Kevin G. Moug

Volume 2A

Direct Testimony and Supporting Schedules:

Kevin G. Moug

Financial Soundness
Capital Structure
Cost of Capital

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___

FINANCIAL SOUNDNESS, CAPITAL STRUCTURE AND COST OF CAPITAL

Direct Testimony and Schedules of
Kevin G. Moug

August 20, 2010

TABLE OF CONTENTS

ATTACHED SCHEDULES

I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Kevin G. Moug. My business address is 4334 18th Avenue SW, Suite 200, Fargo, ND 58103.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am the Chief Financial Officer of Otter Tail Corporation ("OTC"). Otter Tail Power Company ("OTP" or the "Company") is a wholly owned subsidiary of OTC.

Q. WHO ARE YOU TESTIFYING FOR?

A. I am testifying on behalf of OTP.

Q. HAVE YOU INCLUDED A DESCRIPTION OF YOUR QUALIFICATIONS, DUTIES AND RESPONSIBILITIES?

A. Yes, a description of my qualifications, duties and responsibilities is included as Exhibit___(KGM-1), Schedule 1.

Q. WERE THE SCHEDULES TO YOUR TESTIMONY PREPARED EITHER BY YOU OR UNDER YOUR SUPERVISION?

Yes.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. The purpose of my Direct Testimony is to discuss financial issues that are important to the overall financial soundness of OTP and our ability to complete OTP's substantial capital expenditure plans. I will address the capital structure and associated cost of financing for OTP's electric utility operations. I will also discuss the effects on OTP's capital structure of the formation of the new OTC holding company, which became effective on July 1, 2009 and the short-term impact on OTP's capital structure of the financing for the Luverne Wind Farm ("Luverne"). I will also explain the relationship between the substantial capital expenditure plans of OTP and its financial soundness, including the impact of decisions by the South Dakota Public Utilities Commission (the "Commission") on those plans.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS TO THE COMMISSION.

A. OTP recommends an overall rate of return ("ROR") of 9.13 percent. This ROR is based on OTP's cost of capital, including: (i) a proposed capital structure of 53.2 percent common equity, and 46.8 percent long-term debt; (ii) the related cost of long-term debt; and (iii) an 11.25 percent return on equity ("ROE"), which is explained in the Direct Testimony of Mr. Robert B. Hevert. Exhibit___ (KGM-1), Schedule 2, provides a summary of my recommendation.

Q. HOW IS THE BALANCE OF YOUR TESTIMONY ORGANIZED?

A. In Section III, I will explain my recommendation, including the effects of the formation of the new OTC holding company, the short-term effects on the capital structure of the financing for Luverne, and why my recommendation is appropriate and representative of OTP's cost of capital on an ongoing basis. In Section IV, I will explain OTP's capital expenditure plans and the effect of the Commission's decisions in this proceeding relating to ROR and ROE on OTP's ability to complete its capital expenditure plan. Section V summarizes my conclusions and recommendation.

III. RECOMMENDED CAPITAL STRUCTURE AND COST OF LONG-TERM DEBT.

Q. WHAT CAPITAL STRUCTURE AND ROE DO YOU RECOMMEND FOR THIS PROCEEDING?

A. I recommend a capital structure for OTP that contains 53.2 percent common equity, and 46.8 percent long-term debt, along with the related cost of long-term debt, and an

11.25 percent ROE. That capital structure and related costs as shown on attached Exhibit ___(KMG-1), Schedule 2.

Q. WHY DO YOU RECOMMEND THAT CAPITAL STRUCTURE?

A. I recommend this capital structure because: (i) it reflects OTP's actual and separate capital structure, which was established at the time of the holding company reorganization, effective July 1, 2009; and (ii) it is the most representative of OTP's ongoing capital structure that will be in effect during the period of time that the rates determined in this proceeding are in effect.

Q. HOW DOES YOUR RECOMMENDATION REFLECT OTP'S ACTUAL AND SEPARATE CAPITAL STRUCTURE?

A. As I will explain later in my testimony, OTP became a separate legal entity with its own separate capital structure and its own senior unsecured credit ratings when the OTC holding company reorganization became effective as of July 1, 2009. The capital structure I recommend reflects the OTP capital structure for the 6 months ended December 31, 2009, with adjustments, which coincides with OTP becoming a separate corporation.

Q. WHY IS YOUR RECOMMENDATION THE MOST REPRESENTATIVE OF OTP'S ONGOING CAPITAL STRUCTURE?

A. My proposed capital structure is most representative of OTP's ongoing capital structure because it: (i) removes a $75 million two-year note that was used to provide part of the financing for Luverne; and (ii) is typical of the capital structure for OTP that has been used in the past and will be used during the time that rates determined in this proceeding are in effect. The two-year note, which was issued in May 2009, was paid down by $17 million in October 2009 and paid-off in January 2010. The proposed capital structure is also consistent with the capital structures of utilities in the comparable group used to determine the ROE in this proceeding, as Mr. Hevert will explain.

A. LONG-TERM DEBT

Q. WHAT IS THE AMOUNT AND COST OF OTP'S LONG-TERM DEBT IN THE PROPOSED CAPITAL STRUCTURE?

A. The amount of OTP's long-term debt is $288.4 million and the cost of long-term debt is 6.71 percent, as shown on Exhibit___(KGM-1), Schedule 3.

Q. HOW WERE THE AMOUNT AND THE COST OF OTP'S LONG-TERM DEBT CALCULATED?

A. The long-term debt included in the OTP capital structure is based on the 6-month average data for the period ended December 31, 2009, adjusted to remove the $75 million two-year note that was used to provide part of the financing for the Luverne project. It reflects the various components of long-term debt that are part of OTP's permanent capital structure, along with their respective costs.

Q. WHY DID YOU USE A 6-MONTH PERIOD FOR LONG-TERM DEBT AND COST?

A. I used the 6-month period ended December 31, 2009 to determine long-term debt because it reflects OTP's separate long-term debt after formation of the holding company, effective July 1, 2009.

