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**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF SOUTH DAKOTA**

**IN THE MATTER OF THE APPLICATION OF OTTER TAIL POWER COMPANY FOR AUTHORITY TO  
INCREASE ITS ELECTRIC RATES IN SOUTH DAKOTA**

**STAFF MEMORANDUM  
SUPPORTING SETTLEMENT STIPULATION**

**DOCKET EL25-022**

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Commission Staff (Staff) submits this Memorandum in support of the Settlement Stipulation (Settlement) of February 27, 2026, between Staff and Otter Tail Power Company (OTP or Company) in the above-captioned matter.

**BACKGROUND**

On June 4, 2025, the Company filed an application with the South Dakota Public Utilities Commission (Commission) requesting approval to increase rates for electric service to customers in its South Dakota retail service territory by approximately \$5.72 million annually on a net basis, or approximately 12.5%. A typical residential electric customer using 932 kWh per month would see a bill increase of \$14.39 per month, or 13.8% under OTP's proposed rates. OTP's proposes a base rate increase of approximately \$13.65 million annually and associated rider changes of approximately negative \$7.93 million. The proposed base rate increase combined with the rider changes results in the net proposed increase of \$5.72 million.

OTP's proposed increase was based on a historical test year ended December 31, 2024, adjusted for what OTP believed to be known and measurable changes, a 10.80% return allowance on common equity, and an 8.29% overall rate of return allowance on rate base.

OTP's last base rate increase application was filed on April 20, 2018.<sup>1</sup> OTP states<sup>2</sup> that the need for an increase in electric rates is primarily driven by investments made since the last rate case and increases in operating and maintenance costs, including labor, due to inflation since rates were last set.

The Commission officially noticed OTP's filing on June 5, 2025, and set an intervention deadline of July 17, 2025. On June 18, 2025, the Commission issued an Order Suspending Operation of Proposed Rates; Order Assessing Filing Fee; Order Authorizing Executive Director to Enter into Consulting Contracts.

On December 3, 2025, after extensive discovery, Staff provided OTP with its draft revenue requirement determination. Thereafter, Staff and OTP (jointly, the Parties) engaged in settlement discussions to

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<sup>1</sup> See Docket EL18-021.

<sup>2</sup> See Testimony of Matthew J. Olsen.

arrive at a mutually acceptable resolution of the issues. In-person discussions occurred from December 9, 2025, through December 11, 2025. Ultimately, the Parties reached a comprehensive agreement on OTP's overall revenue deficiency and other issues presented in this case including, but not limited to, class revenue responsibilities, rate design, and tariff concerns.

## **OVERVIEW OF SETTLEMENT**

Staff's revenue requirement determination is the result of comprehensive analyses of OTP's filing and information obtained during discovery. Staff accepted some Company adjustments, made corrections where necessary, modified other adjustments, and rejected those that did not qualify as known and reasonably measurable. Lastly, Staff introduced new adjustments not reflected in OTP's filed case.

Company and Staff positions were discussed thoroughly at the in-person settlement conferences. As a result, some positions were modified, and others were accepted where consensus was found. Ultimately, the Parties agreed on a comprehensive resolution of all issues. Staff believes the Settlement is based on sound regulatory principles and avoids additional costly and unnecessary litigation.

The Parties agree that OTP's revenue deficiency recovered through base rates is \$11,422,262. Associated changes to the Energy Adjustment (EAR) Rider, Transmission Cost Recovery (TCR) Rider, and Phase-in Rider (PIR) total \$(8,101,985), resulting in a net deficiency of \$3,320,277. The revenue requirement and supporting calculations described in this Memorandum and attachments depict Staff's positions regarding the Settlement determination of all components of OTP's South Dakota jurisdictional electric revenue requirement.

## **STAFF OVERVIEW OF SETTLEMENT**

Staff's settlement revenue requirement determination begins with total Company costs for the test year ended December 31, 2024, and allocates those amounts to the South Dakota retail jurisdiction. Staff then adjusted the test year results for known and measurable post-test year changes. Staff Exhibit\_\_\_(PJS-1), Schedule 3 illustrates Staff's determination of OTP's *pro forma* operating income under present rates. Staff Exhibit\_\_\_(PJS-2), Schedule 2 illustrates Staff's calculation of OTP's South Dakota retail rate base, and Staff Exhibit\_\_\_(PJS-1), Schedule 2 and Staff Exhibit\_\_\_(PJS-2), Schedule 1 summarize the positions. Staff Exhibit\_\_\_(PJS-1), Schedule 1 summarizes Staff's determination of OTP's base rate revenue deficiency and total revenue requirement.

