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February 10, 2012

Mr. Darrell Nitschke
Director of Administration/Executive Secretary
North Dakota Public Service Commission
State Capitol
Bismarck, ND 58505

**RE: In the Matter of Otter Tail Power Company's Transmission Cost Recovery Rider Filing
Case Nos. PU-11-153 and PU-11-682**

Dear Mr. Nitschke:

Otter Tail Power Company ("OTP") is filing its Post Hearing Brief, Parties' Joint Proposed Findings of Fact, Conclusions of Law and Order ("Joint Proposed Findings") and OTP's Proposed Findings of Fact, Conclusions of Law and Order ("OTP Proposed Findings"). An original and seven copies are being sent to you today by UPS overnight.

The Joint Proposed Findings are the result of discussions with the North Dakota Large Industrial Group intervenors ("ND LIG") and Commission Advocacy Staff (collectively, along with OTP, "the Parties") to arrive at Findings on the uncontested issues in this case. All Parties are in agreement that these Joint Proposed Findings adequately reflect the record evidence in this case. The Joint Proposed Findings have been formatted with placeholders for additional Findings on the one remaining issue in dispute in this case. The Parties will each file separate Proposed Findings supporting their positions on this remaining issue.

Consistent with this agreed upon approach to the Findings, OTP's Proposed Findings are also included with this filing. For convenience, OTP's Proposed Findings include the Parties' Joint Findings, with OTP's specific proposed findings at paragraph numbers 24-38, Conclusion number 43 and Ordering Paragraph number 2.

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Brief and joint proposed Findings of Fact, Conclusions of Law and Order on uncontested issues
Otter Tail Power Company

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Brief and joint proposed Findings of Fact, Conclusions of Law and Order on uncontested issues
Otter Tail Power Company

Mr. Nitschke
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Should you have any questions, please feel free to contact me at 218-739-8475 or bgerhardson@otpc.com.

Sincerely,

/s/ BRUCE G. GERHARDSON

Bruce G. Gerhardson
Associate General Counsel

dm

Enclosures

By electronic filing and UPS overnight

c: Service List

**STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION**

**Otter Tail Power Company
Transmission Cost Recovery Rates**

Case No. PU-11-153

**Otter Tail Power Company
Transmission Cost Recovery Tariff**

Case No. PU-11-682

OTTER TAIL POWER COMPANY’S POST HEARING BRIEF

Otter Tail Power Company (“OTP”) is filing this Post Hearing Brief in support of its request for approval of a Transmission Cost Recovery Rider (“TCR Rider”) rate schedule and the establishment of a TCR Rider rate for 2012. As was indicated at the evidentiary hearing, the only issue requiring Commission resolution in this proceeding is which of three approaches to use for calculating the TCR Rider revenue requirement—the “Schedule 26” method, the “All-In” method, or the “Split” method. This Brief addresses this remaining issue.

The question of which method should be used is raised because OTP’s current transmission investments—the Bemidji to Grand Rapids (“Bemidji CapX”) and Fargo to Monticello (“Fargo CapX”) projects—are eligible for regional cost allocation through the FERC-authorized MISO Tariff, and therefore OTP is authorized to recover a substantial portion of the costs for these projects from other utilities. Specifically, the MISO Tariff allocates 61.25 percent of OTP’s investment in the Bemidji CapX project to OTP and the remaining 38.75 percent to other utilities; it allocates 80.38 percent of the Fargo CapX projects (Phases I-III) to OTP and the remaining 19.62 percent to other utilities.

OTP requests that the Commission approve use of the Split method. The Split method incorporates these investments into retail rates in a practical way that recognizes that the investments have both a retail component and a non-retail component.

I. Background on the three methods proposed in this case for addressing OTP's investments in regional transmission projects.

A. Description of Schedule 26 Method

In its Initial application, OTP proposed that these regional transmission investments should be entirely excluded from the retail rate base. This approach became known during the course of this proceeding as the “Schedule 26” approach, named for the MISO Tariff schedule that allocates regionally the costs for these projects. This Schedule 26 approach 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 Tariff¹ and OTP investments in traditional “local” transmission projects that don’t qualify for regional allocation through MISO’s Tariff.

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

¹ The Schedule 26 charges allocated 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 include recovery of the Schedule 26 charges assessed to OTP for other MISO transmission owners’ transmission investments.

they bear no risk for OTP's investments over the retail share. The Schedule 26 method is a straightforward application of legal and regulatory principles that state regulators should grant deference to federally authorized rates.²

B. Description of the All-In Method

As the name implies, the “All-In” method treats the 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 through as retail costs. The revenues that OTP receives from MISO are treated as a retail revenue credit that reduces the retail revenue requirement.

This method converts all of the investment into 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 highly 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.

