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April 22, 2016



Mr. Darrell Nitschke
Director of Administration/Executive Secretary
North Dakota Public Service Commission
State Capitol
600 East Boulevard, Dept. 408
Bismarck, ND 58505-0408

**RE: In the Matter of Otter Tail Power Company's Request for Approval of its 2016
Renewable Resource Cost Recovery Adjustment Factor
Case No. PU-16-14
Pre-Filing of Tommerdahl Direct Testimony**

Dear Mr. Nitschke:

Enclosed are an original and seven (7) copies of Otter Tail Power Company's ("Otter Tail's") Pre-filing of Stuart Tommerdahl's Direct Testimony for the Formal Hearing scheduled in this Case on Wednesday, April 27, 2016. The testimony and cover letter are being sent to you by electronic mail as well as U.S Mail.

Should you have any questions, please feel free to contact me at 218-739-8279 or stommerdahl@otpc.com.

Very truly yours,

/s/ STUART TOMMERDAHL
Stuart Tommerdahl
Manager, Regulatory Administration

nlo
Enclosures
By electronic filing and U.S. Mail

Before the North Dakota Public Service Commission
State of North Dakota

In the Matter of Otter Tail Power Company's
Application of the Annual Rate Update
For its Renewable Resource Cost Recovery Adjustment
For Langdon, Ashtabula & Luverne Wind Farms

Case No. PU-16-14

Exhibit___

REVENUE REQUIREMENT AND REGULATORY ISSUES

Direct Testimony of

STUART D. TOMMERDAHL

April 27, 2016

1 **I. INTRODUCTION AND QUALIFICATIONS**

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A. My name is Stuart D. Tommerdahl, and my address is 215 South Cascade Street, Fergus
4 Falls, Minnesota 56537.

5
6 Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?

7 A. I am employed by Otter Tail Power Company (OTP or the Company) as Manager,
8 Regulatory Administration.

9
10 Q. PLEASE SUMMARIZE YOUR QUALIFICATIONS, DUTIES, AND
11 RESPONSIBILITIES.

12 A. I graduated from Moorhead State University, now Minnesota State University,
13 Moorhead, Minnesota, in 1983 with a B.S. degree in Accounting and a minor in
14 Economics. I am a Certified Public Accountant (Inactive) in Minnesota as well as a
15 member of the Minnesota Society of Certified Public Accountants and the American
16 Institute of Certified Public Accountants. I started my career as an accountant for Twin-
17 Valley-Ulen Telephone Company in 1983 and then in 1984, joined Great Plains Software
18 in Fargo, North Dakota as an accountant. In 1986, I became Budget & Financial
19 Reporting Manager, where I managed the company budget process and associated
20 financial reporting, as well as held responsibilities for Federal and State corporate income
21 tax returns. In 1993, I joined OTP as Regulatory/Economic Analyst. From 1997 to 2003
22 I worked at Otter Tail Energy Services as Manager, Financial Planning /Analysis and
23 subsequently Director, Financial Services. In 2004 I returned to OTP as Manager, Risk
24 Management and in March of 2012, accepted my current position as Manager,
25 Regulatory Administration. My primary responsibilities in this position are to provide
26 leadership in areas of revenue requirements analysis, pricing and rate design, tariff
27 administration, load research, cost allocation methodologies to be used in cost of service
28 studies, long range revenue forecasting, wholesale energy accounting, cost of energy, and
29 unbilled revenue.

30

1 Q. FOR WHOM ARE YOU TESTIFYING?

2 A. I am testifying on behalf of OTP.

3

4 Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY REGULATORY
5 AUTHORITIES?

6 A. Yes. I have represented OTP in various proceedings before the Minnesota Public
7 Utilities Commission (Commission), the North Dakota Public Service Commission and
8 the South Dakota Public Utilities Commission.

9 **II. PURPOSE OF TESTIMONY**

10 Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

11 A. OTP is requesting approval of the annual update to its Renewable Resource Adjustment
12 (RRA) Rider, as proposed in its February 26, 2016 Supplemental Filing in this case. My
13 Direct Testimony will focus on the key drivers impacting the revenue requirement and
14 associated rate requested in this annual update. I will explain how Federal Legislation
15 passed in late 2015 authorizing the use of bonus tax depreciation is impacting OTP's
16 utilization of tax benefits attributable to the wind projects currently being recovered in
17 OTP's RRA rider. I will also provide an overview of how this Legislation will benefit
18 ratepayers in OTP's other riders. To provide further background and context, my
19 testimony will cover the following items:

- 20 - What wind projects are in OTP's RRA rider
- 21 - What tax benefits (incentives) were utilized on each wind project
- 22 - How these tax benefits flow through the RRA rider
- 23 - How utilization of tax benefits contributed to the current rate in the RRA rider
24 being abnormally low
- 25 - How 2015 Federal Tax legislation is impacting the RRA rider rate and OTP's
26 other riders

27

28 A key point my testimony will show is that while the proposed revenue requirement and
29 associated rate in this annual update to the RRA rider is increasing, North Dakota
30 ratepayers will ultimately see offsetting reductions to the revenue requirements in OTP's
31 Transmission Cost Recovery rider (TCR) and the Environmental Cost Recovery Rider.

1 Collectively, the calendar year 2015 and 2016 revenue requirements across these three
2 riders is projected to be reduced by approximately (\$435,000).

3 **III. PROJECTS IN THE RENEWABLE RIDER**

4 Q. WHAT WIND PROJECTS ARE CURRENTLY INCLUDED IN OTP'S RRA RIDER?

5 A. There are currently three projects included in the RRA rider: The Langdon Wind Project,
6 the Ashtabula Wind Project, and the Luverne Wind Project.

7
8 Q. PLEASE DESCRIBE THE THREE WIND PROJECTS THAT ARE INCLUDED IN
9 THE RENEWABLE RIDER.

10 A. As summarized in the Table 1 below, the Langdon Wind Project is comprised of 27
11 turbines with a nameplate rating of 40.5 MW. That project was placed in service in
12 December of 2007. The Ashtabula Wind Project is comprised of 32 turbines with a
13 nameplate rating of 48 MW. That project was placed in service in November of 2008.
14 The Luverne Wind Project is comprised of 33 turbines with a nameplate rating of 49.5
15 MW. That project was placed in service in September 2009.

