
STAFF MEMORANDUM SUPPORTING SETTLEMENT STIPULATION

TO: COMMISSIONERS AND ADVISORS
FROM: BRITTANY MEHLHAFF, PATRICK STEFFENSEN, AND KRISTEN EDWARDS
RE: DOCKET EL18-060 – IN THE MATTER OF THE FILING BY BLACK HILLS POWER, INC. DBA BLACK HILLS ENERGY FOR APPROVAL OF A RENEWABLE READY SERVICE TARIFF AND TARIFF REVISIONS TO ITS ENERGY COST ADJUSTMENT
DATE: June 18, 2019

Commission Staff (Staff) submits this Memorandum in support of the Settlement Stipulation (Stipulation) of June 17, 2019, between Staff and Black Hills Power, Inc. dba Black Hills Energy (BHE or Company) in the above-captioned matter.

BACKGROUND

On December 17, 2018, BHE filed for approval of a Renewable Ready Service tariff and tariff revisions to its Energy Cost Adjustment (ECA). The Company proposed the tariff due to continued customer interest in renewable energy and to maintain fixed cost contributions by providing an alternative to behind-the-meter generation. The proposed tariff is designed to serve commercial retail customers with an aggregate usage of 300,000 kWh or more per year and governmental accounts desiring renewable energy. Eligible customers¹ may subscribe to a portion of the renewable energy generated by BHE's proposed Corriedale wind project. The Company plans to construct the 40 MW Corriedale wind energy facility near Cheyenne, Wyoming. BHE will own a 50% share of the facility, with the other 50% being owned by Cheyenne, Light, Fuel and Power Company.

Subscribing customers will continue to pay standard rates in addition to a Renewable Ready Charge. These customers will also receive a Renewable Ready Credit. The charge and credit will be based on the subscribing customer's proportional share of Corriedale generation. Such proportional share is chosen by the customer and is limited to 100% of the customer's usage over the previous 12 months.

For the Renewable Ready Charge, BHE proposes a rate per kWh, varying by subscriber agreement term (5-9 years, 10-14 years, and 15-25 years). The Renewable Ready Credit rate will be calculated annually with BHE's ECA filing.

The Company proposes an effective date of July 1, 2019 in its application; however, an August 1, 2019 effective date is requested in the filed tariff sheets.

¹ Approximately 330 customers will be eligible for service under the Renewable Ready Service Tariff.

STAFF'S ANALYSIS OF FILING

Staff conducted a comprehensive review of BHE's filings in this docket and obtained additional information through discovery. Staff's review identified several concerns that needed to be addressed. Each of these concerns is discussed here.

Length of Contracts vs. Life of Project

First of all, the proposed renewable ready charge for 15- to 25-year contracts were set equal to the 25-year levelized cost of the Corriedale Project revenue requirement. After reviewing current non-binding commitments, Staff saw that most customers were signing up for 15-year contracts. This was not surprising given customers would pay the same rate regardless of whether they signed up for a 15-year contract or a 25-year contract. The only reason customers would sign up for the longer 25-year contract term in lieu of a 15-year term is to guarantee their subscribed amount, as longer commitments will receive first choice. Initially the program was not fully subscribed, and all subscriptions thus far are non-binding, so Staff was concerned the preference given to the customers with the longest contracts was not enough to persuade customers to sign a 25-year commitment.

If the program was fully subscribed with 15-year contracts, the revenue requirement would not be paid for within those 15 years, leaving non-participating customers at risk for covering the remaining costs of the project. Even though agreements can be extended after 15 years, there is no guarantee customers will decide at that time to renew, given possible future changes in the economics of behind-the-meter generation or corporate policies. Further, BHE's proposed tariff does allow for termination during the contract term, for a fee. The risk of non-participating customers paying for the Corriedale resource absent sufficient subscribership was Staff's largest concern with the proposal. Staff believes this risk is satisfactorily addressed by item 1 discussed below under Staff's Overview of Settlement.

