

Volume 2A

Direct Testimony and Supporting Schedules:

Thomas R. Brause

Policy

Before the South Dakota Public Utilities Commission
State of South Dakota

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

Docket No. EL10-_____

Exhibit____

POLICY

DIRECT TESTIMONY AND SCHEDULES OF

THOMAS R. BRAUSE

August 20, 2010

TABLE OF CONTENTS

I.	INTRODUCTION AND QUALIFICATIONS	1
II.	DESCRIPTION OF OTP	2
III.	PRIMARY REASONS FOR NEEDING A RATE INCREASE AND MITIGATION EFFORTS	5
	A. RATE BASE ADDITIONS	6
	B. BIG STONE II DEVELOPMENT COSTS	8
	C. OTHER OPERATING COST INCREASES	13
IV.	INTRODUCTION OF WITNESSES	18
V.	CONCLUSION.....	19

ATTACHED SCHEDULES

Schedule 1 – Qualifications and experience of Tom Brause

Schedule 2 – Service territory map

1 **I. INTRODUCTION AND QUALIFICATIONS**

2
3 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

4 A. My name is Thomas R. Brause, and my business address is 215 South Cascade Street,
5 Fergus Falls, Minnesota, 56537.

6
7 Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?

8 A. I am employed by Otter Tail Power Company (“Otter Tail” or “OTP”) as its Vice
9 President Administration. My current duties include providing direction for OTP’s
10 Market Planning, Policy and Compliance, Regulatory Economics, Tariff Application
11 and Compliance, and Information Technology areas.

12
13 Q. PLEASE SUMMARIZE YOUR QUALIFICATIONS AND EXPERIENCE.

14 A. I’ve worked for OTP for over 32 years. During my first 21 years, I worked in various
15 Information Technology roles. In 1999, I became Director Human Resources,
16 Information Technology and Safety. Since 2004, I have been Vice President
17 Administration. My qualifications and experience are more fully described on Exhibit
18 __ (TRB-1), Schedule 1.

19
20 Q. FOR WHOM ARE YOU TESTIFYING?

21 A. I am testifying on behalf of OTP in support of the application to the South Dakota
22 Public Utilities Commission (the “Commission”) for authority to increase rates.

23
24 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

25 A. I provide a description of OTP’s mission and organizational structure. I also describe
26 the primary reasons OTP needs to increase rates and its efforts to mitigate cost
27 increases. Additionally, I discuss the reasons for cancelling the Big Stone II Project. I
28 also introduce the other OTP witnesses.

29
30

1 Q. PLEASE SUMMARIZE OTP'S REVENUE REQUEST.

2 A. We are requesting an overall revenue increase to base rates of \$2,755,954 or 9.96
3 percent over OTP's current base rates. OTP's overall revenue deficiency has been
4 calculated using actual revenues (weather adjusted) and actual expenses from a 2009
5 historical test year, with known and measurable changes. It reflects a return on equity
6 ("ROE") of 11.25 percent and an equity ratio of 53.2 percent, and an overall rate of
7 return on investment of 9.13 percent. With this increase, a typical residential customer
8 using 935 kWh of electricity a month would see an overall increase of \$9.68 a month;
9 a typical commercial customer using 2,415 kWh of electricity a month would see an
10 overall increase of \$15.13 a month.

11

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

13 A. Section II provides a description of OTP, including the reorganization into a holding
14 company legal structure in 2009. Section III describes the primary reasons for
15 needing a rate increase and the efforts OTP took to mitigate the need for the increase.
16 In Section IV, I introduce the other OTP witnesses.

17

18 Q. ARE YOU SPONSORING ANY REQUIRED STATEMENTS?

19 A. Yes I am sponsoring Statement Q, which is a description of OTP's utility operations
20 and is required by Commission Rules (Sections 20:10:13:101 *et seq.*). This Statement
21 is located in Volume 1.

22

23 Q. WERE THE ATTACHED SCHEDULES PREPARED BY YOU OR UNDER YOUR
24 SUPERVISION?

25 A. Yes they were.

26

27 **II. DESCRIPTION OF OTP**

28

29 Q. PLEASE BRIEFLY DESCRIBE OTP.

1 A. OTP is headquartered in Fergus Falls, Minnesota, where it began generating electricity
2 in 1909. OTP provides electricity to 423 communities and to rural areas in
3 northeastern South Dakota, western Minnesota, and the eastern two-thirds of North
4 Dakota. Our 50,000 square-mile service territory, shown on Exhibit __ (TRB-1),
5 Schedule 2, is roughly the size of Wisconsin. The average population of the
6 communities we serve is approximately 400, and over one-half of the communities we
7 serve have populations of fewer than 200. Only three of our communities have
8 populations exceeding 10,000 (Fergus Falls, Minnesota (pop. 13,636), Bemidji,
9 Minnesota (pop. 13,541) and Jamestown, North Dakota (pop. 14,630)). We operate
10 11 customer service centers located throughout our service territory.

