

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair  
Commissioner  
Commissioner  
Commissioner  
Commissioner

In the Matter of Otter Tail Power Company's  
Report on a Call to its Ethics Hotline

ISSUE DATE: March 10, 2006

DOCKET NO. E-017/M-04-1751

ORDER REQUIRING FURTHER FILINGS

**PROCEDURAL HISTORY**

On May 27, 2004, Otter Tail Corporation, D.B.A. Otter Tail Power Company, received an anonymous call to its Ethics Hotline from two of its employees. The Company characterized the call as "claiming that the Utility has been providing false and/or misleading financial information to the Minnesota Department of Commerce, the Minnesota Public Utilities Commission, and the North Dakota Public Service Commission."<sup>1</sup>

In response to the call, the Company conducted an initial investigation, asked its outside counsel to conduct a more comprehensive investigation, met with staff from this Commission and the Minnesota Department of Commerce, and ultimately filed a report on the concerns raised in the call, based in large part on the investigation conducted by its outside counsel.

The Company's report was filed on November 30, 2004. On May 23, 2005, the Minnesota Department of Commerce (the Department) filed comments recommending further explanatory filings, corrective action on specific accounting issues, and an order requiring the Company to file a rate case in the near term.

On May 25, 2005, the Commission issued a notice soliciting comments on the Company's report and the Department's comments.

On June 27, 2005 and December 12, 2005, the Residential and Small Business Utilities Division of the Office of the Attorney General (RUD-OAG) filed initial and reply comments recommending that the Commission continue its investigation, require changes in the Company's accounting practices, require the release of the full report prepared by the Company's outside counsel, and consider appointing an independent investigator with no preexisting relationship with the Company.

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<sup>1</sup> *Report on Hotline Call*, November 30, 2004, at 1-2.

On September 1, 2005, the two Otter Tail employees who had made the call to the Ethics Hotline filed comments concurring with the comments of the RUD-OAG, urging additional investigation and fact-finding, and recommending an investigation by an independent investigator appointed by the Commission.

On February 28, 2006, the case came before the Commission for a determination of what, if any, additional information should be required of the Company before addressing the merits of the claims made by the anonymous callers to the Ethics Hotline.

## **FINDINGS AND CONCLUSIONS**

### **I. Issues Summary**

The concerns expressed by the two employees<sup>2</sup> in their Hotline call and in subsequent conversations with Company management related to two general issues: (1) whether the Company was accurately reporting to state regulators the financial condition of its electric utility; and (2) whether the Company was adequately disclosing to state regulators the accounting principles and practices upon which its financial reporting was based.

The employees raised the concern that the Company might be using questionable accounting practices to present financial data in ways that understated utility earnings. Such irregular financial reporting would prevent regulators from spotting excessive earnings and from protecting ratepayers from the excessive rates necessary to sustain those earnings.

The callers raised the following specific concerns:

- (1) They questioned the Company's decision to change its accounting practices to move profits from "pass-through" electricity sales from the regulated to the unregulated side of the ledger. They also challenged the adequacy of the Company's disclosure of this accounting change.
- (2) They questioned the Company's decision to change its accounting practices to exclude short-term debt in calculating Allowance for Funds Used During Construction – driving up ratepayer costs – by using restrictive covenants in short-term debt instruments forbidding the use of short-term debt for utility construction.
- (3) They questioned whether the Company properly allocated costs between its regulated and unregulated operations, suspecting that reorganization and diversification had resulted in some costs more properly attributable to unregulated operations being allocated to the regulated utility.

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<sup>2</sup> Both employees are now former employees of the Company.

- (4) They questioned the Company's decision to change its primary accounting system from the Uniform System of Accounts, required for use in filings with state and federal utility regulatory authorities, to an alternative system, Oracle, which they believed made it difficult to accurately determine and document the financial information required for utility regulatory purposes.<sup>3</sup>
- (5) They questioned whether the accuracy of reported returns on equity had been compromised, particularly by changes in the accounting treatment of transmission revenues from the Mid-Continent Area Power Pool and by adjustments to the Company's capital structure.
- (6) They questioned the Company's compliance with statutory requirements to seek Commission approval of transactions with affiliated entities.
- (7) They questioned whether the Company's accounting treatment of unbilled revenues resulted in understating earnings.
- (8) They questioned the accuracy of Company reporting on its capital structure, suggesting that diversification and the resulting need to allocate costs could have affected the 50% equity level the Company has consistently been reporting.

