

SETTLEMENT AGREEMENT

HIGH VOLTAGE TRANSMISSION LINES-BIG STONE UNIT II

MINNESOTA PUBLIC UTILITIES COMMISSION DOCKET NO. CN-05-619

This Settlement Agreement ("Agreement") is executed by and between the electric utility companies set forth below and the Energy Planning and Advocacy function of the Minnesota Department of Commerce ("Department"). Together the aforementioned persons are regarded as the Parties ("Parties") to this Settlement Agreement ("Agreement"). The effective date of this Agreement is August 30, 2007 ("Effective Date"). The undersigned Parties recommend that the Minnesota Public Utilities Commission ("Commission") accept this Agreement and approve the Certificate of Need Application filed in the above matter, subject to this Agreement.

**Certificate of Need Proceeding Background**

A. On November 30, 2005, Otter Tail Power Company ("OTP"), Great River Energy ("GRE"), Missouri River Energy Services ("MRES") on behalf of Western Minnesota Municipal Power Agency, Montana-Dakota Utilities Co. ("MDU"), Southern Minnesota Municipal Power Agency ("SMMPA"), Central Minnesota Municipal Power Agency ("CMMPA"), and Heartland Consumers Power District ("HCPD") (hereinafter collectively referred to as "the Owners") applied to the Minnesota Public Utilities Commission ("Commission") for a Certificate of Need ("CON Proceeding") to construct two high voltage transmission lines located in Minnesota, Commission Docket No. CN-05-619, CON Application, Applicants' Exhibit 68A and 68B. The Owners with retail electric load in Minnesota are referred to as the "Minnesota Owners" and are as follows: Otter Tail Power Company, Great River Energy, Missouri River Energy Services, Southern Minnesota Municipal Power Agency, Central Minnesota Municipal Power Agency and Heartland Consumers Power District.

B. The high voltage transmission lines are proposed to connect a 630 MW supercritical, coal-fired power plant to be constructed near Big Stone City, South Dakota ("Big Stone Unit II"), adjacent to the existing Big Stone Unit I, to the transmission grid at substations located in Minnesota. The preferred option consists of a 230 kilovolt line that would run from the Big Stone 230 kV Substation in South Dakota to the Morris Substation near Morris, Minnesota, a distance of approximately 48 miles, approximately 43 miles of which would be within Minnesota (the "Morris Line"). A second line would run from a new substation at the Big Stone power plant to Granite Falls, Minnesota, a distance of approximately 90 miles, 54 miles of which would be within Minnesota (the "Granite Falls Line"). Although initially to be operated at 230kV, the Granite Falls Line would be constructed to 345 kV standards for the purpose of accommodating additional power, likely from wind generation units to be located in western Minnesota and eastern South Dakota. CON Application, Applicants' Exhibit 68A at page 72, attached as Appendix No. 1.

C. Big Stone Unit II is a supercritical, pulverized coal-fired generating plant to be built outside of Big Stone City, South Dakota, next to the existing Big Stone Unit I power plant. Big Stone Unit II is designed to have a nominal operating capacity of 630 MW (net).



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Supplemental Direct Testimony of Mark Rolfes, Applicants’ Exhibit 32, at page 10, attached as Appendix No. 2. Big Stone Unit II is designed to be a baseload facility. It will use sub-bituminous coal from the Powder River Basin in Wyoming and Montana, the same fuel presently being burned at Big Stone Unit I. CON Application, Applicants’ Exhibit 68A, at page 74 and Direct Testimony of Mark Rolfes, Applicants’ Exhibit 7, at pages 3-4, attached together as Appendix No. 3.

At the present time, each Owner’s proposed share of Big Stone Unit II is as follows:

<b>Owner</b>	<b>MW</b>	<b>Percent of Total BSII</b>
MRES	157.5 MW	25.0 %
GRE	121.8 MW	19.33 %
MDU	121.8 MW	19.33 %
OTP	121.8 MW	19.33 %
SMMPA	49.35 MW	7.8 %
CMPA	31.5 MW	5.0 %
HCPD	26.25 MW	4.2 %

The record in the CON Proceeding includes information showing that the costs for Big Stone Unit II are 10% to 18% lower than comparable lifetime costs for investor-owned utilities, and 29% to 44% lower for public power utilities compared to other baseload alternatives considered. These costs assume the following project features and are included in the CON Proceeding record (as cited below):

- Supercritical pulverized coal plant design as chosen by the Owners over alternatives for, among other reasons, its high fuel and operating efficiencies. Rebuttal Testimony of Mark Rolfes, Applicants’ Exhibit 65, at pages 2-3, attached as Appendix No. 4, and Direct Testimony of Ward Uggerud, Applicants’ Exhibit 6, at pages 13-14 and 21, attached as Appendix No. 5.
- Big Stone Unit II’s estimated average fuel efficiency (heat rate) of 8,988 MMBtu/MWh, making it 20% more fuel-efficient (and thereby producing approximately 20% less carbon dioxide per unit of electric output) than existing regional coal plants. Rebuttal Testimony of Mark Rolfes, Applicants’ Exhibit 65, at pages 1-2, attached as Appendix No. 6.
- Environmental wet scrubber equipment to serve both Big Stone Unit II and the existing Big Stone Unit I power plant, such that total SO<sub>2</sub> and NO<sub>x</sub> emissions from the plant site including both units will not exceed current emissions of Big Stone Unit I alone, while site electric output will be more than doubled. Direct Testimony of Terry Graumann, Applicants’ Exhibit 26, at pages 3-4, attached as Appendix No. 7.
- Optimized transmission lines with the Granite Falls Line built to 345 kV standards, rather than 230 kV standards that would otherwise be required to interconnect Big

Stone Unit II to the transmission grid. Together with other planned regional transmission developments, this will provide capacity for 800 MW - 1000 MW of future generation developments, likely renewable wind energy projects. Direct Testimony of Timothy Rogelstad, Applicants' Exhibit 2, at p. 4, and Dec. 5 Transcript at page 86 (Tim Rogelstad), attached as Appendix No. 8.

