BEFORE THE SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

In the Matter of the Application of MONTANA-DAKOTA UTILITIES CO., a Division of MDU Resources Group, Inc., for Authority to Establish Increased Rates for Natural Gas Service	)))))	Docket No. NG12-__

DIRECT TESTIMONY AND EXHIBITS

OF

EARL M. ROBINSON

On The Subject of Depreciation

DEPRECIATION

TABLE OF CONTENTS

I. WITNESS INTRODUCTION 1

II. PURPOSE OF TESTIMONY 1

III. BACKGROUND 2

IV. DEPRECIATION STUDY OVERVIEW 3

V. METHODS, PROCEDURES & TECHNIQUES 7

VI. GROUP DEPRECIATION 13

VII. NET SALVAGE 15

VIII. DEPRECIATION STUDY ANALYSIS 19

IX. COMPREHENSIVE DEPRECIATION STUDY RESULTS AS OF 12-31-08 23

X. NET CHANGE FROM 12-31-11 BOOK DEPRECIATION RATES TO PROPOSED DEPRECIATION RATES FROM 12-31-2008 STUDY 27

XI. RECOMMENDATION 29

I. WITNESS INTRODUCTION

Q1. Please state your name, occupation and business address.

A. My name is Earl M. Robinson. I am a Principal and Director of AUS Consultants. AUS Consultants is a consulting firm specializing in preparing various financial studies including depreciation, valuation, revenue requirements, cost of service, rate of return, and other analysis and studies for the utility industry and numerous other entities. AUS Consultants provides a wide spectrum of consulting services through its practices that include Depreciation & Valuation, Intellectual Property Management, Knowledge Management, Rate of Return, Revenue Requirements & Cost of Service, and Education & Publications. My office is located at 792 Old Highway 66, Suite 200, Tijeras, NM 87059.

Q2. Have you prepared an appendix which contains your qualifications and experience?

A. Yes. Appendix A to my direct testimony contains a summary of my qualifications and experience.

II. PURPOSE OF TESTIMONY

Q3. What is the purpose of your testimony?

A. The purpose of my testimony is to set forth the results of my depreciation review and analysis of the plant in service of Montana-Dakota Utilities Co.-Gas Division and Common Plant ("Company") which was conducted in the process of preparing depreciation studies of the Company's gas and

common plant assets as of December 31, 2008. Reports of my review and analyses are contained in Exhibit No. ___(EMR-1), titled "Montana-Dakota Utilities Co-Gas Division Depreciation Study as of December 31, 2008" and Exhibit No____(EMR-2), the "Montana-Dakota Utilities Co-Common Plant Depreciation Study as of December 31, 2008". In preparing the report, I investigated and analyzed the Company's historical plant data and reviewed the Company's past experience and future expectations to determine the remaining lives of the Company's gas and common plant assets. The studies utilized the resulting remaining lives, the results of a salvage analysis, the Company's vintaged plant in service investment and depreciation reserve to develop recommended average remaining life depreciation rates and depreciation expense related to the Company's plant in service.

III. BACKGROUND

Q4. How is depreciation defined?

A. Depreciation is defined in the 1996 NARUC "Public Utility Depreciation Practices" publication as follows: "Depreciation, as applied to depreciable utility plant, means the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of utility plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are

wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand, and requirements of public authorities."

Q5. Why is depreciation important to the revenue requirements of a utility company?

A. Depreciation is important because, as the above definition describes, depreciation expense enables a company to recover in a timely manner the capital costs related to its plant in service benefiting the company's customers. Appropriate depreciation rates will allow recovery of a company's investments in depreciable assets over a life that provides for full recovery of the investments, less net salvage. Without the appropriate recovery of depreciation costs, the Company ultimately will not be able to meet its financial obligations related to the continued provision of service to customers. Furthermore, the inclusion of the appropriate level of depreciation recovery in revenue requirements serves to reduce overall costs (total of depreciation and return) to customers as opposed to a situation where an inadequate level of annual depreciation expense is currently being provided in rates.

