
**RESPONSE TO REQUEST FOR PROPOSAL
TO PROVIDE CONSULTING SERVICES TO
THE NORTH DAKOTA PUBLIC SERVICE COMMISSION
ECONOMIC REGULATION DIVISION
FOR THE MONTANA DAKOTA UTILITIES (“MDU”) CO.
ELECTRIC RATE CASE**

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RFP NO. PU-10-124

Submitted To:

**North Dakota Public Service Commission
Economic Regulation Division
Procurement Officer: Annette Bendish
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Bismarck, North Dakota 58505-0480
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Submitted By:

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**J. Randall Woolridge, Ph.D.
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June 1, 2010

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- Appendix I: Resumes Larkin & Associates Professionals
- Appendix II: Merger/Acquisition and Recent Electric Case Summaries
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- Appendix IV: Qualifications of Frank Radigan

Attachment

- Letter of Recommendation from Charlie Beck of the Florida Office of Public Counsel
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I. INTRODUCTION

Larkin & Associates and our subcontractors, are pleased to submit this proposal to provide expert consulting assistance requested by the North Dakota Public Service Commission (“NDPSC” or “Commission”), Advocacy Staff of the Economic Regulation Division (“Advocacy Staff”) to assist the department in a thorough analysis of the rate increase application. Larkin & Associates and its subcontractors are proposing to evaluate rate base, rate of return, net operating income, cost allocations and rate design in the electric rate case filed by Montana Dakota Utilities (“MDU” or “Company”).

The following proposal is a firm offer, and will remain open for a period at least 60 days from the deadline for this proposal.

Primary Contractor Information

Larkin & Associates, PLLC (Rate Base/Net Operating Income)
Certified Public Accountants & Regulatory Consultants
15728 Farmington Road
Livonia, MI 48154
(734) 522-3420
email: RSmithLA@aol.com
HLarkinJr@aol.com

Contact Persons:
Ralph C. Smith, CPA
Hugh Larkin, Jr., CPA

Subcontractors

J. Randall Woolridge (Cost of Capital)
120 Haymaker Circle
State College, PA 16801
(814) 865-1160
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Frank Radigan (Rate Design)
Hudson River Energy Group
One Steuben Place, Suite 508
Albany, NY 12207
(518) 436-1628
fradigan@aol.com

Larkin & Associates, Dr. Woolridge and Mr. Radigan have successfully completed numerous rate case engagements together.

Larkin & Associates and its subcontractors will comply with all provisions in RFP No. PU-10-124.

Conflict of Interest Disclaimer

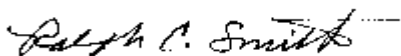
The undersigned does hereby certify there is no financial substantive interest in the utility in this proceeding. It is also certified than no business officer, partner, employee, agent, or any immediate family member has a substantive financial interest in the utility, in this proceeding. It is further certified that, should such a financial interest occur during the period of active involvement in the proceedings, the Commission will be immediately notified and shall have the right to terminate the contract.

This conflict of interest disclaimer is applicable to Larkin & Associates and its subcontractors, Messrs. Woolridge and Radigan.

Authorized Negotiators

Ralph C. Smith, CPA or Hugh Larkin, Jr., CPA, are authorized to bind the consulting firm and negotiate on behalf of the project team:

Ralph C. Smith, CPA,
Senior Regulatory Consultant
Hugh Larkin, Jr., CPA
Senior Partner
15728 Farmington Road
Livonia, MI 48154
(734) 522-3420
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HLarkinJr@aol.com



Ralph C. Smith

May 28, 2010
Date



Hugh Larkin, Jr.

May 28, 2010
Date

By the above signatures, Larkin & Associates certifies that it complies with:

- a) The laws of the State of North Dakota;
- b) North Dakota Administrative Code;
- c) All applicable local, state, and federal laws, code and regulations;
- d) The applicable portion of the Federal Civil Rights Act of 1964;
- e) The Equal Employment Opportunity Act and the regulations issued by the federal government;
- f) The Americans With Disabilities Act of 1990 and the regulations issued by the federal government;
- g) All terms, conditions, and requirements set forth in the RFP;
- h) A condition that the proposal submitted was independently arrived at, without collusion;
- i) A condition that the offer will remain open and valid for the period indicated in the RFP; and
- j) A condition that the firm and any individuals working on the contract do not have a possible conflict of interest.

II. UNDERSTANDING OF THE PROJECT

Understanding of Project Requirements

The purpose of the contract will be to have Larkin & Associates, along with subcontractors Dr. Woolridge and Frank Radigan, provide comprehensive technical assistance to the Advocacy Staff in analyzing the rate increase request made by MDU.

Larkin & Associates will address issues pertaining to rate base/net operating income. Dr. Woolridge will address cost of capital issues and Frank Radigan will address the issue of rate design.

Larkin & Associates is registered to do business in the State of North Dakota and has previously performed utility regulatory consulting work for the Advocacy Staff and would obtain any required licenses to operate in the State of North Dakota if awarded this project.

The subcontractors will also obtain any required licenses to operate in the State of North Dakota if awarded this project.

Deliverables

The ultimate objective of this project involves presenting our conclusions and recommendations, in the form of written and oral testimony that can be effectively and convincingly supported at the proceeding before the Commission. We will assess, in light of the Commission's and the Advocacy Staff's regulatory philosophies and goals, MDU's rate base/net operating income, rate of return and rate design. In order to meet these objectives, we will perform a thorough review of the filings and supporting workpapers underlying the request for an increase in rates.

Approximate Project Schedule

The chart on the following page is a time related project schedule for completion of specific tasks and displays our initial approximation of when each task will be performed.

The Contract starts approximately on June 19, 2010 and will closeout December 31, 2010.

The State reserves the right to extend the contract period for an additional period of time beyond the normal expiration date of the contract, upon mutual written agreement by both parties.

The following display was created based on the approximate dates listed above which were stated in the RFP and the schedule in the Company's last rate case, Docket No.

PU-03-296. We would begin work immediately upon notification that we have been awarded a contract.

Table II-1 – Project Schedule

Work Elements:	2010									
	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	
1. Company Filed Application	◆									
2. Orientation										
3. Review of filing.			◆	◆	◆	◆				
4. Conduct discovery.			◆	◆	◆	◆				
5. Submit progress reports.			◆	◆	◆	◆	◆	◆	◆	◆
6. Analysis of information.			◆	◆	◆	◆	◆			
7. Draft testimony.			◆	◆	◆					
8. Prepare cross examination questions, upon request.							◆			
9. Testify at hearing.							◆			
10. Post hearing assistance.										◆

We do not anticipate that we will have any difficulty accommodating our efforts to the Commission's schedule.

Contract Terms/Conditions

Larkin & Associates, along with its subcontractors, agree to comply with all applicable Equal Employment Opportunity laws and regulations, as well as the applicable provisions of the American Disabilities Act of 1990.

Pertinent Issues/Potential Problems

MDU is proposing a total annual increase of \$15,396,303 or 14 percent, based on a 2010 future test year including reduction associated with the Company’s proposed change in the its mechanism for sharing wholesale sales margins with its customers. MDU is proposing this increase in its electric rates to recover the investment and additional costs associated with the increased investment in facilities, including expansion of wind generation in the Cedar Hills and Diamond Willow projects, the significant loss of wholesale sales margin, and recovery of the deferred generation costs incurred to acquire needed generation. The amounts in this case include the costs associated with the development of three generation projects: the Big Stone II, the Lignite Vision 21 and Milton Young III plants. If resolution of a proposed alternate recovery mechanism pending before the Commission in Case No. PU- 09-733 is approved for the Big Stone II plant costs, the Company stated that these costs will be withdrawn from the case.

A settlement agreement was entered into on April 14, 2010 in related Docket Nos. PU-09-731 and PU-09-733 involving the prudence of MDU’s Discontinuation in the Big Stone II and request for deferred accounting of Big Stone II costs.

The parties agreed in The Settlement Agreement that it was prudent for MDU to discontinue its participation in the Big Stone II project and it should be allowed to recover a portion of the costs associated with the project. The Company incurred approximately \$13.9 million associated with the permitting, engineering and other development activities. North Dakota's share is approximately \$9.6 million. The Company will recover Big Stone II generation costs over six months in the form of an annual rate applied to customer bills as part of the Fuel Adjustment Clause. MDU will include in its total recovery amount a monthly carrying charge on the ND share of Big Stone II Generation Costs for the period November 2, 2009 (the date it ceased accumulating AFUDC on the CWIP balance) up until when the recovery of costs commences, assumed to be June 1, 2010. The carrying charge will be the Company's rate of return approved in its most recent rate case (10.016%).

The Settlement Agreement stated recovery of costs related to the Lignite Vision 21 project and the Milton R. Young III project will be addressed in the Company's current rate case.

On May 18, 2010, a proposed order adopting the Settlement Agreement was filed.

The Company also submitted an Application and Notice for an Interim Increase in Electric Rates in the annual amount of \$7,616,767 to be effective 60 days from filing if the Commission suspends the rate increase sought by MDU through its general electric rate case application and notice. At its regular meeting on May 12, 2010, the North Dakota Public Service Commission passed a motion suspending the tariff revisions filed in Montana-Dakota Utilities Co.'s electric rate increase application and a motion revising the April 28, 2010 Advocacy Staff appointment in the above-referenced case.

The Commission, parties and Staff had a discussion at the hearing regarding the relationship between rate recovery for Big Stone II costs agreed to in the Settlement and in the interim rates requested in MDU's rate increase application. The Commission is concerned about how to assure ratepayers there is no double recovery of these costs.

The Company's electric rates were last increased in Case No. PU-03-296, by 1.2 percent in January, 2004 in conjunction with the Settlement Agreement approved by the Commission on December 18, 2003.

