

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

**Montana-Dakota Utilities Co., a
Division of MDU Resources Group, Inc.
Discontinue Prudence Big Stone II
Application**

Case No. PU-09-731

**Montana-Dakota Utilities Co., a
Division of MDU Resources Group, Inc.
Deferred Accounting - Big Stone II
Application**

Case No. PU-09-733

**Otter Tail Power Company
Deferred Accounting - Big Stone II
Application**

Case No. PU-09-739

**Otter Tail Power Company
Discontinue Prudence Big Stone II
Application**

Case No. PU-10-30

AFFIDAVIT OF SERVICE BY REGULAR MAIL

STATE OF NORTH DAKOTA
COUNTY OF BURLEIGH

John Hamre deposes and says that:

he is over the age of 18 years and not a party to this action and, on the **30th** day of **April, 2010**, he deposited in the United States Mail, at Bismarck, North Dakota, **eight** envelopes by regular mail, with postage fully prepaid, securely sealed, each containing a photocopy of the following:

PRE-FILED DIRECT TESTIMONY OF MIKE DILLER

The envelopes were addressed as follows:

Mr. Daniel S. Kuntz
Associate General Counsel
MDU Resources Group
PO Box 5650
Bismarck, ND 58502-5650

Mr. Bruce Gerhardson
Associate General Counsel
Otter Tail Power Company
215 S Cascade Street
Fergus Falls, MN 56537

32 PU-09-739 Filed 04/30/2010 Pages: 10
Affidavit of Service - Reg. Mail - Pre-Filed Direct Testimony of Mike Diller
Public Service Commission

27 PU-09-733 Filed 04/30/2010 Pages: 10
Affidavit of Service - Reg. Mail - Pre-Filed Direct Testimony of Mike Diller
Public Service Commission

27 PU-09-731 Filed 04/30/2010 Pages: 10
Affidavit of Service - Reg. Mail - Pre-Filed Direct Testimony of Mike Diller
Public Service Commission

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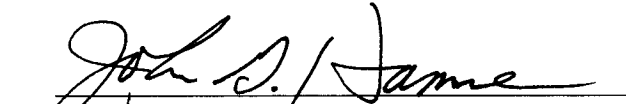

Ms. Bernadeen Brutlag
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Otter Tail Power Company
215 S Cascade Street
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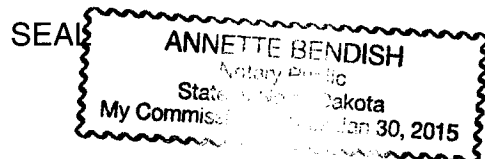
Ms. Kavita Maini
KM Energy Consulting LLC
961 N Lost Woods Road
Oconomowoc, WI 53066

Mr. Larry Schedin
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1137 Plymouth Building
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Each address shown is the respective addressee's last reasonably ascertainable post office address.

Subscribed and sworn to before me
this **30th** day of **April, 2010**.



Notary Public



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**PRE-FILED DIRECT TESTIMONY
of
MIKE DILLER**

PUBLIC SERVICE COMMISSION STAFF

April 29, 2010

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Mike Diller and my business address is the 12th floor of the state
3 capitol, 600 East Boulevard, Bismarck, North Dakota 58505.

4 **Q. BY WHOM ARE YOU EMPLOYED, WHAT IS YOUR POSITION AND**
5 **RESPONSIBILITIES?**

6 A. I am employed by the North Dakota Public Service Commission, as the
7 Director of Economic Regulation. In this position, I am primarily responsible
8 for the management of rates cases and the financial analysis of other cost
9 recovery proposals including Advanced Determination of Prudence (ADP)
10 applications such as the Big Stone 2 project.

11 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK**
12 **EXPERIENCE.**

13 A. I received a Bachelor of Science in Accounting from Oklahoma Christian
14 University in 1981. After graduation, I passed the examination for Certified
15 Public Accountant and maintain my certificate by completing at least 40 hours of
16 continuing education each year. For the past 25 years, I have performed
17 various regulatory functions for the Oklahoma Corporation Commission and the
18 North Dakota Public Service Commission.

