

Service Date: August 29, 2005

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER OF ENERGY WEST)	UTILITY DIVISION
MONTANA, Application for Authority to)	
Increase Rates for Natural Gas Service in its)	DOCKET NO. D2004.3.46
Montana Service Areas)	ORDER NO. 6603b

FINAL ORDER

INTRODUCTION

The Montana Public Service Commission (PSC or Commission) granted formal intervention status in these proceedings to the Montana Consumer Counsel (MCC) and the Federal Executive Agencies (FEA). The FEA intervened on behalf of Malmstrom Air Force Base (Malmstrom), an Energy West Montana (EWM) Negotiated Contract Service (NCS) customer. Allocated cost of service (ACOS) and Rate Design (RD) testimony were filed by George L. Donkin on behalf of the MCC, and by Colonel Everett H. Thomas on behalf of Malmstrom.

On March 26, 2004 EWM filed an Application for a general rate increase for natural gas services provided to its customers connected to its natural gas local distribution system in and around Great Falls, Ulm, Black Eagle, and unincorporated portions of Cascade County. The documents submitted with the EWM filing included the following:

1. An Application for approval of an increase, under normal weather conditions, in annual non-gas Distribution Cost of Service (Distribution COS) revenue requirements of \$1,124,996;
2. Proposed tariffs designed to recover the proposed increase, under normal weather conditions, in the annual Distribution COS revenue requirements;
3. An Application for Interim Relief of the proposed increase, under normal weather conditions, in the annual Distribution COS revenue requirements of \$1,124,996; and

4. A Motion for Waiver of the minimum filing requirements (MFR) contained in Title 38, Chapter 5, Subchapter 1 of the Administrative Rules of Montana (ARM), specifically Statement L-ACOS and Statement M-RD (*ARM 38.5.176 and ARM 38.5.177, respectively*)

EWM maintained that this filing was made necessary due primarily to insurance and property tax increases along with inflationary influences on the Company's overall cost of doing business.

On April 13, 2004 the PSC denied the Motion for Waiver of the MFR and directed EWM to prepare Statement L-ACOS and Statement M-RD as soon as possible for incorporation into this docket. The PSC determined that it was time to establish a baseline for discussions regarding EWM's ACOS and RD. EWM informed the PSC that it had retained the services of R.J. Rudden and Associates (Rudden) to perform the ACOS study and to provide RD recommendations. On June 17, 2004 EWM amended its original application by filing the Company's ACOS study, proposed RD, and the testimony of H. Edwin Overcast, Vice President with Rudden.

On October 14, 2004 the PSC approved a Stipulation and Agreement (the Revenue Requirements Stipulation, *Stipulated Interim Order 6603a*) between the MCC and EWM (the Parties) that provided for an increase, under normal weather conditions, in annual Distribution COS revenue requirements of \$536,209 representing an 8% rate increase to the Residential and General Service (Core) customer classes. The parties agreed to exclude all natural gas inventory (also known as storage gas) from rate base, and further agreed that a carrying cost on the storage gas, equivalent to the agreed upon 9.08% weighted average cost of capital, should be recovered as part of the monthly and annual Gas Cost Tracking Adjustment Procedure (Trackers). The parties to the Revenue Requirements Stipulation also agreed to increase, on an equal percentage basis, both the fixed monthly Customer Charges and the volumetric Distribution Base Rates (\$/Ccf) for all Core customers. The parties to the Revenue Requirements Stipulation effectively settled all outstanding issues in this proceeding related to total revenue requirements and left open the resolution of the ACOS and RD issues.

On April 26, 2005 the MCC filed a Stipulation and Agreement (RD Stipulation) entered into by the parties of record (EWM, MCC, FEA) to settle all outstanding RD issues.

On April 28, 2005 the Commission conducted a public hearing in Great Falls, Montana that, due to the filing of the RD Stipulation, was changed from a contested case hearing to a hearing on the proposed RD Stipulation. At hearing, the Commission requested EWM to prepare and file specified post-hearing exhibits.

On June 17, 2005 EWM filed its final version of the requested post-hearing exhibits that included an Operating Revenue Statement H and a Proof of Revenue Statement.

FINDINGS OF FACT

Overview of EWM's Distribution System

Great Falls Gas Company (now EWM) commenced the distribution of manufactured gas in 1909. In 1928, it began the distribution of natural gas and discontinued the distribution of manufactured gas. EWM is strictly a natural gas local distribution company and did not then, nor does it presently, own natural gas production, storage or transmission properties. EWM began serving Malmstrom under a contract entered into with the U.S. Air Force in 1950.¹

EWM contracts with third parties to provide firm natural gas supply and administrative services. The administrative service provider monitors the transmission of natural gas supply to EWM primary points of delivery, assures that resources are available to meet the EWM system peak-day demand, and ensures compliance with any transmission and storage agreements between EWM and third parties.²

EWM profiles consumption characteristics and volumes of its Core, Distribution Transport Service, and certain NCS customers (e.g. Malmstrom) in order to assess its distribution system supply requirements, and arranges for firm supply through the winter months (November through March).³ Other NCS customers (e.g. Montana Refinery and Benefis Hospital) or their third party suppliers must make arrangements for their specific supply requirements, including firm peak-day supply, for delivery to EWM primary points of delivery.⁴

On April 1, 2000 EWM entered into a "Natural Gas Intrastate Transportation and Storage Service Agreement" (the Agreement) with NorthWestern Energy (NW). NW owns and operates

¹ The Matter of Great Falls Gas Company, Application for Authority to Increase Rates and Charges for Natural Gas Service, Docket No. 4693, Order No. 2759, page 5

² Data response to PSC-002a, attached Memorandum of Agreement

³ Data response to PSC-001c

⁴ Data response to PSC-001c

an intrastate natural gas transmission and storage system.⁵ The Agreement was effective as of April 1, 2000 and continues in force and effect for a primary term ending March 31, 2010. The Agreement can be terminated at the end of the primary term upon at least 3 years' written notice. If this Agreement is not terminated at the end of the primary term it will continue on an annual basis until terminated on the first day of any month upon at least 3 years' written notice by either party.⁶

The Agreement provides EWM with 15,000 Dekatherms (Dkts)⁷ of firm maximum daily delivery quantity (MDDQ) from NW's storage system. Recently, at no additional cost to subscribers, NW increased firm storage capacity for firm storage subscribers from 47 days to 74 days of peak-day deliverability. As a result, EWM firm storage capacity increased from 705,000 Dkts (15,000 MDDQ * 47 days) to 1,110,000 Dkts (15,000 MDDQ * 74 days). Approximately 828,000 Dkts or 75% of EWM firm storage capacity is available at NW's Cobb storage field located north of Cut Bank near the Canadian border, and 282,000 Dkts or 25% of EWM firm storage capacity is available at NW's Dry Creek storage field located southwest of Billings near the Wyoming border. EWM firm MDDQ from NW's storage system remains unchanged at 15,000 Dkts.⁸

The Agreement also provides EWM with 41,800 Dkts of firm MDDQ and up to 2,000 Dkts of interruptible MDDQ on NW's transmission system. NW's primary points of receipt for natural gas supply to be delivered to EWM on NW's transmission system are as follows; Aden - 11,470 Dkts, Carway - 5,000 Dkts, Blaine County #3 - 9,500 Dkts, Cascade Purchase Station - 1,900 Dkts, and NW Storage - 15,000 Dkts.

The flow of natural gas supply from all NW primary points of receipt to EWM primary points of delivery are added together to determine if the firm MDDQ has been exceeded. The interruptible MDDQ quantity is an estimate and is actually determined when the combined flow of natural gas supply to all EWM points of delivery exceeds the 41,800 Dkts of firm MDDQ. EWM primary points of delivery, where the natural gas is transferred from the NW transmission system to the EWM distribution system are; NW's Great Falls City Gate Station #1 –

⁵ Data response to PSC-001b, attached Agreement and Exhibit A

⁶ Data response PSC-001b, attached Agreement, Section 3.1

⁷ Dekatherms and MMBtus are often used interchangeably. Volumes will be given as Dkts, unless otherwise noted.