D. The Owners testified in the CON Proceeding that each utility's individual resource planning studies and proceedings have established a need for additional generation in the near future.

E. The Mid-Continent Area Power Pool (MAPP) 2006 Load and Capability Report predicts that continuing load growth in the Upper Midwest region will result in a deficit in summer 2011 for MAPP U.S. generating capacity even with the addition of Big Stone Unit II. Direct Testimony of Peter Koegel, Project Manager, MAPPCOR, Applicants' Exhibit 23, at page 6, attached as Appendix No. 9.

F. The Midwest Independent Transmission System Operator (MISO) testified in the CON Proceeding that the proposed transmission lines would benefit regional electric grid reliability in addition to providing optimal transmission interconnection facilities. Direct Testimony of Eric Laverty, MISO Exhibit 1, at pages 14-19, attached as Appendix No. 10.

G. The wholesale electricity generation market indicates that there is already a significant increase in the on-peak and off-peak wholesale prices of electricity; this situation supports the addition of transmission and new baseload resources as reasonable.

H. The Owners agree as part of this Agreement to install highly effective pollution control equipment to control emissions from both Big Stone Unit I and Unit II, to wit: emissions of sulfur dioxide (SO<sub>2</sub>) from Big Stone Units I and II will be controlled by a common wet flue gas desulfurization system (i.e., wet scrubber). SO<sub>2</sub> emissions from both Big Stone Unit I and Big Stone Unit II are expected to be less than 15% of the present emissions from Unit 1 alone. Emissions of nitrogen oxides (NO<sub>x</sub>) will also be reduced both by the use of a supercritical boiler and the installation of a selective catalytic reduction (SCR) NO<sub>x</sub> emission control technology on Big Stone Unit II. The sum total of the Big Stone Unit I and Big Stone Unit II NO<sub>x</sub> emissions will be equal to or less than Big Stone Unit I's historical NO<sub>x</sub> emissions. Particulate matter will be controlled by a pulse-jet fabric filter, and Owners expect 99.9% removal. Direct Testimony of Terry Graumann, Applicants' Exhibit 26, at pages 3-4, attached as Appendix No. 7.

I. The Minnesota Owners have agreed to offset 100% of the emissions of carbon dioxide from the Big Stone Unit II that are attributable to the generation of electricity for Minnesota consumers, as described below. MDU, as the only non-Minnesota Owner, does not object to this provision.

J. Action by the State of Minnesota or the federal government to address the emissions of greenhouse gases such as carbon dioxide from power plants is anticipated within the timeframe required for construction of Big Stone Unit II.

K. The Owners submitted evidence in the CON Proceeding that they have considered and analyzed other alternative forms of generation including renewables, natural gas, and integrated gasification combined cycle, and additional demand-side alternatives including additional energy conservation and concluded these other alternatives are not capable of providing a baseload resource alone or are more expensive than the proposed Big Stone Unit II (including the consideration of reasonable costs imposed by future greenhouse gas regulation). The Owners contend such alternatives cannot be constructed within the timeframes required for the additional capacity and energy to be provided by Big Stone Unit II. Direct Testimony of Jeffrey Greig, Applicants' Exhibit 25, Direct Testimony of Kiah Harris, Applicants' Exhibit 24, CON Application, Applicants' Exhibit 68A, Appendix J, Supplemental Direct Testimony of Jeffrey Greig, Applicants' Exhibits 47 and 47A. Direct Testimony of Bryan Morlock (OTP), Applicants' Exhibit 15. Direct Testimony of Stan Selander (GRE), Applicants' Exhibit 17. Direct Testimony of Robert Davis (CMMPA), Applicants' Exhibit 22. Direct Testimony of Gerald Tielke (MRES), Applicants' Exhibit 18. Direct Testimony of Hoa Nguyen (MDU), Applicants' Exhibit 19. Direct Testimony of Larry Anderson (SMMPA), Applicants' Exhibit 20. Direct Testimony of John Knofczynski (Heartland), Applicants' Exhibit 21, collectively attached as Appendix No. 11.

L. The Minnesota Owners are subject to Minnesota's Renewable Energy Standard ("RES"), codified at 216B.1691, which was enacted after the close of the record in the CON Proceeding. Minn. Laws 2007, Ch. 3. As shown in Exhibit A, pursuant to that law, according to the current load forecasts of the Minnesota Owners, the Minnesota Owners will own or purchase more than 2600 GWh per year of renewable energy by the year 2012 (equivalent to approximately 750 MW of nameplate wind capacity at a 40% annual capacity factor) and approximately 5100 GWh per year of renewable energy by the year 2020 (equivalent to approximately 1460 MW of nameplate wind capacity at a 40% annual capacity factor). As discussed below, the Owners' decision to size the Granite Falls Line at 345 kV standards may allow additional renewable power to be delivered, which may assist the Minnesota Owners and other utilities in meeting the RES.

M. Recently enacted legislation in Minnesota imposes annual energy savings goals equivalent to 1.5 % of gross retail energy sales for each individual retail provider in Minnesota through energy conservation improvement programs and rate design, energy codes and appliance standards, programs designed to transform the market or change consumer behavior, energy savings resulting from efficiency improvements to the utility infrastructure and system, and other efforts to promote energy efficiency and energy conservation. Minn. Stat. §§ 216B.2401 and 216B.241, subd.1c. Achieving these goals would mean approximately 390 GWh per year of savings in Minnesota by the Minnesota Owners by the year 2020, as set forth in Exhibit B.

N. The high voltage transmission lines that are proposed to interconnect the Big Stone Unit II are intended to and likely will provide capacity for the transport of wind energy from South Dakota and North Dakota and southwestern Minnesota to the Twin Cities and other markets. See, e.g., Direct Testimony of Timothy Rogelstad, Applicants' Exhibit 2, at page 16, attached as Appendix No. 12.

O. The Commission's Wind Integration Study (Wind Integration Study, Dec. 2006), which shows the approximate cost to the transmission system of adding wind-sourced energy to the generation load in an amount roughly equal to 25% of Minnesota's electricity sales, includes in its base case the high voltage transmission lines in this docket. This information contributes to a showing of the importance of these transmission facilities to wind development in western Minnesota.

