

Before the North Dakota Public Service Commission
State of North Dakota

In the Matter of the Application of Otter Tail Power Company
For Authority to Increase Rates for Electric Utility
Service in North Dakota

Case No. PU-17-

Exhibit___

REVENUE REQUIREMENT AND REGULATORY ISSUES

Direct Testimony and Schedules of

STUART D. TOMMERDAHL

November 2, 2017

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ATTACHED SCHEDULES

Schedule 1 – Tommerdahl Resume

Schedule 2 – Savings Impacts from Big Stone AQCS Project

Schedule 3 - Public Version of the Otter Tail Private Letter Ruling

Schedule 4 – Federal ADIT Proration Schedule

Schedule 5 – Corporate Cost Allocation Manual (Redline)

Schedule 6 – Forecast Corporate Cost Allocation Procedures Manual

1 **I. INTRODUCTION AND QUALIFICATIONS**

2 Q. PLEASE STATE YOUR NAME AND OCCUPATION.

3 A. My name is Stuart D. Tommerdahl. I am employed by Otter Tail Power Company (OTP)
4 as Manager, Regulatory Administration.

5
6 Q. PLEASE SUMMARIZE YOUR QUALIFICATIONS AND EXPERIENCE.

7 A. I graduated from Moorhead State University, now Minnesota State University,
8 Moorhead, Minnesota, in 1983 with a B.S. degree in Accounting and a minor in
9 Economics. I am a Certified Public Accountant (Inactive) in Minnesota. From 1983 to
10 1992, I worked in several accounting, budgeting and financial reporting positions. In
11 1993, I joined OTP as Regulatory/Economic Analyst. From 1997 to 2003 I worked at
12 Otter Tail Energy Services as Manager, Financial Planning /Analysis and subsequently
13 Director, Financial Services.

14 In 2004, I returned to OTP as Manager, Risk Management. In March of 2012, I
15 started my current position as Manager, Regulatory Administration. My primary
16 responsibilities are to provide leadership in areas of revenue requirements analysis,
17 pricing and rate design, tariff administration, load research, cost allocation methodologies
18 to be used in cost of service studies, long range revenue forecasting, wholesale energy
19 accounting, cost of energy, and unbilled revenue. A copy of my resume is included as
20 Exhibit___(SDT-1), Schedule 1.

21 **II. PURPOSE AND OVERVIEW OF DIRECT TESTIMONY**

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

23 A. My Direct Testimony describes a number of revenue requirement and regulatory issues
24 associated with this case.

25
26 Q. PLEASE PROVIDE A BRIEF OVERVIEW OF YOUR DIRECT TESTIMONY.

27 A. My Direct Testimony focuses on the following items:

- 28
- Overview of major capital projects since last case;
 - New Generation Rider;
- 29

- Changes to Fuel Adjustment Clause;
- Accumulated deferred income tax proration;
- Corporate cost allocations; and
- Economic development.

Lastly, my Direct Testimony addresses a few miscellaneous regulatory issues.

Q. HAVE YOU INCLUDED BOTH NORTH DAKOTA JURISDICTIONAL AND TOTAL COMPANY AMOUNTS IN YOUR DIRECT TESTIMONY AND SCHEDULES?

A. Yes. The dollar values presented in my Direct Testimony are jurisdictionalized to North Dakota values and labeled as (OTP ND). The North Dakota jurisdictional values are also presented in combination with total company values, labeled as (Total).

There are certain power plant and transmission projects where OTP is only a part owner. In those circumstances, I included each of the following: the total project costs, labeled as (Total Plant or Total Project), the OTP ownership allocation of the project amounts, labeled as (OTP Total).

Some categories of costs include costs that fall into numerous functions, each with its own jurisdictional allocation, and therefore a straightforward calculation of a jurisdictional amount based on a single allocator is not possible. Examples of these costs include certain labor cost categories, which may include costs functionalized as generation, transmission, distribution, administration and general, with each function having its own unique jurisdictional allocation. For costs that are categorized across functions like this, the North Dakota jurisdictional dollar values have been estimated by multiplying the Total Company costs by a single blended allocator. When such an estimate has been used, the dollar values are labeled as (ND EST).

Q. HOW IS YOUR DIRECT TESTIMONY ORGANIZED?

A. In Section III, I will discuss major capital projects OTP has completed since its last North Dakota rate case. In Section IV, I will explain the new Generation Cost Recovery Rider. In Section V, I will discuss proposed changes to OTP's Energy Adjustment Rider. Section VI includes a discussion of Federal Accumulated Deferred Income Tax (ADIT) Proration in the 2018 Test Year. Section VII includes a discussion of corporate cost

1 allocations. In Section VIII, I address economic development. Section IX includes a
2 discussion of miscellaneous issues, and Section X includes my conclusions.

3 **III. MAJOR CAPITAL PROJECTS SINCE LAST RATE CASE**

4 Q. WHAT IS THE PURPOSE OF THIS SECTION OF YOUR DIRECT TESTIMONY?

5 A. In this section of my Direct Testimony, I will discuss major capital projects that OTP has
6 completed since its last North Dakota rate case, including: (A) the Big Stone plant Air
7 Quality Control System project (AQCS Project); (B) the Hoot Lake plant Mercury and
8 Air Toxics Standards project (MATS Project); (C) the Langdon, Ashtabula and Luverne
9 Wind Projects; and (D) major transmission projects. I will also discuss OTP's new
10 Customer Information System Project.

11
12 Q. WHEN WAS OTP'S LAST RATE CASE IN NORTH DAKOTA?

13 A. OTP's last North Dakota rate case was filed in 2008, and was based on a 2007 Test Year
14 (Case No. PU-08-862).

15 **A. Big Stone AQCS Project**

16 Q. WHAT WILL YOU DISCUSS IN THIS SUBSECTION?

17 A. In this subsection of my Direct Testimony, I will explain the \$3.4 million (OTP ND) of
18 annual savings for North Dakota customers in the 2018 Test Year, which will continue
19 for 30 years, as a result of OTP's completion of the Big Stone AQCS Project far under
20 budget. I will also discuss the reductions in earnings for shareholders resulting from the
21 under-budget completion of the AQCS Project.

22
23 Q. WHAT IS THE BIG STONE AQCS PROJECT?

24 A. The Big Stone AQCS Project is a major environmental upgrade project at the Big Stone
25 plant that went into service on December 29, 2015. It is the largest capital project ever
26 undertaken by OTP. The AQCS Project was needed for the continued operation of the
27 Big Stone plant. The AQCS Project reduces nitrogen oxides and sulfur dioxide emissions
28 at our Big Stone plant by approximately 90 percent and reduces mercury emissions by
29 approximately 80 percent. The Commission granted the Big Stone AQCS Project an

1 Advance Determination of Prudence (ADP) on May 9, 2012.¹ OTP completed the Big
2 Stone AQCS Project substantially under budget and on time. The Big Stone AQCS
3 Project, including the associated capital costs and OTP's completion of the project far
4 under budget, is discussed in detail in the Direct Testimony of OTP witness Mr. Kirk A.
5 Phinney.
6

7 Q. IS OTP PROPOSING TO CHANGE HOW BIG STONE AQCS PROJECT CAPITAL
8 COSTS ARE RECOVERED?

9 A. Yes. The North Dakota jurisdictional share of the Big Stone AQCS Project capital costs
10 currently are being recovered through OTP's North Dakota Environmental Cost
11 Recovery Rider (ECRR), as approved in Cases PU-13-79 and PU-13-84. OTP witness
12 Mr. Bryce C. Haugen describes, in his Direct Testimony, OTP's proposal to move the
13 Big Stone AQCS Project capital costs from the ECRR into base rates at the conclusion of
14 this case.
15

16 Q. DOES THIS PROPOSAL INCREASE COSTS TO CUSTOMERS?

17 A. No. Moving the Big Stone AQCS Project from the ECRR into base rates is merely a
18 change to how the costs of the project are recovered.
19

20 Q. DID OTP COMPLETE THE BIG STONE AQCS PROJECT AT A COST
21 SUBSTANTIALLY BELOW BUDGET?

22 A. Yes. Mr. Phinney explains in his Direct Testimony that the final capital cost for the Big
23 Stone AQCS Project is \$365.5 million (Total Plant), which is over \$125 million below
24 the total original project budget of \$494 million (Total Plant). OTP's total company
25 share of this savings in capital costs is \$69.5 million (OTP Total), and the North Dakota
26 jurisdictional share is \$25.3 million (OTP ND).
27

¹ Case No. PU-11-165

1 Q. HAVE YOU DETERMINED THE SAVINGS IN THE 2018 TEST YEAR REVENUE
2 DEFICIENCY OF COMPLETING THE BIG STONE AQCS PROJECT BELOW
3 BUDGET?

4 A. Yes. I have determined that the under-budget completion of the Big Stone AQCS Project
5 reduced the 2018 Test Year revenue deficiency and will save North Dakota customers
6 approximately \$3.4 million annually (OTP ND). This determination was based on a cost
7 of completion of \$365.5 million (Total Project) (approximately \$129 million (Total
8 Project) below budget) and reflects OTP's 53.9 percent ownership share and the North
9 Dakota jurisdictional allocation of 36.42 percent. This savings for North Dakota
10 customers is the result of (1) the reduction in the North Dakota jurisdictional share of the
11 *return of capital* (depreciation) on approximately \$128.9 million (Total Project) savings;
12 plus (2) the reduction in the annual *return on capital* (earnings for investors plus tax
13 effect) on \$128.9 million (Total Project) savings. My calculation of the estimated annual
14 savings for North Dakota customers for the 2018 Test Year is set forth on
15 Exhibit__(SDT-1), Schedule 2.

16
17 Q. HAVE YOU ALSO DETERMINED THE CUMULATIVE SAVINGS FOR NORTH
18 DAKOTA CUSTOMERS OVER THE INITIAL 10 YEARS OF USE AND THE FULL
19 30-YEAR LIFE OF THE BIG STONE AQCS PROJECT?

20 A. Yes. I estimate that OTP's North Dakota customers will receive cumulative savings of
21 approximately \$32.7 million (OTP ND) over the initial 10-years of use of the Big Stone
22 AQCS Project. I estimate that, over the 30-year life of the AQCS Project, OTP's under-
23 budget completion of the Big Stone AQCS Project will reduce OTP's North Dakota
24 customer costs by approximately \$69.5 million (OTP ND) with a net present value of
25 \$31.8 million (OTP ND). This savings for OTP's North Dakota customers are also the
26 result of the North Dakota jurisdictional share of the reduction in *the return of*
27 *approximately \$128.9 million (Total Project) of capital* (reflected in depreciation) plus
28 the reduction in *the return on* approximately \$128.9 million (Total Project) of capital.
29 My calculations are also set forth on Exhibit__(SDT-1), Schedule 2.

30

1 Q. IN ADDITION TO CUSTOMER SAVINGS, DOES THE UNDER-BUDGET
2 COMPLETION ALSO HAVE AN EFFECT ON SHAREHOLDERS?

3 A. Yes. While the lower investment from the under-budget completion of the Big Sone
4 AQCS Project provides substantial savings for North Dakota customers, there is a
5 corresponding effect on OTP shareholders in the form of reduced earnings resulting from
6 the reduced investment.

7
8 Q. HAVE YOU DETERMINED THE REDUCED EARNINGS FOR SHAREHOLDERS
9 IN THE 2018 TEST YEAR AND IN OTHER YEARS?

10 A. Yes. As a result of OTP's under budget completion of the Big Stone AQCS Project, the
11 return to shareholders will be reduced (after OTP income taxes) by approximately:

- 12 A. \$1.2 million (OTP ND) in the 2018 Test Year;
- 13 B. \$11.6 million (OTP ND) during the first 10 years; and
- 14 C. \$21.2 million (OTP ND) over the 30-year life of the Big Stone AQCS Project.

15 The net present value of reduced earnings is \$8.0 million (OTP ND) over the first
16 10 years and \$10.7 million (OTP ND) over the 30-year life of the Big Stone AQCS
17 Project. My calculations are set forth on Exhibit___(STD-1), Schedule 2.

18
19 Q. IS IT APPROPRIATE FOR THE COMMISSION TO CONSIDER THESE CUSTOMER
20 SAVINGS AND LOWER EARNINGS IN SETTING OTP'S RETURN ON EQUITY?

21 A. Yes. OTP witness Mr. Robert B. Hevert recommends that the Commission consider
22 OTP's under-budget completion of the Big Stone AQCS Project when setting OTP's
23 return on equity (ROE). Considering this accomplishment in setting the ROE for OTP
24 would help to reinforce that prudent execution of capital projects and the resulting cost
25 savings for customers is a priority of both utilities and regulators. While OTP has always
26 made the prudent execution of capital expenditures one of its most important business
27 priorities, OTP believes that reinforcement of that priority in the setting of OTP's
28 authorized ROE is appropriate in this case from a regulatory perspective.

29

1 **B. Hoot Lake MATS Project**

2 Q. WHAT WILL YOU DISCUSS IN THIS SUBSECTION?

3 A. In this subsection, I will discuss the Hoot Lake MATS Project, which OTP also
4 completed under budget.

5
6 Q. WHAT IS THE HOOT LAKE MATS PROJECT?

7 A. The Hoot Lake MATS Project involved the upgrade of Electrostatic Precipitators and the
8 installation of an Activated Carbon Injection system at Hoot Lake. The Hoot Lake
9 MATS Project is designed to control mercury and particulate matter emissions at the
10 plant. The project is described in greater detail in Mr. Phinney's Direct Testimony.

11
12 Q. DID OTP COMPLETE THE HOOT LAKE MATS PROJECT AT A COST
13 SUBSTANTIALLY BELOW BUDGET?

14 A. Yes. Mr. Phinney explains in his Direct Testimony that the final capital cost for the Hoot
15 Lake MATS Project is \$7.145 million (Total), which is \$2.8 million (28 percent) below
16 the total original project budget of \$10 million (Total).

17
18 Q. IS OTP PROPOSING TO CHANGE TO HOW HOOT LAKE MATS PROJECT
19 CAPITAL COSTS ARE RECOVERED?

20 A. Yes. The North Dakota jurisdictional share of the Hoot Lake MATS Project capital costs
21 currently are being recovered through the ECRR. Mr. Haugen describes OTP's proposal
22 to move the Hoot Lake MATS Project capital costs from the ECRR into base rates at the
23 conclusion of this case.

24
25 Q. DOES THIS PROPOSAL INCREASE COSTS TO CUSTOMERS?

26 A. No. Moving the Hoot Lake MATS Project from the ECRR into base rates is merely a
27 change to how the costs of the project are recovered.

28

1 **C. Langdon, Ashtabula and Luverne Wind Projects**

2 Q. WHAT WILL YOU DISCUSS IN THIS SUBSECTION?

3 A. In this subsection, I will explain some of the background and the costs that are included
4 in OTP’s proposal for future cost recovery for the Langdon Wind Project (Langdon), the
5 Ashtabula Wind Project (Ashtabula), and the Luverne Wind Project (Luverne).

6
7 Q. WAS THERE AN AGREEMENT IN OTP’S LAST NORTH DAKOTA RATE CASE
8 REGARDING COST RECOVERY FOR OTP’S WIND PROJECTS?

9 A. Yes. The parties agreed that in its next rate case, OTP would move then-existing wind
10 projects into base rates.² OTP now owns portions of Ashtabula, Langdon, and Luverne
11 and all are currently in service. OTP has been recovering the costs of these wind projects
12 in its Renewable Resource Adjustment Rider (RRAR).³

13
14 Q. IS OTP PROPOSING TO MOVE RECOVERY OF THESE WIND PROJECTS FROM
15 THE RRAR TO BASE RATES IN THIS CASE?

16 A. Yes. Mr. Haugen describes the process OTP proposes to roll-in the wind projects from
17 the RRAR into base rates in his Direct Testimony.

18
19 Q. PLEASE DESCRIBE THE THREE WIND PROJECTS THAT OTP OWNS.

20 A. OTP’s three wind projects are located in eastern North Dakota.

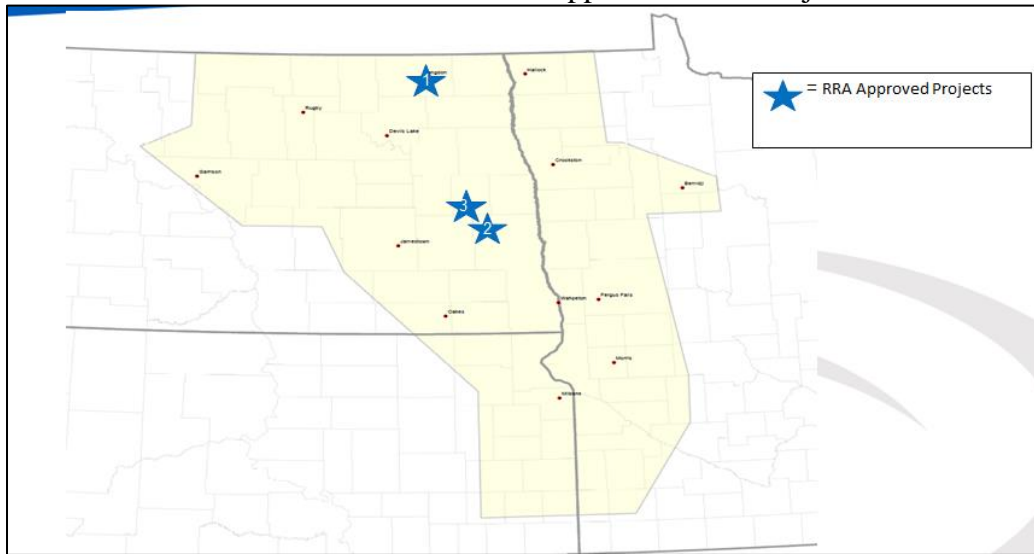
21

² Section II. D. Page 8 of 21 Case No. PU-08-862 and PU-8-742 Amended Settlement Agreement.

³ The Commission approved the inclusion of Langdon in Case No. PU-06-466, Ashtabula in Case No. PU-08-742, and Luverne in Case No. PU-10-018.

1
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Map 1
Locations of OTP's RRAR Approved Wind Projects



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11

As summarized in Table 1 below, Langdon is comprised of 27 turbines with a nameplate rating of 40.5 megawatts (MW). That project was placed in service in December 2007. Ashtabula is comprised of 32 turbines with a nameplate rating of 48 MW. That project was placed in service in November 2008. Luverne is comprised of 33 turbines with a nameplate rating of 49.5 MW. That project was placed in service in September 2009.

12
13

Table 1
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	27	December 2007	40.5	PU-06-466	PTC -10 year; ND ITC
2	Ashtabula	32	November 2008	48.0	PU-08-742	PTC - 10 year; ND ITC
3	Luverne	33	September 2009	49.5	PU-10-018	Federal Grant; ND ITC
4			<i>Total</i>	<i>138.0</i>		

14
15
16
17
18

Q. WHY WERE THESE WIND PROJECTS SELECTED INSTEAD OF OTHER POSSIBLE GENERATION PROJECTS?

A. These projects were identified as least cost resources available to meet OTP's generation needs at the time these projects were developed. A contributing factor to this conclusion

1 was the ability of OTP to utilize certain Federal tax benefits that were available in
2 connection with these projects. The Langdon and Ashtabula wind projects both qualified
3 for Federal Production Tax Credits (PTCs). For Luverne, OTP elected to take a \$30
4 million Federal grant. That grant reduced the net plant in service balance for Luverne
5 within the RRAR, and lowered the overall cost ratepayers would pay for that project.
6

7 Q. WHAT WAS THE TOTAL COST OF THE WIND PROJECTS?

8 A. Table 2 below summarizes the 2018 average plant in service balances of these OTP-
9 owned wind projects.

10
11 **Table 2**
12 OTP-Owned Wind Projects: 2018 Average Plant in Service Balances⁴
13 (\$ millions)

Line #	Wind Project	OTP Total	OTP ND
1	Langdon	\$79.4	\$29.8
2	Ashtabula	\$116.3	\$43.7
3	Luverne ⁵	\$73.0	\$27.4
4	<i>Total</i>	<i>\$268.7</i>	<i>\$101.0</i>

14
15 Q. PLEASE SUMMARIZE THE OPERATIONAL PERFORMANCE OF OTP'S WIND
16 PROJECTS.

