

**STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION**

**Montana-Dakota Utilities Co., a Division of MDU Resources
Group, Inc.
Earnings Sharing Adjustment
Application**

Case No. PU-10-124

ORDER ON SETTLEMENT

December 21, 2012

Preliminary Statement

On June 8, 2011, the North Dakota Public Service Commission adopted an Order on Settlement in the captioned case approving an earnings sharing mechanism that provides for customer refunds if Montana-Dakota Utilities Co.'s (MDU) net income exceeds a 10.75 percent return on equity for its North Dakota operations for any fiscal year prior to either January 1, 2013 or the base period included in MDU's next electric general rate case, whichever occurs sooner. Earnings sharing credits are to be applied as a one-time bill credit.

On April 16, 2012, MDU filed an earnings sharing adjustment for the year ending 2011. MDU proposed that \$1,280,682 be credited to electric customers' bills over two months.

On May 16, 2012, the Commission issued a Notice of Opportunity for Hearing on MDU's proposed earnings sharing adjustment for the year ending 2011.

On October 25, 2012, MDU and Commission Advocacy Staff filed a Settlement Agreement which they assert resolves all outstanding issues for the 2011 electric earnings sharing adjustment. The Settlement proposes that \$1,006,240, adjusted to accrue interest, be credited to electric customers' bills over two months.

On November 9, 2012, the Commission issued a Notice of Opportunity for Hearing providing until December 12, 2012 for comments and requests for hearing. The issue noticed for this proceeding is whether the Settlement Agreement should be approved and adopted by the Commission. The Notice stated that the Commission may make a decision in these cases without hearing. No comments or requests for hearing were received.

On December 12, 2012 the Commission held an Informal Hearing to discuss the issue with MDU and Commission Advocacy Staff.

Discussion

For the twelve months ending 2011, MDU's net income exceeded a 10.75 percent return on equity for its North Dakota operations. In the October 25, 2012 Settlement,

MDU and Commission Advocacy Staff recommend utilization of actual earnings with limited normalizing adjustments for calculation of the earnings sharing adjustment. The result is a 2011 earnings sharing amount of \$2,321,305.

MDU and Commission Advocacy Staff also recommend that the 2011 earnings sharing adjustment be offset by the recalculation of the margin sharing adjustment associated with the treatment of MDU's off-system sales margins for the years 2007 through July 2011 where amounts to be collected under the margin sharing adjustment were understated in periods where the actual off-system sales fell below the floor established in Case No. PU-399-03-296. This margin sharing recalculation results in an offset to the 2011 earnings sharing adjustment of \$1,315,065. This margin sharing amount would be included in the calculation of the 2012 earnings sharing adjustment.

MDU and Commission Advocacy Staff therefore recommend a net refund to MDU electric customers of \$1,006,240, adjusted to accrue interest at the three month Treasury Bill rate.

MDU and Commission Advocacy Staff recommend the refund be applied as a kwh bill credit based on projected electric sales over two months commencing November 2012 or as soon thereafter as the Settlement Agreement is approved and the bill credit can be implemented by MDU. The bill credit would be reflected as a separate line item on the bill. Any amount of the net refund that is over collected or under collected would be included in MDU's deferred fuel cost account.

At the Informal Hearing, the Commission discussed the possibility of combining the 2011 earnings sharing adjustment with the 2012 earnings sharing adjustment expected to be filed in second quarter of 2012.

The Commission makes the following:

Order

1. The Settlement Agreement filed with the Commission on October 25, 2012, a copy of which is attached to this Order, is made a part of this Order and is APPROVED with the condition that the 2011 earnings sharing adjustment be implemented coincident with the implementation of the 2012 earnings sharing adjustment.

PUBLIC SERVICE COMMISSION



Kevin Cramer
Commissioner



Brian P. Kalk
Chairman



Benny M. Fetch
Commissioner

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 25th day of October, 2012, by and among the North Dakota Public Service Commission Advocacy Staff ("Staff"), and Montana-Dakota Utilities Co., a Division of MDU Resources Group, Inc., ("Montana-Dakota" or "Company") (collectively the "Parties"). The Parties agree this Settlement Agreement, if approved by the Public Service Commission ("Commission"), resolves the issues addressed herein in a manner consistent with the public interest.

