Before the North Dakota Public Service Commission
State of North Dakota

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

Case No. PU-23-

Exhibit___

POLICY

Direct Testimony and Schedules of

BRUCE G. GERHARDSON

PUBLIC DOCUMENT –
NOT PUBLIC (OR PRIVILEGED) DATA HAS BEEN EXCISED

November 2, 2023

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I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND CURRENT EMPLOYER.

My name is Bruce G. Gerhardson. I am employed by Otter Tail Power Company (OTP or the Company) as Vice President, Regulation and Retail Energy Solutions.

Q. PLEASE SUMMARIZE YOUR CURRENT RESPONSIBILITIES.

A. I have worked for OTP since 2000. In 2017, I was appointed to my current role. My current duties include providing direction and supervision for OTP's Regulatory Economics, Regulatory Proceedings, Regulatory Compliance, Retail Energy Solutions, and Strategic Planning areas. A summary of my qualifications and experience is included as Exhibit___(BGG-1), Schedule 1.

II. PURPOSE AND OVERVIEW OF DIRECT TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. In my Direct Testimony, I give an overview of OTP and summarize our request. I explain how it has been six years since we last requested an increase to our base rates, and I explain the reasonableness of our request. I also address three specific issues: pension and postretirement medical and life insurance plan costs; our proposal to address the potential for changes to our sales volumes between rate cases; and our update to our Super Large General Service rate.

Q. WHY IS OTP REQUESTING A RATE INCREASE?

A. OTP's request for an increase is the result of cost increases that have occurred over the six years since our last rate case (Case No. PU-17-398), which was filed in November 2017 based on a test year ending December 31, 2018. In particular, and as discussed in more detail by OTP witness Ms. Ann E. Bulkley, interest rates and inflation both increased dramatically beginning in 2021 and remain at elevated levels. These specific factors, along with the aggregate of cost increases that have occurred since 2018, require OTP to update its base rates for electric service in North Dakota.

Q. PLEASE SUMMARIZE OTP'S REQUEST IN THIS CASE.

A. The net effect of OTP's proposal to change base rates will increase revenue by $17,358,237, an 8.43 percent increase above total present revenues.[1] As described in my Direct Testimony and the testimony of other OTP witnesses, our proposal includes moving certain investments currently recovered in the Renewable Resource Cost Recovery Rider (RRCR Rider), Transmission Cost Recovery Rider (TCR Rider), Metering & Distribution Technology Cost Recovery Rider (MDT Rider)(formerly Advanced Metering, Distribution and Technology Cost Recovery Rider or ADMT Rider), and Generation Cost Recovery Rider (GCR Rider) into base rates. Overall, our request results in an approximately $23.3 million *reduction* to rider revenues and an approximately $40.7 million *increase* to base revenues. The result of netting rider decreases and base rate increases is a net average increase of 8.43 percent to customers.[2] Annualized over the six years since our last rate case, the net effect of our requested increase to base rates is approximately 1.4 percent per year, which cumulatively is less than inflation over the same period.

Q. HAVE YOU MADE ANY OTHER REQUESTS IN THIS CASE?

A. Yes. Later in my Direct Testimony, I describe a proposal to address changes to sales volumes that occur between rate case proceedings. The potential for such changes has grown since our last rate case.

Q. HOW WILL THESE REQUESTS IMPACT CUSTOMERS' RATES?

A. As shown in Figure 1, below, OTP has the lowest rates among North Dakota's investor-owned utilities. The same will be true if our requests are granted in this case.

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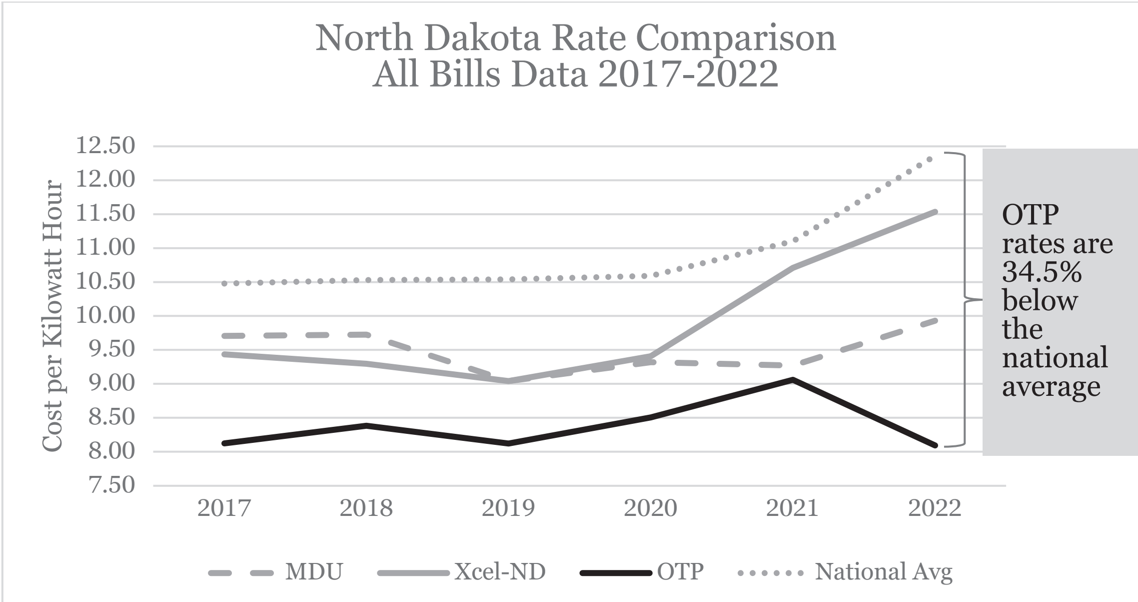
[1] As explained in the Direct Testimony of Christy L. Petersen, while finalizing this case for submission, OTP determined that the 2024 Test Year revenue requirement calculation did not include an intended adjustment to normalize plant outage costs. The adjustment has been incorporated into the proposed interim rate revenue increase. The 2024 Test Year revenue requirement and base rate revenue deficiency amounts discussed in my Direct Testimony do not reflect the impact of the plant outage normalization adjustment. OTP intends for this adjustment to be made at an appropriate time as this case develops.

[2] Other than rider decreases noted above, the net increase does not include any annual rider updates, which may occur prior to implementation of proposed rates.

Figure 1[3]



Q. HOW HAS OTP BEEN ABLE TO MAINTAIN ITS LOW RATES?

A. Our low rates reflect our efforts to control costs, execute on major capital projects, and more recently, sales growth. These factors have allowed us to both maintain low rates and avoid an earlier base rate increase. At this point, however, the cost increases we are experiencing can no longer be offset by sales growth or cost reduction efforts. Again, even with the increase requested, OTP's North Dakota rates will be among the lowest in the United States. Ultimately, OTP's proposed base rates and other rate revisions proposed in this case are just and reasonable and should be adopted.

Q. HOW IS YOUR DIRECT TESTIMONY ORGANIZED?

A. In Section III, I provide a description of OTP, including OTP's facilities, capital expenditures, service area, small size, and rates. In Section IV, I discuss our pension and postretirement medical and life insurance costs, and our proposed ratemaking treatment for these costs. In Section V, I discuss our proposal for a

[3] US Energy Information Administration Electric Sales, Revenue, and Average Price at Table 4, October 2017 – October 2022 Releases accessed October 28, 2023 at https://www.eia.gov/electricity/sales_revenue_price/and EIA Annual Electric Power Industry Report, Form EIA-861 detailed data files , October 2017-October 2023 Releases, accessed October 28, 2023 at https://www.eia.gov/electricity/data/eia861/. The rates reflect an average of classes and include all bill components—i.e., all base rates, all fuel and purchased power rates and all rider rates.

ratemaking mechanism to address the increased potential for material fluctuations in sales volumes between rate cases. In Section VI, I discuss our Super Large General Service rate update. In Section VII, I introduce OTP's other witnesses.

III. DESCRIPTION OF OTP

Q. PLEASE BRIEFLY DESCRIBE OTP.

A. OTP is a very small investor-owned utility that serves customers spread across a very large, sparsely populated area in North Dakota, Minnesota, and South Dakota. We supply retail electric service to approximately 132,500 customers, including approximately 59,000 customers in North Dakota, approximately 62,000 customers in Minnesota, and approximately 11,500 customers in South Dakota.

We serve approximately 420 small communities and rural areas in the eastern two-thirds of North Dakota, western Minnesota, and northeastern South Dakota. We do not, however, serve Fargo or other larger communities in the region, such as Grand Forks, North Dakota, or Moorhead, Minnesota. Our three-state, 70,000 square-mile service territory is roughly the size of Wisconsin. OTP is headquartered in Fergus Falls, Minnesota and is a subsidiary of Otter Tail Corporation, headquartered in Fargo, North Dakota.

Q. HOW DOES OTP COMPARE IN SIZE TO OTHER UTILITIES.

A. OTP is one of the very smallest investor-owned utilities in the country in terms of both number of retail customers and retail revenues generated.

Q. HOW MANY PEOPLE DOES OTP EMPLOY?

In 2024, OTP expects to have an average of 800 full time equivalent (FTE) employees, including approximately 376 union employees and 424 non-union employees (not adjusted for employees of jointly owned power plants).

