

December 31, 2014

Burl W. Haar  
Executive Secretary  
Minnesota Public Utilities Commission  
121 7th Place East, Suite 350  
St. Paul, Minnesota 55101-2147

RE: **Response of the Minnesota Department of Commerce, Division of Energy Resources  
to Otter Tail Power Company's Reply Comments**  
Docket No. E017/M-14-649

Dear Dr. Haar:

Attached are the supplemental comments of the Minnesota Department of Commerce –  
Division of Energy Resources (Department) in the following Matter:

Otter Tail Power Company's Request for Approval to Revise its Energy Adjustment  
Rider to Include Emission Controls Costs.

The petition was filed on July 31, 2014 by:

Stuart Tommerdahl  
Manager, Regulatory Administration  
Otter Tail Power Company  
215 South Cascade Street  
PO Box 496  
Fergus Falls, MN 56538-0496

The Department filed initial comments on the petition on October 2, 2014. Otter Tail Power  
Company filed reply comments on October 20, 2014.

The Department continues to recommend **denial of the petition** as discussed herein. The  
Department is available to answer any questions the Minnesota Public Utilities Commission  
may have.

Sincerely,

/s/ ZAC RUZYCKI  
Public Utilities Rates Analyst

ZR/lt  
Attachment

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

SUPPLEMENTAL COMMENTS OF THE  
MINNESOTA DEPARTMENT OF COMMERCE  
DIVISION OF ENERGY RESOURCES

DOCKET No. E017/M-14-649

**I. BACKGROUND**

On July 31, 2014, Otter Tail Power (OTP or the Company) filed a petition seeking approval to include expenses associated with the purchase of allowances to comply with the Cross State Air Pollution Rule (CSAPR) and the purchase of reagents for compliance with the Mercury and Air Toxics Standard (MATS).

On October 2, 2014, the Department of Commerce – Division of Energy Resources (DOC or Department) submitted comments recommending that the Minnesota Public Utilities Commission (PUC or Commission) allow no recovery for the proposed expenses through OTP's Fuel Clause Adjustment (FCA).

On October 20, 2014 OTP submitted reply comments.

**II. DEPARTMENT ANALYSIS**

**A. REAGENT COSTS**

The Department offers these brief supplemental comments to clarify certain issues highlighted in OTP's October 20, 2014 reply comments.

First, the Company presented background on two dockets previously before the Commission regarding the Advance Determination of Prudence (ADP) of costs associated with installing emissions control equipment at the Big Stone Plant,<sup>1</sup> and the Baseload Diversification Study as part of the Company's 2010 Integrated Resource Plan (IRP).<sup>2</sup> OTP cited this background

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<sup>1</sup> Docket No. E-017/M-10-1082 – The Commission determined prudence regarding the installation of emissions control equipment at the Big Stone Plant to ensure compliance with federal air quality regulations.

<sup>2</sup> Docket No. E-017/RP-10-623 – The Commission determined prudence regarding the installation of emissions control equipment at Hoot Lake Plant to comply with the federal MATS rule until 2020.

material to support its claimed need for the reagents to comply with federal air regulations, and the previous Commission decisions regarding prudence of the costs.

However, the Department has not questioned OTP's need to purchase reagents; thus, the need for reagents has not been analyzed in this docket.

OTP's argument that the Commission's determination in the ADP case (Docket No. E017/M-10-1082), requires the Commission to allow OTP to recover reagent costs through the FCA is not convincing, due to the following. First, OTP did not cite any determination by the Commission that OTP would be entitled to recover the costs of reagents through the FCA. Second, the Commission's January 23, 2012 ADP Order concluded that:

The Commission finds that the Company has met the requirements of Minn. Stat. § 216B.1695 and has demonstrated the prudence and reasonableness of the proposed Big Stone air quality control system project, as modified to eliminate the baghouse component.

