Minnesota Public Utilities Commission
Staff Briefing Papers

Meeting Date: March 3, 2016 ....*Agenda Item # **2**

Company: Otter Tail Power Company

Docket No. E017/M-15-874

In the Matter of Otter Tail Power Company's Petition for Approval of its 2015 Transmission Cost Recovery (TCR) Annual Adjustment

Issue: Should the Commission approve Otter Tail Power's TCR Rider Petition as updated in the Company's December 21, 2015 Supplemental Comments and recommended by the Department?

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Relevant Documents

Otter Tail – Initial Filing..September 30, 2015
Department - Comments ....October 28, 2015
Otter Tail – Reply Comments .... November 9, 2015
Otter Tail – Supplemental Filing ....December 21, 2015
Department – Response to Reply Comments ....January 13, 2016

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February 24, 2016

Statement of the Issue

Should the Commission approve Otter Tail Power's TCR rider petition as updated in the Company's December 21, 2015 supplemental filing and recommended by the Department?

Background

September 30, 2015: Otter Tail filed its initial petition requesting approval of the 2015 annual adjustment to its TCR rider. Otter Tail stated it is seeking to implement new rates based on updated investment, expense and revenue collections that have occurred since the last TCR update. The Company stated that the petition is accounted for within the framework that has been ordered by the Commission in Otter Tail's prior TCR rider dockets.

October 28, 2015: The Department filed its comments and requested that Otter Tail provide additional information regarding cost caps and Schedule 26 revenues. The Department stated that it would offer additional comments and recommendations in response comments after it has reviewed Otter Tail's reply comments.

November 9, 2015: Otter Tail filed reply comments and stated that none of the projects included in the rider have exceeded the costs estimated in their respective estimated cost dockets, with the exception of the Bemidji project.[1] The Company explained the differences in Schedule 26 revenues.

December 21, 2015: Otter Tail filed a supplemental filing to address two items that impact the revenue requirement: Accumulated Deferred Income Taxes (ADIT) and a correction to a formula error made in the initial filing. The overall impact of the two items is a $549,014 reduction in the revenue requirement.

January 13, 2016: The Department submitted response comments and recommended the Commission approve Otter Tail Power's TCR petition.

January 27, 2016: Otter Tail stated via voice mail that they are accepting the Department's recommendation and that the Company would not be filing additional comments in this docket.

Relevant Statute

Minn. Stat. §216B.16, subd. 7b(a), allows the Commission to approve a tariff mechanism, which provides for the automatic annual adjustment of charges that recover the Minnesota jurisdictional costs of new transmission facilities. Minn. Stat. §216B.1645 states that the Commission may approve a rate schedule that provides for the automatic adjustment of charges to recover prudently incurred investments, expenses, or costs associated with facilities constructed to satisfy the renewable energy objectives and standards set forth in Minn. Stat. §216B.1691, including

[1] In Docket No. E-017/M-13-103, the Commission determined the appropriate cost cap for the Bemidji project is $74 million.

those made to transmit electricity generated from renewable generating facilities to Minnesota retail customers.

Otter Tail Power's TCR Proposal

This is Otter Tail Power's fifth request before the Commission for an update of the Company's TCR rider. Prior TCR filings are shown in the table below.

History of OTP's TCR Filings

Docket No.	Order Issued	Rates Implemented
09-881	January 28, 2010	February 1, 2010
10-1061	March 26, 2012	April 1, 2012
13-103	March 10, 2014	No update to rates
14-375	February 18, 2015	March 1, 2015

The Company did not propose any new projects for recovery in this petition. Five transmission projects that were previously approved by the Commission for inclusion in Otter Tail Power's TCR rider are included in this filing:

1) Fargo-Monticello CAPX2020 Transmission Project
2) Bemidji-Grand Rapids CAPX2020 Transmission Project
3) Cass Lake-Bemidji CAPX2020 Transmission Project (Part of Bemidji Project)
4) Brookings-Hampton CAPX2020 Transmission Project
5) Ramsey 230/115 kW Transformer

The Company used a combination of Minnesota Statutes[2] and prior Commission Orders to calculate the revenue requirement. The following table compares the revenue requirement currently being recovered to the Company's September 30 initial filing and the Company's December 21 supplemental filing.

Revenue Requirement	Current	Initial Filing	Supplemental Filing
CAPX 2020 Fargo	$5,019,450	$5,449,948	$5,449,948
CAPX 2020 Bemidji	$283,967	$371,998	$371,998
CAPX 2020 Cass Lake – Bemidji	$253,936	$296,618	$296,618
CAPX 2020 Brookings	$1,493,119	$1,793,997	$1,793,997
Ramsey Transformer Upgrade	$22,476	$16,186	$16,186
Schedule 26 Expense	$5,221,192	$6,616,752	$6,616,752
Schedule 26A Expense	$1,016,177	$2,535,817	$2,535,817
Schedule 26 Revenue	($6,581,872)	($6,900,666)	($7,384,200)

[2] Cost recovery is allowed under both Minn. Stat. §216B.16, subd. 7b, Transmission Cost Recovery Statute and Minn. Stat. §216B.1645, Renewable Cost Recovery Statute.

