



Budget Documentation

Table of Contents

1. **O&M Executive Summary**
2. **O&M Budget Process**
 - Revenue Forecast
 - Fuel & Purchase Power Costs
 - Operating & Maintenance (O&M) Costs
 - i. Labor
 - ii. Non-Labor
3. **O&M Narratives by Business Area**
 - Instructions
 - Asset Management
 - Customer Service
 - Energy Supply
 - Finance/Other
 - Human Resources & Safety Services
 - Information Technology
 - Planning & Strategy
 - Public Relations
 - Regulatory Affairs and Compliance
 - Benefits
 - Corporate Services
 - Accounting Transactions Cost Center
4. **O&M Summary Reports**
5. **Capital Budget Process**



O&M Executive Summary

O&M Executive Summary

This Executive Summary provides an overview of how the components of the Otter Tail Power Company (OTP) Operations and Maintenance (O&M) budget were assembled to produce the 2018 fiscal year budget. The 2018 fiscal year budget provides the foundation for the 2018 Test Year cost of service. The information provided herein demonstrates that financial budget and forecast information surrounding O&M provides a fair and reasonable budget that can be relied on to set just and reasonable rates for OTP's North Dakota retail electric operations using a 2018 Test Year.

The 2018 O&M budget was developed using Utilities International (UI) software. This system allows us to accurately, and efficiently load data to build budgets and forecasts. OTP transitioned to the use of UI in 2013 to improve the accuracy and reduce the amount of time needed to produce forward looking financial statements. Previously OTP used Business Planning & Consolidation (BPC) for its budget process. OTP has almost five years of history using the UI system.

The following provides an overview of the information contained in the primary segments of OTP's O&M budget.

Budget Process. The information contained in this section of OTP's budget documentation describes the process involved in the revenue forecast, along with a description of budgeting for fuel and purchased power costs. The budget process used to develop an O&M expense budget for labor and non-labor costs is also described.

O&M Narratives by Business Area. This section of OTP's budget documentation contains a discussion of the functions and key activities performed by each OTP business area. It also provides analysis of changes between 2016 actual expenses and 2017 forecast expenses, and between 2017 forecast expenses and 2018 budget expenses.

To create this section of OTP's budget documentation, leadership within each business area created its own area-specific budget documentation. Each area received a set of similar instructions asking for a narrative surrounding O&M expense details and variance explanations. Each area is led by a Vice President that is responsible for its planning and operations. The business areas include:

- Asset Management – Business area that oversees the reliability and integrity of OTP's transmission and distribution system.
- Customer Service – Business area that ensures the delivery of safe and reliable electric service to OTP's customers as well as customer support services.
- Energy Supply – Business area that includes the operation and management of OTP's generating facilities.

- Finance/Legal and Strategic Sourcing – Business area that compiles the financial statements of OTP along with creating the budgets, forecasts, and cost of service studies. The “other” areas manage the Company’s legal risk and the public policy discourse with legislatures.
- Human Resources & Safety Services – Business area that oversees all matters relating to OTP’s employees including safety policies.
- Information Technology – Business area that oversees the maintenance and operations of the systems utilized by OTP, specifically, our customer billing system.
- Planning and Strategy – Business area that develops the resource plan, engages in the wholesale energy market, and is responsible for the strategic planning of OTP.
- Public Relations – Business area that facilitates open and timely communication with OTP’s customers, regulators, employees, and shareholders.
- Regulatory Affairs and Compliance – Business area that is responsible for rate recovery, pricing, and regulatory policy and compliance.
- Benefits – A Support area that contains lost time labor costs, pension costs, incentive costs, and worker’s compensations costs.
- Corporate Services – Business area that provides support to OTP through the Board of Directors, external financial reporting, Internal Audit, financial planning, and investor relations.
- Accounting Transactions Cost Center 0960- An Administrative tracking cost center for multiple overhead loading adjustments and accounting assignments that either support overall company operations or are not assigned elsewhere.

Summary Reports. The Summary Reports section of OTP’s budget documentation provides a high-level look at OTP’s O&M costs, comparing 2016 actuals to 2018 budget and 2017 forecast with 2018 budget by FERC Sub-Function, FERC Account, and Sub-Account.

- Summary Report 1a & 1b compares O&M expenses by FERC Sub-Function, including dollar and percentage variances.
- Summary Report 2a & 2b compares O&M expenses by FERC Account, including dollar and percentage variances.
- Summary Report 3a & 3b compares O&M expenses by FERC Sub-Account, including dollar and percentage variances.
- High level variance explanations for any difference greater than \$250,000 and 5 percent.



O&M Budget Process

This document discusses at a high level the process involved with budgeting for Revenue, Fuel and Purchased Power Costs, and Operating and Maintenance expenses.

Revenue Forecast Process

The process Otter Tail Power Company (OTP) undertakes to develop its Revenue Forecast on a quarterly basis. First the regulatory pricing area gathers the following revenue forecast factors as described below.

Forecasted Sales (kWh)

The Resource Planning department creates an energy sales forecast, in a software product called MetrixND. This forecast is generally for five years. The data is by month and rate group. It is entered directly into Utilities International (UI), OTP's budgeting and forecasting model. The process to develop the sales forecast is further described in Mr. Brian H. Draxten's Direct Testimony.

Current Retail Rates

Retail rates are generally taken from the current rate book. At times, it is necessary to combine rates for different rate schedules, as some rate groups contain multiple rate schedules.

Customer Counts

Customer counts are obtained from our Customer Information System (CIS) and forecasted for each year.

Estimated Demands (kW)

Demands are estimated from the Energy Forecasted Sales using an average ratio between demand and energy, and then multiplied by the energy for each month.

Estimated Ratcheted Demand (kW)

Ratcheted demands are estimated from the Energy Forecasted Sales using an average ratio between ratcheted demand and energy, and then multiplied by the energy for each month.

Energy Sales and Demand for Separately Forecasted Customers

The Resource Planning department provides the energy sales forecast for large customers. They are generally the largest OTP customers. The demand for these customers is based on their forecasted load factors or baseline demand. There are currently 16 accounts separately forecasted.

Then the revenue factors above are used to determine the following billing determinants: the energy charge, the demand charge, the customer charge, and the facilities charge. Customers'

bills may or may not be made up of all of these factors. These billing determinants are calculated in UI for each month of the forecast years, by rate group. Rate groups are then combined into the five customer classes used by Business Planning: Residential, Commercial, Industrial, Street lighting, and Other Public Authorities. The end result is forecasted revenues that are computed within UI and reported at both the state and system level.

Fuel & Purchased Power Costs

The process that OTP uses to budget its fuel and purchased power cost involves a number of different sources. The Resource Planning Department utilizes a software program from Ventyx Software called Strategist for the majority of the fuel budget calculations. Strategist uses the sales/load forecast data to determine the overall amount of energy that is needed to meet our customers' needs. Strategist computes an economic hourly dispatch of available resources to meet the needs of our load. The economic dispatch modeling takes into account existing bi-lateral purchases, company owned resources, and forecasted energy market prices to meet the forecasted requirements. The results of the economic dispatch modeling determines the amount of generation required from each resource and the associated cost of the fuel and/or purchased power needed to meet the forecasted load requirements.

Below is a more complete list of key Strategist inputs that determine the components of the fuel and purchased power budget.

1. Sales Forecast - The sales forecast is used as the basis in determining the system energy requirements. A typical monthly load shape is applied to the monthly energy requirements to determine the hourly energy requirements. For further detail on the sales forecast, please see Mr. Draxten's Direct Testimony.

2. Resources
 - a. Owned thermal unit operating characteristics and costs - Company owned thermal units are modeled based upon their operating characteristics and historical or projected costs. Below is a list of typical operating and cost inputs for each company owned resource:
 - i. Heat rate profiles
 - ii. Minimum/maximum capacity
 - iii. Variable Operating and Maintenance costs
 - iv. Fixed Operating and Maintenance costs

- v. Maintenance schedules at the generating facilities
 - vi. Forced outage rate
 - vii. Delivered fuel prices
- b. Bi-lateral contracts, wind energy (PPA and owned) characteristics and costs – Wind resources and bi-lateral contracts are modeled based upon their operating characteristics and contracted costs. Below is a list of typical operating and cost inputs for each resource.
- i. Contract term
 - ii. Nameplate capacity
 - iii. Annual energy
 - iv. Hourly patterns - Wind hourly patterns were developed based on actual historic generation for each wind resource.
 - v. Contract payment rate
- c. Market resources – In addition to the above resources, as a Midcontinent Independent System Operator (MISO) market participant, OTP schedules all generation and load into MISO's centralized energy market on a daily basis. Based on economic dispatch of generating resources determined by MISO, OTP load is served by the lowest cost generation resources available each day. OTP's modeling takes into consideration forecasted hourly market prices in the determination of the economic dispatch priority. Hourly market energy prices are developed using near-term and long-term forecasts. Forward market pricing forecasts are developed using Intercontinental Exchange (ICE) settlement values. The posted ICE values are forward, monthly prices as determined at the MISO Indiana Hub. Updated pricing is posted on ICE daily. Indiana Hub is the most liquid trading point in the MISO market and the ICE settlement values provide current forward pricing signals. OTP uses the Indiana Hub pricing as representative of the forward market as there is no pricing, or liquidity, available at the OTP load zone pricing node.

As noted above, the Strategist model uses the inputs obtained and computes an economic dispatch profile which then determines the amount of generation required from each resource and the associated cost of the fuel and/or purchased power needed to meet the forecasted load requirements.

To calculate the Fuel Clause Adjustment (FCA) forecast, OTP compiles data from several sources. The Resource Planning Department provides a generation forecast that includes monthly kWh generation by source as well as the associated costs of each source. The Resource Planning Department also provides the monthly kWh sales forecast. The Power Services Department provides a forecast that includes a monthly Marketing Book kWh amount as well as a monthly Marketing Book fuel and O & M expense as well as a monthly MISO Ancillary

Services Market forecast amount. These amounts are all combined on a monthly basis in the Fuel Clause forecast calculation and divided by the monthly kWh sales forecast to come up with a monthly FCA adjustment amount.

Operating & Maintenance Costs

Operating and Maintenance(O&M) Costs are made up of two key components, Labor and Non-labor costs. Below is a brief description on how each of these components is budgeted.

Labor Expenses

There are two types of costs that make up a Labor budget: productive time and lost time. Productive hours represent total hours less lost time. Lost time hours represent paid leave which includes vacation, sick, holiday, etc.

The labor pool for OTP is represented by individual employee by cost center with straight time hours for both full time and part time. Full time employees are allotted 173.33 hours each month or 2080 hours for a year. Part Time employees are entered based on prior history. Each cost center manager is able to view detailed employee information and make the appropriate changes for a budget year to each employee they oversee which may include lost time hours, retirements, and increase in pay rates.

The starting point for building a labor budget is the entering of prior year lost time hours into the budgeting system by the Business Planning Department. Each cost center manager must review and adjust the prior year's lost time as they may be aware that someone does not have any leave scheduled for the budgeted year when compared to the prior year. Lost time is converted to dollars simply by taking a specific employee's lost time hours times the current pay rate for that employee.

Productive labor is the entering of the prior year productive labor dollars into the budgeting system by account, sub-account, and FERC account by the Business Planning Department. An inflationary rate is then applied to the year of the budget being built. Adjustments are made to productive labor by each cost center manager once they have determined the amount of lost time hours for each employee as they are able to derive the number of productive hours based on the 2080 hours worked by a full-time employee. Utilities International then calculates a composite rate based on total employees' salaries for a specific cost center which is then applied to that cost center's budget for productive dollars. Each manager must review their total labor dollars to determine if they seem appropriate given their employees and the circumstances that they foresee.

OTP uses a labor loading rate applied to all raw labor. Once the raw labor dollars are allocated to each FERC account, the employee benefit payroll loadings are automatically added based on the calculated loading rate for each area.

Cost center managers also input the number of total hours estimated each month for overtime by cost center rather than individual employee depending on the type of projects that their area anticipates working on. Overtime hours are then converted to dollars by taking the composite rate for each cost center and multiplying it by a 1.5 factor. In addition to overtime, each cost center looks at their prior year history for premium pay to appropriately budget for the current year. Premium pay is assigned dollars rather than hours and is mainly given to employees that receive a step up in pay when the direct supervisor is not on duty.

Non-Labor Expenses

Non-Labor Budgets are developed for all cost centers by the appropriate managers on an annual basis. This process is completed during the second quarter of the year preceding the budgeted year.

The starting point for the development of the non-labor budget is prior year dollars. Prior year forecasted dollars are entered into the budgeting system by account, sub account, and FERC account by the Business Planning Department. An appropriate inflationary rate is then applied to the prior year forecasted dollars to come up with the cost center's total expense target. The targets are adjusted for known and measurable changes from the prior year such as plant outages, in addition to input from the Executive Management Team. The cost center targets are distributed to managers to give them a guideline to use while creating their non-labor budget. Each manager will review each account and determine if the amounts included in their budget are appropriate given the circumstances that they foresee in the budget year.

If the cost center has gone over its total cost center expense target, the manager needs to provide an explanation so that the Vice President of the area can review to determine if the overage is necessary. If the overage is determined to be unnecessary, the cost center manager will have to make the necessary changes in the Budgeting System and then formally repeat the approval process. If the overage is determined to be necessary by the Vice President, then a different cost center needs to absorb the difference and reduce its budget to stay within the target as a whole.



Budget Documentation

Instructions

The purpose of this section is to describe the major functions and key activities that each area is responsible for, to attest as to how these areas add value to our customers, and to provide explanations for items that have changed significantly from one time period to the next. Each of OTP's business areas were asked to prepare budget documentation using the outline discussed below.

Section I – Introduction and Customer Value

This section generally describes the organization (VP-level business unit), the unit's primary focus and the sub-areas included in the business unit.

This section also discusses the key priorities, strategic initiatives and elements of the business area and how they optimize direct benefit to the customer. Examples include productivity improvements, overall management of the generation plants, environmental initiatives, infrastructure modernization and new technologies, increasing capacity requirements, compliance with reliability standards, ensuring the safe delivery of our energy products, etc.

Section II – Major Cost Drivers

Show the business area's 2016 O&M actual costs and the major spend components in the form of a pie chart. Brief explanations of the major components are also to be provided. Then provide a walk-forward schedule of the business drivers and amounts that make up the majority of the increases and/or decreases in costs in the form of tables and bar graphs comparing the 2016 actuals to 2017 forecast and the 2017 forecast to 2018 budget. Essentially this process is walking us from the 2016 actual O&M's to how OTP arrives at the 2018 budgeted O&M's. The walk-forward tables are prepared on an activity-based perspective and include high-level explanations of the changes. Detailed explanations are provided for each major cost driver following the bar graph. Pie charts are also prepared as a graphic for the major components that make up both the 2017 forecast and the 2018 budget to aid in the walking forward from one time period to the next.

Section III – Functional Organization Chart

This section should include an organization chart that identifies all areas that fit within the organization entity being discussed by function.

Section IV – Major Business Functions and Key Activities

This section generally describes the overall responsibilities of each of the areas included in the functional organizational chart. In paragraph form, explain what each function is responsible for and use bullets to show each function's key activities.

Section V – Cost Allocation Methodologies

This section is applicable to business areas that manage costs in OTP that must be assigned to other utilities (such as jointly owned power plants or transmission facilities). All cost assignment or allocation methods used to distribute the business area's budget dollars between legal entities and utilities are shown here. This includes explanations of how each area's costs are assigned directly, or, if allocated, the allocation methodology used.

If not applicable, please write N/A.



2016-2018 O&M Budget Documentation

Asset Management

1.1 Introduction

Asset Management oversees all aspects (construction, operation and maintenance) of Otter Tail Power Company's (OTP's) transmission system, including all transmission lines and associated substation assets and operations. It is accountable for the quality, availability and delivery of materials and engineering associated with providing electric service to OTP customers down to the distribution level. The focus of Asset Management is to efficiently and effectively plan, construct, operate and maintain this system in compliance with all regulations and requirements, in a safe and responsible manner, and to best meet the reliability and energy needs of our customers and regions. The functional areas within Asset Management include Delivery Maintenance, Delivery Engineering, Delivery Planning, Project Management, System Operations Special Projects and Policy.

1.2 Customer Value

Asset Management provides customer value through the maintenance of the company's existing transmission and distribution assets, along with analysis and planning to add new assets when needed to enhance the system, and strategic business engagement in the areas of policy and planning.

Existing Assets: Includes operating, maintaining, restoring, and analyzing the performance of the many existing transmission and substation assets. This includes meeting reliability standards and compliance requirements that are focused on ensuring ongoing system reliability.

New Assets: Includes engineering, permitting and construction of large capital investment commitments and infrastructure modernization.

Strategic Operations: Includes planning for new and upgraded asset development, standards compliance management, business relations, contract management, influencing rules and standards development, regional planning, policy evolution, and facilitating execution and opportunity.

How the six departments within Asset Management carry out these responsibilities is described below.

Delivery Maintenance

Responsible for maintaining the existing assets and for the reliable operation of the system, Delivery Maintenance provides customer value in the following ways:

- Managing and extending the life of our aging assets: The ability to delay the purchase of major assets reduces the cost for the company which in turn benefits our customers by keeping our rates competitive.
- Improving reliability: A proactive approach to monitoring, inspections and testing improves reliability by reducing system interruptions.
- Maintaining power quality for our customers: Attention to power quality mitigates the risk of customer equipment malfunction, failure, and degradation.

Delivery Engineering

Responsible for the design of new assets for the company, Delivery Engineering provides customer value in the following ways:

- All transmission and distribution line designs in Delivery Engineering adhere to the National Electric Safety Code (NESC). The NESC contains the basic provisions that are considered necessary for the safety of employees and the public.
- Systems are designed to leverage the latest technology and contribute to the overall reliability of the electric system.
- Designs are made to minimize interruptions to the delivery of electricity to the greatest extent possible.
- Systems are designed such that the completed projects are cost-effective solutions to minimize the cost to customers.
- Projects are managed with a high level of scrutiny to facilitate completion on time and on budget.

Delivery Planning

The Delivery Planning department carries out several activities that result in direct customer value. These activities include:

- Identification of least cost transmission plans to meet reliability standards.
- Compliance with the North American Electric Reliability Corporation (NERC) reliability standards to minimize penalties arising from non-compliance.
- Optimization of transmission plans (i.e. conductor sizes, configurations, etc.) that result in reduced losses and/or enhanced reliability.
- Participation in regional stakeholder groups that define regional cost sharing criteria within the Midcontinent Independent System Operator, Inc. (MISO).
- Evaluating new interconnection requests to the OTP transmission and distribution system to ensure that the reliability of the overall delivery system is maintained.

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- Negotiation of transmission contracts to best position OTP from a financial perspective and minimize risk for the company.

Project Management

Accountable to route, permit, acquire land rights and manage the construction of transmission lines and substations, the Project Management group enhances customer value by cost effectively securing land and land rights and endeavoring to complete projects on time and on budget.

System Operations

Responsible for the operation and control of the electric system, System Operations has a direct impact on customer value in the following ways:

- System operations strictly adheres to operational and switching procedures designed for safe, reliable, and economic movement of power through, out of, within or into our balancing authority area.
- Safe and efficient power system restoration efforts minimize the duration of power outages to customers.
- Continuous engineering review of the system allows for continuous improvement of operational procedures as the system continues to evolve (upgrades and new additions) ensuring continued reliable and economic delivery of electricity.
- Load balancing, reconciling, and reporting ensure the accurate accounting of power within our balancing authority area.
- Providing accurate load forecast data enables the most economic real-time operations through proper planning of generation resource use.
- Continuous maintenance of our IT resources ensures high-availability of critical applications ensuring high reliability as real-time information is exchanged.
- Extensive training ensures that all personnel are properly trained to perform their functions and all rules and regulations are being followed minimizing the risk of non-compliance.

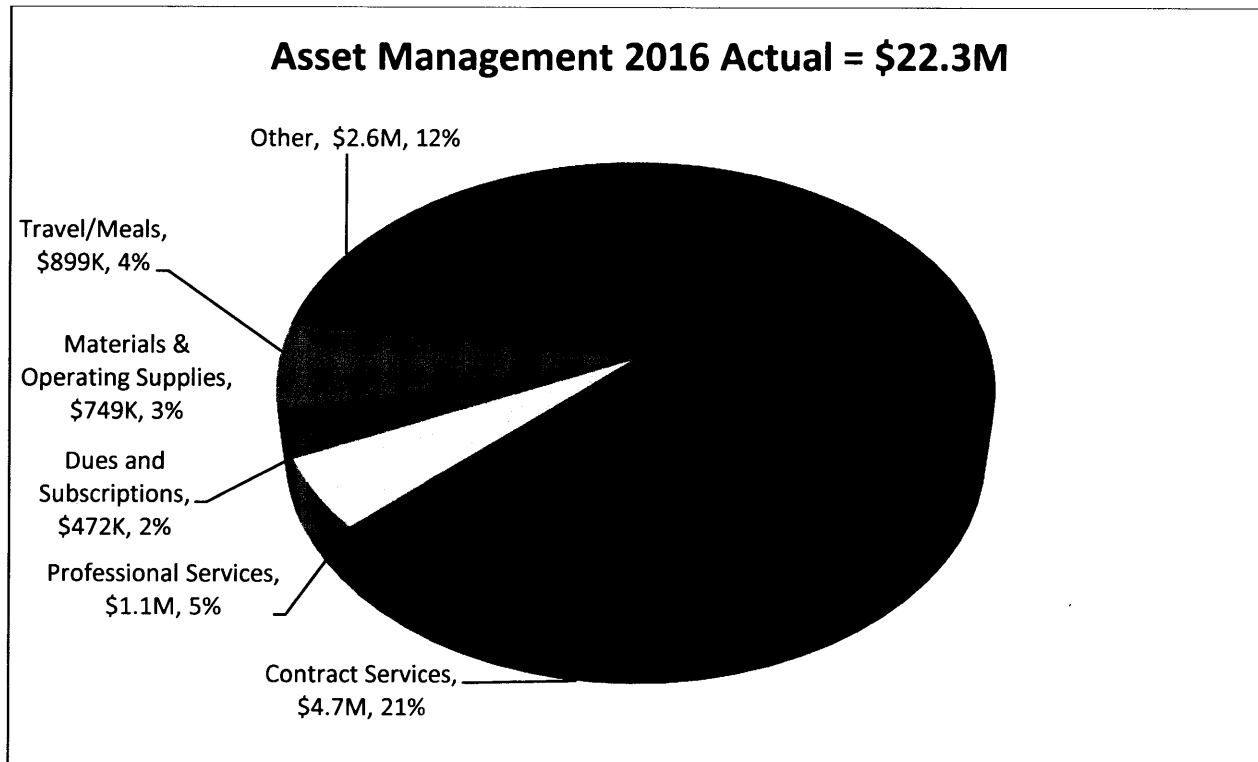
Policy

OTP actively engages in MISO and other stakeholder groups and at the Federal Energy Regulatory Commission on transmission policy and federal regulatory matters. With an increasingly diverse group of parties participating in the transmission policy discussions at all levels, the company continues to place a priority on maintaining a presence and a voice to ensure that customer interests are protected.

Special Projects

The Special Projects department is home to OTP's Computer-Aided Design & Geographic Information System Services (CAD & GIS Services). CAD & GIS Services maintains the database of geospatially located assets; largely transmission and distribution assets. It also provides oversight of OTP's Facilities, Construction and Survey team. This team is focused on the management of OTP's facilities (buildings and infrastructure) and the surveying and related services that support OTP field construction. Finally, Special Projects directs the Technology and Infrastructure Program. The Technology and Infrastructure Program sets and directs enterprise strategy related to development of technology to achieve improved reliability, improved customer satisfaction, and improved business efficiency.

2.1 2016 O&M Actuals



Labor: includes exempt, non-exempt, part-time and full-time employees within the Asset Management area.

Travel/Meals: employee travel related costs associated with operation and maintenance of equipment located in OTP's approximately 70,000 square mile service territory. This includes mileage, meals, lodging, fuel, airfare, other transportation expenses, and conference or training registrations

Dues and Subscriptions: includes industry memberships for the company and employees, subscriptions to industry publications, and training and other reference materials.

Materials and Operating Supplies: includes non-capitalized materials for maintenance and repairs incurred in operating transmission and distribution lines and substation equipment, right-of-way, and hardware, equipment and tools less than \$1,000.

Professional Services: includes external legal expenses and outside engineering services.

Contract Services: includes expenses related to work performed by contractors, such as vegetation management and snow removal.

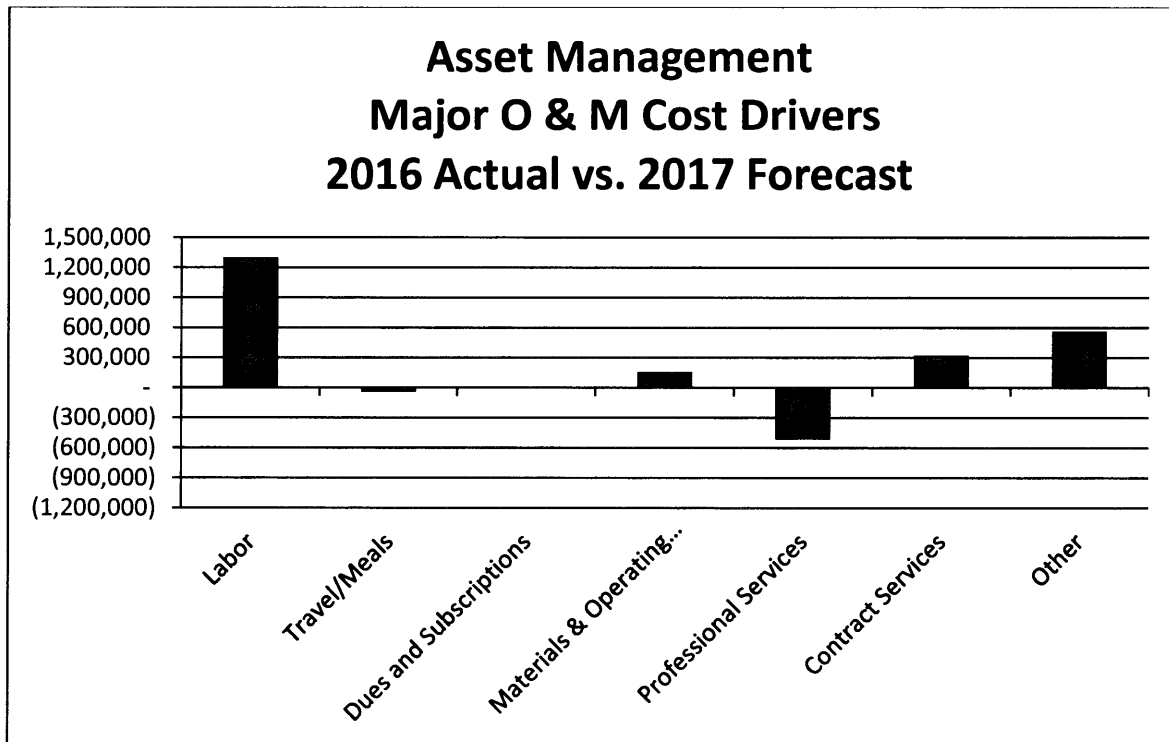
Other: includes MISO Tariff Schedule 11 expense, telephone and communications, lease and rental, office expenses, miscellaneous expenses, and employee benefits.

2.2 2016 O&M Actuals vs 2017 O&M Forecast

Asset Management
2016 Walk forward of Major Cost Drivers

2016 O&M Actuals	\$22,320,464
Labor	1,299,489
Travel/Meals	(44,816)
Dues and Subscriptions	(10,248)
Materials & Operating Supplies	156,820
Professional Services	(514,933)
Contract Services	323,966
Other ⁽¹⁾	568,732
2017 O&M Forecast	<u><u>\$24,099,475</u></u>

(1) Other - includes office expenses, telephone/communication, MISO Schedule expenses, lease/rental expenses, miscellaneous advertising expenses, employee benefits, and other miscellaneous expenses.



Explanations for the major cost drivers for 2016 Actual versus 2017 Forecast:

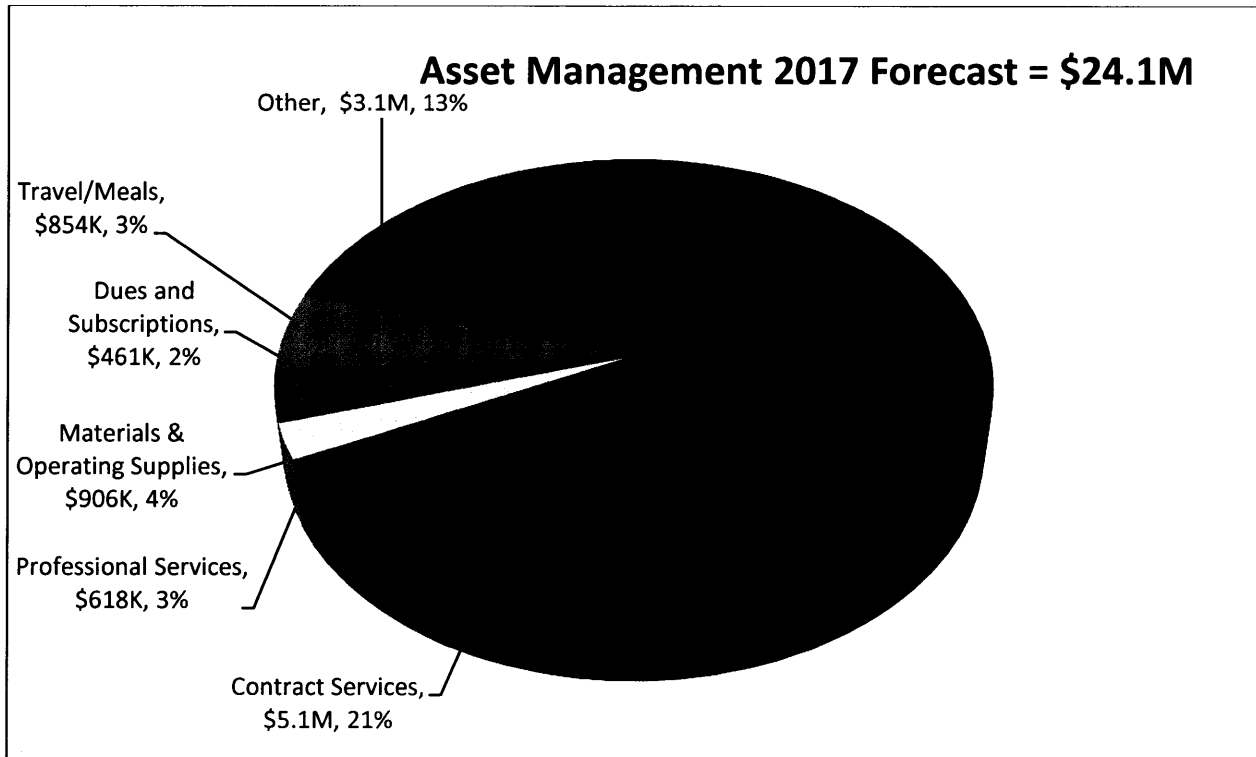
Labor: Labor increases in 2017 were related to a 3% percent annual wage increase, and differences in staffing levels in 2016 and 2017. The differences in staffing from 2016 were primarily the transfer of the Special Projects Department to Asset Management in 2017 and the addition of staff for the Big Stone South to Ellendale project. In addition, there was a decrease in the amount of labor transferred to capital projects from 2016 to 2017, resulting in increased labor O&M.

Materials and Operating Supplies: Increase was due to inventory correction in 2017.

Professional Services: Significant dollars were spent in 2016 resolving issues along the MISO/SPP seam. Most of the issues were resolved in 2017 resulting in a large reduction year over year.

Contract Services: To make-up for reductions to the vegetation management program in 2015, the deferred vegetation work is being spread out over successive years .

Other: Significant increases in tariff expenses in both SPP and MISO are noted. The increases are due to shifting load from Schedule 7 to Schedule 9, as well as a large true-up in 2017 for under-reported load in 2016.



Labor: includes exempt, non-exempt, part-time and full-time employees within the Asset Management area.

Travel/Meals: employee travel related costs associated with operation and maintenance of equipment located in OTP's approximately 70,000 square mile service territory. This includes mileage, meals, lodging, fuel, airfare, other transportation expenses, and conference or training registrations.

Dues and Subscriptions: includes industry memberships for the company and employees, subscriptions to industry publications, and training and other reference materials.

Materials and Operating Supplies: includes non-capitalized materials for maintenance and repairs incurred in operating transmission and distribution lines and substation equipment, right-of-way, and hardware, equipment and tools less than \$1,000.

Professional Services: includes external legal expenses and outside engineering services.

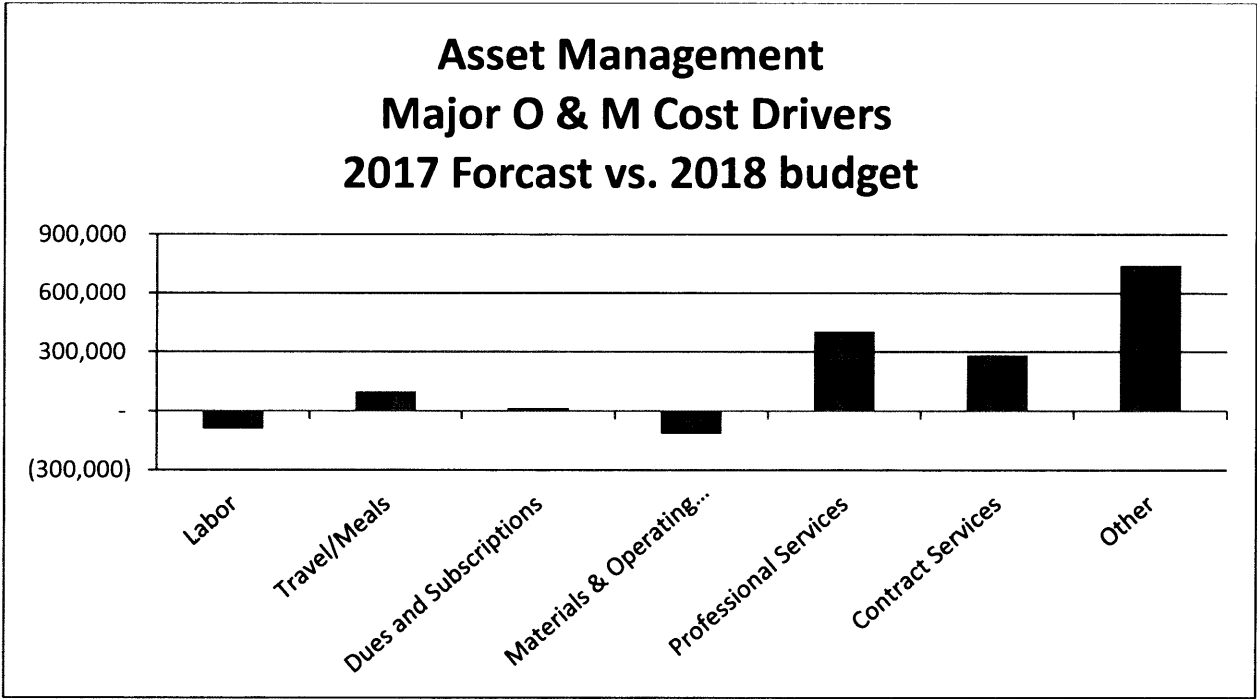
Contract Services: includes expenses related to work performed by a contractor such as vegetation management and snow removal.

Other: includes MISO Tariff Schedule 11 expense, telephone and communications, lease and rental, office expenses, miscellaneous expenses, and employee benefits.

2.3 2017 O&M Forecast vs 2018 O&M Budget

Asset Management
2017 Walk forward of Major Cost Drivers

2017 O&M Forecast	\$24,099,475
Labor	(90,833)
Travel/Meals	99,401
Dues and Subscriptions	15,015
Materials & Operating Supplies	(116,079)
Professional Services	406,050
Contract Services	284,949
Other (1)	746,012
2018 O&M Budget	<u><u>\$25,443,991</u></u>



Explanations for the major cost drivers for 2017 Forecast versus 2018 Budget:

Labor: Base productive and non-productive labor costs include a 3% merit increase for both union and non-union employees offset by staff shifting from work on capital projects to O&M projects like AMI and TIP that will initially be expensed.

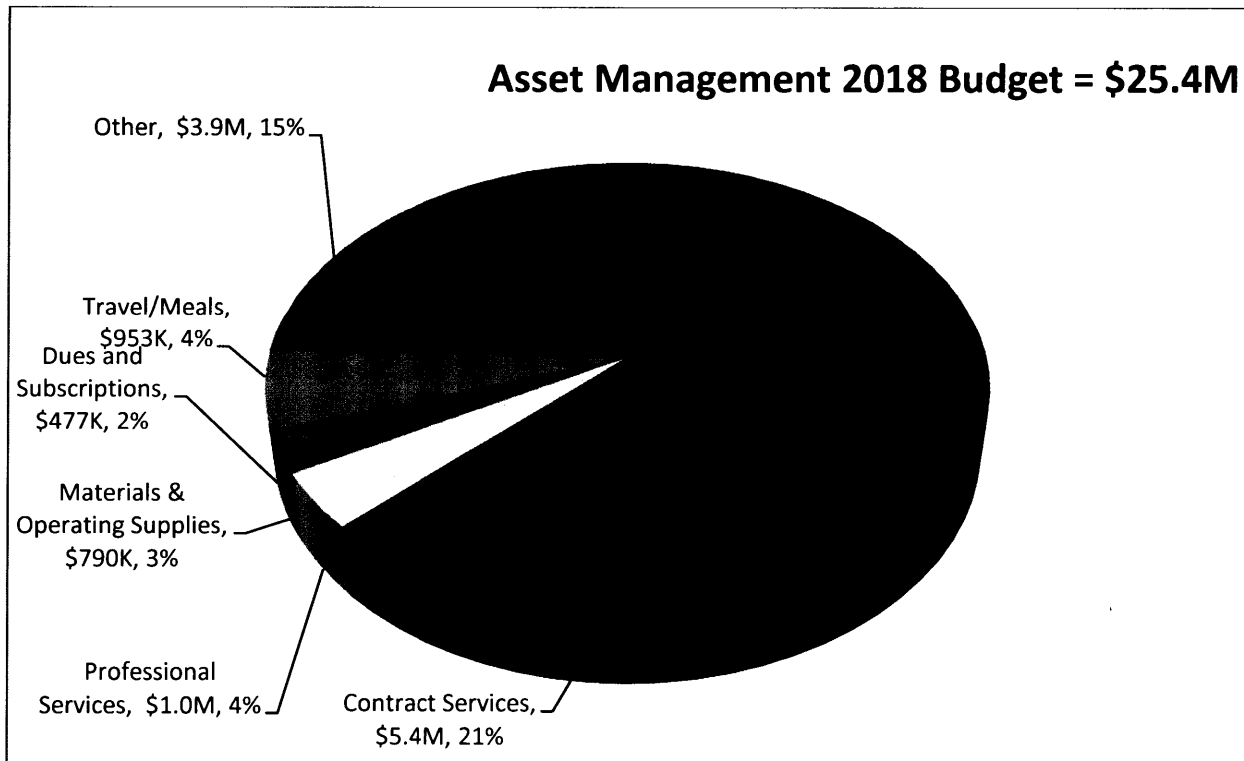
MISO Schedules 7, 8, 9 Revenue Sharing Agreement – Delivery Planning authorizes a monthly payment to other zonal parties based on a Revenue Sharing Agreement in place between the zonal parties as a result of MISO revenues that are received within the OTP Pricing Zone. These monthly payments are approximately \$30,000 to the zonal parties and vary each month.

Materials and Operating Supplies: 2017 represented an anomalous spike in Materials and Operating Supplies due to an inventory correction in 2017.

Professional Services: The 2018 budget reflects TIP related expenses including AMI procurement, FIS/WMS/AMS procurement, and Outage Management Strategy.

Contract services: To make-up for reductions to the vegetation management program in 2015, the deferred vegetation work is being spread out over successive years. Other increases were related to enhanced inspection and maintenance programs to improve reliability.

Other: Primary increase is due to SPP and MISO tariff expense increases largely due to increasing service taken from SPP.



Labor: includes exempt, non-exempt, part-time and full time employees within the Asset Management area.

Travel/Meals: employee travel related costs associated with operation and maintenance of equipment located in OTP's approximately 70,000 square mile service territory. This includes mileage, meals, lodging, fuel, airfare, other transportation expenses, and conference or training registrations. Also includes safety glasses and safety shoes.

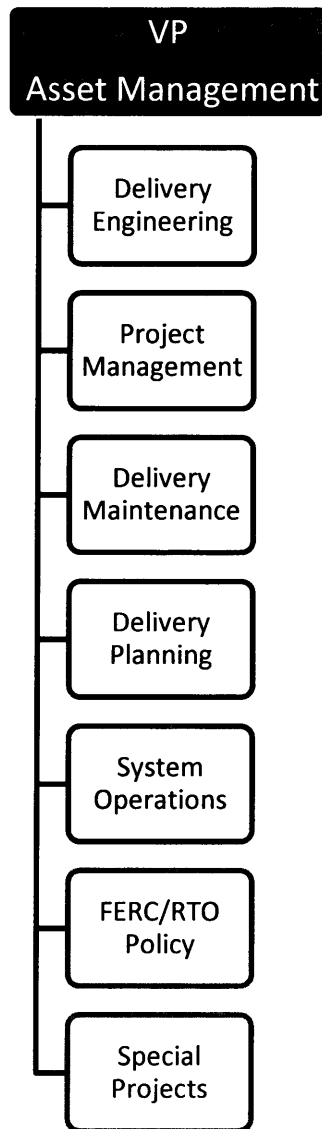
Dues and Subscriptions: includes industry memberships for the company and employees, subscriptions to industry publications, and training and other reference materials.

Materials and Operating Supplies: includes non-capitalized materials for maintenance and repairs incurred in operating transmission and distribution lines and substation equipment, right-of-way, and hardware, equipment and tools less than \$1,000.

Professional Services: includes external legal expenses and outside engineering services.

Contract Services: includes expenses related to work performed by a contractor such as vegetation management and snow removal.

Other: includes MISO Tariff Schedule 11 expense, telephone and communications, lease and rental, office expenses, miscellaneous expenses, and employee benefits.



Delivery Maintenance

Major Functions

The primary areas of responsibility of the Delivery Maintenance group are reliability, maintenance of transmission lines and substations, repair of a variety of substation assets, power quality and stray voltage testing and mitigation. The integrity of OTP's entire transmission and distribution system is directly related to interruption frequency. Delivery Maintenance works to minimize the system interruptions and improve reliability.

In addition, the Delivery Maintenance department is also responsible for Central Stores. Central Stores is OTP's hub for large and frequently used equipment. They house, deliver and distribute

equipment to support Maintenance and Capital projects throughout the 70,000-sq. mile territory. They strive to have adequate material on hand, with timely delivery to the jobsite to support and maintain a reliable electrical system.

Key Activities

- Proactive efforts to communicate, investigate, and resolve reliability issues across our system
- Inform replacement decisions, programs have been developed to monitor, inspect, and test equipment to identify assets that are not performing
- Implement preventative maintenance programs and replacement programs to prolong the lives of our assets
- Recommend and implement inventory levels that provide timely material delivery and do not impede OTP's construction of projects
- Develop vendor alliances when the total cost to OTP can be reduced
- Manage internal Customer Relations and minimize to the extent possible inventory levels and cost

Major Functions

Delivery Engineering

Major Functions

Delivery Engineering designs systems to deliver energy from the output of generation, through transmission, and ultimately distribution to the end use customer. This group also performs the construction of the designs produced by the System Protection group and Substation Civil Engineers.

Key Activities

- Transmission Engineering designs lines on the 41.6, 69, 115, 230 and 345 kilovolt (kV) levels
- Area Engineering designs overhead and underground lines below 41.6 kV and manages the annual capital budget within their respective areas
- System Protection is responsible for the protective devices and controls found within our substations, both distribution and transmission and performs the routine maintenance on the protective devices
- Substation Civil is responsible for site grading, foundations, ground grid, steel and wood structures that make up the physical aspects of our substations, both distribution and transmission.

Delivery Planning

Major Functions

The Delivery Planning department within OTP is responsible for the development of long range transmission plans and strategic transmission projects, evaluating various types of interconnection requests to OTP's transmission and distribution system and the administration and negotiation of all transmission related contracts.

Key Activities

- Perform transmission studies to develop long range transmission plans necessary for OTP to provide safe, reliable energy in the most economical manner
- Monitor transmission studies performed by neighboring utilities and/or regional transmission organizations to ensure that performance of the OTP transmission system complies with all applicable reliability standards
- Develop business cases to support the development of least-cost transmission projects
- Provide engineering expertise to support regulatory filings as they are related to transmission projects, rate cases, or other policy goals of OTP
- Participate actively in state and regional transmission planning activities and represent OTP on key industry stakeholder groups as it relates to transmission planning
- Evaluate third party interconnection requests to OTP's transmission system that result in safe and reliable interconnections to OTP's transmission that adhere to applicable reliability standards
- Process third party generation interconnection requests to OTP's distribution system to facilitate safe and reliable interconnections to OTP's distribution system
- Manage several different transmission contracts and assist in the negotiation of new contracts involving transmission, including integrated transmission agreements, generation interconnections and other transmission-related agreements.

Project Management

Major Functions

OTP's Project Management group (also includes the Land Rights and Permitting department) is accountable to route, permit, acquire land rights and manage the construction of transmission lines and substations. OTP established the Project Management department in 2008. The acquisition of land rights includes the sale and lease of real property and real property rights for the company.

Key Activities

- Manage transmission and large substation projects
- Lead the major permitting efforts, such as state route permits and federal and state Environmental Impact Statements

- Lead minor permitting efforts, including road crossings, U.S. Fish and Wildlife permits, rail road crossing permits and state and county permits.

System Operations

Major Functions

The System Operations department is responsible for the reliable and safe operation of the company's electric transmission system and neighboring systems by administering the movement of power through, out of, within or into our balancing authority area while maintaining transmission voltages on transmission facilities within acceptable limits. The department is responsible for developing and implementing real-time operational procedures and switching procedures for all existing facilities and new system facilities as they are added.

The System Operations department also is responsible for Energy Management and Control (EM&C). EM&C operates an accurate metering system for all customer classes and interchanges of energy between utilities on the bulk electric system.

Key Activities

- Oversee the operation and control of electric system generation dispatch, transmission coordination, interconnected operations and interchange functions
- Manage emergency preparedness and oversee and direct power system restoration efforts and coordination such activities
- Evaluate, initiate, and maintain operational and switching procedures that assist the Power System Operators to safely and efficiently perform their accountabilities
- Perform engineering studies and analysis to provide guidance for reliable and economic operation of the transmission system
- Manage the IT support resources and core applications for system operations ensuring high-availability of critical real-time applications
- Perform hourly, daily, and monthly verifications of balancing area meter readings, reconcile this data, and report this info to the regional transmission operator
- Provide load forecast data and performs analysis to resolve errors and inconsistencies with market participants within our load balancing area
- Provide training to ensure compliance with the rules and regulations that govern the safe, reliable operation of the electric transmission system
- Oversee the installation and testing of all energy meters
- Provide for the timely delivery of energy metering information
- Operate a Reliable Radio Load Management System (RLM) and annually assess receivability and controllability
- Verify the RLM system is monitored and maintained for efficient and reliable performance

Policy

Major Functions

The Policy department directs and manages the company's FERC regulatory policy program and is responsible for the development of the company's strategic direction on FERC and MISO transmission policy and federal regulatory matters. The objective is to ensure that customer interests are protected. In response to FERC Order 1000, for example, the company has been engaged in stakeholder groups addressing the impacts on regional planning, project selection methodology, rule-making and cost allocation development.

Key Activities

- Identify, monitor and analyze impacts and inform others on major FERC initiatives
- Represent the company and lead interactions with FERC, MISO, EEI and the states on transmission policy and federal regulatory matters
- Manage FERC regulatory filings

Special Projects

The Special Projects department is home to OTP's Computer-Aided Design & Geographic Information System Services (CAD & GIS Services); also provides oversight of OTP's Facilities, Construction and Survey team which is focused on the management of OTP's facilities (buildings and infrastructure), surveying and related services that support OTP field construction; directs the Technology and Infrastructure Program.

Key Activities

- Accurately document and map information related to company transmission and distribution assets
- Implement a rigorous system to provide timely, accurate and ongoing updates
- Provide timely and accurate mapping and other informational services for those maintaining, tracking, or building OTP facilities
- Administer company's One-call processes
- Develop relationships to various data sets within the company to aid in better decision making throughout the business
- Maintain buildings and grounds in good condition
- Provide timely, quality service to maximize cleanliness and comfort
- Minimize safety issues or hazards
- Provide survey services that are timely and accurate
- Maintain excellent landowner relations

- Focuses on the customers and employees
- Identify gaps between current business functions and desired or common market functions. Developing technology roadmaps.
- Coordinate related technology developments across the enterprise to reduce overlap/redundancy and gain efficiency
- Execute on technology implementations identified to achieve the vision and business goals within the initiative.



2016-2018 O&M Budget Documentation

Customer Service

1.1 Introduction

Otter Tail Power Company's (OTP's) Customer Service organization provides for the safe and reliable delivery of electric service as well as customer support services to 130,000 customers in Minnesota, North Dakota and South Dakota. This area is responsible for providing high quality customer service in the areas of field and operational support, frontline office personnel and vehicle fleet services. The major areas within customer service consist of: Customer Service-Field Operations, Customer Care and Relations, and Sales, Implementation and Operational Support. Each area is described in more detail below.

1.2 Customer Value

Customer Service-Field Operations

The Customer Service-Field Operations department consists of field service representatives, lineman and management responsible for delivering safe and reliable electric service to our customers. Customer value is provided by effective and efficient maintenance and investment in the transmission and distribution system for the purpose of adding capacity, improving reliability and replacing assets as necessary to maintain optimal system performance. Customer Service-Field Operations budgets for electric system asset replacement and maintenance programs in order to meet the objective of providing safe and reliable electric service. Customer Service-Field Operations also provides value to our customers by promoting electric technology options and safe and efficient use of electric service.

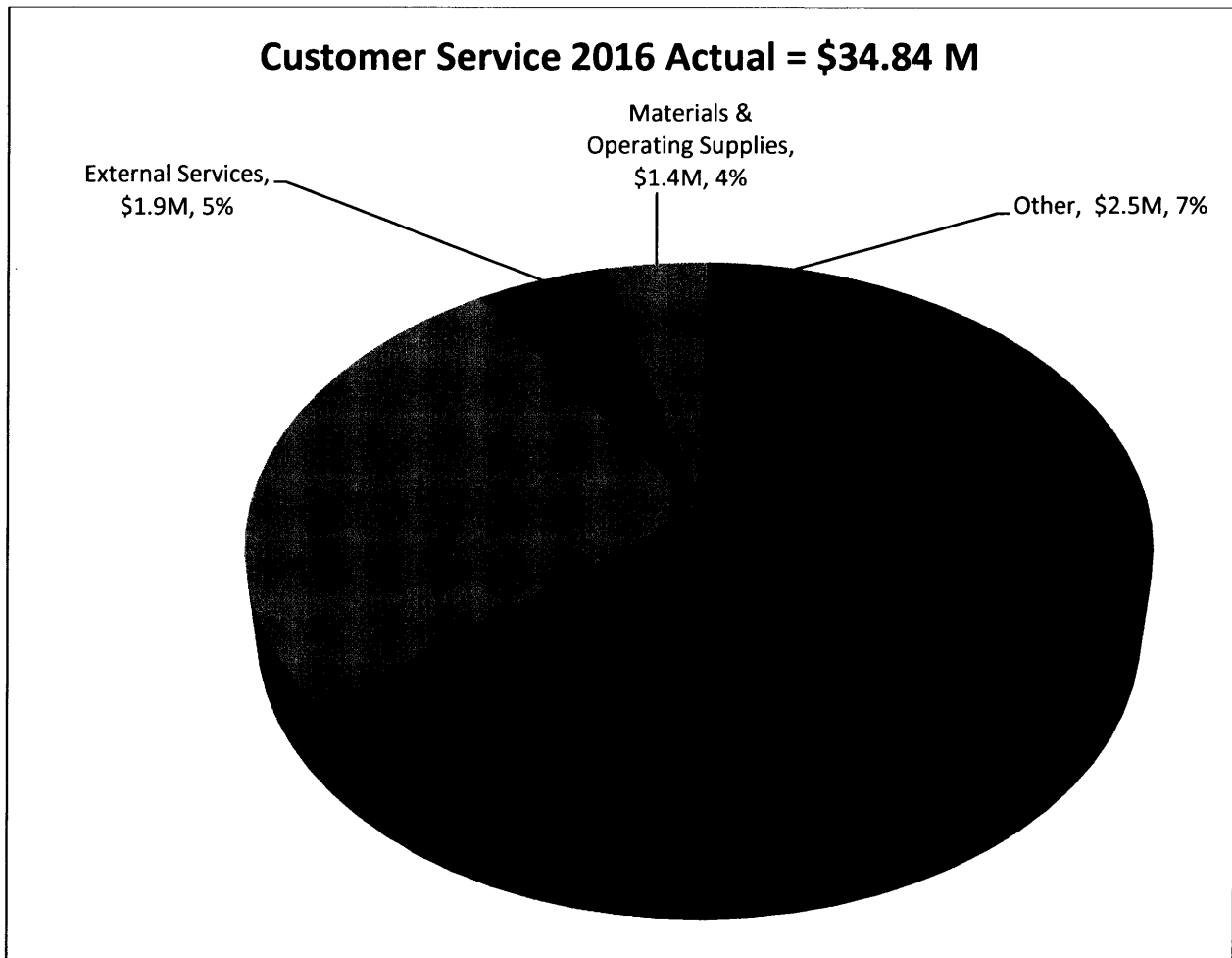
Customer Care and Relations

The Customer Care and Relations department operates our virtual call center, billing, credit and collections, service order processing, overall customer account management, customer service plan design and development, operational audit review support, Customer Idea Center support, quality assurance and training, and administrative support. Within our three jurisdictions, all Customer Service Representatives (CSRs) and Customer Service Managers (CSMs) are trained to handle requests, through our virtual call center, from customers residing in OTP's three state jurisdictions. CSRs and CSMs are responsible for delivering an aligned, consistent, and high-quality response to customer requests and act as an energy advisor to customers with questions about electric service. The employees within Customer Care and Relations are aligned and engaged in an effort to ensure a high-quality customer experience and optimal business results. The Customer Care and Relations department provides customer value by continually improving the customer experience provided to OTP customers.

