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September 30, 2013



Mr. Darrell Nitschke
Executive Secretary and Director of Administration
North Dakota Public Service Commission
State Capitol
600 East Boulevard, Dept. 408
Bismarck, ND 58505-0408

**RE: Otter Tail Power Company Environmental Cost Recovery Rider
Tariff and Rates
Case Nos. PU-13-79 and PU-13-84**

**Montana-Dakota Utilities Co., a Division of MDU Resources Group, Inc.
Environmental Cost Recovery Rider
Tariff and Rates
Case Nos. PU-13-85 and PU-13-83**

OAH File No. 20130326

Dear Mr. Nitschke:

Enclosed for filing in the above-referenced matter are an original and seven copies of Otter Tail Power Company's and Montana-Dakota Utilities Co.'s Proposed Findings of Fact, Conclusions of Law and Order. This document was also submitted electronically to dnitschk@nd.gov and to ndpsc@nd.gov.

Sincerely,

/S/ BRUCE GERHARDSON
Bruce Gerhardsen
Associate General Counsel

dm
Enclosures
By electronic filing and First Class Mail

c: Allen C. Hoberg, ALJ
Daniel Kuntz
Illona Jeffcoat-Sacco
Ryan Norrell

An Equal Opportunity Employer

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Otter Tail Power Company)	Case No. PU-13-79
Environmental Cost Recovery Rider)	
Tariff)	
Montana-Dakota Utilities Co., a Division of MDU)	Case No. PU-13-83
Resources Group, Inc.)	
Environmental Cost Recovery Rider)	
Rates)	
Otter Tail Power Company)	Case No. PU-13-84
Environmental Cost Recovery Rider)	
Rates)	
Montana-Dakota Utilities Co., a Division of MDU)	Case No. PU-13-85
Resources Group, Inc.)	
Environmental Cost Recovery Rider)	
Tariff)	

PROPOSED FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

[date]

Appearances

Commissioners Randy Christmann, Brian P. Kalk, and Julie Fedorchak.

Bruce Gerhardson, Associate General Counsel, 215 S. Cascade St., Fergus Falls, MN 56537, appearing on behalf of Otter Tail Power Company.

Daniel S. Kuntz, Associate General Counsel, P.O. Box 5650, 1200 West Century Avenue, Bismarck, ND 58506-5650, appearing on behalf of Montana-Dakota Utilities Co.

Ryan Norrell, Legal Counsel, Public Service Commission, State Capitol, 600 E. Boulevard Avenue, Bismarck, ND 58505, appearing on behalf of Public Service Commission advocacy staff.

Illona Jeffcoat-Sacco, General Counsel, Public Service Commission, State Capitol, 600 E. Boulevard Avenue, Bismarck, North Dakota 58505, appearing on behalf of the Public Service Commission advisory staff.

Allen C. Hoberg, Administrative Law Judge, Office of Administrative Hearings, 2911 North 14th Street, Bismarck, ND 58503.

Preliminary Statement

On February 8, 2013, Otter Tail Power Company (“Otter Tail”) filed a tariff that provides for an adjustment of rates to recover jurisdictional capital costs and associated operating expenses incurred to comply with federal environmental mandates on existing electricity generating stations, Case No. PU-13-79. Also on February 8, 2013, Otter Tail filed a rate adjustment under that tariff to recover the cost of environmental upgrades to the Big Stone Power Plant (“Big Stone”) to comply with the South Dakota Haze State Implementation Plan and the United States Environmental Protection Agency, Case No. PU-13-84.

On May 8, 2013, Otter Tail filed an Update to its Application in Case No. PU-13-79, noting a reduction in the original estimated cost of the upgrades from \$489 million to \$405 million.

On August 6, 2013, Otter Tail made a Supplemental filing to make a change in its recommended rate design for the proposed ECR.

