*** NON-CONFIDENTIAL VERSION ***

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE APPLICATION OF OTTER TAIL CORPORATION
D/B/A OTTER TAIL POWER COMPANY FOR AUTHORITY TO
INCREASE ITS ELECTRIC RATES

STAFF MEMORANDUM SUPPORTING
SETTLEMENT STIPULATION

DOCKET EL08-030

Commission Staff ("Staff") submits this Memorandum in support of the Settlement Stipulation ("Stipulation") of June 4, 2009, between Staff and Otter Tail Power Company ("OTP" or "Company") in the above-captioned matter.

BACKGROUND

On October 31, 2008, the Company filed an application with the Public Utilities Commission ("Commission") seeking a $3,883,399 or 15.3 percent increase in rates for electric service to customers in its South Dakota retail service territory.

OTP's proposed increase was based on an historic test year ended December 31, 2007, adjusted for alleged known and measurable post-test year changes, an 11.25 % return on common equity, and an 8.89 % overall rate of return on rate base.

By order dated July 2, 2008, the Commission granted OTP a waiver of ARSD 20:10:13:44, which allowed the Company to use a 2007 test year provided OTP's rate filing was made on or before November 1, 2008. The Commission officially noticed OTP's filing on November 6, 2008, and set an intervention deadline of December 19, 2008. No interventions were filed. On December 9, 2008, the Commission issued an Order of Assessment of Filing Fee and Suspension of Imposition of Tariff. On February 12, 2009, the Commission issued an Order Extending Suspension of Imposition of Tariff. On March 4, 2009, the Commission issued an Order For and Notice of Procedural Schedule and Hearing for hearings to be held commencing at 9:30 a.m. on Tuesday, April 14, 2009, and at 9:00 a.m. on Wednesday, April 15, 2009. On March 19, 2009, OTP requested a two-week extension of the procedural schedule so that settlement discussions with Staff could continue before Staff filed its testimony and exhibits. On April 8, 2009, the Commission issued an Order Canceling Hearing.

On March 16, 2009, Staff provided OTP a copy of its revenue deficiency determination. Thereafter, Staff and OTP (jointly the "Parties") held settlement discussions on March 24, 27 and 30, 2009, in an effort to arrive at a mutually acceptable resolution of the issues presented in OTP's rate filing. Additional information was exchanged between OTP and Staff and settlement discussions continued. Ultimately, the Parties reached a comprehensive agreement on OTP's overall revenue deficiency and other issues presented in the case including, but not limited to, class revenue responsibilities, rate design, and tariff concerns.

OVERVIEW OF SETTLEMENT

OTP's proposed increase was based on an historic test year ended December 31, 2007, adjusted for purportedly known and measurable changes, an 11.25 % return on common equity, and an 8.89 % overall rate of return on rate base. OTP proposed twenty-two operating income adjustments and nine rate base adjustments to its financial statements for the test year. A summary of OTP's operating income adjustments is shown on Exhibit ___ (PJB-1), Schedule 8 attached to the testimony of Peter Beithon. A summary of OTP's rate base adjustments is shown on Exhibit ___ (KAS-1), Schedule 4 attached to the testimony of Kyle Sem. OTP's $3,883,399 revenue deficiency calculation is shown on Exhibit ___ (PJB-1), Schedule 1.

Staff based its revenue requirement determination on a comprehensive analysis of OTP's filing and on additional information obtained in discovery. Staff accepted some Company adjustments, made corrections where necessary, modified other adjustments using more recent actual data, and rejected those that did not qualify as known and reasonably measurable. Lastly, Staff introduced new adjustments not reflected in OTP's filed case.

Differences between the Company and Staff positions were discussed thoroughly at the March 24, 27 and 30, 2009, settlement conferences. As a result of these discussions, each party modified certain positions it had previously taken and each party accepted certain positions of the other where common ground was found. Ultimately, the parties were able to agree on a comprehensive resolution of the issues that Staff believes is based on sound regulatory principles and which avoids costly and unnecessary litigation.