The agreed-upon base revenue increase by rate schedule is shown on Staff Exhibit\_\_\_(JMR-1), Schedule 2. The total bill impact summary is shown on Staff Exhibit\_\_\_(JMR-1), Schedule 1. Staff Exhibit\_\_\_(JMR-1), Schedules 3-1 through 3-8 reflect the settlement base rates for each rate schedule. The comparison between present and settlement rates and resulting bill impacts for residential service is shown on Staff Exhibit\_\_\_(JMR-1), Schedule 4.

Below is a brief discussion of the issues that Staff identified in the case and Staff's view of the resulting settlement of each issue. Unless otherwise noted, all changes discussed below are changes from the Company's filed position.

## RATE BASE AND OPERATING INCOME ADJUSTMENTS

**Advertising** – Otter Tail proposed an adjustment to remove certain advertising expenses. The settlement removes costs for additional advertising that is not essential for the provision of safe, adequate, and reliable electric service. The adjustment reduces operating expenses and the revenue deficiency by approximately \$5,000.

**Hoot Lake Solar – EAR** – The Company made a traditional adjustment to O&M expenses to remove the impact of Hoot Lake Solar (HLS). All costs related to HLS are directly assigned to the Minnesota jurisdiction and in order to capture such, fuel expense is calculated as if HLS were not in the generation fleet for South Dakota. The Settlement accepts this adjustment.

**Hoot Lake Solar – ADIT** – The Minnesota Public Utilities Commission has authorized 100 percent allocation of all Hoot Lake Solar project costs to Minnesota retail customers. As a result, OTP is excluding these costs from South Dakota rates. The 2024 unadjusted test year already reflects direct assignment of Hoot Lake Solar to the Minnesota retail jurisdiction, resulting in no impact to South Dakota ratepayers, except for ADIT. Thus, OTP had to make a manual adjustment to make sure it is also directly assigned to Minnesota. The Settlement accepts this adjustment.

**North Dakota Investment Tax Credit** – The North Dakota Investment Tax Credit is a North Dakota state tax credit for OTP’s legacy North Dakota wind projects. As a result, it only impacts North Dakota tax returns and should only be reflected in North Dakota ADIT. The costs for the wind projects, however, are paid for by all of OTP’s jurisdictions, so the Company has traditionally allocated the benefits across jurisdictions to match the payment of costs. This adjustment removes the ADIT component that should only be included in North Dakota. The Settlement accepts this adjustment.

**Short-Term CWIP AFUDC** – Previous South Dakota Commission and South Dakota Supreme Court decisions have disallowed inclusion of short-term CWIP in rate base. Since short-term CWIP is not included in rate base, OTP has added the AFUDC attributable to short-term CWIP to rate base since January 1, 1976. Thus, OTP has historically made an adjustment for AFUDC to reflect the changes to plant and depreciation. While the Company has made these manual adjustments which have increased the revenue requirement for many years, it proposes to stop doing so going forward. In this proceeding, OTP has calculated these adjustments as it has in past rate cases, but it also made corresponding adjustments to back them out of the cost of service, resulting in zero net impact on the cost of service. OTP will not do this in future rate cases but wishes to do so here to be transparent. The Settlement accepts these adjustments.

**Charitable Administration** – The Company proposed to exclude costs associated with administering charitable contributions. The Settlement accepts this adjustment.

**Employee Recognition and Gifts** – The Company proposed an adjustment to remove costs associated with non-cash employee recognition and gifts. The Settlement accepts this adjustment.

**Incentive Compensation** – The Company proposed in its initial filing to recover costs from five incentive compensation plans: Key Performance Award; Key Performance Award – People Leader; Coyote Retention; President’s Plan; Management Incentive Plan. The Company proposed to exclude the financial component of costs associated with its President’s Plan and Management Incentive Plan consistent with EL18-021, which reduced O&M expense by approximately \$150,000. Staff agrees that

the financial component of these incentive compensation plans should be removed and, accordingly, accepts this portion of the adjustment proposed by the Company.

