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Minnesota Department of Commerce

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December 16, 2013

Burl W. Haar
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: ***Additional Response Comments* of the Minnesota Department of Commerce, Division of Energy Resources to Otter Tail Power Company's *Reply to DOC Response Comments***
Docket No. E017/M-13-103

Dear Dr. Haar:

Attached please find the Minnesota Department of Commerce, Division of Energy Resources (DOC or the Department) *Additional Response Comments* to Otter Tail Power Company (OTP or the Company)'s *Reply to DOC Response Comments*.

Based on our review of OTP's *Reply to DOC Response Comments*, the DOC recommends that the Minnesota Public Utilities Commission (Commission) adopt the DOC's recommendations, as discussed in greater detail herein. The DOC is available to answer any questions that the Commission may have.

Sincerely,

/s/ MARK JOHNSON
Financial Analyst

MJ/lt
Attachment

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

COMMENTS OF THE
MINNESOTA DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

DOCKET NO. E017/M-13-103

I. BACKGROUND

On January 28, 2010, the Minnesota Public Utilities Commission (Commission) issued its Order approving Otter Tail Power Company's (OTP or the Company) first Transmission Cost Recovery Rider (TCR Rider) in Docket No. E017/M-09-881.

On March 26, 2012, the Commission issued its Order approving OTP's first annual update to its TCR Rider in Docket No. E017/M-10-1061 (10-1061).

On March 15, 2013, the Commission issued its Order approving TCR Rider eligibility for three new projects in Docket No. E017/M-12-514 (12-514).

On February 7, 2013, OTP filed the instant petition.

On May 24, 2013, the Minnesota Department of Commerce, Division of Energy Resources (DOC or the Department) filed its comments and recommended that OTP provide the following information in their reply comments:

- an explanation as to why the Sheyenne – Audubon 230 kV Line Upgrade was no longer needed;
- the Commission-approved certificate of need (CN) cost estimates for all projects included in OTP's 2013 TCR Rider that required a CN. For any project that did not require a CN, the Department recommended that OTP provide the initial cost estimate first approved by the Commission in another proceeding;
- an explanation as to why OTP did not include any projected Midcontinent Independent System Operator (MISO) Schedule 37 and 38 revenues going forward when all other revenues and costs were projected through April 2014;

- a statement either confirming or denying the Department's understanding that OTP does not receive any other revenues (besides those revenues received under MISO Schedules 26/26A) from other parties for their use of OTP's Regional Expansion Criteria and Benefits (RECB) and Multi-Value Projects (MVP) transmission lines;
- the two figures comprising the $458,000 net increase in annual revenue requirements attributable to OTP's internal capitalized costs; and
- an explanation as to why it is reasonable for OTP to exclude MISO Schedule 26 revenues received from other parties that are attributable to the Company's internal capitalized costs.

On June 27, 2013, OTP filed its reply comments.

On August 30, 2013, DOC filed its response comments. The DOC concluded that:

- OTP's decision to discontinue development of the Sheyenne Project was reasonable. Moreover, the DOC concluded that all costs associated with the Sheyenne Project had been appropriately removed from OTP's TCR Rider;
- forecasted MISO Schedule 37 and 38 revenues were reflected in the Company's TCR Rider via forecasted MISO Schedule 26 revenues. As a result, this issue is resolved in this proceeding. However, in the future, OTP should identify the revenues clearly in its initial filing;
- the appropriate cost cap for the Bemidji-Grand Rapids project was $74 million, after adjusting for inflation;
- OTP had complied with the Commission's Order in Docket No. E017/M-12-708; and
- Given the extraordinary ratemaking allowed in this rider and OTP's reluctance to be held financially responsible for cost overruns, the Commission may wish to invoke its authority under existing statutes to reduce OTP's return on investment for the purposes of the TCR Rider from the 8.61 percent used by OTP in this proceeding.

In addition, the Department recommended that the Commission:

- limit the amount of capital cost recovery allowed in OTP's TCR Rider (cost caps) based on amounts initially approved by the Commission in CN or eligibility filings (if a CN was not required);
- exclude recovery of internal capitalized costs in OTP's TCR Rider;
- limit cost recovery for the Bemidji Project to $74 million (total basis) in the instant proceeding; and
- require OTP to include all MISO Schedule 26 revenues associated with the TCR Rider projects that the Company receives from other utilities, including those that are attributable to its disallowed capital costs. OTP will have the opportunity to support recovery of costs that exceed their CN estimate in the Company's next rate case.

On September 25, 2013, OTP filed additional reply comments.