Q. WHAT IS OTP'S MISSION?

A. OTP's mission is: "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."

Q. PLEASE BRIEFLY DESCRIBE OTP'S GENERATION AND TRANSMISSION FACILITIES.

A. OTP operates two coal-fueled baseload generating plants: Coyote Station (427 megawatts (MW)) and Big Stone Plant (475 MW).[4] We own five major wind farms, all located in eastern North Dakota: the Merricourt Wind Energy Center (Merricourt Wind) (150 MW), the Langdon Wind Energy Center (40.5 MW), the Ashtabula Wind Energy Center (48 MW), Ashtabula III (62.4 MW), and the Luverne Wind Farm (49.5 MW). OTP also owns and operates five peaking plants: Astoria Station simple-cycle natural gas combustion turbine (245 MW), Jamestown 1 and 2 oil combustion turbines (42.5 MW), Lake Preston oil combustion turbine (20 MW), and Solway simple-cycle natural gas combustion turbine (43.7 MW). Finally, we own six hydroelectric stations,[5] the Hoot Lake Solar facility,[6] two smaller solar facilities, and several smaller wind facilities. OTP owns over 6,000 miles of transmission lines. Our electric system is interconnected with the facilities of several neighboring suppliers.

Q. PLEASE FURTHER DESCRIBE THE COMMUNITIES OTP SERVES.

A. As noted above, we serve 420 small communities in total, 245 of which are in North Dakota. The average population of our communities in North Dakota is approximately 240 people. Jamestown is the largest community OTP serves in North Dakota (and system-wide) with a population of approximately 15,800 people. OTP only serves two other communities with populations over 10,000, Fergus Falls (14,000) and Bemidji (14,500), both of which are in Minnesota.

Q. DO YOU HAVE AN ILLUSTRATION SHOWING OTP'S SERVICE AREA AND GENERATING FACILITIES?

A. Yes. Figure 2 is a map illustrating our service area and identifying the locations of our generating facilities.

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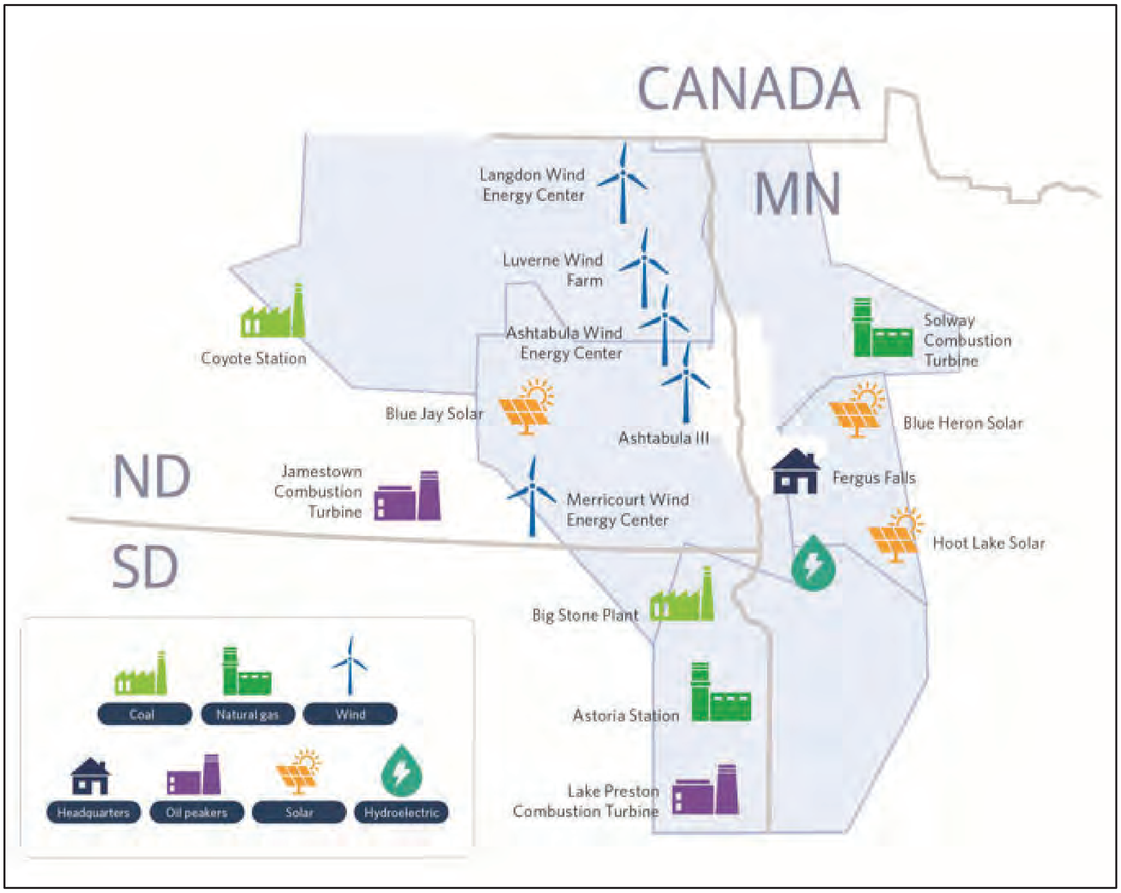
[4] OTP is not the sole owner of Coyote or Big Stone: OTP owns 35 percent of Coyote Station and 53.9 percent of Big Stone Plant.

[5] On February 17, 2022, the Federal Energy Regulatory Commission issued an order granting a new 40-year license for our five hydroelectric plants along the Otter Tail River.

[6] The costs for Hoot Lake Solar are entirely allocated to Minnesota, as described in the Direct Testimony of OTP witness Ms. Christy L. Petersen.

Figure 2
Overview of OTP Service Area and Generation Facilities

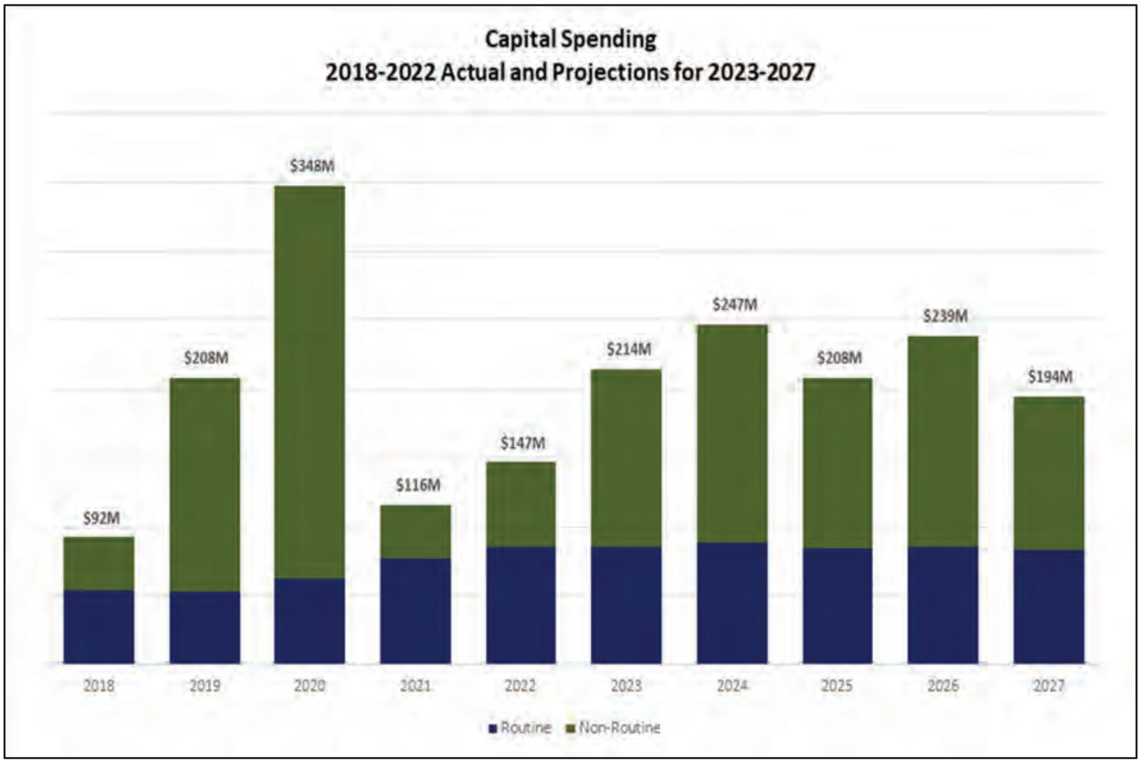


Q. ARE MANY OF OTP'S GENERATING FACILITIES THE RESULT OF CAPITAL EXPENDITURES MADE SINCE OTP'S LAST NORTH DAKOTA RATE CASE?

