**STATE OF SOUTH DAKOTA**
**BEFORE THE**
**SOUTH DAKOTA PUBLIC UTILITIES COMMISSION**

In the Matter of Otter Tail Power Company's Petition to Establish a Transmission Cost Recovery Tariff

Docket No. EL10-015

# COMMENTS OF OTTER TAIL POWER COMPANY

## South Dakota TCR Recovery Scenarios

## I. Introduction and background

OTP filed its request to establish a Transmission Cost Recovery (TCR) Rider in Docket No. EL10-015. In its TCR filing OTP proposed to leave large transmission projects identified in the MISO Attachment GG for OTP at the FERC jurisdictional level. As OTP proposed, these projects would not be included in retail ratebase, but be allocated to a separate FERC jurisdiction for recovery. The MISO allocated costs associated with OTP retail load for these projects would be collected through MISO charges coming through the MISO Schedule 26 charge. Otter Tail would collect its revenue requirements for these transmission facilities through the MISO Schedule 26 revenue received from other utilities through MISO and from the MISO Schedule 26 charges allocated to OTP's retail customers. In other words, retail customers would not be allocated the FERC-authorized MISO revenue associated with Attachment GG transmission projects, as OTP would use that revenue to satisfy the revenue requirements associated with the transmission. Retail customers would only be responsible for the revenue requirements allocated to OTP retail load through the MISO process.

OTP chose to propose the TCR in this manner because there will be a large differential between the amount of transmission investment for which retail load has responsibility and the amount OTP is investing in these large regional transmission projects. Allocating all of this investment into the retail ratebase would expose retail customers to potential financial risks associated with the investments, including primarily the risk that the FERC jurisdictional revenues may not be sufficient to off-set the retail revenue requirements if the projects are placed into the retail ratebase.

Since OTP's initial filing the Company has had several discussions with Commission staff. Three potential scenarios have been developed and discussed for incorporating regional transmission into the transmission cost recovery rider. Regional transmission would include transmission projects identified in MISO Attachment GG which are included in MISO Schedule 26 expense allocations to retail load. The three scenarios include:

- The scenario initially proposed by OTP in which Attachment GG projects would remain at the FERC jurisdictional level and not be included as part of retail ratebase. Only the MISO Schedule 26 expense allocations to retail load would flow through the TCR. Retail customers would not be allocated a revenue requirement obligation for any transmission investments identified in Attachment GG other than the expense allocation. All Schedule 26 revenue would stay with OTP to cover the FERC-jurisdictional revenue requirement of the transmission investment. This scenario has the minimum amount of revenue requirement risk to retail customers (i.e. if the MISO revenues are less than the retail revenue requirement, retail customers would not be affected), and also the minimum amount of revenue credit opportunity to retail customers (i.e. if the MISO revenues are more than the retail revenue requirement, the additional revenues would not be reflected as a reduction to retail rates).
- The second scenario is to allocate the investment into state and FERC jurisdictions on a percent-of-responsibility basis (similar to how OTP allocates responsibility to its three states). The retail load allocation of the investment would have a revenue requirement in the TCR as well the regular MISO Schedule 26 expenses, plus a credit for the pro-rata share of the Schedule 26 wholesale revenues associated with the retail load portion of the transmission investment. This scenario provides the opportunity for retail customers to receive the benefit of the wholesale revenue credits, but also adds some risk in the event the MISO revenue is insufficient to cover the retail revenue requirement of retail allocated

share of the investment. This scenario is in-line with typical ratemaking philosophy, with that portion of the transmission investment being allocated to the jurisdiction which has created the need for the investment (i.e. the South Dakota retail share of the investment would be allocated in proportion to the amount of responsibility allocated to South Dakota retail.

- The third scenario is to allocate all of the transmission investment into the retail TCR and credit the TCR calculation with 100% of the MISO Schedule 26 revenue associated with the transmission investment. This scenario places the most risk of MISO revenue insufficiency upon OTP's retail customers.

In prior comments, OTP has indicated a belief that all three of these scenarios over the long-term will provide reasonable rates and revenue recoveries (however there are risks that this may not be the case). OTP also indicated in those comments that including regional transmission project investments from MISO Attachment GG in the revenue requirement of the retail TCR exposes retail customers to greater risk from the wholesale market. Commission staff has requested OTP provide further input on what constitutes these risks.

## II. OTP Commentary associated with the PUC staff request to provide further comment on risks to retail ratepayers for including MISO Attachment GG transmission in the TCR revenue requirement.

