on actual evidence
18 of what the lives of various kinds of facilities
19 were. And it was found that using those curves, you
20 could ordinarily find a fit for almost any sort
21 of -- as they referred to them, industrial property,
22 to one of the various curves, the right, left and
23 symmetrical curves.

24 Once that's done, you have a dispersion of
25 the asset retirements that you would expect and you

1 can determine using the remaining life of those that
2 have not already been retired what the remaining
3 life would be to use in that situation. Now, that's
4 a pretty rough discussion of that. I have not done
5 that kind of a study. So I understand what's done,
6 but I'm not an expert on using those studies to do
7 what's done other than on a very broad basis.

8 Q. What is an O curve?

9 A. I don't know.

10 Q. Do you know why an O curve is different
11 than an R curve?

12 A. Did you say L?

13 Q. An O.

14 A. No. I think there have been some
15 additional curves developed. I'm not familiar with
16 the O curve.

17 Q. On pages 13 and 14 and 15 you challenge
18 Mr. Majoros' discussion of service lives for mains
19 and services. Did Mr. Majoros recommend any changes
20 to the service lives underlying MDU's current
21 depreciation rates?

22 A. No.

23 Q. From the standpoint of its impact in this
24 case, your criticism of Mr. Majoros' service life
25 discussion is irrelevant; isn't that true?

1 A. Well, I think it's relevant because I would
2 hate to think that anybody would seriously
3 contemplate a change in depreciation rates based on
4 the 116- and 74-year lives he determined with the
5 only computations he did with respect to service
6 lives. I certainly agree he did not reflect those
7 in his final recommendation. To that extent, it's
8 irrelevant, I would agree, but I don't think I could
9 just not comment on it when I don't think it should
10 be used.

11 Q. On page 21 you argue that if the Commission
12 elects to apply FAS 143 to MDU's cost of removal,
13 there would have to be two elements of expense; one,
14 the depreciation of the annual present value of
15 future expense and, two, the accretion of the
16 asset's value each year; is that correct?

17 A. Yes.

18 Q. You also contend that over the life of the
19 plant both methods recover the same amount; is that
20 correct?

21 A. Yes.

22 Q. Do they recover that same amount at the
23 same rate --

24 A. No.

25 Q. -- that is, is one method front-loaded more

1 than the other?

2 A. The SFAS 143 method would recover plant by
3 increasing amounts over time. It would not be
4 front-loaded. It would be back-loaded.

5 Q. Okay. And the present method is front-
6 loaded?

7 A. The present method is -- I think I would
8 call it level. There are methods --

9 Q. Well, if you have the other method being --
10 what did you refer to -- back-loaded, then isn't
11 this more front-loaded?

12 A. In other words, there is more and more
13 expense over time each year. In the present
14 methodology there's the same amount of expense each
15 year, unless there are changes in estimates. You
16 would have depreciation that is level with respect
17 to it. Now, we should be careful about this,
18 because inherent in this discussion is a discussion
19 about a piece of plant that is installed and then
20 later it's retired, all of it. We have many pieces
21 of plant here that have varying lives, with an
22 average life near the center of that long dispersion
23 period of retirement. And if you superimpose SFAS
24 143 over that kind of a situation, I'm not sure I
25 could even answer the questions, but I think it

1 would still involve back-loading or growing expense
2 over time with respect to any property or group of
3 properties. I frankly haven't looked at that.

4 Q. Is Montana-Dakota Utilities subject to FAS-
5 143?

6 A. It is subject to it when it becomes
7 effective, yes.

8 Q. Isn't it effective now?

9 A. No, it's effective -- well, it's effective
10 for some companies now, but for companies with
11 calendar-year financial statements, it's effective
12 for next year.

13 Q. Does MDU intend to implement FAS 143?

14 A. I certainly think so. They won't be able
15 to file financial statements if they don't.

16 Q. So you agree that the company is going to
17 have to comply with FAS 143 and you talked about the
18 complexity of FAS 143. But since the company does
19 have to comply with it, the records will be
20 available for ratemaking purposes; isn't that
21 correct?

22 A. Sure.

23 Q. I'd like to have you turn to your JAJ-2.
24 If the company did not have a legal obligation for
25 the \$500 removal, then the bottom half of your table

1 would be incorrect; isn't that correct?

2 A. Well, the entire exhibit would be incorrect
3 if they don't -- now, excuse me. You specifically
4 put the legal obligation in there and I now
5 understand your question better. That could be
6 true. And as I mentioned in the testimony, the
7 legal obligation is fairly broadly defined. And if
8 we think about what that means in terms of what a
9 company has to do, it's a little hard to imagine
10 very many things that a company would actually
11 remove at the end of the life if they're not
12 required to do so.

13 Now, there are a lot of people that are
14 making requirements of companies to do that kind of
15 thing. The regulatory agency could probably rule on
16 such things and that makes it become a legal
17 obligation, as I read the new standard. The cities
18 that they deal with who were putting things into the
19 streets and alleys, and so forth, may have something
20 to say about whether those items are removed when
21 they're retired. And it seems to me that with the
22 increased concerns of environmentalists, that's all
23 going in the same direction. We are going to have
24 more and more requirements, rather than less. But
25 if there are things that the company feels it must

1 remove, even though there is no legal obligation to,
2 it would seem to me they would be very limited. I
3 mean, I don't know why they would remove anything if
4 they are not required to do so.

5 Now -- and it isn't just removal. In some
6 cases they could be required to be do something to
7 pipe that's in the ground, for instance, to make it
8 safe, fill it with an inert substance, for instance,
9 or do something like that, and that's cost of
10 removal as well, even though technically you're not
11 removing it, you're taking care of a cost that's
12 your obligation at the end of the life, if you are
13 doing that in accordance with some legal requirement
14 as defined.

15 Q. In your earlier testimony you said that it
16 would cost the same to remove a service as the
17 original cost. Do you think that this company digs
18 up an existing service when it replaces it?

19 A. I don't know, but I should straighten out
20 what I said there, if you didn't hear me earlier.
21 What I meant was, it would cost the same in time.
22 The effort to remove a service might be the same as
23 it is to put it in in the first place. In fact, it
24 may be greater because nowadays a lot of services
25 are plowed in and I don't think you can plow them

1 out if you are required to do the removal.

2 But, in any event, what I really was
3 talking about was not cost the same, but take the
4 same amount of effort, and if it took the same
5 amount of effort, my whole point with that was it
6 might cost a great deal more because of inflation.

7 Q. But only if they have to dig up?

8 A. That's correct. And it isn't enough to
9 determine what it would cost. You've got to
10 determine whether or not it has to be done and, if
11 so, when and under what circumstances.

12 Q. And isn't that one of the important
13 concepts of FAS 143, is that it shouldn't be shown
14 as salvage unless there's an obligation to remove
15 it?

16 A. Well, as cost of removal.

17 Q. Okay.

18 A. I mean, actually, 143 does not discuss
19 salvage. Salvage is to continue to be accounted
20 for.

21 Q. I used the wrong term. Cost of removal.

22 A. Cost of removal is what it's aimed at. And
23 it definitely is saying if you have an obligation
24 because of the use of the facilities, then you have
25 to recognize it. And I don't think there are very

1 many companies that are in business for a profit
2 that are incurring and paying costs of removal that
3 they don't have to pay. I mean, I just don't think
4 that's very --

5 Q. I would agree with that. Are you familiar
6 with the concept of insertion?

7 A. Not unless you define it for me.

8 Q. That's okay. Are you familiar with the
9 concept of abandonment in place?

10 A. Yes.

11 Q. Okay. What is that?

12 A. Well, I earlier talked about abandoning
13 buried pipe, for instance, and in some cases that
14 probably will be allowed and it will just stay where
15 it is. It won't be removed. It may require
16 something being done to it if it is, in fact,
17 abandoned. I know, for instance, in gas
18 transmission facilities, cross-country lines,
19 they're trying to provide for all of the things
20 they're going to be required to do because some of
21 that line is very large and if it decays and rusts
22 out, and so forth, you can have a big cavity there,
23 and so they're faced with some significant amount of
24 costs, but not to remove the line necessarily. They
25 may leave it there, but shore it up so that it's not

1 going to be a problem over a long period of time in
2 the future.

3 Q. That's when they replace it, right?

4 A. Well, replace or abandon. If it's
5 abandoned, that would be more likely. If they
6 replace it, I think in the transmission facilities
7 they typically loop it and put another piece of pipe
8 beside it so they wouldn't necessarily retire it,
9 but if they are retiring it, they might leave it
10 underground or because of right of way and other
11 considerations, they might actually take it out and
12 replace it with other pipe.

13 Q. I'd like to now talk a little bit about
14 this building sale that you've discussed at length.

15 A. Yes.

16 Q. Where was that building?

17 A. Downtown Bismarck. It was the Schuchart
18 building, as I understand.

19 Q. When was that building sold?

20 A. It was the first year of that period, so it
21 must have been in 2001. That's when the sale was
22 recorded. I'm not sure if the accounting -- I would
23 say in as large a transaction as that, that's the
24 year it happened also.

25 Q. What was the original cost of that

1 building?

2 A. I don't know.

3 Q. When was the building purchased?

4 A. I don't know.

5 Q. Why was it sold?

6 A. I don't know.

7 Q. What was the sale price?

8 A. The only information I have on that is the
9 sale price was equal to the net book value at the
10 time of the sale, which means the total cost of the
11 facility that the company has paid for it, less the
12 accumulated depreciation, was equal to the sales
13 price.

14 Q. And what was that net book value at the
15 date of sale?

16 A. Well, it was four-million-six or so. Exact
17 amount I'm not sure.

18 Q. Who was the building sold to?

19 A. I think it was sold intercompany with
20 respect to MDU Resources. Now, I'm not real
21 familiar with that, but I believe it was sold to an
22 affiliate, in any event. Might actually have been
23 another division of the same company. I'm not that
24 familiar with their corporate structure.

25 Q. How did the sale price come to match the

1 net book?

2 A. By agreement, I assume. I don't really
3 know that.

4 Q. Do you know if MDU tried to obtain the
5 market value?

6 A. I have no idea.

7 Q. Would you please provide the journal
8 entries in the company's books that relates to the
9 sale of this building as a late-filed exhibit?

10 A. I don't have access to those. I think
11 somebody else that's testifying after I am can.

12 MR. HOBERG: Is this a request you are
13 making of the company?

14 MR. PEARCE: I think Mr. Keller would be an
15 appropriate witness for that.

16 MR. HOBERG: Do you want to reserve that
17 question for Mr. Keller?

18 MR. BINEK: I can reserve that question,
19 unless the company is willing to provide the
20 information.

21 MR. PEARCE: It's certainly willing to
22 provide, but I think he can clarify exactly what you
23 want and describe it by official title. So I think
24 it might be easier to put in through Keller.

25 Q. (MR. BINEK CONTINUING) You state in your

1 testimony that the other 48 states do not use a
2 current period recognition of net salvage; is that
3 correct?

4 A. I said that this morning, but that's an
5 assumption on my part based on the testimony to the
6 effect that Pennsylvania and Kentucky are doing such
7 things.

8 Q. I'd like to have you turn to page 157 of
9 the 1996 NARUC manual that you've been referring to.

10 A. Yes. I'm sorry. What was the page?

11 Q. One fifty-seven. Would you please read the
12 two paragraphs, the first beginning with the
13 statement, "historically, most regulatory
14 commissions"?

15 A. Historically, most regulatory commissions
16 have required that both gross salvage and cost of
17 removal be reflected in depreciation rates. The
18 theory behind this requirement is that since most
19 physical plant placed in service will have some
20 residual value at the time of its retirement, the
21 original cost recovered through depreciation should
22 be reduced by that amount. Closely associated with
23 this reasoning are the accounting principle that
24 revenues be matched with costs and the regulatory
25 principle that utility customers who benefit from

1 the consumption of plant pay for the cost of that
2 plant, no more, no less. The application of the
3 latter principle also requires that the estimated
4 cost of removal of plant be recovered over its life.

5 Some Commissions have abandoned the above
6 procedure and moved to current period accounting for
7 gross salvage and/or cost of removal. In some
8 jurisdictions gross salvage and cost of removal are
9 accounted for as income and expense, respectively,
10 when they are realized. Other jurisdictions
11 consider only gross salvage in depreciation rates
12 with the cost of removal being expensed in the year
13 incurred.

14 Q. Thank you.

15 MR. HOBERG: Mr. Binek, do you have a
16 number of additional questions?

17 MR. BINEK: No, I don't believe so.

18 MR. HOBERG: About how many do you have
19 left?

20 Q. (MR. BINEK CONTINUING) How often should
21 depreciation studies be done?

22 A. Well, it's a little bit varied around in
23 various jurisdictions. Many jurisdictions require
24 that studies be done on a periodic basis and I think
25 five years would be fairly typical of that. Others

1 don't make any requirements and I think some
2 companies go longer times between. Now, they may
3 have looked at the facilities and decided that there
4 aren't any significant changes in what they are
5 seeing with respect to the lives of facilities, and
6 so forth in their records and, therefore, elect not
7 to do it quite as often. But I would say probably
8 in some cases even three years, but depreciation
9 studies are expensive and so three to five to longer
10 periods are probably fairly typical, but with
11 attention to it much more often than that in terms
12 of just deciding whether or not it is required.

13 MR. BINEK: I have no further questions.

14 MR. HOBERG: No further questions. Let's
15 take a luncheon recess here. I'm wondering, though,
16 what we should take? An hour? Commissioners
17 request an hour.

18 COMMISSIONER WEFALD: 1 o'clock.

19 MR. HOBERG: Let's be back at 1 o'clock.

20 (Lunch recess was taken.)

21 MR. HOBERG: Okay. We're ready, back from
22 the luncheon recess, and I think we were -- we just
23 completed the cross-examination by Mr. Binek.

24 So, Commissioner Reinbold, do you have any
25 questions of Mr. Jeter at this time?

1 MR. HOBERG: Mr. Pearce, did you understand
2 the question and hear it?

3 MR. PEARCE: I'm not exactly sure we
4 understand the question. Give us a moment here.
5 We'll certainly do the best we can. We'll have to
6 check with the other MDU personnel who are not here,
7 but we'll certainly try to prepare what we
8 understand that request to be.

9 MR. HOBERG: So it's possible you'll be
10 able to file a late-filed exhibit on that?

11 MR. PEARCE: Yes.

12 MR. HOBERG: Okay. I don't think we've had
13 any other late-filed exhibits to this point so that
14 would be Late-Filed Exhibit 1, if you will, that
15 information.

16 Q. (COMMISSIONER WEFALD CONTINUING) If this
17 number were less than the planned removal cost of
18 service at 140 percent, do some Commissions take a
19 look at actual removal cost and use those versus
20 what the company has planned through depreciation?

21 A. Well, I would say that most would look at
22 the actual relationship between the cost of removal
23 and the cost of the facility as they're retired, but
24 you almost have to deal with this by vantage. In
25 other words, if some mains were put in in 1968, say,

1 and removed in 1998, you would expect that to be
2 something like what they had estimated in the
3 depreciation study.

4 Q. In this case we're talking about the
5 services, not the mains.

6 A. Okay. Well, and this would be true of
7 either. Let me say services then. They would keep
8 track of how many dollars of plant were involved
9 adding services each year and you almost have to
10 look at it year by year when the retirements are
11 coming out, because, for instance -- and this isn't
12 quite so true for services -- but if something goes
13 in and then two or three years later is taken out of
14 service for one reason or another, I mean, property
15 is destructed or a road moves, any number of things
16 can cause that, then you wouldn't necessarily expect
17 the cost of removal to be what they estimate for the
18 whole life of that group of assets in that vantage.

19 Q. Well, for example, I live in an older
20 neighborhood built in 1915, so we started out with a
21 coal furnace in our house, which was converted to
22 natural gas when natural gas was brought to
23 Bismarck. Do you know the year natural gas was
24 brought to Bismarck?

25 A. Well, I understand it was quite early

1 because I was talking to somebody about the fact
2 that natural gas came into Nebraska in either the
3 late '40s or early '50s, and I understand it was
4 earlier than that here, so it may have been.

5 Q. So let's say it was even 1950 and at that
6 point then my service main was probably installed to
7 my home.

8 A. Yes, I would -- it would have to have been.

9 Q. I've lived in the house since 1970 and
10 there hasn't been any change in my service main
11 during that time so I've been in there 32 years now.
12 So are they anticipating someone is going to be
13 coming out to my house in a couple years and taking
14 out my service main that's underneath my cement
15 driveway?

16 A. I don't know how long the kinds of
17 equipment that might have been installed in the
18 1950s would last, but there's a range of time over
19 which assets are retired and so a 50-year sounds
20 like a long time, but that range may go -- assuming
21 that the average life is 50 years, you could have
22 some of them that last 90 years and some 10, but it
23 would be over that whole range and many of them
24 would be clustered around the 50-year point and it
25 might make sense for that facility to be removed or

1 replaced, or both, because of safety or some other
2 requirement, depending on the condition.

3 It's hard to answer it any better than
4 that, but I think there are those kind of
5 considerations and in a situation like that,
6 assuming that you would continue to use the house
7 and want gas service, there might just be a new
8 service put in and the existing one removed at the
9 same time or secured and not actually taken out of
10 the ground. Because I suspect that 50-year-old pipe
11 is not going to be worth much to anybody. First of
12 all, if you're removing, retiring it, more than
13 likely there's a reason for that and it's not very
14 good stuff and so you wouldn't expect to be able to
15 use it.

16 Q. So your answer to my question is that there
17 is more to look at than the actual removal cost
18 versus the planned depreciation removal costs?

19 A. Well, I think you can look at those things.
20 I just believe you need to look at them in more
21 detail and get down into it and know exactly what it
22 is that you're looking at because there would be
23 varied reasons for things once you got into the
24 details and I think that it's necessary to look at
25 those details.

1 you.

2 MR. HOBERG: Thank you. Any further
3 questions of Mr. Jeter?

4 MR. DILLER: I just have one that I might
5 add on to Commissioner Wefald's.

6 Since we're getting the cost of removal for
7 service signs, I think you said five years,
8 Commissioner. Did I hear that right?

9 COMMISSIONER WEFALD: We know they have put
10 on the record 1.4 million is their cost of removal
11 and I asked how that would compare to what they had
12 planned in their depreciation study.

13 MR. DILLER: I think it would be helpful,
14 too, along with that late-filed exhibit, if we could
15 have the number of service lines retired during the
16 last five years.

17 MR. HOBERG: You want that as a separate
18 exhibit?

19 MR. DILLER: However they want to do it.

20 MR. HOBERG: Late-Filed 2 then. Is that
21 possible?

22 MR. PEARCE: Sure.

23 MR. HOBERG: Thank you, Mr. Diller. Any
24 further questions of Mr. Jeter? Mr. Binek?

25 MR. BINEK: Yes, I have one.

1 FURTHER CROSS-EXAMINATION

2 BY MR. BINEK:

3 Q. You said that you incurred 1.4 million in
4 cost of removal; is that correct?

5 A. Yes. Now, I think somebody said five
6 years. That data was actually from '95 to 2001, so
7 it's actually seven years.

8 Q. Okay. But those were the costs incurred by
9 the company. What were the amounts that the company
10 collected for salvage?

11 A. I think that's the same question as we were
12 just discussing. I don't know because I don't know
13 the amount of the plant that was retired, nor how
14 old it was so I can't answer that question, but I do
15 think that that would be answerable with the
16 additional data in the late-filed exhibit, if I
17 understand what's been asked for.

18 MR. BINEK: I would ask that that be
19 included in that data.

20 COMMISSIONER WEFALD: And, actually, if
21 it's supposed to be seven years, I would appreciate
22 that. I'm sorry. I didn't realize. '95 through
23 2001 is seven years.

24 THE WITNESS: That doesn't match his
25 exhibit, but that's what the data was that I got.

1 MR. HOBERG: Mr. Pearce, did you get that?

2 MR. PEARCE: Yeah, that's fine. I have one
3 redirect question, too.

4 MR. HOBERG: Okay. Does that conclude
5 yours, Mr. Binek?

6 MR. BINEK: Yes.

7 REDIRECT EXAMINATION

8 BY MR. PEARCE:

9 Q. Mr. Jeter, in the course of your cross-
10 examination you were asked to read two paragraphs
11 from a NARUC manual. Would you comment on the
12 content of that paragraph and add any additional
13 information you might wish?

14 A. Yes. The sense of that was that their
15 gross salvage and cost of removal are to be
16 reflected in depreciation rates and that it's
17 difficult to estimate and that some Commissions have
18 abandoned the procedure and moved to a current
19 period accounting. And I just want to say that I
20 think that's absolutely wrong for the reasons I
21 talked about earlier, because it doesn't reflect
22 those costs over the proper period and get the right
23 customer charged with those costs over the life of
24 the facility that's involved.

25 And then I'd also like to read in the

1 paragraph that followed the ones that I did read.
2 It says, Determining a reasonably accurate estimate
3 of the average or future net salvage is not an easy
4 task. Estimates can be the subject of considerable
5 discussion and controversy between regulators and
6 utility personnel. This is one of the reasons
7 advanced in support of the current period accounting
8 for these items. When estimating future net
9 salvage, every effort should be made to ensure that
10 the estimate is as accurate as possible. Normally,
11 the process would start by analyzing past salvage
12 and cost-of-removal data and by using the results of
13 this analysis to project future gross salvage and
14 costs of removal.

15 And the reason I'm very much opposed to
16 this is the reason that the Financial Accounting
17 Standards Board has issued its new SFAS 141. They
18 are deadset on recognition of these costs over the
19 life of the facility, not at the end of the life.
20 And if you think of that in terms of a nuclear
21 generating station, you can see why. Because if you
22 wait until the end of the life of a nuclear plant
23 and then put that cost of removal into the rates at
24 that point, you're charging the future customers, if
25 you can recover, rather than those that benefited

1 from the use of the nuclear plant during its life.
2 And that's just plain wrong, as far as I'm
3 concerned, from a regulatory standpoint. And it's
4 easier to understand with a nuclear plant, but it's
5 the same thing with others. It's much more
6 difficult to estimate some of these lives of mass
7 properties where they retire over long periods of
8 time, but it's still doable and it's certainly worth
9 the effort in order to get the costs recognized at
10 the time that those properties are serving
11 customers.

12 MR. HOBERG: Mr. Jeter, did we get in the
13 record what you were reading from again?

14 THE WITNESS: I'm sorry. I was reading
15 from page 157 of the NARUC Public Utility
16 Depreciation Practices Manual, dated August 1, 1996.

