Minnesota Public Utilities Commission
Staff Briefing Papers

Meeting Date: September 11, 2014 ....**Agenda Item **#3**

Company: Otter Tail Power

Docket No. **E-017/M-14-20**1

In the Matter of Otter Tail Power Company's 2013 Demand Side Management Financial Incentives and Annual Filing to Update the CIP Rider

Issue(s):

1. Should the Commission approve Otter Tail's 2013 CIP tracker account?

2. Should the Commission approve an incentive of $4,026,600 for Otter Tail's 2013 CIP achievements?

3. Should the Commission grant Otter Tail's variance to Minnesota Rules part 7820.3500 (K) and a variance to Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket?

4. Should the Commission eliminate the carrying charge or otherwise modify its application to Otter Tail's tracker balance for the CIP rider effective with the date of the Commission's Order?

5. Should the Commission approve OTP's request to book its 2013 financial incentive in the month following Commission approval as it has done in the past?

6. At what level should the Commission set Conservation Cost Recovery Adjustment (CCRA)?

Staff: Marc Fournier 651-201-2214

Relevant Documents

Initial Filing Otter Tail Power Company .... April 1, 2014

Comments of the Department of Commerce,
Division of Energy Resources (DOC) .... May 1, 2014

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

I. Statement of the Issue(s)

1. Should the Commission approve Otter Tail's 2013 CIP tracker account?

2. Should the Commission approve an incentive of $4,026,600 for Otter Tail's 2013 CIP achievements?

3. Should the Commission grant Otter Tail's variance to Minnesota Rules part 7820.3500 (K) and a variance to Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket?

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II. Relevant Statute

Minn. Stat. § 216.16, subd. 6c.

Incentive plan for energy conservation improvement. (a) The commission may order public utilities to develop and submit for commission approval incentive plans that describe the method of recovery and accounting for utility conservation expenditures and savings. In developing the incentive plans the commission shall ensure the effective involvement of interested parties.

(b) In approving incentive plans, the commission shall consider:

(1) whether the plan is likely to increase utility investment in cost-effective energy conservation;

(2) whether the plan is compatible with the interest of utility ratepayers and other interested parties;

(3) whether the plan links the incentive to the utility's performance in achieving cost-effective conservation; and

(4) whether the plan is in conflict with other provisions of this chapter.

(c) The commission may set rates to encourage the vigorous and effective implementation of utility conservation programs. The commission may:

(1) increase or decrease any otherwise allowed rate of return on net investment based upon the utility's skill, efforts, and success in conserving energy;

(2) share between ratepayers and utilities the net savings resulting from energy conservation programs to the extent justified by the utility's skill, efforts, and success in conserving energy; and

(3) adopt any mechanism that satisfies the criteria of this subdivision, such that implementation of cost-effective conservation is a preferred resource choice for the public utility considering the impact of conservation on earnings of the public utility.

The Conservation Improvement Project Rider was submitted in accordance with the Miscellaneous Tariff rules.

III. Background

On June 15, 1994, Otter Tail filed a petition for a CIP Adjustment to recover costs associated with CIP. On October 18, 1994, the Company filed a Motion to File Amended Petition and Accept Settlement Agreement. On December 23, 1994, the Commission issued an Order Approving Settlement and Proposed CIP Adjustment for Otter Tail. In this Order, the Commission approved a CIP adjustment mechanism to be applied to customers' bills on or after July 1, 1995, which the Company began implementing in 1995.

On January 27, 2010, the PUC approved a new shared savings model for 2010 and indicated the new shared savings Demand Side Management (DSM) incentive shall be in operation for the length of each utility's triennial CIP plan.

On March 26, 2012, the PUC approved application of the Average Savings Method (ASM) be applied for counting behavioral project savings with a three-year minimum lifetime, effective with the 2013 program year.

On February 1, 2013, Otter Tail filed its Financial Incentive Proposal Compliance Filing which included 2013 approved budgets, goals net benefits, and resulting incentive levels with the PUC and the Division of Energy Resources (DOC). The filing establishes the 2013 incentive at approved goal. On August 6, 2013, the DOC issued a Decision approving the 2013 Compliance Filing.

On April 1, 2014, Otter Tail Power submitted its petition requesting the approval of the CIP financial incentives, implementation costs, and prospective rates.

On May 1, 2014, the DOC submitted comments recommending that the Conservation Cost Recovery Adjustment (CCRA) be increased by larger amount than proposed by Otter Tail Power.

On May 16, 2014, Otter Tail submitted reply comments modifying its original CCRA proposal. Otter Tail proposed a lower rate for the 12 months starting July 2014. Thereafter, the rate would increase for the next 12 months to zero in order to zero out the tracker balance.

On May 27, 2014, the DOC responded to Otter Tail's proposal and maintained the highrer recommended CCRA in order to minimize carrying costs.