## **II. Positions of the Parties**

### **A. The Company**

Otter Tail denied providing false or misleading information to regulators.

The Company stated that it had learned, during its post-Hotline-call investigation, that it had neglected to file several tax-sharing agreements with affiliates and that it was in the process of preparing those filings. The Company also stated that it had resumed using the Uniform System of Accounts as its primary accounting system after receiving the Hotline call.

The Company declared its willingness to cooperate with state regulators in resolving the concerns raised by the callers. It emphasized that it had already provided a great deal of information, both on its own initiative and in response to information requests from regulators. It stated that it was willing to provide additional, specific information detailed by Department staff and Commission staff members at oral argument, but urged that the Commission close the investigation once that information had been provided.

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<sup>3</sup> The Company has returned to using the Uniform System of Accounts as its primary accounting system since receiving the call to the Ethics Hotline.

## **B. The Department**

The Department recommended further explanatory filings, corrective action on specific accounting issues, and an order requiring the Company to file a rate case in the near term. The agency also made substantive comments on each issue, concluding in most instances that more information was required to resolve the issue or that the issue could be addressed most effectively in another proceeding, such as a general rate case or an investigation of the workings of the Midwest Independent System Operator's wholesale market.

## **C. The RUD-OAG**

The RUD-OAG recommended that the Commission continue its investigation, require changes in the Company's accounting practices, require the release of the full report prepared by the Company's outside counsel, and consider appointing an independent investigator with no preexisting relationship with the Company.

The RUD-OAG also stated that Company documents provided in the course of this investigation may raise additional issues that warrant investigation, citing two examples:

- (1) A settlement document disclosing a \$1,000,000 payment to Otter Tail from Northern States Power Company (NSP) for Otter Tail's agreement to withdraw its petition to intervene in NSP's merger proceeding before the North Dakota Commission and its agreement not to intervene in other NSP merger proceedings, including the one before this Commission.
- (2) Documents showing substantial increases in wholesale profits following the opening of the Midwest Independent System Operator's wholesale market, increasing the importance of proper cost allocation and accounting procedures.

## **D. The Anonymous Callers**

The two former Otter Tail employees who made the call to the Ethics Hotline concurred in the recommendations of the RUD-OAG, urged additional investigation and fact-finding, and recommended an investigation by an independent investigator appointed by the Commission.

## **III. Commission Action**

The concerns raised by the anonymous callers turn on numerous, detailed facts and complex regulatory and accounting principles. It would be premature to reach final conclusions on the callers' concerns at this point. The Commission will therefore require the Company to file additional information before it determines how best to address the concerns raised in the call.

The measures set forth below, all of which were accepted by Otter Tail during the February 28 hearing, should lay the groundwork for resolving the concerns raised by the callers. They should also help improve communications between Otter Tail and the Commission, clarify regulatory requirements for Company personnel, and increase the transparency of Company financial reporting, benefitting the Company, the regulatory bodies, and the public alike.

### **A. Updated Regulatory Compliance Plan**

The Company will file an updated Regulatory Compliance Plan, an in-house manual designed to assist employees in identifying and meeting Company responsibilities under the Minnesota Public Utilities Act and related regulations. The Plan will specifically address Company obligations under the affiliated interest statute and rules, since the Company's post-Hotline-call investigation revealed several tax-sharing agreements with affiliates that it had failed to file.

### **B. Updated Corporate Cost Allocations Manual**

All Minnesota utilities are required to file a cost allocations manual, explaining how they allocate costs between regulated and unregulated operations.<sup>4</sup> Otter Tail has undergone significant diversification since it last filed its manual, and it is clearly time for an update.