IV. DEPRECIATION STUDY OVERVIEW

Q6. What is your professional opinion with regard to the results of the depreciation study that you performed?

A. In my opinion, the proposed depreciation rates resulting from the completed comprehensive depreciation study are reasonable and appropriate given that they incorporate the service life and net salvage parameters currently anticipated for each of the Company's property group investments over their average remaining lives.

Q7. What steps were involved in preparing the service life and salvage database that you utilized?

A. My comprehensive depreciation analyses included a detailed analysis of the Company's fixed capital books and records through December 31, 2008. The Company's historical investment cost records for each account have been assembled into a depreciation database upon which detailed service life and salvage analysis were performed using standard depreciation procedures.

Q8. What is the purpose of the historical database?

A. The historical service life and net salvage data is a basic depreciation study tool that is assembled to prepare a depreciation study. The historical database is used to make assessments and judgments concerning the service life and salvage factors that have actually been achieved, and (along with information relative to current and prospective factors) to determine the appropriate future lives over which to recover the Company's depreciable fixed capital investments. In accordance with this standard depreciation analysis, the Company's depreciation database

compiled through December 31, 2008, which contains detailed vintage level information, was used to develop observed life tables. The development of the observed life tables from the historical information was completed by grouping like aged investments within each property category and identifying the level of retirements that occur through each successive age to develop the applicable observed life tables. The resulting observed lives were then fitted to standard Iowa Curves to estimate each property group's historically achieved average service life.

Likewise, the net salvage database was used as a basis to identify historical experience and trends and to determine each property group's recommended net salvage factors. This was accomplished by preparing various three year rolling band analyses of salvage components as well as a forecast based on the Company's historical salvage experience.

Q9. In the preparation of the depreciation study, have you utilized information from additional sources when estimating service life and salvage parameters?

A. Yes. In addition to the historical data obtained from the Company's books and records, information was obtained from Company personnel relative to current operations and future expectations with respect to depreciation. Discussions were held with Company planning and operations management. In addition, physical inspections were also conducted of various representative sites of the Company's operating property.

Q10. Please briefly describe the information included in the depreciation study reports.

Each of the depreciation reports are divided into seven (7) sections. Section 1 of the report contains a brief narrative summary of the respective report. Two key portions of each of the reports are Sections 2 and 4. Section 2 includes the summary schedules listing the present and proposed depreciation rates for each depreciable property group and other depreciation rate development schedules. Section 4 contains a narrative description of the factors considered in selecting service life parameters for the Company's property. The various other sections of the report contain detailed information and/or documentation supporting the schedules contained in Sections 2 and 4. In addition, Section 5 is the graphical presentation of the average service life analysis, Section 6 is the detailed Average Remaining Life calculations, and Section 7 is detailed Net Salvage analysis schedules.

Q11. What was the source of the data utilized as a basis for determining the depreciation rates?

A. As previously discussed, all of the historical data utilized in the course of performing the detailed service life and salvage study was obtained from the Company's books and records. Historical vintaged data (additions, retirements, adjustments, and balances) were obtained for each depreciable property group.

Q12. Are there standard methods utilized to complete a service life analysis of a company's historical property investments?

A. Yes. As discussed in Section 3 of the depreciation study report as well as later in this testimony, the two most common methods are the Retirement Rate Method and the Simulated Plant Record Method. The method chosen to study a company's historical data is dependent upon whether aged or un-aged data is available. If specific aged data is available, the Retirement Rate Method is used. If only un-aged data is available, the Simulated Plant Record Method is used.

Q13. Were your studies prepared utilizing one of these accepted standard methods?

A. Yes. The Company maintains aged plant records. Therefore, the Retirement Rate Method was utilized in the depreciation studies of the Company's property.

