

Volume 2B

Direct Testimony and Supporting Schedules:

Todd R. Wahlund

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_____

**FINANCIAL SOUNDNESS, CAPITAL STRUCTURE
AND COST OF CAPITAL**

Direct Testimony and Schedules of

TODD R. WAHLUND

November 2, 2023

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I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND EMPLOYER.

A. My name is Todd R. Wahlund. I currently am employed by Otter Tail Power Company (“OTP” or the “Company”). Effective January 1, 2024, I will be employed by Otter Tail Corporation. OTP is a wholly owned subsidiary of Otter Tail Corporation.

Q. PLEASE SUMMARIZE YOUR RESPONSIBILITIES.

A. I am OTP’s Chief Financial Officer. Effective January 1, 2024, I will become the Chief Financial Officer and Vice President of Otter Tail Corporation and will be responsible for the financial functions and performance for Otter Tail Corporation and its operating company subsidiaries, including OTP. I also will direct the corporate services for treasury, accounting, tax and external reporting, investor relations, financial planning, information technology, internal audit and business risk management, and acquisition evaluations.

Q. HAVE YOU INCLUDED A DESCRIPTION OF YOUR QUALIFICATIONS?

A. Yes, a description of my qualifications is included as Exhibit____(TRW-1), Schedule 1.

II. PURPOSE AND OVERVIEW OF DIRECT TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. The purpose of my Direct Testimony is to support OTP’s capital structure and overall rate of return (ROR). In connection therewith, I 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. Finally, I sponsor the information provided in Volume 3, Rate of Return/Cost of Capital Schedules Tab, Schedules D-1 through D-4.

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

A. My Direct Testimony:

- Demonstrates the reasonableness of OTP’s 2024 Test Year capital structure and costs of long-term debt (LTD), short-term debt (STD) and the overall

ROR;

- Discusses the financial impacts and scope of OTP's recent capital expenditures and OTP's estimated future capital expenditures;
- Discusses how constructive regulatory policy, including a reasonable return on equity (ROE), is important for OTP to maintain its strong senior unsecured credit ratings, support OTP's capital expenditures, and enable OTP to attract capital and provide service at a fair and reasonable cost;
- Explains the unique financial characteristics of OTP and how they affect the cost of equity for OTP; and
- Presents OTP's 2024 Test Year capital structure and overall ROR.

Q. PLEASE PROVIDE A BRIEF SUMMARY OF YOUR DIRECT TESTIMONY.

A. OTP's 2024 Test Year capital structure, costs of LTD, STD and ROR are reasonable and should be adopted for determining OTP's rates. Table 1, below, summarizes OTP percentages and costs of LTD, STD, and common equity percentages and costs. These amounts also are shown in Exhibit____(TRW-1), Schedule 2.

Table 1
Recommended 2024 Test Year Capital Structure and ROR

Component	Percentage	Cost	Weighted Cost
Short-Term Debt	2.98%	5.25%	0.16%
Long-Term Debt	43.52%	4.65%	2.02%
Total Debt	46.50%	4.68%	2.18%*
Common Equity	53.50%	10.60%	5.67%
Total	100.00%		7.85%

*Weighted cost of total debt reflects costs of short-term debt and long-term debt before rounding to two decimals.

OTP has been engaged in an extensive investment program, involving capital expenditures of approximately \$1.133 billion from 2018 through 2023, or an average of approximately \$189 million per year.¹ These extensive capital expenditures are projected to continue, with OTP's capital expenditures projected to be approximately \$888 million in 2024-2027 (an average of \$222 million per year).² The Commission's decisions in this proceeding, including the

¹ See Table 2, below.

² Otter Tail Corporation Second Quarter Earnings Conference Call Presentation at 36 (Aug. 1, 2023).

Commission's decisions regarding OTP's capital structure and ROE could significantly affect the costs of financing these expenditures.

Q. WHAT DO YOU RECOMMEND TO THE COMMISSION?

A. I recommend the Commission approve a capital structure for the 2024 Test Year consisting of 53.50 percent equity, 43.52 percent LTD, and 2.98 percent STD. I also recommend the Commission approve an overall ROR of 7.85 percent and a ROE of 10.60 percent.

Q. HOW IS THE BALANCE OF YOUR DIRECT TESTIMONY ORGANIZED?

A. The balance of my Direct Testimony is organized as follows:

- Section III describes our historic and planned financing and investment activities and explains the importance of our regulatory environment and investor perceptions to our capital expenditure plans and costs.
- Section IV discusses OTP's credit ratings.
- Section V discusses some of OTP's unique financial characteristics.
- Section VI describes OTP's proposed capital structure, including its components.
- Section VII summarizes my conclusions.

III. OTP CAPITAL EXPENDITURES AND ONGOING EXPENDITURE PLANS

Q. PLEASE SUMMARIZE OTP'S CAPITAL EXPENDITURES SINCE ITS LAST NORTH DAKOTA RATE CASE.

A. OTP's last North Dakota rate case (Case No. PU-17-398) was filed in November 2017 based on a 2018 Test Year. OTP's capital expenditures from 2018-2023 will total approximately \$1.133 billion, as shown on Table 2 below.

Table 2
OTP Capital Expenditures 2018 – 2023³

Year	OTP Total Capital Expenditure (\$ millions)
2018	\$87
2019	\$187
2020	\$357
2021	\$140
2022	\$148
2023 (Est)	\$214
Total	\$1,133
Average	\$189

Q. HOW DO THESE PRIOR EXPENDITURES COMPARE TO OTP'S NET PLANT IN SERVICE?

A. OTP's net electric plant in service was approximately \$1.451 billion as of December 31, 2017.⁴ OTP's \$1.133 billion capital expenditures during 2018-2023 represents approximately 78 percent of its net electric plant at the beginning of that period. The result, after plant retirements, was a net increase in OTP's net electric plant in service of approximately \$647 million, to approximately \$2.098 billion as of December 31, 2022.⁵ Mr. Gerhardson also provides further information regarding these expenditures.

