Dustin Johnson, Chair
Steve Kolbeck, Vice Chair
Gary Hanson, Commissioner

SOUTH DAKOTA
PUBLIC UTILITIES COMMISSION

500 East Capitol Avenue
Pierre, South Dakota 57501-5070
www.puc.sd.gov

Capitol Office
(605) 773-3201
1-866-757-6031 fax

Warehouse
(605) 773-5280
(605) 773-3225 fax

Consumer Hotline
1-800-332-1782

February 3, 2009

Patricia VanGerpen
SD Public Utilities Commission
500 E. Capitol
Pierre, SD 57501

VIA ELECTRONIC FILING ONLY

Re: EL08-030

Dear Ms. VanGerpen

Enclosed for filing please find Chesapeake Regulatory Consultants, Inc's consulting services proposal for the above referenced docket. Commission Staff respectfully requests the Commission's approval to enter into a contract with said consultant for specified services. Also, per SDCL 49-34A-14 Commission Staff requests an additional ninety day suspension of rates beyond February 28, 2009.

Thank you for your consideration.

Sincerely,

Kara Semmler

Kara Semmler

cc. Ron Spangler, Jr.

RECEIVED

JAN 2 9 2009

SOUTH DAKOTA PUBLIC
UTILITIES COMMISSION

Chesapeake Regulatory Consultants, Inc

1698 Saefern Way
Annapolis, MD 21401-6529

Phone: 410.849.3210
eMail: rgtsbs@comcast.net

Robert G. Towers
Basil L. Copeland, Jr.
David E. Peterson

January 22, 2009

via eMail and US Mail
David A. Jacobson, Utility Analyst
Bob Knadle, Utility Analyst
South Dakota Public Utilities Commission
500 E. Capitol Avenue
Pierre, South Dakota 57501

RE: Report and Consulting Services Proposal
Otter Tail Power Company - Application to Increase Electric Rates
SDPUC Docket No. EL08-030

Dear Dave and Bob:

Thank you for sending Otter Tail's rate filing for our review and preparation of the following proposal. Basil Copeland has reviewed the Company's cost of capital evidence and Dave Peterson and I have reviewed the testimony, exhibits and filing statements pertaining to all other aspects of the Application.

Overview of the Filing

By letter dated October 31, 2008, Otter Tail Power Company ("OTP" or "the Company") filed with the Commission an Application seeking to increase its rates for electric service in South Dakota. The proposed rates were designed to increase its annual revenue from these customers by $3,883,399, or 15.30% above total 2007 revenues billed at the base tariff rates established in 1987, 2007 energy clause adjustments (revenues billed pursuant to the Company's "Energy Adjustment Rider" revenues) and revenues derived from other riders added since 1987. Rate adjustments by customer class would vary between 12.53% and 33.00% based on a class cost of service study ("CCOSS") and restraints to minimize customer impacts. Residential customers would experience a 15.00% increase while much larger increases would be borne by customers on rates that, at present, are not subject to the Energy Adjustment Rider. The rate request is based on OTP's operating results in South Dakota during the year 2007 as adjusted for claimed "known and measurable" cost changes. The requested rates are designed to produce an 8.89% return on the Company's net investment rate base and an 11.25% return on its common equity capital.

Otter Tail is proposing to modify the design of its base rates, notably by establishing a three-part rate that, for the Residential class, would consist of a fixed monthly customer charge, a monthly "Facilities charge" and a single block of seasonal energy charges. The revised rates and trackers were proposed to become effective for service rendered on and after November 30, 2008 but, by Commission Order dated December 9, 2008 the rates were suspended for 90 days.

OTP is a division of Otter Tail Corporation. OTP serves about 130,000 customers of which nearly 12,000 are in South Dakota. It is a vertically integrated electric utility with power production facilities, including fossil-fueled and wind generation, in Minnesota, North Dakota and South Dakota. Otter Tail Corporation has significant investments in diverse non-utility enterprises.

