

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UI 274

In the Matter of)	
)	
CASCADE NATURAL GAS)	ORDER
CORPORATION)	
)	
Application for Approval of the Intercompany)	
Administrative Services Agreement with MDU)	
Resources Group, Inc.)	

DISPOSITION: APPLICATION APPROVED WITH CONDITIONS

On August 9, 2007, Cascade Natural Gas Corporation (Cascade) filed an application with the Public Utility Commission of Oregon (Commission) pursuant to ORS 757.015, ORS 757.495, OAR 860-027-0040 and OAR 860-027-0041, requesting approval of an Intercompany Administrative Services Agreement between Cascade and MDU Resources Group, Inc. (MDU). Cascade is an indirect wholly-owned subsidiary of MDU. A full description of the filing is contained in the Staff Report, attached as Appendix A and incorporated by reference.

Based on a review of the application and the Commission's records, the Commission finds that the application satisfies applicable statutes and administrative rules. At its Public Meeting on September 20, 2007, the Commission adopted Staff's recommendation.

OPINION

Jurisdiction

ORS 757.005 defines a "public utility," and Cascade Natural Gas is a public utility subject to the Commission's jurisdiction.

Affiliation

An affiliated interest relationship exists, as defined under ORS 757.015.

Applicable Law

ORS 757.495 requires public utilities to seek approval of contracts with affiliated interests within 90 days after execution of the contract.

ORS 757.495(3) requires the Commission to approve the contract if the Commission finds that the contract is fair and reasonable and not contrary to the public interest. However, the Commission need not determine the reasonableness of all the financial aspects of the contract for ratemaking purposes. The Commission may reserve that issue for a subsequent proceeding.

CONCLUSIONS

1. The Company is a public utility subject to the jurisdiction of the Commission.
2. An affiliated interest relationship exists.
3. The agreement is fair, reasonable, and not contrary to the public interest.
4. The application should be granted, as modified herein, including certain conditions.

ORDER

IT IS ORDERED that the application of Cascade Natural Gas Corporation to enter into an Intercompany Administrative Services Agreement with MDU Resources Group, Inc., is approved, subject to the conditions stated in Appendix A.

Made, entered, and effective SEP 25 2007.

BY THE COMMISSION:



Becky L. Beier
Becky L. Beier
Commission Secretary

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070(2). A party may appeal this order by filing a petition for review with the Court of Appeals in compliance with ORS 183.480-183.484.

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: September 20, 2007**

REGULAR _____ CONSENT X EFFECTIVE DATE _____ N/A _____

DATE: August 29, 2007

TO: Public Utility Commission

FROM: Dustin Ball ^{DB}

THROUGH: Lee Sparling, ^{LS} Marc Hellman, ^{MH} and Michael Dougherty ^{MD}

SUBJECT: CASCADE NATURAL GAS CORPORATION: (Docket No. UI 274)
Application for Approval of the Intercompany Administrative Services Agreement with MDU Resources Group, Inc.

STAFF RECOMMENDATION:

The Commission should approve Cascade Natural Gas Corporation's (Cascade) application to enter into an Intercompany Administrative Services Agreement (IASA or Agreement) with MDU Resources Group, Inc. (MDU), an affiliated interest, subject to the following conditions:

1. Cascade shall maintain a detailed line item listing of all charges that are included in the allocated costs and be able to provide supporting documentation, including but not limited to, invoices, payroll records, and journal record entries when requested by Staff.
2. Cascade, consistent with the stipulation adopted in Order No. 07-320, shall continue to comply with commitments Nos. 1, 2, 3, 4, 9, 10, 12, and 15 that pertain to the access of books and records concerning the IASA and all other affiliated transactions.
3. The Commission reserves the right to review, for reasonableness, all financial aspects of this transaction in any rate proceeding or alternative from of regulation, including MDU and Cascade's use of cost allocation methods.
4. Cascade shall notify the Commission in advance of any substantive changes to the contract, including any material change in price. Any such change shall be submitted in an application for a supplemental order (or other appropriate format) in this docket.

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5. Cascade shall forward to Commission Staff, budgets for the 2008 budget year for services provided to and by Cascade, within 30 days of the budgets being set.