BACKGROUND

On April 19, 2010, Montana-Dakota filed an application with the North Dakota Public Service Commission ("Commission") for an increase in its retail electric rates to provide an annual increase in revenue of \$15,396,303. Montana-Dakota's initial rate increase request was revised to \$11,519,000 following a partial Settlement Agreement between the Company and Staff dated June 15, 2010. In the partial Settlement Agreement, the Parties recommended approval of a return on equity ("ROE") of 10.75 percent in the Commission's final order and implementation of an earnings sharing mechanism to result in customer refunds if the Company's net income from electric utility service in North Dakota exceeded 10.75 percent. The Settlement Agreement provides that 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 would be applied to customer accounts as soon as practical after July 1; after 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.

An interim rate increase of \$7,617,000 was approved effective June 18, 2010. The June 15, 2010 settlement agreement was modified by a second settlement agreement dated November 8, 2010 which resolved additional outstanding issues in the proceeding. On March 14, 2011, the Parties entered into a third settlement agreement recommending that Montana-Dakota be allowed to file rates to provide an annual test year revenue increase equal to the amount of the interim rate increase. By Order issued June 8, 2011, the Commission approved the three Settlement Agreements between the Parties including the recommended implementation of an earnings sharing mechanism.

On April 16, 2012, the Company submitted a proposed earnings sharing adjustment with schedules showing its return on equity for the twelve months ending December 31, 2011 exceeded 10.75 percent. The Company proposed to implement an earnings sharing refund to customers of \$1,280,682 through a two month bill credit. The Commission suspended the Company's proposed earnings sharing refund and issued a Notice of Opportunity for Hearing on May 16, 2012. No comments or requests for hearing were received in response to the Notice.

In consideration of the record evidence of this proceeding, and discussions by the Parties, the Parties agree to the following subject to approval of this Settlement Agreement by the Commission:

1. Revenue Requirement Increase. The earnings sharing adjustment of \$1,280,682 proposed by Montana-Dakota was calculated by normalizing certain non-recurring revenue and expense items for 2011. By this Settlement Agreement the Parties recommend utilization of actual earnings with limited normalizing adjustments for calculation of the earnings sharing adjustment. Utilization of 2011 adjusted earnings shown on Exhibit 1, page 1 hereto results in a 2011 earnings sharing amount of \$2,321,305.

2. Margin Sharing Adjustment. The 2011 earnings sharing adjustment should be offset by the recalculation of the margin sharing adjustment associated with the treatment of the Company's off-system sales margins for the years 2007 through July 2011 where amounts to be collected under the Margin Sharing Adjustment (MSA) were understated in periods where the actual off-system sales fell below the floor established in Case No. PU-399-03-296, as shown on Exhibit 1, page 3 hereto. This recalculation results in a margin sharing adjustment in favor of the Company in the amount of \$1,315,065. This margin sharing amount shall be included in the calculation of the earnings sharing adjustment for 2012.

3. Net Refund. The Parties recommend a net 2011 refund to Montana-Dakota electric customers of \$1,006,240, adjusted to accrue interest at the three month Treasury Bill rate through October 31, 2012, estimated at \$1,006,906. The Parties further recommend the refund be applied as a kwh bill credit to all North Dakota electric

customers based on projected electric sales over two months commencing November 2012 or as soon thereafter as this Settlement Agreement is approved and the bill credit can be implemented by Montana-Dakota. The credit will be reflected as a separate line item on the bill to all of the Company's North Dakota electric customers. Any amount of the net refund that is over collected or under collected will be included in the Company's deferred fuel cost account.

4. 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 establishing the amount and procedure for the 2011 earnings sharing adjustment pursuant to the Commission's order in this proceeding, the Settlement Agreement does not establish any principle or precedent for this or any future proceeding.

5. 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.

6. Applicability and Scope. This Settlement Agreement shall be effective on the date of the Commission Order approving the Settlement Agreement.

7. Modification. If the Commission Order modifies or conditions approval of this Settlement Agreement, it shall be deemed terminated if either the Company or the

Staff files a letter with the Commission within three (3) business days of the date of such Order stating that a condition or modification to the Settlement Agreement is unacceptable to such party.

CONCLUSION

The Settlement Parties have agreed to the foregoing terms to resolve the issues in the Company's earnings sharing adjustment filing. These terms are a result of negotiations between the Settlement Parties, are in the public interest and will result in reasonable electric issues. For these reasons, the Settlement Parties urge the Commission to approve the Settlement Agreement.