B. COMMON EQUITY

Q. WHAT IS THE AMOUNT OF OTP'S TEST YEAR COMMON EQUITY AND HOW WAS IT DETERMINED?

A. OTP's common equity is $328.1 million and is based on the 6-month period ended December 31, 2009. I used that approach to determine OTP's common equity because it also reflects OTP's separate common-equity after formation of the holding company, effective July 1, 2009, as shown on Exhibit __ (KGM-1), Schedule 4.

Q. HAVE COSTS BEEN INCURRED IN CONNECTION WITH ISSUING COMMON STOCK THAT IS INCLUDED IN OTP'S COMMON EQUITY?

A. Yes. When common stock is issued to the public, the corporation issuing the stock incurs costs in the process of issuance, including underwriter discounts, audit, legal, printing and listing fees, and other expenses of issuance. When these issuance costs (also known as "flotation costs") are incurred, they reduce the net proceeds received by the corporation issuing the stock as required by generally accepted accounting principles. Floatation costs are comparable to the issuance costs for long-term debt.

Q. IS THE ISSUANCE OF ADDITIONAL COMMON STOCK LIKELY IN CONNECTION WITH OTP'S CAPITAL EXPENDITURE PLANS?

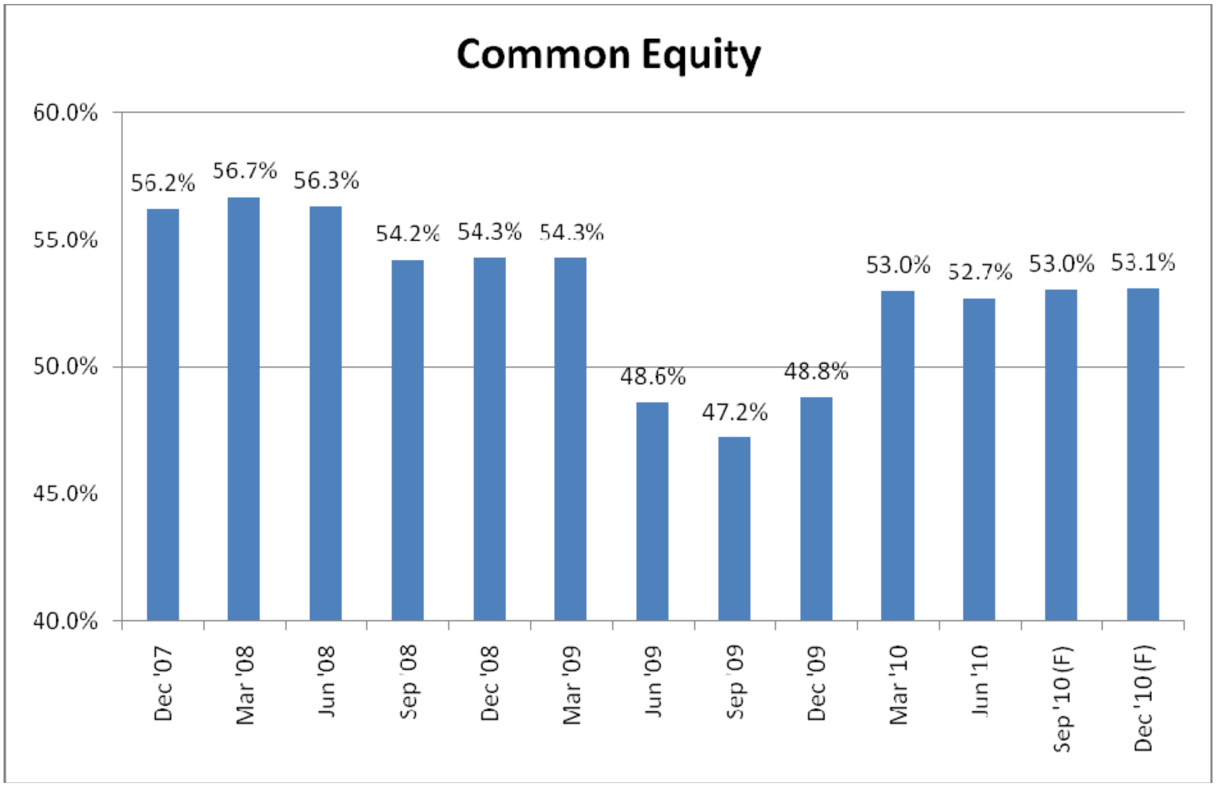
A. Yes. As I will discuss later in my testimony and as further explained by Mr. Thomas R. Brause, OTP's plans over the next four to five years show a significant level of capital expenditures. These capital expenditure plans will need to be financed with a combination of internally generated cash flows and access to the capital markets. Given our commitment to maintaining a strong balance sheet, we would expect to issue a balanced mix of common equity and long-term debt to finance these capital expenditure plans. In fact, in March 2010, OTC entered into a distribution agreement under which it may offer and sell up to $75 million of common shares from time to time. OTC intends to use the proceeds of any sales for general corporate purposes, which may include capital expenditures,[1] although there are no plans to issue common stock during the 2010 time frame.

Q. HOW DOES THE PROPOSED CAPITAL STRUCTURE AND EQUITY RATIO FOR OTP COMPARE TO PRIOR AND PROJECTED TARGET EQUITY RATIOS?

A. The capital structure and ratios of equity and long-term debt that we have proposed in this case are consistent with the target equity ratios that we have maintained for OTP over several years, are consistent with our targets going into the future, and reflect our

[1] Otter Tail Corporation March 17, 2010 Form 8-K and Prospectus Supplement.

needs to maintain solid credit metrics. The equity to total debt ratios for OTP for each quarter from 2007 through second quarter 2010 and the projected equity to total debt ratios for the last two quarters of 2010 are shown in the chart below. This chart shows my recommended capital structure and equity ratio is consistent with both OTP's prior operations and OTP's projected operations.



