MINNESOTA DEPARTMENT OF COMMERCE

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February 1, 2016

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 300
St. Paul, Minnesota 55101

RE: **Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. E017/M-16-373

Dear Mr. Wolf:

Attached are the comments of the Minnesota Department of Commerce, Division of Energy Resources (DOC or the Department) in the following matter:

Otter Tail Power Company's Petition for Approval of the Annual Rate Adjustment to its Environmental Cost Recovery Rider Rate.

The petition was filed on April 29, 2016 by:

Anthony Harris
Rates Analyst, Regulatory Administration
Otter Tail Power Company
215 South Cascade Street
Fergus Falls, Minnesota 56538

The Department recommends that Otter Tail Power Company provide additional information in reply comments; the Department will provide additional comments subsequently. The Department is available to answer any questions the Minnesota Public Utilities Commission may have.

Sincerely,

/s/ MARK A. JOHNSON
Financial Analyst

MAJ/lt
Attachment

MINNESOTA DEPARTMENT OF COMMERCE

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

COMMENTS OF THE MINNESOTA DEPARTMENT OF COMMERCE

DOCKET NO. E017/M-16-373

I. BACKGROUND

On January 23, 2012, the Minnesota Public Utilities Commission (Commission) issued its Order approving Otter Tail Power Company's (OTP or the Company) request for an Advanced Determination of Prudence (ADP) regarding the installation of an Air Quality Control System (AQCS) at its Big Stone Generation Station Plant located near Milbank, South Dakota in Docket No. E017/M-10-1082. The Big Stone Plant is a multiple-owner plant that OTP owns with Montana Dakota Utilities and NorthWestern Energy. OTP owns 53.9 percent of the plant.

On December 18, 2013, the Commission issued its Order approving OTP's request to begin recovery of costs associated with the Big Stone Plant's AQCS under OTP's proposed Environmental Cost Recovery Rider (ECRR) in Docket No. E017/M-13-648.

On November 26, 2014, the Commission issued its Order approving OTP's first annual update to its ECRR in Docket No. E017/M-14-647.

On May 27, 2015, the Commission issued its Order denying OTP's request to recover reagent costs associated with the Mercury and Air Toxics Standards (MATS) rule through OTP's fuel clause adjustment rider in Docket No. E017/M-14-649. In addition, the Commission denied OTP's request for variances to allow the recovery of costs and revenues associated with emission allowances through OTP's fuel clause adjustment rider.

On March 9, 2016, the Commission issued its Order approving OTP's second annual update to its ECRR in Docket No. E017/M-15-719.

On April 29, 2016, OTP filed the instant petition requesting approval of its third annual update to its ECRR in Docket No. E017/M-16-373 (Petition).

On July 5, 2016, the Commission issued its Order granting provisional approval of OTP's third annual update to its ECRR in the instant petition, with the understanding that the final decision will be made at a later date.

On July 14, 2016, OTP filed its compliance filing as required by the Commission's July 5, 2016 Order. The compliance filing indicated that the effective date of the rider is September 1, 2016. OTP also included its updated Rate Schedule Section 13.08 for its ECRR as provisionally approved by the Commission.

II. SUMMARY OF FILING

OTP requests approval of its 2016 ECRR rates to recover its Minnesota jurisdictional share of eligible costs associated with the Big Stone Plant's AQCS. A summary of OTP's proposed project costs and related revenue requirements for the period from September 1, 2016 through August 31, 2017 is included in Table 1 below:

Table 1: Summary of Proposed Projects and Revenue Requirements

Project:	Sept. 2016/ Aug. 2017 Annual Revenue Requirements:
AQCS	$12,487,422
True-up (tracker balance)	$(576,215)
Carrying Costs	($27,494)
Total	$11,883,713

The ECRR is applicable to electric service under all of OTP's Retail Rate Schedules and is calculated as a percent adder to a portion of each customer's bill, described as follows in OTP's tariff at Section 13.08:

> There shall be included on each Minnesota Customer's monthly bill an Environmental Cost Recovery ("ECR") charge based on the applicable cost recovery factor multiplied by the Customer's monthly bill. The Customer's monthly bill shall be based on all applicable charges and credits under the Company's retail rate schedules in Sections 9, 10, 11, 12 and 14, except for Section 14.09 (TailWinds) and Section 14.11 (Released Energy). The Environmental Cost Recovery Charge will not apply to any Mandatory Riders or sales tax and any local assessments as provided in the General Rules and Regulations for the Company's electric service. The Environmental Cost Recovery charge will be included in the Resource Adjustment line item on the Customer's bill.

OTP proposes to continue to use the "percentage of bill method" to allocate costs to customer classes.

OTP's calculated ECRR rate from this update is 6.927 percent, which is 0.079 percent lower than OTP's current ECRR rate of 7.006 percent.

The monthly bill impact of OTP's proposal for a residential customer using, on average, about 750 kWh per month would be $4.92 per month, or about $59.00 per year. A summary of the monthly impact of OTP's proposal on customers' bills is provided below in Table 2.

