Montana Public Service Commission
Docket No. 2022.07.078
Electric and Natural Gas General Rate Review

PRE-FILED DIRECT TESTIMONY – PRIORITY REGULATORY MECHANISMS

OF CYNTHIA S. FANG

ON BEHALF OF NORTHWESTERN ENERGY

TABLE OF CONTENTS

Exhibits

Natural Gas	Exhibit CSF-1.3
Reliability Rider	Exhibit CSF-1.4
Fixed Charge Revenue Mechanism Rider	Exhibit CSF-1.5

Witness Information

Q. Please provide your name, employer, and title.

A. My name is Cynthia (Cyndee) S. Fang. I am NorthWestern Energy's ("NorthWestern") Director of Regulatory Affairs.

Q. Please provide a description of your relevant employment experience and other professional qualifications.

A. As Director of Regulatory Affairs for NorthWestern, my primary responsibility is to lead and manage NorthWestern's regulatory affairs before the Montana Public Service Commission ("Commission"). Prior to joining NorthWestern in 2021, I held various leadership roles at San Diego Gas & Electric ("SDG&E") including Manager of Customer Pricing, overseeing rate strategy; Manager of Energy Research & Analysis, overseeing electric load forecasting, research and analysis; and Origination and Portfolio Design Manager, leading electric procurement efforts. Before SDG&E, I was a Public Utilities Rates Analyst with the Energy Division of the Minnesota Department of Commerce. I hold a Bachelor of Science degree in Political Economics of Natural Resources from the University of California at Berkeley and have completed all of the coursework for a Ph.D. in Economics from the University of Minnesota. In addition, I am the Vice Chair of the Rates and Regulatory Committee for Edison Electric Institute

("EEI") and have presented on a variety of rate design issues, including presenting at the EEI's 2022 Electric Rates Course.

Purpose and Summary of Testimony

Q. What is the purpose of your testimony in this docket?

A. The purpose of my testimony is to present NorthWestern's regulatory proposals as part of this rate review. More specifically, the Administrative Rules of the State of Montana ("ARM") 38.5.106 defines the scope of a rate review in Montana to be based on a historic test year. A rate review filed in 2022 would be based on costs associated with 2021, with the ability to adjust for "known and measurable" facilities, operations, or costs that become effective within 12 months of the last month of the test period.[1] This rule limits the ability for NorthWestern to recover costs to provide safe and reliable service for our customers in the years following the implementation of this rate review. My testimony presents NorthWestern's regulatory proposals to better address more timely cost recovery in a few critical areas needed to ensure safe and reliable service for our customers.

[1] *See* ARM 38.5.106 https://rules.mt.gov/gateway/RuleNo.asp?RN=38%2E5%2E106 "However, no adjustments shall be permitted unless based on changes in facilities, operations, or costs which are known with certainty and measurable with reasonable accuracy at the time of the filing. No adjustment will be entertained unless it will become effective within 12 months of the last month of the test period as used in this section."

Q. Please summarize your testimony.

A. My testimony first describes the current regulatory environment and then presents NorthWestern's proposals to provide for more timely cost recovery. Specifically, these proposals include:

- Fuller utilization of timely cost recovery allowed under current rules, specifically "known and measurable" adjustments;[2]
- The introduction of new regulatory mechanisms to address more forward-looking cost recovery for critical service areas which include: (1) NorthWestern's Enhanced Wildfire Mitigation Plan, (2) Business Technology ("BT"), which includes NorthWestern's IT and Cyber Security needs, and (3) reliability resources with a proposal for a Reliability Rider;
- A proposal to redesign NorthWestern's Power Costs and Credits Adjustment Mechanism ("PCCAM") to better capture evolving market conditions; and
- A proposal to redesign NorthWestern's Fixed Cost Recovery Mechanism ("FCRM") pilot to effectively implement decoupling.

Regulatory Priorities

Q. What are NorthWestern's regulatory priorities in this rate review?

A. NorthWestern has four key priorities in this filing:

(1) To update its cost recovery to reflect the current costs to provide safe and reliable service to its customers. NorthWestern's current cost recovery for electric is based on a 2018 rate review, which reflected costs associated with

[2] *Id.*

a 2017 test year, and current cost recovery for natural gas is based on a 2016 rate review, which reflected costs associated with a 2015 test year. NorthWestern's rate review filing includes the pre-filed direct testimonies of various operations witnesses, which present the investments made during this time to ensure the safe and reliable service of our customers and are summarized by Mr. Brian B. Bird, NorthWestern's Chief Operating Officer;

(2) The introduction of regulatory mechanisms that would provide more timely cost recovery in critical service areas, specifically wildfire mitigation, BT, and reliability, where we expect costs to continue to increase beyond 2022 expected cost levels. NorthWestern intends these proposals to reduce regulatory lag that exists under the current historic test-year rate review structure. Timely cost recovery is necessary to ensure that NorthWestern is able to continue meeting our customers' needs for safe and reliable service;

(3) To present NorthWestern's proposed PCCAM reforms to better reflect current conditions in the energy market; and

(4) To present NorthWestern's proposed FCRM reforms in order for the pilot to appropriately implement decoupling.

Q. What do you mean by "more timely cost recovery?"

A. More timely cost recovery means rates that recover costs as NorthWestern incurs them. This would result if the current cost of providing services to customers were being reflected in customer rates today, providing customers with more accurate price signals, instead of today's cost of service being

captured in future rates paid for by future customers. More timely cost recovery can also help mitigate steep bill increases that may result from a lag in cost recovery. As explained in the Pre-filed Direct Testimony of Crystal D. Lail, NorthWestern requires timely recovery of its costs in order to finance some of the most critical electric and natural gas services at reasonable costs to customers.

Q. What are the obstacles NorthWestern sees to more timely cost recovery?

A. As noted above, currently, NorthWestern's customers are paying electric rates based on a 2018 electric rate review, reflecting 2017 costs of electric service, and a 2016 natural gas rate review, reflecting 2015 costs of natural gas service. In this rate review, while NorthWestern seeks to update its cost of service to reflect 2021 information, the historic test-year structure still results in a lag in cost recovery reflected in the prices customers pay.

Filing more frequent rate reviews would reduce some of this lag in cost recovery, but it will not completely resolve the issue. NorthWestern proposes regulatory mechanisms in this filing to reduce some of this lag in some limited critical services, which are discussed in more detail below.

Q. What is regulatory lag?

A. Regulatory lag generally refers to the delay between when a utility incurs costs and when it is able to recover those costs in rates as a result of limitations or constraints in its regulatory framework. A regulated utility cannot increase its

rates without Commission approval. A utility must file a request to increase rates through the Commission process, which provides parties the ability to scrutinize requests through a contested case proceeding.

Among other things, administrative rules govern the Commission's oversight of Montana utilities. Specifically, as noted previously, ARM 38.5.106 requires that rate reviews for Montana utilities are based on a historic test year, that is, they are based on "costs as reflected on the filing utility's books for a test period consisting of 12 months actual experience ending no earlier than 9 months prior to the date of filing."[3] In this case, NorthWestern's rate review filed in 2022 is a request to increase rates based on the 2021 costs that have already been incurred. By the time this docket is resolved, it is likely that 2023 will be at least half over.

