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

In the Matter of NorthWestern Energy’s Application For)	REGULATORY DIVISION
(1) Unreflected Gas Cost Account Balance and Projected)	
Cost; and (2) Gas Transportation Adjustment Clause)	DOCKET NO. D2013.5.34
Balance)	
)	
and)	
In the Matter of NorthWestern Energy’s Application For)	
(1) Unreflected Gas Cost Account Balance and Projected)	DOCKET NO. D2014.5.47
Cost; and (2) Gas Transportation Adjustment Clause)	(consolidated)
Balance)	

NORTHWESTERN ENERGY’S POST-HEARING REPLY BRIEF

On July 22, 2015, the Montana Consumer Counsel (“MCC”) filed its *Response Brief* (“Response Brief”) in the above-captioned consolidated dockets. Pursuant to the Montana Public Service Commission’s (“Commission”) order, NorthWestern Corporation d/b/a NorthWestern Energy (“NorthWestern”) hereby submits this *Post-Hearing Reply Brief* (“Reply Brief”) to reply to the arguments made by the MCC in its Response Brief.

I. INTRODUCTION

When read in its entirety, the Response Brief demonstrates that the MCC argues:

1. Single-issue ratemaking is bad except when it's not, and
2. The matching principle is sacrosanct except when it's not.

On one hand, the MCC asserts that allowing recovery of lost revenues attributable to Universal System Benefits (“USB”) is single-issue ratemaking, violates the matching principle, and should not be allowed in natural gas cost trackers. On the other hand, the MCC argues that the Commission should require single-issue ratemaking and disregard the matching principle for NorthWestern’s Battle Creek natural gas production assets (“Battle Creek”). Additionally, the MCC argues that the Commission should require adjustment to interim rates for NorthWestern’s Bear Paw and Devon natural gas production properties (collectively “Interim-rate Properties”).

Allowing NorthWestern to recover USB-related lost revenues is not single-issue ratemaking, does not violate the matching principle, is consistent with prior Commission decisions, and is good regulatory policy. Requiring NorthWestern to update only one cost, Battle Creek cost of service, is unjustified single-issue ratemaking and would unreasonably impair NorthWestern’s opportunity to earn its authorized return on equity.

II. ARGUMENT

The Legislature mandated that NorthWestern implement a USB program and required that at least 0.42% of NorthWestern’s prior-year revenue be devoted to low-income weatherization and low-income bill assistance. § 69-3-1408, MCA (2013). The Commission required that NorthWestern direct 21% of the natural gas USB funds it collects to conservation

and 29%¹ to low-income weatherization. *Docket Nos. 2004.7.99, D2004.12.192, and D2005.6.106*, Order No. 6679e, ¶ 105 and Table 3 (December 17, 2008). In tracker years 2012-2013 and 2013-2014, lost revenues related to USB activities totaled \$81,547. *See Exhibit NWE-15, Prefiled Rebuttal Testimony of Joe Schwartzenger, Exhibit__(JS-2)*, p. 1. But for the Legislature's and Commission's mandates, NorthWestern would have received this income.

A. *PERMITTING USB-RELATED ENERGY EFFICIENCY TO IMPEDE NORTHWESTERN'S REASONABLE OPPORTUNITY TO EARN ITS AUTHORIZED RATE OF RETURN WOULD VIOLATE WELL-ESTABLISHED RATEMAKING REQUIREMENTS.*

Utility rates must be reasonable and just. § 69-3-201, MCA (2013). The Fifth and Fourteenth Amendments to the United States Constitution impose a constitutional test of reasonableness. *See Duquesne Light Co. v. Barasch*, 488 U.S. 299, 308, 109 S.Ct. 609, 616 (1989), (“If the rate does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation and so violated the Fifth and Fourteenth Amendment.”). A reasonable rate may not be so low that it is confiscatory in the constitutional sense. *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585, 62 S.Ct. 736, 742 (1942). A regulatory structure that does not provide the utility a reasonable opportunity to earn its authorized rate of return violates the United States Constitution's prohibition against taking property without just compensation. *See, e.g., Potomac Elec. Power Co. v. Public Service Commission*, 380 A.2d 126, 132 (D.C. Cir. 1977) *citing Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 605, 64 S. Ct. 281, 289 (1944).