⁸ Data response to MCC-001

Installations 3-0123-4, 3-0123-5, 3-0123-6 and NW's Great Falls City Gate Station #2 - Installations 3-0266-4 and 3-0123-5.⁹

The Agreement allows EWM, upon reasonable notice, to increase the firm transmission MDDQ up to 46,800 Dkts. Any increase in the firm transmission MDDQ will remain in effect for the term of the Agreement.¹⁰ The Agreement provides for EWM to make monthly storage and transmission payments to NW that include:

- a fixed monthly demand charge on minimum transmission MDDQ of 41,800 Dkts billed at a transmission reservation rate of \$6.935/Dkt,
- a variable charge for all firm transmission quantities billed at a volumetric rate of \$0.055/Dkt,
- a fixed monthly demand charge on minimum storage MDDQ of 15,000 Dkts billed at a storage withdrawal reservation rate of \$4.335/Dkt,
- a variable charge for storage capacity quantities billed at a volumetric rate of \$0.021/Dkt,
- a variable charge for all injection and withdrawal quantities billed at a volumetric rate of \$0.022/Dkt,
- a variable competitive transition charge for a NW regulatory asset amortization (CTC-RA) billed at a volumetric rate of \$0.049/Dkt, and
- a fixed monthly meter charge of \$284.00 per meter installation at EWM primary points of delivery.
- Interruptible transmission quantities are billed at a volumetric rate of \$0.283/Dkt.

The Agreement, in all respects, is subject to NW's Gas Tariff Schedules or superseding Gas Tariff Schedules on file with the PSC, specifically tariff schedules T-FTG-1, T-ITG-1, and S-FSG-1.¹¹

EWM assigns a portion of the 41,800 Dkts of firm transmission to its NCS customers. Although Malmstrom has a dual fueled coal/natural gas fired heating plant that displaces approximately 50% of Malmstrom's peak-day demand, Malmstrom reserved their full

⁹ Data response to PSC-001b, attached Exhibit A

¹⁰ Ibid

¹¹ Ibid, attached Agreement, Section 6.2

assignment of 3,127 Dkts of firm transmission.¹² Montana Refinery and Benefis are interruptible down to their assigned firm transmission of 1,000 Dkts and 100 Dkts, respectively. According to EWM, the interruptible service measures applicable to Montana Refinery and Benefis allow EWM to minimize firm capacity charges on NW's transmission system.¹³

EWM makes monthly payments to NW for the full cost of the 41,800 Dkts of firm transmission and recovers assigned portions from its Core, Distribution Transport Service and NCS customers. The firm transmission costs assigned to EWM's Core and Distribution Transport Service customers are recovered through volumetric rates. The firm transmission costs assigned to Malmstrom are recovered as part of its fixed monthly Customer Charge.

EWM makes monthly payments to NW for the full cost of the 15,000 Dkts of firm storage that is assigned and recovered from the Core and Distribution Transport Service customers through volumetric rates. Any use of EWM firm storage by the NCS customers, especially by Malmstrom, is reimbursed to the Core and Distribution Transport Service customers as a credit to the overall cost of service.

EWM's transmission and storage costs for the test year ending December 31, 2003 totaled \$4,480,000 of which the firm (fixed) transmission and storage components totaled \$4,259,000 (\$355,000 monthly).¹⁴

The EWM distribution system reduces the pressure of the natural gas supply at the primary points of delivery to 55 psig¹⁵, and maintains that pressure on a 60 psig maximum allowed operating pressure (MAOP) loop-line that encompasses the entire EWM distribution system. The 60 psig MAOP loop-line is the high-pressure distribution mains portion of the distribution system. The pressure of the natural gas supply is reduced to 18 psig MAOP at the points where the low-pressure distribution mains cut into the 60 psig MAOP loop-line for downstream distribution to service stubs.¹⁶

Montana Refinery is served by a 175-foot service line that extends directly from NW's Great Falls City Gate Station #1 – Installation 3-0123-6. Malmstrom is served by a service line

¹² Data response to PSC-004a

¹³ Data response to PSC-007c

¹⁴ Data response to PSC-002c

¹⁵ Pounds per square inch, gage. Pressure referenced to ambient air pressure.

¹⁶ Data response to PSC-001b

that cuts into the 60 psig MAOP loop-line. None of the low-pressure distribution main of EWM's distribution system is used to serve either Montana Refinery or Malmstrom.¹⁷

For the test year ending December 31, 2003 there were a total of 7,405 degree-days that, due to warmer weather, were slightly lower than the 30-year 7,590 degree-days experienced under normal weather conditions.

Overview of ACOS Rules

The PSC currently recognizes that the ACOS study be based on marginal cost principles (*ARM 38.5.176(1)(c)*). For natural gas filings the marginal cost of service shall be determined for each of the following functions: production, storage, transmission, distribution, and customer (*ARM 38.5.176(2)(b)*). *ARM 38.5.176* describes the basic marginal cost model the PSC uses to develop and organize cost of service testimony.

Costs are first functionalized to identify the sources of marginal costs, such as production (includes costs to assure sufficient natural gas supply), distribution, and customer costs. Storage and transmission costs are related to the production (natural gas supply) function.

After separating costs into functions, costs within each function are classified according to services provided to customers, such as the capacity to meet demand (demand-related), the flow of natural gas supply (energy-related) and access to the distribution system (customer-related).

Classified costs of service are then allocated to the various customer classes by multiplying those costs by the relevant allocation factors (e.g., peak-day demand, volumes consumed, number of customers). Customer classes attempt to efficiently aggregate customers with similar cost characteristics.

Finally, the ACOS is reconciled to the authorized revenue requirement. Generally, since ACOS is seldom equal to the authorized revenue requirement, it is necessary to make a reconciling adjustment. A uniform or equal percentage basis adjustment is an often used reconciliation method, although there are other methods. If unacceptable rate changes result, the reconciled revenue increases may be moderated on public policy grounds. Prices must ultimately be set to recover the authorized revenue requirement.

¹⁷ Data response to FEA-003 attached testimony of Bruce J. Ambrose, page 18

EWM's ACOS Study and Pre-filed Testimony of H. Edwin Overcast

EWM states that the ACOS study prepared by Overcast demonstrates that the existing RD does not recover the properly allocated Distribution COS for each customer class. The mismatches between the existing revenue responsibilities and the properly allocated Distribution COS for each customer class results in certain interclass subsidies. Due to the recent substantial increases in its Commodity Rates (natural gas portion of gas supply costs), EWM was hesitant to propose an RD that would eliminate the interclass subsidies and generate revenues consistent with each customer classes' properly allocated Distribution COS. Instead, EWM proposes to apply any increase in revenues approved by the PSC to its Core customer classes and exclude the NCS customers. EWM asserts that, based on the ACOS study, the NCS customers currently bear a disproportionate share of the revenue responsibility in relation to their properly allocated Distribution COS.¹⁸

Overcast testifies that the ACOS study is an embedded average cost study. A marginal cost study was not prepared because of cost and time constraints, and the limited value of such a study for determining the appropriate customer class revenue responsibilities. Overcast claims that while marginal cost may be of use in designing economically efficient rates, EWM's current rates do not reflect marginal costs based on even a cursory review.¹⁹ Overcast states that embedded average cost is not a proxy for marginal cost, and that for efficient pricing the proper measure is short run marginal cost.²⁰

Overcast testifies that the ACOS study complies with the MFR because every customer class, defined as a rate schedule (rate class), is included and separately identified. The ACOS study treats all of the individual NCS customers as one customer class.²¹ The absence of separate allocated Distribution COS for each of the NCS customers makes it difficult to objectively assess their potential for system bypass.²²

Overcast testifies it is reasonable to assume that for most customers their properly allocated Distribution COS is below stand-alone costs. The concept of stand-alone costs is a "theoretical value" based on the assumption that the customer provides the entire service

