STAFF MEMORANDUM

TO: COMMISSIONERS AND ADVISORS

FROM: KRISTEN EDWARDS, ERIC PAULSON AND JOSEPH REZAC

RE: DOCKET EL18-011 – IN THE MATTER OF THE FILING BY MONTANA-DAKOTA UTILITIES CO., A DIVISION OF MDU RESOURCES GROUP INC. FOR APPROVAL OF THE ANNUAL UPDATE TO ITS TRANSMISSION COST RECOVERY RIDER RATE

DATE: 4/17/18

BACKGROUND

On March 1, 2018, Montana-Dakota Utilities Co. (MDU or Company) filed an application for South Dakota Public Utilities Commission (Commission) approval of the annual update to its Transmission Cost Recovery Rider (TCRR) rate. The Company proposes their annual true-up of the actual revenue collected from customers through the TCRR and actual costs incurred and revenues credited from the Midcontinent Independent System Operator, Inc. (MISO) and Southwest Power Pool (SPP) through December 31, 2017, and the projected transmission costs and revenues through December 31, 2018. MDU proposes TCRR rates effective May 1, 2018.

SDCL § § 49-34A-25.1 through 25.4 authorize the Commission to approve a tariff mechanism for the automatic annual adjustment of charges for the jurisdictional costs of new or modified transmission facilities with a design capacity of 34.5 kV or more and which are more than five miles in length.

In Docket EL15-024, the Commission approved the establishment of the TCRR, and the revenue requirement and rates associated with the first ten months (July 1, 2016 through May 1, 2017) of the TCRR. MDU's TCRR includes revenues credited and costs assessed to MDU by MISO, including a portion of the costs associated with its regionally-allocated electric transmission facilities as reflected in MDU's transmission rates approved by the Federal Energy Regulatory Commission (FERC). The costs assessed by MISO include MISO administrative costs (MISO FERC Transmission Rate Schedule 10) as well as MISO regional transmission costs (MISO FERC Transmission Rate Schedules 26 and 26A).

MDU's TCRR utilizes the MDU rate templates filed with the FERC. Regarding MDU's Schedule 26A costs, the TCRR replaces the overall rate of return reflected in the FERC rate template with the overall rate of return based on the Company's actual capital structure, including actual long-term debt costs as of the prior year, 12-month average short-term debt costs for the prior year, and the ROE approved in the last rate case, EL15-024. This information is used to compute an adjustment applicable to that portion of the MDU regionally allocated transmission costs to be recovered via the TCRR. Staff and MDU developed this methodology in EL15-024 in order to accomplish the intent of the "refined split method" used for Otter Tail and Xcel in a manner that is more administratively efficient.

Since MDU only owns one Schedule 26 cost-shared project and this project is included in base rates, the South Dakota share of the revenue MDU receives for this project is credited 100 percent to customers.

Prior to the Western Area Power Authority (WAPA) and Basin Electric Power Cooperative (Basin) joining SPP, they had long-standing reciprocal transmission sharing agreements with MDU. Thus, these sharing agreements between MDU and WAPA and between MDU and Basin expired on December 31, 2015 and were replaced with network integrated transmission service, or NITS service, from SPP. These NITS services are reflected in SPP Schedule 9 and provide MDU's customers with firm transmission service rights on WAPA's and Basin's facilities.

Similar to MDU paying for use of WAPA's and Basin's systems in SPP, WAPA and Basin pay for their use of MDU's facilities in areas of MISO where MDU doesn't not receive Section 30.9 Facility Credits from SPP. WAPA and Basin have also chosen to take NITS service from MISO for the portion of its members' load subject to MDU's transmission facilities. These revenues to MDU are similarly reflected in MISO Schedule 9.

MDU has explored many options to lessen the burden on their ratepayers, including withdrawing from MISO and joining SPP and splitting its transmission system into a MISO and SPP system. However, analysis showed taking NITS service from SPP, where needed, was the most economical solution available.

In EL17-011, the Commission approved cost recovery of $662,045. MDU used the methodology as approved by the commission in Docket EL15-024 including the use of the ROE as approved in that rate case proceeding where applicable in this filing. MDU implemented a rate of $0.00438 per kWh, for an increase of $0.00072 per kWh, effective May 2, 2017.

In this docket, MDU proposes to recover a revenue requirement of $814,186, consisting of the forecasted 2018 revenue requirements of $762,749, plus the $52,589 true-up of actual amounts under-collected in 2017. MDU used the methodology as approved by the commission in Docket EL15-024 including the use of the ROE as approved in that rate case proceeding where applicable in this filing. MDU proposed to implement a rate of $0.00545 per kWh, or an increase of $0.00107 per kWh, effective May 1, 2018.

STAFF'S ANALYSIS

Staff conducted a comprehensive review of MDU's filing, assessed the filing's compliance with the statutes authorizing the transmission facilities tariff mechanism, obtained additional information through discovery, and ultimately came to a determination based on this analysis.

Revenue Requirement

The revenue requirement with this TCRR filing is $814,186, subject to later true-up to actual costs and recoveries, based on the forecasted revenue requirements of $762,749, plus the $52,589 true-up of actual amounts under-collected in 2017. This forecasted amount for 2018 and true up of actual amounts under-collected in 2017 both include the SD PUC filing fee in the revenue requirement.

Capital Structure, Cost of Debt, ROR, and ROE

The filing used a capital structure and cost of debt forecast for 2018, to calculate the January 1, 2018 through December 31, 2018 revenue requirements. MDU used the ROR approved in its last general rate case, Docket EL15-024, to calculate the carrying charge. MDU also used the ROE approved in its last general rate case, Docket EL15-024, and the actual 2016 capital structure to calculate the MISO Schedule 26A Return Credit.

Taxes

As noted in MDU's filing, they have acknowledged that updates to the TCRR will be required in order to reflect the changes due to the Tax Cuts and Jobs Act. MDU notes that this update will reduce MISO charges but will be offset in some way by a lower Transmission Facility Credit from SPP. Also, as noted in the filing, MDU and other MISO Transmission Owners with projected rates submitted a filing to FERC on February 1, 2017 requesting FERC waive certain provisions of the MISO tariff in order for the Transmission Owners with projected rates to revise their rates to reflect the reduction in the corporate income tax rate. While the waiver has been granted, MISO has not posted new rates at this time. MDU plans to update the TCRR to include the changes due to the tax reform next year with its 2018 true-up in the 2019 TCRR filing.

May 2018 – April 2019 TCRR Rates

The Settlement Stipulation in Docket EL15-024 requires an effective date of May 1st each year. Therefore, MDU has requested a May 1, 2018 effective date for the new TCRR rate. This rate is based on forecasted sales for calendar year 2018. The rates include the carrying charge, costs assessed by MISO, including a portion of the costs associated with its regionally-allocated electric transmission facilities as reflected in MDU's transmission rates approved by the FERC, MISO administrative costs (MISO FERC Transmission Rate Schedule 10), and MISO regional transmission costs (MISO FERC transmission Rate Schedules 26 and 26-A), and costs assessed by SPP. The net MISO and SPP costs used to determine the revenue requirement are allocated to customer classes based on the 12 Month Peak Demand allocation factors noted on page 2 of attachment B. The rate as proposed by MDU is $0.00545 per kWh, or an increase of $0.00107 per kWh from the rate currently in effect.

RECOMMENDATION

Staff believes the Company's filing is consistent with the Settlement Stipulation approved in Docket EL15-024. The Company has responded to all data requests asked by Staff. Staff recommends the Commission approve the 2018 TCRR revenue requirement and the revised TCRR rate of $0.00545 with an effective date of May 1, 2018.