129 FERC ¶ 61,287
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer and Philip D. Moeller.

Otter Tail Power Company — Docket No. ER10-183-000

ORDER CONDITIONALLY GRANTING TRANSMISSION RATE INCENTIVES AND ACCEPTING TARIFF REVISIONS, AND ORDERING COMPLIANCE FILING

(Issued December 30, 2009)

1. On October 30, 2009, Otter Tail Power Company (Otter Tail) and Midwest Independent Transmission System Operator, Inc. (Midwest ISO) filed a request for approval of various transmission infrastructure investment incentives, and proposed revisions to Otter Tail's transmission formula rate under Attachment O of the Midwest ISO's Open Access Transmission, Energy and Operating Reserve Markets Tariff (Tariff),[1] pursuant to sections 205 and 219 of the Federal Power Act (FPA).[2] In this order, we will conditionally accept Otter Tail's request for transmission incentives and proposed modifications to its Attachment O formula rate, to become effective on January 1, 2010, as requested.

I. **Background**

2. Otter Tail is a Minnesota corporation, providing electricity to 423 communities in western Minnesota, northeastern South Dakota, and eastern North Dakota. Otter Tail owns and operates approximately 5,300 miles of transmission facilities and owns approximately 770 megawatts of generation capacity in three states. Otter Tail is a transmission-owning member of Midwest ISO.[3] Otter Tail operates in a joint pricing

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[1] Midwest Independent Transmission System Operator, Inc., Open Access Transmission, Energy and Operating Reserve Markets Tariff, FERC Electric Tariff, Fourth Revised Volume No. 1.

[2] 16 U.S.C §§824d; 824s (2006).

[3] *See Otter Tail Power Co.*, 97 FERC ¶ 61,226 (2001); see also *Otter Tail Power Co.*, 98 FERC ¶ 62,218 (2002).

zone with Great River Energy (Great River) and Northern States Power Company (Northern States). Otter Tail collects its annual transmission revenue requirement using Midwest ISO Tariff Attachments O and GG formula rates.[4]

3. Otter Tail states that, together with other utilities in the region and subject to the oversight of Midwest ISO, it has been developing plans to upgrade the regional transmission infrastructure in order to provide the infrastructure to meet state renewable energy standards and to ensure that Otter Tail can continue to serve growing load in the region reliably.[5] Otter Tail notes that Minnesota has enacted aggressive renewable energy mandates for electric utilities that require that 25 percent of the energy that Otter Tail sells to its retail customers must come from qualified renewable energy sources by the year 2025. With respect to load growth in its region, Otter Tail states that the demand for transmission capacity is outstripping supply and affecting, or will soon affect, reliability in the region. Otter Tail states that it expects peak demand to continue to increase between 4,000 MW and 6,000 MW by 2020.[6]

4. As part of Otter Tail's effort to expand regional transmission infrastructure, Otter Tail is participating in a comprehensive regional planning initiative by eleven utilities in the region known as the Transmission Capacity Expansion Initiative by the Year 2020 (CapX2020 Project). Specifically, Otter Tail states that it expects to invest between $113-$160 million over the next six years,[7] in the following three projects that are part of Phase 1 of the CapX2020 Project (together, Otter Tail CapX2020 Projects):

> (1) A 240-mile, 345 kV transmission line between Brookings County, South Dakota and the Southeast Twin Cities, as well as a 10-mile, 230 kV line from a new Hazel Creek substation to a substation in Granite Falls, Minnesota.[8] Otter Tail states that the estimated cost of the lines is $600 to $800 million and that it will fund $26 to $33 million of the total cost. Otter Tail expects to own a 4.1 percent share of the project upon completion of the lines (Brookings Line).

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[4] Exhibit No. OTP-5 at 13.

[5] Transmittal Letter at 5-6.

[6] *Id*.

[7] *Id.* at 6.

[8] Exhibit No. OTP-3 at 20-22.

(2) A 250-mile, 345 kV transmission line between Fargo, North Dakota and Monticello, Minnesota. Otter Tail estimates that the line will cost $500 to $750 million. Otter Tail expects to invest $66 to $99 million in the project and to own a 13.2 percent share of the line once the line is completed (Fargo Line).

(3) A 68-mile, 230 kV transmission line between Grand Rapids and Bemidji in northern Minnesota. Otter Tail states that the estimated cost of the line is $100 to $140 million. Otter Tail explains that it will fund between $20 to $28 million of the total cost and that it expects to own a 20 percent share of the line upon completion (Bemidji Line).

Otter Tail states that the projects are anticipated to be phased into service beginning in 2011 and 2015.[9] Otter Tail also notes that, during the same six years, it will also invest an additional $23 million in routine transmission projects. According to Otter Tail, these investments will double Otter Tail's total 2008 year-end net transmission plant of $137 million.[10]

II. The Filing

A. Proposed Incentive Rates

5. Otter Tail proposes changes to its Attachment O-Otter Tail to the Midwest ISO Tariff to permit recovery of two types of incentive rate treatments for its investment in the Otter Tail CapX2020 projects. In particular, Otter Tail requests recovery of: (1) 100 percent of prudently incurred Construction Work in Progress (CWIP) in rate base (100 percent CWIP Recovery), and (2) 100 percent of prudently incurred costs of transmission facilities that are cancelled or abandoned for reasons beyond Otter Tail's control (Abandoned Plant Recovery). Otter Tail also proposes changes to its Attachment O-Otter Tail to recover its revenue requirement under a forward-looking formula rate using projected test period cost inputs with an annual true-up, rather than a formula rate based on historic test period data.

