MINNESOTA
PUBLIC UTILITIES COMMISSION

# Staff Briefing Papers

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|---|---|---|---|
| Meeting Date | July 30, 2020 | | Agenda Item **5 |
| Company | Otter Tail Power Company | | |
| Docket No. | **E-017/D-19-547** | | |
| | **In the Matter of Otter Tail Power Company's Petition for Approval of its 2019 Annual Review of Depreciation Certification** | | |
| Issues | 1. Should the Commission approve the proposed depreciation parameters and the resulting rates for Otter Tail Power Company's annual depreciation update? | | |
| | 2. Should the proposed remaining lives of Hoot Lake Production Plant Units 2 & 3 and Hydraulic Production Plant be reduced by one year to better match depreciation accruals to plant retirement? | | |
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| ✓ **Relevant Documents** | **Date** |
|---|---|
| Otter Tail Power – Petition | August 30, 2019 |
| Minnesota Department of Commerce – Comments | November 7, 2019 |
| Otter Tail Power – Reply Comments | December 2, 2019 |
| Department of Commerce – Response Comments | December 26, 2019 |
| Otter Tail Power – Reply to Response Comments | January 14, 2020 |
| Department of Commerce – Additional Response Comments | February 28, 2020 |

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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.

| ✓ **Relevant Documents** | **Date** |
|---|---|
| Otter Tail Power – Summary Comments | April 24, 2020 |

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## I. Statement of the Issues

1. Should the Commission approve the proposed depreciation parameters and the resulting rates for Otter Tail Power Company's annual depreciation update?

2. Should the proposed remaining lives of Hoot Lake Production Plant Units 2 & 3 and Hydraulic Production Plant be reduced by one year to better match depreciation accruals to plant retirement?

## II. Introduction

Public utilities in Minnesota must receive Commission approval for their depreciation practices pursuant to Minn. Stat. §216B.11 and Minn. Rules, parts 7825.0500-7825.0900. Utilities must also file depreciation studies at least every five years and must use straight-line depreciation unless they can justify a different method.

Because Otter Tail Power uses the remaining life method for depreciating group property accounts, the underlying life and salvage factors may not change, but depreciation rates are adjusted annually to reflect the passage of time on remaining lives, as well as the impact of plant additions, retirements, and other activities. Annual depreciation study updates are required when the remaining-life method is used to allow the Commission the opportunity to approve changes in depreciation rates.

The Commission approved the proposed service lives, salvage values, and depreciation rates contained in Otter Tail's 2018 Five-Year Review of Depreciation Certification in its July 17, 2019 ORDER APPROVING PETITION AND SETTING ADDITIONAL REQUIREMENTS, in Docket No. E-017/D-18-568. In this docket, Otter Tail is asking the Commission to approve its 2019 annual depreciation study.

## III. Background

On August 30, 2019, Otter Tail Power Company (OTP or Otter Tail) filed its 2019 Annual Review of Depreciation Certification. Otter Tail has not proposed any changes to the depreciation parameters currently in effect. Its proposal is to adjust depreciation rates to reflect one year's passage of time, resulting in an increase of $928,236 or 1.65 percent to annual depreciation expense. Otter Tail is requesting an effective date of January 1, 2020.

On November 7, 2019, the Department of Commerce (DOC or the Department) submitted its comments and recommended that the Commission approve OTP's request with modifications.

On December 2, 2019, Otter Tail filed its reply comments disagreeing with the Department's recommendation for a one-year reduction in remaining lives for *Hoot Lake Plant Units 2 & 3* and *Hydraulic Production Plant* but agreeing to the Department's other recommendations.

On December 26, 2019, the Department submitted its response to OTP's reply comments continuing to recommend the one-year reduction to plant remaining lives.

On January 14, 2020, Otter Tail filed its reply to the Department's response comments, again disagreeing with the Department's remaining lives reduction recommendation, but arguing for regulatory asset treatment for the resulting depreciation expense if remaining lives reductions are ordered for the Hoot Lake and related facilities.

On February 28, 2020, the Department filed additional response comments clarifying its position and previous statements and recommending against regulatory asset treatment.

On April 24, 2020, Otter Tail submitted comments summarizing its position in anticipation of hearing.

## IV. Otter Tail – Initial Petition

On August 30, 2019, Otter Tail Power Company (OTP or Otter Tail) filed its 2019 Annual Review of Depreciation Certification. Otter Tail Power's petition is requesting an effective date of January 1, 2020 and is seeking Commission approval to adjust depreciation rates to reflect one year's passage of time for the remaining lives of all facilities with the exception of General Plant amortizable accounts. The net impact of the adjustments result in an updated composite rate of 2.93 percent, which is a 0.05 percentage point increase over the current composite rate of 2.88 percent. The updated total company annualized depreciation accrual is $57,285,177 versus a current depreciation accrual of $56,356,941. The resulting depreciation expense accrual increase of $928,236 (total company) is largely due to changes in the mix of plant investments combined with change in the age distributions of surviving plant. The Minnesota jurisdictional portion of this $928,236 total company increase is $508,283.

Table 1, below, shows a summary of OTP's proposed (Company total) changes in annual depreciation rates and accruals for each primary account (excluding amortization accounts) that are the result of one year's passage of time, including authorized allowances for net salvage.

