

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-17-398
OAH File No. 20170622

Exhibit __

POLICY

Rebuttal Testimony of

BRUCE GERHARDSON

June 22, 2018

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1 **I. INTRODUCTION AND SUMMARY**

2 Q. PLEASE STATE YOUR NAME AND OCCUPATION.

3 A. My name is Bruce Gerhardson. I am employed by Otter Tail Power Company (OTP) as
4 Vice President of Regulatory Affairs.

5

6 Q. DID YOU PREPARE DIRECT TESTIMONY AND SUPPLEMENTAL DIRECT
7 TESTIMONY IN THIS PROCEEDING?

8 A. Yes. I filed Direct Testimony and Supplemental Direct Testimony on behalf of OTP
9 describing OTP and why OTP is requesting a rate increase. I provided a summary
10 showing the very high levels of customer satisfaction OTP has achieved, and I described
11 some of our recent capital expenditures, including the very large recent projects that OTP
12 successfully completed under budget. I also discussed some of the significant sources of
13 OTP's revenue deficiency and introduced OTP's other witnesses

14

15 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

16 A. I will introduce the Rebuttal Testimony provided by OTP witnesses. I will also respond
17 to issues concerning: (1) OTP's overall rate levels and customer satisfaction levels; (2)
18 Return on Equity (ROE) as it relates to OTP's capital expenditure plan and performance;
19 and (3) OTP's management incentives.

20

21 Q. PLEASE INTRODUCE THE WITNESSES OFFERING REBUTTAL TESTIMONY
22 AND PROVIDE A BRIEF SUMMARY OF THEIR TESTIMONY.

23 A. The following individuals will be presenting Rebuttal Testimony in this proceeding:

24 • **Kevin G. Moug** explains how OTP's requested cost of capital is necessary for
25 maintaining OTP's ability to attract capital on favorable terms while it is in a period
26 of significant infrastructure investment, and he describes the negative consequences
27 that OTP and OTP's customers would experience if the Commission adopted a very
28 low ROE, such as the ROE recommended by consultant witness Mr. Aaron L.

1 Rothschild testifying on behalf of North Dakota Public Service Commission
2 (Commission) Advocacy Staff (Staff).

- 3 • **Robert B. Hevert** responds to the Direct Testimony of Mr. Rothschild and to the
4 Direct Testimony of Walmart, Inc. (Walmart) witness Mr. Steve W. Chriss regarding
5 the appropriate ROE for OTP. Mr. Hevert explains that, if the Commission adopted
6 Mr. Rothschild's recommendation, it would be the lowest ROE awarded since at
7 least 1980.¹ In addition to being unreasonable on its face, Mr. Hevert also describes
8 the theoretical and mechanical shortcomings of Mr. Rothchild's analysis that make it
9 unfit for consideration in this case.
- 10 • **Peter E. Wasberg** responds to the Direct Testimony of Staff witness Mr. Ralph C.
11 Smith regarding OTP's compensation and benefit plans. Mr. Wasberg explains
12 OTP's compensation and benefit plans and how they are cost-effective, reasonable,
13 and necessary for OTP to attract and retain qualified employees. He also explains
14 why the Commission should not accept Mr. Smith's proposals to split-out and
15 disallow *individual components* of OTP's total compensation system, when OTP's
16 overall costs of total compensation and benefits are low and necessary. Mr.
17 Wasberg also explains why Mr. Smith's recommendation to reduce OTP's payroll
18 expense is inconsistent with OTP's demonstrated need to attract and retain qualified
19 employees in order to offer safe and reliable service.
- 20 • **Stuart D. Tommerdahl** addresses issues concerning OTP's CISone project raised in
21 the Direct Testimony of Mr. Smith and Midwest Large Energy Consumer Group
22 (MLEC) witness Ms. Kavita Maini. Mr. Tommerdahl also provides an update on the
23 CISone project and addresses issues concerning OTP's proposed Generation Cost
24 Recovery Rider (GCRR) noted in the Direct Testimony of Staff witness Dr. David E.
25 Dismukes, Ms. Maini, and Mr. Chriss. Mr. Tommerdahl also explains why negative
26 expense adjustments advocated by Mr. Smith are unreasonable and not supported by
27 the record. Finally, Mr. Tommerdahl also responds to MLEC witness Mr. Larry
28 Schedin's recommendations for service quality and reliability reporting.

