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PUBLIC SERVICE COMMISSION



December 14, 2009

Darrell Nitschke
Executive Secretary and Director of Administration
North Dakota Public Service Commission
State Capitol
600 East Boulevard, Dept. 408
Bismarck, ND 58505-0480

**Re: In the Matter of the Petition of Otter Tail Power Company Requesting Authority to Use
Deferred Accounting for Costs Incurred During its Participation in the Big Stone II Project
Case No. PU-09-_____**

Dear Mr. Nitschke:

Enclosed for filing is Otter Tail Power Company's Petition requesting authority to use deferred accounting until its next rate case for costs incurred during its participation in the Big Stone II project.

If you have any questions, please feel free to contact me at any time.

Sincerely,

/s/ Bruce Gerhardson

Bruce Gerhardson
Associate General Counsel
BG/dm

Enclosures

An Equal Opportunity Employer

1 **PU-09-739** Filed: 12/14/2009 Pages: 14
**Application for Deferred Accounting – Big Stone
Costs**

Otter Tail Power Company

Bruce Gerhardson, Associate Grnl. Counsel

STATE OF NORTH DAKOTA
BEFORE THE
PUBLIC SERVICE COMMISSION

In the Matter of the Application of Otter Tail
Power Company for Authority to use Deferred
Accounting

Case No. PU-09-_____

APPLICATION FOR AUTHORITY TO USE DEFERRED ACCOUNTING

I. Introduction

Otter Tail Power Company (“OTP”) requests authority to use deferred accounting until its next rate case for costs incurred during its participation in the Big Stone II project. The Big Stone II project was a proposed multi-owner coal-fired generating plant to be located at the site of the existing Big Stone Generating Plant near Big Stone, South Dakota. At the time of its withdrawal, OTP had a 26.54% share of the project and a corresponding responsibility for shared project costs.¹

OTP worked on developing the project for several years. In June of 2005, OTP entered in to project agreements with six other utilities for purposes of pursuing the project.² At that time, the participants applied for the necessary permits, began preliminary engineering work, and began other development work for the project. The South Dakota Public Utilities Commission (“SDPUC”) approved the project Site Permit in July 2006, the North Dakota Public Service Commission (“Commission”) issued an Advance Determination of Prudence for OTP’s

¹ Or more precisely 26.544622425% based on OTP’s proportion of committed off-take: 116MW of a total of 437 MW committed. OTP’s share of the project increased after Great River Energy (“GRE”) and Southern Minnesota Municipal Power Agency (“SMMPA”) withdrew from the project in September 2007. The project was permitted and engineered with an expected capacity between 500 and 550 MW, therefore, without new participants to make up for GRE and SMMPA, OTP’s share of off-take was larger than its requirements and its share of obligation exceeded its expected investment.

² Preliminary investigation of the feasibility of a second unit at the Big Stone site and other project activities had been undertaken before the project group agreements were finalized and executed.

participation in the project in July 2008, and the Minnesota Public Utilities Commission (“MPUC”) issued a Certificate of Need (“CON”) for the Big Stone II transmission lines in March 2009. OTP’s 2005 Integrated Resource Plan, which specifically included the Big Stone II project, was also approved by the MPUC in March 2009. The project also obtained a Water Allocation Permit, Air Permit, and other necessary permits, and completed a Federal Environmental Impact Statement for the project. During the time these permit proceedings were pending, OTP incurred approximately \$13.2 million for the permitting, engineering and other development activities for the project.³

By fall of 2009, a combination of factors decreased OTP’s need for the project and increased risks associated with the project, and therefore OTP withdrew from participation. The combination of factors included: a) significant changes to recent energy price forecasts that are expected to result in changes to OTP’s next resource plan and resource adequacy requirements; b) unprecedented financial market conditions and cost-recovery risks that made raising the large amount of necessary capital unreasonably costly; and c) the risk that OTP could be required to either increase its share of the plant or participate in a smaller and less economic project if additional participants did not join in the project.⁴ OTP was one of five remaining participants when it withdrew from the project.⁵ The remaining participants later discontinued the project.

