STAFF MEMORANDUM

TO: COMMISSIONERS AND ADVISORS

FROM: PATRICK STEFFENSEN, LORENA REICHERT, AND AMANDA REISS

RE: EL16-035 - In the Matter of the Petition of Otter Tail Power Company for Approval of the Transmission Cost Recovery Rider Rate

DATE: January 26, 2017

BACKGROUND

On November 1, 2016, the South Dakota Public Utilities Commission (Commission) received a Petition for Approval of the Annual Update to its 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, 2017 through February 28, 2018, 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.

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 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[1] previously approved transmission projects, one new transmission project (the Casselton-Buffalo project), 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.

[1] 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.

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 (the Oaks Area Transmission Improvements project), and MISO Schedule 26 expenses.

In Docket EL14-090, the Commission approved TCR recovery of the 2015 revenue requirement associated with the six previously approved transmission projects, one new transmission project (the Brookings-Hampton 345 kV Line project), and MISO Schedule 26 expenses. One proposed project, the NERC Compliance project, was not allowed recovery in the TCR, as it was not deemed to be a line modification.

In Docket EL15-045, the Commission approved TCR recovery of the 2016 revenue requirement associated with the seven previously approved transmission projects, the new SPP Schedule 9 and Schedule 11 expenses, and MISO Schedule 26 expenses.

The 2016 TCR implemented the following rates for each customer class effective March 1, 2016:

Class	¢/kWh	$/kW
Large General Service	0.228	0.586
Controlled Service	0.089	N/A
Lighting	0.371	N/A
All Other Service	0.631	N/A

In this filing, OTP initially requested to recover a projected March 1, 2017 through February 28, 2018 revenue requirement of $1,969,053 associated with the seven previously approved transmission projects, one new transmission project (the Big Stone South to Brookings Multi-Value Project), SPP Schedule 9 and Schedule 11 expenses, and MISO Schedule 26 expenses. The request includes the Company's proposal to collect from customers an estimated $66,880 in under-collection of the prior period's remaining balance. The Company's proposed March 1, 2017 through February 28, 2018 revenue requirement results in the following rates for the respective customer classes, based on a March 1, 2017, effective date:

Class	¢/kWh	$/kW
Large General Service	0.222	0.595
Controlled Service	0.090	N/A
Lighting	0.386	N/A
All Other Service	0.683	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 the existing transmission projects, the one new transmission project, MISO Schedule 26 expenses, and SPP Schedule 9 and Schedule 11 expenses.

Staff and OTP (jointly the Parties) had numerous discussions regarding OTP's petition. As a result, OTP agreed to provide an updated filing to reflect several changes that were identified. Ultimately, the Parties agreed on a comprehensive resolution of all issues.

The Parties agree the updated 2017 revenue requirement is $2,053,205, including an over-collection of $88,873, as shown in OTP's Supplemental Filing dated January 20, 2017. This represents an increase of approximately $84,000 from OTP's initial filing on November 1, 2016.

The March 1, 2017 through February 28, 2018 TCR is based on estimated costs of eligible transmission projects subject to later "true-up" to reflect the actual costs and actual recoveries. The Supplemental Filing, filed on January 20, 2017, presents OTP's and Staff's recommendations in this docket. Page 4 provides detail regarding the recommended revenue requirements and revised TCR rates designed to be implemented on March 1, 2017, and pages 2 and 3 provide analysis of the changes made from the initial filing.

SPP Schedule 9 Expense and MISO Schedule 9 Revenue

In 1958, Central Power Electric Cooperative, Inc. (CPEC) and OTP entered into an Integrated Transmission Agreement to jointly plan, develop, and construct transmission facilities. This required the two parties to contribute equally to the construction of new facilities in the Integrated Transmission System (ITS) and resulted in facility ownership being non-contiguous.

Effective January 1, 2016, CPEC placed some of its facilities, including facilities in the ITS, under the control of SPP. As a result, certain parts of the MISO system and OTP native load is now isolated from direct integration into the MISO system, leaving OTP dependent on SPP transmission service in order to reach other areas of MISO and serve OTP load. This has subject OTP to Schedule 9 of SPP's tariff to provide Network Integration Transmission Service (NITS). Under NITS, OTP and its customers receive the highest level of curtailment priority on CPEC's facilities. This firm service is comparable to the service CPEC has on these facilities to reliably serve their native customers.

Similar to OTP paying for use of CPEC's system in SPP, CPEC needs to pay for their use of OTP's facilities in MISO. This was also effective January 1, 2016 and flows through to OTP and its customers in MISO's Schedule 9. As provided in the Supplemental Filing, when MISO's Schedule 9 revenue is netted against SPP's Schedule 9 expense, it has a $313,976 impact on the 2017 revenue requirement.

