

**STATE OF SOUTH DAKOTA
BEFORE THE
SOUTH DAKOTA PUBLIC UTILITIES COMMISSION**

In the Matter of Otter Tail Power
Company's Petition for Approval of
the Annual Update to Environmental
Cost Recovery Rider Charge,
Rate Schedule 13.08

**Docket No. EL17-

PETITION OF
OTTER TAIL POWER COMPANY**

I. INTRODUCTION

Otter Tail Power Company (Otter Tail or the Company) submits this Petition to the South Dakota Public Utilities Commission (Commission) for approval of its annual update (Update) to the Environmental Cost Recovery Rate under Otter Tail's Environmental Cost Recovery Rider (ECR or Rider), Rate Schedule 13.08. This Update results in a decrease to the total revenue requirement of approximately \$155,770, and a corresponding reduction in the ECR charge from \$0.00536 per kWh to \$0.00484 per kWh.

On December 10, 2014, the Commission approved Otter Tail's ECR tariff and charge for the Big Stone Plant's Air Quality Control System (AQCS) and Hoot Lake Plant's Mercury and Air Toxics Standards (MATS) projects in Docket No. EL14-082. On October 15, 2015, the Commission approved Otter Tail's first update to the ECR charge in Docket No. EL15-029. On October 31, 2016, the Commission approved Otter Tail's second update to the ECR charge in Docket No. EL16-030. Otter Tail now files its third update to the ECR charge for actual and forecasted Big Stone AQCS and Hoot Lake Plant MATS project cost and revenue information for the recovery period of November 2017 through October 2018.

This update includes one new tax-related item attributable to the AQCS project not included in previous annual updates. This tax item relates to a one-time depreciation deduction for Research and Experimental expenses as defined in Internal Revenue Code Section 174 (IRS

Section 174).¹ The AQCS project was eligible for a one-time tax deduction of approximately \$8.7 million in December 2015. This deduction was taken on Otter Tail's 2015 tax return which was finalized in late 2016, after the Company submitted its annual South Dakota ECR filing in Docket No. EL16-030. This tax related item is discussed in greater detail in the Revenue Requirement Components and Tracker section of this update and results in a reduction to the revenue requirement.

The rate impact of this request **decreases** the ECR charge from \$.00536 per kWh to \$.00484 per kWh. For a residential customer using 1,000 kWh per month, the ECR charge will be approximately 5.6 percent of the customer's bill.

II. GENERAL FILING INFORMATION

A. Name, Address, and Telephone Number of the Utility.

Otter Tail Power Company
215 South Cascade Street
P.O. Box 496
Fergus Falls, MN 56538-0496
Phone (218) 739-8200

B. Name, Address, and Telephone Number of Utility Attorney.

Cary Stephenson
Associate General Counsel
Otter Tail Power Company
215 South Cascade Street
P.O. Box 496
Fergus Falls, MN 56538-0496
Phone (218) 739-8956

C. Title of Utility Employee Responsible for Filing.

Scott Ruud
Rates Analyst, Regulatory Administration
Otter Tail Power Company
215 South Cascade Street
P.O. Box 496

¹ U.S. Revenue Code § 174 available at <https://www.law.cornell.edu/uscode/text/26/subtitle-A/chapter-1/subchapter-B/part-VI>.

Fergus Falls, MN 56538-0496
(218) 739-8896

D. Date of Filing and the Date Changes Will Take Effect.

The date of this filing is August 31, 2017. Otter Tail proposes that the tariff mechanism for the recovery of jurisdictional costs of these environmental projects be effective on bills rendered on and after November 1, 2017.

E. Statutes and Rules Controlling Schedule for Processing the Filing.

ARSD Part 20:10:13:15 requires a 30-day notice to the Commission of a proposed change in a utility's tariff schedule, after which time the proposed changes take effect unless suspended. Because no determination of Otter Tail's general revenue requirement is necessary, Otter Tail requests an expedited and informal proceeding, including any variances that may be necessary.

Attached to this filing is the Report of Tariff Schedule Change required by ARSD 20:10:13:26 (Attachment 1 – Report of Tariff Schedule Change).

In accordance with ARSD 20:10:13:18, Otter Tail will notify customers of the proposed changes to the ECR by posting notice thereof in each Otter Tail business office in South Dakota for at least 30 days before the change becomes effective. Otter Tail will also provide individual written notice to customers of the proposed changes in accordance with SDCL 49-34A-12. If the changes are approved by the Commission, Otter Tail will provide its South Dakota customers with individual written notice with the first bill for service under the new rate as outlined by ARSD 20:10:13:19. The proposed notice to be provided at implementation is included as Attachment 2.