III. METHODOLOGY USED FOR THE PROJECT

Functional Approach to Work Tasks

The work on this project will be divided into multiple tasks that provide a sensible, chronological series of expected activities, encompassing the required work areas within the established time constraints. The major tasks described below represent the anticipated approach to the overall scope of work. Interaction with Advocacy Staff is anticipated to coincide with all tasks performed, to provide for substantial input by these persons, so as to optimize project team performance.

1. We will discuss with Advocacy Staff assigned to the project, the specifics of the approach the Advocacy Staff wishes to follow in this case. In this meeting, we will discuss the areas that are of particular concern. A time line will be agreed upon establishing all critical project deadlines.
2. We will perform a review of the Company's filing in the current case, including its testimony and supporting workpapers. This will include analysis, review, and evaluation of all pertinent evidence filed on behalf of all parties in the current case. Additionally, we will review testimony, briefs, and orders of the Commission in prior cases to determine what issues were presented by the various parties, and how they were resolved by the Commission. Furthermore, we will determine if there are any new areas of concern that are raised by making a comparison to the testimony and order in the prior case. Based on this analysis, we will advise and recommend an approach to each specific issue.
3. We will conduct discovery of MDU, sufficient to conduct a complete analysis of the Company's case. This will include preparation of an array of written requests for information as may be necessary for the required analysis in this case. Our discovery files contain many standardized data requests designed to obtain the information necessary to thoroughly evaluate typical issues we have encountered in other rate cases. These standardized requests for information provide an efficient, effective starting point in developing the first set of discovery to be served upon the Company. Additionally, we develop Company-specific data requests to clarify issues, pinpoint problem areas, and obtain follow-up information, as well as address issues and quantifications unique to this Company and rate case.
4. Larkin & Associates will submit informal progress reports in which we will update Advocacy Staff of the conclusions and recommendations we have formulated based upon our review of MDU's response to discovery. Such progress reports will also advise Advocacy Staff of any potential problems we foresee in meeting project deadlines.

5. We will carefully analyze and evaluate the information received in steps 1 through 4. All information gathered, as well as analyses and evaluations, will be performed in order to consider all possible issues which come to our attention during the course of our review. Based upon this evaluation, we will discuss our findings with Advocacy Staff to determine which items should form the basis for proposed adjustments as part of our formal testimony.
6. We will submit drafts of testimony and exhibits in advance of the filing date so that Advocacy Staff and Counsel assigned to the project will have ample time to review and provide comments on them. We will thoroughly review, verify, and correct the draft testimony and exhibits to meet the satisfaction of the Committee in order to have finished copies ready for filing sufficiently in advance of the filing deadline.
7. We will assist the Advocacy Staff counsel with the preparation of cross-examination questions upon request. Our tested and effective format for preparing cross-examination includes, for each issue, identification of the appropriate witness; a summary of the issue (what the Company did, why it may be inappropriate, impact on rates, and discussion of relevant discovery responses); specific cross-examination questions (primarily drafted to elicit a “yes” or “no” response to keep the witness on track); and anticipated witness responses.
8. For issues pertaining to rate base, net operating income and jurisdictional cost allocations, Ralph Smith will present expert testimony and undergo cross-examination at the hearings. Dr. Woolridge and Frank Radigan will present expert testimony and undergo cross-examination regarding rate of return and rate design, respectively, at the hearings. Mr. Smith has previously testified before the North Dakota Public Service Commission. As a result of our extensive experience in presenting expert testimony before regulatory commissions, we believe that the best preparation for responding to cross-examination by others is to present thoroughly verified pre-filed written testimony at the onset.
9. If desired, we shall assist Advocacy Staff subsequent to the hearing by preparing proposed findings of fact with respect to issues relevant to our scope of work.

Substantive Approach to Work Tasks

Rate Base/Net Operating Income (Larkin & Associates)

As previously stated, the Company is using a projected 2010 year end test year to incorporate investment in facilities that will be completed in 2010. The Company has undertaken the Cedar Hills Wind Project, which is a 19.5 MW wind project consisting of 13 GE wind turbines scheduled to be completed in June 2010, at a cost of \$47.4 million. This amount includes costs for turbine equipment, substation facilities and transmission

interconnection costs. Per page 1 of Statement M, the Company's 12/31/09 per book rate base is \$210,903,000 and its projected 12/31/10 rate base is \$285,351,000.

1. Rate Base

We would expect to perform the following analysis pertaining to the determination of the rate base:

Analyze any adjustments proposed by the Company to ensure that there is a proper synchronization of rate base with revenue and expense levels. Consideration of North Dakota ratemaking policy will be applied to additions proposed and whether they are known and measurable and/or growth related.

Review the Company's accounting and budget data to assure that the per book or pro forma balances included in the rate base are stated appropriately. Also assure that all major balance sheet accounts have, in some way, been accounted for through either the rate base or capital structure ratemaking components.

Review accounting records, projections, methodologies, assumptions, budget developments, and any supporting studies or analyses to ensure the reasonableness of the data providing the basis for the test year.

Review all pro forma rate base additions requested by the Company. The Company's filing may include pro forma adjustments to the rate base to account for (1) investment additions taking place beyond the end of the test year and (2) pro forma impact on rate base components consistent with associated requested pro forma expense and/or tax increases/decreases (e.g., the pro forma change in the depreciation reserve and deferred tax balances resulting from a requested depreciation/amortization expense increase).

We will examine prior MDU projections and forecasts and will compare those with actual experience. Established tendencies to over-project may require adjustment.

Examine the expected utilization of MDU's existing and proposed facilities. To the extent excess capacity is determined, we will address how the cost for that excess should be allocated between shareholders and ratepayers.

Analyze sources of non-investor supplied capital. Determine whether all non-investor supplied capital has either been appropriately deducted from the rate base, or included in the capital structure at zero cost. Balances that should be appropriately deducted from rate base include:

- A. Accumulated deferred income taxes, reflecting the fact that this represents non-investor supplied capital.
- B. Pre-1971 Unamortized Investment Tax Credits. Deduction from rate base of these tax credits is not prohibited by law. To the extent that such unamortized balances are still on the Company's books, they should be deducted from rate base as non-investor supplied capital.
- C. Accounts Payable associated with Materials and Supplies (M&S). The M&S balances included in the rate base for a current return are partially financed by accounts payable on a continuous basis throughout the year. Such payables (e.g. contractor retentions) represent vendor-supplied capital and should be offset against the M&S balances in the rate base.
- D. Determine whether Contributions In Aid of Construction are present on the Company's books and propose recommendations accordingly. Review proposed plant additions, and recommend that customer advances that are to be received on proposed plant additions be deducted from rate base.
- E. Review the balance sheet for any other types of non-investor supplied capital, which should be deducted from rate base. These would include reserves for items such as injuries and damages, property damage, self-insurance, etc.

Review all Company adjustments to rate base to assure their propriety. Rate base value adjustments are normally made to update items such as plant in service to a specified date, to adjust working capital and depreciation reserve so that they correspond with adjusted expenses, and to also include adjustments to deferred tax offsets to the rate base. Any adjustments must meet the requirements of being known and measurable. We will propose alternative adjustments and explain, through testimony, reasons for rejecting Company adjustments when said adjustments are believed to be inappropriate.

Review any Company adjustments which increase expense based on end of year rate base levels, such as depreciation, for prior Commission precedent, and to ensure that the rate base is correspondingly reduced to reflect the higher expense level, e.g., for increases in depreciation expense.

Review all Construction Work in Progress balances that the Company has included in rate base, and determine whether such treatment is appropriate. This will include a review of CWIP work orders to determine if each project meets the Commission's criteria. We will also cross reference all pro forma CWIP balances with plant-in-service additions to ensure that no double counting exists.

Review the work orders of each pro forma plant-in-service addition to evaluate the expenditures made to date, the need for such expenditures, the cost/benefit of such investment, and determine if such investment was the result of customer or load growth. Pro forma plant-in-service additions will be cross-referenced with CWIP balances, as mentioned above, to ensure that there are no items double counted.

Ensure that components of rate base are determined on a consistent basis with components of capital employed (e.g., 13 month averages, beginning and end of year average balances).

Analyze the specifics of certain typical rate base accounts, such as prepayments and M&S, in sub-account detail to ensure that all sub-accounts are proper for inclusion in the rate base determination.

If prepaid balances are included, we will ensure that the Company's accounting for these items is proper. We will investigate the interrelationship of prepaid balances with the determination of cash working capital under the lead/lag study approach, to ensure that no double counting is included in the rate base.

We will ensure that any inclusion of deferred debits is appropriate, and deferred credits will be reviewed so that we may determine whether any accounts or individual sub-accounts are proper as offsets to the rate base.

We will evaluate the level of M&S inventory included in rate base, and then determine whether the period used to compute the M&S inventory amount represents a normal level of inventory based on a historical review. Furthermore, we shall insure that the cost of any abnormal level of inventory items (e.g., materials required for extensive damage repairs) is not present in the test year. In addition, we will ensure that the portion of the M&S balance supported by outstanding accounts payable is removed from rate base.

On page 1 of Statement E, the Company shows the 12/31/09 book balance of materials and supplies to be \$4,781,794. Per page 1 of Statement N, the Company has included \$5,077,000 of materials and supplies in the test year.

We will analyze the items requested for inclusion by the Company. This entails verifying dollar amounts, as well as the existence of a definite plan of use within a reasonable time frame for each piece of property held for future use included in rate base. We will then determine whether or not each specific item merits inclusion in rate base.

Review the accumulated deferred income tax (ADIT) offset to the rate base in conjunction with detailed review of related accounts, including Account 190 and

Accounts 281, 282 and 283. Account 190 (deferred income tax debit) represents an increase to rate base. Therefore, it is important to ensure that each sub-account is proper for inclusion.

Determine if the Company has adjusted deferred tax balances in accordance with FASB 109. If so, adjustments may be required to restore balances for ratemaking purposes. We will investigate whether the Company's implementation of FASB 109 has had any impact on the ratemaking process, and if so, we will address that by proposing any necessary adjustments.