Since incentive compensation payouts may vary substantially from year to year, the Settlement normalizes the payouts so that the average level of payout from the previous five years (or, if the plan existed fewer than five years, from the plan's inception) was used to derive the incentive compensation payments allowed for recovery. The adjustment reduces operating expenses and the revenue deficiency by approximately \$54,000.

**Organizational Dues** – Otter Tail proposed to exclude costs associated with certain organizational dues. The Settlement revises this adjustment to remove costs associated with additional organizational dues that are not essential for the provision of safe, adequate, and reliable electric service for South Dakota ratepayers. This adjustment reduces operating expenses and the revenue requirement by approximately \$9,000.

**FERC Dockets EL14-12 and EL15-14** – The Company made a traditional adjustment to offset a refund obligation that had been accrued stemming from the FERC dockets. OTP reversed the accrual in the 2024 test year. The impact of this traditional adjustment offsets the one-time event for ratemaking purposes so that rates reflect ongoing sources of revenue. The Settlement accepts this adjustment.

**Renewable Energy Credit** – Otter Tail proposed an adjustment to reflect a decrease in revenues due to renewable energy credits that were attributable to the state of North Dakota. In response to a Staff Data Request, Otter Tail noted renewable energy credits were mistakenly attributed solely to North Dakota. This settlement adjusts the revenues to provide a credit to South Dakota for its share of renewable energy credits. This adjustment increases operating revenues and decreases the revenue deficiency by approximately \$73,000.

**Rider CWIP** – The Company made a traditional adjustment to remove long-term CWIP in order to get a clean revenue deficiency given South Dakota does not allow Construction Work in Progress as a component of rate base when computing the revenue deficiency. A large portion of revenues related to CWIP are added back in for the test year in the Retail Revenue Normalization adjustment. These revenues are added back into the test year as they are associated with projects that are moving from the TCR and PIR to base rates. The Settlement accepts this adjustment.

**FERC Transmission** – The Company proposed an adjustment to remove the non-retail share of net rate base items, expenses, and revenues of its regional FERC transmission projects from the test year. This adjustment is necessary because these items will continue to be included in the TCR. During discovery, Otter Tail identified an error that was made in the calculation of one of the projects. This revision decreases depreciation expense by approximately \$300, decreases property tax by approximately \$200, and decreases rate base by approximately \$10,900. In total, this decreases the revenue deficiency by approximately \$1,400.

**Hydroelectric License** – For accounting purposes, licenses to operate hydroelectric facilities are treated as intangible property. The licenses, however, are necessary to operate the associated production plant, so OTP has made an adjustment to reclassify the hydroelectric facility licenses to production plant. This adjustment has no impact to rate base on a total company basis, since it is a reclassification from intangible plant to production plant, but there is a minor change to jurisdictional rate base and

depreciation expense due to differences in the allocation of production and intangible plant to the South Dakota jurisdiction. The Settlement accepts this adjustment.

**Weather Normalization** – Staff independently evaluated the weather sensitivity of Otter Tail’s sales and revenues. While Staff’s approach differed from Otter Tail’s, the results were comparable overall, and Staff accepted Otter Tail’s weather-normalized sales for purposes of settlement. However, Otter Tail’s proposed adjustment did not include the associated impact on Energy Adjustment Rider (EAR) revenues. Incorporating this change increases operating revenues and decreases the revenue deficiency by approximately \$547,000.

**Plant Annualization** – The Company proposed an adjustment to annualize test year plant additions that went into service during the 2024 test year and to reflect plant investments expected to be placed in service in 2025. The Settlement revises the Company’s adjustment to reflect actual costs for the completed projects through December 31, 2025, and removes the costs associated with three projects that are not yet completed. The net effect of these changes reduces rate base by approximately \$434,000 and reduces depreciation expense by approximately \$43,000. The adjustment reduces the revenue deficiency by approximately \$82,000.

**2024 Depreciation Study** – The Company proposes an adjustment to reflect the expense and rate base effects of updated book depreciation rates derived from its 2023 Five-Year Depreciation Study and related annual technical updates. These depreciation parameters are used to calculate rates for the adjusted Test Year. For purposes of its depreciation study, the Company utilized the services of its depreciation consultant, who has performed each Otter Tail depreciation study for approximately the past forty years. As explained by Company witness Petersen, Otter Tail Power Company conducts depreciation studies on a system-wide basis for its fully integrated electric system and applies a consistent set of depreciation parameters across its service territory. The Settlement accepts OTP’s new depreciation rates adjustment.

