Service Date: August 15, 2017

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

IN THE MATTER OF NorthWestern Energy's Application for Approval to Change and Establish Natural Gas Delivery Service and Production Rates	))))	REGULATORY DIVISION DOCKET NO. D2016.9.68 ORDER NO. 7522g

FINAL ORDER

FOR NORTHWESTERN ENERGY:

Al Brogan and Ann Hill, 208 N. Montana, Suite 205, Helena, MT 59601

FOR THE INTERVENORS:

Montana Consumer Counsel
Robert Nelson, 111 North Last Chance Gulch, Helena, MT 59620

Large Customer Group
Thorvald Nelson and Nikolas Stoffel, 6380 South Fiddlers Green Circle, Suite 500, Greenwood Village, CO 80111

BEFORE:

Brad Johnson, Chairman
Travis Kavulla, Vice Chairman
Kirk Bushman, Commissioner
Roger Koopman, Commissioner
Bob Lake, Commissioner

COMMISSION STAFF:
Will Rosquist, Administrator, Regulatory Division
Justin Kraske, Administrator, Legal Division
Gary Duncan, Revenue Requirements Program Manager
Jeremiah Langston and Jennifer Hill-Hart, Staff Attorneys
Scott Fabel and Dagan Lunch, Rate Analysts

PROCEDURAL HISTORY

1. On September 2, 2016, NorthWestern Energy ("NorthWestern" or "NWE") filed a Motion to Bifurcate Gas Rate Case into Phase I addressing the revenue requirement and Phase II concerning allocated cost of service/rate design. On September 23, 2016, the Commission issued Notice of Commission Action approving NorthWestern's Motion for Bifurcation.

2. On September 30, 2016, NorthWestern filed an Application for Approval to Change and Establish Natural Gas Delivery Service and Production Rates ("Application"). NorthWestern filed Phase I of its general rate case in which it requested to establish revenue requirements for its Transmission, Distribution, & Storage ("TD&S") utility, and for its Battle Creek, Bear Paw ("NFR") and South Bear Paw ("Devon") production assets. The revenue requirement for a smaller production asset, Black Hills, was included with NFR.

3. On October 4, 2016, the Commission issued a Notice of Application and Intervention Deadline and Initial Procedural Schedule, which permitted discovery October 12, 2016 through January 11, 2017 on NorthWestern's Application. On October 20, 2016, the Commission issued a Notice of Staff Action granting intervention to the Montana Large Customer Group ("LCG"), the Montana Consumer Counsel ("MCC"), Energy West Montana ("EWM"), and Cut Bank Gas ("CBG").

4. On November 28 through December 2, 2016, Commission staff and MCC conducted an on-site audit at NorthWestern's headquarters in Butte, Montana.

5. On February 2, 2017, MCC submitted Intervenor Testimony of Al Clark, George Donkin, and John Wilson. On the same day, LCG filed Intervenor Testimony and Exhibits of Michael P. Gorman.

6. On March 14, 2017, NorthWestern filed a Letter Regarding Withdrawal of Interim Rate Request. On March 14, 2017, NorthWestern filed a Motion to Extend Time for Filing Phase II regarding cost allocation and rate design to May 31, 2017. On April 3, 2017, the Commission issued a Notice of Commission Action granting NorthWestern's Motion to extend the deadline to file the Phase II portion of its Application.

7. On April 7, 2017, NorthWestern filed the Rebuttal Testimony of A.M. McKenzie, D.L. Rausch, C.D. Lail, T.E. Meyer, P.M. Normand, W.M. Hitt, P.J. DiFronzo and P.R. Corcoran. On the same day, LCG filed Cross-Intervenor Testimony of Gorman.

8. On May 5, 2017 NorthWestern and MCC filed a Joint Motion for Approval of Stipulation and Settlement Agreement ("First Stipulation"). This Stipulation further reduced the total revenue requirement increase request, proposed a true-up amount for the NFR and Devon interim bridge rates, allocated Administrative and General ("A&G") expense and common plant to TD&S rather than to the production assets as had been advocated by NorthWestern in its direct and rebuttal testimony, and proposed a methodology for calculating the production asset revenue requirement on a going forward basis. The LCG did not join the First Stipulation because it did not agree with the allocation of A&G expense and common plant.

9. On May 9, 2017 through May 11, 2017, the Commission held a public hearing on NorthWestern's Application and the First Stipulation between NorthWestern and MCC. *See* Hr'g Tr. 5:10–15, 668:9–12 (May 9–11, 2017).

