Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: August 10, 2017 .... **Agenda Item **#14**

Company: Otter Tail Power Company

Docket No. **E017/M-17-246**

In the Matter of Otter Tail Power Company's 2016 Conservation Cost Recovery Adjustment and 2016 Electric Demand Side Management Financial Incentive

Issue(s):

1. Should the Commission approve the Demand Side Management (DSM) financial incentive of $5,031,678?

2. Should the Commission approve recoveries and expenditures in the Company's CIP tracker account during 2016 resulting in a year-end 2016 balance of $4,835,852?

3. Should the Commission approve a 2017/2018 Conservation Cost Recovery Adjustment (CCRA) of $0.00774/kWh for bills rendered on and after October 1, 2017?

4. Should the Commission approve the request for a variance to Minnesota Rule 7820.3500 to allow Otter Tail to continue to combine the Fuel Clause Adjustment (FCA) with the Conservation Improvement Adjustment on customer bills? and

5. Should the Commission require Otter Tail to submit a compliance filing, within 10 days of the issue date of the Order in the present docket, with revised tariff sheets reflecting the Commission's determinations in this matter?

Staff: Marc Fournier 651-201-2214

Relevant Documents

Initial Filing -2016 Conservation Improvement Project Status
Report and 2016 DSM Financial Incentive/CIP Rider ....March 31, 2017

Comments of the Minnesota Department of Commerce .... May 1, 2017

Reply Comments Otter Tail Power Company .... May 16, 2017

Reply Comments Midwest Larger Energy Consumers (MLEC)................................ May 19, 2017

Reply Comments Minnesota Department of Commerce .... June 2, 2017

Reply Comments Otter Tail Power Company .... June 16, 2017

Reply Comments Minnesota Department of Commerce ....July 13, 2017

The attached materials are work papers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless noted otherwise.

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I. Background

On March 31, 2017, Otter Tail Power Company (Otter Tail, OTP or the Company) submitted its Annual Filing of the Demand Side Management Financial Incentive Project and Annual Filing to Update the Conservation Improvement Project Rider (Petition). That filing included a proposal to increase the Company's Conservation Cost Recovery Adjustment (CCRA) to $0.00754 per kWh from the current $0.00275 per kWh, an increase of 174 percent, effective October 1, 2017.

On May 1, 2017, the Minnesota Department of Commerce (DOC) submitted comments that included a recommendation for the Minnesota Public Utilities Commission (Commission) to approve the proposed CCRA. In those Comments, the Department also recommended that the Company update its carrying charge rate to reflect the new short term cost of debt, beginning the month the Commission issues its Order in the Company's rate case in Docket No. E017/GR-15-1033.

On May 16, 2017, the Company filed Reply Comments agreeing with the Department's recommendations. On May 19, the Midwest Large Energy Consumers (MLEC) filed comments stating that the proposed increase will coincide with two other rate increases—the increase to base rates and the Energy-Intensive-Trade-Exposed (EITE) Rider—and asked that the Commission spread out the CCRA over a minimum of two years to moderate impact to ratepayers.

On June 2, 2017, the DOC submitted response comments to address MLEC's concerns. On June 16, Otter Tail filed reply comments. On July 16, 2017, the DOC filed a second set of reply comments.

II. Issues

1. Should the Commission approve the Demand Side Management (DSM) financial incentive of $5,031,678?

<u>Otter Tail</u>: Recommends approval.

<u>DOC</u>: Recommends approval.

<u>MLEC</u>: Does not oppose.

2. Should the Commission approve recoveries and expenditures in the Company's CIP tracker account during 2016 resulting in a year-end 2016 balance of $4,835,852?

Otter Tail: Recommends approval.

DOC: Recommends approval.

MLEC: Does not oppose.

3. Should the Commission approve a 2017/2018 Conservation Cost Recovery Adjustment (CCRA) of $0.00774/kWh for bills rendered on and after October 1, 2017?