**Table 1: Current and Updated Rates and Accruals[1]**

| | Accrual Rate | | | 2019 Annualized Accrual | | |
|---|---|---|---|---|---|---|
| **Function** | **Current** | **Updated** | **Difference** | **Current** | **Updated** | **Difference** |
| A | B | C | D=C-B | E | F | G=F-E |
| Intangible Plant | 19.90% | 19.90% | 0.00% | $1,766,935 | $1,765,934 | $0 |
| Steam Production | 3.15% | 3.29% | 0.14% | $18,224,747 | $19,031,863 | $807,116 |
| Hydraulic Production | 9.40% | 10.19% | 0.79% | $661,069 | $717,110 | $56,041 |
| Other Production | 4.32% | 4.36% | 0.03% | $13,492,462 | $13,583,197 | $90,735 |
| Transmission | 1.62% | 1.61% | -0.01% | $7,986,460 | $7,960,015 | ($26,445) |
| Distribution | 2.35% | 2.35% | 0.00% | $11,785,727 | $11,780,141 | ($5,586) |
| General Plant | 4.55% | 4.56% | 0.01% | $2,440,542 | $2,446,917 | $6,375 |
| Total Utility | 2.88% | 2.93% | 0.05% | $56,356,941 | $57,285,177 | $928,236 |

[1] Otter Tail Power's Petition, Attachment 1, page 4, August 30, 2019

### A. Peaking Capacity Cost Information

Otter Tail stated that this filing does not include any new peaking generators. A new peaking generator is not expected until after the Astoria Station becomes available for commercial operation in 2021.

### B. Remaining Lives and Salvage Percentages

Otter Tail derives its Remaining Lives and Salvage Percentages based on 5-year Depreciation Rate Studies and subsequently updates them annually in Technical Updates during each of the interim four years. (This filing, in this docket, is an example of an annual "technical update".) These calculations are as of the Depreciation Study or annual Technical Update date (12/31 of the prior calendar year) and are proposed for use in the year following that year's depreciation certification filing for use in depreciation expense calculation and accumulated reserve recording purposes. This results in a systematic and consecutive one-year lag, which when applied consistently over time yields uniform depreciation expense recognition in a rate regulated environment.

#### 1. Hoot Lake Plant

Hoot Lake Plant will be Otter Tail's next plant to retire (and the first since the retirement of the Ortonville steam plants in the late 1980's). It is forecast to retire on Otter Tail's books as of June 2022. At that point the plant will be fully depreciated, including the forecast 15.6% of net negative salvage amount necessary to cover the Cost of Removal for the disposition of the plant which is also targeted to be completed in roughly that same time frame.

#### 2. Merricourt Wind Energy Center

On August 8th, 2019 construction began on the Merricourt Wind Energy Center (MWEC). The Company expects the 150-megawatt (MW) facility to go into commercial service after its 15-month estimated construction period, sometime in the fourth quarter (Q4) of 2020. Since this depreciation certification petition, in this docket, is requesting remaining lives and salvage percentages for use in calculating depreciation rates for calendar year 2020, Otter Tail is prospectively requesting Commission approval of an initial Remaining Life of 25-years (same as Otter Tail's existing wind farms), and a net negative salvage percentage of -4.00% (same as Otter Tail's Langdon Wind Energy Center) for MWEC. Otter Tail evaluated the current decommissioning study-based salvage percentages from its existing three wind farms and determined that Langdon's net negative salvage percentage of -4.00% was the most representative of what it expects the net negative salvage percentages for MWEC to be once it is constructed.

## V. Department of Commerce – Comments

According to the Department, Otter Tail Power is requesting approval of changes to the lives and salvage rates of property accounts based on its plant and reserve balances as of December 31, 2018. The proposed updated composite depreciation rate would become 2.93 percent. When compared to the current rate of 2.88 percent, this would be an increase of 0.05 percentage points. Otter Tail said that "[t]he increase [in annual depreciation expense] of $928,236 [Total Company] is largely attributable to changes in the mix of plant investments among primary accounts and changes in the age of distributions of surviving plant."[2]

### A. Proposed Depreciation Parameters for Overall Plant

#### 1. Remaining Lives

The Department concluded that accounting for the passage of time by reducing the remaining life values is generally reasonable. Initially, the Department did not correctly interpret the final period/timeframes for some plants (Department Table 2 on page 4) and was concerned with the accuracy of related accruals. Otter Tail resolved the issue in their reply comments (discussed below).

The Department recommended that the remaining life values be reduced by one year for all Production Plants, with the exception of Account 312.1-102 (i.e., the *Hoot Lake Units 2 & 3 Landfill,* assigned a RL of 31.16 years, which appears reasonable and consistent with its stated 2051 retirement year).

#### 2. Salvage Rates

The Department stated that OTP proposed no significant changes to its currently approved salvage rates and the Department concluded that the proposed rates are reasonable.

#### 3. Depreciation Rates

The Department said that it discovered that OTP does not actually implement the updated depreciation rates reported in the Company's technical update Statements. Through discovery, OTP made clear that the Company is not requesting approval of the reported updated depreciation rates to apply in 2020; rather OTP is requesting approval of the depreciation parameters: remaining-life values and salvage percentages, summarized in Attachment 2 of its Petition. OTP seeks to use those parameters to calculate 2020 depreciation rates once 2019 year-end plant and reserve balances are finalized.