P. The Parties agree that Minnesota needs a diverse electric resource mix in the coming years, including additional renewables, additional energy conservation, and new conventional generation facilities. Recent actions by the Minnesota Legislature and Governor with regard to the RES and increased Conservation Improvement Program (CIP) goals are important elements in this future.

The Parties agree that a diverse and balanced resource plan including the Minnesota Owners' actions toward the RES, the increased CIP impacts, and Big Stone Unit II including the high voltage transmission lines proposed in the CON Proceeding, along with other resources is reasonable and prudent. In addition to its other benefits, Big Stone Unit II will help assure electric service reliability and reasonable costs for Minnesota consumers.

Q. The Parties acknowledge that the Administrative Law Judges, in their August 15, 2007 Findings of Fact, Conclusion of Law, and Recommendation, conclude that the Owners have demonstrated compliance with all the criteria for issuance of a Certificate of Need under Minn. Stat. § 216B.243 and other applicable statutes and Minn. R. 7849.0120.

**NOW THEREFORE, THE UNDERSIGNED PARTIES HEREBY ENTER INTO THIS AGREEMENT** in Commission Docket No. CN-05-619 and recommend that the Commission issue a Certificate of Need for the proposed two high voltage transmission lines intended to interconnect the proposed Big Stone Unit II power plant in South Dakota to substations in Minnesota, subject to this Agreement.

## **1.0 JURISDICTION AND PARTIES**

1.1 *Minnesota Public Utilities Commission Jurisdiction.* The Owners have applied to the Commission for a Certificate of Need and Route Permits for the two proposed high voltage transmission lines. The Commission does not have jurisdiction to require a Certificate of Need for Big Stone Unit II.

1.2 *South Dakota Public Utilities Commission Approval.* On July 21, 2006, the South Dakota Public Utilities Commission issued an Energy Conversion Facility Permit and Route Permit for the proposed Big Stone Unit II in South Dakota. On January 16, 2007, the South Dakota Public Utilities Commission issued its order granting a permit to construct the associated transmission facilities in South Dakota. The South Dakota Public Utilities Commission does not have jurisdiction over this Certificate of Need for large energy facilities, such as these proposed transmission lines in Minnesota.

1.3 *Department of Commerce.* The Minnesota Department of Commerce is an agency of the state of Minnesota with statutory authority to represent the public interest in certificate of need and other proceedings before the Commission. The Department provides two separate and distinct roles with two separate and distinct staffs. The Department's Energy Planning and Advocacy function and staff serve as the state agency charged with advocating for the public interest and is a party to this CON Proceeding and to this Agreement. The Department's Energy Facilities Permitting function and staff do not serve as an advocate or a party in either the CON Proceeding, or in the related Route Permit proceeding, Docket No. TR-05-1275, or in this Agreement. However, the Energy Facilities Permitting staff does serve as the facilitators of the processes required in route permitting proceedings as well as ensuring that the route permitting record is complete for the Commission's decision.

1.4 *Otter Tail Power Company.* Otter Tail Power Company (OTP) is an investor-owned public utility organized under the laws of the state of Minnesota and is the utility division of Otter Tail Corporation. OTP provides electricity to over 128,000 customers throughout Minnesota, South Dakota, and North Dakota. Report and Recommendation of the Administrative Law Judges, August 15, 2007, at page 3, attached as Appendix No. 13.

1.5 *Great River Energy.* Great River Energy (GRE) is a not-for-profit generation and transmission electric cooperative headquartered in Elk River, Minnesota, which provides electrical energy and related services to 28 member distribution cooperatives in Minnesota and Wisconsin. Report and Recommendation of the Administrative Law Judges, August 15, 2007, at page 4, attached as Appendix No. 14.

1.6 *Missouri Basin Municipal Power Agency d/b/a Missouri River Energy Services.* Missouri River Energy Services (MRES) is a not-for-profit body politic and public agency organized under Iowa law and existing under the intergovernmental cooperation laws of Iowa, Minnesota, North Dakota and South Dakota. MRES is the agent for Western Minnesota Municipal Power Agency (Western Minnesota). Western Minnesota is a municipal corporation and political subdivision of the State of Minnesota, and will hold title to ownership in the Big Stone Unit II and the high voltage transmission lines proposed in the CON Proceeding, and will sell to MRES its entitlement to the power, energy and transmission capability associated with the Big Stone Unit II project. CON Application, Applicants' Exhibit 68A, at page 27, attached as Appendix No. 15, and Report and Recommendation of the Administrative Law Judges, August 15, 2007, at page 5, attached as Appendix No. 16. In addition, although not an owner of the project, Hutchinson Utilities Commission has rights to the capacity and energy of Big Stone Unit

II through a power purchase agreement with MRES. Direct Testimony of Gerald Tielke, Applicants' Exhibit 18, at pages 18-20, attached as Appendix No. 17.

1.7 *Southern Minnesota Municipal Power Agency.* Southern Minnesota Municipal Power Agency (SMMPA) is a not-for-profit municipal corporation and political subdivision of the state of Minnesota, headquartered in Rochester, Minnesota. SMMPA has 18 municipally-owned member utilities. Report and Recommendation of the Administrative Law Judges, August 15, 2007, at page 5, attached as Appendix No. 18.

1.8 *Central Minnesota Municipal Power Agency.* Central Minnesota Municipal Power Agency (CMMPA) is a not-for-profit municipal corporation and political subdivision of the state of Minnesota, headquartered in Blue Earth, Minnesota. CMMPA has 12 municipally-owned member utilities; all located in Minnesota. In addition, although not a member of CMMPA, the City of Willmar Municipal Utilities is participating in the Big Stone II project through the agency. Report and Recommendation of the Administrative Law Judges, August 15, 2007, at page 4, attached as Appendix No. 19.

1.9 *Heartland Consumers Power District.* Heartland Consumers Power District is a not-for-profit public corporation and political subdivision of the state of South Dakota, headquartered in Madison, South Dakota. Heartland supplies wholesale electric power and energy to 18 municipalities across eastern South Dakota, southwestern Minnesota, and northwestern Iowa. Report and Recommendation of the Administrative Law Judges, August 15, 2007, at page 8, attached as Appendix No. 20.

