

Memo

To: Executive Secretary

From: Mike Diller



Date: November 1, 2012

Re: Support for Settlement Agreement, Case No. PU-10-124

Montana-Dakota Utilities Co. (MDU) filed its Electric Earnings Sharing Adjustment for the year ended 2011 on April 16, 2012 as Ordered by the commission on June 8, 2011. A Notice of Opportunity for Hearing was issued May 16, 2012. No comments or requests for hearing have been received. Advocacy Staff (staff) conducted its investigation resulting in settlement negotiations. A Settlement Agreement was filed by the parties (MDU & staff) on October 25, 2012 to resolve all outstanding issues.

The purpose of this memo is to explain MDU's filing and staff's rationale for settlement. In its initial Revenue Sharing Adjustment filing (Docket 194), MDU begins with its 2011 reported earnings and then makes 5 adjustments to arrive at an adjusted earnings level (See Exhibit A, Page 2, Docket 194). The adjusted earnings level is then used to compute earnings on equity above the ordered 10.75% and then multiplied times 50% to determine the ratepayers' share. Following is a discussion of each adjustment:

1. Reserve Adjustment

The first adjustment is necessary to remove MDU's estimated earnings sharing refund which was booked during the 2011 year as a reduction to earnings. The Reserve Adjustment reverses MDU's estimate and results in increasing the reported earnings for 2011.

2. Margin Sharing Adjustment (MSA)

In MDU's previous rate case (Case No. PU-399-03-296), the commission's Order included a MSA for off-system sales. The purpose of the MSA was to encourage MDU to make off-system sales by setting an assumed floor for sales margins in base rates as well as allowing MDU to keep 15% of all off-system sales margins earned. In MDU's most recent rate case, of which this filing is included, the commission ended the practice of using a MSA. Because of that, MDU argued that any associated revenues in 2011 should be eliminated. Staff argued that the MSA revenues continued to accrue until the commission issued its Order in the middle of 2011. The Settlement Agreement removes MDU's adjustment which increases the reported earnings for sharing.

205 PU-10-124 Filed: 11/1/2012 Pages: 2
Staff memorandum

3. Supplemental Insurance Security Plan (SISP)

The SISP adjustment eliminates an expense that is included in reported earnings. The adjustment is necessary because cost recovery for SISP has been denied by the commission in the past. The adjustment increases reported earnings.

In addition, MDU agrees to no longer recognize SISP expense for purposes of reporting earnings to the commission until such time the commission recognizes the expense for ratemaking purposes.

4. 401K Adjustment

The 401K adjustment excludes tax benefits gained from making dividend payments to its employees. MDU argues that this tax benefit is stockholder related and should not accrue to the benefit of ratepayers. Staff argues that the tax benefits exist because of MDU's regulated utility operations. For settlement purposes, staff agrees to the adjustment which reduces reported earnings.

5. Prior Period Tax Adjustments

This adjustment eliminates tax benefits related to the SISP because the commission does not recognize the cost as a regulated expense and also normalizes the effects of a periodic IRS tax review and resulting tax adjustments. The IRS review covered a 3 year period and therefore the Prior Period Tax adjustment eliminates two-thirds of these adjustments leaving one year's worth of tax adjustments in the 2011 reported earnings.

In summary, the net impact of the Settlement Agreement on earnings sharing for 2011 is an increase of about \$1 million. However, as a result of the review, staff discovered that MDU had been under-recovering on its Margin Sharing Adjustment totaling about \$1.3 million (Exhibit 1, Page 3, Docket 203) resulting in a net loss to ratepayers of about \$.3 million in comparison to MDU's original filing. Because the MSA true-up will add \$1.3 million to 2012 earnings, staff expects that ratepayers will recover half of that through the 2012 earnings sharing agreement that will be filed in April, 2013.

Staff believes the Settlement Agreement resolves all of staff's issues and recommends approval of the proposed refund.