II. DOC'S ANALYSIS

A) SUMMARY OF OTP'S ADDITIONAL REPLY COMMENTS

In its additional reply comments, OTP disagreed with the Department's recommendation to require OTP to pass through all MISO Schedule 26 revenues associated with the projects included in its TCR Rider that it receives from other utilities, including those revenues attributable to the Company's disallowed capital costs. OTP stated that it would not be appropriate to include, as a revenue credit in the TCR Rider, MISO revenues which are based on the full cost of construction while at the same time excluding a portion of the construction costs in the TCR Rider which are the basis for the revenues generated.

Beginning on page 2 of its additional reply comments, OTP stated that the Department's recommendation would create a mismatch between the rate base used to derive the annual revenue requirements or costs of the projects included in the TCR Rider and the rate base used to derive the revenue credits applied in the TCR Rider. In addition, OTP claimed that the Department's recommendation to use two different rate bases in this way would be arbitrary and violate fundamental regulatory and accounting principles. Moreover, OTP stated that accepting such a determination would result in substantial harm to OTP and would serve as a serious disincentive for making such investments even though they are very beneficial to OTP's ratepayers. Finally, OTP claimed that the Department's recommendation would violate the Commission's previous decision regarding the "all-in" approach

B) DOC'S RESPONSE

1. Matching Rate Bases

The Department agrees that our recommendation uses two different rate bases in OTP's TCR Rider calculations. One rate base, which excludes the disallowed capital costs, is used to determine the gross annual revenue requirements, or costs, which are charged to OTP's ratepayers in the TCR Rider. A second and larger rate base, which includes the disallowed capital costs, is used by MISO to determine MISO Schedule 26 revenues and MISO Schedule 26 charges. The MISO Schedule 26 revenues that OTP receives are credited against the gross annual revenue requirements in OTP's TCR Rider. Similarly, the MISO Schedule 26 charges that OTP pays are added to the gross revenue requirements in OTP's TCR Rider.
The Department notes that OTP uses the gross method to recover its annual revenue requirements in its TCR Rider. The following table provides an example of this approach using the revenue requirements associated with OTP's Bemidji-Grand Rapids Project:

Bemidji–Grand Rapids Project Revenue Requirements in OTP's TCR Rider[1]

Line	Description	Revenue Requirements
1	MN Revenue Requirements	$1,447,707
2	MISO Schedule 26 Charges	$1,228,463
3	MISO Schedule 26 Revenues	($1,879,798)
	Total	$796,372

Line 1 is under the Commission's jurisdiction and represents the Minnesota revenue requirements that are associated with this transmission line and includes the disallowed capital costs; the DOC recommends that the disallowed capital costs be removed from this amount. Lines 2 and 3 are under the Federal Energy Regulatory Commission's (FERC's) jurisdiction. Line 2 represents Minnesota's share of the costs or charges OTP pays to MISO for the use of the transmission line that OTP owns jointly with other CAPX members and includes the disallowed capital costs. Line 3 represents Minnesota's share of the revenues OTP receives from MISO for OTP's and other utilities' use of the transmission line and includes the disallowed capital costs. In other words, under MISO, OTP pays itself for the use of its own transmission line – Some of OTP's MISO Schedule 26 charges of $1,228,463 are included as part of OTP's MISO Schedule 26 revenues of ($1,879,798).[2]

It is important to note that in addition to the MISO Schedule 26 charges that OTP pays for the use of its own transmission lines (i.e. $1,228,463); OTP's TCR Rider also includes MISO Schedule 26 charges that OTP pays for the use of other utilities' Regional Expansion Criteria and Benefits/Multi-Value Project (RECB/MVP) transmission lines. This fact is not reflected in the above example.

As explained in our August 30th response comments, the DOC disagrees with OTP's arguments that the two rate bases must match. OTP's Minnesota TCR Rider costs are subject to the Commission's prudency review, but the revenues in question are received due to another jurisdiction's determinations and are received regardless of whether the Commission determines that the costs upon which the revenues are based were prudently incurred. Furthermore, the DOC notes that OTP's <u>actual</u> MISO Schedule 26 revenues will not decrease due to the exclusion of recovery of additional internal capitalized costs from the TCR Rider.[3] Finally, the DOC notes that riders offer utilities special ratemaking treatment between rate cases but are not a blank

[1] Per OTP's September 25, 2013 Reply to DOC Response Comments, Page 4.
[2] Using the net method, the $1,228,463 would be removed from both Lines 2 and 3 and would result in the same total revenue requirements of $796,372.
[3] MISO Schedule 26 revenues are based on the full investment of project's costs and do not reflect decisions made by other regulatory agencies to limit the amount of capital costs recovered in a rider. Likewise, MISO Schedule 26 charges are based on the full investment of project's costs and do not reflect decisions made by other regulatory agencies to limit the amount of capital costs recovered in a rider.

check for utilities to recover costs that exceed the amount that was previously approved by the Commission. Instead, utilities must make a reasonable case for recovering any cost overruns at the time of the appropriate rate case. Further, OTP should not be allowed to keep higher Schedule 26 revenues that are attributable to disallowed capital costs. Doing so would inappropriately make OTP whole for its own cost overruns, at ratepayers' expense, instead of holding OTP accountable to showing why ratepayers should pay for the additional costs. Further, as discussed below, such an approach would not be consistent with Minnesota Statute §216B.16, subd. 7b (2).