**Retail Revenue Normalization** – The Company proposed an adjustment to remove billing corrections related to prior periods and to include billing adjustments related to 2024 that occurred in 2023. The adjustments also include a removal of unbilled revenue accrual, tariff penalty revenues, and revenue from temporary facility extension contract minimums. Staff accepted these adjustments. However, during settlement discussions, the Company proposed additional adjustments which are included as part of the retail revenue normalization adjustment. These include: (1) changes in EAR revenues due to the inadvertent exclusion of weather-normalized expense from the calculation in the original filing, changes in kWh usage from per books to the adjusted test year, and load changes between the Company’s initial filing and the settlement; (2) exclusion of the portion of costs recovered through the Real-Time Pricing (RTP) Rider rather than the EAR, as customers taking service under the RTP Rider are not subject to the EAR charge; and (3) a correction to the calculation of the prior period adjustments from the initial filing to reflect the appropriate summer/winter periods. These adjustments reduce the revenue deficiency by approximately \$14,000.

**Labor Census and Rates** – Otter Tail proposed an adjustment to reflect an increase in wages and salaries due to the 2025 wage increase and an addition to budgeted 2025 full-time equivalent (FTE) positions. Otter Tail used the 2024 actual costs and multiplied that by the 2025 increases. The settlement annualizes 2024 test year wages by applying the actual 2024 wage increases to the months in 2024 prior to the wage increase and provides an entire year effect of the 2025 wage increase. This calculation is consistent with the calculation used in prior OTP wage adjustments. The Settlement does not include

the additional FTEs estimated due to the costs of those FTEs not being known. Moreover, Staff believes the approach that is reflected in the Settlement is more representative of current wages and is an appropriate level of wages to include in the cost of service since no additional wage increases will be included in base rates over four years because of the agreed-upon rate moratorium. Finally, this adjustment calculates an increase in payroll tax which corresponds to the increase in wages. This adjustment increases operating expenses and increases the revenue deficiency by approximately \$35,000.

**Interest Synchronization** – The Settlement properly synchronizes the tax deduction for interest expense with the weighted cost of long-term debt and the test year rate base as adjusted for known and measurable changes. This adjustment decreases the revenue deficiency by approximately \$98,000.

**Medical/Dental, Pension, OPEB** – OTP proposed an adjustment reflecting modifications to medical, dental, pension, and other post-retirement benefits (“OPEB”) for the test year. Several of the Company’s calculations relied on projected forecasts. Staff believes ratemaking is generally best served by relying on verifiable, historical figures rather than forecasted amounts, particularly for cost categories that exhibit variability and are not reliably predicted through forward-looking estimates. For this reason, Staff revised the Company’s proposed adjustment to reflect actual data for Medical & Dental, FAS 112 (Post-Employment Medical), FAS 106 (Post-Retirement Medical), and FAS 87 (Pension) expenses. Specifically, Staff utilized the actual 2024 “Medical & Dental” expense value and applied a multi-year average (2020–2024) to the remaining items to better capture normalized historical experience.<sup>3</sup> This adjustment decreases the revenue deficiency by approximately \$45,000.

**Rate Case Expense** – The Company proposed to amortize projected rate case costs of \$642,000 over a three-year period and include the average unamortized amount of \$535,000 in rate base. This Settlement reflects a total case expense of \$319,093 with a four-year amortization of \$79,773 in actual costs incurred as well as the inclusion of the average unamortized amount of \$159,547 in rate base. The effect of this adjustment decreases the amortization expense by approximately \$134,000 and decreases rate base by approximately \$375,000. This adjustment decreases the revenue deficiency by approximately \$168,000.

**Plant Outage Normalization** – Otter Tail proposed an adjustment to normalize plant outage expenses. Major outages occur on a regular schedule, but since they do not occur every year, it is appropriate to normalize these expenses so that the test year includes representative costs. No major outages occurred during the 2024 test year. Otter Tail’s proposed adjustment includes in rates one-third of the cost of the actual 2021 Big Stone major outage and one-third of the cost of the projected 2025 Coyote major outage, based on historical 3-year outage cycles. While the test year did not include any major outage costs, it did include costs associated with minor plant outages, which vary from year-to-year. Therefore, the Settlement normalizes minor plant outage expenses in addition to the major plant outage expenses.