Otter Tail: The Company is requesting the Conservation Cost Recovery Adjustment (CCRA) factor of $0.00754 per kWh be reflected on customers' bills through the Resource Adjustment starting with bills rendered (dated) on and after October 1, 2017.

Otter Tail provides the following analysis to add clarity to the record regarding the total impacts to customers during the 12-month CIP recovery period for the proposed CCRA.

Interim rates of 9.56 percent will have been in place for approximately 18-months once Otter Tail's General Rate Case, Docket No. E017/GR-15-1033, concludes. Customers will see over a 3 percent decrease in rates once final rates from the general rate case are implemented in the fall of 2017. In addition, customers will receive an 18-month period interim rate refund once final rate case rates go into effect. The refund is the difference between the interim rate of 9.56 percent and the final MPUC approved increase of 6.27 percent which results in a 3.29 percent refund. The refund, annualized over the 12-month CIP recovery period, equates to a 4.93 percent refund.

The proposed EITE rate was recently filed with the MPUC. If approved, it will result in a 0.544 percent increase to customers, with some Large General Service (LGS) customers being exempt without having to pay any of the associated costs. Please see Table 1 of Otter Tail's reply comments for the total impact to customers due to the rate case, the proposed EITE rate, and the proposed CCRA.

Otter Tail pointed out that MLEC's comments did not consider the removal of interim rates and the significant interim rate refund customers will receive once final rates go into effect. With the inclusion of Otter Tail's proposed CCRA rate of $0.00754/kWh, the LGS and residential customers' bills result in an overall decrease. For this reason, Otter Tail maintains the proposed CCRA rate is appropriate and all costs should be recovered over a 12-month period. This recovery remains consistent with the Department's goal of ensuring that current ratepayers pay current costs and avoids imposing these costs on future ratepayers not yet on the system. This is illustrated on table 1 page 5 of Otter Tail's June 16, 2017 reply comments.

With respect to a one versus two year tracker balance recovery, the one year recovery period includes the CIP tracker account forecast based on Otter Tail's proposed CCRA with an updated carrying charge of 2.55 percent starting in May 2017 per the Department's recommendation. After a one-year collection using the proposed CCRA rate of $0.00754/kWh, the rate is forecasted to decrease by nearly 60 percent to $0.00312/kWh for the next 12-month period and should remain stable going forward.

The two year recovery analysis includes the CIP tracker account forecast based on the MLEC's proposal with an updated carrying charge rate of 2.55 percent. The two-year recovery scenario results in a CCRA of $0.00536/kWh for the 24-month period.

DOC: Initially, the DOC recommended that the Commission approve a CCRA of $0.00754 per kWh, to be effective October 1, 2017. However, after the comments filed by MLEC, the DOC modified its position. The DOC notes that avoiding rate shock is a goal that must be balanced with the goal of recovering charges as close to the incurred date as possible. This latter goal not only helps ensure that current ratepayers are the ones paying current costs, but it also avoids imposing these costs on future ratepayers not yet on the system. Further, the goal of maintaining an end-of-year tracker balance of as close to zero as possible minimizes carrying charges imposed on ratepayers (assuming an under-recovered tracker balance).

Typically, the DOC tends to favor setting the CCRA at a rate that recovers CIP costs as closely as possible to the time they were incurred. This is especially true when the Company is carrying a large over- or under-recovered balance in the CIP Tracker, as is currently true for Otter Tail. While acknowledging that the CIP Tracker tends to be "lumpy" throughout the course of the year, and so may dip closer to zero at certain times, the DOC notes that the Company has maintained a December year-end tracker balance close to $5 million since 2010.

Carrying a balance in this way is something the DOC would like Otter Tail to avoid, and so would typically recommend an aggressive recovery timeframe. However, the DOC notes that the proposed rate increase will result in a fairly substantial bill increase for Large General Service customers in particular.