¹ Hevert Rebuttal at 4

- 1 • **Bryce C. Haugen** explains why the Commission should not alter the way customers
2 receive the benefit of Production Tax Credits, as recommended by Ms. Maini. Mr.
3 Haugen describes why Mr. Schedin’s recommendation for additional regulatory
4 requirements for transmission projects and wind farm maintenance are unnecessary.
- 5 • **Tyler A. Akerman** describes adjustments to financial schedules and the revenue
6 deficiency for the 2018 Test Year and responds to certain positions raised in the
7 Direct Testimony of Mr. Smith and Ms. Maini. Mr. Akerman also explains why Mr.
8 Smith’s analysis does not support additional adjustments to 2018 Test Year payroll
9 expenses beyond the pension and benefit cost adjustments already made by OTP.
- 10 • **Gina S. Ice** responds to the Direct Testimony of Dr. Dismukes, Ms. Maini, Mr.
11 Schedin and Mr. Chriss. Ms. Ice explains why OTP’s proposed revenue allocation is
12 more reasonable than revenue allocations proposed by other parties. Ms. Ice also
13 explains why Dr. Dismukes’ observations regarding the OTP Class Cost of Service
14 Study (CCOSS) are not consistent with North Dakota’s prior practices or national
15 practice.
- 16 • **David G. Prazak** replies to the Direct Testimony of Dr. Dismukes, Ms. Maini, Mr.
17 Schedin and Mr. Chriss regarding rate design. Mr. Prazak explains that OTP’s rate
18 design, based on marginal costs, is consistent with North Dakota policy, prior cases,
19 and sound economic theory. Mr. Prazak also describes why the Commission should
20 not accept the rate design recommendations proposed by Dr. Dismukes, which are
21 inconsistent with North Dakota policy and unsupported by the record.
- 22 • **Amparo Nieto** responds to the Direct Testimony of Dr. Dismukes regarding OTP’s
23 Marginal Cost of Service Study. Ms. Nieto explains that Dr. Dismukes’s criticisms
24 are unfounded.

1 **II. REBUTTAL ISSUES**

2 **A. Customer Satisfaction and Rates**

3 Q. DID ANY PARTY DISPUTE YOUR DIRECT TESTIMONY THAT OTP HAS VERY
4 HIGH LEVELS OF CUSTOMER SATISFACTION?

5 A. No. No party disputed that OTP’s customers are highly satisfied with OTP’s service as
6 reflected in the American Customer Satisfaction Index, transaction surveys, and J.D.
7 Power’s study of electric utility residential customer satisfaction. Customer satisfaction
8 is a critical element of our mission and I am proud of how my coworkers have succeeded
9 in meeting and often exceeding our customers’ expectations.
10

11 Q. DID ANY PARTY DISPUTE YOUR DIRECT TESTIMONY COMPARING OTP’S
12 RATES WITH OTHER UTILITIES?

13 A. No. No party disputed that OTP’s overall average rates are substantially lower than
14 regional and national averages, despite the challenges OTP faces as a very small utility
15 serving customers in a very large, sparsely populated service territory. No party
16 challenged the fact Otter Tail Corporation (OTP’s parent company) was recently
17 recognized as the 4th lowest price provider among all utility parent companies
18 nationwide, with a blended rate for all customers of 8.16 cents/kWh. OTP has achieved
19 very high-quality service at very low rates despite being a very small investor-owned
20 utility serving an expansive rural service area.
21

22 Q. DID ANY PARTY RAISE CONCERNS ABOUT OTP’S INDUSTRIAL RATES?

23 Yes. Ms. Maini testified that OTP’s average industrial rates were higher than regional
24 and national averages. Ms. Maini also testified that OTP’s rates, averaged for all 18 rate
25 classes, are approximately 13 percent and 23 percent *lower* than the regional and national
26 averages respectively. She also noted that OTP’s residential rates are 25 percent and 31
27 percent *below* the regional and national averages respectively, and that OTP’s
28 commercial rates are 3.5 percent and 14.5 percent *lower* than the regional and national
29 averages, respectively.

