

Minnesota Public Utilities Commission
Staff Briefing Papers

Meeting Date: January 30, 2014 Agenda Item # **7__

Company: Otter Tail Power Company

Docket No. E017/M-13-103
In the Matter of Otter Tail Power Company's Request for Approval of a
Transmission Cost Recovery Rider Annual Adjustment.

Issue(s): Should the requested amount of capital cost recovery through the Rider
be capped at the amount initially approved by the Commission in
Certificate of Need proceedings and should the Company be allowed to
recover internal capitalized costs through the Rider? How should MISO
Schedule 26 revenues be treated in the Rider?

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Relevant Documents

Otter Tail Power-Initial Filing February 7, 2013
Department of Commerce-Comments..... May 24, 2013
Otter Tail Power-Reply Comments..... June 27, 2013
Department of Commerce-Response Comments August 30, 2013
Otter Tail Power-Reply Comments..... September 25, 2013
Department of Commerce- Additional Response Comments..... December 16, 2013
Otter Tail Power-Reply Comments..... January 6, 2014

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January 23, 2014

Statement of the Issue

Should the requested amount of capital cost recovery allowed through the Rider be capped at the amount initially approved by the Commission in the Certificate of Need proceeding and should the Company be allowed to recover internal capitalized costs through the Rider?

How should Schedule 26 revenues be treated in the Rider?

History of Otter Tail Power's Transmission Cost Recovery Rider

Minn. Stat. §216B.16, Subd.7b allows utilities to petition the Minnesota Public Utilities Commission (Commission) for approval of a tariff mechanism for automatic adjustment of charges for jurisdictional costs of new transmission facilities previously approved under Minn. Stat. §216B.243, or certified as a priority project under Minn. Stat. §216B.2425.

Minn. Stat. §216B.1645 allows utilities to petition the Commission for approval of a rate schedule providing for automatic adjustment of charges to recover costs associated with the transmission of electricity generated from sources developed to satisfy the renewable energy objectives of Minn. Stat. §216B.1691.

These two statutes permit automatic rate adjustments to recover new transmission facilities costs, whether incurred by the utility to build and maintain its own transmission facilities or paid by the utility under federal tariffs for the use of other utilities regionally planned transmission facilities. Costs in the second category are billed by the Midcontinent Independent System Operator (MISO), a regional transmission organization, under MISO Schedule 26.

The order (Docket No. 09-881) establishing Otter Tail Power's Transmission Cost Recovery Rider (TCRR) was issued on January 28, 2010. The Commission ordered the following:

- 1) Approval of cost recovery through the rider for the Appleton-Canby project under Minn. Stat §216B.16, Subd. 7b.
- 2) Approval of cost recovery through the rider of the Langdon -Hansel project under Minn. Stat. §216B.1645.
- 3) The Company shall treat MISO Schedule 26 costs as follows:
 - a) Schedule 26 charges shall be trued-up to actual costs.
 - b) Schedule 26 revenues shall be included in the TCRR as soon as the revenues become available.
 - c) The Company shall provide equal treatment to both revenues and expenses and apply a carrying charge to both revenues and expenses.
 - d) The Company shall report Schedule 26 costs and revenues separately to permit review by the Department and interested parties.
 - e) Schedule 26 costs recovered through the Rider are subject to the Commission's continuing jurisdiction to review the costs for reasonableness and to review the continuing appropriateness of rate recovery through the Rider or other means.

- 4) The Company shall update the wholesale credit each year based on its most recent Attachment O wholesale percentage and shall include all supporting calculations, used in the calculation that year's revenue credit.
- 5) The Company is to use the rate design approved in its last rate case to allocate rider costs between customer classes. 49.2% of the rider costs are allocated to the Large General Service class. Within this class the ratio of 16%/84% is used to allocate between the demand and energy portions of customer bills.

In its second TCRR filing (Docket No. 10-1061) the Company proposed to:

- 1) Update and continue recovery through the rider of its Appleton-Canby and Langdon-Hensel 115 kV lines.¹
- 2) Treat its ownership in two new, Fargo and Bemidji CapX2020, 230 kV lines as if that interest were an unregulated business.
- 3) Continue rider recovery of MISO Schedule 26 charges incurred to use transmission facilities owned by other utilities
- 4) Recover its own costs of the Fargo and Bemidji lines by charging its Minnesota customers Schedule 26 rates for use of the Fargo and Bemidji lines instead of seeking rate recovery for the costs.
- 5) Carve out the wholesale related revenues and costs associated with the Bemidji and Fargo lines which are Multi-Value Projects (MVP) and Regional Expansion Criteria and Benefits (RECB) projects and keep the wholesale revenues for shareholders.

Cost recovery of the Appleton-Canby and Langdon-Hensel lines was not disputed by any of the interested parties. Treatment of the ownership, costs and revenues related to the Fargo and Bemidji lines was an item of contention. The Fargo and Bemidji lines are part of the CapX2020 initiative, were regionally planned and constructed in partnership with other utilities to meet both local and regional transmission needs. The Commission denied the Company's proposal and ordered the Company to:

- 1) Calculate the TCRR revenue requirement using the all-in approach. All Minnesota jurisdictional costs of the two lines will be included in the rider and all revenues attributable to the Minnesota jurisdictional portions of the lines to be credited to ratepayers.
- 2) Adopt an intra-class rate design change which was proposed by the Minnesota Chamber of Commerce (MCC) and agreed to by all interested parties. The change shifted all costs allocated to the Large General Service class with 100% to the demand rate element. Previously, these costs were allocated 16% to demand and 84% energy. The shift was made chiefly for the purposes of simplicity.

The Commission denied the Company's proposed carve out method stating that presently all Minnesota utilities follow the same standard ratemaking principles. The Order also stated the following:

¹ Moved into rate base per Company's last rate case Docket No. E017/GR-10-239

Regulatory oversight of the cost recovery process will be more efficient, more transparent, and more accessible to the public using standard ratemaking procedures than using revised procedures proposed by the Company. While utilities, regulators and stakeholders routinely deal with complex issues, there is no value in avoidable complexity.

The Company expressed concern that the ratemaking treatment of these costs might change in the future, especially if the revenues from the transmission lines not directly serving Minnesota ratepayers dropped significantly. The Commission stated that it decides every case on its specific facts and the law, and it cannot predict the substance or outcome of future filings.

