**MONTANA-DAKOTA UTILITIES COMPANY**
Gas

Executive Summary

Table 1 on pages 2-1 to 2-2 is a comparative summary which illustrates the effect of instituting the revised depreciation rates. The schedule includes a comparison of the annual depreciation rates and annual depreciation expense under both present and proposed rates applied using the Straight Line Method for each depreciable property group of the Montana Dakota Utilities Company – Gas (the "Company") plant in service as of December 31, 2008. Both the present and proposed depreciation rates were developed utilizing the Straight Line (SL) Method, Broad Group (BG) Procedure, and the Average Remaining Life (ARL) Technique. The utilization of the recommended depreciation rates based upon the Straight Line Average Remaining Life Procedure results in the setting of depreciation rates which will continuously true up the Company's level of capital recovery over the life of each asset group. Application of this procedure, which is based upon the current best estimates of service life and net salvage together with the Company's plant in service and accrued depreciation, produces annual depreciation rates that will result in the Company recovering 100 percent of its investment -- no more, no less.

Table 1a on pages 2-3 and 2-4 summarizes the segmentation of the Company's property group's December 31, 2008 book depreciation reserves into the plant only, gross salvage, and cost of removal components.

Table 2 - Plant Only on pages 2-5 through 2-7, (which is the development of average remaining life depreciation rates for the Plant Only recovery component) provides a summary of

the detailed life estimates and service life parameters utilized in preparing the Average Remaining Life depreciation rates for each property group. The schedule provides a summary of the detailed data and narrative of the study results set forth in Sections 4 through 7. The developed depreciation rates (Column I) were determined by studying the Company's historical investment data together with the interpretation of future life expectancies which will have a bearing on the overall service life of the Company's property. This study included an analysis of the content of the property groups, discussions with senior management regarding current and anticipated events that may impact the various property groups.

Table 2 - Gross Salvage on pages 2-8 through 2-10 is a similar table to Table 2 – Plant Only, except that this table develops the component level depreciation rates for the recovery of the gross salvage portion of the property cost.

Table 2 - Cost of Removal on pages 2-11 through 2-13 summarizes the depreciation recovery rates for the cost of removal segment of the total plant cost.

Table 3 on pages 2-14 and 2-15 reconciles the December 31, 2008 account level plant in service balances per books versus the balances utilized in the performance of the depreciation study. The table incorporates pending (unrecorded) retirements identified during the course of completing the depreciation study.

Likewise, Table 4, on pages 2-16 and 2-17, reconciles the December 31, 2008 book depreciation reserve balances per books versus the balances utilized in preparing the depreciation rates per this study. The table incorporates the pending (unrecorded) retirements identified in assembling the detailed accounting data for this study.

Table 5, on pages 2-18 to 2-20, contains a summary of the Company's book depreciation

reserve versus the corresponding theoretical depreciation reserve as of December 31, 2008. The theoretical depreciation reserves were developed using each asset category's utility plant in service as of December 31, 2008 together with the current estimated service life characteristics and net salvage factors developed per the study.

Table 6 on page 2-21 summarizes the annual amortization rates and amounts for each of the general plant accounts for which the depreciation amortization approach is being used while Table 7 on page 2-22 to 2-35 are the supporting detail calculations that develop the amortization rates. The amortization of the investments within the selected general plant accounts is driven by the Company's ongoing difficulty to effectively track various of the property account investments that are in many cases related to a large quantity of items of corresponding small investment amounts. Due to the inability to effectively track the items, many times the items are no longer utilized but remain on the company's books and records as unrecorded retirements. Therefore, the accounting procedure for these property items it that the investments within each vintage of the applicable property group is amortized over a predetermined time period. Once attaining the stated amortization period age the asset's original cost investment will have been fully amortized, and accordingly, is retired from the company's books and records. The property accounts for which asset investment amortization is being used includes Account 391, 393, 394, 395, 397, and 398.

In the process of amortization of the selected general plant accounts, there are, by the very nature of average service life dispersion, vintage investments with the applicable property group which exceeds the estimated average service life / proposed amortization period. Given that each vintage of property will be amortized over the average service life an adjustment needs to

be incorporated into the change over process to recover the under depreciated position of those older investments. Accordingly, the variance between the amortization starting point depreciation reserve and the Company's actual book reserve (either positive or negative) is being recorded on a straight line basis over the proposed amortization period along with the annual amortization of all other vintage investments. The amortization starting point book depreciation reserve is equal to the sum of the original cost for vintage older than the amortization period plus the calculated deprecation reserve for vintages with ages equal to or less than the amortization period.

It is recommended that the Company continue to apply depreciation rates and maintain its book depreciation reserve on an account-level basis. The maintenance of the book reserve on an account-level basis requires both the development of annual depreciation expense and distribution of other reserve account charges to an individual level. Maintaining the Company's depreciation records in this detail will aid in completing the various rate studies and, most importantly, clearly identifies the Company's level of capital recovery relative to each category of plant investment.

The general drivers for the proposed depreciation rates include an assessment of the Company's historical experience with regard to achieved service lives and net salvage factors. In addition, consideration is given to current and anticipated events which are anticipated to impact the Company's ability to recover its fixed capital costs related to utility plant in service utilized to provide service to the Company's customers.