Table 2: Rate Impact of 6.927% ECRR Rate on Bills Excluding Other Riders[1]

	Energy Usage	Demand Usage	Base Bill before ECR Rider	ECR Charge	Percent Increase due to the ECR Rider
Residential (101 Rate)	750		$71.05	$4.92	6.92%
Small Commercial (404 Rate)	750		$74.99	$5.19	6.92%
Large Commercial (603 Rate)	100,000	200	$6,402.00	$443.47	6.93%

OTP's proposed ECRR rates became effective September 1, 2016 on a provisional basis, consistent with the Commission's July 5, 2016 Order in the instant docket.

OTP's AQCS project was placed in-service on December 29, 2015.

III. DOC ANALYSIS

A. STATUTORY REQUIREMENTS – ELIGIBILITY OF THE AQCS PROJECT FOR ECR RIDER RECOVERY

Minn. Stat. § 216B.1692, subd. 1(b) states that:

> Notwithstanding paragraph (a), a project may be approved for the emission reduction rate rider allowed in this section if the project is to be installed on existing large electric generating power plants, as defined in section 216B.2421, subdivision 2, clause (1), that are located outside the state and are needed to comply with state or federal air quality standards, but only if the project has received an advance determination of prudence from the commission under section 216B.1695.

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[1] Per Company's email response on December 29, 2016. A copy is included as Attachment No. 4 to these comments.

The Department notes that the Big Stone Plant is a large electric generating power plant as defined in Minn. Stat. § 216B.2421, subd. 2, clause (1), and is located outside the state of Minnesota (in South Dakota). The AQCS project is needed to comply with the Environmental Protection Agency's (EPA) Regional Haze Rule under South Dakota's State Implementation Plan (SIP). The Big Stone AQCS project received an ADP on January 23, 2012 in Docket No. E017/M-10-1082. Pursuant to the terms of the ADP, OTP excluded costs related to the baghouse and activated carbon injection (ACI) system from its ECR rider request. Based on these facts, the Department concludes that the Big Stone AQCS project is eligible for an emission rate rider under Minn. Stat. § 216B.1692 , subd. 1(b).

Minn. Stat. § 216B.1692 , subd. 3 states:

> **Filing petition to recover project costs**. (a) A public utility may petition the commission for approval of an emissions-reduction rider to recover the costs of a qualifying emissions-reduction project outside of a general rate case proceeding under section 216B.16. In its filing, the public utility shall provide:
>
> (1) a description of the planned emissions-reduction project;
> (2) the activities involved in the project;
> (3) a schedule for implementation;
> (4) any analysis provided to the Pollution Control Agency regarding the project;
> (5) an assessment of alternatives to the project, including costs, environmental impact, and operational issues;
> (6) the proposed method of cost recovery;
> (7) any proposed recovery above cost; and
> (8) the projected emissions reductions from the project.

The AQCS project was described in detail in the ADP proceeding, including the activities involved in the project, the schedule for the project's implementation, an assessment of alternatives to the project, and the projected emissions from the project. The method proposed for cost recovery is described in detail in OTP's Petition. In addition, in compliance with the January 23, 2012 Order granting the ADP, OTP supplies quarterly updates to the Commission to describe progress on the project. OTP's most recent quarterly update was filed on January 13, 2017.

The Department has reviewed the applicable statutory requirements discussed above, and agrees with the OTP's assessment that the Big Stone AQCS project is eligible for recovery under its ECRR.

A. REASONABLENESS OF PROJECT REVENUE REQUIREMENTS AND OVERALL CAPITAL COSTS

OTP discussed the components of its annual revenue requirement calculations on pages 6 through 8 of its Petition. In addition, OTP provided its updated 2016/2017 annual revenue requirement calculations in Attachment 2 of its Petition. As shown therein, OTP's projected annual revenue requirements for the period from October 1, 2016 through September 30, 2017 total approximately $12,487,422. Including the projected over-recovery of the current period's costs of ($576,215) and carrying interest of ($27,494) results in a total net revenue requirements for the Minnesota jurisdiction of 11,883,713.

OTP stated on pages 5-6 of its Petition that the original project budget was $491 million, which OTP reduced to $405 million in 2013 and to $384 million in 2015. OTP stated that the costs included for recovery in the instant petition are based on capital costs of $384 million. As a result, OTP stated that its capital costs are approximately 21.8 percent lower than its original budget. The Department confirms OTP's calculation and appreciates the Company's cost reduction.

The DOC reviewed OTP's updated annual revenue requirement calculations and concludes that, overall, OTP's annual revenue requirement calculations appear reasonable, except for the Company's proposed net operating loss – deferred tax asset (DTA) and prorated accumulated deferred income taxes (ADIT). The DTA and prorated ADIT issues are discussed in more detail in Sections B and C of these comments. In addition, the specific components of OTP's revenue requirement calculations required under Minn. Stat. § 216B.1692 , subd. 5(b) are discussed in Section IV of these comments.

B. PRORATED ACCUMULATED DEFERRED INCOME TAXES (ADIT)

OTP included the effects of proration on its ADIT balances in its revenue calculations. OTP's prorated ADIT calculations are shown in Attachment 5 of its Petition, in which the Company prorates ADIT for each month in the "test year" for this rider – September 2016 through August 2017. As shown therein, OTP's prorated ADIT calculations increased its annual revenue requirements by $396,020.