ARM 38.5.106 does allow for "known and measurable" cost adjustments that "will become effective within 12 months of the last month of the test period."[4] For this case, that means including 2022 projected costs, to provide the utility with an ability to bring costs recovered to amounts that are more current. However, there continue to be limitations even when looking at 12 months beyond the test year. The Commission and intervenors need time to assess the reasonableness of a utility's rate requests. Under Montana Code Annotated § 69-3-303, the Commission has 270 days, or 9 months, to provide a final decision in a rate

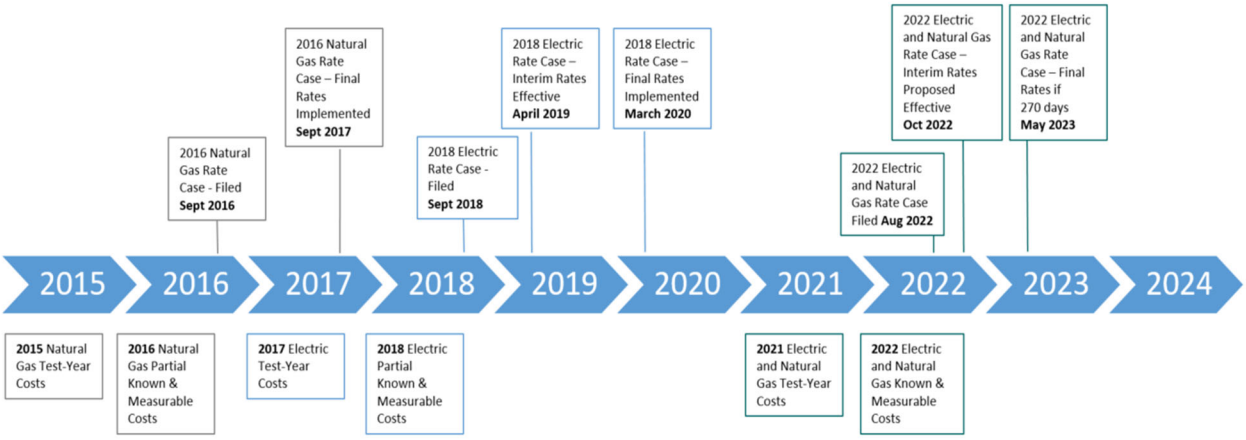
[3] *Id.*
[4] *Id.*

review. Taking this filing as an example, this will result in a final rate implementation date in mid-2023, at minimum, for the recovery of 2021 costs adjusted for 2022 known and measurable changes in costs.[5] NorthWestern does not currently have an authorized regulatory vehicle to recover 2023 cost of service through rates paid by customers in 2023. Under the current regulatory framework, the recovery of NorthWestern's 2023 cost of service requires that they be recovered in a future rate review that would have the same lag in timing for cost recovery.

Figure 1 below provides a timeline that illustrates the lag in timing between when costs are incurred and when NorthWestern is able to update rates to reflect those costs.

[5] NorthWestern's last electric rate review provides an even more extreme example of the gap between when costs were incurred and when final rate implementation occurred. In that docket (2018.02.012), a final order was issued almost 15 months after NorthWestern filed its application seeking to adjust rates, and rates, in turn, were not implemented on even an interim basis until April 1, 2019 to recover costs incurred in 2017. Final rates were effective March 1, 2020.

Figure 1: Rate Review Timeline



Under the existing rate review structure, NorthWestern is unable to recover the year-over-year change in costs associated with providing safe and reliable service to its customers. Even if NorthWestern were to file a rate review every year, the recovery would continue to lag the costs by one to two years. This lag between the costs recovered in Commission-approved rates and the timing of when these costs are incurred is what NorthWestern defines as regulatory lag. Additional regulatory mechanisms are needed to provide NorthWestern with an ability to address this lag between when costs are incurred and timing of recovery.

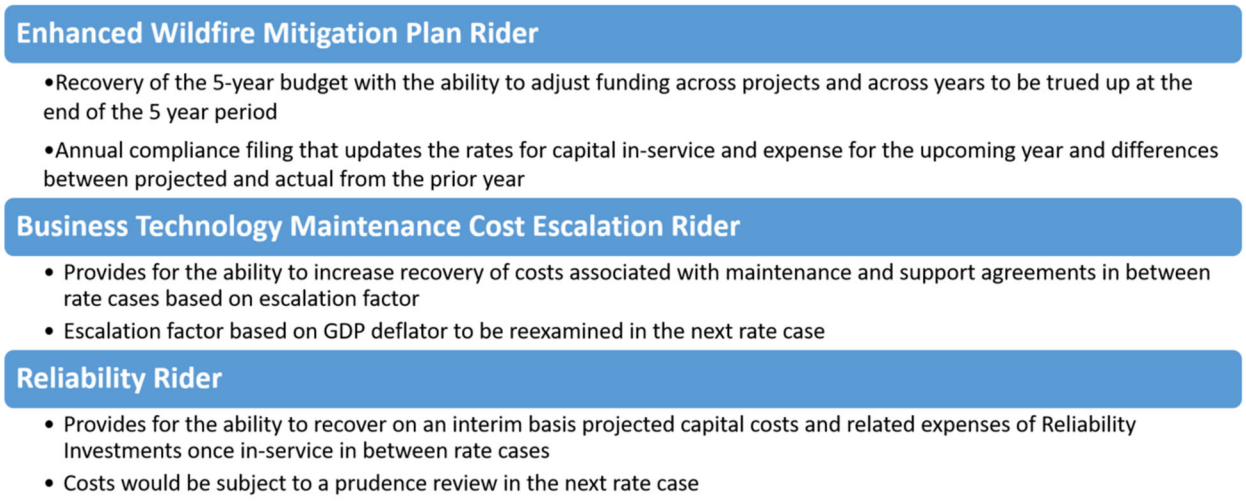
The impact of regulatory lag on the financial health of NorthWestern and how this can result in higher cost of service for its customers is discussed by Ms. Lail.

Q. How does NorthWestern propose to alleviate regulatory lag?

A. The reduction of regulatory lag is necessary for NorthWestern to continue to provide its customers safe and reliable service in an affordable manner. As discussed in the Pre-filed Direct Testimony of Brian B. Bird, NorthWestern in this rate review presents several proposals to reduce regulatory lag related to a few critical service areas. These proposals include the introduction of regulatory mechanisms being utilized across the industry for the recovery of costs beyond the 2022 known and measurable period in specific critical service areas – Enhanced Wildfire Mitigation Plan, BT maintenance costs, and costs of reliability resources once in service. Figure 2 below summarizes NorthWestern's proposed revenue adjustment mechanisms to address regulatory lag. The Pre-filed Direct Testimony of Jennifer E. Nelson discusses the use of regulatory lag mitigation mechanisms across the utility industry.

