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VIA E-FILING

May 15, 2007

Dr. Burl W. Haar
Executive Secretary
MN Public Utilities Commission
121 Seventh Place East, Suite 350
St. Paul, MN 55101-2147

RE: In The Matter of the Commission's Investigation into the
Appropriateness of Continuing to Permit Cost Adjustments
Docket E999/CI-03-802

Dear Dr. Haar:

On March 30, 2007, the Public Utilities Commission issued a Notice for Comments in the above docket, with reply comments being accepted until May 15, 2007. Otter Tail Corporation d/b/a Otter Tail Power Company (Otter Tail) provides the following reply comments.

While we continue to believe issues discussed in this generic docket can be appropriately handled in other dockets, we wish to respond to portions of the Minnesota Department of Commerce's (Department) comments dated April 30, 2007.

Very truly yours,

/s/ BERNADEEN BRUTLAG
Bernadeen Brutlag
Manager, Regulatory Services

BB/jmwf
c: Service List

STATE OF MINNESOTA)
) SS.
COUNTY OF OTTER TAIL)

AFFIDAVIT OF SERVICE

**Re: In The Matter of the Commission's Investigation into the
Appropriateness of Continuing to Permit Cost Adjustments
Docket No. E999/CI-03-802**

I, Jennifer Winningham-Floden, being first duly sworn on oath, depose and say:

That on the 15th day of May, 2007, I served the attached letter, on behalf of Otter Tail Power Company, on Dr. Burl W. Haar and Sharon Ferguson by e-filing and to all other persons on the attached service list by United States first class mail.

/s/ JENNIFER WINNINGHAM-FLODEN
Jennifer Winningham-Floden

Subscribed and sworn to before me this 15th day of May, 2007.

/s/ RON L. SPANGLER, JR.
Ron L. Spangler, Jr.
Notary Public

My Commission Expires on January 31, 2010.

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E999/CI-03-802

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STATE OF MINNESOTA
BEFORE THE PUBLIC UTILITIES COMMISSION

In The Matter of the Commission's
Investigation into the Appropriateness
Of Continuing to Permit Electric
Cost Adjustments

Docket No. E999/CI-03-802

REPLY COMMENTS OF OTTER TAIL POWER COMPANY

Otter Tail Corporation d/b/a Otter Tail Power Company (Otter Tail) provides the following reply comments in the above-captioned docket. While we continue to believe issues discussed in this generic docket can be addressed more appropriately in other dockets, we wish to respond to portions of the Minnesota Department of Commerce's (Department's) comments dated April 30, 2007.

1. Options for Regulation

The Department suggests three options for changing the current fuel clause adjustment (FCA) mechanism. As stated in our initial comments, Otter Tail does not believe changes to the FCA mechanism are warranted. We recognize that increases in the costs of generating and procuring electricity would appear to require some response from regulators, but modifications to the FCA mechanism would be unlikely to impact fuel and purchased energy costs in any helpful way.

The current FCA mechanism has successfully functioned for many years, and changes haven't been warranted because the methods of supplying electricity haven't functionally changed. Utilities continue to supply their customers with self-generated or purchased energy the way they always have.

The main difference today is that the region longer has surpluses of generation like it did several years ago. In recent years, of course, supply in the region (indeed in the Country) has not kept pace with demand, and therefore individual utilities are relying on market purchases more often and they are paying more for those market purchases because regional demand has pressured market prices. While these realities cannot be ignored, altering the recovery mechanism for these costs will not change these fundamentals.

Additionally, we don't disagree that the Commission has the ability to revise FCA rates, but any such revisions must be done in an appropriate manner. While Subpart 1 of Rule 7825.2920¹ states that the automatic adjustment is provisionally approved, Subp. 2

¹ **7825.2920 APPROVAL FOR AUTOMATIC ADJUSTMENT OF CHARGES.**

Subpart 1. **Approval.** Automatic adjustment of charges filed under parts [7825.2900](#) and [7825.2910](#) are provisionally approved and may be placed into effect without commission action, but subject to the conditions in subparts 2 and 3.

provides for refunding for errors in the adjustment. This indicates that appropriate retroactive adjustments would be limited to those necessary to correct errors. The application of any other revisions to the FCA should be prospective only.

2. Overall Benefits of Fuel Clause Adjustments

The Department notes that one of the benefits to customers of an FCA is the ability for utilities to pass on fuel cost savings when they occur. Otter Tail's history would confirm this benefit. Since Otter Tail's last rate case in 1986, our FCA was negative (resulting in a FCA credit on customer bills) for 15 years and has only more recently become positive (resulting in a FCA charge on customer bills) in past 5 years. The net total benefit for the 20-year period through 2006 in total credits to Minnesota customers' bills over the period is still approximately \$15,000,000, meaning Otter Tail's FCA has in total resulted in lower customer bills over the last 20 years, not higher ones.