1. The Commission must consider the impacts of the USB mandates on NorthWestern's reasonable opportunity to earn its authorized return on equity.

¹ Twenty-nine percent is 36.55% of the 78.98% of USB funds devoted to low-income programs.

The Commission may not disregard the impact of USB mandates on NorthWestern's opportunity to earn its authorized return on equity. The Legislature and the Commission have required NorthWestern to allocate USB funds to activities that reduce NorthWestern's sales. The Commission has adopted regulatory practices that make it difficult for a utility to achieve its authorized return on equity. The Commission uses a historical test year with allowed adjustments for known and measurable changes, uses a historical 13-month average rate base, imposes minimum filing requirements that necessitate significant preparation time after the close of a test year, and takes substantial time to process rate cases. All of these things reduce a utility's opportunity to earn its authorized return on equity. The validity of the historical test period approach rests on the assumption that the relationship among revenues, expenses, and rate base, which were established in the test year, will continue into the near future. *Potomac Electric Power*, 380 A.2d at 133, citing *Leterneau v. Citizens Utilities Co.*, 259 A.2d 21, 24 (Vt. 1969) ("The propriety or impropriety of a test year depends upon how well it accomplishes the objective of determining a fair rate of return in the future. It must reasonably represent expected future operations.").

The USB mandates, if not accounted for, render invalid the assumption on which the lawfulness of the historical test period approach rests. Mandated USB conservation and low-income weatherization break the relationship between future revenues and historical billing determinants. In 2012, 2013, and 2014, NorthWestern's natural gas utility failed to earn its authorized return on equity. See *Annual Report of NorthWestern Energy – Gas Utility*, Schedule 27, for 2012, 2013, and 2014. Recovery of the USB-related lost revenues will not eliminate the earnings shortfall, but would reduce it.

2. Recovery of USB-related lost revenues does not violate the matching principle.

Regulatory commissions often consider the matching principle when setting rates. The matching principle means different things to different people. The MCC asserts that the recovery of USB lost revenues violates the matching principle. Response Brief, p. 2. Generally, the matching principle requires that expenses and revenues should be measured within the same time period. *See, e.g. Bryant v. Arkansas*, 907 S.W.2d 140, 145 (Ark. App. 1995).

Recovery of USB-related lost revenues does not violate the usual formulation of the matching principle. Traditional regulation involves two basic formulae:

$$(1) \text{ Revenue Requirement} = (\text{Expenses} + \text{Return} + \text{Taxes})_{\text{TEST PERIOD}}$$

$$(2) \text{ Rate} = \text{Revenue Requirement} \div \text{Units Sold}_{\text{TEST PERIOD}}$$

The matching principle reaches to the first equation, not the second, particularly in a situation like this one in which the statute and administrative rules mandate the utility take USB-related actions that reduce the Units Sold from what they would be otherwise. Nothing about the recovery of USB-related lost revenues disturbs the balance in the first equation. Recovery of USB-related lost revenues does not attempt to recover costs not included in the Revenue Requirement; it does not attempt to recover increased costs without examining all costs; it does not attempt to change the Return component. Recovery of USB-related lost revenues simply attempts to account for the reduction in Units Sold—a reduction that is caused by mandated USB actions, not by normal economic forces or customers acting independently in their economic self-interest. Just as considering other known and measurable changes does not violate the matching principle, considering the reduction in Units Sold due to USB does not violate the matching principle.

In another formulation, the matching principle requires that customers who benefit from a service should pay the cost of that service. *See In re New England Power Company*, 65 FERC ¶ 61,036, ¶ 61,394 (October 6, 1993) (“the ‘matching principle’ (i.e. the general ratemaking principle that costs incurred in providing service should be collected from the customers that benefit from that service)”). Recovery of USB-related lost revenues supports this formulation of the matching principle. No one disputes that NorthWestern’s current customers benefit from the current USB programs. Recovery of USB-related lost revenues simply ensures that NorthWestern’s current customers fully pay for the lost revenues caused by USB programs from which they receive the benefits.

