

Memo

To: Darrell Nitschke, Executive Secretary
From: Mike Diller
Date: August 11, 2015
Re: Montana-Dakota Utilities Co.—Annual Reports for Gas Operations

| | | | |
|-----------|-----------|-----------|-----------|
| Case Nos. | PU-07-154 | PU-08-167 | PU-09-166 |
| | PU-10-136 | PU-11-119 | PU-12-154 |
| | PU-13-170 | PU-14-169 | PU-15-144 |

I recommend that the commission close the cases associated with MDU's annual report filings for its North Dakota gas operations. I will include a motion to that effect on the consent agenda for September 16, 2015.

MDU provides natural gas to about 106,000 customers in North Dakota or about two-thirds of the natural gas customers in the state. Staff has reviewed the Company's 2006 to 2014 annual reports noting reported returns on equity ranging from 6% to 19%. In the last 3 years, MDU's reported gas earnings have been between 6% and 10%. Using a return on equity of 10% for the last 3 years indicates that MDU under-earned by about \$3 million over that time period.

In the last 10 years, the commission has granted one 4% natural gas rate increase to MDU in April, 2014 and an interim increase of 3.4% in April, 2015. The increased costs to provide service are being driven primarily by infrastructure replacement and the building out of service to the Bakken oil field. For perspective, rate base totaled \$23 million in 2006 and has grown to \$90 million by the end of 2014 and projected to be \$114 million by the end of 2015.

Given the moderate earnings levels recently and the current rate case in progress, staff sees no reason to investigate further and recommends that the commission close these cases. Attached are financial summaries of annual reports filed with the commission in recent years.

- Attachment 1 – Revenue Deficiency Calculation and Rate Base
- Attachment 2 – Net Operating Income
- Attachment 3 – Cost of Capital

C: Tamie Aberle, MDU

Montana-Dakota Utilities Co.
 North Dakota Gas Utility
 Revenue Deficiency Calculation and Rate Base
 ('000's)

| Line | Description | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|----------------------------|----------------------------|----------|----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| <i>Revenue Deficiency:</i> | | | | | | | | | | |
| 1 | Average Rate Base | \$22,885 | \$25,254 | \$32,159 | \$35,392 | \$37,445 | \$40,334 | \$52,202 | \$60,895 | \$90,160 |
| 2 | Rate of Return (10% ROE) | 8.488% | 8.610% | 8.031% | 8.426% | 8.430% | 8.513% | 8.273% | 7.655% | 7.800% |
| 3 | Return Required | \$1,942 | \$2,174 | \$2,583 | \$2,982 | \$3,157 | \$3,434 | \$4,319 | \$4,661 | \$7,032 |
| 4 | Return Earned | \$1,760 | \$2,016 | \$3,207 | \$3,664 | \$4,949 | \$4,103 | \$3,804 | \$3,435 | \$6,838 |
| 5 | Return Deficiency (Excess) | \$182 | \$158 | (\$624) | (\$682) | (\$1,792) | (\$669) | \$515 | \$1,226 | \$194 |
| 6 | Tax Factor | 60.45% | 60.78% | 60.78% | 60.84% | 60.84% | 61.65% | 61.65% | 62.06% | 62.06% |
| 7 | Revenue Def. (Excess) | \$302 | \$261 | (\$1,027) | (\$1,121) | (\$2,946) | (\$1,085) | \$835 | \$1,976 | \$313 |
| <i>Average Rate Base:</i> | | | | | | | | | | |
| 8 | Plants in Service & CWIP | \$82,883 | \$87,642 | \$96,601 | \$102,924 | \$108,356 | \$116,592 | \$134,747 | \$151,718 | \$191,927 |
| 9 | Accum. Res. for Depr. | 56,270 | 58,772 | 61,169 | 63,093 | 64,762 | 67,112 | 69,690 | 73,336 | 77,487 |
| 10 | Net Plant in Service | \$26,613 | \$28,870 | \$35,432 | \$39,831 | \$43,594 | \$49,480 | \$65,057 | \$78,382 | \$114,440 |
| 11 | Materials & Supplies | 711 | 811 | 941 | 909 | 806 | 968 | 1,891 | 2,362 | 2,478 |
| 12 | Fuel Stock/Gas IRP/Other | 21 | 29 | 30 | 28 | 30 | 25 | 35 | 45 | 46 |
| 13 | Prepayments | 155 | 148 | 117 | 153 | 117 | 141 | 149 | 166 | 185 |
| 14 | Unamortized Loss on Debt | | | 895 | 832 | 716 | 615 | 598 | 629 | 659 |
| 15 | G. on Sales | | | | | | | | 0 | (171) |
| 16 | Accum. Def. Income Taxes | (3,930) | (3,779) | (4,239) | (4,877) | (5,613) | (8,133) | (11,027) | (13,201) | (17,345) |
| 17 | Accum. Invest. Tax Credits | (101) | (78) | (56) | (35) | (18) | (8) | (3) | 0 | 0 |
| 18 | Customer Advances | (584) | (747) | (961) | (1,449) | (2,187) | (2,754) | (4,498) | (7,488) | (10,132) |
| 19 | Average Rate Base | \$22,885 | \$25,254 | \$32,159 | \$35,392 | \$37,445 | \$40,334 | \$52,202 | \$60,895 | \$90,160 |

