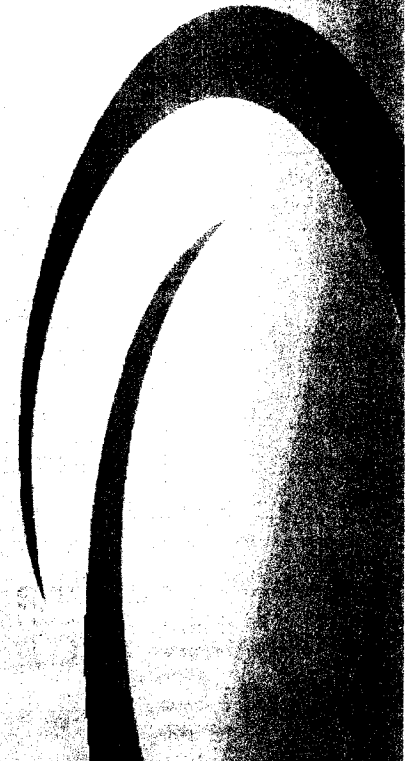


Applications

Determination of prudence to discontinue participation in Big Stone II

Deferred accounting for Big Stone II development costs

May 5, 2010



Introduction

- Big Stone II project overview and timeline
- Development activities
- Otter Tail Power Company share of costs
- Thorough record before the PSC
- Developments warranting Otter Tail's September 11, 2009, withdrawal
- Policy objectives of ADP statute
- Settlement agreement

Big Stone II project overview

- Size: 500 to 630 megawatts
- Technology: Supercritical pulverized coal
- Location: Existing Big Stone Plant site in South Dakota
- Ownership: Initially seven regional utilities, later five
- Transmission: Sized to accommodate up to 800 MWs of wind energy in concert with CapX2020
- Permits: Major permits acquired with several on appeal

Development timeline

- Jan. 1995 Otter Tail begins exploring second unit at Big Stone.
- Dec. 2003 Committee forms to consider feasibility.
- June 2005 Project agreements signed.
(Otter Tail, MDU, MRES, GRE, SMMPA, CMMPA, HCPD)
- July 2006 South Dakota PUC issues site permit.
- Sept. 2007 GRE and SMMPA withdraw from project.
- 2007 -2009 Development activities continue, additional participants sought, all major permits achieved.
- Sept. 2009 Otter Tail withdraws.
- Nov. 2009 Remaining participants wind up the project.

Development activities

For generation and transmission aspects

- Project agreements
- Project management
- Permit proceedings
- Engineering
- Efforts to recruit new participants and revisit project agreements after two participants

Otter Tail incurred approximately \$12.7 million in expenses.

The North Dakota share of these costs is 40.32 percent or \$5.1 million.

Otter Tail share of costs

- With seven participants, Otter Tail had 19.33 percent ownership/cost share.
- After GRE (19.33 percent) and SMMPA (7.83 percent) withdrew in 2007, 27.16 percent of the project was unallocated.
- Otter Tail's ownership/cost share increased to 26.54 percent.
- Big Stone II struggled to secure additional participants.

Thorough record before the PSC

- Otter Tail's proposed participation was thoroughly reviewed in the extensive record of the North Dakota advance determination of prudence proceeding.
- We initially presented the case prior to the GRE and SMMPA withdrawal in September 2007.
- We presented the case again as a 500 to 580 MW project with potential new participants.
- The PSC's August 27, 2008, order issued advance determination of prudence of 121.8 to 130 MW for Otter Tail.

Developments warranting Otter Tail's September 11, 2009, withdrawal

- Significant changes to energy price forecasts influence resource need
- Extraordinary financial market conditions on eve of extraordinary capital need
- Inability to secure new participants (whose participation was likely to add additional regulatory scrutiny) and increase in participation/cost share
- Federal legislative/regulatory uncertainty surrounding CO₂ and other GHGs
- Uncertainty regarding adequate and timely cost recovery
- Permit appeal uncertainty and delay