Figure 2:

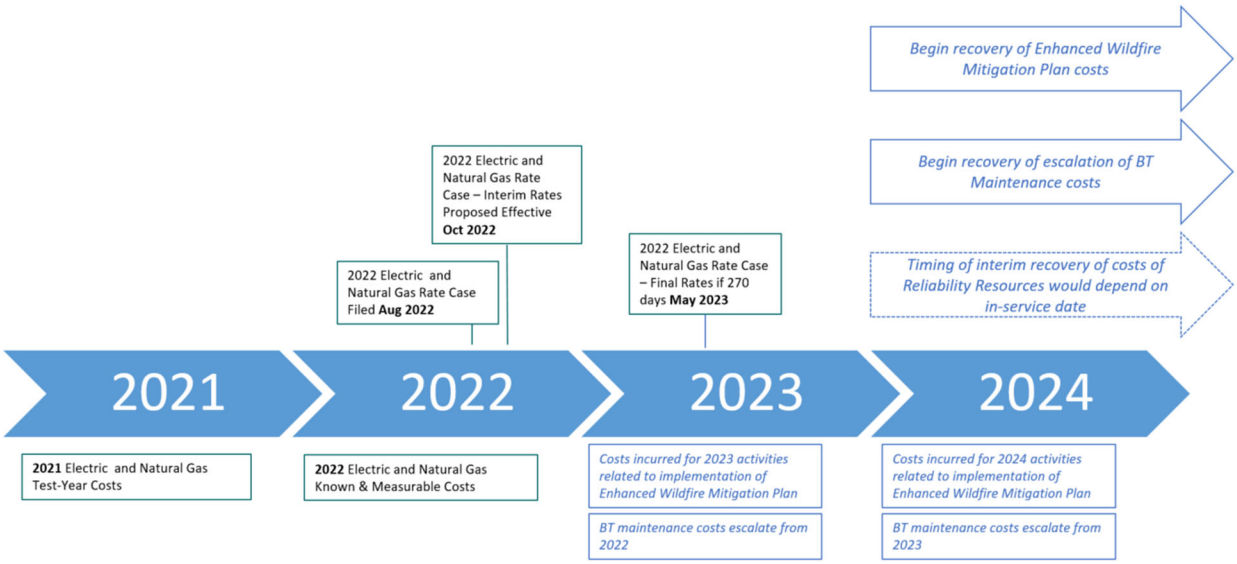
NorthWestern's Proposed Revenue Adjustment Mechanisms



Q. If the Commission grants those proposals to reduce regulatory lag, does NorthWestern still expect to file more frequent rate reviews?

A. Approval of NorthWestern's proposals for mechanisms that mitigate regulatory lag would reduce how frequently NorthWestern would expect to file rate reviews than would occur without these mechanisms. However, to ensure we are able to continue to meet the changing needs of our customers safely and reliably, NorthWestern expects to be filing rate reviews more frequently than it has historically. NorthWestern's proposals for additional revenue adjustment mechanisms address a limited and narrowly defined scope of a few key critical service areas and do not address the full scope of the costs of energy services NorthWestern provides to its customers. NorthWestern's testimonies in this docket discuss how NorthWestern has continued to invest in its plant and programs to best serve Montana customers. Figure 3 below provides a timeline that illustrates the timing of costs incurred and cost recovery that would result from approval of NorthWestern's proposals.

Figure 3: Timeline for Proposed Rate Recovery



Overview of Regulatory Proposals

Q. Please provide a high-level overview of NorthWestern's regulatory proposals in this rate review to address regulatory lag.

A. In this rate review, NorthWestern is seeking to update its costs to provide safe and reliable service to its customers. As discussed above, currently, NorthWestern's authorized cost recovery reflects electric costs associated with a 2017 test year from a 2018 electric rate review and natural gas costs associated with a 2015 test year from a 2016 natural gas rate review. The updates proposed in this filing relevant to cost of service are discussed in more detail by Ms. Lail, who presents NorthWestern's proposed update to the rate of return; Mr. Jeffrey B. Berzina, who presents NorthWestern's proposed update to electric and natural gas rate bases; and Mr. Andrew D. Durkin, who presents NorthWestern's proposed updated revenue requirements for both utilities.

Second, NorthWestern in this rate review will be more fully utilizing existing administrative rule provisions. Specifically, NorthWestern is referring to the known and measurable provision allowed under ARM 38.5.106 to ensure that this rate review captures allowed 2022 costs, the most recent costs permitted under current rules. Under NorthWestern's proposal, NorthWestern will capture additions to rate base within the known and measurable period as long as those additions went into service during the calendar year 2022. I discuss the proposed known and measurable adjustments in more detail below in the Known and Measurable section of my testimony and Mr. Durkin presents the revenue requirement impacts.

Next, NorthWestern proposes regulatory mechanisms that will allow for more timely cost recovery in a limited scope of service areas critical to providing safe and reliable services to customers where the allowed cost recovery under ARM 38.5.106 is insufficient to adequately address costs required to be incurred for these programs. Specifically, NorthWestern proposes revenue adjustment mechanisms for the timely recovery of costs in the following areas:

1. Wildfire Mitigation: Included in this rate review, NorthWestern presents an Enhanced Wildfire Mitigation Plan that is critical to providing safe and reliable service to customers. NorthWestern's Enhanced Wildfire Mitigation Plan is discussed in detail in the Pre-filed Testimonies of Curtis T. Pohl, Gregory F. Bailly, and Nathaniel P. Linder.

2. Business Technology: Similarly, BT provides a critical backbone to all operational areas of NorthWestern, and costs continue to escalate year-over-year. NorthWestern's BT needs are discussed in more detail in the Pre-filed Direct Testimonies of Jeanne M. Vold and Sean M. Cleverly.
3. Reliability Resources: Finally, NorthWestern also requests approval of a Reliability Rider that will allow for more timely recovery of costs of critical reliability resources between rate reviews. Specifically, NorthWestern is requesting (1) approval of a Reliability Rider that will allow NorthWestern to track and recover costs subject to refund for critical reliability resources that the Commission has authorized for recovery through this rider, and (2) approval to include and recover costs of the Yellowstone County Generating Station through the Reliability Rider.

NorthWestern's proposed revenue adjustment mechanisms are summarized in Figure 2 above and are discussed in greater detail below.

Known and Measurable Adjustments

Q. What is a "known and measurable adjustment"?

A. Under the Commission's rules, specifically, ARM 38.5.106, in addition to the 2021 test-year costs, NorthWestern presents the costs from 2022 that are "known with certainty and measurable with reasonable accuracy".[6]

[6] https://rules.mt.gov/gateway/RuleNo.asp?RN=38%2E5%2E106

Q. Please describe NorthWestern's historic use of the known and measurable adjustment.

A. NorthWestern's 2018 Electric Rate Review was based on a 2017 test year with known and measurable adjustments through the end of 2018 for the following costs:

- Labor & Benefits
- Property Taxes
- Hazard Tree Program
- Uncollectible Accounts
- Property Insurance
- Regulatory Expenses

With the exception of the Hazard Tree Program, NorthWestern made these same known and measurable adjustments in its 2016 natural gas rate review. In these prior dockets, NorthWestern did not include plant additions,[7] retirements, accumulated depreciation, and depreciation expense in the known and measurable adjustment even though ARM 38.5.106 allows for such adjustment.

[7] In its 2018 Electric Rate Review, NorthWestern also acquired the Two Dot Wind Qualifying Facility during 2018 and asked the Commission to allow it to include this acquisition in base rates. This request was unique given the fact that NorthWestern had previously been recovering its costs for the purchase of energy and capacity from this facility in its PCCAM.

Q. What is NorthWestern doing differently in this case related to the known and measurable adjustment?

A. ARM 38.5.106 allows for adjustments "based on changes in facilities, operations, or costs which are known with certainty and measurable with reasonable accuracy at the time of the filing [that]… will become effective within 12 months of the last month of the test period."[8] Consistent with that language, in addition to the other costs identified above, NorthWestern will be including known and measurable adjustments for plant additions, retirements, accumulated depreciation, and depreciation expense related to assets that are expected to be in service by year-end 2022. By only including assets that are expected to be in service by the end of the known and measurable period, these assets are known with certainty and measurable with reasonable accuracy. NorthWestern recognizes that the filing of this case is prior to the end of 2022 and will plan to update the assets along with the retirements, accumulated depreciation, and depreciation expense in its rebuttal testimony. The details of these adjustments are presented in the Pre-filed Direct Testimonies of Jeffrey B. Berzina and Andrew D. Durkin.