On February 11, 2013, Montana-Dakota Utilities Co. (“Montana-Dakota”) filed a tariff that provides for an adjustment of rates to recover jurisdictional capital costs and associated operating expenses incurred to comply with federal environmental mandates on existing electricity generating stations, Case No. PU-13-85. Also on February 11, 2013, Montana-Dakota filed a rate adjustment under that tariff to recover the cost of environmental upgrades to Big Stone to comply with the South Dakota Haze State Implementation Plan and the United States Environmental Protection Agency, Case No. PU-13-83.

On May 31, 2013, Montana-Dakota updated its application in Case No. PU-13-83 reflecting revised budget numbers associated with the Big Stone environmental upgrades from \$489 million to \$405 million.

On July 10, 2013, the Commission issued a Notice of Consolidated Hearing for September 16, 2013. Four issues were identified in the Notice in regard to Otter Tail’s and Montana-Dakota’s proposed environmental cost recovery tariffs.

Should the Commission approve each environmental cost recovery tariff?

- (1) Does each tariff allow the respective public utility to recover on a timely basis its investment in capital costs and associated operating expenses incurred to meet federal environmental mandates not reflected in the utility’s general rate schedule?
- (2) Does each tariff allow a return on the respective public utility’s investment made to meet federal environmental mandates at the level approved in the utility’s most recent general rate case?

- (3) Does each tariff provide a current return on construction work in progress to meet federal environmental mandates provided the cost recovery from retail customers of the allowance for funds used during construction is not sought through any other means?
- (4) Does each tariff terminate cost recovery after the respective public utility's costs and expense to meet federal environmental mandates have been recovered fully or have been reflected in the utility's general rate tariffs?

The Notice set forth the following issues to consider in regard to each environmental cost recovery rate adjustment.

Should the Commission approve each environmental cost recovery rate adjustment?

- (1) Does each rate adjustment comply with the respective tariff?
- (2) Are each utility's incurred costs and expenses to meet federal environmental mandates reasonable and prudent?

The Commission held the consolidated hearing on the applications on September 16, 2013 in the Commission Hearing Room, State Capital, 12th floor, Bismarck, North Dakota.

Having allowed all interested persons an opportunity to be heard, and having heard, reviewed and considered all testimony and evidence presented, the Commission makes the following:

Proposed Findings of Fact

1. Otter Tail is a Minnesota corporation and a public utility authorized to provide electric service to retail electric customers in North Dakota.
2. Montana-Dakota is a Division of MDU Resources Group, Inc., a Delaware corporation duly authorized to provide electric service to retail customers in North Dakota.
3. Big Stone is a 475 megawatt (MW) coal-fired electric generation plant located near Big Stone City, South Dakota. Big Stone is co-owned by NorthWestern Corporation d/b/a NorthWestern Energy, Montana-Dakota and Otter Tail.
4. The U.S. Environmental Protection Agency's Regional Haze Rule (40 CFR, Part 51) was promulgated by the U.S. EPA under the Clean Air Act, 41 U.S.C. Section 7479. Pursuant to the EPA's Regional Haze Rule, the South Dakota Department of Environmental and Natural Resources ("DENR") established the South Dakota Haze State Implementation Plan ("SD Haze SIP") that was approved by EPA on April 26, 2012. Under that plan, the owners are required to install Air Quality Control System ("AQCS") equipment at Big Stone to reduce emissions of sulfur dioxide ("SO₂") and Nitrogen Oxide ("NO_x"). The AQCS equipment is required based on a Best Available Retrofit Technology ("BART") determination adopted by the South Dakota DENR. The BART determination requires that the AQCS include flue gas desulfurization ("FGD") for SO₂ reduction, a baghouse for particulate matter control, and selective catalytic reduction ("SCR") with separated overfire air for NO_x reduction.

