STAFF MEMORANDUM

TO: COMMISSIONERS AND ADVISORS

FROM: PATRICK STEFFENSEN AND KRISTEN EDWARDS

RE: EL19-039 - In the Matter of the Petition of Otter Tail Power Company for Approval of the Transmission Cost Recovery Rider Rate

DATE: February 12, 2020

BACKGROUND

On October 31, 2019, 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, 2020 through February 28, 2021, 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 Midcontinent Independent System Operator (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, which were ultimately rolled into base rates in rate case docket EL18-021.

Most recently, in Docket EL18-048, the Commission approved TCR recovery of the 2019 revenue requirement associated with two new transmission projects (Lake Norden Area Transmission Improvements and Big Stone South to Ellendale), a transmission adjustment from rate case EL18-021, Southwest Power Pool (SPP) Schedule 9 and Schedule 11 expenses, and MISO Schedule 26 and 26A expenses, offset by MISO Schedule 9, Schedule 26 and 26A, and Multi-Value Project (MVP) Auction Revenue Rights (ARR) revenues. The 2019 TCR implemented the following rates for each customer class effective October 1, 2019:

Class	¢/kWh	$/kW
Large General Service	0.279	1.033
Controlled Service	0.092	N/A
Lighting	0.401	N/A
All Other Service	0.706	N/A

In this filing, OTP initially requested to recover a projected March 1, 2020 through February 28, 2021 revenue requirement of $2,407,824 associated with the two previously-approved transmission projects, the transmission adjustment from rate case EL18-021, SPP Schedule 9 and Schedule 11 expenses, and MISO Schedule 26 and 26A expenses, offset by MISO Schedule 9, Schedule 26 and 26A, and MVP ARR revenues. The request includes the Company's proposal to collect from customers an estimated $83,738 in under-collection of the prior period's remaining balance. The Company's initially proposed March 1, 2020 through February 28, 2021 revenue requirement results in the following rates for the respective customer classes, based on a March 1, 2020, effective date:

Class	¢/kWh	$/kW
Large General Service	0.232	0.738
Controlled Service	0.108	N/A
Lighting	0.372	N/A
All Other Service	0.705	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, 2019 through February 29, 2020), 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, 2020 through February 28, 2021 revenue requirement associated with the two previously-approved transmission projects, the transmission adjustment from rate case EL18-021, MISO Schedule 26 and 26A expenses and revenues, SPP Schedule 9 and Schedule 11 expenses, MISO Schedule 9 and MVP 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, 2020, to reflect these updates. Staff agrees with OTP's updated 2020 revenue requirement of $2,327,178, including an over-collection of $152. This represents a decrease of approximately $81,000 from OTP's initial Petition filed on October 31, 2019.

The March 1, 2020 through February 28, 2021 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 and 2 provide 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, Expenses, and Sales

The originally filed TCR was based on actual data through September 2019 and projected activity beginning October 2019. OTP's Supplemental Filing provides an updated report of actual costs and revenues through December 2019. This includes updates to the capital costs, expenses, and revenues for each project, MISO expenses and revenues, and OTP sales. OTP also updated the MISO forecasts for January 2020 forward. These changes result in a decrease to the revenue requirement of approximately $69,000.

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 two previously-approved projects, Lake Norden Area Transmission and Big Stone South to Ellendale MVP, is found on Revised Attachments 5 and 6, respectively. Revised Attachments 7 through 17 provide details regarding the remaining revenue requirement components.

Capital Structure and Cost of Debt

The initial filing used a capital structure and cost of debt as of December 31, 2018, to calculate the 2020 revenue requirements. OTP updated its 2020 revenue requirement calculation to include a December 31, 2019, capital structure and cost of debt. This update decreases the revenue requirement by approximately $12,000.

Class Allocation True-up

The TCR incorporates the class allocation and rate design methodology approved in rate case EL18-021. The revenue requirement is allocated to four customer classes based on the transmission demand allocation factor, D2, from OTP's rate case EL18-021. 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.

In Docket EL18-048, OTP agreed to track revenue requirements, billings, and the resulting over- or under-recovery by rate class, as opposed to the prior way of tracking at the total revenue requirement and total billings level. This change begins with this TCR filing and will ensure that TCR true-ups will accurately reflect the class allocations as determined in rate case EL18-021 and minimize cross-class subsidization in the future.

In the initial filing, OTP attempted to accomplish this by reallocating the cumulative under-recovery amount but didn't actually track revenue requirements and billings by class to obtain class-specific over- and under-recoveries. Thus, if there were no cumulative over- or under-recovery in a given year, any cross-class subsidies from the prior year would not be resolved.

The Supplemental Filing correctly tracks revenue requirements and billings by class to obtain class-specific over- and under-recoveries as shown on Revised Attachment 4A. This change does not have an impact on the total revenue requirement; however, it does change each of the classes' responsibility of the revenue requirement, as shown on Revised Attachment 3.

MISO ROE Complaints at the FERC

On November 21, 2019, the Federal Energy Regulatory Commission (FERC) adopted a new methodology for determining whether a jurisdictional public utility's rate of return on equity (ROE) is just and reasonable. When FERC applied the new methodology to the pair of complaints explained in OTP's filing, the FERC determined that MISO transmission owners' current base ROE should be 9.88 percent. Given the uncertainty regarding the timing and ultimate outcome of appeals, OTP and Staff believe it best to not make any hasty revisions at this time and include any revisions as a true-up in next year's TCR filing or the next suitable annual update filing.

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.

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 prior OTP TCR dockets, 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 9 expense, it increases the revenue requirement by $79,352.

OTP has indicated that it continues to take any necessary actions to reduce SPP expenses and gain more long-term certainty of the existing interconnections with CPEC in the future. Otter Tail will continue exploring additional opportunities to reduce SPP expenses in the future and 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. If OTP can lessen the impacts on ratepayers by any means, these changes will be reflected in the true-up mechanism in future TCR dockets.

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 $2,327,178 revenue requirement for the March 1, 2020 through February 28, 2021 plan year. Staff would note that there is only a $0.02 impact on an average residential customer's monthly bill; however, given the changes for the other classes and the change in this filing to track over- and under-recoveries by class, Staff recommends the Commission approve the following rates to be effective March 1, 2020:

Class	¢/kWh	$/kW
Large General Service	0.214	0.679
Controlled Service	0.117	N/A
Lighting	0.367	N/A
All Other Service	0.704	N/A