The Company's third TCRR filing (Docket #12-514) was simply a request for determination of rider eligibility for several transmission related projects. On March 15, 2013, the Commission approved eligibility for the following:

- 1) Ramsey 230/115kV Transformer Upgrade – Minn. Stat §216B.1645, Subd.2a
- 2) The Sheyenne-Audubon 230kV Line Upgrade– Minn. Stat §216B.1645, Subd.2a
- 3) Brookings, SD-Hampton, MN 345kV Upgrade– Minn. Stat §216B.16, Subd.7b

The Commission cautioned the Company that determining the three projects eligible for cost recovery through the TCRR does not guarantee the recovery of any specific level of costs in a future filing. OTP still has the burden of proof to show the requested level of cost recovery is reasonable and prudent.

Background of Otter Tail Power's Transmission Cost Recovery Rider in this Docket

February 7, 2013: Otter Tail Power Company (OTP) submitted its Transmission Cost Recovery TCRR petition to the Commission for approval of OTP's TCR Annual Update and the proposed 2013 Transmission Cost Recovery Factors.

May 24, 2013: The Minnesota Department of Commerce, Division of Energy Resources, (Department) responded to OTP's initial filing and withheld a recommendation until the Company responded to its information requests as a result of their review of the initial filing.

June 27, 2013: OTP filed reply comments in response to the Department's information requests addressing the cancellation of the Sheyenne-Audubon 230kV line upgrade, MISO Schedule 37 and 38 revenue forecasts, Attachment O revenues, cost recovery caps and the inclusion of internal capitalized costs within the TCRR.

August 30, 2013: The Department recommended that the Commission limit the amount of capital cost recovery allowed in the rider to the amount initially approved by the Commission in Certificate of Need (CN) proceedings or, in the absence of a CN, the amount approved in the eligibility filing. Specifically, the Department is recommending the Commission limit the

amount the Company is allowed to recover for the Bemidji-Grand Rapids project to \$74 million as approved in the CN filing.

The Department also recommended the Commission disallow recovery of internal capitalized costs through the rider. The Department is advising the Commission to require OTP to include all MISO Schedule 26 revenues associated with the TCRR projects that the Company receives from other utilities, including those that are attributable to its disallowed capital costs. The Department stated that OTP will have a chance to recover these costs during its next rate case.

September 25, 2013: The Company submitted reply comments arguing that it would not be appropriate to include MISO revenues which are based on the full cost of construction while excluding some of the costs of construction which are the basis for the revenues generated.

December 16, 2013: The Department submitted comments and continued to recommend the Commission require OTP to pass through the Minnesota share of all MISO Schedule 26 revenues and MISO Schedule 26 charges associated with the projects included in the rider. This includes the revenues attributable to the Company's disallowed capital costs.

January 6, 2014: The Company submitted response comments arguing that the DOC's proposal would create a mismatch between the rate base used to determine revenue requirements and the rate base used to derive revenue credits for facilities included in OTP's TCRR.

Project Eligibility

OTP's petition includes projects that have all been deemed eligible for recovery through the TCRR in previous Commission Orders as listed in the *History of Otter Tail Power's Transmission Cost Recovery Rider* section of this briefing paper.

Sheyenne-Audubon Project No Longer Needed

MISO determined that the Sheyenne-Audubon upgrade project was no longer needed to support the interconnection of Luverne and Ashtabula wind farms due to the CapX2020 Fargo project near the point of interconnection. The study showed that with the Fargo line energized, flows along the Sheyenne line would be reduced to levels below the existing rating of the facility, eliminating the need to upgrade. The Department and Company agree that the Sheyenne-Audubon 230kV upgrade is no longer needed and the Company has removed all associated costs from the rider.

Summary of Proposed Projects & Revenue Requirements

A summary of OTP's proposed 2013 TCR revenue requirements is shown in Table 1 below. The costs have been updated from the original filing to remove costs associated with the Sheyenne-Audubon project.

Table 1: Summary of Proposed Projects and Revenue Requirements	
Project:	2013 Revenue
CAPX 2020 Fargo	\$3,225,858
CAPX 2020 Bemidji	\$1,040,139
CAPX 2020 Cass Lake - Bemidji	\$463,263
CAPX 2020 Brookings	\$1,045,507
Ramsey 230/115 kW Transformer Upgrade	\$28,251
MISO Schedule 26 Expense	\$4,011,689
MISO Schedule 26A Expense	\$434,371
MISO Schedule 26 Revenues	(\$6,497,711)
MISO Schedules 37 & 38 Revenues	(\$0)
MISO Schedules 26A Revenues	(\$1,118,623)
Carrying Cost	(\$26,920)
True-up	(\$378,716)
Total	\$2,227,108

OTP's Current and Proposed TCR Rates

Table 2: OTP's Proposed Rates for TCR				
Class	Current Energy Cents/kWh	Current Demand \$/ kW	Proposed Energy Cents/kWh	Proposed Demand \$/ kW
Large General Service	N/A	\$0.391	N/A	\$0.462
Controlled Service	0.019¢	N/A	0.022¢	N/A
Lighting	0.085¢	N/A	0.091¢	N/A
All other service	0.126¢	N/A	0.138¢	N/A

Forecasted MISO Schedule 37 & 38 Revenues

The Department verified with the Company that forecasted MISO Schedule 37 and 38 revenues are reflected in the Company's TCRR in the forecasted Schedule 26 revenues. The Department recommends in future filings the Company separately identify the Schedule 37 & 38 revenues as such.

Attachment "O" Revenues

The Department confirmed its understanding of how Attachment O revenues related to RECB

projects and MVPs with the Company. The Company does not receive any other revenues (besides those received under MISO Schedules 26/26A) from other parties for their use of OTP's RECB and MVP transmission lines. The revenue requirements for the RECB and MVPs have been removed from the Company's Attachment O calculation.

Party Positions

The Department made two recommendations to limit the capital costs included in the TCRR. The first recommendation is that the TCRR should not include internal capitalized labor costs in the total amount of investment used for Rider recovery. The second recommendation is that the capital costs used in the TCRR should be capped at the planning estimates cited in the CN.