Q. PLEASE SUMMARIZE OTP'S ANTICIPATED CAPITAL EXPENDITURES.

A. We anticipate an additional \$888 million of capital expenditures by OTP from 2024 through 2027.⁶ Mr. Gerhardson further explains OTP's capital expenditure plans in his Direct Testimony.

Q. HOW HAS OTP FINANCED ITS RECENT CAPITAL EXPENDITURES?

A. OTP has obtained long term funding for its \$1.133 billion of capital expenditures during 2018-2023 through a combination of approximately \$355 million of LTD issued by OTP (net of retirements), \$115.2 million of earnings retained by OTP and \$300.0 million of equity infusions from Otter Tail Corporation. The sum of

³ Otter Tail Corporation 2018 Form 10-K at 51; Otter Tail Corporation 2020 Form 10-K at 30; Otter Tail Corporation 2022 Form 10-K at 34; Otter Tail Corporation Second Quarter Earnings Conference Call Presentation at 36 (Aug. 1, 2023).

⁴ Otter Tail Corporation 2018 Form 10-K at 112.

⁵ Otter Tail Corporation 2022 Form 10-K at 54.

⁶ Otter Tail Corporation Second Quarter Earnings Conference Call Presentation at 36 (Aug. 1, 2023).

those retained earnings plus equity infusions reflects the net level of reinvestment of OTP earnings.

Q. HAVE YOU SUMMARIZED THOSE RETAINED EARNINGS AND EQUITY INFUSIONS?

A. Yes. Table 3 below identifies the net reinvestment in OTP (the sum of OTP retained earnings plus Otter Tail Corporation equity infusions) for the years 2018-2023. During that time, almost all of OTP's net income has been reinvested in utility operations, either as retained earnings or added infusions of equity from Otter Tail Corporation.

Table 3
Net Reinvestment of OTP Earnings
(\$ millions)

	OTP Net Income	Retained Earnings	Otter Tail Corp Equity Infusions	Net Reinvestment [Retained Earnings + Otter Tail Corp Equity Infusions]	Effective Rate of Reinvestment
2018	\$54.4	\$11.9	\$25.0	\$36.9	67.8%
2019	\$59.0	\$14.5	\$35.0	\$49.5	83.9%
2020	\$66.8	\$22.3	\$150.0	\$172.3	257.9%
2021	\$72.5	\$20.6	\$0.0	\$20.6	28.4%
2022	\$80.0	\$25.0	\$50.0	\$75.0	93.8%
2023 (Est)	\$84.8	\$20.8	\$40.0	\$60.8	71.7%
Total	\$417.5	\$115.2	\$300.00	\$415.2	99.4%
Average	\$69.6	\$19.2	\$60.0	\$79.2	113.8%

These retained earnings and equity infusions have provided essential funding and have allowed OTP to maintain an appropriate balance of debt and equity and a balanced capital structure for OTP.

Q. HAS THE IMPORTANCE OF OTP'S BALANCED CAPITAL STRUCTURE AND OTTER TAIL CORPORATION EQUITY INFUSIONS BEEN RECOGNIZED BY RATING AGENCIES?

A. Yes. Fitch Ratings (Fitch) has stated:

Fitch expects OTP to remain FCF [Free Cash Flow] negative through the forecast period, with future funding needs met by a balanced mix of debt and equity, and that parent Otter Tail Corp. will downstream

1 additional equity as needed to support the balanced capital
2 structure.⁷
3

4 Fitch's credit rating for OTP also assumes that OTP's "large capex program" will be
5 supported by a "balanced capital structure."⁸ Similarly, Moody's Investors Service
6 (Moody's) supported its credit rating for OTP by stating "We expect OTP's capital
7 structure to remain consistent as the company executes its investment program."⁹
8

9 Q. DID FITCH IDENTIFY ANY RISKS ASSOCIATED WITH FAILURE TO
10 MAINTAIN A BALANCED CAPITAL STRUCTURE?

11 A. Yes. Fitch identified the following factors that could, individually or collectively,
12 lead to negative rating action or downgrade:

- 13 • Adverse future regulatory outcomes.
- 14 • Failure to maintain a balanced equity component in its capital
15 structure.
- 16 • Sustained FFO leverage above 4.5x.¹⁰
17

18 Q. WILL THE ROE AND CAPITAL STRUCTURE APPROVED BY THE
19 COMMISSION IMPACT OTP'S CAPITAL EXPENDITURES AND COST?

20 A. Yes. The ROE and capital structure authorized in this proceeding will have a
21 substantial impact on OTP's ability to carry out its capital expenditures and the
22 ongoing cost of doing so in two important ways.

23 First, the ROE and capital structure will have a direct impact on OTP's level
24 of authorized earnings, which will, in turn, directly affect OTP's ability to fund
25 capital expenditures with internally generated retained earnings. As shown above,
26 internally generated retained earnings have been a significant source of funding
27 for OTP's capital expenditures, and OTP expects retained earnings to continue to
28 be a significant source of funding for its future capital expenditure plans.

29 Second, the authorized ROE and capital structure will have a significant
30 effect on rating agencies and investors' perceptions of OTP, the effect of which is

⁷ Fitch Ratings, Fitch Upgrades Otter Tail Corp. and Otter Tail Power's IDRs; Outlooks Stable at 4 (Sept. 22, 2023).

⁸ Fitch Ratings, Fitch Upgrades Otter Tail Corp. and Otter Tail Power's IDRs; Outlooks Stable at 5 (Sept. 22, 2023).

⁹ Moody's Investors Service, Otter Tail Corporation and Otter Tail Power Company Rating Action at 1 (Oct. 3, 2022).

¹⁰ Fitch Ratings, Fitch Upgrades Otter Tail Corp. and Otter Tail Power's IDRs; Outlooks Stable at 5-6 (Sept. 22, 2023). "FFO" stands for Funds from Operations.

likely to be heightened by the scale of OTP's planned capital expenditures. These perceptions will have a substantial impact on both the availability and the cost of the capital needed to complete OTP's capital expenditure plans.