Coyote Station has major overhauls scheduled every 3 years. The Settlement adjustment reflects an average of major and minor outage costs for the years 2023 – 2025. The adjustment includes the actual 2025 major outage costs in lieu of the Company’s projected 2025 major outage costs.

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<sup>3</sup> Medical & Dental exhibited less year-to-year volatility and therefore the most recent actual value provided a representative basis for normalization.

Big Stone's last major overhaul was in 2021. Historically, major overhauls have occurred every three years, but the plant is transitioning to a longer outage cycle. The Settlement adjustment is based on a 3.5-year cycle to reflect this transition. The adjustment excludes one-time costs occurring in 2022 and 2023 associated with an exciter failure, as these costs should not be recurring in the future. The adjustment reduces operating expense and the revenue deficiency by approximately \$61,000.

**Vegetative Maintenance** – The Company proposed an adjustment to reflect estimated increases in costs for vegetation maintenance related tasks. Otter Tail's proposal was based on an estimated budget to achieve a 6-year vegetation maintenance cycle. This Settlement includes a 3-year average of actual costs related to vegetation maintenance, therefore rejecting the estimated budget. Staff feels this average acknowledges costs are increasing while ensuring estimates are not included. Staff does not oppose Otter Tail's goal for a 5-year vegetation maintenance cycle to ensure a safe and reliable system at this time, but stresses that costs to be recovered in base rates need to be spent prior to and during the test year to show costs are actually increasing to meet the 5 or 6-year cycle goals. This adjustment decreases operating expense and the revenue deficiency by approximately \$136,000.

**Meter Reading** – Otter Tail proposed an adjustment to reflect a decrease in meter reading costs due to the implementation of AMI meters. Otter Tail first removed all meter reading costs by changing the meter reading allocation factor, the C7 allocation factor, to 0.0%. Then Otter Tail proposed to add back in approximately \$116,000 in expense and approximately \$148,000 in rate base to account for the employees who used to read meters as a part of their workload working on different tasks within the company. The Settlement accepts this adjustment on the condition that if any of the employees whose labor is included in this adjustment work on any project that goes into a rider that there will be a credit to that project in the rider to account for the costs already included in base rates due to the meter reading adjustment.

**Rider Roll-in** – The Company proposed to roll-in costs from riders to base rates at the time new base rates go into effect. Revenues associated with TCR and PIR projects that will be included in base rates going forward are removed from the test year to avoid double counting. The Settlement revises this adjustment slightly to properly account for an accrual staying in the rider that is not moving to base rates. This change increases operating revenues and reduces the revenue deficiency by approximately \$234,000.

**Wildfire Mitigation Plan** – Otter Tail proposed an adjustment to include increased costs associated with wildfire mitigation. The proposed adjustment consists of costs associated with risk conditions monitoring subscriptions and operations and maintenance costs. The Settlement includes the costs associated with the risk conditions monitoring subscriptions but excludes the remainder of the proposed adjustment since these costs are internal labor costs. Including the labor costs in this adjustment would result in double recovery as these labor costs are already included in the test year. The adjustment reduces operating expenses and the revenue deficiency by approximately \$4,000.

**Astoria Onsite Fuel Storage** – The Company proposed an adjustment to remove expenses associated with onsite fuel storage at Astoria Station. In July 2024, the North Dakota Public Service Commission rejected the Company's application for an advanced determination of prudence. As such, capital costs associated with this project were expenses during 2024 and these one-time costs need to be removed from the test year. The Settlement accepts this adjustment.



with 15 small solar facilities placed in service in 2024. The costs associated with these facilities are recovered entirely from Minnesota customers and thus should be removed from the South Dakota test year. During discovery the Company provided workpapers supporting this adjustment. The adjustment reduces the revenue deficiency by approximately \$5,000.

**Employee Benefits Costs** – OTP sought recovery for the following benefits cost categories: Defined Pension Plan; Other Post-Retirement Plans; Other Post-Employment Plans; Defined Contribution Plan; Employee Medical; Employee Dental; Health Savings Account; LTD & Life Insurance; Other Employee Related Costs; Employee Related Taxes; Lost Time. During the course of the proceeding, Staff identified an unexplained increase related to the “Lost Time” category, particularly the increase related to the “Holiday and Floating Holiday” sub-category. The Settlement removes the impact of this increase. The adjustment reduces the revenue deficiency by approximately \$12,000.