A. Yes. OTP has made significant investments in generating facilities since its last North Dakota rate case. These include the 150 MW Merricourt Wind Energy Center located in southeast North Dakota (the largest capital investment in OTP's history) and Astoria Station, a 250 MW simple cycle natural gas generator located in Deuel County, South Dakota. As discussed by OTP witness Ms. Paula M. Foster in her Direct Testimony, we were able to complete both projects below the cost estimates the Commission already deemed reasonable and prudent for cost recovery. We also purchased Ashtabula III, which previously served OTP via a power purchase agreement. OTP also completed the Hoot Lake Solar Facility in 2023, though the costs for this facility and its electrical output are allocated entirely to Minnesota.

As shown in the figure below, we have invested approximately $1.125 billion (OTP Total) across our system since 2018, mostly in the form of non-routine projects like the Merricourt Wind Energy Center, Astoria Station and large transmission projects.

Figure 3
Summary of Capital Spending
(OTP Total, $ Millions)[7]



Q. PLEASE DESCRIBE OTP'S PLANNED SYSTEM INVESTMENTS.

A. We expect to invest approximately $888 million (OTP Total) across our system in 2024-2027. The average annual investment is projected to increase from $187.5 million (OTP Total) per year during 2018-2023 to $222 million (OTP Total) per year during 2024–2027. Some of the larger investments over this period include the wind farm Upgrade Project (discussed in more detail by Ms. Foster), continued deployment of Advanced Metering Infrastructure (AMI), Demand Response (DR) and Outage Management System (OMS) projects (all also discussed by Ms. Foster) and new regional transmission projects.

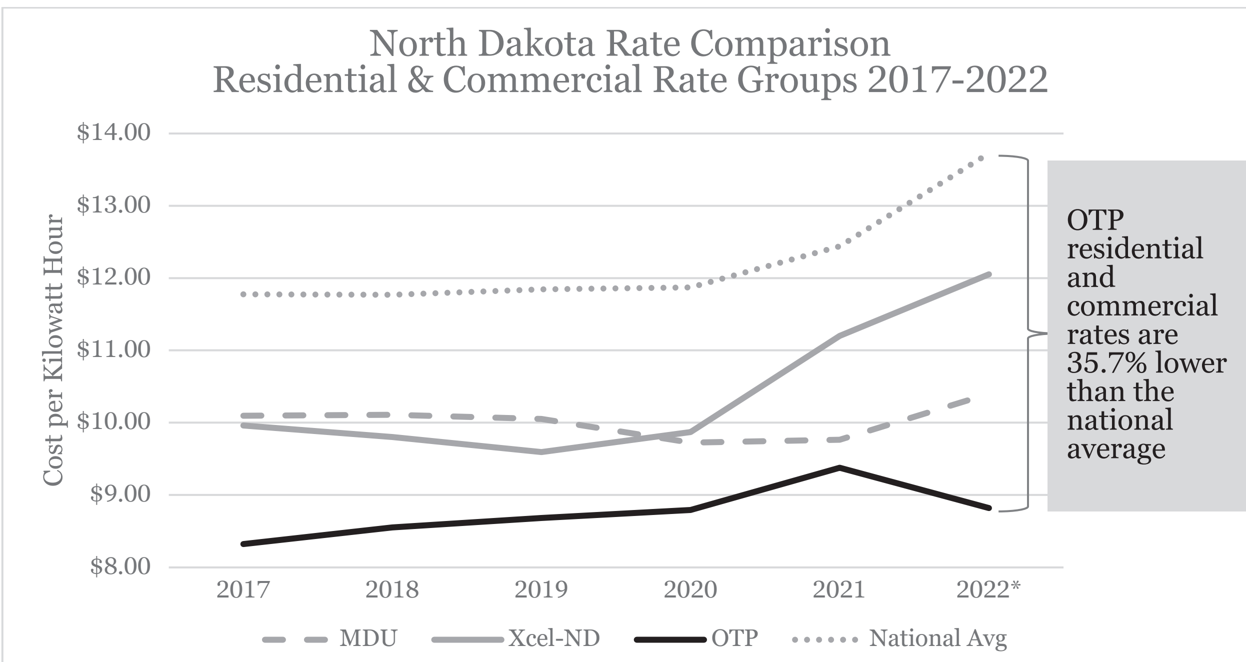
[7] *See* volume 5, Capital Budget Documentation. All values are presented in accordance with the Federal Energy Regulatory Commission Uniform System of Accounts.

Q. HAS OTP BEEN ABLE TO MAINTAIN LOW RATES WHILE CONTINUING TO INVEST IN ITS SYSTEM?

A. Yes. OTP's rates for electric service in North Dakota are among the lowest in the nation and have been so for several years. Even after this case, our rates will remain among the lowest in the nation. We have accomplished this despite the challenges posed by being a very small utility and serving customers in a very large, sparsely populated service territory and with very substantial capital expenditures.

Figure 4 compares OTP's residential and commercial rates to the residential and commercial rates of other North Dakota investor-owned utilities and to the national average of all utilities for residential and commercial rates since 2017.

Figure 4[8]

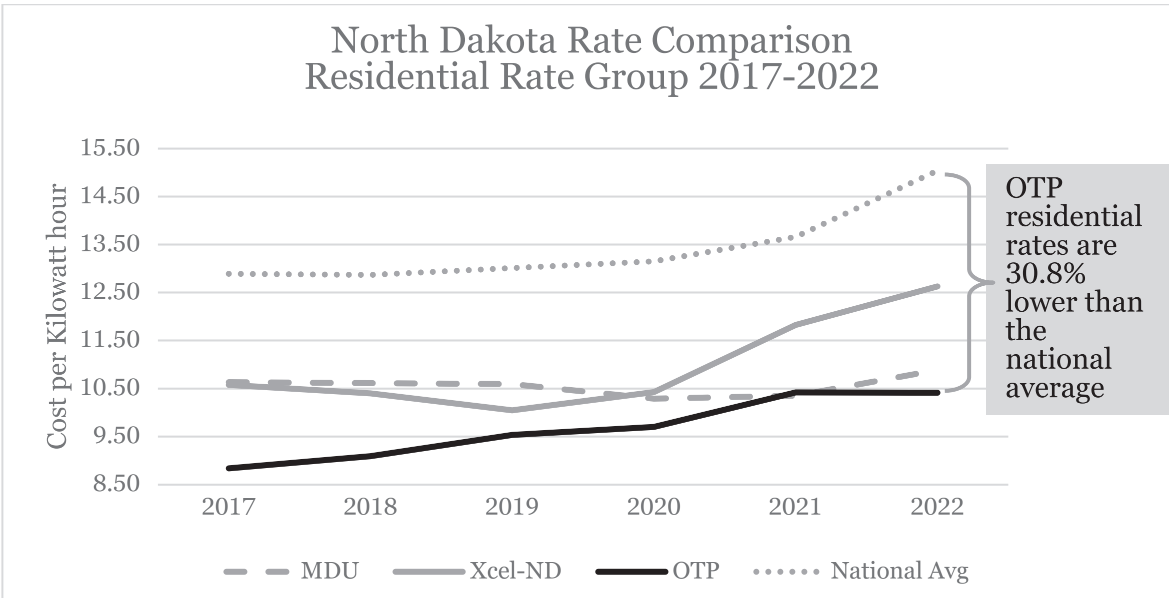


[8] US Energy Information Administration Electric Sales, Revenue, and Average Price at Table 4, October 2017 – October 2022 Releases accessed October 28, 2023 at https://www.eia.gov/electricity/sales_revenue_price/and EIA Annual Electric Power Industry Report, Form EIA-861 detailed data files , October 2017-October 2023 Releases, accessed October 28, 2023 at https://www.eia.gov/electricity/data/eia861/.

Q. DOES THE SAME HOLD TRUE FOR OTP'S RESIDENTIAL AND BUSINESS RATES?

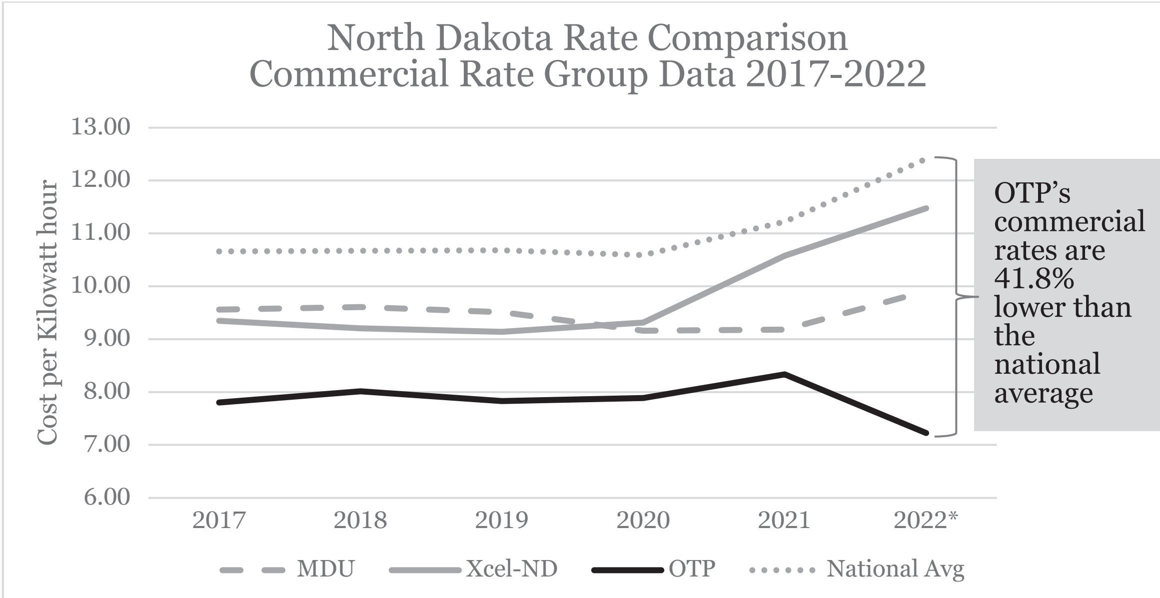
A. Yes. Figures 4, 5 and 6 show that OTP's residential and business rates are the lowest among North Dakota investor-owned utilities and substantially lower than the national average of all utilities.

