STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Otter Tail Power Company
Transmission Facility Cost Recovery
Rates

Case No. PU-11-153

Otter Tail Power Company
Transmission Facility Cost Recovery
Tariff

Case No. PU-11-682

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

April 25, 2012

Appearances

Commissioners Tony Clark, Brian P. Kalk and Kevin Cramer.

Bruce Gerhardson, Associate General Counsel, Otter Tail Power Company, PO Box 496, Fergus Falls, Minnesota 56538-0496, on behalf of Otter Tail Power Company.

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Mitchell D. Armstrong, Special Assistant Attorney General, on behalf of the North Dakota Public Service Commission.

Al Wahl, Administrative Law Judge, Office of Administrative Hearings, 1701 North Ninth Street, Bismarck, North Dakota 58501-1882, as Procedural Hearing Officer.

Preliminary Statement

On April 29, 2011, Otter Tail Power Company (OTP) filed an application with the Public Service Commission (Commission) under North Dakota Century Code (N.D.C.C) §49-05-04.3 for approval of a tariff that will provide for the recovery of investment and associated costs for new or modified transmission

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facilities that are not included in OTP's general rate schedule, and for charges from the Midwest Independent Transmission System Operator (MISO) assessed through Schedule 26 of the federally authorized MISO Open Access Transmission, Energy, and Operating Reserve Markets Tariff (MISO Tariff), Case No. PU-11-682. OTP calls this tariff the Transmission Cost Recovery Rider rate schedule (TCR Rider).

Also on April 29, 2011, OTP filed a rate under the TCR Rider quantifying the costs incurred for several new transmission projects, Case No. PU-11-153.

On June 8, 2011, the Commission suspended the proposed TCR Rider rate.

On November 3, 2011, OTP filed Supplemental Attachments reflecting two alternative methods for cost recovery and updates to the original filing.

On November 23, 2011, the Commission issued a Notice of Filing, Notice of Hearing and Notice of Intervention Deadline that consolidated the above-captioned matters for hearing and identified the following issue to be considered:

1. Whether the proposed transmission cost recovery rider and rate adjustments comply with section 49-05-04.3 and should be approved.

On December 5, 2011, the Commission granted the North Dakota Large Industrial Group's (ND LIG) request to intervene in the proceedings. The ND LIG is a group of OTP's large industrial retail electric customers with locations in North Dakota, including Goodrich Corporation, Cargill Corporation, Cavendish Farms, Inc., Archer Daniels Midland Company, ComDel Innovation, Tharaldson Ethanol LLC, Enbridge Energy LP and Primewood, Inc.

On January 24, 2012, an evidentiary hearing was held at the Commission Hearing Room in Bismarck, North Dakota.

Having allowed all interested persons an opportunity to be heard, and having heard, reviewed and considered all testimony and evidence presented, the Commission makes the following:

Findings of Fact

1. OTP is a Minnesota corporation and a public utility authorized to provide electric service to retail electric customers in North Dakota.

2. OTP is a member and a customer of the Midwest Independent Transmission System Operator (MISO). MISO coordinates generation and transmission of electricity across a large geographic region including the geographic area served by OTP.

3. OTP is assessed costs through a MISO Tariff known as Schedule 26. Such costs represent the charges OTP incurs from MISO as a transmission customer to pay its assigned portion of transmission investments made by MISO transmission owners, which are allowed cost allocation and recovery pursuant to the MISO Tariff.

4. OTP may from time to time have an opportunity to invest in transmission projects that qualify for regional cost allocation through the MISO Tariff. In such cases, OTP recovers the costs of these investments through the MISO Tariff, which allocates some of the costs to OTP and some of the costs to other MISO members. The amount of the costs allocated to OTP and to other MISO members for any particular investment is determined through the MISO Tariff mechanisms based upon the classification of the facility and a determination of the benefits particular regions receive from the investments.

5. OTP incurs Schedule 26 charges from the MISO to pay for a portion of transmission investments of other electric utilities pursuant to Attachment FF of the MISO Tariff. Attachment FF specifies the cost allocation procedures for new transmission projects within MISO. MISO's transmission planning process identifies and evaluates new transmission expansion projects eligible for inclusion in the MISO Transmission Expansion Plan ("MTEP"). The MTEP issued by the MISO is a regional expansion plan with three primary objectives: 1) to perform a reliability assessment of the MISO integrated transmission system; 2) to review transmission owning members' transmission plans and make sure that appropriate projects are reviewed and recommended to the MISO Board of Directors for approval; and 3) to develop transmission upgrades to improve market performance.

