

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA**

**IN THE MATTER OF THE APPLICATION OF OTTER TAIL POWER COMPANY
FOR AUTHORITY TO INCREASE RATES FOR ELECTRIC SERVICE IN SOUTH
DAKOTA**

**STAFF MEMORANDUM SUPPORTING THE
SECOND SETTLEMENT STIPULATION**

DOCKET EL10-011

South Dakota Public Utilities Commission Staff (Staff) submits this Memorandum in support of the Second Settlement Stipulation (Stipulation) of April 14, 2011, between Staff and Otter Tail Power Company (OTP) regarding the remaining issues in this docket.

BACKGROUND

On August 20, 2010, OTP filed with the South Dakota Public Utilities Commission (Commission) an application to increase rates for electric service to customers in its service territory by approximately \$2,756,000 annually or approximately 9.96% based on OTP's 2009 test year.

A settlement was reached between Staff and OTP on February 24, 2011, on all issues except the proposed addition of the Luverne wind farm (Luverne).

Staff witness, Mr. George Evans, filed testimony on the Luverne issue on February 18, 2011, and OTP filed responsive testimony on March 28, 2011. Mr. Evans' testimony took issue with OTP's 2006 Integrated Resource Plan, the basis for OTP's inclusion of Luverne. OTP's responsive testimony defended and more completely explained its 2006 Integrated Resource Plan. In addition, the testimony compared the going-forward Luverne revenue requirements to forecasted costs of replacement power for Luverne.

ISSUES

OTP's responsive testimony compared the current and future revenue requirements of Luverne to forecasted costs of replacement power for Luverne¹. Although OTP's forecasted costs of replacement power may be somewhat high, it is clear that the Luverne revenue requirements, should Luverne be included in the cost of service, will be declining while the future costs of replacement power for Luverne will be increasing. By 2016, the costs of replacement power will likely exceed the Luverne revenue requirements, and after that point, the revenue requirements will continue to decline rapidly while the cost of replacement power will continue to increase.

¹ The methodology for calculating the cost of replacement power is described in the Settlement Stipulation dated February 24, 2011.

According to OTP, the average levelized lifetime cost of Luverne will be approximately \$32 per megawatt-hour. This price per megawatt-hour is significantly lower than originally estimated by OTP, primarily due to a federal grant, made available through the American Recovery and Reinvestment Act, which reduced Luverne's capital costs by 30% and bonus depreciation which allowed OTP to deduct 50% of the cost of Luverne in the year it was placed in service for federal tax purposes. In addition, OTP will receive credit for 25% of installed capacity for Luverne rather than the 10-15% credit originally assumed. As a result, Luverne will provide significantly more reliable capacity than originally estimated.

On a going-forward basis, the inclusion of Luverne in the cost of service should provide significant savings for South Dakota ratepayers.

CONCLUSION

As a result of the considerations described above, Staff supports the inclusion of Luverne in the South Dakota cost of service.