Regional transmission projects that are included in the MISO Attachment GG process can rely heavily on revenues from other MISO load-serving members to provide some or a majority of the revenue requirements. The risks of this revenue stream are what create risks for retail customers by including MISO Schedule GG transmission investments and associated revenues in the TCR structure. OTP reviewed financial prospectus documents by National Grid, PLC[1] and ITC Holdings, Corp.[2] to supplement its own information on the risks. National Grid and ITC Holdings are both entities involved in operating independent transmission systems that rely on FERC jurisdictional revenues for their revenue requirements.

[1] Form F-3 Registration Statement, dated June 28, 2006
[2] Form S-3 Registration Statement Prospectus, dated January 17, 2007

OTP has classified the perceived risks into four broad categories: FERC, MISO, Environmental, and Other. The risks are identified and discussed below.

FERC

- The revenue that is received is under the MISO tariff approved by FERC. FERC establishes the allowed rate of return, which may be higher or lower than the state allowed rate of return. FERC has also established a different capital structure, treats deferred taxes in a different manner, and may make other changes that impact the amount of MISO revenue that OTP receives for these regional transmission investments. This would not impact SD retail customers for transmission investments that are left at the FERC-jurisdictional level, but would impact retail customers for transmission investments that are included in the TCR.
- FERC may make policy decisions that add or remove incentives for the regional transmission investments. These changes would impact the amount of revenue received from MISO which would impact retail customers for transmission investments that are included in the TCR.
- Changes in federal law, regulation, or policies could negatively impact the revenue streams associated with MISO transmission service. These changes would impact the amount of FERC jurisdictional revenue received from MISO which would impact retail customers for transmission investments that are included in the TCR.

MISO

- MISO consists of a collection of voluntary members that may choose to leave MISO to join another ISO, RTO, or other regional entity, or may choose not to belong to any regional transmission entity. MISO does not create any revenue on its own, but only collects revenue from its members and pays out revenue to its members from the revenues received from members. It is possible that at some point MISO membership may drop below a point where revenues do not cover MISO obligations to its members and therefore the members will not receive the revenues they are due.
- MISO membership consists of several components, including transmission service, centralized markets for energy and capacity, and a resource adequacy construct. The loss

of MISO members may result from issues associated with any aspect of MISO membership, and not simply transmission issues.  So loss of transmission service revenue may be as a consequence of issues unrelated to transmission service.

- A MISO member may go bankrupt or be unable to pay its obligations, including obligations due to MISO.  This may result in a situation where MISO is unable to pay members all revenue which is due them.
- MISO may merge with PJM or some other ISO or RTO.  A merger could result in a new transmission tariff for which the allocation of revenues is changed.
- Tariffs are subject to appeal and/or court action that could have negative impacts to revenue streams.
- The revenue stream associated with high voltage transmission lines is subject to essentially a single customer entity (MISO).
- State regulatory agencies may direct one or more of their utilities to discontinue MISO membership for one or more reasons, negatively impacting MISO's revenue situation.

<u>Environmental</u>

- Hazards associated with high voltage transmission may result in suspension of permits or civil lawsuits and penalties.
- Environmental issues, whether real or imagined, such as endangered species impacts, stray voltage, electromagnetic field effects, etc. may impact the operation of high voltage transmission facilities and thus negatively impact the associated revenue stream.

<u>Other</u>

- Acts of war, terrorist attacks and threats, or the escalation of military activity in response to such attacks or otherwise may negatively impact the FERC jurisdictional transmission service revenue stream.

There are other reimbursable risks such as storm damage that may not have a lifetime revenue stream risk but may have a cash timing risk.  Severe storm damage to a transmission facility that requires significant investment to repair will eventually increase the ratebase and associated revenue requirement to MISO in Attachment GG.  However, it may take a year or two following the expenditure before the increased revenue requirement is included in the MISO data. If the increased investment is included in the TCR, the increase in wholesale revenue stream may be delayed and retail customers will pay an increased rate until such time as the MISO wholesale revenue stream is increased.

## III. Conclusion

As previously stated, OTP feels any one of the three scenarios over the long-term is likely to provide reasonable rates and revenue recoveries (provided whichever methodology that is used, is used consistently over the lives of these projects). The second and third scenarios, which include some or all of the MISO Attachment GG investment and wholesale revenue in the TCR, will likely cause short-term volatility in the TCR rate.

OTP believes the scenario that includes the MISO Attachment GG investment and associated revenue in the TCR at a level justified by retail load responsibility is most consistent with standard ratemaking allocations. The amount of the transmission investment that is justified by retail load is treated as investment to serve retail load, while the balance of the transmission investment is allocated to wholesale service.

Please call me or contact me with any questions or to discuss this information.

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