16
17 **TABLE 1**
18 **OTP Owned Wind Projects**

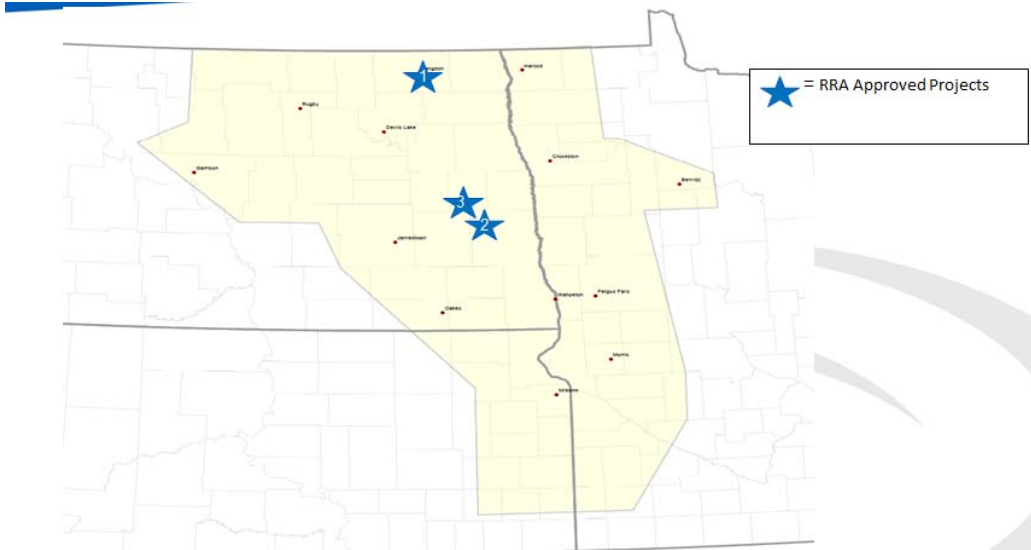
Line #	Project Name	# of Turbines	In Service Date	Name Plate Capacity (MW)	Approved in Case No.	Tax Incentives Utilized
1	Langdon Wind Project	27	December 2007	40.5	PU-06-466	PTC -10 year; ND ITC
2	Ashtabula Wind Project	32	November 2008	48.0	PU-08-742	PTC - 10 year; ND ITC
3	Luverne Wind Project	33	September 2009	49.5	PU-10-018	Federal Grant; ND ITC
4				Total 138.0		

19
20 Q. WHEN WERE THESE PROJECTS APPROVED FOR RECOVERY WITHIN OTP'S
21 RENEWABLE RIDER?

22 A. The North Dakota Public Service Commission approved the inclusion of the Langdon
23 Wind Project in Case No. PU-06-466. The Ashtabula Wind Project was approved in
24 Case No. PU-08-742. The Luverne Wind Energy Project was approved in Case No. PU-
25 10-018. As reflected on the map below, all three projects are located with North Dakota.

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Location of OTP's RRA Approved Wind Projects



Q. WHY WERE THESE PROJECTS SELECTED OVER OTHER GENERATION PROJECTS?

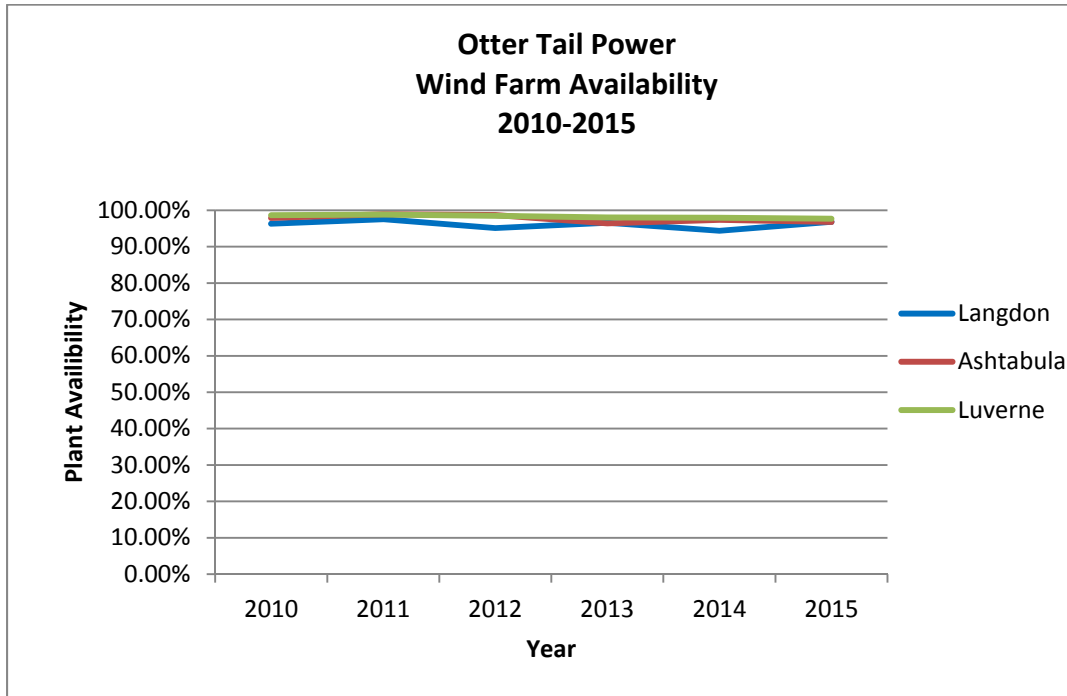
A. At the time these projects were developed, they were identified as least cost resources available to meet OTP's generation needs. A contributing factor was the availability for OTP to utilize certain Federal Tax benefits for these projects. The Langdon and Ashtabula wind projects both qualified for Federal Production Tax Credits (PTCs). I will explain Federal Production Tax credits in more detail, later in my testimony. For the Luverne Wind Project, OTP elected to take a \$30 million Federal grant. That grant reduced the net plant in service balance for the Luverne Project within the Rider, and lowered the overall cost ratepayers would pay for that project.

Q. PLEASE SUMMARIZE THE OPERATIONAL PERFORMANCE OF OTP'S WIND FARMS?

A. OTP's wind farms have performed very well. Table 2 below shows the wind farms availability since 2010.

1

TABLE 2



2

3

4 Q. HOW HAVE OTP’S THREE COMPANY OWNED WIND FARMS PERFORMED
 5 RELATIVE TO OTHER WIND FARMS WITHIN THE MIDCONTINENT
 6 INDEPENDENT SYSTEM OPERATOR (MISO) FOOTPRINT?

7 A. Table 3¹ below shows the relative capacity credits of the 199 wind farms within MISO’s
 8 footprint. The system average capacity credit for all wind farms in MISO is of 15.6%.
 9 The Luverne Wind Farm currently has the highest MISO capacity credit of 27.4%. The
 10 Ashtabula Wind Farm is ranked 12th with a capacity credit of 24%, and the Langdon
 11 Wind Farm is ranked 14th with a capacity credit of 23.5%. These Capacity Credits will
 12 be applicable for the MISO 2016/2017 planning year. The weighted average Capacity
 13 Credit for all three of OTP’s wind farms is 25.07%²