17 MR. HOBERG: Thank you.

18 THE WITNESS: And it was -- the part I read
19 was the fourth paragraph on that page and it
20 continues on page 157 and it continues on the next
21 page.

22 Q. (MR. PEARCE CONTINUING) Just one thing. I
23 think you misspoke. You said 141 and you meant 143,
24 FAS?

25 A. Did I say 141? I'm sorry. Yes, SFAS 143.

1 DIRECT EXAMINATION

2 BY MR. PEARCE:

3 Q. Mr. Keller, you previously identified
4 yourself and gave your position with the company, I
5 think, yesterday. And you have filed some rebuttal
6 testimony in this case. I would ask if you could
7 simply summarize the main points of your written
8 rebuttal testimony and then add anything that you
9 feel is a part of rebuttal to the staff's case.

10 A. Sure. I would like to start by addressing
11 the capital structure and costs of debt that was
12 used by Mr. King. And I'd like to start by just
13 making sure that when we use the name MDU Resources
14 Group or Montana-Dakota, that we understand that
15 they're the same legal entity and that the balance
16 sheet is the same. MDU Resources Group in essence
17 is really a separate cost center within that legal
18 entity where we track the costs for our resources
19 group and we allocate those to our different
20 businesses. So, you know, when we talk about
21 Montana-Dakota, we talk about MDU Resources Group's
22 balance sheet, we're talking about the same thing.

23 And I think it's in this statement,
24 Statement A, where Mr. King tries to, I should say,
25 connect the dots between Centennial's debt and

1 MDU's. He looks at Statement A and on page 1 where
2 we have the unconsolidated balance sheet of MDU
3 Resources Group and he's using that to connect to
4 the consolidated footnotes in that same schedule.
5 And the difference between a consolidated balance
6 sheet and an unconsolidated balance sheet is that
7 MDU's unconsolidated balance sheet does not reflect
8 the assets and liabilities of the subsidiary
9 companies. It only reflects the investment MDU has
10 made in those companies. On the consolidated
11 balance sheet it would reflect all the assets and
12 liabilities of those companies and in essence you'd
13 have a grossed up balance sheet of all the assets
14 and liabilities of the corporation.

15 In Statement A, page 1 of the balance
16 sheet, that only reflects the unconsolidated balance
17 sheet of MDU. However, when we go to pages, I
18 think, 3 through 29, which are the footnotes, those
19 reflect the consolidated footnotes of the company,
20 the ones that were attached to the company's annual
21 report. On page, I think, 11 of that, footnote 6,
22 it lists the long-term debt, including Centennial's,
23 on which it would be listed because it's a
24 consolidated balance sheet. And Mr. King implied
25 that that debt was part of the unconsolidated

1 balance sheet of MDU and that's not correct. That
2 would be Centennial's debt and is not really part of
3 Montana-Dakota's individual balance sheet.

4 Yesterday King made a statement that MDU
5 was attempting to build, quote, a firewall around
6 MDU to separate the debt of Centennial from MDU.
7 And that is exactly what MDU is trying to do. And
8 I'd like to explain to you the reasons for this and
9 why I believe the Commission should support MDU in
10 its efforts. In questioning Witness King,
11 Commissioner Wefald raised a concern as to the
12 negative effect a bad business decision at
13 Centennial, one of its companies, would have on MDU
14 and its cost of debt. And, quite frankly, MDU, as
15 well as the rating agencies, are also concerned
16 about this. The concern is that bad decisions made
17 at Centennial Energy or one of its subsidiary
18 companies could cause default or cause a bankruptcy
19 that could roll up into Montana-Dakota or MDU. And
20 what we're trying to do is prevent this from
21 happening.

22 One of the things that -- we heard Mr. King
23 use the term "firewall." The same kind of
24 philosophy or term is used by the rating agency.
25 They call it ring fencing and attorneys call it

1 bankruptcy proof, but what we're trying to do is
2 protect the assets and the customers of MDU from our
3 nonregulated businesses. And the concern we have is
4 that in the event that there were a default at
5 Centennial or one of its companies, we do not want
6 that to cause a default of MDU. Likewise, if there
7 was a bankruptcy at MDU -- at Centennial, we do not
8 want a bankruptcy judge to have the ability to
9 collapse the corporation and provide the creditors
10 of Centennial or the subsidiaries of Centennial, we
11 do not want them to have access to the assets of the
12 utility. We want to protect our customers from this
13 happening.

14 And there's some things we can do. And one
15 of them is we need to keep separate and distinct
16 books from Centennial, which we currently do. We
17 need to conduct the business of the utility in a
18 manner that is clearly distinguishable and separate
19 from the operations of Centennial, and we do that.
20 MDU does not participate in a money pool or
21 comparable intercompany fund arrangement with
22 Centennial. This means that MDU does not commingle
23 its corporate funds with those of Centennial. It
24 means that MDU and Centennial maintain their own
25 distinct and separate credit facilities. Neither

1 have access to the other's credit agreements. To
2 further strengthen this point, MDU does not lend
3 funds or otherwise extend credit to Centennial, and
4 Centennial does not do the same back to MDU.

5 Mr. King stated yesterday in his testimony
6 that all debt is raised and issued by MDU and is
7 simply pushed down to Centennial and the
8 subsidiaries of Centennial, and this is not correct.
9 A first mortgage lien of MDU's electric property and
10 gas is what's used to secure the long-term financing
11 for MDU. The only property that can be pledged
12 under this is qualifying utility property, and this
13 is our electric and gas property. Centennial cannot
14 pledge its nonregulated assets under this agreement
15 and it cannot access this agreement. There are no
16 cross-default provisions in this credit facility
17 where a default at Centennial would trigger a
18 default at MDU. And there are no requirements from
19 MDU from the capital to advance funds for Centennial
20 or a subsidiary of Centennial under this agreement.

21 Centennial's credit agreements are separate
22 from MDU and require Centennial to use the funds
23 that they raise under this agreement to conduct the
24 operations of Centennial and the Centennial
25 subsidiaries in order to preserve Centennial's

1 financial integrity. And, simply stated, if we
2 allowed MDU to have access to the funds raised under
3 Centennial's financing agreement, we in essence
4 would give a bankruptcy judge an opening to take and
5 collapse the company in the event of bankruptcy by
6 Centennial to give those creditors of Centennial
7 access to our assets. And they would do this under
8 the assumption that we may be using these funds to
9 benefit MDU at the expense of the Centennial
10 creditors. So we do not want to do this.

11 And to further strengthen this position, we
12 make it not only clear to anyone that has borrowed
13 money to Centennial that MDU does not guarantee the
14 debt, but nowhere in those instruments do we allow
15 the name MDU to be used in Centennial's credit
16 agreements.

17 I'd like to comment on Mr. King's Exhibit
18 16 yesterday. What that was, it was an exhibit
19 showing the working capital of Montana-Dakota. And
20 on there he had materials, fuel costs, prepayments,
21 customer advances. And he made the comment there
22 were material differences in these accounts. In my
23 rebuttal testimony I stated that these accounts
24 remain relatively constant and support the
25 long-lived assets such as property and plant. And I

1 further stated it is the Company's policy to finance
2 our long-lived assets with long-term debt. This
3 helps mitigate exposure from interest rate
4 volatility over the asset's life.

5 Now, looking closer at this exhibit, you'll
6 see that from June to July there's a big decrease in
7 the customer advances. And this decrease accounts
8 for essentially most of the variance in the
9 schedule. And this was a result of a refund of a
10 customer advance that was out of the ordinary. It
11 was an abnormal customer advance and it does not
12 reflect normal activity. Without this adjustment in
13 here, the fluctuations would be minimal and it would
14 really be insignificant to the rate base.

15 You know, I find it interesting that
16 Mr. King himself is inconsistent in his method of
17 determining capital structure with that of setting
18 debt cost. In arriving at debt cost, Mr. King uses
19 the argument that all debt is commingled. Mr. King
20 uses the argument because it provides him with the
21 lowest cost on debt. If Mr. King makes his argument
22 and assumes that debt is commingled, then it would
23 only be logical and consistent to assume that
24 equity, as well as all capital, is commingled. To
25 follow through with his arguments and logic,

1 Mr. King should then have used the capital structure
2 of the consolidated MDU resource company versus just
3 the capital structure of MDU.

4 Now, if you look at the consolidated
5 capital structure, the equity portion is over 60
6 percent, compared to the capital structure just of
7 MDU, which is roughly 50 percent equity. However,
8 if you were to use a consolidated capital structure,
9 you would have to increase the costs of capital. So
10 he chose to ignore. What he does, he picks the
11 capital structure when it fits him and he takes the
12 weighted average wherever it provides the lowest
13 cost of debt, and it, in my mind, is arbitrary and
14 inconsistent.

15 In testimony yesterday Mr. King stated that
16 the Commission should use December 23rd, 2001 as a
17 base for the capital structure. As I point out in
18 my rebuttal testimony, North Dakota Administrative
19 Code 49-05-04.1 allows for projected test periods.
20 MDU extends a considerable effort to develop budgets
21 and forecasts from which to make decisions and guide
22 our organization. Mr. King did not provide any
23 testimony or evidence to suggest or dispute the
24 accuracy of these projections and, in fact,
25 Mr. Majoros accepts the projected revenue from this

1 2000 test period in his testimony.

2 MR. HOBERG: I'm sorry, Mr. Keller, what
3 was the code section you referenced?

4 THE WITNESS: 49-05-04.1.

5 MR. HOBERG: That would be the North Dakota
6 Century Code then.

7 THE WITNESS: Okay. I stand corrected.

8 MR. HOBERG: Thank you.

9 THE WITNESS: In setting capital structure
10 and determining debt cost, Mr. King's methods and
11 arguments are illogical, unfair, and even ignore
12 North Dakota's Century Code. Mr. King's attempt to
13 commingle debt with that of Centennial and that of
14 MDU is not only bad public policy, but it also
15 increases the financial risk for our customers. The
16 capital structure that MDU has filed is correct and
17 should be used.

18 I'd also like to just briefly document
19 addressing comments made on 143. I think Mr. Jeter
20 has done a very good job of addressing the company's
21 position, but the industry itself -- when I refer to
22 industry, I'm really talking about EI and AG, which
23 are associations for electric and gas industries.
24 They are recommending that we take a go-slow
25 approach to FAS 143, and we agree with this. The

1 methods we use now are straightforward. They're
2 easy to understand and they're easy to implement.

3 MDU will need to adopt and comply with FAS
4 143. We're still studying the effects of that and
5 we don't know the ultimate outcome, but we believe
6 that any changes that are required because of that
7 will have little or no effect on MDU or its
8 customers. And the reason we say that is because if
9 there's any difference between what's required in
10 143 versus what we do for regulatory purposes, we
11 will defer on said regulatory assets as allowed
12 under FAS-71.

13 I also thought it would be appropriate for
14 me to talk a little bit about the negative salvage
15 or positive salvage and the removal of costs. I
16 worked in the tax department for a number of years,
17 and through the years I spent a lot of time combing
18 through the depreciation reserves for MDU. And I've
19 looked back over probably, oh, early '70s to late
20 '80s. And over all that time, when I looked through
21 those, when you see large amounts of positive
22 salvage, it almost always resulted from one of three
23 things. Either there was a sale of an asset or some
24 insurance proceeds that we received or we traded an
25 asset for another asset.

1 If we looked at the period we're talking
2 about, there was a sale of an asset and that was the
3 Schuchart building we talked about. And that was
4 sold at net book value. Mr. Majoros refers to that
5 and he focuses on that part of the reserve where the
6 salvage shows up. However, there's also offsetting
7 adjustments in the reserve for the retirement of the
8 asset as well. So the effect was that there was no
9 gain or loss on that asset. And while there shows
10 large amounts of salvage, there really -- all the
11 company did was collect its cost for that building
12 from the affiliate to which it was sold.

13 Insurance proceeds in this time period, we
14 received insurance proceeds due to the hailstorm we
15 had in 2001, and we received money for a lot of
16 vehicles and other stuff that was damaged. At the
17 end of it, when we did some repairs and stuff, we
18 had money left over. We took that money and we
19 credited the reserve salvage for that so our
20 customers would benefit in the future from that,
21 rather than take any of that money to the bottom
22 line for the shareholders. That money will help
23 lower depreciation rates going forward.

24 On trade-ins, we have a program where we
25 trade in our equipment, some of our equipment every

1 other year. It's a very effective program and we
2 can trade equipment in and get brand-new equipment
3 for almost little or no cost. The effect of this is
4 that when you look at a reserve, you'll see large
5 amounts of salvage going in. In effect, all it is,
6 we're trading in. We're showing the salvage on one
7 hand. We're replacing a piece of equipment so we
8 have a property addition on the other hand. There's
9 really no net increase in plant because of those
10 transactions. It just shows up as salvage.

11 Removal costs, when we talk about mains or
12 services, in talking to some of our people our
13 normal policy -- or I should say a normal retirement
14 of a service in our company would be that we would
15 take, we would cut the service -- the riser off,
16 which would be next to the customer's premises. We
17 would cut that off below the surface and cap it with
18 a weld or if it's plastic, we put a seal on there.
19 But we also will cut it at the main, and we'll cap
20 it there as well. But we just don't cap and leave
21 the whole service line in the ground. The policy or
22 the procedure we usually do is, we take and remove
23 at least a portion of that service line to move it
24 beyond the public easements, and we do that for some
25 reasons. One of them is that we don't want gas flow

1 in this thing. We don't want the exposure of gas
2 flowing through there. We also don't want dead
3 lines sitting next to the -- you know, to the mains.
4 We don't want the risk that someone may
5 inadvertently mistake a dead service line for the
6 main and think that they've located the proper line,
7 and we don't want to have a situation with our line
8 locators going out there and accidentally marking
9 the wrong line.

10 The cost can be quite expensive to do this
11 here, because what you're usually doing here, what
12 my people are telling me, is a lot of times when you
13 are doing removing, you're excavating and repairing
14 under concrete and asphalt so the cost can run
15 pretty high. And I think those contribute to the
16 \$1.2, \$1.4 million that we're seeing in there. The
17 other comment they're saying is that there are now
18 rules that require the company to maintain detailed
19 records of our dead lines. And so our concern or
20 our thoughts are going forward is that rather than
21 seeing a decrease in these costs, we may see these
22 costs increase in the future because we expect there
23 could be more rules coming down regarding dead
24 lines.

25 So I guess the bottom line is, we've got

1 all these things going through reserves. Unless you
2 do a thorough depreciation study, ask the right
3 questions, I think it's very difficult to know what
4 the proper depreciation rates are going to be. And
5 it would be my comment the last time we did a
6 thorough depreciation study was 1991. It was done
7 by Stone & Webster. And we haven't done one since.
8 We're looking at doing one.

9 One of the reasons we haven't had one
10 completed is that right now it's tough to get
11 consultants. Everyone is busy with 143 and
12 everything else. We also ran into a problem in that
13 Stone & Webster, who previously did our study, they
14 had some financial problems, some people turnover
15 and they moved. They have lost all our records that
16 we had. So it's not just a matter of updating our
17 records going forward. We're going to have to go
18 back and provide and reprovide all our records from
19 back as early as we can -- you know, I think we have
20 most of our records, but we're going to have to redo
21 it. So it's going to take a little longer than our
22 prior study. But we're hopeful to have it done by
23 the end of the year.

24 It would be my recommendation since the
25 last thorough study done was 1991, that that should

1 be used for setting rates in this case, and that
2 143, as recommended by Mr. Fox's opening remarks, is
3 that we should move this to another day. It
4 shouldn't be handled in this case.

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

6 Any additional questions of Mr. Keller?

7 MR. PEARCE: I have no questions. I just
8 will offer the exhibit.

9 Q. (MR. PEARCE CONTINUING) Craig, did you
10 prepare your prefiled rebuttal testimony?

11 A. Yes, I did.

12 MR. PEARCE: And that's marked as Exhibit
13 23. I'll offer that at this time.

14 MR. HOBERG: Exhibit 23-53 --

15 MR. BINEK: No objection.

16 MR. HOBERG: -- is admitted. Okay.

17 Mr. Pearce, did you have some questions of
18 Mr. Keller?

19 MR. PEARCE: I don't.

20 MR. HOBERG: I'm sorry. I looked at
21 Mr. Binek and said Mr. Pearce. Mr. Binek.

22 MR. BINEK: I was about to start asking
23 questions.

24 COMMISSIONER REINBOLD: These guys are not
25 interchangeable.

1 MR. HOBERG: Mr. Binek, please.

2 MR. BINEK: Thank you. I'll take his
3 money, though.

4 CROSS-EXAMINATION

5 BY MR. BINEK:

6 Q. Mr. Keller, if there's a bankruptcy of MDU
7 Resources that is a result of activities of either
8 unregulated or regulated entities of Montana-Dakota
9 or MDU Resources, isn't a bankruptcy court going to
10 look at all assets of MDU Resources to satisfy
11 creditors' claims?

12 A. There's -- it depends on what level.
13 You're saying it's at the parent company level?

14 Q. Right.

15 A. At the parent company level, they can look
16 at the assets of that, yes. However, I should point
17 out what we're protecting, is we're protecting our
18 regulated customers from the nonregulated business
19 and that's what you're -- you know.

20 Q. I realize that, but the protection only
21 goes so far.

22 A. Well, we're trying to do everything we can
23 do to strengthen that as best we can.

24 Q. Now, I'd like to have you turn to page 3 of
25 your rebuttal testimony. And specifically at line

1 16. Are you there?

2 A. Yep.

3 Q. Okay. At line 16 you object to Mr. King's
4 use of a historical year-end 2001 capital structure
5 and argue instead for your forecasted 2003 capital
6 structure. What capital structure did the company
7 use in its rate-of-return testimony in the electric
8 case earlier this year? That's PU-399-01-186.

9 A. I'm going to defer that to Rita.

10 Q. Okay. Now, please turn to page 5 of your
11 rebuttal testimony. At line 14 -- beginning at line
12 14 you state that FAS 143 does not provide levelized
13 depreciation rates, but instead pushes higher costs
14 toward the retirement date of an asset due to the
15 discounting method used.

16 Is it your contention that the current
17 method of recovering negative salary produces a
18 levelized effect on ratepayers over the life of an
19 asset?

20 A. My comment when I made that comment, and I
21 think Mr. Jeter addressed that quite well, is that
22 because of the discounting that is associated with
23 143, it tends to push numbers, push a cost toward
24 the back end because of the way the discounting
25 interest accretion is done and that's what I'm

1 addressing here. If you're going to ask specifics
2 on 143, I guess I would defer to Mr. Jeter because I
3 think he's the expert in that area.

4 Q. Okay. Let's move forward a little bit and
5 see where we end up here.

6 A. Okay.

7 Q. If we assume that an asset has a removal
8 cost of, say, 50 percent of its original cost, that
9 cost is recovered ratably; that is, evenly over the
10 life of the asset, correct?

11 A. That's the theory behind it, yes, the goal.

12 Q. And that's what you mean by levelized?

13 A. When I mean levelized -- when I use my
14 primary term levelized, is that we have rates that
15 are consistent and that the rates aren't changing
16 from year to year. That's what I refer to as
17 levelized. And my concern was under FAS 143 because
18 of accretion, if you follow that to the rule, you're
19 not going to get -- you know, you'll see it pinned
20 on the asset as the asset ages. Because of interest
21 expense, accretion is going to change every year.
22 You will not get levelized rates. They will
23 constantly fluctuate. And when I refer to
24 levelized, that's what I'm referring to.

25 Q. Haven't you forgotten the rate base effect?

1 When an asset is new, it has very little negative
2 salvage, the removal costs accrue and ratepayers pay
3 a return in income tax on the whole investment;
4 isn't that correct?

5 A. Can you restate that for me, please?

6 Q. When the asset is new, it has very little
7 negative salvage cost that's accrued; is that
8 correct?

9 A. If you're accruing it ratably, I would
10 assume so, yes.

11 Q. And the ratepayers pay a return in income
12 tax on the whole investment; isn't that correct?

13 A. On the whole investment net of depreciation
14 reserve?

15 Q. Yes.

16 A. Yes.

17 Q. Only later when the accumulated reserve is
18 built up to a reasonably high level do ratepayers
19 get the benefit of the rate-based deduction
20 represented by accruals of removal cost; isn't that
21 also correct?

22 A. I would disagree with that. They get the
23 benefit the whole time because -- they get a return
24 basically based on the unrecovered book value, so,
25 you know, that rate base deduction, as you collect

1 more depreciation will grow, but they're getting the
2 benefit over the whole time.

3 Q. But it grows; isn't that correct?

4 A. On that particular asset, yes.

5 Q. Isn't it true then that the existing system
6 is front-loaded in contrast to the back-loaded
7 recognition of costs under the FAS 143 procedure?

8 A. I would disagree with that as well. I
9 think the idea of 143 is to accrue it ratably over
10 the life so that you have a proper matching of use
11 with cost. So, you know, I think when we say -- I
12 think 143 tries to separate the interest component
13 from the other pieces. What they're trying to do, I
14 think, is to add some more complexity there, but I
15 think the intent is to accrue it ratably.

16 Q. Because of system growth and because of
17 inflation isn't the company always adding more plant
18 expressed in dollars than it is removing old plant?
19 Maybe -- they're adding more new plant than they're
20 removing old plant?

21 A. Are we talking dollars? Are we talking
22 feet? What are we talking?

23 Q. Dollars.

24 A. I believe that we've been holding -- you
25 know, they've been fairly constant over the last few

1 years, that our overall utilities additions and
2 reserve has been fairly constant, but, you know, I
3 think in some years it's less, some years it's more.

4 Q. Has there ever been a year when the
5 company's gross plant declined?

6 A. Gross plant declined? The gross plant?

7 Q. Right.

8 A. I couldn't answer that question.

9 Q. Now, please turn to page 6 of your rebuttal
10 testimony, line 2.

11 A. Excuse me?

12 Q. Page 6, line 2. There you say that you
13 consider this plant to have an indefinite life.
14 What do you mean by indefinite life?

15 A. When you say plant, we're talking about the
16 system. We have an obligation to serve the
17 customer. And so as long as we have that obligation
18 to serve the customer, you know, we think that we're
19 going to have to maintain the replacements whenever
20 necessary to keep the system operating.