IV. OTP CREDIT RATINGS

Q. ARE CREDIT RATINGS IMPORTANT TO OTP AND OTP'S CUSTOMERS?

A. Yes. Although, OTP has not issued publicly held debt (instead issuing debt through private placements), credit ratings still are very important to OTP and OTP's customers. That is because institutional investors use credit ratings, along with their own analysis, to decide whether to purchase OTP debt and at what price, which in turn, drives the interest rate on that debt. Credit ratings therefore impact the cost of LTD (and STD) OTP requires to fund its substantial capital expenditures.

Q. WHAT ARE OTP'S CURRENT CREDIT RATINGS?

A. OTP's current senior unsecured credit ratings are set out in Table 4 below:

Table 4
OTP Credit Ratings¹¹

	Moody's	Fitch	S&P
Long Term Issuer Default	A3	BBB+	BBB+
Senior Unsecured Debt	N/A	A-	N/A
Outlook	Stable	Stable	Stable

Q. WHAT FACTORS DO AGENCIES CONSIDER WHEN ESTABLISHING A UTILITY'S RATINGS?

A. Credit rating agencies look at a utility's business risk and its financial risk (based on credit metrics) in making rating determinations. Ratings are assigned to both business and financial risks. A utility's required credit metrics increase (become more stringent) to maintain a given rating as the utility's business risk rating decreases (indicating higher business risk). Capital expenditure levels and the regulatory environment are both significant to rating agencies' evaluation of a utility's credit ratings.

¹¹ Fitch Ratings, Fitch Upgrades Otter Tail Corp. and Otter Tail Power's IDRs; Outlooks Stable at 7-8 (Sept. 22, 2023).; Moody's Investors Service, Otter Tail Corporation and Otter Tail Power Company Rating Action at 1 (Oct. 3, 2022); S&P Global Ratings, Otter Tail Power Co. RatingsDirect at 6-7 (Sept. 22, 2023).

1 Q. HAS OTP'S CAPITAL EXPENDITURE LEVEL BEEN RECOGNIZED AS A
2 CREDIT RATING FACTOR?

3 A. Yes. Fitch, Moody's and Standard & Poor's Financial Services (S&P) all identify
4 OTP's planned capital expenditures as factors influencing their credit ratings, with
5 Fitch and Moody's noting those capital expenditures need to be supported by a
6 balanced capital structure and supportive regulatory environments.¹²
7

8 Q. HOW DO RATING AGENCIES VIEW THE NORTH DAKOTA REGULATORY
9 ENVIRONMENT?

10 A. Both Fitch and Moody's consider North Dakota to be credit supportive.¹³
11

12 Q. ARE OTP'S CREDIT RATINGS PREDICATED ON A CONTINUED
13 CONSTRUCTIVE REGULATORY ENVIRONMENT?

14 A. Yes. Fitch, for example, viewed the outcome of OTP's last North Dakota rate case
15 to be "constructive", and that it expects OTP's "regulatory environment to remain
16 supportive of credit quality...."¹⁴ Moody's similarly characterizes OTP's regulatory
17 environment to be "credit supportive" and that its stable outlook for OTP
18 "incorporates our expectation that the company's regulatory environments will
19 remain credit supportive...."¹⁵
20

21 Q. HAVE THE RATING AGENCIES STATED THAT A CHANGE IN OTP'S
22 REGULATORY ENVIRONMENT COULD RESULTS IN A DOWNGRADE?

23 A. Yes. Fitch expressly identified "adverse future regulatory outcomes" as a factor
24 that could lead to a negative rating action or downgrade.¹⁶
25

¹² Fitch Ratings, Fitch Upgrades Otter Tail Corp. and Otter Tail Power's IDRs; Outlooks Stable at 5-6 (Sept. 22, 2023); Moody's Investors Service, Otter Tail Corporation and Otter Tail Power Company Rating Action at 1-2 (Oct. 3, 2022); S&P Global Ratings, Otter Tail Power Co. RatingsDirect at 1 (Sept. 22, 2023).

¹³ Fitch Ratings, Fitch Upgrades Otter Tail Corp. and Otter Tail Power's IDRs; Outlooks Stable at 2-3 (Sept. 22, 2023); Moody's Investors Service, Otter Tail Corporation and Otter Tail Power Company Rating Action at 1 (Oct. 3, 2022).

¹⁴ Fitch Ratings, Fitch Upgrades Otter Tail Corp. and Otter Tail Power's IDRs; Outlooks Stable at 1-2 (Sept. 22, 2023).

¹⁵ Moody's Investors Service, Otter Tail Corporation and Otter Tail Power Company Rating Action at 1-2 (Oct. 3, 2022).

¹⁶ Fitch Ratings, Fitch Upgrades Otter Tail Corp. and Otter Tail Power's IDRs; Outlooks Stable at 5 (Sept. 22, 2023).

1 Q. WHAT KIND OF DECISIONS COULD CONSTITUTE AN ADVERSE
2 REGULATORY OUTCOME?

3 A. From a rating agency perspective, regulatory decisions that put additional pressure
4 on credit metrics could be considered adverse. For example, Moody's has stated:

5 A rating downgrade is possible if OTP's regulatory environments
6 become less credit supportive, such that regulatory lag increase or
7 returns are lowered.¹⁷
8

9 Further, Fitch has noted jurisdictions where authorized ROEs are "materially
10 below the recent industry average" are "somewhat challenging" and such decisions
11 are "unfavorable."¹⁸ These kinds of decisions put pressure on earnings, which, in
12 turn, puts pressure on credit metrics.
13

14 Q. ARE THERE OTHER REGULATORY DECISIONS THAT COULD BE
15 CONSIDERED ADVERSE FROM A CREDIT PERSPECTIVE?

16 A. Yes. As discussed above, ratings agencies predicate OTP's credit on the
17 assumption that OTP will finance its future capital expenditures through a
18 balanced capital structure. Moving away from financing future capital
19 expenditures through a balance of debt and equity would put additional pressure
20 on credit metrics (i.e. make credit ratings agencies look less favorably on the
21 company), both by reducing the amount of internally generated earnings available
22 to fund capital expenditures, and by increasing OTP's debt burden. Further, if the
23 Commission issues a decision that fails to reflect OTP's actual, Test Year capital
24 structure, credit rating agencies could interpret that decision as a deviation from
25 past precedent that signals the Commission becoming less supportive of North
26 Dakota utilities.
27

28 Q. ARE THERE OTHER BUSINESS RISKS THAT IMPACT OTP'S CREDIT
29 RATINGS?

30 A. Yes. Fitch notes OTP's credit profile is similar to the credit profile of its larger
31 peers, despite having better financial metrics and operating in the same
32 jurisdictions:

33 OTP's credit profile is in line with those of its higher rated peers
34 including Black Hills Power, Inc. (BHP; BBB+/Stable), Northern

¹⁷ Moody's Investors Service, Otter Tail Corporation and Otter Tail Power Company Rating Action at 2 (Oct. 3, 2022).