Staff and OTP jointly and separately agree that OTP's revenue deficiency at this time is $2,972,196 justifying an approximate 11.7 % increase in present rates. The revenue deficiency and supporting calculations described in this Memorandum and attachments depict Staff's positions regarding all components of OTP's South Dakota jurisdictional revenue requirement, including a reasonable return allowance on common equity.

STAFF OVERVIEW OF SETTLEMENT

Staff believes this settlement provides OTP with an annual level of revenues relative to its current service costs that is fair, just and reasonable. These settlement rates allow OTP a reasonable opportunity to earn a return that is adequate to enable it to continue providing safe, adequate, and reliable service to its South Dakota retail customers. Staff's determination of the settlement revenue requirement begins with 2007 total company test year costs and allocates total company amounts to the South Dakota retail jurisdiction. It then adjusts the 2007 results for known and measurable post-test year changes. Staff Exhibit ___ (JPT-1), Schedule 3 illustrates Staff's determination of OTP's pro forma operating income under present rates. Exhibit ___ (JPT-2), Schedule 2 illustrates Staff's calculation of OTP's South Dakota retail rate base, Exhibit ___ (JPT-1), Schedule 2 and Exhibit ___ (JPT-2), Schedule 1 summarizes these positions. Staff's calculation of OTP's revenue deficiency and total revenue requirement are shown on Exhibit ___ (JPT-1), Schedule 1.

Rate Base

Average Rate Base – The Company arrived at a test year average rate base using the beginning period (12/31/06) and ending period (12/31/07) plant account balances. Staff's settlement determination reflects a rate base based on an average of the 13 month-end account balances, December 31, 2006, through December 31, 2007. This difference resulted in an approximate $30,000 reduction in OTP's claimed revenue deficiency.

The following OTP and Staff rate base adjustments are based on a 13-point average and reflect the pro forma allocation factors, excluding Staff's Casselton Ethanol Plant adjustment:

Plant Additions - OTP had proposed to increase South Dakota test year plant in service by approximately $19,426,000 (net of accumulated depreciation and deferred income taxes) for post-test year capital additions, anticipating that these plant additions would be in service by the conclusion of this proceeding. Staff's settlement determination revised the Company's adjustments to: 1. Reflect actual costs in lieu of the Company's estimated costs; 2. Eliminate the Hoot Lake Unit 3 superheater tubes adjustment because the project is not complete; 3. Eliminate the Casselton Ethanol Plant adjustment because it is too speculative; and 4. Modify the adjustment to accumulated deferred income taxes relating to the North Dakota investment tax credit for the Langdon and Ashtabula Wind Plants. Staff's adjustment in this regard reflects actual costs and the 2009 difference between book and tax in the calculation. The net effect of these changes is to reduce rate base by approximately $535,000.

Working Capital – The settlement determination modifies OTP's working capital claim by: 1. Including net payment leads and lags for preferred stock dividends, interest on long term debt, depreciation expense, investment tax credit and deferred income taxes; 2. Modifying lead days to reflect statutory payment dates rather than actual payment dates; 3. Recognizing the payment lags associated with South Dakota sales tax related to the revenue deficiency, employee FICA and federal withholding taxes; and 4. Updating to the most recent 13-point averages the rate base allowances for materials and supplies, fuel stocks, prepayments and customer advances as well as the rate base deductions for the reserves for injuries and damages and uncollectibles. These adjustments reduce rate base by approximately $107,000.

FAS 158 and FAS 106 – The settlement determination also updates to the most recent 13-point average the rate base allowances for employee benefits-related regulatory assets, increasing rate base by approximately $92,000.