OTP explained in response to IR No. 4[3] that its methodology was approved by the Commission in its 1993 depreciation filing, Docket No. E-017/D-93-952 (93-952), wherein OTP proposed and changed from a retrospective to a prospective effective date for the application of its

[2] Petition Attachment 1, page 4.

[3] Instant Docket, Department Comments, November 7, 2019, DOC Attachment 1 includes DOC IR No. 4.

depreciation certification petitions. OTP's response in IR No. 4 helps explain the reason why the Company's "updated" depreciation rates published in OTP's depreciation filings, calculated using prior year-end account balances, may not be the same depreciation-rate-values after the Study's parameters are applied to year-end actual account balances one operating year later.

The Department stated:

> Specifically, there are tariffed rate riders in existence today that permit recovery of plant investments, inclusive of depreciation, that did not exist in 1993 when OTP transitioned to its prospective depreciation rate approach. Because OTP's depreciation filings do not reflect the actual rates they will apply in practice, and depreciation is one cost that may be recovered through these now-available cost recovery mechanisms, additional information should be required from OTP in order to allow for verification of the depreciation expense recovery requested in rider. Therefore, the Department recommends that the Commission require OTP to make an annual informational filing in its relevant depreciation petition docket by January 31, or the earliest reasonable date, with their calculated depreciation rates that it will be applying during that calendar year. This approach would provide a more transparent record document and ease regulatory oversight of OTP's depreciation expense recovery amounts in rider mechanisms.

### B. Proposed Depreciation Parameters for Merricourt Wind Energy Center

Otter Tail stated that its Merricourt Wind Energy Center (MWEC) 150 MW facility is expected to go in-service in the later part of 2020 and OTP is proposing an initial 25 year remaining life (the same as three other existing wind facilities) and a net negative salvage percentage of -4.00 percent (the same as its Langdon Wind Facility.)[4]

The Department concluded that these parameters for MWEC are reasonable and recommended Commission approval.

### C. Plant Balance, Additions, and Retirements

Otter Tail's proposed additions and retirements during the year would increase total plant depreciation by about $34.6 million, based on a 1.80% net increase in total plant investment. Most of the increase would be in the Company's distribution and transmission plant accounts, as shown in Table 2 below.

[4] OTP explained that its other two wind facilities' net salvage value differ due to the atypical capital investment dollars associated with them; Ashtabula having sustained higher capital costs for generator tie-in and Luverne having lower recoverable capital cost due to receipt of a federal grant

**Table 2: 2018 Changes in OTP's Primary Plant Account Balances[5] ($)**

| Primary Plant Assets | Balance 12/31/2017 | Additions | Retirements | Transfers | Balance 12/31/2018 |
|---|---|---|---|---|---|
| Intangible Plant | 9,905,743 | 3,135,454 | 4,211,527 | | 8,829,670 |
| Steam Production | 572,876,593 | 7,893,542 | 2,118,114 | | 578,652,021 |
| Hydraulic Production | 7,042,361 | | 7,328 | | 7,035,033 |
| Other Production | 309,859,462 | 1,803,509 | 58,763 | 4,149 | 311,608,357 |
| Transmission Plant | 485,868,025 | 8,967,393 | 992,864 | 625,912 | 494,468,466 |
| Distribution Plant | 481,539,297 | 24,209,873 | 4,040,127 | (636,160) | 501,072,883 |
| General Plant | 53,593,280 | 2,683,378 | 2,681,800 | 60,390 | 53,655,248 |
| **Total Depreciable Plant** | **1,920,684,761** | **48,693,149** | **14,110,523** | **54,291** | **1,955,321,678** |

### D. Future Additions and Retirements

Minnesota Rules 7825.0700, subpart 2, B. states that each utility shall disclose a list of any major future additions or retirements to the plant accounts that the utility believes may have a material effect on the current certification results.

Although Otter Tail stated that it is "unaware of any major future additions or retirements that will materially affect this filing's certification results,"[6] elsewhere, (possibly in other proceedings and in other documents), the Company has stated the following about future additions:

- Construction began on the Merricourt Wind Energy Center, a 150-megawatt (MW) wind farm located in North Dakota, in August 2019 with targeted completion in 2020. The project is expected to cost approximately $270 million.

- Construction began on the Astoria Station, a 245 MW simple cycle, natural gas-fired generation facility, located in South Dakota, in May 2019. This project is expected to cost approximately $158 million and has a planned in-service date of 2021.

And the following about future retirements:

- The above-mentioned new generation facilities (Merricourt and Astoria) will help offset the scheduled 2021 retirement of the Minnesota-located coal-fired Hoot Lake Plant Units 2 and 3 that have a combined output of 140 MWs.

### E. Comparison of Resource Plan and Remaining Lives

According to the Department, in the Company's Attachment 4, OTP's remaining lives for resource planning purposes closely match its remaining lives for depreciation purposes for all of its facilities.

[5] Source: OTP Petition, Statement G

[6] Instant Docket, OTP Petition, Attachment 3, page 1.

The Department supported continuation of the requirement for the Company to reconcile the depreciation forecast and the lives in the resource plan and recommended that the Commission require Otter Tail to include a table comparing the lives and fully explaining any differences.