¹⁸ Fitch Ratings, Fitch Upgrades Otter Tail Corp. and Otter Tail Power's IDRs; Outlooks Stable at 3, 4 (Sept. 22, 2023).

1 States Power Company- Minnesota (NSPC; A-/Stable) and
2 NorthWestern Corp. (NorthWestern; BBB/Stable). OTP's financial
3 metrics are stronger than peers and in line with a 'BBB+' IDR.
4

5 OTP's FFO leverage strengthened to 3.8x in 2022 from 4.2x in 2021,
6 which was slightly stronger than NSPC at 3.9x, better than BHP at
7 4.2x and significantly better than NorthWestern at 6.0x. Fitch
8 considers OTP's regulatory environment in Minnesota and North
9 Dakota to be balanced, while the regulatory environment in South
10 Dakota is somewhat challenging. OTP's peers operate in many of the
11 same states. However, the scale of OTP's utility operations are much
12 smaller than some of its larger peers.¹⁹
13

14 S&P similarly notes OTP's "small customer base of about 133,000 customers" is a
15 key risk in OTP's credit rating.²⁰
16

17 Q. WHAT DO YOU CONCLUDE FROM THESE RATING AGENCY REPORTS?

18 A. These reports confirm OTP's regulatory environment is closely followed by the
19 rating agencies and investors, and that Commission decisions in this case will have
20 a significant effect on OTP's completion of its capital expenditure program and on
21 OTP's cost of completing that program.

22 V. UNIQUE FINANCIAL CHARACTERISTICS OF OTP

23 Q. PLEASE SUMMARIZE THE FINANCIAL CHARACTERISTICS OF OTP.

24 A. OTP is a small utility and provides electricity to approximately 133,000 customers
25 in a service area encompassing 70,000 square miles and over 400 communities.²¹
26 OTP's breakdown of electric revenues was 67.7 percent Commercial and
27 Industrial, 30.6 percent Residential and 1.7 percent other sources.²² OTP has an
28 extensive capital expenditure program in effect as previously discussed. OTP is the
29 only utility operating subsidiary of Otter Tail Corporation.²³
30

¹⁹ Fitch Ratings, Fitch Upgrades Otter Tail Corp. and Otter Tail Power's IDRs; Outlooks Stable at 4-5 (Sept. 22, 2023).

²⁰ S&P Global Ratings, Otter Tail Power Co. Ratings Direct at 1 (Sept. 22, 2023).

²¹ Otter Tail Corporation 2022 Form 10-K at 5.

²² Otter Tail Corporation 2022 Form 10-K at 6. One Industrial customer accounts for over 10 percent of OTP's revenues. *Id.*

²³ Otter Tail Corporation 2022 Form 10-K at 3.

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

2 A. OTP's overall size, including all states in which it does business, is very small
3 compared to other utilities. OTP is Otter Tail Corporation's only utility. Otter Tail
4 Corporation is the fourth smallest (by market capitalization) publicly owned utility
5 in the United States.²⁴ OTP Witness Ms. Ann Bulkley explains the substantial
6 difference in size between OTP (and Otter Tail Corporation) and the companies in
7 her comparable group and the significance of that difference to OTP's cost of
8 equity.

9
10 Q. DOES OTTER TAIL CORPORATION HAVE A LOW AVERAGE DAILY TRADING
11 VOLUME AND RELATIVELY LOW LEVELS OF INSTITUTIONAL OWNERSHIP?

12 A. Yes. Ms. Bulkley explains Otter Tail Corporation's average daily trading volume
13 and level of institutional ownership are considerably lower than the other electric
14 utilities in her comparable group.

15
16 Q. WHAT ARE THE EFFECTS OF RELATIVELY LOW TRADING VOLUME AND
17 INSTITUTIONAL OWNERSHIP?

18 A. A low average daily trading volume limits liquidity for institutional investors, who
19 take significant positions in any stock they purchase. With low average daily
20 trading volume, institutional investors may be limited in their ability to exit an
21 ownership position, which is an impediment to their purchase of a stock. This
22 lower average daily trading volume impacts the liquidity of trading in a stock.
23 Liquidity matters because it influences the cost of capital for the suppliers of shares
24 and the cost of trading for investors. The lower the liquidity, the higher the
25 required returns for investors and the higher cost of capital for companies that
26 issues the shares. Ms. Bulkley's Direct Testimony also explains the effect of
27 relatively low institutional ownership on OTP's cost of equity.

28
29 Q. PLEASE FURTHER EXPLAIN INSTITUTIONAL OWNERSHIP AND ITS EFFECT
30 AS A SOURCE OF EQUITY CAPITAL.

31 A. Institutional ownership measures the level of ownership of a company by large
32 financial institutions, mutual funds, insurance companies, and endowments. A
33 significant benefit of institutional investors is they provide an added source of
34 demand for capital and tend to be an efficient source of equity capital.

²⁴ Edison Electric Institute, 2023 Q2 Financial Update (last accessed Sept. 17, 2023).

