MONTANA-DAKOTA UTILITIES CO.

A Division of MDU Resources Group, Inc.

Before the South Dakota Public Utilities Commission

Docket No. NG-12.__

Direct Testimony
of
Rita A. Mulkern

Q. **Would you please state your name and business address?**

A. Yes. My name is Rita A. Mulkern and my business address is 400 North Fourth Street, Bismarck, North Dakota 58501.

Q. **What is your position with Montana-Dakota Utilities Co.?**

A. I am the Director of Regulatory Affairs for Montana-Dakota Utilities Co. (Montana-Dakota), a Division of MDU Resources Group, Inc.

Q. **Would you please describe your duties as Director of Regulatory Affairs?**

A. I am responsible for the preparation of cost of service studies, fuel cost adjustments, purchased gas cost adjustments and gas tracking adjustments in each of the jurisdictions in which Montana-Dakota operates.

Q. **Would you please describe your education and professional background?**

A. I graduated from North Dakota State University with a Bachelor of Arts degree with majors in Economics and Business Administration and a minor in Statistics. I joined Montana-Dakota in July 1981 as a Regulatory

Statistician, became Cost of Service Supervisor in 1986, Regulatory Analysis Manager in 1999, Regulatory Affairs Manager in 2010 and my current position in 2012.

Q. Have you testified in other proceedings before regulatory bodies?

A. Yes, I have presented testimony before the Public Service Commissions of Montana, North Dakota, and Wyoming and the Minnesota and South Dakota Public Utilities Commissions.

Q. Are you familiar with the books and records of Montana-Dakota and the manner in which they are kept?

A. Yes. Montana-Dakota's books and records are kept in accordance with the Federal Energy Regulatory Commission (FERC) Uniform System of Accounts.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to present the per books cost of service for the twelve months ended June 30, 2012 for South Dakota gas operations, which consists of the Black Hills and East River areas, the pro forma cost of service reflecting known and measurable adjustments that will occur by June 2013 and the calculation of the revenue deficiency for South Dakota. I will also address the proposed changes to the Purchased Gas Cost Adjustment Rate 88 tariff, including the proposed margin sharing mechanism associated with the grain drying volumes.

Since the establishment of the East River in 1993, Montana-Dakota has maintained the Black Hills and East River areas as separate jurisdictions. As discussed by Mr. Goodin, Montana-Dakota is proposing to combine the Black Hills and East River areas into one jurisdiction. The statements have been prepared to show all of the per books information for both the Black Hills and East River area with the combined South Dakota amounts. The pro forma adjustments were made to the combined South Dakota income statement and rate base items.

Q. What statements, schedules and exhibits are you sponsoring?

A. I am sponsoring Statements D through F, Statement H, Statement I, pages 1-6, Statements J through M , Statements P – R and Exhibit No.___(RAM-1).

Pro forma revenue requirement

Q. What were the results of South Dakota gas operations for the twelve months ended June 30, 2012?

A. Rule 20:10:13:96, Statement M, pages 1 and 2 show the per books income statement and rate base for total Company and South Dakota. As shown on page 1, South Dakota gas operations had a return on rate base of 7.441 percent for the twelve months ended June 30, 2012. The per books return on rate base for the individual jurisdictions were 7.373 percent for Black Hills and 9.108 percent for East River. Overall, while the return on rate base in East River is higher than the Black Hills return on a per books basis, East River's overall contribution to the revenue requirement is proportionately smaller. It will be addressed in the rate consolidation as discussed by Ms. Aberle.

The details for each line item, i.e. sales revenue, other revenue, etc., are included in the applicable Statement or rule listed. Page 3 lists the pro forma adjustments to operating revenues, expenses and rate base. All adjustments were calculated on either a South Dakota specific basis or on a total Company basis and allocated to South Dakota, as indicated on the statement or schedule detailing each adjustment.

Q. How was the per books cost of service allocated to South Dakota?

A. The Company utilizes a jurisdictional accounting system that directly assigns and/or allocates every item of revenue, expense and rate base to the jurisdictions as part of the regular accounting process on a monthly basis. The allocation methods and procedures are the same as have previously been used in Commission proceedings and are based on the principle of assigning and/or allocating costs to the cost causer.

