
STAFF MEMORANDUM

TO: COMMISSIONERS AND ADVISORS
FROM: PATRICK STEFFENSEN & KRISTEN EDWARDS
RE: EL22-021 - In the Matter of the Filing by Montana-Dakota Utilities Co., a Subsidiary of MDU Resources Group Inc., a Request for Waiver of Fuel and Purchase Power Adjustment Rate 58
DATE: September 7, 2022

BACKGROUND

On August 3, 2022, the South Dakota Public Utilities Commission (Commission) received a filing from Montana-Dakota Utilities Co., a Subsidiary of MDU Resources Group Inc. (Montana-Dakota or Company) requesting a waiver of the Fuel and Purchased Power Adjustment (FPPA) Rate 58 tariff to allow the Company to retain the Production Tax Credits (PTCs) from the repowering of Diamond Willow Wind Phase 1. Montana-Dakota's FPPA tariff (State of South Dakota Electric Rate Schedule – SDPUC Volume No. 2, Section 3.b.4 on Sheet No. 27.1) states that the adjustment should reflect the Company's fuel and purchased power costs less PTCs adjusted for the effect of income tax.

Diamond Willow Wind Phase 1 was originally placed in service on February 13, 2008¹, thus is no longer eligible for PTCs in the current configuration. The repowering is mainly focused on replacing generators and gearboxes, and refurbishing or replacing blades, effectively resulting in a new turbine on top of an existing structure². It is this new investment which will requalify these facilities for an additional ten-year PTC period, as the fair market value of the used property that is part of the repowered wind turbines is expected to be less than twenty percent³ of the total value of the repowered wind turbines.

All the turbines that are subject to the repowering efforts are currently included in South Dakota rate base, and the associated PTCs were credited to ratepayers through the FPPA. Montana-Dakota will not include the costs of repowering in rates until their inclusion is requested in a future general rate case. Montana-Dakota has indicated in its filing that it currently plans to file a general rate case during the second quarter of 2023.

STAFF ANALYSIS

On December 21, 2017, and May 28, 2020, the Commission issued similar Orders in MidAmerican Energy Company (MidAmerican) dockets EL17-040 and EL20-005, which determined that repowering

¹ Montana-Dakota Response to Staff DR 1-1

² Montana-Dakota Response to Staff DR 1-11

³ Montana-Dakota Response to Staff DR 1-4

existing wind turbines was not subject to the provisions of MidAmerican's ECA tariff. In these prior dockets, Staff's analysis and recommendation regarding the new PTCs focused on three main areas: 1) the appropriate FPPA treatment given the new investment which makes them eligible, 2) the benefit of lower fuel costs, and 3) an analysis of projected future rate case activity.

Given the similarities regarding this Montana-Dakota repowering project, the associated PTCs, and the proposal by Montana-Dakota compared to that of MidAmerican's projects in past dockets, Montana-Dakota's proposal and Staff's analysis of this docket focused on these same three main areas. An analysis of each of these areas is described below.

Appropriate FPPA Treatment

As indicated above, this repowering process will replace generators and gearboxes, and refurbish or replace blades. Thus, this repowering project will result in new turbines on top of existing structures. As in past MidAmerican dockets, this process will essentially create brand new turbines, and it is the cost of this repowering project (and the brand-new turbines) that creates the new PTCs. Thus, it would be reasonable not to include the PTCs in the FPPA until the costs of repowering are included in Montana-Dakota's cost of service.

Lower Fuel Cost Benefit

As indicated in Montana-Dakota's filing, "the repowering process will marginally increase the overall generation from the turbines and thus will lower fuel costs to customers which will be passed through the FPPA". Montana-Dakota estimates that the overall FPPA benefits, including increased wholesale revenues, for South Dakota customers will be approximately \$13 thousand per year⁴. Customers will see these benefits immediately despite the fact they will not see the cost of the repowering until Montana-Dakota requests inclusion of these costs in a future general rate case.

Rate Case Analysis

Staff's final analysis of this docket focused on a review of the cumulative ratepayer impact if Montana-Dakota was required to flow these new PTC's resulting from the repowering through the FPPA to ratepayers. This hypothetically could result in an immediate general rate case filed by Montana-Dakota versus its current plans to file in the second quarter of 2023 with rates effective the fourth quarter of 2023.

Exhibit B to Montana-Dakota's filing provides the projected annual revenue requirement and associated PTCs for the repowering project on a total company basis. As shown under the "Year 1" column, the first-year revenue requirement for the repowering is \$503,787 more than the annual value of the PTCs associated with this project that Montana-Dakota will receive, or \$23,928 as allocated to South Dakota⁵.

⁴ Montana-Dakota Response to Staff DR 1-12

⁵ \$503,787 x 4.749539%

As indicated in Montana-Dakota's filing, the IRS recently announced a 2.6 cents per kwh value for 2022 PTCs versus the 2.5 cents per kwh used for the PTC value in Exhibit B. Further, the Inflation Reduction Act, signed into law by President Joe Biden on August 16, 2022, extends 100 percent project qualification to January 1, 2025, while 80 percent was used in Exhibit B.

If these values are updated in Exhibit B, it drives the annual PTCs to \$2,043,752 on a total company basis⁶, or \$97,069 as allocated to South Dakota⁷. The year-one revenue requirement for the project is now just \$32,151 more than the annual value of the PTCs⁸, or \$1,527 as allocated to South Dakota⁹, but it is still a net cost to ratepayers in year one. Thus, ratepayers benefit by not having to pay the year-one revenue requirement (or partial year-one revenue requirement) of the project, even if that were to mean getting credited for the associated PTCs through the FPPA.

RECOMMENDATION

Given the three areas of analysis as described above, Staff recommends the Commission approve the determination that these new PTCs resulting from the repowering of Diamond Willow Wind Phase 1 are not subject to the provisions of Montana-Dakota's FPPA tariff until Montana-Dakota requests inclusion of the costs of repowering in a future general rate case.

Staff would also recommend that this approval shall not preclude Commission review of the project, including project and cost management and accounting data and methods, review of the prudence and reasonableness of rate recovery in any determination of rates (including rate filings by Montana-Dakota or rate reviews initiated by the Commission), and that it does not guarantee any such rate recovery.

⁶ $62,098,622 \times 100\% \times \$0.026 / (1 - 21\% \text{ tax rate})$

⁷ $\$2,043,752 \times 4.749539\%$

⁸ $\$1,139,530 + \$936,373 - \$2,043,752$

⁹ $\$32,151 \times 4.749539\%$