Sources: Dec '07 – June '10 are actual month-end balances; July-Dec 2010 from cash forecast updated June 19, 2010. Equity percentages exclude consideration of short-term debt.

C. FORMATION OF THE HOLDING COMPANY

Q. DID IMPLEMENTATION OF THE NEW HOLDING COMPANY AFFECT OTP'S ORGANIZATIONAL AND OWNERSHIP STRUCTURE?

A. Yes. OTP is now a separate legal entity and first tier wholly owned subsidiary of OTC, which is the new holding company. All of the common equity in OTP is owned by OTC. The indebtedness of OTP is held by a combination of third party lenders and OTC.

Q. HOW DOES THE CURRENT ORGANIZATIONAL STRUCTURE COMPARE TO THE PRIOR STRUCTURE?

A. Prior to the July 1, 2009 effective date of the new holding company structure, OTP had been an operating division, not a separate legal entity.

Q. DOES OTP'S PROPOSED CAPITAL STRUCTURE REFLECT THE IMPLEMENTATION OF THE NEW HOLDING COMPANY?

A. Yes. Several changes occurred in connection with the implementation of the new holding company (effective July 1, 2009). The 6-month data period ended December 31, 2009 that I recommend to determine the amounts of OTP equity and long-term debt and the cost of long-term debt matches the period of time the new holding company structure was in effect during the 2009 test year.

Q. DID THE COMMISSION REVIEW AND APPROVE THE FORMATION OF THE NEW HOLDING COMPANY?

A. Yes. The Commission approved the formation of the new holding company in its ORDER APPROVING APPLICATION TO FORM A NEW HOLDING COMPANY, dated November 13, 2008 in Docket No. EL08-025.

Q. HOW DID IMPLEMENTATION OF THE NEW HOLDING COMPANY CHANGE OTP'S CAPITAL STRUCTURE?

A. In connection with the formation of the new holding company reorganization, all existing indebtedness was allocated between OTC (the new holding company), and OTP. The preferred stock moved to OTC and OTC provided an intercompany loan to OTP to replace the preferred stock that had formerly been part of the OTP capital structure. OTC also contributed additional cash to OTP shortly after the July 1, 2009 effective date that reflected some of the reassigned debt. These changes were described in OTP's petition, *In the Matter of the Application of Otter Tail Corporation to Form a New Holding Company*, Docket No. EL08-025, and are summarized in the following Table showing the amounts of the components of the OTP capitalization, before and after the formation of the holding company.

OTP - Pre and Post Hold Co. Capitalization[2]

(In thousands)	June 30, 2009	July 1, 2009
Long-term Debt	331,745	356,145
Inter Company Debt	0	15,500
Preferred Stock	15,500	0
Common Equity	321,543	321,543
Total	**$668,788**	**$693,188**

Most of the long-term debt and all of the common equity included in OTP's capital structure remained unchanged by the formation of the holding company. However, some components of long-term debt and the preferred stock were changed.

Q. PLEASE DESCRIBE THE CHANGES TO OTP'S LONG-TERM DEBT AND PREFERRED STOCK THAT OCCURRED WHEN THE NEW HOLDING COMPANY WAS FORMED.

A. The following table shows the changes to OTP's long-term debt and preferred stock that occurred when the new holding company was formed:

Holdco-related changes to OTP Capitalization

	OTP Pre-Holdco	OTP Post-Holdco	Difference
5.778% Series 2017 Cascade	$34,600,000	$0	
6.63% Series 2011 Notes	$36,000,000	$90,000000	
Subtotal	$70,600,000	$90,000,000	$19,400,000
6.47% 2037 Series D Senior Note	$45,000,000	$50,000,000	$5,000,000
Existing Long Term Debt Subtotal	***$115,600,000***	***$140,000,000***	***$24,400,000***
Preferred Stock	$15,500,000	$0	($15,500,000)
Inter Company loan (from OTC)	$0	$15,500,000	$15,500,000

[2] Exhibit ___(KMG-1), Schedule 5.

Preferred Stock/Inter company note	***$15,500,000***	***$15,500,000***	***$0***
Total	***$131,100,000***	***$155,500,000***	***$24,400,000***

Q. PLEASE EXPLAIN THE REASSIGNMENTS OF EXISTING LONG-TERM DEBT.

A. The reassignments of long-term debt that occurred at the time of the formation of the new holding company were made in order to obtain needed consents from lenders to allow the formation of the holding company. In order to grant their consent to the formation of the holding company, the holders of the Series 2011 Notes required all of the $90 million of the Series 2011 Notes be payable by OTP. In order to avoid an excessive increase in OTP's total level of debt, management negotiated a reassignment of the $34,600,000 Cascade Series 2017 debt to OTC.

The Series D Senior note was structured at the time of issuance to also require reassignment of the entire Series D Senior Note be payable by OTP. This required the transfer of the remaining $5 million of Series D debt from OTC to OTP.

In total, the reassignments of existing long-term debt increased the amount of long-term debt in the OTP capital structure by $24.4 million. OTC also contributed an additional $24.4 million of cash into OTP to provide OTP additional cash equal in amount to the additional existing long-term debt that was reassigned to OTP. OTP has used this additional cash to support its capital expenditure program.

Q. HAD SOME EXISTING LONG-TERM DEBT BEEN REASSIGNED TO OTP IN 2008?

A. Yes. In 2008, $25 million of a 6.370 percent, 2027 Series C Unsecured Senior Note and $32 million of a 6.470 percent, 2037 Series D Unsecured Senior Note had been reassigned to the OTP division. These reassignments were made to comply with the agreement with the holders of these notes that required such reassignment prior to the formation of a holding company. These reassignments were made to facilitate the formation of the holding company, but were completed prior to the formation of the holding company. OTC also transferred approximately $63 million of cash to OTP in 2008, which exceeded the debt reassigned to the OTP division.