¹⁸ EWM Cover Letter to ACOS and proposed RD filed on June 17, 2004

¹⁹ Data response to PSC-010a

²⁰ Data response to PSC-010b

²¹ Data response to PSC-011a and PSC-011b

²² Data response to PSC-011c

requirement on a private system dedicated solely to that customer.²³ A simple example where this concept might be applied is the potential for economic system bypass. Stand-alone costs can not be derived from the ACOS study.²⁴

Overcast testifies that, for purposes of developing the ACOS study, all Distribution COS are fixed costs, and he asserts that they are properly allocated as either customer-related or demand-related. The Distribution COS includes distribution operating and maintenance expenses, customer accounting and service expenses, administrative and general expenses, depreciation expense, and tax expense.²⁵ Overcast defines fixed costs as costs that do not change with output, and Distribution COS satisfies this definition. That is, a one-unit change in natural gas sold does not change distribution costs. Overcast asserts that Distribution COS are properly classified as both customer-related and demand-related because some distribution investment is physically required to connect a customer to the distribution system regardless of any actual consumption of natural gas. In addition, a portion of the natural gas supply costs are also fixed (e.g. firm transmission and firm storage charges) and properly allocated as demand-related.²⁶

The ACOS guidelines state that “proxy” cost estimates, as necessary and appropriate, may be used for the marginal cost study (*ARM 38.5.176 (6)(f)*). Overcast allocated the customer-related and demand-related Distribution COS of mains based on “percentages developed from a confidential study of a gas distribution company serving small towns in a mostly rural area” (the “proxy”). The choice of this “proxy” is predicated on the need to estimate the percentage split between customer-related and demand-related distribution costs of mains in the absence of detailed EWM information required to perform the ACOS study.²⁷ According to Overcast, the percentage split is consistent with results in other cost studies from a variety of jurisdictions and therefore appears reasonable.²⁸ Overcast states that for purposes of evaluating the “proxy” allocations between customer-related and demand-related Distribution COS of mains, the use of a comparably sized and configured natural gas distribution company is irrelevant.²⁹ EWM did not provide any information on either the confidential study or the other cost studies from a

²³ Data response to PSC-006a

²⁴ Data response to PSC-006a and PSC-006b

²⁵ Overall Cost of Service Schedule, Rule 38.5.175, submitted with reconciliation worksheets filed on Oct. 18, 2004

²⁶ Schedule HEO-2 page 1, lines 18 through 20 and data response to PSC-012c

²⁷ Data response to PSC-013b

²⁸ Schedule HEO-2 page 3, lines 16 through 19

²⁹ Data response to PSC-013e

variety of jurisdictions to demonstrate that the “proxy” cost estimate was necessary and appropriate.

EWM’s Rate Design and Pre-filed Testimony of H. Edwin Overcast

EWM’s rate structure is composed of tariffs for each rate/customer class. Each tariff consists of two elements, a fixed monthly Customer Charge element and a volumetric Rate (\$/Ccf) element. The volumetric Rate (\$/Ccf) element, with the exception of Malmstrom, includes two rate-blocks at increasing consumption levels charged at decreasing rates. EWM’s volumetric Rate (\$/Ccf) element consists of several components, such as; Distribution Base Rate (the primary issue in this filing), Universal Service Benefit Charge (USBC), Environmental Surcharge, Transport Rate (transmission and storage portion of gas supply costs), Non-gas Surcharge (Tracker adjustment for transmission and storage portion of gas supply costs), Commodity Rate (natural gas portion of gas supply costs), and Commodity Surcharge (Tracker adjustment for natural gas portion of gas supply costs).

For the Core and Distribution Transport Service rate classes, EWM proposes to substantially increase the fixed monthly Customer Charges and substantially decrease the volumetric Distribution Base Rates (\$/Ccf). EWM also proposes to abandon two rate classes, the Distribution Transport without Pipeline Capacity Service (DT-LPT) and the Distribution Transport Interruptible Service (DT-IT), as they no longer serve any useful purpose. Although there have been a couple of instances during the last three years when NW has declared critical operating conditions, EWM has not found it necessary to impose any mandatory curtailments of service to its customers.³⁰

Overcast testifies that there are conflicts between the use of an embedded cost of service model that uses average costs to price services, and a marginal cost of service model that uses marginal cost based pricing to promote efficiency. Since marginal costs tend to be either above or below average cost in both the short and long runs, marginal cost based pricing will either produce too much or too little revenue relative to the authorized revenue requirement.

Economically efficient price signals require a multi-part tariff that primarily includes such elements as a fixed monthly Customer Charge, a fixed monthly Demand Charge, and a volumetric Rate charge (\$/Ccf). According to Overcast, it is not uncommon to sacrifice economic efficiency by excluding the fixed monthly Demand Charge from residential and small

³⁰ Data response to MCC-036

commercial customers' tariffs in order to maintain simplicity. Overcast clarifies that simplicity, as it relates to tariffs or RD, requires prices that are reasonably simple to administer and understand. The reliance on customers to manage their own demands is a small sacrifice given the high economic cost of installing demand meters at each premise.³¹

Overcast testifies that a RD seeks to recover the authorized revenue requirements based on the actual billing determinants occurring during the test period used to develop the proposed RD. At issue for EWM is the allocation and recovery of its Distribution COS. Distribution COS are not recovered in the Tracker mechanisms. Overcast reiterated that the Distribution COS consists entirely of fixed costs, and therefore properly recovered in the fixed monthly Customer Charge. The fixed monthly Customer Charge is also the appropriate tariff element to recover the average costs derived from an embedded cost of service model that are in excess of marginal costs.³² According to Overcast, the marginal customer costs include both the investment of connecting to the customers' premises and the associated customer accounting, billing, and collecting expenses.³³ The short and long run marginal Distribution COS for EWM is very low.³⁴

Overcast claims that the higher fixed monthly Customer Charges will lessen the revenue impacts caused by weather variations, and that the Distribution COS at issue in this filing are fixed and not affected by weather variations and the related levels of consumption. In addition, the proposed RD will provide customers with greater monthly bill predictability and enhance EWM's financial flexibility to meet their system supply, storage, and transmission requirements.³⁵

MCC's Pre-filed Direct Testimony of George L. Donkin

The applicant's rebuttal testimony is included, where appropriate, in the review of Donkin's pre-filed direct testimony.

Customer Bypass

Donkin testifies that there are two separate reasons for EWM to exclude NCS customers from the stipulated rate increase.

³¹ Testimony of H. Edwin Overcast, page 8 and 9

³² Ibid, page 10 and 11

³³ Ibid, page 10 and 11

³⁴ Ibid, page 12

³⁵ Ibid, page 12

First, EWM has determined that based on its review of the economics associated with the NCS customers, these customers remain subject to bypass or have alternative fuel capabilities. These were the same conditions that existed when the PSC approved the NCS customers exclusion from both the increase granted in the last general rate application (*Docket No. D2002.9.120*), and the automatic rate adjustment and tracking for property taxes application (*Docket No. D2003.12.165*).³⁶

Secondly, Overcast's embedded ACOS study indicates that, at current rates, the NCS customers produce rates of return that exceed EWM's system average rate of return.³⁷

As to the first reason for EWM to exclude NCS customers from the stipulated rate increase, Donkin testifies that EWM presented no evidence in its application regarding the bypass opportunities or alternative fuel capabilities of the NCS customers. However, EWM suggests that Montana Refinery has the potential to bypass the EWM system, and that Malmstrom and Benefis, although having alternative fuel capabilities, are not considered to have valid bypass economics.³⁸ In Donkin's judgment, it is both highly speculative and highly unlikely that Malmstrom and other NCS customers would bypass in favor of alternative fuels.³⁹

Donkin testifies that a comparison of the average \$/Mcf for each rate class (calculated from Rule 38.5.164, Statement H – Operating Revenues, and submitted by EWM pursuant to the Stipulation in this filing and Commission Order 6603a) suggests that despite the serious shortcomings in Overcast's embedded ACOS study, it may be reasonable to exclude Malmstrom from the stipulated rate increase. At present rates, Malmstrom's average \$/Mcf greatly exceeds the average \$/Mcf paid by other EWM customers.⁴⁰ The averages developed by Donkin did not exclude the NCS customers' firm transmission revenues that are commingled with their Distribution COS revenues reported on Statement H, Rule 38.5.164.