14

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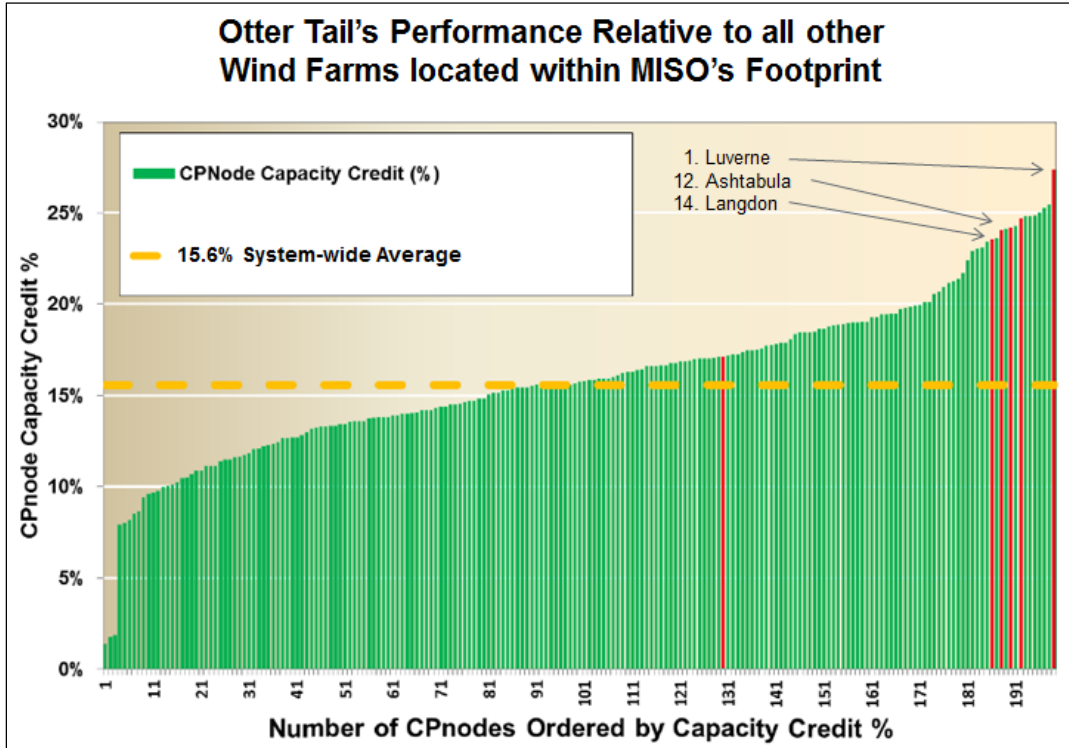
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17

¹ Table 3 was shared with the Commission during OTP’s Resource Plan Stakeholder Meeting on March 18, 2016.

² As reflected on Page 10 of OTP’s Initial Application in this Case, filed December 31, 2015.

TABLE 3



2

3

4 Q. WHAT IS THE PURPOSE OF THE CAPACITY CREDIT?

5 A. The Capacity Credit percentage is a measure of the average power output of a generation
 6 unit relative to its nameplate rating. (For instance, a 100 MW wind farm with a 25%
 7 capacity credit will on average be generating 25 MWs of output during peak load hours
 8 across the MISO system.) The capacity credit percentage determines how much credit an
 9 asset owner will receive for a particular resource toward meeting its resource adequacy
 10 requirement based on forecasted load. (The same 100 MW wind farm with a capacity
 11 credit of 25% will receive 25 MWs of resource credit to be used to meet the Resource
 12 Adequacy requirement.)

13

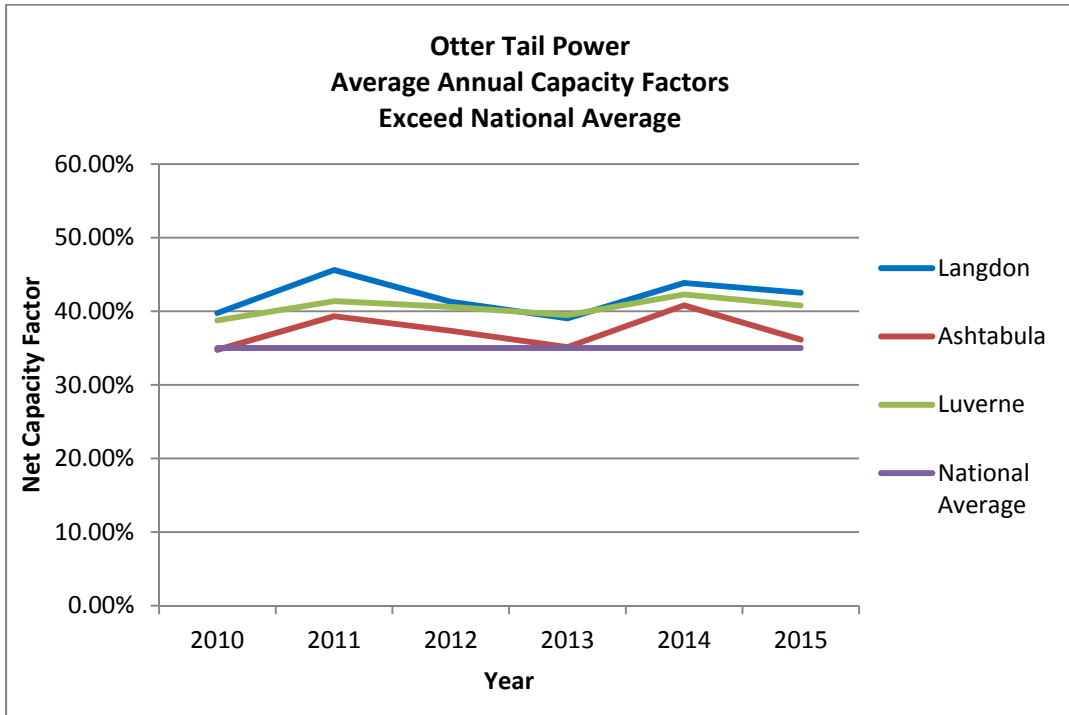
14 Q. HOW HAVE OTP'S WIND FARMS PERFORMED ON AN ANNUAL BASIS?

15 A. All three of OTP's wind farms have average annual capacity factors which exceed the
 16 national average. Table 4 below shows the annual average capacity factor for each of
 17 OTP's Wind Farms from 2010 to 2015. Table 5 shows the total annual kWhs generated
 18 by each of the wind farms since 2008.

19

1

TABLE 4



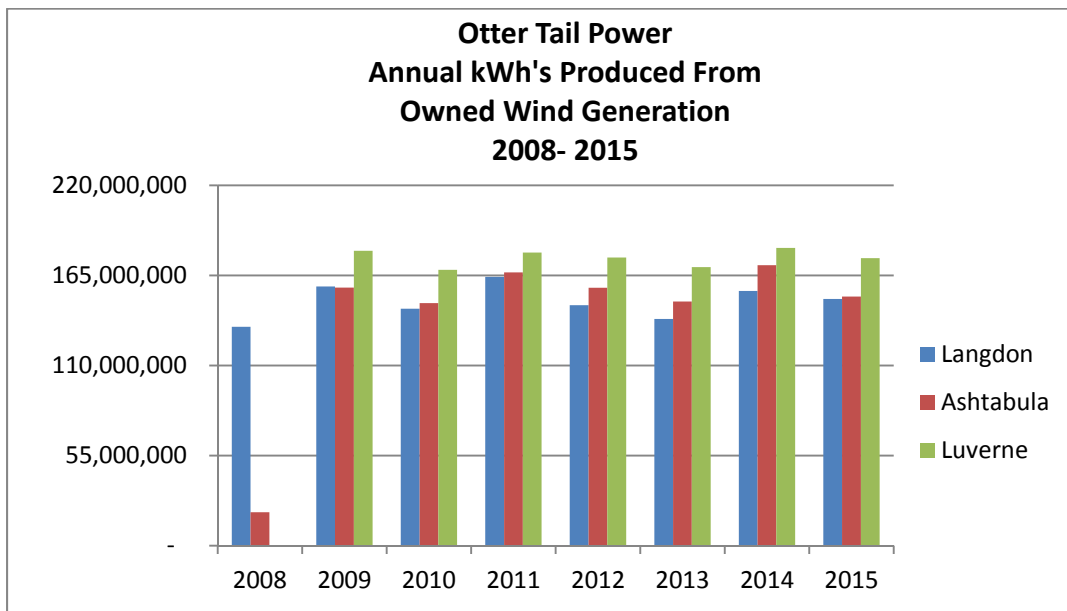
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TABLE 5



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7

1 Q. HOW WOULD YOU SUMMARIZE OTP'S OWNED WIND GENERATION
2 FACILITIES?

3 A. OTP owns some of the best performing wind generation facilities in all of MISO. These
4 North Dakota based facilities were added to OTP's generating fleet in a prudent, cost
5 effective manner. They provide ratepayers a low cost source of both energy and capacity.