21 Q. Okay. Can you identify the specific plant
22 accounts that you consider to have an indefinite
23 life?

24 A. Well, I mean, I think what -- the
25 responsibility is to -- we have the obligation to

1 provide service, reliable service indefinitely, so I
2 would guess that the accounts and the assets we have
3 are necessary to do that, so my question would be
4 which of them -- you know, unless technology makes
5 something obsolete, I'm guessing we need all those
6 accounts. We're going to have to replace all of
7 those assets to continue that service.

8 Q. Did you hear me asking questions about the
9 building that was sold?

10 A. Yes, I did.

11 Q. And I think that I was referred to you.

12 A. Okay.

13 Q. First of all, what building is this that
14 was sold?

15 A. It was the Schuchart building.

16 Q. Okay. Now, where is that building located?

17 A. It's located on Divide, the old Gold Seal
18 building.

19 Q. That's the gold building up here?

20 A. Yeah.

21 Q. When was that building sold? I'm going to
22 go through the same questions.

23 A. I think -- I believe it was transferred,
24 sold to an affiliate, I believe it was July 1, 2001.

25 Q. What was the original cost of that

1 building?

2 A. I don't have the information. It was
3 several million dollars. I don't know the exact
4 number.

5 Q. Okay. But you can provide that
6 information?

7 A. We can provide it, yes.

8 Q. Okay.

9 A. Now, are we talking about the original
10 cost? There was an original cost plus improvements
11 that were made to the building.

12 Q. Right. And I think we're going to want all
13 of that.

14 MR. HOBERG: You want a late-filed exhibit,
15 Mr. Binek?

16 MR. BINEK: Yes, please.

17 MR. HOBERG: That would be 3, Mr. Pearce.

18 MR. PEARCE: That's fine.

19 Q. (MR. BINEK CONTINUING) And when was the
20 building purchased, do you know that?

21 A. It was purchased in the early -- early to
22 mid 1990s. I'm not certain of the date.

23 Q. Okay. Once again, I would ask that all of
24 this information be included in a late-filed
25 exhibit, but I'll go through it anyway --

1 A. Sure.

2 Q. -- if you can provide some information.

3 Why was the building sold --

4 A. Initially, when the building --

5 Q. -- or transferred? I think you used the
6 term transferred.

7 A. Transferred, sold. Initially, when it was
8 purchased, we were running out of space in our
9 current building so we acquired this building. As
10 the company grew, the share of activities associated
11 with the resources group became less and it was
12 decided that it should be moved outside of the
13 utility since it's -- you know, I think the utility
14 now is quite a bit less than half of the operations
15 over there, so it was decided to move to a different
16 company.

17 Q. Okay. And the sales price, do you know
18 what the sales price was?

19 A. The sales price was set at the net book,
20 unrecovered book value of the asset, and I don't
21 know the number. It seems to me it was in that
22 four- to five-million-dollar range. I don't know.
23 It's here someplace.

24 Q. And what was the entity that it was sold
25 to?

1 A. It was a subsidiary of Centennial. I
2 believe the subsidiary's name is Future Source. I
3 can't give you the exact legal name. Future Source.

4 Q. Once again, that will be included, I
5 assume. And I asked Mr. Jeter, I believe it was, to
6 provide all of the journal entries relating to the
7 sale.

8 A. Okay.

9 Q. Was there an appraisal done prior to the
10 sale or transfer of this building?

11 A. I don't believe so, but I can't answer that
12 for sure, but I do not believe there was an
13 appraisal done.

14 Q. Do you know what the tax appraisal of the
15 building was at the time of the sale?

16 A. No.

17 Q. Can you provide that information also?

18 A. Yes, we can.

19 MR. BINEK: Okay. And I'm asking that all
20 of that information be included in a late-filed
21 exhibit.

22 MR. HOBERG: Late-Filed Exhibit 3.

23 MR. BINEK: I have no further questions.

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

25 Commissioner Reinbold, did you have any questions?

1 what I call innovative technology, where they're
2 looking at, I would say, breaking technology that's
3 applicable probably to some of the things we're in.
4 We also have Knife River Corporation, which invests
5 in aggregate mining, as well as building, road
6 construction and stuff, activities.

7 We have USI, which is Utility Services,
8 Inc., which is involved in the building and
9 developing of a -- I should say replacing, I would
10 say, utility, electric, gas, overhead, underground
11 lines. They work with the generation side. They do
12 work in telecommunications, as well as inside
13 electrical work, as well as traffic light signaling.
14 And then we have Centennial Power, which is involved
15 in the investment in IPP, looking at doing
16 investments in IPP. And we also have our foreign
17 operations that are currently in Brazil that have
18 made investments in, I think it's 200 megawatts of a
19 gas turbine and they're also looking at some other
20 projects in South America.

21 Q. You've come a long way?

22 A. Yeah.

23 COMMISSIONER REINBOLD: That's all the
24 questions I have.

25 MR. HOBERG: Thank you, Commissioner

1 Reinbold. Commissioner Wefald, please.

2 EXAMINATION

3 BY COMMISSIONER WEFALD:

4 Q. In Mr. Jeter's testimony he had said that
5 Montana-Dakota has retained AUS Consulting to
6 complete another depreciation study by December 31,
7 2002. Are you anticipating that the study will be
8 done by December 31, 2002?

9 A. Well, we're very hopeful it will be done.
10 As I said, you know, one of the issues and problems
11 we ran into is that we have to provide all our
12 historical records because of the fact that, you
13 know, they inadvertently were lost, but we're
14 hopeful we'll have that completed in that time
15 frame, yes.

16 Q. That was one thing I was wondering about.
17 With the 1991 study, if the Commission wanted to go
18 in and take a look at that and you're recommending
19 the Commission use the 1991 study, is there any
20 backup data that's available to the Commission at
21 this time other than the few summary charts?

22 A. I couldn't answer that without talking to
23 our plant people or Stone & Webster and find out
24 what exactly -- you know, what records they do have
25 left from that, you know, that they were able to

1 locate versus what they don't, but I'm not sure how
2 much information would be available.

3 COMMISSIONER WEFALD: Thank you.

4 MR. HOBERG: Thank you, Commissioner
5 Wefald. Commissioner Clark, any questions of
6 Mr. Keller?

7 COMMISSIONER CLARK: I do have a few.

8 EXAMINATION

9 BY COMMISSIONER CLARK:

10 Q. Getting back to this building, if through
11 the tax appraisal that MDU is going to be
12 submitting, and I understand there wasn't, doesn't
13 sound like, a fair market appraisal done, but if the
14 tax appraisal comes back in the market that the
15 assessors here were setting the value of that, if
16 that ends up being far in excess of the net book
17 value, would it be fair to ratepayers to somehow
18 give them some sort of realization of the difference
19 between the two that, in fact, this asset that had
20 been in the rate base that the ratepayers have been
21 paying for was then transferred to another affiliate
22 within the MDU group, but at far less than the
23 market value of that?

24 Would it be fair to somehow credit, maybe
25 through an offset of that credit that was originally

1 given, so that the ratepayers see some realization
2 of that?

3 A. You know, I would comment that that may be
4 fair for the portion that was allocated to the
5 utility business. A couple comments I'd like to
6 make. One, is that while we didn't do a fair market
7 value, we believe that the book value was very close
8 to the fair market value. So we don't believe, you
9 know -- if we thought there was a big discrepancy in
10 the values, we would have went through and did a
11 fair market value of that, but we don't think there
12 was a big difference between fair market value and
13 net. I'm not sure what the tax value is. I'm not
14 sure if that is a locally assessed or centrally
15 assessed asset. If it's locally assessed, we would
16 have the tax value. If it's centrally assessed, I
17 don't believe it would have a value just for that
18 stand-alone business.

19 Q. What would be the basis of saying that you
20 think it's pretty close to what the fair market
21 value was, the net book?

22 A. Well, because we haven't had it that long
23 and we made some pretty substantial investments in
24 there, so we're pretty comfortable that the fair
25 market value -- the fair market value would not have

1 been much higher than the book value was.

2 Q. Getting back to the depreciation study that
3 is ongoing, kind of lead me through the -- why was
4 the decision made to have a depreciation study at
5 this time? Was it for the rate case?

6 A. I'm going -- I'm going to defer that to
7 Rita, but I believe one of the things is, one, it's
8 been a while since we had one, but, secondly, with
9 the cases coming up, we wanted to take a look at it.
10 You know, we look at our plant all the time. We
11 don't think -- you know, one of the comments made,
12 we don't think the makeup of our plant has changed a
13 lot since our last study, but, you know, we thought
14 it may be appropriate to do one. I think it was
15 recommended that we do one for these cases, but Rita
16 could probably answer that better than I can.

17 Q. When it was originally contracted to be
18 done, was it contracted to be done by the time that
19 this rate case was to be taken up by this
20 Commission?

21 A. We -- right now, I don't think there's as
22 many consultants in the business doing depreciation
23 studies. You know, the number of consultants --
24 there seems to be a lot fewer than there have been
25 in the past. We had a very difficult time getting a

1 depreciation consultant. It was tough to get them.
2 You know, they're quite busy right now. It was
3 difficult to get one. The individual we hired did a
4 depreciation study, just completed one for Great
5 Plains, and we asked him to start on this one as
6 soon as he could and he said he would do his best
7 effort to get it done by the end of this year.

8 Q. I guess I'm a little confused by that,
9 because I know in the RFP that we put out here at
10 the Commission, I think one of the things that was
11 originally in that was a depreciation study and at
12 some point we decided to peel that off and that I
13 guess MDU would be handling it, but -- and maybe
14 Mike will be able to speak to this when we get to
15 Mr. Diller's questions, but it seemed to me that we
16 had at least five that said that they could get it
17 done by the time that we needed to get it done.

18 You're saying MDU didn't find anybody out
19 there who could get it done in time?

20 A. We looked for consultants that had been
21 used by our peers that we knew were very reputable
22 and very good and, you know, we kind of basically
23 looked at -- you know, the people we looked at were
24 the ones we wanted to use. They're very busy right
25 now and timingwise it takes a period of time to do

1 this and it takes a period of time to gather all
2 these records that we have to go back and recreate,
3 so, you know, we just had difficulty getting a
4 commitment to get it done in a time frame that -- in
5 time to have -- you know, time to have -- prior to
6 the case being filed or this date.

7 Q. Well, the depreciation case that you have,
8 the study that you have being done, is it going to
9 be ready for the rate cases in the other states
10 within your jurisdiction; South Dakota, Montana,
11 Wyoming, the ones we've heard about that will be --

12 A. Again, I'm going to have Rita -- he's going
13 to do the study for Montana-Dakota gas operations
14 and would include all our jurisdictions.
15 Timingwise, if that's going to fit with our
16 schedule, Rita could probably answer that.

17 Q. Okay. Do you know how much -- how much did
18 this particular study cost that you're doing? I
19 know we heard before they're fairly expensive.

20 A. I'd have to get you that information.

21 Q. Has MDU received any preliminary
22 information yet on that depreciation study, or is
23 that just all delivered at once?

24 A. We haven't received any preliminary
25 numbers, no. We're in the process now of providing

1 information so the consultant can do his work.

2 MR. HOBERG: Commissioner Clark, did you
3 want a late-filed exhibit on that question?

4 COMMISSIONER CLARK: I'm sorry. Which
5 question?

6 MR. HOBERG: The one about how much it
7 costs.

8 COMMISSIONER CLARK: Yeah, that would be
9 good, if you can provide it.

10 MR. HOBERG: Late-Filed 4, Mr. Pearce.

11 COMMISSIONER CLARK: That's all the
12 questions I have. Thank you.

13 MR. HOBERG: Thank you, Commissioner Clark.
14 Mr. Diller, please.

15 MR. DILLER: Just a couple.

16 EXAMINATION

17 BY MR. DILLER:

18 Q. Mr. Keller, do you have any knowledge of
19 any agreements that the staff reached verbally with
20 the company as to who was going to do the
21 depreciation study? Do you have any knowledge of
22 that?

23 A. I don't have any knowledge of that, no.

24 Q. Okay. I'd also like to add on to
25 Commissioner Clark's late-filed exhibit, if it's all

1 right, the cost associated with supporting this
2 11-year-old depreciation study in this proceeding.
3 Since it's going to be virtually obsolete in three
4 or four weeks or a couple of months, whatever it is,
5 I think that would be some information that the
6 Commission might be interested in.

7 A. Could you rephrase that? Make sure we get
8 what you're looking for.

9 Q. I just want to know what -- I want to know
10 the total cost to the company to support the
11 11-year-old depreciation study in this proceeding.
12 Had the depreciation study been done before this
13 proceeding, we wouldn't have spent all this time and
14 money talking about an old study that's not going to
15 be worth anything in a couple of months. So I'd
16 like to know what the total cost to MDU is to
17 support.

18 A. Well, you know, to say it's not worth
19 anything I think is kind of -- it's a study, but it
20 was a thorough study that was performed and, you
21 know --

22 Q. Did I hear you say -- I couldn't really
23 hear. You said it real quickly. You said it wasn't
24 done in time because you lost some information?

25 A. I said one of the reasons we can't get it

1 done as quickly as we'd like was because we didn't
2 lose some information. Stone & Webster, who
3 performed the last study, lost a lot of the data.

4 Q. So then if staff had hired a consultant
5 then to do the depreciation study, since we had
6 offers to do that in time for this proceeding, would
7 we have had the same problem? Would we have --

8 A. It would have been difficult to give you
9 the information. Again, Mr. Jeter may be able to
10 better address this than I can, but I believe to do
11 a thorough, detailed study, I think there's a lot of
12 historical information you're using and, you know, I
13 think there would have been -- to do a complete
14 study, which we are expecting done, I think would
15 have been -- you know, may have been difficult for
16 your consultant to do in time.

17 Q. Do you understand the question? I'm asking
18 for the cost of --

19 A. Yep.

20 MR. DILLER: Okay. I think that's all the
21 questions.

22 MR. HOBERG: Thank you, Mr. Diller. Any
23 further questions then of Mr. Keller? Mr. Pearce,
24 any?

25 MR. PEARCE: No.

1 MR. HOBERG: Mr. Binek, please.

2 MR. BINEK: Just a couple other questions
3 regarding this depreciation study.

4 RECROSS-EXAMINATION

5 BY MR. BINEK:

6 Q. When did MDU retain a consultant to do the
7 depreciation study?

8 A. I believe we started looking for one about
9 maybe April and we had -- I think he committed to
10 us, I think, maybe in May. I'm not sure of the
11 dates. And we asked him to complete the Great
12 Plains study and then begin work and complete the
13 Montana-Dakota gas study.

14 Q. Okay. Included with the late-filed exhibit
15 4, I would like to ask that any correspondence
16 relating to the contract with -- is it AUS?

17 A. Yeah.

18 Q. -- concerning the contract and the contract
19 itself be included in that exhibit.

20 MR. HOBERG: Mr. Pearce, can you do that?

21 MR. PEARCE: Well, I assume that's
22 possible, barring some kind of a confidentiality
23 provision that that consultant may have. I don't
24 suppose there is, but I don't know of that, so with
25 that possible proviso.

1 MR. HOBERG: Anything further, Mr. Binek?

2 MR. BINEK: No.

3 MR. HOBERG: Any further questions of
4 Mr. Keller? Thank you, Mr. Keller.

5 MR. PEARCE: Can we take a couple minutes?
6 We have some exhibits to mark for Dr. Gaske.

7 MR. HOBERG: Yeah. Let's take five
8 minutes.

9 (Recess was taken.)

10 (Exhibit 31, 32, 33, 34, 35, and 36 were
11 marked for identification.)

12 MR. HOBERG: We're back from recess, and
13 you're taking the rebuttal of Dr. Gaske at this
14 time, Mr. Pearce?

15 MR. PEARCE: Yes.

16 MR. HOBERG: Dr. Gaske, you testified
17 yesterday. I'll remind you today that you're
18 considered to be under oath still.

19 THE WITNESS: I understand.

20 MR. HOBERG: Mr. Pearce, please.

21 J. STEPHEN GASKE,
22 having been previously sworn, was examined and
23 testified as follows:

24

25

1 DIRECT EXAMINATION

2 BY MR. PEARCE:

3 Q. Dr. Gaske, you've prepared prefiled
4 rebuttal testimony in this case, have you not?

5 A. Yes, I have.

6 Q. Rather than go through all the testimony,
7 I'm simply going to ask you to summarize that
8 testimony, if you will, and add any additional
9 rebuttal points that you feel are appropriate after
10 the staff's direct case.

11 A. I will try to go through and summarize my
12 testimony, but I won't read the whole thing. But
13 during the course of the summary I would like to
14 direct the attorneys and the Commissioners to
15 various points in the record, because in the course
16 of summarizing this, I hope to lead you through the
17 facts that have been introduced into the record so
18 that, hopefully, you'll be able to follow along why
19 I'm saying what I am and what the basis of the
20 testimony is.

21 As a broad general overview there are
22 really four big issues with regard to rate of
23 return. One is the question of the flotation cost
24 adjustment. Another is the comparable companies
25 that we use in our DCF analyses. One is the growth

1 rate that we adopt, and the last is our assessment
2 of risk. With regard to those four things, I
3 advocate a flotation cost adjustment, which I'll
4 talk about in a few minutes.

5 There's not a big difference between us
6 with regard to the comparable companies. But there
7 are some differences and there's some key factors
8 that you need to understand. There are large
9 differences between us with regard to the growth
10 rate, and I believe very strongly that my growth
11 rate analysis is based on relatively objective,
12 publicly available information. In contrast
13 Mr. King's is really based on a fairly subjective
14 analysis that on its face appears to be fairly
15 biased.

16 With regard to risk assessment I have two
17 different opinions, depending on which proxy group
18 you use. If you were to adopt the Moody's gas
19 distribution companies as the appropriate proxy
20 group, I believe that Montana-Dakota is slightly
21 above average in terms of their risk. They're
22 slightly riskier than the average company. If you
23 were to adopt the companies that derive more than 75
24 percent of their revenues from gas distribution
25 operations, then I believe Montana-Dakota is average

1 relative to that group.

2 So having said that, I want to walk through
3 and summarize the rebuttal testimony. With regard
4 to the flotation cost issue, it's very important, I
5 think, to understand why you should be allowing a
6 flotation cost adjustment. The standard that's used
7 to evaluate whether a cost of capital or rather
8 allowed rate of return is sufficient is often
9 referred to as a capital attraction standard. That
10 standard requires a rate of return that is
11 sufficient to enable the company to attract capital
12 on reasonable terms. Now, whether the company
13 actually is going out and raising capital, whether
14 it's growing, whether it needs new capital or
15 whether it's built a system that is not growing at
16 all, it still needs to have an adequate rate of
17 return. And so the standard that was established to
18 set that rate of return was this capital attraction
19 standard. There also is a comparable earnings
20 standard, but when we go to using a DCF analysis,
21 we're really looking at a capital attraction
22 standard.

23 When you set a rate of return based on DCF
24 analysis, in theory you are finding the cost of
25 capital that makes the investors indifferent as to

1 whether they invest in this plant or in this company
2 and put utility assets in the ground or whether they
3 put their money in U.S. Treasury bonds or CDs or
4 anything else. In other words, it's exactly the
5 amount of money they need to be compensated for the
6 additional risk.

7 In theory that means that when they invest
8 \$1 in utility assets, the value of that investment
9 will be \$1. That will be the market value after
10 it's in the ground, if everything goes well. If
11 they do invest \$1, though, and they have to raise
12 equity capital to invest \$1 in utility assets, they
13 have to essentially raise more than that. They have
14 to go out into the market and raise perhaps \$1.05.
15 The five cents goes to the investment bankers and
16 then they have \$1 investment in utility assets.

17 Consequently, the rate of return needs to
18 be adjusted to reflect the cost of flotation. It
19 doesn't mean the company is going to go out and
20 issue common stock. It doesn't mean that it's done
21 so recently. It means that in order to be in a
22 position to attract capital, in my opinion, to meet
23 the capital attraction standard, it has to have a
24 rate of return so that it can go out and issue that
25 common stock without diluting the existing

1 investors' investment. I put together a numerical
2 example of this concept that I'd like to hand out as
3 an exhibit. It a little bit complicated, and I
4 won't spend too much time on it, primarily because I
5 think you'll fall asleep if I do.

6 MR. HOBERG: Is this 31?

7 MR. PEARCE: Yes.

8 THE WITNESS: Have you handed them out to
9 everyone?

10 COMMISSIONER REINBOLD: What number is
11 that?

12 MR. PEARCE: 31.

13 THE WITNESS: The general assumptions here
14 are that the company has existing equity of \$100,
15 book value of \$100, and it has a rate of return that
16 is exactly equal to the investor requirement as
17 determined by a DCF analysis. Under those
18 circumstances, the market value should be \$100. The
19 number of shares outstanding is 100, so that the
20 existing investors will have a book value of \$1 per
21 share and they have a market value of \$1 per share.
22 And I've put \$1 into plant and that's what it's
23 worth in the market. If they require a rate of
24 return of 15 percent, they would get \$15 of return.
25 And that's what this shows across the first line of

1 numbers there.

2 If the public utility then goes out and
3 issues new common stock because it needs to build
4 new plant, and it issues \$100 in new common stock,
5 under the example here that I have, I've assumed
6 that the investment bankers take 10 percent of that.
7 They take \$10. So the company issues \$100 in common
8 stock. They raise \$100. \$90 of that gets invested
9 in a utility plant that's allowed to earn a rate of
10 return. If they earn exactly the 15 percent
11 required, the utility -- the new utility plant will
12 have a book value of \$90 that will go into the rate
13 base. The market value will also go up by \$90
14 because they're earning exactly their allowed rate
15 of return. The number of shares outstanding has now
16 doubled. They issued 100 shares all at \$1 apiece.
17 But they got net proceeds of \$90 so they have 200
18 shares outstanding now and the new book value is 95
19 cents per share. And the new market value, if they
20 are earning 15 percent, is also 95 cents per share.

21 The impact on the existing shareholders is
22 that they were sitting there with stock that was
23 worth \$1 and now their stock is worth 95 cents. The
24 reason being is that the company went out and built
25 a utility plant and raised new common equity to

1 build that plant and was left with only \$90 that
2 they could put in their rate base, even though they
3 had to issue \$100 worth of common stock. The effect
4 was to dilute the existing investors' return and the
5 value of their stock. If they earn a 15 percent
6 rate of return, the new larger company would have --
7 in the last column it shows that the new larger
8 company would make \$28.50 a year. They get a 15
9 percent return on the plant that's in the rate base,
10 but they get a zero percent return on the flotation
11 costs that they incurred.