### F. Effective Date of Proposed Depreciation Parameters and Rates

The Department stated that the proposed effective date of January 1, 2020, is consistent with Commission's orders in previous Otter Tail depreciation dockets and concluded that it was reasonable.

### G. Final Recommendation (as of February 28, 2020)

In its additional response comments, the Department recommended the Commission:

- Require the remaining life values to be reduced by one year, from 2.49 to 1.49, for all plant accounts relevant to the Hoot Lake Steam Production Plant Units 2 and 3, with the exception of Account 312.1-102 (i.e., the Hoot Lake Units 2 & 3 Landfill);
- Require the remaining life values to be reduced by one year, from 2.49 to 1.49, for all plant accounts relevant to the Hydraulic Production Plant;
- Approve OTP's proposed remaining-life parameters for the plant not otherwise identified and modified elsewhere by the Commission;
- Approve all of OTP's proposed salvage rates for its plant;
- Require OTP to file, in a compliance filing in this docket, the Company's calculated depreciation rates that it will actually apply in 2020 by the latter of January 31, 2020, or within 30 days after receiving the Commission Order approving the 2020 depreciation parameters;
- Require OTP to file annually in future depreciation dockets the Company's calculated depreciation rates that it will apply in the subject calendar period, by the latter of January 31 of the subject year, or within 30 days after receiving the Commission Order approving depreciation parameters;
- Approve OTP's prospectively requested remaining life and net salvage parameters for the Merricourt Wind Energy Center;
- Require OTP to include in future depreciation filings a table comparing asset lives used for the purpose of the Company's resource planning with the remaining lives proposed in the depreciation filings, explaining any differences;
- Approve OTP's proposed effective date of January 1, 2020; and
- Require OTP to file its next annual depreciation study by September 1, 2020.

## VI. Issues Agreed to Between the Parties

| Issue | Department's Recommendation |
|---|---|
| Proposed remaining lives parameters for all assets, except Hoot Lake Plant, Hydraulic Production, and amortized assets | Approve OTP's proposed remaining-life parameters for the plant not otherwise identified and modified elsewhere by the Commission |
| Proposed salvage rates | Approve all of OTP's proposed salvage rates for its plant |
| Proposed prospective parameters for Merricourt Wind Energy Center (MWEC) | Approve OTP's prospectively requested remaining life and net salvage parameters for the Merricourt Wind Energy Center |
| Proposed effective date | Approve OTP's proposed effective date of January 1, 2020 |
| Proposed next filing date | Require OTP to file its next annual depreciation study by September 1, 2020 |
| Report calculated depreciation rates that are actually used | Require OTP to report in a compliance filing in this docket, the Company's calculated depreciation rates that it will actually apply in 2020 by the latter of January 31, 2020, or within 30 days after receiving the Commission Order approving the 2020 depreciation parameters |
| | Require OTP to file annually in future depreciation dockets the Company's calculated depreciation rates that it will apply in the subject calendar period, by the latter of January 31 of the subject year, or within 30 days after receiving the Commission Order approving depreciation parameters |
| Report comparison between depreciation docket asset remaining lives and resource planning asset remaining lives. | Require OTP to include in future depreciation filings a table comparing asset lives used for the purpose of the Company's resource planning with the remaining lives proposed in the depreciation filings, explaining any differences |

## VII. Should the proposed remaining lives of Hoot Lake Production Plant Units 2 & 3 and Hydraulic Production Plant be reduced by one year to better match depreciation accruals to plant retirement?

### A. Overstated Remaining Lives

#### 1. The Department's Position

The Department maintained its position that the proposed 2020 remaining life parameters for *Hoot Lake Steam Production Units 2 & 3* as well as the *Hydraulic Production Plant* accounts are overstated by one year and, since they are to be retired in the near future, they must be adjusted.

Table 1-RC below shows the Department's corrected understanding of plants that have remaining lives that appear to be overstated.

Table 1-RC
**Plant with Retirement Dates that have Remaining Lives which Appear Overstated**
(Correction to Table 2 presented in Department Initial Comments)

| | Requested Remaining Life (Yrs.) 1/ | If effective for 2020, implies Retirement at this point (yr.): | That is, depreciation would carry to: | Though the stated Retirement Date is: 2/ | RL vs. Retirement Date Timeframe Variance |
|---|---|---|---|---|---|
| **Steam Production:** Hoot Lake Plant –Units 2 & 3 | 2.49 | 2022.49 | Jun-2022 | Jun-2021 | 1 yr. |
| **Hydraulic Production:** All Plant | 2.49 | 2022.49 | Jun-2022 | Jun-2021 | 1 yr. |
| **Other Production:** Jamestown Units 1 & 2 | 14.22 | 2034.22 | Mar-2034 | Jun-2033 | 9 mo. |
| Lake Preston | 14.22 | 2034.22 | Mar-2034 | Jun-2033 | 9 mo. |
| Fergus Falls Control Center | 11.32 | 2031.32 | Apr-2031 | Jun-2030 | 8 mo. |
| Solway | 19.01 | 2039.01 | Jan-2039 | Jun-2038 | 6 mo. |
| Langdon | 13.27 | 2033.27 | Apr-2033 | Jun-2032 | 8 mo. |
| Ashtabula | 14.23 | 2034.23 | Mar-2034 | Jun-2033 | 9 mo. |
| Luverne | 15.19 | 2035.19 | Mar-2035 | Jun-2034 | 9 mo. |
| **General Plant:** Fleet Service Center Buildings | 16.14 | 2036.14 | Feb-2036 | 2035 | n/a, >-2 mo. |
| 1/ Source: Petition, Attachment 2 and Attachment 1 – Statement F- column K | | | | | |
| 2/ Source: Petition, Attachment 4 and Attachment 1 – Statement F – column H | | | | | |