5. In Cases No. PU-11-163 (Montana-Dakota), and PU-11-165 (Otter Tail), the Commission approved Advanced Determinations of Prudence (“ADP”) for the AQCS project. In its Findings of Fact, Conclusions of Law and Order dated May 9, 2012 in those proceedings, the Commission determined “the continued operation of Big Stone is prudent and a least-cost alternative to securing alternative generation.”
6. The Commission conditioned the ADP by stating that it was making no determination as to the prudence of either Selective Catalytic Reduction (“SCR”) or Selective Non-Catalytic Reduction (“SNCR”) technology.
7. Technologies other than SCR were evaluated as part of the SD SIP for NO_x Control at the Big Stone Plant, including SNCR and other technologies.
8. Because the BART determination was specific to Big Stone, its particular design and operational characteristics were important to the BART determination. In particular, Big Stone burns subbituminous coal and it is a cyclone boiler. These were critical characteristics for the NO_x determination because, in contrast to lignite coal, SCR is a feasible technology for plants burning subbituminous coal. The fact Big Stone is a cyclone boiler is an important factor since the inherent design of these boilers typically results in higher baseline levels of NO_x as compared to pulverized coal (“PC”) boilers.
9. A key difference between plants that burn North Dakota lignite and those that burn subbituminous is the much higher sodium and ash levels in North Dakota lignite compared to most subbituminous coals. These characteristics of lignite make the catalyst used in selective catalytic reduction susceptible to blinding and plugging, thereby preventing the catalyst’s ability to reduce NO_x emissions.
10. SCR is the standard NO_x control for coal plants in the United States similar to Big Stone -- large cyclone boilers burning subbituminous coal. As identified through a query of EPA databases, of 29 large cyclone boilers burning subbituminous coal in the U.S. other than Big Stone, nineteen already have SCR installed. Of the ten that do not have SCR, three have recently shut down, two plan to shut down around the time the Big Stone SCR will be operational, and the remaining five have installed rich reagent injection technology (“RRI”), which is a technology that was evaluated for Big Stone to have nearly the same cost effectiveness as SCR but achieve fewer NO_x reductions.
11. Under the Clean Air Act and the EPA’s Regional Haze Rule, Big Stone could not operate using coal as its fuel source after April 26, 2017, without installing the AQCS equipment. The Big Stone owners are required to install the AQCS as expeditiously as practicable, but no later than five years from EPA’s approval of the South Dakota Regional Haze SIP, or April 26, 2017.
12. The installation by the Big Stone Owners of the AQCS environmental controls necessary to meet the SD Regional Haze SIP, and thereby provide for the continued operation of Big Stone, is prudent.
13. At the time of the Application filings in these proceedings (and at the time of the Commission’s Order approving the ADPs), the total cost estimate for the AQCS project was \$491 million (2015 dollars), inclusive of activated carbon injection equipment for mercury control (\$2 million).

14. Montana-Dakota's and Otter Tail's update filings, made on May 31, 2013 and May 8, 2013, respectively, reflected a reduced cost estimate for the project of \$405 million. The companies explained that the project had finalized contracts for procurement of approximately 90 percent of the project costs. With a large percentage of the costs under contract, the total capital budget was revised from the original \$491 million to \$405 million. The new budget is 17.5 percent lower than the original budget for the project.
15. Otter Tail's ownership share in Big Stone is 53.9 percent and Otter Tail's North Dakota share (approximately 40 percent) of the project was originally forecast at \$105 million and is now forecast at \$87 million.
16. Montana-Dakota's ownership share in the Big Stone Plant is 22.7 percent, and Montana-Dakota's North Dakota share (approximately 71.3 percent) of the project was originally forecast at \$79 million and is now forecast at \$65.5 million)
17. The \$86 million reduction is a result of the following four factors:
 - A. Design/engineering modifications, accounting for approximately 45 percent of the reduction.
 - B. The project delivery method, timing and market conditions account for approximately 35 percent of the reduction.
 - C. Otter Tail has taken on the duties of construction management for the project and this change accounts for approximately 13 percent of the reduction.
 - D. Because of the overall reductions, the contingency amount for the project is also reduced which accounts for about 7 percent of the budget reduction.
18. The project is being managed consistent with prudent utility practice, and the expenditures are being made in a prudent and reasonable manner. The project owners have evaluated risks associated with the project and are appropriately mitigating and managing those risks. They have procured equipment, material, and services in a competitive manner and have established procedures and monitoring to insure that the project continues on course and on plan and have knowledge of their progress so corrective actions can be taken if situations arise.
19. When the project is completed and the final as-constructed costs are known, Montana-Dakota and Otter Tail shall provide to the Commission such information as is reasonably necessary to perform a final review of costs incurred in the execution of this project. The costs to be recovered from the proposed ECRR rate adjustments appear reasonable but are subject to further review in totality once the project is complete before ascribing a final determination of reasonableness for all costs incurred. The true-up mechanism of both Montana-Dakota's and Otter Tail's ECRR ensures that the companies will only recover 100% of their costs. Should the Commission later find a discrepancy or an imprudently incurred cost, the ECRR can be adjusted going forward.
20. The ECRR rates filed by the companies comply with the proposed tariffs.