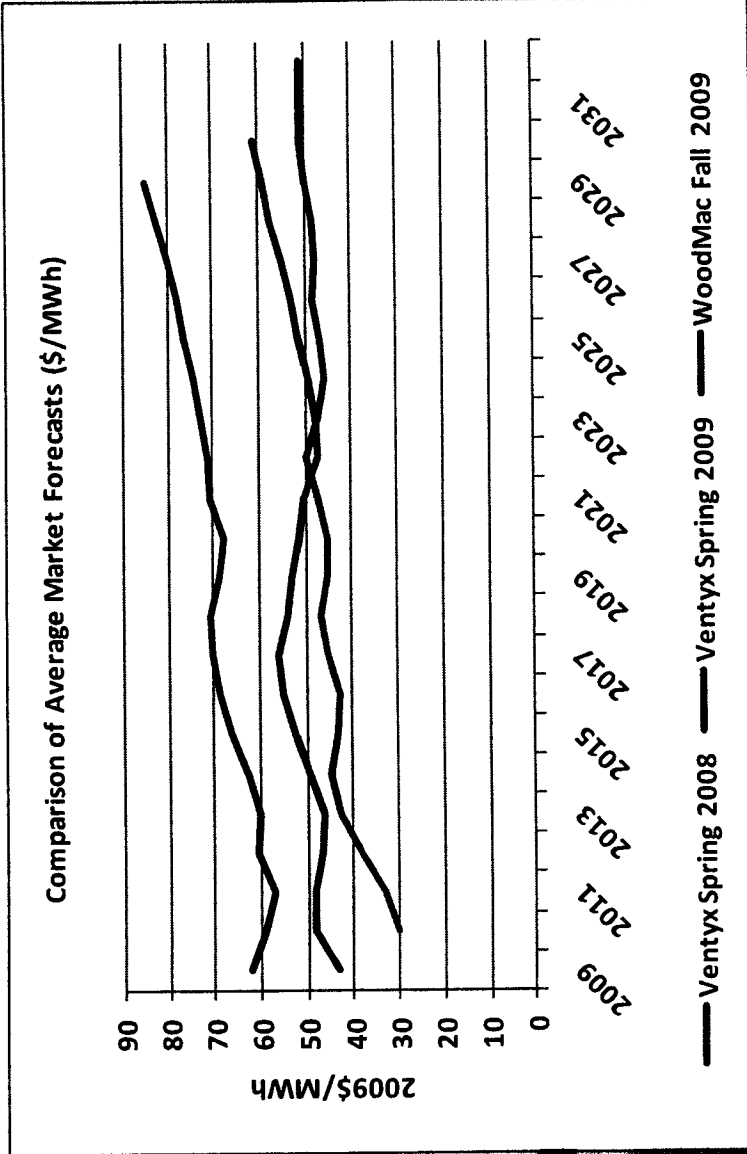
Changes to energy price forecasts

- Unanticipated changes to long-term forecasts for on-peak and off-peak energy prices:
 - do not appear to be recessionary aberrations.
 - do appear to be fundamental shifts in energy marketplace.
- Energy prices forecasts for 2012-2024 are 33 percent to 36 percent lower.
- The changes likely will impact Otter Tail's July 2010 Integrated Resource Plan.