Q. How does this change result in more timely cost recovery?

A. As I stated above, a more comprehensive inclusion of known and measurable costs will result in rates to customers that better reflect the costs for the services they are receiving. Including 2022 plant adjustments in rate base puts plant

[8] https://rules.mt.gov/gateway/RuleNo.asp?RN=38%2E5%2E106

serving today's customers in the rates paid by today's customers instead of in future rates paid by future customers.

Q. What other prior practice is NorthWestern proposing to modify with this application?

A. ARM 38.5.125 requires that Montana utilities "shall show plant balances on a beginning and end of period basis averaged for the test period representing functional classifications and total plant. The effect of proposed adjustments, if any, on the average balances shall also be shown."[9] Historically, NorthWestern used a 13-month average for plant balances included in rate base. This approach results in a heavier weighting on dated historic numbers. In this rate review, NorthWestern uses a rate base more aligned with the administrative rule that is based on an average of the beginning and end of the 12-month test year and the 12-month known and measurable period. This approach better reflects the most current plant providing the services customers receive at the time. That, in turn, results in rates to customers that better approach the costs for the services they are receiving. The detailed workpapers reflecting these adjustments as required by the administrative rule are attached to Messrs. Berzina's and Durkin's testimonies.

[9] https://rules.mt.gov/gateway/RuleNo.asp?RN=38%2E5%2E125

Q. Is NorthWestern's proposed presentation of average rate base and the known and measurable adjustment consistent with other Montana utilities?

A. Yes. Montana Dakota Utilities ("MDU") uses a beginning and ending average for calculating rate base. MDU also includes a known and measurable adjustment to rate base for plant expected to be in service within 12 months after the end of its test year. The most recent examples of MDU's rate base and known and measurable calculations can be seen in its 2018 electric and 2020 natural gas rate reviews (Docket Nos. 2018.09.060 and 2020.06.076, respectively).

NorthWestern's Enhanced Wildfire Mitigation Plan

Q. Why is NorthWestern's Enhanced Wildfire Mitigation Plan critical to providing safe and reliable service?

A. Wildfires present a huge risk to NorthWestern's customers, and Mr. Pohl speaks to the role NorthWestern's Enhanced Wildfire Mitigation Plan ("Plan") plays in ensuring our customers receive safe and reliable service. Protecting our customers from wildfire risks requires a forward-looking cost recovery mechanism so that NorthWestern can proactively implement its Enhanced Wildfire Mitigation Plan.

Q. Please explain why only including 2021 test year costs in the revenue requirement will not provide NorthWestern the ability to adequately fund its Enhanced Wildfire Mitigation Plan.

A. While 2021 includes costs of NorthWestern's Commission-approved Hazard Tree program as well as NorthWestern's current vegetation management activities related to ensuring reliable services that have some wildfire mitigation benefits, those costs only reflect a fraction of the costs needed to support NorthWestern's Enhanced Wildfire Mitigation Plan, which is an exhibit to the Pre-filed Direct Testimony of Gregory F. Bailly.

The more robust Enhanced Wildfire Mitigation Plan will result in:

- Acceleration and expansion of system hardening activities;
- Expansion of vegetation management activities beyond NorthWestern's Commission-approved Hazard Tree program; and
- Establishment of programs related to situational awareness and communications and public outreach.

The details of NorthWestern's Enhanced Wildfire Mitigation Plan are discussed in further detail by Messrs. Bailly and Linder. Mr. Pohl's testimony also further discusses the policy implications related to NorthWestern's Enhanced Wildfire Mitigation Plan.

Q. What is NorthWestern's proposal for recovery of costs for its Enhanced Wildfire Mitigation Plan?

A. NorthWestern proposes a five-year Enhanced Wildfire Mitigation Plan and requests that the Commission approve the necessary annual funding over the five-year period of 2024 through 2028. More details of the costs of NorthWestern's Enhanced Wildfire Mitigation Plan are presented by Mr. Bailly. While NorthWestern is requesting recovery of the budget for the Enhanced Wildfire Mitigation Plan over a five-year period, work has already begun as reflected in Figure 3 above. NorthWestern will be requesting recovery of costs incurred for activities described in the Plan as part of the recovery to begin in 2024.

More specifically, NorthWestern seeks approval for an Enhanced Wildfire Mitigation Plan Rider that would provide for the following:

- Five-year budget with the ability to adjust funding across projects identified in its Enhanced Wildfire Mitigation Plan and across years that would then be trued up at the end of the five-year period;
- Annual updates to rates to reflect the incremental annual revenue requirement and adjustments between forecasted and actuals from the prior year; and
- Annual compliance filings that report on activities from the prior calendar year and provide updates on activities expected for the upcoming calendar year.

The first year of recovery, 2024, would include the 2024 projected revenue requirement and costs to date of Plan activities. Mr. Durkin presents the five-year annual revenue requirements for the Enhanced Wildfire Mitigation Plan.

Q. What are the reasons for this proposed rider, as opposed to filing more frequent rate cases?

A. As presented in Figure 3 above, the timing when costs needed for NorthWestern's Enhanced Wildfire Mitigation Plan will be incurred fall outside of the allowed time period for cost recovery in this rate review. For example, to recover 2023 and 2024 costs through the current rate review process would require the filing of a 2024 rate review with a 2023 test year and 2024 known and measurable adjustment. This would result in cost recovery beginning in 2025 – resulting in regulatory lag in the recovery of costs for the first two years of the Enhanced Wildfire Mitigation Plan. To recover the costs associated with the remaining years of the Enhanced Wildfire Mitigation Plan would further require the filing of a 2026 rate review with a 2025 test year and 2026 known and measurable adjustment with cost recovery beginning in 2027, and another rate review filing, a 2028 rate review, with a 2027 test year and 2028 known and measurable adjustment with cost recovery beginning 2029 – and continued regulatory lag in cost recovery. NorthWestern believes the Enhanced Wildfire Mitigation Plan to be too critical to risk due to regulatory lag.

Business Technology Program

Q. Why is a robust Business Technology Program critical to providing safe and reliable service?

A. The Pre-filed Direct Testimony of Jeanne M. Vold discusses the role Business Technology services plays in ensuring safe and reliable services for our customers. The Pre-filed Direct Testimony of Sean M. Cleverly provides details related to Cyber Security programs, including costs associated therewith.

Q. Please explain why only including 2021 test year costs with 2022 known and measurable adjustments in the revenue requirement will not provide NorthWestern the ability to adequately fund a robust Business Technology Program, including Cyber Security.

A. As discussed in greater detail by Ms. Vold and Mr. Cleverly, Business Technology-related practices are moving more to subscription-based services instead of fixed costs paid at the outset, and many of our BT maintenance agreements include escalation factors resulting in costs increasing year over year rather than staying constant over time. Our BT maintenance agreements provide the necessary foundation for our IT and Cyber Security needs. The 2022 known and measurable costs of these critical BT maintenance agreements will not adequately reflect the costs going forward.

Q. What is NorthWestern's proposal related to recovery of costs for Business Technology?

A. To begin to address these increasing BT costs, NorthWestern requests approval for incremental revenue requirements associated with a year-over-year increase tied to the rate of inflation for certain Business Technology costs described in more detail by Ms. Vold to be in effect until the next rate review. NorthWestern proposes that this escalation tied to inflation remain in place until the next rate review in which NorthWestern will re-examine the trends in Business Technology maintenance costs to determine whether an escalation tied to inflation is still appropriate related to future recovery of these costs.

