BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE APPLICATION OF NORTHWESTERN CORPORATION DBA NORTHWESTERN ENERGY FOR AUTHORITY TO INCREASE ITS ELECTRIC RATES

STAFF MEMORANDUM
SUPPORTING SETTLEMENT STIPULATION

DOCKET EL23-016

Commission Staff (Staff) submits this Memorandum in support of the Settlement Stipulation (Settlement) of December 20, 2023, between Staff and NorthWestern Corporation dba NorthWestern Energy (NorthWestern or Company) in the above-captioned matter.

BACKGROUND

On June 15, 2023, the Company filed an application with the South Dakota Public Utilities Commission (Commission) requesting approval to increase rates for electric service to customers in its South Dakota retail service territory by approximately $30.9 million annually or approximately 16.32%. A typical residential electric customer using 750 kWh per month would see a bill increase of $19.14 per month, or 18.3% under NorthWestern's proposed rates.

NorthWestern's proposed increase was based on a historical test year ended December 31, 2022, adjusted for what NorthWestern believed to be known and measurable changes, a 10.70% return allowance on common equity, and a 7.54% overall rate of return allowance on rate base.

NorthWestern's last base rate increase application was filed on December 19, 2014[1]. NorthWestern states[2] since that time, it has made significant investments in plant and infrastructure, including the Bob Glanzer Generating Station, substations, transmission systems, switchyard upgrades, Advanced Distribution Management System software, AMI meters, and LED streetlight conversion projects. In addition, NorthWestern has experienced increased labor and other operating costs. NorthWestern states a rate increase is necessary in order to ensure that our customers will continue to be served by a financially sound company with access to low-cost capital to continue efficient investments that ensure reliable, safe energy service for customers.

The Commission officially noticed NorthWestern's filing on June 22, 2023, and set an intervention deadline of August 11, 2023. On July 12, 2023, the Commission issued an Order Suspending Operation of Proposed Rates; Order Assessing Filing Fee; Order Authorizing Consulting Contracts.

[1] See Docket EL14-106.
[2] See Notice of Proposed Changes of Rates and Charges

On November 20, 2023, after extensive discovery, Staff provided NorthWestern with its draft revenue requirement determination. Thereafter, Staff and NorthWestern (jointly, the Parties) engaged in settlement discussions in an effort to arrive at a mutually acceptable resolution of the issues presented in NorthWestern's filing, concluding with in-person discussions on November 30, 2023. Ultimately, the Parties reached a comprehensive agreement on NorthWestern's overall revenue deficiency and other issues presented in this case including, but not limited to, class revenue responsibilities, rate design, and tariff concerns.

OVERVIEW OF SETTLEMENT

Staff's revenue requirement determination is the result of a comprehensive analysis of NorthWestern's filing and information obtained during discovery. Staff accepted some Company adjustments, made corrections where necessary, modified other adjustments, and rejected those that did not qualify as known and reasonably measurable. Lastly, Staff introduced new adjustments not reflected in NorthWestern's filed case.

Company and Staff positions were discussed thoroughly at the settlement conferences. As a result, some positions were modified, and others were accepted where consensus was found. Ultimately, the Parties agreed on a comprehensive resolution of all issues. Staff believes the settlement is based on sound regulatory principles and avoids additional costly and unnecessary litigation.

The Parties agree NorthWestern's revenue deficiency recovered through base rates is $21,520,114. Additionally, the Parties agree that NorthWestern will establish a phase in rate plan rider with conditions as discussed below. The revenue requirement and supporting calculations described in this Memorandum and attachments depict Staff's positions regarding all components of NorthWestern's South Dakota jurisdictional revenue requirement.