The prorated ADIT issue stems from recently issued Private Letter Rulings (PLRs) from the Internal Revenue Service (IRS). According to these PLRs, based on facts in proceedings that may be different from the facts in the instant case, the IRS is concerned that utilities may be violating tax normalization rules by passing back the benefits of accelerated depreciation (via an ADIT credit to rate base) to ratepayers too soon. IRS Section 1.167(l)(h)(6) defines the procedures a company must use to normalize the impact on rate making in a forward-looking test year if a company elects to use accelerated depreciation. This section stipulates that the monthly changes to the deferred taxes balance, as calculated by the company, must be prorated prior to computing the average of beginning and ending balances for ADIT.

The Department notes that there is a difference between prorating ADIT balances in riders as opposed to rate cases. Riders have subsequent true-up calculations whereas rate cases do not. In addition, rate cases have interim rates and interim rate refunds, which riders do not have.

The prorated ADIT issue has been discussed extensively in the following riders and rate cases; however, the issue remains largely unresolved:

- OTP's 2015 ECR Rider (Docket No. E017/M-15-719). OTP first proposed to incorporate the effects of prorated ADIT in its 2015 ECR Rider. As explained in the DOC's January 15, 2016 Reply Comments, OTP proposed to raise the annual revenue requirements by $55,000 due to the effects of proration. However, since OTP proposed to keep its current ECR Rider rate in effect, the DOC concluded and the Commission agreed that this issue did not need to be addressed in that proceeding.[2]

- Xcel Energy's 2015 TCR Rider (Docket No. E002/M-15-891). Xcel Energy also proposed to incorporate the effects of prorated ADIT in its 2015 TCR Rider, which increased the annual revenue requirements by $150,830. Xcel's 2015 TCR Rider was based on forecasted calendar year 2016 figures. This docket was before the Commission on December 8, 2016. Since the 2016 calendar year was nearly complete, the Commission directed Xcel to refile its proposed annual revenue requirements using actual 2016 balances once they become known. This essentially eliminated the need for Xcel to prorate its ADIT balances for its 2015 TCR Rider purposes. In addition, the Commission directed the Department to work with Xcel to seek its own Private Letter Ruling from the IRS to determine the proper treatment of prorated ADIT balances in forecasted riders and whether the effects of proration may be returned to ratepayers in subsequent rider true-up calculations that replace prorated ADIT balances with actual non-prorated ADIT balances once they become historical. Xcel's PLR request has yet to be completed and sent to the DOC for review.

- Xcel Energy's 2015 Renewable Energy Standards Rider (RES Rider) in Docket No. E002/M-15-805. Xcel Energy proposed to incorporate the effects of ADIT proration in its 2015 RES Rider, which increased its annual revenue requirement by $38,754. The Department opposed Xcel's proposal to prorate its ADIT balances. However, for purposes of resolving the issue and not using limited state resources, the Department's alternative recommendation was to: 1) allow the prorated ADIT only for recovery of forecasted costs and, 2) require a true-up in the following year (once all amounts are historical/actual) by using actual non-prorated ADIT amounts. Finally, if Xcel continued to pursue this issue to the detriment of ratepayers, the Department recommended that the Commission consider either denying rider recovery or limiting rider recovery to historical costs, as both of these approaches would eliminate the need to prorate ADIT balances.

[2] See Commission's March 9, 2016 Order in Docket No. E017/M-15-719.

Prior to the Commission's January 26, 2017 Agenda meeting, the Company proposed that the Commission apply the same treatment to the prorated ADIT issue in this proceeding as it had in Xcel's TCR Rider.

- **Xcel Energy's 2015 Rate Case in Docket No. E002/GR-15-826).** Xcel Energy proposed to incorporate the effects of prorated ADIT in its 2015 Rate Case, which increased its annual revenue requirements for 2016 through 2019 by $11,549,000. The Department recommended in its Direct Testimony an adjustment to excluded prorated ADIT from the rate case. [3] However, since the parties entered into an aggregated financial settlement, even though the settlement was largely informed by the Department's testimony, specific decisions on individual financial issues were not determined. As a result, the issue remains unresolved.

- **OTP's 2015 Rate Case in Docket No. E017/GR-15-1033.** The prorated ADIT issue was also discussed at length in OTP's 2015 Rate Case. In order to resolve this complex issue, the DOC and OTP agreed to jointly seek a PLR from the IRS to determine the proper rate case treatment of prorated ADIT balances in OTP's forecasted test year and interim rates, including the interim rate refund. OTP filed its PLR request with the IRS on December 29, 2016. A response from the IRS is expected later in 2017.

Since the current petition involves the use of a rider with forecasted figures for at least part of the year, the Department notes that Xcel's forthcoming PLR for its 2015 TCR Rider could be used as a guide on how to treat the prorated ADIT issue in the instant proceeding.

In the meantime, the Department recommends that the Commission approve OTP's proposed ADIT proration for the forecasted test year in the instant petition, subject to a true-up calculation in the following year using actual non-prorated ADIT amounts, which OTP now recommends – see Section D below.