Q. HOW DOES THIS COMBINATION OF FACTORS AFFECT THE COST OF EQUITY FOR OTP?

A. This combination of factors increases the cost of equity for OTP.

VI. OTP TEST YEAR CAPITAL STRUCTURE AND RATE OF RETURN

Q. PLEASE SUMMARIZE OTP'S RECOMMENDED CAPITAL STRUCTURE, COSTS OF DEBT, AND ROR FOR THE 2024 TEST YEAR.

A. OTP recommends an overall ROR of 7.85 percent, which is based on the percentages and costs of LTD, STD, and common equity summarized in Table 5 below (which is a duplicate of Table 1 and provided here for convenience) and shown on attached Exhibit____(TRW-1), Schedule 2.

Table 5
Recommended 2024 Test Year Capital Structure and ROR

Component	Percentage	Cost	Weighted Cost
Short-Term Debt	2.98%	5.25%	0.16%
Long-Term Debt	43.52%	4.65%	2.02%
Total Debt	46.50%	4.68%	2.18%*
Common Equity	53.50%	10.60%	5.67%
Total	100.00%		7.85%

*Weighted cost of total debt reflects costs of short-term debt and long-term debt before rounding to two decimals.

The cost of common equity and proposed ROE are explained in the Direct Testimony of Ms. Bulkley.

Q. HOW DO THE PROPOSED ROR, CAPITAL STRUCTURE AND CAPITAL COSTS COMPARE TO THOSE IN OTP'S LAST NORTH DAKOTA RATE CASE?

A. The proposed 7.85 percent ROR is 21 basis points higher than the 7.64 percent ROR approved by the Commission in OTP's last North Dakota general rate case.²⁵ The proposed ROR reflects a decrease in the cost of LTD (from 5.35 percent to 4.65 percent), an increase in the cost of STD (from 3.84 percent to 5.25 percent) and an increase in ROE (from 9.77 percent to 10.60 percent). The proposed 53.50 percent

²⁵ *Otter Tail Power Company 2017 Electric Rate Increase Application*, NDPSC Case No. PU-17-398, Order on Settlement (Sept. 26, 2018).

equity ratio is an increase from the 52.50 percent equity ratio approved in that case.

Q. DOES OTP'S CAPITAL STRUCTURE BENEFIT CUSTOMERS?

A. Yes. OTP's capital structure, including its equity ratio, has a significant effect on its financial strength. The equity ratio is an important credit metric for rating agencies in determining OTP's credit ratings. OTP's capital structure also assists OTP in financing its investments and operations at a reasonable cost and ensures OTP's ability to access capital markets in a variety of economic conditions. OTP's capital structure has contributed to OTP's ability to simultaneously finance its significant capital expenditures, maintain its ratings from Moody's and obtain an upgrade of its ratings from S&P and Fitch, and reduce its cost of LTD. Finally, we expect OTP's capital structure and equity ratio also will facilitate OTP's completion of its future capital expenditure plan. All these factors benefit OTP customers.

A. Capital Structure

Q. IS OTP'S CAPITAL STRUCTURE AN ACTUAL, MARKET-BASED CAPITAL STRUCTURE?

A. Yes. OTP is a legally separate, wholly-owned subsidiary of Otter Tail Corporation. OTP has its own separate capital structure, its own short-term credit facility, and issues long-term debt securities in private placements to institutional investors. OTP's capital structure is subject to capital market scrutiny from credit rating agencies and institutional investors.

Q. PLEASE DESCRIBE THE SCRUTINY OF CREDIT RATING AGENCIES AND INSTITUTIONAL INVESTORS.

A. OTP has separate, senior unsecured debt ratings from Fitch and S&P, while Moody's issues Corporate Credit/Long-Term Issuer Default Rating (as do S&P and Fitch). Institutional investors conduct significant due diligence on OTP in the process of determining whether, and at what price (and resulting interest rate), to purchase debt issued by OTP. Ultimately, because OTP is a separate legal entity with a separate credit facility and separately issued LTD (in private placements to institutional investors): (1) banks and investors recognize the importance of OTP's separate capital structure; and (2) OTP's capital structure is subject to capital market scrutiny from those banks and institutional investors.

1 Q. HOW DOES OTP'S PROPOSED EQUITY RATIO COMPARE TO THE EQUITY
2 RATIOS OF THE COMPANY'S IN MS. BULKLEY'S COMPARABLE GROUP?

3 A. Ms. Bulkley's Direct Testimony shows that OTP's 53.50 percent equity ratio is well
4 within the range of the equity ratios of companies in her comparable group. Ms.
5 Bulkley notes the equity ratio range for her comparable group is 45.30 percent to
6 60.41 percent. OTP's proposed 53.50 percent equity ratio is well within that range.
7

8 Q. HOW DOES OTP'S PROPOSED EQUITY RATIO RELATE TO ITS CAPITAL
9 EXPENDITURE PLAN?

10 A. OTP has been engaged in a substantial capital expenditure program that began in
11 2012 and is projected to continue through 2027, as discussed above. OTP's equity
12 ratio is needed to support this program and maintain strong senior unsecured
13 credit ratings, as I explained earlier in my Direct Testimony.
14