Just as it does in Docket No. D2014.6.53, the MCC expands the matching principle to bar the “mismatch of revenues, expenses and other volume changes” and cites three Commission orders. Response Brief, pp. 2-3. None of the cases stand for the proposition that the matching principle goes beyond the first equation. In *Montana Power Co.*, Docket No. 83.9.67, Order No. 5051c (“*Order 5051c*”), the Commission considered whether Colstrip Unit 3 could be included in rates in a case that used a 1982 test year with known and measureable changes which occurred in 1983. Colstrip Unit 3 did not achieve commercial operation until January 1984. *Order 5051c*, ¶ 181. The Commission used the matching principle to determine that Colstrip Unit 3 could not be included in rates. On judicial review, the Court reversed and remanded the Commission’s decision. *See, Montana Power Co. v. Montana Public Service Commission*, Cause No. 84-C-388. In *Montana Power Company*, Docket No. 88.6.15, Order No. 5360e (“*Order 5360e*”), the Commission granted the MCC’s motion to strike testimony about updated depreciation expenses, settlement of tax issues, and Toston Dam payments. *Order 5360e*, ¶ 16. In *Montana Power Co.*, D97.7.90, Order No. 5986r, the Commission rejected a request to increase supply rates due to

increased Qualifying Facility costs during a period when a supply rate moratorium was in effect. *Id.*, ¶ 20. The Commission did not discuss inclusion of volume changes in relation to the matching principle in any of the orders cited by the MCC.

While the matching principle is an important consideration in ratemaking, it is not absolute. *See, e.g., In re Pennsylvania Power & Light Company*, 77 FERC ¶ 63,012, ¶ 65,032 (November 6, 1996) (“At times Jersey Central wraps itself in the so-called matching principle= [sic] which is not absolute, yet tries (except where matters are impracticable) to assure that customers receiving service pay for the known, attendant costs.”). The matching principle cannot trump Constitutional considerations, statutory mandates, or Commission rules. Fundamental fairness requires that the Commission address the undesirable impacts attributable to the reduced Unit Sales resulting from mandated USB. Those impacts are known; they are verified by a third-party consultant. They are real. Recovery of USB lost revenues addresses those impacts.

3. Recovery of USB-related lost revenues is not single-issue ratemaking.

Single-issue ratemaking is changing one or more components of a utility’s revenue requirement in isolation. *People ex rel. Madigan v. Illinois Commerce Commission*, 988 N.E. 2d 146, 150 (Ill. App. Ct. 2013) (“*Madigan*”), *affirmed* 25 N.E. 3d 587, (Ill. 2015) (“*Madigan II*”). While single-issue ratemaking is not prohibited by statute, it is disfavored by regulatory commissions. The MCC asserts, “There should be no question that claimed load reduction and resulting revenue loss associated with energy efficiency programs represent a single issue adjustment.” Response Brief, p. 3. The MCC errs.

Importantly, not every adjustment to rates between rate cases constitutes single-issue ratemaking. For example, fuel adjustment clauses, purchased power adjustments, and purchased gas adjustments are not single-issue ratemaking. *See e.g., State ex rel. Midwest Gas Users' Ass'n v. Public Service Commission*, 976 S.W.2d 470, 480 (Mo. Ct. App. 1998), (purchase gas adjustment not single-issue ratemaking).

Similarly, rate design mechanisms such as decoupling and the recovery of USB-related lost revenues are not single-issue ratemaking. *Madigan* is particularly instructive. The Illinois Commerce Commission (“ICC”) approved a volume-balancing-adjustment (“VBA”) that provided for adjustments to rates to account for changes in volumes of natural gas sold. The Illinois Attorney General challenged the ICC’s order, in part, on the basis that the VBA was single-issue ratemaking. *Madigan*, 988 N.E.2d at 150. The Illinois Appellate Court determined that the VBA was a form of decoupling, *id* at 148, and that it affected how the utility’s revenue requirement would be collected, not the level of the revenue requirement. *Id.* at 154-55. The Court noted that the revenue requirement had been determined in a rate case, *id*, and held that the VBA did not constitute single-issue ratemaking. In affirming the Appellate Court’s decision, the Illinois Supreme Court stated:

[T]he Attorney General and CUB conflate the two steps of the ratemaking process. As the companies explain in their brief, the Commission first determines a utility company’s revenue requirement which includes fixed costs and a reasonable return on equity, then designs a rate that allows the company to recover that revenue from its customers as accurately as possible. Here, there is no dispute over the Commission’s calculation of the revenue requirement. There is only a dispute over the Commission’s choice of the mechanism by which the companies recover that figure.