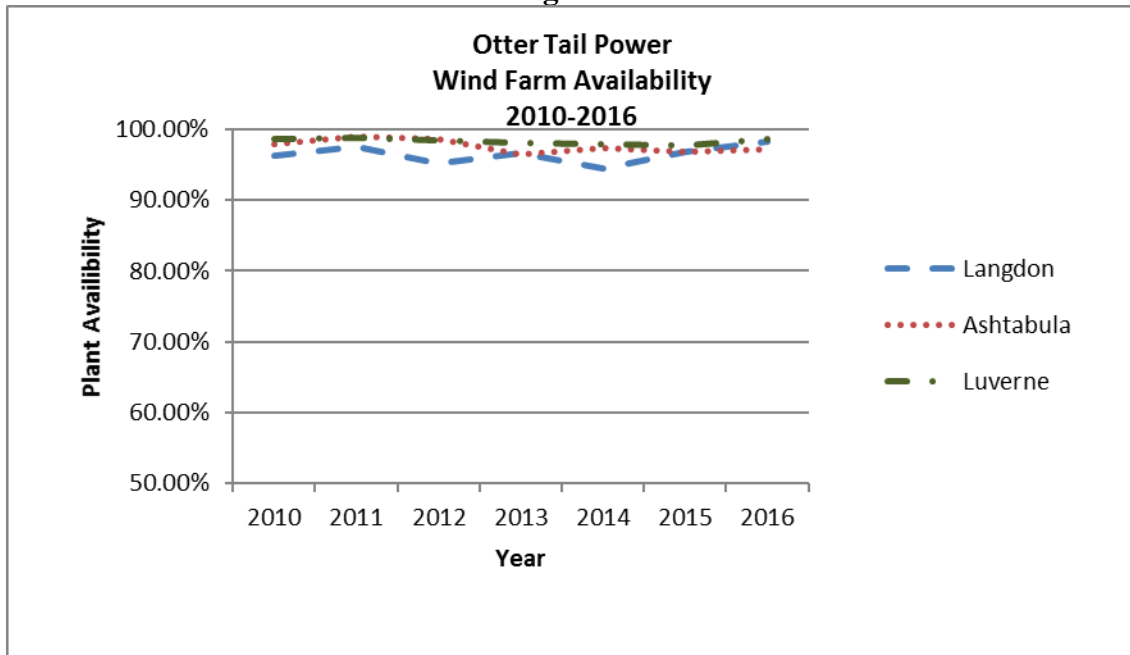
17 A. OTP's wind projects have performed very well. Figure 3 below shows the wind projects
18 availability since 2010.
19

⁴ Haugen Direct BCH-1_Schedule 2

⁵ Balances are after application of Federal grant.

1

Figure 3



2

3

4 Q. HOW HAVE THESE WIND PROJECTS PERFORMED RELATIVE TO OTHER
 5 PROJECTS IN THE MIDCONTINENT INDEPENDENT SYSTEM OPERATOR
 6 (MISO) FOOTPRINT?

7 A. OTP’s wind projects are high performers within MISO’s footprint. Figure 4 below shows
 8 the relative capacity credits of the 205 wind projects within MISO’s footprint. The
 9 system average capacity credit⁶ for all wind projects in MISO for the 2017/2018 Planning
 10 Year⁷ is 15.6 percent. Luverne currently has the highest MISO capacity credit of 26.2
 11 percent. Ashtabula is ranked 9th with a capacity credit of 23.6 percent, and Langdon is
 12 ranked 11th with a capacity credit of 23.3 percent. These Capacity Credits will be
 13 applicable for the MISO 2017/2018 Planning Year. The weighted average Capacity
 14 Credit for all three of OTP’s wind projects is 25.07 percent.

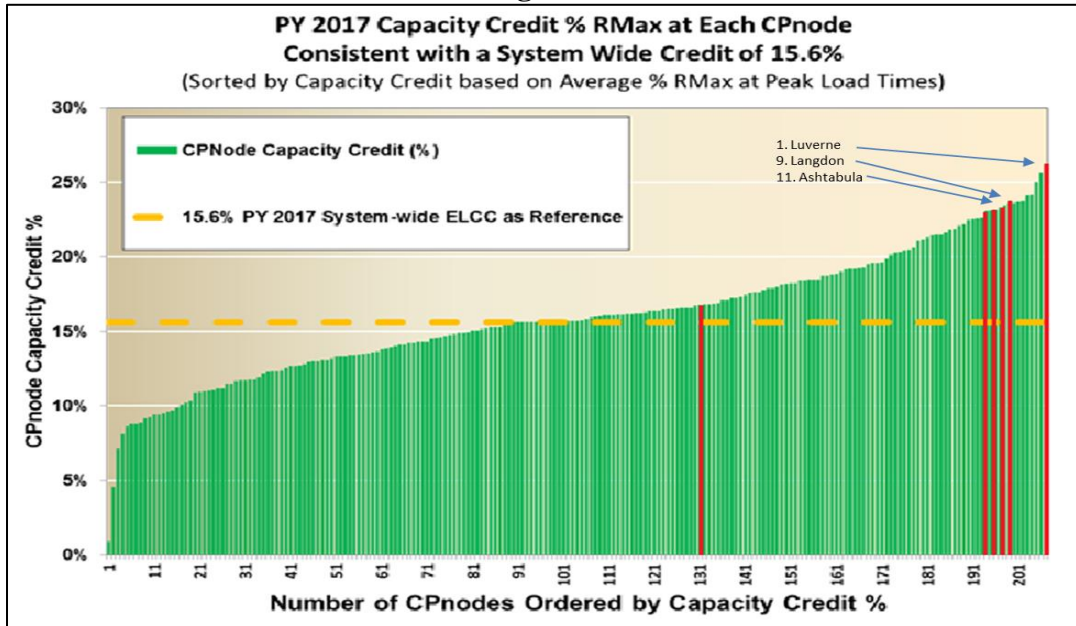
15

⁶ The capacity credit percentage is a measure of the average power output of a generation unit relative to its nameplate rating. For instance, a 100 MW wind project with a 25 percent capacity credit will on average be generating 25 MWs of output during peak load hours across the MISO system. The capacity credit percentage determines how much credit an asset owner will receive for a particular resource toward meeting its resource adequacy requirement based on forecasted load: the same 100 MW wind project with a capacity credit of 25 percent will receive 25 MWs of resource credit to be used to meet the Resource Adequacy requirement.

⁷ The 2017 Planning Year runs from June 1, 2017 to May 31, 2018.

1

Figure 4



2

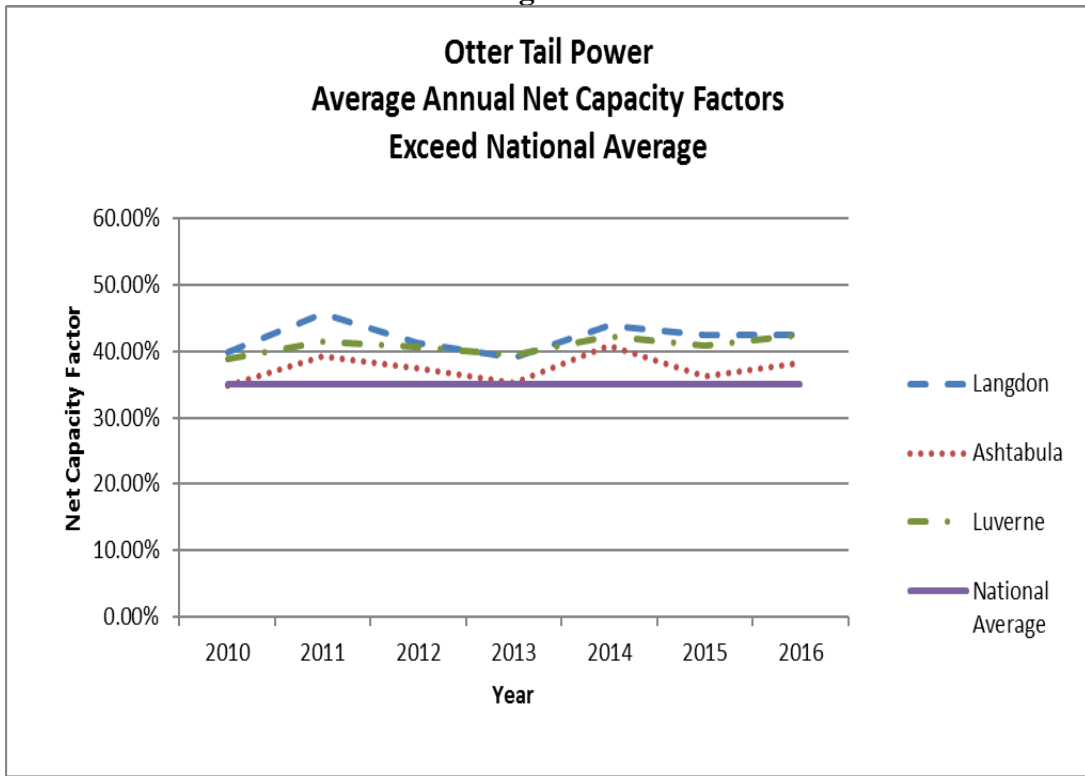
3

4 Q. ARE OTP’S WIND PROJECTS ALSO HIGH PERFORMERS NATIONALLY?

5 A. Yes. All three of OTP’s wind projects have average annual capacity factors that exceed
 6 the national average. Figure 5 below shows the annual average capacity factor for each
 7 of OTP’s wind projects from 2010 to 2016.

1

Figure 5



2

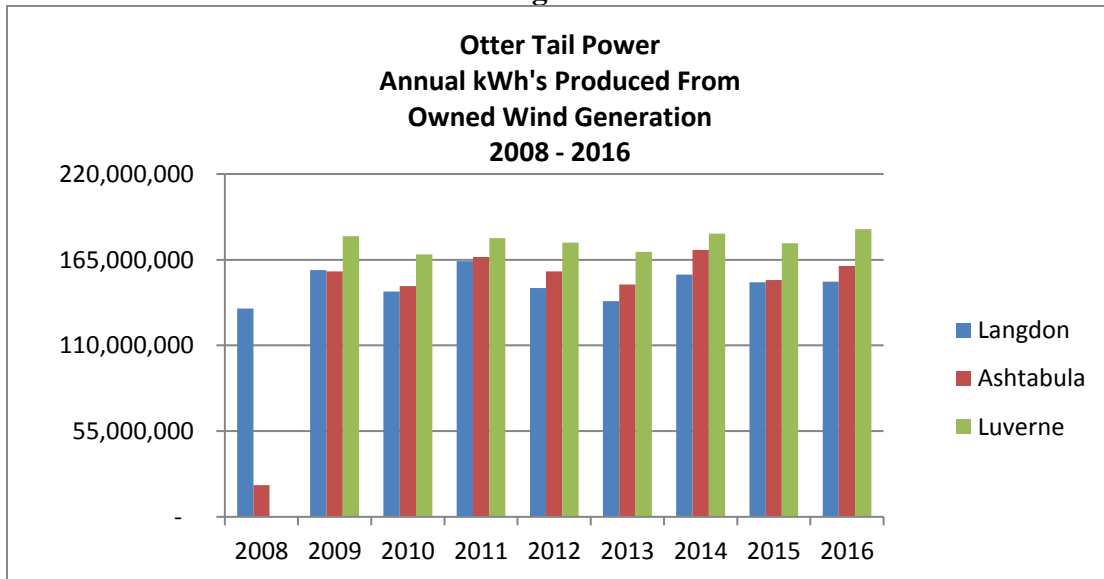
3

4 Figure 6 shows the total annual kWhs generated by each of the wind projects
5 since 2008.

6

7

Figure 6



8

9

1 Q. HOW WOULD YOU SUMMARIZE OTP'S OWNED WIND PROJECTS?

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

6 **D. Transmission Projects**

7 Q. WHAT WILL YOU DISCUSS IN THIS SUBSECTION OF YOUR DIRECT
8 TESTIMONY?

9 A. In this subsection, I will provide background information and a description of OTP's
10 major completed transmission projects, which are included in OTP's proposal to roll
11 transmission projects now included in OTP's Transmission Cost Recovery Rider (TCRR)
12 into base rates. Mr. Haugen will explain that proposal in his Direct Testimony.

13

14 Q. PLEASE BRIEFLY DESCRIBE THE MAJOR TRANSMISSION PROJECTS IN
15 WHICH OTP HAS INVESTED SINCE OTP'S LAST RATE CASE?

16 A. OTP has been involved with numerous transmission projects since OTP's last rate case in
17 2008. The most significant completed projects include: (1) the CAPX2020 transmission
18 projects, including Fargo to Monticello, Bemidji to Grand Rapids, and Brookings to
19 Hampton; (2) OTP's North American Electric Reliability Corporation (NERC)
20 Compliance Projects; (3) the Casselton to Buffalo 115 kV project, and (4) the Oakes Area
21 transmission project. The Commission has reviewed and approved each of these projects
22 for cost recovery in prior proceedings.

23

24 Q. PLEASE BRIEFLY DESCRIBE THE CAPX2020 TRANSMISSION PROJECTS.

25 A. The three CAPX2020 transmission projects in which OTP has invested are part of the
26 CAPX2020 portfolio of five projects formed to upgrade and expand the electric
27 transmission grid to ensure continued reliable and affordable service. The total
28 CAPX2020 portfolio involves an 800 mile, nearly \$2 billion investment initiative,
29 including four 345kV transmission lines and one 230kV line involving 11 transmission-
30 owning utilities in Minnesota, North Dakota, South Dakota, and Wisconsin. The
31 CAPX2020 portfolio projects were approved by MISO as part of its Transmission

1 Expansion Planning process, which identifies issues and opportunities, develops
2 alternatives for consideration, and evaluates those alternatives to determine effective
3 transmission solutions.
4

5 Q. WHAT WAS THE PURPOSE OF THE CAPX2020 FARGO TO MONTICELLO
6 PROJECT?

7 A. The CAPX2020 Fargo to Monticello project improved regional reliability in the southern
8 Red River Valley and north central Minnesota areas. The project also supports additional
9 generation development, including renewable generation, in eastern North Dakota and
10 western Minnesota. The project was energized April 2, 2015.
11

12 Q. WHAT WAS THE PURPOSE OF THE CAPX2020 BEMIDJI TO GRAND RAPIDS
13 PROJECT?

14 A. The CAPX2020 Bemidji to Grand Rapids project improves the reliability for the Red
15 River Valley and north central Minnesota. The 70-mile line allows more electricity to
16 flow to and from the region and relieves bottlenecks that sometimes occurred during
17 periods of high demand while supporting the multi-utility initiative of implementing a
18 comprehensive transmission plan that keeps electric service to customers in the Upper
19 Midwest among the most affordable and reliable in the nation. The project was energized
20 September 2012.
21

22 Q. WHAT WAS THE PURPOSE OF THE CAPX2020 BROOKINGS TO HAMPTON
23 PROJECT?

24 A. The CAPX2020 Brookings to Hampton project helps meet electric growth in south and
25 western Minnesota, and the growing areas south of the Twin Cities metro area. The
26 project also connects to new renewable generation resources in southern and western
27 Minnesota and North Dakota and South Dakota. The project was energized March 26,
28 2015.
29

1 Q. PLEASE DESCRIBE THE NERC COMPLIANCE TRANSMISSION PROJECT.

2 A. The NERC Compliance transmission project is an initiative required to respond to
3 NERC’s October 2010 Recommendation (Rule 810 of NERC’s Rules of Procedure) to
4 the industry to identify discrepancies between design and actual field conditions of
5 transmission lines. The Recommendation included a requirement for transmission
6 owners to prioritize transmission facilities and complete an evaluation of lines within a
7 three-year timeframe depending on line priority (which was to be identified as either
8 “high”, “medium”, or “low” priority based on guidance from NERC) and to report such
9 evaluation to the applicable Regional Entity, which in OTP’s case is the Midwest
10 Reliability Organization. In early 2017, OTP completed the required facility
11 modifications and is in compliance with the NERC Recommendation, which improves
12 the reliability of the transmission system.

13

14 Q. PLEASE DESCRIBE THE CASSELTON TO BUFFALO PROJECT.

15 A. The Casselton to Buffalo project is a baseline reliability project that resulted in
16 construction of 16 miles of 115 kV line, substation modifications at Buffalo, replacement
17 of the Buffalo transformer, and reconductoring a portion of the Mapleton-Sheyenne 115
18 kV line. The completion of this transmission project helps serve increased load in eastern
19 North Dakota. The final portion of this project is scheduled to be in-service in November
20 2017.

21

22 Q. PLEASE DESCRIBE THE OAKES TRANSMISSION PROJECT.

23 A. Sustained load growth between 2003 and 2013 required upgrades to the transmission
24 system around Oakes, North Dakota. The Oakes transmission project addresses that load
25 growth in the Oakes area, improving the adequacy of the transmission system, as well as
26 adding sectionalizing capability along the existing Ellendale, North Dakota to Hankinson,
27 North Dakota 230 kV line. The Oakes transmission project also helps minimize
28 momentary and sustained interruptions to Oakes and Forman, North Dakota area
29 customers. This project was completed in late 2015.

30

1 Q. IS OTP NOW RECOVERING THE COST OF THESE PROJECTS IN OTP'S TCRR?

2 A. Yes. The costs of each of these projects are among the 19 completed projects that OTP is
3 recovering through the TCRR.

4
5 Q. WHAT IS OTP'S PROPOSAL REGARDING THESE COMPLETED TRANSMISSION
6 PROJECTS CURRENTLY BEING RECOVERED IN OTP'S TCRR?

7 A. OTP is proposing to roll the recovery of these investments out of the TCRR and into base
8 rates at the time final rates go into effect in this case. Mr. Haugen discusses the roll-in of
9 these projects into base rates in his Direct Testimony.

10 **E. Customer Information System**

11 Q. WHAT WILL YOU DISCUSS IN THIS SUBSECTION OF YOUR DIRECT
12 TESTIMONY?

13 A. In this subsection, I will provide background information and a description of OTP's new
14 Customer Information System which OTP refers to internally as "CISone."

15
16 Q. IS OTP NOW IMPLEMENTING CISONE?

17 A. Yes. As OTP witness Mr. Bruce Gerhardson briefly describes in his Direct Testimony,
18 OTP is implementing CISone to replace an existing legacy customer information system
19 that OTP built internally and has been using for almost 30 years. Among other things,
20 customer billing will be one of the key functional business operations that will transfer
21 from the legacy system to the new CISone system. Mr. Gerhardson outlines numerous
22 other functional improvements CISone will provide as OTP builds critical technical
23 infrastructure to address changing needs of both customers and OTP employees. OTP's
24 current estimated cost of the system is \$15.8 million (Total) / \$6.5 million (OTP ND).

25
26 Q. PLEASE FURTHER DESCRIBE THE ADDITIONAL FUNCTIONALITY THAT
27 CISONE WILL PROVIDE OTP'S CUSTOMERS AND EMPLOYEES.

