MDU RESOURCES GROUP INC
Form 10-Q
May 05, 2011

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For The Quarterly Period Ended March 31, 2011

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from _____________ to ______________

Commission file number 1-3480

MDU Resources Group, Inc.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 41-0423660 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

1200 West Century Avenue
P.O. Box 5650
Bismarck, North Dakota 58506-5650
(Address of principal executive offices)
(Zip Code)

(701) 530-1000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):

| | |
|---|---|
| Large accelerated filer x | Accelerated filer o |
| Non-accelerated filer o | Smaller reporting company o |

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of April 29, 2011: 188,793,564 shares.

DEFINITIONS

The following abbreviations and acronyms used in this Form 10-Q are defined below:

| Abbreviation or Acronym | |
|---|---|
| 2010 Annual Report | Company's Annual Report on Form 10-K for the year ended December 31, 2010 |
| Alusa | Tecnica de Engenharia Electrica - Alusa |
| ASC | FASB Accounting Standards Codification |
| BART | Best available retrofit technology |
| Bbl | Barrel |
| Big Stone Station | 450-MW coal-fired electric generating facility near Big Stone City, South Dakota (22.7 percent ownership) |
| Big Stone Station II | Formerly proposed coal-fired electric generating facility near Big Stone City, South Dakota (the Company had anticipated ownership of at least 116 MW) |
| Bitter Creek | Bitter Creek Pipelines, LLC, an indirect wholly owned subsidiary of WBI Holdings |
| Brazilian Transmission Lines | Company's equity method investment in the company owning ECTE, ENTE and ERTE (ownership interests in ENTE and ERTE and a portion of the ownership interests in ECTE were sold in the fourth quarter of 2010) |
| Btu | British thermal unit |
| Cascade | Cascade Natural Gas Corporation, an indirect wholly owned subsidiary of MDU Energy Capital |
| CELESC | Centrais Elétricas de Santa Catarina S.A. |
| CEM | Colorado Energy Management, LLC, a former direct wholly owned subsidiary of Centennial Resources (sold in the third quarter of 2007) |
| CEMIG | Companhia Energética de Minas Gerais |
| Centennial | Centennial Energy Holdings, Inc., a direct wholly owned subsidiary of the Company |
| Centennial Capital | Centennial Holdings Capital LLC, a direct wholly owned subsidiary of Centennial |
| Centennial Resources | Centennial Energy Resources LLC, a direct wholly owned subsidiary of Centennial |
| Colorado State District Court | Colorado Thirteenth Judicial District Court, Yuma County |
| Company | MDU Resources Group, Inc. |
| dk | Decatherm |
| Dodd-Frank Act | Dodd-Frank Wall Street Reform and Consumer Protection Act |
| ECTE | Empresa Catarinense de Transmissão de Energia S.A. (10.01 percent ownership interest at March 31, 2011, 14.99 percent ownership interest sold in the fourth quarter of 2010) |
| ENTE | Empresa Norte de Transmissão de Energia S.A. (entire 13.3 percent ownership interest sold in the fourth quarter of 2010) |
| EPA | U.S. Environmental Protection Agency |

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| | |
|---|---|
| ERTE | Empresa Regional de Transmissão de Energia S.A. (entire 13.3 percent ownership interest sold in the fourth quarter of 2010) |
| Exchange Act | Securities Exchange Act of 1934, as amended |
| FASB | Financial Accounting Standards Board |
| Fidelity | Fidelity Exploration & Production Company, a direct wholly owned subsidiary of WBI Holdings |
| GHG | Greenhouse gas |
| Great Plains | Great Plains Natural Gas Co., a public utility division of the Company |
| Intermountain | Intermountain Gas Company, an indirect wholly owned subsidiary of MDU Energy Capital |
| IPUC | Idaho Public Utilities Commission |
| Knife River | Knife River Corporation, a direct wholly owned subsidiary of Centennial |
| Knife River – Northwest | Knife River Corporation – Northwest, an indirect wholly owned subsidiary of Knife River (previously Morse Bros., Inc., name changed effective January 1, 2010) |
| kWh | Kilowatt-hour |
| LPP | Lea Power Partners, LLC, a former indirect wholly owned subsidiary of Centennial Resources (member interests were sold in October 2006) |
| LTM | LTM, Inc., an indirect wholly owned subsidiary of Knife River |
| LWG | Lower Willamette Group |
| MBbls | Thousands of barrels |
| Mcf | Thousand cubic feet |
| MDU Brasil | MDU Brasil Ltda., an indirect wholly owned subsidiary of Centennial Resources |
| MDU Construction Services | MDU Construction Services Group, Inc., a direct wholly owned subsidiary of Centennial |
| MDU Energy Capital | MDU Energy Capital, LLC, a direct wholly owned subsidiary of the Company |
| Mine Safety Act | Federal Mine Safety and Health Act of 1977, as amended by the Mine Improvement and New Emergency Response Act of 2006 |
| MMBtu | Million Btu |
| MMcf | Million cubic feet |
| MMcfe | Million cubic feet equivalent – natural gas equivalents are determined using the ratio of six Mcf of natural gas to one Bbl of oil |
| MMdk | Million decatherms |
| Montana-Dakota | Montana-Dakota Utilities Co., a public utility division of the Company |
| Montana District Court | Montana Seventeenth Judicial District Court, Phillips County |
| MTPSC | Montana Public Service Commission |
| MW | Megawatt |
| NDPSC | North Dakota Public Service Commission |
| Oil | Includes crude oil, condensate and natural gas liquids |
| OPUC | Oregon Public Utilities Commission |

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| | |
|---|---|
| Oregon DEQ | Oregon State Department of Environmental Quality |
| Prairielands | Prairielands Energy Marketing, Inc., an indirect wholly owned subsidiary of WBI Holdings |
| PRP | Potentially Responsible Party |
| ROD | Record of Decision |
| SEC | U.S. Securities and Exchange Commission |
| Securities Act | Securities Act of 1933, as amended |
| SourceGas | SourceGas Distribution LLC |
| WBI Holdings | WBI Holdings, Inc., a direct wholly owned subsidiary of Centennial |
| Williston Basin | Williston Basin Interstate Pipeline Company, an indirect wholly owned subsidiary of WBI Holdings |
| WUTC | Washington Utilities and Transportation Commission |

## INTRODUCTION

The Company is a diversified natural resource company, which was incorporated under the laws of the state of Delaware in 1924. Its principal executive offices are at 1200 West Century Avenue, P.O. Box 5650, Bismarck, North Dakota 58506-5650, telephone (701) 530-1000.

Montana-Dakota, through the electric and natural gas distribution segments, generates, transmits and distributes electricity and distributes natural gas in Montana, North Dakota, South Dakota and Wyoming. Cascade distributes natural gas in Oregon and Washington. Intermountain distributes natural gas in Idaho. Great Plains distributes natural gas in western Minnesota and southeastern North Dakota. These operations also supply related value-added services.

The Company, through its wholly owned subsidiary, Centennial, owns WBI Holdings (comprised of the pipeline and energy services and the natural gas and oil production segments), Knife River (construction materials and contracting segment), MDU Construction Services (construction services segment), Centennial Resources and Centennial Capital (both reflected in the Other category). For more information on the Company's business segments, see Note 15.

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PART I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MDU RESOURCES GROUP, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2011 | 2010 |
| | (In thousands, except per share amounts) | |
| Operating revenues: | | |
| Electric, natural gas distribution and pipeline and energy services | $477,481 | $460,245 |
| Construction services, natural gas and oil production, construction materials and contracting, and other | 424,324 | 374,532 |
| Total operating revenues | 901,805 | 834,777 |
| Operating expenses: | | |
| Fuel and purchased power | 16,954 | 16,911 |
| Purchased natural gas sold | 244,686 | 233,691 |
| Operation and maintenance: | | |
| Electric, natural gas distribution and pipeline and energy services | 67,963 | 62,987 |
| Construction services, natural gas and oil production, construction materials and contracting, and other | 359,797 | 313,786 |
| Depreciation, depletion and amortization | 84,674 | 78,678 |
| Taxes, other than income | 49,665 | 45,795 |
| Total operating expenses | 823,739 | 751,848 |
| | | |
| Operating income | 78,066 | 82,929 |
| | | |
| Earnings from equity method investments | 484 | 2,183 |
| | | |
| Other income | 1,900 | 2,502 |
| | | |
| Interest expense | 22,017 | 20,516 |
| | | |
| Income before income taxes | 58,433 | 67,098 |
| | | |
| Income taxes | 15,904 | 25,326 |
| | | |
| Income from continuing operations | 42,529 | 41,772 |
| | | |
| Income from discontinued operations, net of tax (Note 9) | 448 | — |
| | | |
| Net income | 42,977 | 41,772 |
| | | |
| Dividends on preferred stocks | 171 | 172 |
| | | |
| Earnings on common stock | $42,806 | $41,600 |

| | | |
|---|---|---|
| Earnings per common share – basic: | | |
| Earnings before discontinued operations | $.22 | $.22 |
| Discontinued operations, net of tax | .01 | — |
| Earnings per common share -- basic | $.23 | $.22 |
| | | |
| Earnings per common share – diluted: | | |
| Earnings before discontinued operations | $.22 | $.22 |
| Discontinued operations, net of tax | .01 | — |
| Earnings per common share -- diluted | $.23 | $.22 |
| | | |
| Dividends per common share | $.1625 | $.1575 |
| | | |
| Weighted average common shares outstanding -- basic | 188,671 | 187,963 |
| | | |
| Weighted average common shares outstanding -- diluted | 188,815 | 188,220 |

The accompanying notes are an integral part of these consolidated financial statements.

MDU RESOURCES GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)

| | March 31, 2011 | March 31, 2010 | December 31, 2010 |
|---|---|---|---|
| | (In thousands, except shares and per share amounts) | | |
| ASSETS | | | |
| Current assets: | | | |
| Cash and cash equivalents | $136,016 | $106,664 | $222,074 |
| Receivables, net | 533,279 | 467,790 | 583,743 |
| Inventories | 262,696 | 253,931 | 252,897 |
| Deferred income taxes | 45,206 | 18,543 | 32,890 |
| Commodity derivative instruments | 13,250 | 38,146 | 15,123 |
| Prepayments and other current assets | 73,556 | 104,687 | 60,441 |
| Total current assets | 1,064,003 | 989,761 | 1,167,168 |
| Investments | 117,015 | 141,443 | 103,661 |
| Property, plant and equipment | 7,271,173 | 6,875,397 | 7,218,503 |
| Less accumulated depreciation, depletion and amortization | 3,174,654 | 2,935,453 | 3,103,323 |
| Net property, plant and equipment | 4,096,519 | 3,939,944 | 4,115,180 |
| Deferred charges and other assets: | | | |
| Goodwill | 634,931 | 634,633 | 634,633 |
| Other intangible assets, net | 24,351 | 26,612 | 25,271 |
| Other | 254,472 | 249,454 | 257,636 |
| Total deferred charges and other assets | 913,754 | 910,699 | 917,540 |
| Total assets | $6,191,291 | $5,981,847 | $6,303,549 |
| | | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current liabilities: | | | |
| Short-term borrowings | $— | $7,700 | $20,000 |
| Long-term debt due within one year | 12,785 | 72,572 | 72,797 |
| Accounts payable | 267,922 | 241,465 | 301,132 |
| Taxes payable | 49,852 | 69,077 | 56,186 |
| Dividends payable | 30,850 | 29,796 | 30,773 |
| Accrued compensation | 25,774 | 22,607 | 40,121 |
| Commodity derivative instruments | 40,499 | 32,328 | 24,428 |
| Other accrued liabilities | 227,088 | 187,368 | 222,639 |
| Total current liabilities | 654,770 | 662,913 | 768,076 |
| Long-term debt | 1,414,077 | 1,426,146 | 1,433,955 |
| Deferred credits and other liabilities: | | | |
| Deferred income taxes | 701,933 | 603,803 | 672,269 |
| Other liabilities | 731,428 | 680,965 | 736,447 |
| Total deferred credits and other liabilities | 1,433,361 | 1,284,768 | 1,408,716 |
| Commitments and contingencies | | | |
| Stockholders' equity: | | | |
| Preferred stocks | 15,000 | 15,000 | 15,000 |
| Common stockholders' equity: | | | |
| Common stock | | | |
| | 189,332 | 188,656 | 188,901 |