11 We operate three coal-fired base load generating plants and three peaking plants,
12 one of each in each state where we provide service. We own five hydroelectric
13 stations on the Otter Tail River near Fergus Falls and one on the Mississippi River
14 near Bemidji, Minnesota.

15 We own three major wind farms: (1) the 40.5 MW Langdon Wind farm
16 (“Langdon”); (2) the 48 MW Ashtabula Wind farm (“Ashtabula”); and (3) the 49.5
17 MW Luverne Wind farm (“Luverne”). We also own several smaller wind facilities
18 and procure wind energy from other facilities under purchase power agreements. In
19 total, OTP has just over 180 MW of wind generation serving its customers and, in
20 2009, the equivalent of 12 percent of the energy serving OTP’s retail customers was
21 generated from wind resources.

22 OTP owns a total of 5,148.6 miles of transmission line. To help provide more
23 reliable service at lower cost in the long term, our electric system is interconnected
24 directly with several neighboring suppliers. OTP is a member of the Midwest
25 Reliability Organization (“MRO”), the regional reliability council of the National
26 Electric Reliability Council (“NERC”), which develops and establishes planning and
27 operating reliability standards with which utilities must comply. OTP is also a
28 member of the Midwest Independent Transmission System Operator (“MISO”).
29 MISO serves as the operator of the regional transmission system of its members,
30 implements the MRO planning and operating reliability standards, and includes a

1 regional resource adequacy mechanism for the sharing of generation reserves, all with
2 the goal of lowering costs by maintaining a viable and reliable electric grid.

3
4 Q. HOW MANY CUSTOMERS DOES OTP SERVE?

5 A. As of year-end 2009, OTP was providing electricity and energy services to 129,284
6 customers: 11,742 in South Dakota, 60,598 in Minnesota, and 56,944 in North Dakota.

7
8 Q. HOW MANY PEOPLE DOES OTP EMPLOY?

9 A. As of December 31, 2009, OTP has 723 employees, including full-time, part-time, and
10 temporary, adjusted for our share of employees at jointly owned plants.

11
12 Q. WHAT IS OTP'S CORPORATE STRUCTURE?

13 A. On July 1, 2009, OTP became a separate legal subsidiary of Otter Tail Corporation.
14 The Commission approved this change on November 13, 2008 in Docket EL08-025.
15 Otter Tail Corporation also owns several non-utility businesses whose operations are
16 in separate subsidiaries.

17
18 Q. WHAT IS OTP'S MISSION?

19 A. OTP's mission is:

20
21 To produce and deliver electricity as reliably, economically, and
22 environmentally responsibly as possible to the balanced benefit
23 of customers, shareholders, and employees and to improve the
24 quality of life in the areas in which we do business.
25

26 Q. CAN YOU CITE SOME RECENT EXAMPLES OF OTP'S SUCCESSES IN
27 FULFILLING ITS MISSION?

28 A. Yes. For customer satisfaction, we have semi-annual "relationship" surveys which are
29 telephone surveys of residential customers in our service territory. OTP has
30 historically done extremely well in comparison to the top 29 Investor Owned Utilities
31 ("IOUs"), which serve over 75 percent of all residential customers in the United

1 States. Our 2009 results continue this trend. Our relationship survey score was the
2 highest score of any of the participating IOUs.

3 For service reliability, we use the System Average Interruption Duration Index
4 (“SAIDI”). This measures the average minutes of interruption for a customer over the
5 course of a year, i.e. the “minutes per customer per year.” OTP’s 2009 SAIDI was
6 62.1 minutes – nearly 12 minutes lower than our target of 74 minutes.

7 For generating plant availability, we track our generating plants’ Equivalent
8 Availability, which represents the portion of time that a generating unit is available to
9 operate, including consideration of the effect of partial equipment deratings when a
10 unit is available, but at less than full capability. This measure is more refined than the
11 traditional availability measure that represents the portion of time that a unit is capable
12 of producing energy, regardless of its capacity level. Our steam generating plants
13 consistently outperform the industry average on both measures.

14 For safety, we measure our Occupational Safety and Health Administration
15 (“OSHA”) Recordable Incident Rate based on the OSHA 300 Log. Our benchmarks
16 are set using industry data provided by the Edison Electric Institute as well as OTP’s
17 own historical safety performance. We are proud of consistently having incident-rate
18 results that are below the industry average.

19
20 **III. PRIMARY REASONS FOR NEEDING A RATE INCREASE AND**
21 **MITIGATION EFFORTS**

22
23 Q. WHAT ARE THE PRIMARY REASONS FOR NEEDING A RATE INCREASE?

