



3724 West Avera Drive
PO Box 88920
Sioux Falls, SD 57109-8920
Telephone: 605.338.4042
Fax: 605.978.9360
www.mrenergy.com

November 26, 2008

Ms. Patricia Van Gerpen, Executive Secretary
South Dakota Public Utilities Commission
Capitol Building, 1st floor
500 East Capitol Avenue
Pierre, SD 57501-5070

RE: MRES Renewable Energy Objective Progress Report

Dear Ms. Van Gerpen:

Missouri River Energy Services (MRES) submits this Renewable Energy Objective (REO) Progress Report on behalf of its twelve South Dakota municipal utility members, pursuant to SDCL 49-34A-101 and 49-34A-105. This initial report covers the twelve month period from October 1, 2007, through September 30, 2008. This report is filed on behalf of the following MRES members in South Dakota: Beresford, Big Stone City, Brookings, Burke, Faith, Flandreau, Fort Pierre, Pickstown, Pierre, Vermillion, Watertown and Winner.

If you have any questions regarding this report, please contact me at 605-338-4042 or mrgsimon@mrenergy.com.

Sincerely,

Mrg Simon
Mrg Simon, Attorney at Law
Director, Legal

Copy via fax:

Jay Nordquist, Beresford Municipal Utilities
Aaron Marxen, Big Stone City Municipal Utilities
Steve Meyer, Brookings Municipal Utilities
Jerry Jones, Burke Municipal Utilities
Debbie Brown, Faith Municipal Utilities
Don Johnston, Flandreau Municipal Utilities
Brad Lawrence, Fort Pierre Municipal Utilities
James W. Sellers, City of Pickstown
Leon Schochenmaier, Pierre Municipal Utilities
John Prescott, City of Vermillion
Steve Lehner, Watertown Municipal Utilities Department
Jack Day, Jr., Winner Municipal Utilities

Copy via e-mail:

Tom Marvin, SD Municipal Electric Association

Missouri River Energy Services South Dakota Renewable Energy Progress Report

November 26, 2008

Missouri Basin Municipal Power Agency d/b/a Missouri River Energy Services (MRES) is a body politic and corporate and a public agency organized under the laws of the State of Iowa and existing under the intergovernmental cooperation statutes of the States of Iowa, Minnesota, North Dakota and South Dakota. MRES is a multi-state, member-based joint-action agency, headquartered in Sioux Falls, South Dakota. Its members receive a fixed allocation of hydroelectric power and energy from the Western Area Power Administration (WAPA), and purchase their supplemental power from MRES, a not-for-profit agency, to meet their needs over and above their WAPA allocations. As part of that responsibility, MRES provides its members with a balanced power supply portfolio, including renewable generation. MRES has included wind energy in its power supply program since 2002, which has been used primarily to meet Minnesota's Renewable Energy Objective (REO).

The 2008 South Dakota Legislature passed a voluntary REO which provides that "...ten percent of all electricity sold at retail within the state by the year 2015 be obtained from renewable energy and recycled energy sources," and allows municipal utilities to aggregate their REO through their municipal power agency. SDCL 49-34A-101. The objective is measured by qualifying megawatt hours delivered at retail¹ or by certificates representing credits purchased and retired to offset non-qualifying retail sales. The REO also requires that reports be filed with the Public Utilities Commission (Commission) that detail energy sales during the previous twelve-month period, and efforts to meet the REO goal through 2015. SDCL 49-34A-105. As with the REO itself, municipal utilities are permitted to aggregate their reporting requirements through their municipal power agency.

Given the power supply relationship between MRES and its members, MRES has assumed responsibility for the renewable energy objective and the associated reporting requirements, on behalf of all of its South Dakota member communities. The following twelve South Dakota municipal utilities are members of MRES:

¹ Calculation of the amount of electricity sold excludes from the baseline of retail sales that portion of MRES SD member sales supplied by WAPA pursuant to each member's hydropower allocation. SDCL 49-34A-103. Calculations used in this report are based on the total MRES energy sales at the town gate, pursuant to the supplemental power supply obligations of the S-1 contract between MRES and its members.

- Beresford
- Big Stone City
- Brookings
- Burke
- Faith
- Flandreau
- Fort Pierre
- Pickstown
- Pierre
- Vermillion
- Watertown
- Winner

In order to meet the South Dakota REO, MRES will integrate the South Dakota objective into its resource planning in conjunction with similar requirements in Minnesota and North Dakota.² MRES will allocate its renewable energy generation and renewable energy credits (RECs) based on MRES S-1 energy sales on a pro rata basis by state, beginning in calendar year 2009.³ Going forward from January 1, 2009, MRES renewable resources (generation and credits) will be allocated based on S-1 energy sales by state.

