COMMERCE DEPARTMENT

August 31, 2017

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: **Response Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. E017/M-17-152

Dear Mr. Wolf:

Attached are the Response Comments of the Minnesota Department of Commerce, Division of Energy Resources (Department) in the following matter:

> Otter Tail Power Company's Petition for Approval of the Company's Proposed LED Street and Area Lighting Rate Schedule 11.07 and Associated LED Implementation Plan.

The Department recommends that the Minnesota Public Utilities Commission (Commission) **approve, with modification,** Otter Tail Power's Petition. The Department is available to answer any questions the Commission may have.

Sincerely.

/s/ DANIELLE WINNER
Rates Analyst

DW/lt
Attachment

85 7th Place East - Suite 280 - Saint Paul, MN 55101 | P: 651-539-1500 | F: 651-539-1547
mn.gov/commerce

COMMERCE DEPARTMENT

Before the Minnesota Public Utilities Commission

Comments of the Minnesota Department of Commerce
Division of Energy Resources

Docket No. E017/M-17-152

I. BACKGROUND

On February 22, 2017, Otter Tail Power (Otter Tail, OTP or the Company) filed with the Minnesota Public Utilities Commission (Commission) its *Petition for Approval of the Company's LED Street and Area Lighting Rate Schedule 11.07 and Associated LED Implementation Plan* (Petition). In this Petition, the Company proposed to replace all Company-owned street and area lights throughout OTP's Minnesota service territory from high-intensity discharge (HID) lights to equivalent light-emitting diodes (LEDs) over a five-year period starting in 2017. This proposal entailed opening a new rate schedule, closing a rate schedule, and recovering associated costs through three different mechanisms: tariffed rates, the Conservation Improvement Program's (CIP) Conservation Cost Recovery Adjustment (CCRA), and a future rate case. Otter Tail indicated that its proposal would impact customers' monthly lighting charges slightly, but would be revenue neutral to the Company.

On June 5, 2017, the Minnesota Department of Commerce, Division of Energy Resources (Department) filed Reply Comments. In those comments, the Department clarified that the Department's Energy Regulation and Planning Group typically does not get involved with program-level CIP decisions. This instance, however, is a special case because it involves the following: the use of internal Company labor for program administration, the recovery of capital costs, CIP costs proposed to be recovered through lighting rates rather than through the CIP rider, and CIP rebates accruing to the Company rather than a participating customer. In its comments, the Department concluded that certain aspects of the Company's proposal were not reasonable. Specifically, the Department was opposed to Otter Tail's proposal to include retirement expense, disposal expense, and undepreciated asset balance of the existing lamps in Otter Tail's CIP tracker. The Department stated that these costs are already being recovered in base rates, and therefore permitting recovery through the CIP tracker would result in double recovery. The Department recommended that the Commission allow only the CIP program evaluation, rebate, and administrative costs to be recovered through the CIP tracker. However, the Department supported Otter Tail's proposed rates for the LED lights, which would allow continued cost recovery of the Section 11.04 revenue requirement through the Section 11.07 rates, even though the costs of LED lights are lower. The Department supported this plan, as well as Otter Tail's proposal to establish new Section 11.07 rates in its next rate case, as these actions would avoid single-issue ratemaking.

The Department requested the following information from Otter Tail:

- The estimated annual administrative costs associated with the new vendor;
- A confirmation of the Department's understanding that only actual expenditures, rather than projected expenditures, will be added to the CIP tracker; and
- A clarification as to how the Additional Monthly Charges for the Aluminum Alloy Poles in the proposed Section 11.07 tariff sheets relate to the Total Monthly Pole costs calculated in the updated marginal cost analysis.

On July 7, 2017, Otter Tail filed Reply Comments. In those Comments, Otter Tail changed its proposal to address the Department's concerns regarding the retirement expense, disposal expense, and undepreciated asset balance expense of the existing lamps. For these expenses, the Company stated that it "plans to treat the retirement of existing lights in the traditional manner of treatment for any other asset which is retired early."[1] That is, the Company clarified that it would roll retirement costs and the undepreciated balance into accumulated depreciation, which would then be factored into future depreciation rates. In addition to this change, the Company proposed to recover a rate of return of 7.5056 percent, on the accumulated depreciation of the new lights, through the CIP tracker.