28 A. There are many benefits that OTP customers and employees will realize once CISone is
29 implemented. Much of this is due to the limitations of the current system due to its age.
30 One significant source of high-level benefit will be the system's ability to "talk" to other
31 OTP systems through interfaces, allowing data to flow in real-time rather than through

1 overnight batches and file transfers as is currently done. This will allow information
2 exchange at a much more rapid pace. Other benefits include:

- 3 • **Ease of new or updated rate implementation:** The existing CIS is limited due
4 to field and capacity constraints, and updating or changing rates or riders takes
5 significant database modification. CISone will allow OTP to more easily prepare
6 for rate/rider updates and changes, as well as provide a better process to test those
7 changes.
- 8 • **Customer Self Service (CSS):** CISone will better support self-service and online
9 business.
- 10 • **Mobile work management (MWM):** Mobile field workers will have access to
11 information much more quickly, and they will have access to information that
12 wasn't previously available to them in the field. "Apps" will be available through
13 smartphones and tablets.
- 14 • **A new system will be able to support future initiatives:** CISone will support
15 initiatives such as two-way Geographic Information System (GIS) integration,
16 Advanced Metering Infrastructure (AMI), and Outage Management System
17 (OMS) support.
- 18 • **Less reliance on CIS programmers and technicians:** More functions will be
19 shifted to system end-users.
- 20 • **Improved automation:** The current CIS system is not capable of meeting
21 current functional demands without significant manual intervention, which will
22 not be needed with CISone.
- 23 • **Elimination of reusing of data fields:** This will minimize the risk of data
24 corruption.
- 25 • **Easier detection and correction of billing issues:** Detection and correction will
26 be facilitated.
- 27 • **Advanced ad-hoc reporting:** The new CIS system will come with many reports
28 and queries that previously would have taken significant programming to develop.
- 29 • **More advanced "Checkout and Lock" features:** These features will mitigate
30 the risk of data corruption and account errors.
- 31 • **A more robust primary/secondary failover system:** CISone is designed so that
32 an in the event of a failure it will result in less downtime to restore.
- 33 • **Better ability to drive consistent business processes across all jurisdictions:**
34 CISone will facilitate consistency across all jurisdictions.

35

1 Q. WHEN DOES OTP ANTICIPATE IMPLEMENTING CISONE?

2 A. CISone is currently scheduled to “go-live” in 2018. Implementation will only occur after
3 CISone has been fully tested to confirm that OTP’s customer billings will be accurately
4 and correctly computed and accounted for. OTP will keep the Commission informed on
5 the schedule during the course of this case.
6

7 Q. HOW DOES IMPLEMENTATION OF CISONE RELATE TO THIS RATE CASE?

8 A Because the implementation of the CISone system closely aligns with the timeline of this
9 rate case and the potential implementation date of final rates, one scenario that OTP
10 desires to avoid is simultaneously implementing final rates the same month as CISone is
11 implemented. With perhaps a couple of minor adjustments, OTP could implement final
12 rates in the current CIS system if the Commission deems that to be the most appropriate
13 approach based on the CISone schedule.

14 On the other hand, CISone could potentially be ready for implementation ahead of
15 implementation of final rates. If OTP implements CISone ahead of final rates, OTP
16 believes it would be appropriate to have a two or three month “window” between
17 implementation of CISone and final rates for further confirmation of CISone system
18 operation. With interim rates in effect, OTP would be open to delaying implementation
19 of final rates as an option to best align the schedules of this case and CISone
20 implementation. Customers would be protected and compensated for any delay by
21 interest applied to any interim refund.
22

23 Q. IS OTP SEEKING RECOVERY OF CISONE COSTS IN THIS CASE?

24 A. Yes. OTP included the CISone project, including costs, in the 2018 Test Year. Because
25 the CISone system has a much shorter depreciable life, OTP has included a Test Year
26 adjustment to annualize the costs associated with CISone into the 2018 Test Year. OTP
27 witness Mr. Tyler A. Akerman provides further detail of the normalizing adjustment in
28 his Direct Testimony.
29

1 Q. WILL THE IMPLEMENTATION OF CISONE RESULT IN ANY CHANGES TO
2 OTP'S CUSTOMER BILL CALCULATIONS, RATE DESIGNS, TARIFF
3 LANGUAGE, OR OTP'S GENERAL RULES AND REGULATIONS?

4 A. Yes. Before filing this rate case, OTP met with Commission Staff to inform them that
5 OTP anticipates CISone will necessitate some changes to OTP's tariffs and bills, as well
6 as changes to the language in OTP's rate book. OTP will need Commission approval to
7 make those changes. OTP proposes to make a separate filing in early 2018 to seek
8 approval of the CISone tariff and bill changes. Because of the potential scenarios related
9 to timing of the final rates and CISone, OTP and Commission Staff agreed handling these
10 changes in a separate filing would provide greater flexibility in terms of seeking
11 Commission approvals for CISone related changes. This flexibility is necessary should
12 the schedule indicate CISone could be implemented ahead of the completion of this case
13 and implementation of final rates.

14

15 Q. ARE THERE ANY RATE PROPOSALS IN THIS CASE THAT OTP WILL NOT BE
16 ABLE TO IMPLEMENT IN OTP'S CURRENT CIS SYSTEM?

17 A. Yes. In response to the Commission Order in OTP's last North Dakota general rate case,
18 OTP will be implementing an E8760 allocation of fuel and purchased power costs
19 recovered through the Energy Adjustment Rider (also known as the Fuel Clause or FCA).
20 I will discuss OTP's Energy Adjustment Rider in greater detail later in my Direct
21 Testimony but as a summary, implementing this E8760 allocation results in a distinct and
22 separate Fuel Clause rate for each customer class. OTP's current legacy billing system is
23 not able to facilitate a separate Fuel Clause rate for each class. This functionality is being
24 designed into CISone. OTP proposes that if final rates go into effect before CISone is
25 implemented, that the Commission allow OTP to delay the transition to a 10-class FCA
26 rate until after CISone is implemented. In the interim, OTP proposes to charge all classes
27 the same FCA rate. In OTP's recent Minnesota general rate case, the Minnesota
28 Commission approved delaying a similar E8760 Fuel Clause rate implementation until
29 OTP's CISone system is placed in service.

30

1 Q. HAS OTP PROVIDED SEPARATE RATE SCHEDULES FOR THE ENERGY
2 ADJUSTMENT RIDER SECTION 13.01 TO REFLECT EACH OF THE SCENARIOS
3 ABOVE?

4 A. Yes. In Volume 2, Part D, a proposed version of Section 13.01 is provided which would
5 be applicable to the application of the E8760 allocation to the Fuel Clause once CISone is
6 placed into service. A second proposed version of Section 13.01 is provided which
7 would be applicable in the event final rates in this case are implemented ahead of the
8 implementation of CISone. In this instance, all customers would be charged the same
9 FCA rate as I noted above.

10 **IV. PROPOSED GENERATION COST RECOVERY RIDER**

11 Q. WHAT WILL YOU DISCUSS IN THIS SECTION OF YOUR DIRECT TESTIMONY?

12 A. In this section, I will explain OTP's proposed new cost recovery mechanism, the
13 Generation Cost Recovery Rider (GCRR), along with a brief description of the Astoria
14 Station generation project (Astoria Project). OTP will propose that the GCRR be used to
15 recover costs of the Astoria Project in a later proceeding.

16

17 Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF THE ASTORIA PROJECT.

18 A. The Astoria Project is an approximately 250 MW natural gas-fired, frame-style, simple
19 cycle combustion turbine generation facility to be located near Astoria, South Dakota.
20 The Astoria Project will provide capacity, dispatchable energy, and grid support as part
21 of OTP's two-part plan to reliably meet our customers' electric needs, replace expiring
22 capacity purchase agreements, and prepare for the 2021 retirement of the Hoot Lake
23 plant. The other component of OTP's two-part plan is the construction of the 150 MW
24 Merricourt wind generation facility (the Merricourt Project) in North Dakota. OTP is
25 embarking on the addition of the Astoria Project and the Merricourt Project to meet its
26 customer needs in a least-cost manner.

27

1 Q. PLEASE DESCRIBE OTP’S PROPOSAL REGARDING THE ESTABLISHMENT OF
2 THE GCRR.

3 A. OTP is requesting Commission approval of a GCRR to recover costs associated with
4 OTP’s proposed Astoria Project. OTP witness Mr. David G. Prazak discusses the
5 specifics of the rate design for the GCRR in his Direct Testimony and sponsors the
6 proposed Electric Rate Schedule 13.06 for the GCRR.

7 The GCRR would be a recovery mechanism that is similar to OTP’s current
8 TCRR, ECRR, or RRAR. These riders have allowed OTP to initiate timely recovery of
9 costs associated with significant multi-year capital projects. These riders also have
10 allowed OTP to gradually incorporate the costs of the investments into rates by phasing
11 in recovery over the years the projects have been developed and placed into service.
12 Without these riders, OTP likely would have needed to file multiple rate cases over the
13 last several years to begin recovering the costs associated with recent capital projects.

14
15 Q. HOW WOULD THE GCRR MECHANISM WORK?

16 A. Like OTP’s other capital project riders, the GCRR would include a tracker to capture and
17 track costs associated with the Astoria Project. Through an annual filing, OTP would
18 seek approval of recovery of both actual costs incurred to date as well as projected costs
19 to be incurred over a proposed annual recovery period. In subsequent annual filings,
20 OTP would update the tracker with known actual costs and updated forecast costs and
21 reset the GCRR rate. While the Astoria Project is under construction, OTP would be
22 requesting a recovery of return on investment in lieu of including an Allowance for Funds
23 Used During Construction (AFUDC) in the cost of the project. Once the Astoria Project
24 is in service, OTP would begin to seek recovery of the investment in addition to a return
25 on the investment. OTP anticipates that the investment would only remain in the GCRR
26 until the first rate case following completion of the project.

27
28 Q. IS OTP PROPOSING A GCRR RATE BE ESTABLISHED IN THIS RATE CASE?

29 A. No. This request is only for the establishment of the recovery mechanism. Mr. Prazak
30 discusses the details of the proposed GCRR tariff schedule and rate design. The current
31 project schedule targets the Astoria Project being placed in service by the spring of 2021.

1 Once OTP begins incurring material costs for the project, OTP will make a separate filing
2 to request approval of the current and proposed costs included in the initial rate. OTP
3 currently estimates making that filing in late 2018 or early 2019.
4

5 Q. HAS THE COMMISSION APPROVED A SIMILAR GENERATION RIDER FOR
6 ANY OTHER UTILITY?

7 A. Yes. In Case No. PU-14-108, the Commission approved Montana-Dakota Utilities Co.'s
8 generation resource cost recovery rider to recover costs associated with a new 88 MW
9 combustion turbine generator (Heskett III) located at Mandan, North Dakota.

10 **V. ENERGY ADJUSTMENT RIDER**

11 Q. WHAT WILL YOU DISCUSS IN THIS SECTION OF YOUR DIRECT TESTIMONY?

12 A. In this section, I will provide an overview of OTP's Energy Adjustment Rider and
13 explain two proposed changes to the Energy Adjustment Rider based on changes ordered
14 in OTP's last North Dakota rate case. I will also cover one additional proposed change
15 related to the recovery of reagents and emissions allowances.
16

17 Q. PLEASE DESCRIBE THE PURPOSE AND OPERATION OF OTP'S ENERGY
18 ADJUSTMENT RIDER.

19 A. Historically, the majority of OTP's fuel costs have been recovered in base rates, with the
20 amount recovered in base rates updated concurrently with the filing of a rate case.
21 Because fuel costs vary due to many factors such as demand for energy, dispatch of
22 generating facilities, market prices of power, weather, and volatility in fuel inputs, the
23 average cost of energy will fluctuate over time.

24 OTP's Energy Adjustment Rider reconciles the difference between the portion of
25 fuel or energy costs being recovered in base rates and the actual costs incurred, and either
26 returns to or collects from customers, the monthly deviations of the cost of energy
27 incurred.⁸ A new Fuel Clause rate is calculated and implemented each month to reflect
28 the change in cost, as stated in Section 13.01 of OTP's Electric Rate Schedule.

⁸ The terms "fuel cost" and "energy cost" are commonly used interchangeably.

1 According to Section 13.01, the monthly Fuel Clause rate is computed on a system basis
2 including those costs the Commission has deemed eligible for Fuel Clause recovery
3 based on a trailing four-month average. No changes to the four-month average or system
4 level calculation mechanics are proposed in this case.
5

6 Q. IN OTP'S LAST GENERAL RATE CASE, DID THE COMMISSION ORDER OTP TO
7 MAKE CHANGES TO THE ENERGY ADJUSTMENT RIDER IN THIS CASE?

8 A. Yes. In OTP's last North Dakota general rate case, the Commission ordered OTP to do
9 two things in its next rate case: (1) move all fuel costs out of base rates and recover those
10 costs entirely through the Energy Adjustment Rider;⁹ and (2) allocate fuel costs to each
11 class based on an E8760 allocator.¹⁰

12 **A. Moving All Fuel Costs to the Energy Adjustment Rider**

13 Q. PLEASE DESCRIBE THE PROCESS TO MOVE RECOVERY OF ALL FUEL COSTS
14 INTO THE ENERGY ADJUSTMENT RIDER.

15 A. OTP's present base rates include a base cost of fuel that was established at the end of
16 OTP's last North Dakota rate case. At the end of this case, base fuel will be removed
17 from the new base rates and all Fuel Clause eligible costs will be recovered through the
18 Fuel Clause.
19

20 Q. WHAT PROPORTION OF PRESENT BASE REVENUES ARE RELATED TO FUEL
21 COSTS?

22 A. Currently, customers pay \$0.02803 per kWh in fuel costs as part of base rates. That
23 amounts to \$50.7 million (OTP ND) in present base revenue out of total 2018 Test Year
24 present base revenues of \$128.8 million (OTP ND).¹¹ Under OTP's proposed rates, base

⁹ Section II. B. Page 8 of 21 Case No. PU-08-862 and PU-8-742 Amended Settlement Agreement.

¹⁰ Section II. C. Page 8 of 21 Case No. PU-08-862 and PU-8-742 Amended Settlement Agreement.

¹¹ The \$128.8 million (OTP ND) in present base revenues excludes ECRR, RRAR and TCRR revenues that were incorporated into the calculation of the 2018 Test Year revenue deficiency as an offset to the movement of ECRR, RRAR and TCRR projects into base rates. Mr. Haugen provides additional discussion of the incorporation of ECRR, RRAR and TCRR present revenues into the 2018 Test Year calculations in Sections III.A.1, III.B.1 and III.C.1 of his Direct Testimony.

1 rates would decrease from current levels, and the recovery under the Fuel Clause would
2 increase, both by \$50.7 million.

3
4 Q. HOW WILL FUEL COSTS BE RECOVERED AT THE CONCLUSION OF THIS
5 CASE?

6 A. At the conclusion of the case, the Energy Adjustment Rider will include both the base
7 cost of energy and amounts necessary to true-up actual fuel costs to the base cost of
8 energy.

9
10 Q. HAS OTP CALCULATED A NEW BASE COST OF ENERGY FOR THE INTERIM
11 RATE PERIOD?

12 A. Yes. OTP used forecast costs to compute the new base cost of energy that will be part of
13 base rates during the interim rate period. The computation of the proposed base cost of
14 energy is included in Volume 1 Part E Schedule 1, which reconciles to the costs included
15 in the 2018 Test Year. Effective at the time interim rates go into effect, the base cost of
16 energy in base rates will be set to \$0.024327 per kWh and the monthly Fuel Clause
17 amount will be based on this updated base cost of energy during the interim period.

18
19 Q. HOW WAS THE FORECAST BASE COST OF ENERGY DEVELOPED?

20 A. The Budget Process documentation included in Volume 5 provides an overview of the
21 multi-step process OTP goes through to develop its forecast cost of energy amounts.

22
23 Q. WILL OTP CALCULATE A NEW BASE COST OF ENERGY AT THE
24 CONCLUSION OF THIS CASE?

25 A. Yes. We anticipate calculating a new base cost of energy at the conclusion of this case.
26 That new base cost of energy will be incorporated into the new monthly Energy
27 Adjustment Rider rates on a going forward basis.

28

1 Q. WILL OTP CONTINUE TO CALCULATE MONTHLY FUEL CLAUSE RATES
2 BASED ON A TRAILING FOUR-MONTH AVERAGE?

3 A. Yes. OTP proposes to continue to calculate the monthly Fuel Clause rate based on a
4 trailing four-month average as OTP has done in the past. The only difference is that the
5 entire cost of fuel will be included in the Energy Adjustment Rider as opposed to
6 including just the difference between the current month's rate and the base cost of fuel
7 amount that was previously included in base rates.

8 **B. E8760 Allocator**

9 Q. IS OTP PROPOSING TO ALLOCATE FUEL COSTS USING AN E8760
10 ALLOCATOR?

11 A. Yes. As I mentioned earlier in my testimony, in OTP's last North Dakota rate case, the
12 parties agreed that OTP should use an E8760 allocator for purposes of allocating fuel
13 costs between classes in the Energy Adjustment Rider.

14
15 Q. WHAT IS THE THEORY BEHIND COMPUTING AND USING AN E8760
16 ALLOCATOR FOR FUEL CLAUSE COST RECOVERY?

17 A. Energy usage can vary significantly between customer classes over the course of a day,
18 week, month or year. At the same time, costs to provide that energy also vary while a
19 day, week, month or year. The E8760 allocator takes into account when energy is used
20 and the associated cost of that energy, and creates an appropriate weighting of the overall
21 cost each class is accountable for. As a result, the E8760 allocator yields a distinct and
22 separate Fuel Clause rate for each customer class that more accurately reflects the cost
23 causation responsibility of that class for energy costs.

24 OTP witness Ms. Gina S. Ice discusses the mechanics of the creation of the E8760
25 allocators for the Fuel Clause. Ms. Ice also discusses the specific factors that have been
26 calculated for each class' applicable monthly Fuel Clause rate.

27

1 **C. Reagents and Emissions Allowance Costs**

2 Q. IS OTP PROPOSING ANY OTHER CHANGES TO THE ENERGY ADJUSTMENT
3 RIDER?

4 A. Yes. Because OTP is proposing to roll the recovery of the Big Stone AQCS Project and
5 the Hoot Lake Plant MATS Project out of the ECRR and into base rates, OTP
6 recommends consolidating the current recovery of reagent and emissions allowance costs
7 associated with all of OTP's plants from the monthly Reagent and Emissions Allowance
8 Adjustment (REAA) rider into the Energy Adjustment Rider.

9
10 Q. HOW ARE ALLOWANCES FOR REAGENTS AND EMISSIONS CURRENTLY
11 BEING RECOVERED?

12 A. In Case No. PU-14-668, the Commission approved a monthly cost recovery mechanism
13 for purposes of recovering new reagent costs following the installation of emissions
14 reducing equipment at Big Stone, Coyote and Hoot Lake generating plants to meet
15 Federal Environmental Protection Agency (EPA) emissions rules. Also in this
16 mechanism, the Commission approved the recovery of the cost of emissions allowances
17 OTP would procure to comply with EPA emissions rules applicable to OTP's Hoot Lake
18 plant. The REAA and associated rate calculation is part of OTP's ECRR Electric Rate
19 Schedule 13.08.

20
21 Q. IS THE CALCULATION OF THE REAA SIMILAR TO OTP'S NORTH DAKOTA
22 FUEL CLAUSE CALCULATION?

23 A. Yes. The mechanics of how the monthly REAA is computed are based on the exact same
24 methodology used to calculate the monthly Fuel Clause, using a trailing four-month
25 average of costs incurred for reagents and emissions allowances.

26
27 Q. HOW IS THE REAA CURRENTLY REFLECTED ON A CUSTOMER'S BILL?

28 A. The monthly charge for the REAA is combined with the monthly ECRR charge and
29 presented in total as one line-item amount on a customer's bill.

30

1 Q. WHY IS OTP PROPOSING TO MOVE THE RECOVERY OF REAGENTS AND
2 EMISSIONS ALLOWANCE COSTS TO THE FUEL CLAUSE?

3 A. As I mentioned before, with OTP's proposal to roll recovery of the Big Stone AQCS
4 Project and Hoot Lake MATS Project from the ECRR to base rates, the ECRR rate will
5 effectively go away following any residual true-up from the ECRR. What would remain
6 on the customer's bill as a separate charge would be the REAA monthly charge. Because
7 the monthly bill impact for the REAA is quite small, and the current recovery mechanism
8 mirrors the current Fuel Clause recovery mechanism, consolidating the reagent and
9 emissions allowance costs into the monthly Fuel Clause calculation reduces bill
10 complexity and creates administrative efficiencies from having one less rate to
11 administer. Lastly, the volume of reagents used or emissions allowances needed is
12 directly related to the level of dispatch and output of the plants, just like fuel.

13
14 Q. WHAT IS THE ESTIMATED CURRENT MONTHLY IMPACT ON A RESIDENTIAL
15 CUSTOMER'S BILL FOR THE COSTS OF REAGENTS AND EMISSIONS
16 ALLOWANCES?

