STAFF MEMORANDUM

TO: COMMISSIONERS AND ADVISORS

FROM: BRITTANY MEHLHAFF AND KRISTEN EDWARDS

RE: EL21-031 - In the Matter of the Petition of Otter Tail Power Company for Approval of the Transmission Cost Recovery Rider Rate

DATE: February 15, 2022

BACKGROUND

On October 29, 2021, 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 (Otter Tail 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, 2022 through February 28, 2023, 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 and Otter Tail continues to apply the refined split method for MISO Schedule 26 and 26A expenses today.[1]

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 EL20-032, the Commission approved TCR recovery of the 2021 revenue requirement associated with two previously-approved transmission projects (Lake Norden Area Transmission Improvements and Big Stone South to Ellendale), two new transmission projects (Erie-Frazee and Grant County-Norcross), 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 2021 TCR implemented the following rates for each customer class effective March 1, 2021:

[1] See Docket EL16-035 Staff Memorandum, pages 5 and 6 for a synopsis of the refined split methodology.

Class	¢/kWh	$/kW
Large General Service	0.229	0.686
Controlled Service	0.120	N/A
Lighting	0.421	N/A
All Other Service	0.618	N/A

In this filing, Otter Tail initially requested to recover a projected March 1, 2022 through February 28, 2023 revenue requirement of $2,088,644 associated with the same projects, expenses, and revenues included in the 2021 revenue requirement. The Company did not request inclusion of any new projects. The request includes the Company's proposal to return to customers an estimated $411,847 in over-collection of the prior period's remaining balance. The Company's initially proposed March 1, 2022 through February 28, 2023 revenue requirement results in the following rates for the respective customer classes, based on a March 1, 2022, effective date:

Class	¢/kWh	$/kW
Large General Service	0.219	0.692
Controlled Service	0.116	N/A
Lighting	0.804	N/A
All Other Service	0.585	N/A

STAFF'S ANALYSIS AND UPDATES

Staff's recommendation is based on its analysis of Otter Tail'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, 2021 through February 28, 2022), 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, 2022 through February 28, 2023 revenue requirement associated with the four 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 Otter Tail's initial Petition in this docket.

The following sections provide Staff's analysis of Otter Tail's Supplemental Filing, updates regarding the impact to Otter Tail customers of SPP expenses, and the forthcoming new load which will impact MISO expenses.

Supplemental Filing

Otter Tail identified updates to be incorporated into the Company's proposed revenue requirement and Otter Tail submitted a Supplemental Filing on January 28, 2022, to reflect these updates. Staff agrees with Otter Tail's updated 2022 revenue requirement of $2,197,832, including an over-collection of $314,096. This represents an increase of $109,188 from Otter Tail's initial Petition filed on October 29, 2021.

The March 1, 2022 through February 28, 2023 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 3 of Otter Tail'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.

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 previously-approved projects are found on Revised Attachments 5 through 8. Revised Attachments 9 through 19 provide details regarding the remaining revenue requirement components. The following paragraphs provide a brief discussion of the changes presented in the supplemental filing.

Updated Project Capital Costs, Expenses, and Revenues

The originally filed TCR was based on actual data through September 2021 and projected activity beginning October 2021. Otter Tail's Supplemental Filing provides an updated report of actual data through December 2021 as well as forecasts for January 2022 and forward. These updates decrease the revenue requirement by approximately $10,500.

Updated MISO Expenses and Revenues

Otter Tail's Supplemental Filing updated MISO expenses and revenue with actual data through December 2021 and updated forecasts where new information was available for January 2022 and forward. The Company also identified amounts associated with the MISO ROE settlements that needed to be adjusted. Otter Tail began including the impacts of the refunds associated with the MISO ROE Complaints at the Federal Energy Regulatory Commission (FERC) in last year's TCR filing as MISO began processing the refund for the first complaint period in 2020.

FERC's initial decision on the first complaint was issued in 2016 and granted approval of a 10.32% base ROE plus applicable adders (a 50-basis point adder is applicable to Otter Tail). FERC subsequently set the MISO base ROE at 9.88% plus applicable adders and required refunds be made for the period where the 10.32% base ROE was in effect. However, in 2020, FERC issued an Opinion increasing the base ROE to 10.02%. Given the ROE changed several times throughout this process, it resulted in some partial refunds being completed and needing to be revised, which caused either additional refunds or surcharges to customers. For periods in which MISO resettled amounts that had already come through as ROE resettlements in prior periods, Otter Tail describes as "re-resettlement" amounts.