Donkin testifies that based on the same comparisons, Montana Refinery's average \$/Mcf is far below the average \$/Mcf paid by other EWM customers. In Donkin's judgment, it would require a sufficiently large increase to Montana Refinery in order to have any meaningful impact

³⁶ Direct Testimony of George L. Donkin filed on December 2, 2004, page 3

³⁷ Ibid, page 4

³⁸ Ibid, page 4 and data response to MCC-038

³⁹ Ibid, page 4

⁴⁰ Ibid, page 8

in terms of lower rates to the other EWM customers. Such a rate increase would likely increase Montana Refinery's incentive to bypass.⁴¹

EWM's ACOS Study

As to the second reason, Donkin testifies that Overcast's embedded ACOS study contains serious conceptual flaws. The ACOS study does not allocate any storage costs to the NCS customers. An allocation of storage costs to the NCS customers would produce rates of return for the NCS customers that are closer to EWM's system average rate of return. The ACOS study allocates nearly all of the Distribution COS and storage costs on the basis of either coincident design-day demands or the number of customers. Donkin claims that, in general, it is a serious conceptual flaw to allocate Distribution COS and storage costs on the basis of either coincident design-day demands or the number of customers instead of on the basis of some combination of both peak-day demand and annual consumption or volumes.⁴²

Donkin testifies that EWM uses its gas storage to meet the combination of peak-day, seasonal, and annual gas supply requirements on its distribution system. Donkin points out that EWM also uses storage to mitigate commodity costs as much as possible. Donkin concludes that EWM's use of its gas storage as a major component of its overall gas supply acquisition policy represents compelling support for including seasonal and annual gas volumes in allocating its gas storage costs.⁴³ In addition, Donkin points out that there is no reason for EWM to curtail service to any customers on its distribution system. Donkin interprets this to mean that there are no capacity constraints on the EWM distribution system, and therefore no need to use peak-day demands as a major determinant of customer class revenue responsibility.⁴⁴

In rebuttal, Overcast testifies that rather than allocate storage costs he carried forward EWM's treatment of storage revenues from the NCS customers as a credit to the cost of gas supply to Core customers. Overcast admits that storage costs should be allocated to all rate classes and that those allocations would result in moving the NCS customers' rate of return closer to the EWM system average. However, that movement would not fundamentally change the results of the ACOS study. The calculated rate of return for the NCS customers tends to be more reliable than the returns for the other rate classes due to the quality of the data used to

⁴¹ Ibid, page 8 and data response to MCC-038

⁴² Ibid, page 5 and data response to FEA-005

⁴³ Ibid, page 6 and data response to MCC-039

⁴⁴ Ibid, page 6 and data response to MCC-036

develop the allocation factors. Overcast concludes that on a relative basis the NCS customers produce a higher rate of return than the system average.⁴⁵

Overcast testifies that the fundamental short run nature of fixed supply and fluctuating demand creates short-term price volatility to clear the market. This volatility is a necessary condition for promoting economically efficient use of utility service. EWM uses its storage capacity to manage its distribution system peak-day gas supply requirements and to mitigate gas supply price volatility.⁴⁶

Overcast testifies that EWM's contracted storage costs consist of two components: a fixed monthly Demand Charge and a volumetric Rate (\$/Dkt) for all injection and withdrawal quantities. EWM uses its system peak-day demand to determine the appropriate level of contracted storage capacity, and therefore the coincident design-day demand is the correct allocation factor to use for allocating the fixed monthly Demand Charge component of contracted storage costs. The volumetric Rate (\$/Dkt) component is consumption driven and is therefore appropriately allocated on a volumetric basis.⁴⁷

Overcast testifies that the reason EWM has provided reliable service to its customers is that it contracted storage service to meet the full design-day demand, and it sized its distribution system to accommodate delivery of that full design-day demand.⁴⁸ Having contracted storage service for these purposes, it is only logical that the storage capacity be managed to meet the peak-day demand and maximize the value of that storage for customers by mitigating gas supply costs. Overcast concludes that the mitigation of gas supply costs does not suggest that gas supply volumes are a cost causation factor.⁴⁹

Donkin testifies that the serious conceptual flaw in Overcast's ACOS study is made even worse by classifying 37.7% of gas distribution mains, 87.1% of other gas distribution plant, and 91.1% of general plant as customer-related.⁵⁰ Donkin, in asserting the controversial nature of Overcast's approach (the "minimum-size distribution approach") to cost classification and cost

⁴⁵ Rebuttal Testimony of H. Edwin Overcast filed on January 18, 2005, page 2

⁴⁶ Pre-filed Direct Testimony of H. Edwin Overcast, page 5 and 6

⁴⁷ Rebuttal Testimony of H. Edwin Overcast filed on January 18, 2005, page 3

⁴⁸ Ibid, page 6

⁴⁹ Ibid, page 7

⁵⁰ Direct Testimony of George L. Donkin filed on December 2, 2004, page 5

allocation, provides the following excerpt from the June 1989 NARUC Gas Rate Design Manual of a discussion on “the minimum-size distribution main theory”.⁵¹

The contra argument to the inclusion of certain distribution costs as customer costs is that mains and services are installed to serve demands of the consumers and should be allocated to that function. Under “the basic system theory”, only those facilities such as meters, regulators and service taps, are considered to be customer-related, as they vary directly with the number of customers on the system.

In further support, Donkin refers to Professors James C. Bonbright, Albert L. Danielson, and David R. Kamerschen, in Principles of Public Utility Rates, Second Edition, who concluded that the “minimum-size distribution approach” to cost classification and cost allocation is clearly indefensible. Donkin pointed out that although the conclusion related to a discussion of electric distribution systems, the conclusion was equally applicable and valid to natural gas cost classification and cost allocation.⁵² In Donkin’s judgment the ACOS study, which classifies most of the EWM distribution system’s fixed cost as customer-related, should not be used as the basis for assigning customer class revenue responsibility or deriving cost based fixed monthly Customer Charges in this case.⁵³

The MCC asserts that no portion or percentage of the fixed costs of distribution mains, common plant, and general plant should be allocated on the basis of customers or recovered in the fixed monthly Customer Charges. The MCC went on to mention that in a Montana-Dakota Utilities case (*Docket No. D2004.4.50*), Donkin allocated the fixed costs of distribution service lines and meters on the basis of 50% coincident peak-day demand and 50% number of customers, but later testified that only the customer-related operating expenses should be recovered through the fixed monthly Customer Charge.⁵⁴

In rebuttal, Overcast claims that when a cost analyst looks to allocate costs with an end-result as a goal rather than determining cost causation, parties in rate cases often recommend allocations that favor the group of customers that the analyst represents, and this becomes the basis for arguing that a particular allocation methodology is controversial. Allocations on a volumetric basis, as opposed to a customer basis, favor the residential rate class. Therefore, arguing against the allocation of the EWM distribution system’s fixed cost as customer-related is

⁵¹ Ibid, page 5

⁵² Ibid, page 5

⁵³ Ibid, page 6

simply a request to allocate less fixed costs to the residential rate class. Overcast testifies that in developing the EWM ACOS study, the basis for each classification and allocation of costs relied upon the principles of cost causation. On the basis of cost causation, the allocation of fixed distribution plant must reflect two considerations: the coincident design-day demand (demand-related) and the distance over which the natural gas must travel (customer-related). The customer-related consideration reflects the theoretical costs necessary to connect a customer to the distribution system. The sum of these two considerations determines the allocated cost to deliver the design-day load to a customer or class of customers. Overcast concludes that volumes do not impact the fixed cost of distribution mains, and therefore Donkin's suggested use of annual volumes for cost allocation is inappropriate because volumes are not a cost causation factor.⁵⁵