### **C. Documentation Linking Oracle and the Uniform System of Accounts**

For approximately eight years the Company used an accounting system other than the Uniform System of Accounts, which it must use in presenting financial information to state and federal regulators, as its primary accounting system. That system was called Oracle.

The Company has since reverted to using the Uniform System of Accounts as its primary accounting system, but any clear understanding of Company financial data requires a clear understanding of how the accounting entries and categories of the alternative system relate to the accounting entries and categories of the Uniform System of Accounts. Documentation "mapping" the two systems is necessary, and the Company has agreed to file that documentation.

### **D. General Rate Case**

The general rate case remains the primary regulatory vehicle for a comprehensive examination of a utility's financial condition. Otter Tail has agreed to file a general rate case in the fall of 2007 and to work with Department and Commission staff beforehand to ensure that that filing provides a solid foundation for the level of regulatory review necessitated by the 20-year interval since the Company's last rate case. Cost allocations, one of the areas of concern raised by the Hotline callers, will be addressed in detail in that case.

### **E. FERC Ruling on Issue Relating to Allowance for Funds Used During Construction (AFUDC)**

The exclusion of short-term debt in calculating AFUDC, which the Company is accomplishing by inserting restrictive covenants in its short-term debt instruments, is an issue on which the Federal Energy Regulatory Commission (FERC) has expertise and in which it has a strong interest. The Company has agreed to obtain and file a FERC opinion on its exclusion of short-term debt in calculating AFUDC.

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<sup>4</sup> *In the Matter of an Investigation into the Competitive Impact of Appliance Sales and Service Practices of Minnesota Gas and Electric Utilities*, G,E-999/CI-90-1008, Order Setting Filing Requirements (September 28, 1994).

## **F. FERC Operational Audit**

The Company has just undergone an operational audit by the Federal Energy Regulatory Commission, the results of which could help illuminate the financial issues in this docket and related issues. The Company will file updates on that audit process, as well as the final audit report.

## **G. Minnesota Electric Jurisdictional Annual Report**

The Company, like all Minnesota utilities, files an annual report, which the Department and the Commission use to monitor earnings and regulatory compliance issues. For this monitoring function to work, it is important that year-to-year changes in how the reported information is derived be clearly disclosed. In the future, the Company will file a letter each time it makes a change in how it derives or reports the information covered in the annual report.

The Commission will so order.

### **ORDER**

1. On or before May 1, 2006, Otter Tail Power Company shall file a revised Regulatory Compliance Plan, which, among other things, shall specifically address affiliated interest issues.
2. On or before May 31, 2006, Otter Tail Power Company shall file an updated corporate cost allocations manual, including a discussion of how it addresses the guidance from the Commission's Order of September 28, 1994 in docket G,E-999/CI-90-1008. The Company shall meet with the staff of the Department of Commerce to answer any questions and provide any additional information the agency may need subsequent to the filing.
4. On or before May 31, 2006, Otter Tail Power Company shall file documentation on its Oracle accounting system, including how the system maps to the Uniform System of Accounts and how the transition from Oracle to the Uniform System of Accounts was implemented. The Company shall meet with the staff of the Department of Commerce to answer any questions and provide any additional information the agency may need subsequent to the filing.
5. On or before October 1, 2007, Otter Tail Power Company shall file a general rate case, which shall include comprehensive data on its cost allocation procedures.
6. Otter Tail Power Company shall obtain and file a ruling from the Federal Energy Regulatory Commission on its practice of excluding short-term debt in calculating Allowance for Funds Used During Construction by means of inserting restrictive covenants in its short-term debt instruments.

7. Otter Tail Power Company shall make filings as required to apprise the Commission and the Department of Commerce of developments relating to its operational audit by the Federal Energy Regulatory Commission and shall file the final report of that audit when it becomes available.
8. Otter Tail Power Company shall file a letter with the Commission and the Department of Commerce each time it makes any change in its reporting in its Minnesota Electric Jurisdictional Annual Report.
9. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar  
Executive Secretary

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