In Otter Tail's initial filing, some MISO ROE "resettlement" amounts were incorrectly double counted and some "re-resettlement" amounts were input into the rider with the wrong sign which needed to be reversed as they should have the opposite sign of regular resettlements. The majority of these corrections were made to 2021 amounts; however, corrections were identified for 2020 also which are accounted for and flow through the tracker account. In sum, the MISO updates resulted in an approximately $79,500 increase to the revenue requirement. Otter Tail identified that approximately $61,500 of the $79,500 change is due to the MISO ROE settlement corrections for 2020 and 2021,[2] and the remaining increase is due to updates.

Sales Updates

Otter Tail updated actual sales through December 2021 from the forecasted data provided in the initial filing, which results in an approximate $38,000 increase to the revenue requirement due to actual sales being lower than forecasted.

Capital Structure and Cost of Debt

The initial filing used a capital structure and cost of debt as of December 31, 2020, to calculate the 2022 revenue requirements. Otter Tail updated its 2022 revenue requirement calculation to include a December 31, 2021, capital structure and cost of debt. This update increases the revenue requirement by approximately $2,000.

SPP Related Expenses

As discussed in prior Otter Tail TCR dockets, in 1958, Central Power Electric Cooperative, Inc. (CPEC) and Otter Tail entered into an agreement which 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. In 2016, CPEC placed some of its facilities, including facilities in the ITS, under the SPP tariff. As a result, Otter Tail is dependent on SPP transmission service in order to serve its load. This has subjected Otter Tail to Schedule 9 of SPP's tariff to obtain Network Integration Transmission Service (NITS). Under NITS, Otter Tail and its customers receive the highest level of curtailment priority on CPEC's facilities. This firm service is comparable to the service CPEC has obtained on these facilities to reliably serve their native customers.

Similar to Otter Tail paying for use of CPEC's system in SPP, CPEC needs to pay for their use of Otter Tail's system in MISO. This was also effective January 1, 2016 and flows through to Otter Tail and its customers as a revenue under MISO's Schedule 9. As provided in the Supplemental Filing, when MISO's Schedule 9 revenue is netted against SPP Schedule 9 expenses, it results in a net impact to the revenue requirement of $138,759. The net impact to Otter Tail's customers is increasing due to MISO Schedule 9 revenues decreasing largely due to two factors: (1) CPEC building its own transmission facilities and (2) an increase in 30.9 facility credits received by CPEC in MISO. Otter Tail has relayed to Staff this trend of

[2] Otter Tail response to Staff's Informal Request 1.

lower MISO Schedule 9 revenues is expected to continue in the future, but Otter Tail has put safeguards in place to ensure that MISO Schedule 9 Revenues will never drop below zero.[3]

Otter Tail 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. These cost reduction efforts have primarily included building new facilities to avoid using CPEC facilities and obtaining SPP 30.9 facility credits. Otter Tail has stated it will continue exploring opportunities to reduce SPP expenses in the future and will continue providing updated information in future filings.

In response to Staff[4], Otter Tail provided that its efforts to evaluate new facilities to bypass the SPP system have not been completed. Although Otter Tail was required to renew part of its existing SPP transmission service in 2021 in order to ensure service is not interrupted, Otter Tail elected to only extend its existing SPP transmission service for five years. Otter Tail stated this extension allows Otter Tail to maintain rollover rights of its existing transmission service but does not commit Otter Tail to taking SPP transmission service beyond the next five years, allowing the continued evaluation of building new facilities to potentially bypass the SPP system.

New Material Load Impacting MISO Expenses

Staff noted increasing MISO expenses in 2022, notably Schedule 26A expenses. As shown in the Supplemental Filing, Actual 2021 Schedule 26A expenses were $726,274 and 2022 Schedule 26A expenses are projected to be $858,990. This is an increase of approximately 18 percent. Schedule 26 expenses are expected to increase by a similar percentage from actual 2021 costs to projected 2022 costs, although actual 2021 costs came in less than projected in last year's filing. When Staff inquired as to the increased MISO costs, Otter Tail explained that a major driver is the load growth that Otter Tail is forecasting during 2022 for a new 100 MW load in North Dakota. Due to this load increasing Otter Tail's load ratio share in the MISO footprint, its MISO expenses will increase and will ultimately impact South Dakota customers.