17 A. For a residential customer using 1,000 kWhs a month, the average bill impact has
18 generally been less than 50 cents per month. The same bill will reflect a Fuel Clause
19 charge of approximately \$25 per month once all fuel costs are moved from base rates and
20 into the Fuel Clause. As stated earlier, the relative impact of the reagent and emissions
21 allowance cost on the customer's bill supports combining those costs with the fuel costs
22 and recover both through the monthly Fuel Clause.

23
24 Q. WILL REAGENTS CONTINUE TO BE RECOVERED IN THE REAA DURING THE
25 INTERIM PERIOD?

26 A. Yes. OTP's proposal to move recovery of these costs to the Fuel Clause is at the time
27 final rates go into effect.

28

1 Q. HOW WILL OTP IMPLEMENT THE TRANSITION OF REAGENT AND
2 EMISSIONS ALLOWANCE RECOVERY INTO THE FUEL CLAUSE?

3 A. During the interim rate period, the FCA and REAA riders will continue to function as
4 they do today. At the time final rates from this case are implemented, OTP proposes to
5 set the REAA to zero and consolidate the then-current REAA costs and associated true-
6 up balances into the Fuel Clause mechanism and compute that month's rate accordingly.
7 Because the recovery mechanisms mirror each other, this approach will facilitate an easy
8 transition of recovery from one mechanism to the other.
9

10 Q. ARE THERE ANY UPDATES NEEDED TO THE REAGENT AND EMISSIONS
11 ALLOWANCE BUDGET FOR 2018?

12 A. Yes. Late in the preparation of this rate case, it was discovered that the Total Company
13 reagent and emissions allowance amounts only reflected Minnesota's share of the costs,
14 while the North and South Dakota share of these costs were inadvertently excluded. This
15 Minnesota only share of \$1,263,390 was directly assigned to Minnesota in the
16 Jurisdictional Cost of Service Study, meaning no reagent or emissions allowance costs
17 were included in the North Dakota jurisdictional amounts and hence, the 2018 Test Year.
18 Had OTP correctly included North Dakota's share of the costs in the 2018 Test Year,
19 which are projected to be \$2,366,873 (Total) and \$889,400 (OTP ND), they would have
20 been removed with an interim period adjustment, since recovery of actual amounts will
21 continue in the REAA rider during the interim period. And because recovery of these
22 costs will remain either in the current rider or the Fuel Clause rider at the end of the case,
23 there is no impact to proposed base rates due to this oversight.

24 **VI. ACCUMULATED DEFERRED INCOME TAX PRORATION**

25 Q. WHAT WILL YOU DISCUSS IN THIS SECTION OF YOUR DIRECT TESTIMONY?

26 A. In this section, I will explain the Federal ADIT Proration that is required in order to meet
27 normalization requirements as explained by the Internal Revenue Service (IRS) in a
28 Private Letter Ruling issued by the IRS to OTP. I will also explain how OTP has applied

1 these requirements to the 2018 Test Year for both final rates and interim rates in this case
2 and provide a discussion of the financial effects of doing so.

3
4 Q PLEASE PROVIDE A BRIEF DESCRIPTION OF THE BASIC PRINCIPLES OF
5 INCOME TAX NORMALIZATION.

6 A. Income tax normalization is an approach to determining the regulated rates for a utility
7 that is required by the Internal Revenue Code (IRC) and IRS Regulations that must be
8 followed as a precondition of the utility being allowed to use accelerated and bonus
9 depreciation for determining its federal income taxes. Under normalization, the income
10 tax expense reflected in regulated rates is determined using straight-line depreciation and
11 the difference between the straight-line income tax expense and the current income tax
12 payable under accelerated and bonus depreciation is determined as ADIT, which reduces
13 rate base.

14
15 Q. IS THE USE OF INCOME TAX NORMALIZATION A COMMON PRACTICE FOR
16 UTILITIES AND REGULATORY AGENCIES?

17 A. Yes. The Commission and virtually every state regulatory agency, along with virtually
18 every utility, use income tax normalization and have done so consistently for many years.

19
20 Q. DOES THE TREATMENT OF ADIT THAT IS PART OF INCOME TAX
21 NORMALIZATION LEAD TO LOWER RATES FOR CUSTOMERS?

22 A. Yes. ADIT leads to substantial reductions in rate base. In this case, ADIT reduces
23 OTP's 2018 Test Year rate base by approximately \$276 million (Total)¹² and \$102
24 million (OTP ND).¹³ This reduction in rate base, in turn, leads to a reduction in the
25 revenue requirement. I estimate that the use of accelerated depreciation (and the related
26 reduction to rate base for ADIT) has reduced the 2018 Test Year revenue requirement by
27 approximately \$11.5 million (OTP ND).

28

¹² Akerman Direct, Exhibit____(TAA), Schedule 5.

¹³ Akerman Direct, Exhibit____(TAA), Schedule 5.

1 Q. IS A UTILITY REQUIRED TO PRORATE FEDERAL ADIT IF IT USES A
2 FORWARD-LOOKING TEST YEAR?

3 A. Yes. IRS Regulation Section 1.167(l)-1(h)(6) provides that ratemaking procedures and
4 adjustments must be consistent with normalization accounting. This regulation sets
5 procedures a utility must use to normalize the impact on rate making if the utility wants
6 to use accelerated depreciation methods to determine its federal income taxes. The
7 monthly changes to the Federal deferred taxes balance, as calculated by the utility, must
8 be prorated prior to computing the average of beginning and ending balances for ADIT.

9 When a utility utilizes a forecast test year to determine depreciation, the IRS
10 requires that “the amount of the reserve account for the period is the amount of the
11 reserve at the beginning of the period and a pro rata portion of the amount of any
12 projected increase to be credited or decrease to be charged to the account during such
13 period.”¹⁴ The prorated amount of any increase or decrease during the future portion of
14 the period is determined by multiplying the increase or decrease by a fraction, the
15 numerator of which is the number of days remaining in the period at the time the increase
16 is to accrue, and the denominator of which is the total number of days in the future
17 portion of the period.¹⁵

18
19 Q. WHAT HAPPENS IF OTP FAILS TO COMPLY WITH THIS REGULATION?

20 A. If a utility does not comply with this regulation, the utility would be at serious risk of
21 losing the ability to claim accelerated depreciation in its federal income tax filings.
22 Losing accelerated depreciation would significantly increase rate base due to the
23 elimination of the ADIT offset to rate base.

24
25 Q. HAS OTP OBTAINED A SPECIFIC PRIVATE LETTER RULING FROM THE IRS
26 REGARDING ITS OBLIGATIONS WITH RESPECT TO ADIT PRORATION?

27 A. Yes. OTP obtained a private letter ruling dated June 26, 2017 addressing the
28 requirements for ADIT Proration (the Otter Tail PLR) and the IRS released a public

¹⁴ Treas. Reg. § 1.167(l)-1(h)(6)(ii).
¹⁵ *Id.*

1 version of the Otter Tail PLR on September 29, 2017. A copy of the public version of the
2 Otter Tail PLR is attached to my Direct Testimony as Exhibit __ (SDT-1), Schedule 3.
3

4 Q. DID THE OTTER TAIL PLR PROVIDE DIRECTION AS TO HOW TO PRORATE
5 ADIT IN ORDER TO COMPLY WITH NORMALIZATION REQUIREMENTS?

6 A. Yes. The Otter Tail PLR directs that, in order to comply with normalization
7 requirements, ADIT Proration is to be based on the date rates become effective (relative
8 to the dates of the Test Year used to compute those rates). The Otter Tail PLR also
9 determined how ADIT Proration must be applied for both final rates and for interim rates
10 and interim rate refunds.
11

12 Q. PLEASE EXPLAIN HOW THE EFFECTIVE DATES OF RATES AFFECT THE
13 REQUIREMENTS.

14 A. The principle is that if rates become effective and are in effect during the time when the
15 basis for the rates is forecast, proration must be applied. If rates become effective or are
16 in effect after the forecast period, proration is no longer necessary. For example, if a rate
17 (including an interim or final rate) goes into effect as of January 1 of a forecast January 1
18 to December 31 Test Year, ADIT Proration is applied to the entire Test Year period
19 (because the entire period is deemed a future period). If the rate goes into effect at some
20 other date in the Test Year, ADIT Proration must be applied in setting rates for the period
21 from the effective date of the rate to December 31. If the rate goes into effect after the
22 conclusion of the Test Year, ADIT Proration need not be applied to that rate.
23

24 Q. HOW DO THESE REQUIREMENTS APPLY TO THE FINAL RATES IN THE
25 CURRENT CASE?

26 A. As I explained, to comply with normalization requirements, the rate must be computed by
27 applying ADIT Proration to only the portion of the Test Year that follows the date of
28 implementation of the rates. If it is assumed that final rates will be implemented as of
29 August 1, 2018, ADIT Proration would be required only for the period from
30 August 1, 2018 through December 31, 2018. Changes in ADIT balances from

1 January 1, 2018 to July 31, 2018 are not prorated, but the incremental monthly changes to
2 ADIT from August 1, 2018 to December 31, 2018 are prorated.

3
4 Q. WHAT IS THE IMPACT ON FINAL RATES OF PRORATING FEDERAL ADIT IN
5 THE 2018 TEST YEAR?

6 A. Assuming final rates are implemented as of August 1, 2018, the impact of applying
7 proration to Federal ADIT decreases ADIT and increases the net rate base amount by
8 approximately \$2.2 million (Total) / \$807,000 (OTP ND), resulting in an increase in the
9 revenue requirement of approximately \$91,000 (OTP ND) as shown in Exhibit___(SDT-
10 1), Schedule 4. This is the approach that is required under the Otter Tail PLR, as I
11 explained above.

12
13 Q. HOW IS ADIT PRORATION COMPUTED FOR INTERIM RATES?

14 A. Interim rates are proposed to become effective January 1, 2018. Interim rates are
15 computed based on a January 1, 2018 to December 31, 2018 Test Year. Because interim
16 rates are computed based on an entirely future test period as defined by the IRS, proration
17 is applied to all incremental changes to ADIT balances from January 1, 2018 to
18 December 31, 2018.

19
20 Q. WHAT IS THE IMPACT OF APPLYING THE PRORATION TO ADIT FOR THE
21 2018 TEST YEAR FOR INTERIM RATES?

22 A. The impact of applying proration to the additional Federal ADIT attributable to the 2018
23 Test Year amounts for purposes of computing interim rates, increases the net rate base
24 amount by approximately \$4.6 million (Total) / \$1.7 million (OTP ND), resulting in an
25 increase in the revenue requirement of approximately \$187,000 (OTP ND), as shown in
26 Exhibit___(SDT-1), Schedule 4. As a result, the Interim Test Year revenue requirement
27 is approximately \$96,000 higher than the 2018 Test Year amount due to proration.
28 Because interim rates are expected to be in effect for only a portion of 2018, the actual
29 impact will be less, and the interim effect will be limited to a one-time effect. This is the
30 approach that is required under the Otter Tail PLR, as I have also explained.

31

1 **VII. CORPORATE COST ALLOCATIONS**

2 Q. WHAT WILL YOU DISCUSS IN THIS SECTION OF YOUR DIRECT TESTIMONY?

3 A. In this section of my Direct Testimony, I will explain how corporate costs that are
4 incurred by Otter Tail Corporation in connection with the services provided by Otter Tail
5 Corporation for the operation of OTP are handled in the 2018 Test Year.

6
7 Q. PLEASE DESCRIBE THE STRUCTURE OF OTP.

8 A. OTP is a wholly owned subsidiary of Otter Tail Corporation. In 2008, Otter Tail
9 Corporation filed a petition with the Commission seeking approval to form a new holding
10 company through restructuring, with the purpose of establishing OTP as a separate,
11 subsidiary corporation.¹⁶ The Commission approved the request on October 8, 2008, and
12 as of July 1, 2009, OTP became a separate legal entity, instead of an operating division,
13 which OTP had been prior to the formation of Otter Tail Corporation.

14
15 Q. WHAT SERVICES DOES OTTER TAIL CORPORATION PROVIDE TO OTP?

16 A. Otter Tail Corporation provides the following services to OTP: financial reporting, tax
17 planning and reporting, treasury, financial planning, corporate communications, internal
18 audit, benefits plans, safety and risk management, shareholder services and investor
19 relations, aviation and executive management services.

20
21 Q. ARE THESE SERVICES GOVERNED BY ANY AGREEMENTS?

22 A. Yes. At the time of the restructuring, OTP entered into three agreements with Otter Tail
23 Corporation: (i) an Administrative Services Agreement that describes how services are
24 provided from Otter Tail Corporation to OTP and how costs for such services are
25 assigned and allocated to OTP; (ii) a Tax Sharing Agreement that describes how tax
26 obligations and benefits are to be allocated; and (iii) a Cash Management Agreement that
27 describes how cash management services can be provided by Otter Tail Corporation to

¹⁶ Case No. PU-08-292.

1 OTP. Currently, no cash management services are being provided by Otter Tail
2 Corporation to OTP.

3
4 Q. HOW ARE OTP TAXES COMPUTED UNDER THE TAX SHARING AGREEMENT?

5 A. OTP computes its taxes on a standalone basis, exclusive of Otter Tail Corporation. The
6 determination of taxes on a standalone basis means that OTP incurs the same taxes as if it
7 was a separate corporation and does not incur any taxes for Otter Tail Corporation or for
8 the business of other subsidiaries of Otter Tail Corporation. All tax decisions for OTP
9 are based on strategies beneficial to its ratepayers. All tax calculations included in the
10 2018 Test Year are based only on OTP financial performance. The tax calculations
11 included in this Test Year are detailed in Volume 3 Schedule C-5.

12
13 Q. HOW DO THE SERVICES PERFORMED BY OTTER TAIL CORPORATION
14 COMPARE WITH THE SERVICES PERFORMED BY SUBSIDIARY SERVICE
15 COMPANIES OF SOME OTHER UTILITY HOLDING COMPANIES?

16 A. The services performed for OTP by Otter Tail Corporation are less extensive than service
17 performed by other holding company service company subsidiaries, such as Xcel
18 Energy's corporate services unit. Otter Tail Corporation does not process OTP's invoices
19 or customers' bills; it does not perform billing for OTP; it does not manage OTP's human
20 resources (HR), information technologies (IT), or procurement. Rather, OTP directly
21 provides its own accounting, bill and invoice processing, IT, HR, supply chain,
22 engineering, rates and regulation, payroll, marketing and sales, fuel and energy
23 procurement, and customer service.

24
25 Q. HOW DID YOU ARRIVE AT THE APPROPRIATE LEVEL OF OTTER TAIL
26 CORPORATION EXPENSES TO INCLUDE IN THE FORECAST TEST YEAR?

27 A. Under the Administrative Services Agreement, the costs of corporate functions are
28 allocated using the allocation methodology and specific allocation factors described in
29 the Corporate Cost Allocation Manual (CAM), included as Exhibit____(SDT-1), Schedule

1 5.¹⁷ I have also included a supplement to the CAM, the Forecast Corporate Cost
2 Allocation Procedures (FCAP) manual, included as Exhibit___(SDT-1), Schedule 6,
3 which describes in more detail how forecasted corporate cost allocation factors are
4 developed. Allocation factors were applied to forecasted 2018 corporate expenses,
5 adjusted for certain corporate expenses which have either been capped or disallowed in
6 prior Commission Orders.

7
8 Q. HOW WERE THE COST ALLOCATION METHODOLOGIES DEVELOPED?

9 A. The following goals were considered when the corporate cost allocation methodology
10 was developed:

- 11 1) The result should fully allocate costs;
- 12 2) Costs are directly assigned where possible;
- 13 3) If direct assignment is not possible, an indirect allocation will be made if there is a
14 cost causative link to another cost category for which direct assignment is used;
- 15 4) When neither direct nor indirect cost causation can be found, a representative
16 general allocator is used;
- 17 5) The result is equitable for customers and shareholders;
- 18 6) The method is easy to administer – no additional studies or data gathering is
19 needed; and
- 20 7) The allocators have components that are based on verifiable public information, to
21 the extent possible.

22
23 Q. PLEASE EXPLAIN THE ALLOCATION PROCESS IN MORE DETAIL.

24 A. Otter Tail Corporation costs can be charged to OTP or to Otter Tail Corporation's non-
25 utility operations. The allocation process uses three steps. First, all labor and other costs
26 that are appropriate for direct assignment to OTP or non-utility operations are identified
27 and directly assigned. Members of the Corporate Group use timesheets to directly assign
28 labor. Invoices and other costs are directly assigned as appropriate. In the 2018 Test

¹⁷ Schedule 5 is presented in redline format to identify changes to the CAM since OTP's last North Dakota rate case.

1 Year, approximately 39 percent of all Otter Tail Corporation costs were allocated to OTP
2 or non-utility operations using direct assignment.

3 Second, indirect allocators are used for certain functions. Indirect allocators are
4 used where an indirect-cost causative linkage to another cost category or group of cost
5 categories exists. About 16 percent of corporate costs were allocated to OTP or non-
6 utility operations using indirect allocators.

7 The remaining 45 percent of corporate costs are not appropriate for either direct
8 assignment or indirect allocation. These costs are allocated to OTP or non-utility
9 operations using the general allocator that is composed of revenues, assets and labor
10 dollars, equally weighted.

11
12 Q. HOW MUCH OF THE TOTAL OTTER TAIL CORPORATION COST IS
13 ALLOCATED TO OTP IN THE 2018 TEST YEAR?

14 A. Table 7, below, shows the allocation of Otter Tail Corporation costs for the 2018 Test
15 Year.

16
17 **Table 7**
18 **Otter Tail Corporation Cost Allocation**

	Otter Tail Corporation 2018 Costs		ND Share
Allocated to OTP	\$10,261,053	52.1%	\$3,976,715
Allocated to Non-Utility	\$9,442,702	47.9%	
Total Corporate Costs	\$19,703,755	100.0%	

19
20 Q. HOW WERE THESE 2018 COST ESTIMATES DEVELOPED?

21 A. The 2018 Corporate costs were developed following the procedures outlined in the FCAP
22 manual. Those costs were then allocated between utility and non-utility entities based on
23 the methods outlined in the CAM.

24
25 Q. DOES THE ALLOCATION IN TABLE 7 REFLECT THE COMMISSION'S
26 DECISIONS ON INCENTIVE COMPENSATION?

27 A. Yes. The Otter Tail Corporation costs allocated to OTP in the 2018 Test Year reflect the
28 Commission's decisions regarding bonuses and incentive compensation. Specifically,

1 Otter Tail Corporation executives' bonuses and incentive compensation is capped at 25
2 percent of base salary, as reflected in Volume 4A, workpaper B-16.

3
4 Q. ARE THE COSTS REFLECTED IN TABLE 7 REASONABLE AND APPROPRIATE
5 FOR INCLUSION IN THE 2018 TEST YEAR?

6 A. Yes. All costs have been allocated in a manner consistent with prior cases. The Otter
7 Tail Corporation costs reflected in Table 7 are reasonable and appropriate for inclusion in
8 the 2018 Test Year.

9 **VIII. ECONOMIC DEVELOPMENT**

10 Q. WHAT TOPICS WILL YOU DISCUSS IN THIS SECTION OF YOUR DIRECT
11 TESTIMONY?

12 A. I will discuss three topics related to economic development in this section of my Direct
13 Testimony: 1) economic development costs; 2) the current Economic Development Cost
14 Removal Rider; and 3) new economic development rates.

15 **A. Economic Development Costs**

16 Q. WHY IS ECONOMIC DEVELOPMENT IMPORTANT TO OTTER TAIL?

17 A. As Mr. Gerhardson explains in his Direct Testimony, OTP serves a sparsely populated,
18 rural part of North Dakota that is not growing in population. The average population of
19 the communities we serve is approximately 400, over one-half of the communities we
20 serve have populations of fewer than 200, and we serve a number of towns with fewer
21 than 100 people. Many of the small towns we serve are threatened by significant decline
22 in their populations, as explained by OTP witness Mr. Brian H. Draxten in his Direct
23 Testimony,¹⁸ and these declines may be due to the lack of job opportunities in those
24 communities. Our economic development efforts are aimed at increasing job
25 opportunities within our communities to stem the tide of the migration out of our rural
26 service territory.