12 And just in this example, instead of
13 getting a 15 percent rate of return on all of the
14 dollars that were spent, they get a 14.25 percent
15 rate of return. They don't get the 15 percent that
16 the DCF analysis told you that they required. They
17 were not in a position to issue new common equity on
18 reasonable terms without diluting the value of the
19 stockholders' investment.

20 The second example I have here is a
21 flotation cost adjustment where you increase the
22 allowed rate of return by 10 percent. You multiply
23 1.1 times the 15 percent that investors require.
24 That comes out with an allowed rate of return of
25 16.5 percent, which is more than what investors

1 require, but the goal here is to increase the market
2 value above the book value by 10 percent. Here, if
3 you look at the first line of the second example,
4 you have a book -- starting book value of \$100.
5 Because you've applied a flotation cost adjustment,
6 the market value is actually \$110. So the market
7 value is actually worth more than the book value.
8 And with 100 shares you have \$1 in book value and
9 \$1.10 in market value per share.

10 Now, when the utility goes out and says we
11 need to build new plant, we need to raise common
12 equity to invest in new plant, they sell 100 shares
13 of stock for \$1.10 because that's the market value
14 of the stock. They raise proceeds of \$110. \$10
15 goes to the flotation costs. That ends up going to
16 the investment bankers. And they're left with \$100
17 that they can invest in utility plant. So by
18 issuing the new common stock, they can add to their
19 new plant by an amount of \$100. That new equity if
20 it has an allowed rate of return -- or I'm sorry.
21 They add to their existing plant an amount of \$100.
22 If they get a 16.5 percent rate of return on that,
23 it should be worth \$110.

24 In total now, the company has 200 shares
25 outstanding. They have \$200 in their rate base

1 that's earning a return, and they have a market
2 value of \$220. The market value is higher than the
3 book value in this case because you've made a
4 flotation cost adjustment. The price per share and
5 the book value per share is \$1. \$1 for the book
6 value and \$1.10 for the market value. You can see
7 that those numbers are the same after the issuance
8 as before the issuance.

9 The existing shareholders don't lose
10 anything by virtue of the fact that the company has
11 issued common stock. So the company is able to
12 issue the common stock on reasonable terms without
13 diluting the value of these existing shareholders'
14 investments. That -- I don't think I'll walk you
15 through the rest of it because it's a similar
16 example down below.

17 The last example is just a much larger
18 stock issuance, but the result is the same. You
19 start with a book value of \$1. You have a market
20 value of \$1.10. You're able to issue common stock
21 and still -- the existing shareholders are still in
22 the same position they were before.

23 Now, the question is, if the company has
24 not been issuing common stock in recent years, why
25 do you allow this? It's not because they need to be

1 compensated precisely for what they have just issued
2 in the last year. It's not because they need to be
3 compensated for what they know; in fact, right now
4 they're going to earn next year. It's because the
5 company needs to be in a position to do this at all
6 times. It's a little bit like insurance. I didn't
7 have a car accident last year, so why do I need
8 insurance this year? I didn't have to raise capital
9 last year. Why do I have to have a flotation cost
10 adjustment so I'll be in a position to do so this
11 year? That in essence is what the issue is about.

12 I mentioned in my rebuttal testimony that a
13 number of other economists advocate exactly the same
14 kind of adjustment. It's not an unusual thing. It
15 is supported by the economic literature. Mr. King
16 has indicated that the company's experience in the
17 recent past has been that flotation costs have been
18 0.1 percent of the capital rates. That's actually
19 very misleading, because, in fact, that's not what
20 the flotation costs have been on the capital that
21 has been raised.

22 Let me give you the biggest area where that
23 becomes misleading. Mr. King has noticed that the
24 company issued about \$400 million worth of shares to
25 buy other companies. Well, that's not raising

1 capital. You don't have big flotation costs to swap
2 shares with someone. It's just a share swap. No
3 cash was raised that could be used to go out and put
4 mains in the ground for the public utility
5 customers. Transactions like that don't have very
6 big flotation costs associated. So you really can't
7 include that in the concept of what does it cost
8 this company if it were to have a need to go out and
9 raise cash for the utility operations. The recent
10 historical experience for the company is shown on
11 page 5 of my rebuttal testimony, at lines 12 to 15.

12 COMMISSIONER WEFALD: Which page, please?

13 THE WITNESS: Page 5. In recent years the
14 company has raised \$157 million. It incurred
15 flotation costs of 5.2 million and the flotation
16 cost adjustment or the amount of flotation costs was
17 3.43 percent of the net funds that they raised. So
18 that's been their recent experience. If they had no
19 recent experience whatsoever, they would still need
20 a flotation cost adjustment. If they had raised
21 lots of money recently, they would need one on a
22 forward-looking basis. Because this is much more of
23 a concept similar to the idea of risk where it's a
24 forward-looking thing where you need to be in a
25 position to do so at all times.

1 The study that I've done that appears in my
2 direct testimony was to look at many gas
3 distribution companies and the costs that they have
4 incurred in the past. And I came up with an average
5 of about 4.85 percent as the average for gas
6 distribution companies in terms of the flotation
7 costs. I recommended in this case an adjustment of
8 4.75 percent as being on a forward-looking basis
9 what the company might on average expect to incur.
10 Sometimes they might get less than that. Sometimes
11 they might have to pay more. And it's just
12 depending on conditions in the market at the time.

13 I guess to summarize, there is a need for
14 the flotation cost adjustment. Mr. King's
15 adjustment of 0.1 percent does not reflect what it
16 costs to raise capital, and I'll leave it at that on
17 that issue.

18 The next issue I want to talk about is the
19 proxy group. I have another exhibit to show you.
20 Essentially --

21 MR. HOBERG: Are you offering 31?

22 MR. PEARCE: I'll offer it now.

23 Q. (MR. PEARCE CONTINUING) Dr. Gaske, did you
24 prepare Exhibit 31?

25 A. Yes, I did.

1 MR. PEARCE: I'll offer Exhibit 31.

2 MR. HOBERG: Mr. Binek, any objection?

3 MR. BINEK: No.

4 MR. HOBERG: Exhibit 31 is admitted.

5 Please continue, Dr. Gaske.

6 THE WITNESS: The next exhibit is

7 Exhibit 32.

8 MR. HOBERG: I've got that here for the

9 Commissioners.

10 THE WITNESS: I just noticed that there's

11 one thing that's not correct here and that's in the

12 sources I have bond ratings. And, in fact, there

13 are no bond ratings on this page. I had carried

14 that over from a copy of another exhibit. So --

15 COMMISSIONER WEFALD: Cross that out?

16 THE WITNESS: -- you can cross that out.

17 The other source is the percent gas distribution,

18 and with one exception that was taken from

19 Mr. King's testimony. The one exception is Keyspan.

20 And if you'll recall yesterday, an exhibit was

21 introduced that showed it was from the Keyspan 10-K

22 and it showed their percentage of revenues from gas

23 distribution and I was asked about that percentage.

24 I did not calculate it in my head, but I went home

25 last night or back to the hotel and calculated 54.5

1 percent. So it's at the bottom there.

2 These are the proxy companies that Mr. King
3 and I have used. They're all put together. We have
4 used two different groups. I've used the Moody's
5 gas distribution group. It's a group that I've used
6 routinely in the past in gas distribution cases.
7 The companies in that group are marked with an X
8 here. It's commonly used as a group of companies
9 that are representative of the gas distribution
10 industry and people look at this group for
11 information in general about the industry.

12 Each of the companies is included in Value
13 Line as being a gas distribution company. Each of
14 the companies is also included in the CA Turner
15 Reports as being a gas -- or gas distribution or
16 integrated gas company. So they are widely
17 perceived to be gas companies. I believe it's
18 appropriate to use these companies for a DCF
19 analysis. It is something -- as I note in my
20 testimony, Mr. King used the same companies about a
21 year ago before this Commission.

22 Mr. King has proposed an alternative proxy
23 group. And that's companies that derive at least 75
24 percent of their revenues from gas distribution
25 companies -- or gas distribution operations. The

1 percent gas distribution column, as I said before,
2 is taken right out of his testimony. You can see
3 that the companies that meet the standard that he
4 established include all of the companies down to
5 Peoples Energy Corp, which derives 80 percent. So
6 actually all of the companies that really meet the
7 standard derive not just at least 75, but derive
8 more than 80 percent from gas distribution.

9 Mr. King has proposed to also include WGL
10 Holdings, but in my rebuttal testimony I asked the
11 question since they didn't meet his criteria, you
12 know, why would you include it? So that in essence
13 is -- if you want to look at the companies and the
14 criteria that were used to select them, that
15 compares our two groups and accounts for some -- to
16 a small extent some of the differences between the
17 two of us in our studies.

18 The next area that I want to talk about is
19 the growth rate differences between the two of us.
20 And to help you in the discussion of this, to help
21 me in the discussion of this, I've prepared another
22 exhibit. I know it's been marked as Exhibit 33.
23 Since I'm leaving 32, is there anything --

24 Q. (MR. PEARCE CONTINUING) Are you finished
25 talking about 32?

1 A. Yes.

2 Q. And did you prepare Exhibit 32?

3 A. Yes, I did.

4 MR. PEARCE: I'll offer Exhibit 32.

5 MR. BINEK: No objection.

6 MR. HOBERG: Exhibit 32 is admitted.

7 THE WITNESS: The data on Exhibit 33
8 attempts to do an apples-to-apples comparison
9 between Mr. King's study and my study and other
10 alternatives that have been discussed on the record,
11 as well as alternatives that I have included in my
12 rebuttal testimony. The first column of numbers
13 shows the average results from various studies using
14 various growth rates. My -- and I should say that
15 column is what I refer to as the investor return
16 requirement. It does not have a flotation cost
17 adjustment. The cost of capital after flotation
18 cost adjustment is shown in the last column, but for
19 purposes of this discussion and comparison, I'm
20 really going to focus on the first column.

21 My second stage retention growth method,
22 which was conducted on Moody's gas distribution
23 group, came up with a 12.83 percent rate of return
24 on average. That simply is a weighted average,
25 two-thirds of the weight on the Zacks analyst

1 estimate and one-third on the book value growth
2 rate -- or, actually, the earnings retention growth
3 rate.

4 The second one is the basic study. That's
5 identical to what Mr. King refers to as a classic
6 study, where you simply add the Zacks growth rate
7 estimates. The only difference between us really
8 comes about because we have different companies in
9 our proxy groups. The primary one in my study was
10 one that I looked at the results, I made some
11 subjective judgments and came up with an average of
12 12.63 percent. And you can see where I made my
13 subjective judgment, my average rate of return
14 actually comes in below what either the second stage
15 retention or the basic came in at. And that was
16 very specific to the companies in the Moody's gas
17 distribution group.

18 The next group, going down the list, is
19 really derived from cross-examination yesterday when
20 I was on the stand. I was asked what would the
21 average results be if Keyspan and Laclede were
22 removed from my groups, and I couldn't calculate the
23 average in my head, but -- exactly. I think I had
24 some ballpark number, but my second stage retention
25 results would have been 11.75, and my basic would

1 have been 11.51. Now, I believe that it is
2 appropriate to include Keyspan and Laclede in the
3 results, but these are some numbers that you have
4 before you in the record and when you sit down to
5 consider rate of return, you're going to be looking
6 at these numbers and having to weigh them against
7 the others. I really do believe that those two
8 companies should be included in the group and so you
9 can take those numbers for whatever they're worth.
10 I don't put lots of weight on them.

11 The next set of numbers are numbers that
12 appear in my rebuttal testimony. I would direct
13 your attention to Exhibit JSG-4, which are the
14 exhibits that are attached at the back of my
15 rebuttal testimony.

16 MR. HOBERG: JSG-4?

17 THE WITNESS: Yes. Schedule 1 in
18 particular.

19 COMMISSIONER CLARK: Which page?

20 THE WITNESS: I'm sorry. Schedule 1, pages
21 1 and 2.

22 Here what I've done is to simply take the
23 companies that meet Mr. King's criteria. They
24 derive at least 75 percent of their revenues from
25 gas distribution based on his numbers. It includes

1 all of his companies, except Washington Gas Light or
2 WGL. I've used his Zacks numbers, his stock price,
3 his dividend, and his book value per share with the
4 growth rate. The average Zacks growth rate for
5 these companies is 6.38 percent and the average of
6 Mr. King's estimates of the book value growth rate
7 is 7.14 percent. I've taken a weighted average of
8 those two, giving two-thirds weight to Zacks and
9 one-third to the book value growth and come up with
10 an overall weighted average growth rate. I've then
11 taken his stock price and dividend data and adjusted
12 the dividend yield for the .625 dividend adjustment
13 factor that has been somewhat notorious in the case.

14 And so I've done this in an objective way
15 that matches up with my second stage retention
16 growth method of really taking the information from
17 both of these growth rates and combining them. And
18 I come up with an average of 11.8 percent without
19 flotation costs and 12.4 with. So if you do what I
20 think is much closer to a proper analysis of the
21 growth rate, you would come up with at least 11.8
22 percent for these companies.

23 The next page is virtually identical. It's
24 all Mr. King's data and just taking a weighted
25 average and I come up with a -- when I weight book

1 value growth and Zacks equally, 50-50 for both, I
2 come up with 12 percent for these companies. And
3 those are the numbers and that's the approach.

4 The last group of figures that I want to
5 talk about are from Mr. King's analysis. His first
6 DCF analysis is based on his book value growth rate.
7 And for his companies, which also included WGL
8 Resources, he came up with a 12.18 percent return
9 and that comes from his testimony on page 20. It's
10 table 7 on that page. Now, you can see the 12.18
11 percent return in table 7. Immediately thereafter
12 on pages 20 and 21, he indicates that he really
13 doesn't think that this is representative of what
14 investors expect, primarily because for the 11
15 companies in his analysis, Value Line does not
16 project that their earnings are going to go down in
17 the future.

18 Well, in fact, if these companies had
19 negative growth rates, nobody would be buying them.
20 He also thinks that Value Line is biased because
21 they project that all 11 companies are going to have
22 increased earnings in the future and they're going
23 to maintain or even increase their current rate of
24 return. So he pretty much discounts and rejects
25 this data. The theory is that Value Line is biased.

1 Yesterday, in cross-examination of
2 Mr. King, sheets from Value Line were introduced.
3 It showed that Value Line indeed does project
4 declining earnings, declining return on equity for
5 companies. They're not biased. When they believe
6 that a company's earnings are going to go down and
7 its rate of return is going to go down, they do
8 project that. The fact that you can look at these
9 11 companies and say, gee, they're going to grow in
10 the future is not at all surprising. That's what
11 you expect. That's what the Zacks analysts expect.
12 That's what investors would logically expect for
13 those companies. That's what you expect out of most
14 companies. So at this point in time, you can't take
15 that information and say, well, that means they're
16 biased, just because they think the companies are
17 going to grow or maintain their current rates of
18 return. So Mr. King gives very little weight to the
19 book value analysis, but when you really look at his
20 reason for giving little weight to it, it doesn't
21 make any sense.

22 He has a historical analysis which is based
23 on historical growth rates. That appears on page 22
24 of his testimony in table 8. Here, his average rate
25 of return is 11.72 percent. Now, when you look at

1 table 8 fairly closely, you can see that there's
2 some pretty wild swings. There are some companies
3 that in the past, in the very recent past, have had
4 negative growth rates. No one would actually expect
5 that to be the case in the future. And he has
6 Southwest Gas with a positive 37 percent growth
7 rate, and I don't think you can really expect that
8 to happen in the future, either. These are kind of
9 wildly out of line.

10 My rebuttal testimony discusses the fact
11 that you really can't give much credence at all to
12 these historical results. Certainly, Value Line,
13 when it does its book value projections, book value
14 growth projections, they were aware of this
15 historical data. The Zacks analysts, when they did
16 their projections, they were aware of this data.
17 I'm sure they took it into consideration. So you
18 really don't have a whole lot here on historical
19 growth numbers typically because they were fairly
20 short periods of time in the past to do much with.
21 But, nevertheless, he has these numbers and he does
22 place some weight on them.

23 His last approach, the classic approach is
24 that -- that appears on page 23. And I'm sorry.
25 The summary of the three-year results appears on

1 page 23. The actual analysis appears on page 18,
2 table 6. And here you can see that the average rate
3 of return was 11.29 percent. And that's very
4 straightforward. It's just adding the Zacks
5 analysts' growth forecasts.

6 One of the major places that I think
7 Mr. King's analysis is flawed is in how he's taken
8 this information and used it subjectively. He says
9 that he started with the classic result, 11.29
10 percent. And from that he then looked at the book
11 value results. They're a whole lot higher. So he
12 considered those and worked those into the
13 calculation, these much higher numbers. He also
14 took the historical results, also quite a bit
15 higher. So after he gets finished including these
16 higher numbers in his results, he comes up with a
17 lower average on its face that just doesn't make a
18 whole lot of sense.

19 Now, he says that he went company by
20 company and really analyzed each company
21 individually and described why he did what he did,
22 but the fact of the matter is, is that the level of
23 bias is pretty high when you consider that after
24 consideration of much higher numbers, he ends up
25 with a lower number than he started with. That

1 gives him a 11.23 percent rate of return. You, as
2 Commissioners, will have to decide out of this
3 evidence that's in the record which of these numbers
4 are credible and which ones to place true weight on.
5 And I would say that, in my opinion, the 11.23
6 number doesn't make any sense whatsoever.

7 To the extent that you place any weight on
8 the numbers and evidence that he has put in the
9 record, the recalculation that I've done that gives
10 very explicit consideration to both Zacks and the
11 book value growth rate; the two-thirds/one-third or
12 the 50-50 analysis. They come out pretty close to
13 each other; 11.8 percent or 12 percent before
14 flotation costs. Those at least you can trace
15 mathematically. You can debate whether or not the
16 assumptions are correct and actually have some
17 reasonable basis for decisionmaking.

18 Now, yesterday I talked about the fact that
19 I generally believe that book value is a floor for
20 your long-term growth rate. I think Mr. King agrees
21 with me on that, but then he ends up saying that he
22 really considers book value to be a ceiling because
23 it has the highest number. But if you look at page
24 19, lines 5 to 13 of his testimony --

25 COMMISSIONER WEFALD: 15 to 19 of his

1 testimony?

2 THE WITNESS: Page 19, lines 5 to 13.

3 There he says that the book value growth
4 model is less useful for gas utilities than it used
5 to be for two reasons. One, is that these companies
6 are somewhat diversified. They don't just get their
7 income from regulated operations. The other is that
8 he thinks very few utilities are so closely
9 regulated that the only source of growth in earnings
10 is the increase in book value. Now, I agree with
11 both of those statements. They parrot exactly what
12 I said yesterday when I was on the witness stand.

13 What these two statements say is that these
14 companies have some unregulated operations so book
15 value growth is not necessarily the best indicator
16 of their growth rate because they have ways they can
17 grow even faster than that. So later in his
18 testimony or around this point in his testimony
19 where he says that book value is a ceiling, the
20 reasoning he has in his own testimony suggests,
21 indeed, that it should be a floor, which is what I
22 think. So when you're looking at his testimony and
23 looking at the 12.18 percent book value and the
24 reasons that he gives for rejecting it, I think
25 you'll find that the record shows that they're not

1 particularly good reasons, that they don't actually
2 fit with the reasoning of his own testimony. That's
3 one reason in addition that I really don't give a
4 whole lot of credibility to that 11.23 percent that
5 he came up with subjectively.

6 If you look at the ultimate results he
7 comes up with subjectively, which appear on page 24
8 of his testimony in table 10, he has his 11.23
9 number there, and these are his kind of subjectively
10 derived numbers. The range of rate of return there
11 is 9.5 percent to 14 percent. If you go back to
12 Exhibit JSG-4, Schedule 1, that's at the back of my
13 rebuttal testimony, and looking at Schedule 1, page
14 2 of 2, that's the 50-50 weighting. The range of
15 returns on that exhibit is 9.53 to 14.09. In
16 essence, it's virtually identical to the range that
17 he has in his ultimate DCF analysis. But the
18 average is very different. The average for the
19 group is 12 percent. So I would submit they're not
20 enormous differences between us, but somewhere in
21 the course of making some subjective adjustment,
22 he's come out with a very low number that just is
23 not reflected by the record.

24 I believe that Zacks growth rate and the
25 book value growth rate should both be given at least

1 some serious consideration, should both be
2 reflected, and that the appropriate growth rate is
3 somewhere between the two, not below either of them.
4 So having said that --

5 MR. HOBERG: Commissioner Wefald.

6 COMMISSIONER WEFALD: On Mr. Gaske's -- now
7 we're about page 10 of his 29 pages of testimony.
8 How much longer is he anticipating going, because I
9 do want to make sure that we have a chance to ask
10 questions of the other people who are here and have
11 a chance to hear the other presentations?

12 THE WITNESS: I think I've gone through the
13 really detailed parts. It won't -- I don't think it
14 will be nearly as long to do the last.

15 COMMISSIONER WEFALD: Thank you.

16 THE WITNESS: The next area that's fairly
17 important is the risk assessment. Mr. King believes
18 that the company, Montana-Dakota Utilities, is a
19 relatively low-risk operation. His primary reason
20 for saying that is that Montana-Dakota Utilities is
21 a part of a very large company. Now, yesterday he
22 gave an example of Atlanta Gas Light, who lost a
23 customer and, you know, obviously had some risk
24 there.

25 The thing about Atlanta Gas Light is that

1 in my direct testimony I have evidence that compares
2 the size of Atlanta Gas Light to the size of
3 Montana-Dakota's gas distribution operations and
4 that appears on JSG-2, page 1. And it looks like
5 Atlanta Gas Light's assets are 3.3 billion as
6 opposed to Montana-Dakota's gas distribution assets
7 of 183 million. The operation operating income for
8 AGL was 209 million, but Montana-Dakota's gas
9 distribution operating income was \$4 million, an
10 enormous difference in size. For AGL, with a large
11 territory, a very large population, that it serves,
12 it can lose major customers and it will hurt AGL.
13 Montana-Dakota, on the other hand, can be hurt much
14 more if large companies, large operations leave its
15 service territory leaving people unemployed, and
16 perhaps stranded facilities behind or other impacts
17 along those lines.

18 It's interesting, his argument on the small
19 company issue, because one of the reasons he says
20 Montana-Dakota has low risks is that we're only
21 looking at the gas distribution operations. We're
22 looking at them as a stand-alone operation and
23 they're 100 percent gas distribution, whereas these
24 other companies are diversified, at least to some
25 extent, and at that part of his testimony he says,

1 essentially gas distribution is less risky than a
2 diversified company. However, when he gets to the
3 small company issue, he says, well, actually, these
4 gas distribution operations of Montana-Dakota,
5 they're part of a great big company.

