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

SOUTH DAKOTA TCR UPDATED INFORMATION

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 initial filing OTP proposed to leave large transmission projects identified in the MISO Attachment GG for OTP at the FERC jurisdictional level. As initially proposed by OTP, these projects would not be included in retail ratebase, but be allocated to a separate FERC jurisdiction for recovery. 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 investments. Retail customers would only be responsible for the revenue requirements allocated to OTP retail load through the MISO process.

OTP proposed 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. Based on these discussions, three potential scenarios have been developed and considered for incorporating OTP's investments in regional transmission into retail rate base and the transmission cost recovery rider.[1] The three methodologies include:

- As OTP proposed initially, 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 methodology allocates 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 methodology provides

[1] Regional transmission includes transmission projects identified in MISO Attachment GG which are included in MISO Schedule 26 expense allocations to retail load.

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 methodology is in-line with cost-of-service 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 methodology, 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. OTP's revenue requirement for the non-retail load portion of the investment would be recovered through the FERC approved MISO rates.

- The third methodology allocates all of the transmission investment into the retail rate base and TCR and credits the TCR calculation with 100% of the FERC authorized MISO Schedule 26 revenue associated with the transmission investment. This methodology 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.

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 in 2011 with collection through rates to commence in early 2011. Annual TCR filings going forward would adjust the TCR rate each year based on actual costs and collections. Docket EL10-015 has now remained open into late 2011 so revenue collection has not yet started, and it has not been possible to make the new annual 2012 filing to establish a TCR rate for use in 2012. Through this update OTP proposes to establish a TCR rate that will be in effect through 2012, and the Company will file an update late in 2012 to establish a TCR rate for 2013. Collection of the revenue requirements have been calculated to commence on November 1, 2011. The establishment of a TCR rate to be used through the remainder of 2011 and all of 2012 will benefit all parties. Commission staff and OTP employees will avoid unnecessary administrative costs, and free up labor hours that can be used for other projects. Retail customers will benefit by having a more stable rate through the TCR.

This filing update assumes the proportionally allocated approach which Staff has indicated as the preferred methodology during discussions (the second option described above). Under this approach, MISO 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 actual and projected 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. Several other changes have been made as detailed below.

In OTP's original petition, the Fargo to Monticello CAPX 2020 project was included as a single project for 2011. There are actually three separate phases to the project, with the first phase of the project now scheduled to commence operation in November 2011. The TCR tracker spreadsheet has been modified to provide the detail for the three phases of the Fargo to Monticello project in individual calculations so that each phase can enter service separate from the other construction phases. These revenue requirements details are contained in Attachments 6A, 6B, and 6C.

A project which was included in OTP's Attachment GG filing to MISO for 2011 was the Rugby Wind Farm Interconnection, MTEP Project 1462. The Rugby Wind Farm is interconnected to the OTP system near Rugby, ND. OTP is not involved with the generation or the purchasing of energy from this wind project. The total project costs were $394,398.95, of which $64,516 was allocated to retail customers under the MISO tariff. These costs are associated with upgrades made to the electrical system. The balance of the upgrade investment was directly assigned to the owner of the Rugby Wind Farm. The investment was capitalized in August 2011, with depreciation commencing in September. MISO Attachment GG only contains the retail load responsibility portion of the project investment. Thus, 100% of the Schedule 26 revenues received from this project were allocated back to retail customers through the TCR tracker calculation.

The updated analysis indicates an average TCR rate of $0.0013 per kWh. The detail behind the calculations is shown in 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, and, as discussed above, it has been calculated with the expectation if will be in effect through December 2012. Any new projects to be included in the TCR will need Commission approval in a future TCR update filing. Since the TCR is typically based on a forward-looking projection, the TCR tracker serves as a true-up mechanism to adjust for differences between projected and actual TCR revenues and costs.

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 based upon this updated information. OTP desires to implement the Rider recovery for the period of November 1, 2011 through December 31, 2012 for costs incurred from January 1, 2011 through December 31, 2012. OTP will file an annual 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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