C. DEFERRED TAX ASSET AND NET OPERATING LOSS

OTP proposed to include a deferred tax asset (DTA) for the first time in a rider in the instant proceeding. OTP discussed its DTA in detail on pages 8 through 10 of its Petition. OTP stated in part that:

> The election of bonus depreciation reduces the amount of actual taxes paid when tax returns are filed. Customers benefit through the deferral of taxes until future periods. When the amount of depreciation expense for tax purposes is greater than the depreciation expense computed for book purposes, the difference is accounted for as a Deferred Tax Liability and recorded as an Accumulated Deferred Income Tax. This

[3] See Ms. Nancy's Campbell's June 14, 2016 Direct Testimony in Docket No. E002/GR-15-826, Page 23; $6,483,000+$1,896,000+1,813,000+1,357,000 = $11,549,000 (for 2016 to 2019).

> balance is included as a credit in the determination of the overall rate base upon which the rate of return is calculated. When the ADIT balance grows as a result of bonus depreciation, rate base is reduced leading [to] a lower revenue requirement.
>
> Because of the significant amount of capital investment placed in service (the largest being the AQCS project) that qualified for bonus tax depreciation in 2015, the impact of taking bonus depreciation eliminated Otter Tail's taxable income creating a Tax Net Operating Loss (NOL) position for Otter Tail's 2015 tax year. Otter Tail calculates its tax return on a standalone basis.
>
> A NOL carryforward position creates a Deferred Tax Asset that can be used to offset future taxable income. Otter Tail has allocated the NOL to the AQCS project by dividing the project tax depreciation by the total Company tax depreciation and multiplying that percentage by the Total Otter Tail 2015 forecasted NOL. Any NOL's that are related to the project that is recovered via the ECRR are accounted for as a Deferred Tax Asset in the ECRR which increases rate base. The Deferred Tax Asset balance for the AQCS project at December 31, 2015 was approximately $17.8 million (Total Company), as found in Attachment 2, pages 1-3, line 15. In future periods, as the NOLs are applied against future taxable income, the Deferred Tax Asset balance will be reduced, lowering rate base and the associated revenue requirement.

The DTA increases the ECRR rate base on a total Company basis as shown below in Table 3:

Table 3: Summary of DTA's Effect on ECRR Rate Base[4]

	12/31/2015	12/31/2016	12/31/2017
DTA	$17,769,693	$17,769,693	$17,769,693
Reversal of DTA	$0	($6,250,360)	($6,716,602)
Net DTA	$17,769,693	$11,519,333	$11,056,091

Since OTP stated that it calculated its taxes on a stand-alone basis, the DOC asked OTP, in DOC Information Request No. 1, to explain its definition of "stand alone" and whether it was referring to a separate return calculation or FERC's stand-alone method, which allocates consolidated tax expense to individual members through the recognition of the benefits/burdens contributed by each member of the consolidated group to the consolidated return. OTP replied that:

[4] Per OTP's April 29, 2016 Initial Filing in Docket No. E017/M-16-373, Attachment 2, Lines 15-16.

> Otter Tail used the term “stand alone” on Page 9 of the petition to refer to Otter Tail’s determination of income taxes as if Otter Tail was filing a separate tax return versus part of a consolidated tax return. This approach is based on the last approved Tax Allocation Agreement (TAA) between Otter Tail Corporation and Otter Tail dated July 1, 2009 which is filed with the Commission. Otter Tail was not using that term to refer to the FERC stand-alone method, which is based on an allocation of results.
>
> Otter Tail’s TAA is administered on a “separate return” basis. The TAA aligns with the long-standing principle of maintaining financial separation between regulated and non-regulated entities of the consolidated group. The TAA keeps Otter Tail’s results isolated as if it had filed its own tax return. This ensures only Otter Tail’s expenses are included in the relevant cost of service, and all deductions and credits are taken into account.
>
> There are differences between the results of allocation of consolidated results under the FERC stand-alone method and the results under the TAA. For example, the Otter Tail Corporation consolidated Federal tax net operating loss for tax year 2015 was $54.9 million, compared to Otter Tail’s $67.8 million. The total 2015 tax year consolidated adjustment in Otter Tail’s taxing jurisdictions was $381,817. This means Otter Tail would have had an increase in current tax expense of $381,817 had this been allocated based on the FERC stand-alone method. Otter Tail outlines the 2015 tax year unallocated adjustment to illustrate the benefits Otter Tail ratepayers see by administering our TAA on the separate return basis.[5]

The DOC has several concerns with OTP’s proposal to include DTA balances in its ECRR. First, despite claiming to be in an NOL position, OTP appears to be charging ratepayers for current income taxes in its annual revenue requirements. For example, as shown in Attachment 2 of OTP’s Petition, the Company proposes to charge ratepayers $6,123,484[6] in current and deferred income taxes in its annual revenue requirements for 2016. However, as shown on Lines 80 and 81 of the same attachment, OTP’s deferred income tax totals only $2,376,029 for 2016. In other words, OTP appears to be charging ratepayers $3,747,455 ($6,123,484 - $2,376,029) in current income taxes for 2016, despite claiming to be in an NOL position. The Department recommends that OTP explain in reply comments why it would be reasonable to charge ratepayers for current income taxes when it’s clear that the Company will not be paying any current income taxes due to its NOL.

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[5] Per OTP’s Response to DOC Information Request No. 1; see DOC Attachment No. 1.
[6] Per OTP’s April 29, 2016 Initial Filing in Docket No. E017/M-16-373, Attachment 2, Page 2 of 3, Line 39.

