

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

IN THE MATTER OF the Application of ) REGULATORY DIVISION  
NorthWestern Energy for Automatic Rate )  
Adjustment and Tracking for Taxes and Fees and ) DOCKET NO. D2017.11.86  
Investigation of the Public Service Commission into )  
Taxes and Fees ) ORDER NO. 7580a

**FINAL ORDER**

**PROCEDURAL HISTORY**

1. On December 15, 2017, NorthWestern Energy (“NorthWestern” or “NWE”) filed its *Application for Approval of Automatic Rate Adjustment and Tracking for Taxes and Fees* (“Application”). On December 22, 2017, the Montana Public Service Commission (“Commission”) issued a *Notice of Application and Intervention Deadline, Procedural Schedule and Notice of Public Hearing* (“Notice”). That Notice established a December 27, 2017 deadline for intervention, a deadline to issue data requests of December 29, 2017, and a deadline of January 12, 2018 to submit comments or request a hearing. The Commission issued a *Notice of Hearing* on December 29, 2017, setting a hearing for January 22, 2018. Since this proceeding has a 45-day statutory deadline pursuant to Mont. Code Ann. § 69-3-308(2)(c), parties were offered the opportunity to make closing statements in lieu of briefing. All parties made closing statements and none requested additional process. The Commission held a work session the day after the hearing, on January 23, 2018, and voted to adopt this Order.

2. The Montana Consumer Counsel (“MCC”) and the Large Customer Group (“LCG”) intervened. Both LCG and the Commission issued data requests. MCC and LCG filed comments in response to the Commission's Notice. At the public hearing on January 22, 2018, the Commission received testimony from three NorthWestern witnesses and comment from the two intervenors.

3. In prior utility tax tracker cases, the Commission has found it difficult to obtain answers to its questions within the statutory timeframe. The inability or unwillingness of utilities to provide information in response to Commission requests in these proceedings led the

Commission to adopt rules in 2017 for minimum filing requirements governing tax tracker applications. *Infra* ¶ 31. These rules require information relevant to determining the appropriate allocation of expense to the customers for whom the Commission sets rates, including a twelve-coincident-peak (12-CP) methodology, for the Commission's review. MAR Notice 38-5-236, Mont. Admin. Reg. Issue No. 6, p. 336 (Mar. 24, 2017). The Commission considered comments from NorthWestern, and others, on the proposed minimum filing requirements, incorporating some in the final rules effective June 9, 2017. Mont. Admin. Reg. Issue No. 11 (June 9, 2017). The tax tracker application filed by NorthWestern in December 2017 is NorthWestern's first application pursuant to the newly adopted rules and contains a substantial amount of information that was not previously filed with such applications.

#### **DISCUSSION AND FINDINGS OF FACT**

4. The Commission finds that the Application NorthWestern has made in this proceeding is in error because it overstates the amount of tax expense paid for electric transmission property by the public utility subject to the Commission's jurisdiction.

#### **Jurisdictional Association of Property Tax Expense**

5. Certain property owned by NorthWestern, including electric transmission lines and associated facilities, is used to provide services regulated by the Commission and services exclusively jurisdictional to the Federal Energy Regulatory Commission ("FERC").

6. NorthWestern's state and local taxes and fees subject to automatic adjustment under Mont. Code Ann. § 69-3-308 consist primarily of property taxes. NorthWestern's property taxes are determined on an annual basis by the Montana Department of Revenue ("DOR"), which undertakes an assessment of NorthWestern's enterprise value in order to establish the value of property subject to taxation based on various statutory tax rates. NorthWestern allocates this tax to particular types of plants, including electric transmission. Test. Difronzo, Ex. PJD-1, 36-37 (Dec. 12 2017) (Hearing Ex. NWE-2); Test. Wayne M. Hitt pp 7-8, Ex. (WMH-4) (Dec. 12, 2017) (Hearing Ex. NWE-1); Mont. Admin. R. 38.5.808 (2017)

7. The Commission's review of the revised rate schedules in NorthWestern's Application requires a determination that any rate changes are associated with tax changes for public utility property that provides services to retail customers, as taxes on property used to

provide services to wholesale customers is the exclusive jurisdiction of FERC. In prior applications under Mont. Code Ann. § 69-3-308, both NorthWestern and Montana-Dakota Utilities have recognized that property tax expenses associated with property that provides service to customers within different jurisdictions must be separated in order to determine the amount of the expense subject to tracking under Montana law, which results in adjustments to rates paid by retail customers. At least since the 2006 tax tracker, the Commission has recognized that allocating NorthWestern's electric transmission expense between retail and wholesale customers was a necessary predicate of the tracker's operation. *In re NorthWestern Energy's 2006 Tax Tracker Application*, Docket D2006.12.176, Order 6794a, ¶ 7 (Jan. 18, 2017).

