STAFF MEMORANDUM

TO: COMMISSIONERS AND ADVISORS

FROM: PATRICK STEFFENSEN AND KAREN CREMER

RE: EL14-090- In the Matter of the Petition of Otter Tail Power Company for Approval of its 2015 Transmission Cost Recovery Eligibility and Rate Adjustment

DATE: February 6, 2015

BACKGROUND

On October 31, 2014, the South Dakota Public Utilities Commission (Commission) received a Petition for Annual Update to Transmission Cost Recovery Rider Rate (Petition) from Otter Tail Power Company (OTP or Company) requesting approval of its annual update to its Transmission Cost Rider (TCR) rates. The proposed revised TCR rates reflect the TCR revenue requirements for March 1, 2015 through February 29, 2016, including the tracker balance estimated for the end of the current period, and costs of two new transmission projects that are not currently in base rates and have not previously been approved for inclusion in the TCR.

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.

To provide a brief overview of the history, in Docket EL10-015, the Commission approved the establishment of TCR rates 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 a 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 rates to incorporate the "refined split" method, a refinement of the method approved in Docket EL10-015, for all cost-shared projects beginning in 2013, and to only collect 2013 revenue requirements associated with projects completed and placed in-service during or prior to 2013.

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[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

In Docket EL13-029, the Commission approved TCR recovery of the 2014 revenue requirement associated with the five previously approved transmission projects, one new transmission project[4], and MISO Schedule 26 expenses.

The 2014 TCR implemented the following rates for each customer class effective March 1, 2014:

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

In this filing, OTP initially requested to recover a projected March 1, 2015 through February 29, 2016 revenue requirement of $1,525,790 associated with the six previously approved transmission projects, two new transmission projects[5], and MISO Schedule 26 expenses. The request includes the Company's proposal to return to customers an estimated $47,948 in over-collection of the prior period's remaining balance. The Company's proposed March 1, 2015 through February 29, 2016 revenue requirement results in the following rates for the respective customer classes, calculated based on a March 1, 2015, effective date:

Class	¢/kWh	$/kW
Large General Service	0.179	0.471
Controlled Service	0.069	N/A
Lighting	0.303	N/A
All Other Service	0.508	N/A

STAFF'S ANALYSIS AND RECOMMENDATIONS

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, OTP agreed to provide an updated filing to reflect several necessary changes identified by the Parties. Ultimately, the Parties agreed on a resolution of most issues. The one issue where the Parties could not come to a consensus, the inclusion of the NERC Compliance project, will be discussed in detail below.

The Parties agree the updated over-collection of the remaining balance as of February 28, 2015, is an estimated $78,860, as shown in OTP's Supplemental Filing dated February 2, 2015. The March 1, 2015 – February 29, 2016 TCR is based on estimated costs of eligible transmission projects subject to later

[4] Oakes Area Transmission Improvements
[5] Brookings-Hampton 345 kV Line and NERC Compliance Projects

“true-up” to actual costs and actual recoveries. The Supplemental Filing presents OTP’s and Staff’s recommendations in this docket. Page 3 provides detail regarding the recommended revenue requirements and revised TCR rates designed to be implemented on March 1, 2015.

Tracker Report

The rate approved in Docket EL13-029 was based on the balance in the tracker account and the March 1, 2014 through February 28, 2015 estimated revenue requirement. Staff continues to review the actual 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 provided on February 2, 2015, summarizes the tracker activity by month. Individual project detail for the previously approved projects is found on Attachments 5 through 10.

Unless otherwise noted, all of the changes discussed below are changes from the Company’s originally filed position, are areas where the Parties are in agreement, and are represented in OTP’s “Supplemental Filing” on February 2, 2015.

Updated Tracker Activity

The originally filed TCR tracker report contained actual tracker activity through September 2014 and projected activity beginning October 2014. OTP provided Staff with an updated report of actual costs and revenues through December 2014.

Capital Structure and Cost of Debt

The initial filing used a capital structure and cost of debt as of December 31, 2013, to calculate the 2015 revenue requirements. OTP updated to a December 31, 2014, capital structure and cost of debt to calculate 2015 revenue requirements.

MISO Tariff Schedule 37 Revenue Credit Adjustment

Page 8 of OTP’s Petition describes a revenue reversal in Schedule 37 due to American Transmission Systems Inc.’s (ATSI) dispute to pay its share of transmission investments. Since the initial filing, ATSI has agreed to pay MISO for its share of Schedule 37 expenses. MISO made a payment to OTP in December 2014 and the update reflects this payment.

Oakes Area Transmission Revenue Requirement

Attachment 4 of the initial filing inadvertently included a $175 per month revenue requirement for 2014 for the Oakes Area Transmission project. The update corrects this oversight.

CAPX 2020 Bemidji-Grand Rapids Operations and Maintenance Expense

Attachment 7 of the initial filing inadvertently excluded forecasted 2015 operations and maintenance expense of $18,750 per quarter for the CAPX 2020 Bemidji project. The update corrects this oversight.

MISO Tariff Schedule 26A Expenses Correction

Schedule 26A expenses for the months of February and March 2014, represented under the March and April columns in Attachment 14 of the initial filing, were in error. The update corrects this error.