Second, the Department notes that OTP's proposed 2016 DTA in its ECRR appears to be much higher than the Company's proposed 2016 DTA in its 2015 Rate Case. As shown above in Table 3, OTP's proposed 2016 DTA in its ECRR totals $11,519,333 at December 31, 2016 on a total company basis. In contrast, OTP's proposed 2016 DTA in its 2015 Rate Case totals only $7,218,449 at December 31, 2016 on a total company basis.[7] The Department reasons that the DTA in the ECRR, which only includes the portion of the DTA attributable to the AQCS, should be much lower than the DTA in OTP's 2015 Rate Case, which includes the Company's entire DTA for all capital projects including the AQCS. The Department recommends that OTP explain this discrepancy in its reply comments.

Third, the Department notes that OTP did not include in its Petition the calculations used to determine its total DTA and the portion of the DTA ($17,769,693) that was attributable to the ECRR. The Departments recommends that OTP provide these calculations in its reply comments.

Fourth, OTP did not indicate in its Petition how long it expects to remain in a NOL carryforward position. The Department recommends that OTP provide this information in reply comments.

Finally, the Department notes that, in theory, total deferred tax expense for any given year should match the change in deferred tax balances (ADIT and DTA) for any given year. The Department notes that OTP's total deferred tax expenses do not match the change in deferred tax balances (ADIT and DTA) for the year on which OTP proposes to set rates in the instant petition. The Department recommends that OTP explain in reply comments why the deferred tax expense in the ECRR for any given year does not match the change in deferred tax balances (ADIT and DTA) in the ECRR for any given year.

The Department extensively reviewed the accounting for NOL's and their applicably to riders in Minnesota Power's 2013 Transmission Cost Recovery Rider in Docket No. E015/M-13-410. In that case, the Department and Minnesota Power recommended and the Commission agreed that Minnesota Power be required to use a hybrid approach when accounting for NOL's in its riders. That is, the NOL DTA amount included in rate base each year should be based on the lower of the rider stand-alone or consolidated methods. In that case, the consolidated method referred to the portion of Minnesota Power's total DTA that was assigned to its TCR Rider. As a result, the Department concludes that OTP's proposal in the instant petition is similar to Minnesota Power's consolidated method. The Department recommends that OTP provide in reply comments the effect on the NOL and DTA of using a rider stand-alone basis, which uses only rider revenues, expenses, depreciation, and related accelerated depreciation to determine the NOL and related DTA.

[7] Per Mr. Peter J. Beithon's Direct Testimony in Docket No. E017/GR-15-1033, Exhibit___(PJB-1), Schedule 8, Page 1 of 1, Line 6, Column (B).

D. TRUE-UP AND TRACKER BALANCE

As shown on Attachment 1 of its Petition, OTP proposed to decrease its 2016/2017 ECR Rider revenue requirements by $576,215 to reflect prior over-recoveries. OTP's tracker balance calculations are shown in Attachment 3 of its petition.

OTP stated in its 2015 ECRR filing (Docket No. E017/M-15-719) that it would replace its forecasted prorated ADIT balances with actual (non-prorated) ADIT balances in its next update to its ECRR. The DOC asked OTP, in DOC Information Request No. 3, if it replaced its prorated forecasted ADIT balances with actual (non-prorated) ADIT balances for true-up purposes in the instant petition, and whether it intended to continue this practice for true-up purposes in future ECRR filings. OTP replied that:

> In this Petition, Otter Tail has replaced the prorated forecasted ADIT balances with actual (nonprorated) ADIT balances for true-up purposes. The use of actual balances is reflected on Attachment 2, page 2, where January, February and March are represented by actual numbers versus forecasted amounts. The actual (nonprorated) ADIT factor is shown on line 17 and is represented with a "1" rather than a prorated factor. Otter Tail intends to continue the practice of replacing its prorated forecasted ADIT balances with actual (nonprorated) ADIT balances for true-up purposes in future filings.[8]

The DOC agrees with OTP's approach of not prorating ADIT balances for true-up purposes and concludes that OTP's true-up and tracker calculations appear reasonable and consistent with past ECRR filings (other than the issues discussed in Section C above).

E. CARRYING CHARGES

In previous ECR Riders, the Commission allowed OTP to include monthly carrying charges on its tracker balance at a rate of 1/12 of OTP's cost of capital. As shown on Attachment 1 of its Petition, OTP proposed to <u>decrease</u> its 2016/2017 ECR Rider revenue requirements by $27,494 to reflect carrying charges (interest) on its tracker balance.

Based on our review, the DOC concludes that OTP's carrying charges (interest) appear reasonable and consistent with past ECRR filings and complies with the Commission's Orders in Docket Nos. E017/M-10-1082 and E017/M-14-647.

F. BAGHOUSE AND ACI SYSTEM

As explained on pages 7-8 of its Petition, the Commission's ADP approval did not include the new baghouse portion of the AQCS project or the ACI system that was being added to comply with the MATS rule. As such, OTP stated that it has removed these costs from its revenue

[8] Per OTP's Response to DOC Information Request No. 3; see DOC Attachment No. 3

requirement calculations. The Department agrees with this approach and notes that this is consistent with OTP's previous ECR Rider filings.

