

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair  
Commissioner  
Commissioner  
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Commissioner

In the Matter of Otter Tail Power Company's  
Request for Approval of a Transmission Cost  
Recovery Rider Including the Proposed  
Transmission Factor for the Recovery Period  
from May 2, 2013 to April 30, 2014

ISSUE DATE: March 10, 2014

DOCKET NO. E-017/M-13-103

ORDER CAPPING COSTS, DENYING  
RIDER RECOVERY OF EXCESS  
COSTS, AND REQUIRING INCLUSION  
OF ALL MISO SCHEDULE 26 COSTS  
AND REVENUES IN TCR RIDER

**PROCEDURAL HISTORY**

On February 7, 2013, Otter Tail Power Company (Otter Tail, or the Company) filed a petition to update and revise the revenue requirement being recovered through its transmission cost recovery (TCR) rider, established under Minn. Stat. §§ 216B.16, subd. 7b and 216B.1645.

These two statutes permit automatic rate adjustments to recover new transmission 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.

On August 30, 2013, the Minnesota Department of Commerce (the Department) filed comments recommending that the Commission limit the amount of capital cost recovery allowed in the TCR rider to the amounts initially approved by the Commission in certificate of need proceedings, or, in the absence of a certificate of need, the amount approved in the initial filing seeking rate recovery through the TCR rider. The Department further recommended that the Commission cap cost recovery for the Bemidji project at \$74 million, the inflation-adjusted amount approved in the certificate of need filing for that project. The Department also recommended that the Commission disallow recovery of internal capitalized costs through the rider.

By January 2014 the parties had each filed three sets of comments addressing the issues raised. The Company opposed capping project costs at initially approved levels and opposed disallowing capitalized internal costs. It proposed that, if the Commission took these actions, it withhold from

the rider the difference between the MISO Schedule 26 revenues it receives from other utilities and the MISO Schedule 26 revenues it would have received from them, had MISO charged Schedule 26 rates based on the Minnesota rider rate base instead of charging federally tariffed rates.

The Department continued to recommend that the Commission require the Company to pass through the rider the Minnesota share of all MISO Schedule 26 revenues associated with the projects in the rider, including the revenues attributable to the capital costs not allowed rider recovery.

On January 30, 2014, the petition came before the Commission.

## **FINDINGS AND CONCLUSIONS**

### **I. Background**

#### **A. The Riders at Issue**

Generally, a public utility may not change its rates without undergoing a rate case in which the Commission comprehensively reviews the utility's costs and revenues. However, the Legislature has created exceptions to this general policy, allowing a utility to implement a rider—also referred to as an “annual automatic adjustment mechanism”—to expedite recovery of certain costs not reflected in the company's current base rates.

Two statutory exceptions are relevant in the present case. First, the transmission-cost-recovery statute, Minn. Stat. § 216B.16, subd. 7b, authorizes a utility to recover, through an annual automatic adjustment mechanism, the Minnesota jurisdictional costs of (1) new transmission facilities that the Commission has approved through a certificate of need or under the state transmission plan and (2) charges incurred by a utility under a federally approved tariff that accrue from other transmission owners' regionally planned transmission projects that have been determined by MISO to benefit the utility or the integrated transmission system.

In addition, the renewable-cost-recovery statute, Minn. Stat. § 216B.1645, allows a utility to use an automatic adjustment mechanism to recover investments or expenditures made to satisfy state renewable energy mandates. In the case of transmission expenditures, the recoverable costs are limited to those directly allocable to the need to transmit power from the renewable sources of energy.<sup>1</sup>

The Commission has established Otter Tail's TCR rider as the mechanism by which the Company recovers the costs of its new transmission projects, including transmission projects eligible for recovery under section 216B.1645.<sup>2</sup> Otter Tail files annual petitions to establish TCR rider rates for the upcoming year. The Company proposes new transmission projects for rider recovery and removes any projects whose costs have been incorporated into base rates. Otter Tail also reports on transmission costs and rider revenue from the preceding year and adjusts the current year's revenue requirement for any previous over-or under- recovery, a process referred to as a “true-up.”

