STATE OF NORTH DAKOTA

PUBLIC SERVICE COMMISSION

Montana-Dakota Utilities Co.
Financial Incentive – Power Purchase Agreement Rates

Case No. PU-21-373

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

April 13, 2022

Appearances

Commissioners Julie Fedorchak and Randy Christmann.

Paul Sanderson, Evenson Sanderson, PC, 1100 College Drive, Suite 5, Bismarck, ND 58501, appearing on behalf of Montana-Dakota Utilities Co. ("Montana-Dakota").

Brian L. Johnson, Legal Counsel, Public Service Commission, State Capitol, 600 E. Boulevard Avenue, Bismarck, ND 58505, appearing on behalf of Public Service Commission Advocacy Staff.

John M. Schuh, General Counsel, Public Service Commission, State Capitol,600 E. Boulevard Avenue, Bismarck, North Dakota 58505, appearing on behalf of the Public Service Commission Advisory Staff.

Hope Hogan, Administrative Law Judge, Office of Administrative Hearings, 2911 North 14th Street, Suite 303, Bismarck, North Dakota 58503, as Procedural Hearing Officer.

Preliminary Statement

On August 18, 2021, Montana-Dakota Utilities Co. (Montana-Dakota) filed for Commission approval, an application for financial incentive related to two power purchase agreements (PPA) with Minnkota Power Cooperative (Minnkota) for the purchase of electric capacity and energy from the Milton R Young Unit 1 coal-fired electric generation facility (Milton R. Young).

On October 27, 2021, Public Service Commission Advocacy Staff ("Staff") filed a recommendation regarding the application, recommending denial of the application.

On November 9, 2021, Montana-Dakota filed rebuttal and additional testimony in support of the application.

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Findings of Fact, Conclusions of Law, and Order with Dissenting Opinion of Commissioner Randy Christmann
Public Service Commission

On December 15, 2021, the Commission issued a Notice of Hearing, scheduling a public hearing for January 20, 2022. The issues identified in the Notice of Hearing are:

1. Whether the purchase agreements are for power from a new or existing facility utilizing lignite mined in this state as its primary fuel, and

2. Whether the purchase agreements are for power from a dispatchable on-demand generating unit, plant or facility, and

3. Whether the purchase agreements are for power that will protect grid reliability, and if so,

4. What is a reasonable rate for the financial incentive for the power purchase agreements, and

5. Is it appropriate for the financial incentive to be included in the company's existing Generation Resource Recovery Rider – Rate 56?

On January 20, 2022, the public hearing was held as scheduled in the Commission Hearing Room, State Capitol, 600 E. Boulevard Avenue, 12th Floor, Bismarck, North Dakota 58505.

Having allowed all interested persons an opportunity to be heard, and having heard, reviewed, and considered all testimony and evidence presented, the Commission makes the following:

Findings of Fact

1. Montana-Dakota is a Delaware corporation, authorized to provide electric service to retail customers in North Dakota.

2. On May 4, 2020, and July 22, 2020, Montana-Dakota entered into two PPAs with Minnkota for the purchase of capacity and energy from the Milton R. Young effective June 1, 2021, through May 31, 2026.

3. On August 1, 2021, North Dakota Century Code (N.D.C.C.) § 49-06-02 was amended and reenacted to state that:

> The Commission shall allow a public utility for those new or existing facilities utilizing lignite mined in this state as its primary fuel . . . to recover costs in rates, including a financial incentive set at a reasonable rate for power purchase agreements of a dispatchable on-demand generating unit, plant, or facility deemed to protect grid reliability.

4. SB 2206 was signed on April 13, 2021, and became effective on August 1, 2021. Therefore, Montana-Dakota entered the PPA prior to the amendment to N.D.C.C. § 49-

06-02 and the decision to enter into the PPAs was irrespective of a financial incentive provided by N.D.C.C. § 49-06-02.

5. Montana-Dakota is currently recovering the costs of the PPAs through the fuel and purchase power adjustment rider.

6. Milton R. Young is an existing facility near Center, ND, that is supplied from a mine-mouth source of lignite fuel. Therefore, the Commission finds the PPAs are for power from an existing facility utilizing lignite mined in this state as its primary fuel.

7. Milton R. Young provides a baseload energy supply that is highly reliable and firm. As a result, the commission finds the PPAs are for power from a dispatchable on-demand generating unit, plant, or facility.

8. Milton R. Young can deliver energy to the transmission system on a demand basis, it helps to control transmission system voltage, provides ancillary service in the area, and remains available to support local customers. Milton R Young also is a mine-mouth generating unit that provides additional protection from fuel supply disruption. Based upon these factors, the Commission finds Milton R Young protects grid reliability.

9. Advocacy Staff testified that approval of a financial incentive would only be to increase shareholder profits, not to incent or induce the action of entering a PPA, and therefore a financial incentive is not warranted in this case.

10. Montana-Dakota proposes that a financial incentive of 6.939 percent be applied on the North Dakota portion of the cost of its PPAs beginning August 1, 2021. This proposed incentive rate is based on its weighted average cost of capital, using its authorized return on equity of 9.65 percent along with its cost of short- and long-term debt, and the following capital structure:

Long Term Debt	43.871%	4.647%	2.039%
Short Term Debt	6.310%	1.463%	0.092%
Common Equity	49.819%	9.650%	4.808%
Total	100.000%		6.939%

11. Advocacy Staff submitted that if the Commission chooses to apply a financial incentive, a reasonable rate of financial incentive should not be the rate of return. The rate of return that normally applies to the rate base is set to be commensurate with a risk that is absent in this scenario. Advocacy Staff provided that a reasonable rate of financial incentive should be the risk-free rate of return, which is often set at the treasury bill rate. Advocacy Staff testified that the treasury bill rate is currently around 0.58 percent, or one-tenth the amount requested by Montana-Dakota.