Given these factors, the DOC concludes that in this case, the goal of avoiding rate shock should be given more weight than the goal of recovering charges closer to the date incurred. Therefore, the DOC asks that the Company submit a revised CCRA proposal that amortizes the recovery of the projected CIP tracker balance over the course of two years rather than a single year.

The DOC originally recommended that the Company update its carrying charge rate applied in its CIP tracker to the new approved short-term cost of debt rate beginning the month of the Commission's final Order in Docket No. E017/GR-15-1033. As the Commission's Order in that Docket came out on May 1, 2017, the DOC asks that the Company incorporate this recommendation in its response to these response comments.

On July 13, 2017, the DOC filed reply comments. In the reply comments, the DOC made a correction to Otter Tail's tracker balance and CCRA calculation and provided an alternative proposal in the derivation of the CCRA. First, the DOC reviewed Otter Tail's Tracker projections and noted that while Otter Tail incorporated the new carrying charge rate into the CIP tracker beginning in May 2017, the Company did not adjust the CCRA calculations to reflect that change. With the additional carrying charges, the CCRAs in both scenarios are slightly higher than what Otter Tail projected. The DOC provided an updated CCRA rate based on the new carrying charge rate:

12-Month Amortization (Oct 2017-Sept 2018): CCRA \$0.00774/kWh (1st Year)

12-Month Amortization (Oct 2018-Sept 2019): CCRA \$0.00306/kWh (2nd Year)

24-Month Amortization (Oct 2017-Sept 2019): CCRA \$0.00544/kwh (both years)

In Otter Tail's preferred scenario (the 12-month amortization scenarios), the first twelve-month period results in a CCRA of \$0.00774/kWh, which is an increase of 181.5 percent over the current CCRA of \$0.00275/kWh; the second 12-month period predicts a CCRA of \$0.00306/kWh, which is an increase of 11.3 percent over the current CCRA. In MLEC's preferred scenario (the 24-month amortization scenario), the period results in a CCRA of \$0.00544 over the full 24-month period, which is an increase of 97.8 percent over the current CCRA.

The primary impact on the CIP tracker between the two 12-month scenarios and the one 24-month scenario is the difference in carrying charges: under two years of 12-month scenarios, the total carrying charges paid to the Company is \$87,721, whereas under the 24-month scenario, the total carrying charges paid to the Company is \$193,333.

Historically, the DOC has tended to favor of a 1-year recovery timeline as the assumption for the CCRA calculation. This not only ensures that current customers are paying current costs, but also reduces carrying charges. However, as the DOC noted in its previous comments, the Company's proposed increase may be difficult for customers to absorb within one year; this is true even without taking into account the rate increases from the rate case and the EITE rider. The DOC notes that under the 24-month amortization schedule, no customer's monthly bill exceeds a 5% increase. Under a 12-month scenario, all but the Residential and Lighting classes would experience a greater than 5% increase on monthly bills.

The DOC notes a third option that merits consideration. Otter Tail's CCRA calculation includes next year's projected incentive. That is, rather than beginning recovery of the financial incentive after it is approved, the Company recovers the incentive "as it is being earned." So the \$0.00754/kWh CCRA reflects a projected incentive for 2017 CIP activities, to be approved in the Company's 2018 filing. Removing the projected financial incentive from this year's CCRA calculation would lower the CCRA and defer recovery of the projected incentive until next year's CCRA is approved.

The DOC notes that the Commission could require OTP to remove the projected financial incentive from the CCRA calculation on a one-time basis to help mitigate the large CCRA increase at the present time, but allow recovery of the financial incentive as it is being earned in OTP's subsequent CCRA approval proceedings.

