

Memo

To: Darrell Nitschke, Executive Secretary

From: Mike Diller, Director of Economic Regulation



Date: July 8, 2014

**Re: Big Stone Environmental Cost Recovery Rider
Montana-Dakota Utilities Co., Case No. PU-14-143**

Brief History of Case

On May 9, 2012, Case No. PU-11-163, the commission granted Montana-Dakota Utilities Co. (MDU) 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 February 11, 2013, Case No. PU-13-83, 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 .203 cent per Kwh surcharge on residential and small general customers' bills. MDU implemented the new tariffs for bills rendered on or after January 15, 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 April 8, 2014, MDU 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 .463 cent per Kwh surcharge on residential and small general customers' bills. 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, MDU's North Dakota average rate base for the year ending 2012 was approximately \$269 million whereas its share of Big Stone's AQCS project is expected to total about \$63 million when complete. The total project cost was revised downward again in this filing to \$384 million to reflect further reductions for budgeted contingencies.

Recommend Approval

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-13-85. Staff will prepare a motion for the next meeting to approve the tariff revisions as filed.

Impact to Customers

The change in the surcharge applies to all customer classes except for customers served under special contract in accordance with the tariff. **The proposed rider in this proceeding will increase the average residential bill by \$2.32 for customers using 894 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 would make no sense to require an expenditure of nearly \$400 million to satisfy EPA's rules only to have EPA propose another rule that Big Stone should be ran less by increasing generation from other more expensive natural gas generators owned by someone else. Of course the natural gas generation 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 revenue requirements calculations use North Dakota's 2012 income tax rate rather than the current rate effective for tax years beginning on or after January 1, 2013. The difference is not material enough to warrant a change in this proceeding. However, the next update should contain the effective tax rates back to Day 1 of the rider to correct for any differences.