STAFF OVERVIEW OF BASE RATE SETTLEMENT

Staff's settlement revenue requirement determination begins with total Company test year costs for the twelve months ended December 31, 2022, and allocates those amounts to the South Dakota retail jurisdiction. Staff then adjusted the December 31, 2022, test year results for known and measurable post-test year changes. Staff Exhibit___(PJS-1), Schedule 3 illustrates Staff's determination of NorthWestern's *pro forma* operating income under present rates. Staff Exhibit___(PJS-2), Schedule 2 illustrates Staff's calculation of NorthWestern's South Dakota retail rate base, and Staff Exhibit___(PJS-1), Schedule 2 and Staff Exhibit___(PJS-2), Schedule 1 summarize the positions. Staff Exhibit___(PJS-1), Schedule 1 summarizes Staff's determination of NorthWestern's base rate revenue deficiency and total revenue requirement.

The base revenue increase by rate schedule is shown on Staff Exhibit___(BAM-6), Schedule 2. Staff Exhibit___(BAM-6), Schedules 3-1 through 3-8 reflect the settlement base rates for each rate schedule. The comparison between present and settlement rates and resulting bill impacts for the Residential Service Rate 10 rate schedule is shown on Exhibit___(BAM-6), Schedule 4. Exhibit___(BAM-6), Schedule 1 compares the settlement base revenue increase to the base revenue increase requested in NorthWestern's filing.

Below is a brief discussion of the issues that Staff identified in the case and Staff's view of the resulting settlement of each issue. Unless otherwise noted, all changes discussed below are changes from the

Company's filed position. It should be noted that for most of the issues in this case, NorthWestern's initial position on the issue was identical to how the issue was settled in the Company's last rate case, docket EL14-106. This was greatly appreciated by Staff, as it made for more efficient processing of this rate case. In addition, this means that NorthWestern's requested increase was smaller than it would otherwise have been. This results in a lesser reduction from the proposed request to the settlement determination than we have generally seen in other cases.

RATE BASE AND OPERATING INCOME ADJUSTMENTS

Option L Revenue – NorthWestern proposed an adjustment to normalize test year revenues associated with the Extended Service Rider termed "Option L". NorthWestern began this offering in 1997 which involved long-term service agreements with large industrial customers and discounts for service depending on the length of the agreement. Per Docket EL97-014, these lost margins cannot be collected from other customers. Furthermore, Option L is set to expire in June 2024 and is no longer available for new customers or for renewal of any contracts. Therefore, NorthWestern proposed an adjustment to add back in the discounts the Option L customers received during the test year to ensure other customers are not paying for the revenue shortfall. Staff accepted this adjustment.

Book to Bill – NorthWestern proposed an adjustment to actual revenues booked during the test year to account for the variance between booked revenue and billed revenues in the test year. These revenues differ because of situations such as pro-rated billing cycles, account close-outs, meter misreads, and out-of-period adjustments that affect the amount of revenues booked by the Company versus the revenues billed. The billed revenues were determined based on the test year billing determinants for each rate element multiplied by the tariff rates in effect during the test year. Staff accepted this adjustment.

TCJA Refund – **[Begin Confidential]** [redacted] **[End Confidential]** This occurred in 2019 and resulted in NorthWestern having to refund to customers $155,000, which NorthWestern proposed to return over a 5-year period through an amortization in the cost of service. The settlement makes three modifications to this adjustment.

1. The $155,000 is amortized over a 3-year period to provide the refund more quickly to customers and be consistent with the 3-year moratorium.
2. The average unamortized balance of $77,500 is deducted from rate base, consistent with other amortizations.
3. The adjustment was initially proposed as a decrease to revenue instead of a decrease to expense. This error has been corrected.

These modifications decrease amortization expense by approximately $83,000 and rate base by approximately $78,000 for a total reduction to the revenue deficiency of approximately $89,000.

FERC 555 Adjustment – NorthWestern proposed an adjustment to reflect a five-year average of short-term capacity costs incurred from 2018 through 2022. During settlement, the Parties agreed to remove the test year short-term capacity costs in lieu of adjusting to the five-year average, and instead flow these costs through the Fuel Clause Tracker. NorthWestern requires these short-term capacity agreements to meet its planning reserve margin requirements within the Southwest Power Pool (SPP). These short-term agreements are for one-year or less and have become an increasing and more volatile expense in recent years. Therefore, Staff agrees it is appropriate to include these in the Fuel Clause Tracker at this time. See also “Recovery of Capacity Costs in Fuel Clause Tracker” below under “Other Issues”. The impact of this adjustment reduces operating expenses and the revenue deficiency by approximately $416,000.