Below are the CCRA rates without the projected incentives for the first twelve months, and returning the currently incentive recovery schedule in the second twelve months:

12-Month Amortization (Oct 2017-Sept 2018): CCRA $0.00666/kWh (1st Year)

12-Month Amortization (Oct 2018-Sept 2019): CCRA $0.00526/kWh (2nd Year)

Under this CCRA option, most customer classes would see monthly bill increases of about 5 percent in the first year when compared to current monthly bills; the Interruptible Load and Deferred Load classes would experience monthly bill increases closer to 7 percent. These impacts would drop off slightly in the second year. In all three scenarios—Otter Tail's preferred scenario, MLEC's preferred scenario, and the modified CCRA calculation option—the CCRA would return to a more stable rate in the third year.

While the DOC continues to support minimizing carrying charges, the increased CCRA due to the change in CIP-exempt status of 2 large customers is concerning. The DOC does not oppose any of the three options outlined above; however given that the CCRA increase can be mitigated by removing the projected and not-yet-approved 2017 financial incentive, the DOC recommends that the Commission require OTP to remove the projected 2017 financial incentive from the 2016 CCRA calculation, resulting in a CCRA of $0.00666 per kWh beginning October 2017.

MLEC: Otter Tail ratepayers had an interim increase of 9.56% of base rates, in 2016. The Commission recently approved $12.3 million increase in base rates or over 6%, which are expected to take effect sometime in fall 2017. It is also anticipated that the EITE rate and the CCRA rider rate, if approved at their current proposed amounts, would be increase of at least 7% relative to base rates and be initiated around the same time period as implementation of final rates in the rate case. MLEC is concerned about the rate impacts that ratepayers have seen over this 18 month period. This is an opportunity to moderate rates based on Otter Tail's initial filing, as the Company anticipates that the CCRC rate will decrease significantly for the 2018 filing.

In light of the significance and short time-frame of discussed increases, as well as the anticipated decrease in the CCRA rate for fall of 2018, MLEC sees an opportunity to levelize rates over a two-year period and lessen rate shock for 2017. MLEC respectfully request that the proposed CRA increase be spread, at a minimum, over a period of two years to moderate the impact for ratepayers. In this case, MLEC would not object to a carrying charge being applied to the extended recovery.

4. Should the Commission approve the request for a variance to Minnesota Rule 7820.3500 to allow Otter Tail to continue to combine the Fuel Clause Adjustment (FCA) with the Conservation Improvement Adjustment on customer bills?

Otter Tail: Recommends approval.

DOC: Recommends approval.

MLEC: Does not oppose.

5. Should the Commission require Otter Tail to submit a compliance filing, within 10 days of the issue date of the Order in the present docket, with revised tariff sheets reflecting the Commission's determinations in this matter?

Otter Tail: Recommends approval.

DOC: Recommends approval.

MLEC: Does not oppose.

III. Staff Discussion

Staff acknowledges that there is no controversy for issues 1, 2, 4, and 5. However, the issue of the significant CCRA rate increase was raised by MLEC.[1] In their comments, MLEC appears to imply the interim rates and the final rates from the Companies rate case, Docket No. E-017/GR-15-1033 are cumulative rather than mutually exclusive. As such, MLEC's analysis appears to overstate the rate impacts.

Based on the analysis provided by OtterTail and as updated by the DOC, the proposed CCRA of $0.00774/kWh will increase LGS customers's rates by 6.48% and residential customers' rates by 4.89%. As a result of the Commission's May 1, 2017 Order in the rate case docket, interim rates were eliminated which reduced rates for both classes by 9.56% and increased LGS customers' rates by 6.21% and residential rates by 6.58%, a net reduction. The interim rate refund if spread over a 12 month period, would result in a rate reduction of 4.92% for both classes.

The final component is the proposed EITE rate. This rate is projected to increase general rates by .544% for both classes. The net result of all of these changes is that rates will decrease by

[1] The large increase in the CCRA is largely due to Enbridge Energy, LP and Denco II, LLC receiving exemption from CIP investment and expenditure requirements under Minn. Stat. §216B.241 with respect to retail revenues attributable to their facilities effective January 1, 2017.