The Commission previously approved Otter Tail's ECR rider under SDCL 49-34A-97, which grants the Commission authority to approve "a tariff mechanism for the automatic annual adjustment of charges for the jurisdictional capital cost and operating expenses incurred by a public utility for environmental improvements to its existing generation facilities." Eligible "environmental improvements" under SDCL 49-34A-97 include any "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.” SDCL § 49-34A-99 authorizes the Commission to approve annual rate adjustments to a tariff mechanism for environmental improvements. This filing is Otter Tail’s third application for an annual rate adjustment to its ECR charge.

III. BACKGROUND

On December 10, 2014, the Commission approved Otter Tail’s ECR tariff and charge in Docket No. EL14-082. On October 15, 2015, the Commission approved Otter Tail’s first update to the ECR charge in Docket No. EL15-029 effective November 1, 2015. On October 31, 2016, the Commission approved Otter Tail’s second update to the ECR charge in Docket No. EL16-030 effective November 1, 2016.

Otter Tail requests to update its ECR charge to reflect actual costs incurred through July 2017 and projected costs through October 2018 pursuant to its Electric Rate Schedule 13.08. As of July 2017, the AQCS total project budgeted amount is \$365.6 million (\$21.5 million Otter Tail South Dakota share). Previously approved capital costs of approximately \$6.5 million (\$640,000 Otter Tail South Dakota share) for the Hoot Lake Plant MATS project are also included.

As shown in the Tracker (Attachment 6), the projected revenue requirement for South Dakota is \$2,310,057 less a projected over recovery for the 2017 true-up of (\$216,115) and a carrying **credit** of (\$11,847) to the benefit of customers for a total revenue requirement of \$2,082,095 proposed to be recovered through the ECR over the period of November 1, 2017 through October 31, 2018. The forecasted over-collection as of October 2017 is primarily a result of incorporating the impact of the IRS Section 174 tax deduction, which is described in more detail in Section V. B. of this Petition.

IV. PROJECT DESCRIPTIONS

A. Big Stone Air Quality Control System

Otter Tail operates the Big Stone Plant (Big Stone) near Big Stone City, South Dakota. The Big Stone Plant is co-owned by NorthWestern Corporation d/b/a NorthWestern Energy,

Montana-Dakota Utilities Co., a Division of MDU Resources Group, Inc., and Otter Tail. The Big Stone AQCS project is described in detail in Docket Nos. EL14-142, EL15-029, and EL16-030.

The Big Stone AQCS became operational in December 2015. Since then, Big Stone Plant has incurred additional costs to operate and maintain the AQCS, the largest costs being chemical reagents (lime, powder activated carbon, and anhydrous ammonia) used to control emissions. The Commission approved recovery of chemical reagent costs through the Fuel Adjustment Clause Rider in Docket No. EL14-070, on September 18, 2014.

Otter Tail includes updated revenue requirement information in Attachment 3 to this filing. Otter Tail's total project costs of the Big Stone AQCS are approximately \$204.3 million (Total Company). Otter Tail's South Dakota jurisdictional share of this cost responsibility is approximately \$20.3 million based on the blended D1/E1 factor of 9.9535 percent.²

B. Hoot Lake Plant MATS Project

The MATS project became operational in October 2014. Otter Tail upgraded its Hoot Lake Plant Units #2 and #3 electrostatic precipitators (ESP) to comply with the MATS. Compliance with MATS was required by April 16, 2015. Otter Tail reviewed various compliance options including retiring the Hoot Lake Plant in 2015 and replacing the generation (most likely with natural gas generation), refurbishing the Hoot Lake Plant to operate as a Coal Unit for long-term operation, or installing near-term required upgrades and planning for retirement in the 2020 timeframe.

Otter Tail includes updated revenue requirement information in Attachment 4 to this filing. The Hoot Lake Plant MATS actual project cost was \$6.5 million (Total Company), including AFUDC. Otter Tail's South Dakota jurisdictional share of this cost responsibility is approximately \$0.6 million based on the blended D1/E1 factor of 9.9535.

² South Dakota jurisdictional allocation factors approved in Otter Tail's last general rate case Docket No. EL08-030.

V. REVENUE REQUIREMENT COMPONENTS AND TRACKER

A. Components of the Revenue Requirements Calculation

Attachment 3 shows the revenue requirement calculation for the Big Stone AQCS and Attachment 4 shows the revenue requirement calculation for the Hoot Lake MATS project. The revenue requirement for these projects includes the components as described below.