Rate Case Expense and Holding Company Formation Costs – The settlement revenue requirement determination reflects a five-year amortization of allowed rate case expenses and holding company formation costs to spread these one-time costs over a reasonable period of time. Although OTP did not request rate base treatment for the unamortized balances, the settlement determination includes one-half of the amortized costs, representing the average unamortized balance over the five-year period, increasing rate base by approximately $120,000.

Depreciation Adjustments To Change from a Jurisdictional Direct Assignment Method To An Allocation Method, and to Reflect 2008 and 2009 Changes in Depreciation Accrual Rates – These adjustments, which are explained in the section of this Memorandum dealing with operating income adjustments, reduced rate base by approximately $1,025,000.

Changes In Allocations Due To Effect Of Test Year Adjustments – OTP's revenue requirement model relies on certain secondary allocation factors that are generated within the model (e.g., net plant in service). The settlement determination incorporates the consequences of such allocation changes caused by other elements of the settlement revenue requirement, requiring an increase in rate base of approximately $70,000.

Operating Income

Rate Case Expense – OTP proposed to amortize estimated rate case expenses ($150,000) over the next three years. The settlement increases these costs by $75,000 for the additional costs expected to be incurred by Staff to process this filing and amortizes the expense over five years. These adjustments reduce operating expenses by $5,000.

Holding Company Formation Costs – OTP proposed to amortize its estimated holding company formation costs over five years. The settlement replaces OTP's estimated costs with actual costs incurred to date and reduces the expense allowance by approximately $9,000.

Affiliate Transactions – The Company proposed an adjustment to remove test year affiliate transaction costs in the amount of approximately $6,000 from recoverable costs. The settlement accepts this adjustment.

Inter-Year Billing –OTP proposed a billing adjustment in the amount of approximately ($14,000) to reflect billing corrections and customer reclassifications occurring during the year 2007 that were posted after the end of the test year. The settlement accepts this adjustment.

Economic Development – The Company proposed an expense allowance of $100,000 for economic development activities increasing the actual test year expense by approximately $62,000. OTP did not propose any sharing of the expenses between ratepayers and shareholders. The settlement reflects no increase in test year expenses, which is mainly related to a single employee allocated between South Dakota and Minnesota, but allocates half of the cost to ratepayers and half of the cost to shareholders, reducing operating expense allowance by approximately $81,000.

Industry And Association Dues – The settlement eliminates approximately $3,000 of industry and association dues for lobbying and organizations strictly related to other jurisdictions.

Post-Retirement Employee Benefits Accounting Changed From Pay-As-You-Go To FAS 106 (Accrual) – In an order dated January 26, 1993, in Docket No. EL92-016, the Commission declined to adopt FAS 106 accrual accounting for ratemaking purposes. Nevertheless, OTP adopted FAS 106 for financial reporting purposes in 1993 and began a 20-year amortization of the transition obligation created with the change in accounting. In its filing in this case, OTP proposed to adopt accrual accounting for ratemaking purposes and indicated a willingness to forego recovery of the transition obligation already amortized. The settlement accepts OTP's proposal because the end result is beneficial to South Dakota ratepayers both in this case and in the future.

FAS 112 Post Employment Benefits, FAS 106 Post Employment Benefits and FAS 87 Pension Costs – The Company proposed allowances for these costs based on its forecast of actuarial determinations for 2008. The settlement reflects the actual actuarial determinations for 2008, increasing operating expense allowance by approximately $30,000.

Corporate Allocations – The Company proposed an adjustment to corporate expenses of approximately ($9,000) to reflect increases in wages and benefits and capped individual incentives at twenty five percent. The settlement modifies OTP's request by: 1. Charging ten percent of all indirect charges incurred by the corporate group to corporate level activities; 2. Updating corporate allocation factors to 2008; and 3. Adjusting employee benefits cost based on actual costs in 2008. These adjustments reduce operating expenses by approximately $66,000.