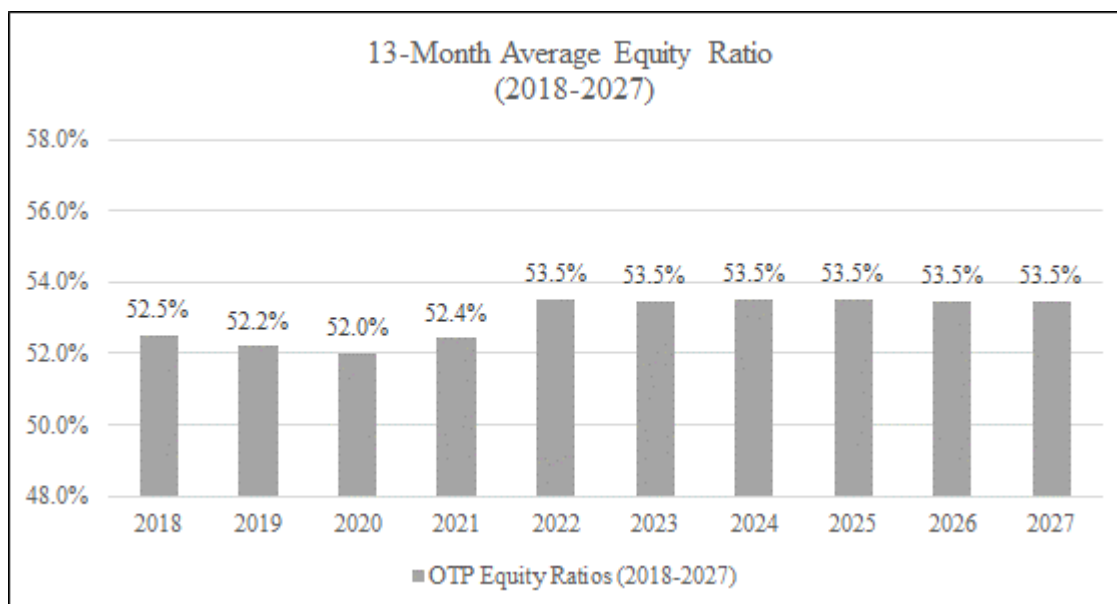
15 Q. HOW HAS OTP FINANCED THIS CAPITAL EXPENDITURE PLAN?

16 A. OTP has sought to maintain a balanced capital structure as it has undertaken these
17 investments, relying on a combination of retained earnings, equity infusions from
18 Otter Tail Corporation and LTD issuances. Historical retained earnings and equity
19 infusions are shown in Table 3, above. Between 2018 and 2023, OTP issued
20 approximately \$355 million of LTD (net of retirements).
21

22 Q. HAS OTP'S EQUITY RATIO INCREASED OVER TIME AS ITS CAPITAL
23 EXPENDITURE PLAN HAS PROGRESSED?

24 A. Yes. Given the scope of OTP's capital expenditure plan, OTP has determined it is
25 prudent to strengthen its balance sheet to support its investment plans and help
26 maintain strong senior unsecured credit ratings. Thus, OTP's equity ratio has
27 increased over time through a mixture of retained earnings and equity infusions
28 from Otter Tail Corporation, as shown in Table 3. OTP's equity ratio is projected
29 to remain at 2024 levels going forward, as shown in the figure below.
30

Figure 1
OTP 13-Month Average Equity Ratios



Q. ARE THERE OTHER REASONS FOR OTP TO HAVE STRENGTHENED ITS BALANCE SHEET?

A. Yes. OTP must be able to access capital at a reasonable cost to finance both investments and operations. Further, this access must occur in a variety of economic conditions. Recent events, including the COVID-19 pandemic, Winter Storms Uri and Elliott, and bank failures in 2023 all severely impacted different aspects of the financial system. Further, different structural changes like sustained higher energy prices, greater sales volatility, supply chain challenges and inflation affect the conditions under which OTP is able to access the financial markets. By strengthening OTP's balance sheet, we are able to better meet those changes and continue to maintain access to capital at reasonable costs.

B. Long-Term Debt

Q. PLEASE DESCRIBE OTP'S LTD ISSUANCES.

A. As discussed above, OTP issues LTD securities in private placements to institutional investors. OTP has not issued public LTD.

Q. WHY DOES OTP ISSUE LTD THROUGH PRIVATE PLACEMENTS?

A. Our LTD offerings have been through private placements with institutional investors because the amounts placed by OTP at any single time are too small for an economic public issuance.

Q. WHAT ARE THE AMOUNT AND COST OF OTP'S LTD FOR THE 2024 TEST YEAR?

A. The 13-month average of OTP's LTD is \$844.3 million and the cost of LTD is 4.65 percent for the 2024 Test Year, as shown on Exhibit____(TRW-1), Schedule 3.

Q. HOW DO THE COST AND AMOUNT OF LTD COMPARE TO OTP'S LAST NORTH DAKOTA RATE CASE?

A. As shown in the table below, the overall cost of LTD has decreased by approximately 70 basis points and the amount of OTP's LTD has increased by approximately \$351.2 million.

Table 6
OTP LTD (2018 North Dakota Rate Case and Current Case)
(\$ millions)

	2018 North Dakota Rate Case²⁶	Current Rate Case	Difference
Amount	\$493.1	\$844.3	\$351.2
Cost	5.35%	4.65%	-0.70%

Q. PLEASE SUMMARIZE OTP'S LTD PLACEMENTS SINCE ITS LAST NORTH DAKOTA RATE CASE.

A. Since January 1, 2019, OTP has placed a total of \$405.0 million of new LTD, and has retired \$170.0 million of LTD. The average cost of LTD placed since January 1, 2019 is 3.56 percent.

Q. HOW HAVE THESE LTD PLACEMENTS RELATED TO THE LONG-TERM FINANCING OF OTP'S CAPITAL EXPENDITURES?

A. These LTD placements, along with OTP retained earnings and equity infusions from Otter Tail Corporation, were used to replace STD incurred during construction and to maintain a reasonable long-term capital structure for OTP.

²⁶ *Otter Tail Power Company 2017 Electric Rate Increase Application*, ND PSC Case No. PU-17-398, Supplemental Direct Testimony of Kevin G. Moug, Updated Schedule 2 (Mar. 23, 2018).

C. Short-Term Debt

Q. WHAT ARE THE AMOUNT AND COST OF OTP'S STD FOR THE 2024 TEST YEAR?

A. The 13-month average of OTP's STD is \$57.8 million, and the cost of STD is 5.25 percent, as shown on Exhibit____(TRW-1), Schedule 4.

Q. HOW WAS THE COST OF STD DETERMINED?

A. The 5.25 percent cost of STD includes the estimated interest expense plus the monthly commitment and other fees associated with OTP's short-term credit facility. OTP can update the STD as the case develops so that final rates will be based on a combination of the actual data that is available and updated forecasts of STD interest rates.

Q. HOW DO THE COST AND AMOUNT OF STD COMPARE TO OTP'S LAST NORTH DAKOTA RATE CASE?

A. As shown in the table below, the overall cost of STD has increased by approximately 141 basis points and the amount of OTP's STD has increased by approximately \$39.6 million.