V. METHODS, PROCUDURES & TECHNIQUES

Q14. Please describe the depreciation methods, procedures, and techniques commonly utilized to develop depreciation rates for utility property.

A. Inherent in all depreciation calculations is an overall method, such as the Straight Line Method (which is the most widely used approach within the utility industry) to depreciate property. Other methods available to develop average service lives and depreciation rates are accelerated and/or

deferral approaches such as the Sum of the Years Digits Method or Sinking Fund Method.

In addition, there are several procedures that can be used to arrange or group property by sub-groups of vintages to develop applicable service lives. These procedures include the Broad Group, the Equal Life Group and other procedures. Due to the existence of very large quantities of property units within utility operating property, utility property is typically grouped into homogeneous categories as opposed to being depreciated on an individual unit basis. While the Equal Life Group procedure is viewed as being the more definitive procedure for identifying the life characteristics of utility property and as a basis for developing service lives and depreciation rates, the Broad Group Procedure is more widely utilized throughout the utility industry by regulatory commissions as a basis for depreciation rates. My comments on the Equal Life Group procedure are discussed later in my testimony.

The distinction between the two procedures is in the manner in which recovery of the cost is achieved. Under the Broad Group Procedure, the useful life and resulting depreciation rate is based upon the overall average life of all of the property within the group, while under the Equal Life Group Procedure, the useful life and resulting depreciation rate is based upon separately recovering the investment in each equal life group

within the property category over the actual life of the property in that group.

A brief example (with a property group that has three units/three equal life groups of like property) will demonstrate the difference between the two procedures. The example incorporates the assumption that unit No. 1 (or equal life group of property) will retire after one year, unit No. 2 (or equal life group) will retire after two years, and Unit No. 3 (or equal life group) will retire after three years. Accordingly, the average life of all three (groups) is two (2) years (1+2+3)÷3. Under the Broad Group Procedure, the average useful life and resulting depreciation rate is calculated based upon the two (2) year average life. The resulting annual depreciation rates would be fifty (50) percent in every year. Conversely, under the Equal Life Group Procedure, each year's average life and resulting depreciation rate is calculated by using the period of time during which the portion of the property group remains in service. Since unit No. 1 (or that portion of the account) was retired from service after one year, the entire investment for that property is recovered over one (1) year. Likewise, since unit No. 2 (or that portion of the account) will have a service life of two years, the recovery of that portion of the account will occur over two years. Lastly, unit No. 3 (or that portion of the account) is recovered over three years. Hence, the useful average life for the property group in the first year is 1.64 years and the first year's annual

depreciation rate is 61.11 percent. In the second year, the useful average life of the surviving group is 2.4 years and the second year's depreciation rate drops to 41.67 percent. This occurs because during the first year, unit No. 1 (or that portion of the account) was fully recovered. Likewise, in year three the useful life of the surviving group is 3 years and the depreciation rate further drops to 33.33 percent. See the following Table EMR-1 (BG and ELG).

BG Average Life Calculation

Year		Investment	Recovery Period (Yrs)	ASL (Years)	Weight
1	Group # 1	300	2		150
	Group # 2	300	2		150
	Group # 3	300	2		150
	Total	900		2.00	450
2	Group # 1	0	0		0
	Group # 2	300	2		150
	Group # 3	300	2		150
	Total	600		2.00	300
3	Group # 1	0	0		0
	Group # 2	0	0		0
	Group # 3	300	2		150
	Total	300		2.00	150
Grand Total		1,800		2.00	900

BG Depreciation Rate Calculation

Investment	Recovery Period (Yrs)	Annual Rate-%	Recovery Amount
300	2		150
300	2		150
300	2		150
900		50.00%	450
0	0		0
300	2		150
300	2		150
600		50.00%	300
0	0		0
0	0		0
300	2		150
300		50.00%	150
1,800		50.00%	900