As is explained in detail below, the MISO revenues being received are currently higher than the retail revenue requirement, so the rates are currently lower. However, changes to the MISO Tariff are anticipated that are expected to reduce the MISO revenues significantly. In

² See, e.g., Narragansett Electric Co. v. Burke, 381 A.2d 1358 (R.I. 1977), cert. denied, 435 U.S. 972 (1978); Nantahala Power and Light Co. v. Thornburg, 476 U.S. 953 (1986).

addition, the opportunity for additional FERC changes are likely over the very long lives of these projects (approximately 60 years), which creates significant risks that OTP's North Dakota retail customers may have higher rates if this method is used. The method would also be a significant departure from fundamental ratemaking principles that historically have excluded from the retail rate base investments that are not used for the provision of retail service.

C. Description of the Split Method

The Split method works mechanically similar to the All-In method, but it 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 that 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.

This method does not inflate the retail rate base amount in excess of what is required to serve OTP's retail customers and therefore, retail customers are not exposed inappropriately to changes in the MISO revenues. Under this Split method, OTP's retail customers will never have higher rates due to MISO revenues declining for investments that are not used for the provision of retail service.

While this method converts the retail portion of the investment from a FERC-authorized rate to a State-authorized rate, and thus it could be argued it does not grant adequate deference to the FERC authorized MISO rates, OTP believes the method approaches these investments in a practical way that recognizes that the investments have both a retail component and a non-retail

component. OTP believes that the method is 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.

II. The magnitude of difference in OTP's retail rate base under each of the three methods.

The essential difference between the three TCR Rider methods described above 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 Otter Tail through the MISO Tariff for its retail load serving obligations (61.25 percent and 80.38 percent, respectively).

OTP's investments in these projects will total \$114 million and therefore the dollar amount of these 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.

The differences between the three methods will be even more pronounced going forward, as OTP is intending to make very substantial investments in projects being built in this region that have been classified as Multi-Value Projects ("MVPs") under the MISO Tariff. The difference between the three methods being considered grows significantly for the MVP projects

because OTP is investing a large amount in these MVP projects, but OTP is allocated a much smaller share of each projects' costs through the MISO Tariff. For example, OTP is planning to invest in three MVP projects in the next 5 years: the Brookings to Twin Cities project (OTP's investment is about \$28 million, or 4 percent of the total project costs); the Big Stone South to Brookings project (OTP's investment is about \$163 million, or 50 percent of the total project costs); and the Ellendale to Big Stone South project (OTP's investment is about \$114 million or 50 percent of the total project costs).

In aggregate, the investment in these three projects will total more than \$305 million for OTP, but OTP will be allocated less than 1 percent of the costs through the MISO Tariff. Consequently, the amount of OTP's investment included in the North Dakota retail rate base under the three methods differs greatly--\$0 under the Schedule 26 method, approximately \$126 million under the All-In method and approximately \$4.4 million under the Split method. When added to the Bemidji CapX and Fargo CapX projects, the magnitude of difference between the All-In method and Split method becomes stark: Under the All-In method, OTP's North Dakota retail rate base would grow \$121 million more than it would under the Split approach—all for investments not being used to serve OTP's retail customers.

OTP's current North Dakota rate base for all existing investments (including all generation, transmission, distribution and other rate base investments) is just \$247 million. So, if the All-In method were used, OTP's rate base will grow by 70 percent³—whereas, if the Split method is used, OTP's North Dakota retail rate base will grow by just 16 percent.⁴ Under the

³ (Bemidji CapX and Fargo CapX + MVPs)/Current North Dakota Retail Rate Base = (47M+126M)/247M=70%.

⁴ (Retail share of Bemidji CapX and Fargo CapX + retail share of MVPs)/Current North Dakota Retail Rate Base = (36M+4.4M)/247M=16%.

All-In method, OTP's retail customers would be responsible to ensure a return on the investment and to cover all operation and maintenance costs for these projects.

As described in detail below, because the risks associated with these responsibilities are significant, and because OTP does not believe it is appropriate to add to the retail rate base investments that are not intended for use in the provision of service to retail customers, OTP recommends that the Split approach should be used to determine the retail revenue requirement for these investments.

III. Response to Anticipated Arguments of other Parties

A. Response to arguments that these investments can be viewed as retail investments

Based upon the testimony at the evidentiary hearing, it is anticipated that one or more of the other Parties may attempt to argue that these regional transmission investments and the MISO revenues received are analogous to OTP's investments in generation and the treatment of wholesale energy sales from those generation assets. They may attempt to argue that because OTP's generation fleet is treated as 100 percent retail rate base, and the "excess" generation from these retail rate base generation assets is treated as a revenue credit, that a similar approach should be used for the "excess" investment in these regional transmission projects. But this argument is based on a false analogy. In the case of OTP's generation fleet, the generation facilities have been constructed at the size required to serve retail customers' needs based upon rigorous integrated resource planning analysis. Wholesale sales are possible from these generators not because OTP constructed them with capacity over retail needs—the wholesale sales are possible only because OTP's retail customers' usage rises and falls daily and

seasonally, and therefore there are times when energy can be generated and made available for energy sales to others.