**Changes in Allocation Factors** – OTP’s revenue requirement model relies on certain secondary jurisdictional allocation factors generated within the model (e.g., net plant in service). The Settlement incorporates the consequences of such jurisdictional allocation changes resulting from changes made to other elements of OTP’s revenue requirement.

The net effect of the Settlement decreases net operating expense by approximately \$639,000, decreases rate base by approximately \$6,558,000, and decreases the revenue deficiency by approximately \$1,227,000.

**Materials and Supplies and Other Working Capital Updates** – OTP’s proposed rate base included an allowance for materials and supplies using an estimated 13-month average balance for the year ended December 31, 2025. It also included an allowance for fuel stocks, prepayments, and customer advances using the 13-month test year average of those balances. The Settlement updates these average balances to actual for the year ended September 30, 2025. The net effect of these changes increases rate base by approximately \$1,178,000 and increases the revenue deficiency by approximately \$106,000.

**Cash Working Capital and Tax Collections Available** – OTP’s proposed rate base included an allowance for cash working capital based on a Company-prepared lead-lag study. A lead-lag study examines the timing of the Company’s receipt of service revenues from customers in relation to the Company’s payment of expenses to vendors and employees. This analysis also considers tax collections available, which the Company receives in advance of turning the related payments over to the taxing authorities. Staff carefully examined OTP’s revenue lag and expense lead day determinations and made the following modifications to OTP’s lead-lag analysis:

1. Included a separate expense lead for vacation pay and uncollectible accounts;
2. Corrected errors in the lead days calculation for Fuel - Coal, Labor and Associated Payroll, and Property Tax;
3. Included expense lead days for Federal Income Taxes and SD Gross Receipts Tax;
4. Revised revenue lag days to reflect automatic bill processing time and the number of days a bill is required to be paid before a late payment charge can be applied;
5. Revised SD Sales Tax expense lead days to incorporate revised revenue lag days and reflect SD Sales Tax remittance statute;
6. Calculated a separate rate base deduction for tax collections available;
7. Revised expenses per day to incorporate into the lead-lag analysis the impacts of Staff’s recommended adjustments to pro forma operating expenses.

These modifications decrease rate base by approximately \$822,000 and decrease the revenue deficiency by approximately \$74,000.

**COST OF CAPITAL AND RATE OF RETURN**

In its initial filing, Otter Tail’s proposed cost of capital, presented in Wahlund Exhibit\_\_\_ (TRW-1), Schedule 2, was 8.29 percent, based on a long-term debt ratio of 46.36 percent, a cost rate of 5.39 percent, a common equity ratio of 53.54 percent, and a rate of return on equity of 10.80 percent. Staff’s issues with this proposed cost of capital included (1) 13-month averages for the capital balances rather than period-ending capital balances (and costs) and (2) inclusion of two 2025 bond issues, as known and measurable changes, in which the debt costs had been used in developing the 5.89 percent average debt cost rate but not the capital balances associated with the bond issues, substantially overstating the average debt cost rate. Staff brought these concerns to Otter Tail’s attention, and Otter Tail updated Wahlund Exhibit (TRW-1), Schedule 2 accordingly, using actual long-term debt and equity balances as of June 30, 2025, reducing the average embedded debt cost rate from 5.39 percent to 4.68 percent and the overall rate of return to 8.04 percent, with capitalization ratios of 45.10 percent long-term debt and 54.90 percent common equity.

Staff also had concerns about the high equity ratio. From a ratepayer perspective, a utility should maximize its use of debt, which is cheaper than equity and for which interest is tax-deductible. Staff analyzed data presented by Otter Tail witness Ms. Ann Bulkley in Exhibit\_\_\_(AEB-1), Schedules 3 and 15, which showed that the average equity ratio for her sample of utilities used to estimate Otter Tail’s cost of equity, with the same bond rating as Otter Tail (BBB+), was 50.37 percent, compared to Otter Tail’s 54.90 percent equity ratio. [BEGIN CONFIDENTIAL] \_\_\_\_\_

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\_\_\_\_\_ [END CONFIDENTIAL] Staff and Otter Tail agreed to an overall rate of return on rate base of 7.09 percent. The reduction in the overall rate of return reduces the revenue deficiency by approximately \$2,940,000.