21. The proposed ECRR tariffs (Montana-Dakota-Rate 57; Otter Tail Rate Section 13.08) will allow Montana-Dakota and Otter Tail to recover on a timely basis their investments in capital costs and associated operating expenses incurred to meet federal environmental mandates not reflected in existing rates. The tariffs provide Montana-Dakota and Otter Tail with a rate mechanism that closer aligns the recovery of such environmental mandated costs as the costs are being incurred rather than to defer cost recovery, accrue Allowance for Funds Used During Construction (AFUDC) and seek recovery at the completion of this multi-year project.
22. The tariffs also provide a return on investment made to meet federal environmental mandates at the level approved in each utility's most recent general rate case.
23. The tariffs provide a current return on construction work in progress to meet federal environmental mandates and Montana-Dakota and Otter Tail are not seeking cost recovery from retail customers of the allowance for funds used during construction ("AFUDC") through any other means. Upon approval and the effectiveness of the ECRRs, AFUDC on ECRR-recoverable costs will no longer be accrued.
24. Montana-Dakota and Otter Tail will maintain tracker account worksheets to track and account for retail revenue requirements until all AQCS Project costs have been fully recovered or reflected in base rates as part of a general rate case. The tracker account information will compare each Company's respective jurisdictional costs and the amounts recovered by the Company through North Dakota retail revenue. The tracker account balance for each company (either positive or negative) will accrue monthly carrying charges as specified in each ECRR tariff. Carrying charges on a negative tracker balance will accrue to the benefit of retail customers and carrying charges on a positive tracker balance will accrue to the company.
25. Montana-Dakota and Otter Tail will make annual filings by January 15 of each year to revise the ECRR rates to reflect updated revenue requirements for the Project and may include, upon Commission approval, the cost of additional new federally mandated environmental measure projects, if any. When submitting annual filings, the tracker account will be updated so any over/under recovered amount at the end of the previous year will be reflected in the Rider adjustment for the upcoming year. This approach ensures that no under/over recovery occurs. While the ECRR tariffs will remain active, for each Company the rate applicable to the AQCS project will terminate once the project is completed and the investment is reflected in each Company's general rates pursuant to a general rate case or when all costs have been recovered.
26. The establishment of the ECRR is beneficial to both the Companies and their customers. First it provides Montana-Dakota and Otter Tail with a rate mechanism by which they can recover costs incurred as a result of compliance with environmental mandates on generating stations outside of a general rate case, thereby reducing cash flow requirements during the construction phase. Second, the tariffs allow for the gradual increase in customer bills over time as compared to a larger rate increase that would occur if the total cost of the project, plus the AFUDC accrued during the project, were introduced into rates upon completion of the project, which may be a number of years as is the case with the Big Stone AQCS project. Customers also benefit through the implementation of the tariff because carrying costs will not be compounded during construction, reducing the amount of rate base to be recovered through rates over the life of the project.

27. Montana-Dakota and Otter Tail have proposed different rate design mechanisms for their ECRR tariffs. Both arrive at a similar result in terms of inter- and intra-class allocations, mirroring those approved in each Company's last general rate case. For Montana-Dakota, the revenue requirement was allocated to the rate classes using the demand factor identified in the Montana-Dakota's most recent general electric rate case; the revenue requirement within each rate class is then recovered based on energy sales. Otter Tail proposes a percent-of-bill method applied to base rates which by its nature reflects the rate design used for all customers as approved in Otter Tail's last general rate case. Advocacy staff clarified at the hearing that both Montana-Dakota and Otter Tail's rate design is a reasonable way to design rates for their ECRRs.

