

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

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IN THE MATTER OF NorthWestern Energy's ) REGULATORY DIVISION  
Application for Approval of Unreflected Gas )  
Cost Account Balance and Projected Gas Cost, ) DOCKET NO. D2013.5.34  
and Gas Transportation Adjustment Clause )  
Balance )

IN THE MATTER OF NorthWestern Energy's ) REGULATORY DIVISION  
Application for Approval of Unreflected Gas )  
Cost Account Balance and Projected Gas Cost ) DOCKET NO. D2014.5.47  
and Gas Transportation Adjustment Clause )  
Balance )

**MONTANA CONSUMER COUNSEL RESPONSE BRIEF**

Montana Consumer Counsel (MCC) submits the following Response Brief in the above-captioned dockets.

**I. Introduction**

NorthWestern Corporation d/b/a NorthWestern Energy (NWE, or the Company) filed its annual gas cost tracking applications for the years ending June 30, 2013 (with forecast costs through June 30, 2014), and June 30, 2014 (with forecast costs through June 30, 2015) on May 31, 2013 and May 29, 2014, respectively. At NWE's request, the dockets pertaining to these applications were consolidated, and the procedural schedule was extended. Interim Order Nos. 7282 and 7282b were issued on June 26, 2013 and June 18, 2014, respectively, approving the requested relief on an interim basis, while noting that nothing would preclude the Commission from adopting rates or "any other item" different from what was provided in the interim order.

MCC submitted the pre-filed testimony of Mr. George L. Donkin in both the 2013 application prior to consolidation, and in the consolidated docket proceeding.

A hearing in these consolidated dockets was held on May 19, 2015.

MCC focused on two issues in these dockets: 1) NWE's request to recover estimated lost revenues related to its Universal System Benefits (USB) expenditures<sup>1</sup>, and 2) NWE's failure to update costs associated with its recently acquired gas production properties in a manner that corresponds with its proffered support for including costs related to those properties in rates.

## **II. The Commission Should Not Increase Rates to Reflect Estimated Lost Revenues Related to Universal System Benefits Expenditures.**

MCC Witness Donkin explained several reasons why USB-related estimated lost revenues should not be included in gas cost trackers. The first of these is that this practice involves a mismatch of revenues, expenses and other volume changes, and can result in unreasonable rate levels. *Ex. MCC-2, 5:16-6:4*. He further observed that automatic rate adjustments may reduce management incentives to control costs. *Ex. MCC-2, 6:12-13*.

It is necessary here to provide some brief context. The "matching principle" is a fundamental and longstanding rate making concept. Examples of its application by this Commission are easily found.

120. The Commission finds the rationale behind adoption of a test year to be the matching principle, and seeks, as nearly as possible to match revenues, expenses and plant within that period.

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<sup>1</sup> NWE has requested inclusion of lost revenues in both the historic and forecast tracking years in these dockets. Interim rates requested and approved in Order No. 7282b contain forecast estimates of lost revenues for the tracking period ending June 30, 2015. The reasons for denying USB-related lost revenue additions are the same for all periods. NWE's passing observation (NWE Brief, fn 1) that these issues have been conflated is in error. Indeed, NWE itself later explicitly acknowledges that the issues are the same for the two time periods. *NWE Brief. Pp. 7-8*. Because the historic periods cannot be reached by the Commission's generic policy inquiry docket, and the issues are the same for past and future periods, the Commission should not defer consideration of this issue as NWE requests.

*Montana Power Co., Docket No. 83.9.67, Order No. 5051c, p. 41 (1984).*

See also, *Montana Power Co.*, Docket No. 88.6.15, Order No. 5360e, p. 9 (1989); *Montana Power Co.*, D97.7.90, Order No. 5986r, ¶ 23 (2000).

There should be no question that claimed load reduction and resulting revenue loss associated with energy efficiency programs represent a single issue adjustment. Rate increases reflecting only this change violate the matching principle. The argument has been advanced, however, that this claimed revenue loss provides a disincentive to a utility for making efficiency investments, and that sacrificing the matching principle in this context would be the lesser of two evils from a public policy perspective. (See, NWE Brief, p. 7: “programs that reduce sales between rate cases from what they would have been without the programs create a financial disincentive.”) There are many reasons to conclude that this theoretical disincentive is overcome by many other factors, and that such a tradeoff is not necessary with respect to any Demand Side Management (DSM) expenditure. These issues are being considered by the Commission in D2014.6.53. The issue in these dockets is much narrower, however, and pertains only to USB-related efficiency expenditures.