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[9] Transmittal Letter at 9. The Commission notes that in Docket No. ER10-147-000, Great Rivers Energy filed for incentive rate treatment for its participation in the same group of projects part of the CapX2020 Project, and states that the projects are expected to go into service in phases beginning in 2013. Docket No. ER10-147-000, Attachment 1 at 7.

[10] *Id.* at 3.

6. Otter Tail proposes revisions to Attachment O-Otter Tail to allow recovery of the requested incentives. Otter Tails seeks to revise its formula to provide 100 percent CWIP Recovery for the three Otter Tail CapX2020 Projects.[11] Regarding Abandoned Plant Recovery, Otter Tail proposes revisions to recover 100 percent of abandoned transmission plant costs, and a return on the unamortized balance of the abandoned plant, for those projects cancelled due to circumstances outside of Otter Tails control.[12] Otter Tail explains that it is not seeking approval of any specific abandoned plant costs at this time, but is seeking approval to add a value of zero in its formula template to act as a placeholder for 100 percent Abandoned Plant Recovery.[13] Otter Tail also explains that, as required by Order No. 679[14], it would make a subsequent filing with the Commission before recovering any costs associated with the abandonment of an Otter Tail CapX2020 Project.

7. Otter Tail asserts that its request for incentives complies with Order No. 679 and Commission precedent. First, Otter Tail states that the Otter Tail CapX2020 Projects are entitled to a rebuttable presumption that they qualify for incentives under section 219 of the FPA. Otter Tail asserts that the Commission previously determined that the three Otter Tail CapX2020 Projects are entitled to a rebuttable presumption "if they receive a Certificate of Need from the Minnesota [Public Utilities Commission]" (Minnesota Commission).[15] Otter Tail states that all three of the Otter Tail CapX2020 Projects have now received Certificates of Need from the Minnesota Commission.[16]

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[11] Exhibit No. OTP-8 at 5.

[12] Exhibit No. OTP-3 at 3-5.

[13] Exhibit No. OTP-1 at 20.

[14] *Promoting Transmission Investment through Pricing Reform*, Order No. 679, FERC Stats. & Regs. ¶ 31,222 (2006), *order on reh'g*, Order No. 679-A, FERC Stats. & Regs. ¶ 31,236, *order on reh'g*, 119 FERC ¶ 61,062 (2007).

[15] *Xcel Energy Services, Inc.*, 121 FERC ¶ 61,284 (2007) (*Xcel)* at P 53.

[16] *In the Matter of the Application of Great River Energy, Northern States Power Company (d/b/a Xcel Energy), and Others for Certificates of Need for the CapX 345-kv Transmission Project*, Order Granting Certificates of Need With Conditions, MPUC Docket No. ET-2, E-002, *et al.*/CN06-1115; (May 2, 2009), *on reconsideration*, Order Granting and Denying Motions for Reconsideration, and Modifying Conditions (August 10, 2009), *appeal pending sub. Nom. A09-1646 and A09-1653.; In the Matter of the Application of Otter Tail Power Company, et al. for a 230 kV Transmission Line from*

(continued…)

8. Second, Otter Tail asserts that the Commission has previously found that the Otter Tail CapX2020 Projects are not routine and present special risks, and that nothing has changed since the Commission made that finding.[17] Further, Otter Tail contends that the Otter Tail CapX2020 Projects are not routine because Otter Tail's investment in the projects represents an extraordinary investment in transmission expansion for Otter Tail over a six-year period. Otter Tail states that its expected investment in the Otter Tail CapX2020 Projects over the next five years will effectively double Otter Tail's existing transmission rate base.[18] In addition, Otter Tail explains that the projects are not routine because the projects extend over Minnesota, South Dakota, and North Dakota, and, as the Commission has recognized, projects located in multiple states present special risks and challenges.[19]

9. Otter Tail also claims that the Commission should find that the Otter Tail CapX2020 projects are not routine because the Commission has held that regional projects are not routine "by definition" and, in this case, the Otter Tail CapX2020 Projects have been planned regionally in conjunction with Midwest ISO.[20] Moreover, Otter Tail contends that the Otter Tail CapX2020 Projects cannot be considered routine,[21] as they are among the largest transmission infrastructure projects to be constructed in the upper Midwest in approximately three decades.[22]

10. Otter Tail states that 100 percent CWIP Recovery will relieve downward pressure on Otter Tail's credit ratings. Otter Tail states that it holds corporate credit and senior unsecured credit ratings from Standard and Poor's (S&P) of BBB-, one notch above non-

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Bemidji to Grant Rapids, *Minnesota* MPUC Dockets E-017, E-015, ET-6/CN-07-1222 (July 14, 2009). Exhibit No. OTP-3 at 14, 19, 23.

[17] Transmittal Letter at 22; Exhibit No. OTP-3 at 27-29 (citing Xcel Order at P 53.).

[18] Exhibit No. OTP-3 at 3. Otter Tails notes that its net transmission plant in-service for calendar-year 2008 as reflected in its current Attachment O under Midwest ISO's Tariff is over $137 million, Exhibit No. OTP-3 at 3 n.1.

[19] Transmittal Letter at 22 (citing Order No. 679 at P 94.).

[20] Transmittal at 23 (citing *Baltimore Gas and Elec. Co.* 120 FERC ¶ 61,084, at P 58 (2007).).

