

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Otter Tail Power Company

Docket No. AC06-32-001

ORDER ON REHEARING

(Issued May 31, 2007)

1. On February 12, 2007, Otter Tail Power Company (Otter Tail Power) filed a request for rehearing of a delegated letter order issued by the Chief Accountant.¹ The January 12 Order denied Otter Tail Power's February 17, 2006, request for a waiver of the Commission's regulations to allow Otter Tail Power to exclude short-term debt from its calculation of its Allowance for Funds Used During Construction (AFUDC) rate. In the alternative, if rehearing is denied, Otter Tail Power requests that the Commission apply the decision in the January 12 Order on a prospective-only basis and allow Otter Tail Power to avoid retroactively adjusting its AFUDC rate calculations, which it claims would be unduly burdensome for a *de minimis* result. For the reasons appearing below, rehearing is denied, but Otter Tail Power's alternative request is granted.

Background

2. In its filing of February 17, 2006, Otter Tail Power requested waiver of the Commission's regulations in order to allow Otter Tail Power to exclude short-term debt financing from its calculation of its AFUDC rate.² Otter Tail Power argued that the Commission's inclusion of short-term debt costs in determining an AFUDC rate was based on the assumption that short-term debt is generally the first source of funds used to

¹ *Otter Tail Power Company*, Docket No. AC06-32-000 (January 12, 2007) (January 12 Order).

² See 18 C.F.R. Part 101, Electric Plant Instruction No. 3(a)(17) (2006). That instruction provides for inclusion of short-term debt in the calculation of the AFUDC rate. *Id.*

fund construction. Otter Tail Power stated, however, that it does not use short-term debt for any of its electric construction, since its current or projected cash flows are sufficient to cover its construction and operation activities. Moreover, Otter Tail Power argued that it has a line of credit agreement with U.S. Bank National Association that explicitly restricts the use of short-term debt to fund non-electric operations.

3. The January 12 Order denied Otter Tail Power's request because it was not consistent with Order No. 561, which established the formula for calculating an AFUDC rate.³ The January 12 Order reiterated, in response to Otter Tail Power's claim that the Commission's rules reflect the assumption that short-term debt is the first source used to finance construction but that Otter Tail Power does not use short-term debt for that purpose, the Commission's statement in Order No. 561 that "[i]t is generally impossible to specifically trace the source of funds used for various corporate purposes and it was not the purpose of our proposed rule to do so."⁴ The January 12 Order further explained that the AFUDC rate formula adopted by the Commission in Order No. 561 is not based on tracing funds; instead it is intended to give utilities an opportunity to be compensated for the overall total cost of capital devoted to utility operations, including construction programs.⁵

4. Moreover, the January 12 Order noted that the fact that the short-term debt proceeds "are restricted" was not a sufficient basis to exclude them from the calculation of the AFUDC rate; Accounting Release No. AR-13 has long held that use-restricted debt should be included in the calculation of the AFUDC rate.⁶ Finally, the January 12 Order

³ *Amendments to Uniform System of Accounts for Public Utilities and Licensees and for Natural Gas Companies (Classes A, B, C and D) to Provide for the Determination of Rate for Computing the Allowance for Funds Used During Construction and Revisions of Certain Schedule Pages of FPC Reports*, Order No. 561, 57 FPC 608 (1977), *reh'g denied*, Order No. 561-A, 59 FPC 1340 (1977), *order on clarification*, 2 FERC ¶ 61,050 (1978).

⁴ Order No. 561, 57 FPC at 608-09; *accord* Order No. 561-A, 59 FPC at 1341. In fact, the Commission made this statement in response to an argument, like that made here, that short-term debt is not necessarily the first source of construction funds. Order No. 561, 57 FPC at 608.

⁵ Order No. 561, 59 FPC at 609; *accord* Order No. 561-A, 59 FPC at 1341.

⁶ Accounting Release No. AR-13, FERC Stats. & Regs. ¶ 40,013 at 40,017 (May 1, 1983).

concluded that two letter orders cited by Otter Tail Power were inapposite, involving different facts and issues.

