

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Montana Dakota Utilities Co.,
a Division of MDU Resources Group, Inc.,
Electric Rate Increase Application

Case No. PU-10-124

SETTLEMENT AGREEMENT

This Settlement Agreement is entered into this 8th day of November, 2010, by and between the North Dakota Public Service Commission Advocacy Staff ("Staff"), Montana Dakota Utilities Co., a Division of MDU Resources Group, Inc., ("Montana-Dakota" or "Montana-Dakota"). Montana-Dakota and Staff were not able to complete this Settlement Agreement timely, such that other parties were able to consider it. This Settlement Agreement resolves certain outstanding issues in the above-captioned proceedings in a manner consistent with the public interest.

BACKGROUND

This proceeding involves Montana-Dakota's request to increase its retail rates to allow it to earn a reasonable return on equity.

Montana-Dakota sought to increase retail rates by \$11,519,000, reflecting the Settlement Agreement dated June 16, 2010 or 10 percent. An interim rate increase of \$7.6 million or 7 percent was approved effective June 18, 2010.

Montana-Dakota's electric operations in North Dakota were revenue deficient and earnings were below a reasonable return on equity ("ROE"). Montana-Dakota's last North Dakota general electric rate case was in 2003 with final rates effective January 2004.

In this current rate case, Montana-Dakota identified primary drivers for the need to request a rate increase as increased investment in facilities, including the expansion of wind generation in the Cedar Hills and Diamond Willow projects and the associated expenses and the significant loss of wholesale sales margin.

Montana-Dakota and Advocacy staff previously settled Cost of Debt, Return on Equity and overall Rate of Return, which are modified in this Settlement Agreement. Issues that remain disputed include handling of investments in wind generation and handling of incentive compensation and Board of Directors expenses.

Terms

The Parties agree to the provisions as defined below.

I. Rate Base and Revenue Requirements in the Rate Case.

The Parties agree with respect to the items discussed below. The agreement is made relative to the revised request amount of \$11,519,000 and is net of Rate Base, ROR and Expense adjustments proposed by Staff. With respect to the settled items below, Staff proposed adjustment of \$2,354,000, the Parties agree that Staff's proposed adjustment should be reduced to \$1,220,000. This \$1,220,000 will reduce the total request amount of \$11,519,000. The parties do not agree how much of a reduction is necessary for Wind or Incentive Compensation and Board of Directors costs.

A) Rate of Return.

The Parties agree to a return on equity of 10.75 percent, with the capital structure and cost set forth in the table below:

Long Term Debt	41.084%	6.845%	2.812%
Short Term Debt	3.199%	2.535%	0.081%
Preferred Stock	2.380%	4.590%	0.109%
Common Equity	<u>53.337%</u>	10.750%	<u>5.734%</u>
Total	<u>100.000%</u>		<u>8.736%</u>

Montana-Dakota agrees to share any earnings above 10.75 percent with customers (see Other Terms and Conditions for a full discussion of this sharing mechanism).

The Parties also agree that an overall rate of return of 8.736 percent will be used for purposes of determining interim rates in Montana-Dakota's next electric rate case.

B) Resolved Issues.

Advocacy Staff's responsive testimony raised several issues of concern. As set forth below, the parties resolve all of the issues, with the exception of bonus and incentive compensation, Board of Directors expense and recovery of wind generation investment and related expenses. As stated above, the total agreed upon adjustment on agreed upon issues, net of Rate Base, ROR and expense items is \$1,220,000. The parties have not agreed to an exact allocation of which issues are assigned specific adjustments, rather the parties agree to the reasonableness of the overall adjustment without allocation to specific items.

The non-monetary adjustments which have been agreed upon are covered herein, below.

Advocacy Staff's adjustment proposals included concerns and the Advocacy Staff requested adjustments on the following issues:

(1) *Margin Sales and Sales for Resale.* Advocacy Staff believed these were separate issues and requested a fixed amount be placed into the cost of service, based on 2009 actual wholesale sales margin. Montana-Dakota proposed to remove all wholesale sales margins from base rates and pass

through 85% of the margins to customers via the Fuel and Purchased Power Adjustment Clause (FCA).

(2) *Aircraft.* Montana-Dakota sought recovery for its ownership in certain aircraft used for travel to service territory locations that are not provided with adequate commercial travel. Advocacy Staff challenged inclusion of the aircraft in rate base, as well as applicable expense items in Montana-Dakota's income statement. Montana-Dakota believes its investment is prudent and a legitimate cost of doing business.

(3) *Customer Deposits.* Advocacy Staff had concerns regarding MDU not using Customer Deposits as a reduction to rate base. Staff requested the jurisdictional amount, instead MDU provided both electric and gas combined balance. Montana-Dakota argues that customer deposits were not included as a reduction to rate base because interest is paid on customer deposits. Staff and Montana-Dakota agreed to include the Customer Deposits applicable to Electric service in the rate base and related interest expense in the cost of service.

(4) *Maintenance Costs for Big Stone and Coyote Generating Facilities.* Advocacy Staff had concerns about the unusually high maintenance costs included in the test year for the Big Stone and Coyote generating facilities. Montana-Dakota believes that if maintenance expenses are adjusted, the corresponding operation expenses should be treated the same way.

(5) *Transmission – WAPA Costs.* Advocacy Staff believed there was too high of a charge included for transmission and WAPA charges. Montana-Dakota did not object to the adjustment.

(6) *Storm Damages.* Advocacy Staff proposed Montana-Dakota be entitled to recovery for storm damages. Advocacy Staff requested that Major Storm Damages be tracked and accounted by the Company, so that from rate case to rate case it can be tracked and properly recovered. Advocacy Staff believes Montana-Dakota should be entitled to a normalized amount to cover costs of major storm damages. Montana-Dakota did not object to the adjustment.