6 **IV. TAX INCENTIVES UTILIZED FOR OTP'S WIND FARMS**

7 Q. WHAT IS THE PURPOSE OF THIS PORTION OF YOUR TESTIMONY?

8 A. I will provide an overview of the various tax benefits that were available for OTP's three
9 wind projects. I will also provide background and context for the discussion later in my
10 testimony, where I will explain how the timing of when some of these tax benefits get
11 utilized, has contributed to the recent variability in the RRA rates.

12

13 Q. WHAT TAX INCENTIVES WERE UTILIZED IN CONJUNCTION WITH THE
14 ACQUISITION AND DEVELOPMENT OF OTP'S WIND FARMS?

15 A. OTP utilized both Federal and State tax Incentives in the acquisition and development of
16 its wind farms. From a Federal tax perspective, OTP elected to take Federal Production
17 Tax credits (PTCs) on the Langdon and Ashtabula Wind Projects. For the Luverne Wind
18 Project, OTP elected to take a Federal Grant in lieu of PTCs. The Ashtabula and Luverne
19 Wind Projects also qualified for Federal Bonus Depreciation. In addition to the Federal
20 Tax incentives, all three of OTP's wind projects qualified for North Dakota Investment
21 Tax Credits. I will provide a summary of these various tax incentives and then later
22 explain how each are treated within OTP's RRA Rider.

23

24 Q. WHAT ARE PRODUCTION TAX CREDITS?

25 A. As their name indicates, Production Tax Credits are earned each month based on the
26 actual MWH production of the wind farms. In 2016, the Langdon and Ashtabula Wind
27 Projects will earn a \$24 tax credit for each MWH generated. These two facilities will
28 generate PTCs for 10 years.

29

30 Q. ANNUALLY, WHAT IS THE VALUE OF THE PRODUCTION TAX CREDITS
31 EARNED?

1 A. Table 2 below shows that over the last five years, OTP has earned between \$6.6 million
 2 and \$7.5 million of PTCs per year. These amounts reflect Total Company amounts. The
 3 North Dakota share is 41.018%.

4
 5 **TABLE 6**

6 **Annual Production Tax Credits Earned**
 7 **Total Company Basis**

Year	Production Tax Credit/ MWH	Langdon (40.5 MW Nameplate)	Ashtabula (48 MW Nameplate)	Total
2011	\$22.00	\$3,633,335	\$3,647,956	\$7,281,291
2012	\$22.00	\$3,230,167	\$3,464,495	\$6,694,662
2013	\$23.00	\$3,183,447	\$3,428,342	\$6,611,789
2014	\$23.00	\$3,577,864	\$3,939,610	\$7,517,474
2015	\$23.00	\$3,568,619	\$3,558,171	\$7,126,790

8
 9 Q. YOU NOTED EARLIER THAT OTP'S LUVERNE WIND PROJECT QUALIFIED
 10 FOR A FEDERAL GRANT.

11 A. Yes. This grant was made available through the American Recovery and Reinvestment
 12 Act. The total amount of the Federal Grant was approximately \$30 million, which OTP
 13 applied against the overall cost of the project, reducing rate base within the RRA Rider.
 14 No PTCs are earned on the Luverne project.

15
 16 Q. PLEASE EXPLAIN THE NORTH DAKOTA INVESTMENT TAX CREDIT.

17 A. The North Dakota Legislature encouraged investment in energy conversion facilities in
 18 North Dakota by making available to developers, an investment tax credit (ITC). All
 19 three of OTP's wind farms qualified for the North Dakota ITC. The credit was equal to
 20 15% of the investment and was earned at a rate of 3 percent per year for the first five
 21 years the property was in service.

22 **V. HOW TAX BENEFITS FLOW THROUGH THE RRA RIDER**

23
 24 Q. WHAT IS THE PURPOSE OF THIS PORTION OF YOUR TESTIMONY?

1 A. I will provide an overview of how the tax benefits described above are handled within the
2 RRA rider.

3

4 Q. HOW ARE THE ANNUAL PRODUCTION TAX CREDITS HANDLED IN OTP'S
5 RRA RIDER?

6 A. The annual PTCs are passed through, dollar for dollar in the year they are earned, as an
7 offset to the various operating, depreciation, and tax expenses included in the RRA.
8 Ratepayers receive the full benefit of the tax credits, regardless of whether OTP is able to
9 use the tax credits on its tax return for the period they are earned. For example, in
10 calendar year 2015, North Dakota rate payers received a reduction in their calendar year
11 RRA rider revenue requirement of approximately \$2,923,267 (Total 2015 PTCs of
12 \$7,126,790 times 41.018% ND Share).

13

14 Q. HAVE PRODUCTION TAX CREDITS BEEN HANDLED THIS WAY SINCE THESE
15 PROJECTS WERE PLACED IN SERVICE?

16 A. Yes. PTCs have been consistently handled this way in the RRA Rider.

17

18 Q. DID OTP EVER CONSIDER HANDLING THE PRODUCTION TAX CREDITS
19 DIFFERENTLY?

20 A. Yes. In Case No. PU-08-742, OTP proposed smoothing the impact of PTC's by slowing
21 down the immediate flow-through of front end tax benefits to customers and amortizing
22 those benefits over the life of the projects.

23

24 Q. WHAT WOULD HAVE BEEN THE EFFECT OF NORMALIZATION OF PTC'S?

25 A. Rather than immediately reducing the revenue requirement by flowing through the
26 amount of PTCs earned each month, normalization would have spread the tax benefits
27 over the expected useful life of the asset.

28

29 Q. DID THE COMMISSION PROVIDE GUIDANCE ON THIS MATTER?

30 A. Yes. The Commission and Otter Tail ultimately came to an agreement that the benefit of
31 the PTCs earned, should be realized immediately.

32

- 1 Q. HOW LONG WILL LANGDON AND ASHTABULA CONTINUE TO GENERATE
2 PRODUCTION TAX CREDITS?
- 3 A. PTCs are earned during the first ten years after a facility is placed into service. Langdon
4 will no longer earn PTCs starting December 2017. Ashtabula will no longer earn PTCs
5 starting November 2018. With the expiration of these PTCs in 2017 and 2018, the RRA
6 rider revenue requirement will increase as there will be no more credit to pass through.
7
- 8 Q. HOW ARE THE NORTH DAKOTA INVESTMENT TAX CREDITS BEING
9 HANDLED IN THE RRA RIDER?
- 10 A. Unlike the PTCs where the benefit is given to ratepayers immediately, the Commission
11 ruled the ND ITCs should be amortized over the 25-year expected life of the wind farms
12 so that all ratepayers will receive a proportional benefit throughout the useful life of the
13 facilities. Each month throughout the life of the project, an equal amount of the tax credit
14 is incorporated into the computation of the monthly revenue requirement.
15
- 16 Q. IS OTP ALWAYS ABLE TO UTILIZE THESE TAX CREDITS ON ITS ANNUAL
17 TAX RETURNS IN THE YEAR THEY ARE EARNED?
- 18 A. No. The ability to utilize tax credits on tax returns is dictated by the amount of taxable
19 income upon which those credits can be applied. Because of the availability of other tax
20 benefits such as accelerated and bonus tax depreciation, certain tax years may have
21 limited actual taxable income upon which to apply the available credits.
22
- 23 Q. IF OTP IS UNABLE TO USE THE CREDITS ON THE TAX RETURN IN THE YEAR
24 THEY ARE EARNED, CAN THEY BE CARRIED FORWARD AND APPLIED TO
25 FUTURE PERIOD TAXABLE INCOME?
- 26 A. Yes. For example, the PTC's have a 20-year carry-forward life, meaning that if a
27 Company is not able to use them on a current year's tax return because there wasn't
28 sufficient taxable income, the tax credits can be carried forward for up to 20 years.
29
- 30 Q. DOES OTP EXPECT IT WILL BE ABLE TO USE ALL OF THE PTCS BY
31 CARRYING THEM FORWARD TO FUTURE TAX RETURNS?
- 32 A. Yes.