5. The January 12 Order therefore denied Otter Tail Power's request that its short-term debt be excluded from its computation of the AFUDC rate.

Request for Rehearing

6. Otter Tail Power has requested rehearing of the January 12 Order, asserting that the Chief Accountant erred by denying Otter Tail Power's request to exclude short-term debt from its AFUDC rate calculations. Alternatively, if rehearing is denied, Otter Tail Power requests that the Commission apply the decision in the January 12 Order on a prospective-only basis and allow Otter Tail Power to avoid retroactively adjusting its AFUDC rate calculations (which affect AFUDC amounts accrued from May 1, 2003 through January 11, 2007). Otter Tail Power claims that any retroactive adjustment would be *de minimis*, yet it would be burdensome to make such an adjustment.

7. In its request for rehearing, Otter Tail Power highlights its unique corporate structure. It explains that Otter Tail Corporation is a diversified corporation with not only utility operations, but also substantial non-utility operations in health services, manufacturing, plastics, and other businesses -- all of which are held by Varistar Corporation, which is in turn held by Otter Tail Corporation. It further states that Otter Tail Corporation's electric utility business goes by the trade name of Otter Tail Power Company, but that Otter Tail Power Company is not a separate and distinct legal entity from Otter Tail Corporation. Otter Tail Power further states that the line of credit agreement funds only non-utility operations, and that the electric utility business does not have access to those borrowings; Otter Tail Power explains that the line of credit agreement specifically provides that loans "shall be used for purposes of funding working capital, capital expenditures, and other corporate purposes of [Otter Tail Corporation], provided, that Loans shall be used only to support non-electrical operations of the Borrower and its Subsidiaries." Therefore, Otter Tail Power concludes, those short-term borrowings are irrelevant to the cost of capital associated with electric utility operations,⁷ and that, since it does not use those short-term borrowings in its electric utility operations, the costs of those funds should likewise be excluded from the calculation of AFUDC rates.

8. Otter Tail Power argues that including in the development of AFUDC rates short-term debt costs that are expressly excluded from electric utility operations would violate the ratemaking principle that a utility's rates should reflect the utility's costs. Next, Otter Tail Power contends, while the Commission has stated it is generally impossible to trace

⁷ Request for Rehearing at 3-4 & n.8.

funds, tracing of funds in this case is possible. It states that the line of credit agreement precludes the use of the short-term borrowings for utility operations.

Discussion

9. The rationale proffered by Otter Tail Power is not persuasive. As Otter Tail Power concedes, it is not a separate corporation. It is a division of Otter Tail Corporation. Otter Tail Power and Otter Tail Corporation are really one and the same entity. And notwithstanding Otter Tail Power's claim that the line of credit's use restriction makes it easy to trace the borrowings, the borrowings cannot be segregated. The funds that Otter Tail Corporation has access to are fungible. That one particular dollar from corporate coffers is, for example, nominally not available for its utility purposes merely means that another identical dollar from the same corporate coffers is available for utility purposes. There is no difference between the two dollars. That is, Otter Tail Corporation's utility and non-utility operations can both draw fungible dollars from the same identical corporate coffers. While the line of credit agreement makes additional funds available to Otter Tail Corporation, those funds will be available from the same common corporate coffers to fund non-utility and utility operations alike. And even if it were somehow possible to segregate such funds, their availability to support non-utility operations would in this case have the practical effect of freeing up other funds that would otherwise have supported non-utility operations – making them available to now support utility operations. Thus, it is appropriate to include those funds for purposes of calculating AFUDC rates, consistent with the express directives of Electric Plant Instruction No. 3(a)(17) and Order No. 561 that AFUDC rates be calculated based on the total corporate capital structure.

10. Moreover, unsecured short-term debt issued by Otter Tail Corporation would be a corporate obligation of Otter Tail Corporation, the borrower of the funds. The source of funds for repayment of notes as they come due would be Otter Tail Corporation, and the assets and/or income stream of Otter Tail Corporation that assure repayment would include the assets and/or income stream of Otter Tail Power. That is so because Otter Tail Corporation and Otter Tail Power are the same entity. That being so, the funds acquired through Otter Tail Corporation's issuance of short-term debt cannot be said to be associated solely and entirely with the non-utility portion of Otter Tail Corporation's business.