Sales, Implementation and Operations Support

The Sales, department is responsible for offering 1) residential, commercial and industrial customers energy management services related to electrical system, such as proven energy efficient technology options, rate information and analysis, rate selection, renewable energy, and onsite generation; 2) promoting energy efficiency programs to meet customers' goals and needs, and; 3) providing analysis and assistance to customers regarding new and expanding load opportunities. Expertise is offered in electric technologies including, but not limited to, heating and cooling technologies, water heating, electricity conservation, indoor and outdoor lighting, electric motors, and commercial refrigeration. In addition, this department serves as the single point of contact for both new and prospective customers, The Operations Support team provides support to company field operations and efficiently manages transportation needs across the company along with providing support to ensure employees are adequately equipped with the appropriate vehicles and equipment to efficiently complete construction and operations and maintenance projects in a safe and timely manner.

2.1 2016 O&M Actuals



Labor: Labor is made up of exempt, non-exempt, part time and full time, and non-union and union employees necessary to perform the key activities that fall within the responsibilities of the Customer Service organization.

Travel: The majority of the travel related costs consist of utilization of company-owned vehicles and personal mileage reimbursements for travel within OTP's approximately 70,000 square mile service territory. Also included in the travel expense category is fleet loading. Fleet loading is used to clear all costs associated with OTP's Fleet Service Center. Fleet loading is a systematic and consistent way to allocate the cost of using company vehicles associated with having a Fleet. Field service representatives and linemen are assigned service trucks and other vehicles for the purpose of operation, maintenance and capital work associated with safe and reliable delivery of electricity to our customers. The majority of the service representatives have an assigned area that averages 600 plus square miles. In addition, managers and supervisors in the department have responsibility for employees in multiple communities across the service territory. Travel is necessary for the day to day supervision and management of employees. Similarly, commercial

and industrial customer representatives have responsibility for customers across the service territory. In all cases and because our service territory is so widely dispersed, it is not uncommon for employees to travel several hundred miles in a day to supervise employees or meet with customers. All employees also participate in company sponsored meetings and training.

External Services: Customer Service uses outside contractors to perform work in the following areas: reading meters, after-hours answering services, installation of underground facilities, online customer service, snow removal, lawn care and cleaning services.

Materials and Operating Supplies: Materials and operating supplies consists of purchases of tools, non-capitalized equipment and office furniture, maintenance of tools, equipment and office furniture, non-capitalized material necessary for maintaining the transmission and distribution system, safety equipment and supplies.

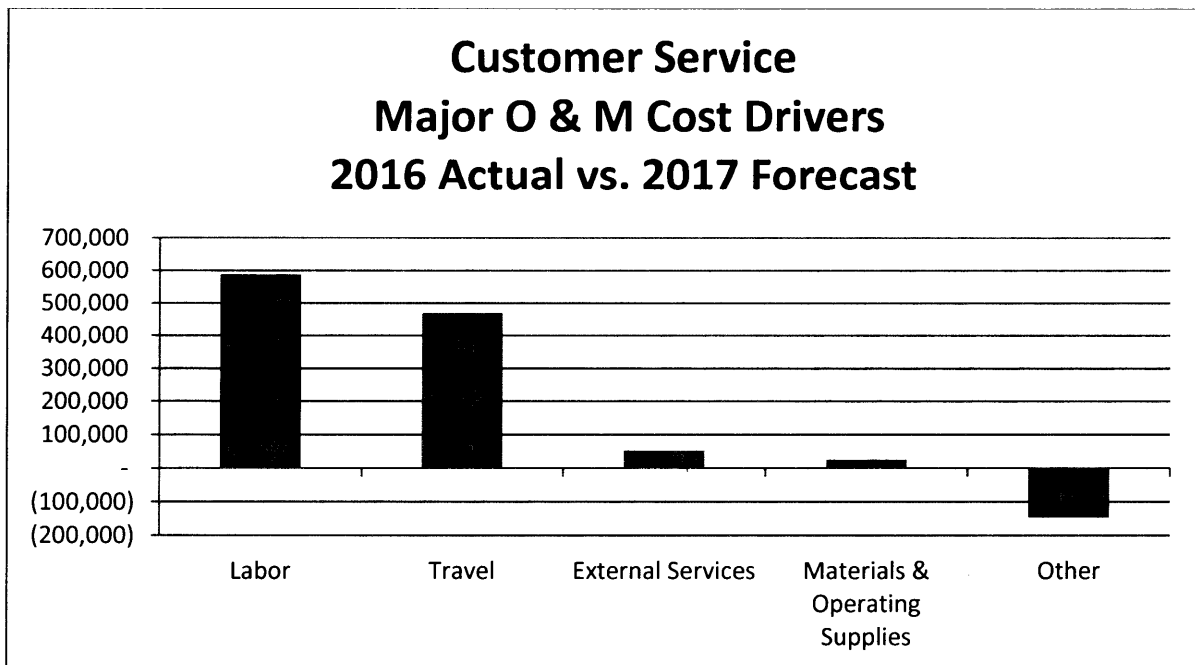
Other: The costs included in the other expenses category consist of employee expenses, dues, subscriptions and books, communication expense (landline and cell phones); miscellaneous office expenses, advertising, promotional expenses, demand side management rebates, maintenance expense for company buildings under the responsibility of customer service, lease/rental expense, insurance and other miscellaneous employee expenses.

2.2 2016 O&M Actuals vs 2017 O&M Forecast

Customer Service
2016 Walk forward of Major Cost Drivers

2016 O&M Actuals	\$ 34,839,987
Labor	588,176
Travel	470,832
External Services	53,085
Materials & Operating Supplies	26,395
Other ⁽¹⁾	(147,527)
2017 O&M Forecast	<u><u>\$ 35,830,948</u></u>

(1) Other - includes employee expenses, dues, books and subscriptions, telephone/communication, miscellaneous office expenses, building and grounds, lease/rental, insurance, advertising, promotional material, demand side management rebates and miscellaneous expenses.

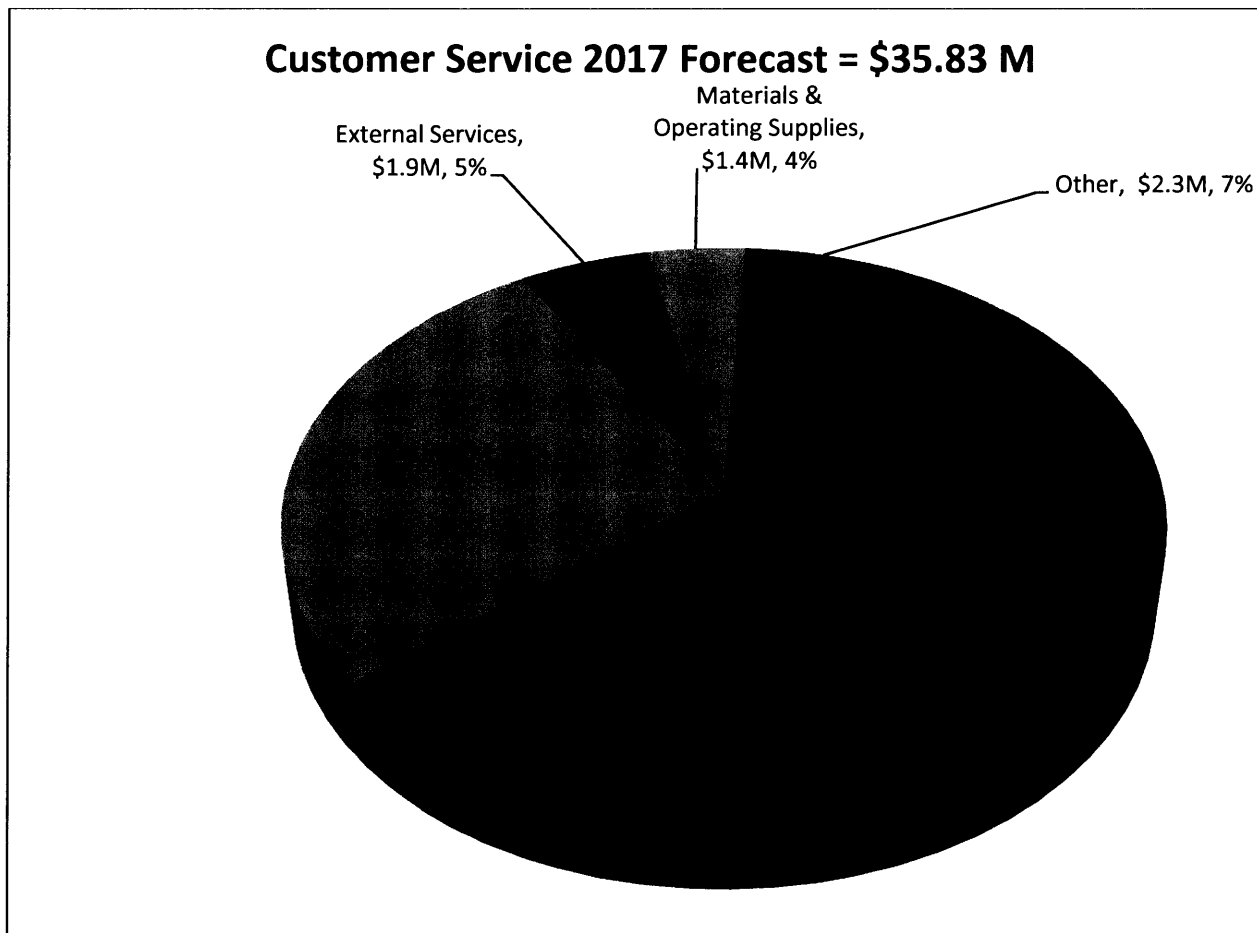


Explanations for the major cost drivers for 2016 Actual versus 2017 Forecast:

Labor: The 2016 actual to 2017 forecast increase in labor costs is related to the annual wage increase of approximately three percent. ($\$19.7 \text{ million} \times .03 = \$591,000$)

Travel: The increase in O&M travel expenses is related in part to anticipated increases in fuel costs in 2017 after relatively low fuel costs in 2016.

Other: The decrease is mostly attributable a one time expense in 2016 that does not repeat in 2017 and beyond.



Labor: Labor is made up of exempt, non-exempt, part time and full time, and non-union and union employees necessary to perform the key activities that fall within the responsibilities of the Customer Service organization.

Travel: Most of the travel related costs consist of utilization of company-owned vehicles and personal mileage reimbursements for travel within OTP's approximately 70,000 square mile service territory. Also included in the travel expense category is fleet loading. Fleet loading is used to clear all costs associated with OTP's Fleet Service Center. Fleet loading is a systematic and consistent way to allocate the cost of using company vehicles associated with having a Fleet. Field service representatives and linemen are assigned service trucks and other vehicles for the purpose of operation, maintenance and capital work associated with safe and reliable delivery of electricity to our customers. The majority of the service representatives have an assigned area that averages 600 plus square miles. In addition, managers and supervisors in the department have responsibility for employees in multiple communities across the service territory. Travel is necessary for the day to day supervision and management of employees. Similarly, commercial and industrial customer representatives have responsibility for customers across the service territory. In all cases and because our service territory is so widely dispersed, it is not uncommon for employees to travel several hundred miles in a day to supervise employees or

meet with customers. All employees also participate in company sponsored meetings and training.

External Services: Customer Service uses outside contractors to perform work in the following areas: reading meters, after-hours answering services, installation of underground facilities, online customer service, snow removal, lawn care and cleaning services.

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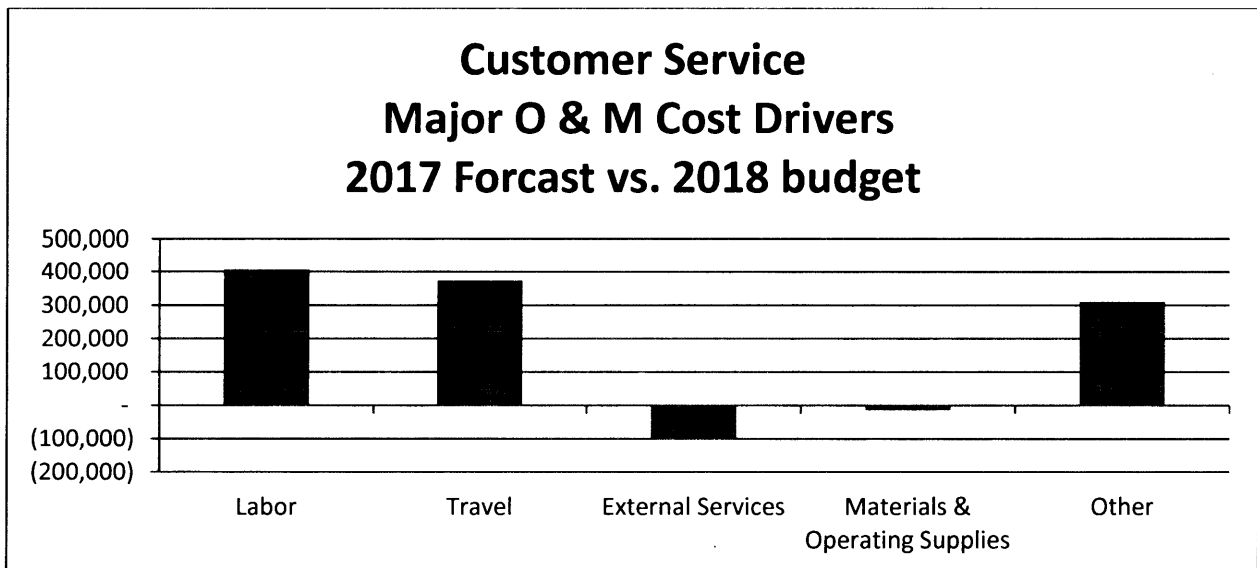
Other: The costs included in the other expenses category consist of employee expenses, dues, subscriptions and books, communication expense (landline and cell phones); miscellaneous office expenses, advertising, promotional expenses, demand side management rebates, maintenance expense for company buildings under the responsibility of customer service, lease/rental expense, insurance and other miscellaneous employee expenses.

2.3 2017 O&M Forecast vs 2018 O&M Budget

Customer Service
2017 Walk forward of Major Cost Drivers

2017 O&M Forecast	\$ 35,830,948
Labor	407,716
Travel	373,650
External Services	(94,711)
Materials & Operating Supplies	(14,785)
Other ⁽¹⁾	311,057
2018 O&M Budget	<u><u>\$ 36,813,874</u></u>

(1) Other - includes employee expenses, dues, books and subscriptions, telephone/communication, miscellaneous office expenses, building and grounds, lease/rental, insurance, advertising, promotional material, demand side management

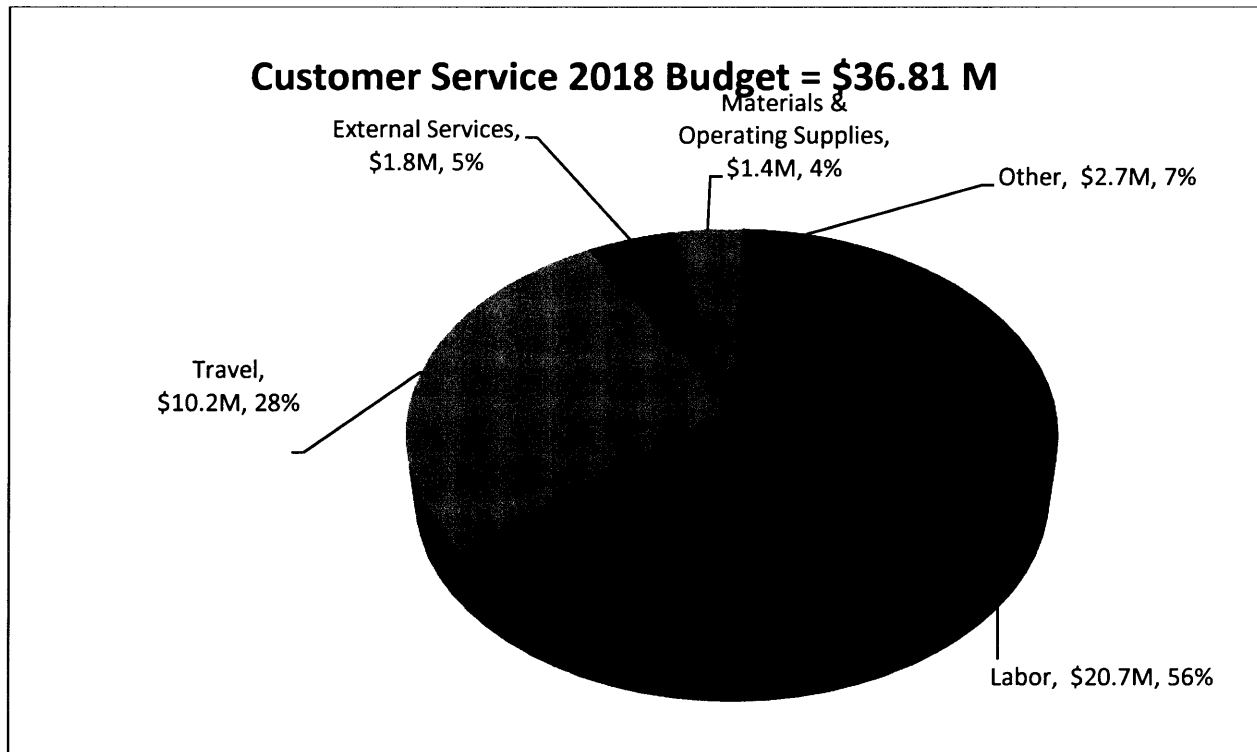


Explanations for the major cost drivers for 2017 Forecast versus 2018 Budget:

Labor: The increases in labor costs from 2017 to 2018 are associated normal costs increases slightly offset by lower benefit costs that are part of overall labor costs.

Travel: Increases in travel costs are related to anticipated cost increases from 2017 to 2018. The year over year increase is approximately 3.7 percent.

Other: The expense categories noted in the Other category are generally due to anticipated cost increases from 2017 to 2018.



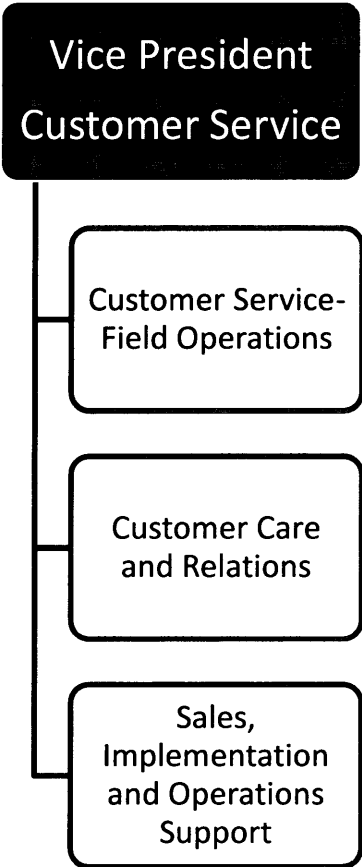
Labor: Labor is made up of exempt, non-exempt, part time and full time, and non-union and union employees necessary to perform the key activities that fall within the responsibilities of the Customer Service organization.

Travel: The majority of the travel related costs consist of utilization of company-owned vehicles and personal mileage reimbursements for travel within OTP’s approximately 70,000 square mile service territory. Also included in the travel expense category is fleet loading. Fleet loading is used to clear all costs associated with OTP’s Fleet Service Center. Fleet loading is a systematic and consistent way to allocate the cost of using company vehicles associated with having a Fleet. Field service representatives and linemen are assigned service trucks and other vehicles for the purpose of operation, maintenance and capital work associated with safe and reliable delivery of electricity to our customers. The majority of the service representatives have an assigned area that averages 600 plus square miles. In addition, managers and supervisors in the department have responsibility for employees in multiple communities across the service territory. Travel is necessary for the day to day supervision and management of employees. Similarly, commercial and industrial customer representatives have responsibility for customers across the service territory. In all cases and because our service territory is so widely dispersed, it is not uncommon for employees to travel several hundred miles in a day to supervise employees or meet with customers. All employees also participate in company sponsored meetings and training.

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Other: The costs included in the other expenses category consist of employee expenses, dues, subscriptions and books, communication expense (landline and cell phones); miscellaneous office expenses, advertising, promotional expenses, demand side management rebates, maintenance expense for company buildings under the responsibility of customer service, lease/rental expense, insurance and other miscellaneous employee expenses.



Customer Service-Field Operations

Major Functions

The services provided by the Customer Service-Field Operations area are primarily for the efficient, safe, and reliable electric service for OTP customers. Customer Service-Field Operations has management and field personnel strategically located throughout our Minnesota, North Dakota and South Dakota service territory. These employees provide day-to day services to our customers located in and around 422 communities. The services provided include operations, service restoration, maintenance and construction of the Company's transmission and distribution system, promoting energy efficiency and demand response programs, and direct customer contact which includes collections, customer service connections, and underground locates.

Key Activities

- Manage and complete projects associated with the overall operation, maintenance and investments in OTP's transmission and distribution system
- Develop and implement workforce plans to assist in scheduling line crews and service representatives
- Manage initiatives for safety, expense/capital budgets, and reliability as well as supporting the achievement of marketing goals and objectives
- Respond to service interruptions including after-hours coverage
- Provide meter reading services
- Respond to customer requests, which includes, start, stop and adding services, and the updating of customer account information by working closely with the appropriate customer service representative
- Account collection services including performing disconnections and reconnections related to non-payment
- Lead economic development, community involvement and customer relationships

Customer Care and Relations

Major Functions

The primary function of Customer Care is to provide training and quality assurance for CSRs and overall customer service support for CSMs. Customer Care employees are also responsible for business process development and standardization, assessing customer satisfaction, and providing communications to customer service staff. The primary functions of Customer Relations are to provide administrative support operations of our virtual call center, credit and collections, and billing and overall customer account management services to OTP customers. CSMs and CSRs are responsible for handling general requests from residential and commercial customers as well as advising customers on energy usage and electric heating and cooling

technology options, working with customers who have trouble paying their bills in full or on time and billing support services for timely and accurate billing statements to all customers.

Key Activities

- **Customer Care**
 - Train and provide quality assurance monitoring for staff, including phone call reviews and accuracy of data entry
 - Customer Information System training for all new employees in Customer Service
 - Circulate communications to Customer Service staff
 - Develop, review, and update Customer Service procedure documents
 - Monitor and respond to customer satisfaction results, customer data privacy processes and improve/standardize internal business processes
 - Educate customers on rates, electric heating and cooling technologies, and energy efficiency
 - Project management for the evaluation, selection and implementation of a commercial off the shelf customer information system
- **Virtual Call Center**
 - Respond to and resolve customer inquiries, including start/stop/transfer service, billing and usage questions, payment arrangements, customer complaints and other miscellaneous requests
 - Provide support to low-income customers and government agencies
 - Educate customers on ways to manage energy use through available programs, rates, and electric heating and cooling technologies
- **Credit and Collections**
 - Assist customers with payment options that take into consideration their specific circumstances
 - Minimize bad debt expense by working with customers whose accounts are delinquent
 - Monitor delinquent accounts and initiate action with Customer Service Operations staff based on Company collections criteria
 - Assess and process deposits for customers with unsatisfactory credit
 - Process payments received on bad debts
 - Work with other internal departments on managing bad debt including relationships with collection agencies
- **Billing and overall customer account management services**
 - Process exception reports to ensure accurate billing
 - Process retail customer payments
 - Educate customers on the types of payment services that are available to them with a focus on paperless billing and electronic payment

- Provide customer support for billing questions and complaints related to but not limited to energy use, how to read an electric service statement, availability of rate/rider options
- Maintaining accurate data associated with meters and associated equipment
- Updating customer account information based on requests from the customer
- Initiating and processing service orders based on specific requests from customers
- Logging customer contacts

Sales, Implementation and Operational Support

Major Functions

This area has ultimate accountability for residential, commercial and industrial customer contacts and sales as well as the promotion of company conservation and demand response programs, providing support to company field operations, and efficiently managing transportation needs across the company.

Key Activities

- Provide overall strategic planning and guidance related contacts and electric sales opportunities with commercial and industrial customers
- Customer support providing rate analyst and cost information
- Accountable for marketing and support of electric sales, conservation and demand side management programs
- Responsibility for the purchase, repair, inspection, maintenance, placement and replacement of Company vehicles and equipment
- Manage apprenticeship program and provide technical training for field personnel.
- Assist with coordination of resources and equipment necessary for storm restoration and mutual aid to other electric utilities
- Accountable for the specification and purchasing of tools, equipment, and line service vehicles
- Investigation and co-management of projects related to O&M and construction work for other entities
- Identifies community partnerships, financing packages, and labor pools to help ensure the success of new business



2016-2018 O&M Budget Documentation

Energy Supply

1.1 Introduction

All of the areas within Energy Supply oversee or support the generating units with Otter Tail Power Company (OTP). The following description is general in nature but is applicable to all areas of Energy Supply.

The primary focus within Energy Supply is the safe, reliable, and efficient operation of the generating units that OTP owns or is under contract with. OTP operates both Big Stone Plant and Coyote Station, which are jointly owned with slightly different ownership groups. These areas are charged with the on-going operation, maintenance, and planning of the generation facilities. These areas maintain a well-trained staff and operate the unit in a safe, efficient and environmentally compliant manner. They plan for needed minor and major maintenance overhauls, and research, justify, and execute capital projects as approved by the co-owners of the facilities. They interact with the fuel supply chain to maintain adequate supply and inventories of fuel for the stations. They oversee implementation of predictive maintenance systems to proactively maintain equipment. They work with vendors and equipment suppliers to stay current with industry trends and information as it relates to the reliability of existing equipment, or the possibility of equipment upgrades that would increase reliability and efficiency. They work with local area stakeholders to maintain positive neighbor and community relationships. The following areas fall under the responsibility of Energy Supply: the operations of Big Stone Plant, Coyote Station, and Hoot Lake Plant, along with Generation Development, Renewable Energy Construction and Operation, and Supply Engineering.

1.2 Customer Value

Customer value is brought forth by Energy Supply by operating and maintaining energy supply assets effectively so they are available for customer needs. The major contributor to success is the setting and tracking of key performance indicators for the generating plants and all areas within supply. While the specific goals are set every year, the Key Performance Indicators for Energy Supply are as follows:

- Safety (OSHA Rate)
- Non-fuel O&M cost per MWh generated
- Equivalent Availability
- Net Plant Heat Rate
- Cost per MMBTU delivered coal
- No NERC violations
- No Environmental violations
- Capital budget accuracy

Safety (OSHA Rate)

Maintaining a safe work environment has been and will continue to be a hallmark of Energy Supply and OTP management philosophy. Energy Supply believes that maintaining a focus on safety is not only the right thing to do for its employees, but is a key factor in a productive operation.

Non-fuel O&M cost per MWH generated

This is primarily focused on OTP's coal units as base loaded facilities. It is generally reflective of staffing levels at each of the three coal-fired stations as well as on-going maintenance costs. One of the key drivers in maintenance costs is the outage planning and schedule coordination which has been and will continue to be a key driver for O&M costs at our coal facilities. Tracking and focusing on this allows for adequate planning to ensure that customer costs for generation remain low.

Equivalent Availability (EA)

EA is a direct reflection of the amount of planned and forced outages at each of our facilities, in addition to derates because of an operational condition or restriction. The major factors for availability have been outage requirements for planned major outages, or short boiler wash outages to maintain the coal units. In addition, equipment failures such as boiler leaks (routine) or major failures (one-time events) can impact availability. A high EA reflects more availability of the generation assets for OTP customers. This would reduce replacement power or capacity costs that would be incurred if the generating units were not available.

Net Plant Heat Rate (NPHR)

NPHR is a direct measure of the overall efficiency of the unit in converting fossil fuel to electricity. Actively monitoring this component ensures that the generating units continue to operate efficiently which correlates to low fuel costs. Many key initiatives or projects have been undertaken at our facilities to maintain or improve efficiency. The initiatives/projects include fuel switching (lignite to subbituminous), steam turbine path efficiency improvements, boiler maintenance and efficiency improvements, feedwater heater and condenser tube replacements, control system upgrades, energy saving efforts such as variable frequency drives, and energy management systems. OTP installed real-time on-line performance monitoring in the early 1990s which has been used to monitor and improve the performance of the coal units.

Cost per MMBTU delivered fuel

This cost is a major factor for our existing coal units, but is significantly different at each of our three facilities. Coyote is a mine-mouth plant that is completing a 35-year contract from an adjacent mine. As the end of the contract neared, the owners of Coyote competitively bid the fuel supply. A new fuel supplier was chosen to supply the coal needs of Coyote station. Low

delivered fuel cost is a key component in the cost of generation at the plants which ultimately impacts OTP customers.

At Big Stone Plant, the key driver in delivered coal cost is the rail transportation which is under the Surface Transportation Board (STB) Tariff to the site. As there are not competitive rail options at the Big Stone Plant site, this cost is under the oversight and control of the STB. For coal supply, Big Stone Plant acquires fuel through a competitive bid process in various amounts for out years depending on need and operating level.

Hoot Lake Plant is currently planning to cease operations at the end of the 2020 MISO Planning Year. This is a factor for planning its fuel supply for the plant's remaining years of operation. The rail shipments are under a STB declared tariff. OTP completed a requirements contract which is a "no minimums" contract and the price is indexed based on the prior year's average price. This allows for periods of time when the Hoot Lake Plant may be off-line due to MISO wholesale market conditions which cannot be forecast with a high degree of precision.

No NERC violations

Many NERC standards and processes have been developed over the last decade, and security and reliability of OTP facilities remains of paramount concern. Therefore, Energy Supply is engaged in the review and planning of compliance with NERC standards as they exist and as they are being planned in the future. Maintaining a culture of compliance is a hallmark of OTP and important in the reliable operation of owned generation.

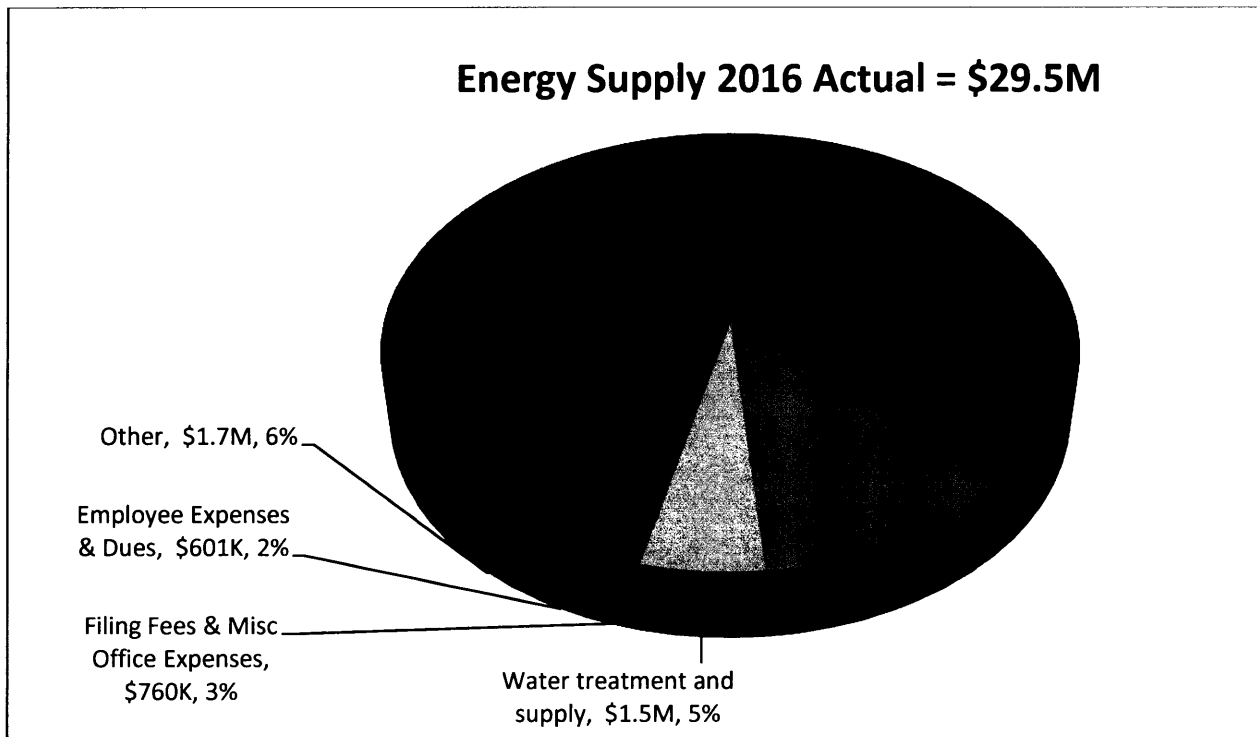
No Environmental violations

An on-going goal within Energy Supply is no Environmental violations. Energy Supply works closely with the Environmental Services Department to meet all on-going requirements as well as awareness of upcoming requirements at each of our facilities.

Capital Budget Accuracy

Major capital initiatives are primarily driven by either environmental regulation needs or major overhaul requirements. Accurately planning and managing capital projects is an on-going effort and is also under the scrutiny of all other co-owners at Big Stone Plant and Coyote Station. These facilities have their own governance and reviews through the co-ownership agreements. The capital spending for the co-owned units is the majority of the capital spending within Energy Supply.

2.1 2016 O&M Actuals



Labor: on-going operation, maintenance, supervision, and administration within Energy Supply.

External Services: includes costs related to the overhaul of steam turbines, maintenance of the wind farms, chemical and fireside cleaning of the boiler and turbine systems, and contract maintenance at the steam generating plants.

Materials & Operating Supplies: includes items such as oil for wind farm gear boxes, insulation and refractory, steam turbine parts, chemical cleaning tank rental, oil not used for generation, scaffolding for overhaul, air compressor service and parts.

Water treatment and supply: costs consist of water treatment chemicals for fossil generating units, water supply, ash hauling contract, leachate treatment, and laboratory testing.

Filing Fees & Misc. office expenses: includes the costs necessary for State Agency filing fees and charges, and office supplies.

Employee Expenses and dues: costs consist of control system maintenance contracts, training costs, safety equipment, meals, and travel.

Other: includes costs for building and grounds maintenance, insurance premiums, and landowner leases for wind farms.

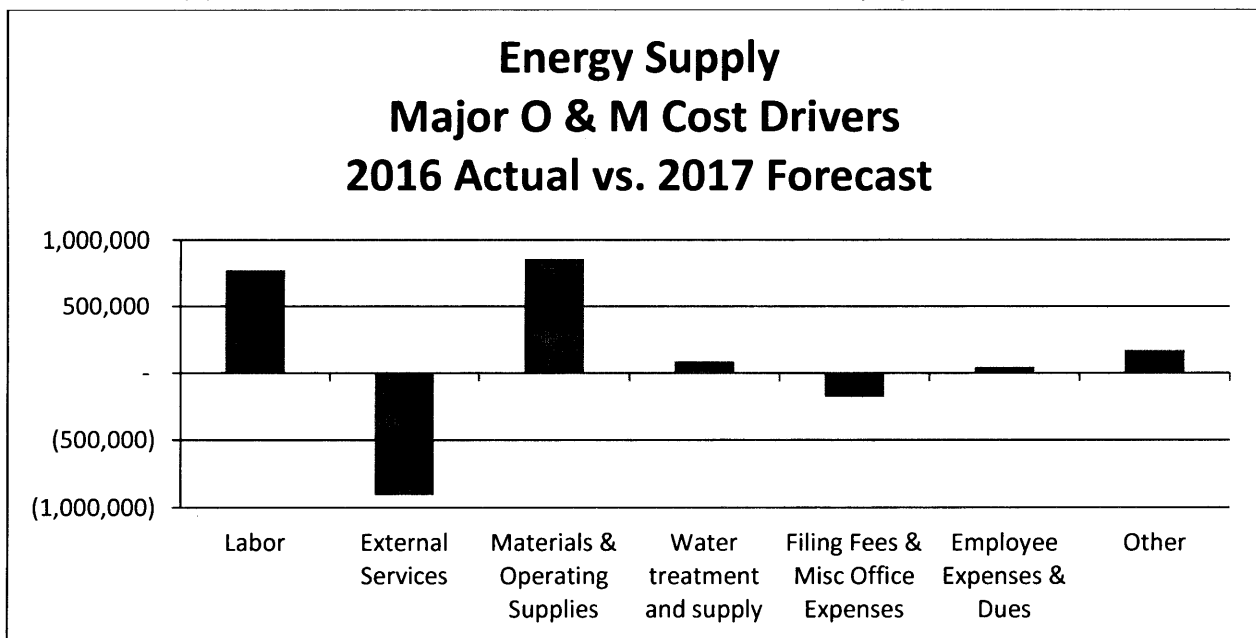
2.2 2016 O&M Actuals vs 2017 O&M Forecast

Energy Supply

2016 Walk Forward of Major Cost Drivers

2016 O&M Actuals	\$29,462,455
Labor	772,731
External Services	(906,629)
Materials & Operating Supplies	860,968
Water treatment and supply	91,061
Filing Fees & Misc Office Expenses	(181,570)
Employee Expenses & Dues	47,417
Other ⁽¹⁾	173,750
2017 O&M Forecast	<u>\$30,320,185</u>

(1) Other - includes lease/rental, insurance and other employee benefits.



Explanations for the major cost drivers for 2016 Actual versus 2017 Forecast:

Labor: Labor increases from 2016 to 2017 are primarily driven by a budgeted 3% wage increase, as well as overtime related to planned outages at Big Stone Plant and labor not being applied to Capital at Hoot Lake. This is somewhat offset by reduced labor costs at Coyote Station as there was a planned major outage at Coyote in 2016 compared to 2017.

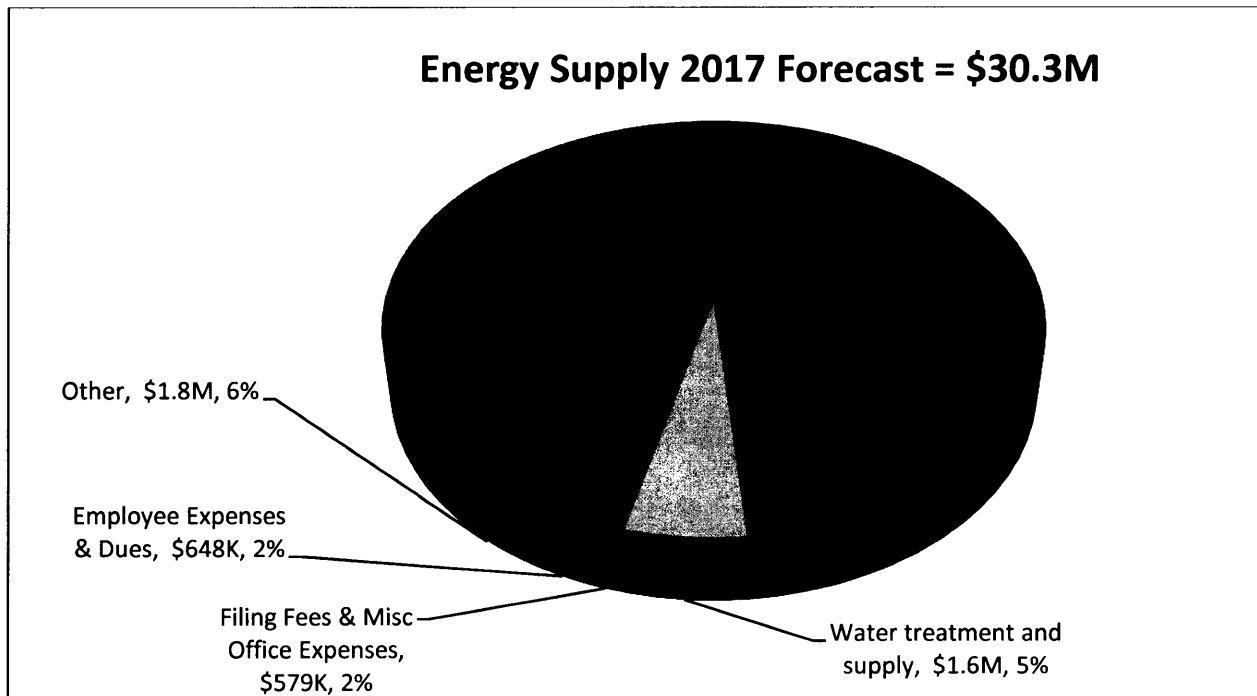
External Services: Overall, External Services saw a decrease. The primary driver was at Coyote station, where a \$1.4M reduction was realized due to a planned major outage in 2016 compared to 2017. This \$1.4M reduction was somewhat offset by an unexpected repair of the combustion turbine at Solway, as well as general price increases (totaling approximately \$0.5M).

Material & Operating Supplies: The majority of cost increase in this category was due to an increase in boiler and rail work at Big Stone Plant (\$0.7M)

Water Treatment and Supply: This modest increase was due to an increase cost in chemicals, as well as higher loads in the case of Coyote Station.

Filing Fees & Misc: The primary driver of this reduction was a decrease in environmental fees at Hoot Lake, approximately \$0.18M.

Other: This increase was primarily due to a payroll loading adjustment at Coyote Station.



Labor: on-going operation, maintenance, supervision, and administration within Energy Supply.

External Services: includes costs related to the overhaul of steam turbines, maintenance of the wind farms, chemical and fireside cleaning of the boiler and turbine systems, and contract maintenance at the steam generating plants.

Materials & Operating Supplies: includes items such as oil for wind farm gear boxes, insulation and refractory, steam turbine parts, chemical cleaning tank rental, oil not used for generation, scaffolding for overhaul, air compressor service and parts.

Water treatment and supply: costs consist of water treatment chemicals for fossil generating units, water supply, ash hauling contract, leachate treatment, and laboratory testing.

Filing Fees & Misc. office expenses: includes the costs necessary for State Agency filing fees and charges, and office supplies.

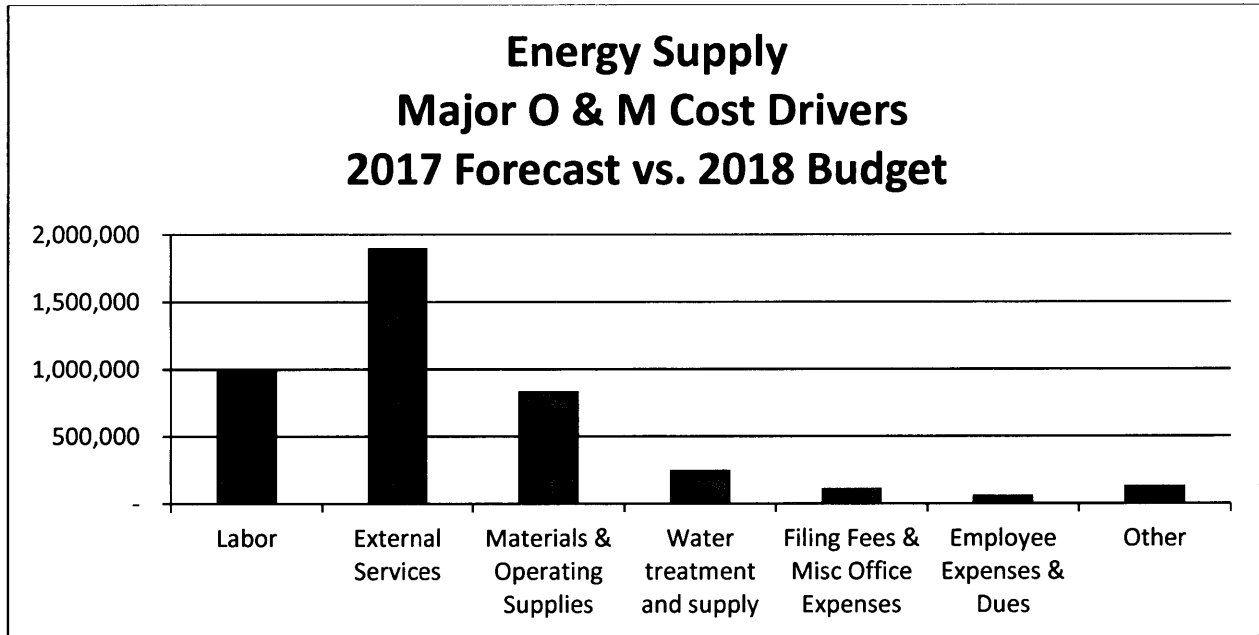
Employee Expenses and dues: costs consist of control system maintenance contracts, training costs, safety equipment, meals, and travel.

Other: includes costs for building and grounds maintenance, insurance premiums, and landowner leases for wind farms.

2.3 2017 O&M Forecast vs 2018 O&M Budget**Energy Supply****2017 Walk Forward of Major Cost Drivers**

2017 O&M Forecast	\$30,320,185
Labor	987,457
External Services	1,902,142
Materials & Operating Supplies	838,119
Water treatment and supply	251,511
Filing Fees & Misc Office Expenses	114,410
Employee Expenses & Dues	63,469
Other ⁽¹⁾	134,171
	<hr/>
2018 O&M Budget	<u>\$34,611,463</u>

(1) Other - includes lease/rental, insurance and other employee benefits.



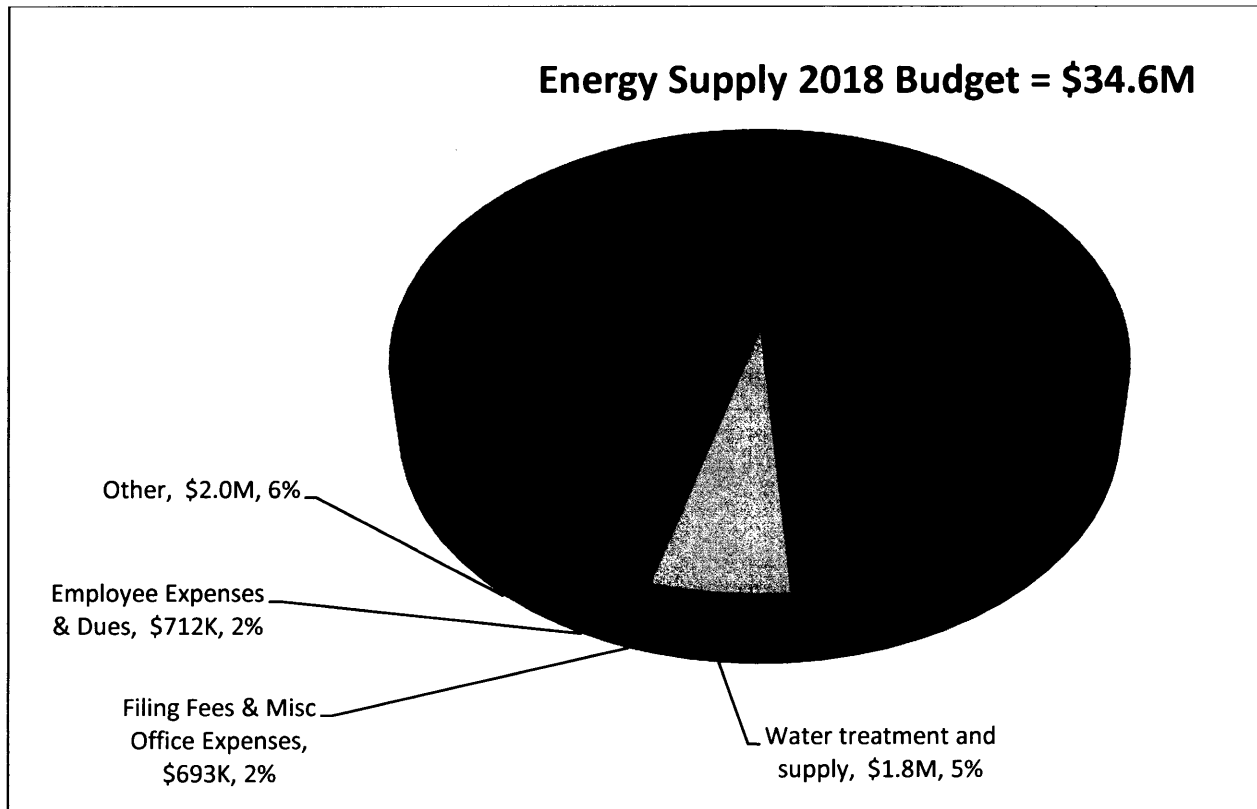
Explanations for the major cost drivers for 2017 Forecast versus 2018 Budget:

Labor: Increases in labor are forecasted to be primarily driven by wage increases at all areas in Energy Supply. Additionally, there is an increase in labor loading rates from 2017 to 2018. Lastly, there is a planned major outage at Big Stone in 2018, which accounts for approximately \$0.35M increase in addition to the factors above.

External Services: the external services increase is primarily driven by the planned major overhaul at the Big Stone Plant. Otter Tail share of this increase in cost at Big Stone is approximately \$1.7M. The other cost centers had modest increases with some offsetting decreases.

Material & Operating Supplies: These costs are primarily driven by the planned major overhaul at the Big Stone Plant. Otter Tail’s share of this increase in cost is approximately \$0.9M. Other cost center areas are budgeted to be close to 2017 levels.

Water Treatment and Supply: Lime expenses at Coyote Station come under this category and are budgeted in 2018 to be approximately \$0.125M higher. The other areas anticipate some higher operation in 2018, as well as increased chemical costs.



Labor: on-going operation, maintenance, supervision, and administration within Energy Supply.

External Services: includes costs related to the overhaul of steam turbines, maintenance of the wind farms, chemical and fireside cleaning of the boiler and turbine systems, and contract maintenance at the steam generating plants.

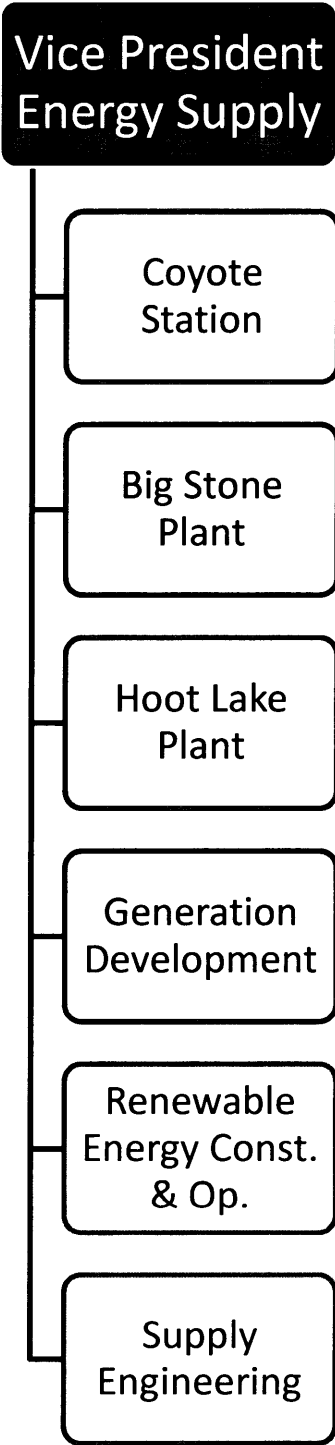
Materials & Operating Supplies: includes items such as oil for wind farm gear boxes, insulation and refractory, steam turbine parts, chemical cleaning tank rental, oil not used for generation, scaffolding for overhaul, air compressor service and parts.

Water treatment and supply: costs consist of water treatment chemicals for fossil generating units, water supply, ash hauling contract, leachate treatment, and laboratory testing.

Filing Fees & Misc. office expenses: includes the costs necessary for State Agency filing fees and charges, and office supplies.

Employee Expenses and dues: costs consist of control system maintenance contracts, training costs, safety equipment, meals, and travel.

Other: includes costs for building and grounds maintenance, insurance premiums, and landowner leases for wind farms.