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<sup>1</sup> Minn. Stat. § 216B.1645, subd. 2.

<sup>2</sup> *In the Matter of Otter Tail Power Company's Request for Approval of a Transmission Cost Recovery Rider Including the Proposed 2010 Transmission Factor*, Docket No. E-017/M-09-881, Order Establishing Transmission Cost Recovery Rider and Approving Costs for Recovery (January 28, 2010).

## **B. The Projects at Issue**

In its petition, the Company identified projects previously approved for inclusion in the TCR rider in Docket No. E-017/M-10-1061, including the Fargo-Monticello project, the Bemidji-Grand Rapids CapX 2020 project, and the Cass Lake-Bemidji project.

On March 15, 2013, the Commission approved transmission cost recovery rider eligibility for three new projects included in this petition -- the Ramsey 230/115kV transformer upgrade project, the Sheyenne-Audubon 230kV line upgrade, and the Brookings, SD-Hampton 345 kV upgrade.<sup>3</sup>

Otter Tail has since notified the Commission that one of the three new projects -- the Sheyenne-Audubon upgrade project -- is no longer needed to support the interconnection of the Laverne and Ashtabula wind farms due to the CapX 2020 Fargo project near the point of interconnection. The Department and the Company agree that the Sheyenne-Audubon 230 kV upgrade project is no longer needed, and the Company has removed all associated costs from the 2013 rider.

The Commission concurs with the parties that the Sheyenne-Audubon 230 kV upgrade project is no longer needed, and should be removed from the Company's TCR rider.

## **II. Summary of Commission Action**

The Commission will cap rider recovery of the costs of the CapX Bemidji transmission line at the inflation-adjusted amount approved in the project's certificate of need proceeding, will disallow rider recovery of capitalized internal labor costs, and will disallow a carrying charge on balances in the TCR and the renewable resource cost recovery rider.

The Commission will require the Company to credit the TCR rider account with the full amount of MISO Schedule 26 revenues paid by other utilities for the use of its transmission facilities.

These actions are explained below.

## **III. CapX – Bemidji Project Cost Cap**

### **A. Positions of the Parties**

The CapX – Bemidji Project is a 70-mile, 230 kV transmission line between Bemidji and Grand Rapids designed to improve reliability in the area. In the Bemidji project's certificate of need application (Docket No. E-017, E-015, ET-6/CN-07-1222), it was estimated that the project would cost \$60.6 million. This estimate was increased to \$66.2 million (2007 dollars) during the route permit proceedings.<sup>4</sup> Otter Tail now anticipates that additional construction and permitting costs will be needed to complete the Bemidji project, for a total of approximately \$111.5 million.

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<sup>3</sup> *In the Matter of Otter Tail Power Company's Request for Determination that Transmission Investments are Eligible for Recovery through the Company's Transmission Cost Recovery Rider*, Docket No. E-017/M-12-514, Order Approving Transmission Cost Recovery Eligibility for Three Projects (March 15, 2013).

<sup>4</sup> Docket No. E-017, E-015, ET-6/TL-07-1327.

The Department recommended that the Commission cap rider recovery for the project at \$66.2 million, adjusted for inflation to \$74 million. The Department pointed out that the Commission has found in similar circumstances that TCR rider recovery for a given project should be capped at the utility's cost estimate at the time the project is approved in a certificate of need proceeding or as eligible for rider recovery.<sup>5</sup>

Otter Tail disputed that the amount listed in the Company's certificate of need filing, escalated to current value, is the correct cost to use in this proceeding. The Company argued that certificate of need planning estimates are preliminary in nature and made without the benefit of routing information or final design engineering. The Company also argued that the \$111.5 million project cost for the Bemidji-Grand Rapids estimate was previously at least tacitly approved by the Commission, when the Commission permitted a TCR rider factor reflecting the project's costs.<sup>6</sup>

## **B. Commission Action**

The Commission is not convinced by Otter Tail's arguments. First, as the Commission has previously recognized, changes in a company's initial cost projections can occur for many reasons. However, regardless of whether a project ends up being under or over budget, overall project expenditures need to be evaluated for reasonableness and prudence before being allowed permanent rate recovery.