MRES Renewable Energy Resources

MRES acquires renewable energy resources through its exclusive power supply arrangement with Western Minnesota Municipal Power Agency (Western Minnesota), and through power purchase agreements with independent developers. At the present time, all MRES renewable resources are based on wind generation. Currently, MRES contracts for the output of the following wind generating resources:⁴

- Worthington (MN) Wind Project, 3.7 MW
- Marshall (MN) Wind Farm, 18.7 MW
- Odin (MN) Wind Farm, 20.0 MW

MRES purchases the full output of these units, and owns all of the environmental attributes associated with such generation. These resources total 42.4 MW of nameplate capacity, most of

² Minnesota's REO goal is 1% by 2005, and 7% by 2010. Minn Stat. 216B.1691, Subd. 2. Beginning in 2012, Minnesota's voluntary REO becomes a mandated Renewable Energy Standard (RES) of 12%, which increases to 17% in 2016, 20% in 2020, and ultimately 25% by 2025. Minn Stat. 216B.1691, Subd. 2a. North Dakota's REO is identical to that of South Dakota, imposing a voluntary goal of 10% by 2015. Iowa does not presently have a renewable energy objective or mandate. NDCC 49-02-28.

³ The MRES Board of Directors approved this allocation strategy at their November 13, 2008, meeting. This decision allows MRES to complete the 2008 calendar year REO reporting for Minnesota in a manner consistent with previous reports filed in Minnesota. As a consequence, the initial reports filed in North Dakota and South Dakota will indicate zero (0) qualifying renewable sales during 2008, and will identify the projected plans to meet the REO goals of North Dakota and South Dakota going forward. MRES does not charge its members a separate rate for including renewable energy as part of its balanced power supply portfolio.

⁴ MRES also purchases the output of two 750 kW turbines owned by member Moorhead Public Service (MPS) and located in Moorhead, Minnesota. The output of the MPS turbines is sold back to MPS, and MPS uses that renewable energy to supply its Capture the Wind® green pricing program required by Minn. Stat. Ann. §216B.169 (West 2007). This transaction results in a net zero purchase to MRES, and thus, MPS generation is not used by MRES for REO compliance purposes.

which is dedicated to meeting the various state REOs.⁵ MRES intends to meet its REO goals by utilizing the contracted wind generation and associated renewable attributes to meet the MRES SD REO benchmark for each year.

The following Table 1 identifies the projections of MRES relating to compliance with the South Dakota REO goal. Specifically, the table identifies the benchmarks that MRES will use in its efforts to progressively ramp up its renewable resources in the state to meet the statutory goal of 10% by 2015 for its South Dakota municipal utility members.

Table 1

Projected MRES SD REO Goals

| Year 1 | MRES SD S-1 Sales² | SD REO annual benchmark | MRES SD REO |
|---------------|--------------------------------------|--------------------------------|--------------------|
| | (MWh) | (%) | (MWh) |
| 2008 | 606,558 | 0 | 0 |
| 2009 | 645,998 | 1 | 6,460 |
| 2010 | 663,528 | 2 | 13,271 |
| 2011 | 683,239 | 3 | 20,497 |
| 2012 | 699,813 | 4 | 27,993 |
| 2013 | 718,283 | 6 | 43,097 |
| 2014 | 735,444 | 8 | 58,836 |
| 2015 | 752,987 | 10 | 75,299 |

Note 1 12 month period ending September 30

Note 2 Town gate sales

MRES continues to evaluate opportunities for additional renewable resources to ensure continuing compliance with the REO goals of Minnesota, North Dakota, and South Dakota, and the future requirements of the Minnesota RES. MRES seeks out projects that meet its needs as well as the needs of its members as part of our continuing commitment to expand the role of

⁵ The Minnesota green pricing statute requires distribution utilities to offer customers the option to purchase renewable and high-efficiency energy at the utility's cost of acquiring the resources. Minn. Stat. §216B.169 (West 2007). MRES Minnesota members are provided the renewable energy needed to meet this obligation through the MRES RiverWindsSM program, which is also available to MRES members in other states. The renewable energy generation that MRES supplies through its RiverWinds program is excluded from the generation available to meet other renewable energy program requirements such as the REO. The green pricing statute has been repealed effective on January 1, 2010. Minn. Stat. Ann. §216B.169 (West 2007).

renewable energy used to serve our member communities. MRES is currently considering additional wind generation projects that are geographically dispersed throughout MRES member states. We also evaluate other renewable and recycled energy generation opportunities as they arise.