Labor – NorthWestern proposed this adjustment to recognize the contracted union salary increases of 2.77% in 2023 and 3.02% in 2024 as well as estimated non-union increases of 4.25% in 2023. Staff’s adjustment accepts the contracted increases for the union work force; however, this adjustment revises the non-union 2023 increase to the actual amount of 4.29%. Staff has reviewed salary studies which indicate NorthWestern’s pay increases are in line with industry averages. Staff’s modifications to the labor adjustment increase operating expense and the revenue deficiency by approximately $2,000.

401k – NorthWestern proposed a corresponding adjustment to recognize the 2023 and 2024 pay increases as they pertain to 401k contributions. Staff accepted the proposed adjustment with a slight revision to reflect the actual 2023 non-union increase. These modifications increase operating expense and the revenue deficiency by approximately $200.

Payroll Taxes – NorthWestern proposed corresponding adjustments to recognize the 2023 and 2024 pay increases as they pertain to Social Security, Medicare, Federal Unemployment Tax, and State Unemployment Tax contributions. Staff accepted the proposed adjustment with a slight revision to reflect the actual 2023 non-union increase. These modifications increase operating expense and the revenue deficiency by approximately $150.

FPP Amortization – NorthWestern proposed this normalizing adjustment to the test year to remove an actuarial gain related to its now terminated Family Protector Plan. NorthWestern recorded an actuarial gain in 2021 and began amortizing it over three years from 2021-2023. With the amortization ending in 2023, a normalizing adjustment of $349,004 has been made as this amortization will not exist after 2023. Staff accepts this adjustment.

Advertising – NorthWestern proposed an adjustment to remove promotional, institutional, and non-jurisdictional advertising expenses that should not be recovered from ratepayers. The settlement accepted this adjustment and further removed additional advertising costs which do not provide for the provision of safe, adequate, and reliable electric service for South Dakota ratepayers. Additional expenses removed include promotional contests, yard makeover prize, and ads not within the South Dakota electric territory. The effect of this adjustment reduced the revenue deficiency by approximately $9,000.

General Advertising – NorthWestern proposed an additional advertising adjustment to remove South Dakota State Fair Sponsorship, sponsorship of sporting events such as SDSU and Stampede Hockey games, and other non-jurisdictional or economic development related items that are capped under Docket EL14-106 that should not be recovered from ratepayers. The settlement accepted this adjustment and further removed additional advertising costs which do not provide for the provision of safe, adequate, and reliable electric service for South Dakota ratepayers. Additional expenses removed include institutional advertising. The effect of this adjustment reduced the revenue deficiency by approximately $4,000.

Leadership SD Sponsorship – NorthWestern proposed an adjustment to remove this sponsorship cost as it did not provide for the provision of safe, adequate, and reliable electric service for South Dakota customers. Staff accepted this adjustment.

Economic Development – The Company proposed to continue its economic development plan as approved in docket EL14-106. Economic development expenses will continue to be split 50/50 between electric customers and shareholders up to $70,000. This adjustment removed all costs over the $35,000 electric customer share from the test year. This settlement accepts this adjustment.

Association Dues – NorthWestern stated in testimony that the lobbying portion of dues expense is recorded below the line. In addition, the Company proposed an adjustment to remove dues paid to the SD Electric Utility Companies. Staff accepted this proposed adjustment and identified that an additional portion of dues paid to the Edison Electric Institute (EEI) related to charitable donations should be removed from the test year, as these dues are not necessary for the provision of safe, adequate, and reliable electric service. This adjustment reduces operating expenses and the revenue deficiency by approximately $1,000.