6. Through its MTEP process, the MISO determines whether a proposed transmission project is eligible for cost-sharing pursuant to Attachment FF of the MISO Tariff. There are a variety of project types under the MISO Tariff that are eligible for cost-sharing including the following. 1) Baseline Reliability Projects (BRP) required to ensure transmission system reliability consistent with North American Electric Reliability Corporation (NERC) standards; 2) Regionally Beneficial Projects (RBP) that provide economic benefit to the MISO transmission system; 3) Generator Interconnection Project Network Upgrades (GIP NU) required for the interconnection of generation to the MISO transmission system; or 4) Multi Value Projects (MVP) that address regional public policy, reliability, and economic value to the MISO footprint.

7. If through the MTEP eligibility screening process, a project does not meet the criteria for a BRP, RBP, GIP NU, or MVP but is determined to provide local benefits, the assignment of costs for that facility is left to the local pricing zone of the transmission owner of the facility. For example, for a proposed transmission facility that primarily benefits a local load center, MISO would not administer cost-sharing provisions under Attachment FF and the local transmission owner(s) would bear those costs.

8. The BRP, RBP, GIP NU, and MVP cost allocation criteria and recovery mechanisms are specified in detail in Attachment FF (specifying the Transmission Expansion Planning Protocols), Attachment GG (specifying the calculation of the Network Upgrade Charge), and Schedule 26 (specifying the Network Upgrade Charge from Transmission Expansion Plan) of the MISO Tariff. The MISO's annual MTEP review process identifies those transmission projects that will be included in "Appendix A" to the MTEP and the respective cost-sharing is identified for each project as applicable.

9. OTP's regional transmission investments included in the current TCR Rider calculations are for the following projects:

a. Bemidji to Grand Rapids CAPX2020
b. Fargo to Monticello Phase I CAPX2020
c. Fargo to Monticello Phase II CAPX2020
d. Fargo to Monticello Phase III CAPX2020

10. OTP is a 20 percent investor in the Bemidji to Grand Rapids CAPX2020 project and a 13.2 percent investor in the Fargo to Monticello Projects.

11. OTP's investment in these projects is larger than the share of costs allocated to OTP's retail customers through the MISO Tariff. For the Bemidji project, OTP is allocated 61.25 percent of the costs of OTP's investment and for the Fargo project, OTP is allocated 80.38 percent of the costs of the investment. The remaining cost responsibility for these investments is allocated to other MISO members pursuant to the MISO Tariff.

12. In its April 29, 2011 application, OTP proposed to flow the North Dakota jurisdictional portion of its Schedule 26 charges through the TCR Rider and it also proposed that the TCR Rider would, in the future, allow recovery of the costs for transmission projects determined to provide local benefits (i.e. projects for which the costs are not regionally allocated through MISO's Tariff). OTP had made no such local project investments in the period covered by the April 29, 2011 application, and therefore no such costs were included in the rider rate calculation for the current recovery period.

13. In its April 29, 2011 application, OTP did not seek retail cost recovery for its investment in regional transmission projects through the TCR rider, other than the expense recovery of the Schedule 26 charges allocated to OTP, as described above. Instead, OTP proposed to leave these investments at the Federal Energy Regulatory Commission (FERC) jurisdictional level with no portion of these investments to be included as part of retail rate base.

14. OTP's proposed TCR Rider rates are based upon the costs projected over the recovery period, and the revenue requirement is based on the demand allocation factor and rate of return (ROR) established in OTP's most recent retail rate case. A tracker account is used to reflect actual costs incurred and actual revenues received through the TCR Rider rates. The tracker account ensures that no over- or under- recoveries occur through the TCR Rider.

15. On November 3, 2011, OTP filed Supplemental Attachments that reflected two alternative methods of calculating the TCR Rider rates, referred to as the Split Method and the All-In Method. These two methods of calculating the TCR rate establish a retail rate base amount for each of OTP's regional transmission investments and a corresponding retail revenue credit that reflects the revenues OTP receives from MISO pursuant to the MISO Tariff. For the Split method the retail rate base amount and the revenue credit are proportional to the amount of costs allocated to OTP through the MISO Tariff. For the All-In Method the retail rate base amount and the revenue credit are based on the entire OTP investment in the projects. The November 3, 2011 Supplemental Attachments also revised the period for which the rates are proposed to be in effect to run through December 2012.

16. At the January 24, 2012 hearing, OTP provided updated Attachments reflecting TCR Rider calculations under the method used in OTP's initial Application (the Schedule 26 Method), calculations under the Split Method and calculations under the All-In Method (Exhibits OTP-4, OTP-5 and OTP-6, respectively). The updates reflected in Exhibits OTP-4, OTP-5 and OTP-6 include actual data for the 2011 calendar year. Previous filings included actual data only for part of 2011 and forecasted data for the remainder of the year. All parties are in agreement that the Exhibits OTP-4, OTP-5, and OTP-6 are accurate updates based on the three methods described and that the TCR Rider rates should be implemented using the calculations reflected in one of the Exhibits OTP-4, OTP-5 or OTP-6, depending on which method the Commission determines should be used.