24 A. OTP filed its last general rate case three years ago, in 2007. Three primary reasons are
25 contributing to OTP’s need for this current rate increase: (1) additional rate base
26 investments (including the addition of the Luverne wind farm) and associated
27 depreciation expense; (2) the need to recover Big Stone II development costs; and (3)
28 significant increases in operating costs, including increased labor and benefit costs
29 largely driven by the 2008 capital market collapse. Mr. Beithon provides greater
30 detail on how each of these factors contributes to OTP’s overall revenue deficiency.

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A. RATE BASE ADDITIONS

Q. PLEASE DESCRIBE OTP’S RECENT INVESTMENTS IN WIND GENERATION.

A. In the last few years, OTP’s most significant infrastructure investments have been in wind generation. The Langdon Wind farm was completed in 2007, of which OTP owns 40.5 MW. In 2008, OTP’s 48 MW share of the Ashtabula Wind farm was placed in service. Investments in the Langdon and Ashtabula wind farms were included in OTP’s last rate case. Last year, 2009, the Luverne Wind farm, of which OTP owns 49.5 MW, was placed in service. The revenue requirements associated with Luverne are included in this case.

Q. PLEASE DESCRIBE THE IMPACT OF THESE WIND FARMS ON OTP’S RATE BASE.

A. As I mentioned, the Langdon and Ashtabula wind farms were included in OTP’s last South Dakota rate case. Mr. Kyle Sem in his direct testimony will cover the impact of the addition of the Luverne Wind farm.

Q. WHAT OTHER RECENT RATE BASE ADDITIONS CONTRIBUTED TO OTP’S REVENUE DEFICIENCY?

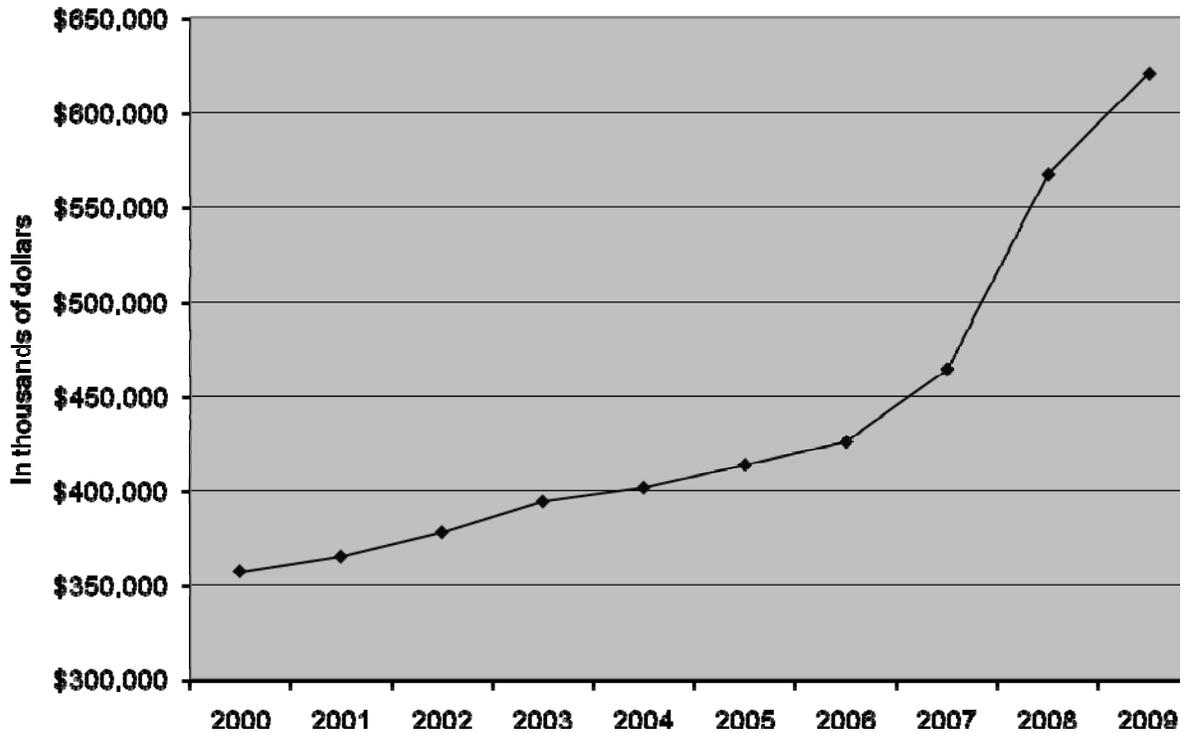
A. OTP has continued to make rate base investments since its last rate case. System-wide, OTP has invested \$75.5 million in infrastructure additions; \$25.6 relating to the wind projects and \$49.9 for other projects. Mr. Sem explains these additions in his testimony.