As shown above, the differences between requested remaining lives and retirement dates is less than a year for *Other Production Plant* and *General Plant.* However, the differences for the

*Hoot Lake Production Plant – Units 2 & 3*, and the *Hydraulic Production Plant* are one-year, which the Department states is a material difference considering that the retirement dates are imminent. The Department then disagrees with OTP's assertion that the "ending year for depreciation of these assets will occur on the schedule recommended by the Department."[7]

Table 3-RC below summarized OTP's depreciation filing RL values compared to the assumed retirement dates for *Hoot Lake 2 & 3* for each year from 2008 to the present. Column J shows the time variance. As shown, the variance increased from a 5-month RL overstatement to a one-year overstatement between the Company's 2009 and 2010 depreciation filing.

**Table 3-RC**

| Hoot Lake Plant Units 2 & 3 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Docket E017/D- | Depr. Study Conducted during: | Using Data As of: | For Use in (yr): | RL Yrs | Retirement Date Implied by (col. e) RL Yrs | | Stated Retirement year assumption | | RL vs. Retirement Date Timeframe Variance |
| | | | | Att. 2 | | mo./yr | Stmt F, Att 1 | Att. 4 | |
| a | b | c | d | e | f = d+e | g | h | i | j = g-i |
| 08-1042 | 2008 | 12/31/2007 | 2009 | **11.32** | 2020.32 | **Apr-2020** | 2019 | | **4 mo.** |
| 09-1019 | 2009 | 12/31/2008 | 2010 | **10.35** | 2020.35 | **May-2020** | 2019 | **12/31/2019** | **5 mo.** |
| 10-953 | 2010 | 12/31/2009 | 2011 | **10.35** | 2021.35 | **May-2021** | 2020 | **5/30/2020** | **1 yr.** |
| 11-886 | 2011 | 12/31/2010 | 2012 | **10.35** | 2022.35 | **May-2022** | 2021 | **5/30/2021** | **1 yr.** |
| 12-933 | 2012 | 12/31/2011 | 2013 | **10.35** | 2023.35 | **May-2023** | 2022 | **6/30/2022** | **11 mo.** |
| 13-795 | 2013 | 12/31/2012 | 2014 | **7.42** | 2021.42 | **May-2021** | 2020 | **6/30/2020** | **11 mo.** |
| 14-732 | 2014 | 12/31/2013 | 2015 | **6.44** | 2021.44 | **Jun-2021** | 2020 | **6/30/2020** | **1 yr.** |
| 15-804 | 2015 | 12/31/2014 | 2016 | **6.44** | 2022.44 | **Jun-2022** | 2021 | **6/30/2021** | **1 yr.** |
| 16-729 | 2016 | 12/31/2015 | 2017 | **5.46** | 2022.46 | **Jun-2022** | 2021 | **6/30/2021** | **1 yr.** |
| 17-652 | 2017 | 12/31/2016 | 2018 | **4.47** | 2022.47 | **Jun-2022** | 2021 | **6/30/2021** | **1 yr.** |
| 18-568 | 2018 | 12/31/2017 | 2019 | **3.48** | 2022.48 | **Jun-2022** | 2021 | **6/30/2021** | **1 yr.** |
| 19-547 | 2019 | 12/31/2018 | 2020 | **2.49** | 2022.49 | **Jun-2022** | 2021 | **6/30/2021** | **1 yr.** |

In its initial comments, the Department noted that in 1993 the Company changed to a prospective effective date application of its depreciation parameters;[8] the "prospective effective date" delays the effective date of a current year's study results to the following calendar year.[9] In its 1993 filing the Company explained that "accounts where remaining life is

[7] OTP Reply Comments, December 2, 2019, page 1.

[8] Docket E-017/D-93-863

[9] DOC: This "delay" has been referred to by the Company as "regulatory lag" in OTP Initial Petition, Attachment 4, comments to Base Load plant Hoot Lake Plant Units 2 & 3.

based upon a forecast retirement date should be reduced by one year to reflect the passage of one year."[10] The Department stated that the one-years overstated retirement date variance in column J suggested the possibility that such an adjustment did not happen.

In further reviewing prior depreciation filings, the Department found that in 1994,[11] the Company said that the retirement date for *Hydraulic Production Plant* accounts was 2021, which is tied to the expiration of its license, and is still the assumed retirement date.

Table 5-RC below shows the reported RL values for Account 331 during 1995-1999. Note that from 1998 to 1999 the RL values increased slightly, when there was no change in the plant retirement date of June 2021.