A more proper analogy related to generation investments would be to merchant generation investment—for example, assume OTP were to propose for its next generation resource to build a power plant 25 percent larger than resource planning studies showed was reasonable for serving retail need, with the intention that this additional generation would be for wholesale market sales. OTP is not aware of any circumstance where the Commission has permitted such a merchant generation investment to be added to a utility's retail rate base, no matter how high the expectations might be for wholesale sales. In fact, the ND LIG's witness testified upon cross examination that she would not support including a utility's investment in merchant generation into the retail rate base and that such an approach to the retail rate base would be a "deviation" from fundamental ratemaking principles.

Also, based on the testimony at the evidentiary hearing, it is anticipated that one or more of the other Parties might attempt to analogize these regional transmission investments to traditional retail rate base investments that have been constructed larger than currently needed with the expectation that retail need will "grow into" the investment during the life of the investment—in other words, the project is being "right sized" to economically address the needs of customers, which will grow over the expected life of the project. Again, this is a false analogy. The amount of these regional transmission investments over retail share are not due to anticipated future needs of OTP's retail customers—OTP's retail customer needs will not grow

into these investment amounts.⁵ The investment amounts over the retail share are being made to serve the needs of other utilities and that is the basis upon which the FERC-approved MISO cost allocations to other regions has been determined. These allocations of responsibility to outside utilities should not be included in OTP's North Dakota retail rate base.

Based upon their testimony, it is anticipated that one or more of the other Parties may try to argue that the investments should be treated as retail investments because OTP sought and received an Advance Determination of Prudence (ADP) for the projects.⁶ That is not a fair interpretation of the ADP. The issues associated with regional allocation of costs and what amount to include in the retail rate base are not addressed in the Commission's Orders in the ADP proceeding. Specifically, Paragraph 7 of the Settlement Agreement approved by the Commission in its October 6, 2010 Order Adopting Settlement in the ADP case, makes it clear that the Settlement did not resolve the question of "the extent or application of federal jurisdiction to the investments." It reads as follows:

"7. Applicants and Advocacy Staff agree that nothing in this Settlement addresses or decides the extent or application of federal jurisdiction to the investments made in the CapX Group 1 Projects."⁷

⁵ In fact, the "right sizing" of the projects and the growth in need of OTP's customers and all other MISO utilities' customers is already built into the MISO allocations. As described at the hearing, for example, the Fargo to Monticello project was constructed as double-circuit-ready, as this approach was determined to be more economic over the life of the project than building a single circuit line now and a second single circuit line later. This "right-sizing" is built into the costs allocated to OTP's retail customers and into the costs allocated to other utilities through the MISO Tariff. The cost of the double circuit is not the cause of OTP's non-retail allocation. The non-retail portion of costs is due to the regional allocation of MISO's Tariff and OTP's allocated retail share of project costs will not grow as the need for completing the double circuiting grows.

⁶ Commission Case No. PU-09-076.

⁷ The "CapX Group 1 Projects" referenced in that Settlement Agreement include the projects under consideration in this proceeding.

As described in this Brief, OTP's recommendation is for the Commission to adopt the Split method for these investments; that method appropriately treats the non-retail portion of the investments as FERC-jurisdictional investments. This approach is perfectly consistent with what was contemplated in the above-referenced Settlement and ADP Order.

B. Response to arguments that the investments should be included in the retail rate base because the perceived opportunities associated with the Investments outweigh the perceived risks

Many of the ND LIG and Advocacy Staff's arguments essentially boil down to their perception that even if there are risks, the opportunities for MISO revenues are adequate to make the investments reasonable for inclusion in the retail rate base. They perceive that the revenues received from MISO will likely exceed OTP's retail revenue requirement for the investments, and therefore the difference, they conclude, will serve as a credit that will reduce retail rates.

Much of OTP's testimony was intended to illustrate that the risks of reduced MISO revenues are not immaterial, especially given that the MISO rates are relatively new and they have undergone frequent changes already. OTP's testimony was also intended to illustrate that a full assessment of the risks these investments may face is not really feasible at this point given the limited history we have with the MISO rates and the very long 60-year lives of the projects. OTP provided testimony that given these very long lives, even basic assumptions such as whether MISO will be in existence for that entire period may not be reasonable. It would be even more unreasonable to assess the risks under the assumption that the MISO Tariff will remain constant over such a lengthy period.