### **Allocation Methodology**

8. Various methods can be used to separate the state and federal portions of this expense. This is in contrast to tax expenses associated with property that exclusively provides services to retail customers at rates set by the Commission, where the entire amount of the associated property tax expense can be tracked, net of its deductibility for income tax purposes pursuant to Mont. Code Ann. § 69-3-308(2)(a)(i)(A).

9. In the past, NorthWestern has separated or allocated retail responsibility for the property tax expense associated with transmission property using a revenue credit method. This method applies a specific percentage value to NorthWestern's total revenue from the provision of transmission services under FERC tariffs. The percentage value is intended to reflect the portion of the total FERC revenue requirement that is associated with Montana property tax expense. NorthWestern applies the percentage value annually to revenues earned from customers taking service under FERC tariffs, in order to derive the amount deducted from the total sum being tracked in the state tax tracker.

10. The Commission last approved a specific percentage value for use in the revenue credit method in 2009. The Commission inferred that the public utility's transmission system had a revenue requirement of \$85,971,955, and that associated transmission property taxes were \$20,454,274. Thus, transmission-related property taxes represented 23.79% of total transmission revenues. *In re NorthWestern Energy's 2008 Tax Tracker Application*, Docket D2008.12.143, Order 6967a, ¶¶ 23-24 (Jan. 23, 2009).

11. The revenue credit method relies on the assumption that the percentage allocator reasonably expresses the wholesale customers' share of costs associated with the underlying expense, in this case property tax. If this assumption is false, the revenue credit method will not accurately depict wholesale customer transmission property tax responsibility, for the purpose of removing that amount from what the Commission must track to retail customers. The table below shows information presented in NorthWestern's annual reports, of which the Commission took administrative notice at hearing. NorthWestern Tax Tracker Hearing (Jan. 22, 2018) Hr'g. Tr. 80-82. As can be seen, NorthWestern's property tax expense has increased at a faster rate than other expense categories. This evidence strongly suggests the 23.79% allocator underlying the revenue credit method is erroneous.

Northwestern Energy - Electric						
Acct.	Year	2012	2013	2014	2015	2016
401	Operation Expenses	\$ 402,400,427	\$ 461,399,787	\$ 462,844,641	\$ 403,375,849	\$ 375,146,001
402	Maintenance Expense	\$ 32,130,631	\$ 39,436,294	\$ 42,418,160	\$ 41,378,859	\$ 40,080,236
408.1	Taxes Other Than Income Taxes	\$ 72,595,885	\$ 78,050,534	\$ 84,188,473	\$ 105,083,939	\$ 115,912,517
	Total	\$507,128,955	\$578,888,628	\$589,453,288	\$549,840,662	\$531,140,770

Acct.	Year	2012	2013	2014	2015	2016
401	Operation Expenses	79.3%	79.7%	78.5%	73.4%	70.6%
402	Maintenance Expense	6.3%	6.8%	7.2%	7.5%	7.5%
408.1	Taxes Other Than Income Taxes	14.3%	13.5%	14.3%	19.1%	21.8%
	Total	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Northwestern Energy Electric Utility Annual Reports

12. NorthWestern appeared to concede at various points during the hearing that the 23.79% wholesale customer transmission property tax responsibility value is out of date. NorthWestern's witness, Ms. Lail, testified that the value today, based on transmission asset growth, would be 25.7%. Hr'g. Tr. 98:1. However, NorthWestern did not include in its application or otherwise provide at hearing any supporting documentation for this assertion. Hr'g. Tr. 98:2-4. The Commission reasons that even this updated, albeit unverified, figure understates the issue. That is because property taxes for a firm such as NorthWestern grow or shrink based on enterprise valuation and not only on asset growth. *Supra* ¶ 8. Therefore, using a new method that updates the percentage allocator on the assumption that it increases in tandem with transmission asset growth would not account for a phenomenon where property tax expense outpaces other expense categories. As Ms. Lail herself concedes, property tax as an expense is

increasing at a more rapid rate than other expenses. Hr'g. Tr. 96:24-97:1. Meanwhile, the Commission does not possess current information that would allow it to recalculate an up-to-date transmission revenue requirement in this case, which would incorporate the change in the rate of growth of property tax expensive relative to other expenses, and would allow a new revenue credit method to be calculated and applied.