We will address the amount of cash working capital to be included in rate base. Cash working capital is a rate base item that reflects the Company's need for cash to conduct its day-to-day operations. Cash working capital should represent investor supplied capital, which the Company must have on hand during the time interval between incurring expenses in the provision of service and the reimbursement of those expenditures through the collection of revenues from ratepayers. If the reimbursement occurs before the Company pays the expense, this results in a negative working capital requirement. We will closely evaluate the Company's cash working capital request and make adjustments as necessary.

2. Operating Income and Expense

In general, we will review operating income and expenses, including normalizing and out-of-period pro forma adjustments. Our review of the operating income statement will include the following areas:

A. Revenues and Sales in the Test Year

Ensure that current revenues reflect rates currently in effect. This will be done by verifying billing determinants to historical experience.

Analyze the Company's filing to determine if test year sales and revenues are representative of normal going-forward conditions, and propose any necessary adjustments.

Operating revenues will be analyzed to ensure that the proper levels of revenue are reflected in these accounts. We will consider adjustments to annualize sales for year-end customer levels and usage, or weather normalization adjustments after review.

We will closely examine the impact of any large industrial or commercial customers closing operations or adding new operations in the Company's service territory.

The sales mix will be analyzed to ensure that unusual or non-recurring conditions have

not temporarily caused shifts in usage between rate classes, such as residential and commercial. Any unusual shift in usage patterns can affect revenue calculations and cost allocation studies.

The components of “other revenues” will be reviewed to ensure that an appropriate level of each type has been reflected in the test year.

Determine whether the test year reflects appropriate levels for miscellaneous revenues, which utilities may claim are difficult to accurately forecast.

Uncollectible accounts will be analyzed to ensure that the adjusted test year balance is representative of normal conditions. We will review the correlation of uncollectibles to revenues. Test year uncollectibles will be compared to historical results. Additionally, we will:

1. Examine the historical results experienced by the Company in order to determine whether the proposed uncollectibles rate is reasonable, and whether it will likely reflect future occurrences.
2. Examine the method the Company used to calculate uncollectibles for reasonableness and compliance with Commission policy.
3. Verify the accuracy of all source amounts, including items such as gross write offs as well as residential and commercial revenues. The mathematical accuracy will also be checked to ensure that the amounts are correct.
4. Determine an appropriate provision for uncollectibles in conjunction with the calculation of the gross revenue conversion factor.
5. Evaluate the level of uncollectibles by computing uncollectibles-to-sales ratios, compare to historical experience, and investigating Company collection policies and efforts.

The Company has projected uncollectibles by taking a five-year average of write-offs to revenues and multiplying that rate times the projected sales revenue. As shown on page 21 of Statement M, the Company has included \$105,000 of Uncollectible Expense.

We will review test year late payment charge revenues. This review will be coordinated with an analysis of uncollectibles.

Determine if a weather normalization adjustment is necessary and appropriate based upon the following type of analysis:

1. Evaluate weather information gathered from weather monitoring stations (airports and other weather stations) and information available from government resources.
2. Determine which weather station's data should be considered representative of the Company's service territory.
3. Compare data to historical averages (which represent "normal") to determine if the test year weather falls outside the range of what is considered normal.
4. Test year weather that falls significantly outside the normal range requires that test year revenues be adjusted as if the weather had been classified as "normal".

Review and analyze the Company's treatment of revenues received from off system sales and net nonjurisdictional revenues. We will coordinate this review with our evaluation of the assignment/allocation of the related costs.

The amount of AFUDC reflected in the determination of operating income will need to be coordinated with the amount of Construction Work in Progress (CWIP) that is included in rate base.

B. Operation and Maintenance Expenses

On pages 29 - 31 of the Company's Statement M, it identifies the following adjustments to O&M expense:

- Fuel & Purchased Power
- Labor
- Benefits
- Glen Ullin Station
- Big Stone Coyote
- Materials
- Vehicles and Work Equipment
- Company Consumption
- Postage
- Demand Side Management
- Uncollectible Accounts
- Advertising
- Insurance
- Utility Discounts
- Industry Dues
- Regulatory Commission Expense

- Regional Market Expenses
- Subcontract Labor
- Software Maintenance

The Company has further adjusted the seven categories of O&M expense by a 2.11 inflation factor. A recent article in the Wall Street Journal indicates that inflation is at a 44-year low and hovers under 1%.

Maintenance expense will be examined to ensure that the test year does not include unusual or non-recurring maintenance, which should be amortized over a longer period for rate case purposes.

Review post-test year adjustments for labor and fringe benefit costs for reasonableness. In addition, we shall review any adjustments for increased labor costs based on projected wage increases. Wage levels of current employees will be evaluated to determine if any increases are reasonable. We will also review wage and benefit analyses conducted by or prepared for the Company. We will compare management wage increases with those granted union employees as the result of arms-length bargaining. As stated on page nine of Company Witness Rita Mulkern's testimony, MDU's projected labor costs for 2010 were based on labor amounts budgeted for 2010, with bonuses adjusted to reflect a three year average and severance amounts paid in 2009 amortized over three years. As shown page 11 of Statement M, the Company has included \$16.555 million for labor expense in the test year.

Compare budgeted with actual wages and staffing levels for a representative historical period. Evaluate whether the Company budgets for unfilled employee positions, or otherwise tends to over-project budgeted wages. We will consider an adjustment for average vacancies. As stated on page three of David Goodin's testimony, the Company has 498 full and part-time employees as of December 31, 2009.

Review relocation expense. Review any austerity measures, such as a temporary hiring freeze, leaving unfilled job vacancies produced by attrition, and offering voluntary early retirement. Investigate the impact upon test year employee costs of these programs. Evaluate the amortization of any large one-time costs, such as those relating to an early retirement program.

Examine the Company's accounting and proposed ratemaking adjustments for pension benefits. Ensure that book pension expense is computed in accordance with FASB 87 guidelines. Also, review the actual contributions to the pension trust.

If the Company has supplemental retirement plans for officers and directors, or an Employee' Investment Plan (i.e., 401k), ensure that the costs of these plans reflected in the test year reflects a normal, reasonable level of costs.

Evaluate the Company's proposal in regard to post retirement benefits other than pensions (PBOP, or OPEB, for other post-employment benefits). The prior decisions of the Commission provide guidance for how utilities are to account for the benefits other than pensions (PBOP's) using the accrual method prescribed by SFAS 106. In performing an investigation of OPEB accounting, we would investigate the following:

1. Identify the Company's OPEB liability under SFAS 106. Review and evaluate any actuarial studies the Company or its actuary has conducted to estimate annual OPEB costs, including interest cost, service cost, and amortization of the transitional OPEB cost existing at the date the Company adopted FASB 106 for book accounting purposes.
2. Evaluate whether or not the Company's request in the current proceeding is in compliance with the Commission's prior decision.
3. Determine whether the Company has fully funded its plan under the most tax advantageous methods.
4. Review all steps being taken or planned by the Company to reduce its prospective employee benefit costs and OPEB liability.
5. Obtain the most recent actuarial estimates for the FASB 106 accrual.
6. Investigate whether the utility has capitalized a portion of its FASB 106 accrual cost. In past cases, we have noted instances where utilities have failed to capitalize portions of their FASB 106 accruals and have inappropriately attempted to over-charge O&M expense as a consequence of such failure.

We will review MDU's adjustment for pension expense.

Actuarial reports, FAS 87 workpapers and other relevant information will be requested and reviewed to evaluate this adjustment.

Review the Company's accounting for legal expense to ensure that unusual or inappropriate costs are not charged to retail ratepayers. The test year should reflect a normal level of legal expense. Remove any penalties or unusual settlements from test year expenses, which should reflect normal operations. Consider deferral of large legal expenditures for litigation in progress concerning questionable areas, e.g., lawsuits against officers and directors for alleged imprudence.

Review incentive compensation arrangements and special bonuses to employees and officers. Ensure that only reasonable amounts are included in the test year. Company

Witness Mulkern stated MDU has removed the Supplemental Income Security Plan (“SISP”) in accordance with prior Commission decisions.

Review special “perks” available to top management, including “golden parachute” arrangements, use of Company assets for personal functions, bonus plans, supplemental pensions, incentive stock options, etc.

Review dues for membership in industry associations. Remove lobbying and institutional advertising portion of such dues. Obtain data concerning benefits of association programs to the Company. Review other membership dues for appropriateness as test year expenses. The adequacy of these adjustments will be reviewed. The Company has included \$105,000 for industry dues in the test year.

Analyze test year advertising and marketing expenses. Determine which programs and activities benefit ratepayers and provide a recommendation based on this determination for recovery of advertising and marketing expenses. The Company stated it has removed promotional advertising and expenses not applicable to North Dakota electric operations.

1. Review copies of advertisements run and bill inserts sent during the test year. Review Company categorization of advertisements.
2. Review test year advertising to ensure that no advertising disallowed in the last docket has been included in the current docket.
3. Review customer surveys the Company may have.
4. Review Commission Orders in recent utility cases to ascertain treatment (allowance or disallowance) of promotional activities. Use such orders as guidance for treatment of marketing programs.

Analyze operating and maintenance accounts by primary and sub-accounts to determine whether any significant increases or decreases in these accounts have occurred. Investigate and document the reasons for any significant changes in operating and maintenance expenses. Recommend adjustments for inappropriate increases and for unexplained, or unjustified cost increases.

C. Taxes Other than Income Taxes

Analyze other taxes by type to determine that the tax expense is related only to the test period under consideration.

Verify tax rates to current state statutes and tax assessments. Evaluate trend in property taxes and tax assessed valuation over a representative historical period. Use the most recent actual tax rates for all property.