Figure 5[9]



[9] US Energy Information Administration Electric Sales, Revenue, and Average Price at Table 4, October 2017 – October 2022 Releases accessed October 28, 2023 at https://www.eia.gov/electricity/sales_revenue_price/and EIA Annual Electric Power Industry Report, Form EIA-861 detailed data files , October 2017-October 2023 Releases, accessed October 28, 2023 at https://www.eia.gov/electricity/data/eia861/.

Figure 6[10]



Q. WHAT IS THE SIGNIFICANCE OF THE COMPARISONS ILLUSTRATED BY FIGURES 1, 4, 5, AND 6?

A. Figures 1, 4, 5, and 6 show that OTP has kept rates low despite the challenges that come with its small size and large rural territory. They also illustrate that our customers, overall, benefit from advantageous rates.

Q. HAS OTP COMPLETED ANY CUSTOMER SERVICE INITIATIVES SINCE ITS LAST NORTH DAKOTA RATE CASE?

A. Yes. Over the last several years, OTP has witnessed an evolution in customer expectations, especially in the areas of digital account access, digital self-service, and digital commerce. Along with these changes to customer expectations, we have also seen an increase in the number of products and services offered by other utilities and others involved in retail commerce. We have responded by improving our customer experience programming to meet customers' expectations while maintaining our commitments to delivering low-cost reliable service. Some examples of completed customer service initiatives include a comprehensive bill

[10] US Energy Information Administration Electric Sales, Revenue, and Average Price at Table 4, October 2017 – October 2022 Releases accessed October 28, 2023 at https://www.eia.gov/electricity/sales_revenue_price/and EIA Annual Electric Power Industry Report, Form EIA-861 detailed data files , October 2017-October 2023 Releases, accessed October 28, 2023 at https://www.eia.gov/electricity/data/eia861/.

redesign (approved by the Commission in Case No. PU-23-173), launching a new Customer Engagement Portal (CEP) and expanding customer communications through the new Outage Management System (OMS).

IV. PENSION AND POSTRETIREMENT MEDICAL AND LIFE INSURANCE PLAN COSTS

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

A. This portion of my Direct Testimony addresses OTP's proposed ratemaking treatment of pension and postretirement medical and life insurance plan (PRM) plan costs in the 2024 Test Year.

Q. HOW ARE OTP'S PENSION AND PRM COSTS DETERMINED?

A. OTP witness Ms. Christy L. Petersen explains in her Direct Testimony that OTP's pension and PRM costs are determined in accordance with ASC 715.[11] The annual costs are calculated by Mercer, who provides actuarial services to OTP and Otter Tail Corporation.

Q. WHAT ARE OTP'S ESTIMATED 2024 PENSION AND PRM COSTS?

A. OTP's estimated 2024 pension and PRM costs are shown in Table 1 below. Both costs are projected to be negative in 2024, meaning they are a credit to income.

Table 1
Estimated 2024 Pension and OPEB Costs[12]
($ Millions)

Category	**Otter Tail Corporation**	**OTP Total**	**OTP ND (est.)**
Pension	($4.7)	($4.58)	($2.0)
PRM	($4.3)	($4.19)	($1.8)

[11] Pension plan costs formerly were accounted for under FAS 87, while PRM costs were subject to FAS 106. A third category of costs, Postemployment (LTD) Medical Benefit Plan costs, are now subject to ASC 712 and formerly were subject to FAS 112.

[12] Amounts shown in Table 1 and throughout my testimony are total costs, including any capitalized portions, unless otherwise noted. Ms. Petersen's testimony discusses the expense portion of pension and PRM costs.

Q. WHEN WILL THE ACTUAL 2024 PENSION AND PRM COSTS BE KNOWN?

A. Mercer will prepare a report based on December 31, 2023, data that will establish the actual pension and PRM costs for 2024. OTP will receive Mercer's final 2024 ASC 715 and ASC 712 accounting report in the first quarter of 2024.

Q. IS OTP RECOMMENDING THAT THE ESTIMATED 2024 PENSION AND PRM COST BE USED TO ESTABLISH THE 2024 TEST YEAR REVENUE REQUIREMENT?

A. No. OTP is recommending that the 2024 Test Year revenue requirement reflect normalized pension and PRM costs based on an average of Mercer's actuarial estimated expense for 2024-2028. These estimates are provided as Schedules 13 and 14 to Ms. Petersen's testimony.

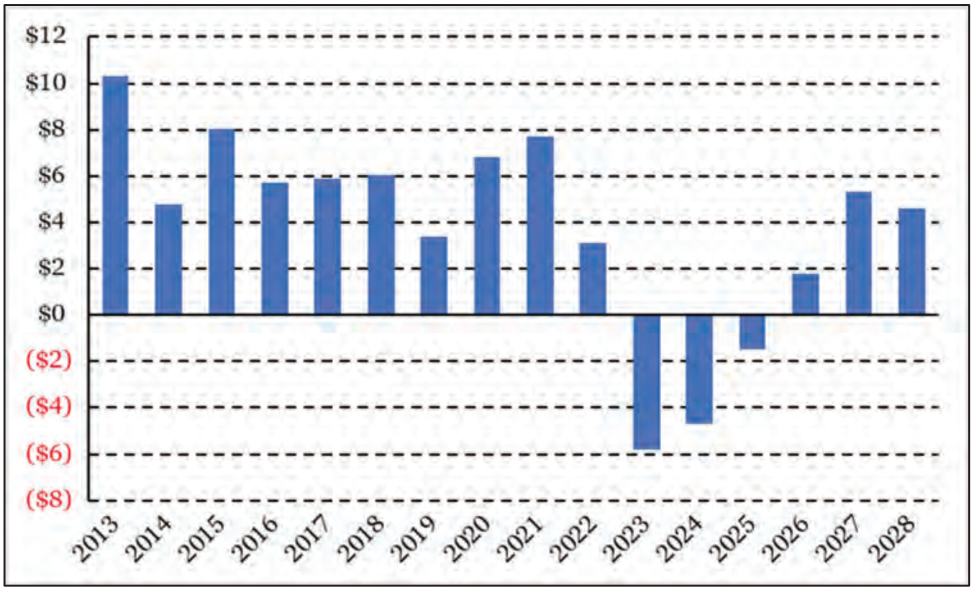
Q. WHY IS OTP RECOMMENDING THAT THE 2024 TEST YEAR REFLECT NORMALIZED PENSION AND PRM COSTS?

A. As discussed in more detail below, 2024 pension and PRM costs are different from both historical experience and our expectations going forward. In this instance, normalization ensures that rates reflect a reasonable and representative amount of costs expected to be incurred during the period rates will be in effect.

Q. HOW DOES THE 2024 EXPECTED PENSION COST COMPARE TO HISTORICAL EXPERIENCE AND EXPECTATIONS GOING FORWARD?

A. As shown in Figure 7 below, the 2024 pension costs are significantly lower than both historical and expected future costs.

Figure 7
Historical and Projected Pension Cost
($ Millions, Otter Tail Corporation)



Q. DO YOU HAVE ANY OBSERVATIONS REGARDING FIGURE 7, ABOVE?

A. Yes. First, the figure shows that until 2023, pension costs always was a positive amount, only turning negative in 2023. Second, pension costs are expected to return to a positive amount in 2026 and return to something approximating historical levels in 2027 and 2028.

Q. WHAT WOULD BE THE EFFECT OF ESTABLISHING THE 2024 TEST YEAR REVENUE REQUIREMENT ON THE ESTIMATED 2024 PENSION COST?

A. Establishing the 2024 Test Year revenue requirement based on the estimated 2024 pension cost would result in a large credit to the cost of service being incorporated into base rates. As pension costs increase in subsequent years, the credit would drive a revenue deficiency and accelerate the need to file a new rate case.