Regarding the controversial nature of cost classification and cost allocation methods, Overcast offered a couple of authoritative sources to counter the excerpt provided by Donkin from the June 1989 NARUC Gas Rate Design Manual. NARUC also publishes an Electric Cost Allocation Manual (February 1991, page 93) that concludes fixed distribution system costs may be classified as demand-related, customer-related or a combination of both. In Gas Rate Fundamentals, Fourth Edition, published by the American Gas Association, the fixed distribution system costs related to mains has both demand-related and customer-related components. Overcast claims that the basis of the opinion cited by Donkin from the Principles of Public Utility Rates rests on the findings of a statistical analysis in "Public Utilities Fortnightly" that found no correlation between distribution costs and number of customers, thus the author's opinion that the "minimum-sized distribution costs" should be recognized as a strictly unallocable portion of total cost. Although the authors (Danielson, Kamerschen, and Bonbright) arrive at an opinion that the "minimum-sized distribution approach" to cost classification and cost allocation is clearly indefensible, they also recognize that the vast majority of utilities use the "minimum-size distribution approach." Overcast asserts that the important point relative to Donkin's argument is that, in practice, the use of the "minimum-size distribution approach" is the prevailing basis for allocating fixed distribution costs.⁵⁶

Overcast testifies that regardless of the demand expected from a customer, the

⁵⁴ Data response to PSC-024d

⁵⁵ Rebuttal Testimony of H. Edwin Overcast filed on January 18, 2005, page 3 and 4

distribution system requires footage of two-inch main (18 psig MAOP) equivalent to the front footage of the customer's premise. To the extent that all or a portion of the two-inch main is not economic based (e.g. large costs relative to historical average costs for distribution plant additions of mains and service lines), the customer makes a contribution in aid of construction (often referred to as CIACs). Larger distribution main (e.g. 60 psig MAOP loop-line) is only installed where peak-day demand requires a larger main to service the system loads. Overcast concludes that only the investment in the larger distribution main is caused by design-day demand and therefore properly classified as demand-related. The rest of the distribution system is directly correlated with the number of customers. This portion of the distribution system consists of fixed costs incurred to set the meter that do not change with volumes consumed, and therefore it is reasonable to classify them as customer-related.⁵⁷

Overcast claims that reliance on the sources cited earlier by Donkin would result in costs being either allocated solely on demands/volumes or not at all. In Overcast's estimation, it is more reasonable, generally accepted, and logically correct to allocate a portion of the fixed distribution mains cost as customer-related based on the "minimum-sized distribution approach."⁵⁸

EWM's Proposed Rate Design

The focal point of Donkin's concern with EWM's proposed RD is the fixed monthly Customer Charges. Donkin argues that most natural gas consumers, especially residential and small commercial customers, are opposed to paying large fixed monthly Customer Charges that are unrelated to gas usage levels. In Donkin's view, the significant increases to the fixed monthly Customer Charge element of the proposed RD violates generally accepted RD principles, such as, understandability, acceptability, and gradualism. RD analysts and regulatory commissions usually prefer making only moderate or gradual changes in rate structures over time, as opposed to making dramatic changes in a single rate case.⁵⁹

In rebuttal, Overcast argues that the principle of gradualism often surfaces whenever parties are opposed to increasing the fixed monthly Customer Charges. Overcast points out that applying this standard, whenever rates are infrequently changed, will result in rates that

⁵⁶ Ibid, page 5

⁵⁷ Ibid, page 7 and 8

⁵⁸ Ibid, page 6

⁵⁹ Direct Testimony of George L. Donkin filed on December 2, 2004, page 9

significantly diverge from their underlying ACOS. It is important to note that revenues collected through the fixed monthly Customer Charge need not be collected through the volumetric Rates (\$/Ccf). Ultimately this leads to the stability and the predictability of the customers' monthly bills. Overcast claims that from a customer's perspective, the higher fixed monthly Customer Charge mitigates the bill impacts caused by abnormal weather conditions.⁶⁰

Donkin testifies that the proposed RD, if adopted, would result in an excessive amount of Distribution COS being recovered in the fixed monthly Customer Charges. Donkin proposes that a more reasonable and appropriate fixed monthly Customer Charge should only recover customer-related distribution operating expenses. Donkin recommends against any increase to the fixed monthly Customer Charges at this time. Furthermore, any Commission approved increase to the fixed monthly Customer Charges should be limited to the percentage increase provided for in the Revenue Requirements Stipulation.⁶¹

In rebuttal, Overcast claims that Donkin's proposal (that a more reasonable and appropriate fixed monthly Customer Charge should only recover customer-related operating expenses) will result in inefficient rates that bear no relationship to the underlying ACOS. Donkin's view will result in larger residential consumers shouldering the fixed distribution costs incurred to set the meters located at customers' premises who have lower consumption patterns, because these costs are recovered through volumetric Rates (\$/Ccf). Overcast concludes that there is no rational reason that customers should not pay for the cost of the facilities dedicated to serve them, in addition to the customer-related operating expenses.⁶²

In response to Donkin's claim that the proposed RD, if adopted, would result in an excessive amount of Distribution COS being recovered in the fixed monthly Customer Charges, Overcast believes that sound RD permits the recovery of fixed costs through fixed charges. Just as importantly, a higher fixed monthly Customer Charge promotes economic efficiency for EWM by allowing for the reasonable recovery of authorized revenue requirements, and assures customers that EWM does not collect revenues greatly in excess of authorized revenues due to weather extremes.⁶³

Overcast concludes that Donkin is wrong in his assessment that the ACOS study is

⁶⁰ Rebuttal Testimony of H. Edwin Overcast filed on January 18, 2005, page 9

⁶¹ Direct Testimony of George L. Donkin filed on December 2, 2004, page 10 and page 8

⁶² Rebuttal Testimony of H. Edwin Overcast filed on January 18, 2005, page 10

⁶³ Ibid, page 11

seriously flawed, and that Donkin's view of the appropriate fixed monthly Customer Charge is unreasonable and unsupported. The ACOS study is generally consistent with the best practices in the industry given the available data from EWM, and provides a reasonable basis that the proposed RD is both reasonable and prudent.⁶⁴

The MCC states it is possible that, over time, increases to rates on a uniform or equal percentage basis will cause customer class revenue responsibilities to diverge from their underlying ACOS. Significant misalignments may require a major correction in a single case. However, given the serious conceptual flaws in the EWM ACOS study identified by Donkin, the MCC believes there is no credible evidence to support the need for a major adjustment, with the possible exceptions for Malmstrom and Montana Refinery.⁶⁵

The MCC does not believe that the declining-block rate structure is either necessary or relevant under the present circumstances. However, the MCC points out that the EWM declining-block rate structure has been in place for several years and has been accepted in prior settlements. The MCC is not aware of any significant opposition to the declining-block rate structure from any EWM customers.⁶⁶

The MCC claims a properly designed fixed monthly Customer Charge should collect the variable costs that are saved or incurred when customers leave or are added to the system. Almost all of the investments in distribution plant (mains, general, other) are fixed costs and unaffected when customers leave or are added to the system. Accordingly, those costs are not properly recoverable in the fixed monthly Customer Charge. Any distribution plant additions for mains and service lines having large costs, relative to historical average costs, are more appropriately recovered through EWM's line extension policy.⁶⁷

Malmstrom's Pre-filed Direct Testimony of Colonel Everett H. Thomas

The FEA operates several facilities served by EWM, including Malmstrom. Malmstrom negotiates contract service from EWM for transportation and distribution of natural gas supply to master meters at Malmstrom. Malmstrom's contracting agent for natural gas supply is the Defense Energy Support Center (DESC). The current DESC contracted natural gas supplier, and the only contracted natural gas supplier for the test year ending December 31, 2003, is Energy

⁶⁴ Ibid, page 1

⁶⁵ Data response to PSC-026b

⁶⁶ Data response to PSC-026c

⁶⁷ Data response to PSC-026e

West Resources. The natural gas is purchased at Carway, one of NW's primary points of receipt for natural gas delivered to EWM on NW's transmission system. The natural gas supply is transferred from the NW transmission system to the EWM distribution system at one of NW's Great Falls City Gate Stations. The EWM distribution system reduces the pressure of the natural gas supply to 55 psig and delivers it on their 60 psig MAOP loop-line to the master meters at Malmstrom. Malmstrom has a maximum storage capacity limit of 80,000 Dkts. Storage charges, if any, are included in its firm transmission rates paid to EWM.⁶⁸