19 **Q. FOR WHOM ARE YOU TESTIFYING?**

20 A. I am testifying on behalf of the ratepayers of Otter Tail Power Company
21 (Otter Tail) and Montana-Dakota Utilities Co. (MDU).

22 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

1 A. The purpose of my testimony is to explain advocacy staff's rationale for
2 agreeing to the settlement in this proceeding and why the commission
3 should approve it.

4 **Q. EXPLAIN HOW THE ADVANCED DETERMINATION OF PRUDENCE LAW**
5 **FRAMED YOUR ANALYSIS AND DECISION TO SETTLE.**

6 A. Otter Tail and MDU requested an advanced determination of prudence from
7 the commission for the Big Stone 2 project as provided for in North Dakota
8 Century Code section 49-05-16, Case Nos. PU-06-481 and PU-06-482. On
9 August 28, 2008, the commission approved the applicants' requests with a
10 number of conditions. Due to a number of circumstances, the project was
11 terminated and the applicants have requested that the commission now
12 determine that discontinuation of Big Stone 2 is the prudent course of action.
13 According to the ADP law, the relevant sections applicable to this proceeding
14 are as follows:

- 15 4. The commission's order determining prudence of the resource
16 adjustment is binding for ratemaking purposes.
17
18 5. If at any time following an initial commission order, the
19 commission, following a subsequent hearing, determines that
20 continuation of a project is no longer prudent or that its prior
21 order should be modified, the public utility may recover in its
22 rates, and in a timely manner consistent with the public utility's
23 financial obligations, the amounts the public utility already has
24 expensed, incurred, or obligated on a project, including interest
25 expense and a return on equity invested in the project up to the
26 time the new order is entered even though the project may
27 never be fully operational or used by the public utility to serve its
28 customers.
29

30 The ADP law is intended to minimize the risk of investor-owned utilities by
31 ensuring, to a large degree, cost recovery for pre-approved projects. The

1 provisions of law and the pre-approval by the commission provide
2 assurances to the capital markets and therefore should result in lower
3 financing costs and ultimately lower rates to customers.

4 The ADP law is good when it works and not so good when it doesn't.
5 When a project is actually constructed and put into service, the ADP law
6 should provide benefits to customers. When a project is abandoned, such
7 as the case with Big Stone 2, the ADP law seems to suggest that utilities
8 have no "skin in the game" and therefore no responsibility or cost impact for
9 a project's failure.

10 However, staff noticed that the law does not address the time period of
11 recovery after a new order is received for discontinuation. Accordingly, staff
12 negotiated for full recovery as provided by the ADP law but with no accrual of
13 interest and capital costs during the period of cost recovery. The settlement
14 agreement with no return on investment during the recovery period discounts
15 the value of dollars recovered from ratepayers.

16 **Q. WHY DID STAFF AGREE TO A THREE YEAR AMORTIZATION OF**
17 **GENERATION COSTS AND WHAT VALUE DOES IT PROVIDE TO**
18 **RATEPAYERS?**

19 A. The three year amortization period was determined through a negotiated
20 process. Advocacy staff argued for a longer amortization period so
21 ratepayers would benefit more from the time value of money but such was
22 not achievable. Staff has calculated the present value of no return on these
23 costs for three years of about 12% using Otter Tail's costs and its currently

1 authorized rate of return of 8.62%. A similar calculation was not done for
2 MDU but the result would be similar.

3 In the end, staff agreed to a three year amortization because it was the
4 most we could get and because it is a fair and reasonable solution to the
5 case. An agreement such as this could be viewed as usurping the intent and
6 purpose of North Dakota's ADP law. If litigated, the opposing lawyers may
7 well be able to argue that the denial of a return during these three years is a
8 taking of private property for the benefit of the public without just
9 compensation. It is against this backdrop that staff agreed to accept a
10 recovery period of three years. Staff believes that a reduction in cost
11 recovery in present value terms of 12% is fair and reasonable for this
12 proceeding and is likely more than could be achieved otherwise.