Q. IS THIS DIFFERENT FROM HISTORICAL EXPERIENCE?

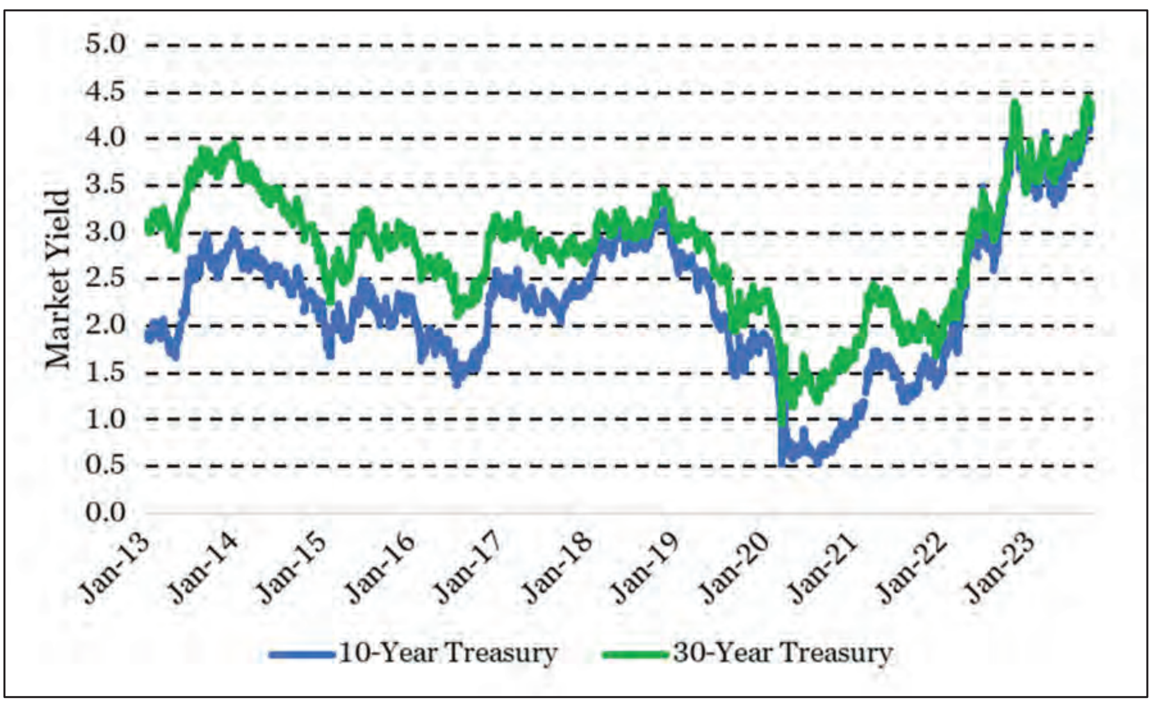
A. Yes. OTP's last rate case was based on a 2018 Test Year and the revenue requirement reflected the actual 2018 pension costs. Pension costs in 2019 were slightly below 2018 levels, while costs in 2020 and 2021 were slightly above the 2018 levels. These ups and downs, however, were not material and did not accelerate the need to file a rate case. Deviations in 2022 and 2023 were larger, but those deviations supported earnings and helped offset cost increases in other areas and delayed the need to seek rate relief.

Setting rates based only on the 2024 costs would have the opposite effect. Base rates would reflect an abnormally low amount (as compared to history and future expectations) and a deficiency would materialize almost immediately as pension costs normalize.

Q. WHAT FACTORS ARE CONTRIBUTING TO THE TEMPORARY DECLINE IN PENSION COSTS?

A. Ms. Petersen explains in her Direct Testimony that pension costs generally are inversely related to interest rates: as interest rates fall, pension costs increase; and as interest rates increase, pension costs fall. As shown in Figure 8 below, interest rates are much higher than historic levels. Interest rates have increased almost continuously since Spring 2020, with increases accelerating rapidly in late 2021 and early 2022. These higher interest rates put downward pressure on pension costs in 2022 and 2023 and are expected to continue placing downward pressure on pension costs in 2024.

Figure 8
Historical Interest Rates



Q. PLEASE EXPLAIN HOW INTEREST RATES IMPACT PENSION COSTS.

A. Ms. Petersen discusses that pension costs are based on five components. Those components are:

(1) The present value of pension benefits that employees will earn during the current year (Annual Service Cost), with the present value being established using the discount rate;

(2) Increases in the present value of the pension obligation that plan participants have earned in previous years (Interest Cost), which is based on the discount rate;

(3) Expected earnings on the pension plan assets during the year (Expected Return on Assets or EROA);

(4) Costs (or income) that differ from assumptions (Amortization of Unrecognized Gains and Losses); and

(5) Cost of changes in benefits (Amortization of Unrecognized Prior Service Cost).

Interest rates impact items (1), (2) and (4) of the calculation, though in different ways. Interest rates influence the discount rate, which is used to determine the present value of Annual Service Cost. All else being equal, a higher discount rate will decrease Annual Service Cost (because you are discounting by a larger number). The higher discount rate will have a similar effect on the present value calculation of the Interest Cost, though that effect is more than offset by the increase in projected benefit obligations, which are assumed to grow at the discount rate.

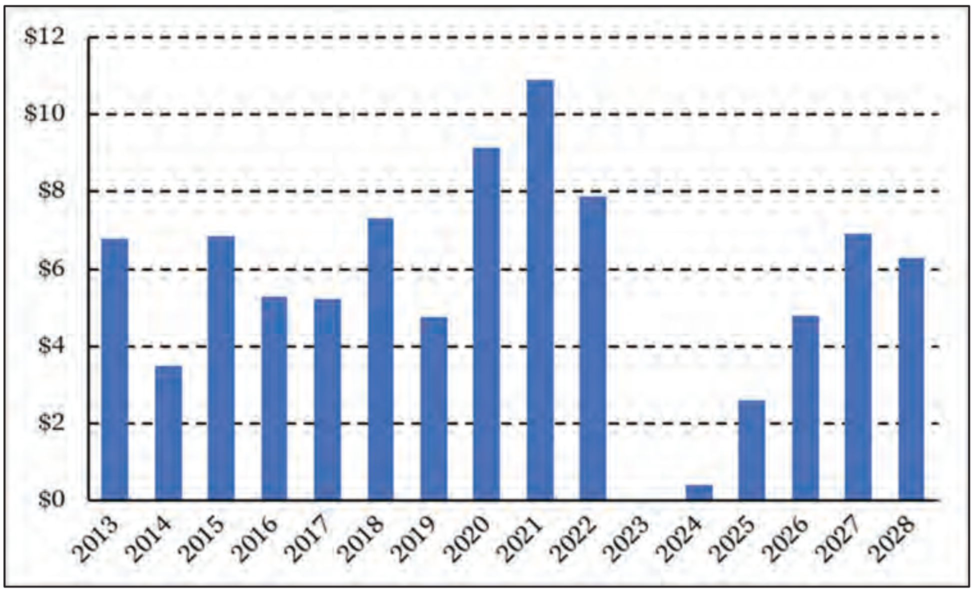
Interest rates impact the Amortization of Unrecognized Gains and Losses through the effect on differences between assumed and actual liabilities. The Amortization of Unrecognized Gains and Losses calculation considers all gains and losses, with gains and losses calculated as the difference between actual results and assumptions. Asset gains and losses are the differences between the actual return on assets during the period and the expected return on assets for that period. Liability gains and losses are the differences between the actual liability at the end of a measurement period and the expected liability at the end of a measurement period.

As interest rates have risen, liabilities have decreased more than initially assumed and the decline in liabilities has been greater than asset losses. These factors have had particularly acute impacts on 2023 and 2024 results.

Q. HAS AMORTIZATION OF UNRECOGNIZED GAINS AND LOSSES HISTORICALLY BEEN A MAJOR CONTRIBUTOR TO THE ANNUAL PENSION COST?

A. Yes. As shown in Figure 9 below, while the Amortization of Unrecognized Gains and Losses has fluctuated over time, 2023 and 2024 are the only years in which this factor does not contribute to pension cost.

Figure 9
Amortization of Unrecognized Gains and Losses – Otter Tail Corporation
($ Millions)



Q. WHY IS THE AMORTIZATION OF UNRECOGNIZED GAINS AND LOSSES EXPECTED TO GROW IN THE FUTURE?

A. Generally, there are two reasons. First, the pension plan experienced a significant market loss in 2022, with year-end plan assets being approximately $101 million lower than expected. Under accounting rules, that loss is "phased-in" over a period of not more than five years. Thus, 2023 was the first year that the market loss was incorporated into the annual cost calculation, but that year only reflected 20 percent of the loss. In subsequent years, an additional 20 percent will be incorporated (so, 40 percent of the 2022 market loss is incorporated into the 2024 pension expense, 60 percent in 2025, 80 percent in 2026 and 100 percent in 2027 and beyond). This phase-in smooths the impact of significant losses and contributes to the increase in the Amortization of Unrecognized Gains and Losses in future years.

The second reason Amortization of Unrecognized Gains and Losses is expected to grow in the future is that it is anticipated that interest rates have stabilized at a new, higher level. As noted above, interest rates increased rapidly throughout 2022, resulting in the decline in pension liabilities being much larger than expected. With an expectation of higher interest rates going forward, the difference between expected liabilities and actual liabilities should stabilize and no longer act as an offset to the Amortization of Unrecognized Gains and Losses.