6 So there's a direct contradiction there in
7 what he's saying. On the one hand, the company is
8 low risk because we'll look at it on a stand-alone
9 basis, 100 percent gas distribution business. On
10 the next hand, it's also low risk because it's part
11 of a larger holding company with other operations so
12 we'll look at it on a consolidated basis for that
13 issue. Two diametrically opposed positions on the
14 risk when analyzing risks in different situations,
15 but both of those positions lead to the same
16 conclusion, low risk, at least in his mind.

17 Now, one of the things that he talked about
18 yesterday was, for example, competition. All of
19 these companies, including Montana-Dakota, face
20 competition. So it's not a major factor to
21 distinguish them. He talked about Washington Gas
22 Light in particular, and I have another exhibit and
23 I won't spend too much time on it, just to introduce
24 it into the record, but I went on the Washington Gas
25 Light Website because I happen to be a customer of

1 theirs. I know something about what happens in
2 their service territory and what has happened in the
3 past.

4 This Exhibit No. 35, which I think was
5 just --

6 MR. HOBERG: Exhibit 34?

7 THE WITNESS: I skipped over 34 in the
8 interest of saving time.

9 MR. PEARCE: While we're paused for a
10 moment, I'd like to offer Exhibit 33, which I didn't
11 do before, the DCF summary.

12 MR. HOBERG: Okay.

13 THE WITNESS: In the late '70s and early --

14 MR. HOBERG: Just a minute, please.

15 Mr. Binek, any objection to 33?

16 MR. BINEK: No.

17 MR. HOBERG: 33 is admitted then. You
18 skipped over 34, Dr. Gaske?

19 THE WITNESS: Yes, I did.

20 MR. HOBERG: Are you still offering 34?

21 THE WITNESS: Yes, I think I'll mention it
22 very quickly at the end.

23 MR. HOBERG: Okay.

24 THE WITNESS: In the Washington, D.C. area
25 a lot of new homes were built with electric heat

1 pumps in the late '70s and early '80s. It was a
2 relatively new type of appliance. The cost of gas
3 at that time was over \$4 a decatherm. On an
4 inflation-adjusted basis we're probably talking
5 about \$12, \$15, and new homes were being built with
6 these heat pumps. The thing about the heat pumps is
7 that they didn't really work very well. My parents
8 have one and they have heavy sweaters that they wear
9 all the time. People figured that out and not a
10 whole lot of heat pumps are being put in place. The
11 price of gas relative to electric heating has come
12 down considerably since then.

13 On their Website they talk about the fact
14 that they have an active program for conversions. A
15 lot of people who bought houses that had heat pumps
16 in them are converting. In their Website they say
17 that for gas heating, gas heating is preferred 4 to
18 1 in their service territory. They have about 80
19 percent of the heating market. They also in the
20 same exhibit say that 9 out of 10 new homes in the
21 metropolitan area are heated with natural gas.

22 COMMISSIONER WEFALD: What is the relevance
23 of this exhibit?

24 THE WITNESS: The relevance is that
25 yesterday we were told that, well, the proxy

1 companies really face a great deal more competition
2 than Montana-Dakota does. Montana-Dakota faces
3 competition, potential competition from propane.
4 This company faces competition from electric heat
5 pumps. And I wanted to place this in context, that,
6 in fact, they're winning 90 percent of the new
7 business. So they do have competition, and I don't
8 dispute that. Montana-Dakota has competition, and I
9 don't dispute that, but it's really a matter of what
10 degree and how much weight do you give that
11 competition in distinguishing between the companies.

12 MR. HOBERG: Are you offering Exhibit 35
13 then?

14 MR. PEARCE: Yes.

15 MR. HOBERG: Any objection to Exhibit 35,
16 Mr. Binek?

17 MR. BINEK: No. I think it's kind of what
18 we were trying to establish yesterday.

19 MR. HOBERG: Okay. 35 is admitted.

20 THE WITNESS: Okay. The last exhibit that
21 I want to introduce is the bond ratings for the
22 companies in Mr. King's proxy group. Now, Mr. King
23 says that Montana-Dakota has very low risk relative
24 to these companies, but when you look at the bond
25 rating, it's right about at the average or the

1 median of the group. It's not exceptionally low.
2 What's interesting about this is that, as he and I
3 both discuss, Montana-Dakota has at least for
4 this -- in this filing and for the utility
5 operations they have a higher equity ratio than many
6 of the other companies. I maintain in my rebuttal
7 testimony that, in fact, they have slightly or
8 somewhat above average business risks. So you have
9 financial risks represented by the capital structure
10 and you have business risks also in there.

11 When you put the two together, the company
12 has about average risks and that's borne out by
13 these bond ratings, which reflect a combination of
14 both business and financial risk. In my direct
15 testimony, as I said earlier, Montana-Dakota's first
16 mortgage bonds have a lower average rating than the
17 Moody's gas distribution group. And my overall
18 assessment of that group indicates to me that they
19 have above-average risk relative to that group, but
20 relative to Mr. King's proxy group, they have
21 essentially average risk and that's supported in
22 part by these bond ratings, that they have a higher
23 equity ratio, but I think they have higher business
24 risk.

25 One of those risks is the fact that they're

1 small. In his testimony Mr. King at one point, and
2 I want to direct you there, but he says, for
3 example, Southwest Gas may be actually less risky
4 because it's growing rapidly. Well, in Montana-
5 Dakota's service territory there's little or no
6 growth at all and, in fact, if you look behind
7 what's going on a little bit, they have customer
8 growth of about 1 percent per year, but a lot of
9 that is people moving out of small towns to the
10 larger cities. So you have a situation where
11 they're needing to expand facilities in the city,
12 but they still have costs that they have to recover
13 in the smaller towns that factor declining
14 population. And in the long run that's a problem
15 for the company.

16 Mr. King indicates that a fast growing
17 company like Southwest Gas has low risk. Well, when
18 you -- I talked about this in my rebuttal testimony.
19 If you look at Montana-Dakota, it's at the other end
20 of the spectrum.

21 I have some additional things in my
22 rebuttal testimony. I demonstrate that the premiums
23 between Baa bonds and U.S. Treasury bonds are the
24 highest now they have -- or just about the highest
25 they have been in 10 years, other than briefly after

1 September 11th. The force and weight of that is
2 that Mr. King has some testimony where he takes the
3 rate of return that's been allowed in some past
4 periods and says, well, here's what the treasury
5 bond rates were then and here's what the treasury
6 bond rates are now, but Baa bond rates are much
7 closer in risk to the common stock of a gas
8 distribution company. And the higher the risk, the
9 bigger the premium. And we talked about this at
10 great length yesterday so I'm not going to go any
11 further than that.

12 But if you really look closely at the
13 question, I believe that this increase in the risk
14 premium required by investors probably indicates
15 that if you use the past allowed rates of return as
16 a benchmark, you probably ought to have even higher
17 rate of return now, but that's just as a benchmark.
18 The real heart and soul of both analyses are the DCF
19 analyses, and, hopefully, I've helped you understand
20 what the difference is between the two -- between
21 the two of us on that issue.

22 MR. HOBERG: Thank you, Mr. Gaske. Did you
23 want to offer 34 and 36?

24 MR. PEARCE: 36, I would offer.

25 Q. (MR. PEARCE CONTINUING) Did you want to

1 say something about Exhibit 34, Dr. Gaske?

2 A. Yesterday I was asked various questions
3 about, I believe it was Exhibit 11 that was
4 introduced that showed returns over a long period of
5 time. Exhibit 34 looks at Ibbotson data, and it
6 finds that when you do a statistical analysis of the
7 difference between bond returns and stock returns,
8 you're assured that there's a difference at a level
9 of about 99.93 percent. And that shows up on the
10 last page of it. I won't go into a lot of detail on
11 the statistical techniques and things like that, but
12 that's the correct way to analyze something like
13 that.

14 I looked at the average difference between
15 the two and I found what you would expect, that the
16 probability that the premiums are higher than
17 average is 50 percent and the probability that they
18 are lower than average is 50 percent. In other
19 words, the historical premiums do represent the best
20 estimate of what kind of premiums have been
21 available over a long run in the market. And the
22 questions yesterday about standard deviation and
23 mean, I believe were really off point for whatever
24 point ultimately is to be made with that data. So I
25 put this in the record to have what I believe is a

1 more appropriate analysis.

2 MR. HOBERG: Thank you. So you're offering
3 34?

4 MR. PEARCE: I'll offer 34 as well.

5 MR. HOBERG: Any objection, Mr. Binek?

6 MR. BINEK: No.

7 MR. HOBERG: 34 and 36 are admitted. Any
8 further questions then, Mr. Pearce?

9 MR. PEARCE: Did I formally offer the
10 written testimony, Exhibit 24? I don't show that
11 yet. I'll offer that at this time.

12 MR. HOBERG: Any objection to the formal
13 written rebuttal testimony of Dr. Gaske?

14 MR. BINEK: No.

15 MR. HOBERG: Exhibit 24-54 is admitted.
16 You have no further questions?

17 MR. PEARCE: No.

18 MR. HOBERG: Mr. Binek, do you have a
19 number of questions?

20 MR. BINEK: It might be a good time to take
21 a little bit of a break and we may be able to
22 shorten our questions.

23 MR. HOBERG: I think all of the witnesses,
24 next witnesses and the questions regarding all the
25 next witnesses maybe you want to look at to see.

1 I'm assuming we're going to get done at 5:00. If
2 that's the goal, then we're going to have to look at
3 ways to do that. So let's take five minutes right
4 here.

5 (Recess was taken.)

6 MR. HOBERG: We are back from recess and
7 completed the direct of the rebuttal of Mr. Gaske.
8 Mr. Binek, do you have any questions on cross-
9 examination?

10 MR. BINEK: Yes, I do have a few. Been
11 able to eliminate a number.

12 MR. HOBERG: Good.

13 CROSS-EXAMINATION

14 BY MR. BINEK:

15 Q. First of all, referring to your exhibits,
16 how many of these exhibits could have been
17 introduced with your rebuttal testimony?

18 A. All of these exhibits were prepared last
19 night or subsequent to the filing of my rebuttal.
20 Except for maybe one, all of them were prepared last
21 night in response to various things that Mr. King
22 had to say yesterday.

23 Q. Based on the record here, they could have
24 been prepared prior to that?

25 A. Some of them could have been, but the ones

1 that could have been really reflect information that
2 was available in the record. Some --

3 Q. Okay. It doesn't matter that much, anyway.

4 A. There really wouldn't have been any reason
5 to introduce them until I heard Mr. King's rebuttal
6 or surrebuttal yesterday where he discussed a number
7 of things that were in my rebuttal testimony.

8 Q. Okay. Your Exhibit 31 assumes a
9 market-to-book ratio of 1; isn't that correct?

10 A. Yes.

11 Q. Do any of either yours or Mr. King's
12 comparable companies have a market-to-book ratio of
13 1 or less?

14 A. No.

15 Q. In fact, don't all of these companies have
16 market-to-book ratios higher than 1?

17 A. The same principle that's shown in there
18 still applies but, yes. Yes, their market-to-book
19 ratios would go down if they were to issue common
20 stock, and so the value of their other assets would
21 go down.

22 Q. When a company sells new stock at a market
23 value greater than book, what does that do to the
24 book value of the existing stocks?

25 A. It increases the book value of the stocks.

1 The book value for original cost of the plant, if it
2 puts it in utility plant, will be equal to the
3 proceeds, and the market value, as I show there,
4 will go down.

5 Q. Now, going to Exhibit 32, if you round WGL
6 Holdings percentage gas distribution to the nearest
7 percentage point, what do you get?

8 A. 75 percent.

9 Q. Okay. Had you included WGL in -- what is
10 it -- pages 1 and 2 of Schedule 1 of JSG-4, what
11 would it have done to the 11.8 percent you show?

12 A. It would have made it approximately 11.6.

13 Q. So it would have reduced it?

14 A. Yes, if you included it.

15 Q. Where does Mr. King say he places weight on
16 his historical DCF returns? Perhaps if you look at
17 page 22 of his testimony at the bottom.

18 A. I'm at page 22.

19 Q. Well, in fact, doesn't he say exactly what
20 you've said about historical results on pages 23 and
21 24 -- or 22 and 23?

22 A. He says -- yes, he says that in general.

23 Q. Okay. Thank you.

24 A. Well, actually we can handle that on brief,
25 because I can't find the passage right now that

1 would answer your original question.

2 Q. Okay. I'd like to have you turn to page 23
3 of Mr. King's testimony. Are Mr. King's book value
4 growth results always higher than the classic
5 returns?

6 A. No.

7 Q. Did Mr. King use book value growth as a
8 ceiling in all cases? We're referring to table 10.

9 A. In some cases, yes. Some cases, no.
10 Actually, you shouldn't say that. On table 10 it's
11 not really entirely clear where those numbers come
12 from. They are really his subjective decisions, and
13 earlier in his testimony he says why he considers it
14 to be a ceiling.

15 Q. But the question was, did he use book value
16 growth as a ceiling?

17 A. Some of those numbers are higher than the
18 book value growth rate for its individual companies,
19 yes.

20 Q. Do you recall Mr. King testifying as to the
21 number of customers AGL has, and do you know how
22 many they have?

23 A. Now, it depends on which part of their
24 operation. He said that AGL has 11, but, in fact,
25 obviously Atlanta Gas Light has, I would guess, more

1 than a million.

2 Q. You're certain of that? Do you know who it
3 markets to?

4 A. Now, are you asking how many customers the
5 utility has or how many gas marketing customers they
6 have?

7 Q. It's one and the same.

8 A. Actually, that's not true.

9 Q. Well, how many gas marketing customers does
10 it have?

11 A. Well, yesterday he said that they had 11,
12 but it's a gas distributor that serves, you know,
13 people all over the Atlanta area.

14 MR. BINEK: No further questions.

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

16 Commissioner Wefald, do you have any questions?

17 COMMISSIONER WEFALD: No, I have none.

18 COMMISSIONER CLARK: I have none. Thank
19 you.

20 MR. HOBERG: Mr. Diller, no questions? Any
21 additional questions, Mr. Pearce?

22 MR. PEARCE: No.

23 MR. HOBERG: Nothing further then of
24 Dr. Gaske. Thank you, Dr. Gaske. Next witness,
25 Mr. Pearce.

1 MR. PEARCE: Call Rita Mulkern.

2 MR. HOBERG: Ms. Mulkern, you, too,
3 testified yesterday so I just need to remind you
4 that you are still under oath.

5 THE WITNESS: Yes.

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

9 DIRECT EXAMINATION

10 BY MR. PEARCE:

11 Q. Ms. Mulkern, you have prepared and had
12 prefiled in this case written rebuttal testimony,
13 have you not?

14 A. Yes, I have.

15 Q. Is that Exhibit 25? You don't have it
16 there. It's been marked as Exhibit 25.

17 MR. PEARCE: I will offer that at this
18 time.

19 Q. (MR. PEARCE CONTINUING) And ask
20 Ms. Mulkern if she could please summarize her
21 testimony.

22 MR. HOBERG: Any objection to Exhibit 25 --
23 actually 25-55?

24 MR. BINEK: No.

25 MR. HOBERG: No objection. Exhibit 25 is

1 admitted.

2 THE WITNESS: I'll summarize my testimony.
3 What I would like to do is to address certain
4 adjustments proposed by Mr. Majoros; namely, the
5 amortization period for rate case expense, the
6 adjustment to other operating and maintenance
7 expenses for inflation, a statement he made
8 concerning the increase requested, and the price of
9 natural gas. And a statement concerning the
10 reasonableness of the increase in the operation and
11 maintenance expenses.

12 On page 15, line 18 of his testimony,
13 Mr. Majoros proposes a five-year amortization of
14 rate case expense, rather than the three-year
15 amortization proposed by the company. And the sole
16 rationale he uses for setting a five-year is the
17 time period between rate cases. And I presume he's
18 referring to the fact that it has been eight years
19 since the last rate case.

20 However, just because it's been eight years
21 since the last rate case does not mean it's going to
22 be another five years before the next rate case. We
23 were able to refrain from filing during that time
24 period because we took action to increase our
25 operating efficiency and reduce costs rather than

1 coming in and seeking a rate increase. And Mr. Fox
2 testified yesterday and specifically talked about
3 some of these measures that we took. He also talked
4 about how we'll continue to strive for operating
5 efficiency and cost reduction, but it is not
6 anticipated that we can replicate our past
7 performance and stay out for -- refrain from filing
8 for another five years. We believe that a
9 three-year amortization provides the best time frame
10 for rate case expense.

11 Alternatively, if the Commission decides
12 that a five-year amortization is appropriate, then
13 the unamortized portion of the balance of that rate
14 case expense should be included as a rate base
15 addition. And the reason for this is that we're
16 spending the money on this rate case. The cash is
17 going out the door today, 2002. With a five-year
18 amortization, the cost will not be fully recovered
19 until the end of 2007 and, therefore, rate base
20 additions will compensate for that time value of not
21 recovering it -- excuse me -- putting in a rate base
22 will give us a return on that component to
23 compensate it for the length of time it takes to
24 recover the cost.

25 On page 16 of his testimony Mr. Majoros

1 proposes to eliminate the inflation amounts from the
2 other operating and maintenance expenses. And he
3 gives his reasons not to allow these because they
4 have not been previously allowed and because he
5 recommends that we not be starting now. Mr. Majoros
6 appears to be missing the point of this adjustment.

7 In this case we're using a projected 2003
8 test period. And in projecting out costs for 2002
9 and 2003, costs were broken down into major
10 categories and these major categories are listed
11 on -- I believe the statements are Exhibit 2,
12 Statement N, page 14. And there we list those items
13 adjusted individually. And those items were labor,
14 benefits, insurance, advertising, and rate case
15 expense. Those adjustments made up 71 percent of
16 the total operating and maintenance expenses for
17 North Dakota gas operations. The remaining 29
18 percent of costs are real costs incurred by the
19 company and they're not likely to remain flat just
20 because they weren't adjusted individually. This
21 category includes such items as materials, postage,
22 vehicle and work equipment expense, uncollectible
23 accounts and some others. And to adjust these
24 upward, we used a three-year average of the Consumer
25 Price Index.

1 The last time this Commission addressed
2 inflation factor in our case was in July of 1991,
3 which was over 11 years ago. Now it is time to
4 recognize that these costs are real costs. They are
5 subject to inflationary pressures, just as the costs
6 we adjusted individually were. For example, we know
7 that postage expense went up July 1, 2002 and
8 overall the increase in our postage expense was
9 about 7 1/2 percent. This postage expense was
10 included in that inflation adjustment, so, if
11 anything, our inflation adjustment could be
12 understated because of that. So the proposed
13 inflation adjustment should be allowed.

14 And now I'd like to just address a couple
15 statements Mr. Majoros made. First, was on page 2,
16 lines 11 and 12 of his testimony, he made the
17 comment that proposed increases will be superimposed
18 on those already resulting from spikes in the market
19 price of gas. Now, that's a very general, broad
20 statement, and is not supported by the evidence.
21 Montana-Dakota's gas cost has been very stable over
22 the long term, with the exception of the winter of
23 2000-2001 where there was a large spike in gas
24 costs, not only here in North Dakota, but it was
25 seen nationwide.

1 Exhibit No. 26 -- or 25 is a graph. Excuse
2 me.

3 MR. PEARCE: RAM-2, Exhibit 25.

4 THE WITNESS: 25 is a graph showing the
5 history of gas costs for North Dakota's gas
6 customers, the amount included in their rates
7 through the monthly purchased gas cost adjustment,
8 and this graph is shown for the period of January of
9 1999 through October of 2002. Now, you can look at
10 the graph and you can see that gas costs, with the
11 exception of that 2000-2001 time period have been
12 very stable and, in fact, they have been slightly
13 lower in 2002 than in previous years. So there have
14 been no spiking gas costs, other than one winter
15 here.

16 In addition, Mr. Majoros seems to be
17 implying that in reviewing a rate case application,
18 one should take into account the cost of gas when
19 looking at that case. But the cost of gas is not
20 what this case is about. As Mr. Fox stated in his
21 testimony, this case is about the distribution
22 portion of our rates, not the gas costs. Those are
23 separate -- done separately through the purchased
24 gas cost adjustment, which we file with this
25 Commission each month under our rate purchased gas

1 cost rate tariff 88.

2 Then on page 5 of his testimony,
3 Mr. Majoros states that a 5.7 percent expense growth
4 rate is not reasonable for the period 2000, 2003.
5 Again, this is a broad, general statement and it's
6 not supported by the evidence. It's unsubstantiated
7 and was made without looking to see why those costs
8 went up. There are certain items that were
9 identified in my direct testimony that increased
10 significantly in 2002 from the 2001 levels. For
11 example, the pension and post-retirement expenses
12 both increased in the 10- to 15-percent range due to
13 the market performance and lower interest rates.
14 Insurance expense also increased significantly in
15 2002 and that was an event that has been experienced
16 nationwide. There's no evidence to back up his
17 statements and, thus, given the current cost levels,
18 a 5.7 increase is entirely reasonable, it's
19 explainable and it's supported by the evidence.

20 In fact, if anything, the 2003 levels are
21 too low. Recently, we received the actuarial report
22 for pension and post-retirement costs for 2003. The
23 results show that the amounts we have in our
24 projected 2003 case are significantly understated.
25 And the reason that these pension costs are too low

1 is because of the returns experienced on the
2 investment in 2001 and 2002. The updated expense
3 for these items will result in an increase in our
4 North Dakota gas operating expenses of \$150,000 for
5 pension and \$90,000 for post-retirement expenses,
6 above what we included in the case. This is a
7 higher level. It's known. It will be -- start
8 recording on the books effective January 2003 and
9 should be recognized.

10 I might note that pension expense -- I
11 talked about significant increases. It's a negative
12 expense. It's a credit to expense. In other words,
13 it lowers -- still lowers the cost of service
14 because it is still a negative expense even with the
15 increases we've seen.

16 In addition, the medical costs for 2003
17 have also increased from the levels projected. And
18 we're projecting now for 2003 it will be \$124,000
19 over the amount that was filed in our rate case.

20 That completes my rebuttal testimony.

21 MR. HOBERG: Any additional questions,
22 Mr. Pearce?

23 MR. PEARCE: No. I have nothing else.

24 MR. HOBERG: Mr. Binek, any questions of
25 Ms. Mulkern?

CROSS-EXAMINATION

1

2 BY MR. BINEK:

3 Q. A question that got passed on to you. What
4 capital structure did the company use in its
5 rate-of-return testimony in the electric case
6 earlier this year?