The Commission's Order was issued under Minn. Stat. § 216B.1695 at that time, which the Commission described as follows in its Order at page 4:

If the Commission determines that the proposed project is prudent, **the utility is permitted to begin recovering its costs in the next rate case**, although it must still show that project costs are reasonable and necessary and must demonstrate its efforts to ensure the lowest reasonable project costs. The Commission is required to review project costs and is authorized to accept, modify, or reject any of those costs.  
(Emphasis added)

Minn. Stat. § 216B.1695 was revised in 2013 to include the phrase "or in a rider approved under section 216B.1692" after the bolded text above, but that provision did not exist at the time the Commission approved the ADP. Given that the ADP case was a contested-case proceeding, there is not an adequate basis to conclude that the Commission would have reached the same conclusion about prudence and reasonableness of the project if it had been assumed that the costs of reagents would be charged to ratepayers through the FCA.

Second, OTP stated:

The Department asserts that Otter Tail has not demonstrated that the costs to be incurred for the use of reagents are prudent.<sup>3</sup>

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<sup>3</sup> OTP Reply Comments, page 4.

And:

The Department has concerns about the costs of the reagents and asserts that Otter Tail has not shown that the estimated costs are reasonable.<sup>4</sup>

The Department notes that it has not examined the reasonableness of OTP's reagent costs since the threshold question is whether it is reasonable to recover any such costs in the FCA. The Department's main point as to the prudence and reasonableness of costs is that:

Allowing utilities to recover all costs of reagents through the FCA without any review of the costs would not be reasonable and may lessen utility incentives for efficiency and cost minimization.<sup>5</sup>

And, in the context of ensuring that including reagent costs in the FCA would not constitute double recovery of costs included in base rates:

At a minimum, OTP must meet the burden of proof of showing that the costs it recovers from ratepayers in rates, including rider rates, are reasonable. OTP offers no mechanism for making such a showing.<sup>6</sup>

The Department did not examine and does not take issue with the contract pricing used by OTP,<sup>7</sup> nor does it make any assessment of the reasonableness of the costs, as stated previously. However, the Department continues to be concerned about the lack of a mechanism to ensure an adequate review of these costs, should they be allowed to pass through the FCA. The cost of fuel that is included in the base rates and adjusted in the FCA undergoes a certain level of scrutiny, including, but not limited to, comparison with historical and market prices and assessment of a utility's hedging practices. There is currently no similar assessment mechanism identified to ensure a commensurate level of review for reagent costs. Without a framework for review, or other safeguards in place to guarantee the reasonableness of those costs, the Company would have little incentive to minimize those costs.

Fourth, the Company states that the Department asserts that the test year reagent costs at Coyote are representative of the reagent costs to all plants. The Department stated in its initial comments:

...the current pebble lime expenses can reasonably be considered to be representative of OTP's pebble lime costs, **just as any expense amount included in current rates are**

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<sup>4</sup> OTP Reply Comments, pages 4-5.

<sup>5</sup> DOC Comments, page 4.

<sup>6</sup> DOC Comments, page 5.

<sup>7</sup> Petition, pages 11-13.

**considered representative and should not be adjusted between rate cases...**<sup>8</sup>  
(Emphasis added)

Even if these new reagent costs are incurred in a plant that has not used the reagent in the past, or if they consist of entirely new reagents to comply with regulations, the fact remains that reagent costs are currently included in the Company's base rates; therefore the Department concludes that allowing expected increases in these costs through the FCA is essentially allowing an ex-post adjustment of base rates.

Additionally, the currently anticipated additional reagent expense is both low, and fixed-price in nature. The Department references the Commission's June 2010 *Utility Rates Study*, which notes that rider recovery may be appropriate for certain costs:

If costs are largely outside the control of the utility, are **unpredictable and volatile, and are substantial and recurring**, it is less likely the utility will have a reasonable opportunity to recover prudent costs and will, therefore, incur added financial risk.<sup>9</sup>  
(Emphasis added)

The Company's initial petition provided a graph illustrating relatively stable to falling anhydrous ammonia prices in the past two years. Additionally, the Company stated that variability in plant generation is the driver for the variability in the cost of the pebble lime used at the Coyote Plant generating station. The quantity of pebble lime used, while clearly tracking generation levels, exhibited significantly less volatility than generation output over that period.<sup>10</sup> Further, the variable use of the reagents and the generation levels of the plant in this case do not appear to be unpredictable and volatile. Given that it does not seem that significant variation in reagent costs occur nor are driven by unpredictable or volatile generation levels, there appears to be minimal financial risk to OTP if the Company is not allowed to automatically recover those costs through the FCA. Thus, the Department continues to support its analysis of OTP's request for a variance to the Commission's FCA rules.

