STAFF MEMORANDUM

TO: COMMISSIONERS AND ADVISORS

FROM: BRITTANY MEHLHAFF, LORENA REICHERT, AND AMANDA REISS

RE: EL17-048 - In the Matter of the Petition of Otter Tail Power Company for Approval of the Transmission Cost Recovery Rider Rate

DATE: February 16, 2018

BACKGROUND

On November 1, 2017, 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 Recovery Rider (TCR) rates. The proposed revised TCR rates reflect the TCR revenue requirements for March 1, 2018 through February 28, 2019, including the tracker balance estimated for the end of the current period.

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.

In Docket EL10-015, the Commission approved the establishment of TCR rates to recover the costs associated with three transmission 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. This method was refined in Docket EL12-054. In subsequent years, the Commission approved recovery of additional projects and expenses.

Most recently, in Docket EL16-035, the Commission approved TCR recovery of the 2017 revenue requirement 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 and 26A expenses.

The 2017 TCR implemented the following rates for each customer class 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

In this filing, OTP initially requested to recover a projected March 1, 2018 through February 28, 2019 revenue requirement of $1,772,184 associated with the eight previously approved transmission projects, SPP Schedule 9 and Schedule 11 expenses, and MISO Schedule 26 expenses. The Company does not request recovery of any new projects with this update. The request includes the Company's proposal to return to customers an estimated $209,275 in over-collection of the prior period's remaining balance. The Company's initially proposed March 1, 2018 through February 28, 2019 revenue requirement results in the following rates for the respective customer classes, based on a March 1, 2018, effective date:

Class	¢/kWh	$/kW
Large General Service	0.186	0.547
Controlled Service	0.087	N/A
Lighting	0.333	N/A
All Other Service	0.610	N/A

STAFF'S ANALYSIS AND UPDATES

Staff's recommendation is based on its analysis of OTP's filing, discovery information, relevant statutes, and previous Commission orders. Staff's analysis consisted of review of the revenue requirement calculation, class allocation, and rate design. Each of these items are discussed below.

REVENUE REQUIREMENT

Staff reviewed the tracker report for the previous period (March 1, 2017 through February 28, 2018), including review of the actual costs to ensure the costs were prudent and at the lowest reasonable cost to ratepayers and the calculation of the under/over collection balance to be incorporated in the new TCR rates. Staff also reviewed the forecasted March 1, 2018 through February 28, 2019 revenue requirement associated with the existing transmission projects, MISO Schedule 26 and 26A expenses and revenues, SPP Schedule 7, 8, & 9 expenses, SPP Schedule 11 expenses, MISO Schedule 9 Revenues, MISO Schedule 37 & 38 Revenues, MISO Multi-Value Project (MVP) Auction Revenue Rights (ARR) Revenues, and filing fee expense. Detailed descriptions of each of these cost/revenue categories are contained in OTP's initial Petition in this docket.

Supplemental Filing

OTP and Staff identified updates to be incorporated into the Company's proposed revenue requirement and OTP submitted a Supplemental Filing on January 29, 2018, to reflect these updates. Staff agrees with OTP's updated 2018 revenue requirement of $1,788,992, including an over-collection of $208,321. This represents an increase of approximately $7,000 from OTP's initial Petition filed on November 1, 2017.

The March 1, 2018 through February 28, 2019 TCR is based on estimated costs of eligible transmission projects subject to later "true-up" to reflect the actual costs and actual recoveries. Table 1 on page 4 of

OTP's Supplemental Filing provides a comparison of the Company's originally filed revenue requirement to the revised revenue requirement and pages 1, 2, and 3 provides descriptions of the changes made from the initial filing.

Staff agrees with the changes made, and the following paragraphs provide a brief recap of these changes.

Updated Capital Costs, Revenues, and Expenses

The originally filed TCR was based on actual data through September 2017 and projected activity beginning October 2017. OTP's Supplemental Filing provides an updated report of actual costs and revenues through December 2017. This includes updates to the capital costs, expenses, and revenues for each project as well as MISO expenses and revenues. OTP also updated the MISO forecasts for January 2018 forward. These changes result in an increase to the revenue requirement of approximately $25,000.

Revised Attachment 2 provided with the Company's Supplemental Filing provides a summary of revenue requirements and Revised Attachment 4 summarizes the tracker activity by month. Individual project detail for the eight previously approved projects is found on Attachments 5 through 12. Revised Attachments 13 through 22 provide details regarding the remaining revenue requirement components.