17. The Schedule 26 Method would allow OTP to recover the costs of these investments directly through the MISO revenues received, some of which would be paid by OTP's North Dakota retail customers (through the Schedule 26 charges included in the TCR Rider) and some of which would be paid by other

utilities. This Schedule 26 Method would rely on the FERC-approved MISO Tariff for the revenue requirement calculations for these regional projects, and no separate retail revenue requirement calculation would be necessary. Going forward, OTP's TCR Rider would only include the Schedule 26 charges allocated to OTP through the MISO Tariff and OTP investments in traditional "local" transmission projects that don't qualify for regional allocation through MISO's Tariff.

18. The Schedule 26 charges assessed to OTP through the MISO Tariff include the costs for these OTP investments and the costs for other MISO transmission owners' regionally allocated transmission investments. All three methods under consideration in this proceeding include recovery of the Schedule 26 charges assessed to OTP for other MISO transmission owners' transmission investments.

19. Through payment of the Schedule 26 charges OTP's North Dakota retail customers pay for their allocated share of the costs associated with OTP's investments in these projects, and they bear no risk for OTP's investments over the retail share.

20. The All-In Method treats OTP's investments as being all in the retail rate base. Under this method, a traditional retail revenue requirement is calculated on the entire investment, both the amount associated with the provision of retail service and the amount regionally allocated to other utilities- Otter Tail's retail rate of return is applied to 100 percent of the investment (treating it all as retail rate base) and 100 percent of the expenses related to the investments are passed though as retail costs. The revenues that OTP receives from MISO are treated as a retail revenue credit that reduces the retail revenue requirement.

21. The All-In Method treats all of the investment as retail rate base investments despite the fact that a substantial portion of the investment is not used for providing service to OTP's retail customers. Whether this method results in higher or lower rates for OTP's North Dakota retail customers is dependent upon whether the MISO revenues received are more or less than the retail revenue requirement. If the revenues are higher, the retail rates will be lower, if the revenues are lower, the retail rates will be higher.

22. The MISO revenues being received by OTP are currently higher than the retail revenue requirement, so the rates calculated under the All-In Method are currently lower than the other methods. However, FERC changes, and changes to the MISO Tariff, are likely over the lives of these projects (approximately 60 years), creating the risk of higher retail rates to OTP's North Dakota retail customers if the All-In Method is used.

23. The Split Method works mechanically similar to the All-In Method, but limits the portion of the investments treated as retail rate base to an amount proportional to the costs allocated to OTP retail load serving obligations through the MISO Tariff. The amount of the investments not used to serve retail customers is treated as a separate FERC-jurisdictional investment. This method recognizes OTP's investment in these projects is larger than the share of costs being allocated to OTP through the MISO Tariff. This method treats the retail investment as retail rate base and the FERC investment as FERC rate base.

24. The Split Method does not increase the retail rate base amount in excess of what is required to serve OTP's retail customers and, therefore, retail customers are not exposed unnecessarily to changes in MISO revenues. Under the Split Method, OTP's retail customers are not at risk to higher rates due to MISO revenues declining for investments that are not used for the provision of retail service. While the Split method is more complicated to implement, there is no evidence suggesting it is unworkable.

25. While the Split method converts the retail portion of the investment from a FERC-authorized rate of return to a State-authorized rate of return, OTP accepts this method as a practical approach to these investments that recognizes the investments have both a retail component and a non-retail component. The Split method is also consistent with fundamental ratemaking principles such as the doctrine that investments used and useful in serving retail customers are appropriate for inclusion in the retail rate base.

26. The essential difference between the three TCR Rider methods under consideration in this case is how much of these regional transmission investments are included in OTP's retail rate base. The Schedule 26 method excludes entirely the investments from the retail rate base; the All-In method includes 100 percent of the investments in the retail rate base; and the Split method includes in the retail rate base the amount of the investments proportional to the costs being allocated to OTP through the MISO Tariff for its retail load serving obligations (61.25 percent and 80.38 percent, respectively).

27. OTP's investments in these projects will total $114 million and the amount of investment included in OTP's North Dakota retail rate base under each of the three methods is as follows: $0 under the Schedule 26 method; $47 million (North Dakota jurisdictional share) under the All-In method; and $36 million (North Dakota Jurisdictional Share) under the Split method. Therefore, OTP's North Dakota retail rate base would increase $11 million dollars more under the All-In method than it would under the Split method and the entire $11 million dollars would relate to investments not used to serve retail customers.

28. LIG asserts that OTP investors have not paid for efforts that resulted in creation of this asset or opportunity at MISO, and the risk has been borne by ratepayers until this point. LIG suggests OTP should have formed, or should be required to form, a non-regulated subsidiary. While it is possible, and possibly would have been more equitable for OTP to form an investment company to share in the risks up to this point, there is no evidence suggesting OTP was required to do so. However, had an investment company been formed by OTP, it is possible much of the present disagreement could have been avoided.