In regards to the Department's requested information, Otter Tail provided the following:

- The administrative costs of the program come from two sources: internal labor "dedicated to other CIP programming" and external vendor labor for project management, which includes sourcing, procuring, and siting materials.[2] The Department will discuss this in further detail below.
- The Company stated, "Like other CIP programs, only actual expenses from these sources will be charge [sic] to the program and ultimately the CIP tracker."[3] The Department is satisfied with this response.
- The Company clarified that the Additional Monthly Charges for the Aluminum Alloy Poles are equal to the monthly incremental costs of these poles, minus the monthly incremental cost of the standard install pole. The Department is satisfied with this response.

Otter Tail ultimately requested from the Commission:

1. Approval of the proposed LED Street and Area Lighting rate schedule 11.07;

---

[1] Page 3, OTP Reply Comments, July 7, 2017.
[2] Page 4, OTP Reply Comments, July 7, 2017.
[3] Page 4, OTP Reply Comments, July 7, 2017.

2. Approval of the closure of its Outdoor Lighting Dusk to Dawn rate schedule 11.04 to new customers; and
3. Approval for Otter Tail to recover administrative expenses, CIP rebates, evaluation expenses, and a return on material investment through the CIP tracker account.

Since Otter Tail's Reply Comments, the Company and the Department have communicated by email and phone regarding the retirement costs of the old lights. The Department will discuss the content of these communications more fully below.

II. DEPARTMENT ANALYSIS

A. PROPOSAL OF RECOVERY OF RETIREMENT EXPENSES

Otter Tail no longer proposes to recover expenses associated with retirement costs through the CIP tracker. Instead, Otter Tail stated:

> The Company plans to treat the retirement of existing lights in the traditional manner of treatment for any other asset which is retired early. The existing lighting facilities would be removed from their plant in service account balance as well as from its accumulated depreciation reserve. The accumulated depreciation reserve has not been built up enough to fully satisfy the plant in service retirement, which leaves a deficiency in the light account's accumulated depreciation reserve. This deficiency will lower reserve ratios, resulting in higher future depreciation rates throughout the lighting account's remaining life. Under this method, Otter Tail will account for the depreciation changes to its lighting accounts in its next rate case and depreciation filings.[4]

The Department supports this proposal for the undepreciated balance of the lights, and agrees that it is the traditional way of treating early retirement of capital assets in regulatory accounting. This is because certain types of utility assets, such as lights, are not counted on individual bases, but as a whole through group/composite/mass-asset accounting. Under composite accounting principles, when assets are retired early, they are not recorded as a loss on the income sheet. Instead, the undepreciated value, minus net salvage value, is rolled into

[4] Page 3, OTP Reply Comments, July 7, 2017.

accumulated depreciation, which is captured and reflected in rates through a future general rate case proceeding.[5]

In addition to composite accounting, Otter Tail also uses another common rate-making convention, which is to capture the costs associated with asset retirement (for example, removal and disposal costs) in its accumulated depreciation calculation. In other words, when the old lights were initially installed, the Company included the initial install cost, as well as the net salvage value (which is equal to the expected removal/disposal costs minus any expected salvage value) in the total capital investment figure to be depreciated. Through this method, removal and disposal costs are “built in” to depreciation rates, and thus into the Company’s base rates. Typically, these costs “flow through” accumulated depreciation.

Since the Company’s Reply Comments, Otter Tail has clarified, and the Department has verified, that the Company under-estimated the cost of retirement for the old lights. In other words, the Company has cost overruns for the retirement costs of the old set of lights. In the Department’s previous comments, the Department assumed that no cost overruns were present, and thus asserted that the retirement and disposal costs of the old lights are already being recovered in base rates. However, these cost overruns were not accounted for in the rate case, and thus are not present in the revenue requirement. Therefore, they are not captured in base rates, and it would not be considered double-recovery for Otter Tail to recover these cost overruns through the CIP tracker.