13. Aware that the version of the revenue credit method NorthWestern uses could be flawed, the Commission previously inquired of NorthWestern about alternative methods and, when information relative to those was not forthcoming, adopted administrative rules last year to obtain that information as a minimum filing requirement of this docket. *Supra* ¶ 3. Pursuant to those rules, NorthWestern submitted information that allows the Commission to determine wholesale customer transmission property tax responsibility with an alternative method, 12-CP method. Admin. R. Mont. 38.5.805(1)(e)(ii). Under the 12-CP method the highest single hour's system demand in each of the twelve individual months of a year are averaged. The wholesale customer transmission property tax responsibility is based on the aggregate wholesale customer average demand in each of the 12 system demand hours as a percentage of the average system demand in those hours.

14. The 12-CP method is widely used in transmission ratemaking to determine cost responsibility for individual customers or classes of customers. Indeed, NorthWestern used the 12-CP method in its last transmission rate case filed with FERC. Test. Crystal D. Lail 5 (Dec. 15, 2017) (Hr'g Ex. NWE-4) (12-CP is the methodology used to bill Network Transmission Service to customers under their FERC Open Access Transmission Tariff ("OATT")); Hr'g Tr. 52:19-25, 53:1-22, 93:5-15. Additionally, NorthWestern proposed to use the 12-CP method in its 2006 tax tracker proceeding. In that case the Commission declined to adopt 12-CP because the record included "contradictory data" and NorthWestern had "offer[ed] no rationale" for the proposal, but the Commission stated that it "neither supports, nor opposes a change in the method." Order 6794a ¶ 21.

15. The Commission sought to investigate whether the 12-CP method would be preferable to the revenue credit method in the context of NorthWestern's 2016 tax tracker application. Docket D2016.12.97. *Infra* ¶ 31. In part, due to NorthWestern's inability to respond to the Commission's methodological inquiries in that docket, the Commission developed minimum filing requirements governing future tax tracker applications which include

information relevant to the 12-CP method of determining wholesale customer transmission property tax expense responsibility. MAR Notice 38-5-236, Mont. Admin. Reg. Issue No. 11, p. 790-800 (Adopted June 9, 2017).

16. The Commission finds that the revenue credit method produces erroneous results. The Commission also finds that 12-CP method accurately determines the allocation of property tax expense for the electric transmission properties in question for the purposes of the tax tracker.

17. The revenue credit method reflects outdated financial information and, in spite of opportunities to do so, NorthWestern has not proposed adjustments to the revenue credit value to make it more current in its annual tax tracker applications. *Supra* ¶ 15. In situations when property tax expense is increasing at a higher rate than other expenses, as here, the revenue credit method systematically overstates the amount of transmission property tax expense associated with public utility property subject to tracking under Mont. Code Ann. § 69-3-308.

18. The Commission also agrees with MCC that the revenue credit method functions to make retail customers the guarantors of property tax increases without regard for whether such property tax increases are properly the responsibility of the retail customers under reasonable cost allocation principles. MCC Comments 3

Rather than considering the appropriate apportionment of the total transmission property tax expense based on an allocator that is recalculated each year, the revenue crediting method is destined to diverge from actual tax expense responsibility unless wholesale revenues and tax expense just happen to grow or fall by the same percentage each year between FERC rate cases. Given the tendency for property taxes to rise over time, this method effectively puts retail ratepayers in the position of being the default insurers of any 'jurisdictional gap' in recovery of such taxes.

*Id.* As such, the revenue credit method imposes an asymmetric risk of rate increases from tax changes on retail consumers and also appears to provide NorthWestern a financial disincentive to request wholesale rate changes that would result in a more appropriate allocation of property taxes.

19. NWE appears to suggest that it is fair for incremental property taxes to be visited upon retail customers and not wholesale customers because the former are the beneficiaries of the programs that property tax revenues support. DR PSC-001(a) (Jan. 5, 2018); Hr'g Tr. 71:1-13. No precedent supports NorthWestern's effort to allocate property tax expense through utility rates to those who benefit from the social programs and other government spending that

the tax revenue supports, and NorthWestern provided no legal rationale for the notion that Mont. Code Ann. § 69-3-308 requires that. Additionally, even if such an allocation approach were supported by policy or law, there is no evidence that wholesale customers do not also benefit from the programs the property tax revenue supports. This argument is at odds with conventional utility regulatory principles which allocate costs of utility plant based on the cost of utility services, not the externalities associated with certain of those costs, such as taxes. *Infra* ¶ 41.