Board Dividends – NorthWestern proposed this adjustment to remove the costs associated with board of Director deferred compensation plans. Staff accepted this adjustment.

CAT Generation O&M Contract – The Company proposed an adjustment to annualize the expenses for daily operations at Bob Glanzer Generating Station, which went into service on May 27, 2022. NorthWestern entered into a contract with Caterpillar to provide the day-to-day operations and maintenance duties. This settlement updates the expenses to include an annualization of the 13-month average of actual expenses from June 2022 to June 2023. The effect of this adjustment increased the revenue deficiency by approximately $14,000.

Bad Debt – NorthWestern proposed an adjustment to increase bad debt expense based on a 5-year uncollectible rate average applied to adjusted retail revenues. The settlement modifies this adjustment to use the settlement amount of adjusted retail revenues. This modification decreases operating expense and the revenue deficiency by approximately $17,000.

Spouse Travel and Lineman's Rodeo Trip on Aircraft – An adjustment was made in rate case docket EL14-106 to remove the aircraft costs related to spouses riding on the NorthWestern aircraft and all aircraft costs related to the trip to attend the National Lineman's Rodeo. A similar adjustment was proposed in this rate case using the same methodology that was used in the last rate case. Staff accepts this adjustment.

Rate Case Expense – The Company proposed to amortize projected rate case costs of $150,045 over a five-year period, net of $45,204 test year expenses, and include the average unamortized amount of $75,023 in rate base. This settlement reflects a three-year amortization of $190,624 in actual costs incurred, net of $45,204 in test year expenses, as well as the inclusion of the average unamortized amount of $95,312 in rate base. The effect of this adjustment increases the amortization expense by approximately $33,000 and increases rate base by approximately $20,000. This adjustment increases the revenue deficiency by approximately $35,000.

Incentive Compensation – NorthWestern offers its officers, managers, and employees opportunities to earn incentive compensation in addition to their base salaries and wages. The Company offers these opportunities under three separate plans: the Long-Term Incentives Plan (LTIP); the Employee Incentive Compensation Plan; and the Retirement Savings Plan Incentive Match. In prior South Dakota gas and electric rate cases, stipulations recommended by Staff which eliminated incentive compensation expenses that were awarded based on achieving financial targets were approved by the Commission. In the instant proceeding, NorthWestern proposed to exclude $866,120 from incentive compensation via the LTIP and STIP Removal. This is the amount that was awarded during the test year for achieving financial performance targets. The remaining incentive expense in the test year is the portion related to safety, customer satisfaction, and reliability. Staff accepts the Company's filed Incentive Compensation adjustments with the condition that if the Company does not pay the remaining Short Term Incentive Plan (STIP) during any given year, the total amount of STIP expenses included in base rates for each year STIP is not paid will be entered into an account and be refunded to ratepayers in the Company's next rate case. The treatment reflected in the settlement in this proceeding is consistent with Staff's and the Commission's treatment of incentive compensation expenses in recent prior electric and gas proceedings.

Claims and Injury Compensation – The Company proposed an adjustment to claims and injury compensation expense to reflect a five-year average from 2018 through 2022. In response to Staff's discovery, the Company proposed an update to correct for an invoice charged inadvertently to FERC Account 925 and should have been charged to FERC Account 924. The settlement reflects this revised adjustment, increasing operating expense and the revenue deficiency by approximately $99,000.

Storm Damage – NorthWestern proposed an adjustment to normalize storm damage expense to reflect a five-year average from 2018 through 2022. Staff accepted this adjustment.

Vegetation Management – NorthWestern proposed an adjustment to normalize vegetation management expense to reflect a five-year average from 2018 through 2022. In response to Staff's discovery, NorthWestern indicated that the Company began using a 7-year cycle for line clearance in 2016. In order to capture an entire vegetation management cycle in the normalization average, Staff proposed a 7-year average be used instead of a 5-year average. Staff's determination of the settlement normalizes vegetation management expense based on a 7-year average from 2017 through 2023. The impact of this adjustment increases operating expense and the revenue deficiency by approximately $23,000.