Second, Otter Tail's claim that its \$111.5 cost estimate for the Bemidji project was considered and approved in Docket 10-1061 is incorrect. In that order, the focus of the parties, and hence the Commission, was the Company's proposed alternative ratemaking approach, and not whether a cost cap should be imposed. In the docket cited, the costs of the Bemidji project were neither at issue, nor squarely addressed.

Accordingly, the Commission continues to believe that project costs included in the TCR rider should be capped at certificate of need levels, and concurs with the Department that the appropriate cap for the Bemidji project is \$74 million. The TCR rider mechanism gives Otter Tail the extraordinary ability to charge its ratepayers for facilities prior to the ordinary timing (the first rate case after the project goes into service) and without undergoing the full scrutiny of a rate case. Holding the Company to its initial estimate is an important tool to enforce fiscal discipline.

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<sup>5</sup> See *In the Matter of Xcel's Request for Approval of a Modification to Its TCR Tariff*, Docket No. E-002/M-09-1048, Order Approving 2010 TCR Project Eligibility and Rider, at 6 (April 27, 2010).

<sup>6</sup> *In the Matter of Otter Tail Power Company's Request for Approval of a Transmission Cost Recovery Rider Including the Proposed 2011 Transmission Factor*, Docket E-017/M-10-1061, Order Setting Rider Revenue Requirement, Authorizing Change in Billing Method, and Requiring Further Filings (March 26, 2012)(hereinafter Docket 10-1061).

Further, imposition of a cap protects the integrity of the certificate of need process, in which it is critical that the cost estimates for the alternatives being compared are as reliable as possible. And, capping costs at the certificate of need levels is consistent with the Commission's actions in similar cases involving other utilities' riders.<sup>7</sup>

The Company is recovering the cost of these transmission facilities through a rider, a unique regulatory tool essentially designed to enable utilities to begin recovering the prudent and reasonable costs of critically needed capital investments between rate cases. The rate case remains the primary vehicle for determining prudence and reasonableness.

In the absence of a rate case, the best available proxy for determining prudence and reasonableness is the cost determination made on the record of a certificate of need or cost recovery eligibility proceeding. Here, the relevant proceeding is a certificate of need case. Otter Tail should continue recovering the costs it sponsored in its certificate of need case unless and until it demonstrates in a rate case that higher costs are prudent and reasonable.

Finally, by this decision the Commission is not finding that the additional Bemidji costs, while significant, were imprudently incurred. Otter Tail will have the opportunity to seek recovery of excluded but prudent costs in its next rate case.

#### **IV. Capitalized Internal Labor Costs**

##### **A. Introduction**

When Otter Tail employees are involved in the construction of new facilities, the Company treats their salaries as a capital cost rather than an operation and maintenance (O&M) expense. Otter Tail included approximately \$1.76 million of capitalized internal labor costs for recovery in its proposed 2013 TCR rider.

##### **B. Positions of the Parties**

The Department recommended that the Commission exclude capitalized internal labor costs from rider recovery because representative amounts are already being recovered from ratepayers through base rates. The Department stated that a representative amount of capitalized internal labor costs was included in the base rates set in the Company's last rate case, either as expensed or capitalized and depreciated costs.

Otter Tail argued that capitalized internal costs should be included in the TCR rider because the Company demonstrated in its last rate case that internal costs attributable to long term construction projects were not being recovered in base rates, and both the Administrative Law Judge and the Commission approved its position.

