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May 30, 2008

VIA REGULAR MAIL & EMAIL

Illona Jeffcoat-Sacco
Executive Secretary
North Dakota Public Service Commission
State Capitol
Bismarck, ND 58505

**Re: Montana Dakota Utilities Co., and Otter Tail Corporation; Advance
Determination of Prudence, Big Stone II Generating Station
Case Nos. PU-06-481 and PU-06-482**

Dear Ms. Jeffcoat-Sacco:

Enclosed for filing in the above matter please find an original and seven copies of the Applicants' Reply Brief along with an Affidavit of Service.

Please direct any questions to Montana-Dakota's Mr. Daniel Kuntz (701-530-1016), Otter Tail's Mr. Mark Bring (218-998-7152), or to the undersigned.

Thank you for your consideration.

Very truly yours,

Todd Guerrero

Todd J. Guerrero

Kas

TJG/kas
cc: Attached Service List (w/encl.)

332 PU-06-482 Filed: 5/30/2008 Pages: 18
Applicants Reply Brief

Applicants
Lindquist & Vennum, Todd Guerrero

327 PU-06-481 Filed: 5/30/2008 Pages: 18
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Lindquist & Vennum, Tod Guerrero

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Montana-Dakota Utilities Co., and
Otter Tail Corporation;
Advance Determination of Prudence
Big Stone II Generating Station

Case No. PU-06-481
Case No. PU-06-482

REPLY BRIEF OF APPLICANTS
MONTANA-DAKOTA UTILITIES CO. AND
OTTER TAIL CORPORATION

May 30, 2008

TABLE OF CONTENTS

I.	INTRODUCTION	3
II.	THERE IS NO MORE PRUDENT OR REASONABLE ALTERNATIVE TO BIG STONE II	4
III.	APPLICANTS' COMPUTER MODELING WAS CONDUCTED USING REASONABLE ASSUMPTIONS.	6
IV.	COAL SUPPLY AND TRANSPORTATION TO BIG STONE UNIT II HAVE BEEN ACCURATELY AND RELIABLY FORECAST.....	8
V.	POSSIBLE FUTURE CO2 REGULATIONS WERE REASONABLY CONSIDERED TO THE EXTENT ALLOWED UNDER NORTH DAKOTA LAW.....	8
VI.	IT IS AN APPROPRIATE TIME FOR THE NORTH DAKOTA PUBLIC SERVICE COMMISSION TO MAKE A PRUDENCE DETERMINATION REGARDING BIG STONE II.....	9
VII.	CONCLUSION.....	11

I. INTRODUCTION

Intervenors Dakota Resource Council and Mark Trechock (collectively DRC) argue that this application for an advanced determination of prudence should be denied because Applicants “have not even attempted to make a North Dakota-specific showing of benefits”¹ Coming from an intervenor whose arguments would effectively halt all future coal development, DRC’s newly found concern for North Dakota’s interests is curious at best. Importantly, however, DRC once again misses the central point. The question is not whether Applicants’ proposed power plant and related transmission lines will create specific “benefits” for North Dakota, South Dakota, or any other state for that matter.² The issue is whether Applicants, acting in good faith, have identified a resource option that is both prudent and reasonable. With energy shortages looming for both Applicants and the region, and with real-world, cost-effective alternatives limited, Applicants submit that their proposal meets that test.

As it did last summer,³ Advocacy Staff continues to agree that Big Stone II is a reasonable and prudent choice.⁴

¹ Intervenors’ Post-Hearing Brief, May 21, 2008, p. 1.

² As Advocacy Staff’s expert Terry Deason clarified last summer, a prudence decision is not based on the location in which the investment is made, i.e., whether the economic “benefits” accrue to one state versus another. Instead, it is based on whether the utility attempted to find the most reliable and economic resource for its customers. “[L]et me say that I believe that the role of a utility regulator is to look at the prudence of decisions, to look at the way a utility can most reliably and cost-effectively provide service to its customers. If that means building a facility within the confines of the state, or even outside the state, so be it. I believe the economic future of the citizens of a state is best served by the least-cost, most reliable source of generation, regardless of where the source is located.” TR. Vol. III, p. 702, lines 1-12 (Deason).

³ Advocacy Staff Post Hearing Brief at Recommendation (“Advocacy staff recommends granting approval of OTP’s and MDU’s applications for advance determination of prudence.”)