ELG Average Life Calculation

Year		Investment	Recovery Period (Yrs)	ASL (Years)	Weight
1	Group # 1	300	1		300
	Group # 2	300	2		150
	Group # 3	300	3		100
	Total	900		1.64	550
2	Group # 1	0	0		0
	Group # 2	300	2		150
	Group # 3	300	3		100
	Total	600		2.40	250
3	Group # 1	0	0		0
	Group # 2	0	0		0
	Group # 3	300	3		100
	Total	300		3.00	100
Grand Total		1,800		2.00	900

ELG Depreciation Rate Calculation

Investment	Recovery Period (Yrs)	Annual Rate-%	Recovery Amount
300	1		300
300	2		150
300	3		100
900		61.11%	550
0	0		0
300	2		150
300	3		100
600		41.67%	250
0	0		0
0	0		0
300	3		100
300		33.33%	100
1,800		50.00%	900

Finally, the depreciable investment needs to be recovered over a defined period of time (through use of a technique), such as the Whole Life or Average Remaining Life of the property group. The distinction between the Whole Life and Average Remaining Life Techniques is that under the Whole Life Technique, the depreciation rate is based on a snapshot and determines the recovery of the investment and average net salvage over the average service life of the property group for that moment in time. The Whole Life technique requires either frequent updates to keep the "snapshot" current or the use of an artificial deferred account that holds "excess" or "deficient" depreciation reserves. In comparison, under the Average Remaining Life Technique, the resulting annual depreciation rate incorporates the recovery of the investment (and future net salvage) less any recovery experienced to date over the average remaining life of the property group. The Average Remaining Life Technique is clearly superior in that it incorporates all of the current and future cost components in setting the proposed annual depreciation rate as opposed to only some of the current and future cost components as is the case with the Whole Life Technique. This means that any changes that occur in between depreciation studies are automatically trued-up in the subsequent study. No artificial deferral account needs to be established to accomplish such a true-up.

The depreciation methods, procedures, and techniques can be used interchangeably. For example, one could use the Straight Line

Method with the Broad Group Procedure and the Average Remaining Life Technique, or the Straight Line Method with the Equal Life Group Procedure and Average Remaining Life Technique, or combinations thereof.

Q15. Which of these methods, procedures and techniques did you use in your depreciation studies?

A. The depreciation rates set forth in my depreciation study reports were developed utilizing the Straight Line Method, the Broad Group Procedure, and the Average Remaining Life Technique.

Q16. Why did you utilize this method, procedure and technique?

A. The Straight Line Method is widely understood, recognized, and utilized almost exclusively for depreciating utility property.

The Broad Group Procedure recovers the Company's investments over the average period of time in which the property is providing service to the Company's customers. While I have used the Equal Life Group procedure in other studies, I used the Broad Group Procedure in this study because it is consistent with depreciation methods and procedures generally accepted by regulatory Commissions and is the approach underlying the Company's current depreciation rates.

Finally, the amount of annual depreciation must be based upon the productive life over which the un-depreciated capital investment is recovered (the Average Remaining Life Technique). The utilization of the Average Remaining Life Technique to develop the applicable annual

depreciation expense (over the average remaining life) assures that the Company's property investment is fully recovered over the useful life of the property, and that inter-generational inequities are avoided as current and future customers will pay their fair share of depreciation expense. The determination of the productive remaining life for each property group relies on a study of both past experience and future expectations and develops the appropriate total life and applicable depreciation rates for each of the Company's property groups. The Average Remaining Life Technique incorporates all of the Company's fixed capital cost components, thereby better assuring full recovery of the Company's embedded net plant investment and related costs. The Average Remaining Life Technique gives consideration not only to the average service life and survival characteristics plus the net salvage component, but also recognizes the level of depreciation which has been accrued to date in developing the proposed depreciation rate. The Average Remaining Life Technique is used by regulated companies and regulatory agencies because it allows full recovery by the end of the property's useful life -- no more and no less.

VI. GROUP DEPRECIATION

Q17. Please explain the utilization of group depreciation.

