STAFF MEMORANDUM

TO: COMMISSIONERS AND ADVISORS

FROM: BRITTANY MEHLHAFF, PATRICK STEFFENSEN, AND KAREN CREMER

RE: EL13-029- In the Matter of the Petition of Otter Tail Power Company for Approval of its 2014 Transmission Cost Recovery Eligibility and Rate Adjustment

DATE: February 11, 2014

Commission Staff (Staff) submits this Memorandum in support of the Settlement Stipulation (Settlement) of February 10, 2014, between Staff and Otter Tail Power Company (OTP or Company) in the above-captioned matter.

BACKGROUND

On August 30, 2013, the Commission received a petition from OTP requesting approval of its annual update to its Transmission Cost Recovery Rider (TCR) rate. The proposed revised TCR rate reflects the TCR revenue requirements for the year 2014, including the tracker balance estimated for the end of the current period, and costs of one new transmission project that is not currently in base rates and has not previously been approved for inclusion in the TCR rider.

SDCL § 49-34A-25.1 through 25.4 authorize the Commission to approve a tariff mechanism for the automatic annual adjustment of charges for the jurisdictional costs of new or modified transmission facilities with a design capacity of 34.5 kV or more and which are more than five miles in length.

In Docket EL10-015, the Commission approved the establishment of the TCR rider to recover the costs associated with three transmission projects, the CAPX2020 Fargo, CAPX2020 Bemidji, and Rugby Wind Farm Interconnection projects, and MISO[1] Schedule 26 expenses. The Commission approved the Settlement Stipulation supporting the “hybrid” or “split method” approach for allocating MISO approved cost-shared projects with company investment.

In Docket EL12-054, the Commission approved TCR recovery of the 2013 revenue requirement associated with the four[2] previously approved transmission projects, one new transmission project[3], and MISO Schedule 26 expenses. The EL12-054 settlement stipulation updated the TCR rider to incorporate the “refined split” method, a refinement of the method approved in Docket EL10-015, for all cost-shared

[1] Midcontinent Independent System Operator, Inc.
[2] In Docket EL12-054, OTP split the CAPX2020 Bemidji project into two parts: CAPX2020 Bemidji and Cass Lake – Bemidji, thus changing the number of initially approved projects from three to four.
[3] Casselton-Buffalo project

projects beginning in 2013, and to only collect 2013 revenue requirements associated with projects completed and placed in-service during or prior to 2013.

The 2013 TCR rider implemented the following rates for each customer class effective May 1, 2013:

Class	¢/kWh	$/kW
Large General Service	0.082	0.202
Controlled Service	0.049	N/A
Lighting	0.134	N/A
All Other Service	0.250	N/A

In this filing, OTP requests to recover a projected 2014 revenue requirement of $902,536 associated with six transmission projects and MISO Schedule 26 expenses. The request includes the Company's proposal to return to customers an estimated $51,511 in over-collection of the remaining balance in 2013. The Company proposed 2014 revenue requirement results in the following rates for the respective customer classes, calculated based on a January 1, 2014, effective date:

Class	¢/kWh	$/kW
Large General Service	0.108	0.272
Controlled Service	0.045	N/A
Lighting	0.178	N/A
All Other Service	0.315	N/A

STAFF'S ANALYSIS AND SETTLEMENT RESOLUTIONS

Staff's recommendation is based on its analysis of OTP's filing, discovery information, relevant statutes, and previous Commission orders. Staff reviewed the tracker report and the forecasted revenue requirement associated with new transmission projects.

Staff and OTP (jointly the Parties) positions were discussed thoroughly at settlement conferences. As a result, some party positions were modified and others were accepted where consensus was found. Ultimately, the Parties agreed on a comprehensive resolution of all issues.

The Parties agree the under-collection of the remaining balance as of February 28, 2014, is an estimated $70,545. The March 1, 2014 – February 28, 2015 TCR rider is based on estimated costs of eligible transmission projects subject to later "true-up" to actual costs and actual recoveries. Attachment 15 attached to the Settlement is designed to implement the revised TCR rider rate on March 1, 2014.

TRACKER REPORT

The rate approved in Docket EL12-054 was based on the balance in the tracker account and the 2013 estimated revenue requirement. In this docket, Staff reviewed the actual 2013 capital costs to determine if the costs were prudent and at the lowest reasonable cost to ratepayers. Staff also reviewed the Company's calculation of the under/over collection of costs incorporated in the new TCR rates, comparing actual recoveries to actual costs.

