

Memo

To: Darrell Nitschke, Executive Secretary

From: Mike Diller, Director of Economic Regulation

Mike Diller

Date: June 10, 2015

Re: **Big Stone Environmental Cost Recovery Rider
Montana-Dakota Utilities Co., Case No. PU-15-143**

Recommend Approval of Environmental Rider but Reject Proposed Tariff Change

Staff recommends approval of the proposed Environmental Cost Recovery Rider (ECRR) rates. This filing represents the current level of costs associated with the AQCS and Lewis & Clark projects in accordance with state law and the tariff approved by the commission in Case No. PU-13-85. Staff will prepare a motion for the next meeting to approve the new rider as filed.

Staff recommends that the commission reject the proposed tariff changes for the additional recovery of reagent and emission costs until such time that the costs are known and established. The tariff revision should be considered in conjunction with the proposed rate recovery. The eventual proposal from MDU should distinguish between new costs and costs that have been occurring in the past to avoid establishing a rider for costs already included in base rates. The commission should consider actual earnings from last year and projected earnings for the current year before determining whether or not to allow additional environmental rider revenues for reagent and emission costs.

Impact to Customers

The proposed changes in the surcharges applies to all customer classes except for customers served under special contract in accordance with the tariff (see application submittal letter page 2 for rates of various customer classes). **The proposed rider in this proceeding will decrease the average residential bill by 60 cents for customers using 894 kWh's per month.**

History of ECRR

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 \$489 million. MDU owns 22.7% of the Big Stone Plant and is therefore responsible for 22.7% of the total project costs. The project was required in order for

the continued operation of Big Stone Plant in accordance with South Dakota's State Implementation Plan as approved by the U.S. Environmental Protection Agency.

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.

On July 15, 2014, Case No. PU-14-143, the commission approved MDU's first update to the ECRR rider increasing it to .463 cent per Kwh effective July 15, 2014 and further reduced the total estimated project cost to \$384 million. The actual costs incurred through February 2014 were \$175 million with a projected balance at the end of June 2015 of \$353 million.

Review and Analysis of Proposed ECRR

On April 10, 2015, MDU requested to update its rider for costs projected through June 2016, plus any cost recovery shortfalls from the last rider, resulting in a proposed .396 cent per Kwh surcharge on residential and small general customers' bills. The AQCS project remains on budget and on schedule to be operational in October 2015.

The proposed recovery also includes revenue requirements associated with MDU's Lewis & Clark upgrades to comply with the Mercury and Air Toxic Standards rule (MATS). The project is to be completed by December 2015 and adds \$.8 million to the overall ECRR.

Last, MDU requests tariff changes allowing it to recover reagents and emission allowance costs as a result of AQCS at Big Stone, the Lewis & Clark upgrades and at Coyote Station to maintain environmental compliance with MATS. The proposed tariff expands the definition of costs to be recovered and provides a mechanism and process for cost recovery. In this case, MDU is not seeking recovery for these costs but will provide a separate filing in the near future.

It appears odd that the proposed rider is being reduced as more investment is being made to complete the AQCS and Lewis & Clark projects. However, the previous rate included almost \$2.5 million of under-recoveries due to timing differences between the outlay of costs and recovery of costs from ratepayers. In this proceeding, under-recoveries have been reduced to

\$.3 million. So then, even though revenue requirements for AQCS increased by nearly \$.9 million and new costs were added associated with the Lewis & Clark Mercury and Air Toxic Standards of \$.8 million, total costs for purposes of the rider declined by \$.5 million (\$.9 + \$.8 + \$.3 - \$2.5). In addition to the lower cost recovery amount, MDU projects an increase of 11% in Kwh sales compared to its last filing. Hence, lower rider costs divided by much higher volumes result in a lower rider rate.

The AQCS project is expected to be completed by October 2015 for about \$105 million less than originally estimated and the Lewis & Clark project is expected to be completed by the end of 2015 for about \$11 million less than originally estimated. Still, 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 next year's rider.