Revenue Requirement	Current	Initial Filing	Supplemental Filing
Schedule 37 & 38 Revenue	($233,418)	($204,016)	($204,016)
Schedule 26A Revenue	($2,035,456)	($2,320,858)	($2,320,858)
MVP ARR Revenue		($31,607)	($31,607)
True-up	$3,928,255	$127,354	$11,836
ADIT Pro-Rate			$50,039
Total[3]	**$8,387,827**	**$7,751,522**	**$7,202,509**
Reduction from Current Revenue Requirement		**$636,305**	**$1,185,318**

The rider is applicable to electric service under all of Otter Tail's retail rate schedules. The Company requested a recovery period from April 1, 2016 to March 31, 2017. The following two tables show the projected revenue requirement the Company requested in its initial filing and as updated in its supplemental filing. The tables also show the current rate being charged to the various customer classes, the rates initially proposed in this docket and the rates proposed in the Company's supplemental filing. The last column is the Company's proposed allocation of the revenue requirement among customer classes.

Projected Revenue Requirement per Original Filing

Class	Units	Current Rate	Original Filing	Amount
Large General Service	2,455,567 kW	$2.058	$1.444	$3,545,669
Controlled Service	190,296,491 kWh	0.122¢	0.072¢	$137,948
Lighting	19,584,210 kWh	0.420¢	0.319¢	$62,419
All Other Service	863,707,737 kWh	0.643¢	0.464¢	$4,005,486
Total Revenue Req.				**$7,751,522**

Projected Revenue Requirement per Supplemental Filing

Class	Units	Current Rate	Supplemental Filing	Amount
Large General Service	2,455,567 kW	$2.058	$1.342	$3,294,542
Controlled Service	190,296,491 kWh	0.122¢	0.067¢	$128,177
Lighting	19,584,210 kWh	0.420¢	0.296¢	$57,988
All Other Service	863,707,737 kWh	0.643¢	0.431¢	$3,721,791
Total Revenue Req.[4]				**$7,202,509**

The next table estimates the monthly rate impact by retail customer class using the proposed recovery period from April 1, 2016 to March 31, 2017. The table compares the rate currently charged to Otter Tail's customers to the rates proposed in the in supplemental filing.

[3] Slight difference in totals due to rounding.
[4] Slight difference in totals due to rounding.

Rate Impact

Class	# Customers	Average Monthly Usage	Current Rate		Proposed Rate	Change in Rate	Average Monthly Bill Impact
Large General Service	529	352 kW	$2.058		$1.342	($.716)	($252.03)
Controlled Service	16,797	928 kWh	0.122	¢	0.067	(.055)	(.51)
Lighting	2,638	635 kWh	0.420	¢	0.296	(.124)	(.79)
All Other Service	59,005	1,206 kWh	0.643	¢	0.431	(.212)	(2.56)

Department of Commerce – Conclusions & Recommendation

The Department reviewed the Company's filings and concluded:

- All of OTP's transmission projects were approved for cost recovery in prior TCR proceedings and are eligible for recovery under the TCR or RCR statutes.
- The project costs included in the TCR rider do not exceed their respective cost caps.
- MISO Schedule 37 & 38 calculations are reasonable and comply with the Commission's Order in Docket No. 13-103.
- The true-up and tracker balance calculations are reasonable and comply with the Commission's Order in Docket No. 14-375.
- The application of wholesale credits from FERC's jurisdictional MISO tariff rate, also known as Attachment O, the Open Access Transmission Tariff (OATT), as reflected in the rider are reasonable.
- Otter Tail's proposed allocations and rate design method are the same as ordered in the Company's most recent rate case and are reasonable.
- The correction to the Schedule 26 formula error is reasonable and results in a $606,615 decrease in the overall revenue requirement.
- The Company's adherence to the IRS ADIT rule is reasonable and results in an increase of $57,601 to the overall revenue requirement.

- Riders have subsequent true-up calculations which replace pro-rated ADIT balances with actual balances. This approach is reasonable as long as the balances are trued-up with interest to make ratepayers whole for the time value of money during this period.

Staff Analysis

Staff is in agreement with the Department's conclusions, with one exception. Staff does not agree with Department's recommendation to true-up the Accumulated Deferred Income Taxes (ADIT) balances caused by bonus depreciation with interest to make ratepayers whole for the time value of money used during this period.

Bonus depreciation has been in effect since 2008 and is the result of provisions in the federal tax laws that allow a corporation to deduct either 50 percent, 100 percent or some lesser amount of the qualifying capital investment in the first year an investment is placed in-service for tax purposes. In the case of the 50 percent bonus depreciation that was in effect in 2014 and will remain in effect through 2017, the remaining 50 percent of the investment is depreciated for tax purposes using the existing accelerated depreciation schedules.