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<sup>7</sup> *In the Matter of Xcel Energy's Petition for Approval of 2012 Transmission Cost Recovery (TCR), Project Eligibility, TCR Rate Factors, and 2011 True-up*, Docket No. E-002/M-12-50, Order Approving 2012 TCR Project Eligibility and Rider, Capping costs, and Modifying 2011 Tracker Report (February 7, 2014); *In the Matter of Northern States Power MN d/b/a Xcel Energy's Petition for Approval of a Modification to its TCR Tariff, 2010 Project Eligibility, TCR Rate Factors, Continuation of Deferred Accounting, and 2009 True-up Report*, Docket No.E-002/M-09-1048, Order Approving 2010 TCR Eligibility and Rider, 2009 TCR Tracker Report, and TCR Rate Factors (April 7, 2010).

Finally, the Company argued that there is no principled basis for disallowing recovery of internal costs, and that it would not be in the public interest to discourage the Company from making the best use of internal resources and expertise.

### C. Commission Action

The Commission finds that the Company has not demonstrated that the internal labor costs it seeks to capitalize in the rider are not already being recovered in base rates; those costs must therefore be disallowed.

The Department correctly pointed out that the rates set in the last rate case do include representative amounts of both capitalized and expensed labor costs; those representative amounts were set based on the best evidence available at that time. And the Department is also correct that this docket, like any rider update docket, is not an appropriate vehicle for making the exacting factual distinctions necessary to identify any internal labor costs not already included in base rates.

Further, the Company's claim that this or a very similar issue was decided in its last rate case is incorrect. The Commission decision to which it refers reads as follows:

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.<sup>8</sup>

That statement comes from the Company's last rate case, in which the Commission accepted the Administrative Law Judge's finding, made after exhaustive evidentiary hearings, that the specific internal costs in question "were excluded from current rates and were therefore not recovered."<sup>9</sup> The Commission therefore permitted their recovery in the rates it was setting in the new rate case despite—and this was actually the issue being addressed in the language quoted above—their having been incurred on behalf of an abandoned project.

That case bears no serious resemblance to this one. It was a rate case in which the costs at issue had been subjected to full evidentiary development and had been found (1) to be reasonable and prudent, and (2) to pose no risk of double-counting by being capitalized. Neither finding can be made here. This case, like most rider update proceedings, did not involve the evidentiary development required to make these findings. For that reason, internal labor costs are not normally capitalized in riders, nor will the Commission permit their capitalization here.<sup>10</sup>

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<sup>8</sup> *In the Matter of the Application of Otter Tail Power Company for Authority to Increase Rates for Electric Utility Service in Minnesota*, Docket No. E-017/GR-10-239, Findings of Fact, Conclusions, and Order at p. 11 (April 25, 2011).

<sup>9</sup> ALJ's Report, Finding 47.

<sup>10</sup> See, for example, *In the Matter of Minnesota Power's Petition for Approval of its Transmission Cost Recovery Rider*, Docket No. E-015/M-10-799, Order Approving Cost Recovery, Excluding Internal Costs, Authorizing Use of Current Factor, and Requiring Compliance Filing, and *In the Matter of Xcel Energy's Petition for Approval of 2012 Transmission Cost Recovery, Project Eligibility, TCR Rate Factors, and 2011 True-up*, Docket No. E-002/M-12-50, Order Approving TCR Project Eligibility and Rider, Capping Costs, and Modifying 2011 Tracker Report.

And, while the Commission agrees that Otter Tail appears to have relatively consistent levels of operations and maintenance and capitalized labor costs, nonetheless the Company acknowledges that fluctuations do occur from year to year, demonstrating that some portion of its total labor costs would be recovered both as O&M expense in base rates and as capitalized costs through the TCR rider.

The Commission's evaluation of a request for rider recovery is based on the specific facts presented in each case, and in this case, Otter Tail has not demonstrated that including capitalized internal labor costs in the rider would not result in double recovery. Nor does this, or any other rider proceeding, provide the comprehensive evidentiary development required to permit the Commission to make the factual determinations required to classify individual labor-cost accounts as subject to capitalization or expensing. The Commission will therefore require Otter Tail to exclude capitalized internal labor costs from its 2013 adjustment to its TCR rider.