As noted above, OTP's TCR Rider also includes MISO Schedule 26 charges associated with OTP's rider-eligible RECB/MVP projects and other utilities' RECB/MVP projects. Moreover, these MISO Schedule 26 charges are based on the full rate base amounts as determined by MISO, and do not exclude any capital costs ordered by any state Commission. Therefore, the Department's recommendation to require OTP to include <u>all</u> MISO Schedule 26 revenues that it receives in its TCR Rider appropriately matches OTP's inclusion of <u>all</u> MISO Schedule 26 charges paid in its TCR Rider, regardless of any Commission decisions to exclude capital costs from any utility.

Further, the Department's recommendation is consistent with Minnesota Statute 216B.16, subd. 7b (2), whereas OTP's proposal is not. This statute requires <u>all</u> revenues that OTP receives from MISO under Schedule 26 to be included in the TCR, in exchange for being allowed to charge OTP's ratepayers for the costs of other transmission facilities charged through MISO's Schedule 26. The TCR tariff:

> …allows the utility to recover charges incurred under a federally approved tariff that accrue from other transmission owners' regionally planned transmission projects that have been determined by the Midcontinent Independent System Operator to benefit the utility or integrated transmission system. **These charges <u>must</u> be reduced or offset by revenues received by the utility and by amounts the utility charges to other regional transmission owners**, to the extent those revenues and charges have not been otherwise offset. (Emphasis added)

The statute does not permit OTP to include only some of the revenues received from MISO in the TCR; OTP *must* include all revenues that they received from MISO or other utilities.

Simply put, the Department recommendation to remove the disallowed capitalized costs only affects the rate base and resulting MN revenue requirements on Line 1, not the rate base and resulting MISO Schedule 26 revenues and MISO Schedule 26 charges found on Lines 2 and 3.

2. Substantial Harm to OTP

Beginning on page 3 of its additional reply comments, OTP disagreed with DOC's statement that the Company would not be harmed by DOC's proposal. Instead, OTP stated that the DOC's proposal would result in substantial harm to OTP, compared to what would happen if OTP were a stand-alone transmission company, and would serve as a serious disincentive for making such investments even though they are very beneficial to OTP's ratepayers. OTP cites to an example on page 4, Table 1, of its additional reply comments, showing that OTP's customers would pay more if OTP was not an investor in the project.

Since OTP is not a stand-alone transmission company, OTP's argument sets up a false comparison. The DOC agrees that OTP would be "harmed" to the extent that it would receive fewer revenues from ratepayers under DOC's proposal than under OTP's proposal. In addition, the DOC agrees that if another entity had built this project as a stand-alone transmission company, OTP's ratepayers likely would have been harmed by having to pay substantially higher returns on equity and other bonuses that the Federal Energy Regulatory Commission (FERC) gave to such entities.[4] However, that comparison is not valid since it was OTP, not a stand-alone transmission company, to which the Commission gave permission to build the facilities in question.

Moreover, the DOC does not agree with OTP's assertion that the Company would be "harmed" under DOC's proposal. Rather, requiring OTP to return all Schedule 26 revenues to its ratepayers is necessary to balance charging OTP's ratepayers for OTP-owned as well as other utilities' RECB/MVP transmission lines. In other words, since OTP's ratepayers are responsible for all the RECB/MVP charges (for transmission lines owned by OTP and for those owned by other utilities), OTP's ratepayers should be credited with all RECB/MVP revenues for the transmission lines owned by OTP. Allowing OTP to retain revenues received for other utilities' use of an OTP-owned transmission line, but charging its ratepayers for the use of OTP-owned as well as other utilities' RECB/MVP transmission lines, is not a balanced approach and is therefore unreasonable in addition to being inconsistent with Minnesota statutes. While the Department supports OTP owning RECB/MVP transmission lines, the Company's proposal would result in OTP unfairly benefiting from such ownership at the expense of ratepayers.