On May 30, 2014, the Minnesota Chamber of Commerce filed comments urging the Commission to consider the Chamber's recommendations that the Commission adopt a lower CCRA, eliminate or reduce the carrying charge to a much lower rate than is currently allowed, and allow existing CIP tracker balance to be recovered over a longer time period.

On June 12, 2014, Otter Tail filed response comments to the Chamber's comments. Otter Tail provided additional support for its position an recommended that the Commission allow the Company to implement a CCRA of $0.00263/kWh, continue to assess a carrying charge based on its average weighted cost capital on its CIP tracker balance, and book the entire 2013 financial incentive in the CIP tracker in month following the Commission's Order.
On July 8, 2014, the Minnesota Department of Commerce (DOC) filed supplemental response comments. The DOC provided a set of updated recommendations that the Commission approve Otter Tail's CIP tracker account, as summarized in Table 1 of the DOC's May 1, 2014 comments, approve an incentive of $4,026,600 for Otter Tail's 2013 CIP achievements, grant Otter Tail a variance to Minnesota Rules part 7820.3500 (K) and a variance to Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket, Eliminate the carrying charge Otter Tail applies to the tracker balance for the CIP rider effective with the date of the Commission's Order, Approve OTP's request to book its 2013 financial incentive in the month following Commission approval, and Approve a CCRA of 0.002640/kWh starting with the first billing cycle in the month following Commission approval, allowing reasonable time for implementation and customer notice.

Additional Background

On May 1, 2014, the Minnesota Department of Commerce (DOC) filed comments concluding that Otter Tail correctly calculated its CIP Tracker account and 2013 financial incentive. However, the Department expressed concern that the Company's proposed Conservation Cost Recovery Adjustment (CCRA) rate would result in a large tracker balance, which would impose an unnecessary level of carrying charges on ratepayers. The Department recommended that the Minnesota Public Utilities Commission (Commission) set OTP's CCRA a $0.00350/kWh to reduce the tracker balance to $892,603 by December 31, 2015.

Because Otter Tail indicated a concern regarding rate shock in the event of a dramatic increase in the CCRA, the Department requested that Otter Tail discuss in reply comments whether it would be reasonable to delay booking the Company's financial incentive in order to help reduce the carrying charges imposed on its customers.

In its May 16, 2014 reply comments, Otter Tail addressed two issues 1) the amount of the CCRA in balance with customer bill impacts and 2) the timing of when the financial incentive is booked in the CIP tracker. Otter Tail proposed a slightly higher CCRA of $0.00263/kWh rather than their originally proposed level of $0.00209/kWh, effective July 1, 2014. As for the timing of when the financial incentive is booked, the Company recommended that the financial incentive be booked in its entirety in the month it is approved by the Commission.

Otter Tail provided an analysis that supported it position that its "stepped" approach of increasing the CCRA to $0.00263/kWh on July 1, 2014 and then to $0.00280/kWh effective July 1, 2015, provides a more reasonable balance between the need to decrease the level of the existing under-recovery in the CIP Tracker and the impact of the increase in the CCRA on customer bills. The Company's updated analysis estimated a CIP Tracker balance of $19,033 under-recovered effective June 30, 2016 using its approach.

Otter Tail noted in its reply comments that the Department's proposed CCRA would increase an average residential customer's bill by 1.73 percent and a large business or school's bill by 2.82 percent. The Company also calculated that the Department's proposed CCRA would increase an average Interruptible Load customer's bill by 3.40 percent.
The Department recommended in its response comments that the Commission:

- approve Otter Tail's CIP tracker account, as summarized in Table 1 of the Department's May 1, 2014 comments;
- approve an incentive of $4,026,600 for Otter Tail's 2013 CIP achievements;
- grant Otter Tail a variance to Minnesota Rules part 7820.3500 (K) and a variance to Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket;
- adopt a CCRA of $0.00350/kWh effective July 1, 2014; and
- approve OTP's request to book its 2013 financial incentive in the month following Commission approval.

On May 30th, the Minnesota Chamber of Commerce (Chamber) filed comments recommending that the Commission:

- Set the CCRA at $0.00209/kWh.
- Modify the current practice of allowing Otter Tail to charge a carrying cost equal to its average weighted cost of capital on the CIP tracker balance such that OTP would not calculate a carrying charge on the CIP tracker balance, or that the Company be allowed to recover a carrying charge equal to its short-term cost of debt.
- Allow the existing CIP tracker balance to be recovered over a longer time period.[1]

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[1] The Chamber argued that a recovery over time would be consistent with when ratepayers receive the benefits. The benefits of these investments are received through efficiency gains and avoided energy costs over time.