11. Likewise, since it is the income stream provided by the utility customers and the assets of the utility which have been paid for by the utility customers that will ultimately be liable to share in the repayment of the short-term debt, the utility customers should share any benefits that may be available by including short-term debt costs in the formula for computing AFUDC rates. In this regard, the use of lower cost short-term debt solely to support non-utility operations would disadvantage utility customers, in that the use of

long term debt to finance utility operations that could otherwise be funded by short-term debt could well come at a higher cost.

12. Otter Tail Power cites *Trans-Elect NTD Path, LLC*, 117 FERC ¶ 61,214, at P 57 (2006), for the proposition that the “AFUDC method compensates the stockholders of a regulated utility for the pre-operational cost of funds invested in a new plant prior to the time the plant actually goes into service.” Otter Tail Power claims that its pre-operational cost of funds invested in new plant did not include funds made available through the use of short-term debt. As we demonstrate above, however, it is not true that pre-operational funds do not involve the use of short-term debt. Moreover, as the Commission stated in both Order Nos. 561 and 561-A, cited above, it was not the intent of the rule to try to trace the source of funds used for various corporate purposes. The Commission explicitly noted that short-term debt can be used for many corporate purposes other than construction. In fact, the reason for assuming that short-term debt is the first source of funds for financing construction is to allow utilities a mechanism to recover short-term debt costs within the regulatory framework, because recovery of short-term debt costs is not typically provided for in the capital structure used for setting rates. Also, short-term debt turns over rapidly, and so amounts outstanding at a given time can reasonably be related to the utility’s construction and operation at that given time.

13. Otter Tail Power next contends that the *Georgia Power*⁸ and *Savannah Electric*⁹ letter orders involve principles that apply equally to Otter Tail Power’s case. Otter Tail Power admits that the two letter orders involved different facts that are not present here. Otter Tail Power nevertheless contends that both cases contain language indicating that short-term debt is a necessary expenditure for conducting utility operations and including it in AFUDC rate calculations is necessary to allow the utility an opportunity to be compensated. Otter Tail Power argues that its short-term debt is irrelevant here, though, because its short-term debt relates solely to non-utility operations. The facts of the two cases are different, as noted by the January 12 Order,¹⁰ and in any event, we disagree

⁸ *Georgia Power Co.*, Docket No. AC03-74-000 (November 18, 2003).

⁹ *Savannah Electric and Power Co.*, Docket No. AC03-74-000 (November 12, 2003).

¹⁰ The two letter orders involved situations where the utilities were recovering certain short-term debt costs in rates. The intent of the two letter orders granting waiver of the Commission’s AFUDC requirements to exclude certain short-term debt was to prevent “double counting” of short-term debt costs included both in retail rates and in AFUDC rate computations. That is not the case here.

with Otter Tail Power's conclusion that short-term debt is irrelevant here for the reasons stated above.

14. Otter Tail Power also cites a 1994 letter order involving Minnesota Power & Light Company,¹¹ which it believes suggested that a restricted line of credit may justify waiver of the regulations. Otter Tail Power claims that the request for waiver at issue in that case was denied because the line of credit was not restricted, and here the line of credit agreement is use-restricted. The requested waiver in that case was not denied because it was not use restricted. It was denied because it was "not consistent with the provisions of Order Nos. 561 and 561-A."¹² Moreover, while we do not disagree that, in theory, a properly restricted debt instrument may justify a waiver and its exclusion from AFUDC rate calculations, given the corporate structure of Otter Tail Corporation there is no basis to exclude short-term debt from Otter Tail Power's calculation of AFUDC.