Ensure that the plant balances used in the calculation of property tax expense are appropriately synchronized with the plant balances reflected in rate base.

Investigate property tax refunds and ensure that they are properly treated for ratemaking purposes.

Analyze the rate used by the Company to determine whether the use of that rate is appropriate for state and municipal taxes.

Examine the tax rates for the major components of state and municipal taxes to ensure that there has been no decrease in state and municipal taxes, which should be reflected in the period being examined.

D. Below-the-Line Revenues and Expenses

Analyze revenues and expenses in so-called “below-the-line” accounts. Examine these accounts with the intention of determining that these revenues and expenses are properly excluded from the cost of service.

Verify the embedded costs of debt and preferred stock to the financial statements and other supporting documents.

Determine whether the Company has sold any property before or during the test year, and realized a gain on such sales. Determine whether sold property was previously included in rate base to earn a return, or in depreciation expense or property taxes, i.e., included in rates. Consider whether any gain on the sale of such property should accrue to the benefit of the ratepayers.

E. Income Taxes

Review all tax computations in the rate filing.

Determine that interest expense used in the tax computation is properly synchronized with the interest computation in cost of capital.

Determine that deferred investment tax credits are being properly amortized. Review tests of ITC amortization performed by the Company and/or its independent auditor to ensure compliance with IRC 46(f). Coordinate ITC amortization with depreciation rates adopted in this case.

Review the Company's federal tax returns for prior two years with particular emphasis on Statement M adjustments.

Review the Company's deferred income taxes, focusing on any Company proposed normalization treatment which deviates from established Commission policy and procedures.

Address the issue of amortization of non-protected excess deferred income taxes.

The interest synchronization calculation will be adjusted to conform with the rate base and weighted cost of debt used in Advocacy Staff's presentation.

F. Depreciation and Amortization Expense

Analyze the Company's calculation of test year depreciation expenses to ensure that the depreciation rates used are appropriate.

Ensure that the depreciable assets used in calculating the depreciation expense agree with the books and records of the Company, or are based on reasonable projections of plant to be in service.

Ensure proper "matching" between depreciation expense reflected in adjusted net operating income and net plant amounts reflected in the rate base, paying particular attention to new additions to rate base.

Review each item being amortized as test year expense. Remove amortizations which will be completed prior to rates set in this proceeding going into effect.

Review the depreciation study filed by the Company for new depreciation rates. Possibly recommend alternatives to the Company-proposed depreciation rates.

Adjust Depreciation Expense for the impacts of any revisions to MDU's proposed depreciation rates.

G. Rate Case Expenses

Review and analyze rate case expenses to be allowed for ratemaking purposes in this proceeding. Address the appropriate level of expenses as well as the appropriate amortization period and treatment of the unamortized balance.

As shown on page 27 of Statement M, the Company has included \$166,000 for rate case expenses to be incurred in this case in the test year amortized over a three year period.

H. Administrative and General Expenses

Ascertain the reasonableness of the Company's test year claims for administrative and general expenses:

1. Examine the individual items by account and sub-account detail, to determine whether such amounts properly relate to the provision of electric service to ratepayers.
2. Examine all membership association dues and the related expenses to ascertain the benefit to ratepayers.
3. Examine all adjustments made by the Company to the test year expenses for reasonableness. Where we find that such adjustments seem unreasonable and do not reflect actual past experience, we will provide alternative amounts to be included as expenses.
4. Examine all costs associated with Company sponsored programs in order to determine whether such amounts are reasonable, and whether the benefits to ratepayers are commensurate with the cost of the programs.

3. Revenue Requirement

We will review the revenue requirement projected by the Company, and in light of all the recommended adjustments to the Company presentation, independently develop a revenue requirement. The revenue level should be sufficient to enable the utility to recover all of its prudently incurred costs found to be includable in the adjusted test year, plus an adequate return on its capital invested in used and useful assets devoted to the provision of jurisdictional utility service. In other words, total allowed revenues should equal total operating expenses, plus depreciation and an adequate return on investment. This is inclusive of a sufficient level of income taxes to provide the utility an opportunity to earn such return on an after-tax basis.

Rate Design Analysis (Frank Radigan)

Frank Radigan, a subcontractor to Larkin & Associates, will address the rate design issues and present expert testimony on such issues. Provide a recommendation on the appropriate rate design for MDU.

MDU's direct case could not be more straightforward – based on its examination of the

Class Cost of Service Study, the Residential Rate Class is providing inadequate rate of return and the company believes it should pay more. Under the argument that most of its costs are fixed, the Company has proposed a rate design that increases the bill for the small user the most. Given that the vast majority of its customers are Residential and most of the revenue increase will be recovered through the increased customer charge, this is a very reasonable outcome for the utility. In testimony, MDU states that its proposed increase in the customer charge of 93% is reasonable as it balances the need of increasing the charge closer to the true cost of service, \$16.40, and bill impacts on customers. The question from the Commission's perspective, however, whether the proposal is reasonable from a customer's point of view. In rate design, reasonableness is not only measured from a cost basis (i.e. is it supported by the Class Cost of Service Study) but also on a fairness basis. Rate stability is one test of fairness and continuing to increase one charge does not seem fair on its face. Thus, the scope of work in this case is to achieve the proper balance. Thus one needs to review the Class Cost of Service Study to determine if it was well prepared and its results reasonable, and one needs to review the proposed rate design to see if the results of the Class Cost of Service Study were reasonable applied.

Larkin and Associates through its subcontractor, Mr. Radigan, will review and make recommendations regarding the cost of service study submitted by MDU. MDU has used the "Average and Excess Demand Allocator (AED)" to allocate many of the costs in the cost of service study. The AED factor is comprised of the sum of the average demand of each class and the difference between the total system peak demand and the average demand as allocated to each class based on the non-coincident demand in excess of the average demand. MDU states that its production investment related to the Company's wind facilities was allocated on a factor based 80% on the energy allocation factor and 20% on the AED allocator to reflect the fact the wind facilities are primarily an energy resource. The investment in transmission plant related items was allocated on the AED factor. The AED Method drives many significant costs in the class cost-of-service study model. For example, one cannot transmit wind power without transmission facilities so the reasonableness of using different allocators for production facilities and transmission facilities must be examined with care. Mr. Radigan will review each allocator so as to determine how best to allocate costs while avoiding undue rate impacts.

1. Based on the results of the cost of service study, we will design appropriate rates by:
 - The rates designed will balance cost of service principals while avoiding undue rate impacts that affect customers.
 - We will prepare a proof of revenue statement. A proof of revenue statement multiplies billing units by present and proposed rates in order to calculate revenues and assure that only the appropriate revenue requirement is recovered from charges and rates.

- We will prepare bill impact analysis by service class and division that illustrate the rate impact on customers under present and proposed rates.
2. MDU is proposing to increase the residential customer charge from the current rate of \$5.50 per month to \$10.64 per month, a 93% increase. The Company states that the final rate is reasonable given that the cost based rate is \$16.40 per month.
 3. Our subcontractor, Frank Radigan, will review and rebut proposed customer charges consistent with the principle of promoting cost-effective fixed cost recovery and conservation of energy.
 4. Review the four proposed automatic adjustment mechanisms to determine if they are reasonable from a ratepayer perspective.
 5. Review and evaluate the Company's proposed "other" changes to its electric tariff to determine if they are cost based, reasonable and in the public interest.

Cost of Capital Analysis (Dr. Woolridge)

Dr. Woolridge will address cost of capital issues and provide financial, economic and technical consultation and expert testimony on behalf of the Advocacy Staff.

Overview and Summary

Below is an overview of Dr. Woolridge's rate of return approach and a general review of the rate of return issues.

I rely primarily on the Discounted Cash Flow (DCF) model, which I would apply to a proxy group of natural gas distribution companies. I support this result with a Capital Asset Pricing Model (CAPM) study. Current estimates suggest an equity cost rate for electric utility companies in the 9.5% range. This figure can be substantiated by the current earned returns on common equity and market-to-book ratios for electric companies. Since electric companies are earning and are projected to earn, on average, a return on common equity of 10.0%, and their common stocks are selling in excess of 1.5 times book value, it is apparent that these companies are earning a return on equity above that which investors require.

Rate of Return Issues

The primary rate of return issues are likely to include the following:

(1) Despite the Financial Crisis, Interest Rates and Capital Costs are still Low– Common equity cost rates remain at low levels. The current 10-year Treasury is only 3.2%.

(2) Capital Structure – The appropriate capital structure for a electric company is about 55% debt and 45% common equity and includes short-term debt.

(3) Short-Term Debt Cost Rate – Three-month LIBOR is currently below 1.0%, making short-term debt cost rates very low. Therefore, short-term debt should be included as all electric utilities use short-term debt as a source of capital.

(4) Long-Term Debt Cost Rate – Long-term cost rates must be reviewed for pro forma financing at interest rates above current market rates.

(5) The Riskiness of Electric Utility– The riskiness of electric utility companies, as measured by beta, is very low compared to other industries in the US. (See study below)

(6) Peer Groups of Electric Utility Companies – Given their low risk level, the peer group must include only pure electric utility companies.

(7) DCF Results – Most analysts rely solely on analysts' forecasts of earnings per share growth estimates to estimate DCF growth. I show that results of Analysts' projections of long-term (5-year) EPS have been shown to be upwardly biased indicators of actual growth. In addition, there are a number of new academic studies that demonstrate that analysts' forecasts of long-term EPS growth are upwardly biased measures of actual long-term EPS growth (see note below).

(8) Risk Premium and CAPM Approaches – Most analysts also use both risk premium and CAPM methodologies to estimate the cost of equity. The problem with all of these studies is the magnitude of the equity risk premium. Most of these equity risk premium studies make unreasonable assumptions about future economic growth and stock market returns.

(9) The Comparable Earnings (“CE”) Approach – The CE approach has become popular among company consultants. The CE approach has not been used in years by regulatory commissions.