Potential Issues and Division of Workload

Otter Tail's filing raises issues similar to those which Staff has dealt with in most other general rate filings – the development of a revenue requirement determination based on actual experience during 2007 (the "2007 Actual Year") but with many adjustments purported to reflect known and measurable changes to be experienced during the two year period following the period of actual experience (the "Test Year"). Each of the major adjustments needs to be evaluated to determine its validity and to assess whether or not it maintains the balance of test year sales levels, operations productivity, price levels and investments. Other adjustments are made to match depreciation rate changes and system cost classifications and allocations either approved, or expected to be approved, by the Minnesota Public Utilities Commission.

But, additional adjustments might be required. For example, while OTP calculates its Federal income tax liablity as if it were a single, stand-alone taxpayer taxed at the corporate rate of 35% of its own "taxable income", the fact is that it is a division of Otter Tail Corporation which joins with its non-utility subsidiaries to file a single consolidated tax return. In 2007 several of the subsidiaries had taxable losses but none of the resulting tax savings to the group were allocated to OTP. In other cases, we have recommended an adjustment to recognize similar consolidated tax savings if such savings are a recurring phenomenon.

The proposed changes in depreciation rates purport to be based on studies submitted to and approved (or expected to be approved) by the Minnesota PUC but none of the studies or approvals were submitted with OTP's rate application. They should be obtained and evaluated.

The Company is proposing to change the South Dakota Commission's ratemaking treatment of Post-retirement Benefits Other than Pensions ("PBOP's", also referred to as "FAS 106 costs") to conform to the accounting treatment prescribed by FAS 106 for financial reporting purposes and offers to absorb some of the past-period transition costs that have never been reflected in South Dakota rates. This proposal appears to be beneficial to South Dakota ratepayers and permits the Company to have a uniform treatment of these costs in all of its rate jurisdictions.

Otter Tail Corporation ("OTC"), of which OTP is a division, provides various services to OTP and OTC's non-utility subsidiaries for which OTP and the subsidiaries are charged though a process of cost allocation. The cost allocations are illustrated in the filing and appear to over-allocate costs to OTP.

The 11.25% return on equity ("ROE") reflected in the Company's claimed cost of capital purports to be supported by various measures of equity costs of a "proxy group" of comparable companies, including alternative DCF, Risk Premium, and Capital Asset Pricing Model analyses. (Hevert testimony, pp. 46-7). An allowance for "flotation costs" is added to the costs to reach the witness' 11.0 –11.75% conclusion and his 11.25% recommendation. By contrast our on-going analysis of equity costs for combination gas and electric utilities suggests a range extending below 10.0%.

Moreover, OTP's 11.25% ROE is applied to its "divisional capital structure" (Moug testimony, p. 3) consisting of 53.3% common equity capital, 3.6% preferred stock capital and 2.8% short term debt. (Moug Exhibit__(KGM-1), Schedule 2). Excluding short term debt from the capital structure – the long-standing South Dakota ratemaking practice – indicates a capital structure consisting of 58.5% equity (both common and preferred) and 41.5% long-term debt. By contrast, OTP's comparable companies appear to have larger debt capitalization and smaller equity capitalization, making them more risky than OTP and suggesting that a reasonable equity return for OTP would be lower than any conclusion drawn from Mr. Hevert's analysis. (Exhibit__(RBH-1), Schedule 9).

The South Dakota jurisdictional cost of service study purports to be consistent with the cost allocations used by OTP in Minnesota and in a recent filing with the North Dakota Commission. A consistent allocation of multi-state costs is desirable and no obvious flaws are evident in OTP's proposal here. The complex South Dakota retail class cost of service study (CCOSS), summarized in Statement N, requires closer examination because it is the principal determinant of the Company's proposed distribution of the rate increase among customer classes, (Beithon testimony, pp. 44-45; also, compare his Tables 2 and 3).