[21] Otter Tail has provided a technology statement but notes that, although it is not seeking an advanced technology incentive, it will use advanced technologies.

[22] Transmittal Letter at 23.

investment grade status. Otter Tail asserts that any downgrade of this rating would have adverse financial consequences for Otter Tail and its customers.[23] Otter Tail states that, absent the requested incentives, the additional debt assumed to fund the Otter Tail CapX2020 Projects would put downward pressure on the credit metrics for interest coverage (i.e., funds from operations divided by interest expense) and leverage (i.e., funds from operations divided by debt) which could then negatively affect Otter Tail's credit ratings. This would increase Otter Tail's future borrowing costs and, ultimately, lead to higher rates for its customers.[24] According to Otter Tail, in order for it to continue to attract investors in the debt capital markets, it must maintain a track record of stable financial and operating statistics, including strong debt service coverage and equity-to-capitalization ratios, predictable and stable cash flows, and favorable regulatory treatment.[25]

11. Otter Tail claims that its request for 100 percent CWIP Recovery is tailored to the risks and challenges associated with its extraordinary investment in the Otter Tail CapX2020 Projects. Otter Tail explains that allowing 100 percent CWIP Recovery will improve Otter Tail's financial options, provide up-front regulatory certainty to its lenders, stabilize rates, increase cash flow, and mitigate the strain on Otter Tail's finances due to the substantial capital expenditures during construction.[26] Further, Otter Tail states that the return on CWIP will help maintain Otter Tail's investment grade rating, generate cash to begin servicing debt, and lower the overall cost of the project.[27] Otter Tail emphasizes

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[23] *Id.* at 25.

[24] Exhibit No. OTP-13 at 12-14.

[25] *Id.* at 7 and 11. Otter Tail states that it expects to face a negative cash flow position as a result of its investment in the Otter Tail CapX2020 Projects and other transmission projects. In particular, Otter Tail states that absent 100 percent CWIP recovery, spending would exceed cash flows by approximately $129.5 million between 2010 and 2014. Otter Tail states that allowing 100 Percent CWIP Recovery will provide it with a more positive cash flow during this time than recording construction costs in the form of Allowance for Funds Used During Construction (AFUDC), as is currently done. Otter Tail contends that if 100 percent CWIP Recovery for these projects is authorized, Otter Tail will be able to recover $128.7 million on the Otter Tail CapX2020 Projects from 2010 through 2015. In contrast, Otter Tail asserts that it would only recover $115.4 million on the Otter Tail CapX2020 Projects during that time period under the traditional AFUDC mechanism.

[26] *Id.* OTP-13 at 7.

[27] *Id.*

that allowing 100 percent CWIP Recovery will not have an adverse impact on electric transmission rates. Otter Tail contends that, on the contrary, allowing 100 percent CWIP recovery will actually reduce rates on a nominal basis, and that customers will pay $23 million less for the Otter Tail CapX2020 Projects with 100 percent CWIP Recovery than they would have paid with the traditional AFUDC mechanism.[28]

12. Otter Tail states that Abandoned Plant Recovery is tailored to the risks associated with the Otter Tail CapX2020 Projects. Otter Tail claims that granting the incentive would eliminate the risk that Otter Tail's stakeholders will have to bear the costs of any of the Otter Tail CapX2020 Projects that are cancelled for reasons beyond Otter Tail's control.[29] It asserts that the Otter Tail CapX2020 Projects present special risks of abandonment because they require the approval of multiple jurisdictions, are dependent upon continued participation by multiple owners, and are being constructed to support expected new generation without existing interconnection and transmission agreements.[30] Otter Tail also contends that potential opposition to the transmission lines may present additional risks that a project may be abandoned for reasons outside of its control.[31]

13. Otter Tail asserts that, taken together, the total package of requested incentives is tailored to the risks and challenges of the Otter Tail CapX2020 Projects. Otter Tail explains that the requested incentives are consistent with each other because each incentive serves to reduce the risks presented by transmission projects and to remove potential obstacles to construction of those projects.[32] Otter Tail states that the Commission has expressly recognized that 100 percent CWIP Recovery and Abandoned Plant Recovery can be used together, and that the incentives are similar in that they are interrelated and each one is designed to remove impediments to transmission construction.[33]

14. Third, Otter Tail contends that the rates resulting from allowing the requested rate incentives are just and reasonable. Otter Tail asserts that its request to add a placeholder for Abandoned Plant Recovery will not impact rates. With respect to 100 percent CWIP

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[28] *Id.* at 23.

[29] Transmittal Letter at 26.

[30] Transmittal Letter at 26-27.

[31] *Id.* at 27 (citing *Southern Calif. Edison Co.*, 112 FERC ¶ 61,014, at P 58-61, *reh'g denied*, 113 FERC ¶ 61,143, at P 9-15 (2005).

[32] Transmittal Letter at 27.

[33] *Id.* at 28 (citing Order No. 679 at P 28-29, 117).

Recovery, Otter Tail claims that the requested incentive will affect only the timing of cost recovery, and that, to the extent that it affects rates, the requested incentive may result in a nominal reduction in the costs that customers pay for the Otter Tail CapX2020 Projects.