13 **Q: DID STAFF CONSIDER USING JUST AND REASONABLE**
14 **STANDARDS AFFORDED BY OTHER PARTS OF NORTH DAKOTA LAW**
15 **TO DISPUTE THE APPLICATION?**

16 A. Yes, a lot of thought and work went towards analyzing the applicants'
17 reasons for abandoning the project and reviewing the actual costs that were
18 incurred.

19 While arguments could be developed for opposing the abandonment of
20 Big Stone 2, the most compelling reason for abandoning the project is the
21 current projected cost of purchased power for the next 20 years of less than
22 6 cents per kWh compared to the all in cost of Big Stone 2 at a cost of more
23 than 8 cents per kWh. Whether these estimates hold true or not will

1 ultimately be determined by the passage of time. For now, the best
2 estimates indicate that the price of purchased power will be far below what it
3 would cost to build Big Stone 2.

4 **Q.WHAT DID YOUR REVIEW OF THE PROJECT'S COSTS DISCLOSE?**

5 A. The Big Stone 2 project began in earnest in January, 2004 and did not end
6 until November, 2009. The total cost of the abandoned project is about \$50
7 million, which is allocated pro rata to each of the various partners. I reviewed
8 the costs of outside service providers billing the project more than \$25,000.
9 This review resulted in reviewing costs of approximately \$30 million. I would
10 characterize the outside service costs very roughly as one-third engineering,
11 one-third legal and one-third environmental, communication and land
12 acquisition. The remaining \$20 million is comprised of internal costs,
13 financing costs and other costs below the \$25,000 threshold.

14 My review of outside service costs disclosed right away that there is a very
15 high cost of securing a Certificate of Need (CON) from the state of
16 Minnesota. The Minnesota commission conducted three hearings on the
17 CON for transmission facilities related to Big Stone 2. Hearings were
18 conducted for the initial application and then again when two of the partners
19 dropped out of the project. The Minnesota commission then asked the Office
20 of Administrative Hearings to conduct further proceedings to develop the
21 record regarding carbon regulation costs, construction costs and fuel costs
22 by hiring its own independent consultant. The Minnesota commission even
23 required Montana-Dakota Utilities Co., with no electric customers in

1 Minnesota, to justify its need for generation as well as its resource mix under
2 the guise that absent a showing of need for the Big Stone 2 generation
3 facility, new transmission facilities in Minnesota are obviously not needed.

4 From my review, it appears that the partners of Big Stone 2 paid in excess
5 of \$3 million to outside vendors for the Minnesota CON, not counting any
6 cost for the internal company time of the managing partner (Otter Tail) or the
7 rest of the partners. Staff thought about denying a portion of these costs for
8 cost recovery in North Dakota but could not develop a foundation for doing
9 so. The costs were incurred before the regulatory body with authority over
10 new transmission lines in Minnesota and those lines are inseparable from the
11 Big Stone 2 project. Had there been a similar and proportional proceeding in
12 North Dakota for transmission facilities, staff would argue for a direct
13 allocation of these costs to Minnesota and of course a direct allocation of
14 North Dakota costs to North Dakota ratepayers.

15 My review of costs also revealed that the legal costs are nearly as much
16 as the engineering costs, which seemed unfathomable at first blush given
17 the project was supposed to be about designing and building something. But
18 having reviewed the timelines of major events since the projects inception, it
19 appears that the lawyers are as indispensable as the engineers—at least in
20 the initial stages. Roughly, I calculate that the project paid for about 30,000
21 hours of legal assistance or about 2.5 full-time attorneys since the project's
22 inception.

1 Projects of this size require a broad range and a large amount of legal
2 expertise and skill. Legal work for the project included developing ownership
3 agreements; operating agreements; developing contracts for bids and
4 services from vendors; regulatory work before three states and the federal
5 government, including water, air, and siting permits and environmental
6 impact statements and so on. Because the work is crucial and time sensitive
7 to the continuation of the project, a large amount of outside legal work is
8 required in the initial stages of a project like Big Stone 2.

9 After reviewing the costs, time lines and the decision making of
10 management along the way, staff believes the costs of Big Stone 2 were
11 prudently incurred.

12 **Q: Does this conclude your testimony?**

13 **A:** Yes, it does.