Capitalized Internal Costs

The Company has included approximately \$1.76 million in of internal capitalized labor costs in its calculation of the proposed TCRR revenue requirement and the resulting TCR rate. In its June 27, 2013 reply comments, OTP summarized its position as follows:

Capitalized Internal Costs should not be excluded from the rate base in the TCRR. OTP demonstrated in its last general rate case that internal costs attributable to long term construction projects were not being recovered in base rates. The Administrative Law Judge in that proceeding made specific findings on the subject and the Commission's Order in that proceeding explained why such costs should not be excluded from recovery, citing both ratemaking and policy reasons for the ruling:

“The Commission likewise agrees with the Administrative Law Judge that there is no principled basis for disallowing recovery of internal costs not reflected in rates and that it is not in the public interest to discourage Otter Tail from making the best use of its internal resources and expertise.”

In its August 30, 2013 response comments, the Department explained its position on why internal capitalized costs should be not be included in the TCRR calculation. The Department noted that this issue was fully addressed and vetted in Minnesota Power's TCR Rider filing in Docket No. E015/M-10-799. The Department maintains its position as discussed therein and continues to conclude that the Commission's decision regarding this issue was correct. Specifically, the Commission's May 11, 2011 Order in that proceeding stated:

Under Minn. Stat. § 216B.03, a utility's rates must be just and reasonable. The Company carries the burden to meet this requirement, and any doubt as to the reasonableness of a rate is to be resolved in favor of the consumer.

The Commission concurs with the Department that the Company has not established that recovering internal costs under the rider is consistent with the rider statute's requirement "that recovery from Minnesota retail customers for the allowance for funds used during construction is not sought through any other mechanism." The Company has not shown that internal costs are not being recovered through base rates. Rather, the Department has demonstrated that a representative portion of the Company's internal costs *are* being recovered through base rates.

The Department concluded that the Commission should reach the same conclusion for OTP.

Cost Recovery Caps

The second recommendation made by the Department is that the capital costs included in the TCRR should be capped at the planning estimates cited in the CN, or Eligibility Determination, if no CN was issued. The Department stated that the Commission has set a standard for evaluating TCR project costs in Xcel Energy's TCR filing (Docket No. E002/M-09-1048). The Commission's Order, dated April 7, 2010, stated that:

...the Commission finds that the TCR project cost recovery through the rider should be limited to the amount of the initial cost estimates at the time the projects are approved as eligible projects, with the opportunity for the Company to seek recovery of excluded costs on a prospective basis in a subsequent rate case. A request to allow cost recovery for project costs above the amount of the initial estimate may be brought for Commission review only if unforeseen or extraordinary circumstances arise on a project.

The Department requested the Company provide clarification of the planning estimates cited in the CN. The Company provided the following schedule:

Project	CON Docket #	TCR Eligibility/Update Docket #	TCR Eligibility/Update Amount (millions)	OTP Ownership Percentage	OTP's Share of Approved Costs (millions)
Fargo-Monticello	06-1115	E017/M-10-1061	\$640.0	13.2%	\$84.5
Bemidji-Grand Rapids & Cass Lake	07-1222	E017/M-10-1061	\$111.5	20.0%	\$22.3
Brookings-Hampton	06-1115	E017/M-12-514	\$669.6	4.1%	\$27.5
Ramsey	No CN	E017/M12-514	\$0.9	100.0%	\$0.9

The Department questioned the numbers the Company provided. The Company clarified the

numbers for Fargo-Monticello and Brooking-Hampton were the numbers provided in the CN. The Ramsey project did not require a CN and the cost estimate used is the amount that was provided in the Eligibility filing.

The \$111.5 million provided for Bemidji-Grand Rapids project, however, was the amount approved for recovery in the Company's last TCR update. The Department has determined the cap amount for the Bemidji-Grand Rapids project to be \$74 million which is the amount approved by the Commission in the CN proceeding adjusted for inflation. The amount the Commission should allow the Company to recover through the TCRR for the Bemidji-Grand Rapids project is disputed between the parties.

The Department noted that cost estimates are used extensively throughout CN and Route Permit proceedings and are relied upon by the Commission when considering the proposed alternatives of the project. Approval of the project in a CN or Route Permit proceeding is not a blank check for cost recovery in riders.

Absent cost recovery caps tied to the record in which the project was selected and approved, utilities have little incentive to expend the effort needed to accurately report project costs in CN and Route Permit proceedings, nor to insure that actual costs are as reasonable as possible. Moreover, disregarding CN and Route Permitting cost estimates and allowing utilities to recover all costs jeopardizes the integrity of the CN and Route Permitting process and the figures relied upon by the Commission in those decisions.

TCR riders give utilities the extraordinary ability to charge their ratepayers for costs of facilities prior to the ordinary timing: the first rate case after the project goes into service. In exchange, ratepayers need some assurance that utilities are being held accountable for the costs they charge to ratepayers. Requiring utilities to wait until the first rate case after a project is in service to justify recovery of cost overruns of projects is the least that can be done to assure ratepayers that utilities are being held accountable.

The Department further recommended the Commission consider reducing the Company's return on investment allowed in the rider, currently set at 8.61%.

The Company submitted response comments on June 27, 2013. The Company stated that CN planning estimates are by their nature preliminary and made without the benefit of routing information or final design engineering. For these reasons, CN planning estimates have not historically been viewed as an upper limitation on prudence and using the CN estimates in this way could not have been reasonably contemplated by the Company at the time of the CN application.

The Company stated that the \$111.5 million project cost for the Bemidji-Grand Rapids estimate is the amount the Commission approved in its last TCRR update in Docket No. E017/M-10-1061. According to the Company the Commission addressed whether it was appropriate and beneficial to include more or less of the costs associated with the project. The Commission ruled that **all costs** should be included. The issue of cost caps was not raised by the Department in that

proceeding. Further, the Department's recommendation to cap costs at CN levels would be a direct contradiction to the Commission's ruling to include all costs so that all revenues could be credited to the Rider.