| | | | |
|---|---|---|---|
| Shares issued -- $1.00 par value, 189,332,485 at March 31, 2011, 188,656,012 at March 31, 2010 and 188,901,379 at December 31, 2010 | | | |
| Other paid-in capital | 1,032,040 | 1,018,441 | 1,026,349 |
| Retained earnings | 1,509,449 | 1,388,914 | 1,497,439 |
| Accumulated other comprehensive income (loss) | (53,112) | 635 | (31,261) |
| Treasury stock at cost – 538,921 shares | (3,626) | (3,626) | (3,626) |
| Total common stockholders' equity | 2,674,083 | 2,593,020 | 2,677,802 |
| Total stockholders' equity | 2,689,083 | 2,608,020 | 2,692,802 |
| Total liabilities and stockholders' equity | $6,191,291 | $5,981,847 | $6,303,549 |

The accompanying notes are an integral part of these consolidated financial statements.

MDU RESOURCES GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| | Three Months Ended March 31, 2011 | 2010 |
|---|---|---|
| | (In thousands) | |
| Operating activities: | | |
| Net income | $42,977 | $41,772 |
| Income from discontinued operations, net of tax | 448 | — |
| Income from continuing operations | 42,529 | 41,772 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation, depletion and amortization | 84,674 | 78,678 |
| Earnings, net of distributions, from equity method investments | (484) | (1,443) |
| Deferred income taxes | 34,502 | 8,226 |
| Changes in current assets and liabilities, net of acquisitions: | | |
| Receivables | 50,260 | 61,914 |
| Inventories | (13,634) | (6,198) |
| Other current assets | (18,897) | (34,546) |
| Accounts payable | (21,875) | (34,795) |
| Other current liabilities | (15,738) | (21,733) |
| Other noncurrent changes | (20,510) | (6,759) |
| Net cash provided by continuing operations | 120,827 | 85,116 |
| Net cash used in discontinued operations | (366) | — |
| Net cash provided by operating activities | 120,461 | 85,116 |
| | | |
| Investing activities: | | |
| Capital expenditures | (82,664) | (123,902) |
| Acquisitions, net of cash acquired | (157) | (1,725) |
| Net proceeds from sale or disposition of property | 10,524 | 1,936 |
| Investments | (9,856) | 1,404 |
| Net cash used in continuing operations | (82,153) | (122,287) |
| Net cash provided by discontinued operations | — | — |
| Net cash used in investing activities | (82,153) | (122,287) |
| | | |
| Financing activities: | | |
| Repayment of short-term borrowings | (20,000) | (2,600) |
| Repayment of long-term debt | (80,630) | (479) |
| Proceeds from issuance of common stock | 5,744 | 1,214 |
| Dividends paid | (30,773) | (29,749) |
| Excess tax benefit on stock-based compensation | 1,248 | 452 |
| Net cash used in continuing operations | (124,411) | (31,162) |
| Net cash provided by discontinued operations | — | — |
| Net cash used in financing activities | (124,411) | (31,162) |
| Effect of exchange rate changes on cash and cash equivalents | 45 | (117) |
| Decrease in cash and cash equivalents | (86,058) | (68,450) |
| Cash and cash equivalents -- beginning of year | 222,074 | 175,114 |
| Cash and cash equivalents -- end of period | $136,016 | $106,664 |

The accompanying notes are an integral part of these consolidated financial statements.

MDU RESOURCES GROUP, INC.
NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS

March 31, 2011 and 2010
(Unaudited)

1. Basis of presentation

The accompanying consolidated interim financial statements were prepared in conformity with the basis of presentation reflected in the consolidated financial statements included in the Company's 2010 Annual Report, and the standards of accounting measurement set forth in the interim reporting guidance in the ASC and any amendments thereto adopted by the FASB. Interim financial statements do not include all disclosures provided in annual financial statements and, accordingly, these financial statements should be read in conjunction with those appearing in the 2010 Annual Report. The information is unaudited but includes all adjustments that are, in the opinion of management, necessary for a fair presentation of the accompanying consolidated interim financial statements and are of a normal recurring nature. Depreciation, depletion and amortization expense is reported separately on the Consolidated Statements of Income and therefore is excluded from the other line items within operating expenses. Management has also evaluated the impact of events occurring after March 31, 2011, up to the date of issuance of these consolidated interim financial statements.

2. Seasonality of operations

Some of the Company's operations are highly seasonal and revenues from, and certain expenses for, such operations may fluctuate significantly among quarterly periods. Accordingly, the interim results for particular businesses, and for the Company as a whole, may not be indicative of results for the full fiscal year.

3. Accounts receivable and allowance for doubtful accounts

Accounts receivable consists primarily of trade receivables from the sale of goods and services which are recorded at the invoiced amount net of allowance for doubtful accounts, and costs and estimated earnings in excess of billings on uncompleted contracts. The total balance of receivables past due 90 days or more was $33.9 million and $21.6 million as of March 31, 2011 and December 31, 2010, respectively.

The allowance for doubtful accounts is determined through a review of past due balances and other specific account data. Account balances are written off when management determines the amounts to be uncollectible. The Company's allowance for doubtful accounts as of March 31, 2011 and 2010, and December 31, 2010, was $16.4 million, $17.1 million and $15.3 million, respectively.

4. Inventories and natural gas in storage

Inventories, other than natural gas in storage for the Company's regulated operations, were stated at the lower of average cost or market value. Natural gas in storage for the Company's regulated operations is generally carried at average cost, or cost using the last-in, first-out method. The portion of the cost of natural gas in storage expected to be used within one year was included in inventories. Inventories consisted of:

| | March 31, 2011 | March 31, 2010 | December 31, 2010 |
|---|---|---|---|
| | | (In thousands) | |
| Aggregates held for resale | $ 82,086 | $ 81,074 | $ 79,894 |
| Materials and supplies | 61,788 | 58,573 | 57,324 |
| Natural gas in storage (current) | 11,953 | 10,741 | 34,557 |
| Merchandise for resale | 31,830 | 29,371 | 30,182 |
| Asphalt oil | 51,506 | 50,423 | 25,234 |
| Other | 23,533 | 23,749 | 25,706 |
| Total | $ 262,696 | $ 253,931 | $ 252,897 |

The remainder of natural gas in storage, which largely represents the cost of gas required to maintain pressure levels for normal operating purposes, was included in other assets and was $47.2 million, $59.3 million, and $48.0 million at March 31, 2011 and 2010, and December 31, 2010, respectively.

5. Earnings per common share

Basic earnings per common share were computed by dividing earnings on common stock by the weighted average number of shares of common stock outstanding during the applicable period. Diluted earnings per common share were computed by dividing earnings on common stock by the total of the weighted average number of shares of common stock outstanding during the applicable period, plus the effect of outstanding stock options and performance share awards. For the three months ended March 31, 2011 and 2010, there were no shares excluded from the calculation of diluted earnings per share. Common stock outstanding includes issued shares less shares held in treasury.

6. Cash flow information

Cash expenditures for interest and income taxes were as follows:

| | Three Months Ended March 31, 2011 | 2010 |
|---|---|---|
| | (In thousands) | |
| Interest, net of amount capitalized | $ 25,579 | $ 25,159 |
| Income taxes | $ 9,981 | $ 5,424 |

7. New accounting standards

Improving Disclosure About Fair Value Measurements In January 2010, the FASB issued guidance related to improving disclosures about fair value measurements. The guidance requires separate disclosures of the amounts of transfers in and out of Level 1 and Level 2 fair value measurements and a description of the reason for such transfers. In the reconciliation for Level 3 fair value measurements using significant unobservable inputs, information about purchases, sales, issuances and settlements shall be presented separately. These disclosures are required for interim and annual reporting periods and were effective for the Company on January 1, 2010, except for the disclosures related to the purchases, sales, issuances and settlements in the roll forward activity of Level 3 fair value measurements, which were effective on January 1, 2011. The guidance requires additional disclosures but does not impact the Company's financial position, results of operations or cash flows.

8. Comprehensive income

Comprehensive income is the sum of net income as reported and other comprehensive income (loss). The Company's other comprehensive income (loss) resulted from gains (losses) on derivative instruments qualifying as hedges, foreign currency translation adjustments and gains on available-for-sale investments. For more information on derivative instruments, see Note 12.

Comprehensive income, and the components of other comprehensive income (loss) and related tax effects, were as follows:

| | Three Months Ended March 31, 2011 | Three Months Ended March 31, 2010 |
|---|---|---|
| | (In thousands) | |
| Net income | $ 42,977 | $ 41,772 |
| Other comprehensive income (loss): | | |
| Net unrealized gain (loss) on derivative instruments qualifying as hedges: | | |
| Net unrealized gain (loss) on derivative instruments arising during the period, net of tax of $(13,109) and $13,159 in 2011 and 2010, respectively | (21,848) | 21,471 |
| Less: Reclassification adjustment for gain (loss) on derivative instruments included in net income, net of tax of $137 and $(573) in 2011 and 2010, respectively | 230 | (934) |
| Net unrealized gain (loss) on derivative instruments qualifying as hedges | (22,078) | 22,405 |
| Foreign currency translation adjustment, net of tax of $137 and $(621) in 2011 and 2010, respectively | 211 | (937) |
| Net unrealized gains on available-for-sale investments, net of tax of $9 in 2011 | 16 | — |
| | (21,851) | 21,468 |
| Comprehensive income | $ 21,126 | $ 63,240 |

9. Discontinued operations

In 2007, Centennial Resources sold CEM to Bicent Power LLC. In connection with the sale, Centennial Resources agreed to indemnify Bicent Power LLC and its affiliates from certain third party claims arising out of or in connection with Centennial Resources' ownership or operation of CEM prior to the sale. In addition, Centennial had previously guaranteed CEM's obligations under a construction contract. The Company incurred legal expenses related to this matter and had an income tax benefit related to favorable resolution of certain tax matters in the first quarter of 2011, which are reflected as discontinued operations in the consolidated financial statements and accompanying notes. Discontinued operations are included in the Other category. For further information, see Note 18.

10. Equity method investments

Investments in companies in which the Company has the ability to exercise significant influence over operating and financial policies are accounted for using the equity method. The Company's equity method investments at March 31, 2011, include the Brazilian Transmission Lines.

In August 2006, MDU Brasil acquired ownership interests in the Brazilian Transmission Lines. The electric transmission lines are primarily in northeastern and southern Brazil. The transmission contracts provide for revenues denominated in the Brazilian Real, annual inflation adjustments and change in tax law adjustments. The functional currency for the Brazilian Transmission Lines is the Brazilian Real.