Q. What criteria were used to determine the pro forma adjustments?

A. The pro forma adjustments to operating revenue, expenses and rate base were based on known and measurable changes occurring by June 30, 2013, conform to past Commission practices and are listed on pages 3 and 4 of Rule 20:10:13:96. All of these adjustments are reasonably certain to occur and can be measured with reasonable accuracy, thus meeting the criteria of known and measurable.

Q. Would you describe the pro forma adjustments to the income statement and rate base?

A. Yes. The adjustments to the income statement are summarized on Rule 20:10:13:96, page 3 and consist of adjustments to revenue, operation and maintenance expenses, depreciation expense, taxes other, and current and deferred income taxes. The adjustments to rate base are summarized on page 4 and include plant, accumulated reserve and associated additions and deductions.

Pro Forma Income Statement

Q. What adjustments were made to operating revenues?

A. The adjustments to operating revenues are contained in Rule 20:10:13:85, Statement I. Adjustment No. 1 restates the per books consumption at current rates, adjusted to reflect an annual gas cost for the period July 2012-June 2013, exclusive of the unreflected gas cost adjustment, and eliminates the unbilled revenue, decreasing revenue by $2,137,487.

Adjustment No. 2 increases revenues by $5,831,766 to reflect the effect of normal weather on sales and transportation volumes, as weather was 20 percent warmer than normal for the twelve months ending June 30, 2012 for the East River area and 18 percent warmer than normal in the Black Hills area. The normalized volumes were determined using a 60 Fahrenheit degree day base for reasons explained by Mr. Morman.

Adjustment No. 3 is an increase to revenues of $416,485 to reflect the annualization of firm customers to the June 2012 level and the elimination of the per books volumes associated with grain drying load.

As explained in more detail later in my testimony, Montana-Dakota is proposing a margin sharing mechanism for these volumes due to the unpredictable nature of the grain drying load.

Adjustment No. 4 is a decrease of $37,558 to reflect adjustments to other operating revenues. The pro forma adjustment consists of the elimination of a out of period transaction, the inclusion of late payment revenue and penalty revenue restated to a three year average.

Q. What adjustments were made to O&M expenses?

A. The adjustments to operation and maintenance expenses are contained in Rule 20:10:13:80, Statement H, and are summarized in Rule 20:10:13:81, Schedule H-1.

The adjustment to the cost of gas (Adjustment No. 5) is shown on Rule 20:10:13:81, page 3, and adjusts the cost of gas to reflect the pro forma dk sales, an annual gas cost level for the period July 2012-June 2013 and a combined gas cost, reflecting the proposed changes in the Purchased Gas Cost Adjustment Rate 88. The proposed changes are discussed in more detail later in my testimony. The pro forma cost of gas per dk was derived by calculating annual demand charges and commodity cost of gas and applying those costs to the December 2012 purchased gas cost adjustment billing determinants. The distribution loss factor of 1.00 percent represents an estimated combined loss factor for the Black Hills and East River areas.

Q. How were the pro forma labor and benefits developed?

A. The adjustment to labor is Adjustment No. 6. The pro forma labor was developed by applying the percentage increase in total Company labor costs to the actual twelve months ending June 30, 2012 South Dakota labor expense. The percentage increase consists of the annualized wages as of June 30, 2012 plus an overall increase of 2.5 percent for union employees effective May 2013 and 3.0 percent for nonunion employees effective in December 2012, with incentive compensation adjusted to reflect a three year average (12 months ending 2010, 2011 and 2012). These changes results in a 7.16 percent increase to per books labor expense.

Benefits are shown on page 5. Adjustment No. 7 is an overall decrease of $45,077 in benefits. Benefits expense consists of medical/dental insurance, pension expense, post-retirement, 401K, workers compensation and supplemental insurance. Each of these items, excluding supplemental insurance, was adjusted individually using current information and applying the percentage change to each type of benefit.

Medical and dental expense increased by 5.61 percent. Pension expense is increasing to 233.31 percent due to a change in the plan discount rate. Post-retirement expense is a decrease of 86.98 percent related to a transition obligation that ceases in 2012. The 401K expense will decrease by 4.05 percent resulting from lower Company contributions as employees retire. Workers compensation is based on the twelve months ending June 30, 2012 per books ratio of workers compensation to per books labor expense and applied to pro forma labor expense. The Supplemental Income Security Plan (SISP) was eliminated.