Dated this 25th day of October 2012.

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

By: Harriet Singer
Title: V.P. Regulatory Affairs & CAO

Dated this 25th day of October 2012.

North Dakota Public Service Commission Staff

By: W. G. Dille
Dir. of Econ. Reg.

**MONTANA-DAKOTA UTILITIES CO.
NORTH DAKOTA ELECTRIC
2011 EARNINGS SHARING SUMMARY
SETTLEMENT**

	<u>2011</u>	<u>Adjustments 1/</u>	<u>2011 Adjusted</u>
Revenue			
Sales	\$128,810,476	\$0	\$128,810,476
Sales for Resale	2,838,998	0	2,838,998
Reserve for Refunds	(640,000)	640,000	0
Other	5,453,500	0	5,453,500
Total	<u>136,462,974</u>	<u>640,000</u>	<u>\$137,102,974</u>
Expenses			
Cost of Fuel & PP	35,904,196	0	35,904,196
Fuel - SFR	777,073	0	777,073
O&M	<u>43,366,547</u>	<u>(608,801)</u>	<u>42,757,746</u>
Total	80,047,816	(608,801)	79,439,015
Depreciation	21,128,807	0	21,128,807
Taxes Other	4,826,878	0	4,826,878
Current Income Taxes	(8,477,328)	1,178,480	(7,298,848)
Deferred Income Taxes	<u>12,994,926</u>	<u>726,599</u>	<u>13,721,525</u>
Expenses	<u>110,521,099</u>	<u>1,296,278</u>	<u>111,817,377</u>
Net Income	\$25,941,875	(\$656,278)	\$25,285,597
Rate Base	\$251,452,820		\$251,452,820
Rate of Return	10.317%		10.056%
Return on Equity	<u>13.341%</u>		12.858%
Authorized Return			10.750%
Difference in Return			2.108%
Revenue to Share			\$4,642,609
Share 50 percent			<u>\$2,321,305</u>
Recovery of MSA 2/			\$1,315,065
Net to Refund			<u>\$1,006,240</u>

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2/ Page 3.

**MONTANA-DAKOTA UTILITIES CO.
NORTH DAKOTA ELECTRIC
2011 EARNINGS SHARING - SETTLEMENT**

	2011	Adjustments					Total Adjustments	Adjusted 2011
		Reserve 1/	MSA	SISP 2/	401K 3/	Prior Period Tax 4/		
Revenue								
Sales	\$128,810,476						\$0	\$128,810,476
Sales for Resale	2,838,998						0	2,838,998
Reserve for Refunds	(640,000)	\$640,000					640,000	0
Other	5,453,500						0	5,453,500
Total	136,462,974	640,000	0	0	0	0	640,000	137,102,974
Expenses								
Cost of Fuel & PP	35,904,196						0	35,904,196
Fuel - SFR	777,073						0	777,073
O&M	43,366,547			(608,801)			(608,801)	42,757,746
Total	80,047,816	0	0	(608,801)	0	0	(608,801)	79,439,015
Depreciation	21,128,807						0	21,128,807
Taxes Other	4,826,878						0	4,826,878
Current Income Taxes 5/	(8,477,328)	245,424	0	80,931	360,159	491,966	1,178,480	(7,298,848)
Deferred Income Taxes	12,994,926			113,368		613,231	726,599	13,721,525
Expenses	110,521,099	245,424	0	(414,502)	360,159	1,105,197	1,296,278	111,817,377
Net Income	\$25,941,875	\$394,576	\$0	\$414,502	(\$360,159)	(\$1,105,197)	(\$656,278)	\$25,285,597
Rate Base	\$251,452,820							\$251,452,820
Rate of Return	10.317%							10.056%
Return on Equity	13.341%							12.858%

1/ Eliminates the reserve for the earnings sharing mechanism.

2/ Eliminates supplemental insurance and related adjustments as it is not included in a general rate case.

3/ Eliminates permanent tax deduction for the the 401K tax deduction.

4/ Eliminates prior period income tax adjustments related to SISP, and two-thirds of FIN 48 tax reversals and interest on FIN 48 tax reversals.