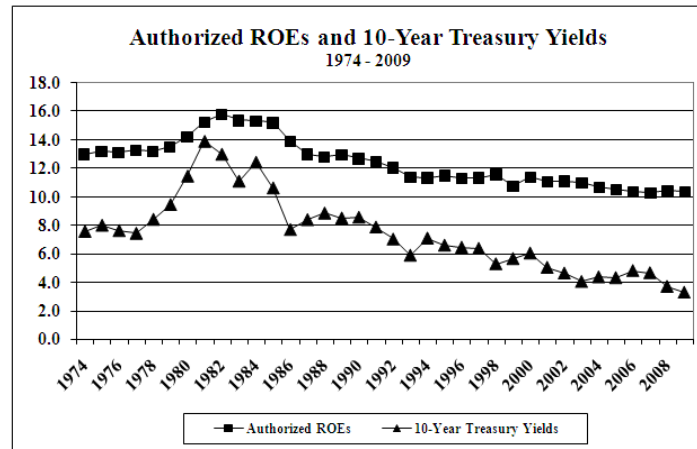
(10) Capital Structure or Leverage Adjustment – It has become common to adjust the cost of equity derived from a proxy group for the leverage differences between the market value and book value capital structures of the proxy group. This has been proposed by utilities in many rate cases in different states. I present results that suggest it is not only erroneous, but also illogical.

(11) Authorized Returns for Electric Utility Companies – The authorized returns for

electric utility companies is in the 10.0%-10.5% range.

(12) The Financial Crisis and Utility ROEs – State regulatory commissions were lenient to utilities in granting higher ROEs during the financial crisis. However, utilities performed extremely well during the financial crisis. In addition, yield spreads on utility debt have come way down since their peaks last year. Therefore, as the crisis comes to an end, we should see authorized ROEs come down.

In summary, my equity cost rate studies indicate that an equity cost rate in the 9.5% range is currently appropriate for electric utility companies.



The Riskiness of Utility Companies

Investment risk encompasses both business risk and financial risk. The degree of business risk for a company is associated with variations in its operating revenues and expenses. The amount of debt a company uses is the primary driver of its financial risk. Due to the essential nature of their service as well as their regulated status, public utilities are exposed to a lesser degree of business risk than other, non-regulated businesses. The relatively low level of business risk allows public utilities to meet much of their capital requirements through borrowing in the financial markets, thereby incurring greater than average financial risk.

The overall investment risk of the three primary public utilities - electric, gas, and water – is below that of other industries. The low investment risk of utilities is indicated by the industry’s low Beta. The table below provides an assessment of investment risk for 100 industries as measured by Beta. According to modern capital market theory, Beta is the only relevant measure of investment risk. These betas come from the *Value Line Investment Survey* and are compiled annually by Aswath Damodaran of New York

University.¹ The study shows that the investment risk of utilities is extremely low. The average betas for water, electric, and gas companies gas distribution companies are 0.82, 0.76, and is 0.68, which are well below the *Value Line* average of 1.17. As such, the cost of equity for utilities is among the lowest of all industries in the U.S.

¹ They may be found on the Internet at [http:// www.stern.nyu.edu/~adamodar](http://www.stern.nyu.edu/~adamodar).

Industry Name	No.	Beta	Industry Name	No.	Beta	Industry Name	No.	Beta
Public/Private Equity	9	2.40	Retail Store	43	1.35	Telecom. Services	140	1.10
Newspaper	15	1.94	Restaurant	68	1.34	Biotechnology	121	1.10
Semiconductor Equip	14	1.93	Shoe	19	1.34	Industrial Services	168	1.07
Steel (Integrated)	15	1.85	Machinery	130	1.32	Reinsurance	8	1.07
Entertainment	95	1.81	Entertainment Tech	35	1.32	Utility (Foreign)	5	1.07
Auto Parts	54	1.75	Apparel	56	1.30	Air Transport	44	1.06
Hotel/Gaming	74	1.74	Trucking	33	1.30	Medical Supplies	264	1.04
Auto & Truck	22	1.72	Railroad	15	1.29	Internet	239	1.04
Cable TV	24	1.69	Natural Gas (Div.)	32	1.29	Beverage	41	1.04
Coal	21	1.67	Chemical (Specialty)	97	1.29	Computer Software	333	1.02
Paper/Forest Products	39	1.63	Computers/Peripherals	129	1.29	Medical Services	162	0.97
Property Management	20	1.63	Information Services	29	1.28	Healthcare Info	33	0.97
Steel (General)	20	1.61	Chemical (Basic)	17	1.27	Environmental	91	0.97
Advertising	36	1.60	Petroleum (Integrated)	24	1.24	Bank (Midwest)	39	0.96
R.E.I.T.	143	1.60	Precision Instrument	98	1.24	Retail Building Supp	7	0.95
Semiconductor	125	1.56	Power	77	1.23	Insurance (Prop/Cas.)	85	0.92
Metal Fabricating	36	1.54	Toiletries/Cosmetics	19	1.23	Oil/Gas Distribution	19	0.89
Home Furnishings	35	1.52	Metals & Mining – Div	79	1.23	Pharmacy Services	21	0.88
Wireless Networking	60	1.50	Manuf. Housing/RV	15	1.21	Bank (Canadian)	7	0.86
Retail Automotive	15	1.46	Diversified Co.	121	1.20	Food Processing	121	0.86
Oilfield Svcs/Equip.	113	1.45	Packaging & Container	31	1.20	Water Utility	15	0.82
Homebuilding	28	1.45	Office Equip/Supplies	25	1.19	Electric Util. (Central)	23	0.79
Building Materials	53	1.45	Funeral Services	5	1.19	Tobacco	12	0.78
Publishing	30	1.43	Aerospace/Defense	67	1.19	Investment Co.	19	0.76
Retail (Special Lines)	157	1.43	Precious Metals	78	1.18	Electric Utility (West)	14	0.75
Recreation	65	1.43	E-Commerce	56	1.18	Educational Services	38	0.75
Heavy Construction	14	1.42	Canadian Energy	10	1.18	Bank	481	0.75
Electrical Equipment	87	1.41	Securities Brokerage	30	1.18	Electric Utility (East)	24	0.73
Financial Svcs. (Div.)	296	1.39	Electronics	183	1.16	Thrift	227	0.73
Investment Co.(For)	16	1.39	Petroleum (Producing)	198	1.16	Ret./Wholesale Food	32	0.73
Maritime	53	1.38	Household Products	23	1.15	Natural Gas Utility	24	0.68
Human Resources	30	1.38	Telecom. Equipment	115	1.15	Total Market	7036	1.17
Insurance (Life)	31	1.38	Foreign Electronics	9	1.13			
Chemical (Div)	31	1.37	Drug	337	1.11			

Source: Damodaran Online

Below is an article in the Wall Street Journal quoting Dr. Woolridge:

THE WALL STREET JOURNAL

Study Suggests Bias in Analysts' Rosy Forecasts

By ANDREW EDWARDS

March 21, 2008; Page C6

Despite an economy teetering on the brink of a recession -- if not already in one -- analysts are still painting a rosy picture of earnings growth, according to a study done by Penn State's Smeal College of Business.

The report questions analysts' impartiality five years after then-New York Attorney General Eliot Spitzer forced analysts to pay \$1.5 billion in damages after finding evidence of bias.

"Wall Street analysts basically do two things: recommend stocks to buy and forecast earnings," said J. Randall Woolridge, professor of finance. "Previous studies suggest their stock recommendations do not perform well, and now we show that their long-term earnings-per-share growth-rate forecasts are excessive and upwardly biased."

The report, which examined analysts' long-term (three to five years) and one-year per-share earnings expectations from 1984 through 2006 found that companies' long-term earnings growth surpassed analysts' expectations in only two instances, and those came right after recessions.

Over the entire time period, analysts' long-term forecast earnings-per-share growth averaged 14.7%, compared with actual growth of 9.1%. One-year per-share earnings expectations were slightly more accurate: The average forecast was for 13.8% growth and the average actual growth rate was 9.8%.

"A significant factor in the upward bias in long-term earnings-rate forecasts is the reluctance of analysts to forecast" profit declines, Mr. Woolridge said. The study found that nearly one-third of all companies experienced profit drops over successive three-to-five-year periods, but analysts projected drops less than 1% of the time.

The study's authors said, "Analysts are rewarded for biased forecasts by their employers, who want them to hype stocks so that the brokerage house can garner trading commissions and win underwriting deals."

They also concluded that analysts are under pressure to hype stocks to generate trading commissions, and they often don't follow stocks they don't like.

Write to Andrew Edwards at andrew.edwards@dowjones.com

V. EXPERIENCE AND QUALIFICATIONS

Experience

Larkin & Associates performs a wide variety of auditing and accounting services, but concentrates in the area of utility regulation and ratemaking. The firm has performed regulatory consulting services primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys general, etc.). Larkin & Associates has extensive experience in the utility regulatory field as expert witnesses in over 800 regulatory proceedings.

Larkin & Associates proposed project team is highly qualified to perform this engagement for the Advocacy Staff. We believe we satisfy the key ingredients for success of this assignment: strong technical skills, utility industry experience, relevant audit experience, extensive experience with electric utility rate and regulatory filings, an understanding of the regulatory environment, and demonstrated project management capability. Our personnel are familiar with issues affecting the revenue requirement of public utilities, including the appropriateness of the test year; the determination of the appropriate capital structure and embedded costs of debt and preferred stock (we generally do not address the determination of the fair return on common equity); the overall return on rate base; rate base, including working capital allowances, pro forma and known-change adjustments (e.g., for recently completed plant); net operating income including the reasonableness of test year revenues and expenses and pro forma or known-change adjustments thereto, attrition adjustments, recovery of conservation load management, and energy purchase/interconnection expenses, depreciation, operating expenses, accounting for FAS 112, taxes (both income and other); revenue requirement calculation including the gross revenue conversion factor; and other general issues, such as the measurement of management efficiency, fuel and purchased power costs, use of cogeneration and independent power production in generation planning; use of "bank balance" accounting for energy transactions with independent producers; changes to Rules and Regulations; and issues surrounding incentive regulation proposals and alternatives to rate of return regulation; as well as many other issues that have been addressed in ratemaking proceedings.