Q. NorthWestern's requests to recover costs for both the Enhanced Wildfire Mitigation Plan and the Business Technology Program extend beyond the known and measurable period for this case. Why should the Commission approve these requests?

A. Adequately funded Business Technology programs and the Enhanced Fire Mitigation Plan are critical to providing safe and reliable service to customers. Business Technology provides a critical backbone to all operational areas of NorthWestern and costs continue to escalate year over year. Wildfire threats in our Montana service territory are growing, which comes at a huge risk to our customers and a large cost, and we have an obligation to our customers to maintain reliable service and public safety. Approving NorthWestern's request to recover the costs of these essential programs beyond the limited 12-month known and measurable period enables NorthWestern to adequately fund the

increasing costs of these programs on a going forward basis and provide the ability to timely implement our plan and optimally protect our customers. Use of outdated historical costs in the revenue requirement calculations does not allow NorthWestern the opportunity to collect the actual costs of providing these critical services without filing annual rate reviews.

Reliability Rider

Q. Please describe NorthWestern's proposed Reliability Rider.

A. NorthWestern's proposed Reliability Rider is a regulatory mechanism that would allow NorthWestern to begin to track and recover costs on an interim basis for critical, new reliability assets between rate reviews, starting interim recovery on the in-service date of the resource. Upon approval by the Commission for such a regulatory mechanism, NorthWestern would make a compliance filing to inform the Commission no later than 90 days prior to the in-service date of a new resource. NorthWestern would then file a tariff letter no later than 15 days prior to the in-service date, which would be the effective date for commencement of the interim rates. These interim costs would then be subject to a prudence review in a future rate review.

Q. Is NorthWestern's need for a rider for cost recovery unique or new to the industry?

A. No. Revenue adjustment mechanisms such as the Reliability Rider proposed by NorthWestern are well-established tools that can be found throughout the

industry. The Pre-Filed Direct Testimony of Jennifer Nelson provides additional details on the use of such revenue adjustment mechanisms in other jurisdictions across the industry. What is unique to Montana is its risky exposure due to its capacity deficit. NorthWestern's proposed Reliability Rider is intended to provide an additional mechanism that would reduce the regulatory lag of Montana's current regulatory structure to make new reliability assets available to serve this critical customer need.

Q. Are you aware of any other jurisdictions that have approved similar riders?

A. Yes. Ms. Nelson further discusses the application of such riders in other jurisdictions.

Q. Why is NorthWestern's proposed Reliability Rider necessary?

A. The Reliability Rider addresses a regulatory gap under existing rules discussed above regarding the need to ensure more timely cost recovery of critical reliability resources needed to ensure safe and reliable service to our customers.

Q. Please expand.

A. As an example, if a resource goes into service in 2023, the costs and the benefit to customers of that resource begin in 2023. As described above, if a utility were to file a rate review in 2024, 2023 test-year costs and adjustments for 2024 known and measurable would be included in that filing. Cost recovery would not begin until 2025 -- more than a year after customers began to receive the

benefits, resulting in regulatory lag. Under NorthWestern's proposed Reliability Rider, customers would be unharmed by the timely recovery of investments made beyond the test year, since recovery would be on an interim basis until a prudence review in the next rate review.

Q. What type of projects/costs can be included in the Reliability Rider under NorthWestern's proposal?

A. NorthWestern proposes that the Reliability Rider include projects and their costs for any investments aimed at improving reliability for electric service customers.

Q. Does NorthWestern present a proposed Reliability Rider tariff for Commission approval in this docket?

A. Yes. Attached as Exhibit CSF-1.4 is NorthWestern's proposed Reliability Rider tariff.

Q. Please explain how NorthWestern will implement the Reliability Rider if approved for the Yellowstone County Generating Station.

A. If the Reliability Rider and recovery of Yellowstone County Generating Station ("YCGS") costs through the rider are approved, NorthWestern would include and recover costs, subject to refund, in rates for YCGS according to the following:

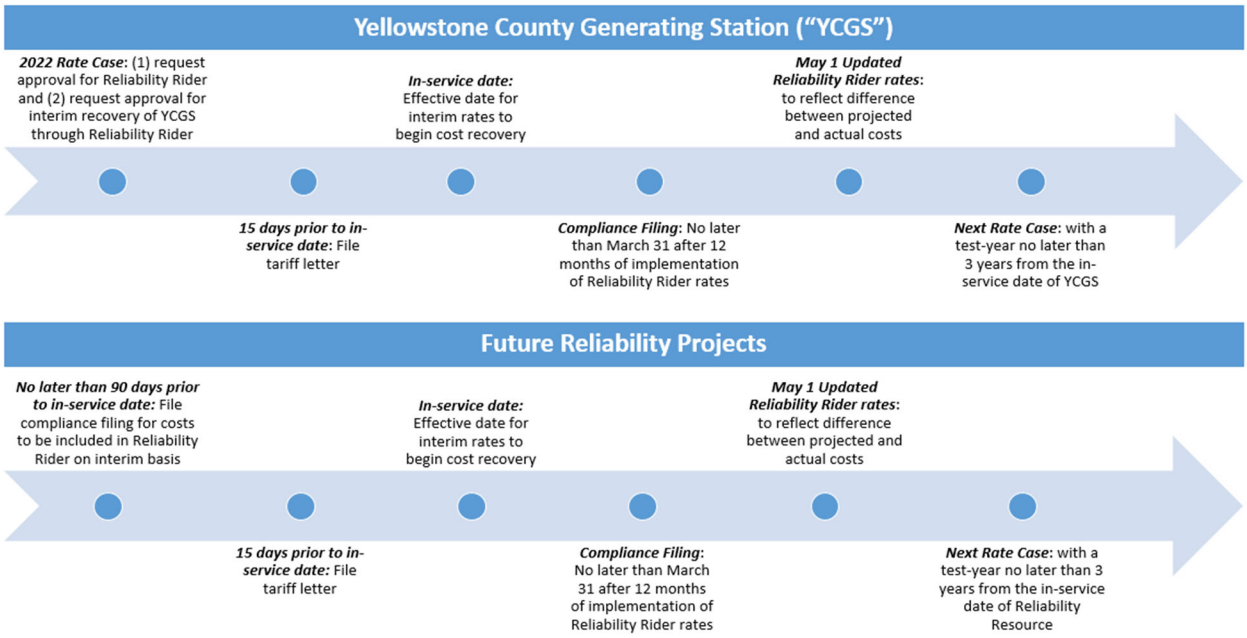
- Mr. Durkin presents the estimated revenue requirement for the YCGS. This estimated revenue requirement is illustrative of the costs we know today, and the actual costs incurred for construction of the plant would be

reflected in the revenue requirement filed with the Commission 90 days prior to the in-service date for the resource and be the basis of the interim rate recovery.

- No later than 15 days prior to the in-service date, NorthWestern would file a tariff letter that reflects rates based on an updated revenue requirement for the YCGS.
- The interim rates would be effective on the first day of the month following the in-service date.
- No later than March 31 following 12 months of the implementation of interim rates, NorthWestern will submit a compliance filing for updated rates to be effective May 1 that reflect the difference between projected costs and actual costs incurred over the 12-month period.
- No later than 15 days prior to the effective date, NorthWestern will submit a tariff letter for updated rates to be effective.
- NorthWestern will file a rate case with a test year that is no later than three years from the in-service date of YCGS.

Figure 4 below illustrates the mechanics of NorthWestern's proposed Reliability Rider and its application to YCGS and other future reliability projects.