Because of the magnitude of OTP’s development costs, and because OTP’s current rates don’t include recovery of these costs, deferred accounting until OTP’s next rate case is appropriate. OTP is currently evaluating when it will file its next rate case. Either in that rate case or in a separate request prior to that rate case, OTP will make application for a

³ The actual amount is \$13,173,953.55

⁴ OTP’s share of Big Stone II costs was estimated at about \$400 million. However, without the addition of other project participants, OTP’s expected share of costs in a similarly sized project would have increased to approximately \$500 million or more. For purposes of illustrating the magnitude of the investment, OTP’s total rate base as of the end of 2008 was approximately \$575 million.

⁵ Two Big Stone II Participants, GRE and SMMPA, withdrew from the project previously.

determination under N.D.C.C. Section 49-05-16 that continuation of the project was no longer prudent.

II. General Filing Information

OTP provides the following general filing information:

A. Name, Address, and Telephone Number of Utility.

Otter Tail Power Company
215 South Cascade Street
P.O. Box 496
Fergus Falls, MN 56538-0496
Telephone: (218) 739-8200

B. Name, Address, and Telephone Number of Utility Attorney.

Bruce Gerhardson
Associate General Counsel
Otter Tail Power Company
215 South Cascade Street
P.O. Box 496
Fergus Falls, MN 56538-0496
Telephone: (218) 998-7108

C. Date of Filing.

This Application is being filed on December 14, 2009.

D. Controlling Statute for Time in Processing the Filing.

There is no set period for a Commission decision on the Application.

E. Title of Utility Employee Responsible for Filing.

Bruce Gerhardson
Associate General Counsel
Otter Tail Power Company
215 South Cascade Street
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Fergus Falls, MN 56538-0496
Telephone: (218) 998-7108

F. Service List.

OTP requests that the following persons be placed on the Commission's official service list for this matter and that any trade secret comments, request, or information be provided to the following on behalf of OTP:

Bruce Gerhardson
Associate General Counsel
Otter Tail Power Company
215 South Cascade Street
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Telephone: (218) 998-7108

III. OTP Should Be Allowed, In Its Next Rate Case, To Recover Prudently Incurred Preconstruction Costs And Investments.

Almost all jurisdictions allow public utilities to recover prudently incurred preconstruction costs and investments for a prudently abandoned plant project.⁶ In *Attorney*

⁶ See, e.g., the Washington Supreme Court, in *Power v. Utilities & Transp. Comm'n*, 711 P.2d 319 (1985), where it cataloged the regulatory and court decisions involving abandoned plants (as of 1985) and found that:

Approximately 100 state regulatory agencies in some 33 jurisdictions have faced the question of how to allocate the burden of costs associated with abandonment of power plant projects. As the Supreme Judicial Court of Massachusetts summarized in *Attorney Gen. v. Department of Pub. Utils.*, 390 Mass. 208, 455 N.E. 2d 414, 422 (1983):

A substantial majority of the public utility regulatory agencies that have considered the question have permitted a utility to recover all or some portion of the prudently incurred costs of a nuclear power plant reasonably abandoned before completion.

As with regulatory agencies, the substantial majority of courts that have considered the matter have also allowed utilities to recover abandoned plant costs, prudently incurred, as operating expenses or as expenses which could otherwise be amortized. *Pacific Power & Light Co. v. Public Serv. Comm'n*, 677 P.2d 799 (Wyo 1984); and *Citizens Action Coalition of Ind., v. Northern Ind. Pub. Ser.Co.*, 472 N.E. 2d 938 (Ind. Ct. App. 1984).

Gen. v. Department of Pub. Utils.,⁷ the Massachusetts Supreme Court explained the overarching policy issue as follows:

If the company now absorbs the Pilgrim II [nuclear power plant] loss, regulatory policies and the returns they dictate, appear to us to be inadequate to compensate investors for the new level of risk. Investors who are inadequately compensated do not remain investors for long. The adverse financial consequences which flow from such circumstances are, in our opinion, inevitable and devastating. The company goes to great lengths in describing how earnings will indefinitely be depressed, stock prices will tumble, bond ratings will collapse, and future capital, if available at all, will be prohibitively priced. Stripped of hyperbole, this assessment remains accurate enough to cause us great pause. The Disdain of the financial markets for this company will be formidable, and that disdain can only mean that eventually the customers of the company will pay a high price in terms of both extravagant compensation for new capital and an unavoidable service deterioration reflecting the scarcity of reasonably priced capital. In a very real sense, what we face today is not the question, who should bear the cost of Pilgrim II. It is, rather, when should those costs be faced.

This important public interest consideration is fully reflected in North Dakota's advanced determination of prudence process.