NWE itself acknowledges that “Montana law requires NorthWestern to have a USB program.” *NWE Brief, p. 2*. Simply put, incentives, or disincentives, should play no role in an obligatory program that is mandated by statute and is funded by ratepayers, not the Company.

NWE incorrectly characterizes these funds as “its natural gas USB funds.” *NWE Brief, p. 6*. They are funds collected from ratepayers, however, specifically in furtherance of the statutory program. That is why they are held in a separate account which bears interest for the benefit of the program. The United States Bankruptcy Court found that these USB funds are “not assets of the Debtor’s [NWE] estate.” *Order No. 6504a, ¶10, D2003.8.114*. The Commission has reached the same conclusion.

USB funds collected by NWE are public purpose funds and such funds are not property of NWE. NWE collects funds that are 100% the proceeds of a special charge specifically identified and mandated by the Montana Legislature, and collected by NWE for public purposes pursuant to PSC direction and approved tariffs. NWE is merely a conduit for USB funds and is intended effectively to pass through those funds by ensuring that they are expended or forwarded solely for designated programs and purposes as established by the Montana Legislature and implemented by the Commission. Order No. 6504a, ¶10, D2003.8.114.

In the face of this nondiscretionary program that is simply administered by NWE, there can be no serious argument that disincentives justify disregarding the fundamental consumer protection that is otherwise afforded by the matching principle.

It is not surprising that NWE focuses solely on revenues, and complains of potential revenue loss associated with its USB activities. *NWE Brief*, p. 2. Revenues, however, are only one part of the larger picture, and USB-related revenues are only one part of total revenue. NWE witness Schwartzenberger himself recognized, for example, that even within the USB program there can be offsetting revenue and expense effects. Those programs can reduce shutoffs and thereby increase sales volumes. They may also reduce expenses incurred in collecting on unpaid bills. Both of these changes can increase net revenue. *TR 88:1 – 89:2*. Many other non-USB program related expense and revenue changes are also occurring.

NWE has not attempted to establish, nor has it even asserted, that it is entitled to a specific level of overall revenue in these tracker proceedings. Instead, its request for a revenue increase is based on a fairness argument; that is, that the Commission should not “penalize” NWE for complying with the USB law. *NWE Brief*, p. 5. This is not a compelling argument for extraordinary rate treatment.

USB expenditures are not the only mandates that apply to NWE and other regulated and non-regulated companies. There are a multitude of regulations, such as those that cause safety related expenses, that are not automatically tracked. The logical flaw in this fairness argument is further evidenced by the fact the USB law also requires large customers to fund USB purposes. Because the large customers do not rely on the utility to administer their funding, however, the utility does not claim lost revenues, even though the effects are presumably similar to those from smaller customer funded programs. *TR 91:21-92:21*.

When a regulated utility believes it cannot absorb expenditures or revenue losses through operational efficiencies (which should be encouraged), it may file a rate increase request that reflects all circumstances in a consistent time frame. While NWE complains about being penalized as a result of the statutory USB program, the fairness question is actually more aptly stated as whether the Commission should penalize ratepayers who are required to provide these USB funds by subjecting them to rate increases that are not tested for reasonableness. It should not.

### **III. Rates Related to NWE's Company-Owned Gas Production Properties Should Be Updated.**

MCC Witness Donkin also described concerns related to rates that are currently being charged to ratepayers for NWE's recently acquired company-owned gas production properties. There are three such properties. One of these, Battle Creek, was acquired in 2010 and has now been included in rates through a general rate case order in 2013 (Order No. 7249e). The other two, Bear Paw and Devon, have been included in interim tracker rates since 2012 and 2013, respectively. This expedited inclusion of producing properties in tracker rates has been referred to as the "bridging concept." *TR 40:24-41:9*. Battle Creek rates are based on a 2011 revenue requirement. *MCC-2, 21:13-19*. Bear Paw rates are based on 2012 costs, and Devon rates are based on 2013 costs. *MCC-2, 22:14-*

23:8. If more current costs provided by NWE in data responses were used, ratepayer savings would be roughly \$3 million per year. *TR 124:12-125:10.*

This circumstance of stale cost information would normally not be of particular concern. Indeed, for rate based assets such as Battle Creek, the matching principle described above could arguably preclude piecemeal updates. Tracked items (Bear Paw and Devon), of course, are not subjected to the matching principle and are treated as standalone items. The more unique distinguishing circumstance, and the larger issue here, however, relates to the original basis for including these assets in rates at all.