15. Otter Tail also makes a number of requests and commitments regarding the Commission's regulations concerning 100 percent CWIP Recovery. Otter Tail notes that applicants seeking CWIP in rate base under a formula rate must make an annual filing informing the Commission of their request for inclusion of CWIP in rate base, and Otter Tail proposes to satisfy this requirement through an annual filing of the FERC's Form No. 730.[34] Otter Tail proposes to implement a "pre-funded" AFUDC calculation, where pre-funded AFUDC is an offset to rate base that is applied after the standard AFUDC is calculated, mandating a zero AFUDC rate for CWIP that was included in rate base.[35] Otter Tail proposes to determine the pre-funded amount by multiplying the standard AFUDC amount by the jurisdictional percentage, i.e., it would multiply the standard AFUDC amount by the percentage of retail and wholesale rate jurisdictions that allow CWIP in rate base.

16. Otter Tail states that AFUDC will be recorded to income and CWIP during the construction phase and a "pre-funded" AFUDC calculation will be simultaneously made on CWIP projects that are included in rate base in the projected rate formula. Otter Tail will then use this "pre-funded" AFUDC amount to offset the amount of AFUDC collected on CWIP projects to avoid double recovery of construction financing costs.[36]

17. Otter Tail proposes to modify the formula rate Attachment O-Otter Tail to implement its requested 100 percent CWIP Recovery and the pre-funded AFUDC. Otter Tail has inserted line 18a, labeled "CWIP for Certificate of Need Projects," to add CWIP,

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[34] Transmittal Letter at 34.

[35] Exhibit No. OTP-19 at 4.

[36] Otter Tail proposes to accrue AFUDC on 100 percent of its CWIP balances by debiting Account No. 107, Construction Work In Progress-Electric, and crediting Account No. 419.1, Allowance for Other Funds Used During Construction, and Account No. 432, Allowance for Borrowed Funds Used During Construction—Credit. To record the pre-funded AFUDC, Otter Tail proposes to debit Account No. 419.1 and Account No. 432, and credit Account No. 254, Other Regulatory Liabilities. When construction is complete, the CWIP will be transferred to utility plant in-service and depreciation will be started. Finally, Otter Tail proposes to amortize the regulatory liability by debiting Account No. 254 and crediting Account No. 405, Amortization of Other Electric Plant, over the average life of the Otter Tail CapX2020 Projects to serve as an offset to depreciation expense.

including its related AFUDC, to rate base. To offset AFUDC on CWIP in rate base, Otter Tail proposes to include an adjustment to rate base on line 23a, labeled "Net Prefunded AFUDC on CWIP included in Rate Base." In addition, Otter Tail proposes to add a new line related to transmission depreciation expense labeled "Pre-funded AFUDC Amortization", which will offset depreciation expense by the amortization of the pre-funded AFUDC recorded as a regulatory liability in Account No. 254.

B. Other Proposed Formula Rate Modifications

18. Otter Tail proposes to implement its Attachment O-Otter Tail formula rates using projected cost inputs to develop the annual transmission revenue requirement and projected transmission loads to calculate the transmission rates.[37] The projected rates would be assessed on a calendar year basis beginning January 1, rather than by calculating the annual transmission revenue requirement based on the previous year's data.[38] Otter Tail states that the projected rates would be subject to an annual true-up, with interest, based on actual costs, as reported in Otter Tail's FERC Form No. 1. The annual transmission revenue requirement based on projected costs for the next calendar year will be posted on its Open Access Same-Time Information (OASIS) by September 1 of each year and Otter Tail will hold a customer meeting by October 31 of each year to explain those Attachment O-Otter Tail formula rate input projections and cost details. Otter Tail states that it has posted the 2010 estimates and formulas on its OASIS concurrently with this filing, and will hold a customer meeting on or before November 30, 2009.[39]

19. Otter Tail states that this will ensure a consistent rate methodology in the Otter Tail pricing zone and eliminate the lag in cost recovery, which has posed problems during years in which Otter Tail is undertaking large transmission capital projects.[40] Otter Tail contends that the proposed revisions to implement its transmission rate formula using projected test period costs would enable Otter Tail to recover its costs in the same year they are incurred. Otter Tail states that the proposed Attachment O-Otter Tail revisions using a forward-looking formula rate follow closely revisions to the

[37] Exhibit No. OTP-8 at 5.

[38] *Id*.

[39] Exhibit No. OTP-5 at 10-11.

[40] Transmittal Letter 14-16.

transmission formula rates of other Midwest ISO transmission owners that the Commission has approved.[41]

20. Otter Tail also proposes an additional procedure,[42] which it notes the Commission has previously approved for other Midwest ISO transmission owners.[43] Specifically, Otter Tail is proposing an option to accelerate any refunds of over-collections to Tariff customers by one year, to lessen the amount of interest due.[44]

21. Finally, Otter Tail requests waiver of a number of provisions of the Commission's regulations. Otter Tail asks the Commission to waive the filing requirements in sections 35.25(c)(4) and 35.25(g) relating to the anticompetitive impacts of CWIP recovery on the basis that it has provided sufficient information to meet the requirements of those sections. Otter Tail also seeks waiver of the requirements of section 35.13(d) concerning Period I and Period II data on the basis that the inputs for its formula rate are provided annually. Noting that it has served the filing electronically and has posted a copy on Midwest ISO's website, Otter Tail maintains that good cause exists for waiver of section 385.2010 because of the volume of potentially interested parties, the limited resources available for service, and the financial burden that mailing copies would impose. Lastly, Otter Tail seeks waiver of any other Commission rule or regulation necessary to permit the proposed tariff changes to be accepted by the Commission and made effective January 1, 2010, as requested.