Senior professionals of Larkin & Associates, including Mr. Smith and Mr. Schultz have presented expert written and oral testimony on behalf of the North Dakota Staff on a number of occasions.

Similar Projects Completed

North Dakota Cases

- US West Cost Studies, Case No. PU-314-97-12
- Application for Transfer of Local Exchanges, Case No. PU-314-94-688
- US West Universal Service Cost Model, TSC Case No. PU-314-97-465
- US West Communications, Inc., Case No. PU-314-92-1060

- US West, Inc. Toll and Access Rebalancing, Case No. 99-419/420
- US West, Inc. Residential Rate Increase and Cost Study Review, PU314-99-119

Recent Electric Rate Cases

- Avista Utilities, Docket No. UE-090134 (Washington Utilities Transportation Commission)
- Puget Sound Energy, UE 090704090134 (Washington Utilities Transportation Commission)
- Rocky Mountain Power Company, D.09-035-23 (Public Service Commission of Utah)
- Potomac Electric Power, Formal Case 1076 (DC Public Service Commission)
- Progress Energy Florida, Docket No. 090079-EI (Florida Public Service Commission)
- Rocky Mountain Power Company, D. 08-035-93 (Public Service Commission of Utah)
- Rocky Mountain Power Company, D. 08-035-38 (Public Service Commission of Utah)
- PacifiCorp, UE-090205 (Washington Utilities & Transportation Commission)
- Arizona Public Service Company, E-01345A-08-0172 (Arizona Corporation Commission)
- Tucson Electric Power, Docket No. E-01933A-07-0402 (Arizona Corporation Commission)
- Tampa Electric Company, Docket No. 080317-EI (Florida Public Service Commission)
- Hawaii Electric Light Company – Docket No. 2008-0083 (Hawaii Public Utilities Commission)
- United Illuminating Company, Docket No. 08-07-04 (CT Department of Public Utility Control)
- Rocky Mountain Power Company, D.07-035-93 (Public Service Commission of Utah)
- Florida Public Utilities, Docket No. 070304-EI (Florida Public Service Commission)
- Connecticut Light & Power Company, D.07-07-01 (CT Department of Public Utility Control)
- Hawaii Electric Light Company – Docket No. 2006-0386 (Hawaii Public Utilities Commission)
- UNS Electric, Docket No. Docket No. E-04204A-06-0783 (Arizona Corporation Commission)
- Arizona Public Service Company, E-01345A-06-0009 (Arizona Corporation Commission)

- Appalachian Power & Wheeling Company, d/b/a American Electric Power, Docket No.05-1278-E-PC-PW-42T (West Virginia Public Service Commission)
- Delmarva Power & Light, Docket No. 05-304 (Delaware Public Service Commission)
- United Illuminating Company, Docket No. 05-06-04 (CT Department of Public Utility Control)

Appendix II also presents a summary of merger/acquisition and recent electric utility rate case engagements in which Larkin & Associates has completed similar work to that required in this project. Each case summary conveniently lists the name of the client, a summary of the scope of work performed, and indicates the professional personnel who participated in the engagement.

Larkin & Associates has also performed a number of rate case engagements in recent years involving gas, water/wastewater and telephone companies for regulatory agencies which are also similar to the case at hand in terms of the development of rate base, net operating income, and revenue requirements.

A comprehensive listing of all regulatory projects and/or work samples can be provided upon request.

Management Plan

The management structure of our proposed project team ensures that our work effort produces a work product of the highest quality, in a timely manner and within budget. A project director and project manager will both be utilized to ensure that the objectives of the project are met in an effective manner.

Throughout the project, a high degree of communication will be maintained among all members of the project team, as well as with Advocacy Staff members assigned to the project. Frequent communications will be facilitated by telephone conference calls and emails.

Our findings will be presented first in the form of oral telephone discussions and progress reports to Advocacy Staff members working on the project. Upon completion of the analytical work, we will prepare and submit to the appropriate Advocacy Staff members drafts of testimony. Then, after discussions with, and approval by these persons, our findings will be presented to the Commission in the form of written testimony and exhibits, to be followed with oral direct testimony and cross examination at the hearings.

We will respond to interrogatories related to our scope of work issued by any parties to the proceeding. We will also analyze rebuttal testimony, prepare and assist in cross-

examination procedures, and prepare and present oral testimony at the hearings. In addition, we will provide Advocacy Staff with technical support at the hearings, and after the hearings, in preparing proposed findings of fact. In order to present a convincing and accurate case to the Commission, we will utilize to the fullest extent possible, our accumulated expertise in accounting, economics, finance, law, taxation, and utility ratemaking.

Larkin & Associates - Personnel Roster

The Larkin & Associates professional staff includes five CPAs with over 100 years cumulative business public accounting experience and utility related work. Our personnel are familiar with rate base, income taxes, lead/lag studies, cost of service, rate design and accounting adjustments, as well as many other issues that have been contested in ratemaking proceedings. This background enables us to analyze these areas and to draw on knowledge gained through comparable studies performed in other utility cases.

Hugh Larkin, Jr., CPA, founder and senior partner of Larkin & Associates, will serve as project director. As head of the project team, Mr. Larkin will be available to provide expert testimony, if necessary; however, it is anticipated that Mr. Larkin will not be one of the expert witnesses for this proceeding. Mr. Larkin's regulatory experience includes rate cases, management audits, litigation assistance, and training seminars. As project director, Mr. Larkin will assume ultimate responsibility for the completion of the project and the quality of the resulting work product. His role on this project will be that of an advisory nature.

Helmuth W. Schultz, CPA, is a senior regulatory analyst and the firm's audit and tax partner. He has over 32 years of experience with regulatory consulting. Mr. Schultz is particularly well versed in the regulatory arena and has presented testimony on several occasions, including before the North Dakota Commission. Mr. Schultz will perform analytical work on this project on an as needed basis.

Ralph C. Smith, CPA, is a senior regulatory analyst with over 31 years of experience with regulatory consulting. Mr. Smith has provided testimony in numerous rate cases and other regulatory matters, including testimony before the North Dakota Commission. He will function as project manager for the overall work effort on this project and testify as an expert witness. As project manager, he will coordinate the daily work efforts of the Larkin & Associates professional staff and subcontractors, monitor the progress of the project, and ensure that all deadlines are met. Ultimate approval of scheduling and each work phase will be done under his supervision. Communications between Mr. Smith and the professional staff assigned to the project will be maintained on a frequent basis. Mr. Smith, with the assistance of regulatory analysts, will perform a substantial amount of the detailed analysis, including the analysis of rate base and net operating

income.

Donna M. (DeRonne) Ramas, CPA, is a senior consultant and has over 18 years of experience as a regulatory consultant. Ms. Ramas has been a key member and presented testimony in numerous regulatory engagements involving electric, gas and water and sewer utilities. Ms. Ramas will perform analytical work on this project on an as needed basis.

Mark Dady, CPA, is a regulatory analyst with over nine years of regulatory experience. Mr. Dady currently performs analysis and prepares testimony, briefs, schedules, exhibits and reports on many regulatory engagements. Mr. Dady will assist with the analysis and testimony preparation on this case.

Tina Miller is a regulatory analyst with over ten years of regulatory experience. Ms. Miller participates in regulatory engagements by reviewing and organizing information, and assisting with the preparation of testimony, briefs, schedules, exhibits, reports. Ms. Miller also performs research relating to regulatory, accounting, and financial issues. Ms. Miller will perform similar duties on this case as needed.

Dawn Bisdorf is a research associate with Larkin & Associates. As such, Ms. Bisdorf assists with the review and analysis of regulatory filings by preparing computer spreadsheets and models, and performing accounting and regulatory research. On this project, Ms. Bisdorf will perform analyses under the direction of the senior professionals, locate testimony and orders online, perform research, proof schedules and testimony, prepare exhibits, verify data, and keep files organized.

John Defever is a research associate with Larkin & Associates. As such, Mr. Defever assists with the review and analysis of regulatory filings by preparing computer spreadsheets and models, and performing accounting and regulatory research. On this project, Mr. Defever will perform analyses under the direction of the senior professionals, locate testimony and orders online, perform research, proof schedules and testimony, prepare exhibits, verify data, and keep files organized on an as-needed

Subcontractors

J. Randall Woolridge, Ph.D.

Dr. Woolridge is a Professor of Finance and the Goldman, Sachs & Co. and Frank P. Smeal Endowed Faculty Fellow in Business Administration in the College of Business Administration of the Pennsylvania State University in University Park, PA. In addition, Professor Woolridge is Director of the Smeal College Trading Room and President and CEO of the Nittany Lion Fund, LLC. He also serves on the Investment Committee of ARIS Corporation, an asset management firm based in State College, PA.

Professor Woolridge received a Bachelor of Arts degree in Economics from the University of North Carolina, a Master of Business Administration degree from the Pennsylvania State University, and a Doctor of Philosophy degree in Business Administration (major area-finance, minor area-statistics) from the University of Iowa. At Iowa he received a Graduate Fellowship and was awarded membership in Beta Gamma Sigma, a national business honorary society. He has taught Finance courses at the University of Iowa, Cornell College, and the University of Pittsburgh, as well as the Pennsylvania State University. These courses include corporation finance, commercial and investment banking, and investments at the undergraduate, graduate, and executive MBA levels.