20. The revenue credit method does not directly track expenses at all, but will instead produce a greater or lesser result due to fluctuations in wholesale customer usage of transmission services. Hr'g Tr. 70:3-73:20. Record evidence does not suggest that the property tax expense and wholesale sales volumes are correlated, much less one the function of the other. NWE's primary argument for retaining the revenue credit method appears to be "consistency." Test. Lail at 7. However, the method itself is internally inconsistent because it combines one style of tracking—of sales volumes of wholesale transmission services, which drive revenue—and another style of tracking—of expense. This mismatch between tracking revenue from wholesale sales and expense from unrelated property tax assessments is the opposite of consistency. It is also inconsistent to tie a fixed-percentage-of-revenue allocator to a volatile expense like property taxes. The Commission concedes that there ideally should be consistency in ratemaking between jurisdictions. Here, however, NorthWestern uses 12-CP for wholesale billing, and indeed when NorthWestern last raised a consistency argument associated with a federal-state jurisdictional allocation, it did so in the context of urging the Commission to adopt 12-CP, which the Commission did. *In re NorthWestern's Application for Approval to Construct the Dave Gates Generating Station*, Docket D2008.8.95, Order 6943e ¶ 31 (Mar. 21, 2012). The Commission finds that the principle of consistency militates in favor of applying 12-CP.

21. The use of 12-CP is also supported by the fact that the Commission understands electric transmission property of the sort at issue here is generally cost-allocated on a demand basis. The Commission, having 12-CP evidence in the record for the first time in many years, believes that a direct allocation methodology such as 12-CP more simply tracks expenses, without the flawed assumptions that the presently used revenue credit method is predicated upon.

22. For these reasons, 12-CP is not only a superior method, but the available method based on the evidence in this proceeding, to determine the portion of property tax expense

associated with electric transmission property used to provide retail service subject to Commission jurisdiction. The Commission therefore adopts it.

### **Tax Expense Associated with 2017**

23. At hearing, NorthWestern argued that if the Commission decided to apply 12-CP to transmission property tax expense, it should do so on a prospective basis. Otherwise, according to NorthWestern, the utility might be left with a jurisdictional gap, with certain costs allocated to wholesale customers, but with the utility left without an avenue to recover them from an appropriate source. Hr'g Tr. 105:14-23. It is unclear whether NorthWestern is arguing that, if the Commission adopts 12-CP, it should do so only for 2018 within the tax tracker, or should wait until the filing of rate cases at both FERC and the Commission. Regardless of its exact position, it is clear that NorthWestern contends that it would be unfair to the Company for the Commission to apply the 12-CP method for 2017.

24. The Commission disagrees with NorthWestern for a number of reasons. First, accepting its position would ignore the reality of how this tracker operates by statute, tariff, and Commission precedent. The core purpose of NorthWestern's Application is to establish rates intended to recover three different time periods of state and local tax expense: the actual expense of 2017, the projected expense of 2018, and the accumulated overcollections or undercollections of all prior years. Electric Tariff Sheet No. 2.5 (Apr. 5, 2006). NorthWestern and the Commission expend little to no effort to determine what the coming year's tax liability is likely to be within this tracker. Instead, projected tax expense for the coming year is merely a number identical to the actual tax expense of the foregoing year. Meanwhile, these proceedings look backward to ascertain "the difference between estimated and actual tax expenses" of the foregoing year. *Id.* For the purposes of the present proceeding, therefore, the Commission is primarily charged with making a determination of the actual tax expense associated with the public utility the Commission regulates in 2017, and then this number is used to establish a rate intended to collect revenues to match, or track, the incremental or decremental tax expense. Test. Pat DiFronzo pp. 5-7, Ex.\_\_(PJD-1) (Dec. 12, 2017) (Hr'g Ex. NWE-2); NWE Tax Tracker Application, App. B (Dec. 12, 2017). This figure, associated with actual revenues, is then subject to a collection that is based on estimated versus actual volumes, since a rate will under- or over-recover actual expense depending on how much of the utility's service is sold. Yet even this is

formulaically reconciled in succeeding trackers through a deferred account, where any under- or over-recovery is iteratively collected through the new rate. In sum, a review of Mr. DiFronzo's work papers makes plain that the tracker is primarily an exercise in calculating rates to collect the actual expenses of prior periods, as opposed to attempting to forecast future expenses or to configure rates to the appropriate expected volumes, since the latter—but not the former—are largely formulaic and do not require the exercise of the Commission's judgment.