OTP's witnesses also explained that current revenues received from MISO might be creating inaccurate perceptions that there is a large potential upside to these investments that will

persist over the projects' long lives—or even if it doesn't persist, that the current upside potential is large enough that the risk of the investments going upside down is relatively low. To illustrate that such perceptions may be overly optimistic, OTP witness Kyle Sem, who is responsible for submitting OTP's annual revenue requirement templates to MISO for these investments, testified regarding currently known changes occurring with the MISO Tariff that are likely to reduce MISO revenues significantly.

For example, he testified that the current period reflects revenues received under the MISO Tariff for an "O & M Adder." He explained that this caused very high current MISO revenues, because Operations and Maintenance ("O & M") revenue is being received under the MISO Tariff, but no O & M costs are being incurred because the projects are currently under construction. Therefore, the MISO Tariff returns are relatively high during the 2011-2012 period. But Mr. Sem went on to explain that this is a very temporary phenomenon. The "O & M Adder" has already been removed for projects under construction that are recovered through the MVP template (Attachment MM), and it is reasonable to assume the change will also be made to remove the O & M Adder from the revenue requirement calculation templates being used for RECB projects being discussed in this Case (Attachment GG). Even if it were not removed, the additional revenues associated with the O & M Adder will not persist beyond construction. As the projects go into service and begin to incur actual O & M costs the FERC formulaic method will calculate an O & M recovery that could potentially be lower than the actual costs incurred. Mr. Sem concluded that for this reason, one should not assume from the current recoveries that the MISO revenues will continue to exceed costs at these levels going forward.

Mr. Sem also concluded that other changes have occurred and that more are likely going forward and that continued pressure on the FERC-authorized MISO rates will likely drive down

the revenue expectations going forward. Mr. Sem went on to explain that there may be a perception that a higher FERC-authorized return on equity (“ROE”) for MISO Tariff rates means the MISO rates will necessarily be higher than the retail revenue requirement, but because the MISO Tariff uses formulaic rates, with very different components from traditional revenue requirement calculations used in the States served by OTP, including North Dakota, the current rates of return (“ROR,” not to be confused with the ROE⁸) under the MISO Tariff do not currently result in revenues materially higher than the retail revenue requirement calculation. Therefore, Mr. Sem concluded there is not as much room in the MISO revenues for reductions to occur before those revenues decline below the retail revenue requirement. Again, the point of Mr. Sem’s testimony is to illustrate that the other Parties’ perceptions of the MISO revenues may be overly optimistic, especially given that much more change is expected over the projects’ very long 60-year lives.

The other Parties may also attempt to argue that OTP’s claims about the risk of revenues declining must not be accurate because OTP has invested in these projects under the assumption that they are reasonable investments. They may try to characterize OTP’s claims about risk as inconsistent with OTP’s willingness to make the investments in the first place.

Such arguments miss the point OTP is making with respect to risk. OTP is not arguing that the risks associated with the investments make them unreasonable investments. OTP is arguing that it is not reasonable to put into the retail rate base investments unrelated to the provision of retail service, no matter how reasonable, or how positively one might perceive the opportunities associated with those investments. One of the primary reasons for this

⁸ The Rate of Return (“ROR”) is the combination of the ROE, the cost of debt and the capital structure.

fundamental regulatory premise is that all investments, even reasonable ones, carry risks, and if those risks materialize, ratepayers will be entitled to ask why they should bear the consequences of those risks. If the investments were made because they were necessary for the provision of retail service, the acceptance of those consequences will be much different from the response that would follow an explanation that the investments were made because there was a perceived opportunity associated with making the investments.

As the OTP witnesses explained at the hearing, OTP believes these are reasonable investments, but the fact that they are reasonable does not, by itself, make them appropriate for inclusion in the retail rate base. Instead, the FERC portion of the investments should be kept out of the retail rate base, leaving the risks and opportunities to OTP's shareholders, who are in a position to assess and, if they so choose, tolerate the investment risks. This is how other non-retail investments have been handled in the past, such as OTP's investments in its diversified operations. The fact that these diversified investments showed the promise of opportunity when they were acquired did not qualify them for inclusion in the retail rate base. Similarly, the perceived opportunity associated with OTP's investment in the non-retail portion of these regional transmission projects does not justify their inclusion in the retail rate base.⁹

⁹ It should also be noted that no Party disagreed that if the investments are included in the retail rate base because of perceived revenue opportunities, it would be inappropriate to later remove them from the retail rate base if the opportunities decline. The result would be an effective "trapping" of FERC-authorized rates – i.e. it would take the upside potential from the FERC-approved revenues without taking the corresponding downside risk of the FERC-approved revenues, thus trapping the revenue risks. Therefore, at a bare minimum, if the Commission decides to include these non-retail investments in the retail rate base, it should include a clear statement in its Order that it is doing so with awareness of the risks and with the intention the investments will remain in the retail rate base for their lives even if the risks materialize. This language is necessary because the projects have very long lives, and the Order would serve as a necessary institutional memory of the Commission's rationale of its decision to depart from traditional "used and useful" criteria.