Typically, when a utility learns that retirement costs for capital assets will be greater than initially expected, the utility rolls these costs into accumulated depreciation. The Commission approves such adjustments in utilities’ annual and 5-year depreciation filings. However, Otter Tail has not made any adjustments to reflect cost overruns for its street lighting retirement costs.

The Department is aware of another instance in which retirement cost overruns were not captured until at or near the end of the expected life of the facility. In Xcel Energy’s 2012 Rate Case (Docket No. E002/GR-12-961), Xcel Energy (Xcel) requested recovery of an additional $33.2 million in cost overruns for the retirement of its Black Dog coal plant. These costs were specifically for the closure of the ash ponds and coal yard at the facility, as well as for remediation costs to address the presence of coal and ash below these structures. In 2010, only two years prior to the rate case, Xcel conducted a Removal Cost Study, and in doing so identified significant cost overruns beyond what was accounted for in depreciation. In the Rate Case proceeding, Xcel requested to recover these cost overruns over a 3-4 year timeline (over the course of the remaining life of the asset), but the Department pointed out that they were

[5] Note that “accumulated depreciation,” “accumulated depreciation reserve(s),” and “depreciation reserve(s)” all refer to the same thing and may be used interchangeably.

capital costs that should have been depreciated over the full 30-year life of the asset. The Department put it thusly:

> Costs of removal, including remediation costs, are capital costs that, for regulatory purposes should be collected over the life of the generation unit, which is typically about 30 years. Net salvage value calculations are, by their nature, estimates, so typically there are small changes in costs to true up at the end of the process. However, Xcel's proposed recovery period more closely resembles an amortization period that might be used for recovery of expenses, rather than recovery of capital costs.[6]

However, because the costs were unexpected, and because the future of the land being remediated was uncertain, the Department recommended splitting the difference and allowing the costs to be recovered over a 15-year period. In the end, the Commission permitted Xcel to:

- Recover total remediation and closure costs of $40.6 million[7] over a 15-year period, keeping the remaining unamortized portions of this $40.6 million in rate base over the 15-year period.
- Create a regulatory asset or regulatory liability for the difference between the amount collected from ratepayers and the cash actually expended by Xcel each year, and collect a return of, and a return on, such regulatory asset or regulatory liability in future rate cases.

There are similarities and differences between that proceeding and the instant one. It is similar because it is a capital asset that incurred unexpected retirement cost overruns that had not been added into the depreciation schedule of the asset. Furthermore, both cases had some degree of project approval prior to requesting cost recovery for these costs. In the case of Black Dog, the Commission had approved the closure of coal operations through Xcel's most recent Integrated Resource Plan; in the case of Otter Tail's lighting, the Department's CIP staff found the project to be cost effective and approved Otter Tail's spending and savings proposals.

However, in the case of Black Dog, the future use of the land by Xcel was uncertain, unlike the instant proceeding; Otter Tail will continue to provide street lighting services to customers. Furthermore, in the case of Black Dog, there was no rider or mechanism to allow the utility to earn a return of, and a return on, the capitalized costs as they were amortized over 15 years,

---

[6] Byrne Direct Testimony, Docket No. E002/GR-12-961.
[7] Xcel had been recovering its initial estimate for negative salvage costs over the life of the plant, and $7.4 million of those costs remained uncollected at the time of the rate case. $40.6 million represented the $7.4 million in the initially projected but uncollected retirement costs, plus the $33.2 million in retirement cost overruns.

which created the need for a regulatory asset or liability. In the instant docket, there is such a mechanism for cost recovery between rate cases, which is the CIP rider. Furthermore, Otter Tail has not requested to earn a return on the retirement cost overruns, even though capital costs typically are allowed a rate of return. Finally, the Department notes that the retirement cost overruns of the lighting are significantly lower than those of the Black Dog plant.

Allowing Otter Tail to recover retirement cost overruns through the CIP tracker is not preferred from an accounting standpoint. However, because the project has been found to be cost effective, and because recovery of these expenses does not result in double-recovery of ratepayer funds, the Department concludes that it would be reasonable to allow Otter Tail to add removal and disposal costs to the CIP tracker as they are incurred (i.e., as lights are retired). This will mean that Otter Tail is allowed an expedited recovery of a cost that typically is depreciated over the life of the asset, but it also means that the Company will not be earning a rate of return on those costs. In the interest of balancing ratepayer and Company interests, the Department recommends that, in this instance, the Commission allow Otter Tail to recover the removal and disposal cost overruns as they are incurred.