25. A tracker is an exception to the conventional utility regulatory practice of establishing rates which are not intended to be adjusted to make up for past periods of expense, but are instead only prospectively applied. Such rates may overcollect or undercollect actual expenses, and are not trued up to those actual expenses. *Mountain Water Co. v. Mont. Dep't of Pub. Serv. Regulation*, 254 Mont. 76, 80, 835 P.2d 4, 6 (1992) (“Historically, utility companies do not receive retroactive rate increases.”). Through trackers, however, the Commission has authorized NorthWestern to recover costs “on an interim basis subject to true-up following” verification of the actual costs. *In re NorthWestern Energy's Consolidated 2005-2006 & 2006-2007 Electric Supply Tracker*, Dockets. D2006.5.66 & D2007.5.46, Order 6836c p 59 (June 3, 2008). This Commission has concisely stated in past trackers “[t]rue-up adjustments are not retroactive ratemaking.” Order 6836c p 59; *see also In re NorthWestern's 2011-2012 Electric Supply Tracker*, Docket D2012.5.49, Order 7219h ¶ 117 (Oct. 28, 2013) (affirming the same). The tax tracker likewise adjusts rates to track an actual expense of a prior period, without running afoul of the typical prohibition against retroactive ratemaking.

26. Specifically in regard to the tax tracker, the authorizing statute requires that before the date when taxes change that the utility make a filing, such as the present Application, if it has a rate schedule or tariff in place allowing them to do so, as NorthWestern does. *See Mont. Code Ann. § 69-3-308*. In the following year, the rate will then be trued up to the actual expenses associated with the year's lien. Electric Tariff Sheet No. 2.5 (Apr. 5, 2006).

27. The Commission's precedent also supports a decision to apply this change to the 2017 period. In a prior tax tracker docket, D2008.12.143, the Commission changed the revenue credit method from a symmetrical revenue credit method to a different method calculated on the basis of a hypothetical FERC revenue requirement. Order 6967a ¶ 19 (rejecting the percentage allocator the Commission had previously derived and replacing it with the 23.79% value, which was derived from an inferred wholesale revenue requirement associated with FERC Docket

No. ER07-46). In that case, the Commission, in calculating rates, did not limit application of the new revenue credit value to 2009 (the prospective year), but also applied the new percentage to ascertain the actual tax expenses associated with 2008. *Id.* ¶¶ 24, 27-28. The only available precedent for which years should be affected by a change in jurisdictional allocating method, in other words, supports the treatment the Commission finds appropriate here.

28. Having found error, *Supra* ¶¶ 4, 8-22, the Commission understands this finding to be a determination that NorthWestern's Application overstates actual expenses for 2017. Correcting this error causes the portion of the rate attributable to the true-up to decrease, and because 2017's actual taxes are used in the tracker as a direct proxy for 2018's estimated taxes, the finding of error has an identical effect on the estimated taxes for 2018, although the rate component associated with 2018 will itself be trued up to actual taxes for that year in the next-filed tracker.

29. The arguments that NorthWestern propounds against applying the finding of error to 2017 are, at their core, subjective arguments about fairness, or whether, in statutory parlance, the rates will be just and reasonable. Mont. Code Ann. § 69-3-201. Such arguments cut both ways. In the Commission's view, it would be unfair to find error in NorthWestern's calculation of tax expense, as the Commission here does, but then fail to apply this finding to the central element of the tracker (2017's expense).

30. The Commission also must consider fairness with regard to both NorthWestern and its retail customers, for whom the Commission must set rates. Those customers have likely paid more than their fair share, year on year, for at least the past three years. (DR PSC-001, showing Ms. Lail calculation of 12-CP for other periods). Nevertheless, the Commission makes no adjustment to the deferral balance associated with prior tax years. Although it could be argued that it would be appropriate to adjust the actual expense associated with years earlier than 2017, the Commission stops at 2017 in this proceeding, reasoning that it was more a function of NorthWestern's Application in Docket D2016.12.97, which was filed in December 2016, than this current proceeding to ascertain the actual 2016 expense, just as this proceeding's paramount question is the determination of actual 2017 expense. In considering the equity interests at stake in this proceeding, the Commission finds the public interest lies in applying the 12-CP method for 2017 because such a decision constitutes a middle ground between the accumulating deferrals of the tracker associated with prior years, the clearly erroneous results of the revenue-credit

methodology for 2017, and the fairness with which the Commission seeks to treat both consumers and NorthWestern. The Commission exercises its discretion in balancing the interests of the utility and consumers by not adjusting the Adjusted 2017 Net Deferral Balance Rate Component Change. *See* Test. DiFronzo, Ex. PJD-1, p. 1, ln. 62.