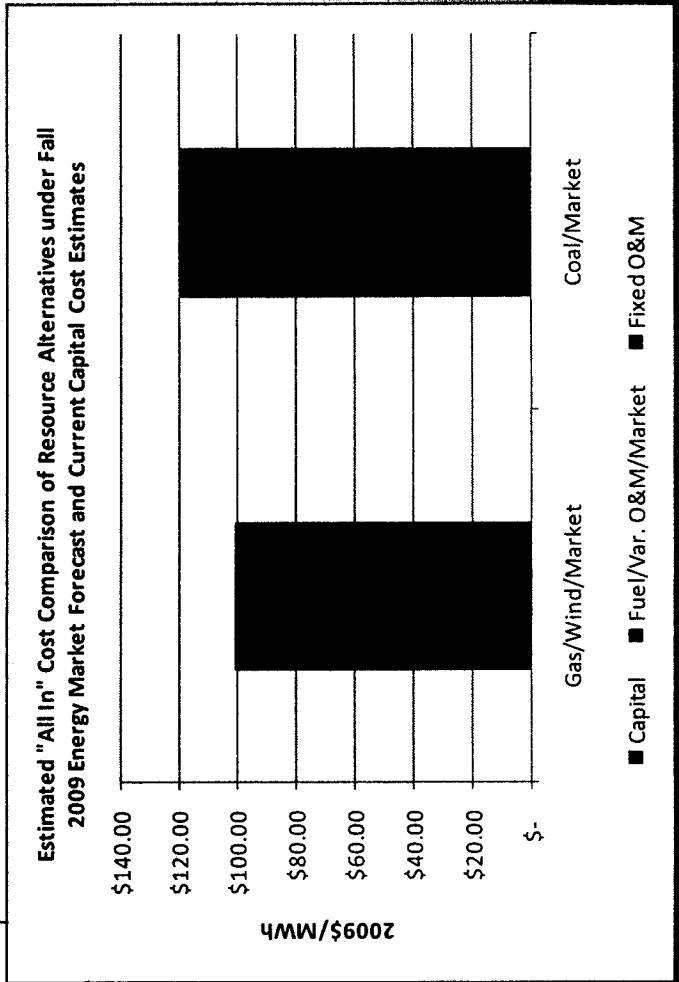
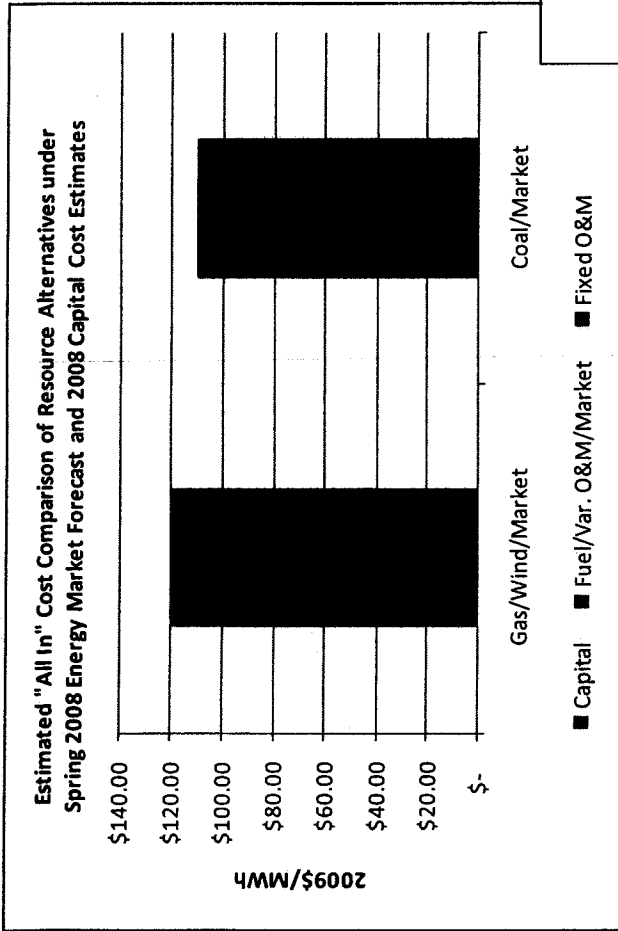
Changes to energy price forecasts

Average \$/MWh from 2012-2024 (2009\$)

Long Term Forecast	On Peak	Off Peak	Average
Ventyx Spring 2008	\$ 86.12	\$ 51.6	\$ 69.04
Ventyx Spring 2009	\$ 65.06	\$ 37.56	\$ 50.66
WoodMac Fall 2009	\$ 58.11	\$ 33.05	\$ 44.98
% Change Spring 2008 to Spring 2009	-24%	-27%	-26%
% Change Spring 2008 to Fall 2009	-33%	-36%	-34%



Changes to energy price forecasts



Extraordinary financial market conditions on eve of extraordinary capital need

- Project agreements required September 2009 commitment to complete financing, issue contractor final notice to proceed, and construct.
- Financial market conditions were unprecedented.
 - Broad economic downturn
 - Issuing debt and raising capital far more difficult and costly

Inability to secure additional participants

- With seven participants, Otter Tail had
 - 19.33 percent ownership/cost share.
 - Estimated \$400 million share of construction costs.
- GRE (19.33 percent) and SMMPA (7.83 percent) withdrew in 2007, leaving 27.16 percent unallocated.
- Without new participation, Otter Tail increased to
 - 26.54 percent ownership/cost share.
 - Estimated \$550 million share of construction costs.

Otter Tail's rate base in 2008 North Dakota rate case was \$630.4 million.