Q. HAS THE COMMISSION PREVIOUSLY RECOGNIZED THE REASONABLENESS OF NORMALIZING PENSION EXPENSE?

A. Yes. In Case No. PU-15-090, Advocacy Staff witness Victor Schock noted that actuarial-based pension accounting "takes into account, among other things, future projected earnings/losses in the pension … accounts." Mr. Schock asserted this approach "exposes the ratepayers to stock market fluctuations from year to year." As a result, Mr. Schock recommended pension expense be based on historical figures, which he contended "remove[ed] market risk exposure [and was] more stable and accurate over time."[13] Mr. Schock's recommendation was incorporated into the Case No. PU-15-090 Settlement Agreement,[14] which the Commission approved in its November 4, 2015 Findings of Fact, Conclusions of Law and Order.[15]

Q. WHY IS OTP RECOMMENDING THE 2024 TEST YEAR BE BASED ON FORWARD-LOOKING PENSION DATA RATHER THAN HISTORICAL INFORMATION?

A. We agree with the observations of Mr. Schock, described above, but we believe using a forward-looking average is preferable to an historical average. First, a forward-looking average incorporates the new, higher interest rate environment that is likely to apply during the period rates are in effect rather than the historically low interest rates that drove historical results. Second, the forward-looking approach matches the expense to the period we expect rates to be in effect.

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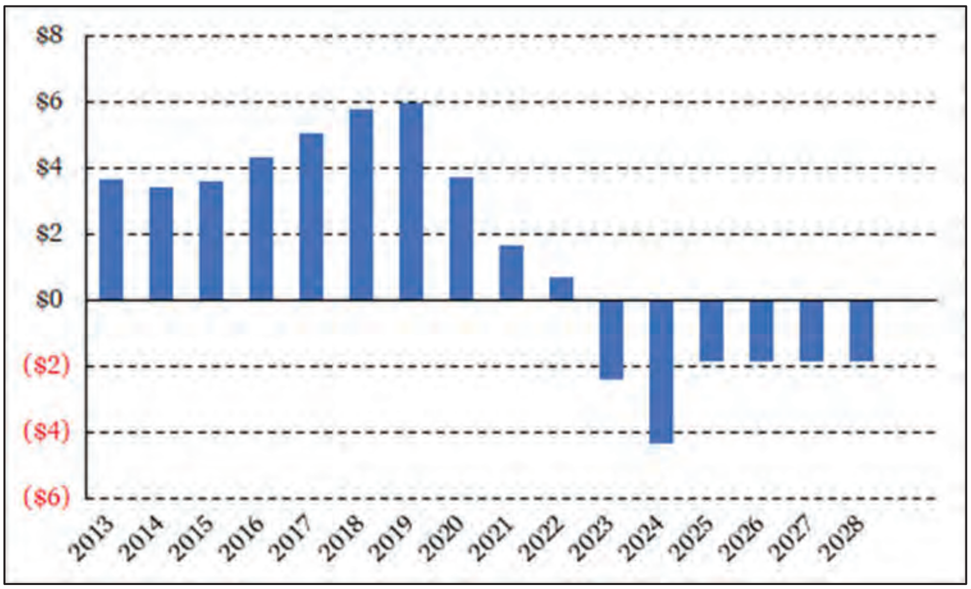
[13] Case No. PU-15-090, Schock Direct at 3 (Schock Direct) (Aug. 7, 2015).
[14] Case No. PU-15-090, Settlement Agreement at ¶2 (Aug. 26, 2015) ("The Company's test year included $426,000 for pension and post-retirement expenses based upon actuarial studies. For ratemaking purposes, the Settling Parties agree this amount shall be reduced to $115,000.").
[15] Case No. PU-15-090, Findings of Fact, Conclusion of Law and Order (Nov. 4, 2015).

Third, the forward-looking estimate considers projected census counts and accounts for what is known today about future obligations.[16] Fourth, in this case, a five-year forward looking average (2024-2028) results in a lower pension expense than a five-year historical average (2019-2023).

Q. WHY IS OTP RECOMMENDING PRM EXPENSE BE NORMALIZED IN THE 2024 TEST YEAR?

A. As with pension expense, the 2024 estimated PRM costs are not reflective of expectations going forward.

Figure 10
Historical and Projected PRM Cost
($ Millions, Otter Tail Corporation)



Q. WHY HAS PRM COST DECLINED FROM 2019 LEVELS?

A. Generally, there are two causes of the decline in PRM costs from 2019 levels. First, as with pension costs, PRM costs generally are inversely related to interest rates. With interest rates increasing during 2020-2023, PRM costs decreased. Second, as discussed by OTP witness Mr. Peter E. Wasberg in his Direct Testimony, OTP made changes to the PRM plan beginning in 2020 that have reduced plan costs.

[16] As discussed below, this will be particularly important for PRM costs.

Q. WHAT CHANGES HAVE IMPACTED THE PRM PLAN?

A. Mr. Wasberg explains that OTP has made two general changes to the PRM plan. First, beginning in 2020, OTP began the process of moving from the Retiree Drug Subsidy (RDS) to the Employer Group Waiver Plan (EGWP) within the PRM plan. This change occurred gradually, with different employees moving to the EGWP plan at different times. Then, in 2023, OTP made the decision to move to a private exchange for Medicare-eligible retirees (post-65), with all Medicare supplemental medical and prescription benefits no longer being provided through our self-insured plan. All age-65 and older retirees will move to the Mercer Marketplace Exchange effective January 1, 2024.

Q. HOW HAVE THESE CHANGES IMPACTED PRM COSTS?

A. The majority of the savings associated with the adoption of the EGWP plan were recognized through Amortization of Unrecognized Prior Service Cost in the years 2020 through 2024. Moving to the Mercer Marketplace Exchange also results in Amortization of Unrecognized Prior Service Cost credits through 2028, but also makes permanent reductions to service costs.

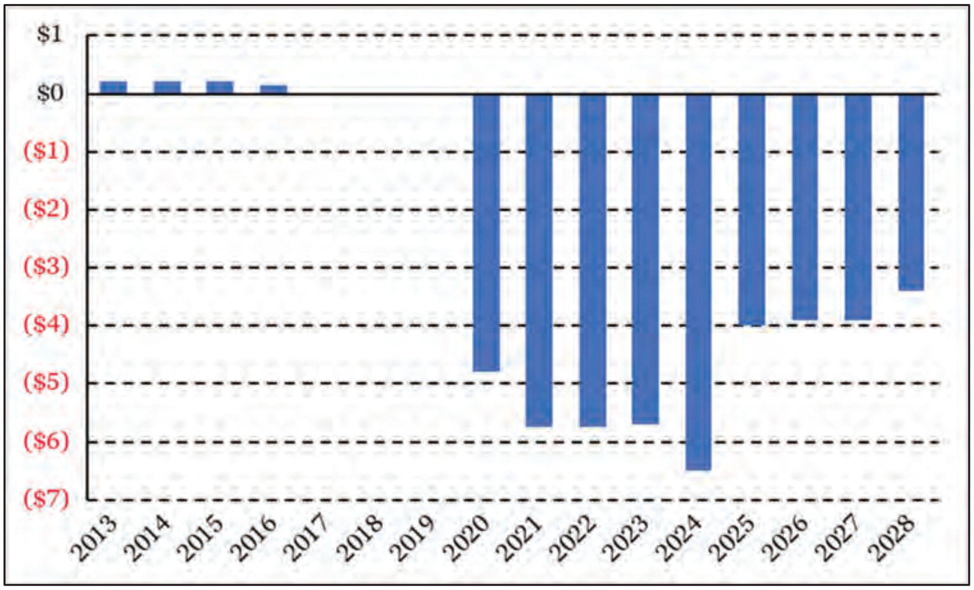
Q. PLEASE EXPLAIN AMORTIZATION OF UNRECOGNIZED PRIOR SERVICE COST CREDITS.

A. Similar to pension, the PRM cost calculation must incorporate Amortization of Unrecognized Prior Service Cost. The Amortization of Unrecognized Prior Service Cost is intended to capture the effect of plan changes on services rendered in prior periods. The effects of those changes are amortized over a period of years.

Q. IS THE AMORTIZATION OF UNRECOGNIZED PRIOR SERVICE COST CREDITS EXPECTED TO CONTINUE BEYOND 2024?

A. Yes, though 2024 reflects the greatest amount of Amortization of Unrecognized Prior Service Cost credits, as shown in the figure below. The relatively stable amounts of Amortization of Unrecognized Prior Service Cost credits in 2025-2028 contributes to the relatively stable amounts of expected PRM costs in those years.

Figure 11
Historical and Projected PRM Amortization of Unrecognized Prior Service Cost Credits
($ Millions, Otter Tail Corporation)



Q. WHY IS OTP RECOMMENDING THE 2024 TEST YEAR BE BASED ON FORWARD-LOOKING PRM DATA RATHER THAN HISTORICAL INFORMATION?

A. As shown in Figure 11, above, our future expected PRM costs are dissimilar to historical experience, primarily due to underlying plan changes. Using a forward looking average to normalize the expense makes sure those savings are reflected in rates. Further, OTP used the same normalization approach for pension and PRM expense. Arguably, using 2025 PRM costs (credit of approximately $1.8 million (Otter Tail Corporation)), or an average of 2025-2028 (credit of approximately $1.65 million (Otter Tail Corporation)) would produce a more representative amount of going-forward PRM expense, after the amount of Amortization of Unrecognized Prior Service Cost credits stabilizes, than the $2.18 million (Otter Tail Corporation) credit used in the 2024 Test Year. We feel that it is reasonable and appropriate to use the same normalization period for both pension and PRM costs.