IV. Conclusion

As explained in this Brief, OTP proposes that the Split method should be used to determine the amount of these investments to include in the retail rate base. The Split method is a practical approach that recognizes the investments have both a retail and non-retail component. Risk to retail customers grows with the amount of the retail rate base, and the Split method appropriately aligns the risks of the investments with the amount of the investments used in the provision of service to retail customers. OTP recommends that the amount of these investments that is not serving OTP's North Dakota retail customers should be excluded from the North Dakota retail rate base and treated as separate FERC-jurisdictional investments.

The All-In method would be a significant departure from fundamental ratemaking principles. Such a departure would also carry with it a significant risk that revenues associated with the investments will not be adequate to support the retail revenue requirement, thus increasing rates to retail customers for investments that have nothing to do with the provision of retail service. If the Commission elects to use the All-In method, for the reasons explained in footnote 9, OTP requests that the Order expressly clarify that the Commission is doing so with awareness of the risks and with the intention that the investments will remain in retail rate base for their lives even if the risks materialize.

OTTER TAIL POWER COMPANY

By: /s/ BRUCE GERHARDSON
Bruce Gerhardson
Associate General Counsel

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Otter Tail Power Company
Transmission Cost Recovery Rates

Case No. PU-11-153

Otter Tail Power Company
Transmission Cost Recovery Tariff

Case No. PU-11-682

**PARTIES' JOINT PROPOSED FINDINGS OF FACT, CONCLUSIONS OF LAW
AND ORDER**

The above-entitled matter came on for hearing before the North Dakota Public Service Commission (“Commission”) and Administrative Law Judge Al Wahl on January 24, 2012, in Bismarck, North Dakota.

The Parties to these Proceedings are Otter Tail Power Company (“OTP”), the North Dakota Large Industrial Group (“ND LIG”) and the Advocacy Staff of the North Dakota Public Utilities Commission (“Advocacy Staff”). OTP is a Minnesota corporation and a public utility authorized to serve retail customers in North Dakota. 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. Throughout these Findings, Conclusions and Order, OTP, the ND LIG and Advocacy Staff are referred to individually each as a Party and jointly as the Parties.

Mr. Bruce Gerhardson, Associate General Counsel for Otter Tail Power Company appeared on behalf of OTP.

Mr. Richard Savelkoul, of the Felhaber, Larson, Fenlon & Vogt, P.A. law firm, appeared on behalf of the ND LIG.

Mr. Mark Gruman, Commission Staff Counsel, appeared on behalf of Commission Advocacy Staff.

FINDINGS

Procedural Background

1. On April 29, 2011, OTP filed an Application with the Commission for approval of a Transmission Cost Recovery Rider rate schedule (“TCR Rider”) pursuant to North Dakota Century Code (N.D.C.C.) §49-05-04.3. OTP’s requested TCR Rider would authorize OTP to recover investments and expenses associated with new or modified transmission projects that are not included in OTP’s base rates and expenses or 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”).
2. On June 8, 2011, the Commission issued an Order suspending the proposed transmission facility cost recovery and 2011 rate adjustment.
3. On November 3, 2011, OTP filed Supplemental Attachments reflecting two alternative methods for cost recovery and updates to the original filing.

4. On November 15, 2011, the Office of Administrative Hearings designated Al Wahl to serve as Administrative Law Judge to preside over these cases.
5. On November 23, 2011, the Commission issued an Order consolidating the above-captioned matters for hearing; the Commission also issued an Order approving a Notice of Filing, Notice of Hearing and Notice of Intervention Deadline; The Notice identified the issue for resolution in this case as follows:

“The issues to be considered in these proceedings are whether the proposed transmission cost recovery rider and rate adjustments comply with section 49-05-04.3 and should be approved.”

6. On December 5, 2011, the ND LIG’s request to Intervene was granted.
7. An evidentiary hearing was held on January 24, 2012, at the Commission Hearing Room in Bismarck.

Background on OTP’s Transmission Costs

8. OTP is an active member of MISO, and is assessed costs through the MISO Tariff known as Schedule 26 charges. 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.
9. 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.

10. 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.

11. 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.

12. 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.

13. 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.

14. The allocation of some project costs to MISO participants on a broader scale than just the utilities or companies that invest in the transmission project means that project investment on an individual company basis is unlikely to match the level of allocation on a load share ratio. In fact, each project that has a system-wide cost allocation

would need to have every MISO entity with a cost allocation to also be an investment participant in the project at the same level or the project would be underfunded and not be constructed. The alternative is that some project investors must invest in projects at a level that exceeds their cost allocation.