Depreciation Direct Assignment Versus Allocation – In the past, OTP has directly assigned depreciation expense and reserves to South Dakota and the other states. OTP proposed an approximate $116,000 expense adjustment in this case to instead allocate depreciation expense and reserves among the three states. In support of OTP's request, the Company stated that for the past twenty years all three state regulators have relied on the same parameters to establish depreciation accrual rates. Consequently, the differences that had existed in prior years because of different regulatory treatments have narrowed considerably and are diminishing each year. The settlement accepts the proposed change which results in a net reduction in revenue requirements when considering both the operating expense and rate base effects.

Depreciation: 2008 And 2009 Accrual Rate Changes – The Company proposed adjustments to decrease the test year depreciation expense by approximately $42,000 to reflect changes in 2008 and 2009 accrual rates. The settlement reflects these changes.

Interest Synchronization – The settlement synchronizes the tax deduction for interest expense with the long-term debt interest portion of the capital structure and rate base.

Storm Repair Expense – The Company proposed an adjustment in the amount of approximately $27,000 to normalize storm expense based on an average of its storm-related expenses over the five-year period, 2003 through 2007. The settlement updates the adjustment to reflect 2004 through 2008 experience, increasing the allowance by an additional $9,000.

Tree Trimming – OTP's filing did not adjust test year tree trimming expenses. The settlement normalizes these expenses based on five-years of the Company's actual experience, 2004 through 2008, reducing operating expenses by approximately $58,000.

NSF Check – The Company proposed to increase the NSF check charge from $10 to $15 but failed to make a corresponding adjustment to test year revenues. The settlement reflects such an adjustment, increasing other operating revenues by approximately $1,000.

New Billing For Sale Of Steam – The Company proposed an adjustment to other operating revenues in the amount of approximately $42,000 to reflect a change, effective January 17, 2008, in billings for projected sales of steam from Big Stone to an ethanol plant. The settlement incorporates the effects of the billing change based on actual 2008 sales, increasing other operating revenues by approximately $77,000.

Purchased Power Reduction – The Company proposed an adjustment reducing purchased power expense by approximately $736,000 to remove the difference between average purchased energy costs and Big Stone's incremental cost of generation during an unanticipated outage. The settlement reflects the effects of this adjustment.

Savings Offsets To Plant Additions – The Company proposed and the settlement reflects rate base allowances for a number of post-test year plant additions. The Company's filing, however, failed to reflect any operational savings resulting from these plant additions. The settlement reflects fuel, purchased power, labor and O&M savings anticipated from the Big Stone Condenser Retube, the Big Stone advanced hybrid particulate controller replacement, and the Hoot Lake Unit 2 superheater tubes projects, reducing operating expenses by approximately $36,000.

Depreciation And Other Operating Expenses For New Plant – The Company proposed an approximate $828,000 adjustment to depreciation expense relating to new plant additions using 2009 accrual rates. The settlement reflects corresponding adjustments limited to the plant additions reflected in the settlement rate base, increasing operating expenses by approximately $16,000. Based mostly on estimates, OTP proposed O&M expense adjustments totaling approximately $256,000 for the Langdon and Ashtabula Wind Plants and a negative $742,000 adjustment for the North Dakota investment tax credit and production tax credits related to the Langdon and Ashtabula Wind Plants. The settlement reflects corresponding adjustments based on actual costs, reducing expenses by approximately $20,000.

Employee Benefits Medical/Dental – The Company proposed an adjustment to increase employee medical/dental expense by approximately $140,000 based on its projection of costs in 2008. The settlement reflects a corresponding adjustment based on actual 2008 costs and correctly assigns a portion of these costs to the Minnesota jurisdiction, together reducing operating expenses by approximately $59,000.

KPA & Utility Management Increases – The Company proposed an adjustment to increase cost recovery for management incentive compensation programs by approximately $13,000 based on five-year average payouts exclusive of management or key performance incentive pay amounts in excess of twenty five percent of individual base pay. The settlement modifies the adjustment based on 2006-2008 experience exclusive of bonuses paid relating to the achievement of stockholder-benefiting financial goals. This reduces operating expenses by approximately $36,000.