Q. DID OTP'S CAPITAL STRUCTURE CONTAIN PREFERRED STOCK PRIOR TO FORMATION OF THE HOLDING COMPANY?

A. Yes. Prior to the formation of the holding company, the OTP division had $15.5 million of preferred stock, consisting of four separate issuances, in its capital structure. This $15.5 million had a blended after tax cost of 4.75 percent.

Q. DOES THE OTP SUBSIDIARY CAPITAL STRUCTURE INCLUDE THAT PREFERRED STOCK?

A. No. Given the underlying agreements related to the preferred stock, these securities were considered direct obligations of OTC and could not be assigned to OTP.

Q. DID THE HOLDING COMPANY PROVIDE A REPLACEMENT SOURCE OF CAPITAL TO OTP FOR THE PREFERRED STOCK?

A. Yes. OTP provided a $15.5 million inter-company loan to OTP at a 7.11 percent blended interest rate. That 7.11 percent interest rate led to the same after-tax cost to OTP. Preferred stock dividends are not tax deductible, while interest is tax deductible. As a result, the blended preferred dividend rate of 4.75 percent had the same after tax cost as the 7.11 percent interest rate on the inter-company debt.

Q. WHAT WAS THE EFFECT OF THE FORMATION OF THE HOLDING COMPANY ON OTP'S COST OF LONG-TERM DEBT?

A. The effect on OTP's cost of long-term debt is set forth in my Exhibit ___(KMG-1), Schedule 5. The exhibit shows that: (i) OTP's long-term debt (not including the $15.5 million of intercompany debt) increased by $24.4 million (from $331.7 million to $356.1 million); and (ii) OTP's blended interest rate for long-term debt increased by 25 basis points (from 5.81 percent to 6.06 percent). In addition, OTP added $15.5 million of intercompany debt, but removed $15.5 million of preferred stock.

Q. HOW DID OTP'S BLENDED LONG-TERM INTEREST RATE COMPARE TO OTC'S LONG-TERM INTEREST RATE?

A. The blended interest rate of the debt assigned to OTP was 6.06 percent. The only long-term debt held by OTC at the time of formation of the holding company was the $50,000,000 Cascade Series 2017 debt, which was repriced to 8.89 percent.

D. DESCRIPTION OF LUVERNE AND RELATED FINANCING

Q. PLEASE BRIEFLY DESCRIBE LUVERNE.

A. Luverne is a 169.5 MW nameplate capacity wind farm located in Steele County, North Dakota of which 49.5 MW is owned by OTP. Luverne is the third rate base wind project for OTP. OTP invested approximately $100.6 million in Luverne.[3] Construction of Luverne began in the second quarter of 2009 and was completed in September 2009. Luverne allowed OTP to add an economic renewable generation resource to its portfolio to meet existing generation needs and continue to meet renewable objectives in South Dakota and North Dakota, and renewable portfolio standards in Minnesota. OTP informed the Commission of its plans for Luverne as a part of its annual DSM and Renewables Programs Report, dated July 1, 2009, pursuant to the Commission's Order in Docket No. EL05-022. Discussion of Luverne was also included in OTP's annual report, dated July 1, 2009, in compliance with the South Dakota Renewable, Recycled, and Conserved Energy Objective contained in Statutes §49-34A-94 through §49-34A-96 and §49-34A-101 through §49-34A-106.

Q. DID CAPITAL MARKET CONDITIONS IN 2009 HAVE AN EFFECT ON FINANCING ALTERNATIVES FOR LUVERNE?

A. Yes. Capital market conditions in 2009 imposed significant obstacles to financing in general, and those conditions also affected financing for Luverne. Capital markets during the first quarter of 2009 (shortly before the beginning of construction of Luverne) were very unstable as a result of the economic recession that began in 2008. In addition, OTC had completed a $155 million equity offering in September of 2008 by issuing common shares at $30 per share. The common stock price of OTC during the first quarter of 2009 ranged from a low of $15.52 to a high of $24.26. This

[3] Otter Tail Corporation Form 10-Q, (September 30, 2009), page 43.

combination of facts made it not feasible to use the equity markets to help finance Luverne.

The public debt markets were also extremely unstable and expensive during 2009. As a result, we concluded it was not advisable to issue long-term debt to finance Luverne, which would have required an issuance at high fixed rates that, over time, were likely to decline.

Q. DID OTP HAVE AN AVAILABLE SOURCE OF SHORT-TERM FINANCING IN 2009?

A. Yes. OTP had available a $170 million revolving credit facility. However, management did not believe it was prudent to use this $170 million facility to finance the entire installation cost for Luverne (which was estimated at approximately $100 million) in light of the prevailing severe economic conditions, because maintaining liquidity was critical in the event the economy continued to decline and the capital markets worsened.

Q. DID OTP USE A COMBINATION OF SOURCES TO PROVIDE INITIAL FINANCING FOR LUVERNE?

A. Yes. The American Recovery and Reinvestment Act of 2009 made available to companies constructing renewable energy projects a 30 percent grant from the U.S. Department of Treasury, which would be provided 60 days after the renewable energy project was put into operation. Given the availability of this grant, OTP was able to work with its banks to put in place a $75 million two-year term loan that could be prepaid at any time without penalty, and that would relieve the need to use OTP's revolving credit facility and allow OTP to maintain its liquidity. That $75 million two-year loan, along with OTP's revolving credit facility provided the financing for Luverne.

Q. HOW HAS THE INITIAL FINANCING BEEN USED?

A. OTP borrowed the $75 million on the two-year note in May 2009 and approximately $11 million on its credit facility in June 2009. These funds, along with other sources, were used to finance construction costs for Luverne. OTP submitted its application for the Treasury Grant in the third quarter of 2009, and in October 2009 the $30.2 million Treasury Grant was received. That $30.2 million was used: (i) to pay down $17 million on the two-year term loan, leaving a balance of $58 million; and (ii) to pay for Luverne project expenditures that had been financed on the OTP revolving credit facility and other sources.

