

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Montana-Dakota Utilities Co.)
Depreciation Study) Case No. PU-399-02-183

SETTLEMENT AGREEMENT

This Settlement Agreement is entered into by and between Montana-Dakota Utilities Co. ("Montana-Dakota" or "Company") and the Staff of the North Dakota Public Service Commission ("Staff"). This Settlement Agreement resolves all outstanding continued issues in this case in a manner consistent with the public interest and will result in just and reasonable depreciation rates and expense accruals for the Company's natural gas distribution operations in North Dakota.

PROCEDURAL HISTORY

1. On April 12, 2002, Montana-Dakota filed an application for an increase in its North Dakota retail natural gas rates based on a 2003 projected test year. The North Dakota Public Service Commission ("Commission") suspended Montana-Dakota's rate filing and set the matter for investigation and hearing. The disputed issues between Montana-Dakota and the Staff included the proper depreciation rates and depreciation expenses for the test year. The Staff's witness recommended that the test year depreciation expenses proposed by the Company be reduced. The Company's witness maintained that no depreciation rate adjustments should be entertained until a depreciation study being conducted by the Company was completed and reviewed.

Montana-Dakota asked the Commission to defer any consideration of the depreciation issue until Montana-Dakota's new depreciation study was complete, Montana-Dakota agreed to submit the new depreciation study for review by January 31, 2003 as a continued issue in this proceeding subject to the standard and customary contested case process with all parties having rights of discovery, testimony, rebuttal testimony, hearing and briefing.

2. In its Order issued December 18, 2002, the Commission approved continuation of the depreciation issue. Montana-Dakota was directed to file its depreciation study as soon as possible but no later than January 31, 2003. Any resulting changes in depreciation expense ordered by the Commission at the conclusion of the review of the depreciation study would be reflected in rates on a prospective basis.

3. On January 31, 2003, Montana-Dakota filed depreciation studies prepared by AUS Consultants related to Montana-Dakota's common and gas division utility plant.

4. On March 12, 2003, the Commission issued a Notice of Hearing and Procedural Schedule setting the following issues for consideration on Montana-Dakota's depreciation studies:

1. What is the value of Montana-Dakota's property, used and useful, for the service and convenience of the public in North Dakota?
2. What is the appropriate treatment of plant retirement costs?
3. What rates and charges are necessary to provide a just and reasonable rate of return on Montana-Dakota's property, used and useful, for the service and convenience of the public in North Dakota?

A hearing on the above issues was scheduled for April 22, 2003. On April 23, 2003, the Commission rescheduled the hearing to July 1, 2003.

5. The Company's depreciation studies indicated the Company's existing depreciation rates, applied to total system-wide depreciable gas division utility plant in service as of December 31, 2001 resulted in an annual depreciation expense of \$7,694,754. In comparison, application of the study's proposed depreciation rates to the same depreciable plant in service as of December 31, 2001 would result in an annual depreciation expense of \$8,010,389; an increase of \$315,635 from existing rates. The composite annual depreciation rate under the existing rates is 4.52% while the Company's study recommended a proposed composite depreciation rate of 4.70%.

6. For common utility plant, the studies indicated the application of existing rates to total system-wide depreciable common plant in service as of December 31, 2001 resulted in an annual depreciation expense of \$2,167,043. Application of the proposed depreciation rates to the total system-wide depreciable common plant in service as of December 31, 2001 would result in an annual depreciation expense of \$2,666,460; an increase of \$499,417 from the existing rates. The composite annual depreciation rate for common plant under the existing rates is 5.84%, while the studies proposed composite depreciation rate for common plant would be 7.18%.

7. On April 7, 2003, the consultant for the Staff, Charles W. King, filed direct testimony reviewing and critiquing the depreciation study prepared by AUS Consultants. Mr. King also recommended alternative depreciation rates for the gas division and common utility plant of Montana-Dakota. The following is a comparison of the Company's existing depreciation rates as well as those recommended by the Company and the Staff:

<u>Plant Category</u>	<u>Existing</u>		<u>Company Proposal</u>		<u>Staff Proposal</u>	
	<u>Composite Rate</u>	<u>Annual Expense</u>	<u>Composite Rate</u>	<u>Annual Expense</u>	<u>Composite Rate</u>	<u>Annual Accrual</u>
Gas Distribution	4.46%	\$6,758,717	4.01%	\$6,082,611	2.33%	\$3,535,250
Gas General	4.98%	\$ 936,037	10.25%	\$1,927,777	5.27%	\$ 990,871
Common	5.84%	\$2,167,042	7.18%	\$2,666,459	5.27%	\$1,955,583

8. On April 28, 2003, the Company filed rebuttal testimony of Earl M. Robinson responding to the testimony and recommendations of Mr. King.

