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

IN THE MATTER NorthWestern Energy's Application for Approval for Authority to Establish Increased Natural Gas Delivery Service Rates and Allocated Cost of Service and Rate Design	)))))	REGULATORY DIVISION DOCKET NO. D2012.9.94

DISSENTING OPINION OF COMMISSIONER TRAVIS KAVULLA

This is one of the more difficult votes I have cast during my time on the Commission. I generally favor stipulations that are reasonable outcomes of contested rate cases, and I have the highest respect for those Commissioners who have chosen to adopt the Stipulations.

However, several considerations would lead me to reject the Stipulations, which I view as an outcome that is impermissibly unjust and unreasonable. Mont. Code Ann. § 69-3-201 (2011).

1) The revenue requirement's size suggests the inclusion in rates of expenses that should not be allowed. Consumers will be overcharged by about $2-3 million annually because of the Stipulations.

2) The Stipulations were substantially undermined by testimony at the live hearing.

3) It is in the public interest for the Commission to provide guidance on several principles of regulation before NorthWestern Energy (NorthWestern) embarks on its planned, years-long capital expansion plan that will grow the rate base considerably.

The Revenue Requirement Does Not Appear Reasonable in Light of the Evidence

The stipulated revenue requirement is an increase of $11.5 million above current rates. (*See* Revenue Requirement Stipulation p. 2 (Apr. 15, 2013).) Parties initially called for increases of $15,738,100 and $4,114,848, proposed by NorthWestern and the Montana Consumer Counsel (MCC), respectively. (*See* NorthWestern's Application p. 3 (Sept. 28, 2012); Ex. MCC-3 p. 24.) The Montana Large Customer Group (LCG) filed testimony recommending a reduction in NorthWestern's proposed revenue requirement of $3.7 million. (*See* Ex. LCG-1, p. 3.) By the time the live hearing was held, the NorthWestern recommendation had decreased to $15,508,198 and MCC's had increased to about $7 million, respectively.[1] The adoption of the stipulated $11.5 million necessarily implies certain additions beyond the MCC's recommendation, and certain reductions below NorthWestern's recommendation.

In analyzing whether I can find the Stipulations to be reasonable, I have preliminarily formed an opinion on each of the contested parts of this proceeding and either retained or subtracted the contested value within the revenue requirement. The result is a revenue requirement that substantially diverges from the stipulated increase, which accordingly I cannot find to be reasonable.

Although my opinion on each of these items could change in light of a live hearing where parties cross-examined one another's witnesses and subsequently offered briefing, my opinions on several of the most impactful issues in light of pre-filed testimony and the live hearing are as follows:

a) Short-term debt should be included in NorthWestern's capital structure for purposes of ratemaking, just as it is for Montana-Dakota Utilities' capital structure. It seems clear that at least some amount of short-term debt is used to finance additions to rate base. (Hrg. Transcr. (Tr.) 124:5-10 (Apr. 16-17, 2013).) There may be ways to divine what amount of short-term debt is related to non-rate base purposes, but absent precise indications, it seems reasonable to calculate it as part of the capital structure. Additionally, as was testified to at hearing, a growing number of companies across the nation have short-term debt counted in their capital structures. (*Id.* at 428:1-20.)

b) NorthWestern proposed an adjustment for a known and measurable change to bonus depreciation, arguing that although 100 percent bonus depreciation was available to the company in the test year, federal tax policy had changed and now only 50 percent bonus depreciation is allowed. (*Id.* at 306:5-18.) If the adjustment were adopted, customers would be

[1] (Ex. NWE-20, p. 10.) Al Clark, for the MCC, testified at hearing that the matter of deferred tax liability had been resolved to his client's satisfaction and that, knowing that his originally suggested treatment of disallowing income taxes as an expense would cause the company to violate Internal Revenue Service normalization requirements for accelerated depreciation benefits, Mr. Clark's final recommendation would be to allow the expense. (Hrg. Transcr. 457:9-20 (Apr. 16-17, 2013).) The MCC did not present an amended exhibit showing the correction to this error, so it is difficult to know with precision what a corrected revenue requirement estimate would be. However, when the deferred tax liability that results from the MCC's otherwise lower revenue requirement is added to their initial recommendation of $4.1 million, the figure arrived at appears to be $6.8 million, assuming the MCC's proposed 9.0 percent return on equity. For the purposes of this calculation, I relied on substituting NorthWestern's recommended increases for the MCC's on a spreadsheet submitted into evidence by Mr. Pat DiFronzo. (*See* Response to Data Request PSC-001 Attachment PJD-2 (Nov. 28, 2012).)

denied a considerable benefit stemming from bonus depreciation, which would be entirely flowed through to the company. This is an unreasonable outcome, especially in an era when capital additions will require the more frequent filing of rate cases, meaning that a test year should be less subject to adjustments of this nature. I would agree with the MCC in its reversal of the company's *pro forma* adjustment.

c) The MCC's proposed adjustment to the accumulated provision for depreciation raises problematic issues relating to the matching principle, but I find it reasonable. While the Commission has not typically countenanced additions or subtractions from rate base after the test year, the adjustment here relates only to plant that is captured in the rate base calculation for the test year, and creates a better match between the year when rates are in effect (2013) and the amount of accumulated depreciation regarding the plant in the test year. (*Id.* at 466:8-25.) The last time this issue was addressed was nearly 20 years ago in D93.6.24.[2] MDU calculates rate base in a way that, on the whole, is more sound, although applying the treatment here would require other re-calculations to the testimony of Mr. Daniel Reardon.