Q. WHAT IS THE MAGNITUDE OF OTP’S RATE BASE ADDITIONS OVER THE LAST SEVERAL YEARS?

A. Table 1 below shows how OTP’s rate base (including the wind projects) has changed over the last 10 years:

Table 1

OTP Rate Base 2000 - 2009



2

3

4 Q. IS OTP EXPECTING ADDITIONAL INFRASTRUCTURE INVESTMENTS IN
5 THE FUTURE?

6 A. Yes. Like many other utilities, we are continuing to operate in a period of
7 unprecedented investment in infrastructure needed to serve our customers reliably.
8 Based on our December 31, 2009 Form 10-K, OTP's anticipated investments for the
9 five-year period of 2010-2014 are \$641 million, an average of \$128 million per year.
10 By contrast, OTP's average investment in 2002-2006 was approximately \$35 million
11 per year.

12 Major investments in the five-year timeframe of 2010-2014 include \$110 million
13 in CAPX 2020 transmission projects and \$245 million for additional generation.
14 OTP's December 31, 2009 Form 10-K also states the current status of EPA's Regional
15 Haze Best Available Retrofit Technology ("BART") as it applies to our Big Stone

1 plant. On January 15, 2010, the South Dakota Department of Environment and
2 Natural Resources proposed recommendation for BART technologies is estimated to
3 cost approximately \$120 million for OTP's share of the Big Stone plant.
4

5 Q. IS THIS RATE CASE IMPORTANT FOR OTP TO MEET ITS CAPITAL NEEDS
6 FOR THESE ANTICIPATED INVESTMENTS?

7 A. Yes. In order to complete these significant infrastructure additions, OTP will need
8 access to unprecedented levels of debt and equity financing. It is essential that OTP
9 be financially strong so that it can attract this capital on the most favorable terms
10 possible. Mr. Kevin G. Moug also discusses OTP's capital needs in his direct
11 testimony and the importance of this case to meeting those needs.
12

13 Q. DID OTP'S WITHDRAWAL FROM BIG STONE II SIGNIFICANTLY DECREASE
14 THE TOTAL AMOUNT OF OTP'S PLANNED CAPITAL EXPENDITURES?

15 A. No. While the anticipated \$395 million of capital expenditures for Big Stone II is no
16 longer part of OTP's plan, other planned expenditures of approximately \$245 million
17 for additional generation have been added because OTP's need for additional
18 generation remains.¹ OTP provided a copy of its resource plan to the Commission in
19 July 2010.
20

21 **B. BIG STONE II DEVELOPMENT COSTS**
22

23 Q. HAVE BIG STONE II DEVELOPMENT COSTS CONTRIBUTED TO OTP'S
24 REVENUE DEFICIENCY?

25 A. Yes. OTP withdrew from the Big Stone II Project in September 2009. A number of
26 factors led to the decision that the Big Stone II Project's advantages had diminished
27 while the risks associated with the project had grown. OTP incurred approximately
28 \$12.7 million pursuing development of that project. South Dakota's jurisdictional
29 share of those costs, based on a five-year amortization, is approximately \$345,000.

¹ OTP filed its Integrated Resource Plan on July 1, 2010, MNPUC Docket No. E017/RP-10-623.

1 OTP is proposing a five-year amortization of these expenditures to match the five-year
2 period over which the expenditures were incurred. Mr. Beithon explains this proposal
3 in more detail in his direct testimony.
4

5 Q. WAS IT REASONABLE FOR THE COMPANY TO PARTICIPATE IN THE BIG
6 STONE II PROJECT?

7 A. Yes. OTP worked on developing the project for several years. In June of 2005, OTP
8 entered into project agreements with six other utilities for purposes of pursuing the
9 project. At that time, the participants applied for the necessary permits, began
10 preliminary engineering work, and began other development work for the project.
11 The South Dakota Public Utilities Commission (“SDPUC”) approved the project Site
12 Permit in July 2006, the North Dakota Public Service Commission (“NDPSC”) issued
13 an Advance Determination of Prudence for OTP’s participation in the project in July
14 2008, and the Minnesota Public Utilities Commission (“MNPUC”) issued a Certificate
15 of Need (“CON”) for the Big Stone II transmission lines in an Order Dated March 17,
16 2009. OTP’s 2005 Integrated Resource Plan (“IRP”), which specifically included the
17 Big Stone II Project, was approved by the MNPUC in March 2009. The project also
18 obtained a Water Allocation Permit, Air Permit, and other necessary permits, and
19 completed a Federal Environmental Impact Statement for the project.
20

21 Q. WAS THERE A SEPARATE SOUTH DAKOTA PROCEEDING IN WHICH THE
22 DEFERRAL OF OTP’S BIG STONE II COSTS WAS REQUESTED?

23 A. Yes. In another proceeding, Docket No. EL09-024 (“The Deferred Accounting
24 Docket”), OTP on February 11, 2010, received permission to defer its Big Stone II
25 development costs for potential recovery in this rate case .
26

27 Q. WOULD DISALLOWANCE OF OTP’S DEVELOPMENT COSTS HAVE A
28 CHILLING EFFECT ON FUTURE PROPOSED PROJECTS?

29 A. Absolutely. The chilling effect would be increased because both utilities and investors
30 are acutely aware of the risk of after-the-fact disallowances of development costs in an

1 environment in which most utility projects are highly controversial and policies are
2 unsettled, increasing the risks of project cancellation.