B. PROPOSAL TO RECOVER A RETURN ON MATERIALS CAPITALIZED

Otter Tail proposed to earn a rate of return on the material cost of the new lights as they are installed, minus accumulated depreciation.

The Department reiterates that the Company will already be earning the approved rate of return on the old lights through base rates charged to lighting customers. This is because the undepreciated cost of the old lights was built into rate base at the time of Otter Tail's last rate case, and Otter Tail is allowed to earn a rate of return on rate base. Rate base captures a snapshot "test year," and so even though the old lights have continued to depreciate since the test year, Otter Tail's rates currently reflect an allowed return on the test year value. As a trade-off for being allowed to do this, utilities are not permitted to earn a rate of return on new assets installed after the rate case; doing so would be referred to as "single-issue ratemaking," which is contrary to general ratemaking principles. Therefore, absent specific rider recovery authority, the Department recommends that the Commission deny Otter Tail's request to be allowed a return on capital investments on the new LED street lights at this time; rather, a rate of return on those investments should be allowed when calculating the Company's test year rate base in a future rate case. Alternatively, given Minnesota Statute § 216B.03's directive to the Commission to "set rates to encourage energy conservation," the Department would not oppose allowing Otter Tail recovery of its rate of return on the incremental cost of the new LED lights over the undepreciated value of the old, less efficient lights (including the now known cost overruns).

C. PROPOSAL OF ADMINISTRATIVE COST

In regards to administrative costs, the Company stated the following:[8]

> The Department recommends only new vendor costs associated with the project should be recovered through the CIP tracker mechanism. The Company agrees with the Department to exclude any internal non-CIP labor to the project. However, the Company plans to use Otter Tail labor dedicated to other CIP programming for administration of the project and will handle administrative expenses in the same manner as other CIP programs.

The Company appears to have misunderstood the Department's concern regarding administrative costs. The Department is not concerned about internal non-CIP labor being put towards the project, but *pre-existing* internal CIP labor being used for the project. In other words, the Department supports recovery of incremental costs resulting from the addition of personnel (or additional labor hours), but to recover a portion of administration costs currently being recovered through base rates would constitute double recovery.

In its initial petition, Otter Tail indicated that the administrative costs proposed to be recovered reflect both costs due to existing personnel, as well as costs due to a new vendor for sourcing, procurement, and siting materials. The Company also indicated that the existing personnel typically works on large transmission projects and that those labor costs are capitalized as part of those projects. The Department notes that internal labor is excluded from recovery through Otter Tail's Transmission Cost Recovery Rider. The Company indicated (Table 2 of its Reply Comments) that it is requesting $64,460 each year for an existing staff member and $100,000 each year for a vendor for project management. The Department recommends that the Commission allow recovery of up to $100,000 in annual administrative costs associated with the new vendor.

[8] Page 4, OTP Reply Comments, July 7, 2017.

III. DEPARTMENT CONCLUSIONS AND RECOMMENDATION

The Department recommends that the Commission approve Otter Tail's proposed LED Street and Area Lighting rate schedule 11.07, modified to allow recovery of the following costs through the CIP tracker, as they are incurred:

	2017	2018	2019	2020	2021	5-Year Total
CIP Program Evaluation	$3,000	$3,000	$3,000	$3,000	$3,000	$15,000
CIP Rebate	$178,572	$178,572	$178,572	$178,572	$178,572	$892,859
Administrative Costs	$100,000	$100,000	$100,000	$100,000	$100,000	$500,000
Retirement and Disposal Costs	$432,803	$432,803	$432,803	$432,803	$432,803	$2,164,015
Total Recovery through CIP Tracker	$624,375	$624,375	$624,375	$624,375	$624,375	$3,121,875

Further, the Department recommends that the Commission condition its approval on the following:

- This approval is capped at dollar amounts and time periods shown in the table above;
- OTP must track and report these costs in the Company's annual CIP tracker filings, and must account for the CIP tracker recovery of the retirement and disposal costs in its depreciation studies and next rate case.