Table 7
OTP STD (2018 North Dakota Rate Case and Current Case)
(\$ millions)

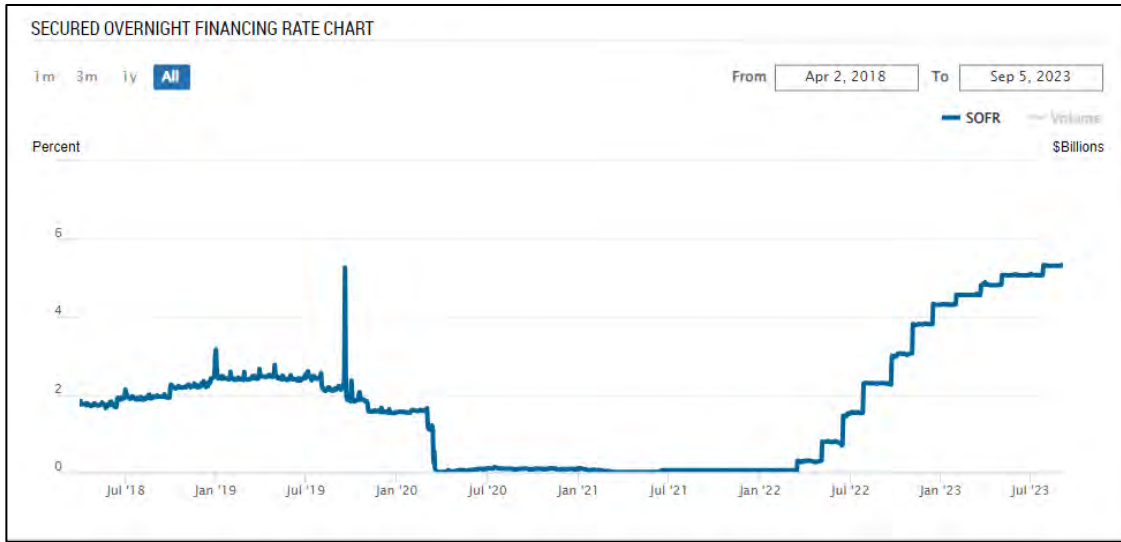
	2018 North Dakota Rate Case²⁷	Current Rate Case	Difference
Amount	\$17.6	\$57.5	\$39.7
Cost	3.84%	5.25%	1.41%

Q. WHAT IS CONTRIBUTING TO THE INCREASE IN THE AMOUNT OF THE COST OF STD?

A. As shown in the figure below, short-term interest rates have increased substantially since OTP's last North Dakota rate case, with the Secured Overnight Financing Rate (SOFR) increasing from 1.80 percent in April 2018 to 5.31 percent as of September 5, 2023. OTP's STD facility is priced according to SOFR, so the increase in the underlying index has directly caused an increase in the cost of STD.

²⁷ *Otter Tail Power Company 2017 Electric Rate Increase Application*, ND PSC Case No. PU-17-398, Supplemental Direct Testimony of Kevin G. Moug, Updated Schedule 2 (Mar. 23, 2018).

Figure 2
Secured Overnight Financing Rate – 2018 – 2023²⁸



Q. ARE THERE OTHER FACTORS THAT CONTRIBUTE TO THE COST OF STD?

A. Yes. Both the margin above SOFR and the commitment fee on OTP's short term credit facility are dependent on OTP's credit ratings. If credit ratings were to deteriorate, then the cost of STD would increase. This is another way in which maintaining OTP's financial strength and integrity directly benefits customers – though lower STD costs.

D. Common Equity

Q. WHAT IS THE AMOUNT OF COMMON EQUITY IN THE PROPOSED 2024 TEST YEAR CAPITAL STRUCTURE AND HOW WAS IT DETERMINED?

A. OTP's common equity is \$1.037 billion, which reflects the average of 13 month-end expected equity balances from December 2023 through December 2024. Exhibit____(TRW-1), Schedule 5 shows the 2024 Test Year equity balance by month.

²⁸ Federal Reserve Bank of New York, Secured Overnight Financing Rate Data, <https://www.newyorkfed.org/markets/reference-rates/sofr> (last accessed September 6, 2023).

1 Q. HOW DOES THE PROPOSED COMMON EQUITY LEVEL COMPARE TO OTP'S
2 LAST NORTH DAKOTA RATE CASE?

3 A. The \$1.037 billion common equity balance is \$472 million (approximately 83
4 percent) greater than the \$565 million balance in our last North Dakota rate case,
5 as shown in Table 8 below:

6
7 **Table 8**
8 **OTP Common Equity (2018 North Dakota Rate Case and Current Case)**
9 **(\$ millions)**
10

	2018 North Dakota Rate Case²⁹	Current Rate Case	Difference
Amount	\$565	\$1,037	\$472

11
12 Q. PLEASE DESCRIBE OTTER TAIL CORPORATION'S STOCK ISSUANCES SINCE
13 2004.

14 A. Since 2004, Otter Tail Corporation has utilized its At the Market Program (ATM),
15 Employee Stock Purchase Plan (ESPP) and Dividend Reinvestment Plan (DRIP)
16 for public issuance of its common stock. Otter Tail Corporation also had secondary
17 offerings in 2004-2005 and in 2008. Detailed information showing the type of
18 issuance (ESPP, DRIP, ATM, and Secondary) by year is included in
19 Exhibit____(TRW-1), Schedule 6.

20
21 Q. ARE THERE COSTS ASSOCIATED WITH THESE ISSUANCES?