Depreciation for New Rates – NorthWestern proposed an overall composite depreciation rate of 3.53% based on an annual accrual of $49,436,290 million based on December 31, 2022 balances. Staff proposed a number of adjustments to NorthWestern's depreciation parameters, including an adjustment of the terminal retirement date for Wind Production, as well as an adjustment to the Company's methodology for estimating future net salvage. The settlement determination adjusts the terminal retirement year for Wind Production to 2045. The settlement determination also continues the currently approved method for estimating future net salvage but includes net salvage percentage amounts that are more consistent with historical data. The overall composite remaining life agreed to as part of the settlement determination is 3.43% based on an annual accrual of $47,989,624. This adjustment decreases depreciation expense by approximately $1,698,000 and increases rate base by approximately $3,807,000 for a net decrease to the revenue deficiency of approximately $1,370,000.

Normalizing Additions/Retirements During Test Year – The Company proposed an adjustment to annualize test year plant additions that were completed during the test year. The settlement determination revises the Company's adjustment to: 1) update depreciation rates to reflect those determined in this case; and 2) use a 12 month calculation for depreciation expense. The net effect of these changes is to increase rate base by approximately $520,000 and reduce depreciation expense by approximately $296,000. This adjustment decreases the revenue deficiency by approximately $251,000.

Interest Synchronization – NorthWestern proposed an adjustment to synchronize the tax deduction for interest expense with the weighted cost of long-term debt and the historic test year rate base as adjusted for known and measurable changes. The settlement modifies this adjustment to use the settlement pro-forma rate base. This modification decreases tax expense and the revenue deficiency by approximately $26,000.

Carrying Charge – NorthWestern proposed an adjustment to remove the recorded interest income from customers calculated on under-collected tracker balances as it is not guaranteed or known for any periods beyond the test year. Staff accepted this adjustment.

Income Tax Adjustment – The Company's filing included pro forma adjustments to income tax for true up items and tax adjustments for temporary differences. The settlement accepts this adjustment.

NERC Relay Substation Testing Expense Normalization – In December 2015, the Federal Energy Regulatory Commission (FERC) issued a Letter Order approving the North American Electric Reliability Corporation's (NERC's) proposed Reliability Standard PRC-005-6 (Protection System, Automatic Reclosing, and Sudden Pressure Relaying Maintenance). Mandatory compliance with this reliability standard began in 2017, including a requirement that all 115 kV substations be tested every six years. Numerous units needed to be tested in 2022 to comply with the six-year testing requirement. However, the same level of required testing is not expected for each year going forward. Therefore, Staff proposed an adjustment to normalize these testing costs. The settlement reflects a normalized cost based on the average devices tested per year multiplied by the average cost per device in 2022. This adjustment reduces operating expense and the revenue deficiency by approximately $51,000.

Steam Power Maintenance – The settlement reflects an adjustment to normalize maintenance expense for Big Stone Plant, Coyote Station, and Neal 4 Plant. These expenses vary from year to year largely due to when major plant maintenance outages occur. The 2022 test year included an overhaul for one of the three coal plants. Staff's determination of the settlement normalizes FERC Account 512 and 513 expenses for each plant including the most recent overhaul year in the average.

The most recent major overhaul at Coyote was in the 2022 test year, with major overhauls scheduled every 3 years. The settlement adjustment reflects an average of maintenance expenses for Coyote for the years 2021 through 2023.

Big Stone's last major overhaul was in 2021. Historically, major overhauls have occurred every three years. The settlement adjustment reflects an average of maintenance expenses for Big Stone for the years 2021 through 2023. In addition, the settlement removes from the average the 2022 and 2023 costs associated with an exciter failure, as these costs should not be recurring in the future.

The most recent overhaul at Neal 4 was in 2019. The settlement adjustment reflects an average of maintenance expenses for Neal 4 for the years 2019 through 2023.