Coyote Station

Major Functions

This function is responsible for the safe, reliable and efficient operation of Coyote Station. Coyote Station is a 427 MW coal burning facility near Beulah, ND and is a mine-mouth facility. The source of lignite coal for this plant is a nearby coal mine. The plant is co-owned by:

- OTP (35%)
- Northern Municipal Power Agency (30%)
- Montana-Dakota Utilities, Co. (25%)
- Northwestern Energy (10%)

Key Activities

- Safe and reliable operations
- Planning and tracking capital and O&M Budgets
- Planning for major and minor overhauls
- Performing maintenance
- Supervision and hiring plant staff
- Communication with the adjacent coal mine for forecasting fuel needs
- Research and justification of capital projects
- Staying current with industry trends

Big Stone Plant

Major Functions

This function is responsible for the safe, reliable and efficient operation of the Big Stone Plant. Big Stone Plant is a 475 MW coal burning facility near Big Stone City, SD. This plant burns Powder River Basin coal as its primary fuel and is delivered to the plant by rail shipment. The plant is co-owned by:

- OTP (53.9%)
- Northwestern Energy (23.4%)
- Montana-Dakota Utilities, Co. (22.7%)

Key Activities

- Safe and reliable operations
- Planning and tracking capital and O&M Budgets

- Planning for major and minor overhauls
- Performing maintenance
- Supervision and hiring plant staff
- Communication with the coal mine(s) under contract for forecasting fuel needs
- Communication with the rail shipper for coal
- Research and justification of capital projects
- Staying current with industry trends

Hoot Lake Plant

Major Functions

The Hoot Lake Plant is a two unit site that is approximately 138 MW. It consists of two units, Unit #2 (~58 MW) and Unit #3 (~80 MW). Hoot Lake Plant is wholly owned by OTP. The source of coal for Hoot Lake Plant is a mine in the Powder River Basin and the coal is delivered by rail to the plant site. Additionally, all of the hydro generation on the Otter Tail River is managed by personnel at the plant site.

The Hydro plants under the supervision of Hoot Lake Plant are:

- Dayton Hollow - 1 MW
- Hoot Lake – 0.3 MW
- Pisgah – 0.6 MW
- Wright – 0.2 MW
- Taplin Gorge – 0.4 MW
- Diversion (not a power generator but supplies water to Hoot Lake Plant)

OTP is currently planning for the retirement of both Hoot Lake Plant Unit #2 and Unit #3 at approximately the end of the 2020 MISO Planning Year.

Key Activities

- Safe and reliable operations
- Planning and tracking capital and O&M Budgets
- Planning for major and minor overhauls
- Performing maintenance
- Supervision and hiring plant staff
- Communication with the coal mine and railroad for forecasting fuel needs
- Staying current with industry trends

Generation Development

Major Functions

This area has been assigned directly to the Big Stone Plant AQCS Project which is a Capital project and has no O&M charges during the analysis period. Once the AQCS project is completed, various assignments that may be Capital or O&M will be assigned as needed.

Renewable Energy Construction and Operation

Major Functions

This area oversees the operation and maintenance of the wind generation and oil-fired peaking units in North and South Dakota. There are currently 5 wind farms either owned or under power purchase agreement for OTP:

- North Dakota Wind II (21 MW purchase) – Edgeley, ND – 2003
- Langdon Wind Energy Center (40.5 MW own and 19.5 MW purchase) – Langdon, ND - 2008
- Ashtabula Wind Energy Center (48 MW own) – Barnes County, ND – 2008
- Luverne Wind Farm (49.5 MW own) – Steele County, ND – 2009
- Ashtabula III (62.4 MW purchase) – Barnes County, ND – 2010

The oil-fired peaking units are:

- Jamestown, ND – two fuel oil combustion turbines – 41.5 MW
- Lake Preston, SD – fuel oil combustion turbine – 19.7 MW

Key Activities

- Manage the maintenance and operation contracts for the wind farms
- Safe and reliable operation
- Planning and tracking capital and O&M Budgets
- Planning for major and minor overhauls for the oil-fired turbines
- Supervision and hiring staff
- Stay current with industry trends

Supply Engineering

Major Functions

Supply Engineering oversees the natural gas fired generation at OTP's Solway site, as well as the hydro generation at the Bemidji site (0.1 MW).

- Solway, MN natural gas-fired combustion turbine, 43.1 MW

Additionally, various engineering, project management and generation plant support and administrative tasks are overseen.

Key Activities

- Oversight and management of large engineering studies
- Support of turbine and rotating equipment outages
- Support of stack testing and verification
- Review and compliance of NERC standards
- Review and submittal of Energy Supply statistics
- Review of Energy Supply Capital and O&M budgets and forecasts
- Management of Capital Projects as needed
- Predictive Maintenance support of generation units

All O&M costs incurred at our jointly owned Big Stone Plant and Coyote Station are allocated to our co-owners based on their ownership share of each plant. A secondary calculation is performed to apportion fuel and reagents consumed above minimum net load fuel costs based on the percentage of generation each owner required over/under their ownership percentage. In that way, each owner can view and offer in the Big Stone Plant cost in their respective market or situation somewhat independently.



2016-2018 O&M Budget Documentation

Finance / Legal and Strategic Sourcing

1.1 Introduction

The Finance Department provides financial leadership and is responsible for the overall financial health of the Utility through the closing of monthly and year-end books, producing monthly and year-end financial statements, creating annual budgets and monthly forecasts, calculating the actual and forward looking Cost of Service Study (COSS) for each jurisdiction, income and property tax reporting, maintaining the Fixed Asset system, processing invoices and disbursements, and negotiating and monitoring contracts and their execution. The Finance Department is responsible for providing accurate financial information that can be used in making decisions to operate the company in an efficient manner for the benefit of the customers. The Chief Financial Officer (CFO) leads the Finance Department as a whole and the following Departments report to the CFO: Accounting Research & Consulting, Fixed Asset Accounting, Financial Reporting, Business Planning-Regulatory Accounting, and Strategic Sourcing. Additional areas that will be discussed within this narrative include the Legal Department and Governmental Affairs.

The primary responsibility of the Legal Department is to manage the legal risks of Otter Tail Power Company (OTP), with a goal of reducing unanticipated litigation exposure and to advance OTP's legal interests. The lawyers within the Legal Department work with internal OTP areas on a daily basis, advising them with regards to changing laws, rules and regulations, contract interpretation and negotiations, as well as drafting transactional documents arising out of business relationships. The members of the Legal Department understand the electric utility industry and OTP's strategic objectives and are able to provide accurate and timely legal advice to its business clients to enhance risk mitigation, improve the likelihood of success in transactions and aptly represent the organization with various stakeholders. Legal Department members also manage external counsel which typically is specialists in certain areas that OTP does not have internal expertise. The Legal Department selects, manages and evaluates the costs of external counsel.

Government Affairs manages the Company's public policy discourse with legislatures in the three state jurisdictions where OTP has utility customers, as well as with Congress in Washington DC. Government Affairs coordinates internal formulations of public policy appropriate to each of these deliberative arenas and manages the company's efforts to engage policy makers with clear and persuasive messages that serve the interests of both ratepayers and shareholders.

1.2 Customer Value

Each of the area's mentioned above has a role in providing benefit to our customers. Overall, the Finance area adds value to our customers through the creation of accounting records in accordance with applicable regulations to ensure accurate reporting to financial and jurisdictional regulatory entities.

Accounting Research & Consulting's key priorities are to ensure proper internal controls are in place over financial reporting, provide quality financial data, remit taxes collected on behalf of taxing jurisdictions, and to pay the taxes that the company owes on a least cost basis. These activities give our customers reassurance that we are abiding by the rules and regulations of the Internal Revenue Service.

Fixed Assets maintains all aspects of property accounting, including depreciation for the fixed assets of the utility. Fixed Assets also prepares and provides support for regulatory filings and performs depreciation studies for the utility. Fixed Assets provides value by supporting utility tax strategies involving calculation of safe harbor tax deductions under section §263(a) of the Internal Revenue Code; is responsible for accounting duties related to jointly owned generation plants; administers the accounting for alternate rate recovery mechanisms such as the cost recovery riders and coordinates the capital budgeting process in order to facilitate prudent construction project evaluation and approval. The Fixed Assets area maintains the necessary accounting to support projects the Company is undertaking which is being completed to ensure the safe and efficient generation, transmission, and distribution of electricity to our customers.

The Payroll Department drives value by coordinating time sheet management across multiple collection platforms and pay schedules in order to facilitate accurate and timely payment of employee wages. Benefit programs implemented by Human Resources are supported by Payroll through administering collection of deductions and program funding. Cash Management supports customer billing procedures by handling non-electronic transactions through the remittance center, administers billing processes for work performed by the utility on behalf of others as well as managing the cash position to minimize handling expenses and ensure adequate liquidity for operations.

Accounts Payable is responsible for processing the payment of OTP business transactions accurately, timely, and as efficiently as possible to maximize the company's use of funds and to protect the company's credit rating.

The Financial Reporting area is responsible for maintaining the integrity of the general ledger system as well as preparing accurate financial statements in accordance with Generally Accepted Accounting Principles. Through compliance with the Securities and Exchange Commission (SEC), Federal Energy Regulatory Commission (FERC) and Sarbanes Oxley (SOX), our customers are benefited by having transparent, accurate information and through the knowledge that we have sound practices in place. Financial Reporting also serves as a liaison to Corporate to ensure accuracy and completeness throughout the consolidation process.

The Business Planning-Regulatory Accounting Department is responsible for all financial planning and forecasting as deemed necessary by OTP and Otter Tail Corporation for use in strategic planning and decision making which includes annual company budgets as well as short and long-term forecasts produced either monthly or annually. In addition, the department is

responsible for leading the work group that prepares the jurisdictional COSS used to calculate the revenue requirements of the Company for use in determining the need for potential rate case filings in each of the jurisdictions OTP serves, providing testimony in those filings as well as miscellaneous other financial analysis used in determining revenue requirements. This Department also manages the production of FERC revenue requirements (O, GG and MM) and provides financial analysis on any other filing that includes revenue requirements calculations such as Renewable Riders, Transmission Riders and Environmental Riders. Our customers receive value through compliance with regulatory rules and processes.

Strategic Sourcing provides procurement and contracting services for the business transactions of OTP to avoid costs and mitigate risk. Effective sourcing keeps costs low for customers.

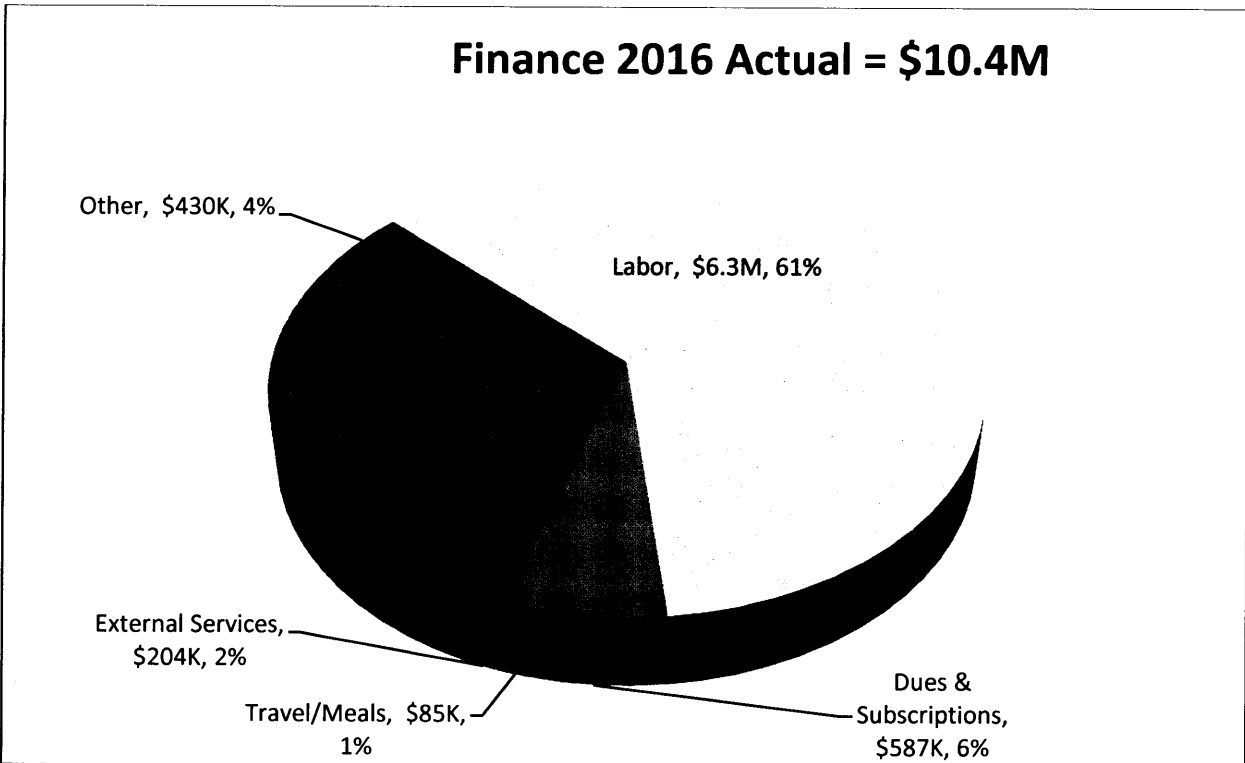
The in-house Legal Department for OTP provides benefits to OTP's customers through two primary factors:

1. Lawyers who understand the industry, business and people within the organization, and are in a position to better proactively and effectively manage legal issues within the organization; and
2. Reduce legal costs through leveraging the experience of the in-house staff as well as partnering with external counsel and overseeing those relationships so that OTP, and ultimately its customers, receive efficient and cost-effective legal advice to the organization.

Government Affairs adds customer value by advocating public policy positions that best protect the near and long-term interests of customers, with a continuous view toward producing and delivering electricity as "reliably, economically and environmentally responsibly as possible". Government Affairs works closely with state and federal legislators to sponsor and support policies consistent with OTP's mission. Customer value is achieved through these means:

1. Government Affairs employees engage consultants in each state to work as cost-effectively as possible to achieve the company's mission.
2. Government Affairs works closely with business allies, consumer and environmental advocates, state administrative agency representatives and public policy makers to achieve balanced outcomes for customers.

2.1 2016 O&M Actuals



Labor: Labor includes exempt, non-exempt, part-time and full-time employees.

External Services: This cost category consists of legal and financial professional services and temporary employees.

Insurance: This cost category consists of premiums for various types of insurance including, property, auto, general liability, fiduciary, professional liability, commercial crime, excess liability and aircraft.

Dues & Subscriptions: These costs include civic service and business club dues, professional dues and certification, as well as software subscriptions or minor upgrades.

Travel/Meals: The costs included in this category primarily include transportation, lodging, and meals for meetings and conferences.

Other: Miscellaneous costs including phone charges, office expenses, lease/rental charges, uncollectable accounts, bank service charges and de minimis employee benefits.

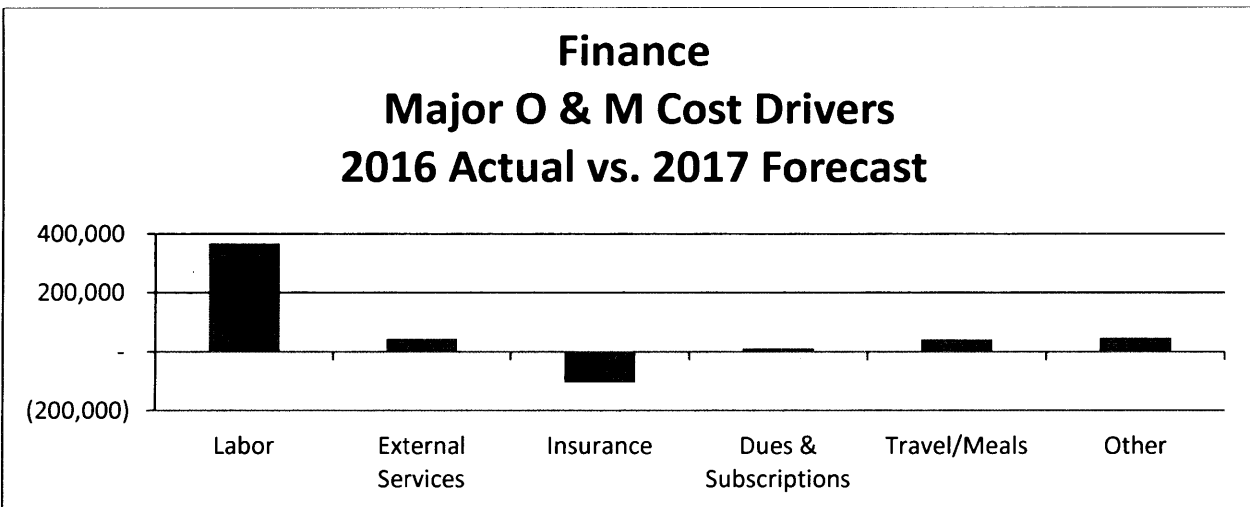
2.2 2016 O&M Actuals vs 2017 O&M Forecast

Finance

2016 Walk Forward of Major Cost Drivers

2016 O&M Actuals	\$10,375,725
Labor	367,841
External Services	44,568
Insurance	(105,524)
Dues & Subscriptions	12,232
Travel/Meals	42,672
Other ⁽¹⁾	47,735
2017 O&M Forecast	<u><u>\$10,785,249</u></u>

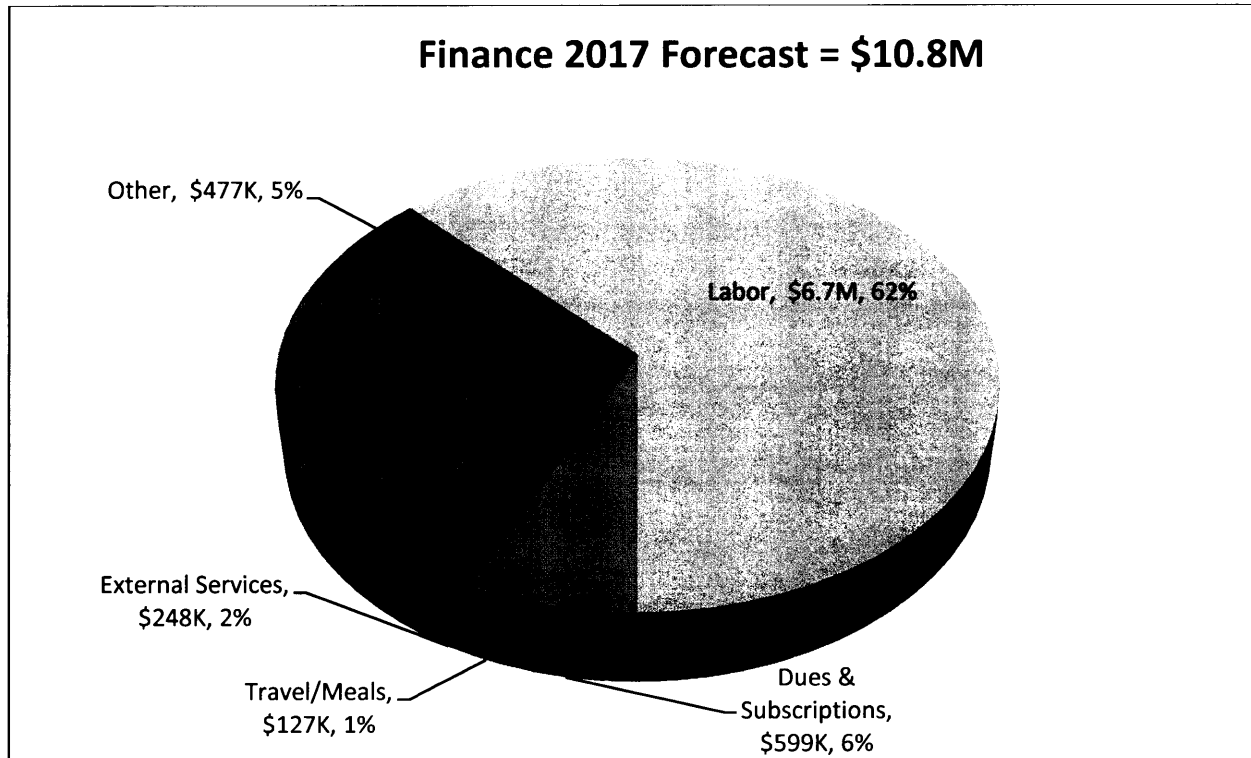
(1) Other - includes employee expenses, office expenses, telephone/communication, bank service charges, uncollectable accounts, material & operating supplies, lease/rental, and other employee benefits.



Explanations for the major cost drivers for 2016 Actual versus 2017 Forecast:

Labor: The increase in labor is standard wage merit increases for non-executive employees, annual wage increases for executives and the addition of a fulltime employee.

Insurance: Lower storm reserves are estimated in 2017. 2016 was a higher year due to the ice storm during Christmas.



Labor: Labor includes exempt, non-exempt, part-time and full-time employees.

External Services: This cost category consists of legal and financial professional services and temporary employees.

Insurance: This cost category consists of premiums for various types of insurance including, property, auto, general liability, fiduciary, professional liability, commercial crime, excess liability and aircraft.

Dues & Subscriptions: These costs include civic service and business club dues, professional dues and certification, as well as software subscriptions or minor upgrades.

Travel/Meals: The costs included in this category primarily include transportation, lodging, and meals for meetings and conferences.

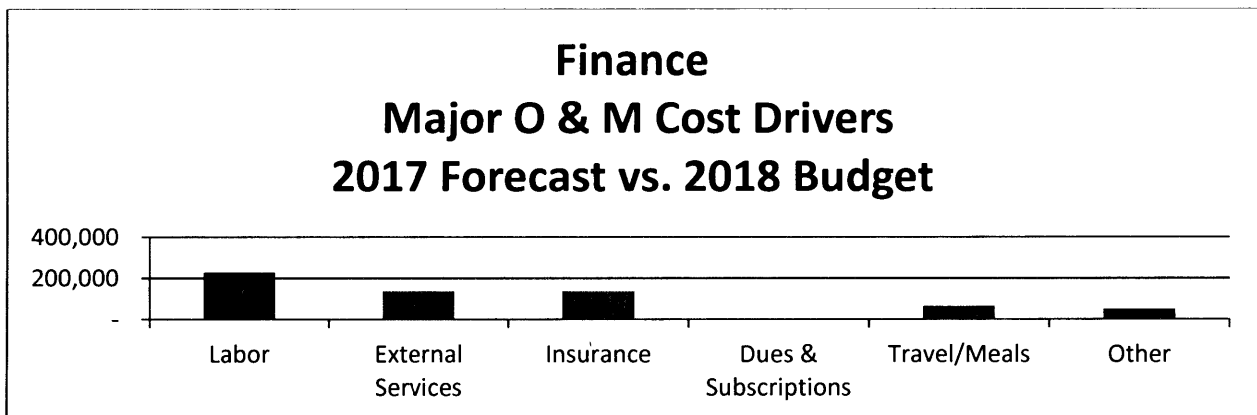
Other: Miscellaneous costs including phone charges, office expenses, lease/rental charges, uncollectable accounts, bank service charges and de minimis employee benefits.

2.3 2017 O&M Forecast vs 2018 O&M Budget

Finance
2017 Walk Forward of Major Cost Drivers

2017 O&M Forecast	\$10,785,249
Labor	228,811
External Services	138,071
Insurance	136,949
Dues & Subscriptions	76
Travel/Meals	64,051
Other ⁽¹⁾	50,890
2018 O&M Budget	<u><u>\$11,404,098</u></u>

(1) Other - includes employee expenses, office expenses, telephone/communication, bank service charges, uncollectable accounts, material & operating supplies, lease/rental, and other employee benefits.

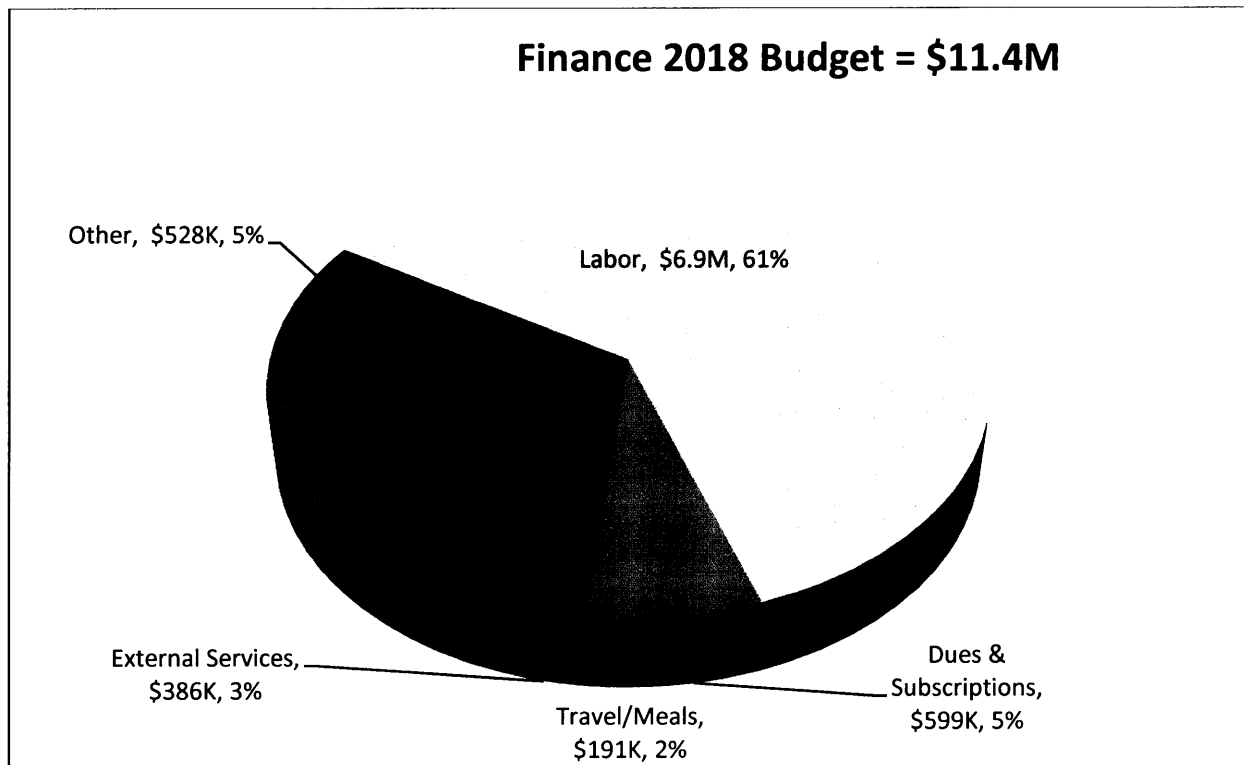


Explanations for the major cost drivers for 2017 Forecast versus 2018 Budget:

Labor: The increase in labor is standard wage merit increases for non-executive employees, annual wage increases for executives and the addition of a fulltime employee.

External Services: The increase in external services is due to the Power Plan upgrade budgeted for in 2018.

Insurance: The higher insurance costs are related to an increase in excess liability premiums and increased premiums as a result of higher property values as a result of additional capital projects.



Labor: Labor includes exempt, non-exempt, part-time and full-time employees.

External Services: This cost category consists of legal and financial professional services and temporary employees.

Insurance: This cost category consists of premiums for various types of insurance including, property, auto, general liability, fiduciary, professional liability, commercial crime, excess liability and aircraft.

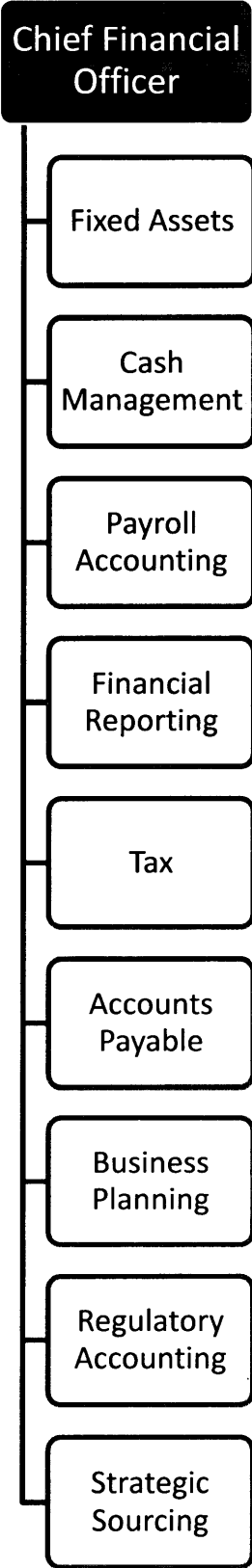
Dues & Subscriptions: These costs include civic service and business club dues, professional dues and certification, as well as software subscriptions or minor upgrades.

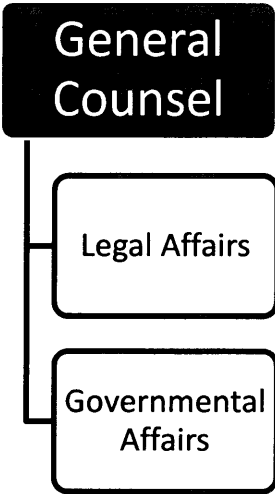
Uncollectible Accounts: These costs include credit services, collector's fees and expenses.

Travel/Meals: The costs included in this category primarily include transportation, lodging, and meals for meetings and conferences.

Bank Service Charges: This category contains letter of credit annual agency fees and various other fees charged by financial institutions.

Other: Miscellaneous costs including phone charges, office expenses, lease/rental charges, and de minimis employee benefits.





The Finance group's primary duties include the closing of month and year-end books, producing financial statements, along with creating annual budgets and monthly forecasts.

Fixed AssetsMajor Functions

The Fixed Assets Department is responsible for maintaining all aspects of property accounting including depreciation for the fixed assets of the company.

Key Activities

- Depreciation calculation and accounting including annual depreciation filings
- Accounting related to jointly owned generation plants
- Production, Transmission, Distribution and General Plant property accounting
- Work order initiation and project management support
- Revenue requirement accounting for transmission and environmental cost recovery riders
- Capital budget administration

Cash ManagementMajor Functions

The Cash Management Department coordinates the collection of non-electronic receipts through the remittance center and manages the overall cash balance position within the company.

Key Activities

- Responsible for remittance processing center
- Manage company line of credit and maintain liquidity
- Provides system administration of Oracle Accounts Receivable module
- Manage third party collection agencies

Payroll AccountingMajor Functions

The Payroll Department is responsible for coordinating the collection of time sheets summary in order to facilitate the accurate and timely payment of employee wages.

Key Activities

- Administers payroll for company personnel
- Payroll tax withholding and remittance to jurisdictions

- Administers benefit related payroll deductions and tracking
- Payroll loading administration

Financial Reporting

Major Functions

The Financial Reporting Department is focused on maintaining the integrity of the general ledger and preparing financial statements in accordance with required standards. Additional responsibilities include maintaining documentation needed to be in compliance with various reporting organization and requirements.

Key Activities

- Preparation of journal entries and account reconciliations
- Generate internal reports and draft financial statements
- Perform financial analysis and review of financial statements
- Responsible for the financial close process including consolidation
- Monitoring of SOX controls/processes
- Identify, update, and implement appropriate accounting policies
- Responsible for the management of financial systems
- Submit required filings and ensure compliance with the SEC and FERC

Tax

Major Functions

The Tax Department is focused on tax planning, reporting and payment for all types of non-payroll taxes.

Key Activities

- Responsible for preparing monthly income tax estimates
- Research the effective of new tax legislation and provide advice to benefit the company
- Responsible for preparing annual income tax return and supporting schedules
- Manage non-payroll taxes other than income taxes such as ad valorem property taxes, real estate, sales and vehicle taxes
- Respond to IRS audits

Accounts PayableMajor Functions

The Accounts Payable Department is accountable for processing payments in an accurate, timely and as efficiently as possible to maximize use of funds and protect the company's credit rating.

Key Activities

- Manage payables and disbursements related reporting. Ensure no negative OTP credit ratings related to company payments.
- Ensure proper payment methodologies to payees. Research, plan, and initiate innovative payment systems.
- Manage the transfer of information and transactions from other systems (i.e. CIS, MIS, etc.) into the AP system.

Business PlanningMajor Functions

The focus of the Business Planning area is preparing financial plans and forecasts for use in strategic planning and decision making.

Key Activities

- Manage the process of modeling the impact of multiple strategic initiatives, utilizing specific Company information, historical data, assumptions and expectations of future conditions, and other external factors
- Develop and manage the process of analyzing financial data to support financial forecasts to prove accuracy of data
- Provide company executives with monthly projected financial updates with recommendations for specific actions
- Manage the long term financial model for strategic planning process
- Manage the production of official company's budget to successfully support cost of services studies and regulatory proceedings

Regulatory AccountingMajor Functions

The Regulatory Accounting area leads the preparation of required regulatory reports.

Key Activities

- Lead the preparation of historic and forecasted test year cost of service studies used in annual jurisdictional filings and rate case analysis
- Lead the preparation of FERC Revenue Requirements via Attachments O, GG and MM
- Provide support to Regulatory Services in regulatory filings and data requests related to revenue requirements ensuring consistency across multiple simultaneous regulatory proceedings

Strategic SourcingMajor Functions

The Strategic Sourcing Department is responsible for providing procurement and contracting services for the business transactions to avoid costs and mitigate risks.

Key Activities

- Develop and implement sourcing strategies leading to the proper procurement of materials and services including – vendor research and selection, bidding methodologies, RFIs, RFQs, RFPs, selection and respective contract development, administration, follow-up, etc.
- Manage the network of internal and external relationships related to the sourcing and contracting processes, including vendor negotiations.
- Develop and carry-out policy for administering procurement contracts and the contracting process.
- Manage purchasing contracts, assess and mitigate risk, and negotiate terms
- Manage and perform Risk Assessments on long-term construction projects. Evaluate, initiate, and assist Project Managers in procuring proper project insurance, bonding, retainage, and other assurances to protect OTP and other Owners. Lead the commercial aspects of projects.
- Lead large-project bid evaluation sessions and pre-sign contract strategy sessions with Subject Matter Experts, formulating appropriate strategies for procurement and methodologies for contracting.

Legal AffairsMajor Functions

The primary responsibility of the Legal Department is to manage the legal risks of OTP, with a goal of reducing unanticipated litigation exposure and to advance Otter Tail Power Company's legal interests.

Key Activities

- Advising OTP employees, managers and executives with regards to applicable laws, change in or newly- issued regulations and court or agency decisions that could have impact on the organization's processes, initiatives or plans.
- Reviewing, drafting and negotiating contracts to advance and protect the company's interests with regards to vendors or joint owners of significant capital projects.
- Advising on topics such as labor and employment issues, real property or right of way matters and litigation or disputed matters.

Governmental AffairsMajor Functions

Governmental Affairs advocates public policy positions that best protect the near and long-term interest of the customers.

Key Activities

- Engage consultants in each state to work as cost-effectively as possible to achieve the company's mission.
- Works closely with business allies, consumer and environmental advocates, state administrative agency representatives and public policy makers to achieve balanced outcomes for customers.
- Maintains productive relationships with the federal delegations of the three states in which the company has customers. The positions taken have a continuous eye toward the value of producing and delivering electricity for the company's customers as "reliably, economically and environmentally responsibly as possible".

Members of the Legal Department often provide legal services that benefit jointly-owned transmission or generation assets within OTP. As a result, the Legal Department members frequently assign their time to joint, shared billing entries. To the extent the advice is provided to OTP alone and not the joint owners of those facilities, the charges remain solely and exclusively paid for by OTP. Furthermore, the General Counsel of the Legal Department also serves as Otter Tail Corporation's Assistant Secretary, and in that role, attends and participates in Otter Tail Corporation's Board of Directors' meetings. In that capacity and in those instances, she designates the actual hours of her time to the corporate general allocator (account 100560).

The Legal Department members do not allocate costs directly to any other internal cost center. To the extent there is a capital work order, the lawyers charge to those work orders.

The Governmental Affairs group, when actively lobbying, assigns its costs to the non-utility/shareholder-only work order (Project 100280).

Government Affairs (Project 100280, Tasks LBYM, LBYN, LBYS and LYBF) includes the labor and non-labor costs for state and federal lobbying activities, as well as the work necessary to support the activities of the federal Political Action Committee (PAC). Lobbying activities are not assessed to the company's ratepayers.

Government Affairs, (Project 100280, Tasks LEGM, LEGN, LEGS and LEGF) includes the labor and non-labor costs associated with monitoring and interpretation of laws and proposed legislation to ensure cost-effectiveness and value for the company's customers.



2016-2018 O&M Budget Documentation

Human Resources and Safety Services

1.1 Introduction

Otter Tail Power Company's (OTP) Human Resources (HR) and Safety Services Departments provide leadership and support throughout the company in all matters relating to HR and Safety.

HR and Safety Services encourages workforce diversity, offers employees competitive compensation and benefits, promotes and strives for a safe work environment, and challenges employees to excel through leadership training and development all in an effort to support the company's mission statement: to produce and deliver electricity as reliably, economically, and environmentally responsibly as possible to the balanced benefit of customers, shareholders, and employees and to improve the quality of life in the areas in which we do business.

HR provides compensation and benefits, employee recruitment and retention, compliance guidance for Federal and State laws and company policies, employee and labor relations and workers compensation.

The Safety Services department provides the development and implementation of safety policies, training and new safety initiatives to ensure compliance with company safety rules, policies and procedures. Safety Services helps to provide safe working conditions, extensive safety training, and appropriate protective equipment for every department by focusing on injury prevention. Safety Services also works to ensure security for employees and assets. The department provides expert technical assistance in all areas and specialties of industrial safety and OSHA regulatory compliance.

1.2 Customer Value

HR provides and administers a compensation and benefits program that helps OTP attract, engage, and retain a quality workforce to provide our customers with reliable and economical service. HR's objective is to ensure that compensation and benefits are competitive in relation to the market in order to retain a skilled workforce while ensuring they are cost effective and do not result in unreasonable costs for our customers. HR is also responsible for providing leadership development training and ensuring employee performance goals are in alignment with company objectives.

Within the next 10 years, OTP anticipates approximately 35-40% of our workforce to reach our average retirement age, taking precious skills and expertise with them. OTP will continue to address this projected labor shortage in our internal succession planning process and by working with current employees to improve efficiencies and maximize the value that the company holds in human capital to maintain service levels while keeping overall customer rates as reasonable as possible.

HR's centralized role in the company ensures that the company is recruiting the right caliber and grade of existing and new employees to be matched to the right job at the right price. HR also builds efficiencies for the business by streamlining HR operations and executing on long-term strategic goals to achieve operational excellence by focusing on the following areas:

- Compensation and Benefits
- Employee Recruitment, Retention and Development
- Compliance: Employment Laws and Company Policy
- Employee and Labor Relations
- Workers Compensation

Compensation and Benefits - Accountable for formulating a total rewards program that has the power to attract, motivate, engage and retain employees with a focus on shared accountability between the employee and the company.

- Compensation - Providing a total compensation package that contains base pay along with variable pay that provides value for the customer, shareholder and employee. Analyzing programs to ensure plans are competitive to the market. Providing service to employees, management and retirees regarding pay and benefit questions.
- Benefits - Developing a comprehensive package of health and welfare programs. Developing and administering retirement programs that are competitive with the utility industry to attract and retain our employees.

Employee Recruitment, Retention and Development – Delivers value by working with outside employment firms, recruiters, colleges and university to maintain a company presence and actively recruit future employees and students in fields of study to provide a future workforce and smooth transition through company restructures, transitions and attrition; evaluates workforce risks and trends in order to develop long-term labor planning; develops and supports leadership development through a series of programs designed to build a common understanding of our company's culture, strategy and processes among all of our employees.

Compliance: Employment Laws and Company Policy - Delivers value by ensuring personnel policies and procedures are followed consistently by all departments; ensuring workforce strategies, actions and practices meet the focus, compliance and needs of all individuals to provide the greatest level of opportunity for all current and potential employees; provides training, both in-person and on-line, around hiring, our anti-harassment policy, and supervision; ensures consistent application of HR practices and processes to minimize risk and liability to the company and to strengthen our company through the benefits that diversity provides.

Employee and Labor Relations –Working directly with Local Union representatives, including representative employees, to create the optimum value related to this segment of the workforce;

providing strong, effective communications with Union represented employees to foster and promote a climate of full cooperation; collectively working with Union leadership to minimize disruptions through safe and productive labor, delivers value.

- Provide workforce resources for consulting on existing labor agreements.
- Provide workforce relations resources to negotiate new labor agreements.
- Provide workforce relations resources for the grievance and arbitration process and procedures.
- Administer workforce relations training including labor contract interpretation training and positive discipline training.

Workers Compensation – Providing direct oversight and management to minimize the potential adverse impact of Workers Compensation related incidents.

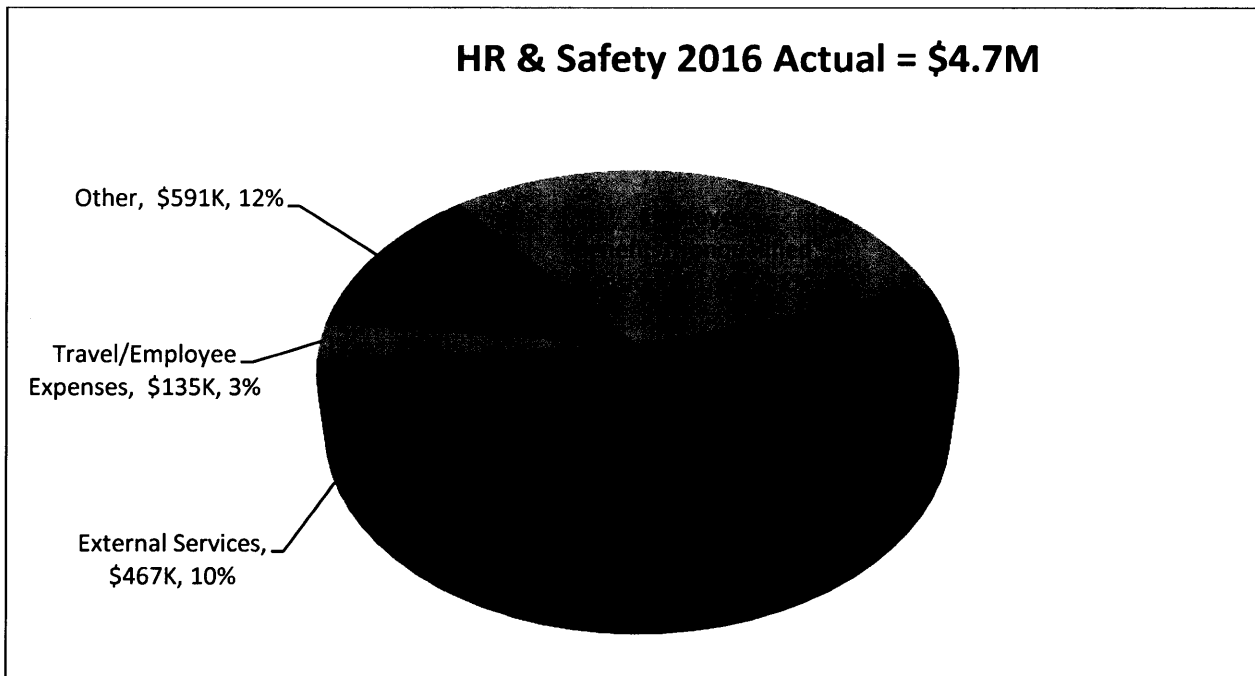
- Working closely with the OTP Safety Services Department to focus on injury and incident prevention thru proactive programs designed to maintain employee safety awareness.
- Managing claims directly, maintaining close contact with employees and medical care providers to ensure a safe and productive return to work for employees away due to injury or incident.
- Working with management and industry organizations to proactively manage Workers Compensation claims, minimizing the impact of any Workers Compensation related incident.

Safety Services

Safety Services creates value by seeking to continuously improve all areas in safety performance by developing and implementing safety programs as well as providing best safety practices across the organization. Safety Services also sustains the protection of Company employees and assets by providing security and protection services.

Some of the Safety programs include: Fire Retardant Clothing for workers exposed to electrical and fire hazards, Vivid On-Line Safety Learning, Hazardous Communication or “Right to Know,” Safety Recognition and Safety Rule Review/Training and Driver Safety. The Safety department strives to create a culture where their customers perceive training as an essential element to their success; It also develops and implements technical skills through quality apprentice and journeyman training programs, while instilling safe work practices and personal accountability, are critical elements of the safety training.

2.1 2016 O&M Actuals



Labor: Includes the costs associated with Human Resources and Safety Services employees who help design and administer multiple health, welfare, compensation, recruitment and selection, retirement, payroll, HR administration, labor relations, diversity, health services, learning and talent management programs, workers compensation and risk insurance management, as well as providing consultation and advice to the business to manage workforce issues. Safety Services employees provide technical assistance in all areas and specialties of industrial safety and OSHA regulatory compliance and also the protection of company employees and assets by providing security and protection services.

Travel/Employee Expenses: Includes travel and related expenses to design and administer health, welfare, compensation, recruitment and selection, payroll, HR administration, labor relations, diversity, health services, retirement, learning, training, talent management programs, Safety related training and programs and also pre-hire assessments, physicals, drug tests, and other expenses such as pre-employment background checks and driving records.

External Services: Consulting costs are incurred for compensation and benefits related studies, workforce planning, employee engagement, leadership training, and health services. HR uses contract outside vendors for employment compliance and benefits program administration. Safety Services hires external speakers each year to present safety related topics at an annual Safety Round Table that provides safety leadership training for approximately ten percent of our employees.

Employee Benefits – Nonqualified Pension: Includes the cost for the Executive Survivor and Supplemental Retirement Plan (ESSRP). The ESSRP provides nonqualified defined benefit payments to executive officers hired prior to September 1, 2006 and to certain key management employees who were working for OTP prior to September 1, 2006.

Employee Benefits – Other: Includes items in support of employee benefits that are not part of the Labor Loading Process. These items include the annual Employee Stock Ownership (ESOP) company contribution, tuition reimbursement programs, annual service awards and meetings, and other employment recognition programs such as Otter Bucks and Dinner for Two certificates. Safety Services related items include training materials such as Vivid On-Line Learning, PowerLift and SafeStart, personal protective equipment (hard hats, fall restraint belts, eye wash stations), compliance software (MSDSonline for Safety Data Sheets tracking, IndustrySafe for injury and incident tracking and reporting) and other related safety items for the security of employees and assets.

Other: Items include lease and rental fees as they pertain to offers of employment, filing fees, dues, subscriptions and books, advertising costs associated with posting of jobs to employment websites and newspapers, and materials and operating supplies to support the Safety Services Department. These include Fire Retardant Clothing program, elementary school training supplies and other safety related programs.

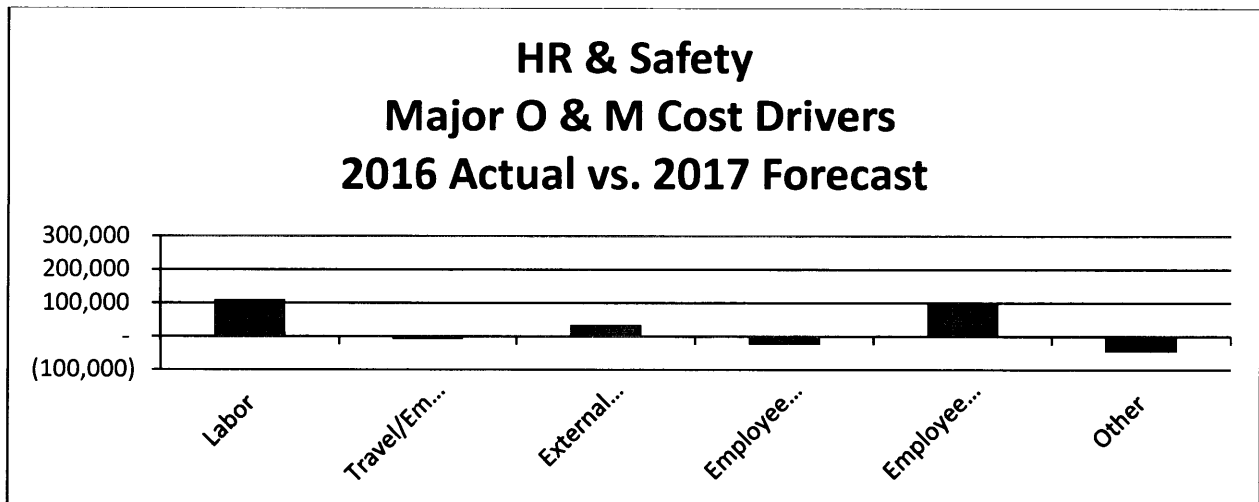
2.2 2016 O&M Actuals vs 2017 O&M Forecast

HR & Safety

2016 Walk forward of Major Cost Drivers

2016 O&M Actuals	\$4,683,832
Labor	110,791
<i>Wage increases</i>	
Travel/Employee Expenses	(7,731)
External Services	35,116
<i>Expenses related to consulting services</i>	
Employee Benefits/Nonqualified Pension	(25,216)
<i>Expenses related to the ESSRP</i>	
Employee Benefits/Other	94,994
<i>Expenses related to anticipated workers compensation settlements</i>	
Other ⁽¹⁾	(46,678)
<i>Expenses related to Fire Retardant Clothing Allowance</i>	
2017 O&M Forecast	\$4,845,108

(1) Other - includes office expenses, dues and subscriptions, material and operating supplies, lease/rental expenses, and other miscellaneous expenses.

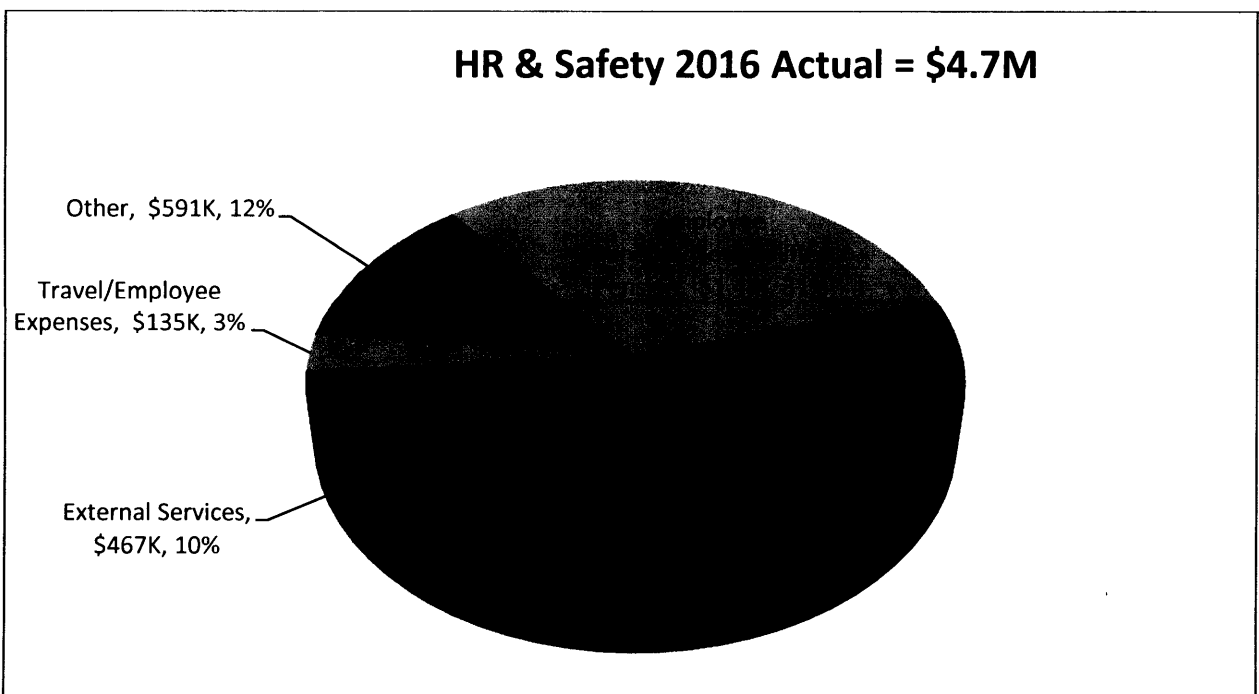


Explanations for the major cost drivers for 2016 Actual versus 2017 Forecast:

Labor: Annual wage increases of 3 percent and increased payroll loading due to an increase in the cost of benefits.

Employee Benefits – Other: Increase is due to pending workers compensation settlements.

Other – Increase due to anticipated implementation of hiring assessments.



Labor: includes the costs associated with Human Resources and Safety Services employees who help design and administer multiple health, welfare, compensation, recruitment and selection,

retirement, payroll, HR administration, labor relations, diversity, health services, learning and talent management programs, workers compensation and risk insurance management as well as provide consultation and advice to the business to manage workforce issues. Safety Services employees provide technical assistance in all areas and specialties of industrial safety and OSHA regulatory compliance and also the protection of company employees and assets by providing security and protection services.

Travel/Employee Expenses: includes travel and related expenses to design and administer health, welfare, compensation, recruitment and selection, payroll, HR administration, labor relations, diversity, health services, retirement, learning, training, talent management programs, Safety related training and programs and also pre-hire assessments, physicals, drug tests, and other expenses such as pre-employment background checks and driving records.

External Services: Consulting costs are incurred for compensation and benefits related studies, workforce planning, employee engagement, leadership training, and health services. HR uses contract outside vendors for employment compliance and benefits program administration. Safety Services hires external speakers each year to present safety related topics at an annual Safety Round Table that provides safety leadership training for approximately ten percent of our employees.

Employee Benefits – Nonqualified Pension: Includes the cost for the Executive Survivor and Supplemental Retirement Plan (ESSRP). The ESSRP provides nonqualified defined benefit payments to executive officers hired prior to September 1, 2006 and to certain key management employees who were working for OTP prior to September 1, 2006.

Employee Benefits – Other: Includes items in support of employee benefits that are not part of the Labor Loading Process. These items include the annual Employee Stock Ownership (ESOP) company contribution, tuition reimbursement programs, annual service awards and meetings, and other employment recognition programs such as Otter Bucks and Dinner for Two certificates. Safety Services related items include training materials such as Vivid On-Line Learning, PowerLift and SafeStart, personal protective equipment (hard hats, fall restraint belts, eye wash stations), compliance software (MSDSonlinefor Safety Data Sheets tracking, IndustrySafe for injury and incident tracking and reporting) and other related safety items for the security of employees and assets.