The main base natural gas distribution system supplies gas to approximately 224 military buildings and 1400 military family housing units. The buildings range in size from large missile maintenance hangars to small administrative facilities, dormitories, and family housing units. Malmstrom also receives residential service for a 194-unit family housing village that is separately metered.⁶⁹

Malmstrom does not charge individual military members or civilians for natural gas usage. The main base natural gas distribution system has limited metering capabilities to eight organizations on the base that are required by Federal law to reimburse Malmstrom. Malmstrom collected \$82,050 in reimbursements during the 2003 test year.⁷⁰

Malmstrom pays EWM to receive uninterrupted natural gas supply and transmission delivery services. Each year, beginning in October and ending in May, Malmstrom heats a total of 81 military buildings by means of a dual fueled coal/natural gas fired heating plant and hot water distribution system. Malmstrom does not recall conducting any formal bypass study. However, Malmstrom is currently investigating the potential of a Propane Air Mix Plant.⁷¹

Thomas believes the EWM ACOS study shows that Malmstrom is currently paying rates that are 7.61 times more than cost based rates. Thomas points out that past negotiations with EWM to reduce Malmstrom's rates have been unsuccessful, and that its only option for rate relief will be through Commission action. Thomas, on behalf of Malmstrom, requests that the Commission take appropriate action to ensure that the Malmstrom rates are fair, reasonable, and based on cost of service.⁷²

⁶⁸ Data response to PSC-020

⁶⁹ Ibid

⁷⁰ Data response to PSC-021

⁷¹ Data response to PSC-022

⁷² Direct Testimony of Colonel Everett H. Thomas, pages 3 and 4

Thomas provided a copy of an EWM letter dated May 30, 2002 that was a follow-up to earlier discussions with Malmstrom regarding contract renegotiations. In the follow-up letter EWM stated that there was insufficient cost support for a renegotiation. In addition, EWM requested that Malmstrom provide it with any documentation of the bypass analysis alluded to during earlier discussions. EWM stated that the bypass information would be very helpful in obtaining Commission approval for any future rate relief.⁷³

Rate Design Stipulation

On April 26, 2005 the MCC filed a Stipulation and Agreement (RD Stipulation) entered into by the parties of record (EWM, MCC, FEA) to settle all outstanding RD issues. The parties agreed to the following, subject to and with the approval of the Commission:

1. The RD Stipulation as proposed is a fair and reasonable resolution of the RD issues and that it is in the public interest.
2. Unless otherwise “contained in this Stipulation and Settlement Agreement (and that Settlement Agreement between Energy West and Montana Consumer Counsel respecting revenue requirements which is on file with the Commission in this Docket) the parties agree that the rates, rate blocks and all other aspects of the proposed rate design filed by Energy West in this proceeding shall be implemented...”
3. The fixed monthly Customer Charge for the Residential Service rate class shall be set at \$6.75 per customer per month.
4. The total increase in non-gas annual Distribution COS revenues for purposes of calculating the volumetric Distribution Base Rates (\$/Ccf) for the Residential Service rate class shall be set at \$309,658.
5. There shall be a decrease of \$100,000 in non-gas annual revenues for Malmstrom. The decrease shall be accompanied by a contract, subject to a primary term of three years from the date of the final order in this docket, which reduces Malmstrom’s assigned peak-day transmission capacity from 3,127 MMBTUs to 2,562 MCFs (Note: 1 MMBTU is approximately equal to 1 MCF). The contract shall include clauses that require Malmstrom to pay excess capacity usage charges and penalties under certain conditions. The contract shall also include clauses that allow Malmstrom to renegotiate the terms and conditions if certain events occur prior to the expiration of the three-year contract period.
6. The execution of the RD Stipulation shall not be deemed to constitute an acknowledgment by any of the parties to the validity of any particular theory or ratemaking principle. The execution of the RD Stipulation shall not be deemed to bind any of the parties to any position asserted by any of the other parties. No findings of fact or conclusions of law other than those stated in the RD Stipulation shall be deemed to be

⁷³ Ibid, Exhibit EHT-1

implicit.

7. The RD Stipulation shall be of no force and effect until accepted and approved by the Commission as to all of its terms and conditions. Any of the parties have the option and right to withdraw from the RD Stipulation, with all rights preserved, in the event that the Commission denies the RD Stipulation in its entirety or approves it with conditions that are not acceptable to any of the parties.
8. The compromises and settlements reached by means of this negotiated RD Stipulation, rather than a formal adversarial process, are in the public interest.

On July 7, 2005 at a regularly scheduled work session, the Commission directed PSC staff to conduct a meeting with representatives from EWM, MCC, and FEA, hereinafter collectively referred to as “the Parties”, for the purpose of discussing and resolving items of concern identified upon the initial review and examination of the RD Stipulation and the post-hearing RD exhibits submitted by EWM implementing the stipulations to that agreement.

Numerous concerns were discussed with the Commission during the July 7, 2005 work session. As a result of that work session and to facilitate the Commission directive, a list of concerns were prepared and presented to representatives of the parties to the RD Stipulation.

The following is a list of the concerns discussed with the participants at the RD Stipulation meeting. Tables have been added for illustrative purposes.

1. Stipulation 4 stated that the parties agreed that the total increase in non-gas Distribution COS annual revenues for purposes of calculating the volumetric Distribution Base Rates (\$/Ccf) for the Residential Service rate class would be limited to \$309,658. There was a concern with the manner in which this stipulation was incorporated into the post-hearing exhibits for the following reason:
The post-hearing exhibit, Statement H – Operating Revenues, used normalized Ccf volumes different from those used to reconcile the ordered interim Distribution COS revenue requirement increase of \$536,209.
 - a. One concern was the rationale for changing the normalized volumes, a change that was not otherwise allowed for and contained in the RD Stipulation. Please note that the total system normalized volumes remained the same.
 - b. Another concern was the rationale for limiting the increase in non-gas Distribution COS annual revenues for purposes of calculating the volumetric Distribution Base Rates (\$/Ccf) for the Residential Service rate class to \$309,658, when the interim increase totaled \$319,868.

Table 1 details the differences in the normalized volumes.

Rate Class	Interim Volumes (Ccf) ⁷⁴ Rate Block 1	Post-hearing Volumes (Ccf) Rate Block 1	Differences (Ccf) Increase/(Decrease)
Residential	16,730,443	16,985,581	255,138
Small General	1,354,176	1,359,805	5,629
Large General	3,190,832	3,161,487	(29,345)
Extended General	1,580,550	1,349,128	(231,422)
Totals	22,856,001	22,856,001	0

2. Stipulation 2 stated that unless otherwise “contained in this Stipulation and Settlement Agreement (and that Settlement Agreement between Energy West and Montana Consumer Counsel respecting revenue requirements which is on file with the Commission in this Docket) the parties agree that the rates, rate blocks and all other aspects of the proposed rate design filed by Energy West in this proceeding shall be implemented...”

There was a concern with the manner in which this stipulation was incorporated into the post-hearing exhibits for the following reason:

PSC staff understood the stipulation to mean that all fixed monthly Customer Charges and volumetric Distribution Base Rates (\$/Ccf), other than those changes required to implement stipulations 3, 4, and 5, would be consistent with and comparable to (but not necessarily equal to) the fixed monthly Customer Charges and volumetric Distribution Base Rates (\$/Ccf) as proposed and filed by EWM.

- a. One concern was the rationale for maintaining the fixed monthly Customer Charges at or near the pre-existing fixed monthly Customer Charges for the Residential Service-Low Income customers receiving discounts, while increasing the non-discounted Residential Service customers’ fixed monthly Customer Charge by 10.84%.

Table2a details the changes to the Residential Service rate class fixed monthly Customer Charges.