⁴ Tr. Vol. III, at p. 1488, lines 9-14 (“My review concludes that the applicants have demonstrated that a downsized version of Big Stone II is a cost-effective means to meet their need for additional baseload generation subject to the conditions and additional explanation and clarification.”) (Deason).

II. THERE IS NO MORE PRUDENT OR REASONABLE ALTERNATIVE TO BIG STONE II

DRC, like the other intervenors who engaged Mr. Schlissel to oppose the Big Stone II Project in both South Dakota and Minnesota, posits a false choice between (1) a super-critical pulverized coal plant capable of providing baseload generation and (2) a theoretical “wind/gas” combination with only a “small amount” of natural gas. The Commission understands that such a choice does not exist in the real world. Reliable baseload capacity simply cannot be cost-effectively provided with renewable resources alone. The only real alternative to Big Stone II is a large amount of natural gas. As Applicants pointed out in their May 19, 2008, Brief, moving to natural gas instead of coal to provide baseload energy would be a mistake.

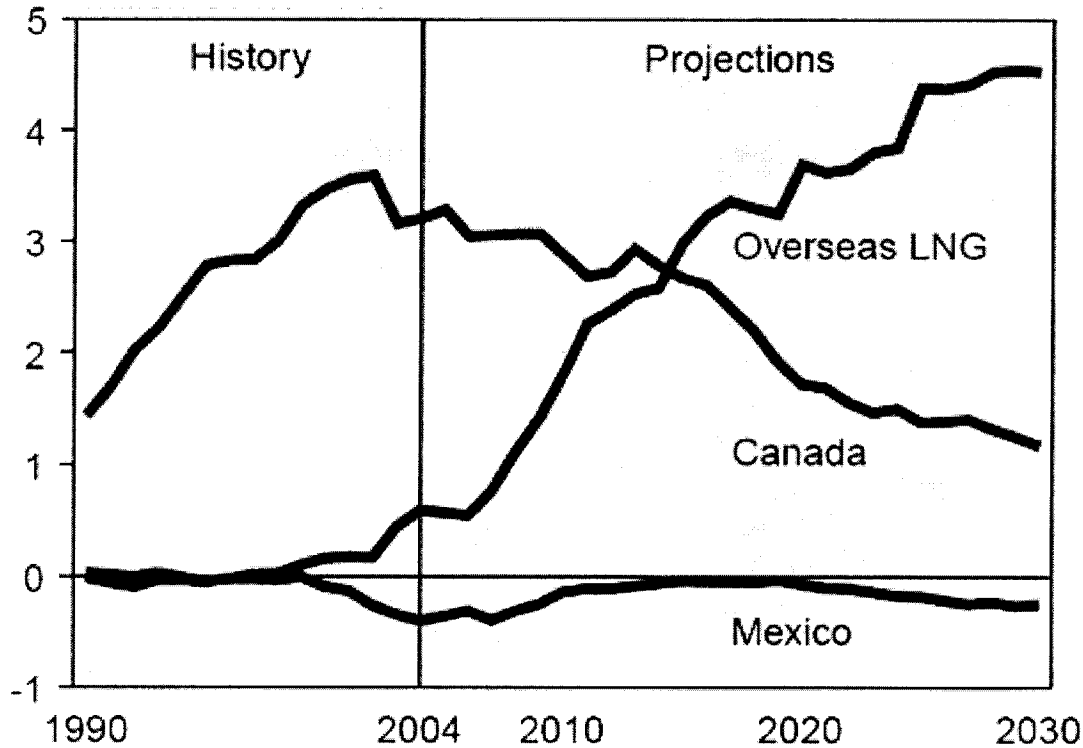
Over-reliance on natural gas for power generation is risky because natural gas prices are continuing to escalate sharply and will likely far exceed the conservative \$7 to \$8 value that the Applicants used to model natural gas prices in this proceeding. The danger of further price increases will expand in the future if greater reliance is placed on natural gas to meet the country’s energy needs. A short recitation of some of the points addressed by Applicants’ expert witness Daniel Klein is appropriate here to illustrate the risks associated with relying on natural gas for electricity generation.⁵

During a period in which the country is faced with a clear need for energy independence, the United States is significantly increasing its reliance on non-North American imports of natural gas transported in the form of liquefied natural gas (LNG). Because North American natural gas production is flat or declining, and because across the country electric generators have built hundreds of thousands of megawatts of new natural gas generation, new gas demand is increasingly being met and is projected to be met with overseas gas supply. The graph below,

⁵ See OTP/MDU Ex. 341 (Klein).

prepared by Mr. Klein, shows the increasing amount of LNG that is being imported into this country.⁶

EXHIBIT 2
U.S. NET IMPORTS OF NATURAL GAS BY SOURCE, 1990-2030
(trillion cubic feet)



As a result, whereas in the past natural gas prices in the U.S. were not tied to world natural gas prices, increasingly they are. The U.S. now competes for natural gas supplies with the emerging economies of China, India and other developing nations, as well as Europe and Japan. Just as increased energy demand from the emerging economies has driven oil prices to record levels, the same effect is being experienced by natural gas prices.