DISCUSSION:

Cascade filed this application on August 9, 2007, pursuant to ORS 757.495, OAR 860-027-0040, and OAR 860-027-0041. Cascade is an indirect, wholly owned subsidiary of MDU¹. Therefore Cascade and MDU are affiliated interests pursuant to ORS 757.015.

Cascade requests authorization from the Commission to enter into an IASA that governs the provisions of administrative services between and among MDU and its utility divisions and subsidiaries, including Cascade.

The administrative services provided by MDU include:

- Services by the Board of Directors; and executive, management, professional, technical, and clerical employees;
- Financial and accounting services, corporate governance and compliance services, legal services, audit services, information and technology services, treasury services, investor relations services, governmental and regulatory services, human resource services, communications services, payroll processing services, employee benefits participation, procurement and fleet management, tax and related services, contract negotiation and administration services, insurance risk management services, environmental services, and engineering and technical services;
- The use of office facilities, including but not limited to office space, furniture, equipment, machinery, supplies, computers and computer software, communications equipment, insurance policies and other personal property; and
- The use of automobiles, airplanes, other vehicles, and equipment.

¹ MDU Resources holds 100 percent of the membership interest of MDU Energy Capital, LLC, which in turn, owns 100 percent of the membership interests of Prairie Cascade Energy Holdings, LLC, which in turn, owns 100 percent of the voting securities of Cascade Natural Gas Corporation.

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The IASA also allows for Cascade to provide, and charge for, administrative services to MDU and other utility divisions or subsidiaries.

The amount Cascade will pay annually for services under the IASA is unknown as the full extent and type of services to be provided to Cascade has not yet been determined, and neither MDU nor Cascade has prepared any estimates at this time. According to the Agreement, Providing Parties are required to prepare and deliver to Recipient Parties, in advance of each budget year, a proposed budget for administrative services to be performed during that year. MDU anticipates preparing their budget for 2008 in the fall of 2007.

Cascade, in Order No. 07-320 (UM 1283)², has previously agreed that through 2012, the allocated shared corporate costs, as well as its allocated and assigned utility division costs, will not exceed the costs the Cascade customers would otherwise have paid absent the acquisition, as adjusted for changes in the Consumer Price Index.

For purposes of this condition the Benchmark for these "stand alone" costs was set at \$6,848,545 for 2005 and for subsequent years will be equal to the prior year's Benchmark multiplied by the Consumer Price Index for All Urban Consumers: Index 1982-84=100 (Series CUUR0000SA) in the previous twelve months.

Issues

Staff investigated the following issues:

1. Terms and Conditions of the IASA
2. Transfer Pricing
3. Public Interest Compliance
4. Records Availability, Audit Provisions, and Reporting Requirements

Terms and Conditions of the IASA

Staff did not observe any unusual terms and conditions of the IASA. The IASA contains an article for accounting and auditing that directs all parties to the agreement to maintain books and records as necessary to support charges in sufficient detail to enable the utility to satisfy regulatory requirements.

The IASA also contains a condition specifying that each Providing Party will bill the Recipient Party monthly for charges pursuant to the agreement and full payment for services will be made by the end of the calendar month following the charge.

² In the Matter of the Application of MDU RESOURCES GROUP, INC. for Authorization to Acquire Cascade Natural Gas Corporation.

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Transfer Pricing

Shared services will be charged at the fully loaded cost by Providing Party. Labor will include such items as salary and wages plus loading incentives, benefits, paid absences, payroll taxes, and payroll additives attributable to such labor. Non-labor costs will be directly billed or allocated at actual amounts incurred by the Providing Party. When capital assets are involved in a provision of a service, a return on the asset may be included in the fully loaded charge.

Pursuant to the IASA, administrative services will be charged on the basis of Direct Assignment, Service Charges, or Allocations. Direct Assignment will be used when administrative service costs are incurred specifically for a Receiving Party. Service Charges will be used to assign costs that are impractical to assign directly but for which a cost/benefit relationship can be reasonably identified between the service and the Receiving Party. Allocations will be used when costs are incurred for the general benefit of the entire utilities group and for which direct charging and service charges are not practicable.