The Commission has cautiously endorsed the concept of utility ownership of gas production properties. Recognizing the risks of such ownership, however, the Commission required that, if NWE pursued such acquisitions, “it must strive to find transactions which provide **compelling customer benefit over buying natural gas at market prices,**” noting that the main factors are price, volume and term. *Public Service Commission Comments, ¶ 49, N2010.12.111 (2011)(emphasis added).* In order to fulfill this requirement to show compelling customer benefits, NWE has provided net present value (NPV) calculations of the production property revenue requirements compared to the NPV of forecasted market purchase costs.

Q: And in that Docket [2012.3.25] did NorthWestern present a net present value calculation of Battle Creek revenue requirement over a 47-year period?

A: I believe Mr. [Bird] had.

Q: Do you recall, was that compared to the net present value of a market price forecast?

A: It was.

Q: And, Mr. DiFronzo, do you recall, was that done in order to determine what was called the point of indifference for customers to pay for these assets?

A: I believe that was the intention of determining the acquisition price.

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Q: That net present value calculation for revenue requirement, was that based on a declining revenue requirement every year?

A: That presented a declining rate base.

Q: Every year?

A: Yeah, that's correct.

*TR 22:17-23:25.*

In the Docket to which Mr. DiFronzo referred, NWE Witness Brian Bird described the NPV analysis and its relation to rate assumptions.

After determining the approximate value to the Sellers, NWE had to determine acceptable prices it would pay to acquire these assets for our customers. To establish the upper bounds of our bid prices, we calculated the NPV of the 47 year annual **regulated revenue requirement** our customers would pay if we purchased and placed the assets into rate base, assuming the same Albrecht production schedule and cost estimates used above. *D2012.3.25, Prefiled Direct Testimony of Brian B. Bird, BBB-8:7-13 (emphasis added).*

In the case of Battle Creek, the Commission allowed inclusion of the acquisition in final rates, explicitly relying on this NPV comparison provided by NWE.

85. The Commission finds that, based on what NWE knew at the time of the transaction, NWE acted prudently in its acquisition of the Battle Creek properties. In its economic analyses of each of the two transactions, NWE calculated the maximum bid price that would produce customer indifference between rate-basing the Battle Creek asset compared to buying the same volumes over the next 47 years at the then-forecast market prices. *Order No. 7201b, citing Brian Bird's testimony.*

In sharp contrast to these NPV analyses and acquisition justifications that are based on regularly declining costs, NWE now proposes to leave charges related to

these properties unchanged for several years. Had this treatment been factored into the NPV analyses, the results would have been much different, as Mr. DiFronzo acknowledged.

Q: With respect to those annual declines in the revenue requirement that we were just discussing, that net present value calculation, if those declines did not occur in that calculation, would that affect the net present value?

A: That would change the calculation.  
*TR 24:1-11.*

Mr. Donkin estimated the current difference at \$3 million per year and noted that “it is absolutely essential that ratepayers get the benefits of declining revenue requirements in early years because it’s the early years where volumes are large.” *TR 132:18-23.* The Commission should reject out of hand NWE’s rationalization that the analysis was done to support the acquisition, but not for ratemaking. *TR 23:16-17.* The analysis was proffered to, and relied upon by, the Commission for purposes of including the properties in the rate setting process.

Mr. Donkin observes that NWE has been using outdated costs for Battle Creek and Bear Paw since 2012, and since 2013 for Devon. To provide ratepayers the opportunity to receive benefits that were envisioned when the properties were acquired, he recommends that NWE be required to file current cost-based rates for each property.<sup>2</sup> *MCC-2, 30:17-31:14.*

NWE responds to this recommendation with various arguments, most of which pertain only to the Battle Creek rates which were previously included in a final order. NWE points out, for example that these rates are prima facie lawful, and presumed just and reasonable. *NWE Brief, p. 9.* NWE is correct on this

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<sup>2</sup> NWE incorrectly asserts that MCC is “advocating ratemaking based on an analysis used to evaluate the acquisition of Battle Creek, not on its actual normalized test period costs.” *NWE Brief, p. 10.* It is suggesting, in other words, that Mr. Donkin proposes to use the exact numbers found in the NPV analyses to set rates. That misrepresents Mr. Donkin’s recommendation. He instead urges that the annual cost decline methodology be reflected in rates, but that NWE file “current cost-based rates.”

point, but it is misplaced. Mr. Donkin has not suggested any form of retroactive ratemaking, and this inability to reach backward actually supports the urgency in his recommendation for a timely filing.