III. Notice of Filings and Responsive Pleadings

22. Notice of Otter Tail's filing was published in the *Federal Register*, 74 Fed. Reg. 58269 (2009), with interventions and comments due on or before November 20, 2009. Timely motions to intervene, raising no substantive issues, were filed by Missouri River Energy Services, Great River, and Xcel Energy Services Inc.

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[41] *Id.* at 14-15 (citing *Michigan Elec. Transmission Co.*, 117 FERC ¶ 61,314 (2006), *order on reh'g*, 118 FERC ¶ 61,139, *order on compliance*, 119 FERC ¶ 61,203 (2007); *American Transmission Co.*, 97 FERC ¶ 61,139 (2001) (*ATC*)).

[42] Otter Tail is also evaluating alternative methods for the Attachment GG true-up and expects to file the applicable methodology in the first quarter of 2010.

[43] *See American Transmission Co*., Docket No. ER05-1506-000 (December 20, 2005) (unpublished letter order); *Southern Indiana Gas & Elec. Co*., Docket No. ER09-180-000 (December 19, 2008) (unpublished letter order); *Xcel*, 121 FERC ¶ 61,284 (2007).

[44] Exhibit No. OTP-8 at 10.

IV. Discussion

A. Procedural Matters

23. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2009), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

B. Section 219 and Order No. 679 Incentives

1. Section 219 Requirements

24. In the Energy Policy Act of 2005,[45] Congress added section 219 to the FPA and directed the Commission to establish rules providing incentives to promote capital investment in transmission infrastructure. The Commission subsequently issued Order No. 679, setting forth processes by which a public utility may seek transmission rate incentives pursuant to section 219, such as the incentives requested here by Otter Tail.

25. Pursuant to section 219, an applicant must show that "the facilities for which it seeks incentives either ensure reliability or reduce the cost of delivered power by reducing transmission congestion."[46] Also, as part of this demonstration, "section 219(d) provides that all rates approved under the Rule are subject to the requirements of sections 205 and 206 of the FPA, which require that all rates, charges, terms and conditions be just and reasonable and not unduly discriminatory or preferential."[47]

26. Order No. 679 provides that a public utility may file a petition for declaratory order or a section 205 filing to obtain incentive rate treatment for transmission infrastructure investment that satisfies the requirements of section 219 (i.e., the applicant must demonstrate that the facilities for which it seeks incentives either ensure reliability and/or reduce the cost of delivered power by reducing transmission congestion).[48] Order No. 679 establishes a process for an applicant to follow to demonstrate that it meets this standard, including a rebuttable presumption that the standard is met if: (1) the transmission project results from a fair and open regional planning process that considers and evaluates projects for reliability and/or congestion and is found to be acceptable to the Commission; or (2) the transmission project has received construction approval from

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[45] Pub. L. No. 109-58 § 1241 (2005), 119 Stat. 594.

[46] Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 76.

[47] *Id.* P 8 (citing 16 U.S.C. §§ 824(d) and 824(e) (2006)).

[48] 18 C.F.R. § 35.35(i) (2008).

an appropriate state commission or state siting authority.[49] Order No. 679-A clarifies the operation of this rebuttable presumption by noting that the authorities and/or processes on which it is based (i.e., a regional planning process, a state commission, or siting authority) must, in fact, consider whether the project ensures reliability or reduces the cost of delivered power by reducing congestion.[50]

27. In *Xcel*, we found that projects that are part of Phase 1 of the CapX2020 Project, three of which are the same as the Otter Tail CapX2020 Projects, qualify for a rebuttable presumption that they are eligible for incentives under the requirements of FPA section 219 if they received Certificates of Need from the Minnesota Commission.[51] Each of the projects has received a Certificate of Need. Therefore, we find that the Otter Tail CapX2020 Projects qualify for a rebuttable presumption that they meet the requirements of FPA section 219.

2. The Nexus Requirement

28. We find that Otter Tail's request for incentives meets the Commission's nexus requirement. To satisfy the nexus requirement, an applicant must demonstrate that there is a nexus between the incentive sought and the investment being made. In Order No. 679-A, the Commission clarified that the nexus test is met when an applicant demonstrates that the total package of incentives requested is "tailored to address the demonstrable risks or challenges faced by the applicant."[52] The Commission noted that this nexus test is fact-specific and requires the Commission to review each application on a case-by-case basis.

29. As part of this evaluation, the Commission has found the question of whether a project is "routine" to be particularly probative.[53] In *BG&E*, the Commission clarified how it will evaluate projects to determine whether they are routine. Specifically, to determine whether a project is routine, the Commission will consider all relevant factors presented by an applicant. For example, an applicant may present evidence on: (1) the

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[49] Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 58.

[50] Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 49.

[51] *Xcel*, 121 FERC ¶ 61,284 at P 53.

[52] Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 40.