## **V. Rider Treatment of Schedule 26 Revenues and Costs**

### **A. Positions of the Parties**

The Company proposed that it reduce the MISO Schedule 26 revenues included in the rider to reflect the portion of its transmission investment that would be denied rider recovery if its recoverable investment were capped at certificate of need levels and if capitalized internal labor costs were disallowed. The Department recommended requiring the Company to include all Schedule 26 revenues in the TCR rider.

The Company disagreed with the Department's recommendation, stating that it would create a mismatch between the rate base used to derive the annual revenue requirements or costs included in the TCR rider and the rate base used by MISO and the Federal Energy Regulatory Commission to set Schedule 26 rates. And, the Company argued that the Department's approach would be at odds with the Commission's decision in Docket 10-1061, in which the Commission denied the Company's request to treat its investment in regional transmission facilities as unregulated business activities.

The Company argued that in Docket 10-1061, the Commission addressed the question of how much of the Company's investment in regional projects should be included in its TCR rider – the entire investment or only the amount that corresponds to retail service. Otter Tail argued that the Commission's order recognized that synchronizing the costs included in the TCR rider and the rate base used to derive the revenue credits requires that the costs of projects included in the TCR rider and revenue credits attributable to those costs must match.

### **B. Commission Action**

Having considered the arguments raised by the parties, the Commission will deny the Company's proposal for alternative ratemaking treatment of Schedule 26 revenues and costs.

First, the Company's interpretation of the March 26, 2012 Order in Docket 10-1061 is incorrect. In that docket the Commission was addressing the Company's proposal to (1) treat its investments in regionally planned transmission facilities, which yield MISO Schedule 26 revenues from other utilities' use of them, as similar to unregulated operations, with all costs and revenues flowing to Company shareholders; or (2) in the alternative, carve out the Minnesota-jurisdictional costs attributable to these facilities and treat the remaining investments as similar to unregulated operations, with all costs and revenues flowing to Company shareholders.

This proposal would have increased Minnesota retail rates by some \$986,409 per year. The rate difference exists mainly because the federally tariffed rates remitted under MISO Schedule 26 are based on a federal ratemaking formula that produces different results—and, at this time and under these circumstances, higher results—than the Minnesota ratemaking process.

The Commission rejected this proposal, not because of any need for matching or symmetry between the Company's Minnesota rate base and its MISO Schedule 26 rate base, but because:

[a]s the Department and the Chamber pointed out, these lines are bedrock utility infrastructure, found to be needed in a Minnesota certificate of need proceeding and currently playing a critical role in providing reliable, affordable, and environmentally sound electric service to Minnesota ratepayers. There is nothing in the nature or function of the lines to suggest that they should not be treated as utility property subject to standard cost-recovery principles.<sup>11</sup>

The decision did not turn in any way on the difference between the rate base used for Minnesota ratemaking purposes and the rate base used for MISO ratemaking purposes. In fact, the order simply noted that “of course, no two ratemaking approaches or outcomes are identical, and rate differentials between different jurisdictions are normal.”<sup>12</sup> In short, the decision in Docket 10-1061 does not support the Company's claim that the two rate bases, MISO's and Minnesota's, must match.

Nor do any fundamental legal or equitable principles require that they match. The two regulatory systems involved here serve different purposes—MISO and the Federal Energy Regulatory Commission are charged with setting the rates transmission owners pay one another for using regionally planned transmission projects; this Commission is charged with determining how Minnesota utilities recover their prudent investments in the Minnesota-jurisdictional portions of those transmission projects.

The two systems use different regulatory frameworks and have different operational details. For example, the federal/MISO system uses formula rates and the Minnesota system uses traditional cost-of-service ratemaking. Both are accepted regulatory approaches; there is no requirement or expectation that the two regulatory systems will operate identically or yield identical results.

Finally, as the Department noted, permitting the Company to withhold from the rider the difference between the MISO Schedule 26 revenues it receives and the MISO Schedule 26 revenues it would have received, had MISO used the Minnesota rate base, would be inconsistent with Minn. Stat. § 216B.16, subd. 7b (b) (2). That statute requires utilities to include as rider credits revenues received from other transmission owners for their use of regionally planned transmission projects.

