

From Minnkota Power Cooperative

Major Rate Increase Drivers since 2009

All of these increases in expenses are occurring while the kilowatt-hour (kWh) sales to the members have remained relatively flat. It is important to look at these expenses and the recovery of them over a two-year period, because Minnkota did not get enough revenue in 2009 and 2010 to cover all of the increases described below. This lack of recovery shows up in the surplus energy sales area.

The primary expense changes that have been driving the rate increases since 2009 are:

Fuel

Fuel costs are increasing at the Milton R. Young Station, as well as at the Coyote Station. Fuel costs for Young 1 are up by \$4.4 million and for Young 2 the increase is \$2.7 million. At the Coyote Station, fuel costs have increased by \$3.6 million.

Since 2009, the total increase in fuel expenses is \$ 10.7 million.

Operating and Maintenance (O&M) Expense

As a result of additional environmental equipment and processes at the Young Station, Minnkota is now experiencing significant increases in operating and maintenance (O&M) expenses. O&M expenses for Young 1 are up by \$8.4 million and for Young 2 the increase is \$5.1 million. At the Coyote Station, O&M expenses have increased by \$400,000.

Since 2009, the total increase in Operating and Maintenance expenses is \$ 13.9 million.

Debt Service

As Minnkota adds large amounts of capital to meet environmental requirements and to replace and expand its transmission system, there is an increase in the amount of revenue that Minnkota needs to recover in depreciation and interest expense. For Young 2, the increase is \$6.7 million. For Minnkota as a whole, interest and depreciation expenses have increased by \$14.4 million. At the Coyote Station, debt service is down in 2011 by \$4.1 million. This was a one-time restructuring of debt that will go back up in 2012.

Since 2009, the total increase in Debt Service is \$17.0 million.

Surplus Energy Sales (Wholesale Power Market Conditions)

In addition to increased expenses to run its own facilities, Minnkota has seen significant pressures applied to its costs as a result of market conditions. Minnkota currently has significant surplus energy in its system that is more costly than it can recover in the wholesale market. Minnkota receives significant energy from its wind resources under long-term contracts. Minnkota also purchases hydroelectric energy from the Western Area Power Administration (WAPA), whose rates have increased as well. Minnkota has not been able to recover all of these expenses each year. In 2011, \$23.3 million of the expenses associated with the \$104.6 million of purchased power expenses is related to past expenses not recovered in 2010.

Since 2009, expenses associated with market conditions have gone up from \$59.1 million in 2009 to \$ 104.6 million in 2011. This is a \$45.5 million increase.

Transmission Expense

Minnkota has also faced a significant increase in the expenses that it pays for in the substation and transmission department. In this area, \$7.0 million is a new expense associated with payments being made to Minnesota Power to use the DC transmission line under the Young 2 Deal. In 2009, Minnkota's transmission and substation expenses were \$17.2 million. In 2011, the projected expense is \$26.4 million.

Since 2009, the total increase in transmission and substation expenses is \$9.2 million

All other expenses

Minnkota has experienced some inflationary expenses on the materials and services that are purchased in the administrative area, as well as necessary materials to meet new regulatory requirements. Approximately \$800,000 in administrative costs has been added to comply with new energy efficiency standards. Addressing all of these areas has increased Minnkota's expenses by approximately \$1 million.

Since 2009, the total increase in General and Administrative expenses is \$1 million.

These expenses taken together since 2009 have required Minnkota and therefore its member-owners to have to pay an additional **\$97.3 million** beyond that historically collected in the rates.

The \$97.3 million in increased expenses is a 41.4 percent increase in the expenses that Minnkota is facing from 2009 to 2011. In 2009, Minnkota's expenses were \$235 million and in 2011, because of all of the issues described above, Minnkota's expenses are \$332.3 million. Because Minnkota is a not-for-profit entity, it is required to pass on the expenses that it collects to its member systems.

When you breakdown the components of these increases, the elements of the \$97.3 million increase ends up being:

Fuel:	\$ 10.7	11.0 percent
O&M:	13.9	14.3 percent
Debt Service:	17.0	17.5 percent
Surplus Market Conditions:	45.5	46.7 percent
Transmission:	9.2	9.5 percent
General and Administration	<u>1.0</u>	<u>1.0 percent</u>
	\$97.3	100 percent

If Minnkota's member system sales were increasing, that growth would cover a large portion of these increases; however, member system sales between 2009 and 2011 are projected to increase minimally. This means that all expenses must be collected by increasing the rates that Minnkota charges.

Since 2009, Minnkota has increased rates on three separate occasions to try and cover the 41.4 percent increase in expenses. Those increases have not generated enough revenue to cover the costs. In 2011, an additional 29.8 percent increase in Minnkota's rate components is necessary to cover the 41.4 percent increase in expenses.

This 29.8 percent increase in the rate components includes taking care of the carryover expenses incurred in 2009 and 2010 that were not collected during those years.

Each of Minnkota's member systems, as well as the municipal customers of NMPA, will be impacted differently by these increases.

Unfortunately, most of these are not one-time cost increases but ongoing expenses that will need to be recovered each year into the future. We are going to carefully review all of our options to manage these increases in the future.