[53] *Baltimore Gas and Elec. Co.*, 120 FERC ¶ 61,084, at P 48 (2007) (*BG&E*), 121 FERC ¶ 61,167, *reh'g denied*, 122 FERC ¶ 61,034 (2008), *reh'g denied*, 123 FERC ¶ 61,262 (2008).

scope of the project (e.g., dollar investment, increase in transfer capability, involvement of multiple entities or jurisdictions, size, effect on region); (2) the effect of the project (e.g., improving reliability or reducing congestion costs); and (3) the challenges or risks faced by the project (e.g., siting, internal competition for financing with other projects, long lead times, regulatory and political risks, specific financing challenges, other impediments).[54] Additionally, the Commission clarified that "when an applicant has adequately demonstrated that the project for which it requests an incentive is not routine, that applicant has, for purposes of the nexus test, shown that the project faces risks and challenges that merit an incentive."[55]

30. As we found in *Xcel*,[56] the Otter Tail CapX2020 Projects are not routine and present special risks. As discussed further below, we find that Otter Tail's request for incentives meets the nexus requirement.

a. **Abandoned Plant Recovery**

31. In Order No. 679, the Commission found that Abandoned Plant Recovery is an effective means to encourage transmission development by reducing the risk of non-recovery of costs.[57] We find that Otter Tail has shown, consistent with our discussion in *Xcel*, [58] a nexus between the requested Abandoned Plant Recovery incentive and its planned investment. Besides their scope, size and long-lead times, the Otter Tail CapX2020 Projects present special risks because they require approvals from multiple jurisdictions, and are still subject to potential cancelation or modifications due to decisions beyond Otter Tail's control. Accordingly, we find that Otter Tail's request for Abandoned Plant Recovery meets the nexus requirement.[59]

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[54] *Id.* P 52-55.

[55] *Id.* P 54.

[56] *Xcel*, 121 FERC ¶ 61,284 at P 56.

[57] Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 163.

[58] *Xcel*, 121 FERC ¶ 61,284 at P 63.

[59] We note that if any part of the Otter Tail CapX2020 Projects is abandoned, Otter Tail must make a filing demonstrating that the costs of the project were prudently incurred, and that the project was abandoned for reasons beyond Otter Tail's control.

b. Construction Work in Progress

32. In Order No. 679, the Commission established a policy that allows utilities to include, where appropriate, 100 percent of prudently-incurred transmission-related CWIP in rate base.[60] The Commission noted in Order No. 679 that this rate treatment will further the goals of section 219 by providing up-front regulatory certainty, rate stability, and improved cash flow for applicants, thereby reducing the pressures on their finances caused by investing in transmission projects.[61]

33. We find that Otter Tail has shown a nexus between the proposed 100 percent CWIP Recovery incentive and its investment in the Otter Tail CapX2020 Projects. Otter Tail has demonstrated that the size and scope of the Otter Tail CapX2020 Projects pose risks of decreasing Otter Tail's investment rating. We find that authorizing 100 percent CWIP Recovery for the Otter Tail CapX2020 Projects will enhance Otter Tail's cash flow, reduce interest expenses, assist Otter Tail with obtaining favorable financing, and improve the coverage ratios used by rating agencies to determine Otter Tail's credit quality by replacing non-cash AFUDC with cash earnings. This, in turn, will reduce the risk of a down-grade in Otter Tail's investment ratings. These factors are comparable to those that the Commission has taken into consideration in authorizing CWIP in rate base for other utilities.[62]

34. Consistent with Commission precedent, we will accept Otter Tail's proposal to file a FERC Form No. 730 report to satisfy the filing requirements for inclusion of CWIP in rate base in its rate formula. We will also accept Otter Tail's proposal to develop and post on OASIS, as part of the annual customer notification and information procedures, work papers that show the cost information and in-service date assumptions regarding the transmission projects and estimated CWIP amounts to be included in its formula rate for each year.

c. Nexus with Total Package of Incentives

35. We find that Otter Tail has shown that the total package of incentives is tailored to address the demonstrable risks or challenges faced by Otter Tail in investing in the Otter Tail CapX2020 Projects.[63] Consistent with Order No. 679, the Commission has, in prior

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[60] Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 29, 117.

[61] *Id.* at P 115.

[62] *Xcel*, 121 FERC ¶ 61,284 at P 59.

[63] *See* Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 21, 27.

cases, approved multiple rate incentives for particular projects.[64] This is based upon our interpretation of FPA section 219 as authorizing the Commission to approve more than one incentive rate treatment for an applicant proposing a new transmission project, as long as each incentive is justified by a showing that it satisfies the requirements of FPA section 219 and that there is a nexus between the incentives being proposed and the investment being made.

36. Here, we find that the total package of incentives requested by Otter Tail is tailored to the risks it faces in investing in the Otter Tail CapX2020 Projects. As discussed above, Otter Tail has demonstrated that each of the requested incentives will reduce the risks that Otter Tail faces and will remove potential obstacles to the construction of these projects.

C. Section 205 Determination

37. The Commission also accepts for filing Otter Tail's proposal to use projected test year cost inputs with a true-up mechanism and formula rate modifications to accelerate refunds and convene customer meetings by October 31 of each year, effective January 1, 2010. Our analysis indicates that Otter Tail's proposal to switch to a forward-looking transmission formula rate with a true-up mechanism is just and reasonable. The use of projected costs is consistent with the formula rates in the Attachment O of the Midwest ISO Tariff that we have previously approved for other Midwest ISO transmission owners.[65]

38. For the reasons discussed below, we find that Otter Tail has demonstrated that it meets the requirements for the requested incentive-based rate treatments. However, the Commission finds that certain modifications need to be made to the formula rate in Attachment O – Otter Tail. Additionally, the Commission finds that Otter Tail must file a new Attachment GG.

39. Attachment O-Otter Tail and Attachment GG work together to calculate charges associated with the Otter Tail CapX2020 Projects. Attachment O-Otter Tail includes a non-levelized formula rate used to calculate Otter Tail's rates for charges under Schedule 7, 8, and 9 of the Tariff for service over its facilities. Attachment O-Otter Tail calculates

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[64] *See, e.g.*, *PATH*, 122 FERC ¶ 61,188; *Southern California Edison Co.*, 121 FERC ¶ 61,168 (2007).