1 Q. YOU STATED EARLIER THAT THE PTCS EARNED ARE IMMEDIATELY
2 PASSED THROUGH TO RATEPAYERS IN THE RRA RIDER, REDUCING THE
3 REVENUE REQUIREMENT FOR THAT YEAR. IF OTP IS UNABLE TO
4 ACTUALLY USE OR MONETIZE THOSE TAX CREDITS ON THE TAX RETURN,
5 HOW ARE THEY ACCOUNTED FOR IN THE RRA RIDER?

6 A. Any tax credits that have been earned but have not been used on OTP's tax returns, are
7 accounted for as a Deferred Tax Asset, and added to rate base within the rider. This
8 treatment is consistent with traditional rate making principles and is consistent with the
9 treatment the Commission approved when OTP's RRA rider was established.

10
11 Q. THE ASHTABULA AND LUVERNE WIND PROJECTS QUALIFIED FOR BONUS
12 TAX DEPRECIATION WHEN THEY WERE PLACED IN SERVICE. WHAT IS TAX
13 BONUS DEPRECIATION?

14 A. As an incentive to stimulate investment in capital items, the Federal Government has
15 periodically approved legislation allowing asset owners to take additional "bonus" tax
16 depreciation in the year the asset is acquired or placed in service. This bonus is in
17 addition to the normal accelerated depreciation which may be allowed. Additional bonus
18 depreciation further reduces the taxable income and the related payment of taxes.

19
20 Q. HOW IS BONUS TAX DEPRECIATION TREATED IN THE RRA RIDER?

21 A. Bonus and other accelerated tax depreciation provisions reduce the amount of actual
22 taxes paid when tax returns are filed. Ratepayers benefit when the payment of taxes can
23 be deferred until future periods, and the mechanics of traditional ratemaking processes
24 take that into account. Typically, when the amount of depreciation expense for tax
25 purposes is greater than the depreciation amount computed for book purposes, the
26 difference is accounted for as Accumulated Deferred Income Taxes (ADIT). In
27 traditional ratemaking, including OTPs riders, the ADIT balances are included as a credit
28 in the determination of the overall rate base upon which a return is calculated. When the
29 ADIT balances grow as a result of accelerated depreciation, the net rate base amount
30 drops.

1 **VI. HOW THE UTILIZATION OF TAX BENEFITS IMPACTED THE**
2 **CURRENT LOW RATE IN THE RRA RIDER**

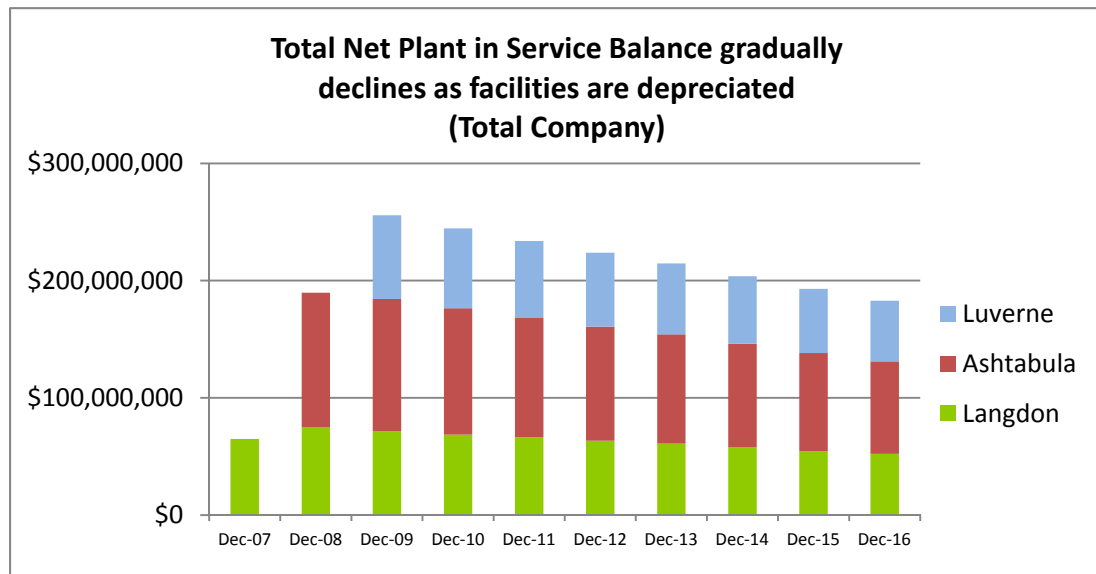
3 Q. WHAT IS THE PURPOSE OF THIS PORTION OF YOUR TESTIMONY?

4 A. In the last couple of years, we've seen increased variability in the annual revenue
5 requirement for OTP's RRA Rider. A big part of this variability is attributable to the
6 timing and utilization of some of the tax benefits discussed above, in particular the PTCs.
7 In this part of my testimony, I will highlight the key components of rate base, and
8 describe the factors which contributed to the establishment of the current rate that was put
9 in effect on April 1, 2015, which was substantially lower than historically seen.

10
11 Q. HOW HAVE THE OVERALL NET PLANT IN SERVICE BALANCES CHANGED
12 SINCE THE WIND FARMS WERE PLACED IN SERVICE?

13 A. As Table 7 below shows, over time, the net plant in service balances continue to decline
14 as these facilities are depreciated. The annual revenue requirement applicable to this
15 portion of rate base has declined accordingly.

16 **TABLE 7**



17
18
19 Q. WHAT OTHER ITEMS ARE INCLUDED IN RATE BASE BESIDES NET PLANT IN
20 SERVICE?

21 A. As mentioned earlier, ADIT balances created by the timing differences between book and
22 accelerated tax depreciation are reflected as a credit to rate base, reducing the overall

1 revenue requirement. With no new wind farms, the ADIT balances attributable to the
 2 existing projects continue to amortize in a predictable manner. The other items that are
 3 currently included in rate base within the RRA rider are the unused balances attributable
 4 to PTCs and ITCs. These balances are generally referred to as Deferred Tax Assets
 5 (DTA).

6
 7 Q. LAST YEAR, THE ANNUAL REVENUE REQUIREMENT AND RELATED RATE
 8 DROPPED SIGNIFICANTLY FROM THE PRIOR YEAR. WHY WAS LAST
 9 YEAR’S RATE SO LOW?