15. 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
16. 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.
17. 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.
18. OTP has also agreed to invest in other regional transmission investments. For example, OTP has made a 4 percent investment in the Brookings project. The Brookings project is classified as Multi-Value Projects (MVPs) and under the MISO Tariff, OTP's retail customers are allocated a very small amount of the costs

associated with such projects. Specifically, for Brookings, OTP will be allocated less than one percent (<1%) of the costs. In other words, only about 20 percent of the costs associated with OTP's investment in Brookings will be allocated to OTP and the remaining 80 percent will be allocated to other MISO members. The current TCR Rider does not include the costs of those projects at this time. It is expected they will be included in OTP's next annual TCR Rider update filing.

19. In its April 29, 2011, Application in this case, 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 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 Application, and therefore no such costs were included in the rider rate calculation for the current recovery period.
20. 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 FERC jurisdictional level with no portion of these investments to be included as part of retail rate base.
21. Riders similar to OTP's proposed TCR Rider have been used in North Dakota for recovery of other costs, such as OTP's Renewable Rider, and Riders have been approved for OTP in other states for OTP's recovery of transmission costs. Similar to those Riders, 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.

22. 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.

23. 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”), the Split method and 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 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.

24. [Placeholder for Commission's findings on method to be used]
25. 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.
26. 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.

CONCLUSIONS OF LAW

27. 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.*

28. It is proper to utilize OTP's TCR Rider as the mechanism to flow through the jurisdictional share of Schedule 26 expenses incurred by OTP as an active member of MISO. Pursuant to N.D.C.C. §49-05-04.3, "*The tariff must . . . 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.” And the Statute explicitly defines “*operating costs*” to include “*federally regulated costs charged to or incurred by the public utility to increase regional transmission capacity or reliability.*” The MISO Schedule 26 charges are precisely the kind of federally regulated charges defined by the statute, and therefore they are appropriate for recovery through OTP’s TCR Rider.

29. 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

[Placeholder for Commission’s conclusions on method to be used]

30. In the future, OTP’s investment in new transmission projects will require Commission approval in a future TCR Rider annual update filing through which the Commission and other parties shall be provided an opportunity to review such projects for statutory compliance. Such projects may be regional or they may be local (projects that do not qualify for regional cost allocation through MISO’s FERC authorized rates).

ORDER

The Commission orders:

1. Having heard this matter, OTP’s Application to establish a TCR Rider rate schedule 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 _____ method for the treatment of OTP's investments in transmission projects eligible for regional cost allocation through the MISO Tariff.
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. OTP's TCR Rider rate design for the Large General Service Class will be based on demand only (\$/kW-month). For the remaining retail rate classes (non-LGS) of controlled service, and lighting, and all other classes, OTP will incorporate an energy rate 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 March 1, 2012, and shall remain in effect until the next TCR Rider rate is approved. Further, the costs which have gone uncollected for the period of January 1, 2011, to the first billing under the TCR Rider will be recovered from the implementation date through the 2012 year, with actual collections reflected in the tracker balance to ensure no over- or under-recovery.
6. OTP will file an annual TCR Rider filing on a going forward basis to be received by the Commission by September 1 of each year. In the annual filings, the tracker account will be updated so that any over- or under-recovered amount at the end of the previous year will be reflected in the TCR Rider adjustment for the upcoming recovery period.

7. OTP shall file compliance rate schedules consistent with this Order.

Dated: _____

NORTH DAKOTA PUBLIC SERVICE COMMISSION

By: _____

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Otter Tail Power Company
Transmission Cost Recovery Rates

Case No. PU-11-153

Otter Tail Power Company
Transmission Cost Recovery Tariff

Case No. PU-11-682

**OTTER TAIL POWER COMPANY'S PROPOSED
FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER**

The above-entitled matter came on for hearing before the North Dakota Public Service Commission (Commission) and Administrative Law Judge Al Wahl on January 24, 2012, in Bismarck, North Dakota.

The Parties to these Proceedings are Otter Tail Power Company ("OTP"), the North Dakota Large Industrial Group ("ND LIG") and the Advocacy Staff of the North Dakota Public Utilities Commission ("Advocacy Staff"). OTP is a Minnesota corporation and a public utility authorized to serve retail customers in North Dakota. 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. Throughout these Findings, Conclusions and Order, OTP, the ND LIG and Advocacy Staff are referred to individually each as a Party and jointly as the Parties.

Mr. Bruce Gerhardson, Associate General Counsel for Otter Tail Power Company appeared on behalf of OTP.

Mr. Richard Savelkoul, of the Felhaber, Larson, Fenlon & Vogt, P.A. law firm, appeared on behalf of the ND LIG.

Mr. Mark Gruman, Commission Staff Counsel, appeared on behalf of Commission Advocacy Staff.