OTP continues to explore options to minimize or eliminate its exposure to SPP costs, including construction of new facilities to bypass use of CPEC facilities and continued settlement discussions in FERC Docket ER 16-209-000. The Supplemental Filing provides the most recent projections of future SPP costs at this time. If OTP is able to lessen the impacts on ratepayers through its intervention at FERC or by any other means, these changes will be reflected in the true-up mechanism in future TCR dockets.

Tracker Report

The rate approved in Docket EL15-045 was based on the balance in the tracker account and the March 1, 2016 through February 28, 2017 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.

Revised Attachment 4 provided on January 20, 2017, summarizes the tracker activity by month. Individual project detail for the seven previously approved projects and one new project is found on Attachments 5 through 12.

Pages 2 and 3 of OTP's Supplemental Filing on January 20, 2017 provide thorough descriptions of all the changes made from the Company's originally filed $1,969,053 revenue requirement to the revised revenue requirement of $2,053,205, depicted on page 4 of the Supplemental Filing. All parties are in agreement on the changes made, and the following paragraphs provide a brief recap of these changes.

Updated Tracker Activity

The originally filed TCR tracker report contained actual tracker activity through September 2016 and projected activity beginning October 2016. OTP provided Staff with an updated report of actual costs and revenues through December 2016. This includes updates to MISO Schedule 26 and Schedule 26A and SPP Schedule 9 and Schedule 11 expense, and updates to MISO Schedule 9, Schedule 26, and Schedule 26A revenue. These changes as well as updates to the 2017 forecast result in an increase to the revenue requirement of approximately $232,000.

Capital Structure and Cost of Debt

The initial filing used a capital structure and cost of debt as of December 31, 2015, to calculate the 2017 revenue requirements. OTP updated to a December 31, 2016, capital structure and cost of debt to calculate 2017 revenue requirements. This update increases the revenue requirement by approximately $4,000.

MISO Transmission Owners Return on Equity Complaint

In November 2013, a group of industrial customers in the MISO region filed a complaint asking FERC to reduce the 12.38 percent return on equity (ROE) used in the transmission formula rates of jurisdictional MISO transmission owners, including OTP, to 9.15 percent.

On September 28, 2016, FERC ruled that the base ROE currently approved for most transmission-owning members of MISO is unjust and unreasonable and should be reduced to 10.32 percent, effective immediately. In addition, FERC has approved a 50 basis point ROE adder for OTP, effective January 6, 2015. MISO and its transmission owners were also ordered to return any excess revenues they collected, plus interest, for the 15-month period extending from November 12, 2013 through February 11, 2015.

This filing has been revised to include these settlement payments for Schedule 26 and 26A expense in Revised Attachment 14 and Schedule 26 and 26A revenue credit in Revised Attachments 17 and 18, respectively, effective February 2017. The revision decreases the 2017 revenue requirement by approximately $150,000 and is the primary driver in the shifting from an under-recovery position in the initial filing to the updated over-recovery position, as shown on page 4 of the Supplemental Filing.

Proration of Federal ADIT and MISO Entergy Regional Through and Out Settlement

Upon further analysis by the Company, it was determined that minor adjustments were necessary in the calculations related to the proration of ADIT and the refund from Entergy's integration into MISO. These corrections decrease the 2017 revenue requirement by approximately $2,000.

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.

MISO Cost-Sharing Review

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[2]-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, 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.

[2] MISO Transmission Expansion Plan

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. Revenues reported under Schedule 26A revenues, such as the CAPX 2020 Brookings project, meet 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.

Big Stone South to Brookings Multi-Value Project

Attachment 12 and Revised Attachment 12 show the revenue requirement impact of the Big Stone South to Brookings MVP project inclusion in the TCR. The facilities which comprise this project are anticipated to be in service in the third quarter of 2017, so this project is included in the rider effective January 2018. This project, as with all MVP projects, are designed to reduce the wholesale cost of energy delivery for the consumers across MISO by enabling the delivery of low cost generation to load, reducing congestion costs, and increasing system reliability.

SPP Cost-Sharing

SPP Schedule 11 expenses are similar to MISO Schedule 26 and Schedule 26A expenses and are for the cost of economic and reliability projects approved through SPP's Integrated Transmission Planning process. These expenses are OTP's estimated share of these costs in whole or in part on a regional and zonal basis. Any differences between actual and estimated cost will be trued-up in future TCR filings.

It should also be noted that the refined split method does not apply in this docket for SPP expenses, as OTP is not making, nor plans to make, investments in transmission in SPP. Any future decisions by OTP to become a transmission owner in SPP will require an analysis of the applicability of the refined split method at that time.

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 EL16-035 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, EL13-029, EL14-090, and EL15-045. 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 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 to its South Dakota tariff.

RECOMMENDATION

Staff recommends the Commission approve the $2,053,205 revenue requirement for the March 1, 2017 through February 28, 2018 plan year. This results in the following rates being effective March 1, 2017:

Class	¢/kWh	$/kW
Large General Service	0.232	0.630
Controlled Service	0.094	N/A
Lighting	0.403	N/A
All Other Service	0.712	N/A