A. Group depreciation is utilized to depreciate property when more than one item of property is being depreciated. Such an approach is appropriate because all of the items within a specific group typically do not have

identical service lives, but have lives which are dispersed over a range of time. Utilizing group depreciation allows for a uniform application of depreciation rates to groups of similar property in lieu of performing extensive depreciation calculations on an item-by-item basis. The Broad Group approach is a recognized common group depreciation procedure.

The Broad Group Procedure recovers the investment within the asset group over the average service life of the property group. Given that there is dispersion within each property group, there are variations of retirement ages for the many investments within each property group. That is, some properties retire early (before average service life) while others retire at older ages (after average service life). This dispersion of retirement ages defines the survival pattern experienced by the applicable property group.

Q18. What factors influence the determination of the recommended annual depreciation rates included in your depreciation reports?

A. The depreciation rates reflect four principal factors: (1) the plant in service by vintage, (2) the book depreciation reserve, (3) the future net salvage, and (4) the composite remaining life for the property group. Factors considered in arriving at the service life are the average age, realized life and the survival characteristics of the property. The net salvage estimate is influenced by both past experience and future estimates of the cost of removal and gross salvage amounts.

Q19. Please explain further the assumptions considered when utilizing your depreciation approach.

A. According to my approach, the Company will recover its un-depreciated fixed capital investment through annual depreciation expense in each year throughout the useful life of the property. The Average Remaining Life Technique incorporates the future life expectancy of the property, the vintaged surviving plant in service, the survival characteristics, together with the book depreciation reserve balance and future net salvage in developing the amounts for each property account. Accordingly, Average Remaining Life depreciation meets the objective of providing a Straight Line recovery of the Company's fixed capital property investments.

Q20. Please explain further the group you have used.

A. My depreciation calculations, as applied in this study, follow a group depreciation approach. The group approach refers to the method of calculating annual depreciation based on the summation of the investment in any one plant group rather than calculation of depreciation for each individual unit of plant. In theory, each unit achieves average service life by the time of retirement. Accordingly, the full cost of the investment will be credited to plant in service when the retirement occurs, and likewise the depreciation reserve will be debited with an equal retirement cost. No gain or loss is recognized at the time of property retirement because of the assumption that the property was retired at average service life.

VII. NET SALVAGE

Q21. What are the net salvage factors included in the determination of depreciation rates?

A. Net salvage is the difference between gross salvage, or the proceeds received when an asset is disposed of, and the cost of removing the asset from service. Net salvage is said to be positive if gross salvage exceeds the cost of removal. If the cost of removal exceeds gross salvage, the result is negative salvage. Many retired assets generate little, if any, positive salvage. Instead, numerous Company asset groups generate negative net salvage at the end of their lives due to the cost of removal.

The cost of removal includes costs such as demolishing, dismantling, tearing down, disconnecting or otherwise retiring/removing plant, as well as any environmental clean-up costs associated with the property. Net salvage includes any proceeds received from any sale of plant.

Net salvage experience is studied for a period of years to determine the trends which have occurred in the past. These trends are considered, together with any changes that are anticipated in the future, to determine the future net salvage factor for remaining life depreciation purposes. The net salvage percentage is determined by comparing the total net positive or negative salvage to the book cost of the property investment retired.

The method used to estimate the retirement cost is a standard analysis approach which is used to identify a company's historical experience with regard to what the end of life cost will be relative to the

cost of the plant when first placed into service. This information, along with knowledge about the average age of the historical retirements that have occurred to date, allows an estimation of the level of retirement cost that will be experienced by the Company at the end of each property group's useful life. The study methodology utilized has been extensively set forth in depreciation textbooks and has been the accepted practice by depreciation professionals for many decades. Furthermore, the cost of removal analysis is the current standard practice used for mass assets by essentially all depreciation professionals in estimating future net salvage for the purpose of identifying the applicable depreciation rate for a property group. There is a direct relationship between the installation of specific plant and its corresponding removal. The installation is its beginning of life cost while the removal is its end of life cost. Also, it is important to note that Average Remaining Life depreciation rates incorporate future net salvage which is typically more representative of recent versus long-term historical average net salvage.