3 Given the current unsettled state of federal and regional energy policy, there are
4 almost no large development projects currently being discussed in the region that are
5 without significant controversies and risks. Generation projects, whether they be
6 fossil fuel, nuclear, or another fuel type, are all burdened with the potential for
7 controversies and significant risk. And this is true of both new projects and projects
8 that would extend the lives and licenses of existing facilities. Alternative and
9 emerging generation technology projects, and conservation and energy efficiency
10 projects, especially large ones, have as much potential for risk and controversy as
11 more conventional projects. Even renewable generation and transmission projects in
12 the region are subject to serious controversies and risks despite having specific
13 legislated rate-recovery mechanisms and other assurances and incentives in some
14 states. About the only factor that is not controversial is that utilities' need to pursue
15 generation and other infrastructure projects in order to continue providing reliable
16 service to their customers.

17 Given these complexities, the industry is already experiencing the chilling effect of
18 uncertainty, and there is a great deal of industry discussion about how distant the
19 horizon may be for a more consistent and clear federal energy policy. Unfortunately,
20 a clear federal direction does not appear to be likely in the near term.

21 The question remains whether the chilling effect will be moderated or exacerbated
22 by state legislative initiatives and regulatory responses to the uncertainty. Obviously,
23 the chilling effect will get even stronger if utilities and those that might choose to
24 invest in utilities are asked to bear the risks of the uncertainty currently restraining
25 infrastructure investments.

26
27 Q. WHAT CIRCUMSTANCES SUPPORTING OTP'S PARTICIPATION IN THE BIG
28 STONE II PROJECT CHANGED TO CAUSE OTP TO WITHDRAW FROM THE
29 PROJECT?

1 A. OTP’s decision to participate in Big Stone II in 2005 and continuing through 2008 was
2 based on circumstances significantly different from those OTP faced in September
3 2009, when the decision to withdraw occurred. A confluence of factors made it
4 reasonable for OTP to withdraw from the project. Those factors included:

- 5 • Significant unanticipated changes to long-term forecasts for on-peak and off-peak
6 energy prices and changes in projected customer demand. These changes are not
7 temporary consequences of the current economy. The changes are long-term due
8 to fundamental shifts in the energy marketplace and resource additions in our
9 region. This fundamental change is reflected in the forecasts of energy prices in
10 the 2012 to 2024 time frame that are about 33 percent lower than reflected in
11 previous forecasts. On July 1, 2010, OTP filed an updated IRP in Minnesota, and
12 the changes in forecasted energy prices and demand impacted the resource
13 additions recommended in that IRP.
- 14 • Unprecedented financial market conditions brought on by the broad economic
15 downturn, which made raising the necessary capital unreasonably risky and
16 potentially more costly. These market conditions have resulted in a lending
17 market in which it has become increasingly difficult to find debt financing at a
18 reasonable cost, especially for such a large project, with increasing uncertainties
19 and an equity market that has significantly driven up the cost of raising equity
20 capital.
- 21 • Great River Energy and SMMPA withdrew. Reasonable efforts to find
22 replacement participants were unsuccessful, creating the risk that OTP’s share of
23 the project costs would have increased substantially. OTP’s initial ownership
24 share was 19.33 percent, approximately \$400 million. Without new participants,
25 OTP’s ownership share increased to 26.54 percent and \$550 million.
- 26 • The growing uncertainty in the direction of federal climate-change legislation and
27 the Environmental Protection Agency’s intent to regulate CO₂. In 2007 the U.S.
28 Supreme Court ruled that green house gases are “air pollutants” within the
29 meaning of the Clean Air Act². In April 2007 the EPA issued a proposal finding

² Massachusetts v. EPA, 549 U.S. 497 (2007).

1 that greenhouse gases emitted by new motor vehicles endanger public health and
2 welfare. On June 26, 2009, the U.S. House of Representatives passed the
3 American Clear Energy and Security Act of 2009 (Waxman-Markey). On
4 November 5, 2009, Kerry-Boxer passed the U.S. Senate Environment and Public
5 Works Committee. On December 7, 2009, the EPA issued an endangered finding
6 that paves the way for potential regulation of greenhouse gases under the Clean
7 Air Act. (While this finding occurred after OTP's decision to withdraw, it was
8 fully expected due to the prior U.S. Supreme Court ruling.)

