South Dakota TCR Recovery Scenarios

I. Introduction and Background

On November 5, 2010 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 proposed by OTP, 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:

- OTP's filing proposed MISO 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 MISO 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 transmission 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 state jurisdictional revenue requirement in the TCR as well the regular MISO Schedule 26 expenses, plus a credit for the pro-rata share of the FERC authorized MISO 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. In this scenario OTP's revenue requirement for the retail load obligation of the investment would be based on the rate of return from the

Company's most recent retail rate case. The non-retail load portion of the investment would earn at the FERC approved rate of return of 12.38%.

- The third scenario is to allocate all of the transmission investment into the retail TCR and credit the TCR calculation with 100% of the FERC authorized MISO Schedule 26 revenue associated with the transmission investment. This scenario places the most risk of MISO revenue insufficiency upon OTP's retail customers. OTP's revenue requirements would be based on the approved rate of return from the Company's most recent South Dakota retail rate case. Retail customers would receive credit for all of the MISO revenue requirements received at the FERC approved rate of return of 12.38%.

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 for OTP, although allocation of risk varies with each scenario. In informal discussions PUC staff has indicated a preference for the second scenario, with the retail obligation portion of the transmission investment being allocated to retail load, with a pro-rata credit for the MISO Schedule 26 revenue.

II. Updated Information and Analysis

OTP's original petition sought recovery of costs incurred on or after January 1, 2011 with collection through rates to commence in early 2011. The proposal was to file updates annually to adjust the TCR rate. Docket EL10-015 has now remained open into late 2011 so revenue collection has not yet started, and it has not been possible to file an update to establish a TCR rate for 2012. Through this update OTP proposes to establish a TCR rate that would be in effect through 2012, and the Company will file an update later in 2012 to establish a TCR rate for 2013. Collection of the revenue requirements would commence on November 1, 2011. The establishment of a TCR rate to be used through the remainder of 2011 and all of 2012 would benefit all parties. Commission staff and OTP employees would avoid unnecessary labor and expense cost, and free up labor hours that can be used for other projects. Retail customers would benefit by having a more stable rate through the TCR.

This filing update assumes the split-the-pie approach which Staff has indicated as the preferred methodology during discussions. Schedule 26 revenues received for the portion of the transmission allocated to retail load responsibility is credited to retail customers on a prorata basis. OTP has updated cost information where it is available. The 2012 calculation includes the Schedule 26 revenue and expense projections for 2012. Actual 2011 data was incorporated through August 2011.

The primary changes update include:

- OTP is taking advantage of 100% bonus tax depreciation for the two projects entering service in 2011. This reduces the ratebase and thus the revenue requirement for the two projects.

- December 1, 2011 is now the anticipated date of commencement of the rider. OTP's request is anticipated to be on the Commission's agenda for November 22, 2011.

The updated analysis indicates an average TCR revenue rate of $0.00127 per kWh. The detail behind the calculations is shown in the attachments. This filing contains the following attachments:

- Attachment 1 – Projected Revenue
- Attachment 2 – Revenue Requirements Summary
- Attachment 3 – Rate Design
- Attachment 4 – Tracker Summary
- Attachment 5 – Bemidji to Grand Rapids Revenue Requirements
- Attachment 6A – Fargo to Monticello Phase I Revenue Requirements
- Attachment 6B – Fargo to Monticello Phase II Revenue Requirements
- Attachment 6C – Fargo to Monticello Phase III Revenue Requirements
- Attachment 7 – Rugby Wind Farm Interconnection Revenue Requirements
- Attachment 8 – Sample Bill Comparisons
- Attachment 9 – Schedule 26 Revenue and Expense

None of the costs included in the TCR calculations were included as investments or expenses for recovery in OTP's most recent rate case, Docket No. EL10-011. An approved TCR rate would remain in effect until modified by a Commission decision. Any new projects to be included in the TCR would need Commission approval in a TCR update filing. Since the TCR is typically a forward-looking projection, the TCR tracker will include a true-up mechanism to adjust for differences between TCR revenues and actual transmission costs for projects and expenses.

III. Conclusion

OTP requests Commission approval to establish a Transmission Cost Recovery Rider to recover the costs of transmission projects that are not included in base rates. OTP seeks to recover costs incurred since January 1, 2011. OTP desires to implement the Rider recovery for the period of December 1, 2011 through December 31, 2012 for costs incurred from January 1, 2011 through December 31, 2012. OTP will file an update in 2012 to reset the TCR for 2013.

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

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