As to the design of the tariff rates, the Company proposes major departures from the existing rate form, relying on what we believe is a questionable notion that consideration of theoretical "marginal costs" is required to send meaningful "price signals" to ratepayers (Prazak testimony, p. 8). The proposed changes to existing rates include elimination of declining block energy charges and the establishment of fixed monthly "facilities charges" akin to the existing customer service charges. Customer service charges are retained such that, together with the proposed facilities charges, the Company would bear virtually no risk of failing to recover its system fixed costs. Variable costs, principally fuel and purchased energy, would be passed on as incurred through the Energy Adjustment Rider that would be extended to customers not presently subject to that Rider. Other tariff changes, such as the establishment of seasonally-differentiated rates appear to be justified on the basis of actual embedded costs. .

Proposal

As you know, we have considerable experience with general rate increase requests by electric and gas utilities including experience with the types of issues that we have identified here. In addition to our participation with the South Dakota Staff in more than thirty formal rate proceedings since 1976, we are presently engaged by the Colorado Consumer Counsel and the New Jersey Rate Counsel (formerly "Ratepayer Advocate") as consultants in gas, electric and water rate cases before the regulatory commissions in those states. We also serve as rate consultants to municipalities, municipal utilities and industrial groups that are consumers of utility services.

In this case, with precedent to guide the Staff on the recurring revenue requirement issues, it would be most efficient to have Staff review and develop positions on the recurring operating revenue and expense adjustments and rate base adjustments for plant additions and working capital. We would provide assistance to Staff in defining and developing positions on these issues, as needed. Indeed, all of our activities would be carried out with as much participation as possible by Staff.

We offer Basil L. Copeland, Jr. to analyze and testify on the cost of capital and capital structure issues. Mr. Copeland will also assess aspects of the Company's reliance on marginal costs in its rate design proposals. David E. Peterson and I would be responsible for accounting issues that are delegated to us by your Staff, the depreciation rate, corporate expense and tax issues, the jurisdictional and class cost of service determinations, and the distribution of the rate increase and rate design issues. We anticipate that CRC's testimony would be presented by Basil Copeland and David Peterson.

We will prepare the necessary data requests to obtain the information needed for our analyses; review the Company's responses, and confer with their witnesses as necessary; and prepare testimony and supporting exhibits describing our analyses, and recommendations. As needed, we will assist Staff witnesses in developing issues on which they will testify. We will also assist Staff Counsel in preparing for hearing and with the preparation of post-trial briefs and other pleadings.

For the purposes of preparing a cost estimate, I have assumed that two or three man-days will be required for participation at hearings in Pierre.

We estimate that the cost of performing these services would amount to approximately $68,865, including out-of-pocket expenses. Of course we would bill only for time actually spent working on the assignment and for our actual out-of-pocket costs, principally air fare for 2 man-trips to Pierre, per diem expenses in Pierre, copier and courier services. Our estimate is derived as follows:

Tasks

	Hours		
	Towers	Copeland	Peterson
• Analyze the filing, identify issues, discovery;	50	24	50
• Developing positions; preparation of testimony and exhibits, including coordination with other Staff witnesses;	40	40	60
• Review rebuttal testimony and preparation for hearing;	20	18	24
• Participation in hearing	8	16	24 .
• Assisting counsel with briefs	16	8	16
Total hours	134	106	174

Cost Summary

Fees: Towers	134 hrs. @ $160		$21,440
Copeland	106 hrs. @ $160		16,960
Peterson	174 hrs. @ $160		27,840
Total fees			66,240
Out-of-pocket expenses:			
Air fare		$1,800	
Hotel		. 300	
Courier		125	
Data base charges for ROE analysis		300	
Other		100	
			2,625
Total cost			**$68,865**

Please let me know if you have any questions about my discussion of the issues, division of the workload between Staff and our firm or any other aspect of this report and proposal. We look forward to working with you again.

Sincerely,

Robert G. Towers
President

Attachment: Fee Schedule (January 2009)