MISSOURI RIVER ENERGY SERVICES®

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

VIA E-MAIL ONLY

March 25, 2009

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

RE: Possible Impact of the President's Budget Proposal on
MRES South Dakota Member Municipal Utilities

Dear Ms. Van Gerpen:

In response to the Commissioners' letter of March 13, 2009, Missouri River Energy Services (MRES) provides the attached information regarding the analysis that we have completed regarding the Possible Impact of the President's Budget Proposal on our South Dakota Member Municipal Utilities. Also included is information on the recent study that demonstrates the economic impact of climate change proposals on Midwestern consumers. MRES is a member of the coalition that commissioned the study.

We appreciate the leadership of the Commission in initiating the public debate regarding the development of a national policy that will balance the goals of controlling the emission of greenhouse gases, while preserving the health of the economy of our state and nation. MRES Chief Executive Officer Tom Heller is planning to participate in the Commission's Carbon Cap and Trade forum on Friday, March 27, in Sioux Falls, and will be available to answer any questions the Commissioners and staff may have regarding this information.

In the meantime, 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

enclosures

"Carbon Cap and Trade: National Policy, Local Impact"

A Forum hosted by the
South Dakota Public Utilities Commission

Response of
Missouri River Energy Services

Possible Impact of the President's Budget Proposal on
MRES South Dakota Member Municipal Utilities

March 25, 2009

Missouri River Energy Services (MRES) is a multi-state, not-for-profit provider of wholesale electricity to member municipal utilities located in the four states of Iowa, Minnesota, North Dakota, and South Dakota. President Obama's recently released revenue projections beginning with the 2012 fiscal year include almost $80 billion in revenue to the federal budget to be generated from the sale of CO_2 allowances by means of a 100% auction through a cap and trade system. This proposal raises some major concerns for MRES and our sixty municipal utility members. Included among those are the twelve MRES South Dakota member communities of Beresford, Big Stone City, Brookings, Burke, Faith, Flandreau, Fort Pierre, Pickstown, Pierre, Vermillion, Watertown, and Winner.

Impact on MRES and its SD Member Communities

Although specific details are not yet available on how the administration arrived at the $80 billion per year figure, MRES has performed an initial analysis using several assumptions. MRES analysis provides a snap-shot of the impact to South Dakota member communities under the scenario of cap and trade on only electric emissions. We have evaluated the cost impact in one year, 2015, assuming an estimated cost to MRES of $35 per metric ton of CO_2, and have included only the costs of emissions related to the two coal-fired resources we expect to be utilizing in 2015, Laramie River Station and Big Stone II. It does not include emission costs related to purchased power or other MRES generation resources.

Based on these assumptions, we have made an estimate of the approximate cost. Most notably, the estimated impact of the President's budget proposal would represent an increase of up to 65% in MRES wholesale power costs in 2015 just to pay for the allowances for generation already included in the MRES generation portfolio or planned for operation by 2015.

For all 12 South Dakota MRES members, that would translate into a total annual cost increase of $33.4 million, resulting in a 54% increase in total power costs (WAPA + MRES). For example, the impact to the largest MRES South Dakota member utility, Watertown, will be an annual cost increase of $13.6 million, or 60% increase in total power costs.

This staggering increase in the wholesale cost of electricity will be paid by the citizens and businesses that are the lifeblood of South Dakota communities. The average cost impact per kWh of retail sales for 12 South Dakota members is estimated to be 2.85 cents. While this average number might not seem significant at first blush, the impact to the average customer in the member communities of MRES in the state is expected be significant.

On average, among the twelve MRES members, the typical Residential customer using 800 kWh per month or 9,600 kWh per year, will have to pay an additional $274 per year, which represents an increase of 31% in their power bill, based on current estimates. The typical Commercial and Small Business customer will see an average increase in their power bill of 33%, on average. Most significantly, larger Industrial customers will see a 50% average increase in their power bill.

What makes this an even more bitter pill is the apparent intention of the budget proposal to use only 20% of the resulting revenue for the research and development of technologies necessary to sustain emissions targets upon which the projected revenues are based. The remaining 80% of these new revenues are proposed to be used to sustain existing tax cuts and to balance the federal budget. In plain English, this is a perpetual tax increase on all South Dakota electric customers.