1.10 *Montana-Dakota Utilities Co.* Montana-Dakota Utilities Co. (MDU) is an investor-owned public utility that operates an integrated electric system in parts of Montana, North Dakota, and South Dakota and a separate electric system in Wyoming. MDU provides electric and natural gas services to approximately 250 communities in these states. Report and Recommendation of the Administrative Law Judges, August 15, 2007, at page 4, attached as Appendix No. 21.

## **2.0 RECOMMENDATION**

2.1 *Compliance with Applicable Criteria.* The Parties hereby stipulate and agree that the record in this matter, as supplemented by this Agreement and all provisions hereof, along with the overarching new laws regarding energy efficiency and renewable energy combine to satisfy the Department's concerns expressed in the record pertaining to the applicable criteria for a Certificate of Need for the two proposed high voltage transmission lines, including those criteria set forth in Minnesota Statutes chapter 216B and Minnesota Rules chapter 7849.

2.2 *Recommendation.* The Parties jointly recommend that the Commission issue a Certificate of Need to the Owners for the two high voltage transmission lines proposed in the CON Proceeding, subject to this Agreement and all provisions hereof.

### 3.0 FACILITIES' COST AND COST RECOVERY

3.1 *Capital Cost of Transmission Lines.* The Owners estimate that the cost of the proposed high voltage transmission lines, including all substation costs with the exception of the 345 kV substation in South Dakota and the conversion of the Canby substation to 345 kV standards, is \$109.8 million (in 2006 dollars), and not including costs for transmission facilities required to provide Delivery Service, for permitting, or for additional transmission studies and agreements. Report and Recommendation of the Administrative Law Judges, August 15, 2007, at pages 18-20, attached as Appendix 22. The CON Proceeding record indicates that the costs will increase by approximately 6% for each year that construction is delayed past the estimated in-service date.

3.2 *Capital Cost of Big Stone Unit II.* The cost of Big Stone Unit II, as presented by the Owners in the CON Proceeding, exclusive of transmission costs, was estimated to be \$1.4 billion based on a April 2012 commercial operation date ("COD"). The record indicates that the costs will increase by approximately 6% for each year that construction is delayed past the estimated in-service date. Report and Recommendation of the Administrative Law Judges, August 15, 2007, at page 17, attached as Appendix No. 23. Attached as Appendix No. 24, is a schedule that shows the cost of Big Stone Unit II on a monthly basis up to and through a proposed commercial operation date of April 2012.

3.3 *Operating Costs.* The estimated levelized annual cost over the lifetime of Big Stone Unit II, assuming the first full year of operation and a January 2012 COD, ranges from \$69.6 to \$74.5 per MWh for investor-owned utilities, to \$56.4 to \$61.2 per MWh for public power utilities. Supplemental Direct Testimony of Jeffrey Greig, Applicants' Exhibit 47, at pages 11-12, attached as Appendix 25. The cost per unit of output from Big Stone Unit II, including costs for both the plant and its transmission, will vary among the Owners depending upon their financing arrangements, capital structure, and other factors. See, e.g., Revised Analysis of Baseload Generation Alternatives, Applicants' Exhibit 47A, attached as Appendix No. 26.

3.4 *Final Capital Costs.* Within fourteen (14) months of Big Stone Unit II's COD, the Minnesota Owners will file a written report with the Commission and the Department containing the actual capital costs of the high voltage transmission lines and Big Stone Unit II and comparing the actual costs with the estimated costs set forth above and explaining the reasons for any differences. Reporting the costs, as required in this paragraph, contributes to but does not fulfill the Owners' obligation to demonstrate that the actual capital costs were reasonably and prudently incurred for purposes of cost recovery as contemplated in section 3.6 below.

3.5 *Periodic Reports.* The Minnesota Owners will report to the Commission and the Department on the annual costs (\$/MWh) for each Minnesota Owner based on actual costs for the preceding twelve months and levelized lifetime carrying charges on the actual investment in the project, including Unit II and the transmission lines. The first report shall be due within

thirty days after the first anniversary of Big Stone Unit II COD, and the Minnesota Owners shall file such a report along with the reporting requirements set forth in section 3.4, for a period of four (4) additional years.

3.6 *Cost Recovery.* The commitments made or to be made by the Owners with respect to this Agreement are made on the expectation that OTP and MDU will obtain cost recovery from the state commissions having jurisdiction of all reasonable and prudent costs and expenditures through a rate case, tariff, rate rider, or other applicable cost or rate recovery mechanism.

Costs attributed to Big Stone Unit II or the proposed high voltage transmission lines shall be set forth separately and distinctly in all applicable cost recovery requests to the Commission, accompanied by supporting documentation.

3.7 *Department Support of Cost Recovery.* The Department will support OTP's recovery of all reasonable and prudent costs and expenditures as long as they are materially consistent with the costs described in sections 3.1, 3.2, and 3.3, and with costs reasonably attributable to the actions required by sections 4.0, 5.0, and 7.0 (unless otherwise recovered through a separate rate recovery mechanism).

#### 4.0 OFFSETS OF GREENHOUSE GAS EMISSIONS

4.1 *100% of Minnesota-Attributable Emission Offsets.* Using the offset methods set forth in section 4.3, the Minnesota Owners agree to offset 100% of the carbon dioxide emissions attributable to the generation of electricity at Big Stone Unit II for customers in Minnesota. For the purposes of this Agreement, the portion of energy output from Big Stone Unit II attributable to a Minnesota Owner's Minnesota customers in a given time period will be the Minnesota Owner's share of the output of Big Stone Unit II expressed in MWh multiplied by the ratio that the Minnesota Owner's Minnesota retail electric energy obligations in that time period bears to the Minnesota Owner's total retail electric energy obligations in the time period.