Other: Items include lease and rental fees as they pertain to offers of employment, filing fees, dues, subscriptions and books, advertising costs associated with posting of jobs to employment websites and newspapers, and materials and operating supplies to support the Safety Services

Department. These include Fire Retardant Clothing program, elementary school training supplies and other safety related programs.

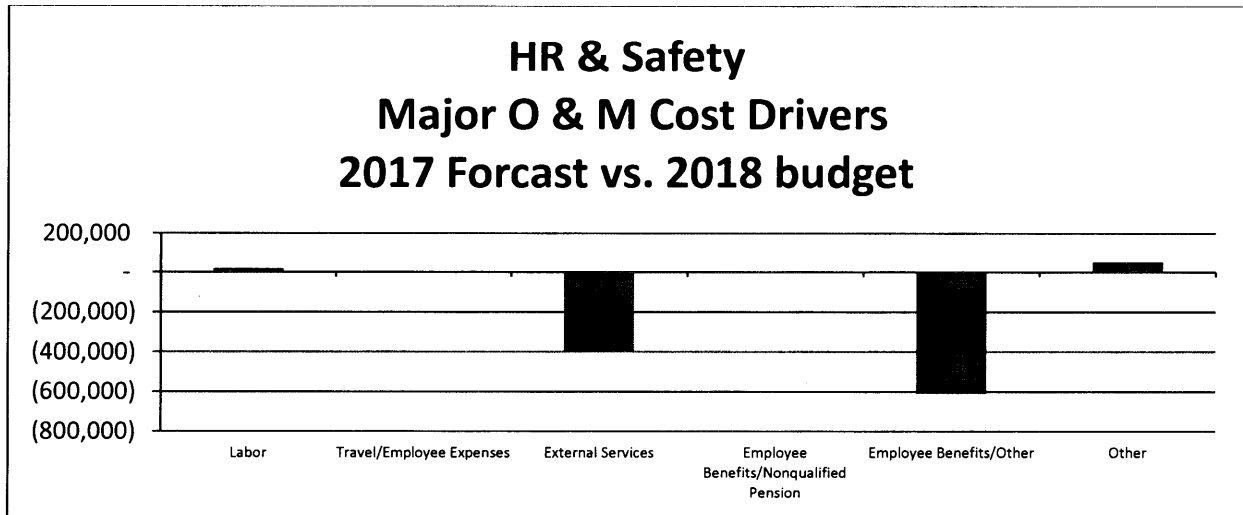
2.3 2017 O&M Forecast vs 2018 O&M Budget

HR & Safety

2017 Walk forward of Major Cost Drivers

2017 O&M Forecast	\$4,845,108
Labor	20,316
Travel/Employee Expenses	(144)
External Services	(395,776)
Employee Benefits/Nonqualified Pension <i>Expenses related to the ESSRP</i>	6,280
Employee Benefits/Other	(611,338)
Other (1) <i>Expenses related to Fire Retardant Clothing Allowance</i>	52,526
2018 O&M Budget	\$3,916,972

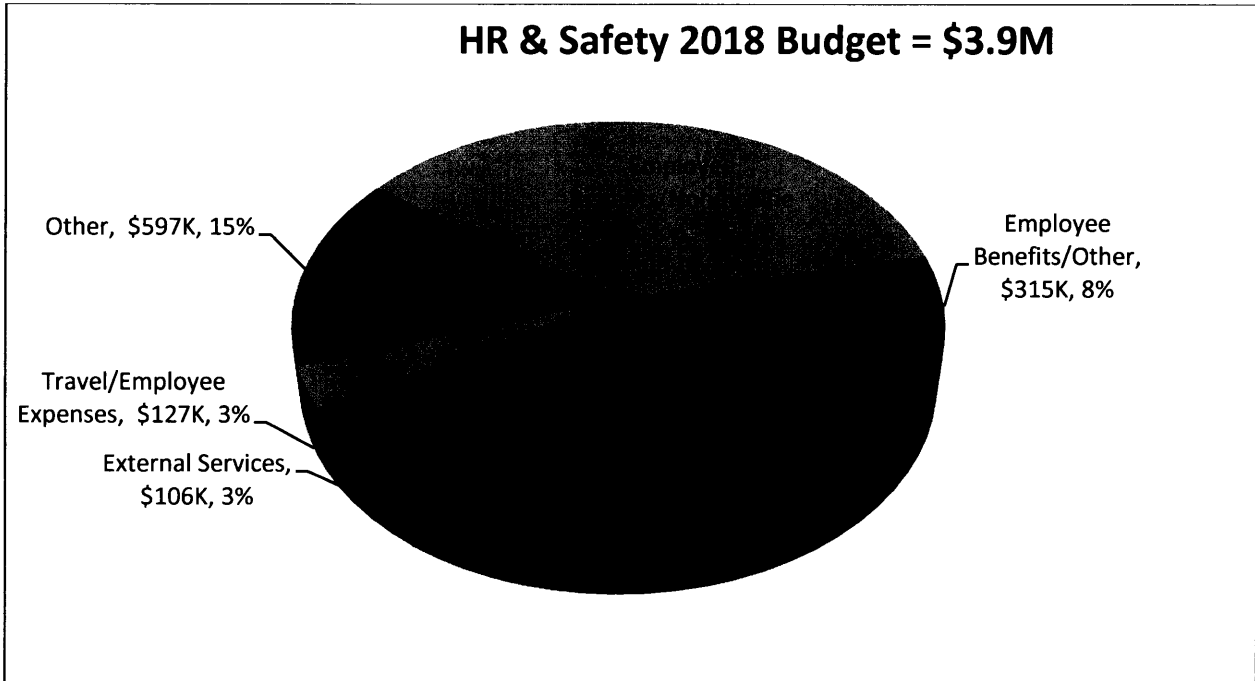
(1) Other - includes office expenses, dues and subscriptions, material and operating supplies, lease/rental expenses, and other miscellaneous expenses.



Explanations for the major cost drivers for 2017 Forecast versus 2018 Budget:

External Services: Decision to move these expenses from O&M to Payroll Loading as they relate to employee benefit costs. This includes professional services such as Mercer actuarial costs, Eide Bailly audit, Flex and COBRA administration, Village Family Services, FMLA Source and Merrill Lynch.

Employee Benefits/Other: The annual Employee Stock Ownership (ESOP) contribution was moved from O&M to Payroll Loading.



Labor: Includes the costs associated with Human Resources and Safety Services employees who help design and administer multiple health, welfare, compensation, recruitment and selection, retirement, payroll, HR administration, labor relations, diversity, health services, learning and talent management programs, workers compensation and risk insurance management as well as provide consultation and advice to the business to manage workforce issues. Safety Services employees provide technical assistance in all areas and specialties of industrial safety and OSHA regulatory compliance and also the protection of company employees and assets by providing security and protection services.

Travel/Employee Expenses: Includes travel and related expenses to design and administer health, welfare, compensation, recruitment and selection, payroll, HR administration, labor relations, diversity, health services, retirement, learning, training, talent management programs,

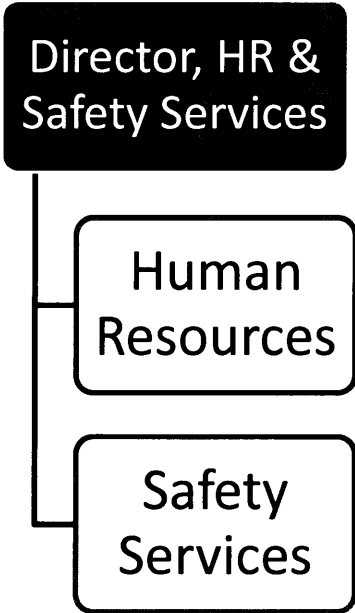
Safety related training and programs and also pre-hire assessments, physicals, drug tests, and other expenses such as pre-employment background checks and driving records.

External Services: Consulting costs are incurred for compensation and benefits related studies, workforce planning, employee engagement and leadership training. HR uses contract outside vendors for employment compliance and benefits program administration. Safety Services hires external speakers each year to present safety related topics at an annual Safety Round Table that provides safety leadership training for approximately ten percent of our employees.

Employee Benefits – Nonqualified Pension: Includes the cost for the Executive Survivor and Supplemental Retirement Plan (ESSRP). The ESSRP provides nonqualified defined benefit payments to executive officers hired prior to September 1, 2006 and to certain key management employees who were working for OTP prior to September 1, 2006.

Employee Benefits – Other: Includes items in support of employee benefits that are not part of the Labor Loading Process. These items include tuition reimbursement programs, annual service awards and meetings, and other employment recognition programs such as Otter Bucks and Dinner for Two certificates. Safety Services related items include training materials such as Vivid On-Line Learning, PowerLift and SafeStart, personal protective equipment (hard hats, fall restraint belts, eye wash stations), compliance software (MSDSonline for Safety Data Sheets tracking, IndustrySafe for injury and incident tracking and reporting) and other related safety items for the security of employees and assets.

Other: Items include lease and rental fees as they pertain to offers of employment, filing fees, dues, subscriptions and books, advertising costs associated with posting of jobs to employment websites and newspapers, and materials and operating supplies to support the Safety Services Department. These include Fire Retardant Clothing program, elementary school training supplies and other safety related programs.



Human Resources

Major Functions

The Human Resources Department is centralized and focuses on management of all HR functions with individuals focused on Compensation & Benefits, Employee Recruitment and Retention, Compliance with Employment Laws and Company Policies, Employee and Labor Relations and Workers Compensation.

Key Activities

- **Compensation and Benefits**
 - Monitor and administer the compensation system to ensure equity across ranges and within roles to retain current employees and provide a marketing advantage for future and potential employees.
 - Manage and administer the total compensation package, including incentive plan compensation, to foster and encourage a system that offers a pay for performance component to promote a high level of employee performance through targeted levels of individual and company performance.
 - Oversight and administration of the health and welfare plans to assist employees in making informed choices relating to the benefits offered in these plans, maximizing the value of the plan for employees.
 - Provide accurate data entry of monthly pension payments and changes to reflect the actual obligations and choices of our retirees.
 - Management of the Job Evaluation Team ensuring that roles are properly and equitably placed within the current matrix and employees are compensated in relation to the value of the role for OTP.

- **Employee Recruitment and Retention**
 - Manage resumes and applications of potential professional hires to ensure a qualified pool of individuals to replace attrition and resignations.
 - Provide aptitude testing to provide a pool of potential future craft employees to replace attrition and resignations.
 - Maintain a presence at local educational institution career fairs to foster relations with the institutions and advertise future employment opportunities with OTP.
 - Promote and respond to requests for employment information to promote OTP as an employer of choice to interested individuals and potential new hires.
 - Work internally through the company's intranet and through external sources to provide a broad base of potential hires. The primary goal is to ensure OTP the best value for related employment marketing while attracting the highest level of candidates.

- **Compliance: Employment Laws and Company Policy**
 - Review all internal and external postings and hires. Work with hiring managers and supervisors to ensure consistency and compliance with the Equal Employment Opportunity Commission (EEOC) and Affirmative Action (AA) laws.
 - Provide an annual review of the AA plan to comply with related laws and ensure an audit proof plan.
 - Collaborate with company personnel to make sure we comply with and practice activities in compliance with the Fair Labor Standards Act (FLSA).
 - Engage in and complete all required non-discrimination testing and annual filings as it relates to the Employment Retirement Income Security Act (ERISA) benefit plans.
 - Collaborate with company management to develop and maintain an accurate list of all company HR policies.
 - Promotion of employee performance evaluations to company management and review of all completed evaluations to ensure compliance with related employment law requirements.
 - Collaborate with OTP management and employees to ensure a consistent, legal application of the Family Medical Leave Act (FMLA) and company sick leave policy.
 - Oversight and management of the OTP Commercial Driver's License (CDL) compliance program.
- **Employee and Labor Relations**
 - Provide pre-retirement planning workshops with employee groups to ensure a smooth transition for the employee and company through the retirement process.
 - Manage the Long-Term Disability (LTD) process to allow all parties to make informed decisions relating to current and future employment status.
 - Provide customer service to internal employees and to retirees as it relates to all HR related matters.
 - Promotion of company assisted programs such as the Employee Assistance Program (EAP) and the Employee Self Improvement Plan.
 - Provide training and administer employee evaluations.
 - Provide Leadership Essential Training.
 - Collaborate with company management to ensure consistent administration of the Positive Discipline Program to appropriately address employee negative performance and behaviors as they relate to the program.
 - Maintain a strong relationship with union business managers and business representatives to ensure an expedient administration of the collective bargaining agreements to maximize productivity and minimize disruption to operations.

- Provide consultation and consistent point of contact for management and union representatives to minimize the instances of debate and grievances' which will limit related business disruptions.
- Facilitate and manage union negotiations and administration of collective bargaining agreements.
- **Workers Compensation**
 - OTP is self-insured for Workers Compensation in Minnesota and South Dakota and is part of the North Dakota Workforce Safety Insurance plan.
 - OTP manages Workers Compensation programs internally and provides excellent value to the Company and Customers with strong program management, keeping rates extremely low with only minimum state required retention limits needed.
 - Managed care programs including monitoring medical treatment and assisting employees and managers regarding their treatment.

Safety Services

Major Functions

Safety Services seeks to continuously improve all areas in safety performance by developing and implementing safety programs as well as providing best safety practices across the organization. Safety Services also sustains the protection of Company employees and assets by providing security and protection services.

Key Activities

- Secure OTP's employees and assets.
- Develop and implement a contractor safety program that includes policy review, policy implementation and program development.
- Improve all areas in safety performance by implementing safety programs such as; SafeStart, Safety Alerts, Near Miss, Best Operating Practices, Monthly Communications, Recognition Programs and PowerLift Program.
- Develop safety rules and best practices that are both in compliance with OSHA and other industry standards applicable to our work environments, in order to drive down risk for OTP employees, contractors and the general public.
- Identify and implement best safety practices across the organization with help from industry peers and organization experts.
- Track and report all injuries in compliance with OSHA.
- Investigate injuries and incidents to determine root cause(s) in order to develop awareness of the hazard and prevent future incidents.

HR and Safety Services departments allocate a percentage of their labor to the jointly-owned plants (Big Stone Plant and Coyote Station). This percentage is calculated by using a headcount ratio of plant employees to total employees. The percentage is then allocated based on the amount of work that is performed by HR and Safety Services staff as it relates to the amount of time spent working on various HR and Safety Services matters. In addition, this same allocation percentage is applied to related benefit expenses such as any outside consulting service or charges directly benefiting the employees of these jointly-owned plants.



2016-2018 O&M Budget Documentation

Information Technology

1.1 Introduction

Otter Tail Power Company's (OTP's) Information Technology department supports OTP's mission of providing for the safe and reliable delivery of electric service to customers in Minnesota, North Dakota, and South Dakota.

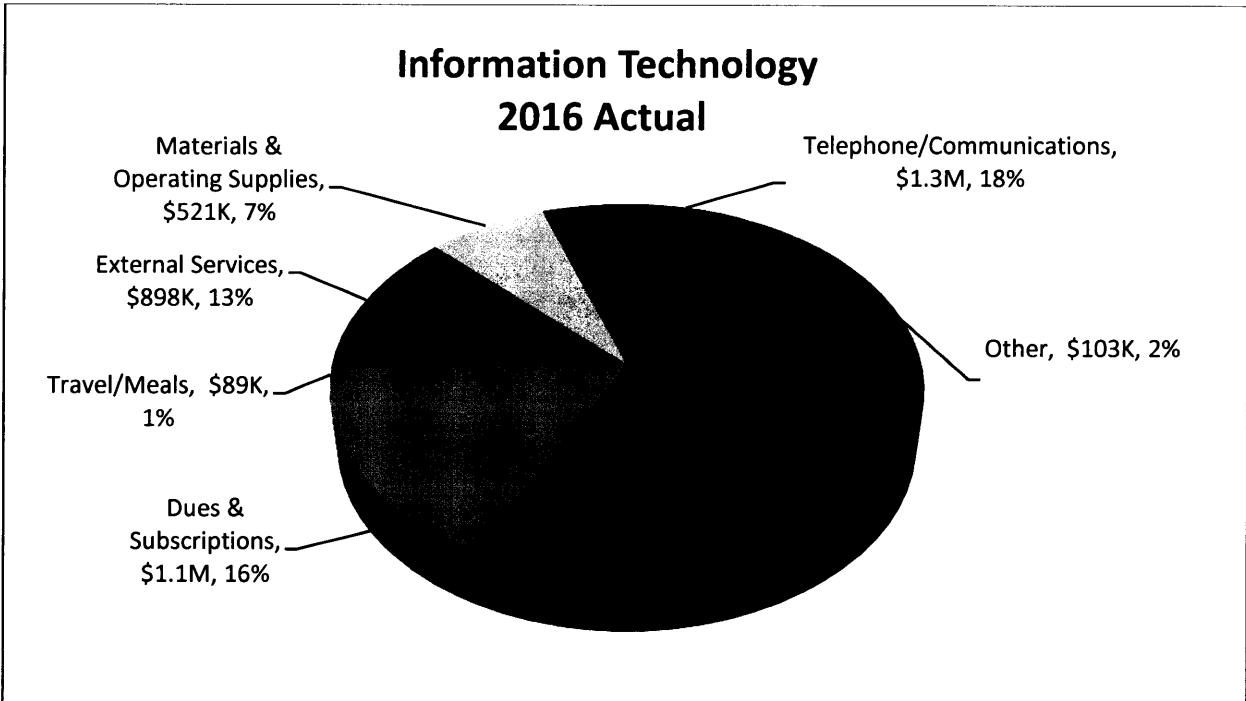
The Information Technology department strives to deliver cyber-secure and valuable business solutions to the enterprise to support operational excellence. Through collaboration with our business partners, we identify and implement solutions that add value by applying technology, achieving process improvements, and increasing business intelligence. Information Technology contains the following departments: Computer Systems, Telecommunications, and IT Compliance.

1.2 Customer Value

The Information Technology Department oversees the maintenance and operations of the systems utilized by OTP. Specifically, one of the system's this area maintains is the customer billing system through which OTP ensures that the related data is secure. The systems this area oversees provide essential services so employees can concentrate on serving OTP customers and the communities in which the company operates. This area stays abreast of technological advances and recommends and implements improvements that are beneficial in ensuring accurate and reliable customer data. In addition, this area ensures that OTP's computer network and physical perimeter is secure.

Information Technology also ensures compliance requirements by designing technology solutions, implementing controls, and documenting all aspects of the NERC Compliance discipline. By properly documenting and reviewing standards and regularly updating senior management, we can ensure the intellectual safety of our facilities and data ultimately allowing us to deliver reliable energy to our customers to fulfill their electricity based needs.

2.1 2016 O&M Actuals



Labor: Employee payroll expenses for employees classified as Union and Non-Union, Exempt and Non-Exempt.

External Services: These costs include contracts for services to support Information Technology services like Help Desk and Network Infrastructure Support.

Dues & Subscriptions: Costs associated with monthly and on-going costs for recurring services for applications and products used to support daily functions with this area.

Travel/Meals: Costs associated with meal and travel expenses for remote location maintenance and updating software and training for employees for meals and lodging incurred while traveling.

Materials & Operating Supplies: Expenses, such as network switches, servers, and racks associated with the day-to-day operations for all cost centers within Information Technology.

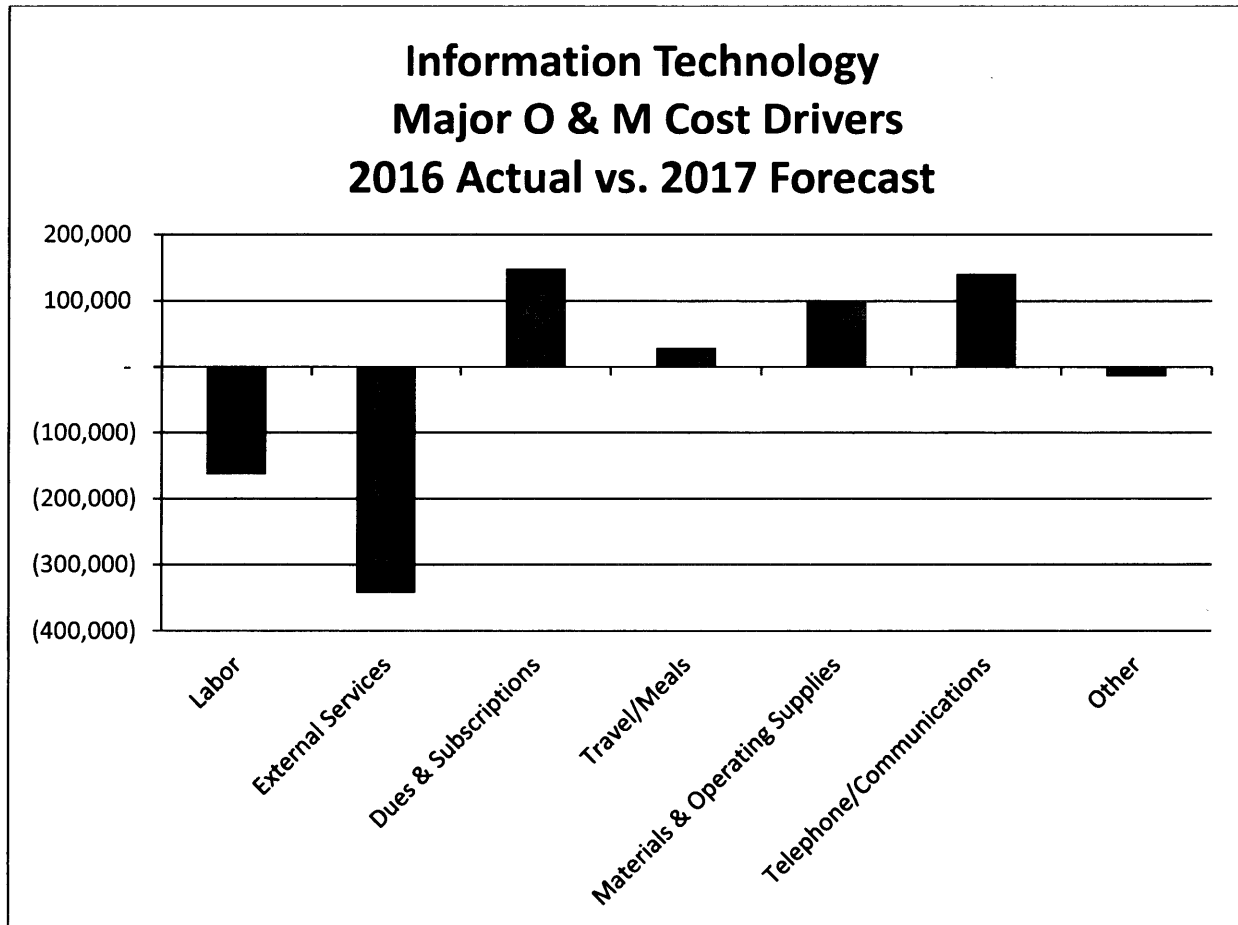
Telephone/Communications: Includes lease circuit costs that provide connectivity to substations, plants and office locations. Also includes equipment and fees associated with maintaining and operating the two-way radio communication system, microwave, cellular and industrial networks.

Other: Includes costs associated with buildings and grounds, office supplies, lease/rental, miscellaneous expenses, and other employee benefits.

2.2 2016 O&M Actuals vs 2017 O&M Forecast**Information Technology****2016 Walk forward of Major Cost Drivers**

2016 O&M Actuals	\$7,070,475
Labor	(163,245)
External Services	(343,114)
Dues & Subscriptions	149,206
Travel/Meals	29,575
Materials & Operating Supplies	97,627
Telephone/Communications	141,331
Other ⁽¹⁾	(14,242)
2017 O&M Forecast	\$6,967,613

(1) Other - includes office expenses, building & grounds, miscellaneous expenses, lease/rental expense, and other employee benefits.



Explanations for the major cost drivers for 2016 Actual versus 2017 Forecast:

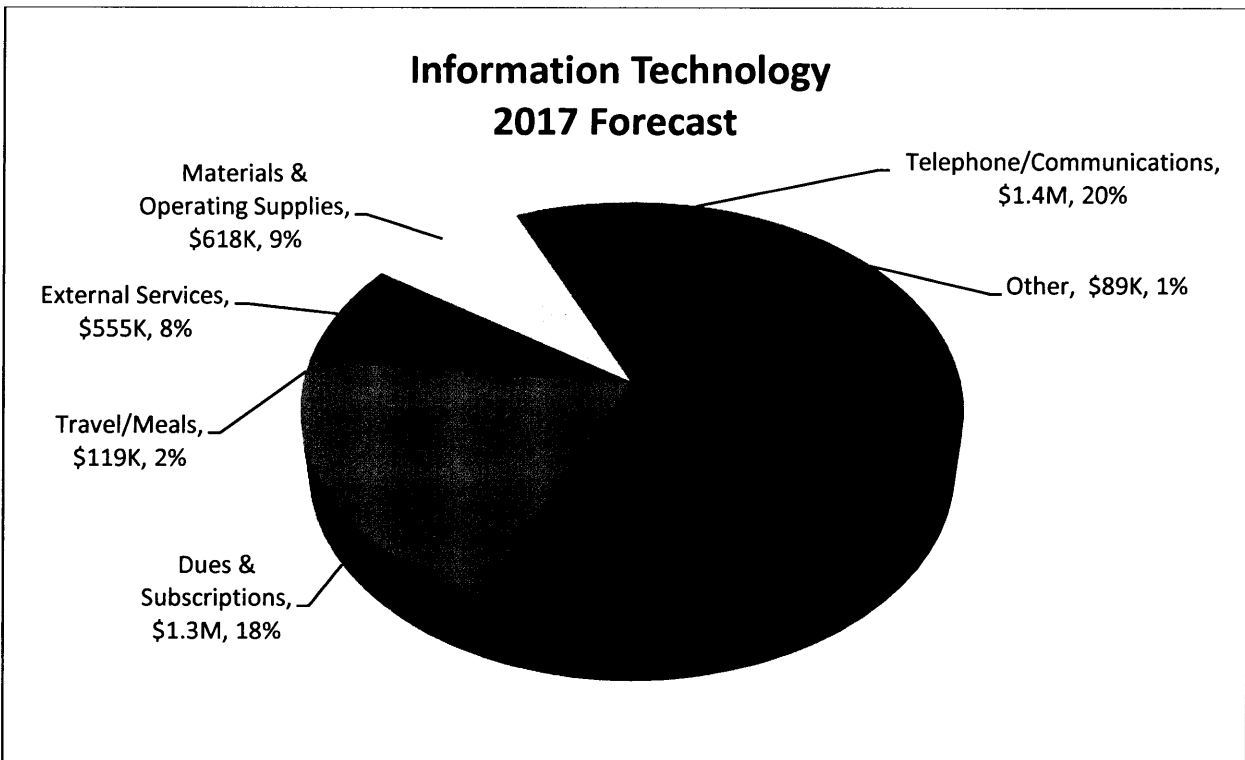
Labor: The decrease is mainly due to a shift to construction projects.

External Services: The decrease is mainly attributable to vendor services mainly from TeleCom.

Dues & Subscriptions: The increase is due to application support and expansion related to workforce automation (such as Office 365,) security (such as mobile device management using AirWatch,) and integration tools (such as Axway). Overall support and maintenance costs for existing hardware and software continue to increase annually due to inflation.

Materials & Operating Supplies: Expenses to support day-to-day functions, such as network switches, servers, and racks caused an increase in this category.

Telephone/Communications: Expansion of the OTP Industrial Communications Network resulted in an increase in the number of leased communications circuits. On average, each added leased circuit costs OTP approximately \$2,000/month.



Labor: Employee payroll expenses for employees classified as Union and Non-Union, Exempt and Non-Exempt.

External Services: These costs include contracts for services to support Information Technology services like Help Desk and Network Infrastructure Support.

Dues & Subscriptions: Costs associated with monthly and on-going costs for recurring services for applications and products used to support daily functions with this area.

Travel/Meals: Costs associated with field crews and remote employees for meals and lodging incurred while traveling.

Materials & Operating Supplies: Expenses, such as network switches, servers, racks, and end-use computing accessories associated with the day-to-day operations for all cost centers within Information Technology.

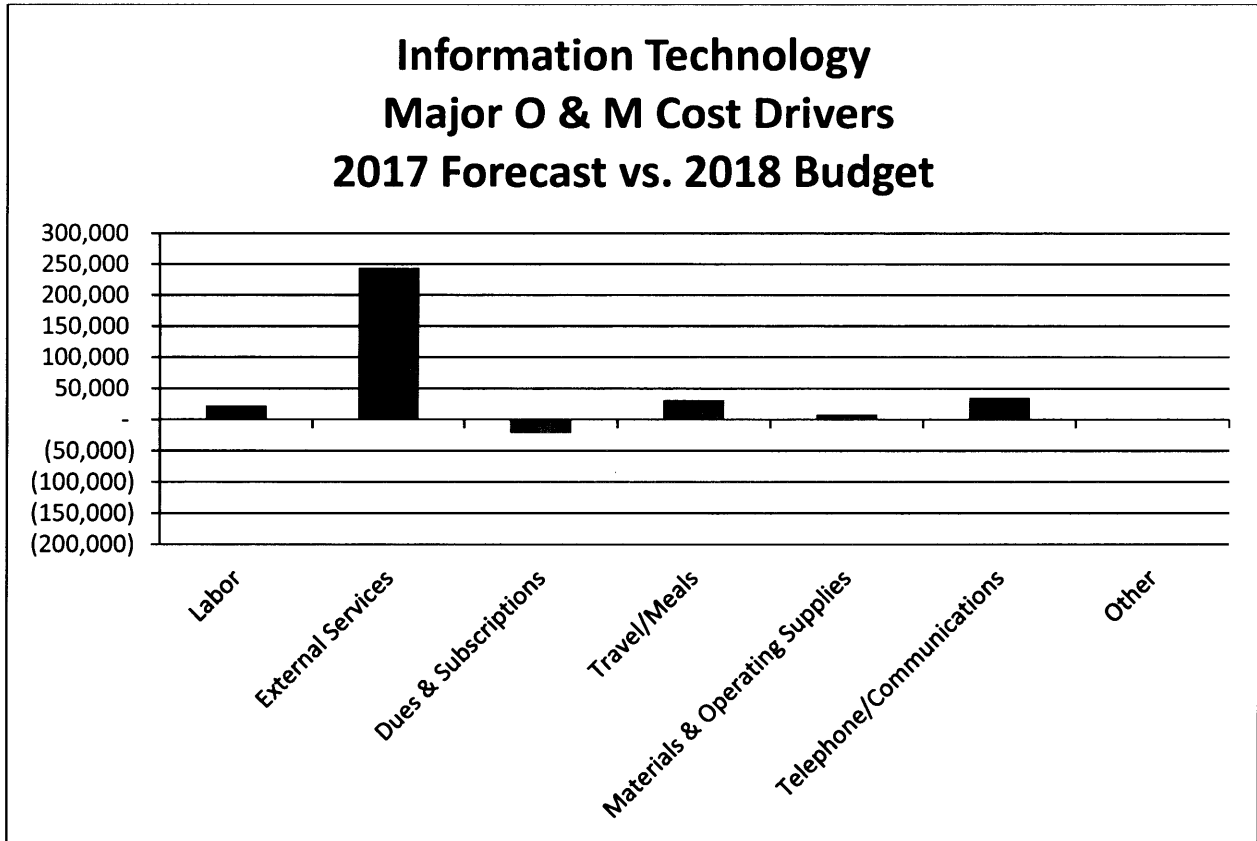
Telephone/Communications: Includes lease circuit costs that provide connectivity to substations, plants and office locations. Equipment and fees associated with maintaining and operating our two-way radio communication system, microwave, cellular and industrial networks.

Other: Includes costs associated with office supplies, lease/rental, miscellaneous expenses, and other employee benefits.

2.3 2017 O&M Forecast vs 2018 O&M Budget**Information Technology
2017 Walk forward of Major Cost Drivers**

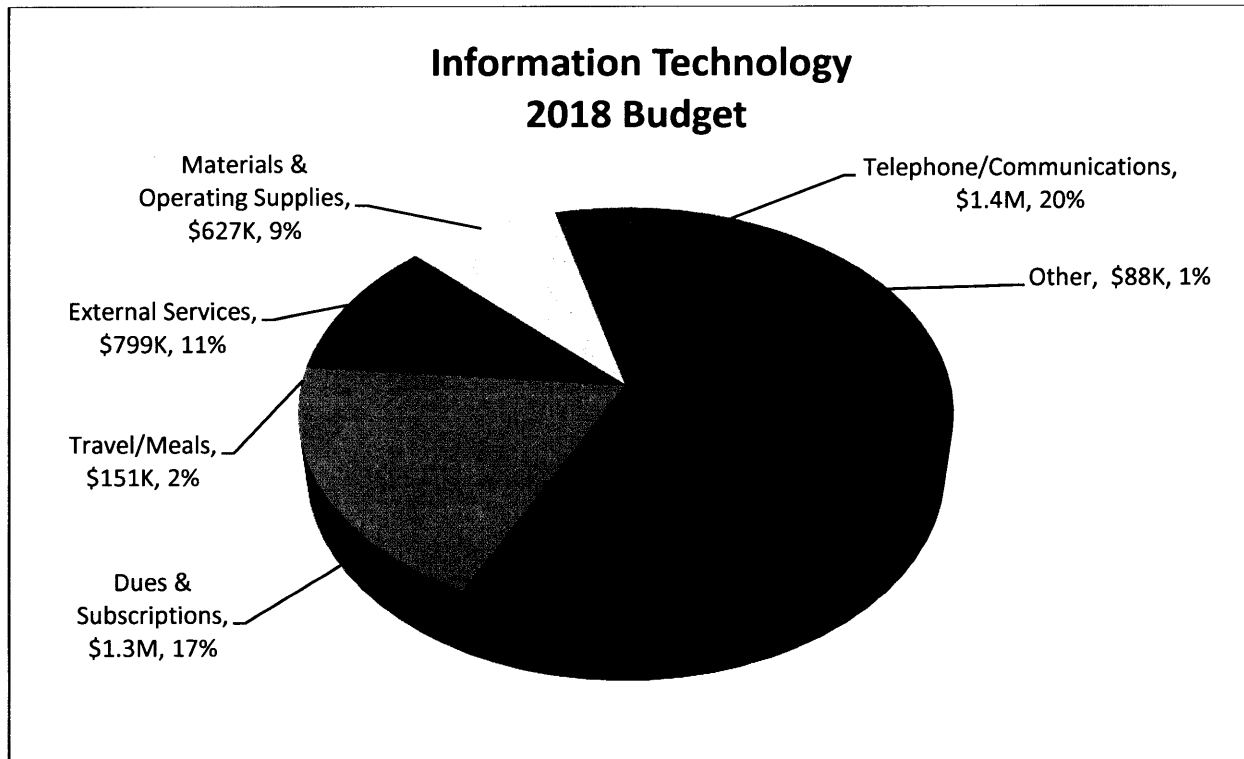
2017 O&M Forecast	\$6,967,613
Labor	22,535
External Services	244,248
Dues & Subscriptions	(21,680)
Travel/Meals	32,158
Materials & Operating Supplies	8,556
Telephone/Communications	35,484
Other ⁽¹⁾	(1,072)
2018 O&M Budget	<u><u>\$7,287,843</u></u>

(1) Other - includes office expenses, building & grounds, miscellaneous expenses, lease/rental expense, and other employee benefits.



Explanations for the major cost drivers for 2017 Forecast versus 2018 Budget:

External Services: Contracted for third party support to assist with selection of a replacement/procurement of an Enterprise Resource Planning System including financials, work management and asset management functionality.



Labor: Employee payroll expenses for employees classified as Union and Non-Union, Exempt and Non-Exempt.

External Services: These costs include contracts for services to support Information Technology services like Help Desk and Network Infrastructure Support.

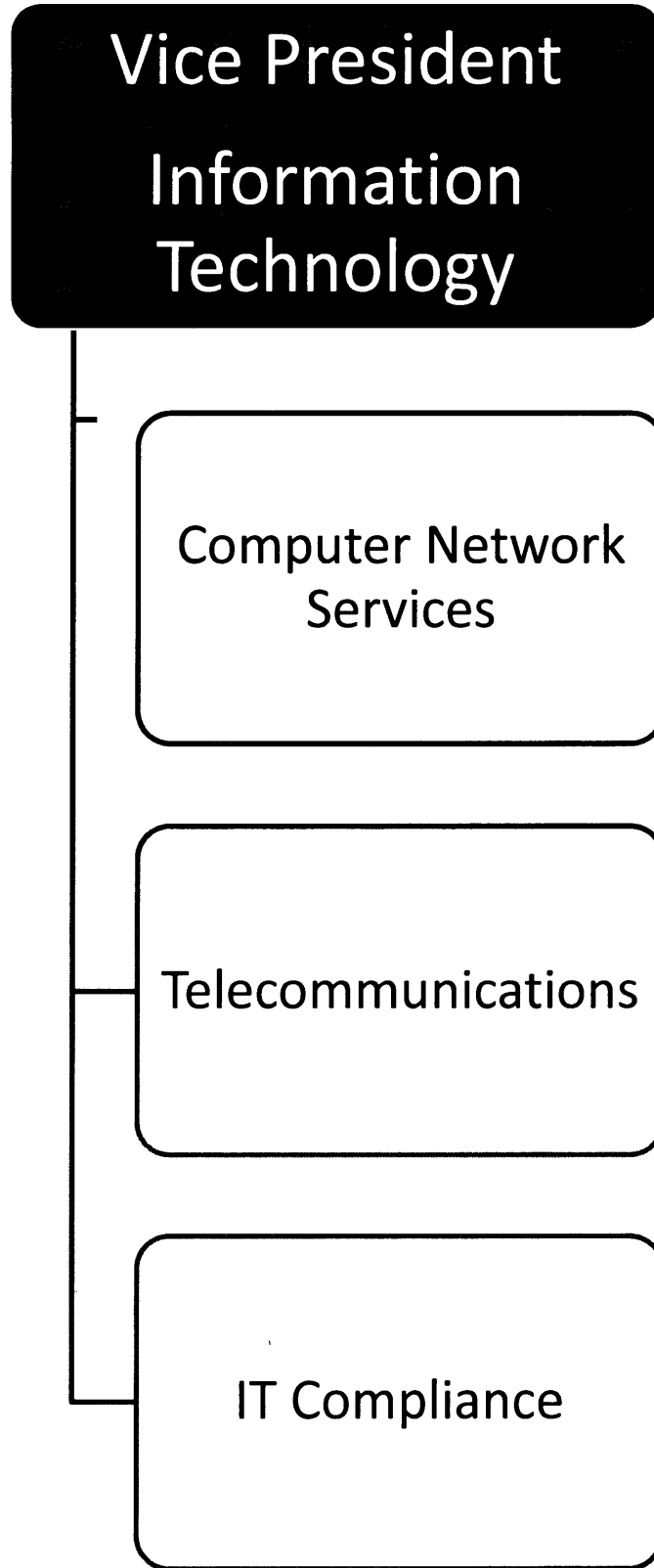
Dues & Subscriptions: Costs associated with monthly and on-going costs for recurring licensing and maintenance services for applications and products used to support daily functions with this area.

Travel/Meals: Costs associated with employees for meals and lodging incurred while traveling.

Materials & Operating Supplies: Expenses, such as network switches, security appliances, servers, racks, associated with the day-to-day operations for all cost centers within Information Technology.

Telephone/Communications: Includes lease circuit costs that provide connectivity to substations, plants and office locations. Also includes equipment and fees associated with maintaining and operating our two-way radio communication system, microwave, cellular and industrial networks.

Other: Includes costs associated with office supplies, lease/rental, miscellaneous expenses, and other employee benefits.



Computer Network Services

Major Functions

Computer Network Services at OTP is typically driven by two major forces. First, Legacy Systems, where end of life prompts replacing old IT Systems by purchasing new IT systems to drive operating improvements. Investing money on IT comes with a lot of hard, smart work and a disciplined structured methodology. Forecasting the benefits and tracking and implementing Organizational Change Management (OCM) are each equally as important as the successful implementation of IT. "GoLive" of new systems need to reflect the system's performance requirements and the changes in business processes that drove the IT initiative.

Second, new IT Systems can be justified when there are new business requirements and there is an available automated solution to drive a more efficient process.

Key Activities

- Ensure a Benefit/Cost or Value justification analysis is in place for all new IT Project requests. A contribution to Productivity, cost reduction is a goal for IT Green Field projects.
- Implement a utility wide team to coordinate consistent prioritization and justification of capital projects
- Develop IT asset replacement plans for buildings, office furniture, Mainframe, Server, Desktop, Laptop and other ancillary IT assets, utilizing diagnostic procedures, criteria for replacement, and age tracking
- Identify types of maintenance (diagnostic, predictive, repair, system patches) and prioritize use of System Specialists (people and dollars)
- Maximize the utilization of Servers by "Virtualizing"
- Move to implement the Virtual Desktop Infrastructure (VDI) to centralize the administration of Virus, Spam, Malware and other outside attacks on the Enterprise System.
- Provide timely response and concise answers to all questions related to OTP IT supported systems.
- Provide an IT Reliability that is maintained over time.

Telecommunications

Major Functions

Telecommunications is focused on developing our Telecommunication, Microwave and Enterprise and Industrial Network through the maintenance of a reliable and secure communications infrastructure for all facets of the enterprise.

Key Activities

- Oversee the design and operation of systems to provide information connectivity to OTP IT systems in a secure manner with system performance KPIs as drivers
- Maintain Reliability at current levels
- Allow proper operation of employee accountabilities.
- Protects enterprise and customer data all while supporting day-to-day business functions.

IT Compliance**Major Functions**

IT Compliance maintains compliance with all aspects of the NERC Compliance discipline. It implements a robust security protocol to protect enterprise and customer data all while supporting day-to-day business functions.

Key Activities

- Properly document and review all standards
- Provide updates to senior management to maintain understanding among all departments
- Self-report potential issues in a timely manner
- Manage and maintain OTP's physical and electronic records
- Coordinate the various regulatory, legal and compliance requirements that apply to records management
- Retention schedules are applied to records as appropriate.

N/A for this business area.



2016-2018 O&M Budget Documentation

Planning and Strategy

1.1 Introduction

The Planning and Strategy organization provides for the setting of environmental planning and policy, resource planning, market planning, utility-strategic planning, and wholesale energy market operations. The Vice President of Planning and Strategy has oversight of four groups: Environmental Services, Market Planning, Power Services, and Resource Planning. In addition, the Vice President of Planning and Strategy is directly responsible for oversight of Strategic Planning initiatives. A brief summary of each functional area is listed below.

Environmental Services

- Maintain compliance with environmental rules and regulations.
- Develop strategies for future environmental regulations and compliance
- Monitor legislative and regulatory actions related to environmental issues

Market Planning

- Develops and manages short, mid-term, and long-term marketing strategies and supporting tactics.
- Understands markets and customers by monitoring changes in the market, determining customer expectations and needs, and strengths and weaknesses of product/service offerings.
- Works in cross functional teams that develop pricing, communication, and advertising strategies.

Power Services

- Participate in wholesale energy markets to effectively meet the energy, capacity, and ancillary services needs of Otter Tail Power Company's (OTP's) customers while minimizing cost and/or risk.
- Identify and execute wholesale energy trading opportunities on behalf of OTP customers.
- Ensure compliance with regulatory requirements.

Resource Planning

- Monitor for new resource alternatives and opportunities.
- Plan for future short-term and long-term capacity and energy needs.
- Prepare and file the Integrated Resource Plan as required by state commissions.
- Work with all affected regulatory bodies and ensure compliance with applicable rules and obligations.

1.2 Customer Value

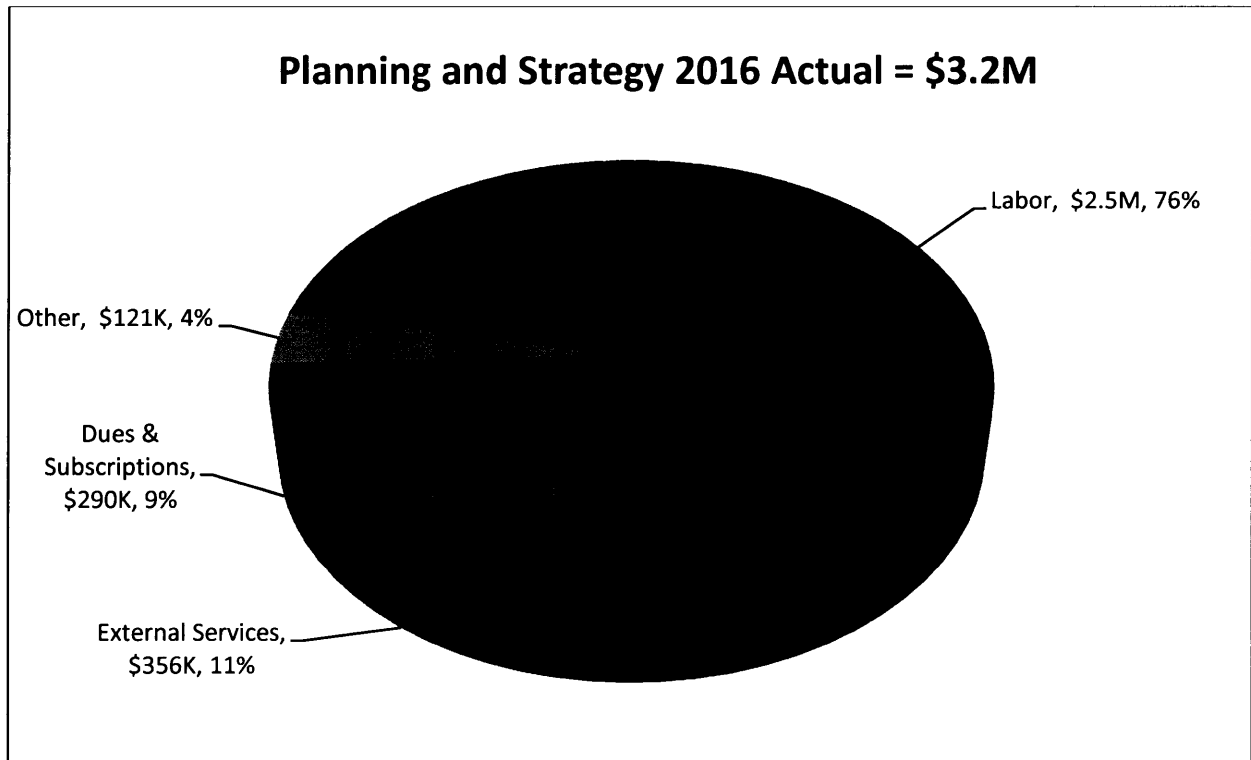
The Planning and Strategy organization brings value to OTP customers through six primary initiatives:

1. Optimization of OTP's generation resources with other resource alternatives to meet customer needs in a low-cost manner.
2. Load forecasting of demand and energy requirements.
3. Identification and determination of future long-term resource needs.
4. Monitoring, developing, and planning for environmental compliance.
5. Organizing and facilitating utility strategic planning efforts.
6. Developing customer focused products and services to meet customers' growing expectations.

The combination of the above mentioned functional areas into one organizational structure results in a number of natural synergies. A few examples of such synergies include:

1. Resource Planning's identification of long term energy and capacity needs combines with Power Services' knowledge of the wholesale energy and capacity markets to procure such products at the best possible pricing. Market planning provides added benefit to capacity planning by growing Otter Tail's ability to control capacity on the customer's side of the meter through demand response program offerings.
2. Environmental Services and Power Services interact in a similar manner when the need for procurement of environmental allowances is required on the wholesale market.
3. Combination of Resource Planning and Environmental Services into the same organizational structure ensures proper assumptions and environmental considerations are evaluated when planning for the future OTP generation portfolio.

2.1 2016 O&M Actuals



Labor: Labor for the Strategy and Planning organization consist of personnel who perform the key activities described under the Major Business and Key Activities section.

Dues and Subscriptions: This is primarily software costs necessary to interact with the MISO energy markets, identify and analyze energy market conditions, load forecasting, and to provide determination of future generation resources.

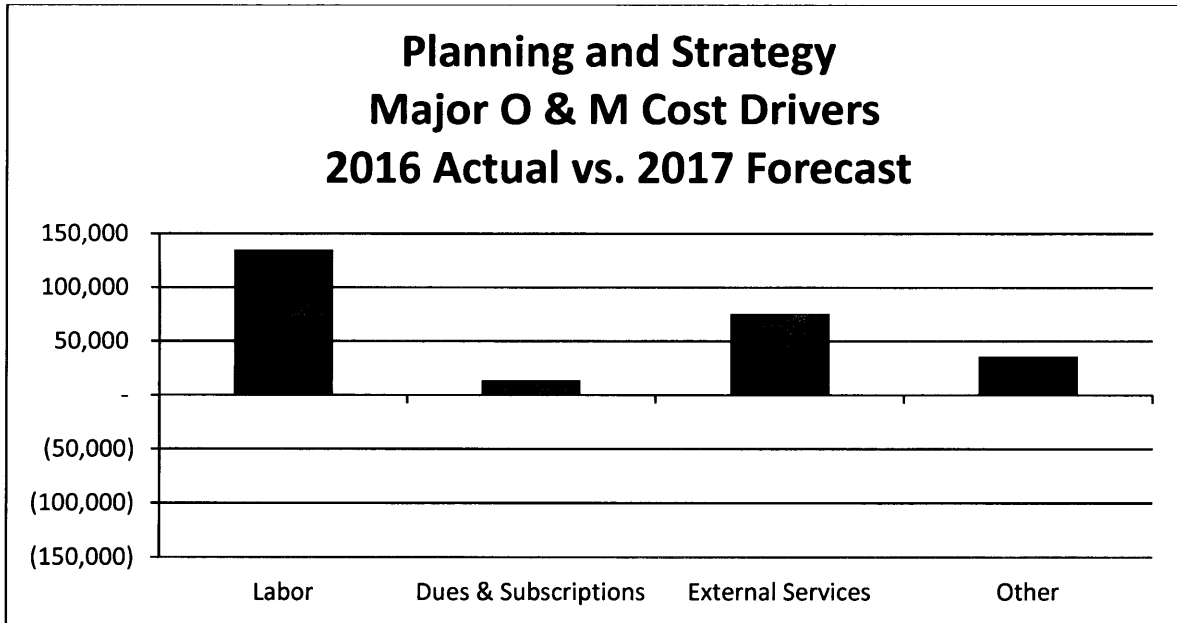
External Services: This expense is associated with external legal fees, professional services, and contract services.

Other: This cost category includes employee expenses, travel, communications, broker fees, advertising, and miscellaneous office expenses.

2.2 2016 O&M Actuals vs 2017 O&M Forecast**Planning and Strategy****2016 Walk forward of Major Cost Drivers**

2016 O&M Actuals	\$3,220,842
Labor	134,863
Dues & Subscriptions	14,054
External Services	75,696
Other ⁽¹⁾	36,113
2017 O&M Forecast	\$3,481,568

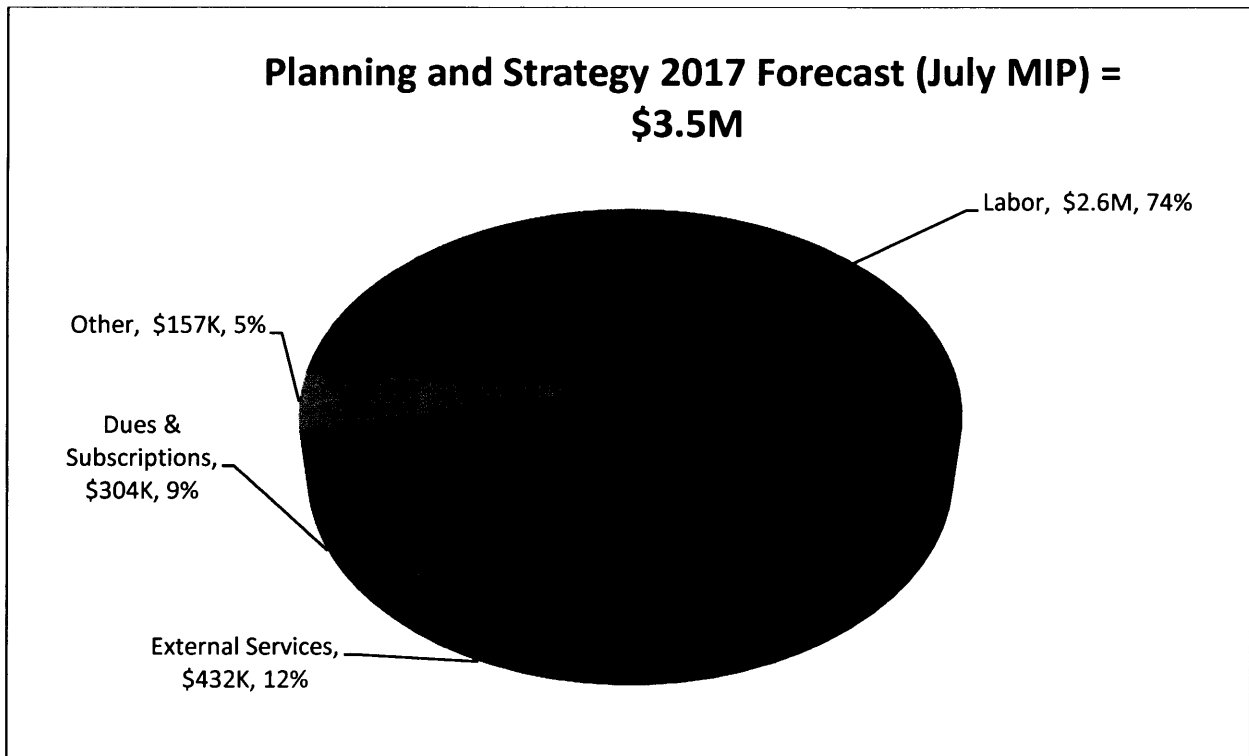
(1) Other - this cost category includes employee expenses, travel, communications, broker fees, and miscellaneous office expenses.