10 A. To help provide some context in response to this question, Table 8 below summarizes the
 11 revenue requirements from the prior two collection periods (Columns A and B), as well
 12 as the proposed rates included in OTP’s Initial Filing (Column C) and the subsequent
 13 Supplemental Filing (Column D) in this Case.

14 **TABLE 8**

		A	B	C	D
		Case PU-14-14	Case PU-15-14	Case PU 16-14	Case PU 16-14
		April 2014 – March 2015 Recovery Period	April 2015 – March 2016 Recovery Period	Current Case Initial Filing	Current Case Supplemental Filing
		Rate Effective April 1, 2014	Rate Effective April 1, 2015	April 2016 - March 2017	April 2016 – March 2017
1	Current Period Revenue Requirement	\$8,213,716	\$7,269,678	\$6,727,270	\$7,392,185
2	Prior Period True-Up	(\$146,049)	(\$1,828,499)	\$361,313	\$1,869,370
3	Total Revenue Requirement	\$8,067,666	\$5,441,178	\$7,088,584	\$9,261,555
	Rate	6.161% ³	4.069%	5.320%	7.573%

15
 16 As you can see in Table 8, the total revenue requirement upon which current rates are set
 17 was approximately \$5.44 million as reflected on Line 3 of column B in Table 8. This

³ The rate reflected is an estimated percent-of-bill rate provided for comparison purposes. The actual rates put in effect April 1, 2014 were based on per kW and per kWh rates. The rate design for the RRA was changed to a percent-of-bill rate, beginning with last year’s annual update in Case No. PU-15-14.

1 revenue requirement included a significant prior period true-up (over-collection) of
2 approximately (\$1.83 million).

3
4 Q. WHY WAS THERE SUCH A LARGE PRIOR PERIOD TRUE-UP FOR THE APRIL
5 2015 TO MARCH 2016 COLLECTION PERIOD?

6 A. There were three primary reasons for the large true-up. First, sales and related billing
7 collections increased during the 2013/2014 winter due to a colder than expected
8 temperatures. We estimate impact of additional sales to be about \$700k. The second
9 factor contributing to the over-collection was a significantly higher use of PTCs on
10 OTP's 2013 tax return which was finalized in Q3 of 2014. Actual PTC use was
11 significantly higher than what was previously estimated for 2013. Once actual PTC use
12 was known following the filing of the 2013 returns, the 2013 deferred tax asset balances
13 related to the PTCs needed to be updated in the rider to reflect this actual usage. The
14 higher use of PTCs reduced the DTA balances included in rate base, resulting in lower
15 revenue requirements for 2013 and subsequent periods. We believe use of PTC's reduced
16 revenue requirement by roughly \$650k. OTP also included the proceeds of REC sales of
17 approximately \$240k. REC sales are not forecasted, but are included as a true-up item
18 when they occur. The final \$240k would be attributable primarily to carrying charges
19 applicable to the three items above and other minor forecast to actual true-up
20 adjustments.

21 **VII. HOW THE 2015 TAX LEGISLATION IMPACTS THE PROPOSED**
22 **RRA RIDER RATE AND OTP'S OTHER RIDERS.**

23 Q. WHAT IS THE PURPOSE OF THIS PORTION OF YOUR TESTIMONY?

24 A. In OTP's Initial Filing in this Case, the revenue requirement was projected to return back
25 to a level more consistent with past history. The proposed revenue requirement in the
26 Initial Filing was \$7,088,584, and the proposed rate was 5.320 percent. However, the
27 Initial Filing did not take into consideration the impacts of Federal legislation passed in
28 late 2015, allowing the use of Bonus Depreciation to be taken on investments placed in
29 service in 2015. This portion of my testimony will explain how the passage of this
30 legislation and OTP's ability to take advantage of Bonus Tax Depreciation in 2015

1 impacts the revenue requirement in the RRA Rider, as well as OTP's other cost recovery
2 riders; the TCR and the ECR.

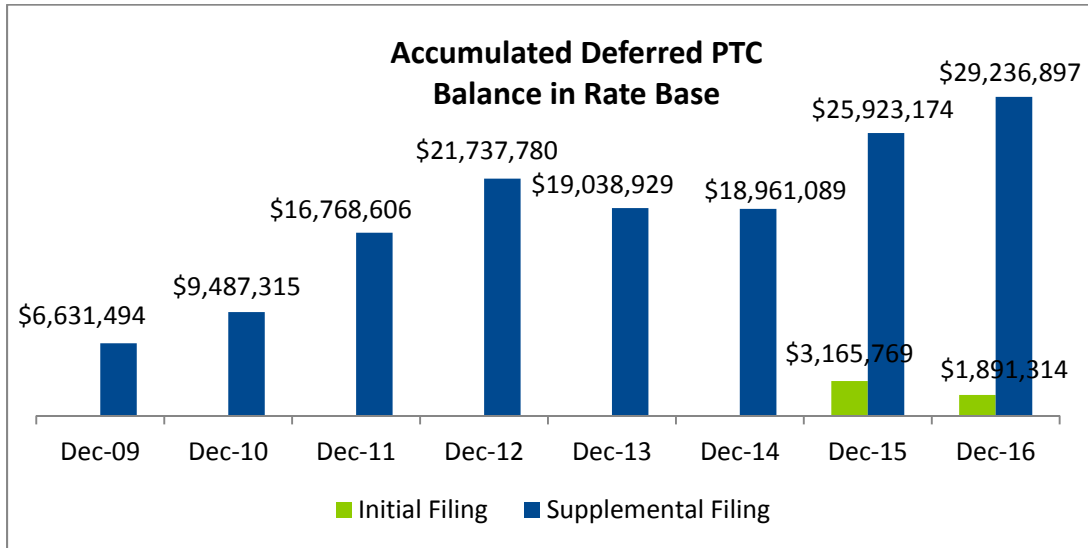
3
4 Q. PLEASE REVIEW THE ASSUMPTIONS INCLUDED IN OTP'S INITIAL FILING.

5 A. When OTP put together the Initial Filing in this Case, it was assumed that in 2015 and in
6 2016, OTP would be able to continue to use PTCs on its tax returns. As a result, OTP
7 projected that the balance of PTCs remaining within the rider, as part of rate base, would
8 continue to decline. To help illustrate this point, Table 9 below shows the actual year end
9 Accumulated Deferred Tax balances for PTCs that have been reflected in OTP's RRA
10 rider since 2008. At the end of 2014, the actual balance of unused PTCs was
11 approximately \$18.96 million. This balance is part of rate base in the RRA rider. For
12 2015 and 2016, OTP was projecting to continue to use PTCs on its tax returns, as
13 reflected by the forecasted balances for 2015 and 2016, shown in green (smaller bars) on
14 Table 9. Specifically, OTP had estimated it would use approximately \$23 million of
15 PTCs on its 2015 tax return, which was a combination of both PTCs generated during the
16 2015, as well as the utilization of prior period unused PTCs. OTP's projected revenue
17 requirement for the April 2016 to March 2017 recovery period was estimated to be
18 \$7,088,584, as reflected in Column C of Table 8.