For example, for a given time period:

$$EO_{MN} = EO_{TOTAL} \times \left[ \frac{Retail_{MN}}{Retail_{TOTAL}} \right]$$

Where:

$EO_{MN}$  = The portion of energy output (in MWh) from Big Stone II attributable to a Minnesota Owner's Minnesota customers;

$EO_{TOTAL}$  = The Minnesota Owner's share of the output of Big Stone Unit II (in MWh);

Retail<sub>MN</sub> = The Minnesota Owner's Minnesota retail electric energy obligations (in MWh);  
and

Retail<sub>TOTAL</sub> = The Minnesota Owner's total retail electric energy obligations (in MWh).

4.2 *Timing and Calculation of Emissions to be Offset.*

4.2.1 *Offsets May Be Secured Ahead of Operations.* The Minnesota Owners may secure offsets using the methods in sections 4.3 at any time, but as soon as Big Stone Unit II begins commercial operation, the offsets must be made within one year of the emissions. The Minnesota Owners may secure offsets of future Big Stone Unit II carbon dioxide emissions prior to the COD of Big Stone Unit II, and may use offsets secured prior to the Unit's commercial operation date to offset future emissions.

4.2.2 *First Year of Operation.* Six months prior to the COD of Big Stone Unit II, the Minnesota Owners will forecast the amount of carbon dioxide that is projected to be emitted by Big Stone Unit II along with the Minnesota Owners' projected method(s) for obtaining offsets for carbon dioxide for the first twelve-months of operation and will request verification of the Minnesota Pollution Control Agency ("MPCA") of said emission and offset amounts, and will advise the Commission and Department of their actions.

4.2.3 *After Operations Have Begun.* As part of the Greenhouse Gas Management Plan under section 4.11, the Minnesota Owners will determine how many tons of carbon dioxide were emitted to generate electricity for their Minnesota customers in the previous twelve months and report this figure along with its estimated offset costs to the Commission, MPCA, and the Department. This amount will be the amount of carbon dioxide that will be used as the baseline forecast for offsets to be procured in the next ensuing twelve-month period, subject to reasonable adjustments based on actual operating history of Big Stone Unit II and other factors, as approved by the Commission.

4.2.4 *"Extra" Offsets Carry-Forward.* Any offsets obtained in one year that are greater than the emissions associated with serving customers in Minnesota for that year may be credited towards the offsets needed in the subsequent year or years unless they are sold, traded or otherwise transferred. In the event the credits are sold, traded, or otherwise transferred, any funds received from the sale by OTP (or any future utility or entity to which this Agreement applies and whose rates are regulated by the Commission) will be used for carbon offsets in subsequent years or credited to OTP's customers (or the customers of any future utility or entity to which this Agreement applies and whose rates are regulated by the Commission), as applicable.

4.2.5 *Emission Offset Calculation Termination.* The Minnesota Owners will continue the process set forth in sections 4.2.1 to 4.2.4 until this requirement is terminated pursuant to section 4.10.

4.3 *Offset Methods.* At the option of the Minnesota Owners, the carbon dioxide offsets required in section 4.1 may be achieved by any one or a combination of the following methods, with the goal being to achieve permanent (or at a minimum permanent during the entire specified time period the purchased credits are intended to apply), quantifiable, verifiable, and enforceable reductions in greenhouse gas emissions that would not otherwise have occurred:

- a. Capture and sequestration;
- b. Emission reductions in any of the Minnesota Owners' existing power plants or through other, verifiable efficiency improvements on the Minnesota Owners' systems that result in reductions in carbon dioxide emissions;
- c. Trading on a recognized Greenhouse Gas ("GHG") exchange, consistent with section 4.4;
- d. Purchases of carbon credits from a credible offset program, consistent with section 4.5;
- e. Setting aside funds, consistent with section 4.6, in a separate, readily identifiable account on the Minnesota Owners' books of an amount equal to \$10.00 per ton of carbon dioxide emissions;
- f. Making investment in transmission that the Commission certifies will enhance renewable energy development, consistent with section 4.7;
- g. Adding renewable energy beyond any amount required by law, consistent with section 4.8;
- h. Achieving energy efficiency savings beyond any amount required by law, consistent with section 4.9; or
- i. Any other method the Commission concludes will result in economic offsets that will achieve permanent, quantifiable, verifiable, and enforceable reductions in greenhouse gas emissions that would not otherwise have occurred.

4.4 *Carbon Trading.* If the Minnesota Owners offset greenhouse gas emissions through an established carbon trading exchange pursuant to section 4.3(c) above, the Minnesota Owners will inform the Commission and the Department of the exchange(s) to be used. While the presumption is that any exchange recognized by a state or federal government is acceptable, the Minnesota Owners have the burden of proving that this offset option should be recognized as credible in Minnesota, with the exception that the Parties agree that the Oregon Climate Trust and the Chicago Climate Exchange (CCX) and its successors are already acceptable without further proof by the Minnesota Owners. Any profits, interest or carrying charges on the monies

received by OTP (or by any future Minnesota-regulated utility to which this Agreement applies) from carbon trading will be credited to OTP's ratepayers (or the ratepayers of any Minnesota-regulated utility to which this Agreement applies) or be deposited into the carbon offset fund established in section 4.6.

4.5 *Purchase of Carbon Credits.* If the Minnesota Owners offset greenhouse gas emissions through the purchase of carbon credits pursuant to section 4.3(d), the Minnesota Owners will inform the Commission and the Department of the program to be used. The Minnesota Owners will show that the program chosen will result in permanent (or at a minimum permanent during the entire specified time period the purchased credits are intended to apply), verifiable, quantifiable and enforceable reductions in greenhouse gas emissions.

4.6 *Carbon Offset Fund.* If the Minnesota Owners offset their greenhouse gas (i.e., carbon dioxide) emissions through payment of a specified sum per ton of carbon dioxide emissions pursuant to section 4.3(e), the Owners will inform the Commission and the Department of their election to do so, amounts paid, amount of carbon dioxide offset in this manner, and of the specifics of the accounts established. Each Owner may elect to establish its own account, or two or more Minnesota Owners may join together to establish one account jointly. No one Owner shall be a party to more than one account.