In January 2010, the remaining $58 million of the two-year term loan was paid off, in large part as a result of a $50 million borrowing on OTP's revolving credit facility. This step eliminated the remaining $58 million of the two-year term loan from OTP's capital structure.

Q. WAS THE OTP CREDIT FACILITY BORROWING PAID DOWN IN THE 2ND QUARTER 2010?

A. Yes. OTC generated a net operating loss for tax purposes in 2009 that resulted in a carryback to previous years and generated a $46 million refund of income taxes previously paid. OTC received the refund in the second quarter of 2010, which was used to pay down the borrowing on OTP revolving credit facility that is related to the financing for Luverne.

Q. WHAT WAS MANAGEMENT'S RATIONALE IN FINANCING LUVERNE?

A. Management recognized that financing the Luverne project with a $75 million borrowing would cause OTP's equity ratio to drop below the typical levels for a short-term period. Management was willing to take this financing approach and have a lower than normal equity ratio for a short-term period because it was the most cost effective way to finance Luverne at the time.

Q. DID OTP'S USE OF THIS FINANCING APPROACH PROVIDE BENEFITS TO RATEPAYERS?

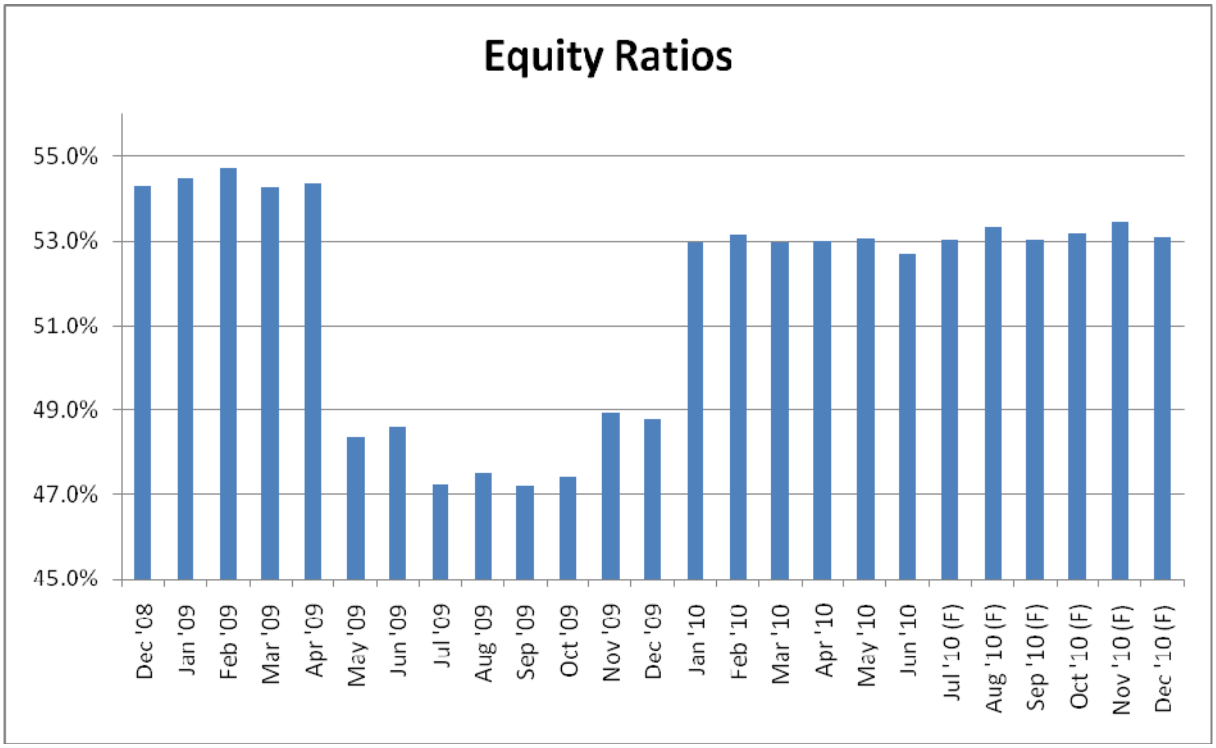
A. Yes. OTP's use of this financing approach to financing Luverne provided significant benefits in at least four areas. First, OTP's use of this approach enabled OTP to complete construction of Luverne. Second, OTP's approach allowed completion of Luverne without incurring high capital costs, which was also a very favorable development given capital market conditions. Third, OTP's approach preserved liquidity for OTP (by limiting use of its credit facility) during a time when many businesses, including utilities, were experiencing impaired liquidity. Fourth, OTP's approach provided a $30.2 million source of capital in the form of the Treasury Grant. The use of that Treasury Grant resulted in a corresponding $30.2 million reduction to rate base, which is the equivalent of cost free capital for ratepayers.

Q. CAN YOU SUMMARIZE HOW THE FINANCING OF LUVERNE AFFECTED THE OTP CAPITAL STRUCTURE DURING THIS TIME PERIOD?

A. Yes. The short-term effect of this financing approach is best seen by examination of the effects on OTP's capital structure, before, during, and after this period. The month-by-month capital structures of OTP from January 1, 2009 through December 31, 2009 and for January 1, 2010 through December 31, 2010 are shown on attached Exhibit ___(KMG-1), Schedule 6. As this schedule shows, the OTP divisional capital structure contained an average equity ratio of 54.4 percent for the period December 31, 2008 to April 30, 2009 (until financing of Luverne began). The equity ratio for OTP from May 2009 (when financing of Luverne began) to May, 2010 (when the tax refund was received) averaged 49.5 percent. The OTP subsidiary capital structure is projected to contain an average equity ratio of 53.1 percent for the period May 2010 through December 2010.

Q. HAVE YOU PREPARED A GRAPH SHOWING THE ACTUAL AND PROJECTED OTP MONTHLY RATIOS DURING THE TIME PERIOD?

A. Yes. The monthly equity ratios for OTP from December 31, 2008 to December 31, 2010 (projected) are shown in the bar graph below.