That process is set forth in North Dakota Century Code Section 49-05-16, which provides that a public utility proposing to construct a generating facility for the purpose of ensuring reliable electric service to its customers may file an application with the Commission for an advance determination that a particular electric resource addition is reasonable and prudent. That statute also provides that, if the Commission makes a predetermination of prudence and the utility later withdraws from the project, the utility is entitled to recover the costs of the abandoned project, subject to the Commission, after a hearing, determining the withdrawal was prudent. The relevant portion of Section 49-05-16 states:

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

⁷ 390 Mass 208, 455 N.E.2d 422 (1983).

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.

Based on the terms of this statute, OTP intends in its next rate case or in a separate request to seek recovery of \$5,311,722 (OTP's North Dakota jurisdictional share of the approximately \$13.2 million Big Stone II costs). Either in that rate case or in a separate request prior to that rate case, OTP will make application for a determination under N.D.C.C. Section 49-05-16 that continuation of the project was no longer prudent.

IV. The Costs Were Prudently Incurred

OTP's participation in the Big Stone II Plant was closely reviewed by the Commission in *Otter Tail Corporation Advance Determination of Prudence Determination*, Case No. PU-06-481. In its Findings of Fact, Conclusions of Law, and Order (August 27, 2008), the Commission made the following findings:

¶ 20. Otter Tail's forecast indicates a winter season capacity deficit of 15 MW in 2007 and increasing to approximately 160 MW by 2012 and 193 MW by 2014. The capacity deficit is increasing due to a combination of events, including system load growth, the expiration of certain purchased power contracts, and the closing of a customer owned generator. Morlock testified that Otter Tail has been selected to provide power to the New Tharaldson Ethanol Project which could require as much as 22 MW peak demand.

¶ 27. At times, both utilities [OTP and Montana Dakota] experience capacity deficits.

¶ 29. There was no dispute among the parties concerning the need for additional electric system resources to ensure reliable electric service to customers of Otter Tail and Montana-Dakota.

¶ 30. The Commission finds that both Otter Tail and Montana-Dakota have a need for additional electric system resources to ensure reliable electric service to customers.

¶ 125 The Commission finds that it is reasonable and prudent for the Applicants to select either a supercritical or ultra-supercritical pulverized coal baseload electric generating station in combination with demand-side management and energy conservation programs that prove more cost effective than such plant.

¶ 139 The Commission finds that it is reasonable and prudent to construct a baseload generating facility at the Big Stone site.

The prudence of OTP's participation in the Big Stone II project was also reviewed and approved by the MPUC and SDPUC. The MPUC's determination of prudence was made in the context of OTP's Integrated Resource Plan,⁸ and in the context of the Certificate of Need proceedings for the associated transmission facilities located in Minnesota.⁹ The SDPUC's Order Granting the Project a Site Permit (July 21, 2006),¹⁰ while noting that it was not making a determination of prudence for the purpose of future ratemaking proceedings, found that: "Based on OTP's resource planning, Big Stone Unit II is shown to be a least-cost baseload resource for the OTP system."¹¹

Continuation of the Project was no longer prudent. The project agreements required OTP to make a final decision on September 11, 2009, that would have committed OTP to continued participation through financing, construction, and operation of the project. Circumstances existing at that point in time, however, made it unreasonable for OTP to irrevocably commit to its continued participation in the project.

OTP's decision to participate in Big Stone II in 2005 and continuing into 2008 was based on circumstances significantly different from those OTP faced in September 2009. A confluence of factors made it reasonable for OTP to withdraw from the project. Those factors included:

- Significant unanticipated changes to long-term forecasts for on-peak and off-peak energy prices and changes in projected customer demand, which are expected to impact OTP's

⁸ *In the Matter of Otter Tail Power Company's 2005 Integrated Resource Plan*, Order Approving Resource Plan, Docket No. E-017/RP-05-968.

⁹ *In the Matter of the Application of Otter Tail Power Company and Others for Certification of Transmission Facilities in Western Minnesota*, Docket No. E-017, ET-6131, ET-6130, ET-6144, ET06135, ET-10/CN 05-619, Order Granting Certificate of Need With Conditions (March 17, 2009).

¹¹ SDPUC Order at paragraph 38.

next resource plan and resulting resource adequacy requirements. The changes include forecasts of energy prices in the 2012 to 2024 time frame that are 40% to 50% lower than reflected in previous forecasts. OTP is in the process of completing an updated Integrated Resource Plan (“IRP”), which it expects to complete by July 1, 2010. OTP expects that these forecast changes will impact the resource additions recommended in that IRP.