G. OTP'S 2015 RATE CASE AND ECRR

As explained in OTP's 2015 Rate Case, the Company proposed to transfer the AQCS project out of its ECRR and into rate base at the time final rates go into effect.[9] OTP also proposed that any remaining tracker balance at that time be recovered or returned to ratepayers through the ECRR over the 12 months following the implementation of final rates.[10] The Department concluded that OTP's proposed treatment of its ECRR appeared reasonable and consistent with the approach used to treat OTP's Renewable Rider in its 2010 Rate Case.[11] As a result, the Department recommended that the Commission approve OTP's proposals regarding the treatment of its ECRR.[12]

H. SPECIFIC REQUIREMENTS UNDER MINN. STAT. § 216B.1692, SUBD. 5(B)

Minn. Stat. § 216B.1692 , subd. 5 (b) authorizes the Commission to approve a Rider that:

> (1) allows the utility to recover costs of qualifying emissions-reduction projects net of revenues attributable to the project;
> (2) allows an appropriate return on investment associated with qualifying emissions - reduction projects at the level established in the public utility's last general rate case;
> (3) allocates project costs appropriately between wholesale and retail customers;
> (4) provides a mechanism for recovery above cost, if necessary to improve the overall economics of the qualifying projects to ensure implementation;
> (5) recovers costs from retail customer classes in proportion to class energy consumption; and
> (6) terminates recovery once the costs of qualifying projects have been fully recovered.

Each of these requirements is discussed below.

[9] Per Mr. Tommerdahl's Direct Testimony at 7-8 in Docket No. E017/GR-15-1033.
[10] *Id.*
[11] Per Mr. Johnson's Direct Testimony at 23-27 in Docket No. E017/GR-15-1033.
[12] *Id.*

1) Costs Net of Revenues

In its previous ECR Rider in Docket No. E017/M-13-648, OTP stated that it did not anticipate any revenues attributable to the AQCS project but would credit them to the ECR Rider tracker if any such revenues were earned in the future.[13] Since OTP did not address this issue in the current Petition, the DOC recommends that OTP explain in reply comments if it received any such revenues, such as those related to emission allowances or revenues or credits (such as tax credits), and whether these revenues have been included in the ECRR.

2) Return on Investment

Minn. Stat. 216B.1691, subd. 5(b)(2) allows a return on investment at the level approved in the utility's last general rate case.

OTP stated on page 2 and 7 of its Petition that its return on investment used the cost of capital approved in OTP's 2010 Rate Case, which totaled 8.61 percent. OTP also stated that it had adjusted its return on investment to 8.07 percent as of April 16, 2016 to coincide with the beginning of interim rates as approved in OTP's 2015 Rate Case. The DOC agrees with this approach but recommends that OTP be required to use the actual rate of return approved by the Commission in its 2015 Rate Case to recalculate its ECRR revenue requirements, true-up, and remaining tracker balance to be charged or returned to ratepayers following the implementation of final rates as discussed above.

3) Allocations

Minn. Stat. 216B.1691, subd. 5(b)(3) allows the Commission to approve a Rider that allocates costs between wholesale and retail sectors.

Consistent with past ECRRs, OTP used its energy (E1) and demand (D1) allocators to allocate costs to the Minnesota jurisdiction. The DOC understands that the E1 and D1 allocators account for the split between retail and wholesale operations.

OTP stated on pages 2-3 of its Petition that it used its jurisdictional allocation factors from its 2010 Rate Case. OTP also stated that it adjusted its jurisdictional allocation factors as of April 16, 2016 to coincide with the beginning of interim rates as approved in OTP's 2015 Rate Case. The DOC agrees with this approach but recommends that OTP be required to use its actual jurisdictional allocation factors approved by the Commission in its 2015 Rate Case to recalculate its ECRR revenue requirements, true-up, and remaining tracker balance to be charged or returned to ratepayers following the implementation of final rates as discussed above.

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[13] Per OTP's July 31, 2013 initial filing in E017/M-13-648, Page 10.

4) Recovery Above Cost

Minn. Stat. 216B.1691, subd. 5(b)(4) allows the Commission to approve a Rider that provides a mechanism for recovery above cost, if necessary to improve the overall economics of the qualifying projects to ensure implementation.

The DOC is not aware of any instances where OTP has requested, or the Commission has approved, a mechanism for recovery above cost in OTP's ECRRs, or of any basis for allowing such recovery.

5) Rate Design

Minn. Stat. 216B.1691, subd. 5(b)(5) allows the Commission to approve a Rider that recovers costs from retail customer classes in proportion to class energy consumption.

As noted above, OTP proposed to continue to use the "percentage of bill" method to allocate costs between customer classes. The DOC agrees with this approach and notes that this is the same method approved by the Commission in previous ECRR filings.

6) Termination Upon Recovery

Minn. Stat. 216B.1691, subd. 5(b)(6) allows the Commission to approve a Rider that terminates recovery once the costs of qualifying projects have been fully recovered.

Since OTP's ECRR has only one project (AQCS), which OTP proposed to recover in final rates in its 2015 Rate Case, the Department expects that OTP's ECRR will terminate once the remaining tracker balance is charged or returned to ratepayers over the 12 months following the implementation of final rates.