Obstacles to meeting the REO

While MRES has expanded its renewable portfolio, and continues to pursue opportunities for additional resources, known obstacles to development continue to exist and new challenges often arise. MRES has experienced several challenges in obtaining additional renewable energy generation to serve its member municipal utilities. In the efforts of MRES to meet Minnesota's renewable good faith effort over the past several years, the following major obstacles to additional development of renewable resources have been identified:

- a) Economic barriers. As not-for-profit entities, MRES and its members are very sensitive to rising power supply costs and the impact on our consumer-owners. It is our mission to provide our members with reliable, cost-effective long-term energy and energy services in a fiscally responsible and environmentally sensitive manner. The price to build or acquire renewable resources (or renewable energy credits) has the potential to substantially increase power supply costs at a time when the electric industry is facing major challenges to contain rising costs, build infrastructure and address climate change. MRES has evaluated countless renewable energy projects over the past eight years, involving a wide variety of fuels and technologies, and has found very few that could meet the goal of adding renewable energy to our resource portfolio without impact to existing rates.
- b) Lack of incentives. Public Power entities face difficult financial challenges in owning renewable resources. The fact that the federal Production Tax Credit (PTC) and accelerated depreciation are not available to Public Power entities provides other utilities and developers advantages that are not available to MRES. In addition, as it has developed, the federal Clean Renewable Energy Bonds (CREBs) program is managed such that it favors only the smallest projects. As a result, CREBs are not feasible for a wholesale utility-scale project. Finally, the lack of state incentives makes projects like the Western Minnesota Worthington Wind Project no longer viable.
- c) Lack of transmission. The region lacks adequate transmission to facilitate the addition of new generation, particularly intermittent wind generation. The cost to construct such facilities in relation to the typical size of renewable energy projects makes construction of needed facilities on a project-by-project basis cost prohibitive. Furthermore, regulatory barriers in other states create significant uncertainty for expansion of the high voltage transmission system. Finally, the fact that an additional, pancaked transmission cost is imposed to deliver wind generated outside of the Midwest Independent Transmission System Operator (MISO) market footprint across the seam and into the MISO market

creates a major economic barrier to development of the excellent wind resources located in North Dakota and South Dakota.

- d) Demand for wind turbines. The demand for wind turbines continues to increase in the United States and world-wide due to renewable portfolio standards. The manufacturing supply chain cannot keep up with the demand for the product, causing prices to rise substantially over the last five years. Wind projects built in 2002 for approximately \$1,000/kW are rapidly approaching \$2,000/kW. Smaller developers have been squeezed out of the marketplace due to the demand for larger projects.
- e) Miscellaneous. Throughout its efforts to develop wind projects over the past several years, MRES has found it difficult to find sufficiently knowledgeable and experienced developers for wind projects who understand the complexities of generation projects. Equally challenging is the persistent difficulty encountered in obtaining the wind turbines, components, equipment, and spare parts necessary to not only construct but to properly operate and maintain a wind project.

Efforts to Overcome Obstacles

MRES is employing alternatives to overcome some of the obstacles described above. For example, to mitigate some of the economic barriers, MRES has executed power purchase agreements with developers for wind generation as one way to overcome the financial disincentive created by the unavailability of the federal PTC to Public Power entities.

To address the transmission limitations, MRES continues its analysis to determine the best location in the region to construct additional wind resources, coordinating both transmission needs and wind resources in relation to MRES member needs. The Marshall Wind Farm is a perfect example of how such analysis was successful in identifying a viable solution. MRES was able to help the Marshall Wind Farm project become a reality by utilizing the transmission service for an existing combustion turbine, and working together with a member community and local developers to make this 18.7 MW project a success.

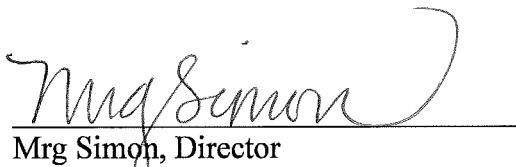
In terms of transmission barriers, MRES works on multiple fronts to address the need for additional transmission capacity and to eliminate artificial economic barriers. MRES actively advocates for transmission policies that will address the existing barriers, both with those who operate the transmission systems (e.g. MISO, WAPA, etc.), and before state and federal policymakers (e.g. Federal Energy Regulatory Commission, state legislatures, Congress, state utility commissions, Midwest Governor's Association, etc.). MRES is also actively involved in development projects to expand the transmission infrastructure in the region, including the Big Stone Transmission Project and the CapX 2020 Twin Cities to Fargo and Twin Cities to Brookings County projects, all of which are currently pending regulatory approvals. The expansion of the backbone transmission system is essential to utility efforts to expand renewable energy generation.

Conclusion

MRES has developed a plan to meet the South Dakota Renewable Energy Objective goal of 10% by 2015 as part of its overall renewable energy goals for members in Minnesota, North Dakota, and South Dakota. The SD REO is being integrated into the MRES resource planning process, and MRES has committed to continue to pursue renewable energy as part of its balanced portfolio to supply its member communities with reliable and cost-effective power supply.

Respectfully submitted this 26th day of November, 2008.

MISSOURI RIVER ENERGY SERVICES



Mrg Simon, Director
Legal
Missouri River Energy Services
3724 West Avera Drive
PO Box 88920
Sioux Falls, SD 57109-8920
(605) 338-4042
mrgsimon@mreenergy.com