V. SALES ADJUSTMENT PROPOSAL

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

A. This portion of my Direct Testimony addresses OTP's proposal to address the effects of changes to sales between rate cases.

Q. PLEASE DESCRIBE OTP'S PROPOSAL.

A. OTP's proposal has two elements: one focusing on base rates and one focusing on riders. Regarding base rates, OTP proposes to create a new mandatory rider, called the Sales Adjustment Rider, which would capture the effect of sales changes on base rate jurisdictional cost allocations and revenues. OTP also requests that the Commission authorize OTP to update jurisdictional allocators used to develop rider revenue requirements between rate cases. The mechanics of both elements of OTP's proposal are discussed further by OTP witness Ms. Amber M. Stalboerger.

Q. WHY IS OTP MAKING THIS PROPOSAL?

A. OTP has experienced several material changes in sales to its largest customers over the last two years or so and conditions are such that we may experience additional abrupt and material changes going forward. Our proposal is intended to develop an efficient regulatory mechanism that provides customers with benefits more quickly and does not allow material sales changes to accelerate otherwise unnecessary rate case filings.

Q. PLEASE DESCRIBE THE RECENT MATERIAL CHANGES IN OTP'S SALES TO ITS LARGEST CUSTOMERS.

A. In 2021, OTP received a Certificate of Public Convenience and Necessity (CPCN) to provide service to APLD Hosting, LLC, a wholly owned affiliate of Applied Digital, Inc. ("Applied") (formerly known as Applied Blockchain).[17] Applied started taking service under OTP's Super Large General Service Tariff, Electric Rate Schedule Section 10.06 (SLGS) in 2022.[18] Applied is OTP's largest North Dakota customer (by sales) and second largest customer (by sales) across all jurisdictions served by OTP. OTP witness Ms. Tammy K. Mortenson also explains that OTP **[PROTECTED DATA BEGINS...**

[17] *See* PU-21-365, Order on Electric Service Area Agreement and Certificate of Public Convenience and Necessity (Sept. 21, 2021).
[18] *See* PU-21-366, Order (Sept. 21, 2021).

...PROTECTED DATA ENDS]. Also, another large customer currently is planning to materially *reduce* its sales **[PROTECTED DATA BEGINS...**

...PROTECTED DATA ENDS].

Q. ARE THESE KINDS OF CHANGES CONSIDERED TO BE NORMAL FLUCTUATIONS IN SALES VOLUMES?

A. No. These kinds of changes are beyond what is considered the normal sales growth (or attrition) that occurs between rate cases. Rather, these are large, step-wise changes that deviate materially from baseline expectations. We believe additional, material sales changes may occur in the future and OTP's proposal is designed so that these changes can be incorporated into rates on a timely basis without the need to file a new rate case. Because we are a very small utility, changes like these are more material than they may be for other utilities.

Q. WHY DOES OTP BELIEVE IT MAY EXPERIENCE ADDITIONAL, MATERIAL SALES CHANGES IN THE FUTURE?

A. There are several reasons. First, as discussed above, we have the lowest commercial and industrial rates among investor-owned utilities in the region and among the lowest rates in the country. These low rates, along with other geographic benefits, make us a good partner for certain energy-intensive and agricultural processing businesses looking to locate new operations. Further, the presence of OTP's SLGS offering gives us narrowly tailored tools to attract the kind of high load factor customers that ultimately reduce costs for all customers (we have an approved SLGS rate offering in each of our three states). As discussed above, the addition of just one of these very large customers can result in sales (and revenues) that are materially different than what was used to establish base rates.

The converse is also true: the decision of a single customer has the potential to materially undermine the assumptions used to set base rates. This risk is evidenced by the **[PROTECTED DATA BEGINS...**

...PROTECTED DATA ENDS] discussed above. This risk is particularly acute given the Inflation Reduction Act provisions that incentivize certain self-supply resources. There also is the potential for the abrupt loss or restriction of a customer's operations by new regulatory restrictions or market changes for those working in emerging industries. These regulatory changes and incentives can create both risks and opportunities that may materially change OTP's sales volumes.

Q. HOW DOES THE SALES ADJUSTMENT RIDER ACCELERATE PROVIDING CUSTOMERS THE BENEFITS OF SALES GROWTH?

A. This case will establish OTP's base rate revenue requirement, and rates will be designed so that when they are applied to 2024 Test Year billing determinants, OTP recovers its cost of providing service, no more, no less. If OTP has a material increase in load in subsequent years, that provides additional revenue available to meet the cost of service. Yet, customers do not experience the benefit of that additional revenue until OTP's next rate case. The Sales Adjustment Rider would alter this construct: if actual base rate revenues are greater than proposed 2024 Test Year base rate revenues, the excess would be credited to customers.

Q. IS THIS SIMILAR TO HOW OTP'S OTHER RIDERS WORK TODAY?

A. Yes. Each rider has its own revenue requirement and rates are designed using an assumed sales volume. The deviations between projected and actual sales are captured in the rider true-up process. Thus, if actual sales in a particular year are much higher than what was assumed when the rider rates were established, customers receive credits through the true-up process. Also, each annual rider update incorporates a new projected sales volume, so material changes in sales (like those discussed above) are incorporated more quickly. This precise thing occurred in 2022 when the addition of Applied resulted in material reductions to OTP's mandatory riders.

Q. WHY IS OTP PROPOSING TO CAPTURE THE EFFECTS OF SALES CHANGES ON JURISDICTIONAL ALLOCATIONS AS PART OF ITS PROPOSAL?

A. This is a natural consequence of updating revenues. If OTP adds a material new load in North Dakota, it has additional revenues to meet its cost of service. At the same time, however, North Dakota would constitute a larger part of OTP's system and North Dakota would bear a larger responsibility for the costs of OTP's integrated system. Updating both revenues and costs maintains symmetry and ensures that these material sales changes contribute to neither over- nor under-recovery.

Q. IS OTP'S PROPOSAL SYMMETRICAL IN TERMS OF SALES INCREASES AND DECREASES?

A. Yes. Over the past two years, OTP has gained far more load from new Large Commercial customers than it has experienced in load attrition. Ms. Stalboerger explains that the addition of Applied in particular provides almost $2.0 million of benefits to other customers in the 2024 Test Year. As such, I have focused most of my discussion on large sales increases, but OTP's proposal is symmetrical in that it would address both sales increases and decreases from what was used to design rates in the 2024 Test Year.

Q. ARE JURISDICTIONAL ALLOCATORS PARTICULARLY IMPORTANT WHEN CONSIDERING POTENTIAL NORTH DAKOTA SALES ATTRITION?

A. Yes. If the proposal only focused on revenue, then a material sales loss would result in a positive Sales Rider adjustment charge, as the rider would recover the difference between 2024 Test Year base rate revenue and actual base rate revenue; it would not account for the fact that North Dakota would constitute a relatively smaller portion of OTP's integrated system. By including the effect of sales changes on jurisdictional allocations and on base rate revenue, the proposal keeps costs and revenues aligned: a material decline in revenue also would need to be matched with a decrease in North Dakota cost responsibility.

Q. DOES YOUR PROPOSAL ADDRESS THE NORTH DAKOTA IMPACTS FROM CHANGES TO SALES VOLUMES IN OTP'S OTHER STATES?

A. Yes. Sales volume changes occurring on OTP's system in other states can have an effect on the allocation of OTP's costs to North Dakota. For example, if OTP were to add a large customer in South Dakota, it would likely have the effect of reducing the cost allocations to North Dakota, and our proposal would have the benefit of getting these cost allocation reductions to our North Dakota customers sooner than under the current regime, which would only permit adjustments following a general rate case filing. As noted above, we have received approval for our SLGS rate offering in each of our states and the forces discussed above that are creating opportunities for large load additions are present in all of our states. Our proposal updates allocators whether due to changes to sales volume in North Dakota or due to changes in a neighboring state.

Q. WHY IS OTP REQUESTING AUTHORIZATION TO UPDATE RIDER JURISDICTIONAL ALLOCATORS BETWEEN RATE CASES?

A. As noted above, our riders already capture the revenue impact of all sales changes, both through the annual true-up process and through the annual update process. Updating the jurisdictional allocator maintains symmetry between costs and revenues, as discussed above.

Q. DID OTP SEEK TO UPDATE JURISDICTIONAL ALLOCATORS IN ITS 2022 RRCR RIDER FILING?

A. Yes. In addition to updating project investments and other matters, OTP proposed in Case No. PU-22-429 to update the jurisdictional allocator used to calculate the RRCR Rider revenue requirement. The Commission did not approve that request.

Q. WHY IS OTP RENEWING ITS REQUEST NOW?

A. First, as discussed above, updating the rider jurisdictional allocators ensures symmetry between rider costs and revenues. Second, this proposal is being made a part of a rate case, where all of OTP's costs and revenues are being assessed. This is in contrast to Case No. PU-22-429, a rider proceeding. We believe making this change in a rate case ensures that all rates, including rider rates, are just and reasonable.