IV. SUMMARY AND RECOMMENDATIONS

The Department recommends that OTP provide the following information in its reply comments:

- Why it's reasonable to charge ratepayers for current income taxes when it's clear that the Company will not be paying any current income taxes due to its NOL;
- why OTP's proposed 2016 DTA in its ECRR (which only includes the AQCS project) appears to be much higher than the Company's proposed 2016 DTA in its 2015 Rate Case which includes all projects;
- the calculations OTP used to determine its total DTA and the portion of the DTA ($17,769,693) that was attributable to the ECRR;
- how long OTP expects to remain in a NOL carryforward position;
- why the deferred tax expense in the ECRR for any given year does not match the change in deferred tax balances (ADIT and DTA) in the ECRR for any given year;

- the effect on the NOL and DTA of using a rider stand-alone basis, which uses only rider revenues, expenses, depreciation, and related accelerated depreciation to determine the NOL and related DTA; and
- identify offsetting revenues OTP received, such as those related to emission allowances or revenues or credits (such as tax credits), and indicate whether these revenues have been included in the ECRR.

The Department recommends that the Commission approve OTP's proposed ADIT proration in the instant petition, subject to a true-up calculation in the following year using actual non-prorated ADIT amounts.

In addition, the Department recommends that the Commission require OTP to use the actual rate of return and actual jurisdictional allocation factors approved by the Commission in its 2015 Rate Case to recalculate its ECRR revenue requirements, true-up, and remaining tracker balance to be charged or returned to ratepayers through the ECRR over the subsequent 12 months following the implementation of final rates.

The Department will offer additional comments and recommendation in subsequent response comments after it has reviewed OTP's reply comments.

/lt

OTTER TAIL POWER COMPANY
Docket No: E017/M-16-373

Response to: Minnesota Department of Commerce
Analyst: Mark Johnson and Nancy Campbell
Date Received: 11/07/2016
Date Due: 11/17/2016
Date of Response: 11/18/2016
Responding Witness: Anthony Harris, Rate Analyst - (218) 739-8564

Information Request:

Subject: Net Operating Losses and Deferred Tax Asset

OTP stated on page 9 of its petition that it has a Tax Net Operating Loss (NOL) position for Otter Tail's 2015 tax year and that it calculates its tax return on a standalone basis.

Please explain OTP's definition of a standalone basis. Is OTP referring to a separate tax return calculation or FERC's standalone method where the consolidated tax expense is allocated to individual members through recognition of the benefits/burdens contributed by each member of the consolidated group to the consolidated return? Please explain.

Attachments: 0

Response:

Otter Tail used the term "stand alone" on Page 9 of the petition to refer to Otter Tail's determination of income taxes as if Otter Tail was filing a separate tax return versus part of a consolidated tax return. This approach is based on the last approved Tax Allocation Agreement (TAA) between Otter Tail Corporation and Otter Tail dated July 1, 2009 which is filed with the Commission. Otter Tail was not using that term to refer to the FERC stand-alone method, which is based on an allocation of results.

Otter Tail's TAA is administered on a "separate return" basis. The TAA aligns with the long-standing principle of maintaining financial separation between regulated and non-regulated entities of the consolidated group. The TAA keeps Otter Tail's results isolated as if it had filed its own tax return. This ensures only Otter Tail's expenses are included in the relevant cost of service, and all deductions and credits are taken into account.

There are differences between the results of allocation of consolidated results under the FERC stand-alone method and the results under the TAA. For example, the Otter Tail Corporation consolidated Federal tax net operating loss for tax year 2015 was $54.9 million, compared to Otter Tail's $67.8 million. The total 2015 tax year consolidated adjustment in Otter Tail's taxing jurisdictions was $381,817. This means Otter Tail would have had an increase in current tax expense of $381,817 had this been allocated based on the FERC stand-alone method. Otter Tail outlines the 2015 tax year unallocated adjustment to illustrate the benefits Otter Tail ratepayers see by administering our TAA on the separate return basis.

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Information Request:

Subject: Net Operating Losses (NOL) and Deferred Tax Asset (DTA)

OTP stated on page 9 of its petition that:

A) NOL carryforward position creates a Deferred Tax Asset] that can be used to offset future taxable income. Otter Tail has allocated the NOL to the AQCS [Advanced Air Quality Control System] project by dividing the project tax depreciation by the total Company tax depreciation and multiplying that percentage by the Total Otter Tail 2015 forecasted NOL. Any NOL's that are related to the project that is recovered via the ECRR [Environmental Cost Recovery Rider] are accounted for as a Deferred Tax Asset in the ECRR which increases rate base. The Deferred Tax Asset balance for the AQCS project at December 31, 2015 was approximately $17.8 million (Total Company), as found in Attachment 2, pages 3-5, line 15.

B) Please explain why OTP's monthly NOL-DTA balance remains constant at $17,769,693 throughout its 2016 and 2017 revenue requirement calculations found in Attachment 2 of its petition.

Attachments: 0

Response:

A) In Attachment 2 of Otter Tail's Petition, Line 15 shows the NOL-DTA of $17,769,693, resulting from the AQCS project.
B) Otter Tail's NOL-DTA balance decreases each month throughout 2016 and 2017. In Attachment 2 of Otter Tail's Petition, the monthly reversal of the deferred tax asset is shown on Line 16 below the beginning NOL-DTA balance of $17,769,693 shown on Line 15. The sum of these two lines results in the net NOL-DTA.