¹⁸ Figure 2 Draxten's Direct Testimony shows that many of the counties OTP serves have experienced population loss since 2010.

1 Population decline can have serious financial impacts on communities. When
2 populations decline, the remaining (now fewer) citizens are each required to share a
3 larger portion of the costs relating to necessary infrastructure. With respect to electric
4 service, the principle is straight-forward. If we do not slow the migration, the cost of
5 providing electric service to our remaining customers will increase.
6

7 Q. DO COMMUNITIES BENEFIT FROM OTP'S ECONOMIC DEVELOPMENT
8 EFFORTS?

9 A. Yes. By creating opportunities and slowing out-migration from our rural communities,
10 we help these communities stabilize their tax base and maintain the number of students
11 they have in their schools. Our efforts also help to ensure that community members have
12 access to health care services and that their children have the same educational
13 opportunities as those who live in larger communities. Our efforts help communities
14 utilize their infrastructure and utility resources more effectively.

15 While these impacts might be difficult to quantify, they are indeed real to the
16 inhabitants of these small towns. For many of our communities, the issues associated
17 with out-migration and lack of opportunity has been among their greatest concerns for the
18 past few decades. Because our customers are so significantly impacted by these issues,
19 we have emphasized these concerns in our mission statement. As Mr. Gerhardson
20 explains, our mission includes a commitment to improve the quality of life in the
21 communities we serve. The economic development program costs included in our 2018
22 Test Year will help fulfill this mission.
23

24 Q. HAS OTP ADMINISTERED ECONOMIC DEVELOPMENT PROGRAMS IN NORTH
25 DAKOTA IN THE PAST?

26 A. Yes. OTP has a long history of involvement in economic development activity within
27 North Dakota. From 1989 until OTP's last rate case in 2008, a plan¹⁹ was set up in which
28 OTP would spend a minimum of \$315,557 annually on economic development activities
29 in its North Dakota service territory. As OTP reported in its 2008 rate case, OTP actually

¹⁹ Commission Orders dated December 20, 1988, and March 7, 1989, in Case No. PU-401-88-374.

1 spent, on average, well over half a million dollars annually from 1989 to 2008. This
2 equated to over \$9.7 million during that time period.

3
4 Q. WHAT IMPACT DID OTP HAVE WITH ITS ECONOMIC DEVELOPMENT
5 EFFORTS IN NORTH DAKOTA FROM 1989 TO 2007?

6 A. From 1989 through 2007, OTP assisted in creating 6,222 jobs and assisted in saving an
7 additional 1,069 jobs in North Dakota. During the last year of that plan in 2007, OTP
8 worked with 53 cities in North Dakota that requested assistance. The projects covered a
9 wide variety of business development projects and helped create 451 jobs.

10
11 Q. HAS OTP HAD AN ECONOMIC DEVELOPMENT PLAN IN PLACE IN NORTH
12 DAKOTA SINCE 2007?

13 A. No. Near the end of the 2008 Rate Case, the Commission decided to discontinue funding
14 of OTP's economic development program and remove those costs. Because final rates
15 had been designed based on OTP's then-proposed level of economic development
16 spending to continue OTP's economic development plan, those costs were removed
17 through the implementation of a rider to credit those costs back to customers. While OTP
18 continues to be actively involved in its communities, OTP does not have the dedicated
19 resources and coordinated activities it once had to help support local communities and
20 their efforts to sustain or grow their economies. For the reasons I cited earlier in my
21 testimony, OTP desires to once again increase its efforts to help our local economies
22 grow and thrive.

23
24 Q. DID OTP BENEFIT FROM THE ECONOMIC EXPANSION IN THE BAAKEN
25 REGION OF NORTH DAKOTA OVER THE LAST DECADE?

26 A. Not materially. OTP's service territory does not extend into those areas of North Dakota
27 that saw rapid economic expansion as a result of recent oil field activity. As Mr. Draxten
28 pointed out in his Direct Testimony, many of OTP's towns have seen declines in
29 population since 2010.

30

- 1 Q. WHAT IS OTP'S PROPOSAL REGARDING ECONOMIC DEVELOPMENT COSTS?
 2 A. OTP has included \$200,000 of economic development costs in the 2018 Test Year. OTP
 3 estimates that these costs will be incurred as noted in Table 8 below:
 4

5 **Table 8**
 6 Economic Development Costs in 2018 Test Year

Cost Category	Amount
Labor	\$155,000
Travel	\$ 20,000
Other O&M	\$ 25,000
Total	\$200,000

- 7
 8 Q. WHAT TYPE OF ECONOMIC ACTIVITIES WILL OTP SUPPORT WITH THIS
 9 FUNDING?

10 A. OTP will add additional staff for purposes of more intentionally engaging with the
 11 communities we serve to support their ongoing efforts to attract and retain businesses that
 12 will help their local economies compete and survive. Specifically, OTP will help increase
 13 business development by helping start-ups, expansions, relocations, financing, planning,
 14 and other development opportunities. From a community perspective, OTP will enhance
 15 the quality of life by helping local and regional community projects including, housing,
 16 jobs training, educational, non-profit and other community based endeavors.

17 **B. Economic Development Cost Removal Rider**

- 18 Q. WHAT IS THE ECONOMIC DEVELOPMENT COST REMOVAL RIDER?
 19 A. In OTP's last North Dakota rate case, the Commission ordered the establishment of a
 20 rider for purposes of issuing a credit to customers for economic development costs still
 21 included in base rates that were proposed to go into effect at the end of that case. That
 22 credit was set at (\$0.00025) per kWh.
 23

- 24 Q. HOW IS OTP TREATING THIS CREDIT FOR THE 2018 TEST YEAR?
 25 A. OTP is resetting the economic development cost removal rider rate to zero. The resetting
 26 would be effective with the implementation of interim rates. As noted above, OTP has

1 requested the inclusion of \$200,000 of economic development costs in final rates, but an
2 interim rate adjustment²⁰ removed those costs from interim rates.

3 **C. Rates to Support Economic Development**

4 Q. DOES OTP'S CURRENT RATE STRUCTURE SUPPORT ECONOMIC
5 DEVELOPMENT?

6 A. Yes. As Mr. Gerhardson points out in his Direct Testimony, OTP has the 4th lowest
7 blended rate for all customers in the United States, and the lowest of any investor-owned
8 utility in North Dakota. High energy use entities that may be considering locating or
9 expanding in North Dakota will give careful consideration to low rates in evaluating their
10 options, including locating in areas in North Dakota that OTP serves. OTP's high
11 customer satisfaction and reliable service are additional supporting factors that helps OTP
12 attract new load.

13
14 Q. HAS OTP RECENTLY PROPOSED A NEW ECONOMIC DEVELOPMENT RIDER
15 RATE?

16 A. Yes. In order to expand OTP's "tool-box" of rate offerings to help attract new business,
17 OTP has designed a special Economic Development Rider (EDR) rate mechanism that
18 will enhance OTP's potential to attract business to North Dakota. This mechanism would
19 allow OTP to compute customer-specific rate quotes in the form of a discount, using a
20 formulaic approach that insures that a proposed discount will still yield benefits to all
21 other customers should the customer take service from OTP. The mechanism calculates a
22 proposed rate discount off OTP's Large General Service Rider rate. OTP could
23 potentially offer a discount for up to a five-year period with this rider. OTP filed for
24 approval of this proposed EDR rate mechanism with the Commission in the spring of
25 2017.²¹ This filing is still pending before the Commission.

²⁰ Volume 1, Part B, Schedule 6 Column F.

²¹ Case No. PU-17-238.

1 Q. IS OTP PROPOSING ANY NEW RATES IN THIS CASE THAT WOULD SUPPORT
2 FURTHER ECONOMIC DEVELOPMENT IN NORTH DAKOTA?

3 A. Yes. In this case, OTP is also proposing a new Super Large General Service (Super
4 LGS) rate offering. Mr. Prazak provides the details associated with this new rate in his
5 Direct Testimony along with proposed Electric Rate Schedule 10.06.
6

7 Q. PLEASE BRIEFLY DESCRIBE THE SUPER LGS RATE.

8 A. The Super LGS rate is intended for very large, high load factor customers such as a data
9 processing facility or a large agricultural processing facility that might have a connected
10 load of 25 MWs or more and run at a very high capacity level (at least 80 percent load
11 factor). Following a similar approach as the EDR rate, a rate would be computed based
12 on a customer's specific operating profile and would be set at a level which still provides
13 benefits to other customers. Unlike the EDR rate, the Super LGS rate could continue
14 beyond a five-year period.
15

16 Q. DO THESE RATES BENEFIT OTHER CUSTOMERS?

17 A. Yes. Because the computation of the rates takes into account the marginal costs OTP
18 would incur to serve these customers, and insures that these marginal costs are covered,
19 the incremental margins over and above the marginal costs helps cover OTP's fixed costs
20 of service. Other customers realize the benefit of these new customers in at least two
21 ways. First, in the near term (for example when a rider filing such as the TCRR is made),
22 the costs being recovered within the rider would be spread over a greater number of KWs
23 or kWhs, reducing the effective rate that all customers would pay. Second, adding new
24 load that contributes incremental margin to OTP could help delay the need for future rate
25 cases. When rates are reset in the next rate case, costs would be spread over a greater
26 number of KWs and kWhs keeping rates lower than without these customers.
27

28 Q. ARE THERE OTHER BENEFITS IF THESE RATES ARE SUCCESSFUL IN
29 ATTRACTING NEW BUSINESS TO OTP AREAS IN NORTH DAKOTA?

30 A. Yes. For example, attracting a large agricultural processing facility or data processing
31 facility would certainly bring with it new employment opportunities; potentially attract

1 more people to the communities OTP serves; provide further economic activity to
2 existing or potentially new additional businesses providing products and services to the
3 areas; increase the state's tax base that would drive increased property, sales, and income
4 taxes for the state.

5
6 Q. HOW WOULD YOU SUMMARIZE OTP'S NEED FOR ECONOMIC
7 DEVELOPMENT ACTIVITY AND RATES?

8 A. The sustainability of the small towns OTP serves across rural North Dakota is critical for
9 OTP's long-term success and its commitment to provide low cost, safe, reliable energy to
10 all customers. A declining customer base results in OTP costs being spread over fewer
11 customers, resulting in an increasing effect on future rates. OTP, its customers, and the
12 state of North Dakota all benefit when economic development efforts facilitate the
13 attraction and development of new business and the expansion or retention of existing
14 business. OTP's request for economic development funds is modest, and the design of
15 the economic development rates discussed above assure benefits are realized to all
16 involved parties involved.

17 **IX. MISCELLANEOUS ITEMS**

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

19 A. In this section of my Direct Testimony, I will discuss: 1) non-asset based trading; 2) rate
20 case expenses; and 3) holding company formation expenses.

21 **A. Non-Asset Based Trading**

22 Q. DOES THE 2018 TEST YEAR INCLUDE ANY COSTS RELATED TO NON-ASSET
23 BASED TRADING ACTIVITIES?

24 A. No. OTP ceased all non-asset based trading activities as of December 31, 2014. Thus,
25 there are no non-asset based trading costs or revenues in the 2018 Test Year.

26

1 Q. WHY DID OTP MAKE THE BUSINESS DECISION TO CEASE NON-ASSET
2 BASED TRADING ACTIVITIES?

3 A. OTP conducted a financial analysis on its non-asset based trading business in the winter
4 and spring of 2014. The analysis showed historically declining margins and reduced
5 profits in the future. Based on this analysis, OTP ultimately concluded that it should exit
6 the non-asset based trading business.

7
8 Q. DOES OTP HAVE ANY REMAINING NON-ASSET BASED TRADING
9 POSITIONS?

10 A. No. The last new non-asset based trades occurred on December 31, 2014. A small
11 number of non-asset based positions carried into the 2015 calendar year, but they were
12 completely liquidated by June 1, 2015. As of that date, OTP had no non-asset based
13 trading positions.

14 **B. Rate Case Expenses**

15 Q. WHAT IS THE ESTIMATED RATE CASE EXPENSE FOR THIS CASE?

16 A. We estimate the rate case expenses associated with this case to be \$775,000 (OTP ND).
17 This expense includes administrative costs, the charges to be expected from the
18 Commission and outside consulting and legal fees.

19
20 Q. HOW DID YOU DEVELOP THIS ESTIMATE?

21 A. Administrative costs and Commission charges are estimated based on fees assessed in
22 other North Dakota rate cases. Consulting fees and outside legal fees estimates were
23 based on information from service providers. The details are reflected in work paper TY-
24 02 in Volume 4A, Workpapers.

25
26 Q. WHAT IS THE AMOUNT OF RATE CASE EXPENSE INCLUDED IN THE 2018
27 TEST YEAR?

28 A. The 2018 Test Year annual rate case expense is \$257,871(OTP ND).
29

1 Q. HOW DID YOU DETERMINE THE AMOUNT OF RATE CASE EXPENSE
2 ATTRIBUTABLE TO THIS CASE, TO INCLUDE IN THE 2018 TEST YEAR?

3 A. There were two steps. The first step was to develop the estimate of the amount of rate
4 case expense attributable to this case, as discussed above. Second, a portion of that
5 estimated expense was allocated to our unregulated activities.
6

7 Q. HOW DID YOU ALLOCATE A PORTION OF THE RATE CASE EXPENSES TO
8 OTP'S UNREGULATED ACTIVITIES?

9 A. We allocated a portion of the estimated rate case expense to our unregulated activities
10 based on a ratio of OTP's unregulated revenues to regulated revenues. This is the same
11 methodology used by OTP in the last rate case.
12

13 Q. WHAT AMORTIZATION PERIOD DID YOU USE?

14 A. We used a three-year amortization period. Because the rate case expense is a one-time
15 expense, it would be inappropriate to treat those expenses as recurring expenses.
16 Therefore, it is appropriate to amortize those expenses over the period of time expected
17 before OTP's next rate case. Based on what we know today, we believe OTP will likely
18 file its next rate case in three years.

19 **C. Holding Company Formation Expenses**

20 Q. DOES THE 2018 TEST YEAR INCLUDE ANY ADJUSTMENT FOR
21 AMORTIZATION OF HOLDING COMPANY COSTS?

22 A. No. In Case No. PU-08-292, the Commission ordered that Otter Tail Corporation
23 holding company formation costs be amortized over a five-year period. OTP included an
24 adjustment to recover the North Dakota share of legal costs attributable to the
25 establishment of Otter Tail Corporation in its last North Dakota rate case. There are no
26 holding company formation expenses included in the 2018 Test Year.

27 **X. CONCLUSION**

28 Q. WHAT ARE YOUR CONCLUSIONS?

29 A. My Direct Testimony supports the conclusions that:

- 1 • OTP has effectively managed its major capital projects which has resulted in very
- 2 substantial customer savings;
- 3 • The roll-in of current investments in the ECRR, RRAR and TCRR into base rates
- 4 is appropriate;
- 5 • Recovery of the costs of the Astoria Project in a new Generation Cost Recovery
- 6 Rider will be appropriate as those costs are incurred;
- 7 • OTP's proposed revisions to its Energy Adjustment Rider are reasonable;
- 8 • OTP's ADIT Proration is required to comply with IRS normalization obligations
- 9 and is appropriate;
- 10 • OTP's corporate cost allocations meet Commission requirements and are
- 11 appropriate; and
- 12 • OTP's proposals for economic development are reasonable and appropriate.

13

14 Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

15 A. Yes, it does.

Mr. Stuart D. Tommerdahl, CPA (Inactive)
Manager, Regulatory Administration
Otter Tail Power Company
215 South Cascade Street
Fergus Falls, Minnesota 56537
218-739-8279

CURRENT RESPONSIBILITIES: (March 2012 to Present)

Provide leadership in revenue requirements analysis, pricing and rate design, tariff administration, load research, allocation methodologies for cost of service studies, long range revenue forecasting, wholesale energy accounting, cost of energy, and unbilled revenue.

PREVIOUS POSITIONS:

Otter Tail Power Company

2012 - Present	Manager, Regulatory Administration
2004 – 2012	Manager, Risk Management
2003 - 2004	Business Analyst

Otter Tail Energy Services

1998-2003	Director, Financial Services
1997-1998	Manager, Financial Planning/Analysis

Otter Tail Power Company

1997 – 1997	Senior Regulatory/Economic Analyst
1993 – 1997	Regulatory/Economic Analyst

Great Plains Software, Fargo, ND

1986 - 1993	Budget & Financial Reporting Manager
1984 – 1986	Inventory Accountant / Purchasing

Twin Valley-Ulen Telephone Co., Twin Valley, MN

1983 – 1984	Accountant
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EDUCATIONAL / CERTIFICATIONS

Moorhead State University-Moorhead, B.S. Accounting, Minor in Economics.
Certified Public Accountant (Inactive)

Otter Tail Power Company
Estimated Project Savings Impacts on Revenue Requirements (Customer Savings) and Earnings (Reduced Shareholder Return) of the Big Stone Air Quality Control System

(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)			(K)			(L)	(M)	(N)	(O)
								Customer Impact			Shareholder Impact						
Line No.	Yr	Original cost Total Project	Final Cost Total Project	Project Savings (1)	OTP Total share @ 53.9%	OTP ND share %	OTP ND Rate Base Balance (30 Year Life)	OTP ND Annual Avoided Depreciation	Total Revenue Requirement (Column F x 11.26% Rate Base Factor) (4)	OTP ND Total Annual Avoided Revenue (Column G + Column H)	OTP ND Avoided Revenue Requirement	OTP ND NPV Avoided Revenue Requirement (5)	OTP ND NPV Available for Return (Column F x 5.41% Equity Return Factor) (6)	OTP ND Years Avoided Available for Return	30 OTP ND Avoided Available for Return (4)	NPV	Notes
1	2015	\$494,410,100	\$365,513,815	\$128,896,285	\$69,475,098	36.422386%	\$25,304,488	\$843,483	\$2,849,285	\$3,692,768			\$1,368,973				
2	2016						\$24,461,005	\$843,483	\$2,754,309	\$3,597,792			\$1,323,340				
3	2017						\$23,617,522	\$843,483	\$2,659,333	\$3,502,816			\$1,277,708				
4	2018 Test Year						\$22,774,039	\$843,483	\$2,564,357	\$3,407,840			\$1,232,076				Test Year
5	2019						\$21,930,556	\$843,483	\$2,469,381	\$3,312,864			\$1,186,443				
6	2020						\$21,087,073	\$843,483	\$2,374,404	\$3,217,887			\$1,140,811				
7	2021						\$20,243,590	\$843,483	\$2,279,428	\$3,122,911			\$1,095,178				
8	2022						\$19,400,107	\$843,483	\$2,184,452	\$3,027,935			\$1,049,546				
9	2023						\$18,556,624	\$843,483	\$2,089,476	\$2,932,959			\$1,003,913				
10	2024						\$17,713,142	\$843,483	\$1,994,500	\$2,837,983	\$32,653,755	\$22,340,398	\$958,281	\$11,636,269	\$8,010,688		Initial 10 Years
11	2025						\$16,869,659	\$843,483	\$1,899,524	\$2,743,006			\$912,649				
12	2026						\$16,026,176	\$843,483	\$1,804,547	\$2,648,030			\$867,016				
13	2027						\$15,182,693	\$843,483	\$1,709,571	\$2,553,054			\$821,384				
14	2028						\$14,339,210	\$843,483	\$1,614,595	\$2,458,078			\$775,751				
15	2029						\$13,495,727	\$843,483	\$1,519,619	\$2,363,102			\$730,119				
16	2030						\$12,652,244	\$843,483	\$1,424,643	\$2,268,126			\$684,486				
17	2031						\$11,808,761	\$843,483	\$1,329,666	\$2,173,149			\$638,854				
18	2032						\$10,965,278	\$843,483	\$1,234,690	\$2,078,173			\$593,222				
19	2033						\$10,121,795	\$843,483	\$1,139,714	\$1,983,197			\$547,589				
20	2034						\$9,278,312	\$843,483	\$1,044,738	\$1,888,221			\$501,957				
21	2035						\$8,434,829	\$843,483	\$949,762	\$1,793,245			\$456,324				
22	2036						\$7,591,346	\$843,483	\$854,786	\$1,698,269			\$410,692				
23	2037						\$6,747,863	\$843,483	\$759,809	\$1,603,292			\$365,059				
24	2038						\$5,904,381	\$843,483	\$664,833	\$1,508,316			\$319,427				
25	2039						\$5,060,898	\$843,483	\$569,857	\$1,413,340			\$273,795				
26	2040						\$4,217,415	\$843,483	\$474,881	\$1,318,364			\$228,162				
27	2041						\$3,373,932	\$843,483	\$379,905	\$1,223,388			\$182,530				
28	2042						\$2,530,449	\$843,483	\$284,929	\$1,128,411			\$136,897				
29	2043						\$1,686,966	\$843,483	\$189,952	\$1,033,435			\$91,265				
30	2044						\$843,483	\$843,483	\$94,976	\$938,459			\$45,632				
31	Total							\$25,304,488	\$44,163,923		\$69,468,411	\$31,819,183		\$21,219,078	\$10,712,614		Life of Project