In the fourth quarter of 2009, multiple sales agreements were signed with three separate parties for the Company to sell its ownership interests in the Brazilian Transmission Lines. In November 2010, the Company completed the sale and recognized a gain of $22.7 million ($13.8 million after tax) which was recorded in earnings from equity method investments on the Consolidated Statements of Income. The Company's entire ownership interest in ENTE and ERTE and 59.96 percent of the Company's ownership interest in ECTE was sold. One of the parties will purchase the Company's remaining ownership interests in ECTE over a four-year period. Alusa, CEMIG and CELESC hold the remaining ownership interests in ECTE.

At March 31, 2011 and 2010, and December 31, 2010, the Company's equity method investments had total assets of $108.2 million, $374.8 million and $107.4 million, respectively, and long-term debt of $46.3 million, $166.4 million and $30.1 million, respectively. The Company's investment in its equity method investments was approximately $11.7 million, $56.0 million and $10.9 million, including undistributed earnings of $2.4 million, $10.8 million and $1.9 million, at March 31, 2011 and 2010, and December 31, 2010, respectively.

11. Goodwill and other intangible assets

The changes in the carrying amount of goodwill were as follows:

| Three Months Ended March 31, 2011 | Balance as of January 1, 2011* | Goodwill Acquired During the Year** | Balance as of March 31, 2011* |
|---|---|---|---|
| | | (In thousands) | |
| Electric | $ — | $ — | $ — |
| Natural gas distribution | 345,736 | — | 345,736 |
| Construction services | 102,870 | 298 | 103,168 |
| Pipeline and energy services | 9,737 | — | 9,737 |
| Natural gas and oil production | — | — | — |
| Construction materials and contracting | 176,290 | — | 176,290 |
| Other | — | — | — |
| Total | $ 634,633 | $ 298 | $ 634,931 |

*Balance is presented net of accumulated impairment of $12.3 million at the pipeline and energy services segment, which occurred in prior periods.

** Includes purchase price adjustments that were not material related to acquisitions in a prior period.

| Three Months Ended March 31, 2010 | Balance as of January 1, 2010* | Goodwill Acquired During the Year** | Balance as of March 31, 2010* |
|---|---|---|---|
| | | (In thousands) | |
| Electric | $ — | $ — | $ — |
| Natural gas distribution | 345,736 | — | 345,736 |
| Construction services | 100,127 | 2,743 | 102,870 |
| Pipeline and energy services | 7,857 | 1,880 | 9,737 |
| Natural gas and oil production | — | — | — |
| Construction materials and contracting | 175,743 | 547 | 176,290 |
| Other | — | — | — |
| Total | $ 629,463 | $ 5,170 | $ 634,633 |

*Balance is presented net of accumulated impairment of $12.3 million at the pipeline and energy services segment, which occurred in prior periods.

** Includes purchase price adjustments that were not material related to acquisitions in a prior period.

| Year Ended December 31, 2010 | Balance as of January 1, 2010* | Goodwill Acquired During the Year** | Balance as of December 31, 2010* |
|---|---|---|---|
| | | (In thousands) | |
| Electric | $ — | $ — | $ — |
| Natural gas distribution | 345,736 | — | 345,736 |
| Construction services | 100,127 | 2,743 | 102,870 |
| Pipeline and energy services | 7,857 | 1,880 | 9,737 |
| Natural gas and oil production | — | — | — |
| Construction materials and contracting | 175,743 | 547 | 176,290 |
| Other | — | — | — |
| Total | $ 629,463 | $ 5,170 | $ 634,633 |

*Balance is presented net of accumulated impairment of $12.3 million at the pipeline and energy services segment, which occurred in prior periods.

** Includes purchase price adjustments that were not material related to acquisitions in a prior period.

Other amortizable intangible assets were as follows:

| | March 31, 2011 | March 31, 2010 | December 31, 2010 |
|---|---|---|---|
| | | (In thousands) | |
| Customer relationships | $ 21,702 | $ 24,942 | $ 24,942 |
| Accumulated amortization | (8,890 ) | (10,093 ) | (11,625 ) |
| | 12,812 | 14,849 | 13,317 |
| Noncompete agreements | 7,685 | 9,405 | 9,405 |
| Accumulated amortization | (4,898 ) | (5,755 ) | (6,425 ) |
| | 2,787 | 3,650 | 2,980 |
| Other | 12,899 | 11,368 | 13,217 |
| Accumulated amortization | (4,147 ) | (3,255 ) | (4,243 ) |
| | 8,752 | 8,113 | 8,974 |
| Total | $ 24,351 | $ 26,612 | $ 25,271 |

Amortization expense for amortizable intangible assets for the three months ended March 31, 2011 and 2010, was $900,000 and $1.0 million, respectively. Estimated amortization expense for amortizable intangible assets is $4.1 million in 2011, $4.0 million in 2012, $3.8 million in 2013, $3.2 million in 2014, $2.6 million in 2015 and $7.6 million thereafter.

12. Derivative instruments

The Company's policy allows the use of derivative instruments as part of an overall energy price, foreign currency and interest rate risk management program to efficiently manage and minimize commodity price, foreign currency and interest rate risk. As of March 31, 2011, the Company had no outstanding foreign currency or interest rate hedges. The following information should be read in conjunction with Notes 1 and 7 in the Company's Notes to Consolidated Financial Statements in the 2010 Annual Report.

Cascade and Intermountain

At March 31, 2011, Cascade held natural gas swap agreements, with total forward notional volumes of 920,000 MMBtu, which were not designated as hedges. Cascade utilizes, and Intermountain periodically utilizes, natural gas swap agreements to manage a portion of their regulated natural gas supply portfolios in order to manage fluctuations in the price of natural gas related to core customers in accordance with authority granted by the IPUC, WUTC and OPUC. Core customers consist of residential, commercial and smaller industrial customers. The fair value of the derivative instrument must be estimated as of the end of each reporting period and is recorded on the Consolidated Balance Sheets as an asset or a liability. Periodic changes in the fair market value of the derivative instruments are recorded on the Consolidated Balance Sheets as a regulatory asset or a regulatory liability, and settlements of these arrangements are expected to be recovered through the purchased gas cost adjustment mechanism. Gains and losses on the settlements of these derivative instruments are recorded as a component of purchased natural gas sold on the Consolidated Statements of Income as they are recovered through the purchased gas cost adjustment mechanism. Under the terms of these arrangements, Cascade and Intermountain will either pay or receive settlement payments based on the difference between the fixed strike price and the monthly index price applicable to each contract. For the three months ended March 31, 2011, Cascade recorded the change in the fair market value of the derivative instruments of $6.6 million as a decrease to regulatory assets. For the three months ended March 31, 2010, Cascade and Intermountain recorded the change in the fair market value of the derivative instruments of $5.1 million as a decrease to regulatory assets.

Certain of Cascade's derivative instruments contain credit-risk-related contingent features that permit the counterparties to require collateralization if Cascade's derivative liability positions exceed certain dollar thresholds. The dollar thresholds in certain of Cascade's agreements are determined and may fluctuate based on Cascade's credit rating on its debt. In addition, Cascade's derivative instruments contain cross-default provisions that state if the entity fails to make payment with respect to certain of its indebtedness, in excess of specified amounts, the counterparties could require early settlement or termination of such entity's derivative instruments in liability positions. The aggregate fair value of Cascade's derivative instruments with credit-risk-related contingent features that are in a liability position at March 31, 2011, was $2.8 million. The aggregate fair value of assets that would have been needed to settle the instruments immediately if the credit-risk-related contingent features were triggered on March 31, 2011, was $2.8 million.

Fidelity

At March 31, 2011, Fidelity held natural gas swap agreements with total forward notional volumes of 29.8 million MMBtu, natural gas basis swap agreements with total forward notional volumes of 17.5 million MMBtu, and oil swap, collar and put option agreements with total forward notional volumes of 3.5 million Bbl, all of which were designated as cash flow hedging instruments. At March 31, 2011, Fidelity held an oil call option agreement with total forward notional volumes of 275,000 Bbl, which did not qualify for hedge accounting. Fidelity utilizes these derivative instruments to manage a portion of the market risk associated with fluctuations in the price of natural gas and oil and basis differentials on its forecasted sales of natural gas and oil production.

The fair value of the derivative instruments must be estimated as of the end of each reporting period and is recorded on the Consolidated Balance Sheets as an asset or liability.

Changes in the fair value attributable to the effective portion of hedging instruments, net of tax, are recorded in stockholders' equity as a component of accumulated other comprehensive income (loss). At the date the natural gas and oil quantities are settled, the amounts accumulated in other comprehensive income (loss) are reported in the Consolidated Statements of Income. To the extent that the hedges are not effective, the ineffective portion of the changes in fair market value is recorded directly in earnings. The proceeds received for natural gas and oil production are generally based on market prices.

Excluding the oil call option agreement, which was not designated as a hedge, the amount of hedge ineffectiveness was immaterial for the three months ended March 31, 2011 and 2010, and there were no components of the derivative instruments' gain or loss excluded from the assessment of hedge effectiveness. Gains and losses must be reclassified into earnings as a result of the discontinuance of cash flow hedges if it is probable that the original forecasted transactions will not occur. There were no such reclassifications into earnings as a result of the discontinuance of hedges. The loss on the derivative instrument that did not qualify for hedge accounting was reported in operating revenues on the Consolidated Statements of Income and was $1.7 million (before tax) for the three months ended March 31, 2011.

Gains and losses on derivative instruments that are reclassified from accumulated other comprehensive income (loss) to current-period earnings are included in operating revenues on the Consolidated Statements of Income. For further information regarding the gains and losses on derivative instruments qualifying as cash flow hedges that were recognized in other comprehensive income (loss) and the gains and losses reclassified from accumulated other comprehensive income (loss) into earnings, see Note 8.

As of March 31, 2011, the maximum term of the derivative instruments, in which the exposure to the variability in future cash flows for forecasted transactions is being hedged, is 21 months. The Company estimates that over the next 12 months net losses of approximately $14.2 million (after tax) will be reclassified from accumulated other comprehensive loss into earnings, subject to changes in natural gas and oil market prices, as the hedged transactions affect earnings.

Certain of Fidelity's derivative instruments contain cross-default provisions that state if Fidelity or any of its affiliates fails to make payment with respect to certain indebtedness, in excess of specified amounts, the counterparties could require early settlement or termination of derivative instruments in liability positions. The aggregate fair value of Fidelity's derivative instruments with credit-risk-related contingent features that are in a liability position at March 31, 2011, was $55.8 million. The aggregate fair value of assets that would have been needed to settle the instruments immediately if the credit-risk-related contingent features were triggered on March 31, 2011, was $55.8 million.