Otter Tail filed response comments to the Chamber's comments on June 12, 2014. Otter Tail provided additional support for its position and recommended that the Commission allow the Company to:

- Implement a CCRA of $0.00263/kWh;
- Continue to assess a carrying charge based on its average weighted cost of capital on its CIP tracker balance; and
- Book the entire 2013 financial incentive in the CIP tracker in month following the Commission's order.

IV. Parties' Comments

Otter Tail:

The Company's request for approval is as follows:

- The Company is requesting approval for $4,026,600 in performance incentives for 2013 CIP activities, a small share of the total net benefits from investments in CIP.

- The Company is requesting the CCRA rate of $0.00263/kWh effective July 1, 2014. The Company will evaluate the CCRA in its next April 15, 2015 CCRA update filing and will propose a CCRA rate to bring the CIP tracker account to a near zero balance.

- Otter Tail is requesting a variance to Minnesota Rule 7820.3500 (E &K), which require that the Fuel Clause Adjustment (FCA) be stated as a separate line item on customer bills. The requested variance would allow the Company to continue to combine the FCA with the CCRA on customer bills.

- The Company is requesting approval of the 2013 CIP Tracker, resulting in a year-end balance of $4,835,558.

Financial Incentive Filing

Otter Tail requested that a financial incentive of $4,026,600 be approved and recovered through its CIP Tracker account.

Conservation Improvement Project Rider

The Company originally requested raising the Conservation Cost Recovery Adjustment factor (CCRA) from $0.00175 to $0.00209. This would be reflected on customer's bills through the resource adjustment starting with bills rendered on or after July 1, 2014 or as soon as the Commission's Order is issued.

In the DOC's reply comments, they accurately acknowledge that the CIP tracker balance is significant at $4,263,408 on June 30, 2015. The Company shares the DOC's concern that the originally proposed CCRA of $0.00209/ kWh does not bring the tracker balance to zero and understands the recommendation to increase the CCRA to avoid carrying charge costs. However, the Company recommends a more gradual increase to the surcharge than the 100% increase proposed by the DOC. Additionally, the DOC's proposal runs the risk of the tracker account balance going negative. As such, the Otter Tail's new recommendation brings the tracker balance closer to zero.

Under the Company's new proposal, effective July 1, 2014 or as soon as the Commission's Order is issued, Otter Tail proposes to increase the CCRA by 50 percent to a rate of $0.00263/kWh. This rate will significantly decrease the CIP tracker in the first year while still being mindful of customer bill impacts. In year two, (July 2015-July 2016) the Company proposes a second smaller increase to $0.00280/kWh in 2015 will smooth the impact to customers over a single large increase in 2014.

The DOC's recommendation drastically decreases the CIP tracker and reduces future carrying charges but the impact to customers is too significant when other alternatives are available. Increasing the CCRA by 100 percent would result in a total bill increase for residential customers of 1.73 percent and an increase to large business customers of 2.82 percent. Additionally, the DOC's proposal would increase Interruptible Load customer's monthly by 3.40 percent. These customers typically heat their homes with electricity, and the impact to winter bills could be even higher.[2]

Otter Tail's new proposed CCRA rate of $0.00263, if approved July 1, 2014, will reduce the CIP tracker balance from an estimated $6,673,152 in July 2014 to $2,972,461 at the end of June 2015. At this point, the Company estimates an increase to the CCRA in July of 2015 of approximately 6.5 percent to $0.00280/kWh will reduce the tracker to near zero by June 2016. The Company believes that this two-step approach moderates the bill impacts and manages the tracker balance rather than a single large increase.

In each of the DOC's scenario analysis, the CCRA rate changes in July 2014 and continues through December 2015. However, the DOC's calendar analysis does not account for the six months of January 2016 through June 2016 where the higher CCRA will be accruing. This exclusion results in Otter Tail greatly over-collecting. This would cause yet another change to the CCRA which is contrary to the goal of rate stability.

Otter Tail compares the various scenarios on an annual basis using the CIP calendar of July-June. This approach ensures that if an annual financial incentive is booked and a new CCRA approved, then the subsequent 12 months of recovery are timed accordingly. The DOC's analysis books a financial incentive in July 2015 but only includes six months of recovery, rather than the actual

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[2] Beginning in 1995/1996 through 2011, the Company applied a CIP Surcharge/CCRA Factor to customer's bills ranging from .50% to 3.8%. Starting in 2012/2013, the Company instituted an actual rate of $0.00142. It increased it by approximately 23% to $0.00175 in 2013/2014. The Company's original proposal in this docket was to increase the CCRA by approximately 19% to $0.00209. Currently, the Company is proposing to increase it by approximately 51% to $0.00264 for 2014/2015.

12 months the recovery would likely occur. This distorts the actual recovery period and the tracker balance at the time a new CCRA is established.