Rider Treatment of Revenue & Charges Including Schedule 26 & Schedule 26A Revenue & Charges

In its August 30, 2013 comments, the Department disputed the Company's interpretation of what the Commission meant when it ordered "all costs should be included" in Docket No. E017/M-10-1061. The Order was issued to address OTP's proposal for alternative ratemaking treatment or "split-method". In that Docket the Company had proposed to:

- 1) Treat its ownership in two new, Fargo and Bemidji CapX2020, 230 kV lines as if that interest were an unregulated business.
- 2) Continue rider recovery of MISO Schedule 26 charges incurred to use transmission facilities owned by other utilities
- 3) Recover the costs of its own Fargo and Bemidji lines by charging its Minnesota customers Schedule 26 rates for use of the Fargo and Bemidji lines instead of seeking rate recovery for the costs.
- 4) Carve out the wholesale related revenues and costs associated with the Bemidji and Fargo lines which are MVP and RECB projects and keep the revenues for shareholders.

The Commission denied the Company's proposal and ordered the Company to:

Calculate the TCRR revenue requirement using the all-in approach. All Minnesota jurisdictional costs of the two lines will be included in the rider and all revenues attributable to the Minnesota jurisdictional portions of the lines to be credited to ratepayers.

The Commission denied the Company's proposed carve out method stating that presently all Minnesota utilities follow standard ratemaking principles. The Order also stated the following:

Regulatory oversight of the cost recovery process will be more efficient, more transparent, and more accessible to the public using standard ratemaking procedures than using revised procedures proposed by the Company. While utilities, regulators and stakeholders routinely deal with complex issues, there is no value in avoidable complexity.

In its September 25, 2013 comments, the Company identified the three outstanding issues:

- 1.) Whether OTP's share of the Bemidji-Grand Rapids construction costs should be capped at the CN estimate and be excluded from the rate base used to derive the TCRR rates.
- 2.) Whether capitalized internal labor costs incurred by OTP during construction should be excluded from the rate base used to derive the TCRR rates.
- 3.) If the answer to the first and/or second issue is yes, is it appropriate to require the

Company to include all of the revenues generated from OTP's investment in these facilities in the TCRR rate calculations, even if the revenues are attributable to disallowed capital costs?

OTP stated that it has addressed the first two issues in its reply comments filed on June 27, 2013 and believes the reply comments demonstrate that the costs should not be excluded from the rate base used to derive the TCRR rates. Issue 3 was identified as a matter of dispute from the Department's August 30, 2013 comments. The Department recommended that the Commission require OTP to pass through all MISO Schedule 26 revenues that it receives from other utilities associated with the projects included in the TCRR, including those revenues that are attributable to the Company's disallowed capital costs.

OTP stated that the Department's recommendation:

- 1.) Would create a mismatch between the rate base used to derive the annual revenue requirements or costs of the projects included in the TCRR and the rate base used to derive the revenue credits applied in the TCRR.
- 2.) Using two different rate bases in this way would be arbitrary and violate fundamental regulatory and accounting principles.
- 3.) Would result in substantial harm to OTP and serve as a serious disincentive for making such investments even though they are very beneficial to OTP's ratepayers.
- 4.) Would violate the Commission's previous decision regarding the "all-in" approach.

Department - December 16, 2013 Additional Response Comments

On December 16, 2013, the Department responded to OTP's comments and:

- 1.) Agreed that their recommendation uses two different rate bases.
 - a.) The Minnesota rate base used to determine the gross annual revenue requirements (or costs), which are charged to OTP's ratepayers in the TCRR, would exclude the disallowed capital costs.
 - b.) The larger rate base used by MISO to determine Schedule 26 revenues and Schedule 26 charges includes the capital costs.
- 2.) Both MISO Schedule 26 revenue and charges are based on the full investment of the project's costs as determined by MISO and do not reflect decisions made by other regulatory agencies to limit the amount of capital costs recovered in a rider.
- 3.) The Department's recommendation to require OTP to include all Schedule 26 revenues appropriately matches OTP's inclusion of all MISO Schedule 26 charges.
- 4.) Since OTP's ratepayers are responsible for all RECB/MVP charges (for transmission lines owned by OTP and for those owned by other utilities), OTP's ratepayers should be credited with all the RECB/MVP revenues for the transmission lines that OTP owns.
- 5.) The recommendation to remove disallowed capital costs only affects the Minnesota portion of the rate base and the resulting Minnesota revenue requirement. The Schedule 26 revenues and charges would remain exactly the same regardless of the decision to cap the costs at the CN estimate or to allow the Company full recovery in the rider.

- 6.) The Commission's previous decision regarding the "all-in" approach was referring to whether the Company was required to include both retail and wholesale related revenues and expenses in its TCRR, not whether the Commission could allow or disallow costs associated with projects included in the TCRR.

OTP - January 6, 2014 Reply Comments

OTP submitted reply comments on January 6, 2013 and summarized its issues as follows:

- 1.) The Department's recommendation to exclude some costs but to include all revenues (even those derived from the excluded costs) would create an internal contradiction in the calculation of the TCRR rate. Creating such an internal contradiction in the calculations for the TCRR rates would be arbitrary, and made only to create a false arbitrage between the revenue requirements and the revenue credits.
- 2.) If ratepayers are paying for all of the investments they should be credited with all of the revenues derived from the investments; if they are paying for some portion of the investments, they should be credited with a corresponding portion of the revenues derived from the investments.
- 3.) Including all costs in the rate base for the revenue requirements and the rate base for the revenue credits (as OTP has proposed) results in lower TCRR rates than if OTP had not made investments in these projects.
- 4.) The TCRR Statute does not require a mismatching of the rate base used for the revenue requirement and the rate base used for the revenue credits, as the DOC claims.
- 5.) The DOC's proposal would not satisfy the purpose of the TCRR Statute, which is for "the utility to recover on a timely basis the costs net of associated revenues of facilities." (Minn. Stat. §216B.16, subd. 7b(a).)
- 6.) OTP would be substantially harmed by the approach recommended by the DOC; it would recover less than 25 percent of what an outside entity, such as an independent transmission company, would recover for these investments.
- 7.) Mismatching the rate base for the revenue requirements and the rate base for the revenue credits (as the DOC has proposed) would not be consistent with the Commission's ruling in OTP's last annual TCRR Update, in which it ruled: "*All Minnesota-jurisdictional costs of the two lines [Bemidji-Grand Rapids and Fargo-Monticello] will be included in the Rider and all revenues attributable to the Minnesota-jurisdictional portions of the lines will be credited to ratepayers.*"
- 8.) In addition to being a fundamentally inappropriate ratemaking approach, inconsistent with the TCRR Statute and the Commission's prior Order, creating a mismatch as recommended by the DOC would discourage OTP and other Minnesota utilities from making these investments. Therefore, they might not be built, they might be delayed, or they might be constructed by other entities at a much higher cost to OTP's retail customers. These outcomes are the opposite of what was intended by the TCRR Statute and they would not serve the public interest.