VI. SUPER LARGE GENERAL SERVICE UPDATE

Q. PLEASE DESCRIBE OTP'S SUPER LARGE GENERAL SERVICE OFFERING.

A. In our last North Dakota rate case, we requested the Commission authorize a new SLGS rate offering.[19] The offering primarily is targeted at attracting high load factor large commercial customers to OTP's service territory. Qualifying customers have access to individual contract pricing based on OTP's marginal cost of service, though that pricing must ensure net benefits to other customers.

Q. HOW IS THE SLGS INDIVIDUAL CONTRACT PRICING DEVELOPED?

A. Contract pricing offered under the SLGS tariff is customized for the individual customer based on their specific load characteristics and investment needed to

[19] OTP's proposal was approved by the Commission and OTP's SLGS tariff, Section 10.06 went into effect for bills rendered on or after February 1, 2019.

serve the customer. SLGS customers also pay rates based on marginal costs rather than embedded costs.[20]

Q. IS OTP UPDATING ITS MARGINAL COSTS AS PART OF THIS RATE CASE?

A. Yes. OTP regularly uses a marginal cost study for its rate designs and OTP witness Mr. David G. Prazak explains that OTP obtained an updated marginal cost study in connection with this case (the 2024 Marginal Cost Study).

Q. WHAT IS THE IMPACT OF UPDATING MARGINAL COSTS ON THE SLGS RATE OFFERING?

A. Updating marginal costs impacts the SLGS rate offering in two ways. First, the SLGS rate offering features a regulatory pre-approval process, whereby OTP's proprietary marginal cost-to-serve model is provided to Commission Staff for verification of rate offerings. The model houses OTP's expected marginal unit cost to serve and, when combined with the potential customer's expected load requirements, generates a minimum incremental revenue. OTP is then able to quote the potential customer an individualized rate so long as it exceeds the minimum incremental revenue. OTP has updated the proprietary SLGS model for the 2024 Marginal Cost study results and will provide it to Commission Staff, consistent with the SLGS tariff.

The second way updated marginal costs affects the SLGS rate offering is through the individualized pricing for customers taking service under the SLGS tariff. As marginal costs change, so does the individualized pricing for the SLGS customers.

Q. HOW MANY CUSTOMERS CURRENTLY TAKE SERVICE UNDER THE SLGS TARIFF?

A. OTP currently has one customer, Applied, taking service under the SLGS tariff.[21]

Q. HAS OTP PREPARED UPDATED INDIVIDUALIZED PRICING FOR APPLIED?

A. OTP has prepared an updated rate for its service to Applied. Mr. Prazak further explains development of this updated rate in his Direct Testimony. Given the confidential nature of this information, the revised rate is being provided directly

[20] OTP witness Mr. David G. Prazak discusses the distinction between embedded and marginal costs in his Direct Testimony.
[21] *See* Case Nos. PU-21-364, 21-365, 21-366.

to Applied. The revenues associated with the updated rate have been incorporated into OTP's proposed rate design.

Q. WHY IS OTP PROPOSING TO UPDATE INDIVIDUALIZED PRICING FOR CUSTOMERS TAKING SERVICE UNDER THE SLGS RATE?

A. There are several reasons. First, as contemplated in the SLGS tariff, costs may change over time, necessitating both updated marginal cost studies and pricing through OTP's proprietary model. Updating the rates offered under the SLGS tariff to reflect the most recent marginal cost study ensures other customers continue to receive net benefits of the SLGS offering.

Second, one aspect of this case is that certain project costs are moving from riders into base rates, which is a typical occurrence during rate cases. This movement is merely a change in the form of cost recovery and on net, has no impact on customers' bills. Yet, that would not be the case if SLGS customers' base rates were not updated concurrently with the reduction in rider rates associated with movement of such costs to base rates. Avoiding this mismatch and the resulting inappropriate windfall to SLGS customers also is consistent with the ultimate condition that SLGS rates result in net benefits to other customers.

Q. WHAT IS THE TOTAL IMPACT OF OTP'S PROPOSAL TO UPDATE INDIVIDUALIZED PRICING FOR CUSTOMERS TAKING SERVICE UNDER THE SLGS RATE?

A. OTP's proposal results in SLGS customers paying approximately **[PROTECTED DATA BEGINS... ...PROTECTED DATA ENDS]** in base rates.[22] Those same customers will experience an approximate **[PROTECTED DATA BEGINS... ...PROTECTED DATA ENDS]** in rider costs (due to projects moving from riders and into base rates, resulting in **[PROTECTED DATA BEGINS... ...PROTECTED DATA ENDS]**.

VII. INTRODUCTION OF WITNESSES

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

A. In this section, I introduce OTP's witnesses and briefly discuss the topics each covers in Direct Testimony.

[22] *See* Volume 3, Schedule E-2.

Q. WHO ARE OTP'S OTHER WITNESSES?

A. OTP's other witnesses are:

- Anne E. Bulkley presents evidence and provides a recommendation regarding the appropriate return on equity for OTP and provides an assessment of the capital structure to be used for ratemaking purposes.
- Christopher E. Byrnes discusses and supports how Otter Tail Corporation allocates its corporate costs to OTP. He explains the Lead Lag Study that is used to calculate the cash working capital component of rate base for the 2024 Test Year. He also presents proposed changes to OTP's Energy Adjustment Rider that will make fuel costs more transparent for our customers, and OTP's proposed treatment of rate case advertising and electronic payment processing expenses.
- Paula M. Foster describes OTP's proposal regarding treatment of certain riders and associated costs in the 2024 Test Year and adjustments to those riders as the result of moving cost recovery from riders and into base rates.
- Tammy K. Mortenson discusses OTP's energy forecasting process and present the results of OTP's sales forecast, which forms the basis of the 2024 Test Year sales and revenues in this proceeding.
- Christy L. Peterson is OTP's overall revenue requirements witness, sponsoring the Jurisdictional Cost of Service Study and the calculation of OTP's 2024 Test Year revenue deficiency. As such, she supports and sponsors much of the financial data provided as part of this case. She also describes OTP's capital and operations and maintenance budgets, which provide the basis for the 2024 Test Year. Finally, she discusses the development of the rate base and net operating statement that are being proposed for use in setting rates in this proceeding, including explaining the financial impact of all Test Year adjustments and providing support for some of the Test Year adjustments.
- David G. Prazak describes the rate structure objectives that were used in developing the proposed rates; explains the role of embedded and marginal costs in OTP's rate design; describes the proposed rate design for OTP's rate schedules; and supports the proposed language changes of OTP's rate schedule provisions.
- Amber M. Stalboerger addresses a variety of regulatory and cost allocation issues, including development of jurisdictional and class allocation factors

and the mechanics of the Company's proposal to address changes in sales volumes between rate case. Ms. Stalboerger also addresses treatment of generator interconnection procedures projects (GIPs), and proration of accumulated deferred income tax (ADIT) in the 2024 Test Year. She also sponsors and presents the results of OTP's 2024 Test Year Class Cost of Service Study and OTP's proposed class revenue responsibilities.

- Todd R. Wahlund supports OTP's capital structure and overall rate of return (ROR). He will also discuss several issues that are related to OTP's proposed capital structure and ROR, including OTP's prior and planned capital expenditures, credit ratings and unique financial characteristics.
- Peter E. Wasberg discusses matters related to OTP's employee compensation and benefits. He describes OTP's current compensation plan, including its four annual incentive plans, and benefits provided to OTP employees and retirees. Finally, he summarizes certain 2024 Test Year compensation and benefit costs.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

Qualifications, Duties and Responsibilities of Bruce Gerhardson

EMPLOYMENT

Vice President, Regulation and Retail Energy Solutions– Otter Tail Power Company
October 2017-Present
Executive leadership over regulatory affairs, market planning and strategic planning

Director, Regulatory Affairs and Compliance – Otter Tail Power Company
April 2017-October 2017
Executive Leadership over regulatory economics, administration, proceedings and compliance

Associate General Counsel - Otter Tail Power Company, Fergus Falls, MN
2000-April 2017
Lead Counsel for regulatory affairs and administrative proceedings. Chief Compliance Counsel. Staff of eight advocacy and compliance personnel, including the Manager of Regulatory Economics and the Manager of Regulatory Proceedings and Compliance.

Partner - Svingen, Athens, Russell and Hagstrom Law Firm, Fergus Falls, MN
1995-2000
Comprehensive legal representation of individual clients, with public utility and agribusiness focus. Regulatory proceedings, project development and other transactions.

EDUCATION

University of Minnesota Law School
JD Cum Laude 1995. Judicial Extern for the Mille Lacs Band of Ojibwe Tribal Court; Summer Associate at Pemberton, Sorlie, Rufer & Kershner Law Firm, Fergus Falls, Minnesota

University of Minnesota-Duluth
Graduate Work, English Literature and Writing 1990-1992; Fellowships and Teaching Assistantships in Writing and Literature

St. Olaf College
BA Cum Laude, English 1988; Semester Abroad at University of Aberdeen, Scotland

Fergus Falls Community College
AA Liberal Arts 1985

INDUSTRY CERTIFICATIONS

Law licenses in Minnesota, North Dakota and South Dakota