Payroll Increases – The Company proposed adjustments reflecting annualization of wage increases that occurred during the test year, increases that occurred in 2008, and increases expected to occur in 2009. In total, OTP's payroll adjustments increase test year payroll expenses by approximately $292,000. The settlement modifies these adjustments by (a) eliminating the 2009 wage increases for BSP & other union, non-union/non-executive and executive because they are not known at this time and (b) correcting an inadvertent omission of a portion of the 2008 wage increase adjustment, reducing operating expenses by approximately $14,000.

Asset-Based Wholesale Margins – The Company's proposal for crediting asset-based wholesale margins to the retail revenue requirement was to utilize a five-year average (2003-2007) margin rather than actual margins achieved during the test year. The Company's proposal would have increased other operating revenues by approximately $57,000 and would have increased production expenses by approximately $132,000. Staff suggested that OTP's proposal be modified to credit 85 % of the margins to the retail cost of service, calculated using a four-year average (2005-2008). Further, Staff suggested that any change to that margin be reflected in the fuel adjustment clause on an annual basis and distributed equally each month over the ensuing twelve months. Flowing through the changes in the margins directly to customers through the fuel adjustment clause as they are realized, on an annual basis, ensures that neither ratepayers nor the Company are disadvantaged by a non-representative margin included in base rates. The settlement reflects Staff's suggestions and reduces other operating revenues by approximately $131,000 and reduces production expense by approximately $73,000.

Non-Asset Based Wholesale Margins – The Company proposed ratepayers receive 15 % of non-asset based margins and that any margins earned be calculated annually after the close of the calendar year and credited to the fuel adjustment clause if the calendar year balance is positive and be distributed equally each month over the ensuing twelve months. The Company's non-asset based activity is unregulated and outside the normal course of OTP's regulated utility operations. Therefore, no direct revenues or expenses related to gross margins are identified in OTP's test year financial statements. The same personnel, who are responsible for conducting asset based sales and are included in OTP's proposed revenue requirement in this proceeding, conduct the Company's non-asset based activity. Moreover, OTP has not allocated any labor or overhead costs, costs which the Company considers incremental for this service, to the non-asset based activity. Instead, the Company proposes ratepayers receive 15 % of the margins OTP earns to cover incremental costs. The settlement provides that 25 % of non-asset based margins, developed from a fully allocated cost study, be flowed through OTP's fuel adjustment clause.

Changes In Allocation Factors Due To Effect Of Test Year Adjustments - OTP proposed an adjustment which synchronized the secondary allocation factors, mainly net plant in service, with the Company's proposed other adjustments to rate base and operating income. The settlement recognizes the need for and therefore reflects, such synchronizing adjustments.

Cost Of Capital And Rate Of Return

OTP's rate request reflected an 8.89% rate of return on rate base derived from its actual "divisional" capital structure during the 2007 test year and incorporating an 11.25 % return on common equity capital based on the filed testimony of its cost of capital witness. Staff's assessment of the settlement determination applies a rate of return which reflects OTP's ******Begin Confidential*** ***End Confidential****** These component costs result in a rate of return on rate base of 8.34 %.

Rate Design Issues

The revenue increase by rate schedule is shown on Exhibit_(JPT-4), Schedule 1, with the current rate design and settlement rate design structural changes shown on Exhibit_(JPT-4), Schedules 2-1 to 2-10. Staff concurred with the changes made by OTP for all rate schedules except for Residential, Residential Demand Control, Farm Service, and General Service Less Than 20 kW. The settlement position reached between Staff and OTP for each of these schedules will be discussed below.