With respect to carrying charges and the CIP tracker balance, the DOC's proposed CCRA of $0.00350/kWh adds an annual $2 million of customer CIP cost recovery to the July 2014-June 2015 period. Otter Tail's new proposal does increase the carrying charges for the period by approximately $80,000 but minimizes the impact to customers by gradually reducing the tracker balance.

Additionally, under Otter Tail's proposal, the CCRA would increase by an additional 6.5 percent to $0.00280/kWh to bring the tracker balance in June of 2016 to $19,033. Carrying charges for this period would total $248,158 which is in line with historic levels from 2011-2013.

With respect to timing the recording of the 2013 financial incentive, Otter Tail pointed out that the financial incentive has been recorded in the CIP tracker the month that the Commission orders approval of the incentive. The incentive is based on results from the previous year's accomplishments. Ideally, the incentive would be recorded in the month it is earned, or shortly after, January 1. Delaying the payment of the financial incentive or booking the incentive in many pieces only further delays the recovery of an incentive the company earned the previous year. Otter Tail has forfeited the first six months of the year's carrying charges. Further delays compound the issue.

Otter Tail understands that regulatory lag and unavoidable delays do occur, rendering a July incentive approval and recording not always be realistic. Otter Tail asks the Commission to keep this process consistent with historical practice, straight-forward and administratively transparent, and reward the company the incentive it has earned in the month it is approved.

Otter Tail's response to the Chamber: State regulators, utilities, and other stakeholders recognized that the CIP tracker balance could be several million dollars between rate cases, and that timely cost recovery and an appropriate carrying charge would be necessary to achieve Minnesota's energy efficiency goals. Since that time Minnesota has forged its energy efficiency rankings in the record books, shored by a consistent and reliable regulatory framework. With the passage of the Next Generation Act, this framework has never been more critical.

With respect to financial incentive cost recovery timing, Otter Tail argued that The CIP financial incentive recognizes achievement of goals executed in the previous calendar year and is recorded in the tracker the month of approval. Recording program costs and carrying charges in the months the costs are incurred has been chronological with program activity recorded in the tracker and matches utility accounting procedures for handling program costs. Proper accounting methods require that costs are dealt with in the time period in which they were incurred. This method also maintains consistency in the tracking of approved programs.

Instead of current practice and historical precedence, the Chamber proposes to spread the recovery of the incentive over a longer period of time. A recovery over time would create a cumulative recovery (i.e., if the incentive was recovered over 5 years and then the next year's was recovered over five years, etc.) The regulatory lag associated with delayed recovery of the incentive would be compounded by potentially larger budgets and associated tracker balances.

Regarding carrying charges, Otter Tail stated that A carrying charge has been in place since 1992, where the Commission agreed with all parties that it is appropriate to begin adding carrying charges to the CIP tracker account. Carrying charges have been part of the CIP tracker using the currently approved rate of return since July 6, 1993.

Otter Tail is not unique in the use of its rate of return as the carrying charge on its tracker balance. Otter Tail's understands that all Minnesota utilities have been authorized to use their respective rates of return for this purpose.

Use of the utility's rate of return for the carrying charge is appropriate as the utility needs to make available cash working capital to cover the outstanding tracker balance and cash working capital is a component of utility rate base. It is also worth noting that when a tracker balance runs negative (meaning the utility has collected more than its to-date revenue requirements), the rate of return on that balance recognizes the contribution to the utility's cash working capital—and serves as a credit to ratepayers.

DOC: The DOC recommends that the Commission set the CCRA at $0.00350/kWh to reduce the tracker balance to $892,603 by June 30, 2015.

During the period from 2006 through 2015, Otter Tail achieved energy savings which increased by 125 percent while CIP expenditures increased by 189 percent. However, Otter Tail's annual carrying charge increased by 623 percent and the year-end tracker balance increased by 451 percent. The DOC noted that timely cost recovery would have resulted in an overall increase in the annual carrying charge amount and year-end tracker balance was proportional to the increase in energy saved and annual CIP expenditures.

The DOC's proposal decreases the total percentage change in carrying to 194 percent by the end of 2015. This would be consistent with the percent energy savings and change in CIP expenditures cited above. The DOC notes that: 1) the tracker balance remains under-recovered through the end of 2015 and 2) the estimated $508,647 under recovery under the DOC's proposal reduces the carrying charges associated with the CIP tracker, but does not eliminate them. Because Otter Tail files its annual CIP status report, including its financial incentive, CIP tracker and the CCRA adjustment request by April 1 of each year, a revised CCRA may be in place prior to December 2015. This revised CCRA could be designed to manage the tracker balance such that it remains as close to zero as possible for the July 2015 – June 2016 time frame.

The DOC notes that Otter Tail is allowed to charge its average weighted cost of capital, 8.61 percent, on any over- or under-recovered balance in the CIP tracker. Given that current interest rates are much lower than 8.61 percent, the DOC concludes that ratepayers would be better served financially if the CCRA is set at a level that increases the rate at which the current under-recovered balance on the CIP tracker is reduced.