12. Montana-Dakota proposes to recover the incentive through its existing Generation Resource Cost Recovery Rider – Rate 56.

Discussion

Prior to the passage of SB 2206 during the 67th Legislative Session, utilities were allowed to recover the costs of purchased power and capacity agreements through the fuel and purchased power adjustment rider. The August 1, 2021, amendment and reenactment of N.D.C.C. § 49-06-02 set forth a requirement for the Commission to permit a utility to recover a financial incentive set at a reasonable rate in addition to the cost of PPAs with a North Dakota lignite generation facility that provides dispatchable and on-demand energy and is found to be necessary to protect grid reliability.

A financial incentive is a means to encourage new action. In determining a reasonable financial incentive, the amount should be rationally tailored to the risk presented by the investment and induced action. This can be differentiated from the just and reasonable rate of return approved through cost-based ratemaking, which includes compensation to shareholders for their capital investments and associated risk. It is foreseeable that the approved weighted average cost of capital may be a reasonable incentive to induce action in many cases, subject to factors that would provide a basis for upward or downward adjustment.

In the current case, the weighted average cost of capital is not a reasonable incentive. The Commission recognizes that the approval of a financial incentive under 49-06-02 may be somewhat retrospective due to the nature of rate regulation, the PPAs, in this case, were signed six months before this legislation was drafted, nine months before it was passed into law and 12 months before the law became effective. Clearly, the possibility of a future financial incentive had no bearing on the company's decision to enter these PPAs. It would be unreasonable to approve a substantial financial incentive that has no connection to the conduct that occurred or a showing that the conduct was induced at least by the anticipation of a financial incentive.

The Commission concludes that several factors, including the shorter term of the PPA, the lack of associated risk, and most importantly, the lack of connection between the action and financial incentive provide that a reasonable financial incentive should be minor if anything. The Commission also concludes that a proxy value of the risk-free rate of return is an appropriate incentive for the current circumstances.

From the foregoing Findings of Fact, the Commission makes the following:

Conclusions of Law

1. The Commission has jurisdiction in this proceeding.

2. The PPAs are for power from a new or existing facility utilizing lignite mined in this state as its primary fuel.

3. The PPAs are for power from a dispatchable on-demand generating unit, plant or facility.

4. The PPAs are for power that will protect grid reliability.

5. A reasonable rate for a financial incentive is the five-year treasury rate at the time of the filing of Montana-Dakota's application, which was approximately 0.79%.

6. It is reasonable for Montana-Dakota to recover the financial incentive in the Generation Resource Cost Recovery Rider – Rate 56.

From the foregoing Findings of Fact and Conclusions of Law, the Commission makes the following:

Order

1. Montana-Dakota is granted a financial incentive at a rate of 0.79% to be calculated consistent with the manner proposed by Montana-Dakota in its application. For the avoidance of doubt, Montana-Dakota may recover one-twelfth of the 0.79% rate or 0.000658% of the monthly PPA cost as its incentive rate.

2. The financial incentive may be recovered in Montana-Dakota's existing Generation Resource Cost Recover Rider – Rate 56 through the true-up mechanism in the next annual filing to be filed on or about November 1, 2023.

3. Montana-Dakota's existing tariffs must be updated in compliance with the Commission's Findings of Fact, Conclusions of Law, and Order.

PUBLIC SERVICE COMMISSION

"Dissent"	Julie Fedorchak	Sheri Haugen-Hoffart
Randy Christmann **Commissioner**	**Julie Fedorchak** **Chair**	**Sheri Haugen-Hoffart** **Commissioner**

DISSENT

Commissioner Randy Christmann

April 13, 2022

Montana-Dakota Utilities Co.
Financial Incentive – Power Purchase Agreement
Rates

Case No. PU-21-373

The Order for Case # PU-21-373 grants Montana-Dakota a financial incentive of .79% for a 5-year power purchase agreement with Minnkota Power Cooperative. This Order should have been rejected in favor of the alternative Order on the agenda which would have granted a financial incentive of 3.50%.

A new law passed in 2021 (after this power purchase agreement was signed) requires the Commission to allow a public utility a financial incentive set at a reasonable rate for power purchase agreements of a dispatchable, on-demand generating unit deemed to protect grid reliability. Either of the Orders before the Commission acknowledge that this PPA meets the requirements of the law. The only question seems to be what amount constitutes a reasonable rate.

Montana-Dakota requested 6.939%, which is their weighted average cost of capital from their last electric rate case. There seems to be no disagreement that the amount requested by Montana-Dakota is too high because the power purchase agreement is only five years and comes with very minimal risk. It is also acknowledged that the agreement was consummated before the law's creation.

An incentive of 3.5% would have been low enough to acknowledge the difference between this very short and low-risk agreement and others that may have been imagined when the law was enacted. It would have also been a just and reasonable reward for the type of purchase being encouraged by this new law.

An incentive of .79% does not, to me, reflect a "reasonable" rate required by law.

Randy Christmann

Randy Christmann, Commissioner