Under the Agreement, direct charging for services will take place when possible. However, when direct charging is not appropriate, the Providing Party may utilize allocation methodologies to assign charges reflective of cost drivers. If used, allocation methodologies for charging services will comply with the following principles:

- For Administrative Services rendered to a Utility for each cost category subject to allocation to a Utility, the Providing Party must be able to demonstrate that such service or cost category is reasonable for the Utility for the performance of its regulated operations, is not duplicative of Administrative Services already being performed within the Utility, and is reasonable and prudent.
- Parties must maintain records sufficient to specifically identify costs subject to allocation, particularly with respect to their origin. In addition, the records must be adequately supported in a manner sufficient to justify recovery of the costs in rates of the Utility.
- It is the responsibility of the Utility Parties to this Agreement to ensure that costs which would have been denied recovery in rates had such costs been directly incurred by the regulated operations are appropriately identified and segregated in the books of the regulated operation.

Although the IASA does not define a set method (formula) for allocating costs, the agreement clearly defines compliance principles, listed above, which must be applied in any cost allocation method that is used. Cascade has previously agreed, in Order

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No. 07-320, that any proposed cost allocation methodology for such allocations will be submitted to the Commission for review or approval. Also, Cascade is required to file a Cost Allocation Manual with the Annual Affiliated Interest Report, which gives Staff the ability to review and audit any allocation methods used.

The Commission, in Order No. 91-513 (UI 105)³, has previously allowed a cost-based approach, instead of the lower of cost or market standard pursuant to OAR 860-027-0048, when affiliated activities were limited to a specific contract function. Additionally, the IASA provision of corporate and administrative services is similar to the previous affiliated interest agreement between PacifiCorp and MidAmerica Energy Holding Company approved by the Commission in Order No. 06-305 (UI 249)⁴.

Public Interest Compliance

The need for, and conditions surrounding the IASA were thoroughly reviewed by Staff during UM 1283. As a result of this review, various Commitments by MDU and Cascade were accepted by the parties involved in the docket. These Commitments include:

- Commitment 2 – Financial statements and other financial books and records for Cascade shall be maintained separate from the books and records of MDU.
- Commitment 9 – The filing of an IASA.
- Commitment 10 – Through 2012, the allocated shared corporate costs, as well as its allocated and assigned utility division costs, will not exceed the costs the Cascade's customers would otherwise have paid.
- Commitment 12 – Requires any proposed cost allocation methodology to be submitted to the Commission for review or approval, and that the allocation methodology will comply with a set of agreed upon principles.
- Commitment 16 – Requires Commission approval of any loans or assumption of obligations or liabilities between Cascade and MDU.
- Commitment 22 – Requires that MDU and Cascade will maintain adequate staffing, in each state, consistent with the provision of safe and reliable service and cost-effective operations.

Although there is no estimate at this time of the costs that Cascade will pay annually for services, Cascade has previously agreed, in Order No. 07-320, Commitment 10, that the allocated shared corporate costs will not exceed the costs the Cascade customers would otherwise have paid absent the acquisition. Additionally, MDU and Cascade

³ In the Matter of the Application of PACIFICORP, dba PACIFIC POWER & LIGHT COMPANY, for an order providing a contract for mining services with Energy West Mining Company, an affiliated interest.

⁴ In the Matter of the Application of PACIFICORP, dba PACIFIC POWER & LIGHT COMPANY, for approval of the Intercompany Administrative Service Agreement with MidAmerican Holdings Company.

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have committed, in Order No. 07-320, Commitment 11, that Cascade will provide annual rate credits of \$200,000 to Oregon Customers through 2012 and that these credits will not be off-settable for the first three years.

Records Availability, Audit Provisions, and Reporting Requirements
Order Conditions Numbers 1, 2, and 5 listed above in the Staff Recommendation, afford the necessary Commission examination of Cascade's records concerning this application.

Based on the review of this application, Staff concludes the following:

1. The application involves an affiliated interest transaction that is fair and reasonable and not contrary to the public interest, with the inclusion of the proposed ordering conditions.
2. Necessary records are available.

PROPOSED COMMISSION MOTION:

Cascade's application for approval of the Intercompany Administrative Services Agreement with MDU Resources Group, Inc. be approved subject to the five recommended conditions.

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