In an application Otter Tail filed with the North Dakota Public Service Commission[5] for approval of a rate request for this customer to take service under Otter Tail's Super Large General Service rate schedule, the Company explained the 100 MW load customer will be constructing a data center for the purpose of computation including blockchain transaction verification and processing operations. The Company's Super Large General Service rate schedule in North Dakota operates similarly to Otter Tail's Super Large General Service rate schedule approved in South Dakota, where the customer has a customized rate based on specific load characteristics and the investment needed to serve them. The intent of the negotiated rate is to ensure the very large customer, who doesn't fit the standard large general service characteristics, pays at the very least the marginal costs to serve this customer and that other customers are not harmed by the negotiated rate.

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[3] Otter Tail response to Staff's Informal Request 3.
[4] Otter Tail response to Staff's Informal Request 3.
[5] See NDPSC Docket PU-21-366

Otter Tail's North Dakota filing also addresses that the Company expects to experience an incremental allocation of costs related to MISO charges when this new load shifts cost responsibility among loads in the Otter Tail pricing zone. The Company stated that it "believes that any class-specific impacts do not warrant special consideration when viewed in the context of the overall 'scorecard' of customer benefits".[6] Otter Tail states that "[a]ll customers are materially advantaged from the addition of this new customer in the form of rider rate reductions and delays on base rate increases (and smaller future base rate increases when they occur)".[7] However, Staff questions whether these benefits are only for North Dakota customers and what the overall impacts are for South Dakota customers. These benefits may only be realized by South Dakota customers if jurisdictional allocation factors are adjusted to reflect the new load.

A new customer of this size should have a material impact on jurisdictional allocation factors and should result in a benefit to South Dakota customers due to the load being located in North Dakota. However, the jurisdictional allocation factor used in the TCR rider is based on the factor set in Otter Tail's last rate case. Staff believes all benefits and costs associated with this new customer load should be examined to ensure that South Dakota customers are not adversely affected by only including a cost associated with the new load in the rider and no benefits. After discussing with Otter Tail, it is Staff's understanding that Otter Tail also agrees that the benefits, in particular the impact on jurisdictional allocations, should be reviewed. Given the exact impacts of the new load are not known at this time given the customer is still in the process of completing its facility, Staff recommends Otter Tail provide additional details in its next TCR filing regarding all costs and benefits associated with this customer and specifically how these costs and benefits impact South Dakota customers. Staff further recommends Otter Tail include in the true-up any necessary adjustments for 2022.

CLASS ALLOCATION AND RATE DESIGN

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 Otter Tail'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.

Compared to the rates currently in effect, the proposed revised rates to be effective March 1, 2022 reflect a modest change for most classes. However, Staff noted the Lighting per kWh rate is proposed to double (0.421 ¢/kWh increasing to 0.843 ¢/kWh), due to the projected sales being substantially lower than from what was used to set the rate in the current recovery period. Otter Tail explained[8] that at the time the March 2021 – February 2022 TCR rates were set, replacement of existing street and area lighting to LED bulbs was occurring at a rate of about 0.5% per year. Since then, Otter Tail has

[6] NDPSC Docket PU 21-366 application, page 7.
[7] NDPSC Docket PU 21-366 application, page 8.
[8] Otter Tail response to Staff's Informal Request 5.

implemented a plan to replace existing bulbs to LEDs at a rate of approximately 18% per year. The Company states this replacement can reduce energy consumption up to 90% depending upon the size and type of bulb being replaced. Staff notes that the class allocation factors may need to be adjusted in the future due to this change.

In Docket EL18-048, Otter Tail 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 began in EL19-039 and ensures 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. The Supplemental Filing tracks revenue requirements and billings by class to obtain class-specific over- and under-recoveries as shown on Revised Attachment 4A.

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 $2,197,832 revenue requirement for the March 1, 2022 through February 28, 2023 plan year, with the following rates to be effective March 1, 2022:

Class	¢/kWh	$/kW
Large General Service	0.226	0.712
Controlled Service	0.124	N/A
Lighting	0.843	N/A
All Other Service	0.626	N/A

Staff further recommends Otter Tail file additional information in its next TCR filing regarding all costs and benefits associated with the new 100 MW load customer in North Dakota and specifically how these costs and benefits impact South Dakota customers. Staff further recommends Otter Tail include in the true-up any necessary adjustments for 2022.