NERC Compliance Project

The Parties were unable to come to an agreement on all issues in this docket, in particular, the inclusion of the NERC Compliance project in the TCR. This project is comprised of a LiDAR assessment that used aircraft-based technology to compare facility line clearances with design standards. OTP then divided their lines into two phases to perform mitigations to increase clearances along various transmission facilities throughout its service territory.

In OTP's response to Staff Data Request 1-10, OTP defined the work required on the facilities as "modifying, moving or replacing line guys, replacement of structures, and raising structures." OTP stated in its response to Staff Data Request 2-2 that there are only "one or possibly two 800 foot spans where new conductor may be necessary due to the existing sag of the current conductor" and that "design capacities for the transmission lines will not be adjusted in these spans or anywhere else to meet NERC compliance."

Staff does not believe the changes described in this project qualify as a "modified transmission facility" under SDCL § 49-34A-25.1, as functionally, the transmission lines continue to operate the same after the project is completed as they currently function. In Staff's opinion, a modification requires a change or alteration which introduces new elements into the facility but leaves the general purpose and effect of the lines intact. Here the Company is bringing its transmission lines into compliance with NERC and not altering or adding new elements to the transmission lines. Staff views the activities as merely maintenance of existing lines. Therefore, Staff recommends disallowance of all costs associated with the NERC Compliance project.

March 2015 – February 2016 TCR Revenue Requirement

Company Recommendation

OTP's updated filing contains all the revisions where Staff and OTP agree, but includes the contested revenue requirement associated with the NERC Compliance project. Thus, the total estimated revenue requirement for March 1, 2015 through February 29, 2016 of $1,538,416, subject to later true-up to actual costs and recoveries, is based on the estimated over-collection in the tracker account as of February 28, 2015, and the estimated March 2015 – February 2016 revenue requirement associated with eight transmission projects and MISO Schedule 26 expenses. With OTP's updated filing, the revised TCR rates for the respective customer classes to be effective March 1, 2015 are:

Class	¢/kWh	$/kW
Large General Service	0.180	0.475
Controlled Service	0.069	N/A
Lighting	0.305	N/A
All Other Service	0.512	N/A

Staff Recommendation

For reasons outlined above, Staff recommends the Commission disallow all revenue requirements associated with the NERC Compliance project. This results in a reduction of $107,766 to the updated OTP filing for a total revenue requirement of $1,430,650. The revised TCR rates as proposed by Staff for the respective customer classes to be effective March 1, 2015 are:

Class	¢/kWh	$/kW
Large General Service	0.167	0.442
Controlled Service	0.065	N/A
Lighting	0.284	N/A
All Other Service	0.476	N/A

OTHER STAFF CONSIDERATIONS

SDCL § 49-34A-25.4 provides that the Commission shall approve the rate adjustment if the costs were or are expected to be prudently incurred and 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 these studies 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 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[6]-approved cost-shared projects without company investment; and
(3) MTEP-approved cost-shared projects with company investment.

[6] MISO Transmission Expansion Plan

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, such as the Oakes Area Transmission Improvements project, are ineligible for cost-sharing through MISO. All of OTP's investment associated with these projects is placed into rate base in the TCR, which is allocated to South Dakota.

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 in 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.

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 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, ratepayers 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 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. It should be noted there are now revenues reported under Schedule 26A revenues, as the CAPX 2020 Brookings project meets the criterion of a MISO Multi-Value Project (MVP). These MVP projects were identified and recommended to meet public policy requirements within the MISO states through 2026.

MISO Schedule 37 and Schedule 38 Revenues

OTP continues to include revenue credits in the TCR 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, 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 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 ratepayers for any such costs that may already be recovered through OTP's retail rates.

MISO Multi-Value Project Auction Revenue Rights

The TCR includes an additional revenue credit to account for revenues derived from increased transmission capacity attributable to MVP projects placed in service within the MISO footprint. These values are determined at annual auctions, distributed monthly, and allocated in a manner similar to that of Schedule 26A expenses. These estimates are subject to change based on seasonal values for transmission capacity, projects in service, and available additional transmission capacity. Thus, OTP will true-up these amounts to actuals in their next TCR filing.

Filing Fee

The Parties agree the filing fee is an eligible expense for inclusion in the TCR, and the TCR includes an estimate of $5,000 for the EL14-090 filing fee. The actual amount billed to the Company will be reflected in the next true-up filing.

Carrying Charge

The TCR 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

The TCR continues to incorporate the rate design approved in Dockets EL10-015, EL12-054, and EL13-029. 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.

Reasonableness of Overall Earnings from Regulated Rates

The Company agrees to file in this docket, by June 1, 2015, 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 to its South Dakota tariff.

RECOMMENDATION

Staff recommends the Commission approve the $1,430,650 revenue requirement for the March 1, 2015 through February 29, 2016 plan year with the exclusion of the NERC Compliance project for the reasons stated above. This results in the following rates being effective March 1, 2015:

Class	¢/kWh	$/kW
Large General Service	0.167	0.442
Controlled Service	0.065	N/A
Lighting	0.284	N/A
All Other Service	0.476	N/A