Sources: Dec '08 - June '10 are actual month-end balances; July-Dec 2010 from cash forecast updated June 17, 2010. Equity percentages exclude consideration of short-term debt.

This chart shows that the Luverne financing had a significant, but short-term, effect on the OTP equity ratio

IV. OTP CAPITAL EXPENDITURE PLANS

Q. WILL THE AUTHORIZED ROE AND CAPITAL STRUCTURE IN THIS PROCEEDING HAVE AN IMPACT ON OTP'S ABILITY TO ACHIEVE ITS CAPITAL EXPENDITURE PLANS?

A. Yes. The ROE and capital structure authorized in this proceeding will have a substantial impact on OTP's ability to carry out this 5-year capital expenditure plan in two important ways. First, the ROE and capital structure will have a direct impact on the level of authorized earnings. That level of earnings will, in turn, directly impact our ability to fund capital expenditures with internally generated funds. Second, the authorized ROE and capital structure will have a significant effect on the perceptions of investors. These perceptions will have a substantial impact on both the availability and the cost of the capital needed to carry out OTP's capital expenditure plans. The reaction of investors is likely to be heightened by the scale of the OTP capital expenditure plan.

Q. PLEASE DESCRIBE OTP'S LEVELS OF CAPITAL EXPENDITURES IN RECENT YEARS.

A. The capital expenditures for OTP have increased substantially over the past several years. As explained by Mr. Brause, OTP's capital expenditures in 2002-2006 averaged approximately $35 million per year. In contrast, OTP invested $104 million in 2007,[4] $199 million in 2008,[5] and approximately $145 million in 2009,[6] an average of $149 million per year.

Q. PLEASE DESCRIBE OTP'S ANTICIPATED CAPITAL EXPENDITURES.

A. As reflected in OTC's December 31, 2009 Form 10-K, it is anticipated that capital expenditures by OTP for the 5-year period of 2010-2014 will be approximately $641 million.[7] By comparison, OTP's net utility plant in service as of December 31, 2009 was approximately $831 million. These anticipated capital expenditures are approximately 77 percent of OTP's net utility plant in service, and would average over $128 million per year for that 5-year period. From a financial perspective, OTP's capital expenditure plan remains very substantial. Mr. Brause further explains OTP's capital expenditure plan in his direct testimony.

Q. WILL OTP NEED CONTINUED ACCESS TO THE CAPITAL MARKETS IN ORDER TO FINANCE ITS CAPITAL EXPENDITURE PLAN?

A. Yes. OTP will fund a portion of its capital expenditure plan with internally generated funds. However, given the size and long-term nature of utility infrastructure projects, OTP will require continued access to the capital markets, at reasonable terms, in order

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[4] Otter Tail Corporation, 2008 Form 10-K, at Exhibit 13-A (February 27, 2009).
[5] *Id*.
[6] Otter Tail Corporation, September 30, 2009 Form 10-Q, at p. 47 (November 9, 2009).
[7] Otter Tail Corporation, 2009 Form 10-K, at p. 53.

to finance its capital expenditure plan. The Commission's decisions relating to ROE and capital structure will have a direct and significant impact on the Company's ability to complete its capital expenditure plans at reasonable costs.

V. CONCLUSION

Q. CAN YOU PLEASE SUMMARIZE YOUR CONCLUSIONS?

A. Yes. I recommend the Commission approve a capital structure consisting of 53.2 percent equity and 46.8 percent long term debt, and an overall rate of return of 9.13 percent, which includes the 11.25 percent ROE recommended by Mr. Hevert.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

KEVIN G. MOUG

EMPLOYMENT

2001-PRESENT	Otter Tail Corporation	Fargo, ND
Chief Financial Officer		
1996-PRESENT	Varistar Corporation	Fargo, ND
Chief Financial Officer & Treasurer		
1993-1996	Advance Dental Management	Mondovi, WI
Chief Financial Officer		
1981-1993	Deloitte & Touche	Minneapolis, MN
Senior Manager – Middle Market Practice		

EDUCATION

- Bachelor of Science in Business Administration — University of North Dakota

INDUSTRY CERTIFICATIONS

- Certified Public Accountant

PROFESSIONAL AFFILIATIONS

• American Institute of Certified Public Accountants	Member
• Financial Executive International	Member
• US Bank Advisory Board	Board Member
• Minn-Kota Chapter of American Red Cross	Board of Directors
• Innovis Health	Board of Directors

OTTER TAIL POWER COMPANY

Electric Utility - State of South Dakota

PROPOSED COST OF CAPITAL FOR TEST YEAR 2009

Line No.	(A) Capitalization	(B) Amount	(C) Percent of Total	(D) Cost of Capital	(E) Weighted Cost of Capital
1	Long term debt	288,367,295	46.8%	6.71%	3.14%
2	Common equity	328,112,867	53.2%	11.25%	5.99%
3	Total Capitalization	616,480,162	100.0%		9.13%