Explanations for the major cost drivers for 2016 Actual versus 2017 Forecast:

Labor –The increased labor cost is partially due to an expected additional full time employee over a portion of 2017. An approximate 3% merit wage increase is netted within this figure.

External Services – The increase in expense is primarily associated with external legal fees.



Labor: Labor for the Strategy and Planning organization consist of personnel who perform the key activities described under the Major Business and Key Activities section.

Dues and Subscriptions: This is primarily software costs necessary to interact with the MISO energy markets, identify and analyze energy market conditions, load forecasting, and to provide determination of future generation resources.

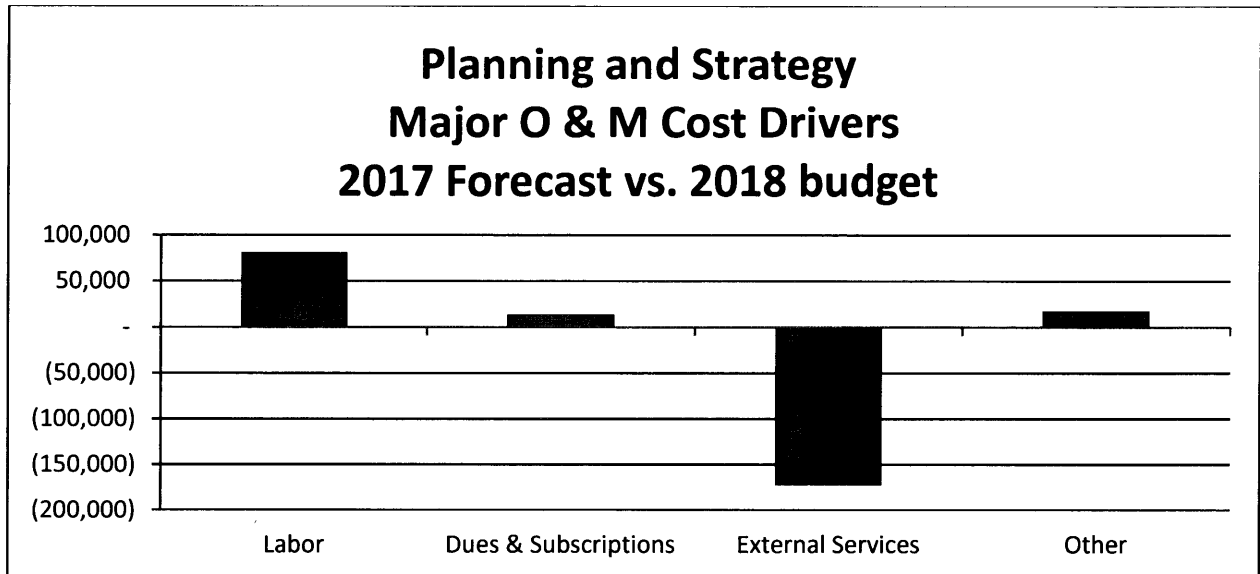
External Services: This expense is associated with external legal fees, professional services, and contract services.

Other: This cost category includes employee expenses, travel, communications, broker fees, advertising, and miscellaneous office expenses.

2.3 2017 O&M Forecast vs 2018 O&M Budget**Planning and Strategy****2017 Walk forward of Major Cost Drivers**

2017 O&M Forecast	\$3,481,568
Labor	81,279
Dues & Subscriptions	13,933
External Services	(172,365)
Other ⁽¹⁾	17,898
2018 O&M Budget	\$3,422,313

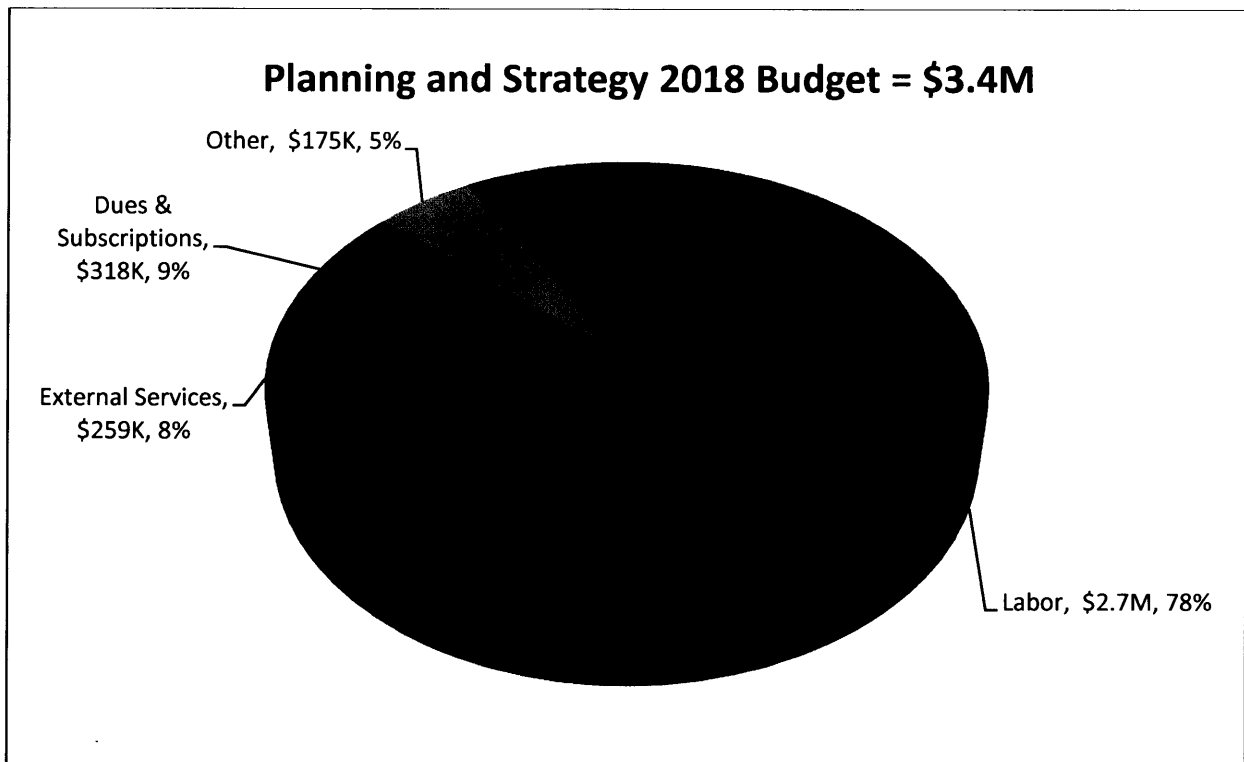
(1) Other - this cost category includes employee expenses, travel, communications, broker fees, and miscellaneous office expenses.



Explanations for the major cost drivers for 2017 Forecast versus 2018 budget:

Labor: The increased labor cost is partially due to an expected additional full time employee in 2018 that was only employed for a portion of 2017. An approximate 3% wage increase is netted within this figure.

External Services: The decrease pertains to reductions in anticipated legal fees.

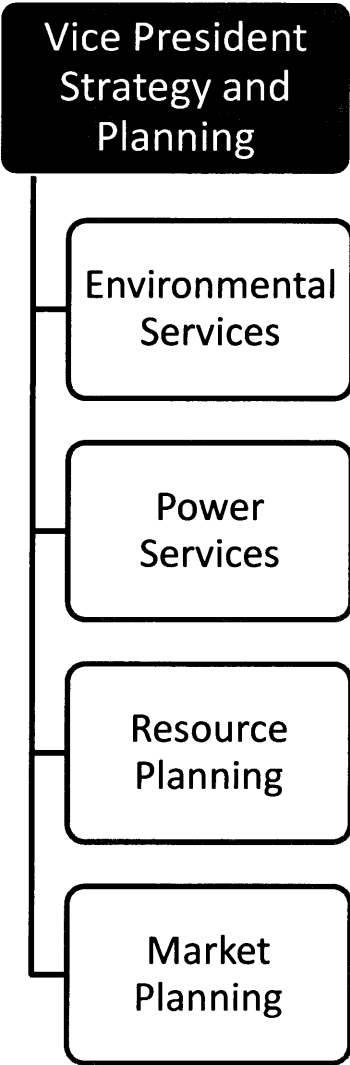


Labor: Labor for the Strategy and Planning organization consists of personnel who perform the key activities described under the Major Business and Key Activities section.

Dues and Subscriptions: This is primarily software costs necessary to interact with the MISO energy markets, identify and analyze energy market conditions, load forecasting, and to provide determination of future generation resources.

External Services: This expense is primarily associated with external legal fees, professional services, and contract services.

Other: This cost category includes employee expenses, travel, communications, broker fees, advertising, and miscellaneous office expenses.



The Planning and Strategy organization operates under the direction of the Vice President of Planning and Strategy and consists of the functional areas of Environmental Services, Market Planning, Power Services and Resource Planning. The main accountabilities of the Vice President of Planning and Strategy are to provide overall leadership, direction, and objective setting for environmental planning and policy, resource planning, marketing, utility-strategic planning, and wholesale energy market operations.

Environmental Services

Major Functions

Environmental Services provides engineering and technical experience to ensure that the Company's obligations and commitments to achieving and maintaining compliance with all applicable regulatory requirements are fulfilled. The department is responsible for overseeing environmental compliance and policy functions, with a primary focus on the Company's generating plants as they are subject to numerous federal and state laws and regulations. This includes the areas of air quality, climate, water, land and natural resources, solid waste, and chemical management.

Key Activities

- Develop and maintain accurate records and supporting documentation to comply with State and Federal laws. Prepare and submit reports to State and Federal agencies in an accurate and timely manner.
- Determine requirements and applicability of new regulations, permit requirements, and regulatory policy. Develop guidance, directives and provide technical assistance and training to plant personnel for implementation of the requirements of regulations, permits and/or policies.
- Participate in strategic planning and decision making to provide insight on environmental policy and regulation.
- Develop accurate information with respect to the Company's financial exposure associated with environmental compliance.
- Direct the acquisition of permits, approvals, or licenses.
- Conduct compliance reviews of Company activities and investigations of environmental incidents, such as spills or plant upsets, provide guidance to response personnel, and provide documentation of the incident and recommendations to the facility operator on prevention of future incidents.
- Keep informed of current industry technology relating to equipment or procedures for meeting environmental regulatory requirements.

Market Planning

Major Functions

The Market Planning area is responsible for compliance with regulatory policies and procedures related to demand response, customer service, related rates, market research, and marketing programs. Performance goals for Market Planning include demand response goals, electronic payment goals, and customer satisfaction goals.

Key Activities

- Develops and manages short, mid-term, and long-term marketing strategies and supporting tactics.
- Understands markets and customers by monitoring changes in the market, determining customer expectations and needs, and strengths and weaknesses of product/service offerings.
- Works in cross functional teams that develop pricing, communication, and advertising strategies.

Power Services

Major Functions

The Power Services responsibilities encompass all wholesale energy trading related functions including origination, day-ahead, real-time, and ancillary services. Additional responsibilities include capacity purchases and sales, procurement of natural gas fuel, procurement of environmental allowances, and vehicle fuel hedging for the OTP fleet vehicles. Prior to December 31st, 2014, Power Services also maintained an unregulated, non-asset based trading portfolio. As of December 31, 2014 this unregulated function was dissolved. Currently Power Services only maintains regulated, asset-based trading portfolios.

Power Services serves as the OTP interface with the MISO and SPP wholesale energy markets. Power Services employees work on behalf of OTP customers to implement strategies to maximize the value of generation resources and minimize the cost to serve load. The organization coordinates all market related aspects of generation optimization and outage coordination. Power Services staff also monitor, verify, and account for all energy market related charges, invoices, and settlements.

Power Services has the responsibility for structuring and negotiating long-term purchase power agreements, monitoring and influencing regional wholesale electric market designs, and monitoring changes in the regulatory environment. The organization is also responsible for procuring and maintaining all financial transmission rights which serve as hedging mechanisms against congestion charges between OTP generation and load.

Key Activities

- Trading/Origination
 - Interface with the day ahead and real time MISO and SPP energy markets to purchase and sell energy and ancillary services on behalf of our retail customers.
 - Procure wholesale long-term energy transactions on behalf of retail customers once a need is identified.
 - Manage the OTP generation resources and long-term purchase power contracts to minimize energy costs and risk to retail customers.
 - Procurement and sales of capacity.
 - Maintain market knowledge in the regions surrounding OTP.
 - Procure and maintain financial transmission rights.
 - Maintain and manage existing wholesale contracts including billing support.
 - Monitor, verify, and account for all energy market related charges, invoices, and settlements.
 - Acquire transmission service to support the above requirements.
- Market Operations
 - Guide the company as a stakeholder in the development of regional transmission organizations and energy markets.
 - Interact with state and federal regulatory agencies, as well as independent market monitors, regarding market operations and related activity.
- Other Wholesale Activities
 - Procurement of natural gas fuel purchases for OTP combustion turbines.
 - Procurement of environmental allowances.
 - Procurement of vehicle fuel futures contracts (Reformulated Blendstock for Oxygenate Blending (RBOB) contracts for hedging purposes).

Resource Planning

Major Functions

The overall function for Resource Planning is to ensure that the Company has adequate capacity and energy resources to meet our customers' needs both in the short-term and the long-term. The resources need to be planned for and acquired at the least possible cost to customers while meeting regulatory and environmental obligations. In order to accomplish this objective, Resource Planning has significant regulatory reporting obligations in the three states that OTP serves.

Additionally, Resource Planning is responsible for the short-term and long-term load forecast for both capacity and energy. This load forecast is used for internal planning and management as well as regulatory filings such as resource plans and rate cases. Resource Planning is responsible for the resource adequacy requirements of MISO. Load and capability need to be reported so that all MISO requirements are met. Another function of Resource Planning is to determine when bilateral capacity and/or energy purchases need to be made. These purchases could be for when a

generating source has an expected or unexpected outage or as a “bridge” to a new resource addition.

Key Activities

- Load Forecasting
 - The load forecast is one of the most critical functions in the entire company.
 - It is the basis for future resource acquisition decisions. These decisions drive company financial and financing decisions.
 - The load forecast is the basis for many regulatory proceedings and is subjected to rigorous scrutiny.
- Integrated Resource Plan
 - The resource plan describes the desired generation resource mix and long terms plans to achieve that mix for the Company.
- MISO Resource Adequacy
 - OTP is a member of MISO and is therefore subjected to the resource adequacy requirements of MISO.
 - A detailed knowledge of filing requirements around resource adequacy as well as following possible changes in the protocol that are being contemplated is needed.
- Capacity / Energy for customers
 - In addition to meeting MISO resource adequacy requirements, the Company often has the need for short-term capacity and energy resulting from planned and unplanned outages of generating stations.
 - Responsible for short-term “bridge” purchases which are often made as a least cost way to have adequate capacity and energy until new facilities are constructed.

N/A for this business area.



2016-2018 O&M Budget Documentation

Public Relations

1.1 Introduction

Otter Tail Power Company maintains some of the lowest electric rates and highest customer satisfaction ratings in the nation—even while we invest in the system that delivers electricity to our customers.

Balancing competing environmental, economic, and community interests can be difficult. But we've been successful at finding a balanced approach to serving multi-state customers. We credit that success, in part, to being:

- Exceptional at both practical and innovative operations.
- Proactively engaged and collaborative with people who care about *who* we are and *how* and *why* we do what we do.

Public Relations works cross functionally to facilitate open and timely communication with customers, regulators, employees, shareholders, and others. We take a lead role in shaping, managing, and protecting the Company's brand. And we partner with other business units to continue earning trust as an electric utility that does the right thing.

Our organization also includes Print and Mail Services, which fulfills the Company's design, printing, finishing, and mailing needs.

1.2 Customer Value

Through open and timely communication, the Public Relations Department helps to empower the individuals, households, businesses, and communities we serve to save energy and money through energy conservation. We facilitate the writing, design, printing, and distribution of all communications that encourage it.

Providing similar customer value are our load-management programs, which allow us to curtail portions of participating customers' electrical loads during periods of high demand, high energy prices, or system maintenance. Again, we facilitate the writing, design, printing, and distribution of communications that inform customers about money-saving options and encourage program participation. An unmatched one-third of our customers partner with us in load management.

The rural communities we serve appreciate that we respect the people who live and work here, that our daily behaviors and operations demonstrate our company values, and that we always remember our roots. We talk to our customers—and others who are interested in who we are and how and why we do what we do—as we would dinner guests across the table. Communication is clear and sensible. Internal and external audiences find comfort in the consistency of our company and our communications.

OTP serves approximately 130,000 customers that live in 422 communities and rural areas throughout our 70,000-square-mile footprint. Approximately 90 percent of the communities we serve are home to less than 1,000 people. Michigan, North Dakota, represents a typical town we

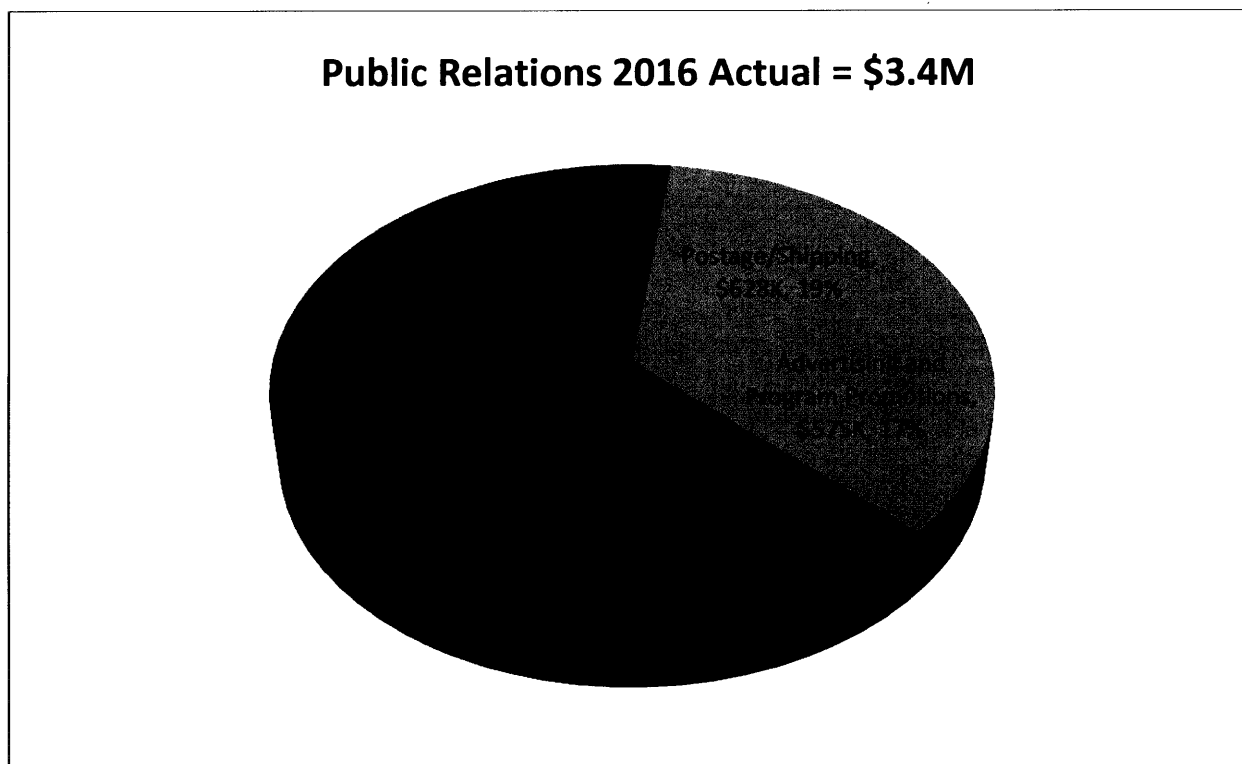
serve with its population of approximately 430. Our century-plus success stems largely from our hometown understanding of the people and places we serve. That understanding gives us the perspective we need to know *how* and *when* to best engage our customers.

Sample initiatives

- **Project communications (generation, transmission, and others):** Through public and agency meetings, Public Relations and project teams make a unified effort to implement processes and communications that are as transparent as legally permissible. We hope that one-on-one relationships and various forms of communication with our customers and governing officials help to simplify processes and encourage open participation.
- **Advertising and Public Relations:** To help ensure safe, reliable, and affordable electric service, we provide customers with information about using electricity wisely. Our website otpc.com, bill inserts, newsletters, news releases, advertisements, etc., emphasize energy conservation, load management, and safety.
- **Employee communications:** Our goal is to deliver timely and easy-to-understand communication to both external and internal audiences. Because employees are the foundation of quality service and customer satisfaction, we help ensure that they know about and understand our company's goals, objectives, plans, and directions, which include top-notch customer service. More than a dozen ongoing internal communications deliverables help to keep our employees informed.
- **Community Connections:** The mission of our Community Connections charitable giving program is to connect with our rural communities to support young minds, invest in our current and future workforce, create vibrant culture and vital communities, improve health and human services, and protect our natural resources. While we provide financial support to a broad array of activities and organizations, we focus our resources on the rural communities we serve.
- **Biennial Stewardship Report:** We publish a biennial Stewardship Report as proof of the ways in which our values of integrity, safety, customer focus, resourcefulness, and community inspire our behaviors and decisions. We're driven to do the right things—with every bolt we fasten, every mile we drive, and every kilowatt-hour we generate. Our Stewardship Report publicly affirms our promise to ensure that the behaviors and values that have guided us for more than a century continue to do so.

The Print and Mail Services arm of our organization fulfills OTP business needs, many of which require high-quality machines that run efficiently and reliably. Sometimes company projects don't require those machines to run at full capacity. To benefit utility customers, we make smart use of machine availability as we provide select services to customers beyond our company.

2.1 2016 O&M Actuals



Labor includes the costs associated with Public Relations and Print and Mail Services employees who help ensure open and timely communication.

Postage/shipping is a significant cost driver reflected in our Print and Mail Services Department, which budgets postage for at least 90 percent of our company.

Advertising and program promotions include expenses associated with broad public sharing of information about safety, conservation, load management, community engagement, and more.

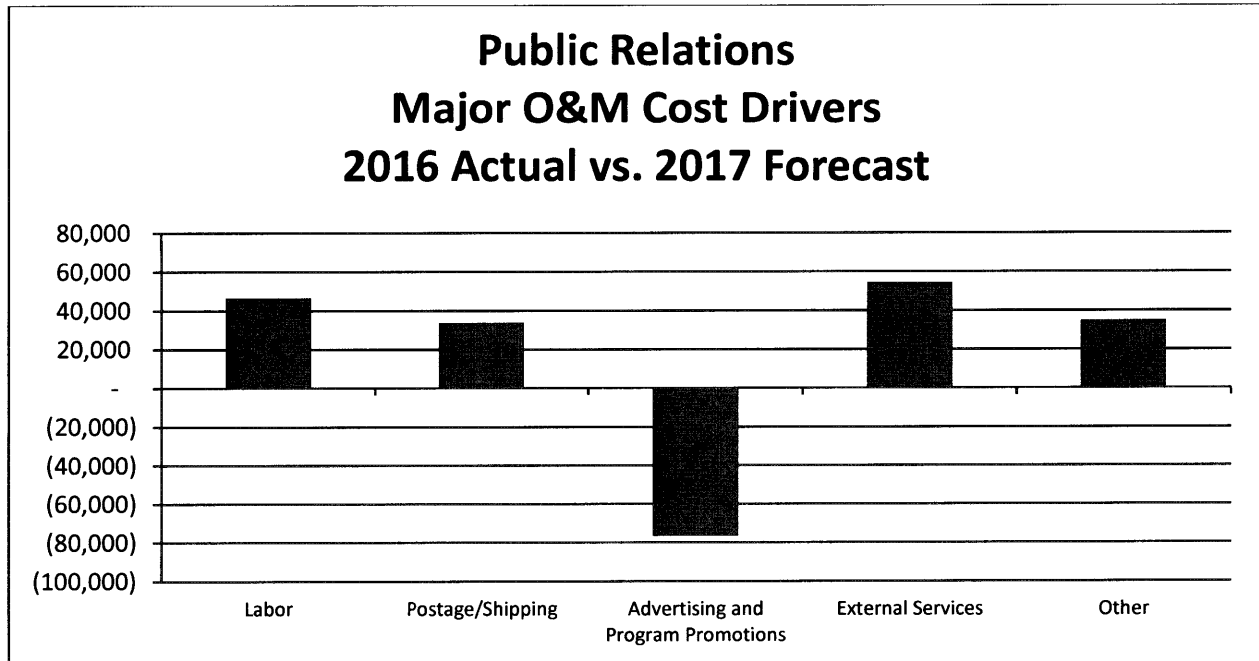
External services include costs associated with external partners who provide the additional expertise and/or human resources that we don't have in-house.

Other includes costs associated with employee expense and travel, office supplies and materials, and equipment lease/rental. It also includes the credit that fully recovers expenses associated with Print and Mail Services' work for external customers.

2.2 2016 O&M Actuals vs 2017 O&M Forecast**Public Relations****2016 Walk forward of Major Cost Drivers**

2016 O&M Actuals	\$3,409,343
Labor	46,626
Postage/Shipping	33,837
Advertising and Program Promotions	(76,662)
External Services	54,433
Other ⁽¹⁾	35,005
2017 O&M Forecast	\$3,502,580

(1) Includes costs associated with employee expense and travel, office supplies and materials, and equipment lease/rental. Also includes the credit that fully recovers expenses associated with Print and Mail Services' work for external customers.



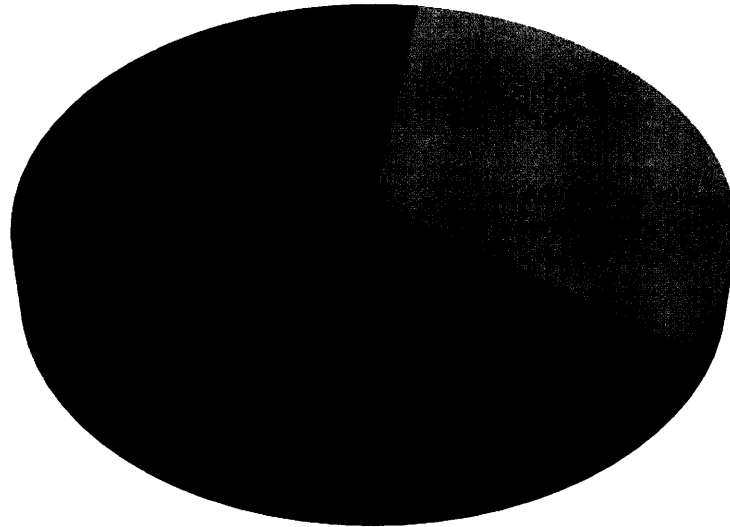
Explanations for the major cost drivers for 2016 Actual versus 2017 Forecast:

Labor increase reflects costs associated with providing healthcare benefits to part-time employees (required by law) and wage adjustments.

Postage/Shipping increase primarily reflects anticipated postage increase from the United States Postal Service.

Advertising and Program Promotions decrease primarily reflects reallocation of those dollars to ensure that we have adequate external services required to support our initiatives.

External services increase reflects the shifting of dollars from advertising and program promotions to ensure that we have adequate external services required to support our initiatives.

Public Relations 2017 Forecast (July MIP) = \$3.5M

Labor includes the costs associated with Public Relations and Print and Mail Services employees who help ensure open and timely communication.

Postage/shipping is a significant cost driver reflected in our Print and Mail Services Department, which budgets postage for at least 90 percent of our company.

Advertising and program promotions include expenses associated with broad public sharing of information about safety, conservation, load management, community engagement, and more.

External services include costs associated with external partners who provide the additional expertise and/or human resources that we don't have in-house.

Other includes costs associated with employee expense and travel, office supplies and materials, and equipment lease/rental. It also includes the credit that fully recovers expenses associated with Print and Mail Services' work for external customers.

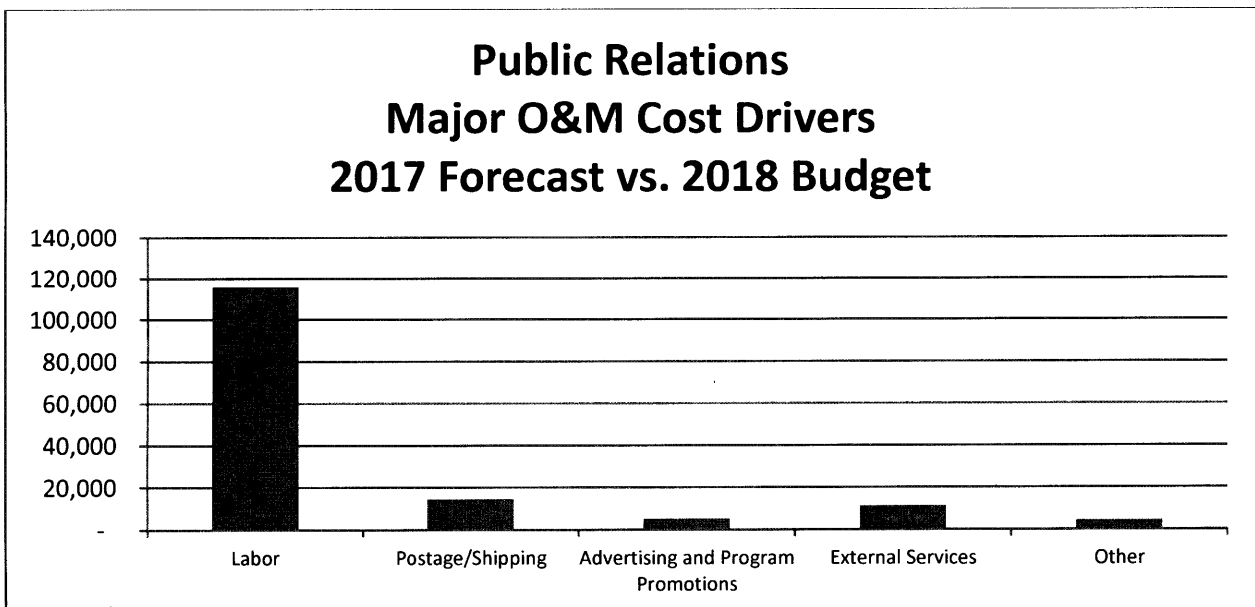
2.3 2017 O&M Forecast vs 2018 O&M Budget

Public Relations

2017 Walk forward of Major Cost Drivers

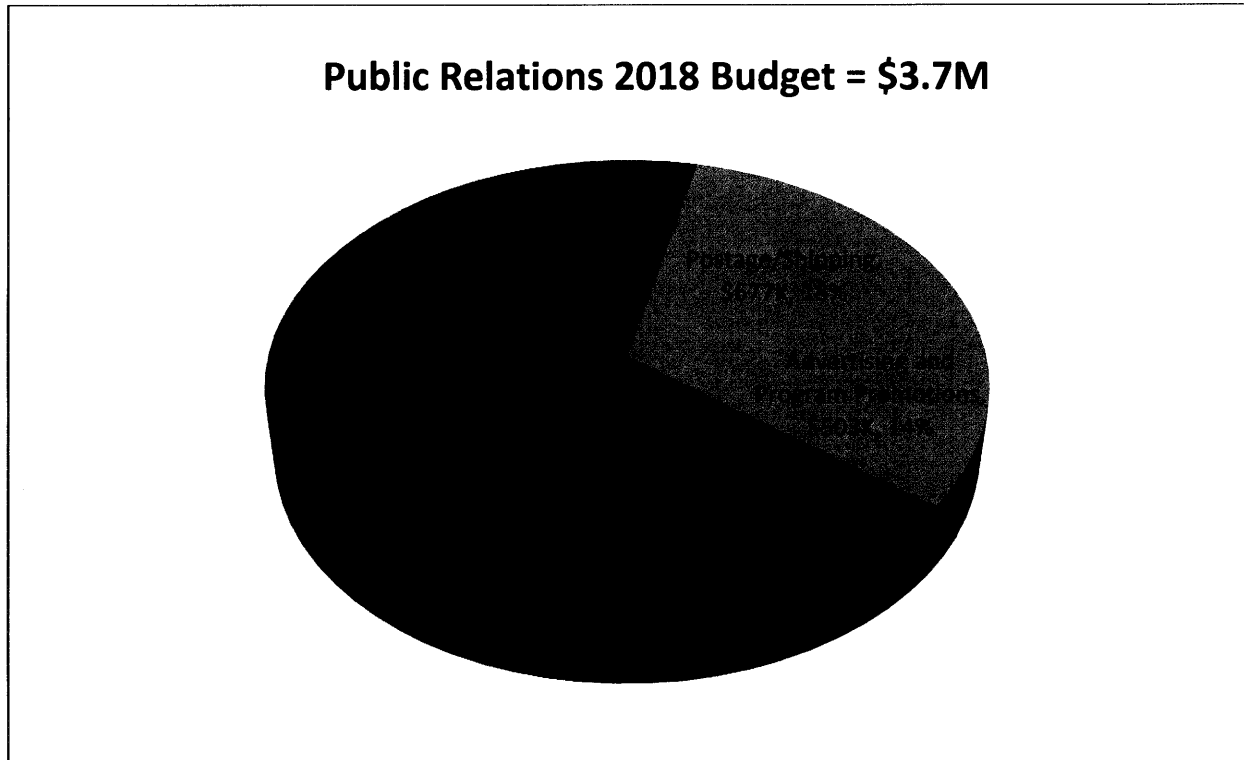
2017 O&M Forecast	\$3,502,580
Labor	115,966
Postage/Shipping	14,517
Advertising and Program Promotions	5,328
External Services	39,306
Other ⁽¹⁾	4,621
2018 O&M Budget	\$3,682,319

(1) includes costs associated with employee expense and travel, office supplies and materials, and equipment lease/rental. Also includes the credit that fully recovers expenses associated with Print and Mail Services' work for external customers.



Explanations for the major cost drivers for 2017 Forecast versus 2018 Budget:

Labor reflects salary for hiring a replacement Communications Specialist who left our organization mid-year 2017 and we have not yet replaced. It also reflects reasonable wage adjustments.



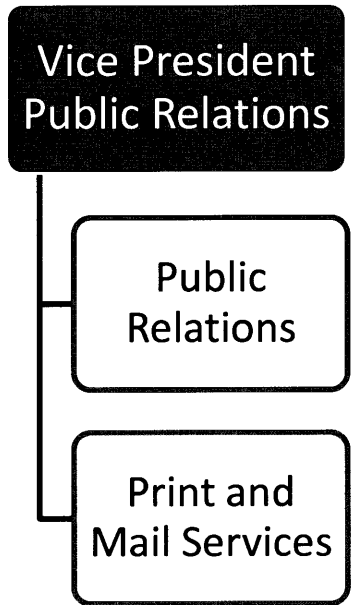
Labor includes the costs associated with Public Relations and Print and Mail Services employees who help ensure open and timely communication.

Postage/shipping is a significant cost driver reflected in our Print and Mail Services Department, which budgets postage for at least 90 percent of our company.

Advertising and program promotions include expenses associated with broad public sharing of information about safety, conservation, load management, rebates, community engagement, and more.

External services include costs associated with external partners who provide the additional expertise and/or human resources that we don't have in-house.

Other includes costs associated with employee expense and travel, office supplies and materials, and equipment lease/rental. It also includes the credit that fully recovers expenses associated with Print and Mail Services' work for external customers.



Public Relations

Major Functions

Our Public Relations team researches, develops, implements, and analyzes communication strategy for company and corporate initiatives. We ensure that communication is timely and easy to understand—helping to meet customer satisfaction as well as conservation and load-management goals and to protect the company's and the corporation's brands.

Key Activities

- Proactively engage and collaborate with people who care about *who* we are and *how* and *why* we do what we do.
- Support communication programs for marketing plans, working cross-functionally with the Market Planning, Customer Service, and Print and Mail Services Departments.
- Lead communication plans for large company projects, including generation and transmission projects.
- Manage design, writing, editing, publishing, and tracking processes for internal communication.
- Work cross-functionally to develop and implement OTP's online and intranet strategies
- Provide multimedia services including, but not limited to, photography, videography, audio recordings, PowerPoint presentations, and equipment purchases and maintenance.
- Help ensure a safe workplace.

Print and Mail Services

Major Functions

Our Print and Mail Services team runs a small full-service print shop that provides the confidentiality, speed, and professional services (including design) required to cost effectively fulfill OTP's needs. We are a nimble team that helps to keep costs low as we operate equipment that otherwise would not be available within 60 miles of Fergus Falls.

Key Activities

- Design effective, attractive, relevant, and timely marketing (and other) materials to accomplish company goals and reinforce company brand.
- Operate digital and offset printing, finishing, bindery, and mailing equipment.
- Provide top-notch customer service.
- Help ensure a safe workplace.

As a service organization, Public Relations directly charges the Minnesota Conservation Improvement Program (CIP), South Dakota Energy Efficiency Plan (EEP), large-project capital budgets, and Corporate Communications Department as needed for time spent on related activities.



2016-2018 O&M Budget Documentation

Regulatory Affairs and Compliance

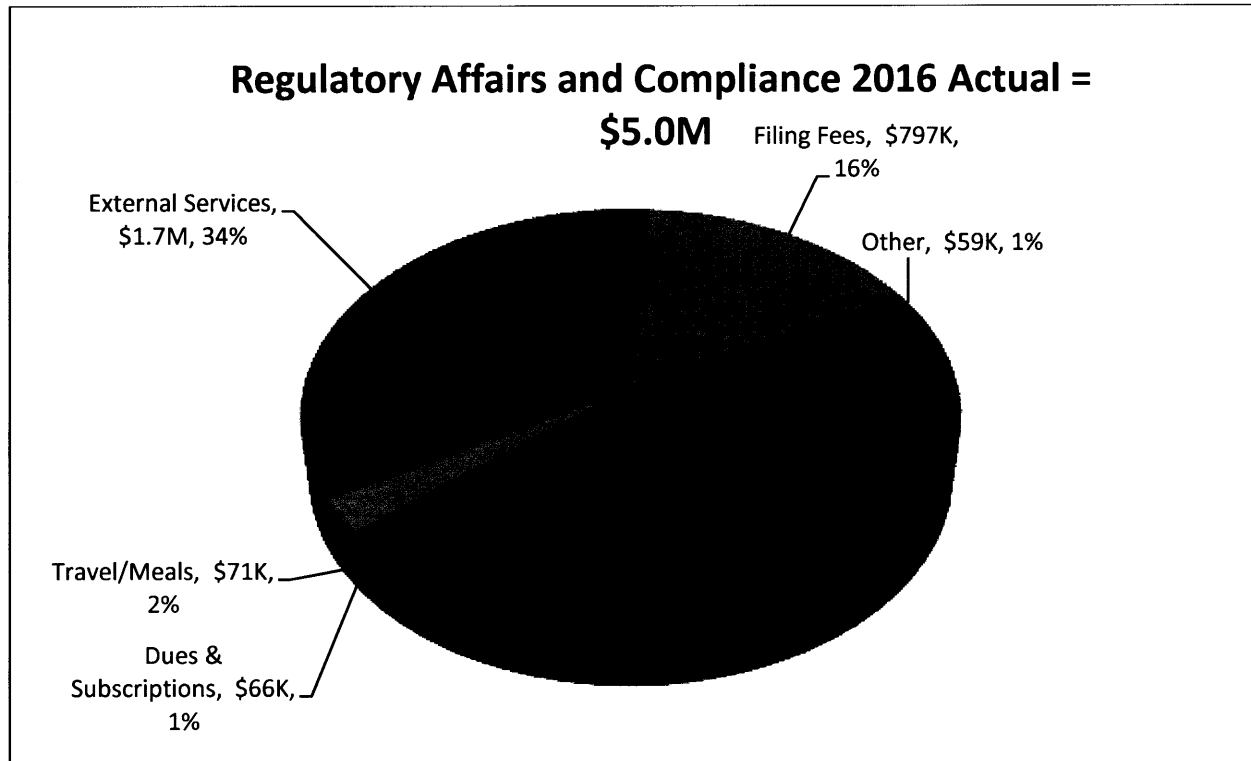
1.1 Introduction

The Regulatory Affairs and Compliance Group consists of the following key functional areas: Regulatory Administration, Regulatory Recovery and Regulatory Proceedings and Compliance. The organization is responsible for submitting regulatory filings, managing regulatory proceedings, managing the company's state and Federal utility compliance programs, including the company's programs for compliance with Federal Energy Regulatory Commission (FERC) and North American Electric Reliability Corporation (NERC) standards and requirements.

1.2 Customer Value

The Regulatory Affairs and Compliance area contains the Regulatory Proceedings and Compliance and Regulatory Recovery areas. Regulatory Proceedings and Compliance stewards continuous assessment of the Company's NERC compliance program, with the overall objective to maintain reliability of the system. Regulatory Proceedings and Compliance also conducts rate case planning and provides advice to management and utility personnel on state (Minnesota, North Dakota and South Dakota) and Federal regulatory statutes, administrative rules, Commission orders, and tariff requirements. The Regulatory Recovery area is responsible for managing recovery of capital investments and related operating and maintenance expenses, including strategy development and making recommendations to OTP's executive team. The Regulatory Recovery area also provides input into the utility's long-term business and capital strategy. Overall, the Regulatory Affairs and Compliance area is responsible for managing regulatory relationships with all areas of the utility. Customers benefit from the work of the Regulatory Affairs and Compliance group because the group promotes compliance with regulations designed to ensure reliability, accuracy, transparency and well-designed cost-effective rates. The Regulatory Administration area oversees development of rates, administration of rates, Company compliance with regulatory policies and procedures, and manages the submittal of regulatory annual filings and reporting requirements. Customers benefit through compliance with regulatory rules designed to ensure reliability and well designed, cost effective rates.

2.1 2016 O&M Actuals



NOTE: 2016 included non-labor operation and maintenance expense from Market Planning. In April of 2017, Market Planning was moved to another executive area.

Labor: Base productive labor costs for employees who work on regulatory and market planning matters (for hourly and salaried employees).

External Services: This includes legal fees for assistance on various regulatory issues and work performed by outside firms on required studies such as regulatory studies. The MN rate case expenses for 2016 of \$1,471k were accumulated here before being set up for amortization and recovery through Minnesota rates.

Dues and Subscriptions: Includes specialized billing software, Open Access Technology International (OATI) software for NERC compliance, CaseWorks software and other miscellaneous dues and subscriptions.

Filing Fees: OTP is billed by the Commissions for the time spent on specific dockets and also charged annual assessments; State Regulatory Commission fees accounted for \$545k of the \$797k spent in 2016. NERC fees of \$241k accounted for most of the remainder.

Travel/Meals: Contains expenditures related to attendance at regulatory hearings in the capital cities of our three jurisdictions, and attendance at meetings and training.

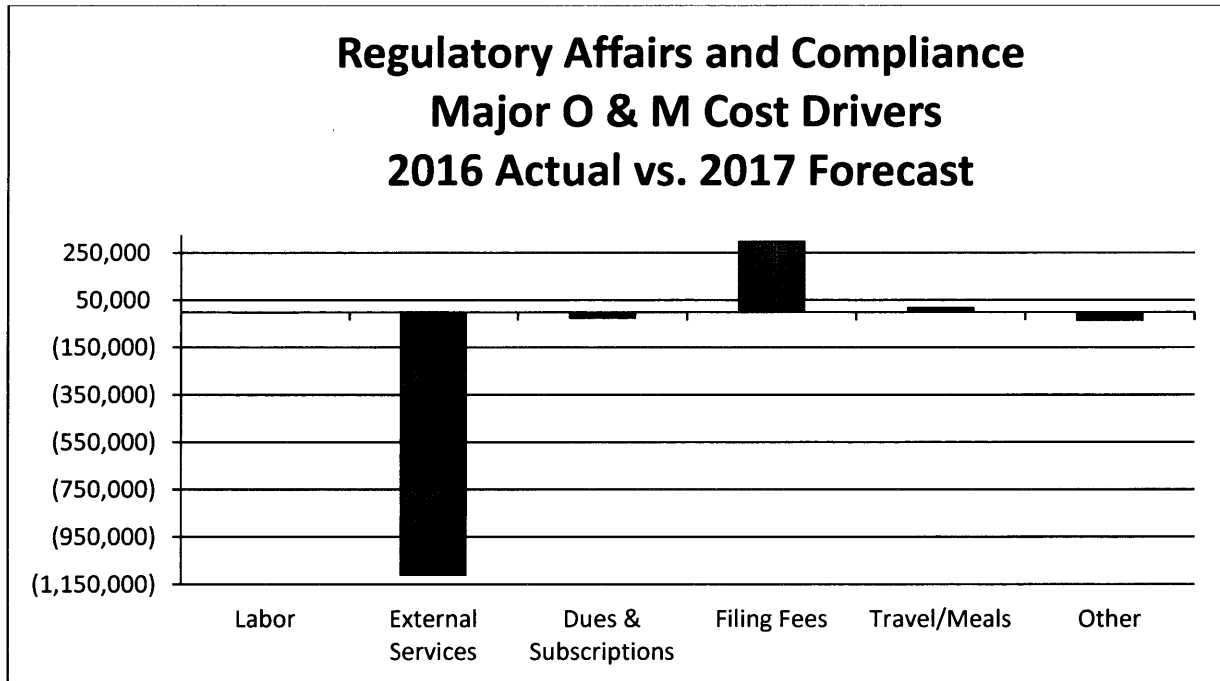
Other: Includes copier expense, case management software, telephone and communication costs, along with other minor expenses.

2.2 2016 O&M Actuals vs 2017 O&M Forecast

2016 Walk Forward of Major Cost Drivers

2016 O&M Actuals	\$4,953,406
Labor	(6,254)
<i>Market Planning Labor was transferred out of the Regulatory Affairs department due to a reorganization, but most Market Planning expense is charged directly to Minnesota CIP, and therefore the effect of this expense transfer is moderate. Three positions were added in Regulatory to manage increased workloads.</i>	
External Services	(1,114,453)
<i>Expenses for Legal and other are down as majority of MN Rate Case expenses were incurred in 2016</i>	
Dues & Subscriptions	(29,437)
<i>Expenses are lower due to transfer of Market Planning Dept.</i>	
Filing Fees	300,936
<i>MN Rate Case Assessments are included</i>	
Travel/Meals	22,398
<i>Travel was lower in 2016 due to rate case activity</i>	
Other ⁽¹⁾	(39,468)
2017 O&M Forecast	<u>\$4,087,128</u>

(1) Other - includes office expense, telephone/communication, material and operating supplies, miscellaneous advertising expense, and other miscellaneous expenses. Transfer of Market Planning accounts for the decrease.



Explanations for the major cost drivers for 2016 Actual versus 2017 Forecast:

Base Labor: Base productive and lost time labor costs are increased based on 3% merit increases for union and non-union employees. The net change is due to Market Planning’s shift to the Planning and Strategy area in early 2017. Most of Market Planning’s labor was charged to Minnesota CIP projects. Two positions were added in Regulatory Proceedings and Compliance during 2016 and one position was added in Regulatory Administration to handle increased regulatory workload.

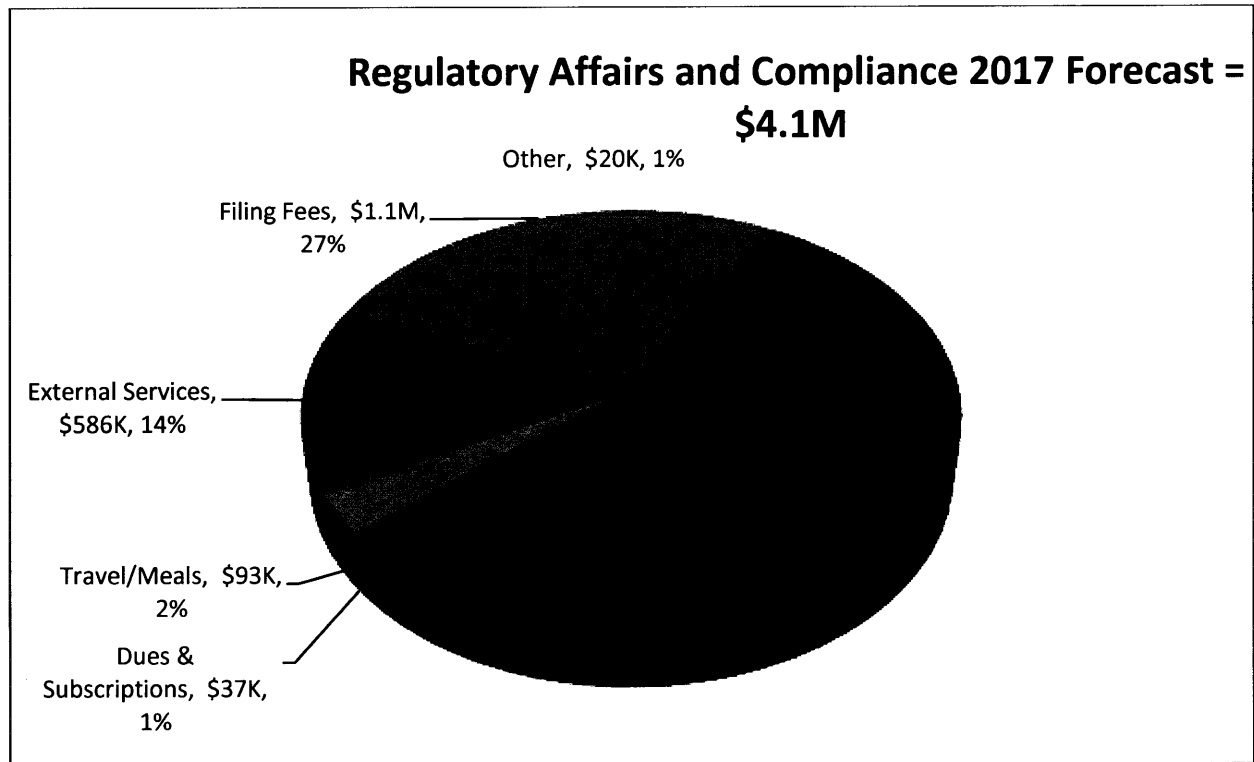
External Services: Decrease due to the majority of legal and other consultant fees for the Minnesota rate case being incurred in 2016.

Dues and Subscriptions: Expenses are lower due to transfer out of the Market Planning Department in early 2017.

Filing Fees: Increase due to filing fees for the Minnesota rate case filed in 2016 being charged in 2017.

Travel/Meals: Travel and meals are increased due the Minnesota rate case.

Other: Decreased due to the transfer out of the Market Planning Department in early 2017.



Labor: Base productive labor costs for employees who work on regulatory and compliance matters (for hourly and salaried employees).

External Services: This includes legal and consultant fees for assistance on various regulatory issues, including a proposed North Dakota general rate case.

Dues and Subscriptions: Includes specialized billing software, CaseWorks software and other miscellaneous dues and subscriptions.

Filing Fees: State Regulatory Commission and NERC fees (OTP is billed by the Commissions for specific dockets and also charged annual assessments). Most of the Minnesota general rate case fees were billed in 2017.

Travel/Meals: Contains expenditures related to regulatory hearings along with meetings and training.

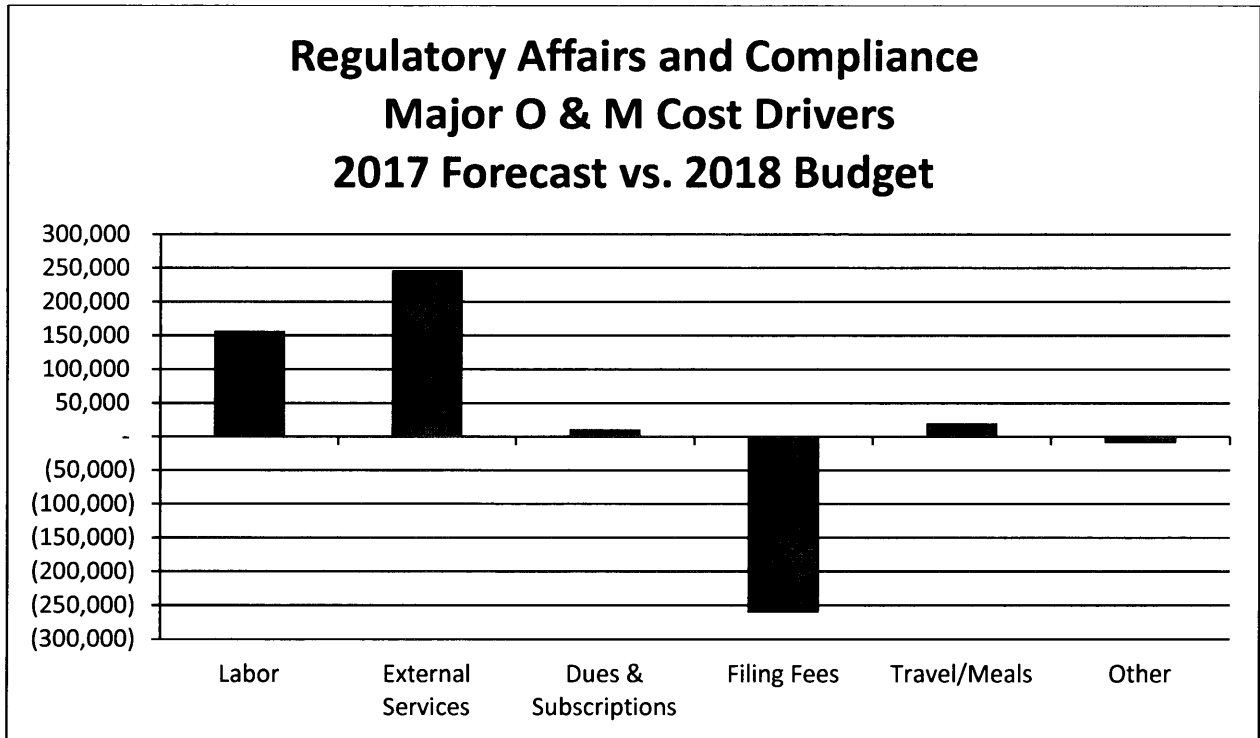
Other: Includes copier expense, case management software, telephone and communication costs, along with other minor expenses.