The Department notes that changes in expenses are assumed to take place between rate cases, both up and down, which incentivizes utilities to manage those changes. Allowing a utility to manage an increase in one cost category by allowing recovery through a rate rider removes the utility's incentive to consider its costs holistically and minimize total cost increases.

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<sup>8</sup> DOC Comments, page 5.

<sup>9</sup> Public Utilities Commission – State of Minnesota Utility Rates Study, June 2010, page 8.

<sup>10</sup> OTP Petition, page 9.

*B. CSAPR PERMIT COSTS*

On October 23, 2014, The U.S Court of Appeals for the District of Columbia Circuit's order ended the stay on the Cross State Air Pollution Rule (CSAPR). As explained below, the Department reiterates its recommendation for the Commission to deny the recovery of purchased emission allowance costs through the Energy Adjustment rider. The Department provides the following discussion of recent developments with the federal Environmental Protection Agency's (EPA) CSAPR and its relevance to the Commission's decisions in this matter.

Previous to the stay being lifted, the assumption was that the CSAPR timeline had been displaced on the compliance continuum by MATS; due to the reduction in both SO<sub>2</sub> emissions and coal use as a result of MATS, the Department perceived the impact on the relative surplus and subsequently the price of allowances in the CSAPR market to be significant. CSAPR operates under an emissions cap not significantly more stringent than that of the Bush-era Clean Air Interstate Rule (CAIR), which was the precursor to CSAPR, and the effect of utilities' compliance investments for MATS on the prices of CAIR allowances has been noticeable, with prices for those allowances subsequently becoming very inexpensive.

Although OTP's facility emissions may not be materially impacted by MATS, as the Company indicated in reply comments, the effect of that rule on the overall CSAPR market, and allowance prices may be significant. The Department concurs with the Company's statements on page 13 of its reply comments:

It is difficult to estimate what actual emissions allowance costs will be until the allowance market is established. Market prices for CSAPR allowances may come down due to broader market reductions of actual SO<sub>2</sub> and NO<sub>x</sub> emissions that may increase the available supply of excess SO<sub>2</sub> and NO<sub>x</sub> allowances.

The Department notes that initial EPA SO<sub>2</sub> allowance price estimates from which the Company drew their cost estimates may not be appropriate to use in accurately estimating compliance costs. There is still a great deal of uncertainty regarding CSAPR itself, what the allowance market is going to look like, and as a result, the price of allowances themselves. The relative liquidity of this market will greatly impact allowance prices, and it is still unknown whether the \$600 allowance price for SO<sub>2</sub> is accurate, high, or low.

The Department concludes that the large amount of uncertainty around the allowance market indicates that OTP's costs associated with CSAPR compliance are yet unknown. Given all the uncertainties, the Department does not support rider recovery at this time. Filing a rate case would not only allow a more holistic view of all of OTP's costs and revenues, it would be more consistent with OTP's indication in its prior rate case (Docket No. E017/GR-10-239) that OTP would file a rate case in three years, by 2013. Therefore, and as discussed in detail on pages 6 – 9 of the Department's initial comments, the Department continues to conclude that OTP's request to include emissions allowances in its Energy Adjustment Rider does not meet the criteria set forth in Minn. Rule 7829.3200, subpart 1.

### **III. RECOMMENDATION**

The Department continues to recommend that the Commission deny OTP's petition to recover reagent costs through Otter Tail's Energy Adjustment Rider mechanism, and deny a variance to Minn. Rule 7825.2400 for emissions allowance recovery through the same mechanism.

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## **CERTIFICATE OF SERVICE**

I, Sharon Ferguson, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, e-mail, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

**Minnesota Department of Commerce  
Supplemental Comments**

**Docket No. E017/M-14-649**

Dated this **31<sup>st</sup>** day of **December 2014**

**/s/Sharon Ferguson**



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