Potential Revenue Requirement Changes Compared to Subscriber Revenue

Staff's main concern discussed above becomes even more of a problem if BHE were to go over budget on Corriedale project costs or if construction delays result in disqualification for Production Tax Credits (PTCs). Either of these situations would result in a higher revenue requirement than the estimated 25-year levelized cost upon which the 15- to 25-year Renewable Ready Charge is based. Under either of these situations, subscriber revenues would not offset the Corriedale project revenue requirement, resulting in other non-participating customers paying for the higher revenue requirement. The Settlement addresses these risks through items 2 and 3 discussed below under Staff's Overview of Settlement.

Lack of IRP Analysis

A utility generally engages in integrated resource planning in order to determine a need for a generation unit and to determine what resource best fits the system and will provide for the need at the lowest reasonable cost to ratepayers. Staff was initially concerned that BHE did not engage in IRP analysis when deciding to construct the Corriedale project.

BHE explained the need for this project was different than a traditional generation unit. The Company explains the Corriedale project is part of a green energy solution to meet customer requirements for

renewable energy and to help protect other customers from the rate impacts associated with customers installing behind-the-meter generation. While Staff doesn't agree that this "need" necessarily outweighs the necessity of prudent planning for generation needs, Staff does believe this concern is mitigated by the Company commitment discussed below under Staff's Overview of Settlement regarding item 1, as the risk of other customers having to pay for the Corriedale project is greatly mitigated.

Renewable Ready Credit Based on Average

The Renewable Ready credit is based on the average annual fuel and purchased power costs. Staff was concerned the average would not be appropriate if Corriedale was producing energy during off-peak time periods and replacing low-cost resources. Staff was concerned that crediting subscribers at the average fuel and purchased power cost would increase ECA costs for all customers. However, the Company provided data to support that a majority of Corriedale's generation is expected to occur during peak hours and in fact is right in-line with the percentage of on-peak usage by current subscribers. While it is still possible that annual system fuel and purchased power costs are reduced at a rate lower than the Renewable Ready Credit, resulting in an increase to the ECA, Staff is satisfied that current data suggests Corriedale will be producing energy a majority of the time during on-peak periods and BHE's market forecasts indicate the Corriedale project revenue requirement will be less per MWh than forecasted market prices for the majority of the 25-year time period.

Continued Risk of Loss of Fixed Cost Recovery

While the proposed Renewable Ready Program aims to address the risk of not recovering fixed costs from customers who install behind-the-meter generation, it does not completely eliminate this risk. It's very likely some large customers that qualify for this tariff will still choose to install behind-the-meter generation. If this risk materializes, significant fixed cost recovery will be lost. Smaller customers who do not qualify for participation in the Renewable Ready Program will likely continue to increase installation of behind-the-meter generation. While the increase in small power producers that BHE continues to experience does not amount to a huge loss of fixed cost recovery at the present time, it is still an issue that will need to be considered. Without the proper rate design and tariff mechanisms in place to address recovery of fixed costs, other customers will be at risk of paying for those costs that should be borne by those with behind-the-meter generation. The Company agreed to research this issue further and provide a proposal to Staff, which is discussed further under item 5 of Staff's Overview of Settlement.

STAFF'S OVERVIEW OF SETTLEMENT

Staff, BHE, and Walmart (jointly the Parties) positions were discussed thoroughly at settlement conferences. The Parties ultimately arrived at a mutually acceptable resolution of all issues. Staff believes the settlement is based on sound regulatory principles and avoids costly litigation. The following provides a brief overview of each of the terms and conditions of the settlement stipulation.

1. Subscription Level Guarantee

During years 1 through 15 of the 25-year life of the Corriedale Project, BHE agrees to guarantee subscription revenues resulting from the project at a level of approximately 75 percent that of full subscribership in the project, or \$1.425 million per year. During the remaining years of the project, years 16 through 25, BHE agrees to guarantee subscription revenues resulting from the project at a level of approximately 90 percent that of full subscribership in the project, or \$1.710 million per year. Thus, in each rate review during the 25-year life of the project, there will be a minimum revenue credit included in the rate review period.