NWE next points to the Commission's "minimum filing requirements" and contends that they must be met by anyone who is seeking a rate change. The Commission, however, has the legal authority, where circumstances justify, to conduct less than a full-scale review. *Montana Consumer Counsel v. PSC*, 168 Mont. 177 (1975) (*affirming gas cost trackers*). Indeed, were this not the case, NWE's single issue applications in these tracker dockets would have to be dismissed. Additionally, the Commission is entitled to receive information in the form that it requests. *Qwest v. PSC*, 2007 MT 350, 340 Mont. 309.

Ironically, NWE now relies on the matching principle to suggest that an adjustment related only to these gas properties would be improper. As discussed above, the Commission should adhere wherever possible to the matching principle. The circumstances in this particular instance are highly unique, however. The gas producing properties at issue here were acquired as a substitute for a tracked expense item: market purchases. Moreover, the substitution was based on a NPV analysis comparison to market purchases and that explicitly relied on regular cost adjustments. That NPV analysis is meaningless without matching rate treatment. These properties have not been treated like traditional rate base additions. They are immediately included in rates through a special "bridging concept" that allows immediate recovery of that one set of costs without any matching. *TR 40:3-41:5*. By arguing that the focus should be on a need to review total company earned returns and whether it is overearning its authorized return, NWE is essentially suggesting that it should be able to make up for any revenue deficiency by charging more now for Battle Creek gas than consumers would have paid for purchased gas. That is more than a little inconsistent with the arguments made for including these costs in rates.

In making a purchase decision, consumers have no interest in cost projections that bear no relationship to what they will actually be asked to pay. Neither should the Commission acting in their stead. There are two alternatives here. Rates can be harmonized with the analysis on which the underlying costs were justified, or the NPV analysis can be modified to conform to intended rate treatment. It should be emphasized that, absent Mr. Donkin's recommended rate treatment, consistency with support for including these properties in rates will require revising the NPV comparative analysis to reflect long periods of rates that exceed cost of service. That may well lead to unfortunate findings that the properties do not provide compelling ratepayer benefits and should not be included in rates, when they actually could provide benefits to both ratepayers and the Company.

NWE further argues that it is not necessary to adjust the Bear Paw and Devon rates because they are interim rates and ratepayers are thus protected from any harm of excessive rates. The testimony in this case, however, establishes that these rates have been in place for roughly two years, and it will be another two years before NWE anticipates they will be finalized. Timing is important. It can cause intergenerational inequities. Moreover, many ratepayers live paycheck to paycheck. It is a hardship to expect them to wait years for benefits they should and could receive currently. *TR 25:21-26:4*. Interim rates should not be held in place for up to four years when there is currently reason to believe that they are roughly \$2.5 million too high.<sup>3</sup> Indeed, the Commission has traditionally been conservative in imposing interim rates. They should at least be set at a reasonable level that isn't likely to generate over-collections.

Finally, NWE warns that eliminating bridging concept rates in the tracker would cause it to be unable to acquire new gas production assets. The Company misrepresents Mr. Donkin's recommendations by cutting off a portion of his testimony in quoting him. It claims that "Mr. Donkin advocated 'that the

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<sup>3</sup> For Bear Paw and Devon.

Commission should direct NWE to make a filing, to be effective July 1, 2015, that removes ‘bridging concept’ rates from the gas tracker.” *NWE Brief, p. 11*. What Mr. Donkin actually said was that “the Commission should direct NWE to make a filing, to be effective July 1, 2015, that removes the ‘bridging concept’ rates from the gas tracker, **to be replaced by actual cost-based rates resulting from the current fixed cost revenue requirements for each ... property.**” *MCC-2, 31:10-14 (emphasis added)*. The omitted material is important. Mr. Donkin did not recommend that these costs not be included in the tracker rates as NWE apparently fears. He simply suggests that they be harmonized with the cost expectations used to justify substituting these costs for the market rates in the tracker.

#### **IV. Conclusion**

The Commission has the legal authority to determine the appropriateness of its rate making practices. It has wisely adhered to the practice of comprehensive rate reviews with notable exceptions such as commodity cost trackers. In those instances, it has carefully described the justification for departures from applying the matching principle. In these dockets, there is no compelling reason to allow single-issue tracking of estimated impacts from a statutorily created public purpose program funded through ratepayer charges. There is, however, a compelling justification to update gas producing property costs that were substituted for tracked market purchases and were specifically represented to be at specified levels to prove customer benefits.

Respectfully submitted July 22, 2015.

A handwritten signature in blue ink, appearing to read "Robert A. Nelson", is written over a horizontal line.

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