**REVENUE DEFICIENCY**

Staff Exhibit\_\_\_(PJS-1), Schedule 1 calculates the revenue deficiency, including gross receipts tax, as \$9,529,923. However, an additional adjustment of \$1,892,399 is necessary to arrive at the total base revenue deficiency of \$11,422,262. As shown on Staff Exhibit\_\_\_(BAM-7), there are three adjustments associated with rider changes that must be reflected. The revenue deficiency calculated in Staff’s model includes certain items that need to be transferred to the riders in the determination of the final revenues. These include: (1) a [BEGIN CONFIDENTIAL] \_\_\_\_\_ [END CONFIDENTIAL] adjustment to

the EAR reflecting OTP's proposal to recover fuel costs related to steam and water sales and to credit the revenues collected from steam and water sales customers through the EAR going forward; (2) a [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] adjustment to the TCR due to allocation methodology changes Otter Tail proposed for certain MISO/SPP expenses; and (3) a [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] adjustment to the PIR to reflect the normalized production tax credits (PTCs) that will flow through the PIR Rider. This results in a total impact to rider revenues of \$(1,892,399). It is necessary to reflect the transfer of these items to the riders and remove the \$(1,892,399) impact from the base rate revenue deficiency, resulting in an increase to the base rate revenue deficiency of \$1,892,399.<sup>4</sup>

Staff Exhibit\_\_\_(BAM-6) outlines all the revenue changes occurring in the case, beginning with per books. Columns (c) through (j) depict all the retail revenue adjustments shown on Staff Exhibit\_\_\_(PJS-1), Schedule 3, broken out by base rate revenues<sup>5</sup> and each rider. Column (k) shows the break-out of the adjusted present retail revenues. The total adjusted present retail revenues of \$36,678,136 are shown on Staff Exhibit\_\_\_(PJS-1), Schedule 1, line 13.

The revenues moving from the TCR and PIR to base revenues are removed from the total retail revenues in the "Rider Roll-in" adjustment discussed above, and shown on Staff Exhibit\_\_\_(PJS-1), Schedule 3, column (aa). This adjustment reflects that these projects will no longer be recovered in the riders and thus the rider revenues are reduced. However, the transfer to base revenues is not reflected within the adjusted present revenues. Column (l) on Staff Exhibit\_\_\_(BAM-6) reflects the transfer of these revenues to base rates, resulting in total present retail revenues of \$42,887,782.

Next, the shift from base to riders for the three items discussed above totaling \$(1,892,399) is shown on Staff Exhibit\_\_\_(BAM-6), column (n). As shown in column (o), the resulting total present retail revenues of \$42,887,782 do not change, but the appropriate amounts are attributed to each revenue component.

The base rate revenue deficiency is \$11,422,262. Total changes to the EAR, TCR, and PIR, including the \$(1,892,399) "post-test year" changes and the \$(6,209,646) reduction associated with the projects moving to base rates, are \$(8,101,985). This results in a net deficiency of \$3,320,277.

The total settlement retail revenue requirement is \$46,208,059.<sup>6</sup>

### **RATE DESIGN ISSUES**

The Settlement position reached between Staff and OTP regarding rate design issues and the class revenue distribution is discussed below.

**Class Cost of Service/Spread of the Increase** – As part of its application, Otter Tail filed a Class Cost of Service Study ("CCOSS") that provided its analytical foundation for assigning revenue responsibility among the customer classes it serves in South Dakota. As is typical in base rate cases, differences arose

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<sup>4</sup> This amount differs from the filed adjustment of \$1,487,451 due to other changes including changes in allocation factors and matching the normalized PTC amounts to those reflected in the plant annualization adjustment.

<sup>5</sup> W/H Credit, A/C Credit, and Tailwinds revenues are shown separately. These items are also reflected in base rates.

<sup>6</sup> \$42,887,782 + \$3,320,277

regarding the appropriate methodology for translating cost-of-service results into final class revenue assignments and the degree to which any indicated shifts should be implemented.

In the Settlement, the Parties resolved these issues through a structured and transparent framework that balances cost-causation principles with gradualism and rate stability.