The Company's historical net salvage experience was analyzed to identify the historical net salvage factor for each applicable property group and is included in Section 7 of the study. This analysis routinely finds that historical retirements have occurred at average ages significantly shorter than the property group's average service life. The occurrence of historical retirements at an age which is significantly younger than the average service life of the property category demonstrates that the

historical data does not appropriately recognize the true level of retirement cost at the end of the property group's useful life. An additional level of cost to retire will occur due to the passage of time until all the current plant is retired at end of its life. That is, the level of retirement costs will increase over time until the average service life is attained. The additional inflation in the estimate of retirement cost is related to those additional years' cost increases (primarily the result of higher labor costs over time) that will occur prior to the end of the property group's average life.

To provide further explanation of the issue, several general principles surrounding property retirements and related net salvage should be highlighted. As property continues to age, assets that typically generate positive salvage when retired will generate a lower percentage of positive salvage as compared to the original cost of the property. By comparison, if the class of assets is one that typically generates negative net salvage (cost of removal) with increasing age at retirement, the negative net salvage percentage as compared to original cost will typically be greater. This situation is routinely driven by the higher labor costs that occur with the passage of time.

A simple example will aid in understanding the above net salvage analysis and the required adjustment to the historical results. Assume the following scenario: A company has two cars, Car #1 and Car #2, each purchased for $20,000. Car #1 is retired after 2 years and Car #2, is retired after 10 years. Accordingly, the average life of the two cars is six

(6) years. Car #1 generates 75% salvage or $15,000 when retired and Car #2 generates 5% salvage or $1,000 when retired.

	Unit Cost	Ret. Age (Yrs.)	% Salv.	Salvage Amount
Car #1	$20,000	2	75%	$15,000
Car #2	$20,000	10	5%	$ 1,000
Total	$40,000	6	40%	$16,000

Assume an analysis of the experienced net salvage at year three (3). Based upon the Car #1 retirement, which was retired at a young age (2 yrs.) as compared to the average six (6) year life of the property group, the analysis indicates that the property group would generate 75% salvage. This indication is incorrect, however, because it is the result of basing the estimate on incomplete data. That is, the estimate is based upon the salvage generated from a retirement that occurred at an age which is far less than the average service life of the property group. The actual total net salvage that occurred over the average life of the assets (which experienced a six (6) year average life for the property group) is 40%, as opposed to the initial incorrect estimate of 75%.

This is exactly the situation that occurs with the majority of the Company's historical net salvage data, except that most of the Company's property groups routinely experience negative net salvage (cost of removal) as opposed to positive salvage.

VIII. DEPRECIATION STUDY ANALYSIS

Q22. Please explain what factors affect the length of the average service life that the Company's property may achieve.

A. Several factors contribute to the length of the average service life which the property achieves. The three major factors are: (1) physical; (2) functional; and (3) contingent casualties.

The physical factor includes such things as deterioration, wear and tear and the action of the natural elements. The functional factor includes inadequacy, obsolescence and requirements of governmental authorities. Obsolescence occurs when it is no longer economically feasible to use the property to provide service to customers or when technological advances have provided a substitute with superior performance. The remaining factor, contingent casualties, includes retirements caused by accidental damage or construction activity of one type or another.

In performing the life analysis for any property being studied, both past experience and future expectations must be considered in order to fully evaluate the circumstances that may have a bearing on the remaining life of the property. This ensures the selection of an average service life which best represents the expected life of each property investment.

Q23. What study procedures were utilized to determine service lives for the Company's property?

A. Several study procedures were used to determine the prospective service lives recommended for the Company's plant in service. These include the review and analysis of historical, as well as anticipated, retirements,

current and future construction technology, historical experience and future expectations of salvage and the cost of removal.