- 9 • Uncertainty surrounding adequate and timely cost recovery.
- 10 • Uncertainty due to protracted appellate processes. For example: (1) the Sierra
11 Club/Clean Water Action petitioned the EPA to Object to the issuance of the Title
12 V (Air) Permit, which was subject to judicial review; (2) the Western Area Power
13 Administration's ruling on the EIS was expected to be challenged; and (3) the
14 MNPUC's grant of a CON related to the Big Stone II transmission project was
15 expected to be appealed by the Environmental Organizations.

16
17 Q. WAS IT REASONABLE FOR THE COMPANY TO WITHDRAW FROM THE BIG
18 STONE II PROJECT?

19 A. Yes. The Company's decision to withdraw from the Big Stone II Project was
20 reasonable and in the best interest of our customers. The project agreements required
21 OTP to make a final commitment on September 11, 2009, that would have committed
22 OTP to continued participation through financing, construction, and operation of the
23 project. Circumstances existing at that point in time, however, made it unreasonable
24 for OTP to irrevocably commit to its continued participation in the project. Given the
25 legislative and regulatory uncertainties and current economic conditions, OTP was
26 unwilling to create a binding financial obligation of approximately \$400 million for its
27 share of Big Stone II (or possibly \$550 million, as explained above).

28
29 Q. DOES THE COMPANY HAVE UNRECOVERED INVESTMENTS IN BIG STONE
30 II?

1 A. Yes. The Company has expended \$12,692,127 participating in the Big Stone II
2 Project. The South Dakota jurisdictional share of these costs is approximately ten
3 percent of the total. The adjustments made to include recovery of these costs in the
4 revenue requirement of this case are described in the testimonies of Mr. Sem and Mr.
5 Beithon. The Big Stone II costs fall generally into the following cost categories:
6 engineering, project development, permitting, legal, other expenditures, and
7 Allowance for Funds Used During Construction. OTP has excluded from the amount
8 for cost recovery any costs incurred for land in which it continues to have a property
9 title interest, and it has excluded any internal and labor-related costs that have been
10 recovered in current rates. For example, OTP incurred costs for certain easements
11 relating to the project and OTP has a continuing real property right in those easements.
12 Therefore, the costs for those easements have been reflected in OTP's property
13 accounts and are not included in the above-referenced totals
14

15 **C. OTHER OPERATING COST INCREASES**
16

17 Q. WHAT EFFECT HAS INCREASES IN OPERATING COSTS HAD ON THE
18 NEED TO INCREASE RATES?

19 A. There has been a 8.8 percent increase in operating costs not including fuel, purchased
20 power, depreciation and general taxes, which is a 4.4 percent average annual increase.
21 The most significant increases in operational costs continue to be labor and employee
22 benefit costs. Total operating expenses, including fuel, purchased power, depreciation
23 and general taxes, have increased only 2 percent. This 1 percent annual average
24 increase includes the known and measureable adjustments for increased costs for
25 labor, and employee benefits (medical/dental) occurring in 2010. Mr. Beithon
26 addresses increases to non-labor operating costs in his direct testimony. Mr. Peter
27 Wasberg addresses in greater detail labor-related cost increases in his direct testimony.
28

29 Q. WHAT HAS OTP DONE TO MANAGE AND CONTAIN THESE RISING
30 OPERATING COSTS?

1 A. OTP has looked for costs savings in every area of its business. One example is in
2 materials procurement. Because the current economic conditions have generally
3 resulted in lower material costs, OTP took the opportunity to rebid many long-term
4 procurement agreements including cable, conductor, poles, and transformers. This
5 resulted in savings in 2009 of nearly \$1 million. With respect to labor costs, OTP
6 implemented a wage freeze in 2009 for all non-union employees. In 2009, we also
7 negotiated a one-year contract with our major bargaining unit that included a 2 percent
8 wage increase. The Local 1570 contract negotiated in 2008 contains a 4 percent
9 annual wage increase for 3 years and new hires after December 31, 2008, are not
10 eligible for the defined benefit pension plan or post-retirement medical benefits.

11
12 Q. WHAT ELSE HAS OTP DONE TO ADDRESS RISING EMPLOYEE BENEFIT
13 COSTS?

14 A. In addition to eliminating these benefits for the new hires under the Local 1570
15 contract, we have taken several additional steps to manage the increases in employee
16 benefit costs. Mr. Wasberg addresses those steps in his direct testimony, including
17 implementing a soft freeze on non-union pension participation, eliminating post-
18 retirement medical coverage for new non-union employees, and increasing the
19 employee-paid portion of active medical costs.

20
21 Q. HAS OTP TAKEN STEPS TO CONTROL OPERATING COSTS?