Staff Analysis

Cost Recovery Caps

The Company is seeking cost recovery of the full amount of the Bemidji-Grand Rapids project. The Company has argued that the Commission approved the \$111.5 million of costs in its previous TCRR filing. OTP's ownership percentage is 20% and the Company's portion of costs under this scenario would be \$22.3 million. The Company has requested the Commission approve cost recovery of \$22.3 million. The Company is requesting recovery of approximately \$1.04 million for the project.

The Department believes that the correct number to allow cost recovery for the project is \$74 million which is the amount approved by the Commission in the Company's CN proceeding plus an allowance for inflation. Multiplied by the Company's 20% ownership, the Department is recommending Commission approval of recovery of \$14.8 million through the rider. The Department's proposal would allow the Company to recover approximately \$990,000 through the rider.

The Commission has established precedent on the issue of whether project costs should be capped at the CN estimates. In Xcel's TCR filing in Docket No. E002/M-09-1048, the Commission set a standard for evaluating TCR project costs going forward. The Commission stated in its April 7, 2010 Order that:

...the Commission finds that TCR project cost recovery through the rider should be limited to the amount of the initial cost estimates at the time the projects are approved as eligible projects, with the opportunity for the Company to seek recovery of excluded costs on a prospective basis in a subsequent rate case. A request to allow cost recovery for project costs above the amount of the initial estimate may be brought for Commission review only if unforeseen or extraordinary circumstances arise on a project.

In its decision on Xcel Energy's TCRR filing in Docket No. E002/M-12-50, the Commission imposed a total project cost cap of \$74 million on Xcel's portion of the investment in the Bemidji-Grand Rapids line.

In its TCRR eligibility determination, Docket No. E017/M-12-514, the Commission's Order cautioned OTP that:

Determining the three projects eligible for cost recovery through the TCRR does not guarantee the recovery of any specific level of costs in a future filing. OTP still has the burden of proof to show the requested level of cost recovery is reasonable and prudent.

Recovery of costs through rate riders is an exception to the traditional ratemaking

process. Riders allow a utility to recover reasonable and prudent costs that arise outside of the test year used to establish the utility's authorized rates. The process for recovery through a rider involves two components: the utility must obtain approval to recover costs through a rider, and must establish that the costs incurred were reasonable and prudent.

The issue of whether to allow costs that exceed those estimated at the time the Commission originally approved a project to be passed through rate riders is a difficult policy question which has been previously addressed by the Commission. In briefing papers that addressed Xcel Energy's TCRR in Docket No. E002/M-09-1048, Staff stated the following:

The administrative burden on parties and the Commission from the proliferation of riders is significant, and expected to be even more significant in the future as more utilities ask for riders and more money flows through riders. Allowing these annual rider proceedings to continue to be "mini rate cases" in which revenue requirements, prudence and reasonableness, and rate design issues are being argued in every annual filing is unmanageable, and takes everyone's resources away from many other important functions, including rate cases. Riders are designed to be short-term vehicles to allow more timely recovery of investments in projects that the legislature and Commission have determined to be in the public interest and wish to encourage. Limiting recovery through riders to the level of costs originally used when the Commission approved the project, and keeping the existing overall rate design in place, perhaps through the use of a percentage of revenue basis, would go a long way to making this process more manageable.

Changes in cost projections can occur for many reasons, some of them largely outside of a utility's control. It is arguable that by not allowing any increases over original estimates to be passed through riders, no matter how justified, the utility would not make optimal choices when faced with changed circumstances and the full legislative intent of the rider would not be fulfilled. However, staff believes that regardless of whether a project ends up being over or under budget, the overall project expenditures need to be evaluated for reasonableness and prudence before being allowed permanent rate recovery. Not allowing costs in excess of original estimates is not denying recovery; it is just requiring that these "excess" costs be justified in a rate case, just as is true for most utility investments.

If the Commission is to allow costs in excess of original projections to be recovered through riders, then staff believes the Company should be required to include support for such recovery in its filing, and be held to a high burden of proof to show that this recovery is reasonable and in the public interest. With respect to the instant case, Xcel offered a detailed explanation of the cost overruns as weather related and field conditions that were unforeseeable at the beginning of the project. If the Commission is inclined to consider inclusion in the rider, then the Commission needs to evaluate whether Xcel has met its

burden to show these costs are reasonable.

OTP points out that all of the costs incurred for the Bemidji-Grand Rapids line were approved for recovery in Xcel's last rate case and the prudence of the costs incurred to construct the line was not an issue. Xcel was allowed to recover its percentage ownership of the \$111.5 cost to construct the line.

Staff recommends the Commission cap the project cost at \$74 million, the level the Company presented in the CN proceeding.

Capitalized Internal Costs

Staff notes that cost recovery for internal capitalized costs is always highly scrutinized due to the risk of double recovery. The Commission has a record of denying cost recovery of internal capitalized costs between rate cases.² It is unusual in rate rider dockets to allow a cost recovery

² Provided by the Department:

- Docket No. E002/M-03-1462. In the Matter of Northern States Power Company d/b/a Xcel Energy for Approval of Deferred Accounting for Costs Incurred for the Web Tool and Time-of-Use Pilot Project. Specifically DOC (then OES) comments dated July 27, 2004 and as approved in the February 25, 2005 Commission Order.
- Docket No. E002/M-06-1315. In the Matter of Northern States Power Company d/b/a Xcel Energy Petition for Approval of Deferred Accounting Treatment of Costs Related to the Mercury Emissions Reduction Act of 2006. Specifically OES comments dated November 15, 2006 and as approved in the January 31, 2007 Commission Order.
- Docket No. E001/M-09-336. In the Matter of Interstate Power and Light Company's Petition for Approval of Deferred Accounting Treatment of the Costs Related to Cancelled Sutherland Generating Station Unit 4; the DOC recommended that the Commission deny IPL's request for deferred accounting for a coal plant that the Company ultimately decided to abandon; however, in the event that the Commission approved IPL's request, the DOC recommended that the Commission deny recovery for IPL's internal related costs (DOC comments dated July 1, 2009). The Commission ultimately denied IPL's request for deferred accounting in its December 18, 2009 Order.
- Docket No. E015/PA-09-526. In the Matter of Minnesota Power's Petition to Purchase Square Butte Cooperative's Transmission Assets and Restructure Power Purchase Agreements from Milton R. Young Unit 2 Generating Station. The DOC recommended and MP agreed to remove any internal costs associated with its purchase of the transmission assets and the renegotiation of its purchase power agreements.
- Docket No. E002/M-09-1083. In the Matter of the Petition of Northern States Power Company, a Minnesota Corporation for approval of the 2010 Renewable Energy Standard Cost Recovery Rider and 2009 RES Tracker Report. Specifically in DOC reply comments dated February 26, 2010 and as approved in the April 22, 2010 Commission Order.
- Docket No. E017/M-09-1430. In the Matter of Otter Tail Power Company's Petition Requesting Authority to Use Deferred Accounting for Costs Incurred During its Participation in the Big Stone II Project. Specifically DOC comments dated March 17, 2010. Otter Tail Power Company later withdrew its deferred accounting request and is addressing the issue in its pending rate case in Docket No. E017/GR-10-239, in accordance with the Commission's Order dated June 7, 2010.
- Docket No. E017/M-09-1484. In the Matter of Otter Tail Power Company's Request for Approval of its 2010 Renewable Resource Cost Recovery Adjustment Factor. Specifically DOC comments dated March 17, 2010 and July 9, 2010. In its Order dated August 27, 2010, the Commission denied Otter Tail Power Company's request to include capitalized labor and internal costs, subject to future true-up if the Commission determines in Otter Tail's pending rate case, Docket No. E-017/GR-10-239, that the amount

request for internal capitalized costs. Generally, recovery of internal capitalized costs are proposed in general rate cases. Rate riders in general are intended to accelerate the process by which utilities are able to recover qualified costs outside the normal rate making process. The language of the Minn. Stat §216B.16, subd. 7b states:

Notwithstanding any other provision of this chapter, the commission may approve a tariff mechanism for the automatic annual adjustment of charges for the Minnesota jurisdictional costs of

(i) new transmission facilities that have been separately filed and reviewed and approved by the commission under section 216B.243 or are certified as a priority project or deemed to be a priority transmission project under section 216B.2425; and

(ii) charges incurred by a utility that accrue from other transmission owners' regionally planned transmission projects that have been determined by the Midwest Independent System Operator to benefit the utility, as provided for under a federally approved tariff.

The Commission must be able to specifically verify that the costs are properly accounted for in order to provide the assurance that double recovery is not occurring. Double recovery of costs can occur when a single cost is recovered (billed) or charged in two separate places. The simplest example of double recovery can occur when a cost is billed both in base rates and through a rate rider. Consider the following example presented in Staff briefing papers in Docket No. E002/M-12-50 as to how double recovery can occur:

For example, assume that in a rate case a company has \$1,000,000 of labor costs and that \$800,000 is included in O&M expense and \$200,000 is capitalized. The \$800,000 would be recovered in the base rates set in the rate case.

Assume in the following year, the company has the same \$1,000,000 of labor costs, but only \$750,000 is included in O&M expense and \$250,000 is capitalized. The company would continue to collect \$800,000 in base rates even though the actual cost is \$750,000. The additional \$50,000 that was capitalized would be included in rate base in its next rate case filing where it would earn a rate of return and would be depreciated over the assigned life. In this example, the company would recover \$50,000 currently and would also recover the same \$50,000 over the life of the asset resulting in double recovery starting in the next rate case.

Unlike a rate case, a rider does not look at all the costs and does not reset base rates. For that reason, there is the potential of double recovery of costs. If the Commission believes that is a concern, there is precedent to disallow recovery of capitalized internal costs from this rider.

should be included.

Legitimate costs are recovered under the proper mechanism either through base rates or through the appropriate rate rider, but under no circumstances should a utility be recovering the same costs in both places. The issue of double recovery of costs occurs in a variety of circumstances. The Commission needs to be able to verify that all costs are properly accounted for and the opportunity for double recovery of costs is minimized.

Staff agrees with the Department's position that recovery of capitalized internal costs should not be allowed through the TCRR. Staff also notes that both Minnesota Power, and Xcel Energy currently do not recover capitalized internal costs through their TCRR.

Schedule 26 & Schedule 26A Revenue & Charges

Under Schedule 26, Transmission Customers shall compensate the Transmission Provider via the current Network Upgrade Charge (NUC). This is a transmission charge in addition to any other charges that a Transmission Customer is responsible for. All Schedule 26 revenues collected by MISO are distributed to the Transmission Owner(s) as follows:

- 1.) The revenues collected by MISO for Schedule 26 Transmission Service provided are fully distributed based on a Transmission Owner's proportionate share of the Total NUC collected each billing cycle.
- 2.) Revenue distribution is the same for all reservations whether external or internal to MISO.

Note that in OTP's case Schedule 26 Revenues are received by OTP for use of its transmission facilities and Schedule 26 Charges are paid by OTP to another entity for use of their transmission facilities.

Under Schedule 26-A, the Multi-Value Project (MVP) modifications to the Tariff were made as part of an ongoing, comprehensive review of MISO's Regional Expansion Criteria and Benefits (RECB) provisions for transmission cost allocation. The MVP is a new transmission planning and cost allocation project category for projects that qualify based on multiple reliability and/or economic criteria affecting multiple transmission zones. Primary drivers for development of this project category were the need to integrate location-constrained resources and large quantities of remote generation resources. Its cost allocation methodology is believed to be better suited to projects benefiting multiple regions than previously effective rules because it allocates project costs among multiple beneficiaries across a larger area (in the case of MVP cost allocation, the entire MISO footprint). A qualifying project cannot be merely of local benefit to the region.

OTP's investment in and retail responsibility for regional transmission projects was explained by the Company in its February 25, 2011 reply comments in Docket No. E017/M-10-1061. The Company stated that:

OTP's investments in these regional projects is larger than its retail load share of responsibility for the projects, therefore OTP's Schedule 26 revenues from the projects (which are based on the level of investment) exceeds OTP's Schedule 26

charges from the projects (which are based on OTP's load levels in MISO—and the particular MISO cost allocation methodology applicable to each project).