4.6.1 *Use of Funds.* Funds set aside pursuant to section 4.3(e) above, and any interest or carrying charges earned thereon, must be used by the Minnesota Owners only for offset methods identified in section 4.3 or research and development projects supporting the offset methods identified in section 4.3 for use by the Minnesota Owners. The Minnesota Owners will advise the Commission and the Department of the expenditure of any of these funds and the balance of the account, in the Greenhouse Gas Management Plan submitted in accordance with section 4.11.

4.6.2 *Accounting Practices and Review.* The Minnesota Owners agree that any accounts established and any account activity pursuant to this section 4.6 will be subject to reasonable accounting methods and to review by the Commission and the Department.

4.7 *Transmission Investments for Renewables.* The Minnesota Owners may seek to obtain offsets of greenhouse gas (i.e., carbon dioxide) emissions for each of the years in which the Minnesota Owners' incremental investment in transmission facilities enhances either the quantity or timing of renewable energy development beyond that which would have otherwise occurred. The Minnesota Owners will ask the Commission to determine in a later proceeding the amount of offset credit, if any. The Minnesota Owners will file with the Commission a proposed offset credit method for purposes of this section 4.7 within two years following Commission approval of the Certificate of Need in this matter. The offset method may include the following formula: if a utility's fixed charge rate is 12% and the utility's aggregate investment in a single project or number of projects is \$7,000,000, then the utility will have an annual carbon offset credit of 84,000 tons (calculated as  $\$7,000,000 \times 0.12 = \$840,000 / \$10/\text{ton} = 84,000$  tons of carbon offset).

4.8 *Renewable Energy Investments.* The Minnesota Owners will be eligible to obtain offsets of greenhouse gas (i.e., carbon dioxide) emissions for each of the calendar years in which the Minnesota Owners add renewable energy in amounts beyond that required by law. These amounts will be determined by comparing the actual renewable energy achieved in any calendar year with the renewable energy requirements under the RES. The Parties agree that the Minnesota Owners shall be eligible for offsets on a MWh for MWh basis for any renewable energy the Minnesota Owners generate or otherwise obtain in excess of those levels required by the Minnesota RES. The Minnesota Owners will report to the Commission, as part of the Greenhouse Gas Management Plan under section 4.11, the actual amount of offsets.

4.9 *Energy Efficiency Investments.* The Minnesota Owners will be eligible to obtain offsets of greenhouse gas (i.e., carbon dioxide) emissions for each of the calendar years in which the Minnesota Owners, their distribution member systems, or both, make energy efficiency improvements in amounts beyond that required by law. These amounts will be determined by comparing the actual energy efficiency (kWh) impacts achieved in a particular calendar year, as determined by the Commissioner of the Department of Commerce, with the energy efficiency savings required by applicable law. Based on this determination, the Parties agree that the Minnesota Owners shall be eligible for offsets on a MWh-for-MWh basis for any energy efficiency impacts the Minnesota Owners achieve in excess of those levels required by Minnesota law. The Minnesota Owners will report to the Commission, as part of the Greenhouse Gas Management Plan under section 4.11, the actual amount of offsets.

4.10 *Termination of Offset Requirement.* The Parties agree that the greenhouse gas emissions offset requirement of section 4.1 will continue until the earlier of (1) the date on which a Minnesota or federal greenhouse gas (“GHG”) program intended to reduce the increase of GHG emissions has been implemented (and which program applies to GHG emissions from Big Stone Unit II), or (2) four (4) years after the Big Stone Unit II COD if a Minnesota or federal GHG program intended to reduce the increase of GHG emissions has not been adopted and implemented by that date. Upon the termination of the Minnesota Owners’ greenhouse gas emissions offset obligations under this section 4.0, the Minnesota Owners are obligated to provide the offsets for any emissions occurring prior to the termination date that have not yet been offset. It is the Parties’ understanding that the Minnesota Owners will not be obligated to offset GHG emissions under both a Minnesota and federal GHG program at the same time that the Minnesota Owners are required to make offsets under the terms of this Agreement. That is, the Minnesota Owners will be required to offset GHG emissions only according to the terms of this Agreement or either (1) a federal GHG program or (2) a Minnesota GHG program and provided the program applies to GHG emissions from Big Stone Unit II.

4.11 *Greenhouse Gas (GHG) Management Plan.* The Minnesota Owners agree that beginning fourteen (14) months from the Big Stone Unit II COD and annually thereafter until terminated according to section 4.10, the Minnesota Owners, individually or collectively, will submit a GHG Management Plan to the Commission, the MPCA, and the Department that will report the status of carbon dioxide offsets required under this Agreement in the previous year as well as any emissions occurring prior to the filing of the GHG Management Plan that have not

yet been offset, and describe the Minnesota Owners' efforts to offset greenhouse gas emissions (i.e., carbon dioxide) in the upcoming year or years. The GHG Management Plan will also be used to verify GHG offsets that have been made in the past, and to review and approve the expenditure of funds as contemplated in section 4.1.

## **5.0 CONTROL OF MERCURY EMISSIONS**

The Owners will control mercury emissions from Big Stone Unit I and Unit II through use of a wet scrubber and also through use of a pulse jet fabric filter. The Owners also agree to install such other control equipment so as to control emissions of mercury from both Big Stone Unit I and Unit II such that the control equipment is equivalent to what is required of certain large generating facilities in Minnesota (*i.e.*, Sherco, and Clay Boswell) under the Mercury Emission Reduction Act of 2006 (Minnesota Statutes §§ 216B.68 to 216B.688) and that is most likely to result in the removal of at least 90 percent of the mercury emitted from the units. The Owners agree to act in good faith to install such equipment as expeditiously as possible, but the parties recognize that given the construction schedule and commercial operation date of Big Stone Unit II, the Owners have until four (4) years after the commercial operation date of Big Stone Unit II for the Owners to achieve compliance with these requirements. On the same dates as required for the GHG Management Plan under section 4.11 above, or until the mercury control goal set forth in this section 5.0 is met, the Owners will also provide a report to the Commission and the Department on the progress of meeting the mercury control goal.