Professor Woolridge's research has centered on the theoretical and empirical foundations of corporation finance and financial markets and institutions. He has published over 25 articles in the best academic and professional journals in the field, including the *Journal of Finance*, the *Journal of Financial Economics*, and the *Harvard Business Review*. His research has been cited extensively in the business press. His work has been featured in the *New York Times*, *Forbes*, *Fortune*, *The Economist*, *Financial World*, *Barron's*, *Wall Street Journal*, *Business Week*, *Washington Post*, *Investors' Business Daily*, *Worth Magazine*, *USA Today*, and other publications. In addition, Dr. Woolridge has appeared as a guest on CNN's *Money Line* and CNBC's *Morning Call* and *Business Today*.

Professor Woolridge has also consulted with and prepared research reports for major corporations, financial institutions, and investment banking firms, and government agencies. In addition, he has directed and participated in over 500 university and company sponsored professional development programs for executives in 25 countries in North and South America, Europe, Asia, and Africa.

Dr. Woolridge has previously filed testimony in numerous other regulatory proceedings before other state commissions. His qualifications can be found in Appendix III attached to this proposal.

As previously stated, Dr. Woolridge will conduct the cost of capital analysis on this project.

Frank Radigan

Frank Radigan is the Principle of Hudson River Energy Group.

The Hudson River Energy Group (HREG) is an engineering consulting firm specializing in the fields of rates, planning and economics for the electric, natural gas and water utility industries. Founded in 1998 by Principal Frank Radigan, HREG serves a wide variety of clients in dealing with the complexities of deregulation and restructuring, including OATT pricing, unbundling of rates, resource adequacy, and transmission planning policies and power supply. Our experience in these areas has brought us to testify before the Federal Energy Regulatory Commission, the Rhode Island Public

Utilities Commission and the New York State Public Service Commission in nearly thirty regulatory proceedings. In addition to addressing restructuring and deregulation issues currently transforming the utility industry, HREG provides expert testimony, performs a variety of studies and services, and develops appropriate energy conservation measures.

Backed by years of experience as a consumer advocate with a thorough understanding of the utility industry, HREG is well-acquainted with the need for focused, diligent analysis and strategic approaches to problems. This experience has enabled a small firm to provide a scope of deliverables far exceeding its size. HREG's experience of over twenty-one years enables them to help clients adapt to meet current challenges while protecting consumers.

HREG provides services to law firms, regulatory agencies, financial institutions, and others engaged in the industry. They are economists, planners, engineers, and appraisers who have been extensively involved in providing support services to the utility industry, from financial analysis and engineering to regulatory support and economic investigations in a wide variety of applications

Mr. Radigan has expert knowledgeable in electric, water, gas and steam industries and has provided expert testimony in each of these areas on approximately 80 occasions. For 16 years, Mr. Radigan was an Engineer with the New York State Public Service Commission. While at the Commission, Mr. Radigan's responsibilities included resource planning, modeling and forecasting forward price curves for the wholesale market, and the analysis of rates and tariffs, rate design and performing embedded and marginal cost of service studies as well as depreciation studies. Before leaving the Commission, Mr. Radigan was responsible for directing all engineering staff during major proceedings including those relating to rates, integrated resource planning and environmental impact studies.

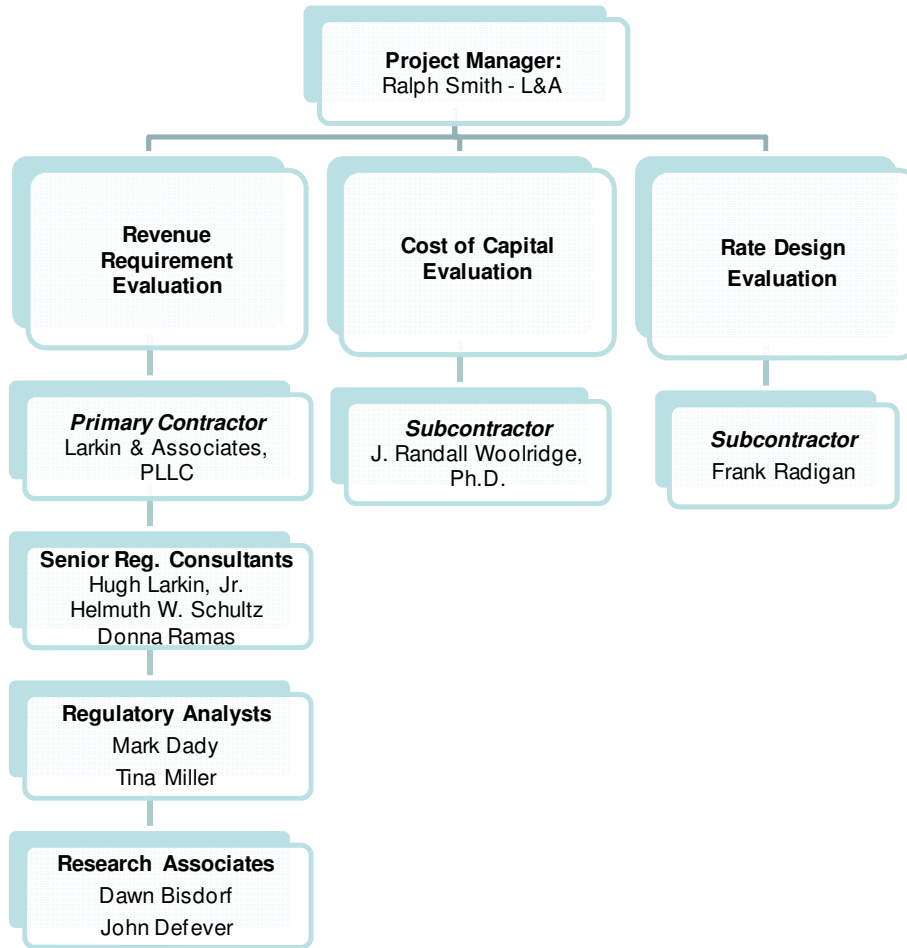
As a consultant, Mr. Radigan has provided research, technical evaluation, due diligence, reporting and expert witness testimony on electric, water, gas and steam utilities. He has performed analysis of rate adequacy, rate unbundling, decoupling, and cost of service studies, rate design, rate structure and multi-year rate agreements. He has provided expertise in electric supply planning, economics, depreciation, regulation, wholesale supply and industry restructuring issues. Mr. Radigan has been addressing decoupling issues since 1994 while working at the New York Public Service Commission.

Mr. Radigan's qualifications can be found in Appendix IV attached to this proposal.

Organizational Chart

A project organizational chart below shows the staffing and lines of authority for the

project team members.



Resumes

Resumes for Larkin & Associates professionals are attached to this proposal in Appendix I. Merger/Acquisition and recent electric case summaries are provided in Appendix II. Resumes for Dr. Woolridge and Frank Radigan can be found in Appendix III and IV, respectively.

Estimated Hours

The estimated hours for each professional is provided in Cost Proposal (Section VI) of this proposal.

References

Below are three references for each contractor that demonstrate our capability to perform the work for this project. These references are for services on projects that are similar in nature, size and scope of work and are for regulated utility ratemaking and

accounting services within the past five years. Each reference is willing to discuss Larkin & Associates' performance with a Division representative.

Larkin & Associates, PLLC

Reference 1:

Client Name: North Dakota Public Service Commission
Contacts: Mr. William Binek
Mr. Pat Fahn
Mr. Mike Diller
Address: State Capitol, 12th Floor
Bismarck, ND 58505-0480
Telephone No.: (701) 328-2400

Reference 2:

Client Name: Florida Public Office of Public Counsel
Contact: Charlie Beck
Address: Service Commission
111 W. Madison Street - 801
Tallahassee, Florida 32399-1400
Telephone No.: (850) 488-9330

Reference 3:

Client Name: State of Connecticut Office of Consumer Counsel
Contact: Richard Sobolewski
Address: 10 Franklin Square
New Britain, Connecticut 06051-2644
Telephone No.: (860) 827-2900

J. Randall Woolridge

Reference 1:

Client Name: Consumer Advocate of Pennsylvania
Contact: Mr. Irwin A. (Sonny) Popowsky
Address: 555 Walnut St., 5th Floor
Harrisburg, PA 17101
Telephone No.: (717) 783-5048

Reference 2:

Client Name: Office of Consumers' Counsel
Contact: Mr. Richard Sobolewski

Address: 10 Franklin Street
New Britain, CT 06051
Telephone No.: (860) 827-2907

Reference 3:

Client Name: Assistant Attorney General Office of Rate Intervention
Commonwealth of Kentucky
Contact: Mr. Dennis Howard
Address: 1024 Capital Center Drive, Suite 200
Frankfort, KY 40601-8204
Telephone No.: (502) 696-5453

Frank Radigan

Reference 1:

Client Name: Office of Consumers' Counsel
Contact: Mr. Richard Sobolewski
Address: 10 Franklin Street
New Britain, CT 06051
Telephone No.: (860) 827-2907

Reference 2:

Client: Phillip S. Teumim LLC
Contact: Phil Teumim – Principal
Address: 37 Ruxton Road
Delmar, NY 12054
Telephone No: (518) 475-0239

Reference 3:

Client: Westchester County Public Utility Supply Agency
Contact: Stewart Glass – Executive Director
Address: Michaelian Office Building
148 Martine Avenue
White Plains, New York 10601
Telephone No.: (914) 995-3143

Letter of Recommendation

Larkin & Associates has included with this proposal a letter of recommendation from a long-time client, the Florida Office of Public Counsel.

VI. COST PROPOSAL

Price

Our estimated price is broken down by task and is presented on the following pages. Details concerning estimated professional fees, hourly rates, out-of-pocket and travel expenses, and the total project cost are shown.

Professional Fees

We estimate professional fees of \$71,500. Costs by work task are presented on the following pages by taking anticipated time for each consultant and multiplying it by the applicable hourly rates.