Tax Cuts and Jobs Act

Staff requested that the Company revise the initial filing to include the impacts from the Tax Cuts and Jobs Act (TJCA) to the TCR. In the Supplemental Filing, the corporate tax rate of 21 percent is reflected effective January 1, 2018 and bonus depreciation was eliminated at the end of third quarter 2017 for applicable projects. These changes result in a decrease to the revenue requirement of approximately $26,000. However, the MISO attachments still reflect a 35 percent federal income tax rate. According to the Company, the changes to these revenues and expenses as a result of the TCJA will be trued up in future TCR updates as the MISO Transmission Owners are currently reviewing the affected tariff.

Capital Structure and Cost of Debt

The initial filing used a capital structure and cost of debt as of December 31, 2016, to calculate the 2018 revenue requirements. OTP updated its 2018 revenue requirement calculation to include a December 31, 2017, capital structure and cost of debt. This update increases the revenue requirement by approximately $6,000.

Proration of Federal ADIT

Upon further analysis, the Company determined the accumulated deferred income tax balances should be revised in order to preserve the effect of the application of the proration methodology for the true-up period, in compliance with IRS regulations. This correction increases the 2018 revenue requirement by approximately $2,000.

As stated above, the net result of these changes is an increase of approximately $7,000 to the revenue requirement initially proposed by the Company. Staff next discusses specific revenue requirement topics of interest.

Project Cost Sharing

OTP's TCR continues to apply the refined split methodology approved in Docket EL12-054 for projects cost-shared in MISO. Previous Staff Memorandums, including the memorandum filed in Docket EL12-054, provide a detailed description of the methodology. Should the Commission desire a review of this methodology, a synopsis can be found on pages 5 and 6 of the Staff Memorandum filed in Docket EL16-035[1].

Staff further notes that SPP Schedule 11 expenses are similar to MISO Schedule 26 and 26A expenses, but an analysis of the applicability of a refined split method does not apply because OTP does not have any transmission investments in the SPP system and therefore OTP is only allocated expenses.

SPP Schedule 7, 8, and 9 Expense and MISO Schedule 9 Revenue

As discussed in Dockets EL15-045 and EL16-035, 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 subjected 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 7, 8, and 9 expenses, it has a $118,778 impact on the revenue requirement. As noted in OTP's Petition, the Company received more MISO Schedule 9 revenues from CPEC than originally forecasted in EL16-035. The major factor contributing to this increased revenue was due to a CPEC load correction from 2016 that occurred in 2017.

Staff requested OTP provide an update on the settlement discussions related to CPEC's integration into SPP. OTP relayed that it formally withdrew its protest in the CPEC integration docket (but not its

[1] http://www.puc.sd.gov/commission/dockets/electric/2016/el16-035/memo.pdf

intervention), due to a lack of progress during settlement discussions. OTP stated it 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/or obtaining SPP facility credits. OTP further stated that it is still engaged in negotiations with CPEC regarding "other facets of the termination of the Integrated Transmission Agreement (ITA) and corresponding integration under the appropriate Regional Transmission Organization (RTO) tariffs. Otter Tail will continue providing updated information and revised rate calculations to South Dakota in future filings."

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 by any means, these changes will be reflected in the true-up mechanism in future TCR dockets.

SPP Expense Variations

OTP noted on page 12 of its Petition that it had less load subject to SPP expenses during 2017 than originally forecasted in EL16-035. In response to discovery, OTP explained that its load subject to SPP expenses can vary due to the configuration of the existing transmission system, the construction of new transmission facilities, weather patterns, and load growth patterns. As an example, the Company noted that if "the existing transmission system is switched into an abnormal state (due to storms, maintenance, equipment failures, etc.), it is likely that Otter Tail will incur additional SPP transmission service expenses because loads normally served from transmission facilities under MISO's tariff could be switched into being served from transmission facilities under SPP's tariff. Otter Tail acquires additional SPP transmission service during abnormal switching conditions by securing firm point-to-point (Schedule 7) or non-firm point-to-point (Schedule 8) transmission service because these types of transmission service can be acquired for a shorter timeframe than network integration transmission service (Schedule 9)."

CLASS ALLOCATION AND RATE DESIGN

The TCR continues to incorporate the class allocation and rate design methodology approved in prior dockets. The revenue requirement is allocated to four customer classes based on the transmission demand allocation factor, D2, from OTP's most recent rate case, Docket EL10-011. Rates for each customer class are then designed based on forecasted sales for the time period rates will be in effect. Projected sales for each class are created by econometric models using various inputs such as weather data, economic data, customer counts, and historical usage. 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

As established per settlement stipulations in prior TCR dockets, 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 $1,778,992 revenue requirement for the March 1, 2018 through February 28, 2019 plan year. This results in the following rates being effective March 1, 2018:

Class	¢/kWh	$/kW
Large General Service	0.187	0.549
Controlled Service	0.087	N/A
Lighting	0.334	N/A
All Other Service	0.612	N/A