- Unprecedented financial market conditions brought on by the broad economic downturn, which made raising the necessary capital unreasonably risky and potentially more costly. These market conditions have resulted in a lending market in which it has grown increasingly difficult to find debt financing at a reasonable cost, especially for such a large project, with increasing uncertainties and an equity market that has significantly driven up the cost of raising equity capital.
- The risk that additional partners would not join the project, leaving OTP responsible for a larger share of the project costs. Two of the prior partners had previously withdrawn, and reasonable efforts to find replacement participants were unsuccessful, creating the risk that OTP’s share of the project costs would have increased substantially.
- Financing risk associated with lender concern over the growing uncertainty in the direction of federal climate-change legislation and the Environmental Protection Agency’s intent to regulate CO₂.
- Uncertainty surrounding adequate and timely cost recovery.
- Uncertainty due to protracted appellate processes.

OTP expended \$13,173,954 participating in the Big Stone II Project. The North Dakota jurisdictional share of these costs is 40.32% or \$5,311,722 dollars.¹² The costs are more fully described in Attachment A, but fall generally into the following cost categories: Engineering, project development, permitting, legal, other expenditures, and Allowance for Funds Used During Construction (AFUDC). OTP has excluded from these costs and investments any costs that it has incurred for land in which it continues to have a title interest, and it has excluded any labor-related costs that were included in the revenue requirement in OTP's recent rate case (Case PU-08-742). For example, OTP incurred costs for certain easements relating to the project and OTP has a continuing real property right in those easements. Therefore, the costs of those easements is reflected in OTP's property accounts, and not included in this deferral request. Additionally, OTP reviewed the internal and labor costs included in this request and verified that they were excluded from the 2007 test year used in OTP's rate case (as they were being accounted for as Construction Work in Progress ("CWIP") along with the other project costs).

As explained earlier in this Application, pursuant to the Advance Determination of Prudence Statute, the Commission will review and decide the reasonableness of the costs at a later date, in the context of a future rate case or in a separate determination of prudence case. In that future proceeding, the prudence of these costs and the reasonableness of allowing their recovery in rates will be reviewed and determined, along with determining the appropriate rate recovery methodology (i.e. amortization period, etc.).

V. Deferred Accounting Is Appropriate.

The need for deferred accounting for costs incurred on abandoned utility projects is a consequence of the change in the accounting treatment for those costs upon project

¹² This jurisdictional allocation percentage is a composite of the E1 and D1 allocators set in OTP's last general rate case.

discontinuance. Prior to discontinuance, the project development costs were capitalized as CWIP typically over multiple years. In OTP's most recent rate case, Big Stone II project-related costs were excluded from the test year —those costs were accumulating in the CWIP account and, therefore, they were not reflected in the revenue requirement either as an expense or as an investment included in rate base.

Upon OTP's withdrawal from the project, absent deferred accounting, all costs for permitting, project management, legal fees and other costs that had accumulated over the several years of OTP's involvement in the project would be expensed in the current period. Through the use of deferred accounting, the financial status quo can be preserved until the next rate case so that the Company's financial statements are not dramatically and unreasonably impacted prior to a Commission decision whether the costs should be included in rates.

The Commission has previously allowed deferred accounting when the amounts are sufficiently large that they could accelerate the timing of a rate case, and when the utility does not have excess earnings that should first be used to offset the higher costs. *See Re Montana-Dakota Utilities Company, a Division of MDU Resource Group, Inc.* Case No PU-399-92-564, Findings of Fact, Conclusions of Law and Order (March 24, 1993) 141 P.U.R. 4th 286, 1993 WL 174126 (N.D.P.S.C.); and Order on Reconsideration (January 18, 1994), 1994 WL 61075 (N.D.P.S.C.).

With respect to the facts of this case, the North Dakota jurisdictional share of the \$13.2 million OTP will include in its next rate case is \$5,311,722. For comparison, in the recently concluded rate case, the authorized increase in the base rate revenue requirement was \$3,597,000. Because the Big Stone II development costs are clearly material to OTP, deferred accounting should be granted.

VI. Conclusion

For the reasons stated herein, OTP should be authorized to use deferred accounting until the Commission rules on the merits of the prudence of withdrawing from the Big Stone II Project.