31. Additionally, in considering the issue of whether the rates will be fair, the Commission observes that NorthWestern has been on notice of the Commission's interest in changing the methodology since last year's tax tracker proceeding and the Commission's subsequent rulemaking concerning the minimum filing requirements of a tax tracker application. In the 2017 tax tracker docket, the Commission asked NorthWestern to calculate the allocation of tax expense associated with electric transmission to retail and wholesale transmission on a 12-CP basis. NorthWestern stated it was unable to answer this question within the 45-day statutory deadline required in the tax tracker statute. *See In re NorthWestern's 2017 Tax Tracker Application*, Docket D2016.12.97, Data Response (DR) PSC-001(b) (Jan. 10, 2017). In many proceedings, the refusal of a party to respond to a data request of the Commission would lead the Commission either to suspend the proceeding until an answer was provided, or to deny the party's requested treatment for a failure to satisfy its burden. Here, the Commission is bound by a statute which allows rates to become automatically effective, even without the issuance of an order, *unless* the Commission finds error. The Commission determined after the D2016.12.97 proceeding that its existing process prevented the Commission from undertaking its responsibilities, and initiated a rulemaking to establish minimum filing requirements for utilities who have chosen to use a tax tracker. Salient to the discussion of allocation methodologies, the Commission provided this reason during its rulemaking for requiring utilities to provide a 12-CP methodology for tax allocation:

Adoption of New Rule V is necessary to allow the department to evaluate a utility's allocation of Montana state and local taxes and fees, excluding income taxation, to properties which are paid for under both rates established by the department and by the FERC, such as electric transmission lines. The inclusion of this minimum filing requirement is necessary for the commission to verify that no errors exist in the utility's application under 69-3-308, MCA, and that there is a sufficient evidentiary basis for the commission to approve rates that are applied for under 69-3-302, MCA.

Mont. Admin. Reg. Issue No. 6, p. 336 (Mar. 24, 2017). The Commission received comments on the proposed requirement to provide information regarding allocation of FERC jurisdictional tax expenses. Mont. Admin. Reg. Notice of Adoption for 38-5-236 No. 11 (June 9, 2017).

32. This is the first instance in which the Commission has considered NorthWestern's tax tracker since implementing administrative rules that require the utility to provide more comprehensive information in their initial filing. The Commission provided a number of responses, upon adopting the new rules, which indicated that the Commission would potentially make modifications to the wholesale and retail transmission tax expenses in coming tracker proceedings. *Id.* As a result of the new information gained by the minimum filing requirement rules, the Commission now stands in a better position to make a better determination about the appropriate allocation of taxes associated with transmission. *Chenery Corp.*, 332 U.S. at 202 (“Some principles must await their own development, while others must be adjusted to meet particular, unforeseeable situations.”).

33. The Commission acknowledges that this is not the first application of the tax tracker by NorthWestern and that the Commission had previously considered the 12-CP approach to allocating transmission costs. Order 6794a ¶ 21. This previous decision was not made as an unequivocal preference for one particular method, and instead indicated that the Commission “neither supports, nor opposes a change in the method[,]” but declined to adopt 12-CP because the record included “contradictory data” and NorthWestern “offer[ed] no rationale.” *Id.* Examination of agency action must be “be tested by the basis upon which it purports to rest . . . .” *Chenery Corp.*, 332 U.S. at 196; *see also Atchison v. Wichita Bd. of Trade*, 412 U.S. 800, 807 (1973) (explaining that the requirement of agencies to follow precedent or explain their departure “is essentially a corollary of the general rule requiring that the agency explain the policies underlying its action”).

34. NorthWestern contends that a portion of the tax expense that, under the 12-CP method, is not recovered through retail rates set by the Commission will go “uncollected.” This is a function at least in part of NorthWestern's historic ratemaking litigation strategy. Seeing that property tax expense associated with electric transmission was going unrecovered from wholesale customers under a 12-CP methodology that it has used for ratemaking at FERC, it could have filed a FERC rate case. Hr'g Tr. 72:6-20. Indeed, it could have filed for formula rates at FERC, which allow a type of rate adjustments tracked to expenses that is similar to the

tracking mechanism used here for state and local taxes. Hr’g Tr. 96:1-16. The Commission fears that making only prospective adjustments creates a perverse incentive for the company not to collect the expenses from customers to whom it is properly allocated.

35. Application of the 12-CP method to NorthWestern’s 2017 tax tracker application produces the rate adjustments shown in the table below. The Commission’s approved electric distribution and transmission rates represent a decrease of 1.47% and the approved electric production asset rates represent an increase of 0.66%. For a typical residential customer using 750 kWh per month, the total bill impact is a decrease of approximately \$0.14 per month or (0.16%). The Commission’s approved natural gas distribution, transportation, and storage revenue reduction represents a rate decrease of 2.60% percent, and the natural gas production asset revenue increase represents an increase of 2.35%. For a typical residential customer using 100 therms per month, the total bill impact is a decrease of approximately \$1.55 per month or 1.98%.