All costs included in the averages for 2023 reflect actual costs to date through November 2023, with a historical average of normal costs used for December. In total, this adjustment increases operating expense and the revenue deficiency by approximately $18,000.

Post Test year Additions/Retirements – NorthWestern proposed an adjustment to reflect plant investments expected to be used and useful prior to rates going into effect. Only one project was proposed to be recovered. The settlement revises the Company's adjustment to: 1) Reflect actual costs for the completed project through December 12, 2023; 2) Update the depreciation rate to reflect the rate determined in this case; and 3) Reflect average accumulated depreciation and accumulated deferred income taxes. The net effect of these adjustments reduces rate base by approximately $77,000 and increases depreciation expense by approximately $23,000. This adjustment increases the revenue deficiency by approximately $17,000.

Huron 1 Removal – Staff proposed, and the settlement includes an adjustment to reduce depreciation, O&M, and rate base for the now retired Huron 1 power plant. This adjustment reduces deprecation by approximately $33,000, reduces O&M by approximately $34,000, and reduces rate base by approximately $867,000. This adjustment reduces the revenue deficiency by approximately $142,000.

Cash Working Capital – NorthWestern's proposed rate base included an allowance for cash working capital based on a lead-lag analysis. A lead-lag analysis examines the timing of the Company's receipt of service revenues from customers in relation to the Company's payment of expenses to vendors and employees. Staff carefully examined NorthWestern's revenue lag and expense lead day determinations and made the following modifications:

1. Corrected an error in the calculation of Other O&M Expense lead days;
2. Revised the lead days for Federal Income Tax;
3. Revised expense per day to incorporate into the lead-lag analysis the impacts of the settlement pro forma operating expense.

These modifications decreased rate base by approximately $399,000 and the revenue deficiency by approximately $34,000.

Tax Collections Available – Staff proposed, and the settlement includes an adjustment to reduce rate base for tax collections NorthWestern receives in advance of turning the related payments over to the taxing authorities. This adjustment reduces rate base by approximately $629,000 and the revenue deficiency by approximately $54,000.

Other Working Capital – NorthWestern proposed an adjustment to remove the accumulated provision for uncollectibles and the accumulated provision for injuries and damages from rate base, because these items have already been properly captured in the lead-lag study in the cash working capital adjustment. The proposal also removes some prepayments from rate base as they either are not used and useful or they have already been properly captured in the lead-lag study in the cash working capital adjustment. The settlement accepts these removals and updates material and supplies, fuel stocks, customer deposits, and the remaining prepayments to reflect a more recent 13-month average. These updates increase rate base by approximately $2,234,000 and the revenue deficiency by approximately $193,000.

COST OF CAPITAL AND RATE OF RETURN

NorthWestern's filing incorporated a requested overall rate of return (ROR) of 7.54 percent, based on a capital structure of 49.50 percent long-term debt and 50.50 percent common equity, with a claimed embedded cost of debt of 4.32 percent and a requested return on equity (ROE) of 10.7 percent. The capital structure and embedded debt costs were based upon December 31, 2022 capital balances with pro forma adjustments to reflect new debt issuances in March and May of 2023, and an adjustment to equity capital to reflect an allocation of deferred tax assets occurring as a result of NorthWestern's reorganization as a holding company with South Dakota/Nebraska jurisdictional and Montana jurisdictional utility operations becoming stand-alone subsidiaries. Upon review, Staff concluded that the resulting capital structure and embedded cost of debt was consistent with Commission precedent and a reasonable basis for developing an overall rate of return. Only ROE remained as a rate of return issue for settlement discussions.

[Begin Confidential] [redacted]

[redacted] **[End Confidential]** the settlement overall rate of return is 6.81 percent.

RATE DESIGN ISSUES

The settlement position reached between Staff and NorthWestern on all issues regarding rate design and the class revenue distribution is discussed below.