2.3 2017 O&M Forecast vs 2018 O&M Budget

Regulatory Affairs and Compliance
2017 Walk Forward of Major Cost Drivers

2017 O&M Forecast	\$4,087,128
Labor	158,917
<i>3 percent wage increase + change in non-productive labor and addition of 1 position</i>	
External Services	246,872
<i>Increased due to North Dakota general rate case and other filings</i>	
Dues & Subscriptions	11,228
<i>Expenses related to increase in cost for software</i>	
Filing Fees	(261,098)
<i>Expenses reduced as MN general rate case and other significant filings were in 2017.</i>	
Travel/Meals	20,057
<i>Increase due to increased staff for a full year over 2017</i>	
Other ⁽¹⁾	
<i>Reduced due to transfer out of Market Planning Department after the first quarter 2017</i>	
	(9,443)
2018 O&M Budget	<u>\$4,253,660</u>

(1) Other - includes office expense, telephone/communication, material and operating supplies, miscellaneous advertising expense, and other miscellaneous expenses.



Explanations for the major cost drivers for 2017 Forecast versus 2018 Budget:

Base Labor: Base productive and lost time labor costs are increased based on 3% increases on-average for union and non-union employees. One additional position is budgeted for 2018.

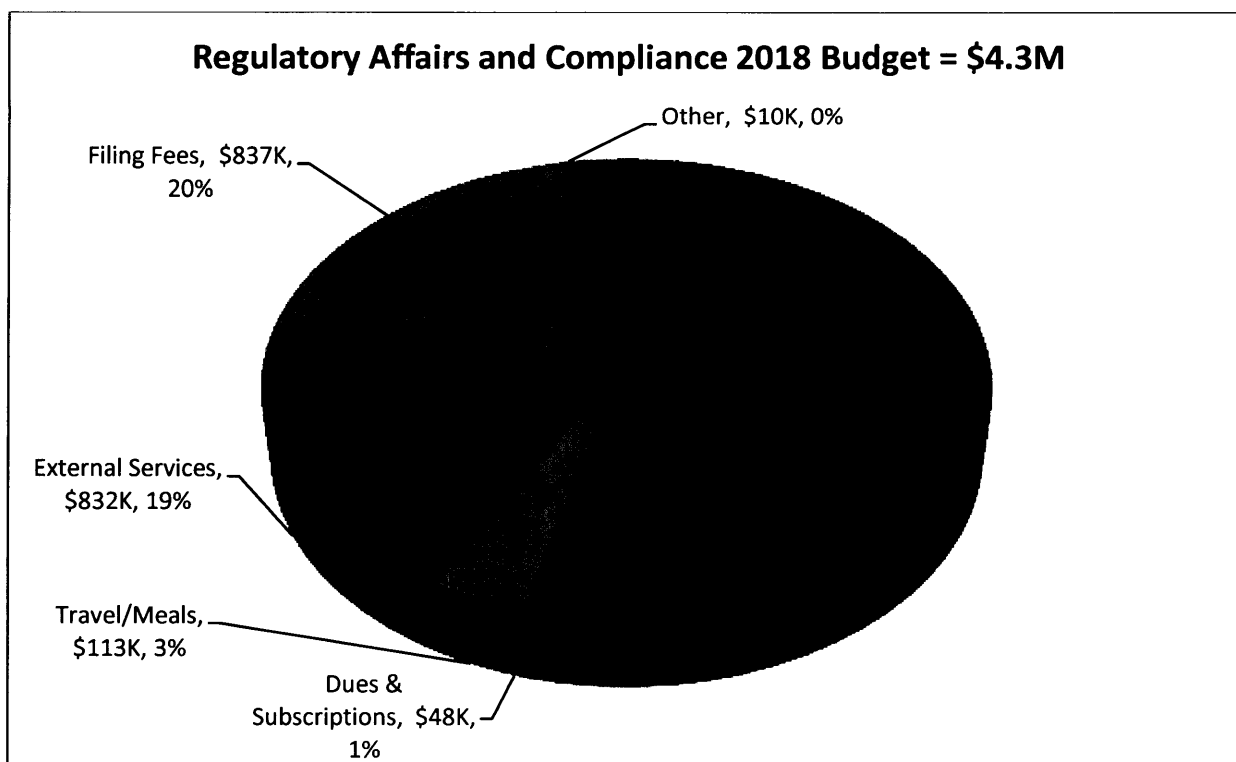
External Services: Increase is due to external services for consulting and legal related to the 2018 ND rate case filing (these costs are not moved to a regulatory asset until the end of 2018).

Dues and Subscriptions: The difference is due to increases in software costs.

Filing Fees: Commission fees are budgeted to decrease due to high 2017 which included Minnesota charges for the Minnesota rate case.

Travel/Meals: Travel and meals increased.

Other: Reduced due to transfer out of Market Planning Department.



Labor: Base productive labor costs for employees who work on regulatory and market planning matters (for union and non-union employees).

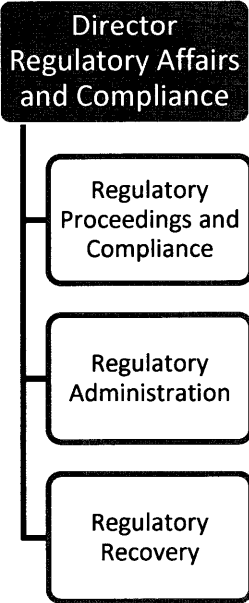
External Services: This includes legal fees for assistance on various regulatory issues and work performed by outside firms on customer satisfaction surveys and related customer research for program development.

Dues and Subscriptions: Includes specialized billing software, CaseWorks software and other miscellaneous dues and subscriptions.

Filing Fees: OTP is billed by the Commissions for the time spent on specific dockets and also charged annual assessments. State Regulatory Commission fees accounted for \$448k of the \$449k budgeted for 2016.

Travel/Meals: Contains expenditures related to regulatory hearings, along with meetings and training.

Other: Includes copier expense, case management software, telephone and communication costs, along with minor expenses.



Regulatory Proceedings and Compliance

Major Functions

The Regulatory Proceedings and Compliance area provides technical analysis and consulting services on regulatory policy and regulatory compliance, and is responsible for submitting regulatory filings and submissions.

Key Activities

- Provides expert testimony to support company positions in regulatory proceedings and coordinates the preparation of expert testimony of subject matter experts in other business areas.
- Manages ongoing communications with regulators to ensure constructive relationships and sharing of timely and accurate information so that Regulators and OTP decision makers have the necessary facts to understand the implications of their actions on customers, shareholders, employees, and the industry.
- Manages the regulatory compliance function to assure compliance with all regulatory requirements for OTP.
- Provides authority and guidance on regulatory policy, requirements, and impacts on numerous projects and activities through interactions with other functional areas in the regulated utility.
- Develops regulatory strategies.

Regulatory Administration

Major Functions

Regulatory Administration manages the pricing and rate design function for OTP. Regulatory Administration is responsible for designing and implementing new rates and updating existing rates, if appropriate, and obtaining necessary regulatory approvals.

Key Activities

- Oversees the development of costing and pricing strategies, theories, methodologies and procedures for the three states in OTP's jurisdiction.
- Prepares and files annual updates to transmission, environmental, cost of energy adjustment and renewable energy riders.
- Completes the monthly calculation of delivered, delivered and billed, and unbilled sales and revenue by rate group within the jurisdiction of the company.
- Develops and maintains the forecasting and pricing models and the data used to make these calculations.
- Designs, manages, and analyzes the company's load research program across its system.

Section IV – Major Business Functions and Key Activities

Regulatory Affairs and Compliance

- Develops and maintains the models and data necessary to efficiently develop allocation factors used in the class and jurisdictional cost of service studies and to develop models used to investigate alternative methodologies.

Regulatory Recovery

Major Functions

Regulatory Recovery manages and supports advocacy for State utility regulation. In coordination with the Regulatory Administration and the Regulatory Proceedings and Compliance, manages communications with Commissioners, Commission Staffs and other agencies.

Key Activities

- Advises management and utility personnel on State (Minnesota, North Dakota and South Dakota) regulatory statutes, administrative rules, Commission orders, and tariff requirements.
- Develops regulatory strategies for rate recovery. Works with other Regulatory and Legal areas to develop theories and strategies for any new issues relating to rate recovery.
- Participates in negotiations, mediations, settlement conferences, and other alternative dispute resolution proceedings.

Not applicable for the Administration area.



2016-2018 O&M Budget Documentation

Benefits

1.1 – Introduction

Estimated benefit costs processed through payroll loading are divided by the estimated annual productive labor dollars to determine the loading rate necessary to allocate the entire cost of benefits to labor. These costs are best understood and explained by accounting and human resources, not at the individual cost center level; therefore, this document is a summary of those costs.

The following costs are budgeted and processed through payroll loading and applied to the overall Otter Tail Power Company (OTP) productive labor dollars. The amounts represented within this benefits narrative includes O&M and capitalized labor. The loading costs follow where the productive labor is charged to.

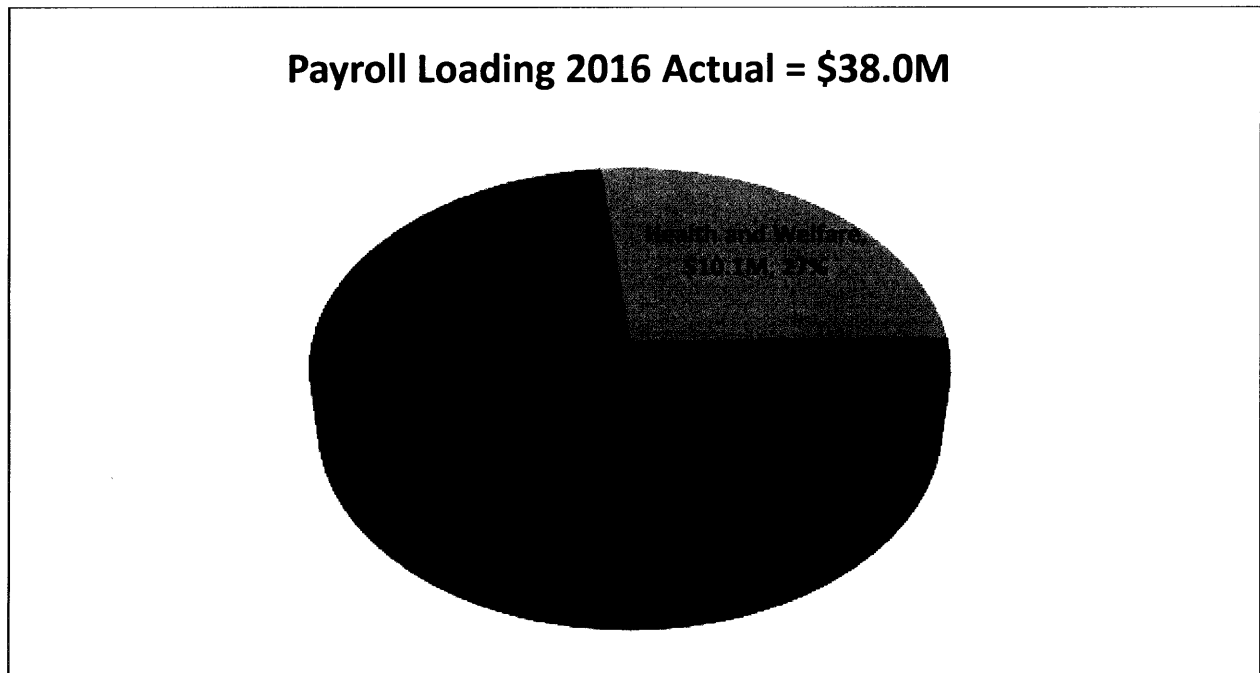
- Qualified pension expense
- 401k match
- 401k enhanced contribution
- Post-retirement medical
- Active medical less premiums paid by employees
- Active dental less premiums paid by employees
- Health Savings Account Company Contributions
- Life and Long-Term Disability (LTD) insurance premiums
- Post-employment (LTD) expense
- Workers compensation
- Taxable Meals
- Vacation and vacation accrual
- FICA and unemployment taxes
- Holidays and floating holidays
- Sick leave and other miscellaneous lost time activity

This payroll loading process and additional benefits offered to employees that do not run through payroll loading are discussed in more detail in Sections IV and V of this document.

1.2 Customer Value

A strong benefits program helps OTP attract, engage, and retain a quality workforce to provide our customers with reliable and economical service. Human Resource's objective is to ensure that compensation and benefits are competitive in relation to the market in order to retain a skilled workforce while ensuring they are cost effective.

2.1 2016 O&M Actuals



Pension & Retirement Related – This category includes pension costs, post-retirement medical benefits for retirees, 401k match, and enhanced contribution costs.

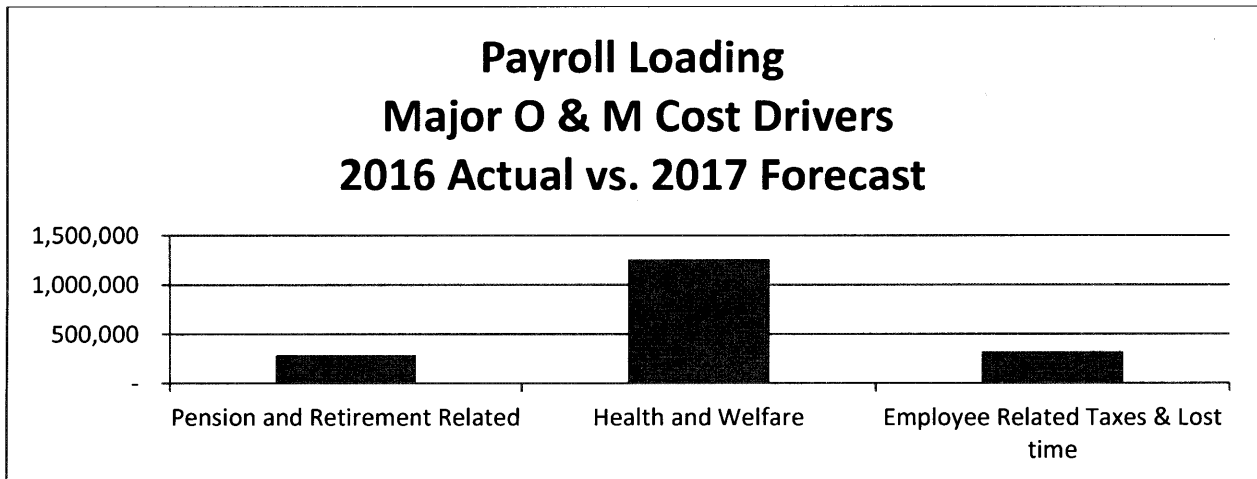
Health & Welfare – Costs include healthcare (medical and dental) for both active employees and long-term disability employees. It also includes workers compensation benefits, company paid life insurance and long-term disability premiums, and company contributions to employees' Health Savings Account through wellness program participation.

Employee Related Taxes & Lost Time – These costs include employer paid FICA and unemployment taxes, taxable meals, vacation, holidays and floating holidays, sick leave, and other miscellaneous lost time.

2.2 2016 Payroll Loading Actuals vs 2017 Payroll Loading Forecast

**Payroll Loading
2016 Walkforward of Major Cost Drivers**

2016 O&M Actuals	\$37,983,120
Pension and Retirement Related	290,772
<i>Pension</i>	
<i>Post-retirement medical</i>	
<i>401(k) matching and enhanced contributions</i>	
Health and Welfare	1,260,339
<i>LTD Medical</i>	
<i>Active Medical</i>	
<i>Workers Compensation</i>	
Employee Related Taxes & Lost time	325,316
<i>Lost Time (Holidays, Vacation, Sick)</i>	
<i>FICA and unemployment taxes</i>	
<i>Taxable Meals</i>	
2017 O&M Forecast	<u><u>\$39,859,546</u></u>

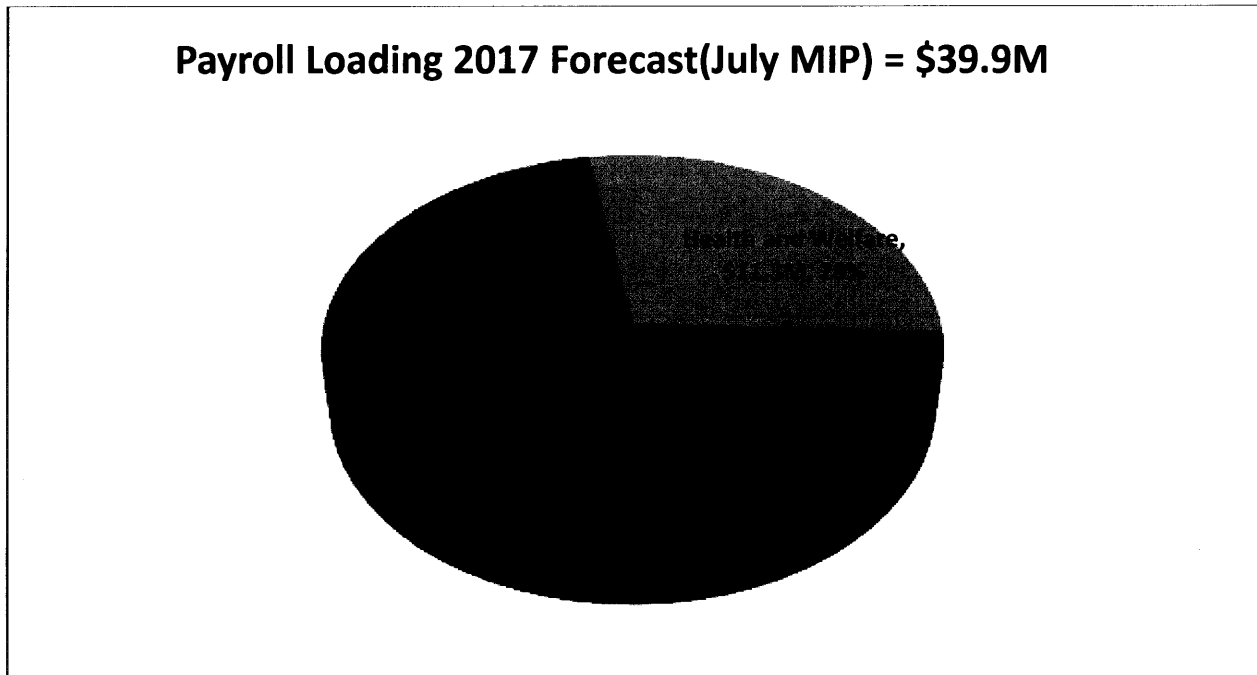


Explanations for the major cost drivers for 2016 Actual versus 2017 Forecast:

Pension & Retirement Related – A majority of the change relates to a pension expense increase due to a discount rate change from 4.57 percent to 3.90 percent.

Health & Welfare – The majority of the increase is for active medical expenses due to higher health care costs.

Employee Related Taxes & Lost Time – Increase is seen mainly in FICA and Unemployment Taxes due to a higher estimate of productive and lost time labor dollars in 2017.



Pension & Retirement Related – This category includes pension costs, post-retirement medical benefits for retirees, 401k match, and enhanced contribution costs.

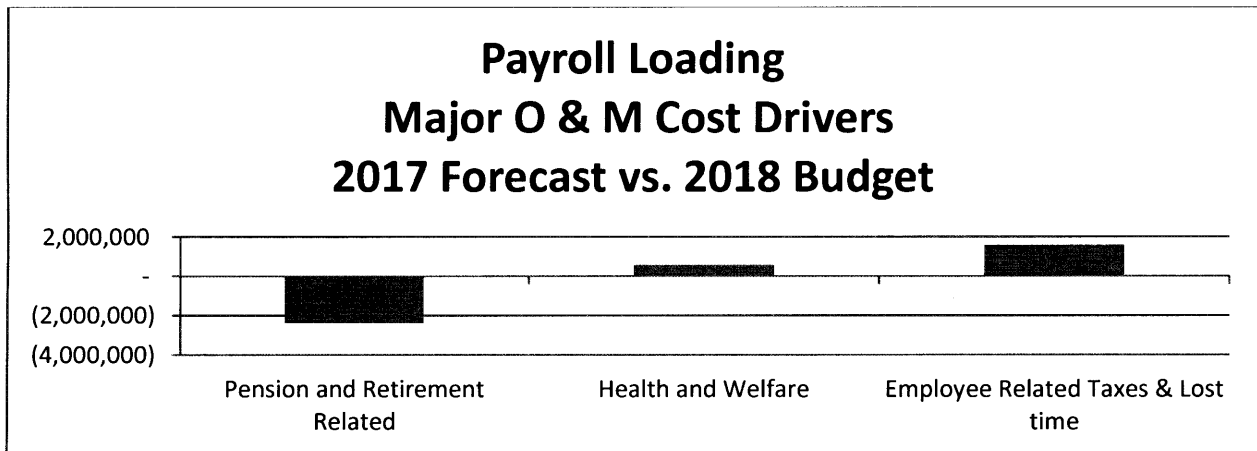
Health & Welfare – Costs include healthcare (medical and dental) for both active employees and long-term disability employees. It also includes workers compensation benefits, company paid life insurance and long-term disability premiums, and company contributions to employees' Health Savings Account through wellness program participation.

Employee Related Taxes & Lost Time – These costs include employer paid FICA and unemployment taxes, taxable meals, vacation, holidays and floating holidays, sick leave, and other miscellaneous lost time.

2.3 2017 O&M Forecast vs 2018 O&M Budget

**Payroll Loading
Walkforward of Major Cost Drivers**

2017 O&M Actuals	\$39,859,546
Pension and Retirement Related	(2,387,892)
<i>Pension</i>	
<i>Post-retirement medical</i>	
<i>401(k) matching and enhanced contributions</i>	
Health and Welfare	587,169
<i>LTD Medical</i>	
<i>Active Medical</i>	
<i>Workers Compensation</i>	
Employee Related Taxes & Lost time	1,608,306
<i>Lost Time (Holidays, Vacation, Sick)</i>	
<i>FICA and unemployment taxes</i>	
<i>Taxable Meals</i>	
 2018 O&M Forecast	 <u>\$39,667,129</u>



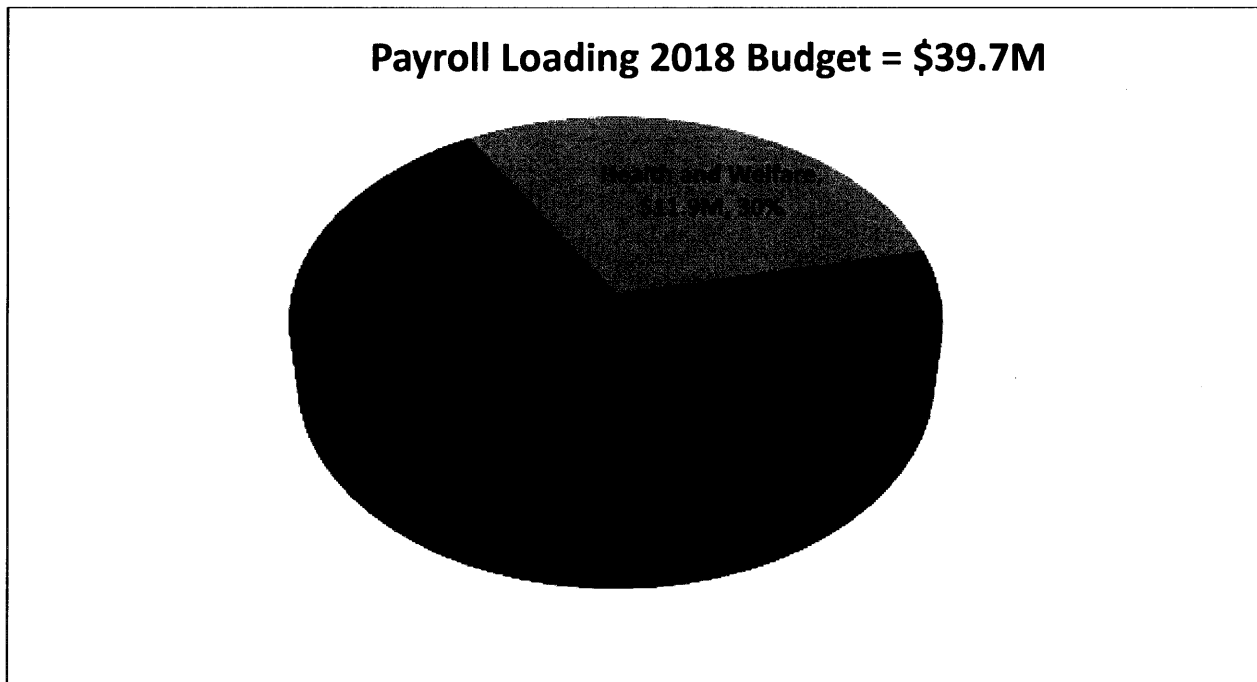
Explanations for the major cost drivers for 2017 Forecast versus 2018 Budget:

Pension & Retirement Related – decrease is mainly due to OTP’s conformity of GAAP ruling that some pension related costs are not allowed to be capitalized, as well as a company pension contribution, change in discount rate to 3.9% from 4.1% and lower service cost due to a soft

freeze to benefit obligations (new hires not eligible for the pension plan). Mr. Pete Wasberg discusses pension costs in his direct testimony.

Health & Welfare - Most of the increase is for active medical expenses due to higher health care costs.

Employee Related Taxes & Lost Time - increase is seen mainly in FICA and Unemployment Taxes due to a higher estimate of productive and lost time labor dollars in 2018.



Pension & Retirement Related – This category includes pension costs, post-retirement medical benefits for retirees, 401k match, and enhanced contribution costs.

Health & Welfare – Costs include healthcare (medical and dental) for both active employees and long-term disability employees. It also includes workers compensation benefits, company paid life insurance and long-term disability premiums, and company contributions to employees' Health Savings Account through wellness program participation.

Employee Related Taxes & Lost Time – These costs include employer paid FICA and unemployment taxes, taxable meals, vacation, holidays and floating holidays, sick leave, and other miscellaneous lost time.

Not applicable for the Benefits area.

The following paragraphs are descriptions of the major components of the payroll loading process. Also described are other benefits that make up the total OTP benefit package. These benefits are not included in the payroll loading process but rather are charged directly to O&M as noted; further discussion on these costs can be seen in the Human Resources & Safety Services Budget Narrative.

Health & Welfare

Active Medical

Active medical costs consist of active employee healthcare costs net of employee contributions. Medical (including prescription drugs) and dental plan options are the typical costs associated with active medical expenses. Blue Cross and Blue Shield of North Dakota and Delta Dental administer these plan options. The budget calculations for active healthcare and dental programs are based on trended claims and administration fee experience related to each plan.

Monthly maintenance fees for health saving accounts, the administration of flex spending accounts (that includes health and dependent care) and company contributions to Health Savings Accounts through wellness programs are included with the payroll loading process. An outside actuarial consulting company, Mercer, provides these budget cost estimates.

Life Insurance

Premium negotiations between Otter Tail Corporation (OTC) and insurance vendors provide the basis for group life and accidental death and dismemberment insurance costs. Life insurance plans are provided by The Standard. Mercer provides these budget calculations for OTP.

Long-term Disability (Post Employment) Medical

OTP accrues for long-term disability medical benefits under ASC 715.

ASC 715 requires an accrual for all future expected disability medical benefit payments for employees who have been determined to be disabled by our insurance providers, UNUM (for new LTD cases effective 01/01/2016) or The Standard. Mercer provides these budget cost estimates. The income replacement feature of the LTD plan is fully insured by UNUM and The Standard.

Workers Compensation

OTP provides workers compensation benefits to active and inactive employees. Some of the benefits that may be included through workers compensation include salary continuation, supplemental unemployment benefits, settlements, and ongoing medical and disability related payments. Workers Compensation benefits are self-insured for Minnesota and South Dakota employees. For North Dakota employees, all workers compensation benefits are covered under

the fully-ensured North Dakota State Plan. The accounting department provides the budget estimates.

Miscellaneous Items

OTP provides other health and welfare benefits to employees that are directly charged to O&M and are not part of the payroll loading process. They consist of programs such as the Employee Assistance Program, adoption assistance, business travel accident insurance, and tuition reimbursement programs. Budget calculations are based on prior year trends, anticipated costs and administration fee experience related to each program.

Pension & Retirement Related

Pension

OTC has one pension plan with two different formulas. OTP recognizes pension costs under ASC 715 (formerly FAS 87). The company's noncontributory funded pension plan covers substantially all company employees and OTP nonunion employees hired prior to January 1, 2006, and all union employees of OTP hired prior to November 1, 2013, excluding Coyote Station employees. Coyote Station employees hired before January 1, 2009 are covered under the plan. The plan provides 100% vesting after 5 years of service and for retirement compensation at age 65, with reduced compensation in cases of retirement prior to age 62. The company reserves the right to discontinue the plan but no change or discontinuance may affect the pensions theretofore vested. Mercer provides the budget cost estimates.

Post-Retirement Medical

OTP accrues for post-retirement medical costs under ASC 715 (formerly FAS 106). The net periodic post-retirement benefit cost consists of service cost, interest cost, and the amortization of prior service costs. Mercer provides the budget cost estimates net of Medicare Part D subsidy for qualifying prescription drugs.

401k Match & Enhanced Contribution

OTP has a 401k Savings Plan which contains a 401k component, with an employer matching contribution as well as an additional company enhanced contribution (non-contributory). Wells Fargo Retirement Services is OTP's record keeper and trustee for the 401k plan. Funding for the Plan comes through voluntary pre-tax and after-tax contributions from participants along with additional matching and enhanced contributions from OTP. Human Resources calculates the budgeted amounts for the 401k match and the enhanced contribution. The budget calculations are based on prior year trends adjusted for salary increases, new employees added and anticipated changes, if any.

Employee Stock Ownership Plan

OTP has an Employee Stock Ownership Plan (ESOP). This is a non-contributory plan where the company contribution is based on income tax benefits available to OTP for a tax deduction on dividends held in the Trust and made in OTTR stock to eligible employees. Wells Fargo Retirement Services is our current record keeper and trustee for the ESOP. The budget calculations are determined by Accounting. The ESOP contribution is not included as part of the benefits costs of payroll loading; rather, it is directly charged to O&M.

Executive Survivor and Supplemental Retirement Plan

The Executive Survivor and Supplemental Retirement Plan (ESSRP) is an unfunded, nonqualified supplemental employee retirement plan (SERP) for executive officers and certain key management employees. The ESSRP provides defined benefit payments to these employees upon their retirement for life or to their beneficiaries on their deaths for a 15-year post-retirement period. Life insurance carried on certain plan participants is payable to the Company on the employee's death. There are no plan assets in this nonqualified benefit plan due to the nature of the plan. Budget estimates are provided by M Benefit Solutions. The ESSRP is not included in the benefits costs of payroll loading. It is recorded directly in O&M.

Employee Related Taxes & Lost-time

Included in the payroll loading process are employee related taxes such as FICA and unemployment taxes and taxable meals. Lost-time hours included in payroll loading include:

- Vacation and vacation accrual
- Holidays and Floating Holidays
- Sick leave, jury duty and other miscellaneous lost-time codes

Incentive and Recognition

- Annual Incentive: The individual annual incentive budget is based on current eligible employees, their base salary and any applicable assumed base salary increases, and the percent of targeted incentive. OTP's accounting and human resources departments provide the incentive accruals and budget calculations. The annual incentive is not part of the benefit costs of payroll loading; rather, it is recorded directly to O&M.

Stock-Based Compensation Programs

OTC's stock-based compensation programs are designed to align the interests of the grantees, which consist of upper level management and executive officers, with that of shareholders by providing an incentive award that will increase in value if shareholder value increases. The awards also promote and reward continuity of service since they generally vest over extended service periods of three to four years and unvested awards are forfeited upon voluntary termination. The actual number of stock-based compensation awards granted varies by grantee. The number of awards granted to upper level management employees is based on the employee's position and the market value of OTC common stock near the date of grant. The number of awards granted to executive officers is based on competitive practices, employee position, and an at-risk component of total compensation and the fair value of the award on the date of grant. Stock-based compensation awards are accounted for in accordance with the requirements of ASC 718, Compensation—Stock Compensation, and described in Note 7 to OTC's consolidated financial statements in its 2016 Annual Report to Shareholders. The budget reflects the estimated fair value to be expensed for future grants and amounts expected to be expensed related to prior years' outstanding grants. The values for future grants are provided by OTC's Human Resources Department. The amortized costs of stock-based compensation awards granted to OTP employees are directly charged (100% allocated) to OTP. The amortized costs of stock-based compensation awards granted to OTC employees, including its executive officers, are allocated to OTP through allocation factors that are based on estimated and actual time devoted to OTP operations. The amortized costs of stock-based compensation awards do not go through the payroll loading process.

Below are the specific features of the Performance Share Plan and Restricted Stock Units:

Performance Share Plan

The Performance Share Plan provides executives with the potential to earn awards based on company performance relative to peer companies on two performance measurements. Total Shareholder Return (TSR) and Adjusted 3-Year Return on Equity (ROE). TSR is measured cumulatively over three-year performance periods using overlapping cycles. OTC's TSR is measured against all other companies in its EEI (Edison Electric Institute) peer group. At the end of each three-year performance period executives receive an award that correlates the extent to which the Company's TSR out-performs or under-performs the other companies in its peer group. The TSR portion of the awards pay out 0% of target shares for below threshold performance and from 33.3% of target shares for threshold performance to 66.7% of target shares at target performance to 100% of target shares for maximum performance. Adjusted 3-Year ROE is equal to the average of the adjusted Return on Equity for each of the three years in the performance

period. Adjusted ROE is equal to the Corporation's Adjusted Earnings divided by the 13-month average of Total Outstanding Common Equity using the 13 months ending at the end of the fiscal year. The ROE portion of the awards pays out 0% of target shares for below threshold performance and from 16.7% of target shares at threshold to 33.3% of target shares at target to 50% of target shares at maximum. The grant-date fair value of these awards is based on a Monte-Carlo simulation valuation methodology for the TSR portion of the award and the Black-Scholes Option Pricing Model for the adjusted ROE component of the award. Because of certain personal income tax withholding provisions in the performance share award agreements, presently, the expense recorded for these awards will ultimately be based on the market value of shares actually earned on the date the shares are issued or transferred to the grantee. OTC's Human Resources Department provides the budget estimates for future awards and the budget reflects 100% of target performance. Expenses for outstanding awards granted in previous periods are based on the ratable allocation of the most recent fair valuation of these awards.

Restricted Stock Units granted to OTP's President and OTC's Executive Officers:

These Restricted Stock Units vest 25% per year for four years after the date of grant. The grant-date fair value of these awards, to be expensed ratably over the grantees requisite service period, is based on the grant-date market value of a share of OTC common stock since the grantees of these awards receive dividend equivalent payments on unvested units during the four-year vesting period.

Restricted Stock Units Granted to Employees other than OTP's President and OTC's Executive Officers:

These Restricted Stock Units cliff vest 100% four years after the date of grant, meaning the employee earns the right to receive full benefits at a specified date, rather than becoming vested gradually over a given period of time. The grant-date fair value of these awards, to be expensed ratably over the grantees requisite service period, is based on the grant-date market value of a share of OTC common stock, discounted to reflect the effect of not receiving a dividend for four years.

Other

Other costs that are recorded directly in O&M and do not go through the payroll loading process include:

- Annual Service Awards. The Human Resources department provides the budget estimates.
- Employee performance recognition, which consists of company store items and recognition meals, may be presented to acknowledge employees for specific business-related actions or results. The Human Resources department provides the budget estimates.
- Achievement Awards, a performance based cash award program for non-exempt employees.

Payroll Loading Process

The calculation of payroll loading begins with an estimate of the annual cost of each item that is included in the loading rate. The annual cost estimates are then divided by the estimated productive labor dollars to determine the loading rate necessary to allocate the entire cost of the benefits to labor expense. The loading rate is reviewed and changed as needed due to changes in assumptions. If a significant difference between actual and expected costs is present, either the loading rate will be changed or a journal entry will be made to adjust the difference. All items are balanced at year-end to match the actual costs of these items.

All labor on nonregulated projects receives the regular payroll-loading rate as described above and an extra overhead loading rate. The overhead loading rate is applied and consists of two parts: the general support rate and the facility rate. This rate is analyzed and updated annually.



2016-2018 O&M Budget Documentation

Corporate Services

1.1 Introduction

Otter Tail Corporation (Corporate or OTC) is a holding company and is publicly traded on NASDAQ. In 2009, the company re-organized into a holding company and Otter Tail Power Company (OTP) became a wholly-owned subsidiary of OTC. At the holding company level, services are provided to all subsidiaries of the organization and are staffed by approximately 50 employees on average. Except for the President of OTP, all Officers of the Corporation are employed by OTC. The Officer team consists of the Chief Executive Officer (CEO), the Chief Financial Officer (CFO), the General Counsel, the President of Varistar, the President of OTP, and the Vice President of Human Resources.

The primary focus of Corporate is to ensure the organization is living its values and mission statement and to set the overall vision for the organization. Corporate does this by working with each of its operating companies to grow their business, to achieve operational excellence, and to develop our employees.

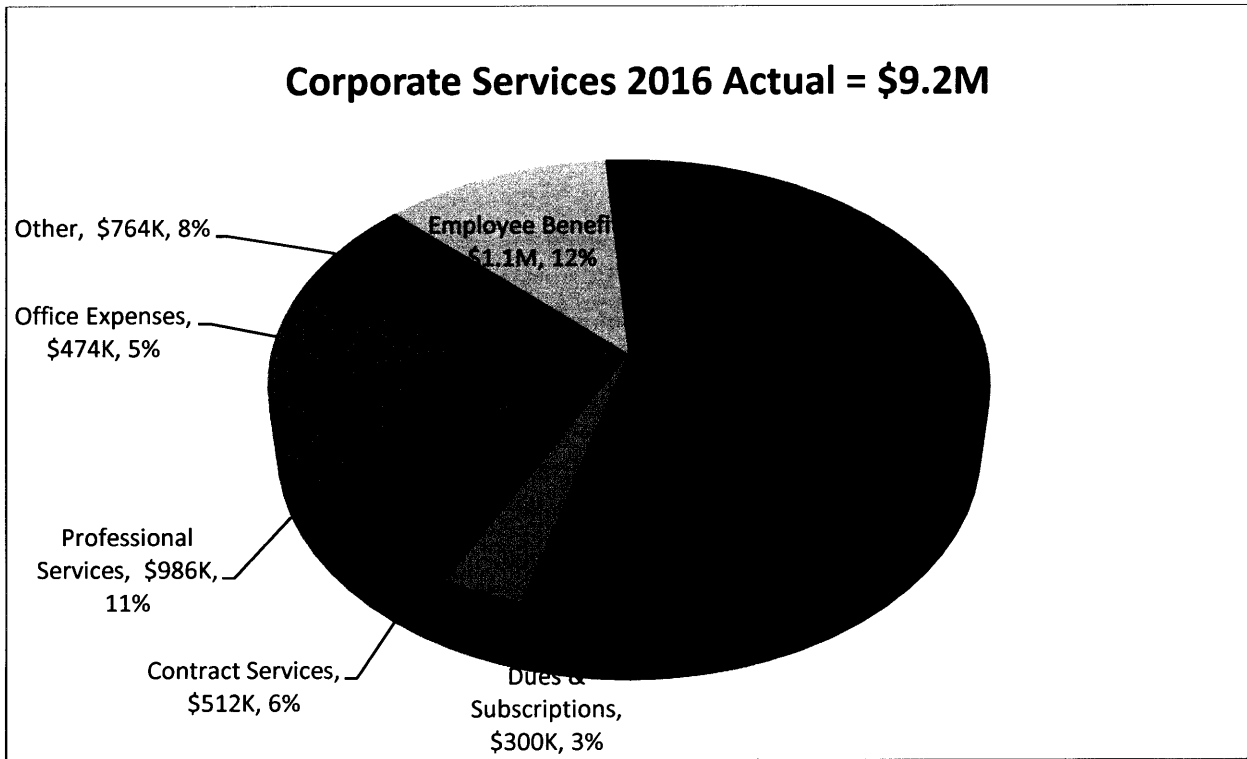
Services performed by Corporate include Board of Directors and governance-related matters, strategic planning, external financial reporting, tax reporting, audit and business risk management, financial planning, treasury, traditional risk management, corporate-related legal matters, investor relations, shareholder services and Human Resource services.

The remainder of this documentation describes Corporate services provided to OTP and the related costs.

1.2 Customer Value

Corporate's strategic planning is essential to the long-term well-being of OTP. Corporate brings value to OTP customers by ensuring that the organization maintains its ability to effectively finance the necessary capital to build and maintain infrastructure to serve OTP's customers. Corporate provides services in representing OTP in dealings with creditors who provide funding through bonds, and shareholders who provide funding through buying stock in Otter Tail Corporation. Corporate also maintains the company's good standing with the Securities and Exchange Commission, with Rating Agencies, and with Financial Institutions.

2.1 2016 O&M Actuals



Labor: Labor includes the costs for Corporate employees that provide services to OTP. Labor is directly assigned or allocated. Directly assigned labor is maintained through timesheets by Corporate employees each week as they directly assign their labor to OTP for OTP specific work performed. Any Corporate labor costs that aren't directly assigned get allocated to OTP via indirect allocators or the general allocator.

Dues & Subscriptions: These costs include dues and subscriptions for various publications and membership fees. In addition, OTP's allocated share of Corporate's computer maintenance agreements and general insurance are recorded in this category via the allocator related to the specific department being charged.

Contract Services: These costs are OTP's allocated share of all other external service providers who Corporate contracts with to provide needed services across the functions performed at Corporate. Contract services can include services such as outside valuation firms, rating agency fees, shareholder proxy services, and others. All contract services are allocated via the specific department allocator or general allocator, unless related to a project specific to OTP.

Professional Services: The costs for these services are mainly associated with two services - fees paid to external independent accountants and legal fees. The audit fees are billed directly to OTC, then are allocated to OTP based on budgeted audit hours (direct assigned), and OTC related audit work (indirect allocation). Amounts paid to external independent accountants relate

to audit and tax services. Certain income tax related consulting fees and legal fees associated with matters concerning OTP are directly paid by OTP. Any remaining accounting fees and legal fees associated with corporate matters for items such as compensation plans, matters concerning the Board of Directors, and SEC filings are allocated to OTP via the general allocator.

Office Expenses: Office supplies, bank charges, license fees, equipment leases, building lease, building maintenance, and software maintenance fees are all included in this category of expense.

Employee Benefits: The costs in this account are associated with the stock incentive plans provided to key employees. This includes amortization of Restricted Stock, Restricted Stock Units, and Performance Shares.

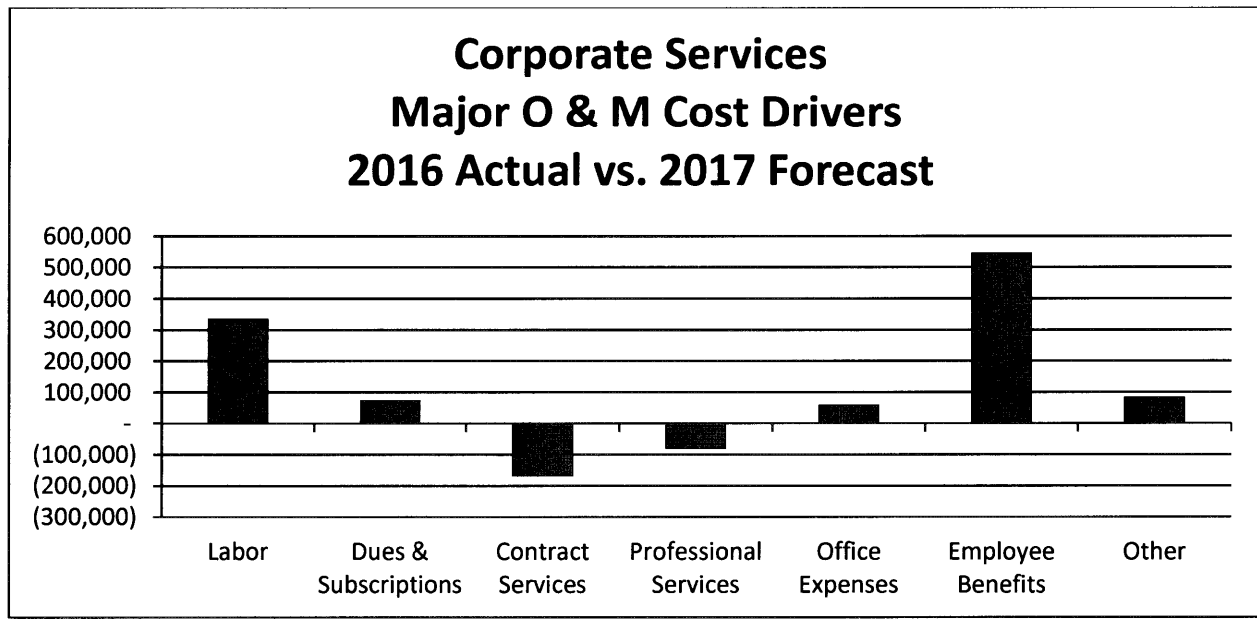
Other: Includes costs associated with employee expense, telephone, advertising, and other miscellaneous costs. The bulk of these costs are Board of Director retainers.

2.2 2016 O&M Actuals vs 2017 O&M Forecast

Corporate Services
2016 Walk forward of Major Cost Drivers

2016 O&M Actuals	\$ 9,157,799
Labor	337,461
Dues & Subscriptions	76,162
Contract Services	(169,360)
Professional Services	(80,206)
Office Expenses	60,672
Employee Benefits	547,617
Other ⁽¹⁾	85,126
2017 O&M Forecast	<u><u>\$10,015,271</u></u>

(1) Other - includes telephone/communication, miscellaneous, advertising, and employee expenses.

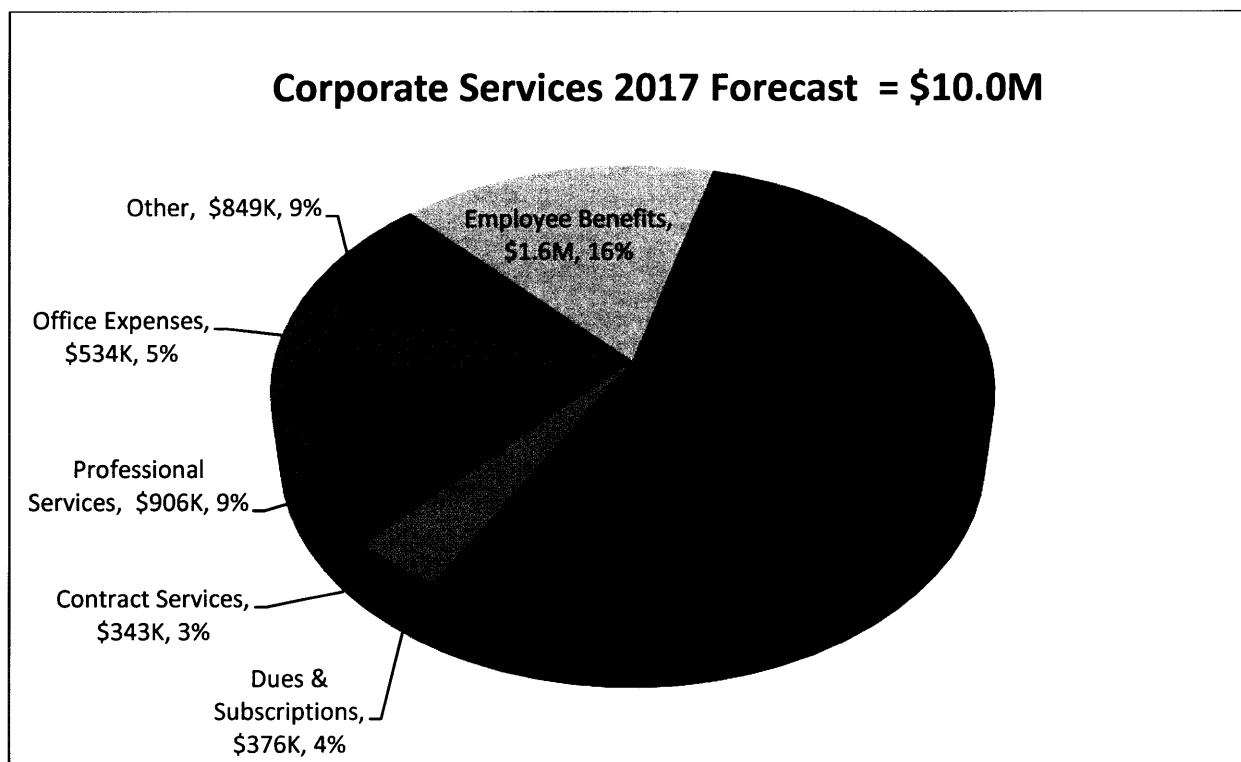


Explanations for the major cost drivers for 2016 Actual versus 2017 Forecast:

Labor: Labor costs increased primarily due to an increase in projected short-term incentive (bonus) payments, related to strong financial performance in 2017.

Professional Services: The primary driver for the decrease in professional services were decreased audit and tax fees.

Employee Benefits: Employee benefit costs increased due to executive Performance Share awards being paid out at a higher level, related to Otter Tail's share price performance as compared to peer companies.



Labor: Labor includes the costs for Corporate employees that provide services to OTP along with any short-term incentive compensation received based on targets set by the Board of Directors. Labor is directly assigned or allocated. Directly assigned labor is maintained through timesheets by Corporate employees each week as they directly assign their labor to OTP for OTP specific work performed. Any Corporate labor costs that aren't directly assigned get allocated to OTP via indirect allocators or the general allocator.

Dues & Subscriptions: These costs include dues and subscriptions for various publications and membership fees. In addition, OTP's allocated share of Corporate's computer maintenance agreements and general insurance are recorded in this category via the allocator related to the specific department being charged.

Contract Services: These costs are OTP's allocated share of all other external service providers who Corporate contracts with to provide needed services across the functions performed at Corporate. Contract services can include services such as outside valuation firms, rating agency fees, shareholder proxy services, and others. All contract services are allocated via the specific department allocator or general allocator, unless related to a project specific to OTP.

Professional Services: The costs for these services are mainly associated with two services - fees paid to external independent accountants and legal fees. The audit fees are billed directly to OTC, then are allocated to OTP based on budgeted audit hours (direct assigned), and OTC

related audit work (indirect allocation). Amounts paid to external independent accountants relate to audit and tax services. Certain income tax related consulting fees and legal fees associated with matters concerning OTP are directly paid by OTP. Any remaining accounting fees and legal fees associated with corporate matters for items such as compensation plans, matters concerning the Board of Directors, and SEC filings are allocated to OTP via the general allocator.

Office Expenses: Office supplies, bank charges, license fees, equipment leases, building lease, building maintenance, and software maintenance fees are all included in this category of expense.

Employee Benefits: The costs in this account are associated with the stock incentive plans provided to key employees. This includes amortization of Restricted Stock, Restricted Stock Units, Performance Shares.

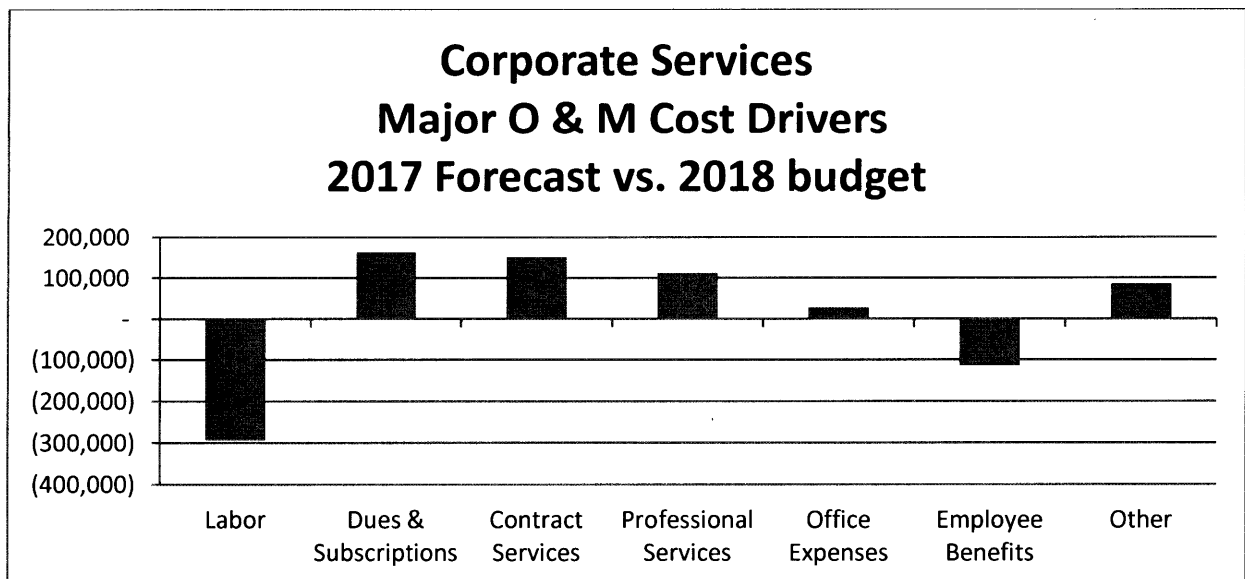
Other: Includes costs associated with employee expense, telephone, advertising, and other miscellaneous costs. The bulk of these costs are Board of Director retainers.