7 A. I don't recall.

8 Q. On pages 1 and 2 of your rebuttal
9 testimony -- I guess, let me go back to this other
10 question. Would you accept, subject to check, that
11 the capital structure that was used was based on a
12 year-end 2000?

13 A. That may be, subject to check. However,
14 this is an entirely different case. The electric --

15 Q. I realize that. That was just my question,
16 what was used there.

17 MR. PEARCE: She's simply answering the
18 question. I suggest we let her answer.

19 MR. HOBERG: Why don't you go ahead.

20 THE WITNESS: The electric rate case you
21 are referring to is an entirely different situation.
22 That was initiated by a staff complaint. It was not
23 a general rate case filed by the company. I believe
24 if you look at past rate cases filed by the company,
25 going back as far as 1986, we have filed projected

1 test years and the Commission has used them.

2 Q. (MR. BINEK CONTINUING) On pages 1 and 2 of
3 your rebuttal testimony, you object to the rate case
4 cost recovery that Mr. Majoros has recommended. I
5 believe you heard the testimony of Mr. Jeter that --
6 about the company preparing a new depreciation study
7 that will be completed by the end of the year?

8 A. Yes, I heard that.

9 Q. If this study shows that MDU's depreciation
10 rates should be changed, would the company be filing
11 a new rate case?

12 A. I guess at this point I can't answer what
13 we will or won't, whether or not we file a rate
14 case.

15 Q. Okay. If the company did, this would
16 result in two rate cases in the space of one year,
17 wouldn't it?

18 A. Well, there are several options. As
19 Mr. Jeter mentioned, one option would be a very
20 limited scope, look purely at the depreciation
21 study, and that would be different than a full-blown
22 rate case like this where we are looking at many
23 different issues.

24 Q. If MDU had completed the depreciation study
25 in time for this case, we'd only have one case; is

1 that correct?

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

3 Q. On page 3 of your testimony you state your
4 disagreement with Mr. Majoros' proposal to allow
5 inflation increase and other expenses. Mr. Majoros
6 says he declined to increase these costs for
7 inflation because such inflation has not previously
8 been allowed. Is he correct?

9 A. Last time this Commission reviewed it was
10 in 1991 and at that time they did not approve it.
11 However, I stated this is 2002. These rates go into
12 2003, and it is time to recognize that these costs
13 are real and they do -- are subject to inflationary
14 pressures.

15 Q. I'd like to have you turn to page 13 of
16 Statement N.

17 MR. HOBERG: Page 13?

18 MR. BINEK: Yes.

19 Q. (MR. BINEK CONTINUING) Do you have that?

20 A. I have it here.

21 Q. Okay. Does that page show the principal
22 categories of cost to which you have applied the
23 inflation factor?

24 A. It shows the cost by function.

25 Q. What is the largest category of expense

1 shown on page 13?

2 A. Largest function is administrative and
3 general expenses.

4 Q. What's the next largest?

5 A. Next largest is customer accounts.

6 Q. Okay. And this category of uncollectible
7 accounts -- or that category would consist primarily
8 of uncollectible accounts, wouldn't it?

9 A. That would be one of the factors in there.
10 Not the sole factor.

11 Q. Why would uncollectible accounts increase
12 with inflation?

13 COMMISSIONER WEFALD: Excuse me. What page
14 are we on?

15 MR. HOBERG: Page 13 of Statement N.

16 COMMISSIONER WEFALD: Thank you.

17 THE WITNESS: Uncollectible accounts are a
18 function of various things. I don't know that I can
19 tie inflation to it specifically or tie it to
20 inflation specifically.

21 Q. (MR. BINEK CONTINUING) Wouldn't
22 uncollectible accounts be more correlated with the
23 overall size of your revenue?

24 A. It would be revenue. It would also be the
25 ability of customers to pay. Maybe if, you know,

1 the economy isn't doing well, customers might have
2 more problems paying their bills. That could be
3 indirectly associated with inflation. There are
4 other factors other than the revenue.

5 Q. Does page 1 of Statement N show that you
6 predict that overall revenue declined dramatically
7 between 2001 and 2002 and will remain virtually flat
8 between 2002 and 2003?

9 A. What we do in a rate case is, we tie our
10 revenues and cost of gas together at a certain point
11 in time in order to -- because we are looking,
12 really, at what the distribution margin is. So the
13 revenue number of 67 million -- this is in
14 thousands, 944 for 2002 is not our projection of
15 what actually revenue would be. It's our projection
16 of what volumes will be for 2004 at the revenues at
17 a certain point in time. In this case it was the
18 revenues in effect for March of 2002. So this
19 number is not representative of a calendar-year
20 revenue that we would expect to see.

21 Q. Okay. And on page 13 of Statement N, is
22 there any recognition that uncollectible accounts
23 will change between 2001, 2002, corresponding with
24 the decline in operating revenues between those two
25 years?

1 A. We did not tie the uncollectible accounts
2 to the revenue.

3 Q. At the bottom of page 4 and the top of page
4 5 you cite a number of items that you expect will
5 increase, including pension and post-retirement
6 expenses and medical costs. Has Mr. Majoros
7 recommended disallowing your quantification of the
8 2003 amounts for any of those items?

9 A. Can you repeat the items he mentioned
10 again?

11 Q. It was pension and post-retirement expenses
12 and medical costs.

13 A. I believe he was in agreement with those.

14 Q. Now, I'd like to have you turn to page 2 of
15 your rebuttal testimony, specifically line 4, and
16 please read -- on page 2, line 4, would you read the
17 statement there down to the end of line 10?

18 MR. HOBERG: It's part of the record. Can
19 we save time by asking a question about it?

20 MR. BINEK: No. We'd like to have that
21 read because there will be some followup questions.

22 MR. HOBERG: Does she have to read it out
23 loud?

24 MR. BINEK: I would prefer that.

25 MR. HOBERG: Okay. Ms. Mulkern.

1 THE WITNESS: The part starting with
2 Montana-Dakota?

3 Q. (MR. BINEK CONTINUING) Yes.

4 A. Montana-Dakota was able to refrain from
5 filing for a rate increase during that time because
6 it took action to increase efficiency and reduce
7 costs using new technologies where possible, rather
8 than seeking an increase in rates, all addressed by
9 Mr. Fox in his direct testimony. Montana-Dakota
10 will continue to strive for operating efficiencies
11 and cost reductions, but it is not anticipated that
12 it can replicate past performance and refrain from
13 filing for another five years.

14 Q. Is it a fact that you did not project past
15 efficiencies and cost reductions in your 2003 test
16 year costs?

17 A. All past efficiencies were included in the
18 2001 base period and, therefore, were included in
19 our 2002 and 2003 projected test periods.

20 Q. Where do we find that?

21 A. Well, these efficiency measures have taken
22 place over time, over a period of years. And what's
23 happened is Mr. Fox mentioned that we're serving
24 more customers per employee and that's taken place
25 over time. Basically, our employees have remained

1 flat. I think maybe even declining. So what you
2 see in 2001 is the effect of all of that. So that's
3 implicit. In our base period those things are --
4 had already happened.

5 Q. Do we see further declines in 2002 and
6 2003?

7 A. No. Because, as Mr. Fox mentioned, and I
8 think I mentioned, we will continue to strive, you
9 know, continue to look everywhere we can to be more
10 cost efficient and reduce costs, but we've looked at
11 all those opportunities. Right now, while we'll
12 continue to look, our option is to file for a rate
13 increase, which is why we are here.

14 Q. Now, turning to page 3 and lines 7 to 9, is
15 it true that the Commission should not rely on its
16 11-year-old decisions?

17 A. I think what I'm saying there is that 11
18 years ago was the last time they looked at it and
19 it's time to take a look at it again because things
20 have changed over 11 years. I think our point is
21 that these costs are real costs. This isn't a game
22 we're playing with these costs. They exist, and
23 they are subject to inflationary pressures. So we
24 do believe the Commission should look at it again
25 and realize it is time to acknowledge that and

1 include an inflation adjustment in our cost of
2 services.

3 Q. Should the Commission rely on the Company's
4 study and data that are 11 years old?

5 A. It depends what you're looking at. As
6 regards the inflation adjustment, I would say no,
7 because I can't make a blanket statement that any
8 time period is exactly the same for everything.

9 MR. BINEK: No further questions.

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

11 Commissioner Wefald, any questions of Ms. Mulkern?

12 COMMISSIONER WEFALD: Yes.

13 EXAMINATION

14 BY COMMISSIONER WEFALD:

15 Q. What if the Commission were to pick a
16 different number than 2.81 percent, higher or lower,
17 how would the company react to that?

18 A. I think we would want to see some
19 recognition of inflationary pressures, and if the
20 Commission would choose a different realistic
21 number, we would accept that.

22 Q. How would you define "realistic number"?

23 A. Well, I guess we defined it as a three-year
24 average of the inflation adjustment. If the
25 Commission might pick a slightly different period, a

1 two-year instead of a three-year average or some
2 other measure that -- you know, that would
3 acknowledge it, we would be content with that.

4 Q. I suppose you can't speculate on what the
5 Commission's thoughts were in not giving an
6 inflation adjustment, but I can perhaps speculate
7 that they wanted to give an incentive to the company
8 to practice savings and to find ways to have savings
9 in those costs while moving forward with their
10 business.

11 If the Commission chose to give a less than
12 2.81 percent with that same idea of giving incentive
13 to the company to try to achieve savings in those
14 areas, what would you think of that?

15 A. Well, I think the company -- we've looked
16 for efficiencies. Our incentive is to -- one of our
17 incentives is to not come in and file for a rate
18 increase, so we are constantly looking for
19 efficiencies so as not to let our costs go up to our
20 customers. If the Commission -- you know, as you
21 said, I can't speculate on why the Commission in
22 1991, precisely why they did not accept it, but I
23 think we already have the incentive to reduce our
24 costs right now.

25 COMMISSIONER WEFALD: Thank you.

1 difficult to find a consultant. We did hire a
2 consultant and that person had to complete a
3 depreciation study for Great Plains before they
4 could start working on Montana-Dakota's study and
5 that took more time than anticipated.

6 Our intent was to have a depreciation
7 study, I believe, around October 1st. Because of
8 various factors, we weren't able to have one by
9 October 1st.

10 Q. Well, if it were to be done by October 1st,
11 that wouldn't leave a whole lot of time for the
12 staff depreciation expert to delve into it, would
13 it?

14 A. No. I'm just kind of referring to the
15 general time frame of this depreciation study.

16 Q. When, about, did you learn that it wouldn't
17 be done on the October 1st time frame?

18 A. I guess I really can't recall when I heard.
19 I said I'm generally aware, but I wasn't
20 specifically involved in the contract.

21 Q. Are you aware of the other pending cases
22 that you have in your other jurisdictions, will that
23 study be able to be used in those jurisdictions?

24 A. We have filed so far two other rate cases
25 in generally about the same time. There was a study

1 filed -- or not a study. A rate case filed in
2 Montana that there will not be a depreciation study
3 by the time that the Commission holds the hearing.
4 We also filed a rate case in Wyoming. They have
5 until June of 2003 to make a decision. I don't know
6 yet what the status would be of the depreciation
7 study in that case.

8 Q. And you haven't filed in South Dakota yet?

9 A. We have not yet filed in South Dakota.

10 Q. Do Montana or Wyoming require periodic
11 depreciation studies to be filed like some states do
12 on a semi-annual basis?

13 A. None of the four states that Montana-Dakota
14 serves natural gas or electricity in requires a
15 depreciation study.

16 Q. Was there any consideration during -- that
17 you're aware of during the last few months that MDU
18 considered delaying this rate case until the
19 Commission could consider it as a whole as opposed
20 to potentially having to do a couple of different
21 rate cases?

22 A. Could you repeat that?

23 Q. Are you aware of any discussions at MDU --
24 have you considered at all kind of holding off on
25 this once you became aware that you may not have a

1 large portion of your -- the evidence that you
2 should have for a rate case available?

3 A. Well, we filed this rate case in April of
4 this year. There are no statutory or legal
5 requirements to file a depreciation study. So our
6 filing is in compliance, if I understand, with the
7 legal and statutory requirements. So I don't think
8 that we were remiss in filing a rate case without a
9 depreciation study because it is not required. I
10 think you had another part to that question.

11 Q. Well, maybe just following up on that, I
12 guess I wasn't implying that there was any legal
13 requirement. It's just my own thought is that,
14 potentially, MDU, being that this is their case and
15 the burden of proof is on them, would want the best
16 information available, but maybe -- I'm just going
17 to close up here quick.

18 You had mentioned that there may be a
19 number of scenarios that could happen as this plays
20 out. Let's assume that the Commission decides a
21 number of issues that are outside of the
22 depreciation part of this case. I think that has to
23 be done in about a month or so. Is that in
24 November, I think? I can't remember what the exact
25 time frame is that we have to have our decision out.

1 But -- and then do what MDU is suggesting, which is
2 just kind of put aside the depreciation portion of
3 this.

4 How does that then play out on December
5 31st beginning next year when you have a new
6 depreciation study? What are the scenarios that
7 could happen here?

8 A. Well, I think part of that is maybe off a
9 little bit. Everyone seems to be presuming in this
10 case that there will be -- that, one, the
11 depreciation rates are going to go down when we do a
12 depreciation study. And I don't think that's a
13 presumption that we can make now. We've provided in
14 this case a 1991 study, a fully detailed study, and
15 we still at this point still stand on that study.
16 We believe that it's still a good study and that is
17 what we filed our case on and it's a good, detailed
18 study based on many years, details going back many
19 years, a lot of data, a very complete study.

20 Q. Okay. So let's go through the scenarios
21 again. If it's the same and it shows the same as
22 the 1991 study and if we accept that as part of this
23 rate case, then nothing would change. If the
24 depreciation changes so that it becomes, in effect,
25 a rate decrease, then do you file updated tariffs

1 just decreasing their rates, decreasing the tariff
2 rates?

3 A. I think I'm getting into an area that I
4 think might be, as far as a legal area, as far as
5 what the Commission -- you know, as far as issuing
6 an order and after that. So I think that's really a
7 legal issue and I don't feel that I can properly
8 address that.

9 Q. Okay. But MDU could consider filing
10 another rate increase if the depreciation schedules
11 indicated that was appropriate, right?

12 A. Yes.

13 COMMISSIONER CLARK: Okay. That's all I've
14 got then.

15 MR. HOBERG: Thank you, Commissioner Clark.
16 Mr. Diller?

17 EXAMINATION

18 BY MR. DILLER:

19 Q. Ms. Mulkern, isn't it true that adjustments
20 for inflation cause inflation? That's a question
21 that Mr. Myer Shark used to ask all the time and I
22 felt like we needed to get his name in the record.

23 And so isn't it true that -- would you
24 agree that adjustments for inflation causes
25 inflation?

1 A. I would not agree with that statement.

2 Q. Could you explain that, please? That's all
3 right. I withdraw the question. I just wanted to
4 have some fun. Let's see if I have a real question
5 here.

6 I think based on the exchange I heard
7 between you and Mr. Binek, if I could maybe
8 characterize your response to him as there's not
9 been any correlation between CPI and these other O&M
10 expenses that haven't been inflated individually in
11 the past, but you feel like CPI will be a fair
12 indicator of what you can expect with these other
13 O&M costs in the future; would that be a fair
14 characterization?

15 A. I think that CPI recognizes that these
16 costs are going to increase with time, with
17 inflation.

18 Q. Now, have you done any long-term comparison
19 between CPI and these other O&M expenses that are
20 being talked about here, any long-term correlations
21 to -- you know, I mean, certainly some years it will
22 be because of efficiencies and this and that the
23 company beats the inflation indicator, but have you
24 done any long-term comparison to see if there's any
25 long-term correlation between CPI and these other

1 O&M expenses?

2 A. Well, I'm not sure what constitutes long
3 term, but I did look back to 1994, since the last
4 rate case, at all these other items, and the
5 increase is greater than inflation for the same time
6 period.

7 Q. Greater than the CPI?

8 A. Yes.

9 Q. That's surprising. But we don't have
10 any -- that's not on the record anywhere?

11 A. No. That was just something that I did on
12 my own.

13 Q. Is that something that's available for
14 providing to the Commission, or is that just
15 something that you kind of did ad hoc and didn't
16 really --

17 A. I have a workpaper on that.

18 Q. Would you mind providing that as a late-
19 filed exhibit?

20 A. I can provide it.

21 Q. I mean, it's not really that long term, but
22 it might be interesting to look at.

23 MR. HOBERG: That would be Late-Filed 5,
24 Mr. Pearce.

25 MR. PEARCE: Yes.

1 Q. All right. So I'm seeing on this just cost
2 of gas?

3 A. These are the items that we did adjust
4 individually. These are the items that make up 71
5 percent of total operating maintenance expense.

6 Q. All right. What are the ones that are not?

7 A. The ones that are not are the ones in the
8 last column that are left over after you adjust all
9 the others separately and that's the one -- that
10 contains such items as postage expense.

11 Q. Now, are you looking under all other O&M?

12 A. That's the one.

13 Q. But it doesn't have anything broken out as
14 to what those include, so you are going to give me a
15 list right now?

16 A. There are many items in this list. These
17 are the ones that make up the 29 percent -- those
18 five items make up 71 percent of all of the O&M,
19 operating and maintenance expenses. All other items
20 make up 29 percent.

21 Q. How do we know which ones are
22 administrative and general of four-million-ninety
23 and there's a separate list of ones that aren't
24 covered? There's some under administrative and
25 general that are covered and then there's some that

1 are not, \$1,617,000?

2 A. Right. We started with our operating
3 expenses in total for North Dakota gas by what we
4 call function, distribution, customer accounting.
5 And from that we deducted in the same by function,
6 the labor expense.

7 Q. Do you determine which ones are not covered
8 by this or did the Commission in its last case?

9 A. No. We looked at what -- kind of the major
10 cost items, the ones that make up the majority of
11 the costs. Five items make up 71 percent. So we
12 looked at those five items specifically. Or I
13 should say some we looked at for other reasons, like
14 rate case expense, but we looked at those five items
15 individually and adjusted those individually.

16 Q. I'm not following you at all. Are they --
17 rate case expense has --

18 A. Rate case expense is included in the
19 administrative and general costs area and --

20 Q. One underneath that?

21 A. One. And that one we adjusted individually
22 because we were looking at the cost of this rate
23 case proceeding, rate case expense. So since we
24 were adjusting that separately, we took it out.

25 Q. You've had other gas cases during this

1 time. I don't understand this chart. So maybe I
2 should just visit with my staff, but I just don't
3 understand the chart at all.

4 A. If I can explain, if you want me to answer.

5 Q. Keep going.

6 A. If you look in the left-hand column and it
7 says "per books," those were the operation and
8 maintenance expenses for 2001.

9 Q. All right.

10 A. And it shows it by function. For instance,
11 the distribution, it covers all the costs in
12 operating and maintaining the distribution system.
13 Customer accounting is for all the billing related
14 and, you know, accounting for the customer for that,
15 and so on.

16 Q. The first one is a total of the other
17 columns; is that correct?

18 A. No. The first column is a starting point.

19 Q. All right.

20 A. From there we were going to -- for
21 instance, for costs of gas for projected 2000 and
22 2003 we calculated that so we adjusted it
23 individually so we deducted it from the total
24 because we're doing that someplace else, we don't
25 want it in this adjustment. Next, we looked at

1 labor and, again, we're going to adjust that
2 separately, so we're going to deduct all the labor
3 costs from this total per books amount. And labor
4 goes into all the functions also.

5 We went down, continued with benefits,
6 which is all charged to an administrative and
7 general account because we adjusted the items and
8 benefits separately. And then insurance we looked
9 at separately. And rate case expense and
10 advertising. So we started with the total per
11 books, we adjusted everything we were going to look
12 at separately, and what's left over is that 29
13 percent I referred to and this is what we applied
14 inflation to, these costs that were remaining after
15 we adjusted certain items individually.

16 Q. So the cost of gas is \$76,000. Is that one
17 of them then?

18 A. That was -- yeah. That's what we had in
19 2001 for gas costs.

20 Q. \$7,988 of labor, is that another one, or am
21 I wrong?

22 A. No. That was labor expense for 2001.

23 Q. I don't get the chart, but I'll work on it
24 later. Thank you. I don't understand it. But
25 thank you very much for trying.

1 MR. HOBERG: Any further questions of
2 Ms. Mulkern? Thank you, Ms. Mulkern. You have
3 three witnesses left?

4 MR. PEARCE: Yes.

5 MR. HOBERG: And a short time to do them
6 in. Next one is Ms. Aberle.

7 MR. PEARCE: Call Tamie Aberle. And I have
8 one -- I have a one-page exhibit.

9 (Exhibit 37 was marked for identification.)

10 MR. HOBERG: Ms. Aberle, you also testified
11 yesterday. I just need to remind you, you are still
12 considered to be under oath. Mr. Pearce. Her
13 rebuttal is Exhibit --

14 MR. PEARCE: 26.

15 MR. HOBERG: -- 26-52.

16 TAMIE A. ABERLE,

17 having been previously sworn, was examined and
18 testified as follows:

19 DIRECT EXAMINATION

20 BY MR. PEARCE:

21 Q. Ms. Aberle, you prepared for this case, did
22 you not, a prefiled written rebuttal testimony?

23 A. Yes, I did.

24 MR. PEARCE: And that's been marked Exhibit
25 26. I'll offer that.

1 Q. (MR. PEARCE CONTINUING) And ask you to
2 summarize your testimony briefly.

3 MR. HOBERG: Any objection to 26?

4 MR. BINEK: No.

5 MR. HOBERG: 26 is admitted.

6 MR. BINEK: Has this been marked as an
7 exhibit?

8 MR. PEARCE: It's marked 37.

9 MR. HOBERG: He hasn't offered it yet.

10 THE WITNESS: I will begin with why I do
11 not agree with Mr. King's position regarding the
12 allocation of mains and the class costs of service
13 study. The company has proposed an allocation of
14 mains based on a customer and demand component.
15 Mr. King advocates that it is not correct to
16 allocate a portion of mains on the customer
17 component. We believe it is appropriate to do so
18 and it is a practice that is used in the gas
19 industry and is supported in a report prepared by
20 the NARUC staff subcommittee on gas. And I've
21 included some references in my rebuttal testimony,
22 Exhibit 26. We did prepare a study that indicates
23 that approximately 36 percent of the mains
24 investment should be allocated to the customer
25 component.