Madigan II, 25 N.E.3d at 597 (citations omitted). Further, the Court emphasized that the VBA had no effect on the utilities’ revenue requirement that was set in the initial step of the

ratemaking process, but rather the VBA accepted the revenue requirement and provided a method to recover it. *Id.* at 599. The Court reasoned that because the VBA had no impact on the revenue requirement, it posed no risk of distorting the ratemaking process and held that it did not constitute single-issue ratemaking. *Id.*

Just like the Illinois Attorney General, the MCC conflates the two ratemaking steps. Recovery of USB-related lost revenues is akin to the VBA in *Madigan* and *Madigan II*. Recovery of USB-related lost revenues provides a method for collecting the revenue that is lost due to USB activities. The recovery of USB-related lost revenue is narrower, but that does not change the analysis. Recovery of USB-related lost revenues is a rate design mechanism; it does not attempt to consider a single cost, only to permit recovery of revenues that are included in the previously approved revenue requirement that NorthWestern does not receive because of mandated USB. Like the VBA, recovery of USB-related lost revenues does not impact the revenue requirement determined in the first step of the ratemaking process; it is not single-issue ratemaking.

B. THE RATES FOR NORTHWESTERN'S NATURAL GAS PRODUCTION ASSETS ARE JUST AND REASONABLE.

NorthWestern owns three groups of natural gas production properties, which are referred to as Battle Creek, Bear Paw, and Devon. These properties are divided into two classes of similarly situated properties. Battle Creek is a rate-based asset. Battle Creek is included in NorthWestern's natural gas utility's rate base, and its costs and revenue requirement were reviewed and approved by the Commission in Docket No. D2012.3.25 and adjusted in a natural gas general rate case in Docket No. D2012.9.94. Bear Paw and Devon, the Interim-rate Properties, are not in rate base, have not had their costs or revenue requirement approved, and

are supported with interim rates that are subject to refund. The analysis of the natural gas production assets depends upon the class of the properties.

1. Battle Creek's rates are just and reasonable.

The Commission approved Battle Creek in Docket No. D2012.3.25, Order No. 7210b (November 16, 2012) ("*Order 7210b*"). In *Order 7210b*, the Commission stated:

81. The Commission agrees with NWE's expectation that, in order to grant NWE's application in this case and approve inclusion of the Battle Creek properties in rate base and recovery of related expenses, the Commission must find that NWE's acquisition of the Battle Creek properties was prudent. If that finding is made, it will follow that the acquisition was in the public interest and that the rates and charges that result from rate-basing the acquisition are just and reasonable.

83. The Commission stated in its comments on the *2010 Plan* that it would evaluate the prudence of any acquisition by NWE of natural gas reserves "based solely on information available to NWE at the time transactions were done." Ex. NWE-1, p. 5 (citing to *2011 Comments*). The Commission advised NWE to evaluate a potential acquisition's volumes, price, and term and to demonstrate that it provides a compelling customer benefit over buying gas supply at market prices. *Id.*, p. JDH-17.

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 natural gas volumes over the next 47 years at the then-forecast market prices. *Id.*, BBB-8. NWE determined the total break-even purchase price for the Battle Creek assets was \$13.725 million, and NWE gained significant customer benefit by paying an actual total price of \$12.4 million for the Helis and Energy Consultants' interests. *Id.*, JDH-18-19.

92. The benefits of the Battle Creek acquisition were enumerated by Hines and Callahan and include: improved ability for NWE to manage short- and long-term natural gas price volatility, reliability and long-term costs; reduced portfolio costs because the assets are located on NWE's gas transmission system; and the well-defined production history of Battle Creek. Ex. NWE-1, pp. JDH 6-8 and pp. PEC 4-5. Donkin noted generally that there are performance risks related to NWE-owned production resources, which can cause unit production costs to fluctuate and affect value to rate payers, but those risks did not cause Donkin to

object to the Battle Creek acquisition. Ex. MCC-1, pp. 6-16. Based on the evidence in the record, the Commission finds the benefits of the acquisition outweigh the risks.

97. The Commission finds that NWE’s purchase of the Battle Creek properties was prudent and in the public interest and that the properties continue to be used and useful. In addition, the Commission finds that the rates that result from inclusion of Battle Creek in rate base are just and reasonable.