The location and fair value of the Company's derivative instruments on the Consolidated Balance Sheets were as follows:

| Asset Derivatives | Location on Consolidated Balance Sheets | Fair Value at March 31, 2011 | Fair Value at March 31, 2010 | Fair Value at December 31, 2010 |
|---|---|---|---|---|
| | | | (In thousands) | |
| Designated as hedges | Commodity derivative instruments | $ 13,250 | $ 38,146 | $ 15,123 |
| | Other assets – noncurrent | 3,148 | 6,960 | 4,104 |
| | | 16,398 | 45,106 | 19,227 |
| Not designated as hedges | Commodity derivative instruments | — | — | — |
| | Other assets – noncurrent | — | — | — |
| | | — | — | — |
| Total asset derivatives | | $ 16,398 | $ 45,106 | $ 19,227 |

| Liability Derivatives | Location on Consolidated Balance Sheets | Fair Value at March 31, 2011 | Fair Value at March 31, 2010 | Fair Value at December 31, 2010 |
|---|---|---|---|---|
| | | | (In thousands) | |
| Designated as hedges | Commodity derivative instruments | $ 35,990 | $ 11,616 | $ 15,069 |
| | Other liabilities – noncurrent | 18,082 | 759 | 6,483 |
| | | 54,072 | 12,375 | 21,552 |
| Not designated as hedges | Commodity derivative instruments | 4,509 | 20,712 | 9,359 |
| | Other liabilities – noncurrent | — | 2,061 | — |
| | | 4,509 | 22,773 | 9,359 |
| Total liability derivatives | | $ 58,581 | $ 35,148 | $ 30,911 |

## 13. Fair value measurements

The Company measures its investments in certain fixed-income and equity securities at fair value with changes in fair value recognized in income. The Company anticipates using these investments to satisfy its obligations under its unfunded, nonqualified benefit plans for executive officers and certain key management employees, and invests in these fixed-income and equity securities for the purpose of earning investment returns and capital appreciation. These investments, which totaled $41.6 million, $36.5 million and $39.5 million, as of March 31, 2011 and 2010, and December 31, 2010, respectively, are classified as Investments on the Consolidated Balance Sheets. The increase in the fair value of these investments for the three months ended March 31, 2011 and 2010, was $2.1 million (before tax) and $1.7 million (before tax), respectively. The change in fair value, which is considered part of the cost of the plan, is classified in operation and maintenance expense on the Consolidated Statements of Income.

The Company did not elect the fair value option for its remaining available-for-sale securities, which include auction rate securities, mortgage-backed securities and U.S. Treasury securities. These available-for-sale securities are recorded at fair value and are classified as Investments on the Consolidated Balance Sheets. The Company's auction rate securities, which totaled $11.4 million at March 31, 2011 and 2010, and December 31, 2010, approximate cost and, as a result, there are no accumulated unrealized gains or losses recorded in accumulated other comprehensive income (loss) on the Consolidated Balance Sheets related to these investments. The Company's mortgage-backed securities and U.S. Treasury securities had unrealized gains of $16,000 (after tax) for the three months ended March 31, 2011, which were recorded in accumulated other comprehensive loss on the Consolidated Balance Sheet.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. The ASC establishes a hierarchy for grouping assets and liabilities, based on the significance of inputs. The Company's assets and liabilities measured at fair value on a recurring basis are as follows:

| | Fair Value Measurements at March 31, 2011, Using | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at March 31, 2011 |
| | (In thousands) | | | |
| Assets: | | | | |
| Money market funds | $ — | $ 75,658 | $ — | $ 75,658 |
| Available-for-sale securities: | | | | |
| Insurance investment contract* | — | 41,594 | — | 41,594 |
| Auction rate securities | — | 11,400 | — | 11,400 |
| Mortgage-backed securities | — | 8,064 | — | 8,064 |
| U.S. Treasury securities | — | 1,720 | — | 1,720 |
| Commodity derivative instruments – current | — | 13,250 | — | 13,250 |
| Commodity derivative instruments – noncurrent | — | 3,148 | — | 3,148 |
| Total assets measured at fair value | $ — | $ 154,834 | $ — | $ 154,834 |
| Liabilities: | | | | |
| Commodity derivative instruments – current | $ — | $ 40,499 | $ — | $ 40,499 |
| Commodity derivative instruments – noncurrent | — | 18,082 | — | 18,082 |
| Total liabilities measured at fair value | $ — | $ 58,581 | $ — | $ 58,581 |

* The insurance investment contract invests approximately 34 percent in common stock of mid-cap companies, 33 percent in common stock of small-cap companies, 32 percent in common stock of large-cap companies and 1 percent in cash and cash equivalents.

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| | Fair Value Measurements at March 31, 2010, Using | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at March 31, 2010 |
| | (In thousands) | | | |
| Assets: | | | | |
| Money market funds | $ 10,977 | $ 65,000 | $ — | $ 75,977 |
| Available-for-sale securities: | | | | |
| Fixed-income securities | 2,785 | 11,400 | — | 14,185 |
| Equity securities | 6,689 | — | — | 6,689 |
| Insurance investment contract* | — | 27,000 | — | 27,000 |
| Commodity derivative instruments – current | — | 38,146 | — | 38,146 |
| Commodity derivative instruments – noncurrent | — | 6,960 | — | 6,960 |
| Total assets measured at fair value | $ 20,451 | $ 148,506 | $ — | $ 168,957 |
| Liabilities: | | | | |
| Commodity derivative instruments – current | $ — | $ 32,328 | $ — | $ 32,328 |
| Commodity derivative instruments – noncurrent | — | 2,820 | — | 2,820 |
| Total liabilities measured at fair value | $ — | $ 35,148 | $ — | $ 35,148 |

* Invested in mutual funds.

| | Fair Value Measurements at December 31, 2010, Using | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at December 31, 2010 |
| | (In thousands) | | | |
| Assets: | | | | |
| Money market funds | $ — | $ 166,620 | $ — | $ 166,620 |
| Available-for-sale securities: | | | | |
| Fixed-income securities | — | 11,400 | — | 11,400 |
| Insurance investment contract* | — | 39,541 | — | 39,541 |
| Commodity derivative instruments – current | — | 15,123 | — | 15,123 |
| Commodity derivative instruments – noncurrent | — | 4,104 | — | 4,104 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Total assets measured at fair value | $ | — | $ | 236,788 | $ | — | $ | 236,788 |
| Liabilities: | | | | | | | | |
| Commodity derivative instruments – current | $ | — | $ | 24,428 | $ | — | $ | 24,428 |
| Commodity derivative instruments – noncurrent | | — | | 6,483 | | — | | 6,483 |
| Total liabilities measured at fair value | $ | — | $ | 30,911 | $ | — | $ | 30,911 |

* The insurance investment contract invests approximately 35 percent in common stock of mid-cap companies, 33 percent in common stock of small-cap companies, 31 percent in common stock of large-cap companies and 1 percent in cash and cash equivalents.

The estimated fair value of the Company's Level 1 money market funds is determined using the market approach and is valued at the net asset value of shares held by the Company, based on published market quotations in active markets.

The estimated fair value of the Company's Level 1 available-for-sale securities is determined using the market approach and is based on quoted market prices in active markets for identical equity and fixed-income securities.

The estimated fair value of the Company's Level 2 money market funds and available-for-sale securities is determined using the market approach. The Level 2 money market funds consist of investments in short-term unsecured promissory notes and the value is based on comparable market transactions taking into consideration the credit quality of the issuer. The estimated fair value of the Company's Level 2 available-for-sale securities is based on comparable market transactions, other observable inputs or other sources, including pricing from outside sources such as the fund itself.

The estimated fair value of the Company's Level 2 commodity derivative instruments is based upon futures prices, volatility and time to maturity, among other things. Counterparty statements are utilized to determine the value of the commodity derivative instruments and are reviewed and corroborated using various methodologies and significant observable inputs. The nonperformance risk of the counterparties in addition to the Company's nonperformance risk is also evaluated.

Though the Company believes the methods used to estimate fair value are consistent with those used by other market participants, the use of other methods or assumptions could result in a different estimate of fair value. For the three months ended March 31, 2011, there were no transfers between Levels 1 and 2.

The Company's long-term debt is not measured at fair value on the Consolidated Balance Sheets and the fair value is being provided for disclosure purposes only, and was based on quoted market prices of the same or similar issues. The estimated fair value of the Company's long-term debt was as follows:

| | Carrying Amount | Fair Value |
|---|---|---|
| | (In thousands) | |
| Long-term debt at March 31, 2011 | $ 1,426,862 | $ 1,526,923 |
| Long-term debt at March 31, 2010 | $ 1,498,718 | $ 1,586,765 |
| Long-term debt at December 31, 2010 | $ 1,506,752 | $ 1,621,184 |

The carrying amounts of the Company's remaining financial instruments included in current assets and current liabilities approximate their fair values.

## 14. Income taxes

In the first quarter of 2011, the Company received favorable resolution of certain tax matters relating to the 2004 through 2006 tax years. As a result, the Company recorded an income tax benefit from continuing operations of $4.2 million. This resolution includes the effects of $2.8 million related to the reversal of unrecognized tax benefits that were previously established for the 2004 through 2006 tax years and associated interest of $600,000.

## 15. Business segment data

The Company's reportable segments are those that are based on the Company's method of internal reporting, which generally segregates the strategic business units due to differences in products, services and regulation. The vast majority of the Company's operations are located within the United States. The Company also has investments in foreign countries, which largely consist of Centennial Resources' equity method investment in the Brazilian Transmission Lines.

The electric segment generates, transmits and distributes electricity in Montana, North Dakota, South Dakota and Wyoming. The natural gas distribution segment distributes natural gas in those states as well as in Idaho, Minnesota, Oregon and Washington. These operations also supply related value-added services.

The construction services segment specializes in constructing and maintaining electric and communication lines, gas pipelines, fire suppression systems, and external lighting and traffic signalization equipment. This segment also provides utility excavation services and inside electrical wiring, cabling and mechanical services, sells and distributes electrical materials, and manufactures and distributes specialty equipment.

The pipeline and energy services segment provides natural gas transportation, underground storage and gathering services through regulated and nonregulated pipeline systems primarily in the Rocky Mountain and northern Great Plains regions of the United States. This segment also provides cathodic protection and other energy-related services.

The natural gas and oil production segment is engaged in natural gas and oil acquisition, exploration, development and production activities in the Rocky Mountain and Mid-Continent regions of the United States and in and around the Gulf of Mexico.

The construction materials and contracting segment mines aggregates and markets crushed stone, sand, gravel and related construction materials, including ready-mixed concrete, cement, asphalt, liquid asphalt and other value-added products. It also performs integrated contracting services. This segment operates in the central, southern and western United States and Alaska and Hawaii.

The Other category includes the activities of Centennial Capital, which insures various types of risks as a captive insurer for certain of the Company's subsidiaries. The function of the captive insurer is to fund the deductible layers of the insured companies' general liability and automobile liability coverages. Centennial Capital also owns certain real and personal property. The Other category also includes Centennial Resources' equity method investment in the Brazilian Transmission Lines.

