
**STAFF MEMORANDUM SUPPORTING
SECOND AMENDMENT TO SETTLEMENT STIPULATION**

TO: COMMISSIONERS AND ADVISORS

FROM: BRITTANY MEHLHAFF, JON THURBER, PATRICK STEFFENSEN, AND KRISTEN EDWARDS

RE: DOCKET EL17-006 – IN THE MATTER OF THE APPLICATION OF BLACK HILLS POWER, INC. DBA BLACK HILLS ENERGY FOR APPROVAL OF 2017 TRANSMISSION FACILITY ADJUSTMENT

DOCKET EL17-008 – IN THE MATTER OF THE APPLICATION OF BLACK HILLS POWER, INC. DBA BLACK HILLS ENERGY FOR APPROVAL OF ITS 2017 ENVIRONMENTAL IMPROVEMENT ADJUSTMENT

DATE: December 31, 2019

Commission Staff (Staff) submits this Memorandum in support of the December 31, 2019 Second Amendment (Second Amendment) to the Settlement Stipulation of June 9, 2017 (Stipulation), between Staff and Black Hills Power, Inc. dba Black Hills Energy (BHE or Company) in the above-captioned matters.

BACKGROUND

On February 15, 2017, BHE filed an application for approval of its 2017 Transmission Facility Adjustment (TFA) and an application for approval of its 2017 Environmental Improvement Adjustment (EIA). The Commission assigned these filings as Docket EL17-006 and Docket EL17-008, respectively. On February 15, 2017, BHE also provided Staff its 2016 Annual Report of South Dakota Jurisdictional Financial Condition (Annual Report), as required pursuant to the Settlement Stipulation in Docket EL15-008 and the Amendment to Settlement Stipulation in Docket EL14-013.

Staff conducted a comprehensive review of BHE’s filings in these dockets and obtained additional information through discovery. Staff’s analysis identified several adjustments that should be made to the Annual Report. **[Begin Confidential] [End Confidential]** Following numerous settlement conferences, the Company and Staff (jointly, the Parties) arrived at a mutually acceptable resolution of all issues and on June 9, 2017, the Parties filed a Joint Motion for Approval of Settlement Stipulation. The Commission issued an Order Granting Joint Motion for Approval of Settlement Stipulation on June 20, 2017.

A review of the terms of the Stipulation is provided below. For a more thorough analysis, refer to Staff’s Memorandum Supporting Settlement Stipulation filed on June 9, 2017 (Staff Memo).

Review of the Stipulation

Staff worked with the Company to design a settlement incorporating alternative performance-based regulation. The Stipulation included several aspects designed to protect ratepayer interests and provide ongoing benefits to customers over the next several years.

The settlement resulted in significant savings to customers throughout a six-year moratorium period (July 1, 2017 through June 30, 2023). **[Begin Confidential] [End Confidential]**

The items of the Stipulation were designed to reduce the Company's earned return on equity, on average over the next five years, to approximately the level approved by the Commission in Docket EL14-026. The Parties held numerous settlement conferences to address potential excess earnings and Staff's concerns with relying on the accuracy of budgets. The Parties arrived at a mutually acceptable resolution of all issues and on May 1, 2018, the Parties filed a Joint Motion for Approval of Amendment to Settlement Stipulation. The Commission issued an Order Granting Joint Motion for Approval of Amendment to Settlement Stipulation on May 16, 2018.

A review of the Performance Based Rates agreed to by the Parties in the Amendment to Settlement Stipulation (First Amendment) is provided below. For a more thorough analysis, refer to Staff's Memorandum Supporting Amendment to Settlement Stipulation filed on May 1, 2018.

Review of the First Amendment to the Stipulation

The Parties agreed that customers would receive a credit at the end of the moratorium period, if the Company achieved an average ROE over the 6-year period of 2017 through 2022 above an agreed upon benchmark. The specific calculations of this customer credit are described in detail in the First Amendment. While the Stipulation was designed to explore alternative performance-based regulation to address future earnings, more certainty was needed for customers. The performance-based rates agreed to in the First Amendment converted a forecasted earnings approach to an actual earnings approach. This modified approach eliminated Staff's concerns with relying on the accuracy of budgets and allowed the Company flexibility by averaging the ROEs over the 6-year period, recognizing that ROEs will fluctuate from year-to-year.

In September 2019, BHE alerted Staff of a concern regarding its actual 2018 ROE and updated 2019 forecast exceeding original forecasts. **[Begin Confidential] [End Confidential]** BHE expressed a desire to amend the Amended Settlement to extend the moratorium period and provide greater rate stability for its customers.

STAFF'S ANALYSIS OF THE SECOND AMENDMENT TO THE STIPULATION

The Parties held several meetings in September through December 2019 to find a solution that was best for BHE's customers. Staff believes the Second Amendment is based on sound regulatory principles and avoids costly litigation.

SD Sun Project Transaction and Development Costs

On July 31, 2019, in docket EL19-028, BHE filed a petition with the Commission for approval of deferred accounting treatment for its SD Sun project transaction and development costs and to amortize the approximate \$5.4 million of costs during the period covered by the performance-based rates. Since this proposed amortization would affect the refund obligation due to customers at the end of the performance-based rates period, Staff found it necessary to include this docket in settlement discussions. Ultimately, BHE agreed for settlement purposes to withdraw its request in docket EL19-028. If the SD Sun Project economics become favorable and BHE includes SD Sun Project Transaction and Development Costs in any future filings, BHE has the burden of proof to demonstrate customer benefit.

Performance Based Rates and Amortization Period

In order to provide further rate stability for BHE’s customers, this settlement extends the current moratorium and performance-based rates mechanism by three years. BHE agrees to not file any rate increase application for an increase in base rates, nor EIA, TFA, and phase-in rates, which would go into effect prior to July 1, 2026. Thus, the performance-based rates will now be calculated over a 9-year period and any refund obligation due at the end of this period will be refunded to customers in May 2026.

The actual ROEs for 2017 and 2018 and the updated ROE forecastsⁱ for the 9-year performance-based rates period are as follows:

[Begin Confidential] [End Confidential]

While this element of the settlement will delay any potential refund by three years, it will provide three more years of rate stability for BHE’s customers. This settlement essentially exchanges the forecasted May 2023 refund for a three-year moratorium extension to eliminate the rate shock customers would’ve experienced in 2023 of a large refund followed by a large rate increase. Cumulatively, this moratorium extension means BHE customers will go approximately 12 years without an increase in their base rates.

Annual Earnings Reports

The Parties agree that beginning on January 1, 2020, BHE will begin weather normalizing based on the Company’s internal weather normalization calculation each month of each calendar year for all remaining normalized jurisdictional reports. This represents a change from the current stipulation language of only weather normalizing the months of June, July, and August. This change should result in some years where normalizing increases revenues and other years where it decreases revenues, but it will provide greater predictability for forecasting.

RECOMMENDATION

Staff recommends the Commission grant the Joint Motion for Approval of Second Amendment to Settlement Stipulation and adopt the Second Amendment without modification.

ⁱ Forecasted ROEs do not include amortization of SD Sun