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Responding Witness: Anthony Harris, Rate Analyst - (218) 739-8564

Information Request:

Subject: Prorated Accumulated Deferred Income Taxes (ADIT)

In OTP's previous ECRR filing in Docket No. E017/M-15-719, OTP stated that it would replace its forecasted prorated ADIT balances with actual (nonprorated) ADIT balances in its next update to its ECR Rider, with the difference between the actuals and prorated forecast amounts incorporated into the true-up applicable to the next collection period. Did OTP replace its prorated forecasted ADIT balances with actual (nonprorated) ADIT balances for true-up purposes in the instant petition? Does Otter Tail intend to continue this practice in future ECRR filings? Please explain.

Attachments: 0

Response:

In this Petition, Otter Tail has replaced the prorated forecasted ADIT balances with actual (nonprorated) ADIT balances for true-up purposes. The use of actual balances is reflected on Attachment 2, page 2, where January, February and March are represented by actual numbers versus forecasted amounts. The actual (nonprorated) ADIT factor is shown on line 17 and is represented with a "1" rather than a prorated factor. Otter Tail intends to continue the practice of replacing its prorated forecasted ADIT balances with actual (nonprorated) ADIT balances for true-up purposes in future filings.

Johnson, Mark (COMM)

From:	Johnson, Mark (COMM)
Sent:	Friday, December 30, 2016 11:01 AM
To:	Harris, Anthony
Subject:	RE: OTP's ECRR 16-373
Follow Up Flag:	Follow up
Flag Status:	Flagged

Thanks, Anthony!

From: Harris, Anthony [mailto:aharris@otpco.com]
Sent: Thursday, December 29, 2016 1:07 PM
To: Johnson, Mark (COMM)
Subject: RE: OTP's ECRR 16-373

Mark
Here is the updated table as well as some comments explaining it

The rate impact table for a residential customer using 750 kwh shows a $0.02 increase over last year, $4.90 last year, compared to $4.92 this year. The current ECR rate of 6.927% was calculated on the base residential rate being $0.08192 per kwh. During the rate case, the base cost of energy was reset and increased the base residential rate to $0.08340. Although the actual rate percentage has declined slightly, because it is applied to a slightly higher base rate, the actual monetary impact to the bill increases slightly. Any over collections caused by this will be included in the true-up at the end of the collection period.

Table 1: Rate Impact of 6.927% ECR Rider Rate on Bills (using winter rates)
Excluding Other Riders[1]

	Energy Usage	Demand Usage	Base Bill before ECR Rider	ECR Charge	Percent Increase due to the ECR Rider
Residential (101 Rate)	750		$71.05	$4.92	6.92%
Small Commercial (404 Rate)	750		$74.99	$5.19	6.92%
Large Commercial (603 Rate)	100,000	200	$6,402.00	$443.47	6.93%

Let me know if you have any other questions about this.
Thanks
Tino Harris

From: Johnson, Mark (COMM) [mailto:mark.a.johnson@state.mn.us]
Sent: Wednesday, December 28, 2016 1:28 PM
To: Harris, Anthony
Subject: RE: OTP's ECRR 16-373

Yes, that makes sense. I discuss the fact that the rate factor is actually decreasing (from 7.006% to 6.927%) in my comments.

From: Harris, Anthony [mailto:aharris@otpco.com]
Sent: Wednesday, December 28, 2016 11:48 AM
To: Johnson, Mark (COMM)
Subject: RE: OTP's ECRR 16-373

Mark, using this format the updated table will still show an increase due to the rider, but the increase will be a lower increase than shown in the table below. I hope that makes sense.
Thanks
Tino

From: Johnson, Mark (COMM) [mailto:mark.a.johnson@state.mn.us]
Sent: Wednesday, December 28, 2016 11:34 AM
To: Harris, Anthony
Subject: OTP's ECRR 16-373

This is an EXTERNAL email. DO NOT open attachments or click links in suspicious email.

Hi Anthony, I am working on the DOC's comments regarding OTP's ECRR. The following table was included in our October 16, 2015 Comments regarding OTP's ECRR in 15-719. I would like to include a similar table in my comments for 16-373. Could you please provide a revised schedule showing the impacts of the proposed 6.927% rate on the average customer bills?

Table 2: Rate Impact of 7.006% ECR Rider Rate on Bills
Excluding Other Riders[1]

	Energy Usage	Demand Usage	Base Bill before ECR Rider	ECR Charge	Percent Increase due to the ECR Rider
Residential (101 Rate)	750		$69.94	$4.90	7.01%
Small Commercial (404 Rate)	750		$73.88	$5.18	7.01%
Large Commercial (603 Rate)	100,000	200	$6,254.00	$438.16	7.01%

Please give me a call in you have any questions.

Thanks,
Mark

Mark Johnson
Public Utilities Financial Analyst
Minnesota Department of Commerce
Phone: 651-539-1824
Email: Mark.A.Johnson@state.mn.us

[1] Per attachment included in Company's email response on October 1, 2015. A copy of this attachment is included as Attachment 1 to these comments.

[1] Per attachment included in Company's email response on October 1, 2015. A copy of this attachment is included as Attachment 1 to these comments.

CERTIFICATE OF SERVICE

I, Sharon Ferguson, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, e-mail, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

Minnesota Department of Commerce
Comments

Docket No. E017/M-16-373

Dated this 1st day of February 2017

/s/Sharon Ferguson

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