D2017.11.86 NWE 2018 Tax Tracker	
Final Approved Rate Change	
Electric	
Delivery (T & D)	(\$3,784,851)
CU4	\$501,973
Spion	\$27,786
DGGS	\$458,088
Hydro	\$3,291,146
Generation	\$4,278,993
Total Electric	\$494,142
Natural Gas	
Delivery (T, D, & S)	(\$2,829,463)
Production Assets	\$530,754
Total Natural Gas	(\$2,298,709)
Total Gas & Electric	(\$1,804,567)

36. As is conventional in the tracker, the 2018 estimated expense will be based off of 2017 actual expense. When NorthWestern files its next tax tracker, it must use updated 12-CP

data for the 12-month cycle represented in Exh. CDL-1 to allocate the property tax expense associated with electric transmission for the purpose of deriving the actual expense that rates in the coming tracker will true up for.

37. Due to the mechanics of this tracker, the Commission does not believe this decision has retroactive effect. Even were it to be understood to be a decision of retroactive effect within the meaning of administrative law, the Commission would nevertheless be justified in making it. Contested case proceedings inherently have some backward looking effect. “Every case of first impression has a retroactive effect, whether the new principle is announced by a court or by an administrative agency. But such retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles.” *SEC v. Chenery Corp.*, 332 U.S. 194, 203, 67 S. Ct. 1575, 1581 (1947). This concept has been refined in subsequent decision making regarding cases of second impression:

[*NLRB v. Wyman-Gordon Co.*, 394 U.S. 759 (1969)] does not prevent an agency in adjudication from declining in subsequent cases to apply a new rule retroactively if equitable or statutory considerations militate against it, any more than Article III prevents a federal court from limiting the retroactive scope of new legal principles articulated in judicial decisions. Nor does *Wyman-Gordon* prevent reviewing courts from refusing to enforce such retroactive orders when the circumstances so dictate. In short, some of the considerations which support retroactivity in cases of first impression are, in subsequent cases, absent from the scale on which a court must weigh its decision.

*Retail, Wholesale & Dep't Store Union v. NLRB*, 151 U.S. App. D.C. 209, 466 F.2d 380, 391 (1972). These cases demonstrate that administrative decision making with retroactive effect in cases of first and second impression is not automatically impermissible; rather, this case law suggests the appropriateness of the retroactive application depends on the circumstances in any particular contested case proceeding. *Id.*, 466 F.2d at 390 (identifying five factors courts have considered in addressing this problem).

38. NorthWestern is not subject to considerable burden through the Commission's use of the 12-CP method for the 2017 tracker period. NorthWestern is not subject to any penalties for violations as is often the concern of retroactive application of agency decision making. *See, e.g. Laidlaw Corp. v. NLRB*, 414 F.2d 99, 107 (7th Cir. 1969) (upholding a back pay order of about \$450,000 against an employer for conduct that at the time was entirely in accord with settled law of the NLRB); *Retail, Wholesale & Dep't Store Union*, 466 F.2d at 385–93 (limiting retroactive requirement to back-pay liability to the point the company would have been on notice of the

NLRB's policy change regarding hiring new employees while former striking employees were seeking reinstatement); *NLRB v. Majestic Weaving Co.*, 355 F.2d 854, 860 (2d Cir. 1966) (Retroactive application of agency decision making is worse "when a financial penalty is assessed for action that might well have been avoided if the agency's changed disposition had been earlier made known, or might even have been taken in express reliance on the standard previously established"). The Commission's authority to set rates is distinct from its ability to seek civil penalties. *Compare* Mont. Code Ann. §§ 69-3-301 to -310 (providing the Commission rate making authority) *with id.* §§ 69-3-206, -209 (providing the Commission authority to seek civil penalties against utilities in district court).

### **Reconsideration**

39. Since this has been a 45-day proceeding, the schedule did not allow parties to brief this matter. On reconsideration, parties may file briefs. A party moving for reconsideration should file its brief within 10 days of the date of this order. Other parties will respond within 10 days. The moving party may file a reply brief 10 days after the briefs of any party that opposes reconsideration. Accordingly, the Commission waives Mont. Admin. R. 38.2.4806(5).