Q. Would you describe the other adjustments made to O&M expense?

A. Yes. Vehicles and work equipment (Adjustment No. 8) reflects all expenses associated with the Company's vehicles and equipment, such as backhoes, including the costs of fuel, insurance, maintenance and depreciation expense. Adjustment No. 8 reflects an increase in this account due to the change in the depreciation component of the expense. It is calculated based on the pro forma plant and the depreciation rates in Statement J. The depreciation expense on these items is not charged to depreciation expense but rather is charged to a clearing account where it is then recorded in O&M expense as the vehicles or work equipment is used.

Company consumption (Adjustment No. 9) is the expense for electric and natural gas consumption in Company buildings. The electric component is projected to remain flat. The natural gas component is expected to increase $3,418 based on the increase in normalized sales revenues.

Pierre Office Rental (Adjustment No.10) reflects the adjustment to eliminate rent associated with the Pierre, South Dakota office building and warehouse in conjunction with the addition of a new office building and warehouse that is included in the plant additions.

Uncollectible accounts (Adjustment No. 11) is based on the five year average of net write-offs to pro forma sales and transportation revenues, which results in a decrease in uncollectible accounts of $9,486.

Postage (Adjustment No. 12) reflects a 2.73 percent increase in postage rates to be effective January 2013.

Advertising expense (Adjustment No. 13) is shown on page 11. Pursuant to past Commission policy, promotional advertising expense has been eliminated. Informational and institutional advertising is adjusted to exclude advertising that is not applicable to South Dakota gas operations.

Q. Would you explain why you are including institutional advertising expenses?

A. Montana-Dakota is seeking to include institutional advertising that we believe benefits customers and serves the public interest. As a corporate citizen, Montana-Dakota needs to be active in the communities that it serves. Montana-Dakota's motto is "In the community to serve" and one of the ways of being a strong community member is to advertise our company and what we do for the communities. Our communities expect nothing less and advertising in the local newspapers, on television, in school yearbooks, programs, etc., is a necessary part of being active in the community. This advertising benefits the community and the customers in that community, thus serving the public interest.

Q. Would you please continue with your explanation of adjustments to operation and maintenance expenses?

Insurance expense (Adjustment No. 14) reflects the expense at current or projected levels for 2013 and is an increase of $4,493.

Industry dues (Adjustment No. 15) reflect the pro forma level of industry dues and are a decrease of $14,595. Rule 20:10:13:81, Statement H, page 13 shows those dues that are directly assigned or allocated to South Dakota.

Regulatory Commission Expense (Adjustment No. 16) reflects the expenses to be incurred in this filing, amortized over a three-year period and a three year average of ongoing regulatory commission expenses. The adjustment is an increase of $113,158.

The items adjusted individually above represent approximately 80 percent of total South Dakota gas O&M, as shown on page 15. The remaining items, which make up approximately 20 percent of other O&M, are assumed to remain flat.

Q. **What adjustments were made to depreciation expense?**

A. The adjustment to depreciation expense is contained in Rule 20:10:13:86, Statement J. Adjustment No. 17 restates annual depreciation expense to the average pro forma level of plant in service, with the proposed depreciation rates from a 2008 study prepared by AUS Consultants. The depreciation rates are shown on Statement J, pages 7 through 11. Mr. Robinson's testimony supports the proposed depreciation rates.

Q. **What adjustments were made to taxes other than income?**

A. The adjustments to taxes other than income are contained in Rule 20:10:13:94, Statement L. Adjustment No. 18 restates ad valorem taxes to the pro forma level of plant in service based on the ratio of ad valorem taxes for the twelve months ending June 30, 2012 to the average plant balance as of June 30, 2012. This adjustment is an increase of $40,007.

The adjustment to payroll taxes (Adjustment No. 19) is an increase of $21,798 based on the ratio of payroll taxes to labor expense for the twelve months ending June 30, 2012 applied to pro forma labor expense.

Adjustment No. 20 restates the South Dakota Gross Receipt Tax to the pro forma level of revenue, excluding other operating revenue not generated in South Dakota, and is a decrease of $8,417.