<u>Residential Service Rate</u>

OTP's initial filing proposed eliminating the declining block structure in favor of a flat seasonally-differentiated volumetric charge. The proposal also included a new flat monthly Facilities Charge of $5 for all customers, and discontinued the existing customer charge differential for urban (Zone 1) and rural (Zone 9) customers. See Exhibit_(JPT-4), Schedule 3, Page 3 for the comparison between present and proposed settlement rates.

Staff concurred with discontinuing the urban/rural customer charge differential, but opposed having a separate Facilities Charge. Since OTP proposed that all residential customers be charged the same flat Facilities Charge, Staff proposed including the

Facilities Charge within the Customer Charge. Combining these two charges will avoid customer confusion that having an additional line item on the bill may cause. OTP proposed an $8 Customer/Facilities Charge;the settlement stipulation reflects a $7 Customer Charge (with no separate Facilities Charge). This results in a $1.20 increase for Zone 1 customers and a $.45 increase for Zone 9 customers over present rates.

While Staff is not conceptually opposed to flattening OTP's present declining block rate structure and adopting a seasonally-differentiated energy rate, Staff believes that rate design changes should be more gradual to avoid customer confusion and unusual bill impacts. The overall increase for the residential class, which is composed of residential service and residential service-demand control, is 11.48% with the residential service rate schedule receiving a 10.93% increase. Under OTP's original proposal, the largest 5% of customers in the summer would have received an increase between 21.56% and 33.44%. In the winter, the largest 5% of residential customers would have received an increase between 14.92% and 25.41% under OTP's original proposal. Staff believed the increases for high usage customers were too dramatic and ignored rate shock and fairness concerns. Another concern with the proposed rate was the magnitude of the seasonal differential. The differential between the summer and winter rates would have ranged from approximately 8 – 10% for customers using between 500 and 2,500 kWh.

The settlement rate schedule reduces the current number of rate blocks in the declining block structure from three to two and incorporates a smaller seasonal differential. See Exhibit_(JPT-4), Schedule 3, Page 1 for the comparison between present and settlement rates. In OTP's originally proposed rates, 80% of the residential customers in the summer would have received less than a 15.22% increase. Under the settlement rates, 95% of the customers in the summer will receive a 13.74% increase or less. The high usage customers will still receive a larger than average percentage increase, with the largest 5% of customers receiving a 13.74% to 20.72% increase in the summer; however, the increase is more than 35% less than OTP's original proposal. Also, the largest 5% of customers will receive a 12.97% to 19.85% increase in the winter. This is approximately 13 to 20% less than OTP's original proposal. The summer/winter differential is reduced in the settlement rates to approximately 3% for customers using between 500 and 2,500 kWh, which cuts the originally proposed differential by more than half. The settlement rate design marks the initial step towards a seasonally-differentiated flat rate in a gradual fashion to mitigate rate shock and customer concerns about fairness.

<u>Residential Demand Control Rate</u>

OTP's original proposal added a $7 Facilities Charge, incorporated a flat seasonally-differentiated energy charge, and changed the demand charge to a slightly higher charge in the summer than winter to reflect OTP's summer marginal capacity costs. The settlement rates reflect the seasonally differentiated energy charge, the moderate increase in the demand charges, and a $1.45 facilities charge within the Customer Charge. The bill impacts were consistent among usage levels within the class (Attachment 1, Page 1).

Farm Service

OTP's originally proposed Farm Service rate eliminated the declining block structure in favor of a flat, seasonally-differentiated energy charge. OTP's proposed rates also would have increased the existing Customer Charge by $.30 to $8.00, eliminated the charge for transformer facilities, and instituted a new surcharge for customers using three-phase service that varied depending on whether the customer is served from overhead or underground facilities and whether the customer's transformer is below 25 kVA or is 25 kVA and greater. See Exhibit_(JPT-4), Schedule 3, Page 4 for the comparison between present and proposed settlement rates.