Dated: December 14, 2009

By: /s/ Bruce Gerhardson
Bruce Gerhardson
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**Otter Tail Power Company
Big Stone II Development Costs
For Period February 1, 2005 through November 30, 2009**

1	Engineering, procurement and construction management	\$1,473,546
2	Project development team (including labor)	\$3,531,343
3	Permitting and environmental impact statement	\$2,528,093
4	Legal	\$3,109,769
5	Other expenditures	\$1,255,091
6	Credit from participants that previously withdrew	-\$725,479
7	AFUDC	<u>\$2,001,590</u>
BIG STONE II PROJECT DEFERRAL REQUEST		<u>\$13,173,954</u>

Ownership percentages:

OTP paid 19.33% of joint project costs through September 2007, the date when GRE and SMMPA withdrew. OTP funded 26.54% from September 2007 through its withdrawal on September 11, 2009. OTP's share of joint project costs were assigned on a composite percentage basis because of changes in ownership percentages over the life of the project.

Descriptions for breakdown categories:

- 1 **ENGINEERING, PROCUREMENT AND CONSTRUCTION MANAGEMENT:** The plant project's engineering, procurement and construction manager designed and specified the electric generating plant, solicited/evaluated six equipment bid packages in 2006, produced three major cost estimate renditions, performed a coal drying assessment, geotechnical investigation and ultra-supercritical study, and provided testimony at regulatory proceedings. Includes the cost of transmission studies conducted to determine the impact the proposed generator has on the transmission system and the upgrades to allow the generator to interconnect and deliver energy to the transmission system, and preliminary engineering efforts to determine proposed structure types and potential substation layouts.
- 2 **PROJECT DEVELOPMENT TEAM (INCLUDING LABOR):** Includes Otter Tail generation project labor; staff expenses such as meals, lodging, travel; and payments to several independent contractors. The project development team provided assistance for project engineering, permitting, communications and financing efforts. Transmission project management time spent on permitting, engineering, environmental, land or other specifically detailed tasks were included in those specific categories. General transmission staff project management time not specifically assigned to other categories is included here. Internal labor costs and expenses included in this filing were excluded from the test year expenses used in OTP's rate case.
- 3 **PERMITTING AND ENVIRONMENTAL IMPACT STATEMENT:** External costs associated with efforts to obtain the Federal EIS and the following permits: MN CON and route, SD site, PSD air, solid waste, water, and groundwater permits. Permitting activities include development of permits, filing fees and hearing expenses. Excludes all outside attorney fees that are included in #4 legal. Plant permitting related internal labor costs that are included in #2 project development. Transmission permitting costs presented here include outside consultants and internal labor and expenses to support these efforts.

**Otter Tail Power Company
Big Stone II Development Costs
For Period February 1, 2005 through November 30, 2009**

- 4 **LEGAL:** Payments to outside legal firms for generation and transmission activities. Includes work on the project agreements including the Participation Agreement, O&M Services Agreement, Joint Facilities Agreement, Trust Agreement, Interconnection and Transmission Upgrade Allocation Agreement, and Blanket Easement Agreement. Includes outside counsel charges related to financing, new participants and equipment contracts. Also includes external attorney fees for obtaining permits including MN CON and route, SD site, solid waste, water, groundwater and PSD air permits.

- 5 **OTHER:**
PLANT: Includes groundwater tolerance testing costs, insurance premiums and broker fees, communications expenses, scrubber evaluation costs, SD use tax payments, credits for SD tax rebates. Includes payments for property easements, options and purchases, mineral and water rights, as well as property tax payments, and other miscellaneous charges net of lease revenues. Includes property purchases committed and obligated prior to withdrawing from the project.
TRANSMISSION: Expenses related to survey permission, easement options and easement acquisition including easement payments, labor and expenses and various other miscellaneous charges.
EXCLUDES any costs for property rights for which OTP continues to have a title interest.

- 6 **CREDIT FROM PARTICIPANTS THAT PREVIOUSLY WITHDREW:** When GRE and SMMPA withdrew from the project in September 2007 they forfeited their trust fund balances and paid exit payments in accordance with the project agreements. The dollars shown here are OTP's 26.54% share of GRE and SMMPA exit payments and trust fund balances when they withdrew from the project.

- 7 **AFUDC:** Allowance for funds used during construction on OTP's CWIP investment for the period February 1, 2005 to August 31, 2009.