Impact on Midwest Consumers

In addition to the analysis MRES has conducted on the potential impact to its members, MRES has also participated in a coalition of consumer-owned utilities which has commissioned a study of the economic effect a cap and trade proposal will have on retail electricity prices paid by consumers in the region.[1] The study projects the potential rate impact of various legislative approaches on their customers, including businesses and industry, and on the economies in seven Midwestern states, including South Dakota. It shows Midwestern states could see average rate increases of 50% to 68% from 2012 to 2030 under a cap and trade program that employs a 100% auction methodology, such as that contained in the President's Budget Proposal. For South Dakota consumers, that

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[1] The study is scheduled to be released shortly. It arises, in part, to evaluate the Midwestern Governors Association's Greenhouse Gas Accord and its progress toward issuance of a model cap-and-trade rule in 2010. The study is entitled "Analysis of the Electricity Price Impacts of Alternative Carbon Emission Cap-and-Trade Programs in the Midwest," prepared by Energy Policy Group LLC and Christensen Associates Energy Consulting LLC., on behalf of Indiana Municipal Power Agency, Madison Gas and Electric Company, Missouri Joint Municipal Electric Utility Commission, Missouri River Energy Services, Southern Minnesota Municipal Power Agency and WPPI Energy,

could mean additional annual costs to ratepayers that could reach $239 million in 2015, increasing to as much as $516 million in 2030.

The study's analysis of the electricity price impacts of alternative carbon emission cap-and-trade programs in the Midwest focuses on protecting customers and mitigating the effects of price increases based on various cap-and-trade approaches. It reveals that if the cap and trade program uses a 100% allocation methodology, rather than a 100% auction, rates would still rise an average of 15% to 26%. The study demonstrates that the implementation details of any cap and trade program are critical. The method chosen to distribute allowances and to distribute auction revenues will dramatically affect the cost of compliance, and therefore the ultimate cost to consumers and the economy, particularly in coal intensive states in the Midwest.

It is important to note that whether allowances are allocated or auctioned will not affect our ability to achieve emission reduction goals. But auctions could result in very high prices for consumers and substantially harm Midwest coal dependent states with energy intensive industries in global competition. Allocations are essential to help states that face the greatest challenges in moving to a low carbon economy. Summary results of the analysis demonstrate that potentially billions of dollars of electric consumer rates are contingent upon the particular approach chosen to distribute allowances and recycle any auction revenues under any cap-and-trade regime.

Policy Priorities

MRES has a long history of noteworthy environmental stewardship. We have achieved this record while maintaining competitive electric rates for more than 250,000 people in Iowa, Minnesota, North Dakota, and South Dakota. While we understand the administration's desire to discourage the growth of CO_2 emitted in the United States, and the ultimate goal of reducing greenhouse gas emissions, MRES does not believe either our members' customers, or the U.S. economy in general can withstand these sorts of increases in such a short period of time.

MRES recognizes that key decisions are likely to be made in the near future on the direction and shape of climate change legislation. MRES believes that any Congressional action must have as its intent a properly structured national economy-wide cap-and-trade greenhouse gas emissions regulatory program, and has developed key principles to guide discussion. Following this analysis of the potential impact of the President's Budget Proposal is our federal position paper addressing Climate Change Regulation which details the elements MRES believes are critical to achieving a balanced approach achieve reductions in greenhouse gas emissions.

MRES appreciates the leadership of the South Dakota Public Utilities Commission in initiating the public debate regarding the development of a national policy that will balance the goals of controlling the emission of greenhouse gases, while preserving the health of the economy of our state and nation. Policy makers must take account of the financial implications when they consider various legislative approaches.

MRES welcomes the debate regarding this proposal and appreciates this opportunity to provide information to the Commission regarding the impact it will have on the businesses and residents that are the lifeblood of our twelve South Dakota member municipal utility communities.

Respectfully submitted this 25th day of March, 2009.

MISSOURI RIVER ENERGY SERVICES

Mrg Simon

Mrg Simon, Attorney at Law
Director, Legal
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PO Box 88920
Sioux Falls, SD 57109-8920
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February 2009

Climate Change: Balanced Program Is Critical

Missouri River Energy Services (MRES) recognizes that key decisions are likely to be made in the near future on the direction and shape of climate change legislation. MRES believes that any congressional action must have as its' intent a properly structured national economy-wide cap-and-trade greenhouse gas emissions regulatory program.

MRES has assembled a diverse power supply for its members in order to reduce risk, promote reliability, and provide cost-effective service. As Congress fashions a federal climate change program, it is important that Congress give utmost consideration to the struggling economy and the hardships many of the citizens in this country are enduring. It is imperative that policy choices made maintain a diverse power supply, meet the needs of consumers for affordable and reliable power, and avoid the temptation to find a quick fix by mandating specific technology choices or fuels.

Given that much of the "low-hanging fruit" in carbon dioxide reductions will come through changes in energy policy that further promote energy efficiency and renewables, MRES urges Congress to act first on energy legislation, so that the resulting greenhouse gas emission reductions can be incorporated in any subsequent climate legislation. Moreover, acting first on energy policy legislation will ensure that utilities, consumers, and others have the tools needed to effectively meet emission reduction targets.