9. Following the analysis of the depreciation studies and the testimony of the parties respective witnesses, settlement discussions were held between the Staff and Company representatives in accordance with the Commission's proposed settlement guidelines (July 1994). As a result of those discussions, the parties have reached this Settlement Agreement. The parties agree the Settlement Agreement resolves all issues in the proceeding in a manner consistent with applicable law and the settlement guidelines.

10. The Settlement Agreement is supported by the administrative record. Accordingly, the parties jointly recommend the Commission issue an Order: (a) approving this Settlement Agreement in its entirety, without conditions or modifications; (b) approving the depreciation rates for the Company's natural gas distribution and common utility plant; and (c) directing the Company to file revised rate schedules reflecting the impact of the proposed depreciation rates on the Company's existing natural gas retail rates in North Dakota and implementing changes in its natural gas retail rates consistent with this Settlement Agreement.

TERMS OF SETTLEMENT AGREEMENT

Attachment 1 is a schedule by functional plant categories and accounts of the

existing and agreed depreciation rates and the annual system-wide depreciation expenses based upon depreciable plant in service at December 31, 2001. A comparison of the existing rates and expenses, the Company proposal, the Staff proposal, and the recommended depreciation rates and annual expense accruals based on December 31, 2001 system-wide plant in service is shown in Attachment 2.

Staff and Montana-Dakota agree and recommend that the Commission approve the recommended depreciation rates on Attachment 1.

The recommended depreciation rates were arrived through negotiations based upon the studies and testimony provided by the expert consultants for the Staff and the Company. Although the Staff and the Company agree and recommend the depreciation rates set forth on Attachment 1, the parties do not adopt or recommend as part of this Settlement Agreement the amount or a methodology for determining net salvage and average service lives for the various plant accounts. Nothing in this Settlement Agreement shall limit the authority of the Commission to establish, or the Staff and the Company to advocate, in future proceedings, the appropriate methodology or the appropriate amounts of net salvage and average service lives for the various plant accounts.

EFFECTIVE DATE OF REVISED RATES

Subject to approval by the Commission of this Settlement Agreement, the revised depreciation rates and the resulting retail rate change will become effective September 1, 2003.

RETAIL RATE ADJUSTMENT

Upon approval of the Settlement Agreement by the Commission, the Company shall file revised tariff sheets reflecting changes to its North Dakota retail natural gas rates

based upon the depreciation rate changes which is a reduction in annual revenues of \$362,085. Attachment 3 shows the calculation of the North Dakota natural gas retail rate reduction to reflect the recommended depreciated rates and expense accruals. The rate reduction shall be applied to the rate classes in the same manner as the increase that was effective with service rendered December 12, 2002. The applicable change will be implemented as a reduction to the distribution delivery charge component of the rate. The revised tariff sheets shall be filed not less than ten (10) days prior to the effective date.

OTHER TERMS AND CONDITIONS

A. Basis of Settlement.

It is agreed this Settlement Agreement contains negotiated depreciation rates and accrual amounts subject to approval by the Commission. The Settlement Agreement does not establish any principle or precedent regarding the methodology for establishing depreciation rates.

B. Effect of the Settlement Negotiations.

It is understood and agreed that all offers of settlement and discussions related to this Agreement are privileged and may not be used in any manner in connection with proceedings in this case or otherwise, except as provided by law. In the event the Public Service Commission does not approve this Settlement Agreement, it shall not constitute part of the record in this proceeding and no part thereof may be used by any party for any purpose in this proceeding or otherwise.

C. Applicability and Scope.

This Settlement Agreement shall be binding on the parties hereto, and their successors, assigns, agents and representatives. Consistent with the Commission's 1994

proposed settlement guidelines, this Settlement Agreement does not set policy or overturn precedent.

D. Effective Date.

This Settlement Agreement shall be effective on the date of final Commission Order approving the Settlement Agreement with the revised depreciation rates and corresponding revised retail rates effective on the dates specified herein. If the Commission Order modifies or conditions approval, this Settlement Agreement shall be deemed terminated if either party files a letter with the Commission within 3 (three) business days of notice of such Order stating that a condition or modification to the Settlement Agreement is unacceptable to such party.

Dated this _____ day of _____, 2003.

Montana-Dakota Utilities Co.

By: _____
Its: _____

Dated this ____ day of _____, 2003.

North Dakota Public Service Commission

By: _____