While setting the CCRA at $0.00350/kWh would not reduce the tracker balance to zero by the end of 2015 the tracker balance would be significantly reduced while mitigating the rate shock that may occur with an even higher CCRA. The DOC considers the bill impacts of the DOC's recommendation to be within a reasonable range in this specific case and appear to be necessary trade-off given the extent of the under-recovery in the tracker balance and the level of the carrying charge Otter Tail is allowed to assess on that unrecovered balance.

With respect to other recommendations or concerns raised by Otter Tail, the DOC appreciates the "step" analysis that Otter Tail provided in reply comments, as it provides a useful refinement to the CCRA calculation. While it did not appear that Otter Tail was suggesting that the Commission approve this stepped approach, the DOC notes for the record that it would not support a stepped or multi-year approach in this instance. The current procedural schedule adequately addresses the timing of these cost recovery issues.

Regarding the choice of calendar year versus a "CIP" or fiscal year perspective for analyzing the CIP tracker, the DOC notes that the "CIP" year perspective can be a bit misleading in that the June ending balance can be significantly different from the subsequent July ending balance due to the approval and accounting for the Company's incentive in July. Consequently, the DOC used the year-end perspective due to the fact that this "lumpy" July cost is somewhat mitigated in the December-ending CIP tracker balance by 6 months of cost recovery from the new CCRA. Otter Tail's reply comments identify a forecasted June-ending 2016 CIP tracker balance, assuming the approval of a 2015 incentive in excess of $2 million in June 2016 would result in a July-ending balance of an under-recovered tracker balance of $1.8 million. Looking only at the June 2016 balance ignores the significant addition to the tracker expected in the next month.

Otter Tail stated in its reply comments that large swings in the CCRA are inappropriate and should be minimized. While rate and bill consistency are laudable goals in any rate setting exercises, they are not the only goals. Nor are they necessarily the preferred goals. In this case the DOC's focus on the rates (the CCRA in this instance) that recover the costs incurred in an equitable and efficient manner is more appropriate than a focus on bill consistency.

Regarding the timing of the recognition and recovery of the financial incentive, the DOC identified four scenarios for booking OTP's $4.0 million 2014 incentive in its comments. Three of those scenarios essentially shifted some of the carrying costs associated with the incentive from ratepayers to shareholders, all else being equal. The Company explained in its reply comments that it prefers to book the incentive in its entirety in the month which the Commission Order is issued, consistent with past practice. The result of this decision would be to maintain the current allocation of carrying costs between the Company and its ratepayers. The Department has no additional comments on this topic.

DOC's Position on Carrying Charge on CIP Tracker

The Chamber in its reply comments stated "there should be no carrying costs since the utility is not incurring any risk in receiving the incentive, nor are dollars being held up to pay for CIP expenditures." The Chamber also recommended that no carrying cost should be calculated for the CIP tracker or the Company should use its cost of short-term debt in lieu of its currently approved average weighted cost of capital in the calculation of the carrying charge.

OTP noted in its response comments that the Commission approved the concept of a carrying charge on the CIP tracker balance in 1992 and that all Minnesota utilities currently use their respective rate of return for this purpose. The Company also noted that the treatment of the tracker balance is symmetrical as well.

After reviewing the Chamber's and the Company's comments on this issue, the Department Concluded that it is reasonable to apply the rationale developed in the Commission's Order to the CIP tracker. Using the TCR and RRCR riders as a point of comparison, the Commission's treatment of the CIP tracker is fairly generous in that it allows the utility to earn a large incentive on its CIP achievements (from 2010-2012 OTP's CIP incentive averaged 62 percent of its program costs) and it also allows the utility to assess a carrying charge on its tracker balance. This comparison suggests that the Chamber's recommendation to discontinue applying a carrying charge on the tracker balance in light of the Commission's recent decision in Docket No. E017/M-13-103 is appropriate. Consequently, the Department supports the Chamber's recommendation to discontinue approving carrying charges for under or over recovered balances in OTP's CIP tracker account.

The Chamber also recommended in its comments that if the Commission decided to allow OTP to continue charging its customers a carrying charge on the CIP tracker balance, such a carrying charge should be set at the Company's rate for short-term debt, not its average weighted cost of capital as is currently the case. The Chamber did not provide specific support for this contingent recommendation; however, the cost of short-term debt would generally be expected to be lower than the overall rate of return.

Similar to the DOC's investigation of the Chamber's primary recommendation regarding the carrying charge on the CIP tracker, the Department reviewed the components of OTP's CIP tracker in an attempt to determine if clear support existed for the use of either the average weighted cost of capital or the cost of short-term debt in the carrying charge calculation.