1 Also, Mr. King suggests in his testimony
2 that main additions are only made at the very edges
3 of the system to provide service to new
4 developments. In our system, main additions are
5 also required for purposes of enhancing system
6 integrity and maintaining pressure requirements
7 throughout the system as customers are added. Main
8 additions -- main investment is not a variable cost
9 that increases or decreases as more or less gas is
10 used. Also, the concept of value of service is not
11 appropriate for allocating embedded costs as
12 Mr. King advocates. The value of the heating
13 content of gas does not represent the company's
14 embodied costs or the causation of that cost.

15 Secondly, with regard to the allocation of
16 mains, the allocator used by Mr. King includes total
17 throughput for the energy, which results in
18 excessive amounts of mains being allocated to the
19 interruptible customers who are not utilizing the
20 distribution mains in order to receive natural gas
21 service. We have a number of customers that are
22 connected directly to the transmission system and
23 there are no mains associated with serving those
24 customers.

25 I have prepared a study reflecting 50

1 percent allocation based on throughput at
2 distribution level and 50 percent at the peak day
3 used for the firm customers, and those returns are
4 reported in my testimony. The results are that --
5 results in higher returns for the Air Force and the
6 interruptible classes, which are those classes that
7 have a larger percentage of customers connected
8 directly to the transmission system.

9 I also do not agree with Mr. King's
10 allocation of the rate increase, based on either the
11 company's class cost to service study or a class
12 study based on Mr. King's proposed allocation as
13 modified and as set forth in my Exhibit TAA-4. An
14 increase to the Air Force small interruptible or
15 large interruptible class is not warranted. The
16 subsidization provided by the interruptible classes
17 should not be increased by allocating another
18 increase to those customer classes that are already
19 providing a return on rate base higher than the
20 overall return. The increase -- any increase in
21 revenues to this class is also at risk given the
22 flexible rate provision applicable to the
23 interruptible customers. Presently, approximately
24 20 percent of the small interruptible class and 80
25 percent of the large interruptible volumes are

1 transported under discounted rates.

2 Finally, the Commission did authorize
3 allocating the entire increase to the firm customers
4 in the last rate case.

5 Now, I'd like to address customer impact
6 discussed by Mr. King yesterday in his testimony. I
7 think it's best to focus on the dollar value impact,
8 rather than the percentage increases. And, also,
9 the rate proposal must be looked at in its entirety
10 to talk about customer impact. I'd like you to take
11 a look at the exhibit that was just handed out
12 marked as Exhibit 37, or TAA-6. This is the same
13 exhibit that is in my direct testimony as Exhibit
14 TAA-2. I've simply added two lines that I think
15 help to portray better what the impact of the rate
16 proposal has on the residential customers.

17 COMMISSIONER WEFALD: This is TAA --

18 THE WITNESS: Dash 6. The one that was
19 just handed out --

20 MR. HOBERG: It's a single sheet.

21 THE WITNESS: -- to you as a single sheet.
22 This is a representation of a customer's bill under
23 current rates and under the proposed rates as filed.
24 And this is a typical, average residential customer
25 using 110 decatherms. And it is meant to represent

1 how that gas is used throughout the year. If you
2 look at the line that I've added, base rate as
3 percentage of total, it's indicating that under the
4 proposed rates, our basic service charge or our
5 fixed component of our rate would collect about 28
6 percent of the total customer's bill versus 16
7 percent under the present rate. So as shown there,
8 it's not in the high percentages I believe were
9 discussed yesterday.

10 Also, corresponding with the increase in
11 the basic delivery charge is a decrease in the
12 distribution delivery charge or the commodity, the
13 variable part of the rate. And I've shown on that
14 second line that the non-gas commodity portion of
15 this customer's bill would decrease by \$37 under
16 this example or approximately 44 percent.

17 A couple of other items I'd also like to
18 point out. The increase to the customers, as we've
19 noted to a residential average customer would be
20 approximately \$24. As shown in the amount of
21 increase column, the highest increase would be in
22 the summer ones when they are using less gas, but
23 that increase would only be \$4 in those months.

24 And as shown in my rebuttal testimony,
25 Exhibit TAA-5, there's another bill comparison,

1 which just shows varying levels of consumption,
2 because, as we know, there's customers above and
3 below this. As shown in that Exhibit TAA-5, if a
4 customer used zero volumes through the entire year,
5 their increase per month would still be only \$5.20.

6 MR. HOBERG: That's the last page of
7 your --

8 THE WITNESS: Last page of my prefiled
9 testimony, rebuttal testimony.

10 This rate form also provides customers --
11 or still provides customers with an incentive to
12 conserve natural gas because each decatherm of gas
13 that they conserve, there's still a reduction of
14 \$3.33 associated with that less gas use. And that
15 is the combination of the distribution delivery
16 charge and the cost of gas. So they're showing that
17 still the majority of the customer's bill is still a
18 variable component.

19 What the proposed price structure will do
20 is provide relief to customers during the winter
21 months when their heating requirements result in
22 higher gas use by lowering the amount collected on
23 the volumetric basis and sending an accurate price
24 signal by accurately reflecting fixed costs in the
25 fixed cost component.

1 Just a couple comments with regard to the
2 distribution delivery stabilization charge that was
3 presented in -- by direct testimony. The company
4 has proposed to implement such a mechanism if the
5 proposed base rate levels are not approved. And I
6 also just wanted to comment that the deferral-type
7 mechanism will not result in significant impact as
8 suggested by Mr. King. As shown on Exhibit No. 8 in
9 Mr. Feingold's testimony, based on -- where we did
10 an example based on historic results, the amount
11 charged per bill will be minimal and significantly
12 less than most PCA changes. In that example, over
13 the four-year period reviewed, a residential
14 customer would see a monthly bill change ranging
15 from a negative 20 cents to a positive 84 cents.
16 And that was a bill change, not an amount per
17 decatherm.

18 And, finally, I wanted to just comment on
19 the company's proposal to build a basic service
20 change on a daily basis versus a monthly charge as
21 done today. And the only reason for proposing this
22 change was to provide better information to those
23 customers that are cutting in and out of service and
24 are receiving bills for less than a normal billing
25 period. The proposal will not affect our meter

1 reading or billing schedules.

2 That's all I have for my summary.

3 MR. HOBERG: Are you offering Exhibit 37?

4 MR. PEARCE: I'm offering Exhibit 37. I
5 have no other questions.

6 MR. BINEK: No objection.

7 MR. HOBERG: Okay. Exhibit 37 is admitted.
8 Thank you, Mr. Pearce. Mr. Binek, do you have any
9 questions of Ms. Aberle?

10 MR. BINEK: Yes.

11 CROSS-EXAMINATION

12 BY MR. BINEK:

13 Q. Mr. King has proposed increases in customer
14 charges, hasn't he?

15 A. Yes, he has.

16 Q. Specifically, he proposes that even if
17 rates are decreased, the volumetric rates should be
18 flattened and the initial block revenue be recovered
19 through increases in the customer charges; is that
20 correct?

21 A. Yes.

22 Q. Do you agree with that recommendation?

23 A. Yes. At a minimum I believe that should be
24 done.

25 Q. Mr. King also recommended that if rates are

1 increased, the increase in customer charge should be
2 twice that of the volumetric rate.

3 Do you agree with that?

4 A. I agree if the proposal is -- the rate
5 increase is approved as provided, that our base
6 rates would be approved.

7 Q. Okay. Well, it isn't nearly as much of a
8 customer charge increase as you propose. Would you
9 agree that Mr. King's proposal moves in the
10 direction of the rate design changes the company is
11 seeking in this case?

12 A. I would agree that it moves in the
13 direction.

14 Q. Are the proposed movements toward the
15 company's preferred rate design sufficient to permit
16 the company to withdraw its DDSM proposal?

17 A. I could not answer that at this time.

18 MR. BINEK: I have no further questions.

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

20 Commissioner Wefald, please.

21 EXAMINATION

22 BY COMMISSIONER WEFALD:

23 Q. Yes. I'd like to ask a few more questions
24 about this monthly charge divided into a daily
25 charge. Tell me about the people. You say these in

1 and out accounts. I would like to have a little
2 information about that on the record.

3 A. The accounts we're talking about are
4 people -- you know, in the fall college students.
5 We get a lot of people in and out. They may move in
6 in the middle of the month versus the beginning of
7 the month.

8 Q. So what happens at this point --

9 A. If you are less -- excuse me.

10 Q. -- if I would move in on the 15th?

11 A. We have a normal billing cycle, which is 28
12 to 32 days. If you're outside of that normal
13 billing cycle, your bill is prorated. So that if
14 you're only in service today for -- in service under
15 today's rates for 10 days, you'll receive 10/30ths
16 of the customer charge on your bill. But that
17 bill -- the way that is presented on the bill,
18 because of the way -- it's a proration. Our
19 customer charge is a monthly charge. So it's a
20 combined number on the bill. It shows -- it's
21 combined with the amount of customer charge and
22 usage at that premise for that time period.

23 And the daily charge would simply allow
24 customers to see the number of days in the bill
25 cycle, which is presented on the bill today, and

1 multiply that by the charge that's in effect, the
2 daily charge that's on the tariff sheet, if
3 approved, and be able to calculate that amount.
4 It's simply an informational item. The real crux of
5 our proposal is the amount of the increase and not
6 so much whether it's billed or presented on a daily
7 basis versus the current monthly charge. It really
8 will not impact the revenues we collect or the
9 amount customers pay. It's really an informational
10 item.

11 Q. I understand that. So if you're giving
12 these people who only are using service less than a
13 month and they are already receiving a different
14 amount than the total amount on their bill, then we
15 can just figure that those people are taken care of
16 already?

17 A. Mm-hmm.

18 Q. So --

19 A. It's just information for those people.

20 Q. So don't you think -- well, so you don't
21 really care whether or not -- you're telling the
22 Commission you don't really care whether we do this
23 on a daily basis or on a monthly basis, as long as
24 the costs come out the same for customers throughout
25 the year?

1 for perjury, do you promise to tell the truth in
2 that matter being heard? If so, answer I do.

3 THE WITNESS: I do.

4 MR. HOBERG: Thank you. Mr. Pearce.

5 RICHARD D. SPRATT,

6 being first duly sworn, was examined and testified
7 as follows:

8 DIRECT EXAMINATION

9 BY MR. PEARCE:

10 Q. Mr. Spratt, you have prepared written
11 rebuttal testimony that's been filed in this case,
12 have you not?

13 A. Yes, I have.

14 Q. I'll ask you to just briefly state your
15 name and business address and what your position is
16 with the company, and then if you could summarize
17 the important points in your written rebuttal
18 testimony.

19 A. Okay. It's Richard D. Spratt. My business
20 address is 400 North Fourth Street, Bismarck 58501.
21 I'm vice-president of human resources for Montana-
22 Dakota Utilities, which is a division of Montana-
23 Dakota Resources Group, Inc. My responsibilities
24 include benefits and compensation, staffing,
25 organizational development, behavior, labor and

1 employee relations.

2 Q. Thank you. Would you summarize your
3 written testimony then?

4 A. Yes, I will. And I basically would like to
5 make just a couple points. I'm here basically to
6 refute Mr. Majoros' -- am I saying that right? --
7 his sort of unsubstantiated statement that we should
8 eliminate bonuses and hold 2003 labor costs equal to
9 2002.

10 Let me start with the bonuses. Basically,
11 we have bonuses as part of a total compensation
12 program, which includes not only bonuses, but it
13 also includes your base salary and your benefits and
14 a certain portion of that salary is what we call at-
15 risk. And we do that in varying degrees with
16 different employees based on what's competitive.
17 And that's my first point is that, you know, we see
18 this to use in a competitive way. It makes us
19 competitive and attracts and retains employees for
20 us and so that's, A, why we have a bonus. Now, B,
21 another reason why we do is it sort of focuses
22 employees in on those areas that we need them to
23 focus in on, particularly in recessionary times, to
24 try to save costs and/or at least reduce costs and
25 have it more efficient. So that's my first one,

1 bonuses.

2 Second one, compensation, where he says
3 that we basically should hold the 2003 labor costs
4 equal to 2002 level. A couple of things there.
5 First of all, again, we use as part of a total
6 compensation package a base is a portion of that
7 total compensation package and to be competitive and
8 to attract and retain employees, we need to have
9 competitive wages and salaries. And right now --
10 along with that, we do what we call a compa-ratio
11 analysis to see just how competitive we are. We
12 also use about 11 different surveys that will show
13 us degrees of competitiveness in various areas,
14 including our engineering and our IT staff and our
15 administrative staff. And the compa-ratio analysis
16 that we've done shows that we're really behind
17 competitively, not only in our industry but in
18 general industry in terms of what we've done. So I
19 think in -- to go back a little bit, in 1996 when we
20 started on this -- really started tightening down
21 and started trying cost efficiencies and, you know,
22 looking at costs and one of the things that we did
23 is we started holding our labor costs down quite a
24 bit. And we've gotten behind over the years because
25 of that.

1 To say that we should not increase or we
2 shouldn't grant, I guess, an increase in labor costs
3 is tantamount to making us fall back another
4 probably -- in one case, in the executive case it
5 would be somewhere in the neighborhood of going from
6 11 to 15 percent behind. And then in the office and
7 administrative it would be about 9 percent behind.
8 So in those two areas, you know, I think we need
9 to -- it's our belief we need to continue to do what
10 we're doing primarily to get the efficiencies.

11 Another way we can do this, though, is we
12 could -- particularly with bonuses, is we could
13 build that into our base structure, which basically
14 would cost more money then and that wouldn't be very
15 good for our customers because that has to be passed
16 along as well.

17 The last thing I'll say is that it's my
18 understanding that the Commission ordered Case No.
19 PU-399-01-186 has allowed these kind of costs and
20 expenses before. With that, questions?

21 Q. (MR. PEARCE CONTINUING) Just one question,
22 Mr. Spratt, to clarify. Why would it cost more to
23 package all of the compensation into wages or salary
24 rather than bonuses?

25 A. Right now we have a certain -- in the

1 beginning I said we had a certain portion of our
2 salaries that are at risk and that -- it's dependent
3 on how we perform against financial goals, as well
4 as -- excuse me -- goals that are personal goals
5 that are set up, cost goals, usually. And that's to
6 make us perform better and to be more efficient.
7 But if we just took those and that's at risk, and if
8 we don't -- if we don't achieve those goals, then we
9 don't get paid that portion of it. So if we just
10 rolled it in, that would obviously make the cost of
11 our payroll go up.

12 MR. PEARCE: Okay. I'll offer Exhibit 27.
13 I have no other questions.

14 MR. BINEK: No objection.

15 MR. HOBERG: Exhibit 27-56 is admitted.

16 COMMISSIONER WEFALD: Where is 27?

17 MR. HOBERG: 27 is the rebuttal testimony
18 of Richard D. Spratt. Mr. Binek, do you have any
19 questions of Mr. Spratt?

20 MR. BINEK: Yes.

21 CROSS-EXAMINATION

22 BY MR. BINEK:

23 Q. Mr. Spratt, what was the total amount of
24 bonuses and commissions awarded last year?

25 A. Dollar?

1 Q. Yes.

2 A. I don't know.

3 Q. Would you accept \$518,000 as the amount,
4 subject to check?

5 A. I honestly don't know.

6 Q. Okay. Do you know how much of the -- of
7 the amount was commissions and how much was bonuses?
8 I assume since you don't know the amount, you
9 probably don't know that, either.

10 A. No.

11 Q. Would you be able to tell us what the
12 percentage split would be between commissions and
13 bonuses?

14 A. No. In fact, that commission kind of
15 throws me. I'm not sure -- I know I saw it in here.
16 I think when we're talking about commission, we're
17 talking about incentive and bonuses, period. We
18 don't really have anybody on commission, that I'm
19 aware of. So this would be, in fact, 100 percent
20 bonus.

21 Q. Okay. And then on page 4 you state 60
22 percent of hourly employees, 75 percent of salary
23 employees and 90 percent of management employees are
24 eligible to receive bonus. What determines these
25 percentages?

1 A. Well, those were done -- those are
2 basically surveys that we've done, that we're a part
3 of and that shows that these are the percentage
4 splits that are partaking in bonuses.

5 Q. Surveys taken of whom?

6 A. Various companies, including our own, the
7 utility industry.

8 Q. But these percentages apply to MDU, not to
9 other companies, right?

10 A. No. No. These percentages apply to other
11 companies. If you took the total of the companies
12 in our surveys, if you go back to -- refer back to
13 in my testimony the back page there, you can see if
14 you go down to utility and energy section and you
15 just take the 20 -- on the left-hand side you'll
16 have industry sectors, utility and energy. What
17 they're showing there is in the utility and energy
18 sector -- well, it shows all -- a number of sectors,
19 but particularly in the utility and energy sector,
20 they're saying that there's an average. If you're
21 in the 30 to \$39,000 range, there's a 62.7 percent
22 of those companies are offering bonuses. For 40,000
23 or more it's 75 percent.

24 MR. HOBURG: Just for the record, you're at
25 RDS-1, page 1 of 3, on the back?

1 THE WITNESS: Yes. There's no page number
2 on it.

3 MR. HOBERG: It's up at the top, RDS-1,
4 page 1 of 3, right-hand corner.

5 THE WITNESS: Oh, yes. Yes, that's it.
6 That's RDS-1. And then RDS-2, if you go over,
7 they'll show that the utility and energy sector and
8 it gives a number of responses up at the top and the
9 sample was 1,149 companies, of which 76 were utility
10 and energy and 91.2 percent of those offered. So
11 these numbers are industry numbers. They're not our
12 numbers. Our numbers are a little different.

13 Q. (MR. BINEK CONTINUING) Okay. So what
14 percentage of hourly employees at MDU receive those
15 bonuses, commissions, whatever they are?

16 A. 100 percent.

17 Q. Okay. And salary employees?

18 A. As well, 100 percent.

19 Q. And management employees?

20 A. 100 percent.

21 Q. So all employees are eligible to receive?

22 A. All employees are eligible, correct.

23 Q. Within each category that's eligible to
24 receive bonuses, what proportion typically receives
25 them in each year?

1 A. I'm not sure. I can tell you approximate
2 percentage, but I'm not sure how many.

3 Q. Give us the approximate percentage.

4 A. Well, to give you an example, two years ago
5 75 percent of -- 75 percent of our total employee
6 population eligible for the BETA received a 7
7 percent bonus. And then last year it was about --
8 overall it was about six-tenths of a percent that
9 they received.

10 Q. Okay. Again, 75 percent of the -- is it 75
11 percent of all employees --

12 A. Yes.

13 Q. -- received these bonuses?

14 A. That's correct.

15 Q. And it was 7 percent, and what was the
16 figure last year?

17 A. Last year was six-tenths of 1 percent.

18 Q. Okay. Does the total amount of bonuses
19 awarded each year typically remain the same, or does
20 it vary from year to year?

21 A. The number of bonuses?

22 Q. Total amount of bonuses.

23 A. The total amount. It would vary some year
24 to year, depending on how we did against our
25 financial goals and how we did against our personal

1 goals.

2 Q. Does the total amount of bonuses vary among
3 the three categories of employees, the hourly,
4 salaried and management?

5 A. Yes, it would.

6 Q. Do the same employees typically receive
7 bonuses each year?

8 A. Overall I would say, yes. I mean, 100
9 percent of our employees are eligible for bonuses
10 and so, I mean, there are some that will --
11 particularly, if we meet our financial goals,
12 everybody shares in that one, but if they don't hit
13 their personal goals, they wouldn't share in that
14 portion of it.

15 Q. At the top of page 7 you state that the
16 annual wage increases each year have averaged 3.7
17 percent over the last five years. According to our
18 calculation, that would mean that over the total
19 five-year period MDU has increased wages by 20
20 percent. Would you agree?

21 A. Yes, approximately.

22 Q. Have bonuses increased proportionately?

23 A. No. Bonuses have been up and down. I
24 mean, one year -- like I said, last year it was very
25 low. The year before that it was fairly high.

1 Q. During the past five years has MDU received
2 any increase in its gas rates?

3 A. I'm not aware of that.

4 Q. In fact, in 1998 the company agreed to a
5 gas reduction; isn't that true?

6 A. I don't know. I've only been here for
7 about a year and a half.

8 Q. So you wouldn't know when the last gas rate
9 increase was?

10 A. That's right.

11 Q. Okay. Would you accept, subject to check,
12 that the last case was decided on November 23, 1993?

13 A. Would I accept that?

14 Q. Yes.

15 A. Certainly, yes.

16 Q. Has the company increased wages each year
17 since 1993?

18 A. No, I don't think they have. Actually, we
19 had a freeze, I know, for a while and, again, that's
20 -- I'd have to defer that. We had a freeze on wages
21 there for a while, I know.

22 Q. But over the last five years you did agree
23 that the increases have averaged 3.7 percent each
24 year?

25 A. Yes.

1 Q. Okay. How has the company been able to
2 hold retail rates level and, in fact, reduce them
3 while increasing wages each year?

4 A. Part of that, I think, goes to the fact
5 that we've just become much more efficient. If you
6 look at our population, we've decreased over the
7 years. And, you know, we've asked our employees
8 actually to do more and then technology has also
9 helped us out in that respect.

10 Q. In other words, you've been able to improve
11 labor productivity over these past years sufficient
12 each year to offset the annual increases in wages,
13 salaries and bonuses; is that correct?

14 A. I don't know if it completely offsets it,
15 but, yes, essentially, you're correct. We've
16 increased our labor productivity.

17 Q. Where in this case do we see a forecast of
18 the productivity offset to the wage and salary
19 increases you predict for the year 2003?

20 A. Where?

21 Q. Yes.

22 A. Say that again, please.

23 Q. Where in this case is there a forecast of a
24 productivity offset to the wage and salary increases
25 you predict for the year 2003?

1 THE WITNESS: Are you talking about the
2 numbers themselves?

3 Q. (COMMISSIONER WEFALD CONTINUING) Yes. For
4 2000, 2001, 2002, 2003.

5 A. Okay.

6 Q. Where would I find the breakout of the
7 numbers of labor and bonuses in this case?

8 MR. PEARCE: Perhaps we can have
9 Ms. Mulkern point us to that. Perhaps we can find
10 it here. It's certainly in these statements of the
11 expense items. I'll see if we can find it. It's
12 just been pointed out to me from both sides. In
13 Statement N, page 7 of 23 and --

14 COMMISSIONER WEFALD: Statement N, page 7
15 of 23.

16 MR. PEARCE: I don't know if the witness
17 has the exhibit up there. I'll give him this copy.

18 Q. (COMMISSIONER WEFALD CONTINUING) So am I
19 correct then that the labor expense in 2001 includes
20 bonuses as well? Bonuses as well as other labor
21 expense?