**Table 5-RC**

| Hydraulic Production Plant<br>Account 331<br>Remaining Life Values during 1995-1999 | | |
|---|---|---|
| **Docket** | **RL Value** | **Effective for Year** |
| E017/D-94-858 | 25.53 | 1995 |
| E017/D-95-939 | 24.52 | 1996 |
| E017/D-96-1014 | 23.53 | 1997 |
| E017/D-97-1347 | **22.52** | 1998 |
| E017/D-98-1658 | ***22.75*** | 1999 |

Also, since 1999, OTP's remaining lives value year-to-year reduction was always less than a full year.[12] The Company's practice is in opposition to what OTP said in its 2007 depreciation study:

> Passage of one-year time**:** Generally relates to accounts in which a "forecast average year of retirement" basis is used with remaining life technique. The proposed average remaining life would naturally decrease by one year as each year passes and that forecast retirement date draws nearer. (Docket No. E017/D-07-1138, Attachment 5).

[10] Docket E-017/D-93-863, Petition for Certification of Depreciation Rates, August 31, 1993, Supplemental Commentary, Schedule 1, page 1.

[11] Docket E-017/D-93-863, Petition for Certification of Depreciation Rates, August 31, 1993, Supplemental Commentary, Schedule 1, page 1.

[12] See DOC Response Comments, December 26, 2019, Attachment A.

On February 28, 2020, the Department filed additional response comments, stating that "[t]he purpose of these Additional Response Comments is to provide clarity to the record, as it appears that OTP may not have accurately understood the Department's position, and to also respond to OTP's alternative proposal presented in the Company's January 14, 2020 Reply to Response Comments.

Clarification of the Department's Position

The Department noted that OTP's Reply to Response Comments was that "there is no clear basis for reducing remaining lives in this proceeding." In response, the Department pointed out that the useful life of both the Hoot Lake Plant Units 2 & 3 (HLP) and the Hydraulic Production Plant end in 2021 while the Department's recommendation is to merely correct the depreciation parameters to match the balance of the plants' useful life; this recommendation upholds the regulatory ratemaking principle to match depreciation expense with the benefits obtained over the useful operating life of the plants.

Clarification of the Department's Statement

The Department stated on page 5 of its initial comments, "[i]t is plausible that depreciation may be recorded in the year following retirement year with use of the mid-year depreciation convention" and OTP has referred to this statement as support for the Company's request to continue to depreciate this plant for a full year after it is taken out of service.

The Department explained the use of a mid-year depreciation convention, which assumes that all assets are placed in service at the mid-point of their individual fiscal year. This naturally means that the recording of the onset and conclusion of depreciation expense accruals will not necessarily match up with the assets actual in-service date and retirement dates. To further clarify the Department's initial comments statement and make it more broadly accurate and indifferent to the fiscal period used, it should be: "It is plausible that depreciation may be recorded following the retirement date of the plant with the use of the mid-year depreciation convention." However, to apply the statement to the HLP, the retirement date is May 2021 and under a mid-year depreciation convention with a calendar year fiscal period, the depreciation accrual should end as of June 30, 2021.

Again, the Department stated that their recommendation does not change the retirement date, but only corrects a depreciation accrual calculation error.

### 2. Otter Tail Power's Position

Otter Tail disagreed with the Department's recommendation for a one year reduction in remaining lives of *Hoot Lake Plant* and *Hydraulic Production Plant* because it believes that the recommendation is "premised on the view that a correction is necessary to align the projected retirement date of June 2021 and depreciation accrual period which continues through June

2022".[13] Otter Tail said that it believes that the adjustment proposed by the Department is "neither prudent nor warranted within this proceeding".[14]

Regarding only the *Hydraulic Production Plant,* the Department noted "it appears that in 1998 OTP did not use the remaining life values approved for its Hydraulic Production Plant in Docket No. E017/D-97-1347 (as well as the values for its Other Production plant) (See note A); rather it appears that OTP inadvertently repeated use of the prior year's (1997) approved values for this plant. This action appears to have effectively extended the calculated remaining life of this plant going forward."[15] In response, Otter Tail said that it "respectfully disagrees with the Department's conclusion. Otter Tail reduced the certified remaining lives of its hydraulic and other production plant by one year in recognition of the passage of one year from 1997 to 1998." OTP said that "Statement I is not intended to depict actual depreciation expense posted to the general ledger in that year, but it is a prospective 'look ahead' to what depreciation expense might be in the year to come, if no other changes are made to the plant in service accounts. If the Department still has further questions regarding accounts 368 (2004), 390.00, 390.10, 390.20, 390.30 and 397.40 (2004), in light of comparing depreciation expense for a stated year against that's years Statement H, rather than Statement I, Otter Tail can provide that information."[16]

Additionally, OTP argued that the Department's recommendations are based on its understanding that "several of the requested remaining-life values for certain plant having forecasted retirement dates do not appear to have been appropriately adjusted for the targeted use period commencing in the year 2020."[17] The Company stated that the Department's recommendation stems from its concern that the proposed remaining life values "would cause the ending year for depreciation accrual to stretch into the second post retirement year of that plant…."[18] According to the Department "it is plausible that depreciation may be recorded in the year following the retirement year with the use of the mid-year depreciation convention; however, use of that convention does not reasonably support depreciation accruals to stretch into the second year following the retirement year."[19]

Otter Tail maintains that "the fact that depreciation accruals continue beyond the Hoot Lake Plant retirement date is not an anomaly requiring correction".[20] The Company pointed out that the June 30, 2021 projected retirement date is when the plant is expected to cease production, but preparation for decommissioning and the decommissioning efforts will occur beyond this projected retirement date.

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[13] OTP Reply to Response Comments, January 14, 2020, page 2.