Attachment 4 attached to the Settlement summarizes the tracker activity by month. Individual project detail for the previously approved projects is found on Attachments 5 through 9.

Unless otherwise noted, all of the changes discussed below are changes from the Company's originally filed position.

Updated Tracker Activity

The filed 2013 TCR tracker report contained actual tracker activity from January 2013 through July 2013 and projected activity for August 2013 through December 2013. OTP provided Staff with an updated report of actual costs and revenues through December 2013. The Settlement reflects these updates.

Formula Correction

The Settlement also reflects a correction in a formula contained in the Cass Lake – Bemidji revenue requirements calculation. A formula was not capturing the Cass Lake Substation total, thus omitting these amounts from rate base for the months beginning in August of 2012. This caused an understatement of the revenue requirement of approximately $58,000.

After incorporating the above changes into the revenue requirement calculation, the under-collection of the remaining balance as of December 31, 2013, is $43,366.

As discussed in more detail below, the Settlement reflects a change in the collection period from a calendar year basis to March 1st through the end of February each year. When the projected tracker activity for January and February 2014 is combined with the ending 2013 tracker balance, the under-collection in the tracker account as of February 28, 2014, is an estimated $70,545.

MARCH 2014 – FEBRUARY 2015 TCR REVENUE REQUIREMENT

The total estimated revenue requirement for March 1, 2014 through February 28, 2015 of $1,348,603, subject to later true-up to actual costs and recoveries, is based on the estimated under-collection in the tracker account as of February 28, 2014, and the estimated March 2014 – February 2015 revenue requirement associated with six transmission projects and MISO Schedule 26 expenses. Five of these projects were approved for recovery in Docket EL12-054. In this filing, the Company seeks approval to include one additional project, the Oakes Area Transmission Improvements, in the TCR rider beginning in 2014.

SDCL § 49-34A-25.1 allows utilities to include costs associated with transmission facilities in the TCR rider with a design capacity 34.5 kV or more and which are more than five miles in length. All projects included for recovery in this filing satisfy these eligibility requirements.

The TCR legislation requires consideration of whether the projects have and are expected to achieve transmission system improvements at the lowest reasonable cost to ratepayers. When a need is identified on the Company's transmission system, transmission planning studies are performed and generally include an investigation of a variety of alternatives and identify a preferred transmission project to meet the need on the transmission system at the lowest overall cost. Such studies were performed for the projects included in this petition.

OTP's TCR rider continues to apply the methodology approved in Docket EL12-054. Projects are separated into three types:

(1) New or modified projects, ineligible for cost-sharing through the MISO tariff;
(2) MTEP[4]-approved cost-shared projects without company investment; and
(3) MTEP-approved cost-shared projects with company investment.

The projects included for recovery in OTP's filing are allocated into these 3 project types, as detailed below.

Type (1) Projects

Projects in this category are ineligible for cost-sharing through MISO. All of OTP's investment associated with these projects is placed into rate base in the TCR rider, which is allocated to South Dakota.

This Settlement is the first to include a non-cost shared project, the Oakes Area Transmission Improvements, in OTP's TCR rider. The Oakes Area Transmission Improvements project was approved as an Appendix A project by MISO through the MTEP12 planning cycle. The 230 kV portion of this project does not meet the $5 million threshold for regional cost-allocation through MISO. This project aims to improve the adequacy of the transmission system, add sectionalizing capability along the existing Ellendale-Hankinson 230 kV line, and help to minimize momentary and sustained interruptions to customers. Oakes Area Transmission Improvements will be completed in phases, with the first phase being completed in 2014. The Oakes Area Transmission Improvements revenue requirement is calculated on Attachment 10 attached to the Settlement.

Under the MISO Tariff, revenue requirements for non-cost shared projects are recovered under Attachment O. Transmission assets are included in the Open Access Transmission Tariff (OATT) revenue requirement under Attachment O and OTP collects revenue from other transmission users in MISO. These revenue collections are returned to customers through the TCR rider under the form of a transmission revenue credit applied to the project revenue requirement.

Type (2) Projects

Expenses incurred by a utility as a result of MISO's cost allocation methods are considered by Staff to be a cost of MISO membership. As was initially approved in Docket EL10-015, OTP's Schedule 26 and 26A expenses continue to be recovered through the TCR rider.