The information below follows the same accounting policies as described in Note 1 of the Company's Notes to Consolidated Financial Statements in the 2010 Annual Report. Information on the Company's businesses was as follows:

| Three Months Ended March 31, 2011 | External Operating Revenues | Inter-segment Operating Revenues | Earnings on Common Stock |
|---|---|---|---|
| | | (In thousands) | |
| Electric | $ 57,845 | $ — | $ 8,524 |
| Natural gas distribution | 370,385 | — | 27,516 |
| Pipeline and energy services | 49,251 | 24,741 | 6,920 |
| | 477,481 | 24,741 | 42,960 |
| Construction services | 202,180 | 1,217 | 4,632 |
| Natural gas and oil production | 78,410 | 25,541 | 16,269 |
| Construction materials and contracting | 143,533 | — | (21,402 ) |
| Other | 201 | 2,288 | 347 |
| | 424,324 | 29,046 | (154 ) |
| Intersegment eliminations | — | (53,787 ) | — |
| Total | $ 901,805 | $ — | $ 42,806 |

| Three Months Ended March 31, 2010 | External Operating Revenues | Inter-segment Operating Revenues | Earnings on Common Stock |
|---|---|---|---|
| | | (In thousands) | |
| Electric | $ 49,696 | $ — | $ 5,884 |
| Natural gas distribution | 349,026 | — | 23,344 |
| Pipeline and energy services | 61,523 | 27,086 | 8,791 |
| | 460,245 | 27,086 | 38,019 |
| Construction services | 153,066 | 23 | 127 |
| Natural gas and oil production | 71,659 | 35,927 | 22,211 |
| Construction materials and contracting | 149,807 | — | (20,137 ) |
| Other | — | 2,238 | 1,380 |
| | 374,532 | 38,188 | 3,581 |
| Intersegment eliminations | — | (65,274 ) | — |
| Total | $ 834,777 | $ — | $ 41,600 |

Earnings from electric, natural gas distribution and pipeline and energy services are substantially all from regulated operations. Earnings from construction services, natural gas and oil production, construction materials and contracting, and other are all from nonregulated operations.

16. Employee benefit plans

The Company has noncontributory defined benefit pension plans and other postretirement benefit plans for certain eligible employees. Components of net periodic benefit cost for the Company's pension and other postretirement benefit plans were as follows:

| Three Months Ended March 31, | Pension Benefits 2011 | Pension Benefits 2010 | Other Postretirement Benefits 2011 | Other Postretirement Benefits 2010 |
|---|---|---|---|---|
| | (In thousands) | | | |
| Components of net periodic benefit cost: | | | | |
| Service cost | $ 827 | $ 804 | $ 339 | $ 357 |
| Interest cost | 4,960 | 4,926 | 1,189 | 1,277 |
| Expected return on assets | (5,700 ) | (5,692 ) | (1,218 ) | (1,392 ) |
| Amortization of prior service cost (credit) | 43 | 38 | (669 ) | (864 ) |
| Recognized net actuarial loss | 1,543 | 972 | 311 | 388 |
| Amortization of net transition obligation | — | — | 531 | 532 |
| Net periodic benefit cost, including amount capitalized | 1,673 | 1,048 | 483 | 298 |
| Less amount capitalized | 248 | 276 | (67 ) | 47 |
| Net periodic benefit cost | $ 1,425 | $ 772 | $ 550 | $ 251 |

Defined pension plan benefits to all nonunion and certain union employees hired after December 31, 2005, were discontinued. Employees that would have been eligible for defined pension plan benefits are eligible to receive additional defined contribution plan benefits. Effective January 1, 2010, all benefit and service accruals for nonunion and certain union plans were frozen. These employees will be eligible to receive additional defined contribution plan benefits.

Effective January 1, 2010, eligibility to receive retiree medical benefits was modified at certain of the Company's businesses. Current employees who attain age 55 with 10 years of continuous service by December 31, 2010, will be provided the current retiree medical insurance benefits or can elect the new benefit, if desired, regardless of when they retire. All other current employees must meet the new eligibility criteria of age 60 and 10 years of continuous service at the time they retire. These employees will be eligible for a specified company funded Retiree Reimbursement Account. Employees hired after December 31, 2009, will not be eligible for retiree medical benefits.

In addition to the qualified plan defined pension benefits reflected in the table, the Company has an unfunded, nonqualified benefit plan for executive officers and certain key management employees that generally provides for defined benefit payments at age 65 following the employee's retirement or to their beneficiaries upon death for a 15-year period. The Company's net periodic benefit cost for this plan for the three months ended March 31, 2011 and 2010, was $2.1 million.

17. Regulatory matters and revenues subject to refund

In April 2010, Montana-Dakota filed an application with the NDPSC for an electric rate increase. Montana-Dakota requested a total increase of $15.4 million annually or approximately 14 percent above current rates. The requested increase included the

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investment in infrastructure upgrades, recovery of the investment in renewable generation, the costs associated with Big Stone Station II and the significant loss of wholesale sales margins. In June 2010, the NDPSC approved an interim increase of $7.6 million effective with service rendered June 18, 2010. In June 2010, Montana-Dakota and the NDPSC Advocacy Staff filed a partial settlement agreement agreeing to an overall rate of return and a sharing of earnings over a specified return on equity. In July 2010, Montana-Dakota filed an amendment to its application to exclude the development costs associated with Big Stone Station II because of a settlement agreement approved by the NDPSC that provided for recovery of such development costs. In November 2010, Montana-Dakota and the NDPSC Advocacy Staff filed a second settlement agreement resolving certain issues raised by the NDPSC Advocacy Staff in its investigation of the rate increase application. Montana-Dakota revised its requested rate increase to $8.8 million annually or 7.7 percent as a result of the settlements, the exclusion of the Big Stone Station II development costs and other adjustments. The NDPSC Advocacy Staff sought reductions of $8.3 million annually from Montana-Dakota's requested increase. A hearing on the application was held in November 2010. On March 14, 2011, Montana-Dakota, the NDPSC Advocacy Staff and the Missouri Valley Resource Council filed a settlement agreement that resolved all outstanding issues in the case, resulting in an increase of $7.6 million annually. The NDPSC has set a hearing on the settlement for May 2011.

In August 2010, Montana-Dakota filed an application with the MTPSC for an electric rate increase. Montana-Dakota requested a total increase of $5.5 million annually or approximately 13 percent above current rates. The requested increase included the investment in infrastructure upgrades, recovery of the investment in renewable generation, the costs associated with Big Stone Station II and the significant loss of wholesale sales margins. Montana-Dakota requested an interim increase of $3.1 million or approximately 7.4 percent. On February 8, 2011, the MTPSC approved an interim increase of $2.6 million or approximately 6.28 percent, effective with service rendered February 14, 2011. On February 23, 2011, Montana-Dakota and intervenors to the case jointly requested that the hearing set for February 28, 2011, be vacated and reset to a later date as the parties believed they would be able to negotiate a settlement agreement. The hearing was vacated on February 23, 2011. Settlement discussions are ongoing.

On March 21, 2011, the WUTC filed a complaint against Cascade, alleging safety violations in the operations of its natural gas distribution system. For more information, see Note 18.

## 18. Contingencies

The Company has reserved $40.5 million and $45.3 million for potential liabilities related to litigation and environmental matters as of March 31, 2011 and December 31, 2010, respectively, which includes $26.6 million related to the natural gas gathering operations as well as amounts that may be reserved for other matters discussed in litigation and environmental matters within this note.

### Litigation

Guarantee Obligation Under a Construction Contract Centennial guaranteed CEM's obligations under a construction contract with LPP for a 550-MW combined-cycle electric generating facility near Hobbs, New Mexico. Centennial Resources sold CEM in July 2007 to Bicent Power LLC, which provided a $10 million bank letter of credit to Centennial in support of the guarantee obligation, which letter of credit expired in November 2010. In

February 2009, Centennial received a Notice and Demand from LPP under the guaranty agreement alleging that CEM did not meet certain of its obligations under the construction contract and demanding that Centennial indemnify LPP against all losses, damages, claims, costs, charges and expenses arising from CEM's alleged failures. In December 2009, LPP submitted a demand for arbitration of its dispute with CEM to the American Arbitration Association. The demand seeks compensatory damages of $149.7 million. LPP's notice of demand for arbitration also demanded performance of the guarantee by Centennial. In June 2010, CEM and Bicent Power LLC made a demand on Centennial Resources for indemnification under the 2007 purchase and sale agreement for indemnifiable losses, including defense fees and costs which CEM and Bicent Power LLC have stated are more than $10.0 million, arising from LPP's arbitration demand and related to Centennial Resources' ownership of CEM prior to its sale to Bicent Power LLC. The Company believes the claims against Centennial and Centennial Resources are without merit and intends to vigorously defend against such claims. Centennial and Centennial Resources filed a complaint with the Supreme Court of the State of New York in November 2010, against CEM and Bicent Power LLC seeking damages for breach of contract and other relief including specific performance of the 2007 purchase and sale agreement allowing for Centennial Resources' participation in the arbitration proceeding and replacement of the letter of credit. On January 28, 2011, CEM and Bicent Power LLC filed a motion to dismiss the complaint filed by Centennial and Centennial Resources. The arbitration hearing on LPP's claim is currently scheduled for late in the third quarter of 2011.

Construction Materials In 2009, LTM provided pavement work under a subcontract for reconstruction at the Klamath Falls Airport owned by the City of Klamath Falls, Oregon. In October 2010, the City of Klamath Falls filed a complaint against the project's general contractor alleging the work performed by LTM is defective. The general contractor tendered the defense and indemnity of the claim to LTM and its insurance carrier. On January 18, 2011, the general contractor served a third party complaint against LTM seeking indemnity and contribution for damages imposed on the general contractor. LTM filed a fourth-party complaint seeking contribution and indemnity for damages imposed on LTM against the project engineer firm which prepared the specifications for the airport runway. LTM's insurance carrier accepted defense of the complaint against the general contractor and the third party complaint against LTM subject to reservation of its rights under the applicable insurance policy. Damages, including removal and replacement of the paved runway, are estimated by the plaintiff as $6.0 million to $11.0 million. LTM believes its work met the specifications of the subcontract and expects to vigorously defend against the claims.

Natural Gas Gathering Operations In January 2010, SourceGas filed an application with the Colorado State District Court to compel Bitter Creek to arbitrate a dispute regarding operating pressures under a natural gas gathering contract on one of Bitter Creek's pipeline gathering systems in Montana. Bitter Creek resisted the application and sought a declaratory order interpreting the gathering contract. In May 2010, the Colorado State District Court granted the application and ordered Bitter Creek into arbitration. An arbitration hearing was held in August 2010. In October 2010, Bitter Creek was notified that the arbitration panel issued an award in favor of SourceGas for approximately $26.6 million. As a result, Bitter Creek, which is included in the pipeline and energy services segment, recorded a $26.6 million charge ($16.5 million after tax) in the third quarter of 2010. On April 20, 2011, the Colorado State District Court entered an order denying a motion by Bitter Creek to vacate the arbitration award and granting a motion by SourceGas to confirm the arbitration award as a court judgment. Bitter Creek filed an appeal from the Colorado State District Court's order and judgment to the Colorado Court of Appeals on April 28, 2011.

In related matters, Noble Energy, Inc. made a written demand in December 2010, to Bitter Creek and SourceGas for arbitration under the gathering contract between Bitter Creek and SourceGas. Noble Energy, Inc. contends it is a third party beneficiary of the contract and alleges it is damaged by the increased operating pressures demanded by SourceGas on the natural gas gathering system. Bitter Creek filed a complaint in Colorado State District Court to enjoin arbitration by Noble Energy, Inc. In July 2010, Omimex Canada, Ltd. filed a complaint against Bitter Creek in Montana District Court alleging Bitter Creek breached a separate gathering contract with Omimex Canada, Ltd. as a result of the increased operating pressures on the same natural gas gathering system. Omimex Canada, Ltd. seeks unspecified damages and injunctive relief.