2.3 2017 O&M Forecast vs 2018 O&M Budget

Corporate Services
2017 Walk forward of Major Cost Drivers

2017 O&M Forecast	\$ 10,015,271
Labor	(292,356)
Dues & Subscriptions	164,126
Contract Services	151,721
Professional Services	112,827
Office Expenses	28,333
Employee Benefits	(112,912)
Other ⁽¹⁾	86,257
2018 O&M Budget	<u>\$ 10,153,267</u>

(1) Other - includes telephone/communication, miscellaneous, advertising, and employee expenses.



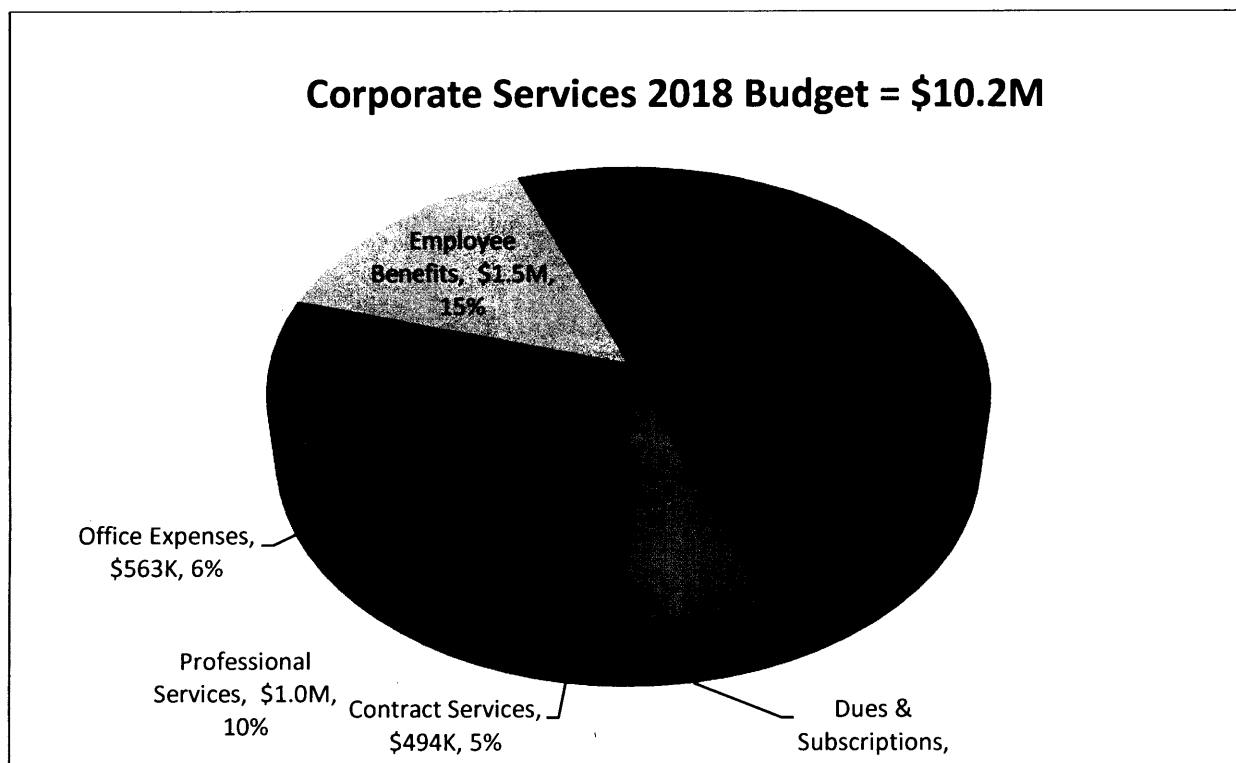
Explanations for the major cost drivers for 2017 Forecast versus 2018 Budget:

Labor: Labor costs are projected to be lower in 2018 due to the reduction in short term incentive (bonus) costs, as 2017 was projected to be higher than normal due to strong financial performance. This is partially offset by normal wage increases.

Professional Services: Professional service costs are projected to be higher due to a bi-annual 3rd party cybersecurity audit.

Employee Benefits: The favorable variance in employee benefits is related to a retirement on the executive team and the associated performance share and other benefit costs as compared to the planned successor.

Contract Services: The increase in contract services is partly related to Business Risk Management (BRM) consulting services



Labor: Labor includes the costs for Corporate employees that provide services to OTP along with any short-term incentive compensation received based on targets set by the Board of Directors. Labor is directly assigned or allocated. Directly assigned labor is maintained through timesheets by Corporate employees each week as they directly assign their labor to OTP for OTP

specific work performed. Directly assigned labor accounts for approximately 21% of total labor. Any remaining Corporate labor costs that aren't directly assigned get allocated to OTP via indirect allocators or the general allocator.

Dues & Subscriptions: These costs include dues and subscriptions for various publications and membership fees. In addition, OTP's allocated share of Corporate's computer maintenance agreements and general insurance are recorded in this category via the allocator related to the specific department being charged.

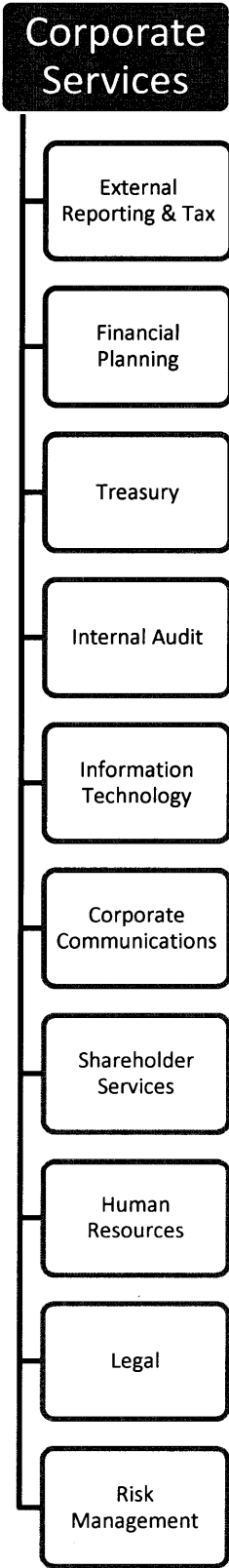
Contract Services: These costs are OTP's allocated share of all other external service providers who Corporate contracts with to provide needed services across the functions performed at Corporate. Contract services can include services such as outside valuation firms, rating agency fees, shareholder proxy services, and others. All contract services are allocated via the specific department allocator or general allocator, unless related to a project specific to OTP.

Professional Services: The costs for these services are mainly associated with two services - fees paid to external independent accountants and legal fees. The audit fees are billed directly to OTC, then are allocated to OTP based on budgeted audit hours (direct assigned), and OTC related audit work (indirect allocation). Amounts paid to external independent accountants relate to audit and tax services. Certain income tax related consulting fees and legal fees associated with matters concerning OTP are directly paid by OTP. Any remaining accounting fees and legal fees associated with corporate matters for items such as compensation plans, matters concerning the Board of Directors, and SEC filings are allocated to OTP via the general allocator.

Office Expenses: Office supplies, bank charges, license fees, equipment leases, building lease, building maintenance, and software maintenance fees are all included in this category of expense.

Employee Benefits: The costs in this account are associated with the stock incentive plans provided to key employees. This includes amortization of Restricted Stock, Restricted Stock Units, Performance Shares.

Other: Includes costs associated with employee expense, telephone, advertising, and other miscellaneous costs. The bulk of these costs are Board of Director retainers.



External Reporting & Tax

Major Functions

The primary function of the External Reporting and Tax area is to prepare accurate consolidated financial results of the Corporation for shareholders and for SEC and tax reporting. The reports prepared are necessary to obtain the appropriate funding needed by OTP for its major construction projects.

Key Activities

- Complete the 10-Q and 10-K for SEC reporting compliance
- Management Reporting
- Accurately record transactions
- Maintain and perform allocations between Corporate and OTP
- Prepare federal and state income tax returns
- Consult with OTP

Financial Planning

Major Functions

Financial Planning is responsible for coordinating and consolidating the financial forecasts of the Corporation.

Key Activities

- Consolidate financial forecasts
- Maintain the software used for budgeting and consolidation purposes
- Collaborate with OTP to review their monthly results
- Conduct goodwill testing when necessary
- Perform financial and enterprise value analysis as needed

Treasury

Major Functions

Corporate has a centralized treasury function that has the responsibility for overall corporate financing functions as well as cash management.

Key Activities

- Lender relationship management for all of OTP's debt instruments, including responsibility for interest payments on OTP's debt and covenant compliance.

- Access the equity and debt markets to raise funds for OTP. The scope includes: negotiating pricing, terms and optimal agreements, as well as ongoing monitoring of the debt and equity markets.
- Monitor and maintain an optimal capital structure
- Oversee lease agreements and negotiate lease arrangements.
- Chairs the Investment Sub-Committee that is responsible for overseeing the pension plan investments.

Internal Audit

Major Functions

The primary function of Internal Audit is performing strategic, financial, compliance and consulting projects. Internal Audit accomplishes its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the organization's risk management, control, and governance processes.

Key Activities

- Develop a flexible annual audit plan using appropriate risk-based methodology, including any risk or control concerns identified by management
- Establish an adequate balance of financial, operational, regulatory and strategic auditing according to the organizational needs that support strategic objectives.
- Evaluate the reliability and integrity of information and the means used to identify, measure, classify, and report such information.
- Assess the effectiveness and efficiency of organizational resources and recommend process and system improvements.
- Follow up on project findings and recommendations until open issues are cleared.
- Issue periodic reports to the Audit Committee and senior management summarizing the internal audit activity's purpose, authority, responsibility, and performance relative to its plan.

Information Technology

Major Functions

The primary function of IT is to manage and support long term planning, direction and organization of enterprise IT services. In addition, this area supports the Corporate office's computers, networks, software, and telephonic components.

Key Activities

- Determine the systems and applications appropriate for corporation.
- Perform maintenance and patches on networks and software
- Management of the Microsoft Enterprise Agreement, Gartner Agreement and Antivirus Software agreements for entire organization.
- Supports corporate workstations, networks server infrastructure, phone system, software and company-owned mobile devices.
- Responsible for review of cyber security issues across the organization.
- Provide training for cyber security
- VP of Information Technology is on the Steering Committee for the implementation of the new customer information services project
- VP of Information Technology will lead the enterprise centralization strategy

Corporate Communications**Major Functions**

The primary function of Corporate Communications is to communicate the Corporation's strategic plan inside and outside OTP, along with providing consistent and clear communication to all stakeholders including shareholders and employees.

Key activities

- Act as a spokesperson in relations with media and the public
- Maintain the Corporation's website
- Publish quarterly press releases
- Coordinate the preparation of the annual report

Shareholder Services**Major Functions**

The primary function of Shareholder Services is to perform the various services on behalf of shareholders and manage investor relations.

Key Activities

- Plan and attend investor fairs
- Maintain shareholder records
- Manage transfer agent and activities
- Plan the annual shareholder meeting

Human ResourcesMajor Functions

The primary function of Human Resources is to oversee and consult on all HR, leadership development and benefit-related matters across the organization and to establish and maintain policies related to executive compensation, employment and benefits of corporate employees.

Key Activities

- System administrator duties for the UltiPro Software, which is a comprehensive HR management system used by OTP and all operating companies. Establish and maintain policies related to employment, incentive comp, benefits and executive compensation, including various stock-based compensation programs
- Search for candidates for upper-level management positions
- Plan and facilitate leadership training
- Interacts with the Board of Directors' compensation committee in the review and approval of executive compensation and benefits
- Assist in the completion of the annual proxy statement with Legal and Shareholder Services for filing with the SEC

LegalMajor Functions

The primary function of Legal is to handle legal matters associated with the operations of a publicly held Corporation. This includes matters pertaining to the Board of Directors, SEC filings, Officer-related matters, benefit plans, and other Corporate-related matters.

Key Activities

- Review contracts with third parties along with any other matter needing legal review or input
- Coordinate Board of Director meetings
- Maintain minutes for all Board-related meetings
- Coordinate litigation
- Coordinate completion of annual proxy statement with Human Resources and Shareholder Services for filing with the SEC

Risk Management

Major Functions

The primary function of Risk Management is to assist operating companies with assessing and managing risk of loss, implementing loss-control strategies, managing loss claims, and identifying and documenting environmental conditions of OTP.

Key Activities

- Manage the consolidated insurance program including property, casualty, D&O, excess general liability, crime, and fiduciary
- Manage the captive insurance program for casualty insurance (the self-retention layer of commercial casualty)
- Act as liaison between insurance carriers and OTP on recommendations of loss-control measures
- Manage loss claims along with our third-party claims management party

The following documentation is from the Corporate Cost Allocation Procedures document and describes the way that Corporate costs are allocated to the operating companies.

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.

The five allocation factors developed are as follows:

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

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 employee's time allocation over the previous 12 months is used to allocate their respective salary and benefit costs.

Non-labor O&M in the budget/forecast is allocated using the same allocation factors as mentioned previously. 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.



Accounting Transactions
Cost Center 0960

Cost Center 0960 is used as an Administrative tracking cost center for multiple overhead loading adjustments and accounting assignments that either support overall company operations or are not assigned elsewhere.

Credits

Credits of various types are the result of accounting transfers from one cost center to another, generally for the purpose of charging the correct FERC account. Typically, the debit side of the journal entry is controlled and the responsibility of an operating area or construction project. The Credit side of the entry, if not posted to a single cost center, i.e. 0960, can be very confusing to managers. Therefore, the credit side of these entries is accumulated in a single cost center to reduce confusion and facilitate better control over the charged accounts. Credits in Cost Center 0960 are as follows:

Loading for Joint CapX 2020 Transmission projects

Jointly owned CapX 2020 Transmission projects have a labor loading component as agreed upon as part of the operating agreements. This represents the allocation of administration and general expenses as a percentage of total company O&M salaries and wages which is charged to all labor charges and applied to a CapX 2020 Transmission project.

Loading for Joint Operations of Big Stone Plant and Coyote Station

Jointly owned power plants have labor loadings as part of the operating agreement. This represents the administration loading to all labor charged to jointly owned plants, not originating from the plant cost center.

Administrative and General Transfers to Capital work

There is an administration loading for all capital work, excluding jointly owned plants. Charges are made to each work-order, and the credit is posted to Cost Center 0960.

Loadings for Below-the-line Projects

Below-the-line Projects are accounted for as non-utility and require a loading to reduce the cost to above-the-line Utility operations.

Loadings for Billings to Others

On occasion, OTP will bill for work performed for others. When this occurs, there is a labor administrative loading component applied to the bill.

Vehicle Use

When a vehicle is utilized, the charge to the appropriate expense or capital project follows the cost center that has used the vehicle. The vehicle use credit is posted to Cost Center 0960.

Warehouse Clearing / Loading

Materials in warehouse inventory are charged to the user's Cost Center and the correct FERC account, whereas the credit for their use is posted to Cost Center 0960.

Meter Installation Capitalization

The costs to install a meter are capitalized (charged) to meter inventory when it is purchased. The corresponding credit is posted to Cost Center 0960.

Computer Installation Costs

The costs to install computers are capitalized (charged) to computer capital FERC accounts when in is purchased. The credit is posted to Cost Center 0960.

Other Charges (Debits)

Other charges also appear in this cost center for expenses to support the entire company, yet are not the responsibility of any one Cost Center manager.

- Annual incentive payments to all employees
- Annual year end payroll and expense accruals
- Annual bad debt provision
- Other miscellaneous accruals and charges not the responsibility of any single Cost Center manager.



O&M Summary Reports

OTP presents three Summary Reports for two time periods to provide an overview of our operating and maintenance (O&M) costs within the Summary Reports portion of Volume 5, Budget Documentation.

Summary Report #1a and 1b – shows O&M costs by FERC Sub-Function for 2016 Actuals versus 2018 Budget data as well as 2017 Forecast versus 2018 Budget data. Explanations follow these two reports.

Summary Report #2a and 2b – shows O&M costs by FERC Account for 2016 Actuals versus 2018 Budget data as well as 2017 Forecast versus 2018 Budget data.

Summary Report #3a and 3b – shows O&M costs by Sub-Account for 2016 Actuals versus 2018 Budget data as well as 2017 Forecast versus 2018 Budget data.

Summary Report #1a
O&M's by FERC Sub-Function
2016 Actuals versus 2018 Budget

	2016	2018	Variance	% Variance
Steam Power Generation	\$ 25,021,337	\$ 29,715,810	\$ 4,694,473	19%
Hydraulic Power Generation	\$ 388,418	\$ 444,301	\$ 55,883	14%
Other Power Generation	\$ 4,562,129	\$ 5,181,611	\$ 619,482	14%
Other Power Supply	\$ 495,930	\$ 823,512	\$ 327,582	66%
Total Power Production	\$ 30,467,813	\$ 36,165,234	\$ 5,697,420	19%
Transmission	10,929,769	12,850,039	\$ 1,920,270	18%
Regional Market Expenses	1,031,178	796,439	\$ (234,739)	-23%
Distribution	16,790,846	16,916,980	\$ 126,134	1%
Customer Accounts	12,476,087	13,849,926	\$ 1,373,839	11%
Customer Service	2,647,690	3,098,724	\$ 451,034	17%
Sales	344,660	372,941	\$ 28,281	8%
Administrative & General	44,694,829	51,411,940	\$ 6,717,111	15%
Total O&M	\$ 119,382,873	\$ 135,462,223	\$ 16,079,350	13%

Variance explanations for 2016 Actuals to 2018 Budget

Labor:

Total labor hours increased by approximately 1325 (.08%) between 2016 and 2018. O&M labor hours increased and capitalized labor hours decreased by approximately 8,900 between 2016 and 2018, reflecting completion of projected capitalized in 2018, mainly OTP's Customer Information System(CISOne).

Total O&M labor increases including rate increases, loadings and the above comment

\$ 3,100,000

Non-Labor:

MISO increased Schedule 10 expenses- FERC Cost Adder	380,000
MISO increased Schedule 11 expenses - Wholesale distribution services	850,000
Big Stone Plant planned maintenance outage (2018)	3,600,000
Coyote Plant planned maintenance outage (2016)	(1,400,000)
GAAP 715 compliance (pension and OPEB)	2,800,000
Discount rate decreases (pension and OPEB)	
Pension 87	2,600,000
OBEB 106	850,000
Other, including general inflation (3% total 2016-2018)	3,300,000
	<u>3,300,000</u>
	\$ 16,080,000

Effects of primary sources of variances by FERC Sub-Function

Steam Power Generation	\$ 4,694,473
Variance reflects difference between changes in planned maintenance outages at Coyote and Big Stone Plants as well as the assumption of normal demand for energy from Midcontinent Independent System Operator(MISO)	
Hydraulic Power Other Power Generation	55,883
Variance reflects no significant changes	
Other Power Generation	619,482
Variance reflects general inflation and normal labor increases	
Other Power Supply	327,582
Variance reflects general inflation and normal labor increases	
TOTAL POWER SUPPLY	5,697,420
Transmission	1,920,270
Variance reflects MISO increases listed above	
Regional Market Expenses	(234,739)
Variance reflects reduction in labor costs due to reduced staffing levels	
Distribution	126,134
Variance reflects general inflation and normal labor increases	
Customer Accounts	1,373,839
Variance reflects increase in labor expense due to reclass of capital labor to O&M for the CISOne project	
Customer Service	451,034
Variance reflects general inflation and normal labor increases	
Sales	28,281
Variance reflects general inflation and normal labor increases	
Administrative &General	6,717,111
Variance reflects increases in Pension and OPEB expenses (GAAP 715 compliance and discount rate decrease), general inflation, and normal labor increases	

Summary Report #1b
O&M's by FERC Sub-Function
2017 Forecast versus 2018 Budget

	2017	2018	Variance	% Variance
Steam Power Generation	\$ 25,464,829	\$ 29,715,810	\$ 4,250,981	17%
Hydraulic Power Generation	\$ 481,163	\$ 444,301	\$ (36,862)	-8%
Other Power Generation	\$ 5,134,831	\$ 5,181,611	\$ 46,780	1%
Other Power Supply	\$ 733,483	\$ 823,512	\$ 90,029	12%
Total Power Production	\$ 31,814,305	\$ 36,165,234	\$ 4,350,929	14%
Transmission	11,995,851	12,850,039	\$ 854,188	7%
Regional Market Expenses	899,804	796,439	\$ (103,365)	-11%
Distribution	17,134,572	16,916,980	\$ (217,593)	-1%
Customer Accounts	13,162,654	13,849,926	\$ 687,272	5%
Customer Service	2,644,518	3,098,724	\$ 454,206	17%
Sales	355,559	372,941	\$ 17,382	5%
Administrative & General	44,095,251	51,411,940	\$ 7,316,689	17%
Total O&M	\$ 122,102,514	\$ 135,462,223	\$ 13,359,709	11%

Variance explanations for 2017 Forecast to 2018 Budget

Labor:

Total labor hours decreased by approximately 500 (.03%) between 2017 and 2018. O&M labor hours increased and capitalized labor hours decreased by approximately 17,000 between 2017 and 2018, reflecting completion of projected capitalized in 2018, mainly OTP's Customer Information System(CISOne).

Total O&M labor increases including rate increases, loadings and the above comment

\$ 1,000,000

Non-Labor:

MISO increased Schedule 10 expenses- FERC Cost Adder	80,000
MISO increased Schedule 11 expenses - Wholesale distribution services	750,000
Technology & Infrastructure Program	800,000
Big Stone Plant planned maintenance outage (2018)	2,700,000
GAAP 715 compliance (pension and OPEB)	2,800,000
Discount rate decreases (pension and OPEB)	
Pension 87	2,500,000
OBEB 106	250,000
LTD Medical 107	450,000
Other, including general inflation (3% total 2016-2018)	2,030,000
	<u>\$ 13,360,000</u>

Effects of primary sources of variances by FERC Sub-Function

Steam Power Generation	\$ 4,250,981
Variance reflects difference between changes in planned maintenance outages at Coyote and Big Stone Plants as well as the assumption of normal demand for energy from Midcontinent Independent System Operator(MISO)	
Hydraulic Power Other Power Generation	(36,862)
Variance reflects no significant changes	
Other Power Generation	46,780
Variance reflects no significant changes	
Other Power Supply	90,029
Variance reflects general inflation and normal labor increases	
TOTAL POWER SUPPLY	4,350,929
Transmission	854,188
Variance reflects MISO increases listed above	
Regional Market Expenses	(103,365)
Reduction in labor costs due to reduced staffing levels	
Distribution	(217,593)
Variance reflects general inflation and normal labor increases	
Customer Accounts	687,272
Variance reflects increase in labor expense due to reclass of capital labor to O&M for the CISOne project	
Customer Service	454,206
Variance reflects general inflation and normal labor increases	
Sales	17,382
Variance reflects no significant changes	
Administrative &General	7,316,689
Variance reflects increases in Pension and OPEB expenses (GAAP 715 compliance and discount rate decrease), general inflation, and normal labor increases	
TOTAL O&M	\$ 13,359,709

Summary Report #2a
O&M's by FERC Account
2016 Actuals versus 2018 Budget

	2016	2018	Variance	% Variance
4118 - Gains from disposition of allowances	(17)		17	-99.06%
5000 - Steam Power Generation - Operation supervision and engineering	1,722,605	2,241,304	518,699	30.11%
5010 - Steam Power Generation - Fuel	358,312	538,055	179,744	50.16%
5020 - Steam Power Generation - Steam expenses	3,619,760	3,808,416	188,656	5.21%
5050 - Steam Power Generation - Electric expenses	2,309,873	2,725,371	415,498	17.99%
5060 - Steam Power Generation - Miscellaneous steam power expenses	4,887,526	5,625,956	738,430	15.11%
5070 - Steam Power Generation - Rents	4,971	376	(4,596)	-92.45%
5090 - Allowances	-	-	-	0.00%
5100 - Steam Power Generation - Maintenance supervision and engineering	861,972	985,523	123,551	14.33%
5110 - Steam Power Generation - Maintenance of structures	1,150,873	953,820	(197,053)	-17.12%
5120 - Steam Power Generation - Maintenance of boiler plant	7,510,932	8,889,850	1,378,917	18.36%
5130 - Steam Power Generation - Maintenance of electric plant	1,239,787	2,214,626	974,839	78.63%
5140 - Steam Power Generation - Maintenance of miscellaneous steam plant	1,354,726	1,732,514	377,788	27.89%
5350 - Hydraulic Power Generation - Operation supervision and engineering	10,601	21,209	10,608	100.07%
5370 - Hydraulic Power Generation - Hydraulic Expenses	21,007	12,312	(8,694)	-41.39%
5380 - Hydraulic Power Generation - Electric Expenses	34,694	107,141	72,447	208.82%
5390 - Hydraulic Power Generation - Miscellaneous hydraulic power generation expenses	17,444	6,901	(10,543)	-60.44%
5410 - Hydraulic Power Generation - Maintenance supervision and engineering	12,384	2,842	(9,542)	-77.05%
5420 - Hydraulic Power Generation - Maintenance of structures	1,824	7,607	5,783	317.04%
5430 - Hydraulic Power Generation - Maintenance of reservoirs, dams and waterways	284,145	266,776	(17,369)	-6.11%
5440 - Hydraulic Power Generation - Maintenance of electric plant	6,319	17,838	11,519	182.29%
5450 - Hydraulic Power Generation - Maintenance of miscellaneous hydraulic plant	-	1,674	1,674	0.00%
5460 - Other Power Generation - Operation supervision and engineering	246,551	200,533	(46,018)	-18.66%
5480 - Other Power Generation - Generation Expenses	2,210,732	2,619,279	408,547	18.48%
5490 - Other Power Generation - Miscellaneous other power generation expenses	701,799	963,420	261,622	37.28%
5500 - Other Power Generation - Rents	581,889	613,105	31,216	5.36%
5510 - Other Power Generation - Maintenance supervision and engineering	124,683	36,478	(88,205)	-70.74%
5520 - Other Power Generation - Maintenance of structures	34,076	40,327	6,250	18.34%
5530 - Other Power Generation - Maintenance of generating and electric plant	518,892	695,557	176,665	34.05%
5540 - Other Power Generation - Maintenance of miscellaneous other power generation plant	143,507	12,911	(130,596)	-91.00%
5560 - Other Power Supply Expenses - System control and load dispatching	441,056	584,423	143,368	32.51%
5570 - Other Power Supply Expenses - Other Expenses	54,874	239,088	184,214	335.70%
5600 - Transmission Expenses - Operation supervision and engineering	464,279	461,603	(2,677)	-0.58%
5611 - Transmission Expenses - Load dispatch - reliability	71,442	79,019	7,577	10.61%
5612 - Transmission Expenses - Load dispatch - monitor and operate transmission system	2,471,306	2,666,618	195,312	7.90%
5614 - Transmission Expenses - Scheduling, system control, and dispatching services	1,069,288	997,846	(71,442)	-6.68%
5615 - Transmission Expenses - Reliability, planning, and standards development	763,506	744,316	(19,190)	-2.51%
5616 - Transmission Expenses - Transmission service studies	140	3,530	3,389	2420.97%
5617 - Transmission Expenses - Generation interconnection studies	625	-	(625)	-99.95%
5620 - Transmission Expenses - Station expenses	318,041	356,660	38,619	12.14%
5630 - Transmission Expenses - Overhead line expenses	599,907	320,668	(279,239)	-46.55%
5650 - Transmission Expenses - Transmission of electricity by others	433,213	29,247	(403,965)	-93.25%
5660 - Transmission Expenses - Miscellaneous transmission expenses	656,770	1,972,101	1,315,331	200.27%
5670 - Transmission Expenses - Rents	49,879	34,972	(14,908)	-29.89%
5680 - Transmission Expenses - Maintenance supervision and engineering	204,232	234,569	30,336	14.85%
5691 - Transmission Expenses - Maintenance of computer hardware	50,158	83,238	33,080	65.95%
5692 - Transmission Expenses - Maintenance of computer software	727,917	775,578	47,661	6.55%
5693 - Transmission Expenses - Maintenance of communication equipment	91,267	94,585	3,318	3.64%
5700 - Transmission Expenses - Maintenance of station equipment	1,175,177	1,426,767	251,590	21.41%
5710 - Transmission Expenses - Maintenance of overhead lines	1,779,654	2,568,723	789,068	44.34%
5720 - Transmission Expenses - Maintenance of underground lines	1,772	-	(1,772)	-99.98%
5730 - Transmission Expenses - Maintenance of miscellaneous transmission plant	1,195	-	(1,195)	-100.00%
5752 - Regional Market Expenses - Day-ahead and real-time market administration	716,422	484,089	(232,334)	-32.43%
5753 - Regional Market Expenses - Transmission rights market administration	2,217	70,969	68,752	3101.14%
5754 - Regional Market Expenses - Capacity market administration	-	-	-	0.00%
5755 - Regional Market Expenses - Ancillary services market administration	28,980	6,112	(22,868)	-78.91%
5756 - Regional Market Expenses - Market monitoring and compliance	66,617	2,086	(64,531)	-96.87%
5763 - Regional Market Expenses - Maintenance of computer software	216,943	233,184	16,241	7.49%
5800 - Distribution Expenses - Operation supervision and engineering	277,252	282,930	5,678	2.05%
5810 - Distribution Expenses - Load Dispatching	224,423	264,990	40,567	18.08%
5820 - Distribution Expenses - Station expenses	310,375	288,304	(22,071)	-7.11%
5830 - Distribution Expenses - Overhead line expenses	273,050	386,493	113,443	41.55%
5840 - Distribution Expenses - Underground line expenses	1,937,284	1,462,508	(474,775)	-24.51%
5850 - Distribution Expenses - Street lighting and signal system expenses	-	1,483	1,483	0.00%
5860 - Distribution Expenses - Meter expenses	840,341	961,020	120,679	14.36%
5870 - Distribution Expenses - Customer installation expenses	215,285	291,190	75,905	35.26%
5880 - Distribution Expenses - Miscellaneous distribution expenses	3,677,204	2,987,571	(689,633)	-18.75%
5890 - Distribution Expenses - Rents	241,832	265,841	24,009	9.93%
5900 - Distribution Expenses - Maintenance supervision and engineering	823,850	754,325	(69,525)	-8.44%
5920 - Distribution Expenses - Maintenance of station equipment	804,090	750,629	(53,461)	-6.65%
5930 - Distribution Expenses - Maintenance of overhead lines	4,188,930	5,029,839	840,909	20.07%
5940 - Distribution Expenses - Maintenance of underground lines	1,029,141	1,132,581	103,440	10.05%
5950 - Distribution Expenses - Maintenance of line transformers	74,444	47,846	(26,597)	-35.73%
5960 - Distribution Expenses - Maintenance of street lighting and signal systems	1,014,230	1,173,607	159,377	15.71%
5970 - Distribution Expenses - Maintenance of meters	736,064	721,512	(14,552)	-1.98%
5980 - Distribution Expenses - Maintenance of miscellaneous distribution plant	123,052	114,310	(8,741)	-7.10%
9010 - Customer Accounts Expenses - Supervision	48,006	210,470	162,464	338.42%
9020 - Customer Accounts Expenses - Meter reading expenses	5,743,243	5,275,051	(468,192)	-8.15%
9030 - Customer Accounts Expenses - Customer records and collection expenses	5,229,744	6,955,859	1,726,114	33.01%
9040 - Customer Accounts Expenses - Uncollectible accounts	930,000	900,000	(30,000)	-3.23%
9050 - Customer Accounts Expenses - Miscellaneous customer accounts expenses	525,093	508,546	(16,547)	-3.15%
9070 - Customer Service and Informational Expenses - Supervision	595,471	861,727	266,256	44.71%
9080 - Customer Service and Informational Expenses - Customer assistance expenses	1,579,196	1,751,824	172,628	10.93%
9090 - Customer Service and Informational Expenses - Informational and instructional advertising expenses	413,306	431,892	18,586	4.50%
9100 - Customer Service and Informational Expenses - Miscellaneous customer service and informational expenses	59,717	53,281	(6,436)	-10.78%
9110 - Sales Expenses - Supervision	76,266	29,021	(47,245)	-61.95%
9120 - Sales Expenses - Demonstrating and selling expenses	262,712	330,908	68,196	25.96%

Summary Report #2a
O&M's by FERC Account
2016 Actuals versus 2018 Budget

	2016	2018	Variance	% Variance
9130 - Sales Expenses - Advertising expenses		1,423	1,423	0.00%
9160 - Sales Expenses - Miscellaneous sales expenses	5,682	11,590	5,908	103.97%
9200 - Administrative and general salaries	22,524,725	21,708,216	(816,509)	-3.62%
9210 - Office supplies and expenses	6,914,141	9,712,588	2,798,447	40.47%
9220 - Administrative expenses transferred -- Credit	(2,472,648)	(3,063,358)	(590,709)	23.89%
9230 - Outside services employed	1,353,266	1,329,645	(23,621)	-1.75%
9240 - Property insurance	3,168,173	2,226,899	(941,275)	-29.71%
9250 - Injuries and damages	2,248,103	2,184,837	(63,266)	-2.81%
9260 - Employee pensions and benefits	3,113,201	10,160,901	7,047,700	226.38%
9280 - Regulatory commission expenses	4,390,992	2,846,860	(1,544,132)	-35.17%
9301 - General advertising expenses	490,312	524,560	34,248	6.98%
9302 - Miscellaneous general expenses	1,539,761	1,028,903	(510,858)	-33.18%
9310 - Administrative and General Expenses - Rents	287,129	408,270	121,140	42.19%
9350 - Maintenance of general plant	1,137,692	2,343,620	1,205,928	106.00%
Grand Total	119,382,873	135,462,223	16,079,350	13.47%

**Summary Report #2b
O&M's by FERC Account
2017 Forecast versus 2018 Budget**

	2017	2018	Variance	% Variance
4118 - Gains from disposition of allowances	(16)		16	-99.06%
5000 - Steam Power Generation - Operation supervision and engineering	1,874,930	2,241,304	366,373	19.54%
5010 - Steam Power Generation - Fuel	467,695	538,055	70,360	15.04%
5020 - Steam Power Generation - Steam expenses	3,506,850	3,808,416	301,565	8.60%
5050 - Steam Power Generation - Electric expenses	2,534,820	2,725,371	190,551	7.52%
5060 - Steam Power Generation - Miscellaneous steam power expenses	5,559,798	5,625,956	66,158	1.19%
5070 - Steam Power Generation - Rents	1,098	376	(722)	-65.80%
5100 - Steam Power Generation - Maintenance supervision and engineering	928,450	985,523	57,073	6.15%
5110 - Steam Power Generation - Maintenance of structures	1,184,510	953,820	(230,690)	-19.48%
5120 - Steam Power Generation - Maintenance of boiler plant	7,189,096	8,889,850	1,700,754	23.66%
5130 - Steam Power Generation - Maintenance of electric plant	945,041	2,214,626	1,269,585	134.34%
5140 - Steam Power Generation - Maintenance of miscellaneous steam plant	1,272,540	1,732,514	459,975	36.15%
5350 - Hydraulic Power Generation - Operation supervision and engineering	22,394	21,209	(1,186)	-5.29%
5370 - Hydraulic Power Generation - Hydraulic Expenses	9,854	12,312	2,458	24.95%
5380 - Hydraulic Power Generation - Electric Expenses	88,409	107,141	18,732	21.19%
5390 - Hydraulic Power Generation - Miscellaneous hydraulic power generation expenses	12,893	6,901	(5,993)	-46.48%
5400 - Hydraulic Power Generation - Rents	107		(107)	-100.36%
5410 - Hydraulic Power Generation - Maintenance supervision and engineering	3,389	2,842	(547)	-16.13%
5420 - Hydraulic Power Generation - Maintenance of structures	9,055	7,607	(1,448)	-15.99%
5430 - Hydraulic Power Generation - Maintenance of reservoirs, dams and waterways	305,221	266,776	(38,445)	-12.60%
5440 - Hydraulic Power Generation - Maintenance of electric plant	28,112	17,838	(10,274)	-36.55%
5450 - Hydraulic Power Generation - Maintenance of miscellaneous hydraulic plant	1,728	1,674	(54)	-3.11%
5460 - Other Power Generation - Operation supervision and engineering	197,744	200,533	2,789	1.41%
5480 - Other Power Generation - Generation Expenses	2,477,980	2,619,279	141,300	5.70%
5490 - Other Power Generation - Miscellaneous other power generation expenses	906,041	963,420	57,379	6.33%
5500 - Other Power Generation - Rents	604,118	613,105	8,987	1.49%
5510 - Other Power Generation - Maintenance supervision and engineering	65,117	36,478	(28,639)	-43.98%
5520 - Other Power Generation - Maintenance of structures	46,037	40,327	(5,710)	-12.40%
5530 - Other Power Generation - Maintenance of generating and electric plant	846,461	695,557	(150,904)	-17.83%
5540 - Other Power Generation - Maintenance of miscellaneous other power generation plant	(8,668)	12,911	21,579	-248.95%
5560 - Other Power Supply Expenses - System control and load dispatching	561,424	584,423	23,000	4.10%
5570 - Other Power Supply Expenses - Other Expenses	172,059	239,088	67,030	38.96%
5600 - Transmission Expenses - Operation supervision and engineering	534,145	461,603	(72,542)	-13.58%
5611 - Transmission Expenses - Load dispatch - reliability	76,569	79,019	2,450	3.20%
5612 - Transmission Expenses - Load dispatch - monitor and operate transmission system	2,553,997	2,666,618	112,621	4.41%
5614 - Transmission Expenses - Scheduling, system control, and dispatching services	1,232,629	997,846	(234,783)	-19.05%
5615 - Transmission Expenses - Reliability, planning, and standards development	768,791	744,316	(24,475)	-3.18%
5616 - Transmission Expenses - Transmission service studies	2,964	3,530	565	19.08%
5618 - Transmission Expenses - Reliability planning and standards development services	10,000		(10,000)	-100.00%
5620 - Transmission Expenses - Station expenses	356,197	356,660	464	0.13%
5630 - Transmission Expenses - Overhead line expenses	351,364	320,668	(30,696)	-8.74%
5650 - Transmission Expenses - Transmission of electricity by others	315,912	29,247	(286,665)	-90.74%
5660 - Transmission Expenses - Miscellaneous transmission expenses	917,305	1,972,101	1,054,796	114.99%
5670 - Transmission Expenses - Rents	29,388	34,972	5,584	19.00%
5680 - Transmission Expenses - Maintenance supervision and engineering	222,218	234,569	12,351	5.56%
5691 - Transmission Expenses - Maintenance of computer hardware	83,447	83,238	(209)	-0.25%
5692 - Transmission Expenses - Maintenance of computer software	724,280	775,578	51,297	7.08%
5693 - Transmission Expenses - Maintenance of communication equipment	101,430	94,585	(6,845)	-6.75%
5700 - Transmission Expenses - Maintenance of station equipment	1,440,351	1,426,767	(13,584)	-0.94%
5710 - Transmission Expenses - Maintenance of overhead lines	2,274,863	2,568,723	293,859	12.92%
5752 - Regional Market Expenses - Day-ahead and real-time market administration	597,629	484,089	(113,540)	-19.00%
5753 - Regional Market Expenses - Transmission rights market administration	37,829	70,969	33,140	87.60%
5755 - Regional Market Expenses - Ancillary services market administration	14,481	6,112	(8,369)	-57.79%
5756 - Regional Market Expenses - Market monitoring and compliance	22,804	2,086	(20,718)	-90.85%
5763 - Regional Market Expenses - Maintenance of computer software	227,061	233,184	6,123	2.70%
5800 - Distribution Expenses - Operation supervision and engineering	306,999	282,930	(24,069)	-7.84%
5810 - Distribution Expenses - Load Dispatching	224,104	264,990	40,886	18.24%
5820 - Distribution Expenses - Station expenses	281,105	288,304	7,199	2.56%
5830 - Distribution Expenses - Overhead line expenses	598,296	386,493	(211,803)	-35.40%
5840 - Distribution Expenses - Underground line expenses	1,722,009	1,462,508	(259,500)	-15.07%
5850 - Distribution Expenses - Street lighting and signal system expenses		1,483	1,483	0.00%
5860 - Distribution Expenses - Meter expenses	447,344	961,020	513,676	114.83%
5870 - Distribution Expenses - Customer installation expenses	267,717	291,190	23,473	8.77%
5880 - Distribution Expenses - Miscellaneous distribution expenses	3,347,545	2,987,571	(359,974)	-10.75%
5890 - Distribution Expenses - Rents	253,075	265,841	12,766	5.04%
5900 - Distribution Expenses - Maintenance supervision and engineering	862,432	754,325	(108,107)	-12.54%
5920 - Distribution Expenses - Maintenance of station equipment	807,050	750,629	(56,421)	-6.99%
5930 - Distribution Expenses - Maintenance of overhead lines	4,902,869	5,029,839	126,970	2.59%
5940 - Distribution Expenses - Maintenance of underground lines	1,092,542	1,132,581	40,039	3.66%
5950 - Distribution Expenses - Maintenance of line transformers	62,941	47,846	(15,095)	-23.98%
5960 - Distribution Expenses - Maintenance of street lighting and signal systems	1,069,629	1,173,607	103,978	9.72%
5970 - Distribution Expenses - Maintenance of meters	768,380	721,512	(46,868)	-6.10%
5980 - Distribution Expenses - Maintenance of miscellaneous distribution plant	120,536	114,310	(6,225)	-5.16%
9010 - Customer Accounts Expenses - Supervision	132,344	210,470	78,126	59.03%
9020 - Customer Accounts Expenses - Meter reading expenses	5,425,918	5,275,051	(150,867)	-2.78%
9030 - Customer Accounts Expenses - Customer records and collection expenses	6,237,359	6,955,859	718,500	11.52%
9040 - Customer Accounts Expenses - Uncollectible accounts	850,000	900,000	50,000	5.88%
9050 - Customer Accounts Expenses - Miscellaneous customer accounts expenses	517,033	508,546	(8,487)	-1.64%
9070 - Customer Service and Informational Expenses - Supervision	720,476	861,727	141,251	19.61%
9080 - Customer Service and Informational Expenses - Customer assistance expenses	1,467,374	1,751,824	284,450	19.38%
9090 - Customer Service and Informational Expenses - Informational and instructional advertising expenses	431,894	431,892	(2)	0.00%
9100 - Customer Service and Informational Expenses - Miscellaneous customer service and informational expenses	24,775	53,281	28,506	115.06%
9110 - Sales Expenses - Supervision	61,516	29,021	(32,495)	-52.82%
9120 - Sales Expenses - Demonstrating and selling expenses	285,936	330,908	44,972	15.73%
9130 - Sales Expenses - Advertising expenses	1,472	1,423	(50)	-3.38%
9160 - Sales Expenses - Miscellaneous sales expenses	6,635	11,590	4,955	74.68%
9200 - Administrative and general salaries	22,296,974	21,708,216	(588,759)	-2.64%

Summary Report #2b
O&M's by FERC Account
2017 Forecast versus 2018 Budget

	2017	2018	Variance	% Variance
9210 - Office supplies and expenses	7,795,400	9,712,588	1,917,188	24.59%
9220 - Administrative expenses transferred -- Credit	(2,085,688)	(3,063,358)	(977,669)	46.88%
9230 - Outside services employed	1,147,156	1,329,645	182,489	15.91%
9240 - Property insurance	1,814,331	2,226,899	412,568	22.74%
9250 - Injuries and damages	2,219,720	2,184,837	(34,883)	-1.57%
9260 - Employee pensions and benefits	3,246,931	10,160,901	6,913,970	212.94%
9280 - Regulatory commission expenses	2,921,207	2,846,860	(74,346)	-2.55%
9301 - General advertising expenses	440,324	524,560	84,236	19.13%
9302 - Miscellaneous general expenses	1,446,945	1,028,903	(418,042)	-28.89%
9310 - Administrative and General Expenses - Rents	362,420	408,270	45,849	12.65%
9350 - Maintenance of general plant	2,489,548	2,343,620	(145,928)	-5.86%
Grand Total	122,102,514	135,462,223	13,359,709	10.94%

Summary Report #3a
O&M's by Sub Account
2016 Actuals versus 2018 Budget

	2016	2018	Variance	% Variance
4340.0000 - Gain from Disposition of Allowances	(17)		17	-99.06%
5015.0000 - Pollution Control Equipment/Reagents		10,216	10,216	0.00%
5015.1000 - Pollution Control Reagents / Lime	596,900	687,193	90,294	15.13%
5020.1000 - Water Supply / Chemicals	434,727	611,293	176,565	40.62%
5020.1200 - Water Supply / Ash Handling - Plants O	410,701	461,529	50,829	12.38%
5020.2000 - Water Supply / Water Supply/Miscellaneous	48,802	63,454	14,652	30.02%
5044.0010 - SPP Schedule 1 Expense	128,000	92,700	(35,300)	-27.58%
5044.0015 - SPP Schedule 1A Expense	178,000	257,088	79,088	44.43%
5044.0020 - SPP Schedule 2 Expense	-	-	-	0.00%
5044.0120 - SPP Schedule 12 Expense	-	6,705	6,705	0.00%
5045.0000 - MISO Tariff Expense / MISO Other Sched	-	-	-	0.00%
5045.0100 - MISO Tariff Expense / MISO Schedule 10	1,197,273	1,577,076	379,803	31.72%
5045.0110 - MISO Tariff Expense / MISO Schedule 11	302,691	1,165,680	862,989	285.11%
5100.1100 - Labor / Operations	55,766,515	56,276,565	510,050	0.91%
5100.1110 - Labor / Operations - Transfer To (out)	(33,071)	21,390	54,461	-164.68%
5100.1120 - Labor / Operations - Transfer From (in)	(453,370)	2,160	455,530	-100.48%
5100.1200 - Labor / Maintenance	14,392,343	15,456,967	1,064,624	7.40%
5100.1210 - Labor / Maintenance - Transfer To (out)	(62,018)	1,561	63,578	-102.52%
5100.1220 - Labor / Maintenance - Transfer From (in)	(117,405)		117,405	-100.00%
5100.1230 - Labor / Fleet Mtce-Transfer to ac 5103	786,789	221,096	(565,693)	-71.90%
5100.1300 - Labor / Construction	0		(0)	0.00%
5100.1700 - Labor / Fuel Inventory	(24,473)		24,473	-100.00%
5100.2100 - Labor / Offsetting Entry	(667,228)	(220,515)	446,713	-66.95%
5100.2150 - Labor / Labor True-up	(624,268)	16,667	640,935	-102.67%
5101.2500 - Employee Expense / Miscellaneous	861,104	1,045,284	184,180	21.39%
5101.2600 - Employee Expense / M&E 50% Deductible	97,845	133,417	35,571	36.35%
5101.2700 - Employee Expense / Meals & Entertainment	190,729	239,326	48,597	25.48%
5102.0000 - Dues, Subscriptions & Books	3,250,448	3,696,790	446,342	13.73%
5103.0000 - Travel	1,186,712	2,563,642	1,376,930	116.03%
5103.1000 - Travel / Vehicle Depreciation	1,817,963	1,873,063	55,099	3.03%
5105.0000 - Telephone/Communications	1,916,374	2,301,773	385,400	20.11%
5106.1000 - Misc Office Expense / Postage & Shipping	826,608	838,187	11,579	1.40%
5106.2000 - Misc Office Expense / Filing Fees & As	1,424,576	1,360,752	(63,824)	-4.48%
5106.3000 - Misc Office Expense / Bank Service Charge	133,792	210,899	77,107	57.63%
5106.4000 - Misc Office Expense / Other Misc Office	657,617	681,190	23,572	3.58%
5107.0000 - Materials & Operating Supplies	3,734,316	5,823,829	2,089,514	55.95%
5107.9999 - Materials & Operating Supplies / Invoices	(0)	708	708	0.00%
5108.0000 - Building & Grounds	994,273	1,210,316	216,043	21.73%
5109.0000 - Contract Services - Internal	273	1,173	900	329.53%
5110.1000 - External Services / Professional Services	5,340,472	4,066,329	(1,274,144)	-23.86%
5110.2000 - External Services / Contract Services	15,076,309	16,687,423	1,611,113	10.69%
5111.0000 - Lease/Rental	1,165,700	1,336,562	170,862	14.66%
5115.3000 - Insurance / Property Insurance	1,878,511	1,941,586	63,075	3.36%
5115.3100 - Insurance / Provision for Storm Reserves	1,942,945	1,000,000	(942,945)	-48.53%
5115.3200 - Insurance / Injuries & Damages - Other	1,574,756	1,551,671	(23,085)	-1.47%
5115.3201 - Insurance / Injuries & Damages - Vehicle	5,127		(5,127)	-100.00%
5116.0000 - Miscellaneous	1,788,427	1,638,976	(149,451)	-8.36%
5117.0000 - Advertising Promo & PR	937,201	968,982	31,781	3.39%
5118.0000 - Uncollectible Accounts	988,598	967,000	(21,598)	-2.18%
5240.1000 - Employee Benefits / Insurance	(64,845)	0	64,845	-100.00%
5240.2000 - Employee Benefits / Pension	1,455,800	9,374,465	7,918,665	543.94%
5240.3000 - Employee Benefits / Other	2,187,577	2,068,889	(118,687)	-5.43%
5800.0000 - Allocations	(3,434,559)	(4,071,913)	(637,354)	18.56%
5800.1000 - Allocations / CAPX 2020	(748,523)	(669,501)	79,022	-10.56%
5800.2000 - Allocations / Standard Billings	(64,145)	(87,419)	(23,274)	36.28%
Grand Total	119,382,873	135,462,223	16,079,350	13.47%

Summary Report #3b
O&M's by Sub Account
2017 Forecast versus 2018 Budget

	2017	2018	Variance	% Variance
4340.0000 - Gain from Disposition of Allowances	(16)		16	-99.06%
5015.0000 - Pollution Control Equipment/Reagents	5,617	10,216	4,599	81.87%
5015.1000 - Pollution Control Reagents / Lime	557,017	687,193	130,177	23.37%
5020.1000 - Water Supply / Chemicals	468,386	611,293	142,906	30.51%
5020.1200 - Water Supply / Ash Handling - Plants O	484,188	461,529	(22,658)	-4.68%
5020.2000 - Water Supply / Water Supply/Miscellaneous	66,983	63,454	(3,529)	-5.27%
5044.0010 - SPP Schedule 1 Expense	90,000	92,700	2,700	3.00%
5044.0015 - SPP Schedule 1A Expense	249,600	257,088	7,488	3.00%
5044.0120 - SPP Schedule 12 Expense	14,265	6,705	(7,561)	-53.00%
5045.0100 - MISO Tariff Expense / MISO Schedule 10	1,495,608	1,577,076	81,468	5.45%
5045.0110 - MISO Tariff Expense / MISO Schedule 11	427,357	1,165,680	738,323	172.76%
5100.1100 - Labor / Operations	56,531,979	56,276,565	(255,414)	-0.45%
5100.1110 - Labor / Operations - Transfer To (out)	12,749	21,390	8,642	67.78%
5100.1120 - Labor / Operations - Transfer From (in	(208,736)	2,160	210,896	-101.03%
5100.1200 - Labor / Maintenance	14,970,806	15,456,967	486,161	3.25%
5100.1210 - Labor / Maintenance - Transfer To (out	(25,877)	1,561	27,437	-106.03%
5100.1220 - Labor / Maintenance - Transfer From (i	(52,975)		52,975	-100.00%
5100.1230 - Labor / Fleet Mtce-Transfer to ac 5103	449,329	221,096	(228,233)	-50.79%
5100.1700 - Labor / Fuel Inventory	(14,499)		14,499	-100.00%
5100.2100 - Labor / Offsetting Entry	(418,369)	(220,515)	197,854	-47.29%
5100.2150 - Labor / Labor True-up	(46,732)	16,667	63,399	-135.67%
5101.2500 - Employee Expense / Miscellaneous	925,952	1,045,284	119,332	12.89%
5101.2600 - Employee Expense / M&E 50% Deductible	112,563	133,417	20,854	18.53%
5101.2700 - Employee Expense / Meals & Entertainme	221,270	239,326	18,056	8.16%
5102.0000 - Dues, Subscriptions & Books	3,544,348	3,696,790	152,442	4.30%
5103.0000 - Travel	2,031,073	2,563,642	532,569	26.22%
5103.1000 - Travel / Vehicle Depreciation	1,889,315	1,873,063	(16,253)	-0.86%
5105.0000 - Telephone/Communications	2,121,138	2,301,773	180,635	8.52%
5106.1000 - Misc Office Expense / Postage & Shippi	878,708	838,187	(40,521)	-4.61%
5106.2000 - Misc Office Expense / Filing Fees & As	1,536,198	1,360,752	(175,446)	-11.42%
5106.3000 - Misc Office Expense / Bank Service Cha	178,004	210,899	32,895	18.48%
5106.4000 - Misc Office Expense / Other Misc Offic	658,730	681,190	22,460	3.41%
5107.0000 - Materials & Operating Supplies	5,026,609	5,823,829	797,220	15.86%
5107.9999 - Materials & Operating Supplies / Invoi	565	708	142	25.22%
5108.0000 - Building & Grounds	1,036,468	1,210,316	173,848	16.77%
5109.0000 - Contract Services - Internal	518	1,173	654	126.32%
5110.1000 - External Services / Professional Servi	3,681,208	4,066,329	385,120	10.46%
5110.2000 - External Services / Contract Services	14,222,412	16,687,423	2,465,011	17.33%
5111.0000 - Lease/Rental	1,251,557	1,336,562	85,005	6.79%
5115.3000 - Insurance / Property Insurance	1,786,593	1,941,586	154,994	8.68%
5115.3100 - Insurance / Provision for Storm Reserv	608,320	1,000,000	391,679	64.39%
5115.3200 - Insurance / Injuries & Damages - Other	1,523,616	1,551,671	28,055	1.84%
5116.0000 - Miscellaneous	1,445,807	1,638,976	193,169	13.36%
5117.0000 - Advertising Promo & PR	929,512	968,982	39,470	4.25%
5118.0000 - Uncollectible Accts	912,606	967,000	54,394	5.96%
5240.1000 - Employee Benefits / Insurance	(0)	0	0	0.00%
5240.2000 - Employee Benefits / Pension	1,429,790	9,374,465	7,944,675	555.65%
5240.3000 - Employee Benefits / Other	2,888,242	2,068,889	(819,353)	-28.37%
5800.0000 - Allocations	(3,081,015)	(4,071,913)	(990,899)	32.16%
5800.1000 - Allocations / CAPX 2020	(649,778)	(669,501)	(19,723)	3.04%
5800.2000 - Allocations / Standard Billings	(64,497)	(87,419)	(22,921)	35.54%
Grand Total	122,102,514	135,462,223	13,359,709	10.94%



Capital Budget

TABLE OF CONTENTS

I.	Capital Budgeting Process	3
1.0	Executive Summary	3
2.0	Overview and Planning Horizon	4
3.0	Routine Capital Projects	5
4.0	Non-routine Capital Projects	5
5.0	Development and Approval of the Five Year Capital Budget	5
5.1	Project Prioritization	6
5.2	Routine Capital Budget Targets	6
5.3	Capital Budget Committee	6
5.4	Approval by OTP Executive Team	7
5.5	Individual Project Review & Approval for Routine and Non-routine Projects	8
5.6	Finalization and Approval by OTP Board of Directors	8
6.0	Management and Oversight of Construction	8
6.1	Project Management Initiative	9
6.2	Phase Review Process	9
7.0	Reporting	10
7.1	Routine / Non-routine Capital Projects	10
7.2	Additional Reporting Requirements for Projects Included in PMI	11
8.0	Reforecasting	11
8.1	Monthly Capital Budget Reforecasting	11
8.2	Quarterly Capital Budget Reforecasting for Routine Capital Projects	12
8.3	Quarterly Capital Budget Reforecasting for Non-routine Capital Projects	12
II.	FIVE YEAR HISTORIC COMPARISON OF BUDGET TO ACTUAL (2011-2015)	13
1.0	Executive Summary	13
2.0	Routine Capital Spending By Business Unit	13
3.0	Total OTP Routine Capital Spending	21
4.0	Historical and Forecasted Spending from 2012 through 2021	23

ATTACHMENTS

Attachment 1 – Capital Budget Actuals Report Template

Attachment 2 – Capital Budget Variance Report Template

Attachment 3 – PMI Financial Monthly Template

Attachment 4 – Risk Summary Template

Attachment 5 – Quarterly PMI Report Template

I. Capital Budgeting Process

1.0 Executive Summary

The Otter Tail Power Company (OTP) capital budget is comprised of “Routine” capital projects and “Non-routine” capital projects. Routine projects are typically lower cost projects which for which the construction does not normally span more than one year. Routine projects are projects done in the normal course of business for utilities which help maintain the functionality of an asset, support typical customer growth, address minor compliance requirements, and maintain system reliability. Routine projects also include projects related to serving new customers by building new facilities or upgrading existing facilities. Non-routine capital projects are typically higher cost projects which are not done on a yearly basis and for which the construction duration normally spans more than one year. Non-routine projects are typically done to address major compliance requirements and/or adding a significant transmission or generation asset.

