

**From:** PUC  
**Sent:** Wednesday, December 03, 2014 11:16 AM  
**To:** [REDACTED]  
**Subject:** OTTER TAIL, EL14-082

Mr. Skaarer:

This is in response to your email regarding the commission's recent action on Otter Tail Power's environmental cost recovery. You are correct that the commission approved this for OTP, amounting to a 7.1 percent average rate increase for this ECR. The utility projects the total rate increase to be below 12 percent when the retrofit of the Big Stone Plant is completed in 2015, thus these are not pancaked increases. The reason for the necessary construction is to comply with federal mandates regarding coal-fired power plants. Here is a link to the press release we issued following the decision on this matter: <http://www.puc.sd.gov/News/2014/112614.aspx>

Here is a link to the full docket online, EL14-082: <http://puc.sd.gov/Dockets/Electric/2014/el14-082.aspx>

Here is a link to OTP's filed application attesting to the need for the retrofit. Note the Background on MATS Regulation section on page nine: <http://puc.sd.gov/commission/dockets/electric/2014/EL14-082/petition.pdf>

You ask how plant upgrades should be paid for, and the Background on page three of this document helps address that:

*SB 118 passed by the South Dakota Legislature in 2007 (now incorporated as SDCL Chapter 49-34A, Sections 97 through 100) authorizes the Commission to approve a tariff mechanism for the automatic annual adjustment of charges for a public utility to recover the South Dakota jurisdictional portion of eligible investments in and expenses related to new environmental measures. The statute defines eligible new environmental measures as any environmental improvements required under the Clean Air Act, the Clean Water Act, or any other federal law or rule, or any state law or rule implementing a federal law or rule, or voluntary environmental measures designed to protect the environment.*

As a regulated electric utility, these environmental upgrade expenses are appropriately funded by the utility's customers. You suggest the utility's profits pay for these costs; however, the laws governing regulated utilities include what is known as ring-fencing. This separates the accounting and revenue of the regulated entity from the other owned entities within a larger corporate ownership structure. This essentially prevents an investor-owned utility of being stripped of its profits by shareholders. The purpose is to retain sufficient funds to operate the utility and reinvest in the system in order to provide safe, reliable service to the utility's customers.

As a regulated utility, OTP has its rates set by the commission based on an authorized rate of return. The rates are set based on a ROR established by utility debt and equity market rates determined by present market conditions. In the past several years, the commission's approved ROR have been the lowest in the nation for the electric sector.

The commission is required by law to allow rates based on a reasonable ROR for the regulated utility sector. In South Dakota the rates of OTP, Xcel Energy, Black Hills Power, Montana-Dakota Utilities, NorthWestern Energy and MidAmerican Energy are regulated. This is required by the statutes passed by the South Dakota Legislature, and has been upheld by multiple decisions of the South Dakota Supreme Court and the United States Supreme Court. The Supreme Court has ruled that it is unconstitutional according to the takings clause of the Constitution for the commission to set rates based on debt and equity values that are not within the current range of market rates for utility debt and equity securities.

The reason for such regulations is that these utilities are in a captive rate situation. Since OTP is a monopoly situation, there is no market to discipline prices. However, they are not permitted to charge whatever rates management decides to charge, as other businesses do. Thus, a regulated utility's ROR is almost always significantly lower than for unregulated business corporations.

You ask if the rates will be reduced when the upgrade costs have been paid off, and yes, the utility can recover only the costs of the retrofit as allowed by law, and the commission will oversee this expense recovery process.

Please do not ever feel that your questions are a bother to me. I hope this reply answers them. Since this docket remains open, your comment and my response will be filed in the online docket.

Gary Hanson, Chairperson  
South Dakota Public Utilities Commission  
[www.puc.sd.gov](http://www.puc.sd.gov)