

Memo

To: Darrell Nitschke, Executive Secretary
From: Mike Diller *MRD*
Date: June 29, 2010
Re: Otter Tail Renewable Resource Cost Recovery Adjustment Factor
Case No. PU-10-18

Attached is a staff response prepared by Larry Nyquist prior to his departure dated April 22, 2010. Larry completed the detailed review prior to his departure with only a few blanks to fill in after the reception of information requested. I filled in those blanks and left the rest unchanged.

I have reviewed the case to a lesser extent but having reviewed the case with Larry and my own analysis; I am comfortable recommending approval of the Project to the commission. However, I have not reviewed the compilation of the final recovery rate mechanism and request that a compliance filing is made before the commission acts on this case. Staff will review the compliance filing and issue a response as quickly as possible.

**STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION
ADVOCACY STAFF RESPONSE**

April 22, 2010

**Otter Tail Power Company
2010 Renewable Resource Cost Recovery Adj. Factor
Tariff**

Case No. PU-10-18

Application Background Information

On December 31, 2009, Otter Tail Power Company (“OTP”) filed an application for approval of its 2010 Renewable Resource Cost Recovery Adjustment Factor (“RRA”) under OTP’s Renewable Resource Cost Recovery Rider (“Renewable Rider”) and for advance determination of prudence (“ADP”) for its Luverne Wind Project (“Project”).

On January 13, 2010, the Public Service Commission (“Commission”) suspended OTP’s rates filed with its Renewable Rider and appointed Advocacy Staff to the Case.

On January 18, 2010, OTP filed an amended application for the 2010 RRA and removed the application for ADP for the Project. The amended application corrects an error in the table reflecting bill impact amounts shown on the bottom of page 11 of the original application. The removal of the request for ADP for the Project was made at the request of Commission Staff.

On February 11, 2010, Advocacy Staff sent an initial data request to OTP. Responses to the data request were received from OTP on March 11, 2010.

On February 24, 2010, the Commission issued a Notice of Opportunity for Hearing with the deadline for petitions to intervene of April 2, 2010 and the deadline for comments and requests for hearing of May 12, 2010.

On March 24, 2010, the Commission adopted the Order Granting Intervention to the North Dakota Large Industrial Energy Group.

On April 14, 2010, Advocacy Staff sent a second data request to OTP. Responses to the data request were received from OTP on April 23, 2010.

Project Description

The Project is a wind generation project located in Steele County approximately six miles north of Luverne, North Dakota. The Project is part of a larger wind energy generation center called the Luverne Wind Energy Center jointly developed by OTP and NextEra consisting of 113 General Electric wind turbines with an aggregate nameplate capacity of 169.5 MW. OTP's share is approximately 29 percent consisting of 33 wind turbines with an aggregate nameplate capacity of 49.5 MW, tower foundations, operational equipment, electric collection circuit lines, project substation, approximately 13 miles of 230 kV line, and real property interests.

OTP requested long-term firm transmission delivery service for the Project output under a Midwest Independent Transmission System Operator ("MISO") Transmission Service Request. If the long-term request was not confirmed by the operational date, OTP planned to request short-term firm service from MISO.

The Project went into commercial operation in mid-September 2009 below budget and a very low projected cost of energy. In fact, the cost of the Luverne Project is less than the Ashtabula Wind Project already approved by the Commission.

The Project was eligible for a 30 percent investment tax credit ("ITC") as part of the American Recovery and Reinvestment Act ("ARRA") of 2009. By OTP applying and receiving this Federal grant, rate base associated with the Project was also reduced by 30 percent which impacted the return to shareholders. However, this also allowed OTP to take advantage of other incentives, including bonus tax depreciation.

2010 RRA Description

The 2010 RRA includes actual revenue requirements and billed revenue information through October 2009 and projected revenue requirements and billed revenue information from November 2009 through March 2011 for investments in the Langdon, Ashtabula, and Luverne Wind Projects.

The currently effective RRA includes the revenue requirements and billed revenue associated with investments in the Langdon and Ashtabula Wind Projects. OTP is requesting the addition of the revenue requirements associated with its investment in the Luverne Wind Project along with updated costs associated with the Langdon and Ashtabula Wind Projects to be included the 2010 RRA.

OTP has used the allocation factor (38.830 percent) approved in its most recent rate case to arrive at North Dakota's share of total revenue requirements. Based on the Settlement Agreement in Case No. PU-08-742, and MISO's determination that the wind capacity credit for planning year 2010/11 will be 8 percent, OTP is proposing a rate per kW

and per kWh for the large general service class (“LGS”) with a rate per kWh for All Other customers based on the 8 percent capacity factor.

The current and proposed rates are as follows:

	LGS	All Others
Current Rate -		
Rate/kWh	\$0.00369	\$0.00369
Proposed Rate -		
Rate/kW	\$0.181	N/A
Rate/kWh	\$0.00497	\$0.00572

The Overall Rate/kWh for the 2010 RRA is based on the following calculation:

Total Allocated North Dakota Revenue Requirements	=	\$9,993,871.28
Projected North Dakota MWh Sales (April 2010 – March 2011)	=	<u>1,779,560</u>
Overall Proposed Rate (in \$/MWh)	=	<u>\$0.00562</u>

Advocacy Staff’s Analysis of Project

Under NDCC § 49-05-1(6), there is a rebuttable presumption that a renewable energy facility located in the state is considered prudent. Even though OTP in its amended application, dated January 18, 2010, dropped its request for approval for ADP for the Project at the request of Commission Staff, the assessment of the prudence of the 2010 RRA is inextricably linked to the prudence of the Project. Commission Staff requested OTP to either file the ADP separately from the 2010 RRA or not at all since the Project was

already in service. As a result OTP dropped its request for approval for ADP in its amended application.