Otter Tail's FCA history illustrates that the Commission should be cautious in making changes to the FCA just because fuel costs are currently higher than they have been historically. To illustrate further, if the FCA were discontinued during a period of high market prices, customers would not get the benefit of lower adjustments in subsequent periods. Similar unintended (albeit possibly smaller) consequences can result if the FCA mechanism is altered to address short range concerns without taking into consideration the long-term function of the FCA. If a longer range view isn't taken into consideration it can have an effect that is similar to a poor investor that buys high and sells low in reaction to short range market information. For these reasons, Otter tail believes the FCA should not be altered at this time.

3. Minimizing FCA Costs and Generating Plant Outages

On pages 6-7 of its Comments the Department accuses utilities of not being concerned about high costs of replacement energy being passed along to customers and advocates the need for penalties to ensure that utilities are in fact making the right operating decisions regarding plant outages.

Otter Tail respectfully but strongly disagrees with the Department's misperception on plant and system operations. All Minnesota electric utilities have for nearly a century been in the business of efficiently and reliably producing and delivering electricity to their customers. They perform well when they wisely invest in generating plants and appropriately maintain them to keep them running efficiently. With all due respect to the Department, they simply cannot credibly suggest that the power plants serving Minnesota

Subp. 2. **Errors.** Errors made in adjustment must be refunded by check or credits to bills to the consumer in an amount not to exceed the amount of the error plus interest computed at the prime rate upon the order of the commission if (1) the order is served within 90 days after the receipt of the filing defined in part [7825.2900](#) or [7825.2910](#) or at the end of the next major rate proceeding, whichever is later, and (2) the amount of the error is greater than five percent of the corrected adjustment charge.

customers could be operated better with more intervention from St. Paul. The technical expertise and operational experience just does not reside there.

It should also be noted that there are strong incentives for Otter Tail to optimize the efficiencies of its plants.

Several of Otter Tail's current tariffs do not include the FCA, so about six percent of the change in fuel and purchased energy costs are not recovered from retail customers. That under-recovery falls directly to Otter Tail's ROE. And while six percent may not sound like a lot, in 2006, Otter Tail's total Minnesota cost of energy that was not recovered through the FCA (the six percent) was approximately a million dollars. That's significant to Otter Tail, which has after-tax earnings from Minnesota electric operations of only \$17 million. Likewise, in North Dakota, our similar non-FCA tariffs in that state resulted in over \$2.0 million of fuel and purchased energy costs that were not collected through fuel clause adjustment. In South Dakota, about Four hundred thousand dollars was uncollectible for the same reason. For all three states served by Otter Tail, \$3.4 million of fuel and purchased energy costs were not collected last year because Otter Tail's FCA does not apply to all its tariffs, and \$3.4 Million is more than 10% of the Company's utility net income. The impact of these non-FCA costs provides a significant incentive for Otter Tail to optimize its plant operations and otherwise minimize fuel and purchased energy costs. As prices have increased recently, the amount Otter Tail has been unable to collect through its FCA has increased proportionately. Because of this, Otter tail has shared with its customers a strong financial interest in minimizing fuel and purchased energy costs.

Otter tail has also demonstrated that it will aggressively pursue lower fuel and purchased energy costs for its customers. In recent years, for example, Otter Tail has twice sought legal relief to increasing fuel costs. The first instance was a successful effort to reduce the price of coal for Otter Tail's Coyote Generating Station, a mine-mouth plant in North Dakota. The second was an unfortunately unsuccessful Surface Transportation Board challenge to the rates of the Burlington Northern & Santa Fe Railroad, brought in an effort to reduce the transportation cost for coal to our Big Stone Plant in South Dakota. Each of these pursuits has required the devotion of significant resources. The legal and expert fees alone for the STB challenge to the BNSF rates exceeded \$4.5 million. Those costs have not been recovered from our customers.

Finally, it should be noted, that contrary to the Department's assertion that MISO does not have any control over its members' timing of planned outages, Section 4 MISO's Business Practices Manual (BPM) for Outage Coordination sets out the requirements for outage coordination and discusses the situations where MISO can override scheduled outages. Section 2 of the BPM explains "Midwest ISO performs regional transmission and generation outage coordination in order to identify proposed transmission and generation maintenance that would create unacceptable system conditions and works with the facility owners to provide remedial steps to be taken in advance of such proposed maintenance." Exhibit 2-2 of the BPM sets out the criteria for planning generation plant outages.

4. Conclusion

While we agree that the FCA and related issues have an increased visibility today, we do not believe that changes to the FCA mechanism are warranted. We also believe that these issues can be dealt with in other dockets to the extent it is necessary.

Respectfully Submitted,

/s/ BERNADEEN BRUTLAG
Bernadeen Brutlag
Manager, Regulatory Services