22 A. Yes. As was also explained in our 2008 rate case filing, we have developed efficient
23 transmission, distribution and generation maintenance protocols and prudent
24 purchasing practices to keep operating costs as low as possible. These practices and
25 the impact they have had can be seen in our material standardization practices. More
26 specifically, we have partnered with suppliers to use industry-wide specifications for
27 materials rather than materials with specifications unique to OTP. This has led to
28 reduced costs and has allowed us to shorten lead times for material procurement.

29 OTP has also continued to improve the efficiency of our plants to reduce fuel costs
30 and to improve the use of load management to mitigate purchased power costs.

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Q. WHAT ARE SOME OF THE THINGS OTP HAS DONE TO IMPROVE PLANT EFFICIENCY?

A. During the 2009 maintenance outage at Coyote Station, we completed three energy efficiency improvement projects that have significantly increased that plant's efficiency.

Q. PLEASE BRIEFLY DESCRIBE THESE THREE PROJECTS.

A. Rotor Replacement

The largest project involved replacing the existing High Pressure/Intermediate Pressure (HP/IP) turbine rotor with a redesigned HP/IP steam turbine and stationary components on the main turbine/generator. The purpose of the project was to improve the efficiency of the HP/IP turbine through the enhanced design of the steam flow path. The improved turbine design allows the electric generator to provide more electrical output per pound of steam by more efficiently transferring the energy in the steam to the electric generator. As a result, Coyote Plant will produce 17 more megawatts of power with the same steam flow that currently exists while also maintaining the same level of heat input. It should be noted that this replacement was made not because of any problem with the existing equipment. Rather, it was done to obtain the increased efficiency. Mr. Sem also discusses this project in his testimony.

The other two projects were smaller by comparison, and together they result in a 4 percent reduction in the amount of electricity needed to operate Coyote (station service).

Cooling tower fan VFD's

Coyote Station converted the ten 250 HP fan motors on its cooling tower to Variable Speed Drive. The measured results are a drop from 190 kW/motor/hour to 114kW/motor/hour for about 75 percent of the year. For the ten motors, this is a total of 18 MWh per day that we can now use to serve our customers instead of using that electricity internally for station service.

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New station air compressors

This project involved replacing the station air compressors. By using slightly more costly variable speed drive air compressors, we are saving about 2 MWh per day in station service.

Q. HAS OTP TAKEN ACTION TO MANAGE ITS LOAD?

A. Yes. We continue to increase our load management capabilities by promoting load management rates. Load management allows us to reduce our customers' use during times of peak demand, thereby reducing the need to purchase energy during peak times, when energy prices in the real-time energy market are often the most expensive and volatile. As of 2009, more than 30 percent of OTP's customers are participating in some form of load management.

Q. HOW DOES LOAD MANAGEMENT LOWER COSTS?

A. MISO's resource adequacy rules require OTP to have capacity accreditation on resources that equal our forecasted mean peak demand plus a reserve margin of 4.5 percent for the 2010 Planning Year. Combined with the capacity resource accreditations, the non-coincident load based reserve margin is 11.94 percent for the 2010 Planning Year. This combined reserve margin assures that we have adequate resources to meet expected demands, plus some cushion for contingencies such as larger-than-expected load at peak periods or large generation resource outages at peak times. The accreditation of demand resources, such as OTP's load management system, allows the mean forecast to be reduced, prior to calculating the reserve margin of 4.5 percent on the demand forecast. For every MW of accredited load control, OTP avoids purchasing 1.045 MW of capacity. As of February 23, 2010, MISO accredited OTP's load-management system as a demand resource equivalent to 25 MW during the summer and 105 MW during the winter. This includes our direct load management and also load-control capability with specific customers. Absent that accredited load management, OTP would have needed to purchase additional capacity

1 or invest in additional generation resources to meet that need. To put this into
2 perspective, a 105-MW peaking capacity resource addition would cost approximately
3 \$100 million. This provides a good example of how OTP's aggressive pursuit of load
4 management opportunities over the years has helped to keep rates low.

5
6 Q. HAS OTP BEEN ACTIVE IN ADVOCATING ITS CUSTOMERS' INTEREST IN
7 PROCEEDINGS THAT COULD INCREASE THE COST OF PROVIDING
8 SERVICE ?

9 A. Yes. OTP continues to advocate on behalf of our customers at the Federal Energy
10 Regulatory Commission ("FERC"), MISO, and in other forums where our customers'
11 interests are at stake. For example, OTP has been extremely active at FERC and
12 MISO in advocating for a fair allocation of transmission interconnection costs. As
13 OTP has noted in other proceedings, issues such as region-wide cost allocation
14 methodologies could result in significant cost increases for OTP customers and,
15 therefore, OTP continues to advocate for fair allocations. Similarly, OTP has
16 advocated for reductions or moderations of fuel costs, rail transportation rates, and
17 other charges that would increase the cost of electricity. OTP has also been active in
18 pursuing legislation in each of the states where we provide service that reduces property
19 and ad valorem tax obligations, reducing the cost of service to our customers.