In its response comments to the Chamber, the Company included a passage from a Commission Order from Docket No. E-017/M-91-457 dated March 12, 1992, which provides a history of the carrying charge. The DOC believes that the Commission's intent was to allow carrying charges on CIP investments. The Commission did not address whether it was appropriate to apply carrying charges on CIP financial incentives.

There is a clear distinction between an investment and an incentive. Webster's on-line dictionary defines incentive as: "something that incites or has a tendency to incite to determination or action." It defines an investment as "the outlay of money usually for income or profit." Therefore, an incentive is not an investment. Consequently, and consistent with the Commission's decision to "compensate the Company for . . . money invested in the CIP projects," the Department concludes that it is inappropriate for the Otter Tail to receive a carrying charge on an incentive payment given tothe utility to invest in conservation. As a result, the Department recommends that in the event that the Commission continues to allow the application of carrying charges to the over and under recovery of CIP tracker accounts, that the carrying charge not be applied to the Company's financial incentive.

In addition, a material change in facts has occurred since the Commission's Order above was issued. According to information contained in page 7 of the Commission's Order in Docket No. E-017/M-91-457, OTP's financial incentive was $23,714. By contrast, as noted above, OTP's most recent financial incentive was $4,026,000, an increase of over $4 million, or 16,880 percent higher than in 1992. In other words, there were few options available to encourage CIP in 1992, whereas there are currently more significant options available to encourage utilities to invest in CIP.

If the Commission decides to allow OTP to continue to charge its customers a carrying charge on the CIP tracker, the question becomes what carrying charge accurately identifies the time value of money the Company has invested in CIP program? The presumption is that carrying charges compensate the Company for the time value of money invested in the CIP projects.

The Department cannot identify a threshold decision criterion for making this determination. Otter Tail mentioned in its response comments that the Company is required to make cash working capital available to cover the outstanding tracker balance and that cash working capital is a component of utility rate base. However, one could argue that any over or under recovery of the CIP tracker balance should be a short-lived phenomenon that is correspondingly financed with short-term debt. In addition, it would appear that lowering the carrying charge to the Company's cost of short-term debt would provide an incentive for the Company to minimize the CIP tracker balance over time.

Given that the DOC's charge is to protect ratepayers' interests and in light of the absence of an identifiable advantage to either of these alternatives, the DOC recommends that this carrying charge should be based on the Company's short-term cost of debt, if the Commission chooses to allow OTP to charge any carrying charge on its tracker balance.

Timing of Recovery of the 2013 Incentive

The Department's initial comments asked that Otter Tail address the reasonableness of delaying recovery of the Company's 2013 financial incentive. The Chamber recommended that OTP be required to delay the timing of the recovery of the financial incentive. In its reply comments, Otter Tail cited the complications associated with a multi-year recovery period. While the Department's suggested delay was limited to 12 months, we note that the existence of the tracker essentially defines these CIP costs as requiring accelerated recovery. Consequently, absent agreement by the Company to delay booking its 2013 financial incentive to ease the financial impact of this increase in the CCRA on its customers, the Department concludes that current public policy allows Otter Tail to book the incentive in the manner they propose.

Appropriate Level for the CCRA

The Chamber mentioned two additional increases in charges collected through OTP riders – the TCR rider and the Environmental Cost Recovery Rider (ECRR). The Chamber identified a potential 273 percent increase in the TCR rate factor and an increase of 4 percent in base rates due to the introduction of the ECRR. The Chamber did not provide any customer bill impacts in its reply comments. The Department developed a customer bill impact analysis to determine the combined effect of the CCRA, TCR and ECRR.

The CCRA Under Three Scenarios

The DOC analyzes the impact on customers of the CCRA under three different levels. The Department originally supported a CCRA of $0.0035/kWh, to reduce the tracker balance below $1 million by December, 2015. The potential monthly rate increases that would result from the combined increases in the ECRR (approved), CCRA (proposed), and TCR (proposed) are much higher (residential 8.8%, small commercial 9.4%, and large commercial 7.9%) than the 1.74 percent average CCRA-only increase due to "medium" CCRA recommended by the Department, as the Department calculated in its Comments in this proceeding. While the Department is not pre-judging the merits of OTP's proposed increase in the TCR, a combined rate increase of this magnitude over a period of less than twelve months would present a very different picture of the extent to which ratepayers will need to manage their usage and bills.

In second analysis assuming a CCRA of $0.00209/kWh, originally proposed by the Company. The nominal and percentage increases resulting from this level of the CCRA (residential 7.3%, small commercial 7.8%, and large commercial 5.5%) are still well above the nominal and percentage increases the DOC's analysis identified with its comments on May 1. The Chamber supports the implementation of this lower CCRA.