The difference between OTP's investment percentage and its retail responsibility for the Bemidji-Grand Rapids projects is as follows:

Project	OTP Investment %	OTP Retail Load Responsibility	Retail Responsibility for OTP Investment
Bemidji	20%	12.25%	61.25%

According to the Company, if the Commission decides to apply a cost cap to the Bemidji-Grand Rapids project and/or exclude recovery of capitalized internal costs from rate base, then the Company should be allowed to exclude the corresponding Schedule 26 revenue credits from the rider. The Company demonstrated that removing the corresponding revenue credits associated with the disallowed costs would lower the TCR rate the Company is proposing for recovery.

The Department and Staff disagree with the Company and recommend that all of the Schedule 26 revenues and all of the Schedule 26 costs be included in the Rider. The Company has previously argued for alternative ratemaking treatment for Schedule 26 items in prior TCRR filings. The Company's position and the Commission's prior decisions in relation to Schedule 26 items is outlined below.

The Commission's Order issued on January 28, 2010, which established OTP's TCRR in Docket No. E017/M-09-881 stated that MISO Schedule 26 shall be treated as follows:

- a.) Schedule 26 charges shall be trued up to actual costs.
- b.) Schedule 26 revenues shall be included in the TCRR as soon as the revenues become available.
- c.) The Company shall provide equal treatment to both revenues and expenses and apply a carrying charge to both revenues and expenses.
- d.) The Company shall report Schedule 26 costs and revenues separately to permit review by the Department and interested parties.
- e.) Schedule 26 costs recovered through the Rider are subject to the Commission's continuing jurisdiction to review the costs for reasonableness and to review the continuing appropriateness of rate recovery through the Rider or other means.³

³ Staff believes it necessary to make the Commission aware that the RECB charges are of a continuing nature. It is Staff's understanding that costs for transmission projects recovered through the RECB will continue to be recovered through the RECB process until the owner's investment in the transmission project is recovered. Further, it is Staff's understanding that Minnesota utilities expect that the RECB charges (and revenue offsets) will continue to be recovered through the TCR recovery mechanism. In other words, it appears that there is the potential for significant RECB cost recovery to occur through the TCR mechanism well into the future.

As noted, the statute authorizing the inclusion of the MISO charge in the TCR mechanism is permissive, and does not require that such charges be afforded special rate treatment outside of a general rate proceeding. While the costs presented for recovery in this proceeding are limited in amount and mostly originate from projects within OTP's

In the Company's TCRR update filed in Docket No. E017/M-10-1061 the Company proposed to treat Schedule 26 costs as follows:

- a.) Treat its ownership in the Fargo and Bemidji lines as if that interest were an unregulated business.
- b.) Continue Rider recovery of MISO Schedule 26 charges incurred to uses transmission facilities owned by other utilities.
- c.) Recover the costs of its own Fargo and Bemidji lines by charging its Minnesota customers Schedule 26 rates for use of the Fargo and Bemidji lines instead of seeking rate recovery for the costs.
- d.) Carve out the wholesale related revenues and costs associated with the Bemidji and Fargo lines which are MVP and RECB projects and keep the revenues for the shareholders.

The Commission denied the Company's proposed carve out method stating that presently all Minnesota utilities follow standard ratemaking principles. The Order also stated the following:

Regulatory oversight of the cost recovery process will be more efficient, more transparent, and more accessible to the public using standard ratemaking procedures than using revised procedures proposed by the Company. While utilities, regulators and stakeholders routinely deal with complex issues, there is no value in avoidable complexity.

In the current filing, the Company argued that the Department's recommendation to include all Schedule 26 revenues and all Schedule 26 costs would:

- a.) Create a mismatch between the rate base used to derive the annual revenue requirements or costs of the projects included in the TCR Rider and the rate base used to derive the revenue credits applied in the TCR Rider.
- b.) Be arbitrary and violate fundamental regulatory and accounting principles.
- c.) Result in substantial harm to OTP and serve as a serious disincentive for making such investments, even though they are beneficial to OTP's ratepayers.
- d.) Would violate the Commission's previous decision regarding the "all-in" approach.

Staff and the Department disagree with OTP's argument regarding the "all-in" approach. In E017/M-10-1061 the Commission was responding to the Company's proposal to carve out the wholesale portion of related revenues and costs and retain the wholesale revenues for OTP's shareholders. In the current docket, the Company wants to carve out and keep the revenues that are attributable to disallowed capital costs generated from OTP's investment in the Bemidji-Grand Rapids line in the TCRR rate calculations.

area, at some point it may be appropriate to include such costs in base rates rather than allowing them to build in amount and continue being afforded rate rider treatment into perpetuity.

Staff and the Department agree with the Company that requiring the Company to include all Schedule 26 revenues and all Schedule 26 costs would create a mismatch between the rate base used to derive the annual revenue requirements or costs of the projects included in the TCRR and the rate base used to derive the revenue credits. However, Staff and the Department believe there is no requirement that the two rate bases must match. MISO Schedule 26 revenues are based on the full investment of the project's costs and do not reflect decisions made by other regulatory agencies to limit the amount of capital costs recovered in a rider. It is also true that MISO Schedule 26 charges are based on the full investment of the project's costs and do not reflect decisions made by other regulatory agencies. Regardless of any decision made by the Minnesota Public Utilities Commission, the MISO Schedule 26 costs and revenues would remain unchanged.

Staff notes that both Minnesota Power and Xcel Energy include all Schedules 26 revenues and Schedule 26 costs in their TCR calculations and recommends OTP be required to do the same. Staff repeats the argument in made in Docket No. E002/M-09-1048,

The administrative burden on parties and the Commission from the proliferation of riders is significant, and expected to be even more significant in the future as more utilities ask for riders and more money flows through riders. Allowing these annual rider proceedings to continue to be "mini rate cases" in which revenue requirements, prudence and reasonableness, and rate design issues are being argued in every annual filing is unmanageable, and takes everyone's resources away from many other important functions, including rate cases.

Staff also repeats the language from the Commission's Order in Docket No. E017/M-10-1061:

Regulatory oversight of the cost recovery process will be more efficient, more transparent, and more accessible to the public using standard ratemaking procedures than using revised procedures proposed by the Company. While utilities, regulators and stakeholders routinely deal with complex issues, there is no value in avoidable complexity.