Staff's concerns with OTP's Farm Service rate proposals were similar to its concerns with OTP's Residential Service proposal. That is, OTP's proposed rate design had large bill impacts for high usage customers. Moreover, the seasonal differential dramatically shifted a larger portion of OTP's annual revenue requirement to the summer months. These changes should be made more gradually to avoid rate shock and fairness concerns.

The settlement rate keeps the existing declining block structure, but reduces the energy rates between the blocks in an effort to move towards a flatter rate structure. The settlement rates also moderate the seasonal differential to reduce the increase in the summer months. See Exhibit_(JPT-4), Schedule 3, Page 2 for the comparison between present and settlement rates. The settlement rate includes the Customer Charge and eliminates the Transformer Facilities Charge that OTP had proposed. The three-phase surcharge also was reduced in proportion to the agreed to revenue requirement.

General Service Less Than 20 kW

OTP's original proposal eliminated the declining block structure and demand charge in favor of a seasonally-differentiated volumetric charge. OTP also proposed discontinuing the existing zone differential in the Customer Charge and increasing the Customer Charge to $10. OTP's proposed rates would have resulted in a $4 increase for Zone 1 customers and a $2.80 increase for Zone 2 customers. A new flat Facilities Charge was proposed for all customers; $3 for secondary services and $2 for primary services.

Staff opposed the flat energy rate for small general service customers based on rate stability and gradualism as the largest 5% of customers would have received an increase of approximately two times the overall increase for this schedule. However, Staff supports eliminating the load factor block and demand charge to allow for a simpler, more transparent structure for small customers. Staff also recommended combining the Facilities Charge with the Customer Charge and eliminating the existing zone differential. The settlement stipulation reflects a $12 Customer Charge, resulting in an increase of $6 for Zone 1 customers and $4.80 for Zone 2 customers.

The settlement rates reduce the current number of energy blocks from four to two and incorporate the seasonal differential. See Attachment 1, Page 2 for the comparison between present and settlement rates.

Changes to Other Rate Schedules

A. Eliminate Declining Blocks

Declining block and load factor block structures were eliminated in the following rate schedules in favor of flat, seasonally-differentiated energy charges:

General Service – 20 kW and Greater (Attachment 2, Page 2)
Large General Service (Attachment 2, Page 5)
Municipal Pumping (Attachment 2, Page 7)
Controlled Service – Interruptible Load Rider CT Metered < 80 kW (Attachment 2, Page 9)
Controlled Service – Interruptible Load Rider < 80 kW (Attachment 2, Page 10)

OTP's proposed flat, seasonally-differentiated energy charges are based on the marginal costs of purchasing power on the MISO market. Since OTP does not have the available capacity as it did in 1987 when the declining block structures were last approved, flat rates are reasonable.

B. Seasonally Differentiated Energy Charges

The Irrigation Service (Attachment 2, Page 6) flat energy rate was modified to include a seasonal differential. The seasonal rate differential is supported by both the energy and generation capacity costs provided in OTP's 2009 Marginal Cost Study.

C. Penalty Rates

The following rate schedules included a new or significantly increased penalty rate for unauthorized use during control periods:

Controlled Service – Interruptible Load Rider CT Metered
Water Heating – Controlled Service
Controlled Service – Interruptible Load Rider < 80 kW
Controlled Service – Deferred Load Rider
Fixed Time of Delivery Rider

Penalty rates are based on the number of hours of load control and the associated marginal costs (energy and demand) during those control hours. OTP calculates an average cost of market power during all hours of load control. A customer operating during the control period will pay the regular rate plus the penalty rate during the control period even if OTP does not have to purchase the power through MISO. This penalty provision should send an appropriate price signal to not use energy during control periods.

Applying the Fuel Clause Adjustment to All Rate Schedules

OTP is proposing to add the fuel clause adjustment (FCA) to three rate schedules: Schedule 14.04 Controlled Service – Interruptible Load Rider CT Metered, Schedule 14.05 Controlled Service – Interruptible Load Rider (Less than 80 kW) and Schedule 14.12 Controlled Service – Bulk Interruptible.