Montana-Dakota Utilities Co.
 North Dakota Gas Utility
 Net Operating Income
 (000's)

Schedule 2

| Line | Description | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|------------------|---------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| 1 | Operating Revenues | \$122,206 | \$105,311 | \$139,464 | \$113,566 | \$99,628 | \$104,610 | \$84,849 | \$110,797 | \$140,007 |
| 2 | Cost of Gas | 99,532 | 82,212 | 113,198 | 88,881 | 74,119 | 78,480 | 58,003 | 81,268 | 103,658 |
| 3 | Production | | | | | | 287 | 271 | 261 | 0 |
| 4 | Other Gas Supply Expense | 119 | 122 | 125 | 108 | 134 | 112 | 117 | 108 | 227 |
| 5 | Net Margin | \$22,555 | \$22,977 | \$26,141 | \$24,577 | \$25,375 | \$25,731 | \$26,458 | \$29,160 | \$36,122 |
| 6 | Distribution Expense | \$ 6,546 | \$ 6,629 | \$ 7,768 | \$ 6,477 | \$ 6,545 | \$ 7,370 | \$ 7,668 | \$ 8,595 | \$ 9,137 |
| 7 | Customer Accounts Exp | 3,108 | 2,973 | 2,745 | 2,588 | 2,263 | 2,364 | 2,159 | 2,616 | 2,854 |
| 8 | Customer Service & Info | 177 | 190 | 247 | 211 | 177 | 191 | 237 | 201 | 245 |
| 9 | Sales Expense | 366 | 360 | 313 | 206 | 132 | 168 | 148 | 176 | 161 |
| 10 | A & G Expense | 6,570 | 6,680 | 6,906 | 5,871 | 5,066 | 6,261 | 6,020 | 6,615 | 6,751 |
| 11 | Other O&M | \$ 16,767 | \$ 16,832 | \$ 17,979 | \$ 15,353 | \$ 14,183 | \$ 16,354 | \$ 16,232 | \$ 18,203 | \$ 19,148 |
| 12 | Depreciation | | 1,004 | 1,068 | 0,854 | 0,924 | 1,153 | 0,993 | 1,121 | 1,052 |
| 13 | Taxes Other Than Income | 2,838 | 2,934 | 3,027 | 3,235 | 3,190 | 3,520 | 3,723 | 4,877 | 5,868 |
| 14 | Expenses (Lines 6-12) | 1,339 | 1,283 | 1,479 | 1,296 | 1,351 | 1,500 | 1,599 | 1,617 | 1,638 |
| 15 | Income Tax Expense | \$ 20,944 | \$ 21,049 | \$ 22,485 | \$ 19,884 | \$ 18,724 | \$ 21,374 | \$ 21,554 | \$ 24,697 | \$ 26,654 |
| 16 | Net Operating Income | \$ (149) | \$ (88) | \$ 449 | \$ 1,029 | \$ 1,702 | \$ 254 | \$ 1,100 | \$ 1,028 | \$ 2,630 |
| 17 | Return on Equity | 8% | 9% | 14% | 14% | 19% | #REF! | 8% | 6% | 10% |
| Tax Calculation: | | | | | | | | | | |
| 18 | NOI before Income Taxes | \$ 1,611 | \$ 1,928 | \$ 3,656 | \$ 4,693 | \$ 6,651 | \$ 4,357 | \$ 4,904 | \$ 4,463 | \$ 9,468 |
| 19 | Rate Base | \$22,885 | \$25,254 | \$32,159 | \$35,392 | \$37,445 | \$40,334 | \$52,202 | \$60,895 | \$90,160 |
| 20 | Weighted Cost of Debt | 3.661% | 3.255% | 3.160% | 3.282% | 3.087% | 3.004% | 2.833% | 2.510% | 2.547% |
| 21 | Interest Deduction | \$838 | \$822 | \$1,016 | \$1,162 | \$1,156 | \$1,212 | \$1,479 | \$1,528 | \$2,296 |
| 22 | Other Tax Adjustments | (\$1,150) | (\$1,330) | (\$1,495) | (\$904) | (\$1,149) | (\$2,483) | (\$557) | (\$225) | (\$241) |
| 23 | Taxable Income | \$ (377) | \$ (224) | \$ 1,145 | \$ 2,628 | \$ 4,346 | \$ 662 | \$ 2,869 | \$ 2,709 | \$ 6,931 |
| 24 | Combined Tax Rate | 39.55% | 39.23% | 39.23% | 39.16% | 39.16% | 38.35% | 38.35% | 37.94% | 37.94% |
| 25 | Income Tax Expense | \$ (149) | \$ (88) | \$ 449 | \$ 1,029 | \$ 1,702 | \$ 254 | \$ 1,100 | \$ 1,028 | \$ 2,630 |
| 26 | Effective Income Tax Rate | -9% | -5% | 12% | 22% | 26% | 6% | 22% | 23% | 28% |
| 27 | Overall Depreciation Rate | 3.4% | 3.3% | 3.1% | 3.1% | 2.9% | 3.0% | 2.8% | 3.2% | 3.1% |