[14] *Ibid*.

[15] Department Comments, November 7, 2019, Footnote 8, pages 5-6.

[16] Otter Tail Reply Comments, December 2, 2019, Footnote 11, page 7.

[17] Department Comments, November 7, 2019, page 4.

[18] *Ibid.*

[19] Department Comments, November 7, 2019, page 5.

[20] OTP Reply to Response Comments, January 14, 2020, page 2.

On April 24, 2020, the Company filed Summary Comments describing the "key point of disagreement in this docket is the Department's recommendation that the Commission reduce the remaining life of Otter Tail's Hoot Lake Plant by one year on the eve of that facility's retirement."

Otter Tail went on to point out that this recommendation would take effect on January 1, 2020, and would "effectively deny Otter Tail the ability to recover the resulting increase to depreciation expenses, at least through the 2020 calendar year (OTP is not in a position where it could file a rate case that would allow interim rates with the increased depreciation expense to be implemented prior to 2021)." The Company stated that the impact of this recommendation would be material, resulting in an increase to 2020 depreciation expense of $2.5 million, with about 55 percent occurring in Minnesota; and that this large impact is due to the short remaining life in which the one-year change can be accommodated.

Otter Tail went on to state:

> The Commission has approved the remaining life for Hoot Lake Plant as currently reflected in this docket in numerous prior depreciation dockets,[21] and Otter Tail's current retail rates were set to reflect the remaining lives approved by the Commission.

OTP also said:

> [I]n prior cases, the Commission has authorized an extension of remaining lives well beyond the date a facility is officially retired.[22]

In conclusion, the Company stated that, if the Department's recommendation is adopted, it "will have a material impact on Otter Tail, complicating an already difficult task and sending the wrong signal to utilities working with the Commission to retire major facilities. The materiality of its effect cannot be mitigated by Otter Tail, as it would apply retroactively to January 1, 2020,

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[21] OTP footnote: "The Commission approved Otter Tail's proposed remaining life for Hoot Lake Plant in its January 7, 2016 Order in Docket E-017/D-15-804, setting the remaining life of facility at 6.45 years, the level requested in OTP's Initial Filing dated September 1, 2015, Attachment 1, p 8. In each subsequent annual filing, the remaining life of Hoot Lake Plant was decreased by one year for the passage of time. See Docket E-017/D-16-729, OTP Initial Filing, Attachment 1, p. 8; E-017/D 17-625, OTP Initial Filing, Attachment 1, p. 8, Docket E-017/D-18-568, OTP Initial Filing, Attachment 1, p. 25; E-017/D 19-547, OTP Initial Filing, Attachment 1, p. 8."

[22] OTP footnote: "In Docket No. E,G002/D-12-151, the Commission addressed Xcel's Minnesota Valley Plant, which was no longer in operation but was still being depreciated in order to collect the 2009 estimated cost of decommissioning the plant. The docket filings including the Briefing Papers references Xcel' 2005 Remaining Life filing in Docket No. E,G002/D-05-288, where the Commission extended the remaining life of the Minnesota Valley Plant 12.5 years past the operating life of the plant in order to re-coup COR reserves through further depreciation expense primarily from customers that would have benefited from the plant."

causing a material change in annual depreciation expense and giving Otter Tail no opportunity to remedy the under-recovery caused by the increase in expense."

#### 3. Staff Analysis

Staff notes that whatever caused the discrepancy between the planned retirement and the final depreciation accrual may not be relevant at this late date in the asset lifecycle (assuming this does not represent systemic depreciation errors over other assets). Matching the life-time depreciation expense to the benefits received by ratepayers is a primary goal of proper ratemaking. Staff tends to agree with the Department that accruing depreciation more than one-year beyond closing does not seem reasonable.

### B. Current Treatment of Depreciation Reflected in Rates

#### 1. The Department's Position

OTP argued that prior depreciation filings were used as the basis to set general rates and if any depreciation methodology changes were made, then it should be done in a rate case proceeding. The Department responded with the following three points:

1) the purpose of depreciation filings is to accurately recognize the cost of service of a facility over its expected life and it no longer makes sense to continue to recognize depreciation after the facility ceases to be used or useful in providing service;

2) the manner in which depreciation expense was determined when setting base rates in a general rate case is static and the amounts do not change from year to year, but does not preclude future changes although such change is not reflected in base rates until the next rate case, and;

3) the Company controls when to file its next general rate case and may choose its test year.

#### 2. Otter Tail Power's Position

Otter Tail said that it has applied Commission-approved remaining lives and salvage values each year as shown by the Department's table 3-RC[23] from 2008 through 2019. The Commission has reviewed and approved the remaining lives that resulted in carrying depreciation accruals past 2021, through June 2022 and is reflected in OTP's current retail rates. OTP contends that the Department's recommendation to reduce these remaining lives contradicts these prior depreciation decisions and the depreciation expense recovery established in two interceding rate cases.[24] Further, the Department has previously acknowledged that "[i]t is plausible that

[23] Briefing Papers, page 10 above.

[24] Docket No. E-017/GR-15-1033; Docket No. E-017/GR-10-239.

depreciation may be recorded in the year following the retirement year with use of the mid-year depreciation convention…."[25]

#### 3. Staff Analysis

Staff agrees with the Department's arguments that there is nothing inherently sacrosanct in determining depreciation expense in a rate case and also sees no contradiction in the Commission having approved past depreciation filings and rate cases.