For all these reasons, the Commission will not authorize the Company to reduce the MISO Schedule 26 revenues passing through its rider to reflect what those revenues would have been using the Company's Minnesota rate base.

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<sup>11</sup> Docket 10-1061, Order Setting Rider Revenue Requirement, Authorizing Change in Billing Method, and Requiring Further Filings (March 26, 2012) at 5.

<sup>12</sup> Id. at 3.



## **VI. MISO Rule 37 and 38**

After reviewing the Company's initial filing, the Department questioned the Company as to whether forecasted MISO Schedule 37 and 38 revenues are reflected in the Company's TCR rider in the forecasted Scheduled 26 revenues. The Department recommended that in the future, the Company separately identify the MISO Schedule 37 and 38 revenues as such. The Commission concurs, and will require the Company to identify Schedule 37 and 38 revenues as such in future filings.

## **VII. Carrying Charges**

In Otter Tail's last renewable energy rider docket, the Commission requested that the Company explain, in its next rider filing of any type, why the inclusion of a carrying charge imposed on a rider tracker account balance is justified.<sup>13</sup> The Company responded to the Commission's request in this docket by stating that a rider reflects either an over- or under-recovery of the tracker balance and the carrying charge provides symmetrical treatment in both circumstances.

Having considered the issue, the Commission will not allow the Company to add a carrying charge to the tracker balance for its transmission cost recovery rider and its renewable resource cost recovery rider. While the Company's observation about symmetrical treatment is true, it does not go to the heart of the issue. As discussed above, the TCR rider and the renewable resource cost recovery rider are extraordinary cost-recovery mechanisms adopted to expedite the construction of critically needed infrastructure.

They offer unique advantages over traditional ratemaking treatment. For example, they permit cost recovery—including recovery of the authorized rate of return—to begin with construction, instead of when the facilities are placed into service. And both riders permit cost recovery to begin before the facilities' costs have been fully scrutinized in a rate case. The additional advantages of a carrying charge are therefore unnecessary either to ensure fairness or to act as an incentive.

For all these reasons, the Commission will not permit carrying charges on either rider.

## **VIII. Implementation**

To accommodate the Company, the Commission will require that all changes to the TCR rider arising from the Commission's actions in this matter will be effective as of the date of the Order. The Company shall file a compliance filing within 30 days of the date of the Commission's Order demonstrating the Company's recalculation of the TCR rider and its proposal to credit ratepayers to reflect the changes in the TCR rider set forth in this Order.

## **ORDER**

1. The Commission finds that the Sheyenne-Audubon project is no longer needed.

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<sup>13</sup> *In the Matter of Otter Tail Power Company's Request for Approval of its Renewable Resources Cost Recovery Adjustment Factor*, Docket No. E-017/M-12-708, Order Approving Request to Reduce Rider Recovery Factor, Approving Refund, and Setting Requirements for Future Rider Filings, Ordering Point No. 4 (April 2, 2013).

2. Otter Tail Power shall identify MISO Schedule 37 and 38 revenues as such in future filings.
3. Projects being recovered in the TCR rider are subject to a cost cap. The cost cap for the Bemidji project is \$74 million.
4. Otter Tail shall remove the capitalized internal costs of approximately \$1.76 million from the TCR rider.
5. Otter Tail shall include all Schedule 26 costs and all Schedule 26 revenues in the Transmission Cost Recovery Rider.
6. Otter Tail shall not add a carrying charge to the tracker balance for the TCR rider and the Renewable Resource Cost Recovery Rider effective with the date of this Order.
7. All changes to the TCR rider arising from the Commission's actions in this matter will be effective as of the date of the Order. The Company shall file a compliance filing within 30 days of the date of this Order demonstrating the Company's recalculation of the TCR rider and its proposal to credit ratepayers to reflect the changes in the TCR rider set forth in this Order.
8. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar  
Executive Secretary



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