Steam production plant	jurisdictional allocator	Base / Peak %
E1	35.658308% (2)	81.730000% (3)
D1	39.840452% (2)	18.270000% (3)
ND	Jurisdictional Share %	36.422386%

32
33
34
35
36
37
38 (1) Phinney Direct Table 1, Page 10
39 (2) JCOSS Page 15-1
40 (3) Workpaper C-1 (Base/Peak Split)
41 (4) Rate Base Revenue Requirement Factor 11.26% Pg 2 of 2
42 (5) Net Present Value (NPV) computed using ROR Discount Rate 7.97% Pg 2 of 2
43 (6) Rate Base Equity Return Factor reflects the after-tax earnings 5.41% Pg 2 of 2

OTTER TAIL POWER COMPANY					
Revenue Requirement Factor Calculation					
To be used when estimating revenue requirement on rate base amount changes					
Amounts rounded to 4 decimal places =					
1	Effective Tax Rate	ND			
2		37.8015%			
3	Capital Structure	Rate	Ratio	Cost	Weighted Debt Cost
4	LT Debt	5.3897%	47.50%	2.5600%	5.39%
5	ST Debt	0.0000%	0.00%	0.0000%	
6	Common Equity	10.3000%	52.50%	5.4100%	
7	Required Rate of Return			7.9700%	
8	Equity Return Tax RR (5.41% Equity X Tax Effect 1.61) - 5.41% Equity)			3.2900%	
9	Rate Base Revenue Requirement Factor			11.2600%	
10					
11					
12	Tax Effect 1 / (1 - Tax Rate)	1.607755814047	Gross Up of Equity %		8.70%
13			Equity %		5.41%
14			Difference		3.29%
15					
16	PROOF - EXAMPLE		Total	Debt	Equity
17	Rate Base		\$ 10,000	\$ 4,750	\$ 5,250
18					
19	Revenue Requirement	11.26%	\$ 1,126		
20	Interest on Debt (Weighted Debt Cost X Debt Amt)		\$ 256		
21	Taxable Income		\$ 870		
22	Taxes	37.8015%	\$ 329		
23	Return on Rate Base		\$ 797	7.97% ROR	
24	Available for Return (Equity 5.41% X RB)		\$ 541	10.30% ROE	
25					
26	Equity Return				
27	Revenue		\$ 1,126		
28	Interest Expense		\$ 256		
29	Taxes		\$ 329		
30	Available for Return		\$ 541		
31	Equity		\$ 5,250		
32	ROE (Line 30/Line 31)		10.31%		
33					
34					

Internal Revenue Service

Number: **201739001**
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Index Number: 167.22-01

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B06
PLR-100199-17

Date:
June 20, 2017

In Re:

Legend:

Parent =

Taxpayer =

State A =

State B =

State C =

Commission A =

Commission B =

Department =

OAG =

Office =

Year 1 =

Year 2 =

Director =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

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Date 10 =
Date 11 =
Month 1 =
Month 2 =
Month 3 =
Month 4 =

Dear :

This letter responds to the request, filed December 28, 2016, submitted on behalf of Taxpayer for a ruling on the application of the depreciation normalization rules of § 168(i)(9) of the Internal Revenue Code (“Code”) and § 1.167(l)-1 of the Federal Income Tax Regulations (“Regulations”) (together, the “Normalization Rules”) with respect to the computation of accumulated deferred federal income taxes (“ADFIT”) in its calculation of rate base in a rate proceeding.

The representations set out in your letter follow.

Parent is the common parent of a group of affiliated corporations that includes Taxpayer and files a consolidated federal income tax return on a calendar year basis employing the accrual method of accounting. Parent and Taxpayer are incorporated in State A. Parent is currently under the audit jurisdiction of the Large Business and International Division of the Internal Revenue Service.

Taxpayer is a rate-regulated electric utility involved in the production, transmission, distribution and sale of electric energy in State A, State B, and State C. Taxpayer is subject to regulation of rates and other matters in each of the three states in which it operates and by the Commission A for certain operations. Taxpayer is subject to the jurisdiction of Commission B with respect to certain matters. Taxpayer’s most recently-completed Commission B general rate case resulted in an order issued on Date 1, and effective Date 2, granting an increase in rates.

On Date 3, Taxpayer filed a request with Commission B for an increase in revenue recoverable under general base rates in State A. At Taxpayer’s option, this general rate case was based on a forecasted Year 1 test year. Rates will not be final until Year 2, after the close of the forecasted Year 1 test year. Until final rates are implemented, Taxpayer is allowed to charge interim rates. In its filing, Taxpayer also requested an interim rate increase in general base rates. An order of Commission B on Date 4 approved interim rates, which became effective on Date 5. These interim rates are subject to refund at the end of the rate case in Year 2, if final rates determined by Commission B are less than interim rates.

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Through this pending rate case proceeding, Taxpayer is also proposing to recover, in base rates, revenue currently subject to recovery under riders. Decisions on recovery of costs in these riders will not be made until Year 2, when the costs proposed to be recovered will be historical.

Taxpayer's request for an interim rate increase was based on the anticipated suspension by Commission B of the effective date of Taxpayer's request for an increase in revenue recoverable under general base rates in State A. Under State A law, interim rates are issued before a full review of costs is completed and are based primarily on the utility's proposed final rates. Under State A law, interim rates are subject to refund or credit to customers, plus interest (the "Interim Rate Refund"). An Interim Rate Refund results if, at the end of the contested case, amounts collected under the interim rate schedule exceed final rates and, if applicable, is typically a one-time refund/credit based on the amount of excess of interim rates over final rates and the time period from the implementation of interim rates until final rates become effective. Taxpayer's final rates are suspended until Date 6, with Commission B's final rate order (subject to reconsideration and other post order procedures) expected on or before Date 6.

On Date 4, Commission B issued an order suspending the effective date of Taxpayer's requested rate increase until Date 7, and referred the matter to the Office to receive testimony, conduct a contested case process, including potential evidentiary hearing, and issue a recommendation to Commission B. Commission B determines final rates, and they can accept, reject, or modify the recommendation from Office.

On Date 4, Commission B also issued an order approving an interim rate increase to the base rates, as modified and subject to the Interim Rate Refund. The interim increase, subject to the Interim Rate Refund, became effective Date 5, and is expected to remain in effect until Commission B makes a final determination on Taxpayer's overall request and final rates become effective. Taxpayer filed a letter on Date 8, agreeing to extend the effective date of Taxpayer's requested rate increase until Date 6.

Taxpayer computed interim rates by applying the proration methodology that is required for future test periods to its ADFIT and proposed that final rates reflect ADFIT proration. Taxpayer also asserted that, whether or not application of the proration formula to final rates is required under the normalization rules, the incremental effect of the revenue requirement on interim rates charged during the test period should not cause or increase the Interim Rate Refund.

In its Order dated Date 4, Commission B set interim rates with ADFIT proration. No party filed an objection to the interim rates set by Commission B. Interim rates are charged from Date 5 through the date in Year 2 when final rates will be implemented.

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The Department proposed that ADFIT proration not be reflected in final rates. The Department stated that, because final rates in this proceeding will not go into effect until Year 2, after the forecasted test year, final rates would be based on a then-historical Year 1 test year. Specifically, the Department did not oppose the use of ADFIT proration in setting the interim rates, but proposed that: (1) the level of the Interim Rate Refund for Date 5 through Date 9, be determined without reflecting any ADFIT proration for that period; (2) the level of the Interim Rate Refund for Date 10 until implementation of final rates by Taxpayer by determined without reflecting any ADFIT proration for that period; and (3) federal income tax expense used to set final rates reflect the level of federal income taxes reflected in ADFIT with no proration. Alternatively, the Department recommended that future rate cases rely solely on historical test years.

An evidentiary hearing was conducted by the Office. The report and recommendation of the Office to Commission B is expected on Date 11. Oral arguments before Commission B are expected to occur in Month 1 Year 2, and Commission B's "final" rate order (subject to reconsideration and other post order procedures) is expected on or before Date 6. Final rates are expected to become effective in Month 2 Year 2 and the potential Interim Rate Refund is expected to be paid or credited in Month 3 Year 2.

Taxpayer's revenue requirement for the Year 1 general rate case utilized calendar year, Year 1, as the test year. Amounts estimated for the Year 1 test year include, but are not limited to operating costs (including depreciation expense on Year 1 additions and income tax expense) and rate base items (including plant additions during Year 1, accumulated depreciation reflecting Year 1 depreciation and ADFIT). The Year 1 test year is the basis for both the interim rates (effective beginning on Date 5 and expected to remain in effect until Month 2 Year 2) as well as the final rates (expected to become effective in Month 2 Year 2).

The amounts estimated for the Year 1 test year (including but not limited to operating revenues, costs, plant additions, ADFIT, and other factors affecting the computation of the revenue requirement) are not generally "trued-up" to actual amounts after the end of Year 1 for the determination of final rates. Final rates reflect the resolution of contested items such as the allowed return, recovery of specific categories of operating expenses or the amount of certain operating expenses and inclusion of specific investments and certain costs in rate base. In the case of the Year 1 general rate case, the final rates will also consolidate into base rates the costs and investments historically recovered as part of the riders.

The following rulings are requested on behalf of Taxpayer:

- 1) The computation of ADFIT for purposes of final rates (apart from consideration of an Interim Rate Refund) charged beginning in Month 2 Year 2 without applying the

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proration formula rules for future test periods or part-historical and part-future periods under § 1.167(l)-1(h)(6) would not violate the normalization requirements of § 168(i)(9).

2) The computation of ADFIT for purposes of interim rates charged beginning on Date 5, without applying the proration formula rules for part-historical and part-future periods under § 1.167(l)-1(h)(6) would violate the normalization requirements of § 168(i)(9).

3) The future portion of a part-historical and part-future period for purposes of interim rates charged beginning on Date 5, began on Date 5 for purposes of determining the total number of days in the future portion of the period under § 1.167(l)-1(h)(6).

4) The computation of an Interim Rate Refund in Year 2 such that the effects of the proration formula rules under § 1.167(l)-1(h)(6) on interim rates charged in Year 2 are returned in Year 2 (by causing or increasing an Interim Rate Refund) would not violate the normalization requirements of § 168(i)(9).

5) The computation of an Interim Rate Refund in Year 2 such that the effects of the proration formula rules under § 1.167(l)-1(h)(6) on interim rates charged in Year 1 are returned in Year 2 (by causing or increasing an Interim Rate Refund) would violate the normalization requirements of § 168(i)(9).

6) Any reduction in tax expense recoverable in final rates or the computation of any Interim Rate Refund that has the effect of offsetting some or all of the level of revenues resulting from prorated ADFIT that may be required (under the proration formula rules for future test periods or part-historical and part-future periods under § 1.167(l)-1(h)(6)), would violate the normalization requirements of § 168(i)(9).

7) Any reduction in the depreciation expense recoverable in final rates or the computation of any Interim Rate Refund that has the effect of offsetting some or all of the level of revenues resulting from prorated ADFIT that may be required (under the proration formula rules for future test periods or part-historical and part-future periods under § 1.167(l)-1(h)(6)), would violate the normalization requirements of § 168(i)(9).

Law and Analysis

Issues 1, 2, and 3

Section 1.167(l)-1(h)(6) of the Regulations sets forth normalization requirements with respect to public utility property. Under § 1.167(l)-1(h)(6)(i), a taxpayer does not use a normalization method of accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes excluded from the rate base, or treated as cost-free capital, exceeds the amount of the reserve for the period used in determining the taxpayer's ratemaking tax expense. Section 1.167(l)-1(h)(6)(ii) also provides the procedure for

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determining the amount of the reserve for deferred taxes to be excluded from rate base or to be included as no-cost capital.

Section 1.167(l)-1(h)(6)(ii) of the Regulations provides that for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under § 1.167(l)-1(h)(6)(i), if solely an historical period is used to determine depreciation for federal income tax expense for ratemaking purposes, then the amount of the reserve account for the period is the amount of the reserve (determined under § 1.167(l)-1(h)(2)) at the end of the historical period. Section 1.167(l)-1(h)(6)(ii) provides that if solely a future period is used for such determination, the amount of the reserve account for the period is the amount of the reserve at the beginning of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during such period.

Section 1.167(l)-1(h)(6)(ii) of the Regulations provides if, in determining depreciation for ratemaking tax expense, a period (the “test period”) is used which is part historical and part future, then the amount of the reserve account for this period is the amount of the reserve at the end of the historical portion of the period and a pro rata amount of any projected increase to be credited to the account during the future portion of the period. The pro rata amount of any increase during the future portion of the period is determined by multiplying the increase by a fraction, the numerator of which is the number of days remaining in the period at the time the increase is to accrue, and the denominator of which is the total number of days in the future portion of the period.

Section 1.167(l)-1(h)(6)(i) of the Regulations makes it clear that the reserve excluded from rate base must be determined by reference to the same period as is used in determining ratemaking tax expense. A taxpayer may use either historical data or projected data in calculating these two amounts, but it must be consistent. As explained in § 1.167(l)-1(a)(1), the rules provided in § 1.167(l)-1(h)(6)(i) are to insure that the same time period is used to determine the deferred tax reserve amount resulting from the use of an accelerated method of depreciation for cost of service purposes and the reserve amount that may be excluded from the rate base or included in no-cost capital in determining such cost of services.

If a taxpayer chooses to compute its ratemaking tax expense and rate base exclusion amount using projected data then it must use the formula provided in § 1.167(l)-1(h)(6)(ii) of the Regulations to calculate the amount of deferred taxes subject to exclusion from the rate base. This formula prorates the projected accruals to the reserve so as to account for the actual time these amounts are expected to be in the reserve. As explained in § 1.167(l)-1(a)(1), the formula in § 1.167(l)-1(h)(6)(ii) provides a method to determine the period of time during which the taxpayer will be treated as having received amounts credited or charged to the reserve account so that the disallowance of earnings with respect to such amounts through rate base exclusion or

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treatment as no-cost capital will take into account the factor of time for which such amounts are held by the taxpayer.

The purpose of the proration formula is the same as that of the requirement for consistent periods discussed above: to prevent the immediate flow-through of the benefits of accelerated depreciation to ratepayers. The proration formula stops flow-through by limiting the deferred tax reserve accruals that may be excluded from rate base, and thus the earnings on rate base that may be disallowed, according to the length of time these accruals are actually in the reserve account.

The effectiveness of § 1.167(l)-1(h)(6)(ii) of the Regulations in resolving the timing issue has been limited by its failure to define some key terms. Nowhere does this provision state what is meant by the terms “historical” and “future” in relation to the test period for determining depreciation for ratemaking tax expense. How are these time periods to be measured? One interpretation focuses on the type or quality of the data used in the ratemaking process. According to this interpretation, the historical period is that portion of the test period for which actual data is used, while the portion of the period for which data is estimated is the future period. The second interpretation focuses on when the utility rates become effective. Under this interpretation, the historical period is that portion of the test period before rates go into effect, while the portion of the test period after the effective date of the rate order is the future period.

The first interpretation, which focuses on the quality of the ratemaking data, is an attractive one. It proposes a simple rule, easy to follow and to enforce: any portion of the reserve for deferred taxes based on estimated data must be prorated in determining the amount to be deducted from rate base. The actual passage of time between the date ratemaking data is submitted and the date rates become effective is of no importance. But this interpretation of the regulations achieves simplicity at the expense of precision; in other words, it is overbroad. The proration of all estimated deferred tax data does serve to magnify the benefits of accelerated depreciation to the utility, but this is not the purpose of normalization. Congress was explicit: normalization “in no way diminishes whatever power the [utility regulatory] agency may have to require that the deferred taxes reserve be excluded from the base upon which the utility’s permitted rate of return is calculated.” H.R. Rep. No. 413, 91st Cong., 1st Sess. 133 (1969).

In contrast, the second interpretation of § 1.167(l)-1(h)(6)(ii) of the Regulations is consistent with the purpose of normalization, which is to preserve for regulated utilities the benefits of accelerated depreciation as a source of cost-free capital. The availability of this capital is ensured by prohibiting flow-through. But whether or not flow-through can even be accomplished by means of rate base exclusions depends primarily on whether, at the time rates become effective, the amounts originally projected to accrue to the deferred tax reserve have actually accrued.

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If rates go into effect before the end of the test period, and the rate base reduction is not prorated, the utility commission is denying a current return for accelerated depreciation benefits the utility is only projected to have. This procedure is a form of flow-through, for current rates are reduced to reflect the capital cost savings of accelerated depreciation deductions not yet claimed or accrued by the utility. Yet projected data is often necessary in determining rates, since historical data by itself is rarely an accurate indication of future utility operating results. Thus, the regulations provide that as long as the portion of the deferred tax reserve based on truly projected (future estimated) data is prorated according to the formula in § 1.167(l)-1(h)(6)(ii) of the Regulations, a regulator may deduct this reserve from rate base in determining a utility's allowable return. In other words, a utility regulator using projected data in computing ratemaking tax expense and rate base exclusion must account for the passage of time if it is to avoid flow-through.

But if rates go into effect after the end of the test period, the opportunity to flow through the benefits of future accelerated depreciation to current ratepayers is gone, and so too is the need to apply the proration formula. In this situation, the only question that is important for the purpose of rate base exclusion is the amount in the deferred tax reserve, whether actual or estimated. Once the future period, the period over which accruals to the reserve were projected, is no longer future, the question of when the amounts in the reserve accrued is no longer relevant (at the time the new rate order takes effect, the projected increases have accrued, and the amounts to be excluded from rate base are no longer projected but historical, even though based on estimates).

Taxpayer's computation of ADFIT for purposes of final rates occurs after the end of the test period on which those amounts are based. The calculation is determined by reference to a purely historical period. Thus, the test period is one that occurs prior to the effective date of the rates which result from the computation. Accordingly, the computation of ADFIT for purposes of final rates employs an historical test period and is not subject to the proration formula rules under § 1.167-1(h)(6) of the Regulations; there is no need to follow the proration formula rules designed for future test periods or part-historical and part-future periods to calculate the differences between Taxpayer's projected ADFIT balance and the actual ADFIT balance during the period.

In contrast, Taxpayer calculates its ADFIT for purposes of interim rates charged beginning on Date 5. The rate is based on costs Taxpayer projects it will incur during the test year, Year 1. Rates go into effect as of Date 5. Therefore, rates go into effect before the end of the test period. Accordingly, the test period for Taxpayer's interim rates is a future test period, subject to the proration formula rules under § 1.167-1(h)(6) of the Regulations, and Taxpayer is required to apply the proration formula rules for part-historical and part-future periods to calculate the differences between Taxpayer's projected ADFIT balance and the actual ADFIT balance during that period.

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The revenue requirement for the interim rates, subject to refund, became effective Date 5, pursuant to a Commission B order issued on Date 4. The interim rates were based on a calendar year, Year 1, test year, but excluded costs and return associated with public utility property recovered through riders. Rate base for the Year 1 test year was computed as an average rate base. The average ADFIT amount was based on a simple average based on the estimate of ADFIT as of the beginning of the Year 1 test year and the estimate of ADFIT as of the end of the Year 1 test year, as prorated. The future portion of a part-historical and part-future period for purposes of interim rates charged began on Date 5, for purposes of determining the total number of days in the future portion of the period under § 1.167(l)-1(h)(6) of the Regulations.