Congress recently extended many of the tax provisions in the Internal Revenue Code that expired at the end of 2014 including a five-year extension for bonus tax depreciation under which capital investments through 2019 would qualify for bonus depreciation. 50 percent of the investment will qualify for bonus depreciation in years 2015, 2016 and 2017. For 2018 and 2019, the amount of the investment that qualifies will drop to 40 and 30 percent respectively.

In its supplemental filing, the Company stated (at p. 1):

> IRS Regulation Section 1.167(l)(h)(6) provides that ratemaking procedures and adjustments must be consistent with normalization accounting. This section defines the procedures a company must use to normalize the impact on rate making if a company elects to use accelerated depreciation methods. Specifically, 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. According to the rule, Otter Tail would risk losing its ability to take accelerated depreciation if it fails to comply with this rule. Accelerated depreciation is a significant benefit to ratepayers as ADIT amounts are credited against rate base amounts when establishing rates making adherence to this rule important to Minnesota customers.

The Department agreed. However, in its January 13 response comments (at p. 3), the Department stated that

> The Department notes that, in rider petitions, this approach essentially shifts when the ADIT balances are included in the TCR Rider. That is, riders have subsequent true-up calculations which replace pro-rated ADIT balances with actual ADIT balances. Thus, the Department concludes that this approach is reasonable in

> riders as long as the balances are trued-up with interest for the customers on the tracker balance to make ratepayers whole for the time value of money during that period. [footnote omitted]

Bonus depreciation and the associated ADIT is really only a timing issue. Ratepayers receive less deferred tax credits in the short term which results in higher rates. Over time, ratepayers receive the deferred credits and pay the same amount of taxes they would have without the deferred credits. This is especially true if cost recovery is allowed through a cost recovery rider or tracker.

The issue of allowing the Company to apply carrying charges in a cost recovery rider was last addressed in Otter Tail Power's 2013 Transmission Cost Recovery Adjustment filing in Docket No. E-017/M-13-103. The Commission denied the Company's request to apply a carrying charge in that case. (In its initial filing in this docket, on September 30, on p. 5, OTP explained that "[p]er the Order in Docket 13-103, the carrying charge has been eliminated from the revenue requirement calculation ...")

In the 2013 TCR filing, Staff suggested that the Commission may want to revisit whether carrying charges are appropriate for rate riders and will repeat the same argument in this filing. It should be noted that the argument made in the 2013 TCR filing was made in objection to the Company's request to allow a carrying charge within the tracker. In the current docket it is the Department recommending a carrying charge to benefit ratepayers. The argument reaches the same conclusion that it is not necessary to include a carrying charge within the tracker to benefit either the ratepayers or the Company.

The purpose of the TCR rate rider is to provide for accelerated recovery of certain types of capital projects outside of a rate case. The calculation of the amount to be recovered in the rider mimics the recovery allowed in a rate case including earning a rate of return on the cost of the project. The Company is allowed to track the recovery and true-up and collect any under-recovery.

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

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

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

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

It is a given that a forecast by its nature will vary from actual. That fact alone does not justify a carrying charge. The benefits provided by rider recovery accrue to the Company. Ratepayers do not benefit because they pay increased costs sooner and also increased rates for under-recovery true-up that they would not pay under normal rate recovery. A carrying charge is used to compensate for the time value of money. Because the utility is getting accelerated recovery in the rider compared to normal rate recovery, there is no reason to compensate for the time value of money.

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

In its March 10, 2014 Order,[5] in Docket No. E-017/M-13-103, the Commission agreed with Staff's position and determined the Company shall not add a carrying charge to the TCR tracker balance. The Commission also extended it to the Company's Renewable Resource Recovery rider effective with the date of the Order.

The Commission concluded in the March 10, 2014 Order (at p. 9):

> 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. 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

[5] Order Capping Costs, Denying Rider Recovery of Excess Costs, and Requiring Inclusion of All MISO Schedule 26 Costs and Revenues in TCR Rider, 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, Docket No. E-017/M-13-103 (March 10, 2014)

> 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. [footnote omitted]

Decision Alternatives

1.) Revenue Requirement and Resulting Factors

   a.) Approve the revenue requirement and resulting factors as presented in the Company's initial filing.
   b.) Approve the revenue requirement and resulting factors as presented in the Company's supplemental filing. [OTP, DOC]

2.) Carrying Charge on Tracker Balance

   a.) Do not allow the Company to apply a carrying charge to the tracker balance.
   b.) Allow the Company to apply a carrying charge to the tracker balance.

3.) Require Otter Tail Power to make a compliance filing including updated tariff sheets within 15 days of the Commission's Order.

Recommendation

1b, 2a, and 3