19

1

TABLE 9



2

3

4 Q. WHEN WAS THE FEDERAL LEGISLATION PASSED, AUTHORIZING THE USE
5 OF BONUS DEPRECIATION FOR 2015?

6 A. On December 18, 2015, Congress passed its legislation authorizing 50% bonus
7 depreciation for 2015.

8

9 Q. WHEN DID OTP MAKE ITS INITIAL FILING IN THIS CASE?

10 A. The Initial Filing in this Case was submitted December 31, 2015. In that filing, OTP
11 acknowledged its awareness of the passage of this legislation. However, there was not
12 adequate time between the passage of the legislation and our filing due date to assess the
13 impact of this new legislation and incorporate that impact into our Initial Filing.

14

15 Q. ON FEBRUARY 26, 2016, A SUPPLEMENTAL FILING IN THIS CASE WAS
16 MADE, INCORPORATING THE IMPACT OF THIS LEGISLATION INTO THE RRA
17 RIDER. HOW DID THIS LEGISLATION IMPACT THE RRA RIDER?

18 A. The primary impact within the RRA rider is a change in the projected use of PTCs for the
19 2015 and 2016 tax years. Instead of continuing to use PTCs in 2015 and 2016, thereby
20 reducing the PTC Tax Asset balances included in rate base (as was reflected in the Initial
21 Filing) OTP now projects that no PTCs will be used in 2015, and that the PTC Tax Asset
22 balances will instead grow as new PTCs are earned in 2015 and 2016. As a result, the
23 proposed revenue requirement increased from the \$7,088,584 proposed in the initial

1 filing, to \$9,261,555.

2
3 Q. WHY WILL OTP NOT BE ABLE TO USE PTCs ON ITS 2015 TAX RETURN?

4 A. In 2015, several large projects were placed into service, including the Big Stone Air
5 Quality Control System (AQCS) as well as transmission projects and other capital
6 projects throughout the Company. The ability to take bonus depreciation for these
7 projects in 2015 will put OTP in a tax net operating loss (NOL) position for the 2015 tax
8 year. Since OTP will not have any taxable income for 2015, no PTCs will be used on its
9 tax return; as such, the accumulated DTA balances relating to PTCs are now projected to
10 grow for 2015 and 2016, as reflected in Table 9.

11
12 Q. ARE THERE ANY OTHER IMPACTS TO THE RRA RIDER FROM BONUS
13 DEPRECIATION?

14 A. Since OTP is in a Tax NOL position for 2015, any unused Tax NOLs can also be used to
15 offset future taxable income. OTP has allocated the NOL to each project by dividing the
16 project tax depreciation by the total Company tax depreciation and multiplying that
17 percentage by the total 2015 forecasted NOL. The allocation of the NOL creates a
18 relatively small deferred tax asset of approximately \$100k (Total Company) which is
19 included in rate base. In future periods, as the NOL's are applied against future taxable
20 income, the DTA balance will be reduced, lowering rate base and the associated revenue
21 requirement.

22
23 Q. HOW DO RATE PAYERS BENEFIT FROM BONUS DEPRECIATION?

24 A. Bonus and other accelerated tax depreciation provisions reduce the amount of actual
25 taxes paid when tax returns are filed. Ratepayers benefit when the payment of taxes can
26 be deferred until future periods, and the mechanics of traditional ratemaking processes
27 take that into account. Typically, when the amount of depreciation expense for tax
28 purposes is greater than the depreciation amount computed for book purposes, the
29 difference is accounted for as Accumulated Deferred Income Taxes (ADIT). In
30 traditional ratemaking, including OTP's riders, the ADIT balances are included as a
31 credit in the determination of the overall rate base upon which a return is calculated.

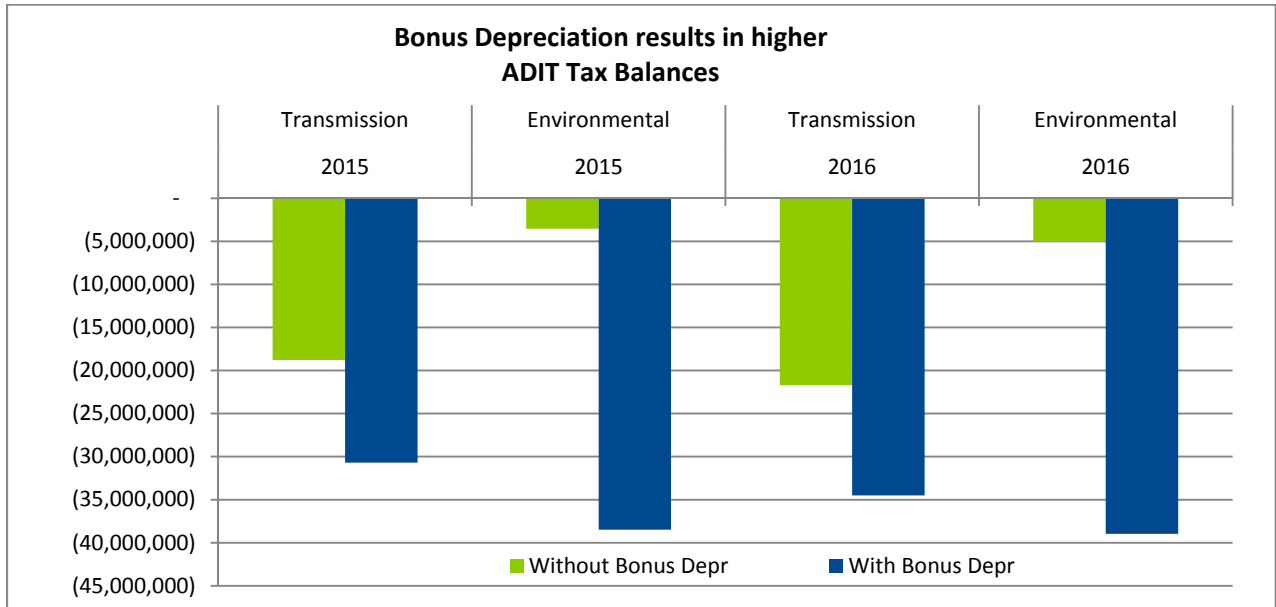
1 When the ADIT balances grow as a result of accelerated depreciation, the net rate base
2 amount drops.

3
4 Q. IS OTP UTILIZING BONUS DEPRECIATION ON INVESTMENTS PLACED IN
5 SERVICE THAT ARE CURRENTLY BEING RECOVERED IN ITS OTHER
6 RIDERS?

7 A. Yes. And the impact of the bonus depreciation in these riders will benefit ratepayers. As
8 noted earlier, one of the largest projects put into service in 2015 was the Big Stone AQCS
9 Project. This project is currently being recovered in OTP's ECR rider. OTP just filed its
10 next annual update to the ECR rider on March 31, 2015. The bonus tax depreciation that
11 will be taken on the AQCS project will result in a larger ADIT balance in OTP's ECR
12 rider, reducing the rate base in the rider. As a result, the rate will be lower in the ECR, as
13 reflected in that annual update, than it would have been without the bonus tax
14 depreciation. The bonus depreciation will also have a positive impact in OTP's TCR rider
15 in its next update. To help illustrate the impacts of bonus Depreciation in the ECR and
16 TCR further, Table 10 below shows the estimated change in Accumulated Deferred
17 Income Tax balances for 2015 and 2016 in the ECR and TCR riders as a result of OTP'S
18 ability to take bonus depreciation. Larger ADIT balances reduce rate base and the
19 corresponding revenue requirement.