## **6.0 PROTECTION OF BIG STONE LAKE**

Big Stone Lake is a treasured natural resource of both South Dakota and Minnesota. It is also important to the operation of the Big Stone Units I and II. As a result, the Owners understand the importance of not adversely affecting the long-term level or flow of the lake. Accordingly, the Owners agree to:

- utilize groundwater for drought protection at the Big Stone Unit II;
- provide to the South Dakota Department of Environment and Natural Resources (“SDDENR”) and the Minnesota Department of Natural Resources (“MNDNR”) by June 27, 2007 and will provide, on an on-going basis, all data used to evaluate the Veblen aquifer and the effect on Big Stone Lake of extended groundwater withdrawal;
- provide to the SDDENR and the MNDNR by June 27, 2007 and will provide, on an on-going basis, all data used to evaluate the effect on the Minnesota River of an extended period of withdrawal of water from Big Stone Lake;
- support the granting of party status to the Minnesota Department of Natural Resources before the South Dakota Water Management Board (“WMB”) in its requested Water Permit No 6846-3; and

- perform tests on the groundwater supply to evaluate well production and impacts relative to the modeling conducted pursuant to Water Permit No. 6846-3, consistent with the Owners' actual construction schedule and process for Big Stone Unit II.

The Owners have participated in meetings between the staffs of the SDDENR and MNDNR to work through the data prior to the July 11, 2007 WMB hearing on Water Permit No. 6846-3.

If the groundwater tests performed by the Owners as part of its construction of Big Stone Unit II differ materially from the models relied on by the Owners in the Water Permit No. 6846-3 before the WMB, the Owners understand that the MNDNR may request and that the WMB may reconsider the terms and conditions of Water Permit No. 6846-3, should it be granted in the first place.

Finally, the Owners also believe that long-term management of Big Stone Lake can best be done through organized, frequent communications between the two states and urges the two states to establish such communications by December 31, 2007. To that end, the Owners agree when asked by the state agencies, to constructively participate in meetings to address the management of the Big Stone Lake water flow and level issues.

## **7.0 RENEWABLES**

*7.1 Renewable Energy Standard.* The Minnesota Owners understand and are subject to Minnesota Statutes § 216B.1691 (2007), that direct utilities in Minnesota to obtain from renewable resources seven percent (7%) of their total retail electric sales to retail customers in Minnesota by the end of 2010; twelve percent (12%) by 2012; seventeen percent (17%) by 2016; 20 percent (20%) by 2020; and twenty-five percent (25%) by 2025. The Department expects that the Minnesota Owners will meet these obligations.

*7.2 Community-Based Energy Development.* The Minnesota Owners commit to own or procure from C-BED projects no less than twenty-four percent (24%) of their individual RES obligations for the year 2012 expressed on an annual energy basis, subject to commercially reasonable contract terms and price. The Minnesota Owners will achieve this level of C-BED energy output no later than four years following the Big Stone Unit II COD.

Although any C-BED qualified renewable technology may be used to fulfill this energy commitment, for purposes of illustration based on current load forecasts of the Minnesota Owners for the year 2012 this annual energy commitment would be equivalent to the output of 180 MW of C-BED wind energy projects, assuming an annual wind capacity factor of 40%. The actual amount of energy from C-BED projects will be determined by the Minnesota Owners' actual RES obligations in 2012, expressed on an annual energy basis. The actual megawatts of C-BED capacity will be based on the actual RES energy obligations of the Minnesota Owners in 2012, and on the types of qualifying C-BED projects chosen to fulfill this C-BED energy commitment.

The Minnesota Owners may fulfill this C-BED commitment either as individual utilities or in aggregate. All C-BED commitments will be accomplished as part of, and not in addition to, the Minnesota Owners' RES obligations.

In addition to this 24% of RES commitment, the Minnesota Owners will take reasonable steps to identify additional C-BED projects that can meet the Minnesota Owners' cost and reliability requirements to satisfy a portion of the Owners' RES obligations under Minnesota Statutes, section 216B.1691. The Minnesota Owners will file reports with the Department by July 1, of 2013 and 2018 describing how these C-BED commitments are being fulfilled.

## **8.0 ENERGY EFFICIENCY AND CONSERVATION**

8.1 *Compliance with the Conservation Improvement Program Goal.* The Minnesota Owners understand and are subject to Minnesota Statutes §§ 216B.2401 and 216B.241 (2007). The Department expects that the Minnesota Owners will meet these obligations. By June 1, 2008, the Minnesota Owners will file with the Department a plan describing how each utility (and its members for GRE, SMMPA, MRES, and CMMPA) intends to meet its energy savings goal.

8.2 *Aggregated DSM.* SMMPA, CMMPA, MRES, and GRE will strive to aggregate the DSM filings of their respective Minnesota members. For example, SMMPA will strive to aggregate the DSM filings of its members, GRE its members, etc.

8.3 *Water Heater Incentives.* The Owners who have established electric water heater incentives greater than \$50 per heater that are not part of a DSM program shall terminate such programs by July 1, 2008. The Minnesota Owners will work in good faith with any of their Minnesota members who also have such programs to eliminate such programs by July 1, 2010.

8.4 *Elimination of Block Rates.* OTP shall propose the phased elimination of its declining block rate program in its next Minnesota rate case.

## **9.0 GENERAL TERMS AND CONDITIONS**

9.1 *Entire Agreement.* This Settlement Agreement constitutes the entire agreement and understanding between the Parties pertaining to the resolution of this matter.

9.2 *Not Precedential.* The Parties agree that no precedent is established by the resolution of issues made in this Agreement. The resolutions reached herein are for settlement purposes only and do not necessarily represent the positions the Parties would take in litigation, the Owners' respective Integrated Resource Plans (IRP), or otherwise. The Parties will not use this Agreement as evidence for impeachment of a party in any future proceeding before the Commission or for use in any other administrative or judicial body.

9.3 *Not Admissible.* Unless the Commission approves this Agreement, this Agreement, and any statements made in furtherance thereof, shall not be admissible in evidence in this proceeding or in any other administrative or judicial proceeding.