A third analysis which assumes the Company's last proposed CCRA increase of $0.00263 would lead to the following percentage increases in customers average monthly bills: residential 7.9%, small commercial 8.4%, and large commercial 6.4%. The DOC now recommends that the Commission adopt this rate for two reasons. First, the Department is recommending the elimination of carrying charges and thus the amount of under recovery that Otter Tail is currently experiencing will not have a negative financial impact on the Company's ratepayers. Second, this lower CCRA will moderate the incremental bill impact associated with the combined increase in the CCRA and the TCR that will likely occur later this year. Regarding the Company's proposed increase to the CCRA in 2015, the DOC makes no recommendation at this time. Rather, the DOC will review the Company's CIP tracker balance when Otter Tail files its annual CIP tracker report next May and will develop a recommendation on the level of the 2015 CCRA on the basis of that information.

To summarize the DOC's positions:

- approve Otter Tail's CIP tracker account, as summarized in Table 1 of the Doc's May 1, 2014 comments;
- approve an incentive of $4,026,600 for Otter Tail's 2013 CIP achievements;
- grant Otter Tail a variance to Minnesota Rules part 7820.3500 (K) and a variance to

Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket;

- Eliminate the carrying charge Otter Tail applies to the tracker balance for the CIP rider effective with the date of the Commission's Order;
- adopt a CCRA of $0.002630/kWh effective on the first billing cycle following Commission approval; and
- approve OTP's request to book its 2014 financial incentive in the month which the Commission orders its approval.

Minnesota Chamber: As initially filed, Otter Tail's proposed CIP charge will increase 19% from $0.00175/kWh to $0.00209/kWh. The Chamber does understand the DOC's concern with respect to carrying charges, but noted that the proposed DOC charge of $0.00350/kWh is essentially a doubling of the current charges. If the CIP charge were the only proposed increase this year, the impact would not nearly be as problematic. However, with OTP's proposed transmission rate increasing from $0.391/KW to $1.458/KW and a potential increase of the Environmental Cost Recovery Rider of approximately 4% of base rates, doubling the CIP rider charges will result in excessive increases. Due to the importance of energy in Minnesota's rural northern economy, commercial and industrial customers will really feel these excessive increases. As such, the Chamber recommends that the Commission approve Otter Tail's initial proposal of $0.00209/kWh.

With respect to carrying charges, the Chamber believes that Otter Tail or any of the other utilities should not utilize a carrying cost equal to the proposed rate of return. It seems unreasonable for the utility to earn a return on the CIP financial incentive (i.e. a return on the CIP return on investment) that makes up the tracker balance at the end of June 2015.

The Chamber believes that there should be no carrying costs since the utility is not incurring any risk in receiving the incentive nor are dollars being held up to pay for the CIP expenditures. In the alternative, in the event that the Commission believes that carrying charges should be allowed, the Chamber recommends using the short term debt rate.

Finally, the Chamber argues that the financial incentive should be spread over a larger period of time. This would be consistent with when ratepayers receive the benefits. The benefits of these investments are received through efficiency gains and avoided energy costs over time. Furthermore, the CIP financial incentive is based on the net present value of the net benefits over the lifetime of the measures. Accordingly, it follows that the financial incentive should be also be spread over a much longer period than proposed.

The Chamber recommends the following:

- The Commission should approve OTP's initially proposed CIP charge of $0.00209/kWh.
- With respect to carrying costs, the Chamber recommends either no carrying costs or using the short term debt rate.
- The CIP financial incentive should be booked over a larger period.

V. Staff Discussion

Staff agrees with the DOC that the 2013 tracker account was calculated correctly. As such, the Commission should approve Otter Tail's 2013 CIP Tracker account of $4,35,558 as reported by the DOC. To put this amount in perspective, below is the tracker balance from 2006:

Year	DSM Financial Incentive	Year-End Tracker Balance
2006	$158,363	$1,035,608
2007	$25,066	$490,713
2008	$273,798	$265,056
2009	$1,101,060	$1,927,314
2010	$3,531,538	$3,721,665
2011	$2,608,098	$5,188,129
2012	$2,681,575	$3,572,621
2014	$4,026,600	$4,835,558
2015*	$2,213,974	$6,648,566
2016*	$2,213,974	$5,708,014

* Projected

Staff notes that the tracker balance is projected to increase by approximately 451% between 2006 and 2015. Also, there is a strong positive correlation between the size of the tracker balance and the magnitude of the DSM financial incentive.[3]

With respect to the 2013 CIP incentive amount, Staff agrees with the DOC that the amount of $4,026,600 should be approved by the Commission.

Pursuant to Minnesota Rules 7829.3200, Otter Tail requested a variance to Minnesota Rules 7820.3500 (G & K), which require that the fuel clause adjustment (FCA) be stated as a separate line item on customers' bills. The requested variance would allow the Company to continue to combine the FCA with the Conservation Improvement Adjustment on customer bills.

Staff believes that the variance should be approved for this year. However, going forward, the Commission may wish to consider separating the CCRA from the FCA. This will allow for more transparency for the customer.