⁶ OTP/MDU Ex. 344 (Klein).

Moreover, because many of the countries that are leading LNG suppliers are not friendly to the U.S., concern is growing that natural gas pricing will be set by political as well as economic factors and that the country could be exposed to the same type of natural gas supply disruptions as occurred to oil in the 1970s. Apart from the United States, the top-ten list of leading countries with LNG reserves consists of Russia, Iran, Qatar, Saudi Arabia, United Arab Emirates, Nigeria, Algeria, Venezuela, and Iraq, and they collectively control 75 percent of global LNG reserves. The three countries with the most currently undeveloped LNG reserves, and therefore over time the three largest likely suppliers, are Russia, Iran and Venezuela.

In sum, there would be many risks associated with rejecting Big Stone II for natural gas. All parties agree that renewable resources are an important component of Applicants' future resource portfolio. The Applicants are pursuing significant amounts of renewable energy. But what is also needed, and needed quickly, is more baseload generating capacity that a facility such as Big Stone II is intended to provide.

III. APPLICANTS' COMPUTER MODELING WAS CONDUCTED USING REASONABLE ASSUMPTIONS.

DRC states in its Brief that the Applicants' computer modeling is flawed and unreliable because DRC disagrees with the assumptions used in the modeling. DRC, naturally, thinks that different assumptions more favorable to wind and natural gas should be incorporated into the modeling to show that a combination of the two is lower cost than Big Stone II. As described in our Initial Brief, Applicants made the most realistic assumptions available at the time of modeling, and in many ways actually favored wind and natural gas. Additionally, the Commission Advocacy Staff witness Terry Deason concluded that the Applicants' modeling was appropriate.⁷

⁷ See Tr. Vol. III, p. 1489-1491 (Deason).

On this issue, there are just a few points raised by DRC that necessitate a response. First, DRC asserts that the capital costs are out-of-date. The Applicants, however, have taken into account the fact that costs of constructing new generation resources have increased, for all types. An inflationary factor was applied to the costs. The fact that the Applicants do not have a more recent cost estimate does not undermine the validity of the modeling results in comparing various options. Other changes and updates in modeling assumptions could be made as well, but there is no reason to conclude that another round of modeling is justified. Some updated assumptions will make wind and natural gas look even less effective. For example, as just discussed in the previous section of this Brief, the estimates used by the Applicants for future costs of natural gas are surely on the low side.

DRC relies on the recent decision by Westmoreland Coal Company to suspend development of its Gascoyne 500 MW lignite plant proposal⁸ to support its argument that the costs of Big Stone II have increased to the point that the Applicants should take another look at the prudence of Big Stone II. Westmoreland's decision notwithstanding, regulators in other areas of the country continue to recognize that it remains prudent to build new coal plants to provide needed capacity and baseload energy. The Virginia State Corporation Commission recently approved a baseload coal plant;⁹ in fact, the main witness opposing the plant was the same witness (David Schlissel) that Joint Intervenors used here. In addition, on April 30, 2008, the Iowa Utilities Board approved the Sutherland Unit 4, a plant very similar in size, technology

⁸ A copy of an Associated Press article about the Westmoreland Coal Company decision is attached. While the article states that at least one reason for the company's decision was the state of uncertainty with respect to greenhouse gas regulation, another item noted is the fact that the company did not have any customers for the energy to be produced at the plant.

⁹ Final Order, for a certificate of public convenience and necessity, Case. No. PUE-2007-00066. The Order is 28 pages long and can be found at <http://www.docket.scc.virginia.gov/vaprod/main.sp> and searching under the docket number.

and cost to Big Stone II.¹⁰ And of course the South Dakota Public Utilities Commission has already approved Big Stone Unit II. Thus, despite concerns over rising costs, many utility commissions are nonetheless able to recognize that coal must remain a part of this country's energy security.