Natural Gas Distribution The WUTC on March 21, 2011, filed a complaint against Cascade, alleging pipeline safety violations in the operation of its natural gas distribution system. The complaint alleges more than 360 violations of pipeline safety regulations and seeks relief including unspecified monetary penalties. Cascade filed its answer to the complaint admitting some and denying other of the alleged violations. Cascade recognized certain compliance issues and has been working with the WUTC to become fully compliant. The Company's leadership is committed to pipeline safety compliance and over the past year and a half substantial resources have been invested by Cascade to improve pipeline safety documentation and procedures. Cascade believes most of the violations have been or are in the process of being remedied. Cascade also intends to make significant additional technological and other investments over the next year to improve its compliance procedures and results. The WUTC will set a schedule for hearing the complaint. At this time, the Company cannot estimate the amount of likely civil penalty related to this matter.

The Company also is involved in other legal actions in the ordinary course of its business. Although the outcomes of any such legal actions cannot be predicted, management believes that the outcomes with respect to these other legal proceedings will not have a material adverse effect upon the Company's financial position, results of operations or cash flows.

Environmental matters

Portland Harbor Site In December 2000, Knife River – Northwest was named by the EPA as a PRP in connection with the cleanup of a riverbed site adjacent to a commercial property site acquired by Knife River – Northwest from Georgia-Pacific West, Inc. in 1999. The riverbed site is part of the Portland, Oregon, Harbor Superfund Site. The EPA wants responsible parties to share in the cleanup of sediment contamination in the Willamette River. To date, costs of the overall remedial investigation and feasibility study of the harbor site are being recorded, and initially paid, through an administrative consent order by the LWG, a group of several entities, which does not include Knife River – Northwest or Georgia-Pacific West, Inc. Investigative costs are indicated to be in excess of $70 million. It is not possible to estimate the cost of a corrective action plan until the remedial investigation and feasibility study have been completed, the EPA has decided on a strategy and a ROD has been published. Corrective action will be taken after the development of a proposed plan and ROD on the harbor site is issued. Knife River – Northwest also received notice in January 2008 that the Portland Harbor Natural Resource Trustee Council intends to perform an injury assessment to natural resources resulting from the release of hazardous substances at the Harbor Superfund Site. The Portland Harbor Natural Resource Trustee Council indicates the injury determination is appropriate to facilitate early settlement of damages and restoration for natural resource injuries. It is not possible to estimate the costs of natural resource damages until an assessment is completed and allocations are undertaken.

Based upon a review of the Portland Harbor sediment contamination evaluation by the Oregon DEQ and other information available, Knife River – Northwest does not believe it is a Responsible Party. In addition, Knife River – Northwest has notified Georgia-Pacific West, Inc., that it intends to seek indemnity for liabilities incurred in relation to the above matters pursuant to the terms of their sale agreement. Knife River – Northwest has entered into an agreement tolling the statute of limitations in connection with the LWG's potential claim for contribution to the costs of the remedial investigation and feasibility study. By letter in March 2009, LWG stated its intent to file suit against Knife River – Northwest and others to recover LWG's investigation costs to the extent Knife River – Northwest cannot demonstrate its non-liability for the contamination or is unwilling to participate in an alternative dispute resolution process that has been established to address the matter. At this time, Knife River – Northwest has agreed to participate in the alternative dispute resolution process.

The Company believes it is not probable that it will incur any material environmental remediation costs or damages in relation to the above referenced administrative action.

Manufactured Gas Plant Sites There are three claims against Cascade for cleanup of environmental contamination at manufactured gas plant sites operated by Cascade's predecessors.

The first claim is for soil and groundwater contamination at a site in Oregon and was received in 1995. There are PRPs in addition to Cascade that may be liable for cleanup of the contamination. Some of these PRPs have shared in the investigation costs. It is expected that these and other PRPs will share in the cleanup costs. Several alternatives for cleanup have been identified, with preliminary cost estimates ranging from approximately $500,000 to $11.0 million. An ecological risk assessment draft report was submitted to the Oregon DEQ in June 2009. The assessment showed no unacceptable risk to the aquatic ecological receptors present in the shoreline along the site and concluded that no further ecological investigation is necessary. The report is being reviewed by the Oregon DEQ. It is anticipated the Oregon DEQ will recommend a cleanup alternative for the site after it completes its review of the report. It is not known at this time what share of the cleanup costs will actually be borne by Cascade.

The second claim is for contamination at a site in Washington and was received in 1997. A preliminary investigation has found soil and groundwater at the site contain contaminants requiring further investigation and cleanup. EPA conducted a Targeted Brownfields Assessment of the site and released a report summarizing the results of that assessment in August 2009. The assessment confirms that contaminants have affected soil and groundwater at the site, as well as sediments in the adjacent Port Washington Narrows. Alternative remediation options have been identified with preliminary cost estimates ranging from $340,000 to $6.4 million. Data developed through the assessment and previous investigations indicates the contamination likely derived from multiple, different sources and multiple current and former owners of properties and businesses in the vicinity of the site may be responsible for the contamination. Cascade received notice in April 2010, that the Washington Department of Ecology has determined that Cascade is a PRP for release of hazardous substances at the site. In October 2010, Cascade received notice from the United States Coast Guard that a hazardous substance appearing to be manufactured gas plant waste was released into the waterway from an abandoned pipe located on the shoreline in the vicinity of the former manufactured gas plant. Cascade subsequently received an administrative order from the United States Coast Guard requiring Cascade to remove the abandoned pipe and conduct other associated time-critical actions. Cascade agreed to remove the pipe and perform the other time-critical actions pursuant to a work plan approved by the United States Coast Guard. The work satisfying the administrative order was completed in November 2010. It is expected that subsequent remedial action at the site will be conducted under the oversight of the EPA. Cascade has reserved $6.4 million for remediation of this site. In April 2010, Cascade filed a petition with the WUTC for authority to defer the costs, which are included in other noncurrent assets, incurred in relation to the environmental remediation of this site until the next general rate case. The WUTC approved the petition in September 2010, subject to conditions set forth in the order.

The third claim is also for contamination at a site in Washington. Cascade received notice from a party in May 2008 that Cascade may be a PRP, along with other parties, for contamination from a manufactured gas plant owned by Cascade and its predecessor from about 1946 to 1962. The notice indicates that current estimates to complete investigation and cleanup of the site exceed $8.0 million. Other PRPs have reached an agreed order and work plan with the Washington Department of Ecology for completion of a remedial investigation and feasibility study for the site. The remediation investigation and feasibility study report are expected to be completed by late 2011. There is currently not enough information available to estimate the potential liability to Cascade associated with this claim.

To the extent these claims are not covered by insurance, Cascade will seek recovery through the OPUC and WUTC of remediation costs in its natural gas rates charged to customers.

Guarantees

Centennial guaranteed CEM's obligations under a construction contract. For further information, see litigation in this note.

In connection with the sale of the Brazilian Transmission Lines, as discussed in Note 10, Centennial has agreed to guarantee payment of any indemnity obligations of certain of the Company's indirect wholly owned subsidiaries who are the sellers in three purchase and sale agreements for periods ranging up to 10 years from the date of sale. The guarantees were required by the buyers as a condition to the sale of the Brazilian Transmission Lines.

WBI Holdings has guaranteed certain of Fidelity's natural gas and oil swap and collar agreement obligations. There is no fixed maximum amount guaranteed in relation to the natural gas and oil swap and collar agreements as the amount of the obligation is dependent upon natural gas and oil commodity prices. The amount of hedging activity entered into by the subsidiary is limited by corporate policy. The guarantees of the natural gas and oil swap and collar agreements at March 31, 2011, expire in the years ranging from 2011 to 2012; however, Fidelity continues to enter into additional hedging activities and, as a result, WBI

Holdings from time to time may issue additional guarantees on these hedging obligations. The amount outstanding by Fidelity was $37.4 million and was reflected on the Consolidated Balance Sheet, at March 31, 2011. In the event Fidelity defaults under its obligations, WBI Holdings would be required to make payments under its guarantees.

Certain subsidiaries of the Company have outstanding guarantees to third parties that guarantee the performance of other subsidiaries of the Company. These guarantees are related to construction contracts, natural gas transportation and sales agreements, gathering contracts, a conditional purchase agreement and certain other guarantees. At March 31, 2011, the fixed maximum amounts guaranteed under these agreements aggregated $181.7 million. The amounts of scheduled expiration of the maximum amounts guaranteed under these agreements aggregate $105.8 million in 2011; $67.6 million in 2012; $1.2 million in 2013; $200,000 in 2014; $800,000 in 2018; $300,000 in 2019; $1.8 million, which is subject to expiration on a specified number of days after the receipt of written notice; and $4.0 million, which has no scheduled maturity date. The amount outstanding by subsidiaries of the Company under the above guarantees was $700,000 and was reflected on the Consolidated Balance Sheet at March 31, 2011. In the event of default under these guarantee obligations, the subsidiary issuing the guarantee for that particular obligation would be required to make payments under its guarantee.

Certain subsidiaries have outstanding letters of credit to third parties related to insurance policies, natural gas transportation agreements and other agreements, some of which are guaranteed by other subsidiaries of the Company. At March 31, 2011, the fixed maximum amounts guaranteed under these letters of credit, aggregated $27.3 million. In 2011 and 2012, $22.2 million and $5.1 million, respectively, of letters of credit are scheduled to expire. There were no amounts outstanding under the above letters of credit at March 31, 2011.

WBI Holdings has an outstanding guarantee to Williston Basin. This guarantee is related to a natural gas transportation and storage agreement that guarantees the performance of Prairielands. At March 31, 2011, the fixed maximum amount guaranteed under this agreement was $5.0 million and is scheduled to expire in 2014. In the event of Prairielands' default in its payment obligations, WBI Holdings would be required to make payment under its guarantee. The amount outstanding by Prairielands under the above guarantee was $1.4 million. The amount outstanding under this guarantee was not reflected on the Consolidated Balance Sheet at March 31, 2011, because this intercompany transaction was eliminated in consolidation.

In addition, Centennial, Knife River and MDU Construction Services have issued guarantees to third parties related to the routine purchase of maintenance items, materials and lease obligations for which no fixed maximum amounts have been specified. These guarantees have no scheduled maturity date. In the event a subsidiary of the Company defaults under these obligations, Centennial, Knife River and MDU Construction Services would be required to make payments under these guarantees. Any amounts outstanding by subsidiaries of the Company for these guarantees were reflected on the Consolidated Balance Sheet at March 31, 2011.

In the normal course of business, Centennial has surety bonds related to construction contracts and reclamation obligations of its subsidiaries. In the event a subsidiary of

Centennial does not fulfill a bonded obligation, Centennial would be responsible to the surety bond company for completion of the bonded contract or obligation. A large portion of the surety bonds is expected to expire within the next 12 months; however, Centennial will likely continue to enter into surety bonds for its subsidiaries in the future. As of March 31, 2011, approximately $555 million of surety bonds were outstanding, which were not reflected on the Consolidated Balance Sheet.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW
The Company's strategy is to apply its expertise in energy and transportation infrastructure industries to increase market share, increase profitability and enhance shareholder value through:

- Organic growth as well as a continued disciplined approach to the acquisition of well-managed companies and properties
- The elimination of system-wide cost redundancies through increased focus on integration of operations and standardization and consolidation of various support services and functions across companies within the organization
- The development of projects that are accretive to earnings per share and return on invested capital

The Company has capabilities to fund its growth and operations through various sources, including internally generated funds, commercial paper facilities, revolving credit facilities and the issuance from time to time of debt and equity securities. For more information on the Company's net capital expenditures, see Liquidity and Capital Commitments.

The key strategies for each of the Company's business segments and certain related business challenges are summarized below. For a summary of the Company's business segments, see Note 15.

