

June 8, 2015

Darrell Nitschke, Executive Secretary
North Dakota Public Service Commission
600 E Blvd
Bismarck, ND 58505-0480

Re: MDU's Earnings Sharing Provision (Case Nos. PU-14-108 and PU-14-109)

During the commission deliberations on May 27, 2015 regarding the above referenced case, questions were raised concerning the difference in MDU's estimated 2014 earnings (9 months actual combined with 3 months projected) compared to actual reported earnings for its electric operations. I was unable to attend the meeting but writing here to respond to your questions.

This is of particular interest to the commission because staff presented information at an informal hearing on December 17, 2014 that MDU generally earns more than it needs and showed how its projected earnings changed dramatically during 2014. Staff also expressed concern about the difficulty in forecasting margins (revenues less cost of fuel and purchased power) given the growth in the Bakken; a portion of which is served by MDU. Revenues and the cost of generating electricity are the two largest components in determining earnings levels and earnings sufficiency. Staff was comfortable with most of MDU's projections but was not so confident in the projected margins because determining such is difficult to do during times of economic expansion.

MDU followed staff's presentation on December 17 and argued that more margins are better than less margins because such reduces the need for rate cases and rate increase applications. MDU further argued that since it has some of the lowest rates in the state that the commission should not be overly concerned about over-earnings. MDU presented an ad hoc schedule of residential rates charged by some of the cooperatives and utilities operating in the state showing MDU to be next to the least expensive electric provider in the state. An advance copy was not provided to staff but just a cursory review of the numbers during the hearing indicated that the schedule was not accurate and it was not a complete comparison of all providers in the state.

The projected return for 2014 of 10.24% based on nine months actual and 3 months projected compared to actual earnings of 11.29% is a difference of more than \$3 million in revenue requirements and is primarily a result of the difference in margin levels. Actual revenues were

more than \$2 million higher than projected. Fuel costs and purchased power costs were about \$1 million lower. Normally, higher sales result in higher costs to produce electricity. Nevertheless, the primary difference in reported earnings compared to projected earnings lies within the margins reported by MDU.

MDU filed its own comments regarding your deliberations on May 29, 2015 indicating that the two primary drivers for the budget / actual difference was weather and the extension of bonus tax depreciation. Staff does not agree. It is true that November was very cold but it is equally true that December was unusually warm offsetting the increased need for electric heat in November. Heating degree days for the last three budgeted months of 2014 were very normal taken as a whole. The extension of bonus tax depreciation may have impacted taxes paid but the effective tax rate for 2014 actual results increased when comparing actuals to projected. If the extension of bonus tax depreciation reduced MDU's tax expense, then there is more than offsetting tax increase changes.

Predicting margins is difficult not only because of the fluctuations caused by economic growth but also because of the billing cycles and the proper matching of revenues with fuel costs. Northern States Power Company now reports annual earnings for its gas operations in North Dakota by excluding all purchased gas costs and all associated gas cost revenues to avoid the noise in margins that was ever present and throwing off earnings projections and earnings reports from one year to the next. Now, NSP's annual reports are much more stable and accurate and do not fluctuate nearly as much. We have not deployed such a technique on the electric side but staff will consider requiring such across-the-board in next year's annual reports from utilities companies.

There are lots of differences between MDU's actual results and projected results but most of the difference lies within the reported margins. Margin differences are difficult to analyze because of the many different revenue streams and expenses that are included. At this time, staff is unable to look into this matter further given our current workload.

Sincerely,



Mike Diller
Director of Economic Regulation