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
Response Comments

Docket No. E017/M-17-152

Dated this 31st day of August 2017

/s/Sharon Ferguson

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Julia	Anderson	Julia.Anderson@ag.state.mn.us	Office of the Attorney General-DOC	1800 BRM Tower 445 Minnesota St St. Paul, MN 551012134	Electronic Service	Yes	OFF_SL_17-152_M-17-152
Christopher	Anderson	canderson@allete.com	Minnesota Power	30 W Superior St Duluth, MN 558022191	Electronic Service	No	OFF_SL_17-152_M-17-152
Ray	Choquette	rchoquette@agp.com	Ag Processing Inc.	12700 West Dodge Road PO Box 2047 Omaha, NE 68103-2047	Electronic Service	No	OFF_SL_17-152_M-17-152
Ian	Dobson	Residential.Utilities@ag.state.mn.us	Office of the Attorney General-RUD	1400 BRM Tower 445 Minnesota St St. Paul, MN 551012130	Electronic Service	Yes	OFF_SL_17-152_M-17-152
James C.	Erickson	jericksonkbc@gmail.com	Kelly Bay Consulting	17 Quechee St Superior, WI 54880-4421	Electronic Service	No	OFF_SL_17-152_M-17-152
Sharon	Ferguson	sharon.ferguson@state.mn.us	Department of Commerce	85 7th Place E Ste 280 Saint Paul, MN 551012198	Electronic Service	No	OFF_SL_17-152_M-17-152
Bruce	Gerhardson	bgerhardson@otpco.com	Otter Tail Power Company	PO Box 496 215 S Cascade St Fergus Falls, MN 565380496	Electronic Service	No	OFF_SL_17-152_M-17-152
Jason	Grenier	jgrenier@otpco.com	Otter Tail Power Company	215 South Cascade Street Fergus Falls, MN 56537	Electronic Service	No	OFF_SL_17-152_M-17-152
Shane	Henriksen	shane.henriksen@enbridge.com	Enbridge Energy Company, Inc.	1409 Hammond Ave FL 2 Superior, WI 54880	Electronic Service	No	OFF_SL_17-152_M-17-152
James D.	Larson	james.larson@avantenergy.com	Avant Energy Services	220 S 6th St Ste 1300 Minneapolis, MN 55402	Electronic Service	No	OFF_SL_17-152_M-17-152

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Douglas	Larson	dlarson@dakotaelectric.com	Dakota Electric Association	4300 220th St W Farmington, MN 55024	Electronic Service	No	OFF_SL_17-152_M-17-152
Kavita	Maini	kmaini@wi.rr.com	KM Energy Consulting LLC	961 N Lost Woods Rd Oconomowoc, WI 53066	Electronic Service	No	OFF_SL_17-152_M-17-152
Andrew	Moratzka	andrew.moratzka@stoel.com	Stoel Rives LLP	33 South Sixth St Ste 4200 Minneapolis, MN 55402	Electronic Service	No	OFF_SL_17-152_M-17-152
David G.	Prazak	dprazak@otpco.com	Otter Tail Power Company	P.O. Box 496 215 South Cascade Street Fergus Falls, MN 565380496	Electronic Service	No	OFF_SL_17-152_M-17-152
Larry L.	Schedin	Larry@LLSResources.com	LLS Resources, LLC	332 Minnesota St, Ste W1390 St. Paul, MN 55101	Electronic Service	No	OFF_SL_17-152_M-17-152
Cary	Stephenson	cStephenson@otpco.com	Otter Tail Power Company	215 South Cascade Street Fergus Falls, MN 56537	Electronic Service	No	OFF_SL_17-152_M-17-152
Stuart	Tommerdahl	stommerdahl@otpco.com	Otter Tail Power Company	215 S Cascade St PO Box 496 Fergus Falls, MN 56537	Electronic Service	No	OFF_SL_17-152_M-17-152
Daniel P	Wolf	dan.wolf@state.mn.us	Public Utilities Commission	121 7th Place East Suite 350 St. Paul, MN 551012147	Electronic Service	Yes	OFF_SL_17-152_M-17-152