With respect to the carrying charge applied to the CIP tracker, Staff recommends that it should be eliminated for two reasons. First, Staff believes that the current carrying cost structure provides a perverse incentive for the Company to maintain the CCRA at relatively low level and

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[3] A correlation for the data revealed that the level of tracker balance and the sizes of the DSM incentive were significantly related, $r = +.766$, $n=10$, $p < .01$, two tails.

carry a significant positive tracker account balance. This increases the cost of the CIP over the long run.

Second, Staff believes that the goal should be to carry a zero balance as much as possible in the tracker account. By having a carrying charge of any size, it will reduce the likelihood of such an outcome. Again, the goal should be to keep CIP costs at a minimum. In this context, having an incentive structure which facilitates this outcome, generally will facilitate the achievement of the desired outcome.[4]

Regarding the incentive recovery, Staff believes that this incentive should be viewed as a reward for doing what the CIP program is designed to do. It was calculated based on Commission orders. For the sake of simplicity, it should be booked at a single point in time. Any other approach would seem to needlessly complicate this item.

Finally, the CCRA rate should be set with the goal of bringing the tracker account to zero in a timely but reasonable manner. In the event the Commission eliminates or reduces the carrying charges, it would be it would be reasonable to bring the tracker to zero as quickly as possible. At the same time, the Commission needs to mindful of the rate impact on the Company's customers.

With the factors identified above in mind, Staff believes that a reasonable rate at this time would be $0.00263/kWh. This was the rate proposed by Otter Tail in reply comments.[5] Staff does not recommend the second year rate at this time. Next year, the Company should evaluate the progress that has been made, and propose a rate which would continue the progress to bring the tracker balance to zero.

VI. Commission Options

A. Should the Commission approve Otter Tail's 2013 CIP tracker account?

1. Approve Otter Tail's 2013 CIP tracker account as indicated at page four of the DOC's May 1, 2014 comments.

2. Do not approve Otter Tail's 2013 CIP tracker account.

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[4] In the event the Commission does not wish to eliminate the carrying charge in its entirety, Staff agrees with the DOC that the carrying charge not be applied to the Company's financial incentive portion of the tracker balance. The impact would be similar. In not applying the carrying charge to the DSM financial incentive, the carrying charge would be applied to substantially smaller tracker. This option is reflected in option D4.

[5] In their May 16, 2014 reply comments, the Company proposed a two year rate plan. In the first year of this plan, the Company proposed a rate of $0.00263/kWh. In the second year, the Company proposed a rate of $0.00280.

B. Should the Commission approve an incentive of $4,026,600 for Otter Tail's 2013 CIP achievements?

1. Approve Otter Tail's 2013 financial incentive for CIP achievements.

2. Do not approve Otter Tail's 2013 financial incentive for CIP achievements.

C. Should the Commission grant Otter Tail's variance to Minnesota Rules part 7820.3500 (K) and a variance to Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket?

1. Grant the rule variance to allow Otter Tail to combine the CCRA in with the fuel clause adjustment (FCA) line item on customer's bills.

2. Do not grant the rule variance to allow Otter Tail to combine the CCRA in with the fuel clause adjustment (FCA) line item on customer's bills.

D. Should the Commission eliminate the carrying charge or otherwise modify its application to Otter Tail's tracker balance for the CIP rider effective with the date of the Commission's Order?

1. Eliminate the carrying charges to the tracker balance for the CIP rider effective with the date of the Commission's Order.

2. Do not eliminate the carrying charges to the tracker balance for the CIP rider effective with the date of the Commission's Order.

3. Modify the carrying charge so that it is based on the Company's Short-term cost of debt.

4. Modify the application of the carrying charge to exclude Company's financial incentive when determining the amount of carrying charges allowed for recovery.

5. Take other action the Commission deems appropriate.

E. Should the Commission approve OTP's request to book its 2013 financial incentive in the month following Commission approval as it has done in the past?

1. Approve Otter Tail's request to record the incentive in a lump sum fashion following the issuance of the Commission's Order.

2. Record the incentive over 12 months commencing after the issuance of the Commission's Order.

3. Record the incentive over 9 months commencing after the issuance of the Commission's Order.
4. Record the incentive over some other time period.

F. What rate level for the CCRA should the Commission approve for the first billing cycle in the month following Commission approval, assuming reasonable time for implementation and customer notice?

1. Set the CCRA at $0.00263 as recommended by the Company and the DOC.

2. Set the CCRA at $0.00209 as originally recommended by the Company and currently advocated by the Chamber.

3. Set the CCRA at $0.0035 as originally recommended by the DOC.

4. Leave the CCRA at its current level of $0.00175.

VII. Staff Recommendation

Staff recommends items A1, B1, C1, D1, E1, and F1.