Out-of-Pocket/Travel Costs (Hearings Only)

The estimated cost for out-of-pocket and travel costs is \$4,500. We minimize expenses by staying at economical hotels, comparing airline flights and car rentals, and the efficient and economical use of supplies and resources.

Total Not-to-Exceed Price

Our total not-to-exceed price for the project is \$76,000. It may be possible to complete the project for less than this, and, if so, we would only bill for professional fees and expenses incurred.

INDIVIDUAL PRICE BY TASK

TASK	DESCRIPTION	INDIVIDUAL PRICE
1	Rate Base, Operating Income Evaluation	\$ 36,000
2	Rate Design Evaluation	\$ 18,000
3	Cost of Capital Evaluation	\$ 22,000
TOTAL NOT TO EXCEED PRICE		\$ 76,000

Larkin & Associates, Revenue Requirement Separately

If selected to perform work related to revenue requirement, Larkin & Associates proposes a total not-to-exceed price of \$36,000. This includes estimated professional fees of \$34,500 and \$1,500 for expenses. This does not include cost for an on-site review at MDU's offices, which if desired by the Advocacy Staff, we have separately priced, as described below.

J. Randall Woolridge, Rate of Return Separately

The separate issue price for the cost of capital section of this project is \$22,000. This price includes \$1,000 for travel and expenses, and is a firm, not-to-exceed price.

Frank Radigan, Rate Design Separately

The separate issue price for the rate design section of this project is \$18,000. This price includes \$2,000 for travel and expenses, and is a firm, not-to-exceed price.

Estimated Additional Cost for On-Site Review at MDU Offices

In the event that an on-site review at NSP's offices is deemed necessary or desirable by Advocacy Staff, our total bid would increase by \$3,500. This additional amount includes professional fees plus travel expenses related to such on-site review.

Direct Costs

Total number of hours at various hourly rates

Personnel	Est. Hours	Rate/ Hour	Professional Fees
Rate Base, Net Operating Income Analysis			
<i>Larkin & Associates, PLLC</i>			
Hugh Larkin, Jr., CPA - Project Director		\$ 125	\$ -
Ralph Smith, CPA - Project Manager	170	\$ 115	\$ 19,550
Sr. Regulatory Analysts - Helmuth Schultz, CPA/ Donna Ramas, CPA		\$ 115	\$ -
Regulatory Analyst - Mark Dady, CPA	100	\$ 95	\$ 9,500
Regulatory Analyst - Tina Miller	40	\$ 75	\$ 3,000
Research Associates - Dawn Bisdorf, John Defever	50	\$ 45	\$ 2,250
Word Processing/Secretarial	8	\$ 25	\$ 200
Total Estimated Professional Fees			\$ 34,500
Cost of Capital Analysis			
<i>J. Randall Woolridge</i>	100	\$ 210	\$ 21,000
Rate Design Analysis			
<i>Frank Radigan</i>	80	\$ 200	\$ 16,000

Direct Expenses

Estimated Travel Costs for Hearings	
Larkin & Associates	\$ 1,500
J. Randall Woolridge	\$ 1,000
Frank Radigan	\$ 2,000
Total Direct Expenses	<u>\$ 4,500</u>

Indirect Costs

Supplies	0
Overhead	0
Profit	10%

Larkin & Associates' hourly billing rates are composed of the following (approximate) percentages: 70% direct labor costs, 13% payroll loading factor, 7% administrative and general expense and 10% profit.

Prompt Payment Discount Terms

Larkin & Associates and its subcontractors do not offer prompt payment discounts.

VII. EVALUATION CRITERIA/WHY LARKIN & ASSOCIATES

Evaluation Criteria

This section summarizes how our proposal meets each of the factors identified in section five of the RFP that will be used for contractor selection.

Understanding of the Project

We believe our proposal demonstrates a thorough understanding of the project requirements, particularly in Sections II and III. Section III, Methodology Used for the Project, combines our innovative methodologies with appropriate phasing that is realistic under the stated time constraints. Larkin & Associates is knowledgeable and experienced with the technical aspects required for this project, employs appropriate and cost-effective analytical techniques, including document reviews, on-site document review, interviews, and review of accounting records. We are familiar with utility regulatory issues on a national scope. We are familiar with the treatment of issues under the state of North Dakota's regulatory law, as well as trends and perspectives related to policies and practices of regulated electric utilities and the impact of these issues upon the consumers of North Dakota.

Methodology Used for the Project

The project team has extensive experience performing utility regulatory consulting services and has a well-earned reputation for meeting project terms, requirements and deadlines while providing a quality work product. We believe we have devoted sufficient professional consulting resources to this project to perform the work in a thorough manner and meet the stated deadlines. This belief is based on our management of a wide range of regulatory consulting projects, including similar rate cases, over the past 40+ years. Larkin & Associates considers project management to be an essential responsibility. We have substantial experience managing a full spectrum of consulting engagements, including many complex, large-scale projects. The senior consultants responsible for providing direction to the project team insure that there is sufficient depth, detail and balance to work plans. We use detailed work activity plans and budgets to monitor progress and as a focal point for communications with the client and have experience managing large regulatory projects, so that they are completed on time and within budget. The firm has repeatedly demonstrated the ability to manage consulting teams that produce quality results on time and within budget.

Experience, Qualifications, and Financial Strength

Larkin & Associates is an auditing and regulatory consulting firm that has been performing utility regulatory consulting services for more than 40 years and has participated in numerous rate case and other regulatory engagements. We have extensive experience auditing and testing for compliance with Commission rules and policies and reviewing utility management performance. We have extensive experience

producing reports and testimony which are supportable in proceedings before regulatory commissions. We believe we satisfy the key ingredients necessary for the success of this assignment: strong technical skills, high familiarity with electric utilities, accounting and ratemaking principles, an understanding of the regulatory environment and demonstrated project management capability. Our prior work experience includes numerous electric utility revenue requirement and rate cases and prior experience with addressing a variety of regulatory issues, including rate cases before the North Dakota Public Service Commission.

Section V briefly describes the qualifications and anticipated project functions of the professionals assigned to this project. Complete resumes of project team professional detailing education and relevant work experience are provided in Appendices I, III and IV. Also, attached to this proposal following the appendices, Larkin & Associates has attached a letter of reference from a long-time client describing our capabilities.

Quality of Written Proposal

We have made every effort to conform our proposal to the requirements stated in the RFP. We feel our proposal presents a logical description of our approach to the project.

Contract Cost

We understand that cost is an important factor in the selection process. We believe that the estimated total costs detailed in Section VI are reasonable for the scope and level of detail involved in these projects. Larkin & Associates offers high quality consulting services in the area of utility regulation at competitive hourly billing rates. We strive to minimize expenses by utilizing the most economical airfares and car rentals and the efficient use of resources. We believe that the Commission will find our hourly rates and relatively low level of actual out-of-pocket expenses to be very attractive, especially in view of the high level of expertise provided and quality work product that we expect to produce.

Why Larkin & Associates

Our project team is unusually well qualified to conduct these important projects for the Division. We believe we satisfy the key ingredients for the success of this assignment: strong technical skills, extensive utility industry experience, relevant audit experience, an understanding of the regulatory environment, and demonstrated project management capability.

The distinct advantages of our approach include the following:

Importance of this engagement. We can offer all of the talents and experience of a large consulting firm. At the same time, we are a small growing business where every client is very important. We strive to give each client a high degree of personalized care and attention. We anticipate being able to bring to this project a valuable blend of big

firm capabilities and small firm commitment, attention, and responsiveness.

Experience with North Dakota utility regulation. Larkin & Associates has experience with North Dakota utility regulation, having assisted the Staff in a variety of utility regulatory projects.

Extensive electric utility industry experience. Collectively, the consultants available for our assignments have extensive and diverse experience with utilities and regulation. In addition to possessing the requisite professional skill, our project team brings together people with broad practical experience. The consultants we propose have meaningful prior experience in their field of specialization, which is the public utilities sector.

Experience as expert witnesses. Project team members have presented testimony and have been cross-examined on numerous issues in regulatory proceedings. As a result of this experience, our team has a sharper appreciation of the value of rigorous fact verification and documentation of our findings and conclusions. We approach the investigative audit process with the type of discipline that enhances our ability to support our findings in subsequent regulatory proceedings, if and as necessary.

Demonstrated project management capability. We consider project management to be an essential responsibility. We have substantial experience managing a full spectrum of consulting engagements, including many complex, large-scale projects. Senior consultants are responsible for providing direction to the project team, insuring that there is sufficient depth, detail, and balance to work plans. We use the detailed work activity plans and budgets to monitor progress and as a focal point for communications with the client.

Several CPAs on project team. Our project team includes five seasoned CPAs, each of whom has devoted his or her career to addressing the issues affecting public utilities. In our extensive public utility consulting work, which encompasses management studies and rate case assistance, we stress the quantification of recommendations. Having several experienced CPAs on our team helps to insure that all of our recommendations are quantified, where possible, and that the underlying facts have been thoroughly verified.

Proven technical skills. Consulting is a skill-based professional service. Our project team is made up of seasoned, career consultants who have climbed well up the experience curve at each functional discipline. The methodologies we employ have been tested successfully on many engagements. We believe our approach provides the greatest probability of producing both useful and measurable benefits.

Value added approach. Our consulting philosophy emphasizes a collaborative approach. We strive to establish the closest possible working relationship with our

client's personnel. We believe that the success of consulting engagements varies directly with the degree of client involvement. Therefore, we encourage our clients to become actively involved in our assignments.

Maximum consulting skill applied to each assignment. The effective use of consultants rests on finding the best fit between the client's needs and the skill, knowledge, and experience of the individual consultants who actually work on the assignment. Our approach maximizes the productive time of the senior consultants who work on the engagement. Furthermore, we are not encumbered by the overhead necessary to support a large firm; consequently, our clients receive more pure consulting services for every dollar they spend.