- *Rate base section.* This section provides details on the amount of plant in service, accumulated depreciation, construction work in progress (CWIP), accumulated deferred taxes, and includes a 13-month average rate base calculation.
- *CWIP.* SDCL § 49-34A-25.2 allows a current return on CWIP.
- *Expense section.* The expenses applicable to a project are listed here and include operating costs, property taxes, and income taxes.
- *Revenue requirements section.* This section shows the components of the revenue requirements. Included are the items computed from the sections previously mentioned, including expenses and return on rate base.
- *Return on investment (cost of capital).* While projects are under construction they use the year end short-term and long-term debt balance and rate as well as the year-end total company equity balance and rate. Once a project is in service the year end long-term debt balance and rate and the year-end total company equity and rate are used.
- *Depreciation expense.* Depreciation expense is calculated using Otter Tail's current composite depreciation rate.
- *Property taxes.* The property tax calculation is based on Otter Tail's composite tax rate for the jurisdiction in which the environmental retrofit facilities are located, and are calculated in accordance with the procedures specified by that state.
- *Operation and maintenance (O&M) expense.* The Company includes O&M costs specifically associated with the AQCS project in this rider. Reagent costs are not included in either project. Otter Tail received Commission approval to collect those costs through the Fuel Adjustment Clause Rider on September 18, 2014 in Docket No. EL14-070.

- Proration of Accumulated Deferred Income Tax (ADIT).* The proration of Federal ADIT was first incorporated into the ECRR in Docket No. EL16-030 after Otter Tail became aware of the requirement per Internal Revenue Service (IRS) normalization rules. Otter Tail provides Attachment 5 to this filing to show the Federal ADIT proration calculation impact on the revenue requirement for the recovery period.

In Otter Tail's next annual update to its ECRR, actual ADIT balances will replace the federal prorated forecast ADIT amounts included in this filing. Line 7 of Attachment 3 (AQCS) shows the monthly proration factor that is applied to the monthly calculations on lines 6 and 8. Line 5 of Attachment 4 (MATS) shows the monthly proration factor that is applied to the monthly calculations on line 6. The impact of the Federal ADIT proration reduces the revenue requirement by approximately \$1,580 as shown on Attachment 5.
- Net Operating Loss (NOL) Position.* Because of the significant capital investment by Otter Tail in 2015, the impact of taking bonus depreciation created a Tax NOL for 2015. The Deferred Tax Asset balance for the AQCS project at December 31, 2016 was approximately \$14.7 million (Total Company), as found in Attachment 3, line 5. Otter Tail anticipates this NOL balance to be reduced to \$0 by the end of 2017 as it is offset by taxable income.

B. Details of Tax Updates

Depreciation Deduction for AQCS Project

As noted above, Otter Tail took a one-time \$8.7 million depreciation deduction related to Research and Experimental expenses as defined in Internal Revenue Code Section 174 for its 2015 taxes. For the Big Stone Plant, the development of the AQCS was a major facility upgrade that caused the Company to develop a customized system to comply with Environmental Protection Agency requirements. For financial accounting purposes, taxpayers generally capitalize a variety of costs incurred in the development of self-constructed facilities and equipment. Otter Tail engaged an outside firm to conduct an embedded cost review to among other things identify opportunities to deduct (or amortize ratably over a shorter life) certain costs that are otherwise capitalizable into the cost basis of depreciable assets. This review identified deductible Research and Experimental expenses, as those terms are defined in IRS Section 174.

This allowed for a one-time \$8.7 million depreciation deduction taken with Otter Tail’s 2015 tax statements, which were completed in late 2016. Otter Tail includes this reduction to rate base in this filing. This deduction results in an approximately \$40,000 reduction to the revenue requirement for 2017-2018 recovery period.

C. Tracker Balance

Otter Tail maintains a tracker account worksheet and accounting system to track and account for retail revenue requirements until all costs have been fully recovered or reflected in base rates as the result of a general rate case. The tracker account information compares Otter Tail’s South Dakota jurisdictional costs, as described in section V(A), and the amount recovered through South Dakota retail revenue. The tracker account balance (either positive or negative) accrues monthly carrying charges at a rate of 1/12 of Otter Tail’s cost of capital times the tracker balance. Carrying charges on negative tracker balances, as is the case in this annual filing, accrue to the benefit of retail customers in the amount of (\$11,847). The tracker balance detail is included in Attachment 6.

VI. RATE DESIGN

Otter Tail continues to use the rate design approved in prior ECR dockets by calculating the revenue requirement from November 2017 through October 2018 by dividing the total forecast kWh for South Dakota electric retail customers for the same period. The rate design calculation is shown on Attachment 7.