2. Corriedale Project Cost Cap

For rate-making purposes, BHE agrees to implement a \$57 million “soft” cost cap and \$63 million “hard” cost cap on project costs relating to the Corriedale Project. In return, Staff and the intervenor, Walmart, agree to not challenge the prudence or recovery of costs of the project in the next general rate review up to BHE’s allocation of the \$57 million project estimate. However, Staff and Walmart may challenge (and BHE may defend) BHE’s allocation of project costs between \$57 million and \$63 million. BHE agrees to not seek cost recovery of any allocation of project costs above the hard cost cap of \$63 million.

3. Production Tax Credits

BHE also agreed to bear the risks related to construction delays with the Corriedale Project that result in the project not qualifying for PTCs. If the project fails to qualify for PTCs, in whole or in part, PTCs will be imputed at the PTC value that would have been in effect had the entire project been in service on December 31, 2020. Then, the imputed PTC value will be included in the determination of the revenue requirement for any subsequent rate review.

4. Black Hills Wyoming Tariff

The initial application only included a Renewable Ready Service tariff for the South Dakota portion of BHE’s service territory, without a separate filing being made in Wyoming for approval of the tariff in the Wyoming portion of BHE’s service territory. The Settlement specifies that BHE will file an application with the Wyoming Public Service Commission (PSC) for approval of the Renewable Ready Service Tariff for its Wyoming customers. Further, the Settlement specifies that for purposes of future South Dakota jurisdictional revenue requirement determinations, the revenues from Renewable Ready subscribers shall not be directly assigned to the state jurisdiction where originated, but instead shall be allocated consistent with the general allocation of the Corriedale Project, as determined in future rate reviews.

5. Fixed Cost Recovery Proposal

Since this Renewable Ready Service Tariff does not completely resolve the underlying issue of fixed cost recovery concerns with behind-the-meter generation, BHE has agreed to prepare a proposal for reasonably addressing the under-recovery of fixed costs which occurs when customers elect to install behind-the-meter generation. BHE will prepare this for Staff’s consideration by July 1, 2020, and Staff and BHE will work together at that time to determine the appropriate next steps regarding the proposal.

6. Related Wyoming Dockets

Since this Renewable Ready Service Tariff docket is being processed simultaneously with related Renewable Ready Service Tariff and Corriedale Project CPCN dockets for Cheyenne, Light, Fuel and Power Company in front of the Wyoming PSC, and the project is dependent on approval in both jurisdictions, the Parties agreed this Settlement is conditioned on similar approval in Wyoming. Further, if there is a settlement in Wyoming that results in any conditions that are more favorable, as determined by Staff, the more favorable terms will be incorporated into this Settlement via an amendment presented to the Commission for approval.

STAFF'S JUSTIFICATIONS FOR APPROVAL OF SETTLEMENT

Evolving Customer Preference in Black Hills Region

The BHE testimony, responses to Staff data requests, and information obtained during settlement discussions show an ever-changing desire by BHE customers in seeking renewable energy. Some quantitative evidence exists, as BHE has seen a 65.8 percent² increase in customers on its small power production tariff in approximately two years. Other evidence is more anecdotal, as Rapid City Regional Health and Xanterra Parks and Resorts have stated an interest to install more behind-the-meter generation, Walmart has announced a goal to be 50 percent renewable by 2025, and Black Hills State University³ was the first South Dakota university to set a goal to reach carbon neutrality by 2050.

As far as the large business customers where this proposed tariff applies, some of this desire to go renewable is coming from corporate responsibility pressures and what their customers are demanding, while other pressure is coming from outside marketers. BHE has indicated there are some marketers currently active in the Black Hills region targeting its large customers for behind-the-meter installs.