Q. **What adjustments were made to income taxes?**

A. The adjustments to income taxes are contained in Rule 20:10:13:88, Statement K. The adjustment to interest expense (Adjustment No. 21) is shown on page 8. Interest is deductible for tax purposes and interest expense is calculated on the pro forma rate base using the weighted cost of debt and debt ratio from Statement G. The resulting interest expense is a decrease of $239,607 from the per books level.

The adjustments for tax depreciation and deferred taxes on the pro forma plant additions (Adjustment No. 22) are shown on page 9. The calculation of tax depreciation on the plant additions, shown on page 19, reflects the bonus tax depreciation rate of 50 percent for the 2012 plant additions, as the bonus tax depreciation expires in 2012, and ordinary tax depreciation on the 2013 plant additions.

Other tax deductions for SISP and 401K were eliminated in Adjustment No. 23 on page 10. The SISP tax deductions are eliminated to match the elimination of the SISP expense from benefits and the 401K deduction relates to an election by MDU Resources and thus not attributable to customers. There is a corresponding adjustment to deferred taxes for the SISP adjustment.

The current income tax expense on all of the pro forma adjustments to operating revenues and expenses are calculated on page 11 in Adjustment No. 24.

The closing/filing and prior period adjustments in the current income tax accrual and in the deferred taxes are eliminated in Adjustment No. 25, page 12. This adjustment adjusts current and deferred income taxes to the calculated amount for South Dakota and conforms to past Commission practices.

Rate Base

Q. How was the rate base developed?

A. The pro forma rate base reflects known and measurable adjustments that will occur twelve months beyond June 30, 2012, with the resulting rate base is stated on an average basis. The pro forma adjustments to rate base are summarized on Rule 20:10:13:96, Statement M, page 4. Adjustment A is the known and measurable plant additions that will be in service by June 30, 2013. The additions of $6,229,710 include additions to production, distribution, general and common plant and are shown on Rule 20:10:13:54, Statement D, pages 7 through 9. Statement D, Schedule D-2, pages 3 and 4 and 5 contain the detailed the plant additions for Black Hills and East River areas. Several significant projects since the last general rate case that are reflected in plant in service or are proposed plant additions include the Billings Landfill production facility, discussed by Mr. Morman, the new customer information system discussed by Mr. Gardner, the distribution plant projects and the new Pierre office and warehouse building and Spearfish building discussed by Mr. Skabo.

Adjustment B, shown in Rule 20:10:13:64, Statement E, page 2 increases the average reserve for depreciation on the per books plant by $3,037,017 to restate the reserve to the average pro forma level in order to match the average pro forma plant levels.

The working capital adjustments are summarized on Rule 20:10:13:68, Statement F, with each adjustment included in Schedule F-1. Materials and supplies are restated to a thirteen-month average balance in Adjustment C, for an increase of $50,336.

Insurance expense is restated to a thirteen month average balance in Adjustment D with actual balances through October 31, 2012 and balances for November 2012 through June 2013 are based on the pro forma insurance expense and is a decrease of $11,535.

The adjustment to the net unamortized gain(loss) on reacquired debt balances is included as Adjustment E.

Deferred FAS 106 costs and the associated deferred income taxes are included as Adjustment F. Deferred FAS 106 costs will be fully amortized in the test period.

The adjustments to accumulated deferred income taxes are summarized on Rule 20:10:13:88, Statement K, page 18. Adjustment I is an increase to deferred taxes to extend the average accumulated deferred tax balance to match the pro forma plant and accumulated reserve along with customer advances and contributions in aid of construction.

Adjustment J is a decrease to deferred taxes to reflect the amortization of the full normalization.

The deferred taxes associated with the unamortized loss on debt (Adjustment E) and deferred FAS 106 costs (Adjustment F) are also included on page18.

Adjustment G represents the net plant amounts that relate to plant investment that are covered by a letter of credit or customer guarantee. While traditionally Montana-Dakota has received a customer advance for the extension of service where it is not known with certainty that the new load will support the cost of the extension, utilizing a letter of credit has also become a common method to ensure that Montana-Dakota does not take on the risk if the extension does not meet volume expectations. It is similar to a customer advance but in the case of a customer guarantee

Montana-Dakota does not receive the advance, rather if the new load associated with the extension does not meet expectations, Montana-Dakota will call on the letter of credit. Adjustment G is $876,572 representing average pro forma balance and is shown on Rule 20:10:13:69, Statement F, Schedule F-1, page 6.