1

TABLE 10



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While the updates to OTP’s three rider mechanisms and the incorporation of the bonus tax depreciation impacts will occur at different times over the next few months, Table 11 below illustrates the estimated incremental impacts bonus tax depreciation will have on the revenue requirements of each of OTP’s North Dakota riders for the calendar year 2015 and 2016 time-frames.

TABLE 11

ND Recovery Mechanism	January - December 2015 Revenue Requirement			January - December 2016 Revenue Requirement		
	Without Bonus Depreciation	With Bonus Depreciation	Change 2015	Without Bonus Depreciation	With Bonus Depreciation	Change 2016
Renewable Rider	\$7,612,115	\$8,274,389	\$662,274	\$6,799,750	\$7,974,995	\$1,175,245
Environmental Rider ⁴	9,470,693	9,284,142	(\$186,551)	13,124,209	11,399,458	(1,724,751)
Transmission Rider ⁵	5,803,480	5,758,730	(\$44,750)	6,400,824	6,084,430	(316,394)
Total Projected Revenue Requirement	\$22,886,288	\$23,317,261	\$430,973	\$26,324,783	\$25,458,883	(\$865,900)

⁴ The Environment Rider impact in this table has been updated to reflect the final revenue requirements included in the ECR Rider Update Application (Case No. PU-16-148), as compared to the estimated Environmental Rider amounts in the table OTP provided in its Supplemental Filing dated February 26, 2016 in OTP’s Annual Update to its Renewable Resource Rider in this Case.

⁵ The Transmission Rider revenue requirements are based on the recoverable projects. The revenue requirements provided in the table do not include Southwest Power Pool nor Midcontinent Independent System Operator expenses and revenues because these Regional Transmission Organization components of the rider are not impacted by bonus depreciation.

1 Q. PLEASE SUMMARIZE WHAT TABLE 11 IS SHOWING.

2 A. When the impact of the 2015 Bonus Depreciation legislation is included in all three of
3 OTP's riders, ratepayers will see a net reduction to the calendar year 2015 and 2016
4 revenue requirements across OTP's three cost recovery riders of approximately
5 (\$434,927); a \$430,973 increase in 2015, and a (\$865,900) decrease in 2016.
6

7 Q. COMMISSION STAFF INQUIRED ABOUT THE STATUS OF OTP'S 2015
8 EARNINGS. HAS OTP COMPLETED THAT ANALYSIS?

9 A. Yes. OTP has shared with Commission staff that our current analysis of 2015 ND
10 earnings, including all riders, yielded a return on equity (ROE) of 10.94%. This result is
11 slightly higher than OTP's authorized ROE of 10.75% and equates to approximately
12 \$558,000 of additional revenue. OTP expects to file its ND Annual report by May 2.
13

14 Q. DOES OTP ANTICIPATE THAT THESE RESULTS WILL CHANGE BETWEEN
15 NOW AND MAY 2?

16 A. While these results are still under review, we don't anticipate any material changes. We
17 would certainly inform staff if something was to materially change but at this point, we
18 are not aware of anything.
19

20 Q. HOW DO OTP'S 2015 EARNINGS COMPARE TO PRIOR YEAR'S EARNINGS?

21 A. In 2011, OTP reported an 11.8% ROE, in 2012 - 12.03%, in 2013 - 9.36%, and in 2014 -
22 10.1%.
23

24 Q. HAS OTP COMPLETED AN ANALYSIS OF WHAT 2016 RETURNS MAY LOOK
25 LIKE?

26 A. Not yet. We don't expect that analysis to be completed until sometime in May. We have
27 discussed with staff that we would keep them informed in the event we anticipate
28 earnings in 2016 to be at or higher than the 2015 levels.
29

30 Q. ARE JURISDICTIONAL ALLOCATIONS HAVING ANY IMPACT ON EARNINGS?

31 A. OTP did share with staff that 2015 energy-related allocation factors were lower than the
32 approved levels in OTP's last rate case. Demand factors were actually slightly above the

1 levels approved in the last case. Factors can and have varied from year to year based on
2 changes in energy sales, peak demands, and customers across OTP's system. Although
3 weather during the first quarter of 2016 was warmer than normal, it is possible that we
4 could see similar allocation factor levels in 2016 as we did in 2015.

5
6 Q. HAS OTP AND PSC STAFF DISCUSSED MAKING ANY ADJUSTMENTS WITHIN
7 OTP'S RENEWABLE RIDER TO COUNTER ANY POTENTIAL OVER EARNINGS
8 GOING FORWARD?

9 A. Yes. PSC staff and OTP have discussed making an adjustment within the RRA rider as a
10 means of tempering earnings in 2016. OTP and staff have agreed to the following
11 proposal:

12
13 Beginning May 1 of 2016, OTP will replace the current E2 energy factor approved in
14 OTP's last rate case, which is used to determine North Dakota's share of the revenue
15 requirement in the RRA rider, with the 2015 E2 factor. The allocation factor would drop
16 from the current 41.018 percent to the 2015 E2 factor of 39.209 percent. OTP will also
17 reduce the allowed ROE amount from 10.75 percent to 10.5 percent in the RRA rider as
18 of the same effective date. OTP estimates the impact of these adjustments will reduce the
19 RRA revenue requirement from May 1 of 2016 to March 31, 2017, by approximately
20 \$442,000.

21
22 OTP and staff propose to leave the proposed rate of 7.573 percent, as determined in
23 OTP's February 26, 2016 Supplemental Filing in this case, unchanged and reflect the
24 impact of these changes in the true-up in next year's filing. While the current rate was
25 calculated assuming a May 1, 2016 implementation date, OTP and staff now assume the
26 earliest effective date would be June 1, 2016.

27
28 Q. WHY DO YOU BELIEVE THIS IS A REASONABLE PROPOSAL?

29 A. While OTP reported earnings below its allowed ROE levels in 2013 and 2014, OTP
30 understands staff's concerns that OTP's earnings were slightly more than its currently
31 authorized return in 2015. There is no formal earnings sharing mechanism in place at the
32 present time, in the event OTP has earnings in excess of its authorized ROE. OTP has had

1 sharing mechanisms⁶ in place for periods of time in the past that would have returned
2 50% of the revenues over specified amounts. The proposal that OTP and staff have
3 agreed to would effectively return nearly 80% of revenues over its authorized return to
4 ratepayers through the RRA rider, as well as address concerns staff has raised with regard
5 to where OTP's earnings are relative to its peers.

6
7 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

8 A. OTP respectfully requests the Commission approve the 2016 Renewable Resource Cost
9 Recovery Adjustment as reflected in its February 26th Supplemental filing in this Case,
10 based on the tracker activity and cost recovery for the Langdon, Ashtabula, and Luverne
11 Wind projects. OTP's wind farms continue provide reliable, low cost energy to its rate
12 payers. Although the revenue requirement is increasing in this Case, due in part to the
13 recent tax legislation, as well as coming from a current rate that is abnormally low,
14 ratepayers will also see lower revenue requirements in OTP's other rider mechanisms for
15 the two years ending in 2016 as a result of that legislation.

⁶ In OTP's last general rate case, the following sharing mechanism was agreed to:
If OTP earns in excess of 10.75 percent ROE during the 2009 or 2010 calendar years, OTP will refund to customers
revenues corresponding to earnings as shown below:

- 50 percent of earnings in the calendar year above 10.75 percent up to and including 11.25 percent; and
- 75 percent of earnings in the calendar year above 11.25 percent.