[65] *See International Transmission Co.*, 116 FERC ¶ 61,036 (2006); *Michigan Elec. Transmission Co. LLC,* 117 FERC ¶ 61,314 (2006); and *ITC Holdings Corp.*, 121 FERC ¶ 61,229 (2007).

total costs less costs recovered under other schedules and rate formula attachments in the Midwest ISO Tariff.

40. Attachment GG, which will be used to recover the costs of the Otter Tail CapX2020 Projects to the extent they qualify for regional cost sharing under Attachment FF of Midwest ISO's Tariff, is a formula rate used to calculate Otter Tail's transmission service charges under Schedule 26 of Midwest ISO's Tariff which are in addition to any charges under Schedule 7, 8, and 9. Attachment GG applies fixed charge rates, reflecting average company costs (e.g. return, income taxes, taxes other than income taxes, and operating and maintenance expenses), to project plant investment and adds depreciation. The Attachment GG costs for the project are then treated as reductions on Attachment O-Otter Tail to avoid double recovery.

41. Otter Tail modifies Attachment O-Otter Tail to include line items for CWIP, prefunded AFUDC on CWIP in rate base and prefunded AFUDC amortization to reflect the 100 percent CWIP Recovery incentive. In addition, Otter Tail modifies Attachment O-Otter Tail to include line items for inclusion of the unamortized balance of abandoned plant and abandoned plant amortization, with a placeholder equal to zero, to reflect the Abandoned Plant Recovery incentive.

42. With respect to the Abandoned Plant Recovery incentive, we find that Otter Tail's revision of the formula rate in Attachment O-Otter Tail to include a placeholder for this incentive is reasonable. Otter Tail's request for Abandoned Plant Recovery will not affect Otter Tail's transmission rates without Otter Tail making a future filing with the Commission to demonstrate that the costs of the abandoned plant were prudent and that the plant was abandoned for reasons beyond Otter Tail's control. If Otter Tail were to make such a showing, this placeholder will allow Otter Tail to recover an amortized portion of the abandoned plant as well as earn a return on the unamortized portion of the abandoned plant, as appropriate. However, it appears to the Commission that Otter Tail overlooked the need to make some modifications to Attachment GG to reflect properly the requested Abandoned Plant Recovery incentive. Otter Tail should file a new Attachment GG to include the unamortized balance of abandoned plant in project net plant amounts so that customers taking service under Schedule 26 will be charged the return on any future abandoned plant costs, to the extent that the projects qualify for regional cost-sharing under Attachment GG, and so that such costs will not be fully born by those customers taking service under Schedules 7, 8 and 9.

43. With respect to Otter Tail's proposed implementation of 100 percent CWIP Recovery, we find that Otter Tail has not implemented the incentive properly in its formula rate in Attachment O. Otter Tail proposes accounting procedures and formula rate modifications intended to avoid double recovery of capitalized AFUDC and amounts associated with CWIP in rate base. Specifically, Otter Tail establishes a "pre-funded" AFUDC credit that will offset the capitalized AFUDC on projects that received approval for inclusion of CWIP in rate base to avoid double recovery of construction financing

costs. Otter Tail states that its pre-funded AFUDC mechanism to avoid double recovery is based on other Commission-approved incentive proposals.[66] However, Otter Tail's proposal is not identical to previously approved proposals. To implement the 100 percent CWIP Recovery incentive properly and avoid double recovery, Otter Tail is hereby ordered to submit a compliance filing within 30 days of this order, to revise its formula as explained below.

44. AFUDC represents a return on construction expenditures that is capitalized as part of the cost of the plant and included in rate base when the plant is put into service. The utility recovers AFUDC (i.e., return on construction expenditures), as a part of the cost of the plant, over the useful life of the plant through depreciation expense. Under Order No. 679, the Commission can grant a project-specific incentive that allows a utility to include 100 percent of CWIP related to that project in rate base. By including the CWIP in rate base, the utility recovers a return on the construction expenditures during construction. Thus, CWIP in rate base creates a timing difference from what would have occurred with AFUDC treatment. In other words, with CWIP in rate base, the utility earns a return on construction expenditures during construction instead of capitalizing the return on construction expenditures, putting the associated plant into service and recovering the return on construction expenditures over the life of the plant as would happen with AFUDC. Because both inclusion of CWIP in rate base and AFUDC represent a return on construction expenditures, the Commission requires utilities to implement accounting and rate procedures to prevent a double recovery of the return on construction expenditures (i.e., to prevent recovering a return on construction expenditures through CWIP in rate base while also accruing a return on construction expenditures through AFUDC to be recovered later over the life of the plant).

45. Under the proposed formula rate and narratives, Otter Tail includes 100 percent of AFUDC on all transmission investment, including 100 percent of AFUDC on those facilities approved for the CWIP in rate base incentive. With our granting of the 100 percent CWIP Recovery above, Otter Tail will have CWIP in rate base for the Otter Tail CapX2020 Projects while it is accruing AFUDC on those same projects. Otter Tail proposes to ameliorate this double recovery by including, as a reduction to rate base, a "pre-funded" AFUDC credit that would offset the accrued AFUDC. To the extent the "pre-funded" AFUDC fully offsets the accrued AFUDC on the projects included in rate base, double recovery would be eliminated.