The depreciation rate for each individual account changed as a result of reflecting estimates obtained through the in-depth analysis of the Company's most recent data together

with an interpretation of ongoing and anticipated future events. Some of the revisions were not significant and typically reflect fine tuning of previously utilized depreciation rates while others were more substantial in nature. Several of the accounts did reflect more significant changes (as outlined in Section 4 of this report) from the previously utilized depreciation rates.

The most notable depreciation/amortization occurred relative to Account 376 - Mains, Account 380 - Services, Account 391.1 - Office Furniture and Equipment, Account 391.5 - Computer Equipment - Other and Account 392.20 - Transportation Equipment - Cars & Trucks.

The proposed depreciation rate for Account 376 – Mains, increased from 1.92 percent to 2.97 percent. The proposed depreciation rate is the result of combined changes of both the average service life and net salvage parameters for the various property categories that comprise the overall plant account. Based upon the Company's actual historical plant in service data individual service life parameters were estimated for each of the primary property groups (including Steel, Plastic, Valves, Manholes, and Bridge and River Crossings) as outlined in section 4 of the depreciation study report. The proposed average service life for each sub property group was changed in accordance with the life indication developed through an analysis of the Company's historical data and consideration of future expectations. The resulting proposed composite average service life of the various property groups is forty-seven (47) years, while the average service life underlying the present depreciation rate is an implicit forty-five (45) years. The future net salvage underlying the proposed depreciation rates is negative 50 percent while the future net salvage underlying the present depreciation rates is negative 60 percent. Notwithstanding the fact that both the estimated average service life was lengthen and the negative net salvage was reduced in developing the proposed depreciation rate, the resulting

rate increased. Accordingly, the ARL depreciation rate increase is being driven by the fact that the current book depreciation reserve is at a lower level than required relative to the estimated depreciation parameters and currently average age of the property groups.

The proposed depreciation rate for Account 380 – Services, increased from 5.66 percent to 8.18 percent. The proposed depreciation rate is the result of combined changes of both the average service life and net salvage parameters for the various property categories that comprise the overall plant account. Based upon the Company's actual historical plant in service data individual service life parameters were estimated for each of the primary property groups (including Steel, Plastic, and Farm and Fuel Lines) as outlined in section 4 of the depreciation study report. The proposed average service life for each sub property group was changed in accordance with the life indication developed through an analysis of the Company's historical data and consideration of future expectations. The resulting proposed composite average service life of the various property groups is an implicit forty (40) years, which is the same forty (40) year implicit average service life underlying the present implicit depreciation rate. The future net salvage underlying the proposed depreciation rates is negative two hundred (200) percent while the future net salvage underlying the present depreciation rates is negative one hundred seventy five (175) percent and is reflective of the increased level of negative net salvage being experienced by the company.

The depreciation rate relative to Account 392.20 - Transportation Equipment - Cars & Trucks decreased from 21.13 percent to 0.00 percent. The current estimated average service life is 7 years and the net salvage factor is estimated at 15 percent. The depreciation rate decrease is the product of the fact that the current plant in service investment is fully depreciated. Given the

typical shorter average service life experienced by this property class, the depreciable life, net salvage rate and resulting annual depreciation rate requires more frequent review than has previously occurred. To the extent that significant retirements of existing property investments and additions of new property investments occur in the coming intervening years (and the current fully depreciated status of the property group declines significantly) a depreciation rate of 12.14 percent (based upon the 7 year average service life and 15 percent net salvage) should be utilized until the next depreciation study is performed.

Various of the remaining account/sub-accounts experienced increases and/or declines in recommended depreciation rates to a lesser degree, as noted per Table 1 of this report. This revision in annual depreciation rates and expense is the result of both changes in the estimated service lives and salvage factors, and reflects the impact of the Company's property changes since the most recent study.

With regard to the inclusion of higher negative net salvage levels in the development of proposed depreciation rates, as noted within my discussion related to net salvage both in Section 3 of the depreciation report, the level of experienced net salvage should simply be a benchmark from which to estimate future net salvage. It is highly likely that the negative net salvage amounts experienced even recently will simply be the floor above which future negative net salvage levels will increase to a higher level. To appropriately and proportionately allocate the true total asset cost (original cost adjusted for net salvage) over its applicable service life, proper consideration must be given in each accounting period, to the total costs that are anticipated to occur relative to the Company's assets that provide customer service.

Applying the proposed depreciation rates to the Company's December 31, 2008 plant in

service produces annual depreciation/amortization expense of $10,224,058 which is a increase of $525,793 from current depreciation rates.

The following summary compares the present and proposed composite depreciation rates for illustrative purposes only. The Composite Depreciation Rate should not be applied to the total Company investment inasmuch as the non-proportional change in plant investment as a result of property additions or retirements would render the composite rate inappropriate. The Table 1 schedule lists the recommended annual depreciation rates for each property account.

Present Depreciation Rates

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|---|---|
| Depreciable Plant In Service at December 31, 2008 | $251,825,094 |
| Annual Depreciation Expense | 9,698,264 |
| Composite Annual Depreciation Rate | 3.85% |

Proposed Depreciation Rates

| | |
|---|---|
| Depreciable Plant In Service at December 31, 2008 | $251,825,094 |
| Annual Depreciation Expense | 10,224,058 |
| Composite Annual Depreciation Rate | 4.06% |