Staff strongly recommends the Commission deny the Company's proposal for alternative ratemaking treatment of Schedule 26 items.

Carrying Charge on Tracker Balances

Ordering paragraph #4 of the Commission's April 17, 2013 Order Approving Request To Reduce Rider Recovery Factor, Approving Refund, and Setting Requirements for Future Rider Filings in Docket No. E-017/M-12-708⁴ required the Company to:

⁴ 2012 Renewable Resource Cost Recovery Adjustment Factor Filing

In its next rider filing of any type, Otter Tail Power Company shall provide justification for any carrying charge it proposes to impose on rider tracker account balances.

This requirement was made because of a concern raised by Staff. Staff suggested that the Commission may want to revisit whether carrying charges are appropriate for rate riders. The purpose of the rider is to provide for accelerated recovery of certain types of capital projects outside of a rate case. The calculation of the amount to be recovered in the rider mimics the recovery allowed in a rate case including earning a rate of return on the cost of the project. The Company is allowed to track the recovery, true-up and collect any under-recovery. There seems to be a presumption by utility companies that simply because there is a tracker account, that there should be a carrying charge on the tracker balance.

Recovery of non-rider eligible plant additions commences with the first rate case subsequent to the plant being placed in service or the test year in which the plant is placed in service. Recovery of rider eligible plant additions begins immediately with the initial rider factor approval so there is more timely recovery of the cost. In the case of the transmission rider, the recovery starts with construction rather than when placed into service.

Most rate cases are based on forecasted test years. The recovery of plant additions is not tracked or trued-up in a future rate case so there is no guarantee of recovery. The recovery of rider-eligible plant additions is trued-up both for variances between the forecasted and actual costs as well as for variances in sales volumes providing a guarantee of recovery of the costs.

Given all the additional perks of rider recovery compared to normal rate case recovery, Staff questioned whether allowing a carrying charge on top of all the other benefits of rider recovery can result in fair and reasonable rates.

OTP's response to that requirement was included in its June 27, 2013 Reply starting on page 17:

Due to the nature of how rate rider recovery mechanisms work, when revenue requirements are determined for each collection period, actual revenues collected will never match the approved revenue requirement for the collection period. To provide protection to both the ratepayers and OTP, a carrying charge is assessed on any over-collection or under-collection balance realized in the tracker. The carrying charge is based on OTP's overall rate of return approved in its most recent general rate case.

OTP requests that the Order in this matter include an indication that this explanation satisfies the requirement created by Ordering paragraph 4 of the April 2, 2013 Order in Docket No. E017-M-12-708.

The Department stated on page 13 of its August 30, 2013 comments that OTP addressed this issue on pages 17 and 18 of its reply comments. The Department stated it agreed that OTP has

complied with the Commission's Order in Docket No. E017/M-12-708. Moreover, the DOC agrees that OTP's *calculation* of carrying charges appears reasonable.

OTP complied with the Order to the extent that it addressed the issue in its comments. The calculation of the carrying charge may be reasonable as noted by the Department but that is not the issue that was required to be addressed.

The Company titled its response "Compliance requirement from Order in Docket No. E017/M12- 708: demonstration that carrying charges used in OTP's rider provide fair and equitable treatment of tracker account balances." As the title indicates OTP's response was essentially that a rider reflects either an over or under-recovery and the carrying charge provides symmetrical treatment in both circumstances. It is a given that a forecast by its nature will vary from actual. That fact alone does not justify a carrying charge.

The Commission directed OTP to explain why a carrying charge is justified for these riders. The Company's response does not provide the required justification. Further, the Department acknowledged on page 8 of its August 30, 2013 comments that "Riders give utilities an *extraordinary means* to recover costs; under normal ratemaking, utilities cannot recover costs of new facilities until the rate case subsequent to when the facilities are used and useful." (Emphasis added) As discussed, and also stated by the Department, riders provide an extraordinary means to recover costs compared to normal rate recovery.

The benefits provided by rider recovery accrue to the Company. Ratepayers do not benefit because they pay increased costs sooner and also increased rates for under-recovery true-up that they would not pay under normal rate recovery. A carrying charge is used to compensate for the time value of money. Because the utility is getting accelerated recovery in the rider compared to normal rate recovery, there is no reason to compensate for the time value of money.

Requiring ratepayers to pay a carrying charge based on the Company's rate of return in addition to the extraordinary means of recovery is not justified.

Decision Alternatives

- 1.) Sheyenne-Audubon Project
 - a.) Determine that the Sheyenne-Audubon project is no longer needed.
 - b.) Determine that the Sheyenne-Audubon project is needed.
 - c.) Determine that the Sheyenne-Audubon project should be studied further to determine if the project is needed.
- 2.) Forecasted MISO Schedule 37 & 38 Revenues
 - a.) Order the Company to identify Schedule 37 & 38 revenues as such in future filings.
 - b.) Do not order the Company to identify Schedule 37 & 38 revenues as such in future filings.

3.) CapX2020 Bemidji Project Cost Cap

- a.) Determine that projects being recovered in the TCRR are subject to a cost cap and determine that the cost cap for the Bemidji-Grand Rapids project is \$74 million.
- b.) Determine cost cap does not apply and allow rider recovery of OTP's 20% ownership percentage of the \$111.5 million investment, or \$22.3 million for the Bemidji-Grand Rapids project.

4.) Capitalized Internal Costs

- a.) Determine that the capitalized internal costs of approximately \$1.76 million will not be allowed to be recovered in the TCRR.
- b.) Determine that the capitalized internal costs of approximately \$1.76 million will be allowed to be recovered in the TCRR.

5.) Schedule 26 Revenues and Costs

- a.) Require the Company to include all Schedule 26 costs and all Schedule 26 revenues in the Transmission Cost Recovery Rider.
- b.) Allow the Company to exclude the Schedule 26 revenue credits that correspond with the disallowed capital costs in the Transmission Cost Recovery Rider.

6.) Carrying Charge

- a.) Allow the Company to continue to add a carrying charge to the tracker balance.
- b.) Do not allow the Company to add a carrying charge to the tracker balance for the Transmission Cost Recovery Rider and the Renewable Resource Cost Recovery Rider effective with the date of the order in this docket.

Recommendation

Staff recommends 1a, 2a, 3a, 4a, 5a, 6b