DRC suggests at page 11 that the Applicants have failed to take into account new mercury regulations that will be enacted at the federal level. To the contrary, Applicants have already committed to optimal mercury controls and have taken the costs of that effort into account.¹¹

Last, DRC claims that Montana-Dakota withheld evidence regarding its modeling runs. This is a belated claim without merit relating to some modeling data exploring the dispatch realignment with Big Stone II online and additional wind on the Montana-Dakota system.¹² The Applicants' modeling efforts have been completely disclosed and examined in this proceeding.

IV. COAL SUPPLY AND TRANSPORTATION TO BIG STONE UNIT II HAVE BEEN ACCURATELY AND RELIABLY FORECAST.

Incredibly, DRC questions the credibility of Applicants' expert Thomas Crowley. As this Commission knows, Mr. Crowley is one of the country's preeminent authorities on fuel and transportation. Mr. Crowley testified that Applicants' forecasts were accurate and reasonable. DRC's arguments on this question are simply without merit.

V. POSSIBLE FUTURE CO₂ REGULATIONS WERE REASONABLY CONSIDERED TO THE EXTENT ALLOWED UNDER NORTH DAKOTA LAW.

DRC suggests that Applicants have ignored the possibility of future carbon costs. The Commission knows that, notwithstanding the statutory prohibition on considering potential

¹⁰ *In re Interstate Power Co.*, Docket No. GCU-07-1. The Iowa Utilities Board decision was oral and the written order has not been issued. A copy of a press release from Interstate Power and Light Co. is attached for convenience.

¹¹ See Tr. Vol. I, pp. 935-936 (Uggerud) and Tr. Vol. I, p. 1012 (Rolfes).

¹² Tr. Vol. II., p. 1098 (Stomberg).

future environmental costs, Applicants have taken the potential for future carbon regulation into account in making their decision to proceed with Big Stone II. The Applicants did this in two ways – first by Otter Tail applying CO₂ costs in its resource planning analysis in states that allow such analysis,¹³ and second, by having Burns & McDonnell conduct an analysis, again in other jurisdictions, that compare costs of various technologies considering a number of assumptions including a range of carbon costs.¹⁴ Only under the most favorable (and unlikely) of assumptions for wind and natural gas does a wind/natural gas combination appear lower cost than Big Stone II.

Advocacy staff witness Terry Deason recognized that a prudent businessperson would take into account the potential for significant regulatory costs associated with a particular course of action.¹⁵ The Applicants agree. They are well aware of the potential for future greenhouse gas regulation but have determined that a new, highly efficient pulverized coal plant is a prudent and reasonable resource selection, even in a carbon-constrained future..

VI. IT IS AN APPROPRIATE TIME FOR THE NORTH DAKOTA PUBLIC SERVICE COMMISSION TO MAKE A PRUDENCE DETERMINATION REGARDING BIG STONE II.

DRC argues that North Dakota customers do not need the energy that will be generated by the Big Stone Unit II facility. Of all the risky assertions that have been made in this case, asserting that North Dakota does not need this power seems the riskiest of all. The evidence firmly establishes that both Otter Tail and Montana-Dakota, and indeed, the entire region, need more baseload generation.

DRC wants the Commission to wait until the Minnesota Public Utilities Commission has made a decision on the transmission lines in that state. The Minnesota PUC is scheduled to hear

¹³ See OTP Ex. 117, p. 8, l. 22 – p. 9, l. 5 (Morlock).

¹⁴ See OTP/MDU Ex. 326 and Ex. 327 (Greig).

¹⁵ PSC Ex. 4 at p. 22 (Deason).

oral argument on this matter on June 3 and to make a decision on June 5. The North Dakota Commission will know of the Minnesota PUC decision before it makes its final decision.

Finally, DRC requests that if the Commission grants the prudence request, it condition the decision on excluding future carbon costs from the Applicants' rate base. DRC even claims that the Advocacy Staff supports this condition. DRC is apparently confused about this point. Advocacy Staff witness Terry Deason testified that it was not appropriate in this proceeding to consider limiting recovery for increased capital costs or carbon-related costs or other cost increases.¹⁶

Limiting Applicants' ability to recover reasonably incurred project costs places unreasonable limitations on Applicants, is without legal foundation, and is outside the bounds of sound public policy. If the Commission believes that such conditions are appropriate, Applicants will most certainly not move forward with this or any other coal project.