46. While it appears that Otter Tail is including 100 percent of AFUDC on projects included as CWIP in rate base, Otter Tail states that the pre-funded AFUDC will be adjusted by a jurisdictional percentage that reflects all jurisdictions in which Otter Tail does business. If the jurisdictional percentage reduces the pre-funded AFUDC offset to

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[66] Transmittal Letter at 31 (citing *Xcel*, 121 FERC ¶ 61,284 at P 2.).

an amount less than the AFUDC accrued on CWIP balances included in rate base, Otter Tail would over-recover. Therefore, the Commission directs Otter Tail in its compliance filing to include in its pre-funded AFUDC (line 23a), 100 percent of the pre-funded AFUDC for projects that the Commission allowed CWIP to be included in rate base on line 18a. If Otter Tail wants to use a jurisdictional percentage less than 100 percent in its pre-funded AFUDC calculation, Otter Tail must explain in its compliance filing how it will avoid double recovery of capitalized AFUDC and amounts related to CWIP in rate base.[67]

47. To clarify further Otter Tail's implementation of the 100 percent CWIP Recovery, we will also require Otter Tail to make changes to its formula rate in the required compliance filing. On Page 2, line 18a, of the Attachment O transmission formula rate, Otter Tail describes and titles, line 18a Note Z as "CWIP for Certificate of Need Projects." That description in line 18a Note Z does not limit the includable projects to those that receive Commission approval for inclusion of CWIP in rate base. The Commission finds that Otter Tail must limit CWIP amounts on line 18a to those projects for which Commission has allowed inclusion of CWIP in rate base. Therefore, in its compliance filing, Otter Tail must modify the title to line 18a, and all related footnotes, to include only those projects authorized by the Commission for inclusion of CWIP in rate base. Additionally, Otter Tail titles line 23a, on Page 2 of the Attachment O formula rate "Net Prefunded AFUDC on CWIP Included in Rate Base (Note Y and Note Z)". It is unclear what Otter Tail means by "net." Accordingly, Otter Tail must include in its compliance filing an explanation of how line 23a, Net Prefunded AFUDC, will be determined.[68]

48. In addition, with respect to the treatment of the 100 percent CWIP Recovery incentive on Attachment GG, a corresponding amount of prefunded AFUDC should be removed from the formula rate in Attachment GG for any accrued AFUDC amounts on plant included in CWIP balances in rate base. While Attachment GG is explicit in the inclusion of any CWIP balance in rate base approved for projects, it lacks an explicit statement to remove a corresponding amount of prefunded AFUDC. The result could be that charges under Schedule 26 would over-recover return on capital expenditures (i.e. recover both AFUDC and return on CWIP). For this reason, Otter Tail is directed to file a new Attachment GG to state explicitly that a corresponding amount of prefunded

[67] *Xcel*, 121 FERC ¶ 61,284 (2007).

[68] In addition, Otter Tail did not explain its internal controls or procedures to properly calculate pre-funded AFUDC for all Commission approved projects receiving 100 percent CWIP Recovery. Therefore, Otter Tail must include in its compliance filing its internal controls and procedures to calculate pre-funded AFUDC to ensure it includes all AFUDC amounts related to CWIP included in rate base.

AFUDC will be removed under the formula in Attachment GG for any associated CWIP balance included in rate base for the projects.

49. Accordingly, we will direct Otter Tail to make a compliance filing within 30 days from the date of this order to revise its proposed formula rates as discussed above.

D. Accounting Issues

50. The Commission finds that Otter Tail must modify its accounting treatment related to its 100 percent CWIP Recovery incentive. Specifically, in order to amortize the pre-funded AFUDC in Account No. 254, Otter Tail must credit Account No. 407.4, Regulatory Credits, rather than Account No. 405. Account No. 405 includes charges for amortization of intangible or other electric utility plant which does not have a definite or terminable life and which is not subject to charges for depreciation expense. We find Otter Tail's amortization of pre-funded AFUDC to be different from intangible or other electric plant that is properly amortized to Account No. 405. Therefore, consistent with prior approvals, we find it appropriate to amortize pre-funded AFUDC in Account No. 254 to Account No. 407.4.[69]

E. Request for Additional Waivers

51. We will grant Otter Tail's waiver of sections 35.25(c)(4) and 35.25(g) of the Commission's regulations because we agree with Otter Tail that the information provided in the filing is sufficient to meet the requirements of those sections. Similarly, we will grant Otter Tail's request for waiver of section 35.13(d) of the Commission's regulations because Otter Tail provides the inputs for its formula rate on an annual basis.[70] Likewise, we find that Otter Tail has shown good cause for waiver of section 385.2010 of the Commission's regulations, and we will grant its request.

The Commission orders:

(A) Otter Tail's requests for 100 percent CWIP Recovery and Abandoned Plant Recovery are hereby granted, effective January 1, 2010, as discussed more fully above.

(B) Otter Tail's proposed revisions to Attachment O-Otter Tail are hereby conditionally accepted, effective January 1, 2010.

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[69] *The United Illuminating Company*, 119 FERC ¶ 61,182 (2007); *Northeast Utilities Service Company and National Grid USA*, 125 FERC ¶ 61,183 (2008).

[70] *See Michigan Electric Transmission Co., LLC*, 117 FERC ¶ 61,314, at P 33-34 (2006).

(C) Otter Tail is ordered to make a compliance filing, to be submitted within 30 days of this order, with the modifications to Otter Tail's Attachment O and a new Attachment GG, as discussed in the body of this order.

(D) Otter Tail is hereby granted waiver of sections 35.25(c)(4), 35.25(g), 35.13(d), and 385.2010, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.