28. Each of the ECRR tariffs should be approved.

29. Each of the rate adjustments for the Big Stone AQCS Project complies with their respective tariff and should be approved.

From the foregoing Findings of Fact, the Commission now makes its:

Conclusions of Law

1. The Commission has jurisdiction of the matters of these proceedings.

2. NDCC §49-05-04.2 provides in pertinent part as follows:

The commission may approve, reject, or modify a tariff filed under section 49-05-06, which provides for an adjustment of rates to recover jurisdictional capital costs and associated operating expenses incurred by a public utility to comply with federal environmental mandates on existing electricity generating stations. For purposes of this section, federal environmental mandates are limited to any requirements under the Clean Air Act, the Clean Water Act, or any other federal law or rule designed to protect the environment. Associated operating expenses are costs incurred by the public utility to comply with the environmental mandate. The tariff must:

- a. Allow the public utility to recover on a timely basis its investment in capital costs and associated operating expenses incurred to meet federal environmental mandates not reflected in the utility's general rate schedule.*
- b. Allow a return on the public utility's investment made to meet federal environmental mandates at the level approved in the utility's most recent general rate case.*
- c. Provide a current return on construction work in progress to meet federal environmental mandates provided the cost recovery from retail customers of the allowance for funds used during construction is not sought through any other means.*
- d. Terminate cost recovery after the public utility's costs and expenses to meet federal environmental mandates have been recovered fully or have been reflected in the utility's general rate tariffs.*

3. The proposed tariffs and the proposed rate adjustments comply with the provisions of N.D.C.C. §49-05-04.2.

From the foregoing Findings of Fact, Conclusions of Law and Order, the Commission now makes its:

Order

1. Montana-Dakota's and Otter Tail's applications to establish ECRR tariffs and the ECRR rate adjustments for the Big Stone AQCS Project to be implemented with an expected recovery period through March 2014 are APPROVED.
2. The initial ECRR rate for each Company will be implemented with an effective date of November 1, 2013, and will remain in effect until the next ECRR rate adjustment is approved.
3. By January 15 of each year, Montana-Dakota and Otter Tail shall file with the Commission an annual ECRR rate adjustment on a going forward basis. In the annual filing, each Company's tracker account will be updated so any over- or under-recoveries at the end of the previous recovery period will be reflected in the ECRR rate adjustment for the upcoming recovery period.
4. The companies will coordinate the filing of their annual ECCR updates so they are similar in nature. Specifically, they will coordinate their filings so the same joint costs appear in each of their applications.
5. Montana-Dakota and Otter Tail shall file compliance ECRR rate schedules consistent with this Order.
6. Montana-Dakota's and Otter Tail's cost recovery under an ECRR rate adjustment shall terminate after their costs for ECRR eligible projects have been fully recovered or have been reflected in their respective general rate tariffs.

PUBLIC SERVICE COMMISSION

Randy Christmann
Commissioner

Brian P. Kalk
Chairman

Julie Fedorchak
Commissioner

**STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION**

Otter Tail Power Company **Case No. PU-13-79**
Environmental Cost Recovery Rider
Tariff

Montana-Dakota Utilities Co., a Division of MDU **Case No. PU-13-83**
Resources Group, Inc.
Environmental Cost Recovery Rider
Rates

Otter Tail Power Company **Case No. PU-13-84**
Environmental Cost Recovery Rider
Rates

Montana-Dakota Utilities Co., a Division of MDU **Case No. PU-13-85**
Resources Group, Inc.
Environmental Cost Recovery Rider
Tariff

OAH File No. 20130326

CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of Otter Tail Power Company's and Montana-Dakota Utilities Co.'s **PROPOSED FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER** were electronically filed with the North Dakota Public Service Commission and emailed to the following individuals on the 30th day of August 2013. Copies were also sent by First Class mail.

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