Residential Service Class	Pre-Existing Customer Charge	Post-hearing Customer Charge	\$ Change Incr./(Decr.)	% Change Incr./(Decr.)
Regular	\$6.09	\$6.75	\$0.66	10.84%
RS <30%	\$3.57	\$3.50	(\$0.07)	(1.96%)
RS 31-60%	\$3.99	\$4.00	\$0.00	0%
RS 61-90%	\$4.40	\$4.40	\$0.00	0%
RS >90%	\$4.80	\$4.80	\$0.00	0%

⁷⁴ 1 Ccf is equal to 1/10th of an Mcf.

- b. Another concern was, with respect to the General Service rate classes, the rationale for changing only the volumetric Distribution Base Rates (\$/Ccf) while retaining the fixed monthly Customer Charges, “As Proposed and Filed”, in preparing the “Post-hearing” RD (refer to Table 2b, boxed area).

Table 2b details the fixed monthly Customer Charges and volumetric Distribution Base Rates for the “Pre-existing”, the “As Proposed and Filed”, and the stipulated “Post-hearing” RDs.

Rate Class ⁷⁵	Pre-existing Rate Design	As Proposed and Filed Rate Design	Post-hearing Rate Design	Post vs. Filed \$ Change Incr./.(Decr.)	Post vs. Pre \$ Change Incr./.(Decr.)
Residential	\$6.09	\$12.00	\$6.75	(\$5.25)	\$0.66
Block 1/Ccf	\$0.10973	\$0.04720	\$0.13500	\$0.08780	\$0.02527
Block 2/Ccf	\$0.07925	\$0.02323	\$0.01782	(\$0.00541)	(\$0.06143)
RS <30%	\$3.57	\$4.15	\$3.50	(\$0.65)	(\$0.07)
Block 1/Ccf	\$0.03174	\$0.02594	\$0.03860	\$0.01266	\$0.00686
Block 2/Ccf	\$0.00000	\$0.00000	\$0.01782	\$0.01782	\$0.01782
RS 31-60	\$3.99	\$4.72	\$4.00	(\$0.72)	\$0.00
Block 1/Ccf	\$0.04067	\$0.03555	\$0.04885	\$0.01330	\$0.00818
Block 2/Ccf	\$0.01021	\$0.01777	\$0.01782	\$0.00005	\$0.00761
RS 61-90	\$4.40	\$5.64	\$4.40	(\$1.24)	\$0.00
Block 1/Ccf	\$0.05002	\$0.03960	\$0.06161	\$0.02201	\$0.01159
Block 2/Ccf	\$0.01956	\$0.01980	\$0.01782	(\$0.00198)	(\$0.00174)
RS >90%	\$4.80	\$6.74	\$4.80	(\$1.94)	\$0.00
Block 1/Ccf	\$0.05936	\$0.04265	\$0.07357	\$0.03092	\$0.01421
Block 2/Ccf	\$0.02889	\$0.02133	\$0.01782	(\$0.00351)	(\$0.01107)
Small General	\$7.75	\$17.00	\$17.00	\$0	\$9.25
Block 1/Ccf	\$0.18479	\$0.16142	\$0.19850	\$0.03708	\$0.01371
Block 2/Ccf	\$0.14670	\$0.08038	\$0.06840	(\$0.01198)	(\$0.07830)
Large General	\$38.75	\$90.00	\$90.00	\$0	\$51.25
Block 1/Ccf	\$0.13713	\$0.14219	\$0.18650	\$0.04431	\$0.04937
Block 2/Ccf	\$0.12444	\$0.07175	\$0.06150	(\$0.01025)	(\$0.06294)
Extend Gen.	\$553.51	\$575.00	\$575.00	\$0	\$21.49
Block 1/Ccf	\$0.10676	\$0.13094	\$0.15410	\$0.02316	\$0.04734
Block 2/Ccf	\$0.09407	\$0.07670	\$0.06080	(\$0.01590)	(\$0.03327)
Malmstrom ⁷⁶	\$54,536.28	\$54,536.28	\$50,548.67	(\$3,987.61)	(\$3,987.61)
Block 1/Ccf	\$0.02849	\$0.02849	\$0.00891	(\$0.01958)	(\$0.01958)
Block 2/Ccf	\$0.00000	\$0.00000	\$0.00000	\$0.00000	\$0.00000
NCS-Other	\$501.50	\$501.50	\$501.50	\$0	\$0
Block 1/Ccf	\$0.08439	\$0.08439	\$0.08439	\$0.00000	\$0.00000
Block 2/Ccf	\$0.05986	\$0.05986	\$0.05986	\$0.00000	\$0.00000
MT Refinery	\$500.00	\$500.00	\$500.00	\$0	\$0
Block 1/Ccf	\$0.04470	\$0.04470	\$0.04470	\$0.00000	\$0.00000
Block 2/Ccf	\$0.01622	\$0.01622	\$0.01622	\$0.00000	\$0.00000

⁷⁵ The Distribution Transport Service rate classes are classified and charged the same as the Residential and General Service rate classes.

⁷⁶ The monthly fixed Customer Charge for Malmstrom recovers both Distribution and Transmission COS.

3. Stipulation 5 stated that the parties agreed to a decrease of \$100,000 in the non-gas annual revenue responsibility for Malmstrom.

There was a concern with the manner in which this aspect of the stipulation was incorporated into the post-hearing exhibits for the following reasons:

Staff 's perception was that the \$100,000 decrease in the non-gas annual revenue responsibility for Malmstrom may be substantially attributed to fixed transmission costs that are charged to customers based on system peak-day capacities/demands assigned by EWM to its various customers and customer classes. The RD Stipulation reduces Malmstrom's assigned system peak-day capacity from 3,127 MMBTUs to 2,562 Mcfs. The perception is that the 565 MMBTU (or Mcf) reduction in peak-day capacity assigned to Malmstrom results in an annual cost-shifting from Malmstrom to the Core and Distribution Transport Service rate classes of \$47,121 (565 MMBTU * \$6.935 * 12 months). It appears that EWM incorporates the cost-shifting of these perceived fixed transmission costs into its post-hearing rate design by decreasing Malmstrom's fixed monthly Customer Charge ($\$54,536.28 - \$50,548.67 = \$3,987.61 * 12 = \$47,851.32$).

The concern was the rationale for increasing the Core rate classes Distribution Base Rates (\$/Ccf) to recover the full decrease of \$100,000 in the non-gas annual revenue responsibility for Malmstrom, given that a substantial portion of that decrease may be attributed to Transmission COS.

Table 3 illustrates the perceived cost-shifting scenario relative to EWM's contractual obligations with NorthWestern Energy, EWM's transmission and storage services provider.

Customers/ Rate Classes	Current Assigned Capacity MMBTUs ⁷⁷	Revised Assigned Capacity MMBTUs	MMBTU Change Incr./(Decr.)	Capacity Charges \$ Change Incr./(Decr.)
Firm:				
Malmstrom	3,127	2,562	(565)	(\$47,121)
Refinery	1,000	1,000	0	\$0
Other NCS	806	806	0	\$0
Core& DT	36,867	37,432	565	\$47,121
Subtotal	41,800	41,800	0	\$0
Interruptible:	2,000	2,000	0	Volumetric
Total Contracted Capacity⁷⁸	43,800	43,800	0	

⁷⁷ Current Assigned Capacities are per EWM's monthly gas supply (and transportation) cost tracker for April 1, 2005.

⁷⁸ Total firm and interruptible contracted capacities are per the Transmission and Storage Agreement between EWM and NorthWestern Energy that is set to expire in the year 2010.

COMMISSION FINDINGS ON RATE DESIGN STIPULATION

EWM explained that the difference in the normalized volumes used for reconciling the post-hearing exhibit, Statement H – Operating Revenues, and the normalized volumes used for reconciling the interim Distribution COS revenue requirement increase of \$536,209 was attributed to the correction of certain misclassified Housing Authority customers' normalized volumes within and between the Core rate classes.

The Commission finds that EWM's explanation effectively resolves this concern.

By applying the corrected normalized volumes in calculating the pre-existing normalized operating revenues for the Residential Service rate class, the total increase to the non-gas annual Distribution COS normalized revenue responsibility for the Residential Service rate class essentially agrees with the stipulated limitation of \$309,658.