Type (3) Projects

The Settlement approved by the Commission in Docket EL12-054 implemented the use of the "refined split method" for projects that qualify for regional cost allocation through MISO's tariff. This method

[4] MISO Transmission Expansion Plan

aims to recognize the appropriate separation of state and federal jurisdiction regarding interstate transmission and wholesale charges. A detailed explanation of the method and Staff's arguments for using the method was provided in Staff's Memorandum in Docket EL12-054. A review of the mechanics of the method is provided again below.

Refined Split Method: The "refined split method" only places into the TCR rate base the Company's MISO determined retail responsibility for its own investment. OTP is also responsible for a portion of the line invested in by others and is charged Schedule 26 expenses through the MISO tariff for this responsibility. These Schedule 26 charges flow through the TCR as an expense. Thus, rate payers are responsible for OTP's entire financial responsibility. The Company's financial responsibility is partially paid for through rate base at the South Dakota return and partially through expenses at the FERC return. Other members of MISO are financially responsible for the remaining portion of the line invested in by OTP. These MISO members are charged Schedule 26 expenses, through the MISO tariff, for this responsibility and OTP receives this amount as revenues from MISO. In sum, OTP is charged Schedule 26 expenses relating to its total financial responsibility, including OTP's responsibility for its own investment and OTP's responsibility for the portion of the line invested in by others. OTP receives revenues relating to its total investment in the projects, including OTP's responsibility for its own investment and others' responsibility for OTP's investment. In the "refined split method" the total Schedule 26 charges flow through to ratepayers as an expense and the total revenue is adjusted to remove the revenues the Company receives from others, leaving a revenue credit to ratepayers relating to OTP's responsibility for its own investment. Since rate base only includes the costs associated with the Company's responsibility for its own investment, ratepayers do not receive a credit for the revenues the Company receives from others. The Company uses this revenue to pay for the portion of its investment for which other members of MISO are responsible.

OTP's TCR rider only includes projects that are completed and placed in service. Thus, the Schedule 26 and Schedule 26A expenses and revenues are adjusted to exclude the amount of such expenses and revenues associated with OTP's investment in projects that are currently under construction and not included in the TCR rider. No MISO Multi-Value Projects (MVP) projects are included in the TCR rider as they are not yet completed, therefore Schedule 26A revenues which are attributable to investment in MVP projects, are excluded from the TCR rider.

Large Regional Transmission Projects: The large regional cost shared projects approved for recovery in Docket EL10-015 and EL12-054 and that continue to be recovered in the TCR are the CAPX2020 Fargo – Monticello Phase I, CAPX2020 Bemidji – Grand Rapids, Cass Lake – Bemidji, and the Ruby Wind Interconnection project. The Fargo – Monticello, Bemidji – Grand Rapids, and Cass Lake - Bemidji projects all qualify for regional cost allocation as Baseline Reliability Projects[5] (BRPs) and the Rugby Wind Interconnection project is a Generation Interconnection Project[6] (GIP). Phase II of the CAPX2020 Fargo – Monticello project is included in the TCR rider beginning January 2015. Although this phase of the project is anticipated to be placed into service in 2014, it is not included in the TCR rider until January 1,

[5] Projects qualifying as BRPs are required for regional reliability purposes.
[6] Projects qualifying as GIPs are identified through an interconnection study to be eligible for sharing.

2015, in order to more easily administer matching the corresponding Schedule 26 expenses and revenues on a full calendar year basis.

Lower Voltage Regional Transmission Projects: For projects included in MTEP Appendix A prior to June 1, 2012, the MISO regional cost sharing methodology for transmission projects below 300 kV is similar to the methodology for those over 300 kV except the use of a 20 percent MISO wide allocation ("postage stamp") treatment is not used[7]. Instead, the entire cost of the transmission project is afforded the Line Outage Distribution Factor[8] (LODF) treatment methodology. MISO has since eliminated the regional cost sharing methodology for all transmission projects below 300 kV, effective with projects included in MTEP Appendix A after June 1, 2013. Going forward, the costs of such projects will be assigned to the transmission zone in which the assets are located.

Since the Casselton – Buffalo project was included in MTEP11, it qualifies for MISO regional cost sharing for projects less than 300 kV. MISO designated this project as a BRP, with the cost allocation done using the LODF treatment only. The Casselton – Buffalo project will continue to be recovered through the TCR rider during the March 2014 – February 2015 recovery period.

