
STAFF MEMORANDUM

TO: COMMISSIONERS AND ADVISORS
FROM: ERIC PAULSON, JOSEPH REZAC, AND AMANDA REISS
RE: Docket EL16-030 - In the Matter of the Petition of Otter Tail Power Company for Approval of the Environmental Cost Recovery Rider Charge
DATE: October 20, 2016

Commission Staff (Staff) submits this Memorandum regarding its recommendations for the above captioned matter.

BACKGROUND

On August 31, 2016, the Commission received a petition from Otter Tail Power Company (Otter Tail) for approval of its annual update to the Environmental Cost Recovery Rider rate under its Environmental Cost Recovery (ECR) Rider, Rate Schedule 13.08, for the actual and forecasted costs and revenue through the recovery period of November 2016 through October 2017 for Big Stone Plant's Air Quality Control System (AQCS) and Hoot Lake Plant's Mercury and Air Toxics Standards (MATS).

SDCL 49-34A-97 through 100 authorize the Commission to approve a tariff mechanism for the automatic annual adjustment of an electric utility's charges to recover costs incurred for environmental improvements to its electric generation facilities. Eligible costs are those incurred for environmental improvements required under the Clean Air Act, the Clean Water Act, or any other federal law or rule or any state law or rule implementing a federal law or rule, or voluntary environmental measures designed to protect the environment.

In Docket EL12-027, the Company initially requested approval of an ECR Rider tariff to recover costs associated with the environmental retrofit at the Big Stone Plant. Otter Tail later requested that action on the petition be suspended until the project neared completion or withdrawal of the petition with the intention of re-filing the petition at a later time. The Commission issued an Order Granting Request to Withdraw Petition and Close Docket on April 24, 2013.

In docket EL14-082, the Commission established the ECR Rider tariff to recover costs associated with the environmental projects at Big Stone and Hoot Lake. Also, the Commission approved ECR recovery of the November 1, 2014 to October 31, 2015 revenue requirement associated with the Big Stone AQCS and Hoot Lake MATS projects to be effective December 1, 2014.

In docket EL15-029, the Commission approved ECR recovery of the November 1, 2015 to October 31, 2016 revenue requirement associated with the Big Stone AQCS and Hoot Lake MATS projects.

In this filing, the projected South Dakota revenue requirement associated with the two environmental improvements for the period November 1, 2016, through October 31, 2017, is \$2,546,204. This revenue requirement less a projected over recovery of the current period's costs of \$239,073 plus a carrying

credit to the customers' benefit of \$(13,213) gives a total cost of \$2,293,918 to be recovered through the ECR charge over the period November 1, 2016, through October 31, 2017. Otter Tail states the rate impact of the current request (for both projects) will decrease the ECR Rider Rate from \$.00643 per kWh to \$.00550 per kWh. Otter Tail anticipates the rate impact, in total, after this update will be just over 6% of a customer's bill on average, less than its previous estimate of slightly less than 12%. The bill decrease for a typical residential customer averaging 955 kWh per month will be approximately \$0.89 or 1.00%.

STAFF'S ANALYSIS AND RECOMMENDATIONS

Staff's recommendation is based on its analysis of Otter Tail's filing, discovery information, relevant statutes, and related dockets.

ENVIRONMENTAL PROJECT UPDATES

As stated in the Company's application, the Hoot Lake MATS project was placed in-service in October 2014. The actual project cost was approximately \$6.8 million, including AFUDC, as compared to the original cost estimate of approximately \$10 million and the estimate of \$8.2 million included in the Company's filing in Docket EL14-082. Otter Tail's South Dakota cost is approximately \$680,000.

The Big Stone AQCS project's total estimated cost in docket EL15-029 was \$384 million. In this docket, the Big Stone AQCS project's total estimated cost is \$368 million. Otter Tail's share is approximately \$198 million, and an additional \$15 million in costs directly incurred by Otter Tail, with Otter Tail's South Dakota costs being approximately \$21.3 million.

The Big Stone AQCS project was placed in-service in December of 2015. The testing and in-service date for Big Stone AQCS was delayed from its original in-service date in October 2015 to address cracks found during normal maintenance inspections performed at the same time as the final AQCS project cutover was occurring. The HP section of the turbine was sent to a vendor's facility for replacement of the blades, requiring an extension of the scheduled outage. AQCS testing was delayed since testing could not begin until the plant was operational.

ACCUMULATED DEFERRED INCOME TAXES PRO-RATE

Since the last ECR filing Otter Tail became aware of an IRS rule interpretation regarding the normalization of ADIT in a forward looking test year, at type of test year which is used in this rider. A series of Private Letter Rulings notified Otter Tail of the issues. IRS Regulations provide the procedures and adjustments companies such as Otter Tail need to follow in order to be consistent with normalization accounting. By calculating the ADIT Pro-rate pursuant to IRS regulation, Otter Tail will avoid a potential normalization violation from the IRS and the loss of the ability to take accelerated depreciation.

BONUS DEPRECIATION AND NOL DEFERRED TAX ASSET

In 2015 Congress approved bonus depreciation and applies the bonus depreciation to equipment placed into service starting in 2015. The AQCS qualifies for this bonus depreciation. As note in the filing, the bonus depreciation is a primary contributor to the reduction in the revenue requirement and rate in this

filing. Due to the amount of bonus depreciation, a Net Operating Loss (NOL) position occurred for Otter Tail's 2015 tax year. The NOL carry forward can be used to offset future taxable income for Otter Tail.

CAPTIAL STRUCTURE CORRECTION

Through discovery, Otter Tail noticed an error in how the capital structure was being calculated. Staff DR1-4 provides an explanation into the correction of the capital structure error. This correction reduces the revenue requirement by approximately an additional \$56,000.

TRACKER BALANCE

The rate approved in Docket EL15-029 was based on the estimated revenue requirement for the time period November 2015 through October 2016. This filing updates the revenue requirement to actual costs through July 2016 and updated projected costs for August 2015 and thereafter. The Company's tracker account compares the updated revenue requirement to forecasted recoveries. A carrying charge (or credit) based on the overall rate of return is calculated on the over/under balance in the tracker. The estimated balance, including the carrying credit, as of October 31, 2016, is a \$284,465 over recovery plus an over recovery carrying credit of \$14,767. This over collection balance is carried over to this filing in the tracker account and reduces the revenue requirement by \$299,232.

NOVEMBER 1, 2016 – OCTOBER 23, 2017 REVENUE REQUIREMENT AND RATE

The total revised estimated revenue requirement of \$2,237,8658, subject to later true-up to actual costs and recoveries, is based on the over-collection in the tracker account and the estimated November 2016 through October 2017 revenue requirement associated with Big Stone AQCS and Hoot Lake MATS, the ADIT proration, less the projected carrying credit. These calculations are found on Attachments 3, 4, and 5 of the Petition.

Otter Tail's ECR continues to use a single rate per kWh applicable to all customers, calculated by taking the revenue requirement from November 2016 through October 2017 divided by the forecasted kWh from November 2016 through October 2017. A rate of \$0.00536 per kWh is calculated on Attachment 7 of the Petition. The average impact of this rate change for typical residential customer using 955 kWh per month is a decrease of approximately 1.15% or \$1.02. The estimated rate impact by customer class is shown on pages 11 and 12 of the Petition.

RECOMMENDATION

Staff recommends the Commission approve the revised revenue requirement of \$2,237,865, and the Environmental Cost Recovery Rider Charge of \$0.00536 for the November 1, 2016 through October 31, 2017 plan year the reasons stated above with an effective date of November 1, 2016.