The customers on rates 14.04 and 14.05 have been receiving service and not paying for increases in fuel and purchased power costs that have occurred since OTP's last rate case in 1987. As a result of including fuel costs in base rates, the average increase for the 52 Controlled Service – Interruptible Load Rider CT Metered customers is 39.47% and 31.69% for the 759 Controlled Service – Interruptible Load Rider (Less than 80 kW) customers. Although these increases are significant, adequate support was provided to justify the increase. All of the increase is attributable to fuel costs. Base rates without fuel costs for these two rate schedules actually decreased from existing levels under the settlement rates.

The Controlled Service – Bulk Interruptible rate schedule has one customer and is subject to Commission approval for its contract with deviation. Staff agrees with OTP that the FCA should be included in the above rates going forward.

OTP stated that it will contact these customers to explain the increase.

Cancelled Rate Schedules

OTP proposed eliminating the following two general service rate schedules which currently have customers: General Service – Commercial Demand Control and General Service – Electric Climate Control. Although OTP has provided adequate support to justify eliminating these rates, these customers will experience significant rate increases. OTP's energy management representatives will work with these customers to review other rate options.

General Service – Commercial Demand Control has been an experimental rate for over 20 years and currently has 4 customers. These customers will quality for either the Small General Service or General Service rate. The two customers who qualify for Small General Service will receive on average a 35% increase in rates or approximately $60 increase per month (Attachment 2, Page 1) The other two customers who qualify for General Service will receive on average a 47% increase in rates, or approximately $1,250 and $2,750 increase per month respectively (Attachment 2, Page 4).

OTP also proposed eliminating the General Service – Electric Climate Control rate which has been closed to new customers since 1981 and currently has approximately 70 customers. These customers will qualify for either the Small General Service or General Service rate. The eighteen customers who qualify for Small General Service will receive on average a 13.92% increase in rates (Attachment 1, Page 3). The other fifty two customers who qualify for General Service will receive on average an 18.10% increase in rates (Attachment 2, Page 3). The settlement rates reflect the movement of these customers to other rate schedules.

OTP also proposed canceling the Large General Service Off-Peak Rider. Since no customers have signed up for the rider, Staff has no concerns with this action.

New Rate Schedules

Commercial Time of Use – Under this schedule, General Service customers that use less than 80 kW per month pay a higher rate in those hours defined by OTP to be periods of peak conditions. The proposed rate has a flat, seasonally-differentiated rate that varies between on-peak, shoulder, and off-peak time periods, as well as a demand charge in the shoulder and off-peak period. This new structure gives a strong price signal to customers during critical hours.

Large General Service Time-of-Day – This rate has seasonally differentiated charges with on-peak, shoulder, and off-peak periods for weekdays and weekends. Time-of-day rates provide clear and accurate signals by showing costs in different times during the day as opposed to an all-hours flat rate.

Real Time Pricing Rider – This rider is available to customers who have maintained a measured demand of at least 200 kW during the historical period used for customer baseline load. Real time pricing promotes efficient energy use and rewards those who make an effort to have better consumption patterns.

Large General Service Rider – Customers would take service on this rider in order to allow the Company to interrupt load above the customer's baseline load. Customers would see savings since the rate structure would discount demand charges.

Controlled Service – Interruptible Load Rider CT-Metered Option B – This option will allow motor load up to 5 percent of the metered maximum demand. The rate is in contrast to the current option (Option A) which only allows motor load, used to distribute the heat, to be connected separately to the appropriate General Service rate schedule.

Bill Impacts

The comparisons between present and settlement rates are shown on Exhibit_(JPT-4), Schedule 3, pages 1 - 4, and Attachment 1, pages 1 - 3 and Attachment 2, pages 1 – 11.