Customer advances for construction (Adjustment H) are restated to a thirteen-month average balance, with actual balances through September 30, 2012 and is an increase of $9,485 as shown on Rule 20:10:13:69, Statement F, Schedule F-1, page 7.

These are all of the pro forma adjustments to revenue, expense and rate base.

Q. What is the additional revenue requirement calculated on Exhibit No.____(RAM-1)?

A. Exhibit No.____(RAM-1), which is identical to Rule 20:10:13:96, Statement M, page 7, shows the calculation of the revenue deficiency of $1,547,999 based on the pro forma operating income and rate base and using the overall rate of return of 8.101 percent from Rule 20:10:13:72, Statement G, page 1.

Q. Would you describe the proposed changes to the Purchased Gas Cost Adjustment (PGA) Rate 88 and Rate 89 tariffs?

A. Yes. There are several proposed changes to the purchased gas cost adjustment. Montana-Dakota is proposing to combine the East River and Black Hills purchased gas cost adjustments in Rate 88 and eliminate

Rate 89, to change the PGA classes to reflect the cost of gas commensurate with the service provided. Montana-Dakota is also proposing to establish a grain dryer margin sharing mechanism for the grain drying load to be served under interruptible rates.

Q. Why are the Black Hills and East River area PGAs being combined?

A. As discussed in Mr. Goodin's testimony, the Company is proposing to combine the Black Hills and East River areas into one jurisdiction. Correspondingly, the PGAs are also proposed to be combined. While there are currently two separate PGAs, the methodology for determining and assigning or allocating gas costs are the same in both areas. With this proposal, Rate 89 will be eliminated and Rate 88 will be applicable to all customers and the language in Rate 88 has been changed accordingly. The impacts to firm customers in both East River and Black Hills will be very small. Since the costs and allocation methodology is the same, it makes sense to also combine the the two jurisdictional PGAs into one PGA.

Q. Would you explain the change to the PGA classes that you are proposing?

A. Montana-Dakota is also proposing to consolidate into two PGA classes under Rate 88 – firm (residential and small general service) and interruptible. Montana-Dakota currently has firm (Rate 66 and 76) and 100 percent load factor (special contract) classes in East River and firm

(Rates 60, 70, 71 and 72), large interruptible (Rate 85) and Air Force (Rate 64) classes in the Black Hills.

The proposed PGA classes will combine all firm classes (Rates 60, 66, 70, 72 and 76) into the firm PGA. The interruptible class will include all interruptible classes (Rates 64, 71 and 85). While in the past small interruptible customers (Rate 71) have been served under the firm PGA, it is more appropriate to move these customers to the interruptible PGA to reflect that their service is interruptible. The Air Force PGA class was separate to reflect that the Air Force was served at the transmission level and therefore did not experience any distribution losses. As discussed by Ms. Aberle, with the changes in the distribution system the Air Force is no longer a transmission level customer and can be incorporated into the interruptible PGA. The proposed Rate 88 tariff is included in Appendix B and supported by Ms. Aberle.

Q. What is the final proposed change?

A. As noted earlier, the volumes associated with the grain drying load to be served under interruptible rates are difficult to predict with any certainty given the various factors affecting the need for natural gas at the grain drying facilities where in addition to weather factors, commodity prices and the demand for certain commodities will also affect the operation of the grain dryers. Therefore, the Company is proposing to implement a margin sharing adjustment that will provide a credit to all residential and firm general service customers through the PGA mechanism at 90 percent of actual margins received on an annual basis, with the Company retaining 10 percent of the margin. A 90/10 sharing mechanism is appropriate to provide the Company incentive to secure new economic new grain drying load while also providing a timely credit to other customers.

A new paragraph has been added to Rate 88 to set forth the method for applying the margin sharing credits to customers. Montana-Dakota proposes to track those revenues and once a year, in the annual PGA filing, amortize the balance of 90 percent of the margin received over the following twelve months with a credit per dk applicable to all firm customers.

Q. Does this complete your direct testimony?

A. Yes, it does.