The Commission finds that this reconciliation effectively resolves this concern.

According to the MCC, other than the stipulation that the fixed monthly Customer Charge for the Residential Service rate class shall be set at \$6.75 per customer per month, the remaining fixed monthly Customer Charges and volumetric Distribution Base Rates (\$/Ccf) were left to the discretion of EWM. The MCC offered no objection to the post-hearing RD filed by EWM.

The Commission finds that MCC's explanation effectively resolves this concern.

The Commission also finds that the fixed monthly Customer Charge element of the post-hearing RD filed by EWM is not unduly discriminatory against the General Service rate classes.

The manner in which the decrease of \$100,000 in the non-gas annual revenue responsibility for Malmstrom was incorporated into the post-hearing exhibits is not an issue with the parties to the Rate Design Stipulation.

The FEA argued that the \$100,000 decrease in Malmstrom's non-gas annual revenue responsibility was fair and reasonable. In addition, the FEA applauded the Commission's denial of EWM's Motion for Waiver of the minimum filing requirements and directing EWM to prepare Statement L-ACOS and Statement M-RD, commenting that the information provided in EWM's ACOS study was invaluable, and otherwise unobtainable, in supporting Malmstrom's argument that their current revenue responsibility was both unfair and unreasonable.

Due to the stipulated limitation in the increase to the Residential Service rate class, the entire \$100,000 decrease to Malmstrom's non-gas annual revenue responsibility will be

recovered from the General Service rate classes. The stipulated limitation in the increase to the Residential Service rate class effectively locks in the Residential Service rate class' interim increase. Since the NCS customers have been excluded from any rate increase, the \$100,000 decrease to Malmstrom's non-gas annual revenue responsibility will be recovered from the remaining General Service rate class customers (refer to Table 5 for additional details).

The Commission finds that the functional cost (Distribution COS or Transmission COS) of the \$100,000 decrease to Malmstrom's non-gas annual revenue responsibility and the appropriate recovery mechanism for those costs (Distribution Base Rates or the Tracker) may best be resolved in the next general rate application.

The Commission also finds that the recovery of the entire \$100,000 decrease to Malmstrom's non-gas annual revenue responsibility from the General Service rate classes is not unduly discriminatory.

An important aspect of the stipulated decrease of \$100,000 in the non-gas annual revenue responsibility for Malmstrom is that the decrease shall be accompanied by a contract, subject to a primary term of three years from the date of the final order in this docket. The FEA commented that the Department of Defense has and will continue to reassess Malmstrom's role in providing for the national defense. The FEA stated that Malmstrom's diminishing military role, in conjunction with the efficiency gains in its on-base dual fueled coal/natural gas fired heating plant, most likely reduces its need for future transmission capacity.

The Commission finds that the contractual aspect of the RD Stipulation involving Malmstrom, subject to a primary term of three years from the date of the final order in this docket, will substantially bridge the period between now and when the Transmission and Storage Agreement with NW is set to expire in the year 2010 and is in the public interest.

The Commission finds that the RD Stipulation is fair and reasonable, and that the compromises and settlements reached by means of the negotiated RD Stipulation, rather than a formal adversarial process, are in the public interest, and accepts and approves the RD Stipulation as to all of its terms and conditions.

On July 27, 2005 EWM filed a set of tariffs that conform to the RD Stipulation and are in effect a set of compliance tariffs. The Commission, concurrent with the RD Stipulation, accepts and approves EWM's compliance tariffs, as filed (refer to Table 2a, Post-hearing Rate Design for details).

Table 5 details the proposed normalized operating revenues and rate increases over the pre-existing normalized operating revenues.

Rate Class	Pre-existing Normalized Oper. Revenues	Post-hearing Normalized Oper. Revenues	\$ Change Increase / (Decrease)	% Change Increase / (Decrease)
Residential	\$3,955,382	\$4,258,995	\$303,613	7.68%
RS <30%	\$2,916	\$3,233	\$317	10.87%
RS 31-60%	\$8,060	\$8,882	\$822	10.20%
RS 61-90%	\$21,042	\$22,896	\$1,854	8.81%
RS >90%	\$29,503	\$31,989	\$2,486	8.43%
Total Res.	\$4,016,903	\$4,325,995	\$309,092	7.69%
Small General	\$705,907	\$789,999	\$84,092	11.91%
Large General	\$1,626,739	\$1,828,011	\$201,272	12.37%
Extended Gen.	\$355,236	\$399,154	\$43,918	12.36%
Total General	\$2,687,882	\$3,017,164	\$329,282	12.25%
Total Res.&Gen.	\$6,704,785	\$7,343,159	\$638,374	9.52%
NCS-Other	\$201,091	\$201,091	\$0	0.00%
Malmstrom	\$733,139	\$631,197	(\$101,942)	(13.90%)
Refinery	\$196,382	\$196,382	\$0	0.00%
All Classes	\$7,835,397	\$8,371,829	\$536,432	6.85%

Table 6 details the incremental normalized operating revenues and rate increases over the interim normalized operating revenues.

Rate Class	Interim Normalized Oper. Revenues	Post-hearing Normalized Oper. Revenues	\$ Change Increase / (Decrease)	% Change Increase / (Decrease)
Residential	\$4,272,448	\$4,258,995	(\$13,453)	(0.31%)
RS <30%	\$3,152	\$3,233	\$81	2.57%
RS 31-60%	\$8,706	\$8,882	\$176	2.02%
RS 61-90%	\$22,720	\$22,896	\$176	0.77%
RS >90%	\$31,850	\$31,989	\$139	0.44%
Total Res.	\$4,338,876	\$4,325,995	(\$12,881)	(0.30%)
Small General	\$762,350	\$789,999	\$27,649	3.63%
Large General	\$1,756,810	\$1,828,011	\$71,201	4.05%
Extended Gen.	\$383,644	\$399,154	\$15,510	4.04%
Total General	\$2,902,804	\$3,017,164	\$114,360	3.94%
Total Res.&Gen.	\$7,241,680	\$7,343,159	\$101,479	1.40%
NCS-Other	\$201,091	\$201,091	\$0	0.00%
Malmstrom	\$733,139	\$631,197	(\$101,942)	(13.90)%
Refinery	\$196,382	\$196,382	\$0	0.00%
All Classes	\$8,372,292	\$8,371,829	(\$463)	(0.01%)

The approved RD Stipulation will decrease the interim increase in annual non-gas Distribution COS revenue requirements for the Residential rate class from 7.99% to 7.69%, increase the interim increase in annual non-gas Distribution COS revenue requirements for the General Service rate classes from 8.31% to 12.25%, and decrease Malmstrom's annual non-gas Distribution COS revenue requirements by 13.9%.⁷⁹ The average Residential Service rate class customer's annual bill will increase by \$13.08, and the average General Service rate class customer's annual bill will increase by \$121.87.

CONCLUSIONS OF LAW

EWM provides natural gas service within the State of Montana and as such is a "public utility" within the meaning of § 69-3-102, MCA.

The Montana Public Service Commission properly exercises jurisdiction over the EWM rates and operations pursuant to Title 69, Chapter 3, MCA.

The rates approved herein are just and reasonable.

ORDER

THEREFORE THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

EWM is hereby authorized to implement all final rate and revenue changes as outlined in the Rate Design Stipulation Agreement.

EWM is hereby authorized to implement on a final basis, the previously approved interim increase in annual Distribution COS revenue requirements of \$536,209.

The rates which implement this Stipulated Final Order will be effective for all services rendered on and after September 1, 2005.

DONE AND DATED IN OPEN SESSION at Helena, Montana on this 16th day of August, 2005, by a vote of 5 to 0.

⁷⁹ The interim rate increases, originally applied on an equal percentage basis of 8.00%, have been modified to reflect the correction of the Housing Authority normalized volumes.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

GREG JERGESON, Chairman

BRAD MOLNAR, Vice Chairman

DOUG MOOD, Commissioner

ROBERT H. RANEY, Commissioner

THOMAS J. SCHNEIDER, Commissioner

ATTEST:

Connie Jones
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.