3. All-In Approach

Beginning on page 6 of its additional reply comments, OTP stated that the beneficial effect of increasing the rate base (and thus increasing the revenues) for the rider rate calculation was recognized in OTP's previous TCR Rider (10-1061), in which the Commission made the determination that the "all-in" method should be used for OTP's investments in regional transmission projects. OTP stated that the Department's proposal to reduce the rate base (but not the revenues) would create a mismatch and would ignore the decision made by the Commission. Moreover, OTP stated that the Commission explained how its decision should be applied by citing to the Commission's Order which stated:

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[4] The Department is aware that a complaint has been filed by the Association of Businesses Advocating Tariff Equity, Coalition of MISO Transmission Customers, Illinois Industrial Energy Consumers, Indiana Industrial Energy Consumers, Inc., Minnesota Large Industrial Group, and Wisconsin Industrial Energy Group in FERC Docket No. EL14-12, regarding the increasingly large difference in returns on equity (ROE) for utilities subject to state regulation and significantly larger ROEs for stand-alone transmission companies.

> All Minnesota jurisdictional costs [of the Bemidji-Grand Rapids and Fargo-Monticello lines] will be included in the rider and all revenues attributable to the Minnesota-jurisdictional portions of the lines will be credited to ratepayers.[5]

In addition, OTP stated that:

> The effect of this ruling was to increase the amount of the investment included in the TCRR rate base over the costs allocated to OTP based on its retail load-serving obligations; an outcome that would typically have been opposed by the Department and not likely approved by the Commission (because typically increasing rate base increases rates to customers). But in the instance of these regional projects that generate MISO revenues, the Commission agreed that OTP's rate base should include all of the costs incurred for these investments--not just the portion associated with retail service--because doing so increases the corresponding revenues derived from that larger investment. For the Department to now propose to disallow certain costs (to decrease the investment included in the rate base) but to continue to include all revenues is a recommendation for a reversal of that "all-in" determination—but a reversal on only half of the "all-in" equation. For all the reasons explained above, the Department's recommendation should not be accepted. Instead, OTP should be authorized to continue calculating its TCRR rate for eligible projects as the Commission articulated in the last TCRR rate proceeding…[6]

The DOC disagrees with OTP's interpretation of OTP's previous TCR Rider and of the Commission's decision regarding the "all-in" method. In OTP's previous TCR Rider (10-1061), OTP proposed to carve-out its wholesale-related revenues and costs associated with its MVP/RECB projects and to keep these revenues for shareholders. As a result, OTP proposed to pass along only its recently determined retail- related share of revenues and costs in its TCR Rider.[7] In other words, in the 10-1061 case, the "all-in" approach referred to whether OTP was required to include both retail- and wholesale-related revenues and expenses in its TCR Rider; the issue was not whether the Commission could or could not disallow costs associated with projects included in the TCR Rider. As a result, OTP again presented a false comparison in its comments.

[5] Commission's March 26, 2012 Order in Docket No. E017/M-10-1061, Page 5, B. Commission Action, Paragraph 1.
[6] OTP's September 25, 2013 Additional Reply Comments, Page 6.
[7] Due to the sharing mechanism under MISO-designated MVP/RECB projects, OTP's proposal in the 10-1061 docket would have resulted in a significant benefit for shareholders at the expense of OTP's ratepayers.

4. DOC's Recommendation

Based on the above, the Department continues to recommend that the Commission require OTP to pass through Minnesota's share of all MISO Schedule 26 revenues and MISO Schedule 26 charges associated with the projects included in its TCR Rider, including those revenues that are attributable to the Company's disallowed capital costs. OTP will have the opportunity to support recovery of the costs that exceed their cost estimate in its next rate case. Alternatively, the DOC notes that OTP may choose to use normal ratemaking and wait for the rate case subsequent to the facilities being used and useful to address the costs and associated MISO revenues.

III. SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS.

The Department recommends that the Commission:

- limit the amount of capital cost recovery allowed in OTP's TCR Rider (cost caps) based on amounts initially approved by the Commission in CN or eligibility filings (if a CN was not required);
- exclude recovery of internal capitalized costs in OTP's TCR Rider;
- limit cost recovery for the Bemidji Project to $74 million (total basis) in the instant proceeding; and
- require OTP to pass through Minnesota's share of all MISO Schedule 26 revenues and MISO Schedule 26 charges associated with the projects included in its TCR Rider, including those revenues that are attributable to the Company's disallowed capital costs. OTP will have the opportunity to support recovery of costs that exceed their CN estimate in the Company's next rate case.

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CERTIFICATE OF SERVICE

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

Minnesota Department of Commerce
Additional Response Comments

Docket No. E017/M-13-103

Dated this **16th** day of **December, 2013**

/s/Sharon Ferguson

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