VII. RATE APPLICATION AND IMPACT

Otter Tail proposes that the ECR continue to be applicable to electric service under all of Otter Tail’s retail rate schedules. The charge is shown on the “Environmental Cost Recovery” line on customers’ bills. The proposed rate for the recovery period is as follows:

Customers	Amount
All Customers	\$ 0.00484/kWh

The following table shows the estimated rate impact by retail customer class comparing the monthly bill impact of the current rate that is in effect, to the proposed (reduced) rate in this filing.

Rate Class	*Average Data		Monthly Impact		
	955	kWh/bill	avg. \$ current ECR	\$5.12	
Residential	\$82.79	avg. \$ / bill before ECR	avg. \$ proposed ECR	\$4.62	
			Proposed Change	-\$0.50	-0.56%
	1,640	avg. kWh/bills	avg. \$ current ECR	\$8.79	
Farm	\$132.43	avg. \$ / bill before ECR	avg. \$ proposed ECR	\$7.94	
			Proposed Change	-\$0.85	-0.60%
General	2,854	avg. kWh/bills	avg. \$ current ECR	\$15.30	
Service	\$228.23	avg. \$ / bill before ECR	avg. \$ proposed ECR	\$13.81	
			Proposed Change	-\$1.48	-0.61%
Large	311,119	avg. kWh/bills	avg. \$ current ECR	\$1,667.60	
General Srvc	\$17,372.08	avg. \$ / bill before ECR	avg. \$ proposed ECR	\$1,505.82	
			Proposed Change	-\$161.78	-0.85%
Irrigation	1,843	avg. kWh/bills	avg. \$ current ECR	\$9.88	
	\$128.28	avg. \$ / bill before ECR	avg. \$ proposed ECR	\$8.92	
			Proposed Change	-\$0.96	-0.69%
Outdoor	83	avg. kWh/bills	avg. \$ current ECR	\$0.44	
Lighting	\$11.10	avg. \$ / bill before ECR	avg. \$ proposed ECR	\$0.40	
			Proposed Change	-\$0.04	-0.37%
Municipal	2,647	avg. kWh/bills	avg. \$ current ECR	\$14.19	
Pumping	\$162.14	avg. \$ / bill before ECR	avg. \$ proposed ECR	\$12.81	
			Proposed Change	-\$1.38	-0.78%
Water Heating	220	avg. kWh/bills	avg. \$ current ECR	\$1.18	
Controlled	\$14.77	avg. \$ / bill before ECR	avg. \$ proposed ECR	\$1.06	
			Proposed Change	-\$0.11	-0.72%
Interruptible	2,166	avg. kWh/bills	avg. \$ current ECR	\$11.61	
Load	\$88.60	avg. \$ / bill before ECR	avg. \$ proposed ECR	\$10.48	
			Proposed Change	-\$1.13	-1.12%
Deferred	2,775	avg. kWh/bills	avg. \$ current ECR	\$14.87	
Load	\$123.74	avg. \$ / bill before ECR	avg. \$ proposed ECR	\$13.43	
			Proposed Change	-\$1.44	-1.04%

*All average data comes from Otter Tail's proposed rates in Statement I that was filed in compliance to the SD PUC's Order (Docket No. EL10-011) on April 21, 2011

The above charges are calculated based on an expected implementation date of November 1, 2017. Revenue Requirement calculations are based on the November 2017 through October 2018 estimated costs and forecasted prior recovery period true-up. If the effective date is significantly later than November 1, 2017, Otter Tail requests the option to recalculate the ECR charge in order to recover all approved costs in the remainder of the collection period.

VIII. ENVIRONMENTAL COST RECOVERY RIDER RATE SCHEDULE

Otter Tail’s revised Rate Schedule 13.08 is provided as Attachment 8 to this Petition, in both redline and clean formats.

IX. FILING FEE

Under SDCL 49-1A-8, the Commission may require a deposit of up to fifty thousand dollars for the filing of a tariff for approval under the provisions of § 49-34A-4 and §§ 49-34A-25.1 to 49-34A-25.4, inclusive, or makes a filing pursuant to §§ 49-34A-97 to 49-34A-100. Otter Tail will pay such deposit amount as the Commission determines appropriate upon the Commission’s Order assessing such fee.

X. CONCLUSION

Otter Tail respectfully requests the Commission approve the updated ECR charge to become effective November 1, 2017, based on the tracker activity.

Date: August 31, 2017

Respectfully submitted,
OTTER TAIL POWER COMPANY

/s/ SCOTT RUUD
Scott Ruud
Rates Analyst,
Regulatory Administration
215 South Cascade Street
P.O. Box 496
Fergus Falls, MN 56538-0496
Phone (218) 739-8896