### **CONCLUSIONS OF LAW**

40. The Commission has full power of supervision, regulation, and control of public utilities. Mont. Code Ann. § 69-3-102. NorthWestern is a public utility subject to the jurisdiction of the Commission, which may investigate its rates, tolls, charges, or practices at any time. *Id.* §§ 69-3-101, 69-3-324.

41. Nothing in Mont. Code Ann. § 69-3-308 permits full recovery of taxes properly allocable to wholesale transmission customers. Mont. Code Ann. § 69-3-201 requires just and reasonable rates and that "every unjust and unreasonable charge is prohibited and declared unlawful." This standard has traditionally prohibited discriminatory rates. *See Portland General Exchange, Inc.*, 51 F.E.R.C. ¶ 61,108, 61245, 1990 FERC LEXIS 923, \*28, 112 P.U.R.4th 264 (F.E.R.C. 1990) ("[D]ifferences in rates must be based upon factual differences, for instance, in a utility's cost of service"); *United States v. Ill. C. R. Co.*, 263 U.S. 515, 524 (1924) ("Self-interest of the carrier may not override the requirement of equality in rates"). Traditional rate making

requirements, contained in Mont. Code Ann. §§ 69-3-201, 69-3-301 to -310, ameliorate towards application of the 12-CP methodology to the 2017 tracker period.

42. The Commission does not have jurisdiction over public utilities inasmuch as they offer services subject to the exclusive jurisdiction of FERC. Such exclusive jurisdiction includes the rates set for the collection of expense associated with the public utility's transmission of electric energy in interstate commerce. 16 U.S.C. §§ 824-825r (1982). "FERC has exclusive authority to determine the reasonableness of wholesale rates." *Miss. Power & Light Co. v. Mississippi*, 487 U.S. 354, 371 (1988) (finding FERC's proceedings allocating wholesale costs of a nuclear power plant preempted a prudence inquiry by a state regulatory agency). "States may not regulate in areas where FERC has properly exercised its jurisdiction to determine just and reasonable wholesale rates or to insure that agreements affecting wholesale rates are reasonable." *Id.*, 487 U.S. at 374. This is true "even when States exercise their traditional authority over retail rates . . . ." *Hughes v. Talen Energy Mktg., LLC*, 136 S. Ct. 1288, 1299 (2016). This does not hinge on "whether a particular matter was actually determined in the FERC proceedings." *Miss. Power & Light Co.*, 487 U.S. at 374. Instead, this is a "bright line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis." *Fed. Power Comm'n v. S. Cal. Edison Co.*, 376 U.S. 205, 215-16 (1964). Thus, the Commission declines to knowingly permit a discriminatory allocation of taxes that has the effect of imposing state regulation over costs that are properly within FERC's ratemaking authority.

43. Pursuant to statute, the Commission must allow public utilities subject to Commission jurisdiction to automatically adjust rates to track "Montana state and local taxes and fees, except state income tax, paid by the public utility." *Id.* § 69-3-308(2)(a). Under this annual tax tracker, the "amended rates must automatically go into effect on January 1 following the date of change in taxes paid on an interim basis." *Id.* § 69-3-308(2)(b). These amended rates must include:

- (A) adjustments for the net change in federal and state income tax liability caused by the deductibility of state and local taxes and fees;
- (B) retroactive tax adjustments; and
- (C) adjustments related to the resolution of property taxes paid under protest.

*Id.* If the Commission determines "that the revised rate schedule is in error," it may order the utility "to address any errors or omissions" within 45 days of receiving its filing. *Id.*

§ 69-3-308(2)(c). Failure to issue an order “is considered approval on the part of the [C]ommission.” *Id.* § 69-3-308(d).

44. All findings of fact that are properly conclusions of law are incorporated herein and adopted as such.

### **ORDER**

IT IS HEREBY ORDERED THAT:

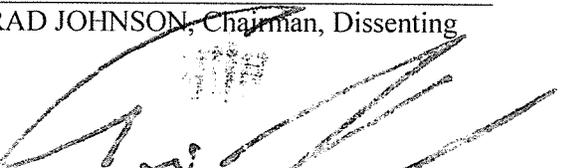
45. NorthWestern shall file compliance tariffs within ten days of the service date of this order.

DONE AND DATED this 23rd day of January, 2018, by a vote of 3 to 2.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION



BRAD JOHNSON, Chairman, Dissenting



TRAVIS KAVULLA, Vice Chairman



ROGER KOOPMAN, Commissioner



BOB LAKE, Commissioner, Dissenting



TONY O'DONNELL, Commissioner

ATTEST:



Rhonda J. Simmons  
Commission Secretary

(SEAL)