1 Q. HOW IS OTP ADDRESSING INDUSTRIAL RATES?

2 A. We are taking a number of steps to address industrial rates. First, as discussed by Ms.
3 Ice, OTP recommends a revenue allocation that will move all customer classes closer to
4 their cost responsibilities. Our industrial classes are currently above cost, so our
5 recommendation results in those classes receiving a somewhat lower increase than the
6 overall increase proposed by OTP. This approach will allow the industrial customer
7 classes to appropriately share in the benefits of OTP's overall low rates, as do the other
8 customer classes. We have also agreed to Ms. Maini's recommendations regarding Large
9 General Service (LGS) rates. Mr. Prazak addresses this agreement in his Rebuttal
10 Testimony. These steps help to mitigate the concerns raised by Ms. Maini.

11 Second, we have developed specific, targeted rate proposals that are intended to
12 attract and retain large industrial loads. Mr. Tommerdahl and Mr. Prazak address these
13 proposals in their Rebuttal Testimonies.

14 Third, we continue to recommend the Commission approve funds intended to spur
15 economic development in North Dakota. These funds would assist the industrial
16 customers identified by Ms. Maini and OTP's customer population overall by furthering
17 job opportunities and fostering additional sales over which costs can be spread. Mr.
18 Tommerdahl provides additional discussion of OTP's economic development proposal.

19

20 **B. Capital Expenditures**

21 Q. DID YOU PROVIDE DIRECT TESTIMONY CONCERNING OTP'S EXPECTED
22 CAPITAL EXPENDITURES?

23 A. Yes. I testified that OTP is expecting to make significant capital expenditures in
24 generation and transmission facilities and in routine projects. Specifically, OTP expects
25 to invest an additional \$862 million between 2017 and 2021 at a total company level.

26

27 Q. WILL THE COMMISSION'S DECISION IN THIS CASE HAVE SIGNIFICANT
28 IMPACTS ON OTP'S COST OF CAPITAL NEEDED FOR THESE INVESTMENTS?

29 A. Yes. As I noted in my Direct Testimony and as explained by Mr. Moug in his Direct
30 Testimony, OTP will need access to significant levels of external debt and equity

1 financing and internally generated equity to complete these significant infrastructure
2 investments. The costs of this debt and equity financing will be directly affected by
3 investors' confidence in OTP and in OTP's regulatory environment.
4

5 Q. WOULD MR. ROTHSCHILD'S ROE RECOMMENDATIONS HAVE AN ADVERSE
6 EFFECT ON OTP AND ITS CUSTOMERS?

7 A. Yes, they would. Mr. Rothschild has recommended an extremely low 8.31 percent ROE.
8 As explained in the Rebuttal Testimonies of Mr. Moug and Mr. Hevert, this
9 recommendation is far below the Commission-approved ROE for other vertically
10 integrated electric utilities and far below the mainstream ROEs approved by other state
11 regulatory commissions. Adopting a ROE for OTP outside the mainstream, much less
12 the unprecedented ROE recommended by Mr. Rothchild, would cause OTP's cost of
13 capital to increase, ultimately harming OTP's customers. These consequences would be
14 amplified due to the substantial investment we are making in beneficial infrastructure.
15

16 Q. DO YOU HAVE OTHER CONCERNS REGARDING ROE?

17 A. Yes. I am concerned about the overall signal an unreasonable ROE would send when
18 OTP is performing so exceptionally. As I earlier mentioned, there is no dispute that OTP
19 has been consistent in keeping rates low while maintaining high customer satisfaction
20 levels. The inconsistency between OTP's demonstrated performance and a ROE below
21 the mainstream would signal a sea change in the North Dakota regulatory environment
22 with potential long-term adverse consequences for OTP and its North Dakota customers
23 and all customers receiving service from utilities regulated by the Commission. This
24 inconsistency would be especially problematic given OTP's \$862 million capital
25 expenditure plan to address necessary infrastructure in the next several years. Ultimately,
26 OTP's performance merits a ROE materially above the national average and above ROEs
27 approved for other utilities.