¹⁶ Tr. Vol. III, p. 1498, line 9 to p. 1499, line 20 (Deason).

VII. CONCLUSION

The record supports a decision by the Commission that construction of Big Stone II and the related transmission facilities is a reasonable and prudent decision. The Applicants urge the Commission to so find.

Date: May 30, 2008

Respectfully submitted,

Montana-Dakota Utilities, Co. a division of MDU Resources Group, Inc. **Otter Tail Corporation**

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Attorneys for Applicants

Coal co. suspends efforts to build ND power plant

May 21, 2008 10:29 AM ET

BISMARCK, N.D. (AP) - After seven years of planning, a coal company has suspended development of a 500-megawatt power plant in southwestern North Dakota because of uncertainty about federal carbon dioxide rules, a company official says.

Westmoreland Power Inc. is returning \$562,500 in state subsidies for the Gascoyne project, said Keith Alessi, the executive chairman of parent company Westmoreland Coal Co. The money came from a North Dakota research fund that is financed by a tax on coal mining.

Electric power plants that are fueled by coal are a major source of carbon dioxide. The gas has been linked to global warming, and Congress is preparing to debate legislation to regulate carbon dioxide emissions this summer.

"There is much uncertainty in the utility sector on when future carbon regulation will come into effect. This has slowed the development of coal-fired power plants," Alessi said in a letter to Karlene Fine, the director of North Dakota's Industrial Commission. The commission administers state coal research grants.

"At this time (we) cannot predict when a long-term customer (for the plant's electricity) can be found and the actual plant construction could commence," Alessi's letter said. "Westmoreland does intend to continue development of the Gascoyne site. We cannot guarantee that this will take place ... any time soon."

The Industrial Commission had agreed to commit up to \$10 million in research money to the Westmoreland project, which included the development of a new coal mine. A Westmoreland subsidiary operates the Beulah Mine, which supplies coal to the Coyote and Heskett power plants in western North Dakota.

Gov. John Hoeven, the commission's chairman, said the money now may be used for other initiatives.

"These projects evolve depending on the technology, on the requirements for emissions management, all of those things," Hoeven said. "We kind of knew (Westmoreland was) in this situation ... We need to make sure that we've got the dollars to put behind the projects that continue to develop."

Westmoreland, which is based in Colorado Springs, Colo., had applied for a state Health Department air quality permit for the plant. Terry O'Clair, director of the agency's air quality division, said Tuesday the application has been delayed because of uncertainty about federal mercury emissions rules.

Critics of the proposed plant have also questioned whether it would create pollution and haze problems in the south unit of the Theodore Roosevelt National Park, which is about 60 miles to the north.

The Westmoreland announcement is the most recent North Dakota electric power plant initiative that has stalled because of questions about carbon dioxide regulation, air pollution and the capacity of the region's electric power transmission network.

Great River Energy, of Elk River, Minn., which operates power plants near Stanton and Underwood, studied a proposal to build a third in western North Dakota before dropping the idea about five years ago. Great River supplies power to electric

AP Associated Press

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cooperatives that serve customers in Minnesota and Wisconsin.

Great Northern Power Development LP, which owns vast coal reserves in North Dakota and other states, mulled construction of a power plant in western Stark County before deciding instead to build a factory to make synthetic natural gas from coal.

Westmoreland and Montana-Dakota Utilities Co., a unit of MDU Resources Group Inc. of Bismarck, began planning the Gascoyne electric power station in 2001. That year, Westmoreland completed its purchase of coal reserves in the area held by another MDU Resources unit, Knife River Corp.

Montana-Dakota withdrew from the Gascoyne project in May 2007, saying it intended to concentrate on Big Stone II, a proposed power plant in northeastern South Dakota. Westmoreland continued the Gascoyne initiative by itself.

Big Stone II's future is in doubt after two Minnesota administrative law judges recommended that the state not allow construction of new power lines that the plant would need to export its electricity to Minnesota customers.

Great River Energy, which was one of the founding partners of a group of utilities that was developing Big Stone II, withdrew from the consortium last September.

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Recent Press Release

Interstate Power and Light Company receives pre-certification approval for construction of proposed Sutherland Generating Station Unit 4

DES MOINES, Iowa – April 30, 2008 – Interstate Power and Light Company (IPL), a subsidiary of Alliant Energy Corporation (NYSE: LNT), received pre-certification approval today from the Iowa Utilities Board (IUB) for construction of the company's proposed Sutherland Generating Station Unit 4, located in Marshalltown, Iowa.