In the application, OTP indicated that the Project, like the previous Langdon and Ashtabula Wind Projects, was the least-cost option for additional energy to serve OTP's retail load. As indicated earlier, the Project was eligible for a 30 percent ITC as part of the ARRA of 2009. In addition, the Ashtabula and Luverne Wind Projects both qualified for bonus tax depreciation as defined in the Internal Revenue Code. The Ashtabula Wind Project went into service in 2008 and the Luverne Wind Project went into service in 2009 so the entire tax basis qualifies for the 50 percent bonus each year. In addition, the State of North Dakota provides three primary incentives for wind projects. The incentives are as follows:

1. Sales Tax Exemption – Exempt property includes tangible personal property to construct a new facility;
2. Property Tax Reduction – Includes an 85 percent reduction in taxable value thus reducing the taxable value from 10 percent to 1.5 percent; and
3. Income Tax Credit – Includes a 15 percent ITC over 5 years; with carry forward of 20 years for unused credits on projects built between September 30, 2008 and January 1, 2012; and a carry forward of 10 years for unused credits on projects built between January 1, 2012 and January 1, 2015.

Based on the data request responses received from OTP as to the analysis performed to determine that the Project was the least cost alternative, OTP had a number of other resource alternatives to the Project in its IRP model that it could select from. OTP also indicated that the resource plan modeling, scenario analysis, and sensitivity analysis

performed was extensive and was reviewed previously in several proceedings including the Big Stone II ADP proceedings before the Commission (Case No. PU-06-481). During these proceedings, 160 MW of wind generation was selected by the modeling as part of OTP's least cost resource plan. The 160 MW of wind generation was also included in the IRP analysis filed with the Commission on March 10, 2008 as well as the Commission's Order dated August 27, 2008 when it found prudence for the Big Stone II project.

According to OTP the estimated total levelized cost of the Project over its 25 year assumed life is very reasonable compared to previous projects and current cost estimates. In addition, OTP anticipates the capacity factor for the Project at XX%. Both of these measures confirm the results of OTP's analysis determining that the Project was the least cost alternative. In addition, OTP does not have excess capacity as its current planning reserve margin is 12.69 percent per the MISO resource adequacy obligation for the 2009 Planning Year.

It is important that the Project was the least cost resource alternative because assuming the Project was in service for the entire year of 2009 and based on OTP's 2009 retail sales, 15.8 percent of retail sales would have been produced by renewable resources. This percentage exceeds the state's renewable energy and recycled energy objective of 10 percent of retail sales from renewable energy and recycled energy by 2015.

Although not part of and beyond the scope of this instant application, the impact that ever-increasing amounts of wind resources are having on the operation of baseload coal-fired units is becoming apparent.

Regarding the proposed 2010 RRA, the revenue requirements were calculated using the same methodology as they were in previous filings. Included in the revenue

requirement is a deferred uncollected amount of \$337,256 from a previous period as approved by the Commission per Settlement Agreement in Case Nos. PU-08-862 and PU-09-742. This deferred balance is to be amortized over 48 months beginning with the 2010 cost recovery period. Including this amount, OTP seeks to recover a total of \$9,993,871 from the 2010 RRA.

As indicated previously, OTP used the allocation factor approved in its most recent rate case of 38.830 percent to arrive at North Dakota's share of total revenue requirements. Based on the Settlement Agreement in Case No. PU-08-742, and MISO's determination that the wind capacity credit for planning year 2010/11 will be 8 percent, OTP is proposing a rate per kW and per kWh for the large general service class with a rate per kWh for all other customers based on the 8 percent capacity factor. Advocacy Staff agrees with this approach.

North Dakota's allocation of total revenue requirements are further allocated to customer classes, namely the LGS and All Other customer classes using demand and energy allocation factors. It is recommended that customer class demand and energy allocation factors be updated to reflect actual 2009 results. Most of the revenue requirements are energy-related. For those revenue requirements that are demand-related, a demand allocation factor which assumes an eight percent capacity factor was applied. The allocated demand- and energy-related revenue requirements are then divided by forecasted billing units (kW and kWh for LGS and kWh only for All Other customer classes) for the April 2010 – March 2011 time period to calculate the resulting proposed rates.

Lastly, OTP proposes that if implementation of the 2010 RRA begins after April 1, 2010, that the RRA be adjusted to recover the approved revenue requirements over the remaining months of the period through March 2011. Given that April 1, 2010 has already elapsed, Advocacy Staff is concerned about the rate impact this might cause given the already significant rate increase (52.3 percent) in the 2010 RRA from the 2009 RRA. As a result, Advocacy Staff recommends deferring any shortfalls into the next time period or general rate case. Since OTP indicates that it doesn't anticipate any new wind projects on the planning horizon for the next few years, this will help transition the impact of the RRA going forward.

Advocacy Staff's Recommendation to Commission

Advocacy Staff recommends that the Commission adopt the application as submitted with one update and one exception. It is recommended that the customer class demand and energy allocation factors be updated to reflect actual 2009 results. The exception is in regard to the treatment of any revenue requirement shortfalls as a result of the delay in having the 2010 RRA go into effect beyond April 2010. Advocacy Staff recommends that these shortfalls be deferred into the next time period or general rate case rather than having the 2010 RRA adjusted to capture these revenue requirements over the remaining months of the period (through March 2011). This will help transition the RRA going forward since OTP doesn't anticipate any new wind projects on the planning horizon for the next few years.

Larry K. Nyquist