20
21 Q. IN LIGHT OF THE CURRENT RECESSION, HAS OTP TEMPORARILY
22 REDUCED OR DELAYED SOME EXPENSES?

23 A. Yes. OTP made significant temporary cuts in the following areas: internal labor
24 (wage freeze and minimal new hires), and external labor (consultants and contractors)
25 and other operating costs. OTP did not give any non-union salary increases in 2009.
26 OTP restricted travel and training and other expenditures and was able to reduce total
27 system O&M expenses by more than 3 percent below 2008 levels. These actions have
28 required OTP to temporarily delay many planned projects that will be necessary to
29 maintain reasonable service quality into the future. While OTP was able to implement

1 these cuts on a temporary basis without imminent risk to current reliability and
2 customer satisfaction, these cost reductions will not be sustainable for the long term.

3
4 Q. IS IT IMPORTANT FOR OTP TO REMAIN FINANCIALLY STRONG IN THESE
5 CURRENT ECONOMIC CONDITIONS?

6 A. Absolutely. As I have explained, the recession has provided significant opportunities
7 to reduce costs, but it has also had significant negative effects. Most importantly, we
8 continue to have an aging transmission and generation system that must be maintained
9 and upgraded if we are to continue providing reliable service. That, in turn, requires
10 financial strength. We need adequate resources to retain the trained and talented
11 professional staff needed to aggressively pursue opportunities for our customers
12 through lower prices and greater operating efficiencies.

13
14 **IV. INTRODUCTION OF WITNESSES**

15
16 Q. PLEASE IDENTIFY THE WITNESSES OTP IS SPONSORING IN THIS
17 PROCEEDING.

18 A. The following individuals will be presenting testimony in this proceeding:

- 19 • Peter J. Beithon addresses the development of the test year operating statement
20 with known and measurable and regulatory adjustments, the required financial
21 schedules (developing and supporting the revenue requirement), the class cost of
22 service study, OTP's proposed class revenue allocation and the Corporate
23 Allocation Manual.
- 24 • Kyle Sem addresses the development of the test year rate base.
- 25 • Robert B. Hevert, of Concentric Energy Advisors, presents his recommendation
26 regarding the appropriate ROE.
- 27 • Kevin G. Moug addresses: capital structure, cost of debt and the overall cost of
28 capital, which incorporates the ROE recommended by Mr. Hevert; a brief
29 discussion of the 2009 reorganization and resulting holding company structure;

1 OTP's capital investment plans; and a discussion of the sources of funding for
2 OTP construction.

- 3 • Peter E. Wasberg addresses matters relating to employee compensation and costs.
- 4 • David G. Prazak sponsors proposed rate design changes and general tariff changes.

5
6 **V. CONCLUSION**

7
8 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

9 A. As reflected in our Mission Statement, we take very seriously our responsibility to
10 deliver electricity as reliably, economically and environmentally responsibly as
11 possible and to improve the quality of life in the areas we serve. We take pride in
12 fulfilling that mission. Continuing to fulfill that mission requires adequate financial
13 strength. We now require an overall revenue increase of 9.96 percent, or \$2,755,954,
14 based on the 2009 historical test year, with known and measurable changes, and
15 including an overall rate of return of 9.13 percent. OTP is facing a growing need to
16 invest in additional infrastructure in the next five years and will need to go to the
17 market to raise additional capital. Consequently, we need to have reasonable earnings
18 and a competitive ROE.

19 There continues to be rapid change in the electric industry, within OTP, and in the
20 economy. In recognition of these changes, we request approval of: (1) recovery of
21 costs related to Luverne wind farm; (2) recovery of development costs associated with
22 the Big Stone II Project; (3) adequate operating cost recovery; and (4) our proposed
23 tariff changes and rate design.

24
25 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

26 A. Yes.

Mr. Thomas R. Brause
Vice President Administration
215 South Cascade Street
Fergus Falls, Minnesota 56537
218-739-8525

CURRENT RESPONSIBILITIES (2004 – Present)

Provide direction of Otter Tail Power Company's Market Planning, Policy and Compliance, Regulatory Services and Information Technology areas.

PREVIOUS POSITIONS

Otter Tail Power Company	
2004 – Present	Vice President Administration
2002-2004	Director Human Resources, Information Technology and Safety
1999-2002	Director Human Resources and Information Technology
1995-1999	Director Information Services
1988-1995	Manager Information Systems
1986-1988	Supervisor Information Systems
1984-1986	Supervising Analyst, Load Management Computer Systems
1982-1984	Programmer/Analyst
1978-1982	Programmer

EDUCATION

Moorhead State University – BA, Computer Science, minor in Mathematics