Class Cost of Service/Spread of the Increase – NorthWestern hired an outside expert, Mr. Paul Normand, to conduct a class cost of service study ("CCOSS"). A CCOSS is useful in aiding the analyst in assigning a utility's revenue requirement to customer classes based on cost causation. The fundamental principle underlying cost allocation studies is that costs are attributed to customer groups based on the costs to serve those groups or on the relative benefits received by the groups. Costs examined in a cost study may be either directly assigned or allocated to the customer classes. Rationally allocated costs are an important factor to consider, but not the sole factor, in establishing class revenue targets. CCOSS results also can be useful in designing the rates charged within customer classes.

The CCOSS that Mr. Normand prepared for NorthWestern is traditional in that he used the same allocation procedures used by NorthWestern in prior cases, which are methods that are frequently used by utilities in other jurisdictions. Specifically, Mr. Normand used the twelve-monthly coincident peaks to allocate the Company's production and transmission facilities. He used class non-coincident peak demands and, in some cases, individual customer maximum demands to allocate the Company's distribution facilities to the customer classes. Each of these treatments is well-known in the industry.

Based on the results of his CCOSS, Mr. Normand concluded that revenues from the Residential class are somewhat less than the allocated cost of service for that class and that revenues from the Irrigation and Lighting classes, while relatively small as a class, are significantly less than their allocated costs.

Revenues for the Commercial and Industrial classes exceed their allocated costs of service, on the other hand. In the end, however, Mr. Normand proposed a relatively uniform percentage revenue increase for all rate classes, essentially to maintain rate stability.

Staff carefully reviewed Mr. Normand's CCOSS and has no significant concerns with the way in which the study was conducted. Staff also is supportive of a relatively uniform percentage spread of the agree-upon revenue increase among all rate classes. Settlement rates were designed with the goal of an overall revenue increase per class of approximately 11.38%, as shown on Exhibit 3 to the Settlement Stipulation. The resulting increases per class in accordance with the settlement rates is summarized on Exhibit___(BAM-6) Schedule 1.

Rate Design (Residential Customer Service Charge) – Presently, NorthWestern's Residential (Rates 10, 10YS, 11, and 11YS) monthly service charge is $6.00 per month. Mr. Normand's CCOSS indicates that the current service charge rate is below the allocated cost, although the amount of the deficiency is disputed by the Parties. During settlement negotiations, the Parties agreed that the Residential monthly service charge should be increased by no more than approximately the overall percentage revenue increase. Staff can verify to the Commission that the agreed-upon $7.00 monthly service charge does not exceed Staff's interpretation of the class cost of service results and that $7.00 is a reasonable rate.

<u>OTHER ISSUES</u>

Bob Glanzer Generating Station (BGGS) – NorthWestern sought cost recovery[3] for the BGGS, which is a 58-MW natural gas-fired Caterpillar Reciprocating Internal Combustion Engine (RICE) generation facility that went into service in June 2022. BGGS is essentially a replacement for Huron units 1 and 2 with a combined nameplate capacity of approximately 60 MW. NorthWestern's 2018 plan evaluated a number of retirement and replacement options for its aging plants. Replacement of Huron units was found to be the least cost in this evaluation.

Huron 2 ceased operations due to a fire in January 2019. Prior to the fire, the Company had scheduled for this unit to be retired in 2022 due to age and scarcity of parts. Huron 1 was much older than Huron 2 and its life was being extended to coincide with the retirement of Huron 2 to allow for efficient use of the site and interconnection. Huron 2's fire essentially triggered a replacement for both the units. .

Efforts were made to evaluate whether 58 MW capacity was the appropriate amount given that NorthWestern was facing a need in addition to replacing Huron 1 and 2. NorthWestern chose a 60 MW limitation due to the existing Large Generator Interconnection Agreement (LGIA) of this amount. Since SPP's interconnection queue would have resulted in taking four years to reach a determination of a larger size, the 58 MW size is found to be appropriate. In this manner, the Company was able to maximize the use of its existing LGIA without lags and cost effectively construct generation needed to replace the Huron units. The Company secured short term capacity agreements to meet incremental need.