### C. Cost Recovery and Regulatory Asset Treatment

#### 1. The Department's Position

In Otter Tail's January 14, 2020, Reply to Response Comments, the Company requested regulatory asset treatment for any unrecovered depreciation expense balance resulting from a one-year life reduction for the *Hoot Lake Plant Units 2 & 3*. The Department said that it does not support this proposal for the following five reasons:

1) this proposal would result in single issue ratemaking;

2) when base rates were set, there was no expectation for future true-up of revenues and expenses to actuals from one rate case to the next;

3) once established, base rates remain static until the next rate case, which means that the asset's outstanding accrued depreciation balance - upon which OTP bases it recovery - would be different from what the Company has (or has not) recovered in rates;

4) allowing the proposed regulatory asset could be retroactive ratemaking; and

5) OTP has not made a case for its proposal for deferred accounting.

[25] Department Comments, November 7, 2019, p. 5.

### 2. Otter Tail Power's Position

Otter Tail said:

> Filing a rate case in 2020 using a historic test-year does not mitigate the impact of the Department's recommendation. Otter Tail is required under accounting standards to recognize the Commission-approved depreciation expense for the year approved. A historic test year could not be filed until sometime in 2021, after the 2020 year is over, and the $1.39 million (MN Share) for 2020 is recognized on Otter Tail's books. It isn't the test year that creates the inability to recover these expenses. It is the fact that the majority of the affected period will have passed by the time a filing could be made and interim rates could be implemented, and therefore a rate case filing could not be used to prevent the significant impact from regulatory lag associated with the Department's proposal.

The Company argues that if the Commission concluded that the life reduction is necessary, it should do it in a way that does not keep OTP from being able to recover depreciation expense. This could be done by allowing OTP to treat the unrecovered depreciation expense as a regulatory asset in its next rate case. Under GAAP, Otter Tail believes it is required to deem Hoot Lake Plant an impaired asset if the Commission requires reducing the plant's life by one year but allowing the Company to record the impairment as a regulatory asset would be a reasonable approach.

### 3. Staff Analysis

Staff notes that, traditionally, the Commission has reserved deferred accounting for costs that are unusual, unforeseeable, and large enough to have a significant impact on the utility's financial condition. While the cost of approximately $1.39 million (MN jurisdiction) might be considered significant, it would be hard to justify past depreciation accrual discrepancies, or failure to update the remaining life to match the retirement date, as unusual or unforeseeable circumstances.

## VIII. Decision Alternatives

**Remaining Life Reductions**

1) Require the remaining life values to be reduced by one year, from 2.49 to 1.49, for all plant accounts relevant to the Hoot Lake Steam Production Plant Units 2 and 3, with the exception of Account 312.1-102 (i.e., the Hoot Lake Units 2 & 3 Landfill). [DOC]

**And**

2) Require the remaining life values to be reduced by one year, from 2.49 to 1.49, for all plant accounts relevant to the Hydraulic Production Plant. [DOC]

**OR**

3) Approve OTP's proposed remaining lives and salvage rate percentages and do not require one-year remaining life reduction for Hoot Lake Steam Production Plant Units 2 and 3 and/or Hydraulic Production Plant. [OTP]

**If the Commission adopts the Department's recommendation (in alternatives 1 and 2 above).**

4) Approve OTP's request to treat any unrecovered depreciation expense balance for the Hoot Lake Plant* as a regulatory asset in the Company' next general rate case. [OTP]

**OR**

5) Deny OTP's request to treat any unrecovered depreciation expense balance for the Hoot Lake Plant* as a regulatory asset in the Company' next general rate case. [DOC]

**Note: Staff is assuming that OTP's January 14, 2020 Response to Reply Comments, p. 5-6 reference to Hoot Lake Plant is to both Hoot Lake Plant Units 2 and 3 as well as the Hydraulic Production Plant.*

**Depreciation Parameters and Certification**

6) Approve OTP's proposed remaining-life parameters for the plant not otherwise identified and modified elsewhere by the Commission. [DOC, OTP]

7) Approve all of OTP's proposed salvage rates for its plant. [DOC, OTP]

8) Approve OTP's prospectively requested remaining life and net salvage parameters for the Merricourt Wind Energy Center. [DOC, OTP]

**Effective Date**

9) Approve OTP's proposed effective date of January 1, 2020. [DOC, OTP]

**Compliance**

10) Require OTP to file, in a compliance filing in this docket, the Company's calculated depreciation rates that it will actually apply in 2020 by the latter of January 31, 2020, or within 30 days after receiving the Commission Order approving the 2020 depreciation parameters. [DOC, OTP]

11) Require OTP to file annually in future depreciation dockets the Company's calculated depreciation rates that it will apply in the subject calendar period, by the latter of January 31 of the subject year, or within 30 days after receiving the Commission Order approving depreciation parameters. [DOC, OTP]

12) Require OTP to include in future depreciation filings a table comparing asset lives used for the purpose of the Company's resource planning with the remaining lives proposed in the depreciation filings, explaining any differences. [DOC, OTP]

**OTP's Next Annual Depreciation Filing**

13) Require OTP to file its next annual depreciation study by September 1, 2020. [DOC, OTP]