Issues 4 and 5

The interim rates set by the order of Commission B dated Date 5, are charged during the pendency of the rate case until final rates are implemented (expected to be in Month 2 Year 2). A separate set of interim rates are not determined for Year 2. Once final rates are determined, the Interim Rate Refund is calculated, based on the difference between final rates and interim rates for the period during which interim rates have been collected.

The determination of the Interim Rate Refund includes the question of how to calculate the Interim Rate Refund for interim rates collected in Year 2 (that is, after the test year is completed.) Issue # 4 focuses on the calculation of the Interim Rate Refund based on the difference between final rates and the interim rates that are charged starting in Month 4 Year 2 and collected until final rates are implemented.

Similarly, the determination of the Interim Rate Refund includes the question of how to calculate the Interim Rate Refund for interim rates collected in Year 1. Issue # 5 focuses on the calculation of the Interim Rate Refund based on the difference between final rates and the interim rates that were charged during the Year 1 test year.

Once the future portion of the part-historical and part-future test year is no longer future (for example, for rates charged after the end of the test year), the question of when the amounts in the reserve for deferred taxes accrued is no longer relevant. Specifically, while interim rates are charged in Year 2, the projected Year 1 ADFIT increases have accrued, and the amounts to be excluded from rate base are no longer projected but historical, even though based on estimates. Thus, the purpose of the proration formula has been accomplished and associated prevention of flowthrough accounting has been avoided as of the beginning of Year 2 (that is, after the end of the Year 1 test year).

Commission B will use the Interim Rate Refund to adjust Taxpayer's interim rates charged after the end of the test year. Commission B is not adjusting interim rates but is instead using the approach to reflect the Year 2 incremental effects of the proration

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formula on the revenue requirement on which interim rates are based in the Interim Rate Refund. Accordingly, the computation of an Interim Rate Refund in Year 2 such that the effects of the proration formula rules under § 1.167(l)-1(h)(6) of the Regulations on interim rates charged in Year 2 are returned in Year 2 (by causing or increasing an Interim Rate Refund) would not violate the normalization requirements of § 168(i)(9) of the Code.

The issue of whether it is appropriate to permit the Interim Rate Refund to reverse the effects of the proration formula on interim rates charged *during* the Year 1 test year differs from the issue of the proration formula to interim rates charged *after* the Year 1 test year. The purpose of the proration formula is to prevent the immediate flow-through of the benefits of accelerated depreciation to ratepayers. The proration formula stops flow-through by limiting the deferred tax reserve accruals that may be excluded from rate base, and thus the earnings on rate base that may be disallowed, according to the length of time these accruals are actually in the reserve account. To permit the effects of the proration formula on interim rates charged during the Year 1 test year to be reversed in a subsequent phase of the ratemaking would be economically equivalent to not applying the proration formula in the first place.

Accordingly, the computation of an Interim Rate Refund in Year 2 such that the effects of the proration formula rules under § 1.167(l)-1(h)(6) of the Regulations on interim rates charged in Year 1 are returned in Year 2 (by causing or increasing an Interim Rate Refund) would violate the normalization requirements of § 168(i)(9) of the Code.

Issues 6 and 7

Regarding issues six and seven, reduction of Taxpayer's tax expense or depreciation expense recoverable in final rates or the computation of any Interim Rate Refund that has the effect of offsetting some or all of the level of revenues resulting from prorated ADFIT that may be required would, in effect, flow through the tax benefits of accelerated depreciation deductions to rate payers. This is so even if the intent of such reduction is not specifically to mitigate the effects of the normalization rules. In general, taxpayers may not adopt any accounting treatment that directly or indirectly circumvents the normalization rules. See generally, § 1.46-6(b)(2)(ii) (In determining whether, or to what extent, the investment tax credit has been used to reduce cost of service, reference shall be made to any accounting treatment that affects cost of service); Rev. Proc. 88-12, 1988-1 C.B. 637, 638 (It is a violation of the normalization rules for taxpayers to adopt any accounting treatment that, directly or indirectly flows excess tax reserves to ratepayers prior to the time that the amounts in the vintage accounts reverse).

Accordingly, any reduction in tax expense or depreciation expense recoverable in final rates or the computation of any Interim Rate Refund that has the effect of offsetting

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some or all of the level of revenues resulting from prorated ADFIT in setting interim rates that may be required (under the proration formula rules for future test periods or part-historical and part-future test periods under § 1.167(l)-1(h)(6) of the Regulations), would violate the normalization requirements of § 168(i)(9) of the Code.

Therefore, we rule as follows:

- 1) The computation of ADFIT for purposes of final rates (apart from consideration of an Interim Rate Refund) charged beginning in Month 2 Year 2 without applying the proration formula rules for future test periods or part-historical and part-future periods under § 1.167(l)-1(h)(6) would not violate the normalization requirements of § 168(i)(9).
- 2) The computation of ADFIT for purposes of interim rates charged beginning on Date 5, without applying the proration formula rules for part-historical and part-future periods under § 1.167(l)-1(h)(6) would violate the normalization requirements of § 168(i)(9).
- 3) The future portion of a part-historical and part-future period for purposes of interim rates charged beginning on Date 5, began on Date 5 for purposes of determining the total number of days in the future portion of the period under § 1.167(l)-1(h)(6).
- 4) The computation of an Interim Rate Refund in Year 2 such that the effects of the proration formula rules under § 1.167(l)-1(h)(6) on interim rates charged in Year 2 are returned in Year 2 (by causing or increasing an Interim Rate Refund) would not violate the normalization requirements of § 168(i)(9).
- 5) The computation of an Interim Rate Refund in Year 2 such that the effects of the proration formula rules under § 1.167(l)-1(h)(6) on interim rates charged in Year 1 are returned in Year 2 (by causing or increasing an Interim Rate Refund) would violate the normalization requirements of § 168(i)(9).
- 6) Any reduction in tax expense recoverable in final rates or the computation of any Interim Rate Refund that has the effect of offsetting some or all of the level of revenues resulting from prorated ADFIT that may be required (under the proration formula rules for future test periods or part-historical and part-future periods under § 1.167(l)-1(h)(6)), would violate the normalization requirements of § 168(i)(9).
- 7) Any reduction in the depreciation expense recoverable in final rates or the computation of any Interim Rate Refund that has the effect of offsetting some or all of the level of revenues resulting from prorated ADFIT that may be required (under the proration formula rules for future test periods or part-historical and part-future periods under § 1.167(l)-1(h)(6)), would violate the normalization requirements of § 168(i)(9).

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These rulings are based on the representations submitted by Taxpayer and are only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above. This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Patrick S. Kirwan
Chief, Branch 6
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

cc:

Otter Tail Power Company
Proration of Accumulated Deferred Income Tax for Test Year
Proration - August - December
2018 Test Year

	(A)	(B)	(C)	(D)
		12/31/2017	12/31/2018	Simple Average
1				
2	Non-Prorated Accumulated Deferred Income Taxes			
3	Federal	(200,636,641)	(216,960,281)	(208,798,461)
4	Minnesota	(32,443,938)	(34,054,163)	(33,249,051)
5	North Dakota	(36,972,077)	(36,584,630)	(36,778,353)
6		(270,052,657)	(287,599,074)	(278,825,865)
7				
8	Prorated Accumulated Deferred Income Taxes			
9	Federal	(200,636,641)	(212,489,268)	(206,562,955)
10	Minnesota	(32,443,938)	(34,054,163)	(33,249,051)
11	North Dakota	(36,972,077)	(36,584,630)	(36,778,353)
12		(270,052,657)	(283,128,061)	(276,590,359)
13				
14	Prorate Impact to Test Year ADIT			
15	Federal			2,235,506
16	Minnesota			0
17	North Dakota			0
18	Total Change In ADIT (Total Company)			2,235,506
19				

NEPIS Allocation Factor	0.36083
TY ADIT Balance Impact - ND	\$ 806,648
Rate Base Revenue Requirement Factor	11.26%
Test Year ND Revenue Requirement Impact	\$ 90,829

Otter Tail Power Company
Proration of Accumulated Deferred Income Tax for purposes of computing the Interim Period Adjustment
Proration - January - December
2018 Interim Test Year

	(A)	(B)	(C)	(D)
		12/31/2017	12/31/2018	Simple Average
1				
2	Non-Prorated Accumulated Deferred Income Taxes			
3	Federal	(200,636,641)	(216,960,281)	(208,798,461)
4	Minnesota	(32,443,938)	(34,054,163)	(33,249,051)
5	North Dakota	(36,972,077)	(36,584,630)	(36,778,353)
6		(270,052,657)	(287,599,074)	(278,825,865)
7				
8	Prorated Accumulated Deferred Income Taxes			
9	Federal	(200,636,641)	(207,744,716)	(204,190,679)
10	Minnesota	(32,443,938)	(34,054,163)	(33,249,051)
11	North Dakota	(36,972,077)	(36,584,630)	(36,778,353)
12		(270,052,657)	(278,383,509)	(274,218,083)
13				
14	Prorate Impact to Interim Test Year ADIT			
15	Federal			4,607,783
16	Minnesota			0
17	North Dakota			0
18	Total Change In ADIT (Total Company)			4,607,783
19				

NEPIS Allocation Factor	0.36083
ADIT Balance Impact for Interim Purposes - ND	1,662,646
Rate Base Revenue Requirement Factor	11.26%
Interim Test Year ND Revenue Requirement Impact	\$ 187,214

Interim Adjustment

Estimated Revenue Requirement Impact

	ADIT Proration Balance Impact ND	Revenue Requirement Impact
Interim (12 Months Prorated) ADIT	\$ 1,662,646	\$ 187,214
2018 TY (August - December prorated) ADIT	\$ 806,648	\$ 90,829
Total Interim Adjustment to ADIT Balance	\$ 855,999	\$ 96,385

Schedule 5

Stuart D. Tommerdahl



Corporate Cost Allocation Manual

Last Update: February ~~2008~~2017

I. INTRODUCTION

The corporate entity (“Corporate”) of Otter Tail Corporation provides services to the operating companies that comprise the Corporation. One of three things can occur with costs from Corporate services: 1) allocated to Otter Tail Power Company; 2) allocated to Varistar Inc., or 3) not allocated and remain at Corporate. The purpose of this manual is to detail how costs are being allocated to Otter Tail Power Company.

Otter Tail Power Company (the largest operating company of Otter Tail Corporation) serves retail electric customers in three jurisdictions including Minnesota, North and South Dakota and is governed by the rules and regulations in each jurisdiction. As a regulated utility, Otter Tail Power is allowed to recover prudent and reasonable costs for services it receives from Corporate, and reflects the cost of these services in its revenue requirements for setting rates. Costs allocated from Corporate are based on allocation factors that are calculated annually. In Minnesota, a different allocation method for the general allocator has been ordered for regulated reporting; however, this change in percentage is adjusted by Otter Tail Power Company so all costs billed from Corporate are at the same rate, regardless of jurisdiction.

The services provided by Corporate include financial reporting, tax planning and reporting, treasury and cash management, financial planning, internal audit, human resource and labor expertise, benefit plans, corporate communications, safety and risk management, shareholder services and investor relations, ~~sourcing~~, aviation and executive management services (CEO, COO, CFO and General Counsel). These services are distinct from and do not duplicate similar services in Otter Tail Power Company. See Section V below for additional information of Corporate services. To support these services, there are specific corporate costs associated with administration and information technology (“IT”) that also need to be allocated.

The remainder of this document is devoted to explaining the services being provided and the methodology and allocation factors used to allocate Corporate service costs to Otter Tail Power Company.

II. METHODOLOGY

Corporate identifies costs in three categories: 1) directly assignable costs, 2) indirect costs that are allocated on a department or functional allocation factor, and 3) general costs that are allocated using a general allocation factor.

Directly assignable costs are those costs where the purpose behind the costs can be attributed to a specific operating company. For example, consulting fees to help with a project related to an individual operating company would be directly assigned to that operating company.

Indirect costs have an identifiable cost causation related to another activity or factor. For example, costs for an employee in the Risk Management department of Corporate to attend a seminar on safety would be allocated using a functional allocation factor such as number of employees.

General costs are those costs that cannot be directly assigned or where cost-causation cannot be identified. Examples would include postage, local telephone and communication service costs, time spent preparing the annual report and other SEC filings, preparing to meet with rating agencies, working with and tracking shareholder matters. These types of costs will be allocated on a general allocation factor discussed below.

Allocation factors are updated annually in February with the most recent calendar year's data. The updated allocation factors are then implemented and utilized for all Corporate Costs in February and remain unchanged for 12 months. ~~Current year factors are applied to corporate billings to the utility in first month following availability of final, audited financial information required for some factors.~~

III. ALLOCATION FACTORS

Indirect Allocation Factors:

- A. IT Factor: This factor is based on the previous year ending December 31 ratio of corporate labor assigned to Otter Tail Power where the numerator is the total Corporate labor (not including bonuses) assigned to Otter Tail Power and the denominator is the total of all Corporate labor (not including bonuses). See Appendix A.
- B. HR Factor: This factor is based on the average of the previous year ending December 31 ratio of employees, and the previous year ending December 31 ratio of benefit expenses. For the employee ratio the numerator is ~~both~~ full ~~and part~~-time employees in electric operations and the denominator is the total number of full ~~and part~~-time employees for all of Otter Tail Corporation. For the benefit ratio, the numerator is total benefit costs (including benefit costs cleared through the payroll loading rate) from electric operations, and the denominator is consolidated benefit costs for all of Otter Tail Corporation (including benefit costs cleared through the payroll loading rate) ~~excluding benefit costs for Corporate employees.~~ The specific consolidated corporate accounts that will be used to calculate this ratio (including Otter Tail Power benefit costs cleared through payroll loading) are accounts C5030, C5230, C6030, C6530, C7030. See Appendix A.

- C. RM Factor: This risk-management factor is the average of the previous year ending December 31 ratio of employees, and the ~~previous~~current year ratio of insurance premiums paid. For the employee ratio the numerator is ~~both~~-full ~~and~~-part-time employees in electric operations and the denominator is the total number of full ~~and~~-part-time employees for all of Otter Tail Corporation. For the insurance premium ratio, the numerator is the total premiums paid by Otter Tail Power and the denominator is the sum of insurance premiums paid by all operating companies. See Appendix A.
- D. Internal Audit Factor: This factor is based on the previous year ending December 31 ratio where the numerator is the total hours spent auditing electric operations and the denominator is the sum of hours auditing electric and non-electric operations. Non-electric operations do not include hours spent auditing Corporate-related matters. See Appendix A.

General Allocation Factor:

This factor is based on a three-factor formula that is comprised of the average ratio of Total Assets, Total Revenues and Total Labor Dollars for the most recent calendar year. The specific consolidated corporate accounts that will be used to calculate the Total Labor Dollars ratio are C5010, C5020, C5030, C5210, C5220, C5230, C6010, C6015, C6020, C6030, C6510, C6520, C6530, C7010, C7020 and C7030. Appendix A shows the computation of this factor based on prior-year audited numbers and shows the source for the information to calculate each ratio.¹

IV. CLARIFICATION ON CERTAIN COSTS

There are certain costs that need to be discussed in further detail to gain an understanding of exactly how they are being allocated, or in some instances, not being allocated. This section will list each of these costs individually and provide background and instruction on how each is handled for allocation purposes.

- A. Labor: ~~Each employee~~Employees at Corporate ~~track~~track their time on a daily basis. ~~Attached as Appendix B are samples of time sheets for typical corporate employees.~~ Percentages are used ~~instead of hours~~-to track time between Corporate, UtilityOtter Tail Power Company, and ~~Non-utility~~Varistar activities. The time designated UtilityOtter Tail Power is directly assigned to ~~Otter Tail Power~~the power company. The percentage of time being recorded in the Corporate column is allocated based on the employee's position and will use one of the allocation factors discussed above in Section III.

¹ The Minnesota Public Utilities Commission (PUC) has ordered in Otter Tail Power Company's last rate case (Docket No. E017/GR-07-1178), that the General Allocator calculation method must comply with the PUC's orders in Docket E.G999/CI-90-1008. That docket established a general allocator based on the ratio of regulated to unregulated expenses, excluding fuel, purchased power, and purchased cost of goods sold.

- B. Bonuses and Benefits: Cash bonuses are allocated based on each employee's labor ratio from the previous year. An employee's labor ratio reflects both directly assigned and allocated labor. Bonuses are accrued and allocated during the current year, and a true-up is made in the following year after the exact bonus amount is determined and the employee's actual labor ratio from the previous year is available. Benefit costs are allocated on each employee's labor ratio from the most recent 30-day pay period.
- C. Contributions, ~~Employee Stock Purchase Plan and Deferred Compensation Expense~~: The ~~costs associated with these three items~~contributions made by Otter Tail Corporation are not allocated to Otter Tail Power. Each operating company makes ~~their~~its own contributions and those contributions made from a corporation perspective are typically not allocated. ~~Costs for the stock purchase plan and deferred compensation plan are kept at Corporate and not allocated.~~
- D. Employee Stock Purchase Plan and Deferred Compensation Expense: The costs associated with the Employee Stock Purchase Plan are allocated based on the ratio of Otter Tail Power employee stock purchases to the total of the most recent stock purchase and Deferred Compensation expense is allocated to Otter Tail Power based on the general allocator.
- ~~D.E.~~ Stock Option Expense: Under ~~FAS 123(R)~~Accounting Standard Codification (ASC) Topic 718 companies are required to record the value of stock options over the period in which the options vest. These expenses are allocated to Otter Tail Power based on the number of options granted to employees in this company. No stock options were granted in 2016 and none are expected to be granted to employees in 2017.
- ~~E.F.~~ Restricted Stock and Restricted Stock Units: Under ~~FAS 123(R)~~ASC Topic 718 companies are required to record the value of restricted stock and restricted stock units over the period in which the shares vest. Restricted stock and restricted stock unit expense on shares granted to Otter Tail Power employees are directly assigned to Otter Tail Power. ~~No~~The portion of restricted stock or restricted stock units granted to Corporate employees and the Board of Directors is allocated to Otter Tail Power Company based on the general allocator.
- ~~F.G.~~ Executive Stock ~~Incentive~~Performance Award Plan: Under ~~FAS 123(R)~~ASC Topic 718 companies are required to record the value of incentive stock, awarded based on the performance of the company's stock price, over the time period used to evaluate performance. Otter Tail Corporation provides incentive stock to the corporate officers as part of their overall compensation package. The costs associated with this plan are ~~not allocated.~~allocated based on the prior year time allocations for each executive. In addition when performance shares are awarded to Otter Tail Power's president the cost related to his award is directly assigned to Otter Tail Power.

G.H. Bank Charges: Corporate serves as the “Bank” for ~~all~~ operating companies and therefore incurs the various fees associated with ~~all~~ the accounts maintained by the operating companies. ~~Each operating company~~ Otter Tail Power is directly charged for ~~their~~ respective fees and the fees associated with Corporate’s accounts are allocated using the General Allocation Factor.

H.I. External Audit Fees: Otter Tail Corporation currently retains an independent registered public accounting firm to audit its financial reports and records. Each year this firm provides to Otter Tail Corporation a Client Service Plan that outlines the number of hours it has assigned to audit electric and non-electric operations. Fees from the firm are allocated based on the ratio of assigned hours for electric versus total audit hours on consolidated operations. ~~The hours assigned to corporate are allocated using the general allocator.~~

H.J. Meetings: Costs associated with periodic meetings that involve personnel from across the operating companies such as ~~quarterly~~ leadership meetings, quarterly accounting and HR meetings are not allocated ~~based on the number of people attending from each company, versus the total number of people in attendance.~~

K. Training and Development: ~~Costs associated with training and development are direct charged where possible but otherwise allocated using the appropriate indirect allocator or the general allocator.~~

J.L. Travel and meals: With the exception of travel-related expense related to operations of Otter Tail Power’s jointly owned generation plants, ~~or if corporate employees are working specifically for Otter Tail Power, corporate~~ travel expense is not allocated.