Docket No. EL10-____
Exhibit __ (KGM-1), Schedule 3

OTTER TAIL POWER COMPANY
Electric Utility - State of South Dakota

COMPOSITE COST OF LONG-TERM DEBT FOR TEST YEAR 2009

Line No.	DESCRIPTION		Interest Rate	PRINCIPAL AMOUNTS OUTSTANDING Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09	AVERAGE MONTHLY BALANCES	INTEREST COST
	Debentures										
1	6.630%	Series for 2011	6.630%	$90,000,000	$90,000,000	$90,000,000	$90,000,000	$90,000,000	$90,000,000	$90,000,000	$5,967,000
2	5.778%	Series 2017 Cascade	5.778%	0	0	0	0	0	0	0	0
3	5.950%	Unsecured Series A 2017 Senior Notes	5.950%	33,000,000	33,000,000	33,000,000	33,000,000	33,000,000	33,000,000	33,000,000	1,963,500
4	6.150%	Unsecured Series B 2022 Senior Notes	6.150%	30,000,000	30,000,000	30,000,000	30,000,000	30,000,000	30,000,000	30,000,000	1,845,000
5	6.370%	Unsecured Series C 2027 Senior Notes	6.370%	42,000,000	42,000,000	42,000,000	42,000,000	42,000,000	42,000,000	42,000,000	2,675,400
6	6.470%	Series D 2037 Unsecured Senior Notes	6.470%	50,000,000	50,000,000	50,000,000	50,000,000	50,000,000	50,000,000	50,000,000	3,235,000
7		**Total Debentures**		**$245,000,000**	**$245,000,000**	**$245,000,000**	**$245,000,000**	**$245,000,000**	**$245,000,000**	**$245,000,000**	**$15,685,900**
8	**Pollution Control Revenue Bonds**										
9	4.650%	Series 2017 PCR Bonds (BSP)	4.650%	$5,165,000	$5,165,000	$5,125,000	$5,125,000	$5,125,000	$5,125,000	5,138,333	$238,933
10	4.850%	Series 2022 PCR Bonds (Coyote)	4.850%	20,580,000	20,580,000	20,400,000	20,400,000	20,400,000	20,400,000	20,460,000	992,310
11	AJ Rate Series of 2012		Varies	10,400,000	10,400,000	10,400,000	10,400,000	10,400,000	10,400,000	10,400,000	372,000
12		**Total Pollution Control Bonds**		**$36,145,000**	**$36,145,000**	**$35,925,000**	**$35,925,000**	**$35,925,000**	**$35,925,000**	**$35,998,333**	**$1,603,243**
13	**Dividend Series**										
14	5.330%	Formerly $3.60 Dividend Series, 60,000 shares	5.330%	$6,000,000	$6,000,000	$6,000,000	$6,000,000	$6,000,000	$6,000,000	$6,000,000	$319,800
15	7.210%	Formerly $4.40 Dividend Series, 25,000 shares	7.210%	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	$180,250
16	7.620%	Formerly $4.65 Dividend Series, 30,000 shares	7.620%	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000	$228,600
17	9.350%	Formerly $6.75 Dividend Series, 40,000 shares	9.350%	4,000,000	4,000,000	4,000,000	4,000,000	4,000,000	4,000,000	4,000,000	$374,000
18		**Total Dividend Series**		**$15,500,000**	**$15,500,000**	**$15,500,000**	**$15,500,000**	**$15,500,000**	**$15,500,000**	**$15,500,000**	**$1,102,650**
19		**Subtotal**		**$296,645,000**	**$296,645,000**	**$296,425,000**	**$296,425,000**	**$296,425,000**	**$296,425,000**	**$296,498,333**	**$18,391,793**
20		Loss/Gain on Reacquired Debt		(7,934,934)	(8,452,348)	(8,303,222)	(8,188,103)	(8,033,265)	(7,874,354)	(8,131,038)	950,184
21		**TOTAL DEBT CAPITAL**		**$288,710,066**	**$288,192,652**	**$288,121,778**	**$288,236,897**	**$288,391,735**	**$288,550,646**	**$288,367,295**	**$19,341,976**
22						**WEIGHTED COST OF LONG-TERM DEBT**					**6.71%**

OTTER TAIL POWER COMPANY
Electric Utility - State of South Dakota

COMMON EQUITY FOR TEST YEAR 2009

		Month-end Balances		
Line No.		CONTRIBUTED CAPITAL	RETAINED EARNINGS	TOTAL COMMON EQUITY
1	July	200,661,392	124,821,892	325,483,284
2	August	200,661,392	128,090,668	328,752,060
3	September	202,861,392	121,984,807	324,846,199
4	October	202,861,392	124,764,986	327,626,378
5	November	202,861,392	129,070,914	331,932,306
6	December	204,861,392	125,175,580	330,036,972
7	Average Common Equity			$328,112,867

June 30, 2009 (Pre Holdco)

Bond	**Initial Rate**	**Issued Amt**	**** Annualized Interest Exp**	*** Annualized Amort. Of Debt Issuance Costs**	**Total Expense**	**% of Bond**
6.70% Series 2011 (1)	6.70%	36,000,000	$ 2,412,000	$ -	$ 2,412,000	6.70%
Variable Series 2012 PCR	3.50%	10,400,000	$ 364,000	$ -	$ 364,000	3.50%
4.65% Series 2017 PCR (Big Stone Plant)	4.65%	5,165,000	$ 240,173	$ -	$ 240,173	4.65%
4.85% Series 2022 PCR (Coyote)	4.85%	20,580,000	$ 998,130	$ -	$ 998,130	4.85%
5.95% Series A- Unsecured Senior Note	5.95%	33,000,000	$ 1,963,500	$ 21,526	$ 1,985,026	6.02%
6.15% Series B - Unsecured Senior Note	6.15%	30,000,000	$ 1,845,000	$ 12,932	$ 1,857,932	6.19%
6.37% Series C - Unsecured Senior Note	6.37%	42,000,000	$ 2,675,400	$ 21,067	$ 2,696,467	6.42%
6.47% Series D - Unsecured Senior Note	6.47%	45,000,000	$ 2,911,500	$ 10,232	$ 2,921,732	6.49%
Variable Luverne Wind Development	3.81%	75,000,000	$ 2,855,625	$ 926,250	$ 3,781,875	5.04%
5.778% Series 2017 (1)	5.78%	34,600,000	$ 1,999,188	$ 25,313	$ 2,024,501	5.85%
Total		331,745,000	18,264,516	1,017,320	*$ 19,281,836*	*5.81%*

* Annualized amounts are exclusive of debt issuance costs incurred to achieve formation of holding company.