(7) *Deferred Generation Costs.* Advocacy Staff believed Montana-Dakota should not be entitled to recover deferred generation costs that fall outside of the rate case. Montana-Dakota believes the deferred generation costs were prudently incurred and should be recovered. The Company applied for a deferred accounting order for these generation development costs.

(8) *Treatment of Costs Associated with Refinancing Certain Debt at Lower Interest Rates.* Advocacy Staff was supportive of recovery, but proposed modification as to how the Company recovered costs associated with refinancing debt. Montana-Dakota believes its treatment of the unamortized loss on debt and associated debt costs is in compliance with FERC accounting.

(9) *Labor Costs.* Advocacy Staff had concerns regarding the level of labor costs and compensation being included in the rate case, along with the

methodology being used to calculate those costs for the test year. Montana-Dakota does not believe that Staff reflected current (2010) wage and salary levels in its adjustment.

C) Wholesale Sales margins

For purposes of determining the overall revenue requirement, the Parties agree to credit to customers through the FCA 100 percent of North Dakota's portion of asset-based margins received by Montana-Dakota. Passing these credits directly through the FCA as they are realized ensures that neither customers nor Montana-Dakota will be disadvantaged by a non-representative margin forecast in the test year. Montana-Dakota will, starting with the month final rates go in place, include in its fuel clause adjustment calculation, the actual amount of wholesale sales margins for the applicable month. Any balance of unrecovered Margin Sharing Adjustment (MSA) amount remaining at time final rates become effective will be recovered over a twelve month period based on forecasted kWh sales volumes and included in the FCA until fully recovered.

II. Issues to be Addressed before Montana-Dakota's Next Rate Case.

Montana-Dakota will meet with the Staff to discuss a potential study to be completed by the filing of the Company's next general rate case and to be conducted by a mutually agreeable independent consultant. The Company agrees to fund up to \$125,000, or such other mutually agreeable amount, for such study. The scope of the study shall be agreed to by the parties but may include all or any of the following three major issues raised by the Staff in this proceeding:

1. Review Montana Dakota's Accounting System and the jurisdictional allocation process. One of the goals is, to determine if a better process can be developed to create an easier audit trail and a more transparent reporting process.
2. Develop an appropriate Minimum Standard Filing Requirements to facilitate a better review of Rate Case components in future cases. Staff will take the lead in identifying the standard information to be filed when requesting for a rate increase.
3. Review the corporate allocation process and the affiliate transactions used to allocate costs associated with MDU Resources and other affiliates to Montana-Dakota's gas and electric operations.

III. Allocations and Rate Design for the Rate Case.

The rate design shall be as Montana-Dakota proposed in its request, modified to reflect adjustments to the revenue requirement and class allocations described in this Agreement.

Montana-Dakota shall file compliance tariff pages setting forth the revised electric rates and tariffs provided by this Settlement Agreement at least thirty (30) days prior to the effective date of final rates.

IV. Other Terms and Conditions

A) Customer Refunds for Earnings Above Authorized ROE.

Per the settlement in Attachment A, the Parties agree to an earnings-sharing mechanism that will result in customer refunds if the Company's net income exceeds a 10.75 percent ROE for its North Dakota electric operations.

If the Company earns in excess of 10.75 percent ROE as reflected in the annual report of jurisdictional regulated electric earnings for any fiscal year prior to either: (i) January 1, 2013; or (ii) the base period included in the Company's next electric general rate case (whichever occurs sooner); the Company will refund to customers revenues corresponding to 50 percent of earnings above 10.75 percent ROE.

Earnings sharing credits will be applied to customer accounts as soon as practical after July 1, following the annual report of electric earnings for the given fiscal year has been filed with the Commission (typically on April 15). A refund would be administered as a one-time bill credit.

B) Deferred Generation Costs.

The Company shall be entitled to recover, outside of rate base, a \$172,000 expense, for ten years. The parties agree that this amount will be included in expenses of future rate cases for ten years from the filing of this rate case. This amount is included in and not in addition to the settled amount discussed above.

C) Basis of Settlement Agreement

It is agreed this Settlement Agreement is a negotiated settlement agreement subject to approval by the Commission. Except for the purpose of setting interim rates in the Company's next electric general rate case, as required in tracking adjustment mechanisms that may be approved by the Commission, the Settlement Agreement does not establish any principle or precedent, nor adopt or recommend any specific type or amount of expense or rate base, for this or any future proceeding.

D) Effect of the Settlement Negotiations.

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

E) Applicability and Scope.

This Settlement Agreement shall be binding on the Parties, and their successors, assigns, agents, and representatives. Consistent with the Commission's settlement guidelines, this Settlement Agreement does not set policy or overturn precedent. This Settlement Agreement shall not in any respect constitute an agreement, admission or determination by any of the Parties as to the merits of any specific allegation or contention made by the Parties in this proceeding.

F) Effective Date.

This Settlement Agreement shall be effective on the date of the Commission Order approving the Settlement Agreement.

CONCLUSION

The Parties have agreed to the forgoing terms to resolve some of the contested issues in the electric rate case proceeding. These terms are a result of negotiations between the Parties, are in the public interest and will result in reasonable electric rates.

For these reasons, the Parties urge the Commission to approve the Settlement Agreement.

Dated this 8th day of November, 2010.

Montana-Dakota Utilities Co.
A Division of MDU Resources Group, Inc

By: David L. Goodin
Name and title
DAVID L. GOODIN
PRESIDENT + CEO

Dated this 8th day of November, 2010.

North Dakota Public Service Commission Staff

By: Ken J. Sed
Name and title
Attorney for
Commission Staff