Key Strategies and Challenges
Electric and Natural Gas Distribution
Strategy Provide competitively priced energy and related services to customers. The electric and natural gas distribution segments continually seek opportunities for growth and expansion of their customer base through extensions of existing operations, including electric generation with a diverse resource mix that includes renewable generation, and transmission build-out, and through selected acquisitions of companies and properties at prices that will provide stable cash flows and an opportunity for the Company to earn a competitive return on investment.

Challenges Both segments are subject to extensive regulation in the state jurisdictions where they conduct operations with respect to costs and permitted returns on investment as well as subject to certain operational and environmental regulations. The ability of these segments to grow through acquisitions is subject to significant competition. In addition, the ability of both segments to grow service territory and customer base is affected by the economic environment of the markets served and competition from other energy providers and fuels. The construction of electric generating facilities and transmission lines may be subject to increasing cost and lead time, extensive permitting procedures, and federal and state legislative and regulatory initiatives, which may necessitate increases in electric energy prices. Legislative and regulatory initiatives to increase renewable energy resources and reduce GHG emissions could impact the price and demand for electricity and natural gas.

Construction Services
Strategy Provide a competitive return on investment while operating in a competitive industry by: building new and strengthening existing customer relationships; effectively controlling costs; retaining, developing and recruiting talented employees; focusing business development efforts on project areas that will permit higher margins; and properly managing risk. This segment continuously seeks opportunities to expand through strategic acquisitions.

Challenges This segment operates in highly competitive markets with many jobs subject to competitive bidding. Maintenance of effective operational and cost controls, retention of key personnel, managing through downturns in the economy and effective management of working capital are ongoing challenges.

Pipeline and Energy Services
Strategy Utilize the segment's existing expertise in energy infrastructure and related services to increase market share and profitability through optimization of existing operations, internal growth, and acquisitions of energy-related assets and companies. Incremental and new growth opportunities include: access to new sources of natural gas for storage, gathering and transportation services; expansion of existing gathering, transmission and storage facilities; expansion of related energy services; and incremental expansion of pipeline capacity to allow customers access to more liquid and higher-priced markets.

Challenges Challenges for this segment include: energy price volatility; natural gas basis differentials; environmental and regulatory requirements; recruitment and retention of a skilled workforce; and competition from other natural gas pipeline and energy services companies.

Natural Gas and Oil Production
Strategy Apply technology and utilize existing exploration and production expertise, with a focus on operated properties, to increase production and reserves from existing leaseholds, and to seek additional reserves and production opportunities both in new and existing areas to further expand the segment's asset base. By optimizing existing operations and taking advantage of new and incremental growth opportunities, this segment's goal is to add value by increasing both reserves and production over the long term so as to generate competitive returns on investment.

Challenges Volatility in natural gas and oil prices; timely receipt of necessary permits and approvals; environmental and regulatory requirements; recruitment and retention of a skilled workforce; availability of drilling rigs, materials, auxiliary equipment and industry-related field services, and inflationary pressure on development and operating costs; and competition from other natural gas and oil companies are ongoing challenges for this segment.

Construction Materials and Contracting
Strategy Focus on high-growth strategic markets located near major transportation corridors and desirable mid-sized metropolitan areas; strengthen long-term, strategic aggregate reserve position through purchase and/or lease opportunities; enhance profitability through cost containment, margin discipline and vertical integration of the segment's operations; and continue growth through organic and acquisition opportunities. Ongoing efforts to increase margin are being pursued through the implementation of a variety of continuous improvement programs, including corporate purchasing of equipment, parts and commodities (liquid asphalt, diesel fuel, cement and other materials), and negotiation of contract price escalation provisions. Vertical integration allows the segment to manage operations from aggregate mining to final lay-down of concrete and asphalt, with control of and access to permitted aggregate reserves being significant. A key element of the Company's long-term strategy for this business is to further expand its market presence in the higher-margin materials business (rock, sand, gravel, liquid asphalt, ready-mixed concrete and related products), complementing and expanding on the Company's expertise.

Challenges The economic downturn has adversely impacted operations, particularly in the private market. The current economic challenges have resulted in increased competition in certain construction markets and lower margins. Delays in the multiple year reauthorization of the federal highway bill and volatility in the cost of raw materials such as diesel, gasoline, liquid asphalt, cement and steel, continue to be a concern. This business unit expects to continue cost containment efforts and a greater emphasis on industrial, energy and public works projects.

For further information on the risks and challenges the Company faces as it pursues its growth strategies and other factors that should be considered for a better understanding of the Company's financial condition, see Item 1A – Risk Factors, as well as Part I, Item 1A – Risk Factors in the 2010 Annual Report. For further information on each segment's key growth strategies, projections and certain assumptions, see Prospective Information. For information pertinent to various commitments and contingencies, see Notes to Consolidated Financial Statements.

Earnings Overview
The following table summarizes the contribution to consolidated earnings by each of the Company's businesses.

| | Three Months Ended March 31, 2011 | 2010 |
|---|---|---|
| | (Dollars in millions, where applicable) | |
| Electric | $8.5 | $5.9 |
| Natural gas distribution | 27.5 | 23.3 |
| Construction services | 4.6 | .1 |
| Pipeline and energy services | 6.9 | 8.8 |
| Natural gas and oil production | 16.3 | 22.2 |
| Construction materials and contracting | (21.4) | (20.1) |
| Other | (.1) | 1.4 |
| Earnings before discontinued operations | 42.3 | 41.6 |
| Income from discontinued operations, net of tax | .5 | — |
| Earnings on common stock | $42.8 | $41.6 |
| Earnings per common share – basic: | | |
| Earnings before discontinued operations | $.22 | $.22 |
| Discontinued operations, net of tax | .01 | — |
| Earnings per common share – basic | $.23 | $.22 |
| Earnings per common share – diluted: | | |
| Earnings before discontinued operations | $.22 | $.22 |
| Discontinued operations, net of tax | .01 | — |
| Earnings per common share – diluted | $.23 | $.22 |
| Return on average common equity for the 12 months ended | 9.1% | 10.5% |

Three Months Ended March 31, 2011 and 2010 Consolidated earnings for the quarter ended March 31, 2011, increased $1.2 million from the comparable prior period largely due to:

- Higher construction workloads and margins, as well as higher equipment and electrical supply sales at the construction services business
- Increased retail sales volumes, partially offset by higher operation and maintenance expense at the natural gas distribution business

Partially offsetting these increases was:

- Lower average realized natural gas prices, higher depreciation, depletion and amortization expense, increased lease operating expenses and decreased natural gas production, partially

offset by higher average realized oil prices and increased oil production at the natural gas and oil production business

FINANCIAL AND OPERATING DATA
Below are key financial and operating data for each of the Company's businesses.

Electric

| | Three Months Ended March 31, 2011 | 2010 |
|---|---|---|
| (Dollars in millions, where applicable) | | |
| Operating revenues | $57.8 | $49.7 |
| Operating expenses: | | |
| Fuel and purchased power | 16.9 | 16.9 |
| Operation and maintenance | 16.0 | 15.2 |
| Depreciation, depletion and amortization | 8.2 | 5.7 |
| Taxes, other than income | 2.5 | 2.7 |
| | 43.6 | 40.5 |
| Operating income | 14.2 | 9.2 |
| Earnings | $8.5 | $5.9 |
| Retail sales (million kWh) | 794.7 | 749.8 |
| Sales for resale (million kWh) | 6.7 | 29.8 |
| Average cost of fuel and purchased power per kWh | $.020 | $.021 |

Three Months Ended March 31, 2011 and 2010 Electric earnings increased $2.6 million (45 percent) due to:

- Higher electric retail sales margins, primarily due to implementation of higher rates in Wyoming, as well as interim rates in North Dakota
  - An income tax benefit of $700,000 related to favorable resolution of certain income tax matters
- Higher retail sales volumes of 6 percent, reflecting increased demand in all customer classes due to colder weather than last year

Partially offsetting these increases were:

- Increased depreciation, depletion and amortization expense of $1.5 million (after tax), including the effects of higher property, plant and equipment balances
- Lower other income of $1.1 million (after tax), primarily lower allowance for funds used during construction related to electric generation projects, which were placed in service in 2010

Natural Gas Distribution

| | Three Months Ended March 31, 2011 | | 2010 | |
|---|---|---|---|---|
| | (Dollars in millions, where applicable) | | | |
| Operating revenues | $370.4 | | $349.0 | |
| Operating expenses: | | | | |
| Purchased natural gas sold | 257.5 | | 245.2 | |
| Operation and maintenance | 34.4 | | 32.7 | |
| Depreciation, depletion and amortization | 11.1 | | 10.6 | |
| Taxes, other than income | 17.7 | | 16.5 | |
| | 320.7 | | 305.0 | |
| Operating income | 49.7 | | 44.0 | |
| Earnings | $27.5 | | $23.3 | |
| Volumes (MMdk): | | | | |
| Sales | 43.9 | | 38.1 | |
| Transportation | 34.1 | | 34.5 | |
| Total throughput | 78.0 | | 72.6 | |
| Degree days (% of normal)* | | | | |
| Montana-Dakota | 111 | % | 99 | % |
| Cascade | 103 | % | 86 | % |
| Intermountain | 105 | % | 95 | % |
| Average cost of natural gas, including transportation, per dk | $5.86 | | $6.44 | |

* Degree days are a measure of the daily temperature-related demand for energy for heating.

Three Months Ended March 31, 2011 and 2010 Earnings at the natural gas distribution business increased $4.2 million (18 percent) due to increased retail sales volumes, largely resulting from colder weather than last year. Partially offsetting this increase was higher operation and maintenance expense of $1.4 million (after tax), primarily increased payroll and benefit-related costs.

Construction Services

| | Three Months Ended March 31, 2011 | 2010 |
|---|---|---|
| | (In millions) | |
| Operating revenues | $203.4 | $153.1 |
| Operating expenses: | | |
| Operation and maintenance | 184.9 | 141.8 |
| Depreciation, depletion and amortization | 2.9 | 3.3 |
| Taxes, other than income | 7.7 | 6.5 |
| | 195.5 | 151.6 |
| Operating income | 7.9 | 1.5 |
| Earnings | $4.6 | $.1 |

Three Months Ended March 31, 2011 and 2010 Construction services earnings increased $4.5 million primarily due to higher construction workload and margins, largely in the Western region. Also contributing to the earnings increase were higher equipment and electrical supply sales.

Pipeline and Energy Services

| | Three Months Ended March 31, 2011 | 2010 |
|---|---|---|
| | (Dollars in millions) | |
| Operating revenues | $74.0 | $88.6 |
| Operating expenses: | | |
| Purchased natural gas sold | 34.1 | 47.5 |
| Operation and maintenance | 17.6 | 15.2 |
| Depreciation, depletion and amortization | 6.4 | 6.4 |
| Taxes, other than income | 3.6 | 3.0 |
| | 61.7 | 72.1 |
| Operating income | 12.3 | 16.5 |
| Earnings | $6.9 | $8.8 |
| Transportation volumes (MMdk) | 27.3 | 30.5 |
| Gathering volumes (MMdk) | 17.5 | 19.1 |
| Customer natural gas storage balance (MMdk): | | |
| Beginning of period | 58.8 | 61.5 |
| Net injection (withdrawal) | (25.9) | (18.0) |
| End of period | 32.9 | 43.5 |

Three Months Ended March 31, 2011 and 2010 Pipeline and energy services earnings decreased $1.9 million (21 percent) due to:

- Lower gathering volumes of $700,000 (after tax)
- Decreased transportation volumes of $700,000 (after tax), largely lower volumes transported to storage, as well as lower off-system transportation volumes
- Lower storage services revenue of $400,000 (after tax)
- Lower energy-related services margins of $400,000 (after tax)

Partially offsetting the earnings decrease was an income tax benefit of $500,000 related to favorable resolution of certain income tax matters. The previous table also reflects higher operation and maintenance expense related to energy-related service projects.