1 **C. Performance Based Compensation**

2 Q. DO YOU HAVE ANY REACTIONS TO MR. SMITH’S RECOMMENDATIONS AS
3 THEY PERTAIN TO THE COMPANY’S EXECUTIVE TEAM AND RELATED
4 INCENTIVE COMPENSATION EXPENSES?

5 A. Mr. Smith appears to be of the mindset that OTP’s Executive Team primarily serves
6 shareholders’ interests. That is not the case, and OTP’s performance in keeping rates low
7 and customers satisfied demonstrates that he is not correct. The OTP Executive Team
8 shares a strong public service focus and a commitment to our customers, employees and
9 the communities we serve. This is consistent with our mission, which is: “To produce
10 and deliver electricity as reliably, economically, and environmentally responsibly as
11 possible to the balanced benefit of customers, shareholders, and employees and to
12 improve the quality of life in the areas in which we do business.” To the extent that
13 Company management can minimize costs, improve processes and maximize
14 productivity as a result of our compensation program, shareholders and customers alike
15 share this benefit. They are not mutually exclusive.

16
17 Q. DOES INCENTIVE COMPENSATION PROMOTE THE INTEREST OF
18 SHAREHOLDERS OVER CUSTOMERS?

19 A. No. Mr. Wasberg’s Rebuttal Testimony provides more detailed explanation of the
20 advantages to customers of certain OTP employees having variable or “at risk”
21 compensation, both in terms of economic advantages and in helping with recruitment,
22 retention and motivation of talented employees. As to executives, I would add that
23 variable pay provides alignment and encourages me and my colleagues to pursue
24 organization-wide goals and common objectives, and it is a strong signal sent to me and
25 the other executives about the importance of the organization’s core values and its
26 objectives.

1 Q. DO YOU HAVE A REACTION TO THE VARIOUS DISALLOWANCES
2 SUGGESTED BY MR. SMITH REGARDING THE COMPANY'S INCENTIVE-
3 BASED COMPENSATION?

4 A. Yes. To disallow performance-based compensation, as has been proposed by Mr.
5 Smith, sends the message that pay-for-performance is not desired. There are significant
6 ramifications of such a message to consider. While regulators play a critical role in
7 reviewing the reasonable nature of costs incurred to provide service, competitive market
8 forces and the reasoned judgement of the utility's management should drive the mix of
9 overall reasonable compensation levels, including the mix of guaranteed and at-risk
10 compensation that will result in optimal levels of service to the organization's
11 stakeholders.

12 Logically, the refusal to allow cost recovery of performance-based compensation
13 would encourage a utility to move performance-based compensation into base salaries. If
14 the utility failed to do so (i.e. if the incentive compensation were removed without a
15 corresponding adjustment to base compensation), the overall compensation package
16 would not be competitive, and it would be inadequate to recruit and retain employees.
17 Furthermore, reducing incentive compensations levels and increasing base compensation
18 levels would also result in the removal of reasonable performance incentives which is not
19 in the best interest of customers. OTP's record of consistently low rates and superior
20 customer satisfaction demonstrates the benefits to customers that arise from OTP's
21 performance-based compensation plan. Instead, the Commission should assess OTP's
22 overall total cost of compensation and benefits, which Mr. Wasberg demonstrates are at
23 or lower than industry benchmarks and therefore should be approved.

24 **III. CONCLUSION**

25 Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

26 A. OTP has maintained low rates with high customer satisfaction levels despite being a very
27 small investor-owned utility serving small communities in an expansive rural service
28 area. The recommendations of Mr. Smith and Mr. Rothschild would send a negative
29 signal concerning the North Dakota regulatory environment and ultimately result in

1 negative consequences for our customers. Finally, OTP's total cost of compensation and
2 benefits for its employees and executives are reasonable and the incentive components in
3 the compensation and benefit plans support our efforts deliver electricity as reliably,
4 economically and environmentally responsibly as possible and to improve the quality of
5 life in the areas we serve.

6

7 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

8 A. Yes.