5/ Tax Calculation	Reserve	MSA	SISP	401K	Prior Period Tax	Total Adjustments
Change in Rev. & Expense	\$640,000	\$0	\$608,801	\$0	\$0	\$1,248,801
Change in Tax Deductions			397,755	(939,199)	273,990	(267,454)
Net change in taxable income	640,000	0	211,046	939,199	(273,990)	1,516,255
Income Taxes @ 38.3475%	245,424	0	80,931	360,159	(105,068)	581,446

Montana-Dakota Utilities Co.
Margin Sharing Adjustment Rate 57

	Initial Year							2011	
	2004	2005	2006	2007	2008	2009	2010	Partial Year	Total
Level of ND Allocated Off-System Sales Margins	\$8,530,664	\$10,099,610	\$6,374,832	\$2,144,420	\$2,992,704	\$393,081	\$226,002	\$138,744	
Rate 57 Margin Sharing Adjustment Calculation									
If Margins are greater than \$3,300,000 then:									
Level of Benefit Received in Base Rates	\$6,115,355	\$6,500,000	\$6,500,000						
Less: 85% of Actual Margins	7,251,063	8,584,668	5,418,607						
Margin Sharing Adjustment Surcharge (Credit)	<u>(\$1,135,708)</u>	<u>(\$2,084,668)</u>	<u>\$1,081,393</u>						(\$2,138,983)
If Margins are lower than \$3,300,000 then:									
Floor Amount				\$3,200,000	\$3,200,000	\$3,200,000	\$3,200,000	\$1,782,871	
Plus 15% of Actual Margins				321,663	448,906	58,962	33,900	20,812	
Margin Sharing Adjustment Surcharge (Credit)				<u>\$3,521,663</u>	<u>\$3,648,906</u>	<u>\$3,258,962</u>	<u>\$3,233,900</u>	<u>\$1,803,683</u>	\$15,467,114
Margins Distributed to MDU									
Margins Earned	\$8,530,664	\$10,099,610	\$6,374,832	\$2,144,420	\$2,992,704	\$393,081	\$226,002	\$138,744	
Margin Sharing Adjustment per Rate 57	(1,135,708)	(2,084,668)	1,081,393	3,521,663	3,648,906	3,258,962	3,233,900	1,803,683	
Profit Margin Included in Base Rates	<u>(6,115,355)</u>	<u>(6,500,000)</u>	<u>(6,500,000)</u>	<u>(6,500,000)</u>	<u>(6,500,000)</u>	<u>(6,500,000)</u>	<u>(6,500,000)</u>	<u>(2,884,839)</u>	
Net Benefit to MDU	<u>\$1,279,601</u>	<u>\$1,514,942</u>	<u>\$956,225</u>	<u>(\$833,917)</u>	<u>\$141,610</u>	<u>(\$2,847,957)</u>	<u>(\$3,040,098)</u>	<u>(\$942,412)</u>	
Margins Distributed to Ratepayers									
Ratepayer Benefit (Margins Assumed in Base Rates)	6,115,355	6,500,000	6,500,000	6,500,000	6,500,000	6,500,000	6,500,000	2,884,839	
Surcharges (Credits) Billed through MSA	(1,135,708)	(2,084,668)	1,081,393	3,521,663	3,648,906	3,258,962	3,233,900	1,803,683	
Net Benefit to Ratepayers	<u>\$7,251,063</u>	<u>\$8,584,668</u>	<u>\$5,418,607</u>	<u>\$2,978,337</u>	<u>\$2,851,094</u>	<u>\$3,241,038</u>	<u>\$3,266,100</u>	<u>\$1,081,156</u>	
Total Distributed Off-System Sales Margins	<u>\$8,530,664</u>	<u>\$10,099,610</u>	<u>\$6,374,832</u>	<u>\$2,144,420</u>	<u>\$2,992,704</u>	<u>\$393,081</u>	<u>\$226,002</u>	<u>\$138,744</u>	
Difference									
MDU's Calculation of MSA	(1,135,708)	(2,084,668)	1,081,393	2,978,337	2,851,095	3,241,038	3,266,100	1,815,479	\$ 12,013,066
MDU Over-Calculated (Under-Calculated) MSA	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>(\$543,326)</u>	<u>(\$797,811)</u>	<u>(\$17,924)</u>	<u>\$32,200</u>	<u>\$11,796</u>	<u>(\$1,315,065)</u>