22 A. Yes. When common stock is issued, the corporation issuing the stock incurs costs
23 in the process of issuance, including underwriter discounts, audit, legal, printing
24 and listing fees, and other expenses of issuance. When these issuance costs (also
25 known as "flotation costs") are incurred, they reduce the net proceeds received by
26 the corporation issuing the stock (under generally accepted accounting principles).
27 Flotation costs are comparable to the issuance costs for LTD. The flotation costs
28 associated with Otter Tail Corporation's common stock issuances are identified in
29 Exhibit____(TRW-1), Schedule 6. Ms. Bulkley has taken these costs into account
30 in making her ROE recommendation. All of these flotation costs were treated as a
31 reduction in proceeds and reflected on the balance sheet and not expensed, which
32 is the standard practice with all flotation costs.
33

²⁹ *Otter Tail Power Company 2017 Electric Rate Increase Application*, ND PSC Case No. PU-17-398, Supplemental Direct Testimony of Kevin G. Moug, Updated Schedule 2 (Mar. 23, 2018).

1 Q. HAVE THESE COMMON STOCK ISSUANCES BY OTTER TAIL CORPORATION
2 BEEN RELATED TO OTP'S CAPITAL EXPENDITURES?

3 A. Yes. These Otter Tail Corporation common stock issuances are directly related to
4 OTP's prior, current, and planned future capital expenditures.
5

6 Q. WERE THESE EQUITY ISSUANCES NECESSARY FOR OTTER TAIL
7 CORPORATION TO PROVIDE THE EQUITY INFUSIONS NEEDED BY OTP?

8 A. Yes. These equity issuances were needed for Otter Tail Corporation to fund the
9 equity infusions required by OTP.

10 **VII. CONCLUSION**

11 Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS.

12 A. I recommend the Commission approve a capital structure for the 2024 Test Year
13 consisting of 53.50 percent equity, 43.52 percent LTD, and 2.98 percent STD. I
14 also recommend that the Commission approve an ROE of 10.60 percent and an
15 overall ROR of 7.85 percent.
16

17 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

18 A. Yes, it does.

TODD R. WAHLUND

EMPLOYMENT

2018-PRESENT Otter Tail Power Company <i>Chief Financial Officer</i>	Fergus Falls, MN
2017-2018 Otter Tail Corporation <i>VP, Financial Planning and Treasurer</i>	Fergus Falls, MN
2012-2017 Otter Tail Corporation <i>VP, Finance, Planning, and M&A</i>	Fargo, ND
2012 Otter Tail Power Company <i>VP, Energy Trading and Planning</i>	Fergus Falls, MN
2008-2012 Otter Tail Power Company <i>VP, Resource Planning and Risk Management</i>	Fergus Falls, MN
2004-2008 Otter Tail Power Company <i>Director, Risk Management and Business Planning</i>	Fergus Falls, MN
2002-2004 Otter Tail Power Company <i>Manager, Business Planning</i>	Fergus Falls, MN
2001-2002 Otter Tail Power Company <i>Manager, Financial Analysis</i>	Fergus Falls, MN
1992-2001 Otter Tail Power Company <i>Various financial and operational roles</i>	Fergus Falls, MN

EDUCATION

• Bachelor of Science in Accounting	Minnesota State University-Moorhead
• Masters in Business Administration	University of North Dakota

INDUSTRY CERTIFICATIONS

- Certified Public Accountant (Inactive)
- Certified Management Accountant
- Certified in Financial Management

PROFESSIONAL AFFILIATIONS

• Institute of Management Accountants	Member
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PROPOSED COST OF CAPITAL FOR 2024 TEST YEAR

	(A)	(B)	(C)	(D)	(E)
Line No.	Capitalization	Amount	Percent of Total	Cost of Capital	Weighted Cost of Capital
1	Short term debt	\$57,841,876	2.98%	5.25%	0.16%
2	Long term debt	844,276,579	43.52%	4.65%	2.02%
3	Total debt	<u>\$902,118,455</u>	<u>46.50%</u>	4.68%	<u>2.18%</u>
4	Common equity	\$1,037,715,501	53.50%	10.60%	5.67%
5	Total Capitalization	<u><u>\$1,939,833,956</u></u>	<u><u>100.00%</u></u>		<u><u>7.85%</u></u>

WEIGHTED COST OF LONG-TERM DEBT	4.65%
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[illegible]

Short-term Debt

Line No.	Month	Month end balances	Cost of Short-Term Debt		
			Monthly Interest Expense	Monthly Fee Expense	Average Short- Term Debt Cost
1	2023 Dec	98,911,504			
2	2024 Jan	149,149,431	540,566	14,958	
3	2024 Feb	17,591,775	363,357	15,422	
4	2024 Mar	34,081,902	112,606	15,597	
5	2024 Apr	45,979,848	174,468	15,764	
6	2024 May	62,944,014	237,363	15,641	
7	2024 Jun	-	125,928	16,090	
8	2024 Jul	8,695,135	7,710	16,555	
9	2024 Aug	33,526,371	92,008	16,811	
10	2024 Sep	57,349,005	198,033	16,698	
11	2024 Oct	65,252,487	267,169	41,755	
12	2024 Nov	77,590,726	311,279	16,680	
13	2024 Dec	100,872,190	388,900	16,429	
14	Average	\$57,841,876			
15	Total \$ Cost		2,819,387	218,400	3,037,786
16	Total % Cost		4.87%	0.38%	5.25%

COMMON EQUITY FOR 2024 TEST YEAR

		Month-end Balances		
Line No.		CONTRIBUTED CAPITAL	RETAINED EARNINGS	TOTAL COMMON EQUITY
1	December 2023	676,988,966	293,355,899	970,344,864
2	January	676,988,966	303,696,641	980,685,607
3	February	676,988,966	311,730,502	988,719,467
4	March	676,988,966	299,325,135	976,314,101
5	April	676,988,966	304,353,091	981,342,057
6	May	676,988,966	309,527,405	986,516,371
7	June	777,688,966	298,110,693	1,075,799,658
8	July	777,688,966	306,796,656	1,084,485,621
9	August	777,688,966	315,043,241	1,092,732,206
10	September	777,688,966	304,696,104	1,082,385,070
11	October	777,688,966	310,267,971	1,087,956,937
12	November	777,688,966	318,387,151	1,096,076,116
13	December	777,688,966	309,254,458	1,086,943,424
14	Average Common Equity			<u>\$1,037,715,501</u>

Floatation Costs

[illegible]