In its oral decision, the IUB approved IPL's Application for Generation Siting Certificate (Siting Certification) on the conditions that IPL would periodically review the viability of carbon capture and sequestration technology for the proposed power plant with the IUB; the facility would utilize switch grass, corn stalks or other similar agriculturally based products for five and ten percent, respectively, of its fuel source within two and five years, respectively, of the facility becoming operational; ten percent of the company's energy would be derived from renewables by 2013 and IPL would increase the amount of renewables in its energy portfolio by one percent per year for 15 years after the Sutherland Generating Station Unit 4 becomes operational.

The IUB expects to issue its written order within the next several weeks. The written order will provide additional details concerning the decision.

"Today's decision moves forward the process of constructing and operating Sutherland Generating Station Unit 4," stated Tom Aller, President-IPL. "Through the construction of Sutherland Generating Station Unit Four, our company is pleased to support Iowa's economy by providing new Iowa-based sources of safe, reliable and environmentally responsible energy. The continued support IPL has received from its partners, labor representatives and residents and business leaders in Marshalltown and across our service area for this project has been overwhelming."

The IUB's decision to grant certification for construction of the proposed Sutherland Generating Station Unit 4 is also contingent upon IPL receiving all necessary permits and regulatory approvals related to the proposed power plant project. There are two required approvals, including the company's air permit application and approval of advanced ratemaking principles, remaining before construction of Sutherland Generating Station Unit 4 begins. IPL expects to receive a decision from the Iowa Department of Natural Resources on its air quality permit application by the end of the third quarter 2008. The company also expects to receive a decision from the IUB on its request for advanced ratemaking principles in the third quarter 2008. The company expects to begin construction by the end of 2008 and expects the facility to be operational in 2013.

"We remain strongly committed toward making Sutherland Generating Station Unit Four a reality for the benefit of all Iowans," added Aller. "While we are awaiting the IUB's written order in the coming weeks, the conditions set forth in today's decision appear to be reasonable and attainable."

Sutherland Generating Station Unit 4 is a 630 megawatt facility with an additional 19 megawatt equivalent of steam cogeneration that will be available for use by nearby industries. The power plant's design consists of a hybrid technology, which allows the facility to utilize switch grass, corn stalks or other similar agriculturally based products for up to 10 percent of its fuel source. As a result, IPL expects to reduce the amount of coal burned at the facility.

This statement contains forward-looking statements. These forward-looking statements can be identified as such because the statements include words such as "expects," or other words of similar import. Similarly, statements that describe future plans or strategies are also forward-looking statements. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those currently anticipated. Actual results could be affected by such factors as: state or federal regulatory actions or local government actions, including inability to obtain all necessary approvals and permits; unanticipated construction issues, delays or expenditures; current or future litigation, regulatory investigations, proceedings or inquiries that could impede the implementation of the IPL's plans; failure of equipment and technology to perform as expected;

unsuccessful negotiations with potential partners for co-ownership or purchased power arrangements; inability to find additional partners; political conditions in IPL's service territories; and economic conditions in IPL's service territory. These factors should be considered when evaluating the forward-looking statements and undue reliance should not be placed on such statements. The forward-looking statements included herein are made as of the date hereof and Alliant Energy and IPL undertake no obligation to update publicly such statements to reflect subsequent events or circumstances.

Media Contact: Rob Crain (608) 458-4469

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STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Otter Tail Corporation, Advance
Determination of Prudence
Application

AFFIDAVIT OF SERVICE

Montana-Dakota Utilities Co.,
a Division of MDU Resources Group,
Inc., Advance Determination of Prudence
Application

Case Nos. PU-06-481, PU 06-482

Kristen A. Swenson, of the City of Minneapolis, County of Hennepin, in the State of Minnesota, being duly sworn on oath says: that on the 30th day of May, 2008, she served the following:

Applicants' Reply Brief along with an Affidavit of Service.

A copy has also been served upon the attached service list via electronic mail and U.S. Mail.



Subscribed and sworn to before me
this 30th day of May, 2008.



Notary Public



STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Otter Tail Corporation, Advance
Determination of Prudence
Application

SERVICE LIST

Montana-Dakota Utilities Co.,
a Division of MDU Resources Group,
Inc., Advance Determination of Prudence
Application

Case Nos. PU-06-481, PU 06-482

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