29. Because of the risks associated with the All-In Method in this case and for the other reasons discussed above, it is the Commission's decision that the Split Method be used to determine the retail revenue requirement for these investments in regionally allocated transmission projects.

30. The Parties are in agreement that the TCR Rider should use the transmission demand allocation factor from OTP's last North Dakota general rate case to allocate total revenue requirements to jurisdictions and rate classes.

31. The parties also agree that the rate design for the TCR Rider should be based on demand only ($/kW-month) for the Large General Service ("LGS") class. For the remaining retail rate classes (non-LGS), OTP will use an energy rate ($/kWh-month). This rate design is consistent with transmission costs being driven by customer demands. Therefore, demand-based allocations and rate design are appropriate, except for rate design outside the LGS class, as the non-LGS classes do not generally have demand metering.

From the foregoing Findings of Fact, the Commission now makes its:

Conclusions of Law

1. The Commission has jurisdiction over this proceeding under North Dakota Century Code Chapter 49-22.

2. Pursuant to North Dakota Century Code (NDCC) §49-05-04.3:

> The commission may approve, reject, or modify a tariff filed under section 49-05-06 which provides for an adjustment of rates to recover jurisdictional capital and operating costs incurred by a public utility for new or modified electric transmission facilities. For purposes of this section, an electric transmission facility includes an electric transmission line as defined in chapter 49-21.1 and other transmission line equipment, including substations, transformers, and other equipment constructed to improve the power delivery capability or reliability of the electric transmission system; and

operating costs include federally regulated costs charged to or incurred by the public utility to increase regional transmission capacity or reliability. The tariff must:

a. Allow the public utility to recover on a timely basis its investment and associated costs for new or modified electric transmission facilities not reflected in the utility's general rate schedule;

b. Allow a return on the public utility's investment made for new or modified electric transmission facilities at the level approved in the utility's most recent general rate case;

c. Provide a current return on construction work in progress for new or modified electric transmission facilities, provided the cost recovery from retail customers of the allowance for funds used during construction is not sought through any other means; and

d. Terminate cost recovery after the public utility's costs for new or modified electric transmission facilities have been recovered fully or have been reflected in the utility's general rate tariff.

3. With respect to the treatment of OTP's investments in regional transmission investments (those that qualify for regional cost allocation through MISO's tariff), the Commission concludes that the Split Method reduces the risks to the ratepayer and is more consistent with traditional ratemaking principles. Therefore, the Split Method shall be used to determine the retail revenue requirement for these investments.

From the foregoing Findings of Fact and Conclusions of Law, the Commission now makes its:

Order

The Commission orders:

1. OTP's application to establish a TCR Rider and a TCR Rider rate to be implemented with an expected recovery period through December 31, 2012 is APPROVED.

2. The TCR Rider and the TCR Rider rate shall use the Split Method for the treatment of OTP's investments in transmission projects eligible for regional cost

allocation through the MISO Tariff. The TCR Rider rate shall be as calculated in the Split Method calculations filed as Exhibit OTP-5 at the evidentiary hearing.

3. The TCR Rider rate design will utilize the transmission demand allocation factor from OTP's last North Dakota general rate case (Commission Case No. PU-08-862) to allocate total revenue requirements to jurisdictions and rate classes.

4. The TCR Rider rate design for the Large General Service Class will be based on demand only ($/kW-month). The TCR Rider rate design for the remaining retail rate classes will be based on energy only. A rate for each class will be calculated equal to the revenue requirement divided by the kilowatt-hour sales for the projected period.

5. The initial TCR Rider rate will be implemented with an effective date of May 1, 2012, and will remain in effect until the next TCR Rider rate is approved. The initial TCR Rider rate will include the costs that have gone uncollected for the period of January 1, 2011 to the first cycle billing that includes the TCR Rider. Those uncollected costs will be recovered from May 1, 2012 through December 31, 2012, with actual collections recorded in a tracker account to determine over- or under-recoveries when compared to actual costs incurred.

6. By September 1 of each year, OTP shall file with the Commission an annual TCR Rider rate on a going forward basis. In the annual filing, the tracker account will be updated so that any over- or under-recoveries at the end of the previous recovery period will be reflected in the TCR Rider adjustment for the upcoming recovery period.

7. OTP shall file a compliance TCR Rider and TCR Rider rate consistent with this Order.

8. OTP's cost recovery shall terminate after its costs for new or modified electric transmission facilities have been recovered fully or have been reflected in its general rate tariff.

PUBLIC SERVICE COMMISSION

Kevin Cramer **Commissioner**	**Tony Clark** **Chairman**	**Brian P. Kalk** **Commissioner**