** There are two series with variable rates. The annualized amount consists of using the rate at June 30, 2009.

	Issuance Amount	Annualized Dividend Amt	% of shares
Preferred Stock			
$3.60 Dividend Series, 60,000 shares	6,000,000	$ 216,000	3.60%
$4.40 Dividend Series, 25,000 shares	2,500,000	$ 110,000	4.40%
$4.65 Dividend Series, 30,000 shares	3,000,000	$ 139,500	4.65%
$6.75 Dividend Series, 40,000 shares	4,000,000	$ 270,000	6.75%
Total	15,500,000	$ 735,500	4.75%

Common Equity	$ 321,542,855
Total Capitalization	$ 668,787,855

(1) These inter-company notes were part of OTP s pre-holdco capital structure. As part of the move to holding company structure, the entire $90 million 6.63% notes due in December 2011 were included in OTP s capital structure. In order to accomplish this the parent company invested an additional $19.4 million in cash in OTP.

July 1, 2009 (Post Holdco)

Bond	Initial Rate	Issued Amt	* Annualized Interest Exp	Annualized Amort. Of Debt Issuance Costs	Total Expense	% of Bond	
6.63% 2011 Ser es	6.63%	90,000,000	$ 5,967,000	$ 279,369	$ 6,246,369	6.94%	
Var ab e 2012 Ser es PCR	3.50%	10,400,000	$ 364,000	$ 7,511	$ 371,511	3.57%	
4.65% Ser es 2017 PCR (B g Stone P ant)	4.65%	5,165,000	$ 240,173	$ 20,114	$ 260,287	5.04%	
4.85% Ser es 2022 PCR (Coyote)	4.85%	20,580,000	$ 998,130	$ 61,739	$ 1,059,869	5.15%	
5.95% 2017 Ser es A Unsecured Sen or Note	5.95%	33,000,000	$ 1,963,500	$ 45,276	$ 2,008,776	6.09%	
6.15% 2022 Ser es B Unsecured Sen or Note	6.15%	30,000,000	$ 1,845,000	$ 26,303	$ 1,871,303	6.24%	
6.370% 2027 Ser es C Unsecured Sen or Note	6.37%	42,000,000	$ 2,675,400	$ 27,118	$ 2,702,518	6.43%	
6.470% 2037 Ser es D Unsecured Sen or Note	6.47%	50,000,000	$ 3,235,000	$ 21,140	$ 3,256,140	6.51%	
Var ab e Luverne W nd Deve opment	3.81%	75,000,000	$ 2,855,625	$ 943,181	$ 3,798,806	5.07%	
Tota		356,145,000	$ 20,143,828	$ 1,431,752	*$ 21,575,579*	*6.06%*	(1)

* There are two ser es w th var ab e rates. The annua zed amount cons sts of us ng the rate at June 30, 2009

Inter-Company Note	Note Amount	Annua zed Interest Amt	Pre-tax nterest rate
$3.60 Ser es A	6,000,000	$ 319,800	5.33%
$4.40 Ser es B	2,500,000	$ 180,250	7.21%
$4.65 Ser es C	3,000,000	$ 228,600	7.62%
$6.75 Ser es D	4,000,000	$ 374,000	9.35%
Tota	15,500,000	$ 1,102,650	7.11%

Common Equ ty	$ 321,542,855
Tota Cap ta zat on	$ 693,187,855

(1) Inc udes amor t zat on of ega /f nanc a costs assoc ated w th move to ho d ng company structure. Parent company, Otter Ta Corporat on exper enced a arger percentage ncrese n the r cost of debt f nanc ng as a resu t of the move to ho d ng copany structure

OTTER TAIL POWER COMPANY
Electric Utility - State of South Dakota

Capital Structure
December 2008 - December 2010

Line No.		2008 December	2009 Actual January	February	March	April	May	June	July	August	September	October	November	December
1	Long-term debt	251,872,019	251,921,478	251,970,937	251,975,396	252,024,855	325,299,012	324,309,681	363,710,066	363,192,652	363,121,778	363,236,897	346,391,735	346,550,646
2	Preferred stock	15,500,000	15,500,000	15,500,000	15,500,000	15,500,000	15,500,000	15,500,000	0	0	0	0	0	0
3	Common equity	317,481,244	320,108,646	323,378,052	317,410,998	318,336,894	319,013,176	321,542,855	325,483,284	328,752,060	324,846,199	327,626,378	331,932,306	330,036,972
4	Total capitalization	$584,853,263	$587,530,124	$590,848,989	$584,886,394	$585,861,749	$659,812,188	$661,352,536	$689,193,350	$691,944,712	$687,967,977	$690,863,275	$678,324,041	$676,587,618
5	Equity ratio	54.3%	54.5%	54.7%	54.3%	54.3%	48.3%	48.6%	47.2%	47.5%	47.2%	47.4%	48.9%	48.8%
6	**Dec 2008 through Apr 30, 2009 average equity ratio**				**54.4%**									

Line No.		2009 December Actual	2010 Projected January Actual	February Actual	March Actual	April Actual	May Actual	June Actual	July	August	September	October	November	December
7	Long-term debt	346,550,646	296,425,000	296,425,000	292,171,454	292,171,454	292,171,454	292,171,454	292,171,454	292,171,454	292,171,454	292,171,454	292,171,454	292,171,454
8	Preferred stock	0	0	0	0	0	0	0	0	0	0	0	0	0
9	Common equity	330,036,972	333,772,205	336,162,524	329,183,612	329,628,218	330,259,315	325,398,441	329,894,645	333,774,610	329,967,701	332,021,531	335,247,112	330,625,477
10	Total capitalization	$676,587,618	$630,197,205	$632,587,524	$621,355,066	$621,799,672	$622,430,769	$617,569,895	$622,066,099	$625,946,064	$622,139,155	$624,192,985	$627,418,566	$622,796,931
11	Equity ratio	48.8%	53.0%	53.1%	53.0%	53.0%	53.1%	52.7%	53.0%	53.3%	53.0%	53.2%	53.4%	53.1%
12	**May 2009 through April 2010 average equity ratio**				**49.5%**									
13	**May 2010 through December 2010 average equity ratio**				**53.1%**									

Source for Mar-Dec 2010 is cash forecast updated June 19, 2010.