Figure 4: NorthWestern's Proposed Reliability Rider



Q. Last year, NorthWestern withdrew its application for preapproval of the YCGS. How is NorthWestern's proposed Reliability Rider different from preapproval?

A. In the case of preapproval, NorthWestern requests the inclusion of the asset in base rates when the asset begins serving customers, rather than in a subsequent rate review. With the Reliability Rider mechanism, costs are recovered on an interim basis subject to refund until the next electric rate review.

Q. For future use of the Reliability Rider, how soon after NorthWestern starts recovering the costs on interim basis will it file a rate review to allow the Commission to determine the prudency of those costs?

A. NorthWestern will file a rate case with a test year that is no later than three years from the in-service date of the reliability resource using the Reliability Rider.

Q. Do you consider NorthWestern's rider proposal to be single-issue ratemaking?

A. No. NorthWestern's proposal for a Reliability Rider is part of this rate review. The ability to ensure reliable service for our electric service customers is critical and too risky to expose to the risks associated with regulatory lag. Ms. Lail speaks to the need for more timely cost recovery to maintain the financial health of the Company and continue to provide safe and affordable services. NorthWestern's proposal for a Reliability Rider is to begin recovery of costs related to new critical reliability resources through interim rates which are subject to refund in between rate reviews that would be subject to a prudence review as part of a future rate review. Since the proposal is interim and subject to refund, customers would be unharmed by the timely cost recovery from this proposal while benefitting from the additional reliability resources.

PCCAM Redesign

Q. Why is NorthWestern proposing to redesign its PCCAM?

A. NorthWestern is proposing a redesign of its PCCAM to address changing market conditions and capacity needs as well as a need to improve forecasting accuracy. NorthWestern's proposal to forecast the PCCAM Base Costs annually using PowerSimm™ modeling software is included in the Pre-filed Direct Testimony of Joseph M. Stimatz.

Q. What is NorthWestern's proposal to redesign the PCCAM?

A. In reviewing NorthWestern's current PCCAM mechanism, NorthWestern identified the following issues:

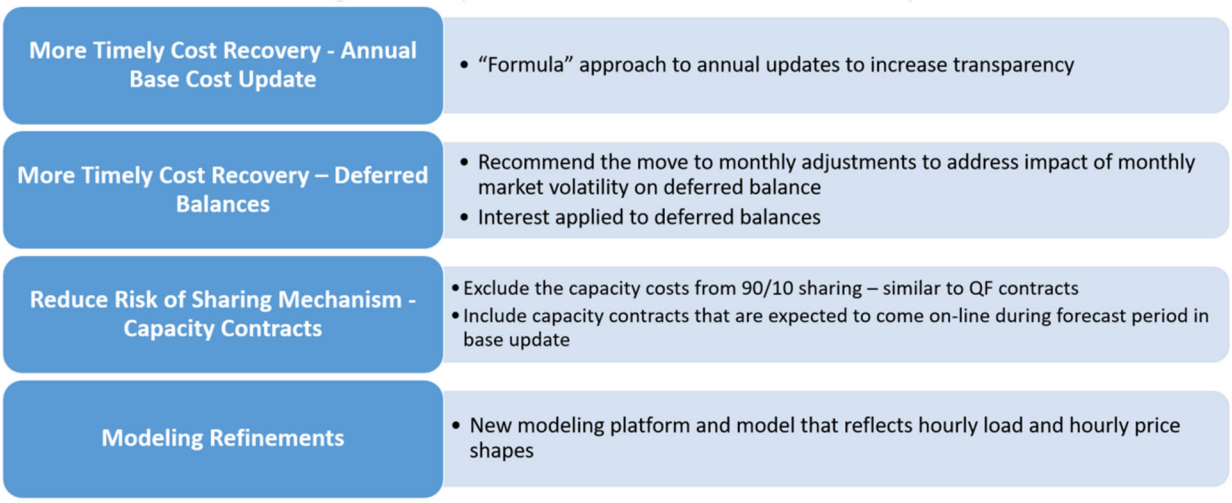
- **Lack of timely cost recovery:**
  - The length of time between updates of base costs and credits results in greater difference from actuals as time progresses creating greater deferred balances that can cause greater customer bill volatility.
  - Interest is not currently calculated on deferred balances**.**
- **The 90/10 sharing mechanism applied to all market costs over which NorthWestern has limited control creates unreasonable risk associated with the current sharing mechanism.** For instance, new capacity contracts added between base updates get an automatic 10% haircut due to sharing**.**
- **Lack of accuracy associated with current forecast modeling.** The current PCCAM forecasting method does not consider hourly needs and pricing.

To address these concerns, NorthWestern proposes to redesign its existing PCCAM mechanism according to the following:

1. **More timely cost recovery through annual Base Cost updates:** NorthWestern seeks approval to update its PCCAM Base Costs annually with an annual forecast based on PowerSimm modeling software. This proposal is also discussed by Mr. Stimatz.
2. **More timely cost recovery through changes to Deferred Balances:** NorthWestern seeks to change from annual to monthly adjustments and add interest to balances. The proposal for monthly adjustments is included in Mr. Durkin's testimony.
3. **Reduced risk by excluding Capacity Contracts from Sharing Mechanism:** NorthWestern will be including forecasted capacity contracts in its Base Costs and seeks approval to exclude capacity contract costs from the 90/10 sharing.
4. **Modeling Refinements** to account for hourly load and hourly prices. Mr. Stimatz further discusses these modeling refinements.

NorthWestern's proposal to redesign its PCCAM mechanism is summarized in Figure 5 below.

Figure 5: NorthWestern's Proposed PCCAM Redesign



Q. Please provide the reasons supporting annual updates.

A. Since the original design of the PCCAM in 2017, the nature of the market has changed significantly and NorthWestern's supply portfolio is changing through the addition of capacity resources necessary to meet the reliability needs of our customers. More frequent PCCAM Base Cost updates are needed in order to capture these changes. Without more frequent updates, the PCCAM Base Costs do not reflect a realistic forecast of NorthWestern's costs as illustrated by the significant deferred balance.

NorthWestern recognizes that an annual filing to update the PCCAM Base Costs will add to the administrative burden of the Commission and its Staff. To reduce the administrative burden, NorthWestern recommends that the annual PCCAM Base Costs update between rate reviews take on a "formulaic" approach, that is, it will reflect the update of clearly stated inputs such as market prices and

changes to the resources in NorthWestern's supply portfolio. NorthWestern's proposal for annual updates is discussed further by Mr. Stimatz.

Q. How will NorthWestern implement the annual rate changes associated with annual PCCAM Base Costs updates?

A. NorthWestern requests that updated PCCAM Base Costs be automatically updated on July 1 each year to then be finalized as part of the annual September PCCAM filing. The annual filings and their schedule under NorthWestern's proposal are discussed by Mr. Durkin.

Q. Why should capacity costs be excluded from the 90/10 sharing?

A. NorthWestern's PCCAM allows for the recovery of 90% of the difference between forecasted revenues and actual costs. In Order No. 7563c in Docket No. D2017.5.39, the Commission approved NorthWestern's proposal at that time to include a 90/10 sharing mechanism, stating "the Commission believes that a 10% assignment to the utility's shareholders provides an adequate incentive to minimize costs."[10] NorthWestern's capacity deficit results in a heavy reliance on market resources over which NorthWestern has limited control over costs. Given the fixed-cost nature of capacity resources and NorthWestern's capacity deficit over the long term, the intent of leveraging the sharing mechanism to incent cost reductions is not applicable and should not apply to capacity costs/resources.