Service lives are affected by many different factors, some of which can be determined from studying past experience, others of which must rely heavily on future expectations. When physical characteristics are the controlling factor in determining the service life of property, historical experience is a useful tool in selecting service lives. In cases where there are changes in technology, regulatory requirements, Company policy or the development of a less costly alternative, historical experience is of lesser or little value. However, even when considering physical factors, the future lives of various properties may vary from those experienced in the recent past.

While a number of methods are available to study historical data, as I mentioned previously, the two methods most commonly utilized to determine average service lives for a company's property are the Retirement Rate Method and the Simulated Plant Record Method. Given that the Company does not have complete historical vintage based investment records, it was required that the Simulated Plant Record Method be used to analyze the past historical data. The Company is currently in the process of implementing a new property record system which will enable increased use of actuarial study analysis in future years.

Q24. Please explain further the use of the retirement rate method.

A. With this method of analysis, the Company's actuarial service life data, which is sorted by age, is used to develop a survivor curve (observed life table). This survivor curve is the basis upon which smooth curves (standard Iowa Curves) are matched or fitted to then determine the average service life being experienced by the property account under study. Computer processing provides the capability to review various experience bands throughout the life of the account to observe trends and changes. For each experience band analysis, an "observed life table" is constructed using the exposure and retirement experience within the selected band of years. In some cases, the total life cycle of the property has not been achieved and the experienced life table, when plotted, results in a "stub curve." It is the "stub curve," or the total life curve, if the total life curve is achieved, which is matched or fitted to the standard Iowa Curves. The matching process is performed both by computer analysis, using a least squares technique, and by overlaying the observed life tables on the selected smooth curves for visual reference. The fitted smooth curve is a benchmark which provides a basis to determine the estimated average service life for the property group under study.

Q25. Do the depreciation study reports contain charts which compare the analysis of the Company's actual historical data to the service life parameters you are proposing as a basis for your recommended annual depreciation rates?

A. Yes. Graphical representations of the Company's plant balances versus simulated plant balances based upon the estimated lives and Iowa Curves are contained in Section 5 of the report.

Q26. You have referred to the use of the Iowa or smoothed survivor curves. Can you generally describe these curves and their purpose?

A. The preparation of a depreciation study typically incorporates smoothed curves to represent the experienced or estimated survival characteristics of the property. The "smoothed" or standard survivor curves are the "Iowa" family of curves developed at Iowa State University and which are widely used and accepted throughout the utility industry. The shape of the curves within the Iowa family is dependent upon whether the maximum rate of retirement occurs before, during or after the average service life. If the maximum retirement rate occurs earlier in life, it is a left (L) mode curve; if it occurs at average life, it is a symmetrical (S) mode curve; if it occurs after average life, it is a right (R) mode curve. In addition, there is the origin (O) mode curve for plant which has heavy retirements at the beginning of life.

At any particular point in time, actual Company plant may not have completed its life cycle. Therefore, the survivor table generated from the Company data is not complete. This situation requires that an estimate be made with regard to the incomplete segment of the property group's life experience. Further, actual company experience often varies from age interval to age interval, making its utilization for average service estimation

difficult. Accordingly, the Iowa Curves are used to both extend Company experience to zero percent surviving as well as to smooth actual Company data.

Q27. What is the principal reason for completing the detailed historical life and salvage analysis?

A. The detailed historical analysis is prepared as a tool from which to make informed assessments as to the appropriate service life and salvage parameters over which to recover the Company's plant investment. However, in addition to the available historic data, consideration must be given to current events, the Company's ongoing operations, Company management's future plans, and general industry events which are anticipated to impact the lives that will be achieved by plant in service.

IX. COMPREHENSIVE DEPRECIATION STUDY RESULTS AS OF 12-31-08

Q28. What is the basis for the Company's currently approved depreciation rates?