K.M. Aviation Services: Corporate provides air service for the operating companies of Otter Tail Corporation. There ~~are two aircrafts~~ is one aircraft available for use. ~~One is which is the King Air. The King Air is~~ owned by Otter Tail Power Company ~~(the King Air), the other is owned by Varistar Corporation (the Citation).~~ To help recover the variable costs associated with flying ~~these two~~ this aircraft, corporate charges ~~\$650/hr~~ hourly rates which are reviewed periodically.² (See Appendix B for ~~the King Air and \$920/hr for the Citation.~~ hourly rates)³

Because the King Air is owned by Otter Tail Power, at the end of each quarter the costs associated with the King Air that have not been recovered through the hourly rate are

² ~~The aviation charge rates may be changed during the year to reflect changes in variable costs (i.e., aviation fuel).~~

³ ~~The aviation charge rates may be changed during the year to reflect changes in variable costs (i.e., aviation fuel).~~

charged to Otter Tail Power. For example, the costs not cleared for the quarter total \$9,000. Otter Tail Power has recorded depreciation expense for the quarter of \$1,000 which is added to the \$9,000 of un-cleared costs for a total of \$10,000. The \$10,000 is multiplied by the non-utility usage factor (the percentage of hours flown for operating companies other than Otter Tail Power) and for our example we'll say it's 52%. Otter Tail Power will then be charged \$3,800 (\$9,000 less \$5,200 (\$10,000 x 52%)) to reflect the utility-portion of costs not cleared on the King Air.

V. DESCRIPTION AND ALLOCATION OF SERVICES PROVIDED

Further detail is discussed below on the services provided by Corporate. Each service shown below is directly related to an individual cost center at Corporate. For each service a description is provided along with the primary allocation factor that is used to allocate associated costs. Again, costs that can be directly assigned to the various operating companies are directly assigned. Indirect costs are allocated using one of the factors discussed in Section III.

A. Corporate Overheads

Description: Represents charges for ~~succession planning and developing leadership at the operating companies,~~ bank charges, building lease and depreciation expense.

~~Allocation Factor: Costs associated with succession planning and developing leaders at the various operating companies are not allocated but kept at Corporate. All other~~
Allocation Factor: All costs not directly assigned are allocated on the General Allocation Factor.

B. Executive Management Services

Description: Represents charges for Otter Tail Corporation's executive management team ~~comprised of the four Officers,~~ and Contributions.

Allocation Factor: Contributions are not allocated and all other costs not directly assigned are allocated on the General Allocation Factor including labor classified as Corporate.

C. Board of Directors

Description: Represents charges for board of director fees, restricted stock, travel and other expenses associated with attending Board meetings or related to being a board member.

Allocation Factor: Fees and restricted stock expense are allocated on the General Allocation Factor. Otter Tail Power is not allocated any costs associated with ~~restricted stock granted to directors or~~ travel related expenses.

D. Corporate Development

Description: Represents charges for the ~~Platform Leaders and their Corporate Development~~ staff that ~~have oversight responsibilities with the non-electric operating companies, are responsible for~~ identifying and researching acquisition candidates, due diligence on acquisition targets, and integrating recently acquired companies into Otter Tail Corporation.

Allocation Factor: All costs are currently being directly assigned to Varistar Corporation but if Otter Tail Power uses these services for an acquisition, the associated costs would be directly billed to Otter Tail Power.

E. Platform Leadership

Description: Represents charges for the Platform Leaders and their staff that have oversight responsibilities with the non-electric operating companies.

Allocation Factor: All costs are currently being directly assigned to Varistar Corporation.

E.F. Administrative Services

Description: Represents charges for providing administrative support to all the other services, office supplies, ~~cell phones~~ and office equipment leases.

Allocation Factor: All costs not directly assigned are allocated on the General Allocation Factor including labor classified as Corporate.

F.G. Information Technology

Description: Represents charges for supporting corporate computers, networks, land-based phones and T1 lines, internet, software and other various pieces of hardware. In addition, consulting services are provided as requested to the various operating companies.

Allocation Factor: License and maintenance fees comprise a large portion of the non-labor costs. As much as possible, these costs are directly assigned based on the number of user licenses utilizing the software by each operating company. All costs not directly assigned are allocated on the IT Factor including labor classified as Corporate. The corporate VP of Information Technology is a shared position with Otter Tail Power

Company. The specific costs for this position are directly assigned to Otter Tail Power as appropriate.

G.H. Corporate Accounting

Description: Represents charges for maintaining financial records, statements and systems, SEC filings, tax accounting and filings, cash management and consulting with various operating companies on an as-needed basis.

Allocation Factor: External audit fees are allocated as discussed in Section IV. Costs not directly assigned are allocated on the General Allocation Factor including labor classified as Corporate.

H.I. Internal Audit

Description: Represents charges for reviewing internal controls and conducting operation audits at the various companies within Otter Tail Corporation.

Allocation Factor: Costs not directly assigned are allocated on the Internal Audit Factor including labor classified as Corporate.

I.J. Financial Planning ~~and Sourcing~~

Description: Represents charges for supporting financial analysis and budgeting at the operating company and corporate level.

Allocation Factor: Costs not directly assigned are allocated on the General Allocation Factor including labor classified as Corporate.

K. Treasury

Description: Represents charges for communicating with both debt and equity analysts, maintaining Otter Tail Corporation's capital structure, monitoring and accessing capital markets and other services as identified by the Chief Financial Officer. ~~Charges also represent services related to sourcing, procurement, vendor relationships, and developing strategies to leverage the consolidated buying power of Otter Tail Corporation as a whole.~~

Allocation Factor: ~~Sourcing related costs are directly assigned in most instances.~~ Costs not directly assigned are allocated on the General Allocation Factor including labor classified as Corporate.

J.L. Corporate Communications

Description: Represents charges for corporate communications including press releases, advertising and branding and annual report preparation. Another service provided is coordinating and tracking contributions made on behalf of Corporate.

Allocation Factor: Costs not directly assigned are allocated on the General Allocation Factor including labor classified as Corporate.

K.M. Shareholder Services

Description: Represents charges for maintaining shareholder records, communicating with investors at various fairs, coordinating transfer agents and planning the annual shareholder meeting.

Allocation Factor: Costs not directly assigned are allocated on the General Allocation Factor including labor classified as Corporate.

L.N. Human Resources/Leadership Development

Description: Represents charges for establishing and maintaining policies related to employment and benefits of corporate employees and executive compensation, searches for candidates for upper-level management positions on behalf of operating companies, ~~organizesorganizing~~ and ~~facilitatesfacilitating~~ leadership training, ~~organizesorganizing~~ and ~~aidsaiding~~ in the administration of company benefit programs.

Allocation Factor: Costs not directly assigned are allocated on the HR Factor including labor classified as Corporate. In case of leadership and employee development training, costs are allocated based on employees in attendance at training sessions, if possible and otherwise allocated using the HR allocator.

M.O. Legal Affairs

Description: Represents charges for legal services related to employment law, litigation, contracts, rates and regulation, environmental matters, real estate and other various legal matters.

Allocation Factor: ~~All~~Most costs associated with legal services are directly assigned. ~~All~~but if costs cannot be directly charged, the general allocator is used. Typically, labor costs for all corporate lawyers other than the General Counsel are ~~directly~~generally assigned to ~~one operating company, or a group of operating~~the Varistar companies:

~~Three as Otter Tail Power employs their own attorneys, however, there are times when corporate lawyers are currently perform work for Otter Tail Power which would be assigned to Otter Tail Power and two lawyers are assigned to non electric companies. as such.~~

N.P. Risk Management

Description: Represents charges for assisting operating companies with assessment and management of risks, identifying and implementing loss control strategies to minimize the frequency and financial consequences of accidental losses, assisting operating companies in post loss claim management, overseeing Otter Tail Corporation's consolidated insurance program, and identifying and documenting the environmental conditions during the process of acquiring a new company.

Allocation Factor: Costs not directly assigned are allocated on the RM Factor including labor classified as Corporate.

VI. CONCLUSION

As circumstances arise, such as adding a new service that will be provided by Corporate, appropriate changes will be made to the manual. Appendix A will be updated annually in February when the prior-year audited records are available. ~~and Appendix B will be updated as Aviation Rates are changed.~~

Schedule 6

Stuart D. Tommerdahl



Forecast Corporate Cost Allocation Procedures

Updated: October 2017

I. INTRODUCTION

The corporate entity (“Corporate”) of Otter Tail Corporation provides services to the operating companies that comprise the Corporation. One of three things can occur with costs from Corporate services: 1) allocated to Otter Tail Power Company (“OTP”); 2) allocated to Varistar Inc., or 3) not allocated and remain at Corporate. The procedures laid out in this document detail how budgeted/forecasted costs are being allocated to Otter Tail Power Company.

Corporate prepares a budget for the following year during the fourth quarter. For example, the 2018 budget is prepared in the fall of 2017. During the budget year (2018), three additional forecasts are made for 2018. The first is in April and covers the remainder of the year and the following year. The second is in July and covers only the remaining months of the current year. The third is in October and forecasts the remaining three months of the current year along with the five-year budget.

Otter Tail Power desires to file any future rate case on a forward-looking test year if the jurisdiction allows this methodology. In order for interim rates to go into effect on January 1, the rate case must be filed on or before November 1. Therefore, it is the updated forecast Otter Tail Power receives from Corporate in April for allocated costs which will most likely be used in the forward-looking test year.

The remainder of this document discusses the methodology and allocation factors used to allocate forecasted corporate service costs to Otter Tail Power Company.

II. LABOR AND BENEFIT ALLOCATION

Corporate identifies costs in three categories: 1) directly assignable costs, 2) indirect costs that are allocated on a department or functional allocation factor, and 3) general costs that are allocated using a general allocation factor.

Directly assignable costs are those costs where the purpose behind the costs can be attributed to a specific operating company. If there is a forecasted cost which is specifically for OTP, then it will be directly assigned in the forecast/budget. For example, any legal fees associated with a project or function identified as strictly for the benefit or need of OTP.

Labor and benefit costs make up 60-65% of Corporate’s overall budget or total expenses. Corporate employees track their time each pay period and based on how their time is distributed between operating companies, labor and benefit costs are allocated accordingly. For budget/forecast purposes, each employees’ time allocation over the previous 12 months is used to allocate their respective salary and benefit costs.

III. NON-LABOR O&M ALLOCATION

Non-labor O&M in the budget/forecast is allocated using the same allocation factors as defined in the Corporate Cost Allocation Manual (“Manual”). As defined in the Manual, the allocations factors for the current year are based on actual results from the prior year. Since the budget is prepared before actual results are available, the allocation factors for the following year are estimated using the nine months of actual data and three months of forecasted data. The estimates produced have been very comparable to the final allocation factors once the actual results for the year are available. For the forecasts created in April, July and October actual allocation factors from Exhibit A of the Manual are used.

The five allocation factors developed are as follows:

- General Allocator
- IT Allocator
- HR Allocator
- RM Allocator
- Internal Audit Allocator

The rest of this section discusses each service or function/department comprising Corporate and what allocator is used to allocate their respective non-labor O&M costs.

- A. Corporate: This department houses all the costs like depreciation expense, rent expense, CAM charges for maintaining and cleaning the space Corporate rents, and costs associated with the Employee Stock Purchase Plan (“ESPP”). In addition, incentive compensation for all Corporate employees is accrued in the department. The allocation of incentive compensation follows how each Corporate employees’ labor is allocated. The factor used to allocate costs other than incentive compensation and ESPP is the **General Allocator**.
- B. Officers: This department is for all the costs associated with the Officers of Otter Tail Corporation along with Contributions and Long-Term Stock Incentive Compensation costs. The allocation procedures for these two costs are discussed in more detail below. Because of the varying nature of costs recorded in this department, the procedure is to directly assign as many of the budgeted/forecasted costs as possible. All other costs not directly assigned are allocated using the **General Allocator**.
- C. Board of Directors: This department tracks costs for board of director fees, restricted stock, travel and other expenses associated with attending Board meetings or related to being a board member. The factor used to allocate costs is the **General Allocator**.

- D. Corporate Development and Platform Leadership: These two departments deal with non-regulated companies or those companies who roll up under Varistar. No costs from these two departments are charged to OTP except for a small portion of labor and benefit costs associated with an executive assistant who supports the CEO.
- E. Administrative: This department is for all costs associated with running and maintaining the office. Costs like postage, office supplies, rent expense for copying machines and printers and other office-related costs. The factor used to allocate these costs is the **General Allocator**.
- F. IT: This department tracks all the costs associated with maintaining all the related IT costs like network maintenance, computer supplies, IT support, and other IT-related costs. The factor used to allocate these costs is the **IT Allocator**.
- G. External Reporting and Tax: This department is responsible for both internal and external reporting of the consolidated financial results of the Corporation. This includes SEC reporting for the 10Q and 10K, management reporting, accounting for all the transactions at Corporate, and maintaining the allocation manual and methodologies. In addition, all federal and state income taxes are prepared by this group. The factor used to allocate these costs, (except for external audit fees discussed below), is the **General Allocator**.
- H. Internal Audit: This department incurs costs associated with performing strategic, financial, compliance and consulting projects in partnership with Otter Tail's operating companies. The factor used to allocate these costs is the **Internal Audit Allocator**.
- I. Financial Planning: This department is responsible for coordinating and consolidating the financial forecasts for each of the operating companies. It also performs valuation and goodwill testing on those companies having goodwill, maintaining the software used for budgeting and consolidation purposes, monthly operating reviews with each operating companies and any financial analysis as requested by the Chief Financial Officer. The factor used to allocate these costs is the **General Allocator**.
- J. Treasury: This department is responsible for all the daily cash management activities, monitoring and accessing equity and debt markets, maintaining the Corporation's capital structure, lease agreements, and Chairing the Investment Committee responsible for overseeing the pension plan. The factor used to allocate these costs (other than Rating Agency fees discussed below) is the **General Allocator**.
- K. Corporate Communications: This department is responsible for communicating the Corporation's strategic plan inside and outside Otter Tail Corporation, shaping, managing and protecting the Corporation's brand, and acting as a spokesperson in relations with media and the public. The factor used to allocate these costs is the **General Allocator**.

- L. Shareholder Services: This department is responsible for all costs and services performed on behalf of shareholders, SEC filings on behalf of Corporate Officers, and investor relations. The factor used to allocate these costs is the **General Allocator**.
- M. HR and Leadership Development: These two departments are responsible for all HR and benefit-related matters, payroll, maintaining our UltiPro software, consulting with the HR departments at each operating company, and developing the leadership skills of all employees across the corporation. The factor used to allocate these costs (except for various costs discussed below) is the **HR Allocator**.
- N. Legal: This department is responsible for all legal matters regarding the Corporation and the operating companies. Any legal matter directly attributable to one of the operating companies is billed directly to the operating company and does impact Corporate's budget/forecast. All Corporate-related legal matters are allocated using the **General Allocator**.
- O. Risk Management: This department manages the insurance program for all Otter Tail Corporation companies. This includes the commercial lines for property, excess GL, Worker Comp, and Auto, D&O, and several other commercial lines. It also manages the captive insurance program for casualty insurance. The factor used to allocate these costs is the **RM Allocator**. Finally, this department also manages the Aviation program for the corporation. This is discussed in more detail below.

IV. CLARIFICATION ON CERTAIN COSTS

There are certain costs that need to be discussed in further detail to gain an understanding of exactly how they are being allocated, or in some instances, not being allocated. This section will list each of these costs individually and provide background and instruction on how each is handled for allocation purposes used in developing the forecast.

- A. Employee Stock Purchase Plan: The costs associated with this Plan are allocated based on the ratio of Otter Tail Power Company employees stock purchased under the Plan divided by the total stock purchased.
- B. External Audit Fees: Otter Tail Corporation currently retains an independent registered public accounting firm to audit its financial reports and records. Each year this firm provides to Otter Tail Corporation a Client Service Plan that outlines the number of hours it has assigned to audit electric and non-electric operations. Forecasted Fees from the firm are allocated based on the ratio of assigned hours for Otter Tail Power Company versus total audit hours on consolidated operations. The hours assigned to corporate are allocated using the **General Allocator**.

- C. Rating Agency Fees: These fees will be direct assigned where applicable. Otherwise, fees for rating on long-term debt are allocated based on Otter Tail Power Company's share of long-term debt relative to consolidated long-term debt. Fees for ratings on the lines of credit are allocated based on Otter Tail Power Company's credit facility amount relative to the consolidated credit facility amount.
- D. Restricted Stock and Restricted Stock Units: Under ASC Topic 718, *Compensation—Stock Compensation* companies are required to record the value of restricted stock and restricted stock units over the period in which the shares vest. Restricted stock and restricted stock unit expense on shares granted to Otter Tail Power employees are directly assigned to Otter Tail Power. The portion of restricted stock or restricted stock units granted to Corporate employees and the Board of Directors is allocated to Otter Tail Power Company based on the **General Allocator**.
- E. Executive Stock Incentive Plan: Under ASC Topic 718, *Compensation—Stock Compensation* companies are required to record the value of incentive stock awarded based on the performance of the company's stock price and ROE over the time period used to evaluate performance. Otter Tail Corporation provides incentive stock to the corporate officers as part of their overall compensation package. The costs associated with this plan are allocated based on the prior year time allocations for each executive. In addition, when performance shares are awarded to Otter Tail Power's president the cost related to his award is directly assigned to Otter Tail Power.
- F. Bank Charges: Corporate serves as the "Bank" for operating companies and therefore incurs the various fees associated with the accounts maintained by the operating companies. Otter Tail Power is directly charged for its respective fees and the fees associated with Corporate's accounts are allocated using the General Allocation Factor.
- G. Contributions: The contributions made by Otter Tail Corporation are not allocated to Otter Tail Power. Each operating company makes its own contributions and those contributions made from a corporation perspective are typically not allocated.
- H. Meetings: Costs associated with periodic meetings that involve personnel from across the operating companies such as leadership meetings, quarterly accounting and HR meetings are not allocated.
- I. Travel and meals: With the exception of travel-related expense related to operations of Otter Tail Power's jointly owned generation plants and travel that can be direct assigned, travel expense is not allocated.
- J. Leadership Development: These costs are allocated based on Otter Tail Power Company employees in attendance in training sessions divided by the total number of employees

attending. Budgeted/Forecasted costs will be allocated based on the actual allocation incurred over the most recent 12-month period.

- K. Aviation Services: Corporate provides air service for the operating companies of Otter Tail Corporation. There is one aircraft available for use which is the King Air. The King Air is owned by Otter Tail Power Company. To help recover the variable costs associated with flying this aircraft, corporate charges an hourly rate of \$750 which is reviewed periodically.¹

Because the King Air is owned by Otter Tail Power, at the end of each quarter the costs associated with the King Air that have not been recovered through the hourly rate are charged to Otter Tail Power. For example, the costs not cleared for the quarter total \$9,000. Otter Tail Power has recorded depreciation expense for the quarter of \$1,000 which is added to the \$9,000 of un-cleared costs for a total of \$10,000. The \$10,000 is multiplied by the non-utility usage factor (the percentage of hours flown for operating companies other than Otter Tail Power) and for our example we'll say it's 52%. Otter Tail Power will then be charged \$3,800 (\$9,000 less \$5,200 (\$10,000 x 52%)) to reflect the utility-portion of costs not cleared on the King Air.

VI. CONCLUSION

There is a one-month delay in Corporate costs being billed to Otter Tail Power Company. So for example, January's costs for Corporate are billed to OTP and recorded in February. Therefore, the credit to account 7999 in Corporate's ledger for February reflects the Otter Tail Power Company allocated costs from January.

Corporate and Otter Tail Power Company share common costs like pension expense, post-retirement and post-employment. Coordination takes place each forecast to make sure both entities are reflecting their share of the same total for each of these costs.

Finally, any updates to the Allocation Manual are reviewed quarterly by Financial Planning and the procedures used to allocate budgeted/forecasted costs will try and reflect to the extent possible any changes in allocation methodology.

¹ The aviation charge rates may be changed during the year to reflect changes in variable costs (i.e., aviation fuel).