22 A. Reflects average -- yes, 3.15 increase
23 reflecting average 2002 bonus. Footnote 1 there.

24 Q. Well, it doesn't tell me the exact amount
25 that was paid out in bonuses during that time, does

1 it?

2 A. 3.15 percent, but it doesn't give you the
3 dollar number, you're correct.

4 Q. But it says that that reflects an average
5 2000, 2002 bonus?

6 A. Yes. What was your question?

7 Q. My question was, does this chart tell me
8 how much was paid in labor and how much was paid in
9 bonuses in the year 2001?

10 A. Year 2001, it does not, it appears. I'm
11 sorry. No, it does. It's 2001, 2002, but it just
12 gives you the average of the increase. It doesn't
13 break out bonus and dollar.

14 MR. PEARCE: I think if I may interject,
15 it's -- labor expense isn't broken out, I don't
16 think, anywhere in those statements. That would
17 have to be extracted from the company records. I
18 guess it could be done.

19 MR. HOBERG: Is that something you'd like
20 to see?

21 COMMISSIONER WEFALD: Well, I think it
22 would be helpful because the company -- the staff is
23 arguing that we should eliminate bonuses and they
24 have a number. They're saying that it's half of the
25 increase or something that's projected -- I saw that

1 number someplace. Just a moment. In Mr. Majoros',
2 on page 15 it says, it is unreasonable to be
3 granting bonuses which, in fact, amount to roughly
4 half of the company's overall requested increase
5 when the company is proposing a rate increase to
6 begin with. So I'd like to know what those numbers
7 are so that I can understand better when he talks
8 about it's roughly half of the company's overall
9 requested increase. I'm assuming in labor costs.

10 MR. HOBERG: Mr. Pearce, can you provide
11 that?

12 MR. PEARCE: I assume we can. We'll
13 certainly try to provide that number. That would be
14 6, I think.

15 MR. HOBERG: Late-Filed Exhibit 6.

16 Q. (COMMISSIONER WEFALD CONTINUING) So
17 perhaps it would be helpful to have the actual
18 numbers for 2000 and 2001. We don't -- do you know
19 what the numbers are yet for 2002, because we are
20 not at the time end of the year?

21 A. No, we don't know that now. We wouldn't
22 have the actual until after --

23 MR. HOBERG: Could you project those out,
24 though, on --

25 THE WITNESS: We could, yes. It's not

1 looking good for this year.

2 Q. (COMMISSIONER WEFALD CONTINUING) And then
3 if you'll explain to me what MDU is doing here. Are
4 you -- in your calculation on page 7 of 23,
5 Statement N, explain to me how you're doing this.

6 A. Give me that cite.

7 Q. That same page that we were looking at.

8 A. Seven.

9 Q. Okay. So you're just taking from
10 \$7,988,000 for labor costs in 2001, you're putting
11 in place a 3.15 percent increase for year 2002 and
12 then you're projecting a 3 percent increase for
13 January 1st, 2003?

14 A. That's correct.

15 COMMISSIONER WEFALD: Okay. Thank you.

16 MR. HOBERG: Commissioner Clark, any
17 questions?

18 COMMISSIONER CLARK: Just a couple.

19 EXAMINATION

20 BY COMMISSIONER CLARK:

21 Q. When calculating the C ratio compa-ratio,
22 is the term "market value," is that the same as
23 market average? In other words, when you say 91
24 percent of the market value, is that saying you're
25 90 percent of the market average for a given

1 position or wages?

2 A. Essentially, that's correct. We're at
3 midpoint market average or market value. It's the
4 midpoint of that.

5 Q. Okay.

6 A. We're 91 percent of that.

7 Q. Got it. And that's companywide, it's
8 across the board?

9 A. That's right.

10 Q. Would that follow that individual positions
11 are typically at about that or are there certain
12 areas of --

13 A. Lower and higher. And more lower than
14 higher, though. Because if you took 100 percent,
15 that would mean that everybody was right at the
16 midpoint of their salary range or that market value
17 of their salary range.

18 Q. Do you have any particular area of
19 expertise that tends to be more of a problem where
20 you are at with midpoint than others?

21 A. Well, if you read further, you'll see that
22 the managers are actually lower paid, I think.
23 That's probably where we have more of a problem.

24 Q. Do the C ratios or compa-ratios, include
25 bonuses, or is that just salary?

1 A. No, that's just salary.

2 Q. Is there any way to get a handle on what
3 the bonuses, kind of where that brings it? Because
4 it would seem like if the company has a policy which
5 is trying to move more toward bonuses, which in a
6 lot of ways make sense because it's more incentive
7 based and it has some tax advantages or some savings
8 advantages, when you add those in, where do salaries
9 fall?

10 A. Well, if you take the total compensation
11 package, you know, and you look competitively,
12 you'll see that in various classifications, they'll
13 have different bonus amounts. Overall for mid
14 managers, what we call mid managers -- executives
15 are a little different -- mid managers, but we use
16 about a 15 percent average and that's based on,
17 again, study from Towers Perrin and --

18 Q. So explain, a 15-percent average means 15
19 percent of their total compensation package?

20 A. 15 percent of their base salaries.

21 Q. 15 percent of their base salaries is?

22 A. And that's really at risk. I mean,
23 that's -- you know, they have to perform to get any
24 of that.

25 Q. Okay. I think you're going to have to

1 explain this 15 percent again. It's 15 percent of
2 their base salary?

3 A. Base salary, right. That's what they're
4 eligible to receive.

5 Q. In bonus?

6 A. Up to 15 percent of their base salary and
7 that's for the middle management.

8 Q. And you said that rate is comparable to
9 other industry peers?

10 A. That's -- yeah. That's -- in fact, it's
11 probably a little bit low. If you look at the
12 study, they're going to come in somewhere between 17
13 and 22 percent.

14 COMMISSIONER CLARK: That's all I've got.

15 Thanks.

16 MR. HOBERG: Thank you, Commissioner Clark.

17 Commissioner Wefald.

18 FURTHER EXAMINATION

19 BY COMMISSIONER WEFALD:

20 Q. So if I'm to assume that in 2001 on this
21 same page 7 of 23, Statement N, that a certain
22 amount of dollars are already in 2001 for bonuses?

23 A. 2001?

24 Q. Mm-hmm.

25 A. Those are actuals, I think, aren't they?

1 Q. Those are actuals in 2001. The actual
2 bonuses that were given in 2001.

3 A. Right. I'm assuming that's what they are.
4 I didn't make this chart, but since that's past.

5 Q. So each year you're projecting to give more
6 bonuses, if you put in the increase of the 3.15
7 percent, is that correct? In the first year to 2002
8 and 2003 you would be giving each year a greater
9 amount -- have the potential to have a greater
10 number of dollar bonuses in those three years?

11 A. Let me see if I can clear this up.

12 Q. Let's say there's \$500,000 of bonuses in
13 the first year.

14 A. Let's start with \$1,000. It's easier for
15 me to calculate. Let's say we have a \$1,000 worth
16 of -- well, first of all, let's say we have \$2,000
17 worth of salary, period, and we give a 3 percent
18 increase across the board to those \$2,000, so that
19 would be \$60. So now we have \$2,060. Now, if you
20 assume -- you've got the 3 percent of 2,000 would be
21 60, 3 percent of 2,060 would be something a little
22 more than that. So you're right in assuming that if
23 you give increases, that providing -- and there's
24 nothing guaranteed about these bonuses. If you hit
25 your maximum, then your bonuses would also increase.

1 Q. But if Mr. -- is it Mr. Majoros who was
2 discussing this in his testimony? Is it your
3 understanding that he's recommending eliminating the
4 entire dollar amount of bonuses out of 2001, or is
5 he just recommending that there not be an increase
6 in the dollar amount of bonuses that's included in
7 2001?

8 A. I'm not sure. 2001 is by us so now --

9 Q. Yes, last year. And your chart here is
10 based on 2001 and then you're making an adjustment,
11 reflects an average of 3.15 percent increase.

12 A. Over the actuals paid in 2001.

13 Q. Reflects average 3.15 percent increase
14 reflecting average 2000, 2002 bonus.

15 MR. PEARCE: I think we may be getting
16 stuck here. Perhaps Ms. Mulkern could come back
17 because she's the one that prepared --

18 COMMISSIONER WEFALD: Okay. That would be
19 good.

20 MR. PEARCE: Maybe you can get through this
21 a little faster.

22 MR. HOBERG: Ms. Mulkern, do you want to
23 come back up? Let's do it right now while we're on
24 the subject. If you could stand up there by the
25 mike, please.

1 MS. MULKERN: Can I describe maybe how we
2 developed that labor increase?

3 COMMISSIONER WEFALD: Sure.

4 MS. MULKERN: Okay. We started with 2001
5 actual -- in developing a labor adjustment, we
6 started with the actual gas utility labor expense,
7 total company gas utility for 2001, and that
8 contained the payroll over time, these commissions
9 and bonuses, and we use that title. It really isn't
10 bonuses. It kind of carries over from previous
11 years. And looked at 2001, and then we looked at
12 2002, what was in the budget. And in 2001 we had a
13 higher bonus payout and so if we stayed with the
14 2001 amount and increased that, really, we would be
15 overstating. So we included a three-year average of
16 bonuses and used a three-year average of bonuses for
17 2002, 2001, and 2000 and included that as the
18 bonuses for 2002.

19 So the 3.1 percent -- 3.15 percent increase
20 reflects a three-year average of bonuses in it. So
21 the bonus level for 2000, indirectly 2002 that's
22 embedded in that is less than was actual in 2001
23 because instead of using the actual bonuses, we
24 restated it to a three-year average.

25 COMMISSIONER WEFALD: So there is money in

1 2001 here for bonuses and 2002 you altered the
2 amount of bonus dollars in these and then you also
3 figured a 3.5 percent increase, not only on the
4 bonuses, but on all labor costs?

5 MS. MULKERN: The 3.15 increase for 2003 is
6 net of the bonus. It's not on top of it. It's net
7 of the change in bonus. So that's the overall
8 increase in all labor and reflecting a three-year
9 average.

10 COMMISSIONER WEFALD: All right. And then
11 what happens in 2003?

12 MS. MULKERN: And then in 2003 we adjusted
13 everything up by 3 percent. And that makes sense
14 because everyone's wages are going up and so,
15 generally, the bonus is based on the percent of base
16 salary. So that base goes up and the bonus will go
17 up. If I got, say, a .5 percent bonus in 2002 based
18 on my 2002 salary and, hopefully, I would get a wage
19 increase in 2003 and I got the identical percentage
20 bonus, it would be higher cost because my wage has
21 gone up. So it is appropriate to increase the bonus
22 rate 3 percent, because the overall wages are going
23 up, therefore, the bonus would go up also.

24 COMMISSIONER WEFALD: All right. I
25 understand it. Thank you.

1 DIRECT EXAMINATION

2 BY MR. PEARCE:

3 Q. Mr. Espeland, for this case you prepared
4 written prefiled rebuttal testimony, did you not?

5 A. Yes, I have.

6 MR. PEARCE: And that's been marked as
7 Exhibit 28, I believe. I'll offer that exhibit and
8 I have no further questions.

9 Q. (MR. PEARCE CONTINUING) Would you please
10 give a summary of your testimony?

11 MR. HOBERG: Before you do, any objection
12 to Exhibit 28?

13 MR. BINEK: No.

14 MR. HOBERG: Exhibit 28-55 is admitted.

15 Mr. Espeland, please.

16 THE WITNESS: Thank you. In my written
17 testimony -- and I'll very briefly summarize and
18 refer mainly to the attachments, which provides us
19 supporting information, because I know in making
20 rate case decisions what common practice is,
21 sometimes needs to be supported. If you look at the
22 Exhibit RAE-2, I provided two survey sources to
23 support the common approach using a SERP or a
24 supplemental income security plan for senior
25 management.

1 If you look at page 2 of 3 of Exhibit RAE-2
2 you notice from the Hay survey under the left-hand
3 column under non-qualified plans, it says, 74
4 percent of plan sponsors have some form of non-
5 qualified retirement plan. So three-fourths of the
6 employers have these types of plans. They're very
7 common. Also, if you look at the right-hand column
8 of the survey highlights, the second bullet from the
9 bottom says, target retirement ratios fall into the
10 50 percent to 70 percent range, and so that a 50 to
11 70 percent replacement ratio for retirement income
12 is very common.

13 On page 3 of 3 is another survey of another
14 survey of another consulting company, Clark/Bardes
15 Consulting. They also, if you look at the plan
16 prevalence, have shown that in 2001 on the left-hand
17 bar, 75 percent of the companies surveyed also have
18 these type of plans. If you look up at the top
19 introduction, the last -- on the right-hand column,
20 about halfway through that paragraph, it says, the
21 primary reason for adopting a SERP is the Omnibus
22 Budget Reconciliation Act of 1993, which lowered
23 calculations to 150,000. And at the time prior to
24 that the index was 225,000. So they reduced by over
25 a third the amount of compensation that could be

1 considered in a defined benefit pension plan. That
2 was in part what caused these plans to be added.

3 If you then turn to RAE-3, the next page,
4 which is a graph that shows the percent retirement
5 replacement income, I've shown there on the top ones
6 that qualified plans as to what percent replacement
7 income they provide, and you can see 30,000 is 84
8 percent, and at the top level it's 20 percent, well
9 below the 50 to 70 percent that is common.

10 So that's why we have our SISP program and
11 that's why it's appropriate to include in the rates
12 as a common practice as part of the total
13 compensation program. And the bottom graph reflects
14 how it changes when you add SISP. I believe the
15 prior testimony said that we have an inverse
16 relationship with our SISP where the lower level
17 gets a smaller percentage replacement income under
18 SISP and the higher level gets a higher percentage,
19 and that's correct, but that's only a small part of
20 the total picture. You've got to keep things in
21 context.

22 There are four major parts to our
23 retirement plan. Social Security, and you'll see
24 the inverse relationship there where 40 percent out
25 of the \$30,000 level is provided by Social Security,

1 but only about 3 percent at the top level comes from
2 Social Security. And same with the other plans.
3 Our 401(k) plan has 20 percent provided at the lower
4 income levels, and 8 percent at the higher level.
5 Twenty-four percent comes from the defined benefit
6 pension plan on the lower level and only 9 percent
7 at the top level. That's why we have the SISP, to
8 be fair and competitive and have a reasonable amount
9 of replacement income at the 50 percent level at the
10 top end, which is at the low end of the range of
11 common practice.

12 Again, I want to emphasize as Mr. Spratt
13 has commented, that we approach compensation in a
14 total compensation approach. We can deliver \$1,000
15 in a lot of different ways. We choose to offer base
16 salary. We choose to have incentive pay so it's not
17 a fixed cost, but it's only given if performance is
18 there. And we choose to have benefits and other
19 programs that provide for economic security. It's
20 the most cost-effective way of doing -- delivering
21 value to the executives and to the employees at all
22 levels. And we could easily pay them all in base
23 salary, all in base rate. It would not be the most
24 cost-effective or the most incentivizing for good
25 customer service.

1 That concludes my remarks.

2 MR. PEARCE: I'll offer Exhibit 28. I
3 don't think I did before.

4 MR. HOBERG: You did.

5 MR. PEARCE: I didn't mark it. I have no
6 further questions.

7 MR. HOBERG: Mr. Binek, any questions?

8 MR. BINEK: This has been covered pretty
9 thoroughly, I think, and I'm going to resist the
10 temptation of asking any questions. So I have no
11 questions.

12 MR. HOBERG: Thank you. Commissioner
13 Wefald, any questions?

14 COMMISSIONER WEFALD: I have no questions
15 of this witness.

16 MR. HOBERG: Commissioner Clark, any
17 questions?

18 COMMISSIONER CLARK: None. Thank you.

19 MR. HOBERG: Thank you, Commissioner.
20 Mr. Diller, no questions? No one else has any
21 questions of Mr. Espeland? Thank you, Mr. Espeland.

22 COMMISSIONER WEFALD: I have one for
23 Mr. Spratt.

24 MR. HOBERG: Mr. Spratt, Commissioner
25 Wefald would like to ask a question of you.

1 COMMISSIONER WEFALD: One more.

2 THE WITNESS: Am I still under oath?

3 MR. HOBERG: Yes, you are.

4 FURTHER EXAMINATION

5 BY COMMISSIONER WEFALD:

6 Q. Why should the Commission consider 2002 in
7 an average for bonuses when you haven't even
8 completed the whole year?

9 A. Because we started out last year and told
10 our employees that there was going to be a bonus
11 program. And in that bonus program we have
12 objectives that they're meeting and there are
13 certain financial objectives that we have to meet,
14 as well as personal objectives. So in order for us
15 to be able to keep our promise to our employees, I
16 would like the Commission to do that.

17 Q. Well, we're not going to be approving
18 anything that would go into effect for 2002. Our
19 earliest date of the order would be --

20 A. 2003.

21 Q. Isn't that the year that we're looking at?

22 A. Yes.

23 Q. So it wouldn't make any difference what the
24 Commission did for 2002. So we have to make our
25 decision before the end of 2002 and you have to make

1 projections of what people are going to be getting,
2 but how do we know you are actually going to be
3 giving those bonuses or that people will actually
4 meet the requirements by the end of the year? What
5 I'm wondering is why we shouldn't just use the
6 average of maybe 1999, 2000, and 2001, or maybe just
7 2000 and 2001, instead of -- if we are even
8 considering adding bonuses and why we would even
9 look at numbers from 2002 when they're not actuals?

10 MR. PEARCE: I think this is really
11 Ms. Mulkern's area again. Probably she should
12 address it.

13 MR. HOBERG: Ms. Mulkern, come back up
14 again.

15 COMMISSIONER CLARK: We want you to sing
16 Stairway to Heaven this time.

17 MS. MULKERN: We used an average of 2002,
18 2001 and 2000 because when we were preparing this
19 case in March of 2002, the bonuses are generally
20 paid out in February of each year. So when we
21 prepared this case in March, we had the actual
22 amount of bonuses that had been paid for 2002.

23 COMMISSIONER WEFALD: Okay. Thank you.
24 That answers that question.

25 MR. HOBERG: Any additional questions of

1 Mr. Spratt? Thank you, Mr. Spratt. Is there
2 anything else to bring to the attention of the
3 Commission in regard to evidence in this matter?
4 Mr. Pearce?

5 MR. PEARCE: Just, I guess, in the way of a
6 general statement. There has been a lot of
7 discussion on the depreciation study that's
8 currently underway and, of course, it's our position
9 that that may or may not have some effect in the
10 future on rates, but really isn't critical for this
11 case because we are operating now under a
12 Commission-approved depreciation study from 1991
13 that we think is the appropriate one to be used. So
14 that ongoing depreciation study certainly isn't
15 critical. Now, it may or may not have any effect on
16 rates in the future.

17 Also, I think it's appropriate to renew our
18 motion. It's been taken under advisement, I think,
19 that this proceeding is not the proper one to
20 implement FAS 143 for ratemaking purposes.

21 MR. HOBERG: That's been taken under
22 advisement, yes. Are you going to be providing the
23 late-filed exhibits shortly?

24 MR. PEARCE: What sort of time frame? I
25 think those can be done rather quickly.

1 MR. HOBERG: Probably within the next 15
2 days?

3 MR. PEARCE: Certainly, I would think.
4 Even 10 or 15. Fifteen is fine.

5 MR. HOBERG: That would be appropriate, I
6 believe. There's been some discussion about how to
7 close this out and it's my understanding that both
8 of the -- the staff and you want to file proposed
9 findings of fact, conclusions of law and post
10 hearing briefs?

11 MR. PEARCE: Yes.

12 MR. HOBERG: Mr. Binek; is that correct?

13 MR BINEK: Yes.

14 MR. HOBERG: Okay. We can do that within
15 30 days; is that correct?

16 MR. BINEK: When will the transcript be
17 prepared?

18 MR. HOBERG: Are we preparing a transcript?

19 MR. PEARCE: Yes. And I think we should go
20 off the record because the reporter indicated to me
21 she prefers not to be pushed on the record as to the
22 time.

23 MR. HOBERG: Let's go off the record.

24 (Discussion off the record.)

25 MR. HOBERG: Let's go back on the record.

1 MR. PEARCE: Maybe something like --
2 talking about the last week of October then, maybe.

3 MR. HOBERG: The Commission has until the
4 12th of December to issue a decision.

5 MR. BINEK: I was going to suggest possibly
6 November 15 as a date for proposed findings and
7 briefs.

8 MR. PEARCE: That's fine. Sure.

9 MR. HOBERG: That would give the Commission
10 30 days.

11 MR. BINEK: Just about 30 days.

12 MR. HOBERG: Okay. So you have them to the
13 Commission by the 15th, not mailed or anything, to
14 them by the 15th.

15 MR. PEARCE: Right, in their hands.

16 MR. BINEK: I can get them in their hands.

17 MR. HOBERG: You can do that.

18 MR. PEARCE: We have messengers. I can do
19 that, too.

20 MR. HOBERG: Okay. So proposed findings of
21 fact, conclusion of law and briefs to the Commission
22 by November 15. Late-filed exhibits within 15 days.
23 Is there anything else that needs attention at this
24 time? Mr. Pearce?

25 MR. PEARCE: Nothing for me.

1 MR. HOBERG: Mr. Binek?

2 MR. BINEK: No.

3 MR. HOBERG: Thank you. Commissioner
4 Wefald, did you have any closing statements to make?

5 COMMISSIONER WEFALD: Thank you for a good
6 hearing.

7 MR. HOBERG: Thank you. Commissioner
8 Clark?

9 COMMISSIONER CLARK: Thank you.

10 MR. HOBERG: Let's close this hearing.
11 It's approximately 5:30.

12 (Concluded at 5:30 p.m., the same day.)

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CERTIFICATE OF COURT REPORTER

I, Linda L. Gingery, a Registered Professional Reporter,

DO HEREBY CERTIFY that I recorded in shorthand the foregoing proceedings had and made of record at the time and place hereinbefore indicated.

I DO HEREBY FURTHER CERTIFY that the foregoing typewritten pages contain an accurate transcript of my shorthand notes then and there taken.

Dated at Bismarck, North Dakota, this 21st day of October, 2002.

Linda L. Gingery
Registered Professional Reporter