FINDINGS

Procedural Background

1. On April 29, 2011, OTP filed an Application with the Commission for approval of a Transmission Cost Recovery Rider rate schedule (“TCR Rider”) pursuant to North Dakota Century Code (N.D.C.C.) §49-05-04.3. OTP’s requested TCR Rider would authorize OTP to recover investments and expenses associated with new or modified transmission projects that are not included in OTP’s base rates and expenses or 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”).
2. On June 8, 2011, the Commission issued an Order suspending the proposed transmission facility cost recovery and 2011 rate adjustment.
3. On November 3, 2011, OTP filed Supplemental Attachments reflecting two alternative methods for cost recovery and updates to the original filing.

4. On November 15, 2011, the Office of Administrative Hearings designated Al Wahl to serve as Administrative Law Judge to preside over these cases.
5. On November 23, 2011, the Commission issued an Order consolidating the above-captioned matters for hearing; the Commission also issued an Order approving a Notice of Filing, Notice of Hearing and Notice of Intervention Deadline; The Notice identified the issue for resolution in this case as follows:

“The issues to be considered in these proceedings are whether the proposed transmission cost recovery rider and rate adjustments comply with section 49-05-04.3 and should be approved.”
6. On December 5, 2011, the ND LIG’s request to Intervene was granted.
7. An evidentiary hearing was held on January 24, 2012, at the Commission Hearing Room in Bismarck.

Background on OTP’s Transmission Costs

8. OTP is an active member of MISO, and is assessed costs through the MISO Tariff known as Schedule 26 charges. 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.
9. 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.

10. 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.

11. 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.

12. 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.

13. 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.

14. The allocation of some project costs to MISO participants on a broader scale than just the utilities or companies that invest in the transmission project means that project investment on an individual company basis is unlikely to match the level of allocation on a load share ratio. In fact, each project that has a system-wide cost allocation

would need to have every MISO entity with a cost allocation to also be an investment participant in the project at the same level or the project would be underfunded and not be constructed. The alternative is that some project investors must invest in projects at a level that exceeds their cost allocation.

15. 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

16. 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.

17. 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.

18. OTP has also agreed to invest in other regional transmission investments. For example, OTP has made a 4 percent investment in the Brookings project. The Brookings project is classified as Multi-Value Projects (MVPs) and under the MISO Tariff, OTP's retail customers are allocated a very small amount of the costs

associated with such projects. Specifically, for Brookings, OTP will be allocated less than one percent (<1%) of the costs. In other words, only about 20 percent of the costs associated with OTP's investment in Brookings will be allocated to OTP and the remaining 80 percent will be allocated to other MISO members. The current TCR Rider does not include the costs of those projects at this time. It is expected they will be included in OTP's next annual TCR Rider update filing.

19. In its April 29, 2011, Application in this case, 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 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 Application, and therefore no such costs were included in the rider rate calculation for the current recovery period.
20. 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 FERC jurisdictional level with no portion of these investments to be included as part of retail rate base.
21. Riders similar to OTP's proposed TCR Rider have been used in North Dakota for recovery of other costs, such as OTP's Renewable Rider, and Riders have been approved for OTP in other states for OTP's recovery of transmission costs. Similar to those Riders, 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.

22. 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.

23. 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”), the Split method and 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 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.

24. The Schedule 26 approach 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.

25. The Schedule 26 charges allocated 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.

26. 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. The

Schedule 26 method is a straightforward application of legal and regulatory principles that state regulators should grant deference to federally authorized rates.

27. As the name implies, the All-In method treats the 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 through as retail costs. The revenues that OTP receives from MISO are treated as a retail revenue credit that reduces the retail revenue requirement.
28. The All-In method converts all of the investment into 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 highly 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.
29. 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, changes to the MISO Tariff are anticipated that are expected to reduce the MISO revenues significantly. In addition, the opportunity for additional FERC changes are likely over the very long lives of these

projects (approximately 60 years), which creates significant risks that OTP's North Dakota retail customers may have higher rates if the All-In method is used. The method would also be a significant departure from fundamental ratemaking principles that historically have excluded from the retail rate base investments that are not used for the provision of retail service.

30. The Split method works mechanically similar to the All-In method, but it 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 that 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.
31. The Split method does not inflate the retail rate base amount in excess of what is required to serve OTP's retail customers and therefore, retail customers are not exposed inappropriately to changes in the MISO revenues. Under this Split method, OTP's retail customers will never have higher rates due to MISO revenues declining for investments that are not used for the provision of retail service.
32. While the Split method converts the retail portion of the investment from a FERC-authorized rate to a State-authorized rate, and thus it could be argued it does not grant adequate deference to the FERC authorized MISO rates, OTP accepts this method as a practical approach to these investments that recognizes that the investments have

both a retail component and a non-retail component. The 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.

33. 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 Otter Tail through the MISO Tariff for its retail load serving obligations (61.25 percent and 80.38 percent, respectively).

34. OTP's investments in these projects will total \$114 million and therefore the dollar amount of these 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.