1.27% for LGS customers and 2.48% for residential customers. The net result is a rate reduction. When this is put up against the objective of driving the tracker to zero, the CCRA should be set at a level that drives it to zero in the most timely fashion.

While the proposal offered by the DOC has merit, it does not provide necessary relief to customers to move away from the original Otter Tail proposal. If this method is chosen, Staff is afraid that the cushion of the interim reduction/refund will be lost. This method would have been more appropriate in the event customers had not experienced higher rates during the interim rate period.

Staff agrees with the DOC that rate shock is always a relevant concern. While Staff has had the benefit of Otter Tail's analysis, Staff does not believe that this situation constitutes rate shock. Staff is always sympathetic when customers directly get involved via the comment process and intervention. Staff applauds the MLEC for their efforts in this proceeding and others. However, the Otter Tail's rates will be effectively lower going forward than they were for the 18-month interim rate period.

IV. Commission Options

1. Should the Commission approve the Demand Side Management (DSM) financial incentive of $5,031,678?

   A. Approve the Demand Side Management (DSM) financial incentive of $5,031,678.

   B. Do not approve the Demand Side Management (DSM) financial incentive of $5,031,678.

2. Should the Commission approve recoveries and expenditures in the Company's CIP tracker account during 2016 resulting in a year-end 2016 balance of $4,835,852?

   A. Approve recoveries and expenditures in the Company's CIP tracker account during 2016 resulting in a year-end 2016 balance of $4,835,852.

   B. Do not approve recoveries and expenditures in the Company's CIP tracker account during 2016 resulting in a year-end 2016 balance of $4,835,852.

3. Should the Commission approve a 2017/2018 Conservation Cost Recovery Adjustment (CCRA) of $0.00774/kWh for bills rendered on and after October 1, 2017?

   A. Approve a 2017/2018 Conservation Cost Recovery Adjustment (CCRA) of $0.00774/kWh for bills rendered on and after October 1, 2017. (This rate would bring the CIP tracker balance to zero in one year) (Rate updated by DOC)

B. Approve a 2017/2018 Conservation Cost Recovery Adjustment (CCRA) of $0.00536/kWh for bills rendered on and after October 1, 2017. (This rate would bring the CIP tracker balance to zero in two years)

C. Approve a 2017/2018 Conservation Cost Recovery Adjustment (CCRA) of $0.00666/kWh for bills rendered on and after October 1, 2017. (This rate would bring the CIP tracker balance to zero in two years) (DOC offered this as a way to mitigate the rate increase by removing the projected financial incentive for the first year)

D. Approve some other rate for a 2017/2018 Conservation Cost Recovery Adjustment (CCRA) for bills rendered on and after October 1, 2017.

4. Should the Commission approve the request for a variance to Minnesota Rule 7820.3500 to allow Otter Tail to continue to combine the Fuel Clause Adjustment (FCA) with the Conservation Improvement Adjustment on customer bills?

A. Approve the request for a variance to Minnesota Rule 7820.3500 to allow Otter Tail to continue to combine the Fuel Clause Adjustment (FCA) with the Conservation Improvement Adjustment on customer bills.

B. Do not approve the request for a variance to Minnesota Rule 7820.3500 to allow Otter Tail to continue to combine the Fuel Clause Adjustment (FCA) with the Conservation Improvement Adjustment on customer bills.

5. Should the Commission require Otter Tail to submit a compliance filing, within 10 days of the issue date of the Order in the present docket, with revised tariff sheets reflecting the Commission's determinations in this matter?

A. Require Otter Tail to submit a compliance filing, within 10 days of the issue date of the Order in the present docket, with revised tariff sheets reflecting the Commission's determinations in this matter.

B. Require Otter Tail to submit a compliance filing, within a different number of days of the issue date of the Order in the present docket, with revised tariff sheets reflecting the Commission's determinations in this matter.

VII. Staff Recommendation

Staff recommends option #1A, 2A, 3A, 4A, and 5A.