OTP’s capital budget process includes a five year horizon and begins during the first quarter of each year when Project Sponsors assigned to carry out capital projects within OTP submit forecasts for new projects. After all potential capital projects have been submitted and reviewed by the respective Vice Presidents, the Capital Budget Committee prioritizes a list of capital projects during the second quarter of each year to develop a preliminary Five Year Capital Budget. The preliminary Five Year Capital Budget must conform to the Routine capital budget targets established for OTP by its Chief Financial Officer (CFO). The OTP Executive Team approves the preliminary Five Year Capital Budget during June of each year. Following approval of the preliminary Five Year Capital Budget, presentations of new Routine and Non-routine capital projects expected to begin in the following year are given by Project Sponsors within OTP.

During the fourth quarter of each year, the preliminary Five Year Capital Budget is refreshed by Project Sponsors with any necessary updates that have occurred since the June timeframe. This refreshed Five Year Capital Budget is reviewed and modified by the Capital Budget Committee so that the best projects are included in the final Five Year Capital Budget. After the refreshed Five Year Capital Budget is completed by the Capital Budget Committee, the OTP Executive Team approves the final Five Year Capital Budget in early November of each year. Thereafter, the final Five Year Capital Budget is reviewed and approved by the OTP Board of Directors and Otter Tail Corporation Board of Directors. As part of this approval process, the OTP Executive Team finalizes the overall project-by-project details of the Five Year Capital Budget while the OTP Board of the Directors and Otter Tail Corporation Board of Directors approves the total spending within the Five Year Capital Budget.

Following approval, OTP has various processes in place to closely monitor Routine and Non-routine capital projects to promote completion on time and on budget, and to mitigate risk. The

Project Management Initiative (PMI) is one process that involves monthly reporting requirements and quarterly meetings between the Project Sponsors and members of the OTP Executive Team. The PMI is primarily focused on approved Routine and Non-routine projects that have a forecasted spend of more than \$250,000.

Another methodology used by OTP to actively manage Routine and Non-routine capital projects is the Phase Review Process. This process allows for an incremental approach to project commitment and is used mostly for Non-routine capital projects and a very limited number of Routine capital projects. The first phase of this review process is development, which normally secures enough funding to do the necessary research to determine the feasibility of the project. The second phase of this process is construction, which is when construction agreements are executed, vendors are chosen, material is procured and construction commences. The third phase of this review process is post project review and includes an assessment of the performance of the project against the scope and objectives developed during the development phase.

Capital budget spending is monitored and reported on a monthly basis through various reports. The core document for monthly reporting of capital projects is the Capital Budget Actuals Report, which includes monthly, year-to-date, and forecasted year end spending for each project and is sent to the OTP Executive Team, Project Sponsors, and other interested OTP employees. Additional monthly reports are also distributed for capital projects included within the PMI.

Forecasted spending for capital projects is updated monthly for all Routine and Non-routine capital projects. The reforecasting process is different between Routine and Non-routine capital projects. Monthly reforecasting for Non-routine capital projects is done by Project Sponsors between the 18th and 22nd of each month. Reforecasting for Routine capital projects is performed monthly, with Project Sponsors requested to verify and/or update forecasts during two different times of each year.

The capital budget process is continuous throughout each year and has proven to be effective within OTP resulting in very accurate performance of actual spending to budget. A comparison of the historical budget to actual results for Routine projects over the past five years has shown that, on average, the actual spending is less than a 1 percent variance from budget between 2011 and 2015.

2.0 Overview and Planning Horizon

The capital budget for OTP is developed, maintained, and updated by the Delivery Planning Department. The OTP capital budget normally covers a six year horizon, from the current year to five years into the future. For example, during 2016, actual monthly spending plus the remaining forecast for the current year is closely tracked while a five year budget (2017 – 2021)

is also developed and maintained. The OTP capital budget for Routine capital projects and Non-routine capital projects is described in further detail below.

3.0 Routine Capital Projects

Routine projects are typically lower cost projects which for which the construction does not normally span more than one year. Routine projects are projects done in the normal course of business for utilities which help maintain the functionality of an asset, support typical customer growth, address minor compliance requirements, and maintain system reliability. Routine projects also include projects related to serving new customers by building new facilities or upgrading existing facilities. Examples of Routine capital projects include, but are not limited to, replacement of: (1) poles; (2) underground cable; (3) circuit breakers; (4) substation batteries; (5) vehicles; (6) computer equipment; and (7) other necessary equipment needed to generate, transmit, and deliver energy to customers. The Routine capital budget also includes projects related to serving new customers by building new facilities or upgrading existing facilities.

OTP's Routine capital budget is divided into nine Business Units: (1) Energy Supply; (2) Asset Management; (3) Customer Service; (4) Information Technology (IT) & Special Projects; (5) Finance & Business Planning; (6) Public Relations; (7) Human Relations/Safety; (8) Planning and Strategy; and (9) Regulatory Affairs and Compliance. Many capital budget reports published internally have these nine Business Units broken out separately for easy identification and reference. Human Relations/Safety, and Planning and Strategy and Regulatory Affairs and Compliance seldom have projects included in the annual capital budget.

4.0 Non-routine Capital Projects

Non-routine capital projects are typically higher cost projects which are not done on a yearly basis and for which the construction duration normally spans more than one year. Non-routine projects are typically done to address major compliance requirements and/or adding a significant transmission or generation asset. Examples of Non-routine capital projects include, but are not limited to: (1) generation additions; (2) large transmission projects; (3) environmental upgrades at generation stations; and (4) generation interconnection projects. Recent Non-routine capital projects within OTP have included OTP's wind farms, the BSSE Big Stone Ellendale and BSSE Big Stone Brookings.

5.0 Development and Approval of the Five Year Capital Budget

OTP's capital budget process for the upcoming five year horizon begins the first quarter of each year. Project Sponsors assigned to carry out capital projects within OTP are responsible for submitting forecasts for new projects and/or updating existing projects in the five year horizon.

The Project Sponsors submit these projects into OTP's capital budgeting software called Power Plant ("Power Plant").

Project Sponsors are required to justify each new capital project by identifying: (1) the need for the project; (2) the work to be completed; (3) the benefits of the project; and (4) any alternatives considered. Project Sponsors are also required to identify the location, estimated start date, estimated in-service date, and if Allowances for Funds Used During Construction (AFUDC) should accrue for each project.

Project Sponsors are also responsible for forecasting monthly cash flows for projects and are required to answer ranking questions to assist the Capital Budget Committee in the prioritizing projects during the development of the preliminary and final Five Year Capital Budget.

After all capital project submittals are verified for completeness by the P&CB Accountant, they are reviewed by the Vice President of the corresponding Business Unit and either approved or denied for consideration in the Five Year Capital Budget.

5.1 Project Prioritization

After all capital projects have been submitted and reviewed by the respective Vice Presidents, the Capital Budget Committee begins the process of prioritizing projects during the second quarter of each year to develop the preliminary Five Year Capital Budget. The objective of the Capital Budget Committee is to develop the list of projects to include in the preliminary Five Year Capital Budget in accordance with the Routine capital budget targets that have been established for OTP.

5.2 Routine Capital Budget Targets

The annual targets for OTP's Routine capital budget are determined by the OTP CFO. The development of a Routine capital budget target each year has been effective at identifying a reasonable spending rate to keep the assets of OTP operating safely and dependably and ensure continued reliable service to OTP customers at reasonable rates.

5.3 Capital Budget Committee

OTP's Capital Budget Committee is comprised of managers from various Business Units and serves as a decision-making body for determining if projects can be deferred, removed, combined or need to stay in the year in which they are forecasted. These activities are largely driven by committee members consulting with Project Sponsors and their respective Vice Presidents. Factors that are considered by the Capital Budget Committee when developing the Five Year Capital Budget include: (1) project rankings from Power Plant; (2) planned outages for coal plants; (3) historical spending patterns;

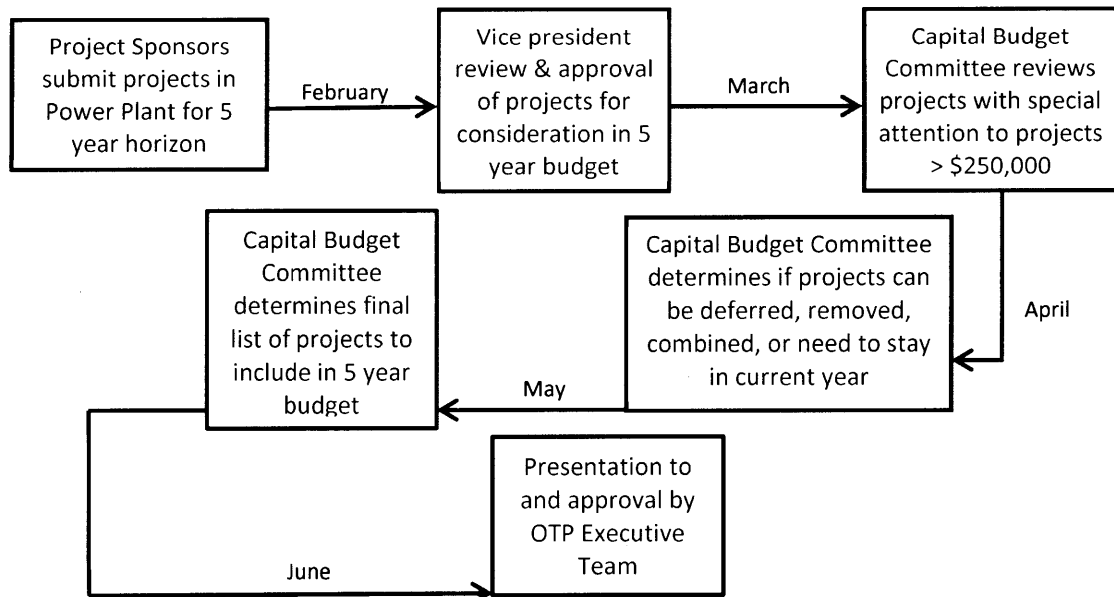
and (4) consequences of not completing projects in a given year. Through past interaction between the Capital Budget Committee and the OTP Executive Team, general guidance on the priority of allocating dollars within the Five Year Capital Budget is as follows: (1) safety; (2) regulatory requirements (federal, state); (3) generation; (4) transmission; (5) information technology and telecommunications; (6) vehicles; and (7) buildings.

The Capital Budget Committee generally discusses all Routine capital projects greater than \$250,000. The Capital Budget Committee does not typically review the list of the Non-routine capital projects because these projects have generally been approved during the previous budget cycle. Through this process, a list of Routine capital projects is developed for inclusion in the preliminary Five Year Capital Budget during the second quarter of each year.

5.4 Approval by OTP Executive Team

After the Capital Budget Committee has finalized a list of projects to include in the preliminary Five Year Capital Budget, the P&CB Accountant along with the Manager of Delivery Planning (“Manager – DP”) present that preliminary Five Year Capital Budget to the OTP Executive Team for approval. The presentation and approval from the OTP Executive Team normally occurs during the first half of June each year. After approval of the preliminary Five Year Capital Budget by the OTP Executive Team, the preliminary Five Year Capital Budget is returned to the Capital Budget Committee and shared by the members of the Capital Budget Committee within each of their Business Units to assist in planning for the upcoming year.

The following block diagram gives a general overview of how the preliminary Five Year Capital Budget is developed and approved within OTP each year:



5.5 Individual Project Review & Approval for Routine and Non-routine Projects

Following approval of the preliminary Five Year Capital Budget by the OTP Executive Team, formal presentations of new Routine and Non-routine capital projects expected to begin in the following year are prepared by Project Sponsors.

Smaller Routine projects (generally less than \$500,000) are presented and approved through staff meetings of the respective Vice President. Larger Routine projects (generally greater than \$500,000) are first presented to the Capital Budget Committee for review and approval. After the Capital Budget Committee has reviewed and approved these projects, they are presented to a subset of OTP Vice Presidents involved in the Project Management Initiative (PMI) for approval, as discussed in more detail below.

Routine and Non-routine capital projects over \$1,000,000 generally require project review and approval from the full OTP Executive Team. The OTP President can approve Routine and Non-routine capital projects up to \$5,000,000. If the Routine or Non-routine capital project is greater than \$5,000,000, the project requires approval by the OTP Board of Directors. The OTP Board of Directors can approve Routine and Non-routine projects up to \$15,000,000. Any Routine or Non-routine capital project over \$15,000,000 requires approval by the Otter Tail Corporation Board of Directors.

5.6 Finalization and Approval by OTP Board of Directors

During the fourth quarter of each year, the preliminary Five Year Capital Budget is refreshed with any necessary updates. After finalization of the refreshed Five Year Capital Budget by the Capital Budget Committee, presentations are made to the OTP Executive Team, normally in early November each year. Following approval by the OTP Executive Team, the final Five Year Capital Budget is presented to the OTP Board of Directors and the Otter Tail Corporation Board of Directors for approval. As part of this approval process, the OTP Executive Team finalizes the overall project-by-project details of the Five Year Capital Budget while the OTP Board of the Directors and Otter Tail Corporation Board of Directors approves the total spending within the Five Year Capital Budget. After approval of the Five Year Capital Budget, it is returned to the Capital Budget Committee and shared within each of the Business Units.

6.0 Management and Oversight of Construction

OTP has implemented various processes to closely monitor approved Routine and Non-routine capital projects to ensure they are completed on time, on budget, and with minimal risk. These processes include the Project Management Initiative and Phase Review Process.

6.1 Project Management Initiative

The Project Management Initiative (PMI) involves monthly reporting requirements and quarterly meetings between the Project Sponsors and members of the OTP Executive Team for certain Routine and Non-routine capital projects. The PMI is primarily focused on approved Routine and Non-routine projects that have a forecasted spend of more than \$250,000. The PMI was implemented during 2013 to: (1) ensure the prudent execution of capital projects; (2) define consistent reporting procedures and formats for capital projects on a monthly basis; and (3) engage a subset of Vice Presidents within OTP to monitor capital projects. The PMI is primarily administered by the Delivery Planning Department with involvement by the Project Sponsors and a subset of the OTP Executive Team comprised of Vice Presidents from Asset Management, Energy Supply, and Administration, as well as the General Counsel and CFO.

During the last month of each calendar year, the P&CB Accountant provides a list of Routine capital projects greater than \$250,000 to each Vice President for the upcoming year. The Vice Presidents review the projects in their areas of accountability and determine whether or not a project should be included in the PMI for the upcoming calendar year. The general rule is to include more complex projects with higher risk.

Certain Non-routine projects that span multiple years and have intensified risk or capital spending have been incorporated into a specific review process as a result of PMI. These types of projects are reviewed at regularly scheduled staff meetings of the OTP Executive Team. The CapX2020 transmission projects and the Big Stone AQCS projects have been reviewed at regular intervals by the OTP Executive Team.

As part of the PMI, Project Sponsors are required to establish project-specific charters, work force plans and risk summaries. Project Sponsors are also required to report financial updates and risk updates monthly with more thorough reporting required each quarter. This information is reviewed by a subset of OTP Executives monthly and during quarterly meetings with the Project Sponsors. Project Management Training for Project Sponsors is also provided.

6.2 Phase Review Process

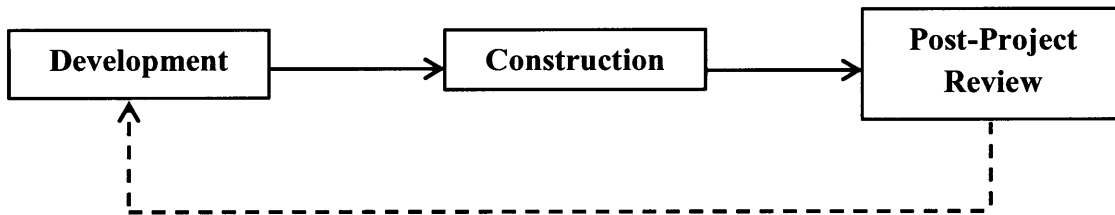
Another methodology used by OTP to manage Routine and Non-routine capital projects is the Phase Review Process implemented in 2010. The Phase Review Process allows an incremental approach to project commitment and management and is typically used for capital projects classified as Non-routine, but has also been applied to Routine projects on a very limited basis.

The first phase of the Phase Review Process is development (the “Development Phase”). During the Development Phase, funding is secured to do the necessary research to determine the feasibility of the project. This research includes, but is not limited to, negotiations of project development agreements, preparing and submitting regulatory filings, and developing detailed projects scopes with a cash flow forecast. During the Development Phase, there is no commitment to proceed with the full project.

After the Development Phase, the Project Sponsor seeks approval and final commitment to proceed with construction of the project (the “Construction Phase”). During the Construction Phase, construction agreements are executed, leading to the selection of vendors, procurement of material and construction of the project.

After the project is completed, the project is reviewed (the “Post Project Review Phase”). The Post Project Review Phase includes an assessment of (1) the performance of the project against the scope and objectives developed at the beginning of the project; (2) expenses and savings; and (3) lessons learned. Knowledge gained from the Post-Project Review Phase is applied to future capital projects.

The Phase Review Process is illustrated in the block diagram below.



7.0 Reporting

7.1 Routine / Non-routine Capital Projects

Capital budget spending is monitored and reported on a monthly basis by the P&CB Accountant through coordination with the Accounting Department and Business Planning Department.

The P&CB Accountant creates the Capital Budget Actuals Report that outlines the capital spending for OTP’s Routine and Non-routine capital projects on a project-by-project basis divided into each of the nine Business Units. The Capital Budget Actuals Report includes monthly, year-to-date spending, and forecasted year end spending for each project and is sent to the OTP Executive Team, Project Sponsors, and other interested OTP employees by the 10th of each month. Attachment 1 is a template of the Capital Budget Actuals Report.

The P&CB Accountant also creates a Capital Budget Variance Report each month. Project Sponsors provide an explanation for the variance in this report, which is also sent to the OTP Executive Team, Project Sponsors, and other interested OTP employees by the end of each month. Attachment 2 is a template of the monthly Capital Budget Variance Report.

7.2 Additional Reporting Requirements for Projects Included in PMI

For projects included within the annual PMI, Project Sponsors update a Financial Dashboard monthly that includes the current year spending to date and the total forecasted project spending along with the current authorization level. A template of the Financial Dashboard for projects within PMI is included as Attachment 3. Project Sponsors also update a Risk Summary on a monthly basis that identifies risk concerns, likelihood of the risk occurring, impact/costs, mitigation measures, and the status of each risk. A sample template of a Risk Summary is included as Attachment 4.

The Financial Dashboards and Risk Summaries are sent to a subset of the OTP Executive Team and Project Sponsors involved in the PMI each month. On a quarterly basis, Project Sponsors complete a separate PMI Quarterly Report that includes updates on project milestone schedules, budget summary, major accomplishments within the last quarter, upcoming milestones/activities in the next quarter, deviations from project scope and schedule, and an updated risk summary. A sample template of the PMI Quarterly Report for projects included in PMI is included as Attachment 5. The Project Sponsors present this information in quarterly meetings to a subset of the OTP Executive Team.

8.0 Reforecasting

8.1 Monthly Capital Budget Reforecasting

Monthly reforecasting is performed for all Routine and Non-routine capital projects. Monthly reforecasting process is different between Routine and Non-routine projects.

8.1.1 Non-routine Capital Projects

Monthly reforecasting for Non-routine capital projects is done each month by Project Sponsors to ensure that the Non-routine capital project forecasts included in each monthly Capital Budget Actuals Report reflects the most accurate information possible.

8.1.2 Routine Capital Projects

Reforecasting for Routine capital projects also occurs monthly, but is largely driven by the P&CB Accountant rather than the Project Sponsors. If a Routine capital project had more spent than what was forecasted for a particular month, the forecasted spending in the next month of cash flows for that project is reduced. If a Routine capital project has spent less than what was forecasted for a particular month, the unspent dollars from that month are re-spread over the remaining months of that year.

8.2 Quarterly Capital Budget Reforecasting for Routine Capital Projects

Reforecasting for Routine capital projects, which occurs at the end of the second and third quarter of each year, is more extensive than the monthly reforecasting process described above. For the second and third quarter reforecasts of Routine capital projects, all Project Sponsors are requested to update all current year forecasts on their respective capital projects. This allows a refresh of the projects during the construction phase of most capital projects after some of the uncertainty in projects has been eliminated. This quarterly process of reforecasting Routine capital projects also ensures that any inaccuracies introduced by the monthly re-spread of cash flows are corrected.

8.3 Quarterly Capital Budget Reforecasting for Non-routine Capital Projects

Non-routine capital projects are re-forecasted monthly. Accordingly, there is no need for additional quarterly reforecasting for Non-routine capital projects.

II. FIVE YEAR HISTORIC COMPARISON OF BUDGET TO ACTUAL

1.0 Executive Summary

A five year historic comparison (2012-2016) of budget to actual spending for Routine capital projects shows that OTP average actual spending is less than one percent of budget. This information is presented in both tabular and graphical form below, shown separately for each Business Unit along with a roll-up of the total Routine capital budget for each year.

2012-2016 Budget to Actual Comparison For Routine Capital Expenditures (\$,000)				
Year	Routine Capital Budget	Routine Capital Actual Expenditure	Variance	Variance %
2016	\$ 45,599,084	\$ 48,190,895	\$ 2,591,811	5.684%
2015	\$ 43,316,000	\$ 44,929,064	\$ 1,613,064	3.724%
2014	\$ 42,324,500	\$ 41,608,185	\$ (716,315)	-1.692%
2013	\$ 39,350,740	\$ 36,944,152	\$ (2,406,588)	-6.116%
2012	\$ 39,000,000	\$ 35,964,087	\$ (3,035,913)	-7.784%
Avg. 2014- 2016	\$ 43,746,528	\$ 44,909,381	\$ 1,162,853	2.658%
Avg. 2012- 2016	\$ 41,918,065	\$ 41,527,277	\$ (390,788)	-0.932%

2.0 Routine Capital Spending by Business Unit.

The following tables and charts are a summary of the Routine capital budget comparing the actual spend with the budget by Business Unit for 2012 through 2016. As previously mentioned, Human Relations/Safety, and Resource Planning/Strategy and Regulatory Affairs and Compliance seldom have specific projects in the annual capital budget.

2012 Capital Budget				
Business Unit	Budget	Actuals	\$ Variance	% Variance
Energy Supply	\$9,600,582	\$6,614,689	(\$2,985,893)	68.9%
Asset Management	\$25,067,701	\$24,619,450	(\$448,251)	98.2%
Customer Service	\$2,650,717	\$2,417,523	(\$233,194)	91.2%
IT & Special Projects	\$1,515,000	\$2,471,261	\$956,261	163.1%
Finance	\$150,000	(\$164,237)	(\$314,237)	-109.5%
Public Relations	\$16,000	\$5,401	(\$10,599)	33.8%
Total	\$39,000,000	\$35,964,087	(\$3,035,913)	92.2%

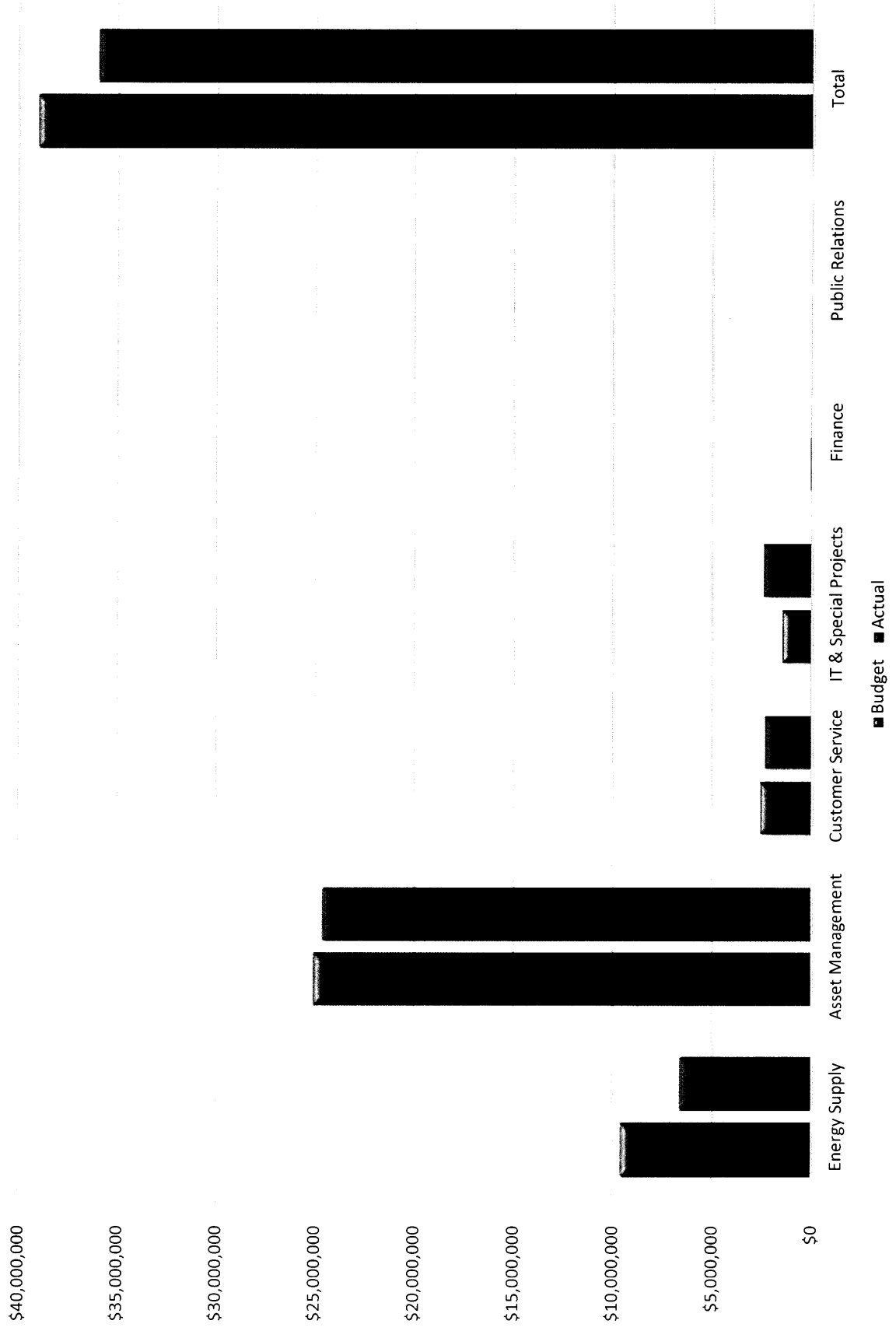
2013 Capital Budget				
Business Unit	Budget	Actuals	\$ Variance	% Variance
Energy Supply	\$8,844,637	\$5,777,835	(\$3,066,802)	65.3%
Asset Management	\$24,550,924	\$23,667,963	(\$882,961)	96.4%
Customer Service	\$2,638,679	\$2,779,037	\$140,358	105.3%
IT & Special Projects	\$2,884,000	\$4,374,551	\$1,490,551	151.7%
Finance	\$424,000	\$243,064	(\$180,936)	57.3%
Public Relations	\$8,500	\$101,701	\$93,201	1196.5%
Total	\$39,350,740	\$36,944,152	(\$2,406,588)	93.9%

2014 Capital Budget				
Business Unit	Budget	Actuals	\$ Variance	% Variance
Energy Supply	\$7,542,994	\$9,901,807	\$2,358,813	131.3%
Asset Management	\$27,427,296	\$27,211,967	(\$215,330)	99.2%
Customer Service	\$2,634,377	\$2,308,494	(\$325,883)	87.6%
IT & Special Projects	\$4,483,833	\$2,158,850	(\$2,324,983)	48.1%
Finance	\$150,000	(\$11,079)	(\$161,079)	-7.4%
Public Relations	\$86,000	\$38,147	(\$47,853)	44.4%
Total	\$42,324,500	\$41,608,185	(\$716,315)	98.3%

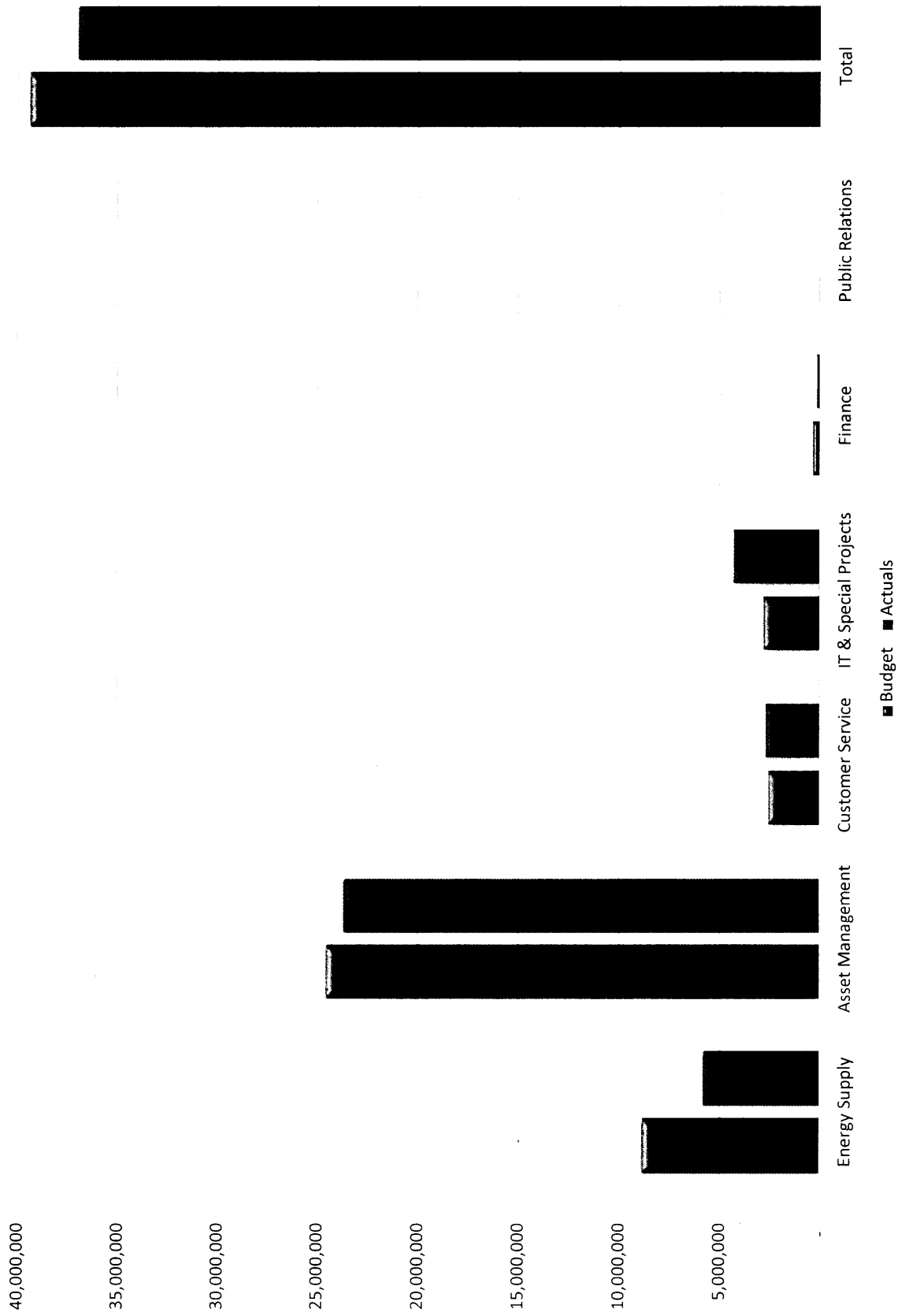
2015 Capital Budget				
Business Unit	Budget	Actuals	\$ Variance	% Variance
Energy Supply	\$15,342,574	\$16,974,434	\$1,631,860	110.6%
Asset Management	\$21,314,524	\$23,696,182	\$2,381,658	111.2%
Customer Service	\$3,020,920	\$3,034,691	\$13,771	100.5%
IT & Special Projects	\$3,435,482	\$1,204,569	(\$2,230,913)	35.1%
Finance	\$200,000	\$16,912	(\$183,088)	8.5%
Public Relations	\$2,500	\$2,275	(\$225)	91.0%
Total	\$43,316,000	\$44,929,064	\$1,613,064	103.7%

2016 Capital Budget				
Business Unit	Budget	Actuals	\$ Variance	% Variance
Energy Supply	\$13,764,351	\$12,652,125	(\$1,112,226)	91.9%
Asset Management	\$24,373,351	\$28,937,742	\$4,564,391	118.7%
Customer Service	\$1,534,382	\$1,649,493	\$115,111	107.5%
IT & Special Projects	\$5,709,000	\$4,984,261	(\$724,739)	87.3%
Finance	\$200,000	(\$38,000)	(\$238,000)	-19.0%
Public Relations	\$18,000	\$5,274	(\$12,726)	29.3%
Total	\$45,599,084	\$48,190,895	\$2,591,811	105.7%

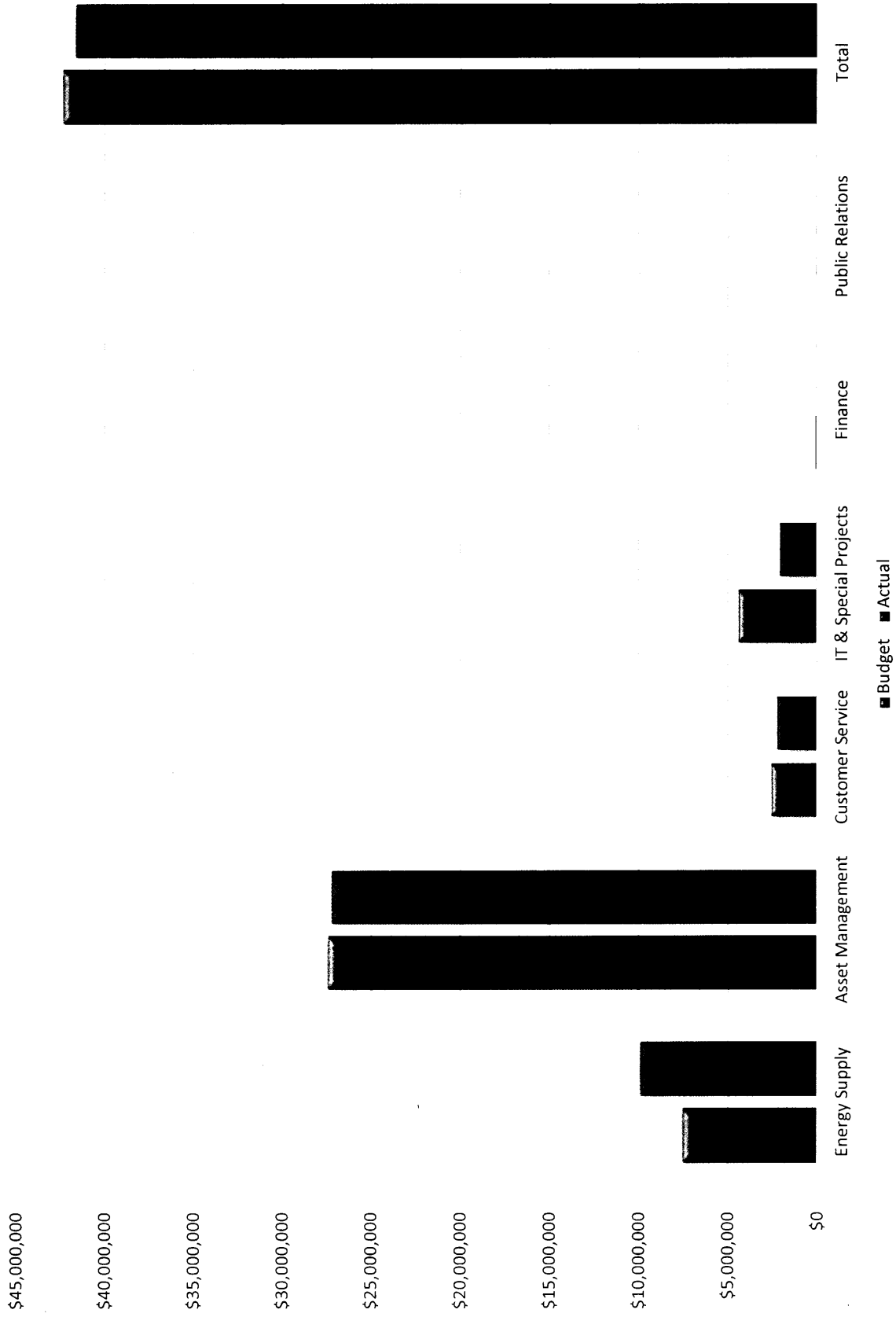
2012 Routine Capital Budget Summary (Budget vs Actual)



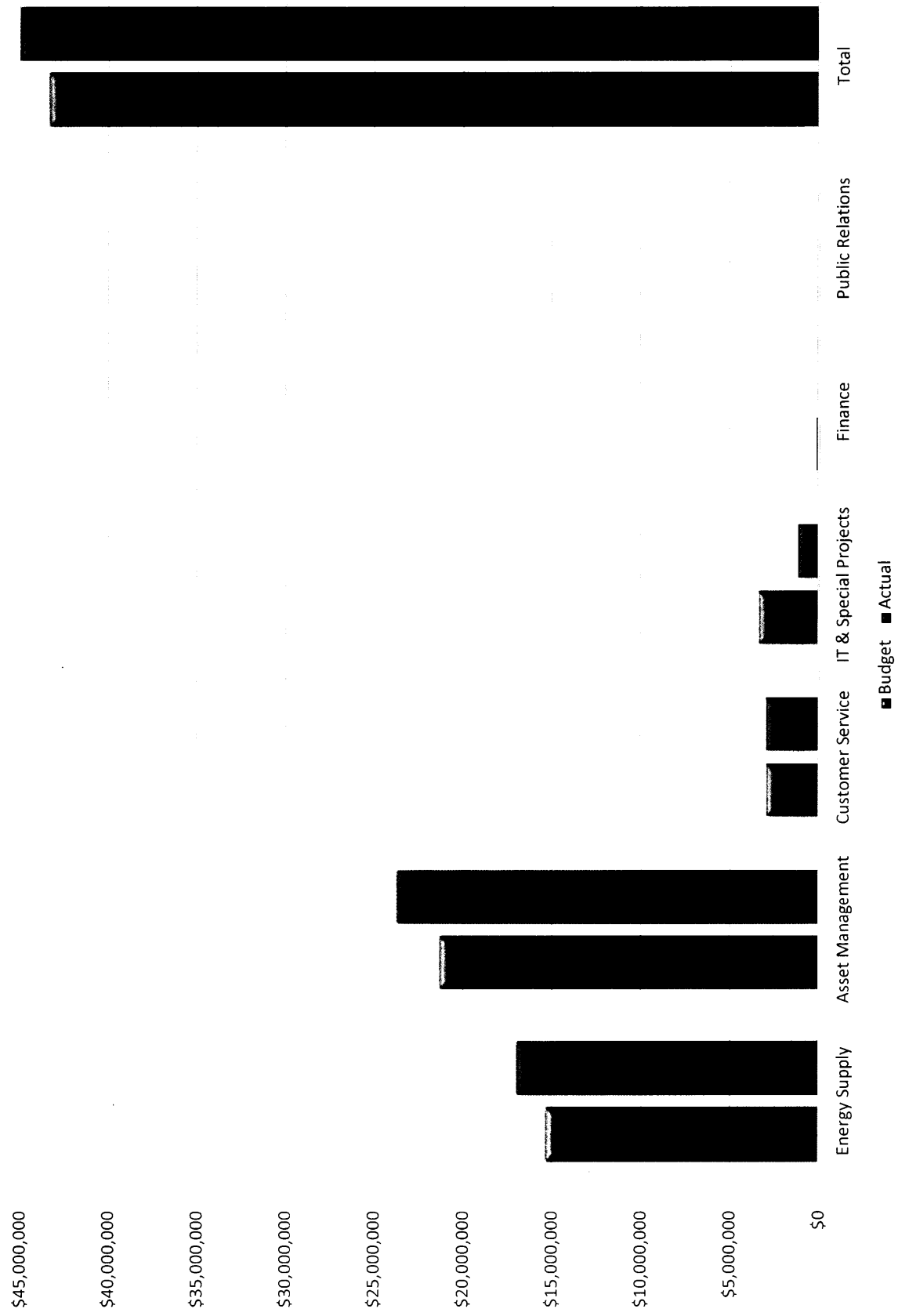
2013 Routine Capital Budget Summary (Budget vs Actual)



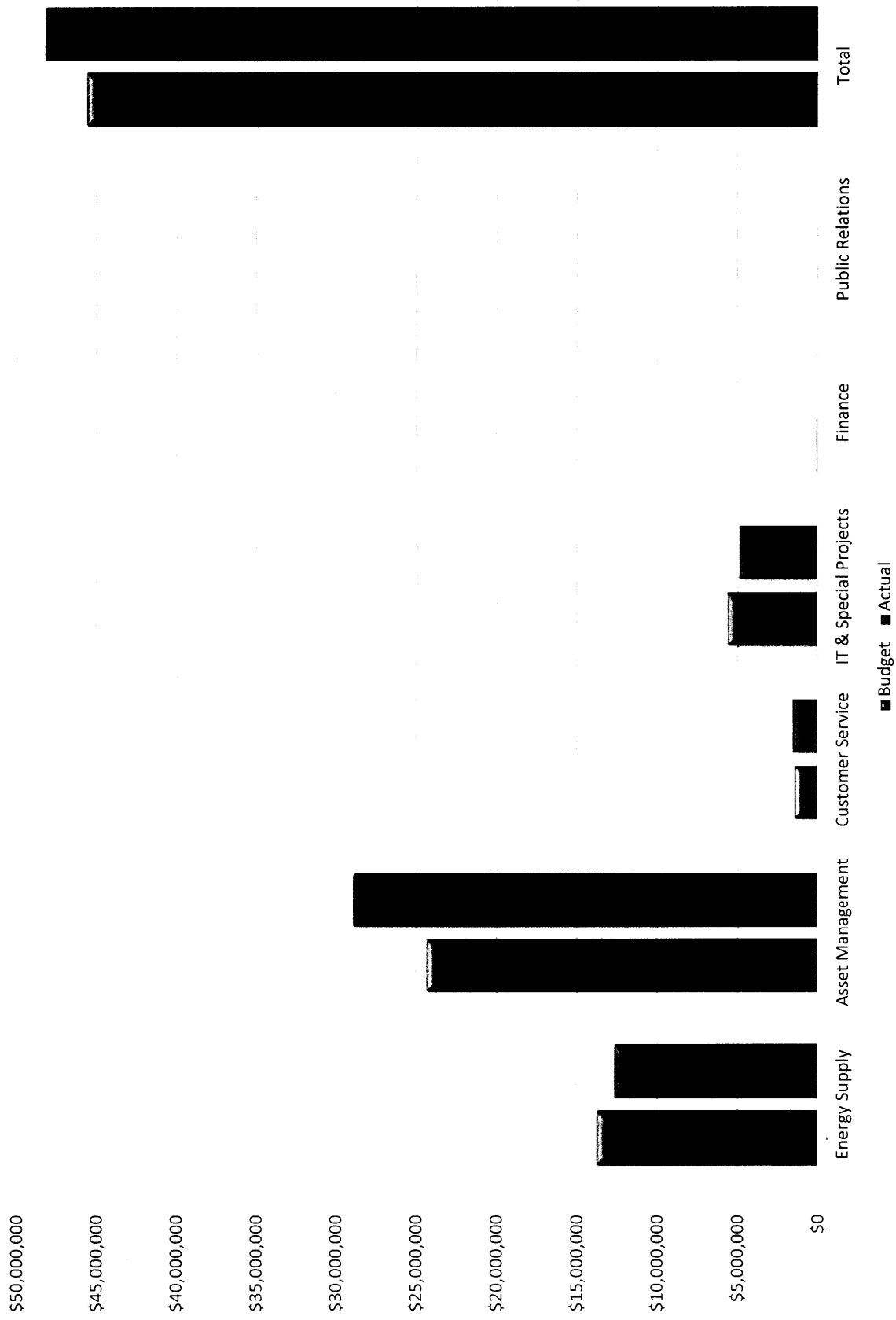
2014 Routine Capital Budget Summary (Budget vs Actual)



2015 Routine Capital Budget Summary (Budget vs Actual)



2016 Routine Capital Budget Summary (Budget vs Actual)

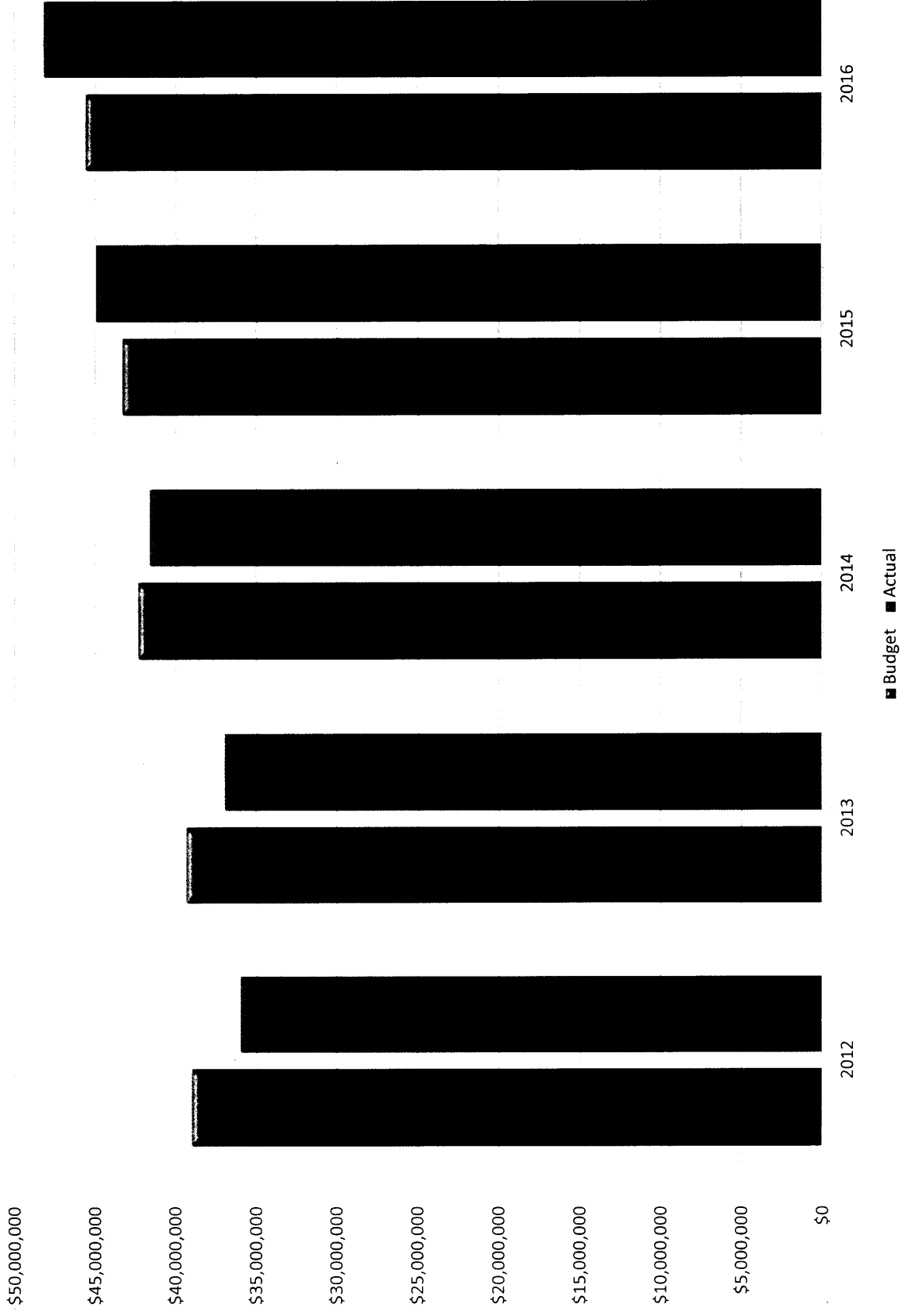


3.0 Total OTP Routine Capital Spending

The following table provides a summary of the Routine capital budget and actual Routine capital spending for 2012 – 2016:

Year	Budget	Actual	\$ Variance	% Variance
2012	\$39,000,000	\$35,964,087	(\$3,035,913)	92.2%
2013	\$39,350,740	\$36,944,152	(\$2,406,588)	93.9%
2014	\$42,324,500	\$41,608,186	(\$716,314)	98.3%
2015	\$43,316,000	\$44,929,064	\$1,613,064	103.7%
2016	\$45,599,084	\$48,190,895	\$2,591,811	105.7%

2012-2016 Routine Capital Budget Summary (Budget vs Actual)



4.0 Historical and Forecasted Spending from 2012 through 2021

The majority of capital spending since 2012 has been directed to the CapX2020 and Big Stone AQCS projects. In the future, Non-routine capital spending will continue to comprise the majority of OTP's capital spending with Non-routine capital spending on a wind project in 2018, and a natural gas project between 2018 and 2020 to replace Hoot Lake Plant. Additionally, forecasted expenditures for Non-routine capital projects in the future also currently include the MISO-approved Multi-Value Project (MVP) Big Stone South to Ellendale 345 kV Project.

The following chart shows OTP's historical capital spending from 2012 through 2017 as well as OTP's forecasted capital spending for 2018 through 2021.

Historical and Forecasted Spending from 2012 through 2021