Under the Settlement, class revenue responsibility is determined by moving each class twenty-five percent toward the revenue-responsibility results indicated in Commission Staff's preferred CCOSS, which utilized the Basic Customer Method to allocate distribution plant. Under this approach, only a defined basic level of distribution investment is allocated on a customer basis, while the remaining distribution plant is allocated using demand-based allocation factors. Compared to the Company's methodology, Staff's approach allocates a smaller portion of distribution costs based solely on customer counts, which correspondingly affects the implied relative revenue responsibility of classes with larger customer populations.

The Settlement moves each class partway from its current revenue contribution toward the level indicated by Staff's CCOSS results, rather than fully adopting those results. This structured movement advances cost-causation principles while avoiding abrupt shifts in class revenue responsibility. In addition, the Settlement limits any individual class's percentage increase to no more than 1.5 times the system-average percentage increase. Any revenue that cannot be assigned due to this limitation is redistributed proportionally among the remaining classes. These safeguards ensure that movement toward cost-based revenue responsibility occurs in a measured manner and does not result in excessive impacts to any single class.

**Residential Rate Design** – The Residential Customer Service Charge was a central rate design issue in this proceeding. OTP's current Residential customer charge is \$10.00 per month. In its initial filing, the Company proposed increasing this charge by 50 percent to \$15.00. The Company supported its proposal using its marginal cost study, which produced a residential customer charge substantially higher than the current \$10.00 level. In addition to the proposed increase in the customer charge, OTP proposed implementing a new residential facilities charge of \$3.50 per month. In combination, the proposed increase to the existing customer charge and the addition of the facilities charge would have increased fixed charges to residential customers from \$10.00 to \$18.50 per month—an 85 percent increase.

Commission Staff did not support setting the Residential customer charge based primarily on marginal cost study results. Instead, Staff performed an embedded cost analysis, which produced a lower customer-related cost than that reflected in the Company's marginal study. Staff also did not support implementation of a new residential facilities charge in this proceeding, concluding that creation of a separate fixed charge would alter the existing rate structure and increase tariff complexity without sufficient demonstration that current rates inadequately recover distribution-related costs.

Under the Settlement, the Parties agreed to increase the Residential customer charge by \$1.00, resulting in a monthly charge of \$11.00, and to not implement the proposed residential facilities charge. The resulting fixed charge of \$11.00 represents a 10 percent increase over current levels and avoids the substantial increase in fixed charges proposed in the Company's initial filing.

This outcome represents a reasonable compromise. It provides the Company with modest additional fixed-cost recovery while protecting residential customers from abrupt or disproportionate increases and maintaining an appropriate balance between fixed and variable rate components.

OTP proposed rates that are designed to recover the annual embedded cost revenue requirement on a non-seasonal basis instead of seasonal rates that differ from summer to winter. Moving away from seasonal calculations provides a more stable and practical framework for customers to understand. Staff agrees that OTP's proposal to implement annual rates is reasonable and the settlement rates are designed as such.

## **OTHER ISSUES**

**Rate Moratorium** – The Parties agree that OTP shall not file any rate application for an increase in base rates that will go into effect prior to December 1, 2029, subject to the occurrence of certain extraordinary events.

**Implementation of Rates** – The tariffs found in Exhibit A attached to the Settlement Stipulation are intended to become effective for services rendered on and after April 1, 2026. Customer bills will be prorated so that usage prior to the effective date will be billed at current rates and usage on and after the effective date will be billed at the new rates.

**Interim Rate Refund** – OTP implemented interim rates on December 1, 2025. The agreed-upon revenue deficiency results in a revenue increase that is less than the interim rate level. In the Settlement, the Company agreed to issue refunds to customers for the difference between interim rates and the permanent rates for usage during the period December 1, 2025, through March 31, 2026. The amount to be refunded will include interest, calculated by applying a 7% annual interest rate to the average refund balance for each month that interim revenues were collected. The detailed refund plan is provided as Exhibit B to the Settlement Stipulation. As noted in Exhibit B, the calculations will be updated<sup>7</sup> at the time of the actual refunds and will be provided as a compliance filing within 30 days of when the refunds have been completed.

## **RECOMMENDATION**

Staff recommends the Commission approve the Settlement for the reasons stated above.

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<sup>7</sup> As February and March interim revenues collected were not known at the time of the Settlement filing, the refund calculation is not yet calculated for those months.