EXHIBIT
PSC-1

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**

PRE-FILED DIRECT TESTIMONY
of
MIKE DILLER

PUBLIC SERVICE COMMISSION STAFF

April 29, 2010

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Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

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

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

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

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

Q. FOR WHOM ARE YOU TESTIFYING?

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

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

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

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

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

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

The ADP law is intended to minimize the risk of investor-owned utilities by ensuring, to a large degree, cost recovery for pre-approved projects. The provisions of law and the pre-approval by the commission provide assurances to the capital markets and therefore should result in lower financing costs and ultimately lower rates to customers.

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

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

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

A. The three year amortization period was determined through a negotiated process. Advocacy staff argued for a longer amortization period so ratepayers would benefit more from the time value of money but such was not achievable. Staff has calculated the present value of no return on these costs for three years of about 12% using Otter Tail's costs and its currently authorized rate of return of 8.62%. A similar calculation was not done for MDU but the result would be similar.

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

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

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

While arguments could be developed for opposing the abandonment of Big Stone 2, the most compelling reason for abandoning the project is the current projected cost of purchased power for the next 20 years of less than 6 cents per kWh compared to the all in cost of Big Stone 2 at a cost of more than 8 cents per kWh. Whether these estimates hold true or not will ultimately be determined by the passage of time. For now, the best estimates indicate that the price of purchased power will be far below what it would cost to build Big Stone 2.

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

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

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

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

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

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

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

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

Q: Does this conclude your testimony?

A: Yes, it does.