d) It seems the Pipestone Campground was used and useful during the test year. (Tr. 288:19-289:17.) If it was, I agree with NorthWestern that its exclusion is unwarranted, because doing so would be an outside-of-test-year violation of the matching principle. I agree with Mr. Reardon that only properties of significant value should be treated exceptionally. (*Id.* at 291:10-20.)

e) I agree with the MCC's proposed amortization of the discontinued Kalispell Loop project, which did not result in used and useful plant, but which should be recovered as an expense over time, with no return allowed on the defunct investment.

f) I agree with the MCC's adjustment that excludes property taxes paid on Construction Work in Progress (CWIP). CWIP is by definition not used and useful. Axiomatically, expenses associated with property that is not used and useful must be excluded from rates. Mr. Kendall Kliewer, for NorthWestern, agreed that property tax expense associated with property that is not used and useful should not generally be recoverable in rates. (*Id.* at 265:5-8.)

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[2] As it was put in a separate opinion in that case, "Depreciation associated with that plant is known and measurable with certainty. The actual value of that specific plant will clearly be less during the time rates are in effect than at the end of the test year." *See* Order No. 5709d (Apr. 25, 1994) (Rowe, Commr. dissenting).

g) The Long-Term Incentive Plan (LTIP) appears, in one respect, to be a replacement for parts of the base salaries of certain management employees. On the other hand, its authorizing documents make clear that LTIP "is intended to align management with stockholder interests." (*See* Response to Data Request (DR) PSC-019, Updated Attachment 2, p. 1 (Dec. 19, 2012).) Stockholders should have to pay for it. I would disallow the costs, although permit the recovery of consumer-oriented incentive programs, and be open to consideration of how to allow incentive-based pay that replaces base salaries.

h) I am persuaded by certain of MCC's adjustments on less monetarily impactful issues, including among other matters the adjustment for association dues and averaging of years for some operations and maintenance expense.

i) Finally, the return on equity in this proceeding was the subject of a considerable amount of debate. It is clear from the testimony that capital costs have declined, and that regulated utilities' authorized returns on equity have not been quick to catch up to that trend of decline. Recent authorized returns for the proxy group companies appear to range from 9.2 percent to 10.2 percent. (*See* DRs MCC-004 & PSC-098.) A 9.8 percent return falls within that range, but is probably high compared against the results of a multi-stage discount cash flow model that is adjusted for quarterly dividends (based on Mr. Robert Hevert's recommendation) and uses a reasonable long-term growth rate (based on Mr. Michael Gorman's recommendation). (*See* Ex. NWE-7 pp. 10-11; Tr. 230:13–233:23). It also is excessive when compared against market risk-premium models presented by Dr. John W. Wilson. (Ex. MCC-2 pp. 27-33.)

While again re-stating the caveat that my opinion on the above matters could have changed in the event of a live hearing and substantial briefing, my preliminary calculations indicate that a reasonable revenue requirement would be about $2-3 million below the stipulated revenue requirement. To my mind, that is too large of a difference to justify approving the stipulated increase as being in the public interest.

The Stipulations were Undermined by Live Testimony

A stipulation must be supported by the reasoned testimony of parties' witnesses, and not merely their conclusory statements of support. Mr. Hevert, for NorthWestern, asserted that a 9.8 percent return on equity would be, on a stand-alone basis, unreasonably *low*, but for the favorable treatment offered to the company by the overall revenue requirement. (Tr. 169:9-15.)

Meanwhile, Dr. Wilson, for the Consumer Counsel, asserted that 9.8 percent return on equity would be, on a stand-alone basis, unreasonably *high*, but for the favorable treatment offered to consumers by the overall revenue requirement. (*Id.* at 422:8-23.) Clearly, both of these things cannot be true. I am hesitant to vote to approve the Stipulations in light of the live testimony in the matter, which in my view substantially undermined the Stipulations.

The testimony in this proceeding is complete, a substantial amount of discovery was issued and responded to, and the Commission's hearing on this matter unearthed substantial live testimony that would enable the Commission to render a more transparent decision in this matter. A further hearing would offer the parties, in the event of a rejection of the Stipulations, an opportunity to examine each others' witnesses, after which the Commission could reach a reasoned decision in an efficient manner.

The Commission Should Provide Guidance on Near-Term Capital Additions

NorthWestern plans significant capital additions in the coming years which, as Mr. Brian Bird testified, could practically double the natural gas utility's rate base. (*Id.* at 135:1-15.) Many regulatory issues surrounding the treatment of rate base—from the proper calculation of the test-year plant balance, to the treatment of accumulated depreciation, to the appropriateness of post-test year adjustments to rate base, to the returns that rate-base investments earn—deserve clarification in advance of a period of intensive capital investment. Those issues were well argued by both sides, but in stipulating to an outcome, the Commission offers judgment on none of them, even though in so doing the Commission would promote regulatory certainty which is in the public interest.

The last time the Commission reached a judgment on NorthWestern's revenue requirement without a stipulation was more than a decade ago, in Order 6271c, issued in May 2001. Surely it is time to revisit some of the regulatory principles that are held over from that era and which, as has been seen through the course of this proceeding, result in disparities in how we treat NorthWestern and Montana-Dakota Utilities.

Given the Commission's relatively new membership, parties in a proceeding like this deserve to know more about Commissioners' thoughts on important issues that will, as a result of granting the Stipulations, go unremarked upon. Even were the Commission to arrive at a return on equity and an overall revenue requirement that was similar to that contained in the

Stipulations, an exercise of reasoning would add value to a process that has now been rendered largely superfluous.

For the foregoing reasons, I respectfully DISSENT

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Travis Kavulla, Commissioner (dissenting)