The Risk of Doing Nothing

Given the amount of current and growing demand in the Black Hills region for renewable energy, any mitigation of the risk of losing contributions to fixed costs by these large customers installing behind-the-meter generation is important. BHE is currently estimating \$2.9 million⁴ per year in fixed cost recovery would be put back on the system if its current subscribers were to install behind-the-meter generation in place of their renewable ready commitment. While BHE did not perform a complete class cost of service study to arrive at this number and Staff cannot be certain all subscribers would choose to install behind-the-meter generation absent this tariff, it still provides a good sense of scale for how important fixed cost contributions of BHE's largest customers is. Further, utility-scale projects generally save money for those opting to use renewables. Utility-scale projects like the Corriedale Project will likely benefit all customers.

² This tariff had 38 customers on 1/20/17 as shown in response to DR 1-2 in EL16-042 and had 63 customers on 5/1/19 as shown in the application in EL19-022.

³ <https://www.wapa.gov/EnergyServices/Documents/Feb17.pdf>

⁴ See Attachment 1

The Risk of Doing Something

Staff acknowledges there is still a risk associated with approving the Renewable Ready tariff, not having expected subscribership come to fruition, and having the cost of the Corriedale project recovered by BHE's customers, including the non-subscribers. BHE has greatly lessened this risk with a 75 percent subscription guarantee for the first 15 years of the plan. Staff feels this is adequate because BHE currently has commitments for full subscribership⁵ for at least the first 15 years of the plan, and there are still approximately 300 customers that haven't even been contacted about the plan yet.

Furthermore, since the current commitments are only for the first 15 years of the plan, BHE has agreed to increase the subscription guarantee to 90 percent for the last ten years of Corriedale's project life, years 16 through 25. This helps mitigate the risk of what is unknown 15 years into the future. With the decrease in costs for behind-the-meter generation, this will help protect against the possibility of these subscribers leaving to install their own generation after their initial 15-year term, while incentivizing BHE to continue to sell this plan throughout its project life.

Advantages Over Current Small Power Production Tariff

In at least one respect, Staff views this Renewable Ready tariff as an upgrade over the existing Cogeneration and Small Power Production tariff. While the load and usage characteristics certainly differ between customers on the small power production tariff and those eligible for the Renewable Ready tariff, it is important to note that where customers on the small power production tariff do not contribute to fixed costs for the energy they self-generate, the customers on the Renewable Ready tariff will still contribute to fixed costs for the energy they subscribe to from Corriedale. This proposed tariff will only add a new charge and new credit to these subscribers' bills, and they will continue to be charged the same other tariffed rates they are currently being charged.

Potential Cost Savings for Non-Subscribers

Under current subscribership levels, BHE ratepayers will receive an approximate \$576 thousand benefit through BHE's existing performance-based regulation during the remainder of the moratorium period. Beyond that, any ratepayer benefit will depend on the timing of BHE's future rate case filings and the level of subscriber/guarantee revenue and Corriedale costs remaining at that time.

Government Regulation

According to BHE, it is not currently meeting South Dakota's voluntary Renewable, Recycled, and Conserved Energy Objective. However, BHE states that with the Corriedale project, it will have attained approximately 5 percent of the 10 percent goal. Furthermore, if national public policy were to drive utility companies toward lower carbon-emitting generation resources, customers will benefit from the presence of Corriedale reducing the burden of these regulations.

⁵ See Attachment 1

RECOMMENDATION

Staff believes the Settlement results in an appropriate balance between designing a program to address certain customer preferences for renewable energy and mitigating the risk of fixed cost recovery loss due to behind-the-meter generation, while also protecting non-participating customers from the risk of paying for a generation resource that has not been shown to be needed from a capacity or energy perspective.

Staff recommends the Commission grant the Joint Motion for Approval of Settlement Stipulation and adopt the Stipulation without modification. Staff also recommends the Commission approve the tariff sheets as filed with the application, effective August 1, 2019.