Montana-Dakota Utilities Co.
North Dakota Gas Utility
Cost of Capital
(000's)

Schedule 3

| <u>Line</u> | <u>Description</u> | <u>Balance</u> | <u>Ratio</u> | <u>Cost</u> | <u>Return</u> |
|-------------|---------------------|------------------|-----------------|-------------|---------------|
| 1 | Long-Term Debt | \$141,950 | 34.567% | 7.983% | 2.760% |
| 2 | Short-Term Debt | \$55,473 | 13.509% | 5.436% | 0.734% |
| 3 | Preferred Stock | 15,000 | 3.653% | 4.567% | 0.167% |
| 4 | Common Equity | 198,225 | 48.271% | 10.000% | 4.827% |
| 5 | Total - 2006 | \$410,648 | 100.000% | | 8.488% |
| 6 | Long-Term Debt | \$153,750 | 38.210% | 7.311% | 2.794% |
| 7 | Short-Term Debt | \$17,289 | 4.297% | 6.512% | 0.280% |
| 8 | Preferred Stock | 15,850 | 3.939% | 4.605% | 0.181% |
| 9 | Common Equity | 215,490 | 53.554% | 10.000% | 5.355% |
| 10 | Total - 2007 | \$402,379 | 100.000% | | 8.610% |
| 11 | Long-Term Debt | \$193,254 | 37.683% | 7.016% | 2.644% |
| 12 | Short-Term Debt | \$53,998 | 10.529% | 3.558% | 0.375% |
| 13 | Preferred Stock | 15,750 | 3.071% | 4.601% | 0.141% |
| 14 | Common Equity | 249,840 | 48.717% | 10.000% | 4.872% |
| 15 | Total - 2008 | \$512,842 | 100.000% | | 8.031% |
| 16 | Long-Term Debt | \$258,256 | 45.476% | 6.855% | 3.117% |
| 17 | Short-Term Debt | \$1,880 | 0.331% | 11.590% | 0.038% |
| 18 | Preferred Stock | 15,650 | 2.756% | 4.597% | 0.127% |
| 19 | Common Equity | 292,113 | 51.437% | 10.000% | 5.144% |
| 20 | Total - 2009 | \$567,899 | 100.000% | | 8.426% |
| 21 | Long-Term Debt | \$280,499 | 44.590% | 6.845% | 3.052% |
| 22 | Short-Term Debt | \$4,016 | 0.638% | 5.427% | 0.035% |
| 23 | Preferred Stock | 15,550 | 2.472% | 4.592% | 0.114% |
| 24 | Common Equity | 328,992 | 52.299% | 10.000% | 5.230% |
| 25 | Total - 2010 | \$629,057 | 100.000% | | 8.430% |
| 26 | Long-Term Debt | \$280,492 | 43.316% | 6.845% | 2.965% |
| 27 | Short-Term Debt | \$1,934 | 0.299% | 13.053% | 0.039% |
| 28 | Preferred Stock | 15,450 | 2.386% | 4.588% | 0.109% |
| 29 | Common Equity | 349,672 | 53.999% | 10.000% | 5.400% |
| 30 | Total - 2011 | \$647,548 | 100.000% | | 8.513% |
| 31 | Long-Term Debt | \$280,485 | 40.597% | 6.846% | 2.779% |
| 32 | Short-Term Debt | \$26,206 | 3.793% | 1.406% | 0.053% |
| 33 | Preferred Stock | 15,393 | 2.228% | 4.585% | 0.102% |
| 34 | Common Equity | 368,815 | 53.382% | 10.000% | 5.338% |
| 35 | Total - 2012 | \$690,899 | 100.000% | | 8.273% |
| 36 | Long-Term Debt | \$317,977 | 39.834% | 6.149% | 2.449% |
| 37 | Short-Term Debt | \$61,280 | 7.677% | 0.788% | 0.060% |
| 38 | Preferred Stock | 15,347 | 1.923% | 4.583% | 0.088% |
| 39 | Common Equity | 403,646 | 50.566% | 10.000% | 5.057% |
| 40 | Total - 2013 | \$798,250 | 100.000% | | 7.655% |
| 41 | Long-Term Debt | \$392,969 | 42.556% | 5.870% | 2.498% |
| 42 | Short-Term Debt | \$37,100 | 4.018% | 1.213% | 0.049% |
| 43 | Preferred Stock | 15,308 | 1.658% | 4.581% | 0.076% |
| 44 | Common Equity | 478,047 | 51.769% | 10.000% | 5.177% |
| 45 | Total - 2014 | \$923,424 | 100.000% | | 7.800% |