[10] DOCKET NO. D2017.5.39, ORDER NO. 7563c ¶ 69.

Q. Why does NorthWestern seek to move to monthly adjustments of the deferred balance?

A. Currently NorthWestern's PCCAM results in NorthWestern carrying large deferred balances, that is, the accumulation of the difference between actual costs and forecasted costs as reflected in the Commission-approved PCCAM Base Costs. NorthWestern currently carries these balances without interest. This creates a disconnect between the costs paid by customers and the costs incurred by NorthWestern to serve customers. To better align customers' cost of service with the prices they pay, NorthWestern proposes to move to monthly adjustments for deferred balances related to PCCAM. In addition, NorthWestern seeks Commission approval to apply interest to PCCAM deferred balances. NorthWestern's proposals related to deferred balances are discussed further by Mr. Durkin.

Q. Why should the Commission grant NorthWestern's request to apply interest to deferred balances in the PCCAM?

A. While the application of interest for deferred account balances is common practice, the current PCCAM does not apply interest to deferred balances. The change in recovery of deferred balances from annual to monthly should also be reflected in the interest rate applied, that is, the interest rate should reflect the short-term nature of these balances. With the proposal to collect deferred balances on a monthly basis, NorthWestern proposes that the interest rate applied to deferred balances will be equal to one-twelfth of the interest rate on

three-month Commercial Paper for the previous month, as reported in the Federal Reserve Statistical Release, H.15, or its successor publication.

Fixed Cost Recovery Mechanism Pilot Redesign

Q. What is the Fixed Cost Recovery Mechanism?

A. The FCRM is a four-year decoupling pilot approved by the Commission in NorthWestern's last electric rate review, Docket No. 2018.02.012, in Order No. 7604u that is intended to decouple NorthWestern's recovery of electric fixed costs from its sales of energy.[11] The FCRM, however, is actually a limited decoupling pilot that applies only to the electric residential and small commercial (GS-1 Secondary non-demand metered) classes.

Q. Please explain how the currently approved FCRM works.

A. The purpose of decoupling is to remove the "throughput incentive", that is, the incentive to "sell" more energy in order to ensure recovery of fixed costs recovered through energy rates. The current FCRM pilot design has several limitations.

- Under the current FCRM, allowed revenue recovery is to be matched to test-year cost of service and billing determinants from the most recent rate review at the class level and limited to residential and GS-1 Secondary Non-Demand customer groups. Failure to include all customer groups

[11] *See* ¶ 96.

means that the utility's ability to recover its fixed costs of service remains limited.

- Given the historic test-year structure in Montana, an adjustment to base revenue requirements associated with the fixed costs of service is necessary to account for the needs of new customers. The current FCRM includes an adjustment for new customers limited to transmission and distribution services – there is no adjustment for the fixed generation needs of new customers. This fails to recognize the capacity deficit NorthWestern already faces.
- The current FCRM Pilot includes a soft cap of 3% to limit customer impacts at the class level.[12] This further limits the utility's ability to recover its fixed costs of service. These impacts were exaggerated with the unanticipated impacts to customer load during the beginning of the COVID-19 pandemic. The impacts of the COVID-19 pandemic on the implementation of the FCRM pilot are discussed further below.

Q. What is the status of that pilot?

A. The Commission issued Final Order No. 7604u on December 20, 2019. The implementation of the FCRM pilot was expected to occur on July 1, 2020, with the first annual adjustment to apply to the July 1, 2020 through June 30, 2021 period. Early in 2020, COVID-19 spread to become a pandemic resulting in shut-downs across the country and world-wide. This resulted in dramatic changes,

[12] *Id. at* ¶ 97.

which included changes in customer behavior, energy production and consumption, and utility services, among other things. On May 29, 2020, the Commission issued a Notice of Opportunity to Comment ("Notice") in Docket No. 2020.05.064 to determine whether adjustments in the timing, structure, or other aspects of the FCRM pilot program in light of COVID-19 were necessary. On August 19, 2020, in Order No. 7742 in Docket No. 2020.05.064, the Commission granted a one-year suspension to the start of NorthWestern's FCRM pilot.[13] On July 29, 2021, in Order No. 7742a, the Commission approved NorthWestern's request for an additional one-year delay of the FCRM pilot. Then, on April 15, 2022, NorthWestern requested the Commission defer implementation of the pilot to allow for its redesign in this docket. The Commission approved that request on June 9, 2022. Notwithstanding the delays, NorthWestern has continued to provide shadow accounting information during what was originally intended to be the FCRM pilot period.

Q. Why did NorthWestern request that the pilot be postponed until this rate review?

A. Initially, NorthWestern's requests to delay the implementation were the result of the dramatic and unanticipated impact of the COVID-19 pandemic on customer loads. Since the FCRM pilot was part of NorthWestern's 2018 electric rate review, the basis for the pilot was 2017 test-year loads, that is, pre-COVID loads. Unprecedented changes to customer loads occurred following the nationwide

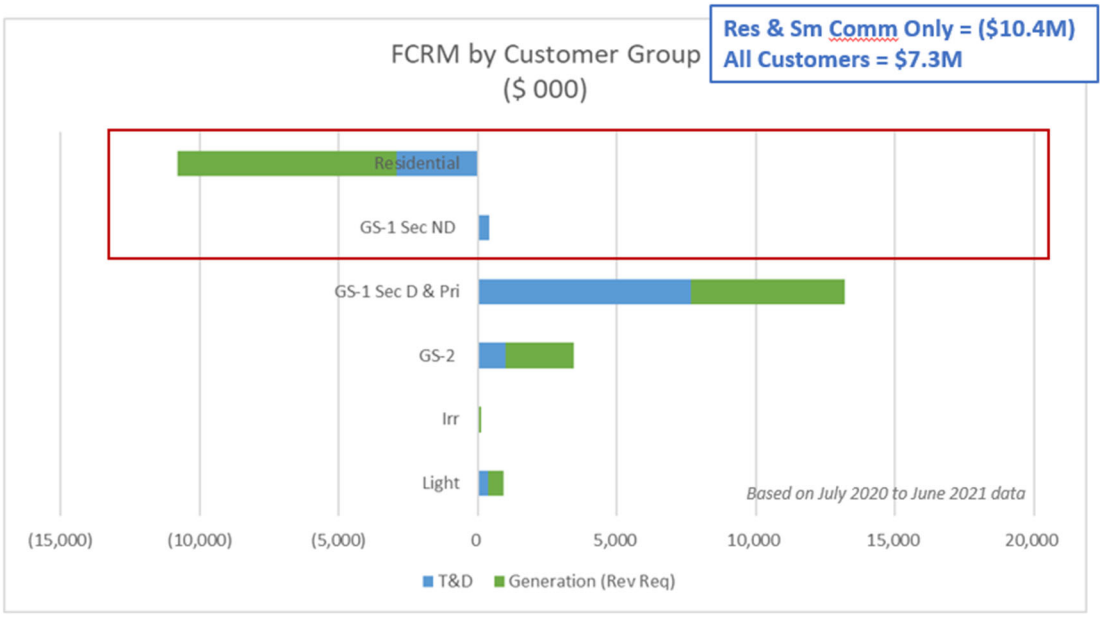
[13] ¶ 13, p.3.

and global shut-downs that occurred as a result of the pandemic with dramatic increases to residential load and equally dramatic decreases to commercial and industrial loads, and most notably to the small commercial customer class.