A. As shown in Exhibit No. ___(EMR-1), Table 1, pages 2-1 to 2-2, the prior depreciation rates for the plant were based upon depreciation parameters set forth in a study completed using the Company's plant investment data through December 31, 2001. The current account level depreciation rates composite to an annual depreciation rate of 3.85 percent when applied to each of the December 31, 2008 plant in service account balances.

Q29. What are the most notable changes in annual depreciation rates and expense between the present and proposed depreciation rates as set forth in Section 2 of the Montana-Dakota gas depreciation report?

A. With regard to plant in service, several of the proposed rates reflect changes (as outlined in Section 4 of the study) from the current 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 lengthened 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.

Q30. What is the net change to the composite depreciation rate under the proposed depreciation rates in comparison to December 31, 2008 present depreciation rates?

A. Application of the proposed account level depreciation rates to the Company's plant in service as of December 31, 2008 produces a composite depreciation rate of 4.06 percent. By comparison the application of the December 31, 2008 then currently utilized account level depreciation rates to the Company's plant in service as of December 31, 2008 produces a composite depreciation rate of 3.85 percent.

Q31. What is the net change in annual depreciation expense under the proposed depreciation rates in comparison to present December 31, 2008 depreciation rates?

A. Exhibit No.___(EMR-1), Section 2, Table 1, pages 2-1 to 2-2 indicates a net increase in annualized depreciation expense of $525,793 in comparison to the depreciation expense produced by the then current depreciation rates, when applied to the Company's plant in service investment as of December 31, 2008.

X. NET CHANGE FROM 12-31-11 BOOK DEPRECIATION RATES TO PROPOSED DEPRECIATION RATES FROM 12-31-2008 STUDY

Q32. Are there updates that need be incorporated into the proposed account level depreciation rates set forth in the December 31, 2008 depreciation study?

A. Yes, in the December 31, 2008 depreciation study the Company did not have investments in Account 333-Field Compressor Station Equipment.

Since that period of time, the Company has invested approximately $10 million in equipment contained in this property account. Subsequent to the placement of the property and related investment, the Company implemented a book depreciation rate of 3.33% for this property group.

Also, at the time of the completion of the December 31, 2008 depreciation study Account 392.2-Transportation Equipment was fully accrued, which resulted in a then proposed depreciation rate of 0.0%. Since that time the Company has added and retired various items of plant in the property account. As of December 31, 2010, calculations were completed and the Company adjusted it book depreciation rate to 0.26%. With the passage of time, changes will continue to occur in the property account. Accordingly, due the nature of this type of plant, the Company will recalculate the depreciation rate on a more frequent basis.

Q33. Have you prepared an exhibit which compares the composite depreciation rate under current book depreciation rates versus the account level deprecation rates from the December 31, 2008 depreciation study when applied to the Company's December 31, 2011 plant in service balances?

A. Yes, that information is contained on Exhibit No.___(EMR-3).

Q34. What is the net change to the Company's composite depreciation rate under the proposed December 31, 2008 depreciation study rates in comparison to present book depreciation rates when applied plant in service as of December 31, 2011?

A. Exhibit No. ___(EMR-3) shows the application of the proposed December 31, 2008 depreciation study account level depreciation rates to the Company's plant in service as of December 31, 2011, which, as shown on page 2 of the exhibit, produces a composite depreciation rate of 4.16 percent. By comparison, the application of the pre-2008 depreciation rates (Column D) to the Company's plant in service as of December 31, 2011 produces a composite depreciation rate of 3.12 percent, or an increase in the composite rate for Montana-Dakota of 1.04 percent based on 2011 levels.

XI. RECOMMENDATION

Q35. What is your recommendation in this proceeding?

A. I recommend that the proposed depreciation rates set forth in the comprehensive depreciation study reports be uniformly and prospectively adopted by the Commission for regulatory purposes as well as by the Company for accounting purposes.

Q36. Does this conclude your direct testimony?

A. Yes, it does.