Federal legislative/regulatory uncertainty surrounding CO₂ and other GHGs

- U.S. Supreme Court in 2007 held GHGs are “air pollutants” under existing Clean Air Act.
- EPA on April 17, 2009, proposed finding that GHGs emitted by new motor vehicles endanger public health.
- U.S. House of Representatives on June 26, 2009, passed the American Clean Energy and Security Act of 2009 (Waxman-Markey).

Federal legislative/regulatory uncertainty surrounding CO₂ and other GHGs

- U.S. Senate Environment and Public Works Committee on November 5, 2009, approved Kerry-Boxer.
- EPA on December 7, 2009, issued an endangerment finding that paves the way for regulation of GHGs under the existing Clean Air Act (regardless whether legislation regulating GHGs is enacted).

Federal legislative/regulatory uncertainty

surrounding CO₂ and other GHGs

- Regulation of GHGs would have increased cost of energy from the project, diminishing its advantages over alternatives.
- Regulatory uncertainty makes financing more difficult and costly.

Uncertainty about adequate and timely cost recovery

- Regulatory lag between expenditures and authorized recovery through rates
- Possibility of stranded cost due to potential denial of cost recovery
- Cost recovery uncertain for carbon
- Cost recovery uncertain for potential cost overruns

Permit appeal uncertainty and delay

- Title V (Air) Operating Permit
 - In June 2009 the South Dakota Board of Minerals and Environment issued the permit.
 - In August 2009 the Sierra Club/Clean Water Action petitioned EPA to object to the permit.
 - EPA could deny or grant the petition.
 - It is subject to judicial review after EPA final action.

Permit appeal uncertainty and delay

- Federal Environmental Impact Statement (EIS)
 - Western Area Power Administration issued the EIS record of decision (ROD) on August 24, 2009.
 - Either an administrative appeal or a federal court challenge of Western's ROD was likely.

Permit appeal uncertainty and delay

- Minnesota Public Utilities Commission Certificate of Need for Transmission
 - On March 17, 2009, the MPUC issued CON and Route Permit.
 - On June 5, 2009, interveners appealed the CON to the MN Court of Appeals.
 - The MN Court of Appeals decision could have been ~~appealed~~ to the MN Supreme Court.

Permit appeal uncertainty and delay

- North Dakota Public Service Commission
Advance Determination of Prudence
 - On August 27, 2008, PSC issued ADP
 - In September 2008, Dakota Resource Council appealed ADP to state district court
 - On August 19, 2009, state district court affirmed PSC
 - On November 25, 2009, DRC appealed to North Dakota Supreme Court

Perfect storm of uncertainty

- Otter Tail faced an overwhelming amount of uncertainty with continued participation in Big Stone II.
- As Gordon van Welie, president/CEO, ISO-New England, said in March 2010, “The single greatest issue facing the operation, expansion, and regulation of the power system is the uncertainty about national energy policy.”
- Potential capital expenditure of up to \$550 million (nearly equal to Otter Tail’s entire rate base) was not in the best interests of Otter Tail’s customers or shareholders

Policy objectives of ADP achieved

- Facilitate development of utility infrastructure necessary to serve ratepayers.
- Relieve constraints to--and cost of--capital.
- Foster deliberative process serving public interest.
- Risks of ADP, including the possibility a project is never used and useful, outweighed by the benefit of potential investment to serve ratepayers.

Settlement agreement

- Otter Tail's decision to discontinue participation in Big Stone II was prudent.
- Over a three-year period, Otter Tail should recover from North Dakota ratepayers the jurisdictional share of Big Stone II generation costs (\$4,064,293).
- The North Dakota share of transmission costs (\$1,053,173) should be returned to CWIP and eligible for AFUDC from September 2009 to be included in rate base if construction commences within three years of PSC settlement approval.

Settlement agreement

- The settlement agreement requires PSC approval.
- Otter Tail foregoes recovery of carrying costs during three-year recovery period, an estimated \$529,000.
- Impact:
 - \$0.62/month on residential customer with 750 kWh usage
 - \$254.76/month on large general service customer with 600 kW demand and 324,000 kWh usage

Summary

- Otter Tail Power Company requests that the Commission issue an order:
 - Approving the settlement agreement.
 - Finding Otter Tail's decision to discontinue participation in Big Stone II prudent.
 - Authorizing recovery of Big Stone II development costs from North Dakota ratepayers pursuant to the terms of the settlement agreement.

○ Finding Otter Tail's deferred accounting petition moot.