Natural Gas and Oil Production

| | Three Months Ended March 31, | |
|---|---|---|
| | 2011 | 2010 |
| | (Dollars in millions, where applicable) | |
| Operating revenues: | | |
| Natural gas | $45.4 | $57.5 |
| Oil | 58.6 | 50.1 |
| | 104.0 | 107.6 |
| Operating expenses: | | |
| Operation and maintenance: | | |
| Lease operating costs | 18.0 | 15.8 |
| Gathering and transportation | 5.7 | 5.8 |
| Other | 8.3 | 8.7 |
| Depreciation, depletion and amortization | 34.2 | 29.7 |
| Taxes, other than income: | | |
| Production and property taxes | 10.1 | 9.5 |
| Other | .3 | .3 |
| | 76.6 | 69.8 |
| Operating income | 27.4 | 37.8 |
| Earnings | $16.3 | $22.2 |
| Production: | | |
| Natural gas (MMcf) | 11,758 | 12,243 |
| Oil (MBbls) | 802 | 761 |
| Total Production (MMcfe) | 16,570 | 16,808 |
| Average realized prices (including hedges): | | |
| Natural gas (per Mcf) | $3.86 | $4.70 |
| Oil (per Bbl) | $72.98 | $65.79 |
| Average realized prices (excluding hedges): | | |
| Natural gas (per Mcf) | $3.39 | $4.56 |
| Oil (per Bbl) | $79.24 | $66.40 |
| Average depreciation, depletion and amortization rate, per equivalent Mcf | $1.96 | $1.67 |
| Production costs, including taxes, per equivalent Mcf: | | |
| Lease operating costs | $1.09 | $.94 |
| Gathering and transportation | .34 | .35 |
| Production and property taxes | .61 | .56 |
| | $2.04 | $1.85 |

Three Months Ended March 31, 2011 and 2010 Natural gas and oil production earnings decreased $5.9 million (27 percent) due to:

- Lower average realized natural gas prices of 18 percent
- Higher depreciation, depletion and amortization expense of $2.8 million (after tax), due to higher depletion rates
- Increased lease operating expenses of $1.3 million (after tax), including higher well maintenance costs and costs associated with properties acquired in April 2010
- Decreased natural gas production of 4 percent, largely related to normal production declines at existing properties, partially offset by production from the Green River Basin properties, which were acquired in April 2010

Partially offsetting these decreases were:

- Higher average realized oil prices of 11 percent
- Increased oil production of 5 percent, largely related to drilling activity in the Bakken area, the previously mentioned Green River Basin properties, as well as from the South Texas properties, partially offset by normal production declines at certain existing properties

Construction Materials and Contracting

| | Three Months Ended March 31, 2011 | 2010 |
|---|---|---|
| | (Dollars in millions) | |
| Operating revenues | $143.5 | $149.8 |
| Operating expenses: | | |
| Operation and maintenance | 146.8 | 146.0 |
| Depreciation, depletion and amortization | 21.5 | 22.6 |
| Taxes, other than income | 7.7 | 7.2 |
| | 176.0 | 175.8 |
| Operating loss | (32.5) | (26.0) |
| Loss | $(21.4) | $(20.1) |
| Sales (000's): | | |
| Aggregates (tons) | 2,827 | 2,963 |
| Asphalt (tons) | 165 | 154 |
| Ready-mixed concrete (cubic yards) | 397 | 476 |

Three Months Ended March 31, 2011 and 2010 Construction materials and contracting experienced a seasonal first quarter loss of $21.4 million. This increased loss was the result of:

- Decreased construction margins of $2.5 million (after tax), primarily due to weather-related delays
- Lower earnings of $1.7 million (after tax) resulting from lower ready-mixed concrete margins and volumes, largely due to less available work, increased competition, as well as weather-related delays
- Lower earnings of $600,000 (after tax), resulting from lower aggregate volumes and margins

Partially offsetting the increased loss were:

- An income tax benefit of $2.0 million related to favorable resolution of certain income tax matters
- Lower selling, general and administrative expense of $1.4 million (after tax), largely payroll-related

Other and Intersegment Transactions
Amounts presented in the preceding tables will not agree with the Consolidated Statements of Income due to the Company's other operations and the elimination of intersegment transactions. The amounts relating to these items are as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2011 | 2010 |
| | (In millions) | |
| Other: | | |
| Operating revenues | $2.5 | $2.3 |
| Operation and maintenance | 2.9 | 1.9 |
| Depreciation, depletion and amortization | .4 | .4 |
| Taxes, other than income | .1 | .1 |
| Intersegment transactions: | | |
| Operating revenues | $53.8 | $65.3 |
| Purchased natural gas sold | 46.9 | 59.0 |
| Operation and maintenance | 6.9 | 6.3 |

For further information on intersegment eliminations, see Note 15.

PROSPECTIVE INFORMATION
The following information highlights the key growth strategies, projections and certain assumptions for the Company and its subsidiaries and other matters for certain of the Company's businesses. Many of these highlighted points are "forward-looking statements." There is no assurance that the Company's projections, including estimates for growth and changes in earnings, will in fact be achieved. Please refer to assumptions contained in this section, as well as the various important factors listed in Part II, Item 1A – Risk Factors, as well as Part I, Item 1A – Risk Factors in the 2010 Annual Report. Changes in such assumptions and factors could cause actual future results to differ materially from the Company's growth and earnings projections.

MDU Resources Group, Inc.
- Earnings per common share for 2011, diluted, are projected in the range of $1.05 to $1.30. The Company expects the approximate percentage of 2011 earnings per common share by quarter to be:
  - Second quarter – 20 percent
  - Third quarter – 35 percent
  - Fourth quarter – 25 percent

- Although near term market conditions are uncertain, the Company’s long-term compound annual growth goals on earnings per share from operations are in the range of 7 percent to 10 percent.

- The Company continually seeks opportunities to expand through strategic acquisitions and organic growth opportunities.

Electric and natural gas distribution
- In April 2010, the Company filed an application with the NDPSC for an electric rate increase, as discussed in Note 17.

- In August 2010, the Company filed an application with the MTPSC for an electric rate increase, as discussed in Note 17.

- The Company is analyzing potential projects for accommodating load growth and replacing purchased power contracts with company-owned generation. The Company is reviewing the construction of natural gas-fired combustion generation.

- The Company is pursuing opportunities associated with the potential development of high-voltage transmission lines and system enhancements targeted towards delivery of renewable energy from the wind rich regions that lie within its traditional electric service territory to major market areas. The Company has signed a contract to develop a 30-mile high-voltage power line in southeast North Dakota to move power to the electric grid from a proposed 150-MW wind farm. The proposed project will total approximately $20 million and will include substation upgrades with construction expected to begin in 2011. Its customers would not bear any of the costs associated with the project as costs will be recovered through an approved interconnect tariff. A major market party to the wind farm project has recently announced its intentions to withdraw from the project which may affect development of the associated power line by the Company.

- The South Dakota Board of Minerals and Environment has approved rules implementing the South Dakota Regional Haze Program that upon approval by the EPA will require the Big Stone Station to install and operate a BART air quality control system to reduce emissions of particulate matter, sulfur dioxide and nitrogen oxides as early as January 2016. The Company's share of the cost of this air quality control system could exceed $100 million. At this time the Company believes continuing to operate Big Stone Station with the upgrade is the best option; however, it will continue to review alternatives. The Company intends to seek recovery of costs related to the above matter in electric rates charged to customers.

Construction services

- Work backlog as of March 31, 2011, was approximately $347 million, compared to $400 million a year ago, and $373 million at December 31, 2010. The backlog includes a variety of projects such as substation and line construction, solar and other commercial, institutional and industrial projects including refinery work.

- As a result of the continued slow economic recovery, the Company anticipates margins in 2011 to be comparable to 2010 levels.

- The Company is pursuing expansion in high-voltage transmission and substation construction, renewable resource construction, governmental facilities, refinery turnaround projects and utility service work.

- The Company continues to focus on costs and efficiencies to enhance margins. Selling, general and administrative expenses are down approximately 30 percent for the trailing twelve months through March 31, 2011, compared to the annual expenses in 2008, the peak earnings year for this segment.

- With its highly skilled technical workforce, this group is prepared to take advantage of government stimulus spending on transmission infrastructure.

Pipeline and energy services

- The Company continues to pursue expansion of facilities and services offered to customers. Energy development within its geographic region, which includes portions of Colorado, Wyoming, Montana and North Dakota, is expanding, most notably the Bakken of North Dakota and eastern Montana. It owns an extensive natural gas pipeline system in the Bakken area. Ongoing energy development is expected to have many direct and indirect benefits to this business.

- The Company solicited customer interest in a 27 MMcf per day expansion of its existing natural gas pipeline in the Bakken production area in northwestern North Dakota in the first quarter of 2011. Sufficient customer interest was received to move forward on a project. It continues to solicit further interest in the expansion.

- Final agreements have been executed to construct approximately 12 miles of high pressure transmission pipeline providing takeaway capacity for processed natural gas in northwestern North Dakota. The project is expected to be completed in the fourth quarter of 2011. The Company believes it is in a good position to provide similar services for other natural gas processing facilities in the area.

- The Company has three natural gas storage fields including the largest storage field in North America located near Baker, Montana. It continues to see interest in its storage services and is pursuing a project to increase its firm deliverability from the Baker Storage field by 125 MMcf per day. The Company has received commitment on approximately 30 percent of the total potential project and is moving forward on this phase with a projected in-service date of November 2011.

Natural gas and oil production

- Capital expenditures in 2011 are expected to be $306 million. The Company continues its focus on returns by allocating a growing portion of its capital investment into the production of oil in the current commodity price environment. Its capital program reflects further exploitation of existing properties, acquisition of additional leasehold acreage, and exploratory drilling. The 2011 planned capital expenditure total does not include potential acquisitions of producing properties.

- For 2011, the Company expects a 5 percent to 10 percent increase in oil production offset by a 4 percent to 8 percent decrease in natural gas production. If natural gas prices recover, the Company believes it is positioned to spend additional capital on drilling its low cost natural gas properties.

- The Company added a second drilling rig in the Bakken in late April 2011.

- Bakken – Mountrail County, North Dakota

  - The Company owns approximately 16,000 net acres of leaseholds targeting the middle Bakken and Three Forks formations. The drilling of 12 operated and participation in various non-operated wells is planned for 2011 with approximately $52 million of capital expenditures. Plans include drilling 12 wells annually for the two-year period 2012 through 2013.

  - Over 50 future wells sites have been identified, 20 middle Bakken infill locations and the remainder Three Forks locations. Estimated gross ultimate recovery per well for the middle Bakken wells is 250,000 to 400,000 Bbls.

- Bakken – Stark County, North Dakota

  - The Company holds approximately 50,000 net exploratory leasehold acres, targeting the Three Forks formation. It anticipates drilling 6 operated wells on this acreage and participating in various non-operated wells in Stark County in 2011 with capital of approximately $37 million.