15. Finally, we emphasize that our regulations are clear and explicit that short-term debt should be included in the calculation of AFUDC rates,¹³ and the Commission's policy toward treatment of user-restricted debt is also clear.¹⁴ The January 12 Order, relying on those regulations and that policy, denied Otter Tail Power's request, and we find it appropriately did so. It was and is Otter Tail Power's obligation to justify a departure, *i.e.*, a waiver of those regulations and that policy, and Otter Tail Power did not and has not done so. We affirm the January 12 Order and deny rehearing.

16. Inasmuch as we are denying the request for rehearing, we will now consider Otter Tail Power's plea in the alternative, that the January 12 Order be given prospective effect from January 12, 2007 forward and that Otter Tail Power be allowed to avoid making any retroactive adjustments for the period May 3, 2003 to the issuance of the order on January 12, 2007. Otter Tail Power proposes to revise the AFUDC rate for prospective AFUDC accruals, and to revise transmission plant balances in future Form No.1's to reflect the use of the revised AFUDC rate for past periods. Otter Tail Power claims that applying the January 12 Order on a prospective-only basis is appropriate since Otter Tail Power relied on the advice of its outside auditing firm in excluding short-term debt from its AFUDC rate calculations during the period in question; the exclusion of short-term

¹¹ *Minnesota Power & Light Co.*, Docket No. AC 93-204-000 (March 9, 1994).

¹² *Id.* at 1.

¹³ *See supra* notes 2-5.

¹⁴ *See supra* note 6.

debt would have a miniscule impact on Commission-jurisdictional rates, yet it would be administratively burdensome to include short term debt in AFUDC rate calculations retroactively; and Commission precedent supports prospective-only application.

17. Otter Tail Power elaborates that allowing it to exclude the cost of short-term debt from its AFUDC rate calculations from May 3, 2003 until January 12, 2007 would not have any significant rate impact, due to the applicable Midwest Independent Transmission System Operator, Inc. (Midwest ISO) rate structure. Since Otter Tail Power was a transmission-owning member of the Midwest ISO, its transmission rates were calculated pursuant to the formula rate in the Midwest ISO open access transmission tariff, Attachment O. That formula relies on book plant data reflected in the FERC Form No. 1. During the May 2003 - January 2007 timeframe, Otter Tail Power states it did not receive any revenues based on its zonal rate; it only received revenues based on its share of through and out transmission revenues of the Midwest ISO. Otter Tail Power provides, in Attachment A to its request for rehearing, a calculation of the impact on the Midwest ISO of the exclusion of short-term debt from AFUDC. The effect of such exclusion, as calculated by Otter Tail Power, is only one one-thousandth of one percent of the Midwest ISO through and out rate. This, claims Otter Tail Power, would be an insignificant correction. Moreover, the administrative burden of such a correction would be significantly higher than the resultant worth of the correction. This is due primarily to the fact of discounted transportation during the period in question and the need to go back and recalculate hundreds of already-completed transactions for such a small amount of money.

18. On March 14, 2007, the Midwest ISO filed a motion for late intervention and comments in support of Otter Tail Power's request for rehearing, citing the challenging administrative burden to calculate very small refunds. In order to make the calculations, the Midwest ISO states it would be required to reconfigure its computer systems to calculate through and out rates to the seventh decimal place, or millionth of a penny, instead of the current fourth decimal place, or one hundredth of a penny, and expend approximately \$1.25 million in labor costs alone. Midwest ISO further states that the effect of the calculation once made would be refunds to customers for through and out transactions of approximately \$52 on average based on a total amount of \$25 million collected for 2006.

19. We are persuaded by Otter Tail Power that the burden of calculating the adjustments for such a small amount of money does not justify application of the January 12 Order except on a prospective-only basis, as requested by Otter Tail Power.

Therefore, for good cause shown, the alternative request of Otter Tail Power will be granted.¹⁵

The Commission orders:

Otter Tail Power's request for rehearing is hereby denied, but its request for prospective-only application of the January 12 order is hereby granted, as more fully discussed above.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

¹⁵ See, e.g., *Niagara Mohawk Power Corp. v. FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967) (Commission's discretion is at its zenith when it comes to remedies).