MISO SCHEDULE 37 AND SCHEDULE 38 REVENUES

OTP continues to include revenue credits in the TCR rider to reflect revenues received from MISO pursuant to Schedules 37 and 38 of the MISO tariff. Companies subject to Schedule 37 and Schedule 38 who have departed MISO have an obligation to pay for MISO projects identified under these schedules for the life of the projects. OTP receives Schedule 37 and Schedule 38 revenues pursuant to the MISO tariff for its allocation from MISO of contributions required of the departing companies. MISO does not prepare a forecast for Schedule 37 and Schedule 38 revenues because they are embedded in the Schedule 26 forecast. Therefore, in the TCR rider, for months in which the MISO revenues are projected, no Schedule 37 and Schedule 38 revenues are shown as it is included under Schedule 26 revenues. Once the actual revenues are known, the revenue credits will be appropriately denoted under Schedule 26, Schedule 37, and Schedule 38 revenues.

OVERHEAD REVENUE CREDIT

The TCR rider includes an additional revenue credit to account for reimbursements through MISO's tariff for administrative and general O&M expenses. The revenue credit provides reimbursement to customers for any such costs that may already be recovered through OTP's retail rates.

2014 RATE OF RETURN

The EL12-054 settlement reflected the use of the actual capital structure and debt costs at the end of the preceding calendar year, December 31, 2012, and an ROE of **Begin Confidential** [redacted] **End**

[7] Projects 345 kV and higher qualifying as a Baseline Reliability Project (BRP), have 20% of costs allocated on a system-wide basis to all transmission customers in MISO and 80% of costs allocated on a sub-regional basis to all transmission customers in designated pricing zones based on power flow analysis.
[8] LODF is an engineering measure of the benefits of a new line used to allocate costs on a more local level based on power flows.

Confidential, resulting in an overall rate of return of 7.58% for 2013. The Company's 2014 petition also used a 7.58% ROR for 2014. Subsequently, OTP provided the actual capital structure and debt costs as of December 31, 2013, and updated the 2014 overall rate of return to 7.39%. This ROR is reflected in the Settlement.

FILING FEE

The Parties agree the filing fee is an eligible expense for inclusion in the TCR rider. The Settlement includes an estimate of $7,500 for the EL13-029 filing fee as opposed to the $20,000 estimate included in OTP's petition. The actual amount billed to the Company will be reflected in the next true-up filing.

CARRYING CHARGE

The Settlement continues to apply a carrying charge to the monthly over-or-under recoveries based on the overall rate of return implemented for each year.

RATE DESIGN

As proposed by OTP, the Settlement continues to incorporate the rate design approved in Docket EL10-015 and EL12-054. The revenue requirement is allocated to customer classes based on the transmission demand allocation factor, D2, from OTP's most recent rate case, Docket EL10-011. The large general service class rate design incorporates both a demand charge and an energy charge while the remaining retail rate classes have an energy rate only.

TIMING OF FUTURE FILINGS AND EFFECTIVE DATE

The Settlement reflects a change in the current annual filing schedule to more closely align the TCR updates to the annual filing OTP makes with MISO and subsequent availability from MISO of updated rates for annual Schedule 26 and 26A expenses and revenues. The annual SD TCR filing date will shift from September 1st to November 1st, with the proposed effective date shifting from January 1st to March 1st.

The revised TCR rate is designed to be implemented effective March 1, 2014, based on forecasted sales from March 2014 through February 2015 and reflecting estimated revenues received through February of 2014 under the current TCR rates. Delaying the implementation of the revised TCR rate allowed OTP to update the TCR calculations to incorporate actuals through December 31, 2013, and update forecasts based on more current information from MISO.

The net effect of the changes outlined in this memo is an estimated March 2014 – February 2015 South Dakota revenue requirement of $1,348,603 associated with transmission investments, including the true-up of the under-collection as of February 28, 2014 of $70,545. The revised TCR rates for the respective customer classes to be effective March 1, 2014 are:

Class	¢/kWh	$/kW
Large General Service	0.160	0.417
Controlled Service	0.064	N/A
Lighting	0.253	N/A
All Other Service	0.448	N/A

OTHER ISSUES

Reasonableness of Overall Earnings from Regulated Rates

The Company agrees to continue to file, by June 1 of each year, an annual report with the Commission detailing its South Dakota jurisdictional earnings for the preceding calendar year. Staff believes the report is necessary to monitor the Company's earnings and the potential effect of adding the TCR rider to its South Dakota tariff.

RECOMMENDATION

Staff recommends the Commission approve the Settlement Stipulation for the reasons stated above.