As NorthWestern continued to monitor the potential impacts of the FCRM pilot through shadow accounting with the Commission-approved delay, NorthWestern observed that the current design of the FCRM pilot was flawed and does not meet its intended policy purpose. The design flaws are the result of the current FCRM being designed to address decoupling at the class level and the limited application to the residential and small commercial classes only.

Figure 6 below illustrates the impacts of the current flawed FCRM design. When all customers are included in the FCRM design, the calculation of fixed cost revenues using the revenue-per-customer methodology would result in an *under-collection* of $7.3 million of fixed cost revenues for the period of July 2020 to June 2021. When fixed-cost revenues are narrowly limited to the residential and small commercial (GS-1 Sec ND) classes, the result instead is the net *over-collection* of $10.4 million, which misstates NorthWestern's fixed costs of service to serve customers for that period.

Figure 6: Flawed FCRM Pilot design[14]



Q. Does NorthWestern still want to implement a pilot FCRM?

A. As stated by Mr. Bird in his testimony, the current FCRM design is flawed and should be eliminated if it is not reformed. The purpose of a properly designed decoupling mechanism is "to make a utility indifferent to the volume of its energy sales (and technologies that impact the volume of retail sales) by breaking the link between energy sales and the utility's ability to recover its fixed costs."[15] As shown above in Figure 6, the design of NorthWestern's current FCRM pilot does not create this result.

[14] Based on data from July 2020 to June 2021.
[15] *IN THE MATTER OF NorthWestern Energy's Application for Authority to Increase Retail Electric Utility Service Rates and for Approval of Electric Service Schedules and Rules and Allocated Cost of Service and Rate Design*, Docket No. 2018.02.012, Direct Testimony of Amanda Levin, p.3.

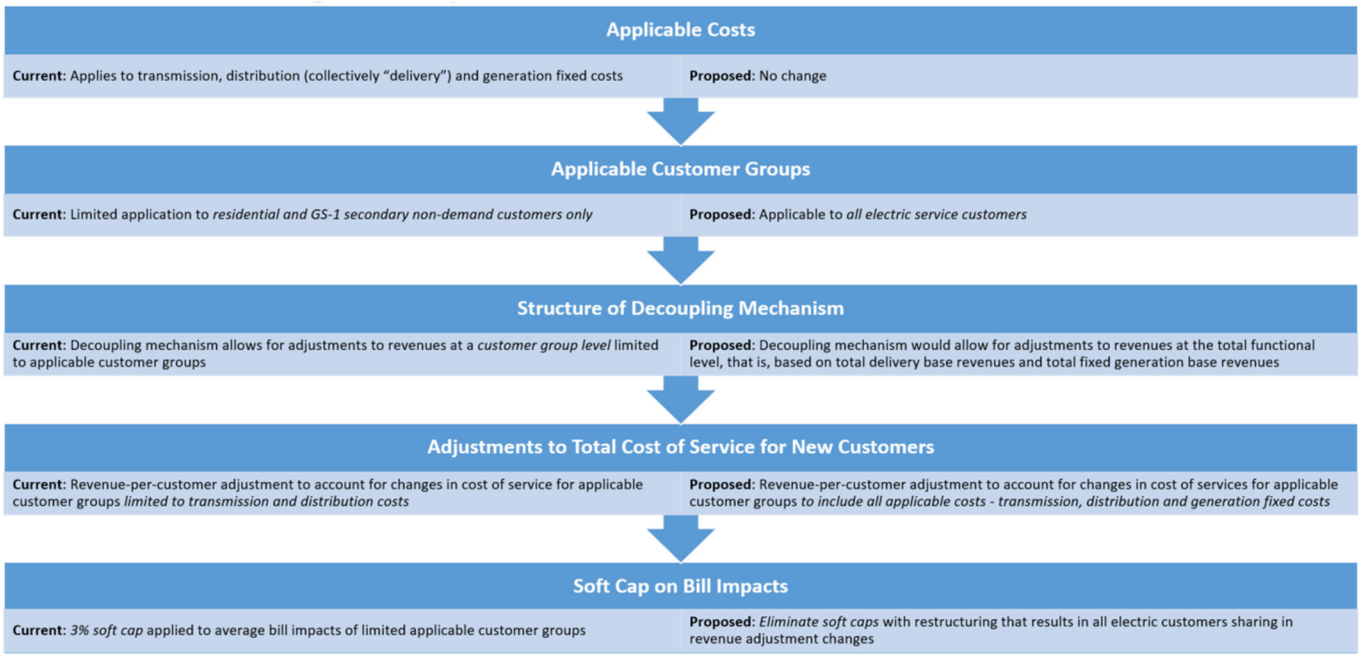
Q. Please walk through NorthWestern's proposed redesigned FCRM pilot.

A. NorthWestern proposes the following changes to the current FCRM pilot:

1. Base Period Reference: Update the base reference to be the 2021 test year, as adjusted for known and measurable changes, used in this rate review;
2. Term of Pilot: The redesign pilot would start on July 1, 2023 and will continue until NorthWestern's next electric rate review;
3. Applicable Costs: Continue to apply to transmission, distribution (collectively "delivery") and generation fixed costs;
4. Applicable Customer Groups: Expand to include all electric service customers rather than limited to residential and GS-1 Secondary Non-demand customers;
5. Structure of Decoupling Mechanism: Set decoupling to be based on total functional cost areas (i.e., delivery and fixed generation) rather than at the customer class level;
6. Adjustments to Total Cost of Service for New Customers: Revenue-per-customer adjustment to account for changes in cost of services to apply to all costs of utility service – transmission, distribution, and generation fixed costs; and
7. Soft Cap on Bill Impacts: Eliminating the soft caps given NorthWestern's proposed restructuring results in all electric customers sharing in revenue adjustment changes.

NorthWestern's proposal to redesign its FCRM mechanism is summarized below in Figure 7.

Figure 7: NorthWestern's Proposed FCRM Pilot Redesign



Q. Why is NorthWestern's redesigned FCRM pilot more appropriate?

A. The current FCRM design is more limiting than delaying timely cost recovery; it can actually prevent the utility from recovering its Commission-approved fixed cost revenue requirements. Adoption of NorthWestern's proposed changes to the FCRM pilot will result in a mechanism that actually allows the utility to recover its Commission-authorized revenue requirements related to fixed cost recovery.

Q. Why is it appropriate that the T&D revenue requirement used in the redesigned FCRM pilot continue to be based on customer counts, but the generation revenue requirement will be fixed?

A. Under the current pilot, fixed T&D costs are allowed to grow with customer counts while generation revenue requirement does not. This fails to recognize the need for fixed generation resources to serve the needs of new customers safely and reliably, does not recognize NorthWestern's current capacity deficit, and is therefore inappropriate.

Q. Please summarize why the Commission should approve NorthWestern's proposals for a redesigned FCRM pilot in this rate review.

A. As stated by Mr. Bird, the current FCRM design is flawed and should be eliminated if it is not reformed. NorthWestern proposes changes to the FCRM pilot to ensure that the design will achieve its intended purpose – to make a utility indifferent to the volume of its energy sales (and technologies that impact the volume of retail sales) by breaking the link between energy sales and the utility's ability to recover its fixed costs – by ensuring NorthWestern is able to recover its Commission-authorized revenue requirements related to fixed cost recovery.

Q. Does this complete your testimony on these issues?

A. Yes, it does.

VERIFICATION

This Pre-filed Direct Testimony of Cynthia S. Fang is true and accurate to the best of my knowledge, information, and belief.

/s/ Cynthia S. Fang
Cynthia S. Fang