9.4 *Terms Binding on Project Participants; Assignment.* The commitments and obligations of the Owners have application to, and are binding on, only those individual Owners so long as the utility is an Owner of the Big Stone Unit II or otherwise has entitlement to the capacity and energy from Big Stone Unit II. No individual Owner is responsible for the obligations of any other individual Owner, unless the Owner agrees in writing to assume the obligations of another Owner or former Owner. Within thirty days of the execution of any changes to the ownership structure for either Big Stone Unit II or the transmission facilities at issue in this docket, the Owners will notify the Commission and the Department of the change and provide any regulatory filings that may be applicable to the change. This Agreement and all provisions hereof is binding upon and inure to the benefit of the Parties and their respective successors and assigns.

9.5 *Commission Action; No Construction.* In the event the Commission disapproves this Agreement or takes other action inconsistent with this Agreement, or changes materially the terms of this Agreement as a condition to its acceptance, or if the Commission does not approve the needed Route Permits for the proposed transmission facilities in Minnesota in Docket #TR-05-1275, or if the Big Stone Unit II generating plant is not constructed for any reason, all Parties retain the right to treat this Agreement as null and void, or to seek reconsideration to modify their positions. Each party shall notify the other parties and the Commission of its intention regarding this Agreement in such event.

9.6 *Amendment.* No amendment to this Agreement is effective unless in writing and signed by all the Parties.

9.7 *Preparation of the Agreement.* All parties to this Agreement have had the opportunity to participate in the drafting of the document. There shall be no legal presumption that any specific party was the drafter of any particular provision.

9.8 *Authority.* The signatory for each organization entering into this Agreement has the necessary authority to bind the party and agrees to be bound by the Agreement in the future.

9.9 *Counterparts.* This Agreement may be signed in counterparts.

SETTLEMENT AGREEMENT  
EXECUTION COPY  
MPUC DOCKET Nos. CN-05-619

Agreed to by the following Parties:

Edward A. Garvey Dated 8/30/07  
Minnesota Department of Commerce  
Edward A. Garvey  
Deputy Commissioner – Energy and  
Telecommunications Division

\_\_\_\_\_ Dated \_\_\_\_\_  
Otter Tail Power Company  
Chuck MacFarlane  
President

\_\_\_\_\_ Dated \_\_\_\_\_  
Great River Energy  
David Saggau  
Chief Executive Officer

\_\_\_\_\_ Dated \_\_\_\_\_  
Missouri River Energy Services  
Thomas J. Heller  
Chief Executive Officer

\_\_\_\_\_ Dated \_\_\_\_\_  
Southern Minnesota Municipal Power Agency  
Ray Hayward  
Chief Executive Officer

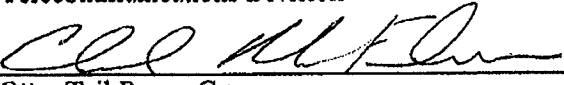
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Robert Elston  
President

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Heartland Consumers Power District  
Mike McDowell  
Chief Executive Officer

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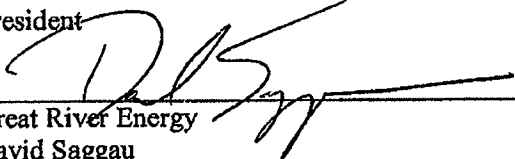
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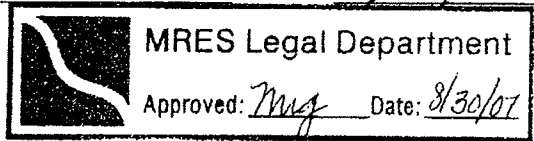
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<i>Raymond H. Hayward</i>	Dated 8/30/07
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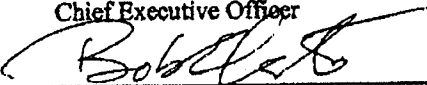
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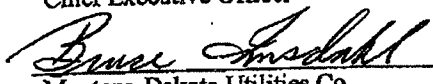
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Montana-Dakota Utilities Co.  
Bruce Insdahl  
Chief Executive Officer

**Exhibit A**  
**Current Energy Forecasts and Renewable Energy Standard Obligations**  
**of the Minnesota Owners<sup>1</sup> in the Years 2012 and 2020**

<b>Big Stone II Owner</b>	<b>Minnesota Retail Load in 2012 (GWh)</b>	<b>Renewable Energy Standard Obligation in 2012<sup>2</sup> (GWh)</b>	<b>Minnesota Retail Load in 2020 (GWh)</b>	<b>Renewable Energy Standard Obligation in 2020<sup>3</sup> (GWh)</b>
CMMPA	588	71	777	155
GRE	12,868	1,544	14,937	2987
Heartland	836	100	493	99
MRES	1,603	192	2,340	468
OTP	2,489	299	2,860	572
SMMPA	<u>3,536</u>	<u>424</u>	<u>4,158</u>	832
<b>Total</b>	<b>21,920</b>	<b>2,630</b>	<b>25,565</b>	<b>5,113</b>

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<sup>1</sup> Montana-Dakota Utilities (MDU) has no retail electric load in Minnesota.

<sup>2</sup> 2012 RES obligation calculated at 12% of Minnesota retail load.

<sup>3</sup> 2020 RES obligation calculated at 20% of Minnesota retail load.

**Exhibit B**  
**Current Energy Forecasts and Legislative CIP Goals**  
**for the Minnesota Owners<sup>4</sup> in 2020**

<b>Big Stone II Owner</b>	<b>Minnesota Retail Load in 2020 (GWh)</b>	<b>CIP Goal in Year 2020<sup>5</sup> (GWh/year)</b>
CMMPA <sup>6</sup>	1,181	18
GRE	14,937	224
Heartland	493	7
MRES	2,340	35
OTP	2,860	43
SMMPA	<u>4,158</u>	<u>62</u>
<b>Total</b>	<b>25,969</b>	<b>390</b>

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<sup>4</sup> Montana-Dakota Utilities (MDU) has no retail load in Minnesota.

<sup>5</sup> 2020 CIP goal calculated at 1.5% of Minnesota retail load.

<sup>6</sup> CMMPA forecast includes Willmar Municipal Utilities for purposes of illustrating CIP goals.