

Memo

To: Darrell Nitschke, Executive Secretary

From: Mike Diller, Director of Economic Regulation

MKD

Date: July 1, 2014

**Re: Big Stone Environmental Cost Recovery Rider
Otter Tail Power Company, Case No. PU-14-142**

Brief History of Case

On May 9, 2012, Case No. PU-11-165, the commission granted Otter Tail Power Company (Otter Tail) an Advanced Determination of Prudence (ADP) for the Air Quality Control System (AQCS) at the Big Stone Plant except for the portion regarding the deployment of Selective Catalytic Reduction Technology (SCR) for the removal of nitrogen oxides. The total project cost including SCR was estimated to be \$491 million.

On December 18, 2013, Case No. PU-13-84, the commission approved the first rider for cost recovery of the Big Stone AQCS in accordance with North Dakota's law (49-05-04.2) providing for cost recovery of the federal environmental mandates including costs for SCR amounting to a 4.319% surcharge on customers' bills effective January 1, 2014. The total project cost was revised downward to \$405 million due to redesign efforts, reuse of existing plant, favorable market conditions, internal management of the project, and budget reductions for contingencies.

Current Proceeding

On March 31, 2014, Otter Tail requested to update its rider for costs projected through June, 2015, plus any cost recovery shortfalls that have accumulated during the use of the first rider, resulting in a proposed 7.531% surcharge. The purpose of the AQCS rider serves not only as a cost recovery mechanism for the costs incurred while construction is in progress but it also provides a gradual increase in rates for this very large project. For perspective on the size of the project, Otter Tail's North Dakota total average rate base for the year ending 2012 was approximately \$194 million whereas Otter Tail's North Dakota share of Big Stone's AQCS project is expected to total about \$83 million when complete. The total project cost was revised downward again in this filing to \$384 million to reflect further reductions for budgeted contingencies.

Recommendation

Staff has reviewed the application and recommends approval of the proposed rate without further hearings. This filing represents an interim adjustment to reflect the current level of expenses during the construction of the AQCS in accordance with state law and the Environmental Cost Recovery Rider tariff approved by the commission in Case Number PU-13-79. Staff will prepare a motion for the next meeting to approve the tariff revisions as filed.

Impact to Customers

Otter Tail continues its "percent-of-bill" method of recovery which results in a surcharge of 7.531% on most of the electric bill components. The rate surcharge does not apply to certain rider charges as described in the tariff such as the Energy Adjustment Rider, Renewable Resource Rider and the Transmission Cost Recovery Rider to avoid assessing a rider on a rider. **The proposed rider in this proceeding will increase the average residential bill by \$2.96 for customers using 1,000 kWh's per month.**

Review

The project is expected to be completed by January 2016 for about \$107 million less than originally estimated and approved by the commission based on least cost planning. That said, staff will conduct a review of the total project costs after the project is complete. Staff understands that a review of costs for reasonableness and prudence is separate and apart from the granting of ADP. Any adjustments resulting from that final review will be factored into the final setting of rates for cost recovery once the project is complete.

On June 2, 2014, the EPA released its proposed Clean Power Plan to reduce carbon emissions 30% by 2030 as compared to 2005 levels. It appears that the new rules could impact the run time of Big Stone. However, Otter Tail and the other owners of Big Stone remain optimistic that the Clean Power Plan State Implementation Plans for North Dakota and South Dakota in concert with other mitigation measures will allow for the continued operation of Big Stone. It makes absolutely no sense to require an expenditure of nearly \$400 million only to suggest through another rule that it should be ran less by increasing other natural gas generation owned by someone else. Of course the natural gas owners would want compensation from the Big Stone owners for the power they displace. Staff remains hopeful that, in the end, some level of common sense will prevail and the AQCS upgrades will be fully utilized through the economic dispatch of Big Stone.

Recommended Changes for Next Rider Application

The Customer Notice (Application Attachment 1) provided by the Company in its next rider application should describe what the "Environmental Cost Recovery Rider" is for and why it is necessary. Otter Tail should take advantage of its opportunity to communicate with its customers by better informing them through the Customer Notice. It is quite significant that the final cost of this one project will add about \$10 a month to the average residential bill and they should understand it so they can more fully participate in the environmental debate.

Secondly, Otter Tail should use actual monthly revenue requirements rather than the practice to date of averaging yearly costs for its monthly calculations. The commission uses an annual average rate base in rate case proceedings to establish base rates but the rider here is computed month to month and should reflect actual monthly costs. Using actual monthly costs is preferable to assuming that investments are made evenly throughout the year. Staff believes that using actual monthly costs will make the worksheets tracking the costs easier to follow and more accurate. Changing this process for this proceeding is not necessary as the rider is an estimate; results in materially the same answer; and contains a true-up mechanism to correct for any differences next time.