Once Congress turns to climate change legislation, MRES encourages action that:

- **Addresses Climate Change Through Congressional Action.** Federal action to address climate change will impact every sector of the economy and present policymakers with numerous difficult choices. These complex decisions must be decided by Congress – not left to Environmental Protection Agency bureaucrats to decide. To accomplish this objective, Congress must enact climate legislation that addresses key details including allowance distribution.

- **Adopts Realistic Targets and Schedules.** Unlike earlier congressional action to address acid rain, there is no commercially available control technology for utility greenhouse gas emissions. While adoption of climate change legislation will prompt technological innovation, time is still needed for new technologies to be developed, demonstrated, and deployed. Consequently, MRES believes initial greenhouse gas emission reduction targets should be modest, with more aggressive reductions back-loaded once control technologies emerge. In addition, this approach will minimize consumer costs – a particularly important objective during trying economic times.

- **Considers Impact on the Consumer.** MRES recognizes that any climate change program will impose new costs on the production of electricity – and on consumers. MRES believes one of the most important steps Congress can take is the adoption of ***meaningful*** cost-containment measures. Inclusion of cost caps are necessary to reduce economic disruption and price volatility, contain the impact on electric consumers, and provide predictable price signals for utilities to make needed resource investments. Given uncertainties with availability of technologies and program operations, it is appropriate for Congress to take meaningful measures to contain cost as an insurance policy against highly disruptive economic and consumer consequences. Merely providing a pool of extra allowances – without a price ceiling on those allowances – is inadequate to provide the protections needed for a smooth transition until workable and cost-effective control technologies are readily available.

- **Distributes allowances to load serving entities.** Emission allowances should be allocated to local distribution utilities – not auctioned to the highest bidder. Local utilities are either owned by their consumers (municipal and cooperative utilities) or regulated by state agencies (private utilities), and this oversight can ensure that allowances (or allowance proceeds) are used for the benefit of consumers. Distributing allowances for free or at the lowest possible cost to load serving entities will satisfy many of the same objectives as an allowance auction but without the negative consumer consequences. Under this scenario, local utilities would sell allowances to generators that need them, with the resulting revenue used exclusively to finance investments in energy conservation and renewables and to offset low-income consumer rate increases.

- **Allows use of offsets.** MRES supports the use of offsets and believe offsets are critical for minimizing program costs. Offsets are a potentially cost-effective mechanism that can also provide multiple environmental benefits. For instance, in the Upper Midwest region, changes in agricultural practices such as no till farming applications or taking more tillable acres out of production could lead to more sequestering of carbon dioxide in the soil and also provide reductions in river sedimentation. Just as we encourage a portfolio of options for power supply, we believe Congress should authorize the broadest possible offset program that includes agricultural, forestry, wetland, and industrial offset projects.

- **Prevents Manipulation of Carbon Dioxide Markets by Speculators.** Carbon Dioxide "allowances" – the tradable emission credit created under any cap-and-trade system – will become a valuable, finite, and essential resource. As such, the market for these credits will be ripe for manipulation and abuse. The fewer allowances that are allocated (as occurs under an auction), the greater the opportunities for market manipulation by speculators. In order to protect both the market and electric consumers, it is essential that Congress include strong provisions to oversee the physical and derivative allowance markets, prevent manipulation and other abusive practices, appropriately limit the role of parties that lack a compliance obligation and participate in carbon dioxide markets solely for economic gain, and penalize those parties that seek to exploit the market.

- **Discourages Duplicative and Conflicting State and Regional Efforts**. In the absence of federal action, many states and several regions are working to fashion their own programs to address climate change. These efforts are inherently hindered by their limited geographic scope. In order to discourage conflicting and duplicative programs – which could create a compliance nightmare for utilities – Congress should pass legislation that pre-empts more excessive standards from the states once a federal system is in place.

- **Funds needed research, development, and deployment.** MRES believes there is a considerable amount of research and development needed on many aspects of the climate change issue including more study to determine the degree to which human beings are contributing to this phenomenon. Many of the technologies needed to address climate change are undeveloped, in their infancy, or cost-prohibitive. An aggressive national effort is needed to provide the necessary funding for technology research, development, and deployment. While MRES supports an immediate expansion of government funding for this effort, we recognize that non-governmental funding will be needed. Given our concerns about an allowance auction, we support, as an alternative, imposition of a mandatory user fee to provide the needed revenue. If an auction is used, the funds must be sequestered from the rest of the federal budget and used exclusively for efforts to develop and deploy needed technology.

In order to protect consumers and ensure a reliable and affordable power supply, MRES urges the delegation to advance policies during the congressional debate on climate change that meet the objectives outlined above.