(emphasis added). Once the Commission approves rates, those rates are just and reasonable and lawful until they are changed pursuant to Title 69, Chapter 3, § 69-3-305(2), MCA (2013).

The Commission has recognized that when it approves including an asset in rate base the rates are no longer subject to revision in tracker dockets. *See, e.g.* Docket No. D2010.5.50. In that docket, the MCC argued that Colstrip Unit 4’s (“CU4”) fixed costs should be adjusted. The Commission recognized that it had approved CU4’s fixed costs in a resource approval docket, D2008.6.69, not in a tracker docket. The Commission noted that the MCC had opportunities to contest the CU4 fixed rate prior to the tracker docket and concluded that CU4’s fixed costs were outside the scope of the tracker docket. Docket No. D2010.5.50, Order No. 7093c, ¶ 44 and Conclusion of Law ¶ 8.

The MCC is repeating the same advocacy pattern that the Commission rejected with respect to CU4. The MCC did not challenge Battle Creek’s fixed rates when Battle Creek was originally approved in Docket No. D2012.3.25. The MCC did not challenge the fixed Battle Creek rates when they were adjusted in Docket No. D2012.9.94. Now the MCC argues that the Commission should require single-issue ratemaking that the MCC admits would violate the matching principle. *See* Response Brief, p. 6. Twice, the MCC had the opportunity to challenge Battle Creek’s fixed rates; it did not do so. It should not be allowed to do so now. Unlike the Interim-rate Properties, the Battle Creek rates were approved in a docket that is closed.

The MCC asserts that Battle Creek cost information is “stale” because it is based on 2011. All of NorthWestern’s natural gas utility’s rates that are associated with rate-based assets are based on costs from 2011 (except for known and measurable changes included in Docket No. D2012.9.94). The Battle Creek rates are fresh. NorthWestern last adjusted them after the Commission issued the Final Order in Docket No. D2012.9.94 and they were approved on May 8, 2013, just over two years ago.

2. There is no need to adjust the Interim-rate Properties’ rates.

The Commission has approved bridging-concept interim rates for natural gas production assets. This recognizes the realities that the natural gas industry does not allow the time for advanced approval of production asset acquisition and that a utility cannot provide natural gas from production assets without recovering the value of the gas provided. Generally, bridging-concept interim rates remain in effect from acquisition until an asset is placed in rate base. Any difference between the interim rates and the final rates is surcharged or refunded to NorthWestern’s customers, with interest.

The MCC argues that generational equity requires a rate change and asserts that it is needed because many ratepayers live paycheck to paycheck. Response Brief, p. 10. There is simply no evidence in the record to support such a change.

III. RELIEF REQUESTED

Based on the foregoing and the record evidence presented in this docket, NorthWestern requests that the Commission issue an order that:

1. Approves the rates proposed by NorthWestern in this docket for its natural gas supply costs;

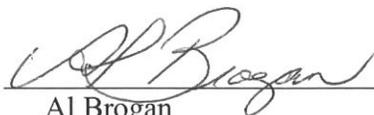
2. Allows NorthWestern to recover lost revenues for the tracker period of July 1, 2012 through June 30, 2014 and to continue to recover lost revenues for its USB activities through its natural gas supply trackers;
3. Finds that NorthWestern incurred recoverable lost revenues as presented herein during tracker years 2006-2007 through 2011-2012; and
4. Finds that the current natural gas rates for NorthWestern's production assets are reasonable as presented herein.

IV. CONCLUSION

NorthWestern has shown that the costs incurred for natural gas supply during the tracker period of July 2012 to June 2014 were prudently incurred and thus, rates should be adjusted as proposed by NorthWestern. Wherefore, based on the foregoing, NorthWestern respectfully requests that the Commission grant the relief requested in Section III of this Brief.

Respectfully submitted this the 5th day of August 2015.

NORTHWESTERN ENERGY

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of NorthWestern's Post-Hearing Reply Brief in Docket Nos. D2013.5.34/D2014.5.47 has been hand delivered to the Montana Public Service Commission and the Montana Consumer Counsel and e-filed with the Montana Public Service Commission. It has also been emailed to counsel of record and served upon the following persons by postage prepaid via first class mail as follows:

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