35. The differences between the three methods will be even more pronounced going forward, as OTP is intending to make very substantial investments in projects being

built in this region that have been classified as Multi-Value Projects (“MVPs”) under the MISO Tariff. The difference between the three methods being considered grows significantly for the MVP projects because OTP is investing a large amount in these MVP projects, but OTP is allocated a much smaller share of each projects’ costs through the MISO Tariff. For example, OTP is planning to invest in three MVP projects in the next 5 years: the Brookings to Twin Cites project (OTP’s investment is about \$28 million, or 4 percent of the total project costs); the Big Stone South to Brookings project (OTP’s investment is about \$163 million, or 50 percent of the total project costs); and the Ellendale to Big Stone South project (OTP’s investment is about \$114 million or 50 percent of the total project costs).

36. In aggregate, the investment in these three projects will total more than \$305 million for OTP, but OTP will be allocated less than 1 percent of the costs through the MISO Tariff. Consequently, the amount of OTP’s investment included in the North Dakota retail rate base under the three methods differs greatly--\$0 under the Schedule 26 method, approximately \$126 million under the All-In method and approximately \$4.4 million under the Split method. When added to the Bemidji CapX and Fargo CapX projects, the magnitude of difference between the All-In method and Split method becomes stark: Under the All-In method, OTP’s North Dakota retail rate base would grow \$121 million more than it would under the Split approach—all for investments not being used to serve OTP’s retail customers.

37. OTP’s current North Dakota rate base for all existing investments (including all generation, transmission, distribution and other rate base investments) is just \$247 million. So, if the “all-in” method were used, OTP’s rate base will grow by 70

percent—whereas, if the Split method is used, OTP’s North Dakota retail rate base will grow by just 16 percent. Under the All-In method, OTP’s retail customers would be responsible to ensure a return on the investment and to cover all operation and maintenance costs for these projects.

38. Because the risks associated with these responsibilities are significant, and because it is not appropriate to add to the retail rate base investments that are not intended for use in the provision of service to retail customers, it is the Commission’s decision that the Split approach shall be used to determine the retail revenue requirement for these investments in regionally allocated transmission projects.

39. 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.

40. 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.

CONCLUSIONS OF LAW

41. 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.

42. It is proper to utilize OTP's TCR Rider as the mechanism to flow through the jurisdictional share of Schedule 26 expenses incurred by OTP as an active member of MISO. Pursuant to N.D.C.C. §49-05-04.3, "*The tariff must . . . 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.*" And the Statute explicitly defines "*operating costs*" to include "*federally regulated costs charged to or incurred by the public utility to increase regional transmission capacity or reliability.*" The MISO Schedule 26 charges are precisely the kind of federally regulated charges defined by the statute, and therefore they are appropriate for recovery through OTP's TCR Rider.

43. 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 risks associated with these responsibilities are significant, and because it is not appropriate to add to the retail rate base investments that are not intended for use in the provision of service to retail customers, the Split approach shall be used to determine the retail revenue requirement for these investments.

44. In the future, OTP's investment in new transmission projects will require Commission approval in a future TCR Rider annual update filing through which the

Commission and other parties shall be provided an opportunity to review such projects for statutory compliance. Such projects may be regional or they may be local (projects that do not qualify for regional cost allocation through MISO's FERC authorized rates).

ORDER

The Commission orders:

1. Having heard this matter, OTP's Application to establish a TCR Rider rate schedule 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 Rates 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. OTP's TCR Rider rate design for the Large General Service Class will be based on demand only (\$/kW-month). For the remaining retail rate classes (non-LGS) of controlled service, and lighting, and all other classes, OTP will incorporate an energy rate 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 March 1, 2012, and shall remain in effect until the next TCR Rider rate is approved. Further, the costs which have gone uncollected for the period of January 1, 2011 to the first billing under the TCR Rider will be recovered from the implementation date through the 2012 year, with actual collections reflected in the tracker balance to ensure no over- or under-recovery.
6. OTP will file an annual TCR Rider filing on a going forward basis to be received by the Commission by September 1 of each year. In the annual filings, the tracker account will be updated so that any over- or under-recovered amount at the end of the previous year will be reflected in the TCR Rider adjustment for the upcoming recovery period.
7. OTP shall file compliance rate schedules consistent with this Order.

Dated: _____

NORTH DAKOTA PUBLIC SERVICE COMMISSION

By: _____

CERTIFICATE OF SERVICE

**RE: In the Matter of Otter Tail Power Company's
Transmission Cost Recovery Rider Filing
Case Nos. PU-11-153 and PU-11-682**

I, Diane Merz, hereby certify that I have this day served a true and correct copy of the attached Brief, Joint Proposed Findings of Fact and Otter Tail Power Company Proposed Findings of Fact by email and/or by U.S. Mail, postage prepaid, addressed to the following persons:

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Dated: **February 10, 2012**

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