The Company implemented a Request for Proposals (RFP) process to competitively solicit the resource itself. The Company's detailed evaluation led to choosing the 58-MW natural gas fired Caterpillar RICE unit. The assessment associated with the resource plan and the competitive solicitation indicate that the BGGS is a cost-effective resource replacement to the Huron units compared to other alternatives.

[3] BGGS is included in the "Normalizing Additions/Retirements During Test Year" adjustment discussed above.

Production Tax Credit (PTC) Sales – During settlement discussions, NorthWestern indicated that the Inflation Reduction Act of 2022 (IRA) created the ability for utilities to monetize PTCs generated after 2022. At present, the Company passes through 100% of the credits to customers independent of whether it has enough taxable income to utilize the credits. Any unutilized PTCs are categorized as a deferred asset on the Company's balance sheet, which is an addition to rate base and earns a return.

To the extent that NorthWestern continues to be unable to utilize the PTCs, the Company's proposed approach is to monetize the PTCs and pass through the Fuel Clause Tracker, net of the costs of transferability, instead of further accumulating as a deferred tax asset. At present, NorthWestern owns one wind project (i.e., Beethoven), with PTCs expiring in May 2025. Staff agreed to consider NorthWestern's proposed approach for the Beethoven project as a test case. However, the onus will be on the Company to provide the analysis necessary to demonstrate net benefits for ratepayers, in future Fuel Clause Tracker filings where it seeks to monetize the PTCs.

Recovery of Short-term Capacity Costs in Fuel Clause Tracker – During settlement discussions, NorthWestern indicated that it will likely have the need to secure additional short-term capacity contracts and proposed to recover the related costs through the Fuel Clause Tracker. Staff viewed these purchases as a bridge between current resource disposition and building a new resource to meet need and agreed to NorthWestern's proposal provided the capacity purchases are short term in nature and do not exceed one year in duration[4]. Further, Staff conditioned its agreement on the requirement that the pass through of the short-term capacity purchases expire once the Company acquires a new resource and seeks recovery through the Phase in Rate Plan Rider or future base rate increase, whichever comes first. In the event NorthWestern demonstrates that it remains capacity deficient and was constrained to build the required capacity to meet its need due to SPP interconnection queue challenges or existing LGIAs, Staff is not opposed to considering NorthWestern's request to recover the capacity purchases through the Fuel Clause Tracker or an appropriate recovery mechanism depending on the term that is most cost effective for ratepayers.

Phase In Rate Plan Rider – SDCL 49-34A-73 allows for the recovery of capital investments not yet included in base rates or otherwise recovered through other available mechanisms. The settlement creates a tariff and allows for the future rider recovery of NorthWestern's incremental generation capacity resource through this Phase In Rate Plan Rider. This rider is subject to annual Commission review and must be filed 90 days prior to the effective date of rates. The filing shall include, but not be limited to, detail regarding the proposed generation resources, including justification of need, project costs, and an updated tariff with relevant rates. NorthWestern must also file an annual earnings report by June 1 of each year, as is custom with rider approvals.

Rate Moratorium – The Parties agree that NorthWestern shall not file any rate application for an increase in base rates which would go into effect prior to January 1, 2027.

Implementation of Rates – The tariffs shown on Exhibit 4 attached to the Settlement Stipulation are proposed to be implemented for service rendered on or after January 10, 2024. Customer bills will be prorated so that usage prior to that date is billed at the current rates and usage on and after that date is billed at the new rates.

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[4] The Commission has approved the flow through of short-term capacity related transactions in the Fuel Clause trackers for other utilities in the past. See for example, EL14-026.

Interim Rates – As part of the settlement, NorthWestern decided to forego implementing interim rates in this docket. Assuming rates go in effect on January 10, 2024, this saves customers approximately $1,651,000.

RECOMMENDATION

Staff recommends the Commission approve the Settlement for the reasons stated above.