10. On June 9, 2017, NorthWestern, MCC, and the LCG filed a Join Motion for Approval of Stipulation and Settlement Agreement ("Second Stipulation"). LCG joined this Stipulation because there was an agreement regarding the allocation method for the A&G expense and common plant acceptable to the LCG. This Stipulation further reduced the proposed revenue requirement and moved the A&G expenses and common plant allocation from the TD&S utility revenue requirement to the Total Production Asset revenue requirement. On June 9, 2017, NorthWestern filed its Initial Post-Hearing Brief. On June 21, 2017, MCC filed its Post-Hearing Brief. On June 30, 2017, NorthWestern filed its Post-Hearing Reply Brief.

11. On July 20, 2017, the Commission held a regularly scheduled work session to discuss and act on NorthWestern's Application; the First Stipulation between NorthWestern and MCC; and the Second Stipulation between NorthWestern, MCC, and LCG.

FINDINGS OF FACT

12. With the filing of the First and Second Stipulations in this docket, the parties acknowledged that there were no contested issues among the parties and that the stipulations were a settlement of the Phase I—Revenue Requirement Determination Phase of Docket D20167.9.68. *See* Second Stipulation ¶¶ 8–9. These stipulations, therefore, became the focus of the Commission's analysis and deliberations in this docket. The three major proposals before the Commission for approval in the stipulations are:

- Stipulated bridge rate true-ups for the NFR and Devon production assets.

- Stipulated revenue requirement increases for the TD&S, the Battle Creek production asset, the NFR production asset, and the Devon production asset.
- Stipulated going forward revenue requirement methodology for the production assets.

Additionally, the Commission provides direction on future acquisition of utility owned assets, *see infra* ¶¶ 53–55, and potential treatment of the production assets in Phase II of this rate case. *See infra* ¶ 56.

Stipulated bridge rate true-ups for the NFR and Devon production assets.

13. NorthWestern has proposed a true-up of the revenues collected for the NFR and Devon production assets under interim bridge rates. The revenues collected were compared against the revenue requirements for the years in question as presented by NorthWestern. According to NorthWestern, for the period of November 2012 through December 2016, NFR had revenue under-collections of $2,689,958. Rebuttal Test. Patrick DiFronzo, Ex.__(PJD-39) through Ex.__(PJD-40) (Apr. 7, 2017). For the period of December 2013 through December 2016, Devon had over-collections of $1,281,521. NorthWestern proposes to collect, over one year, the net under-collection of $1,408,437.

14. The Commission has allowed rate true-ups for the production assets in the past. The Battle Creek revenues were trued up prior to the Battle Creek production asset being brought into rate base and a revenue requirement approved. Similarly, Both NFR and Devon have implemented Commission approved true-ups. Eight month true-ups were implemented for both in November 2013.

15. MCC, in its original testimony, had only minor adjustments to the suggested true-ups and did not contest the implementation of such a true-up. In the First Stipulation, MCC agreed that the 2013-2016 Devon and NFR interim rate/revenue true-ups as presented in the rebuttal testimony of Mr. DiFronzo should be implemented. First Stipulation ¶ 4(g).

16. NorthWestern, in its true-up, proposed adjustments to the return on equity (“ROE”) associated with the assets, relying on back-casting the financial conditions that prevailed at the time. This practice is unusual, to the extent that the expert witness offering testimonial support of the back-cast ROE said that only “very rarely” had he been asked to engage in such an examination. Hr’g Tr. 503–504. Additionally, the underperformance of certain unregulated business functions of the gas assets, such as gathering and compression, resulted in

an under-collection of the revenue requirement which, through a true-up, is backfilled through regulated revenues. Hr'g Tr. 618–620. Both of these features of the true-up strike the Commission as noteworthy, but the Commission will not set aside the stipulation's true-up provision in order to make further adjustments. If the company proposes a revenue requirement in the future which effectively proposes a subsidy from regulated revenues to the underperformance of unregulated lines of business, the Commission will examine the issue at that time.

17. The Commission approves the NFR and Devon true-ups as agreed to in ¶ 4(g) of the First Stipulation.

Stipulated revenue requirement increases for the transmission, distribution and storage utility (TD&S) and the natural gas production assets.

18. Table 1 shows the different revenue requirements presented in this docket. While the LCG did not file an actual revenue requirement, the Commission derived an implied revenue requirement for LCG based on its proposed ROE versus the ROE advocated by NorthWestern.

Table 1

D2016.9.68 Revenue Requirement Increases ($Millions)					
	Gas TD&S	**Battle Creek**	**NFR**	**Devon**	**Total**
Sept. 30, 2017 NWE Direct	7.4	0.0	1.5	2.0	10.9
Feb. 2, 2017 MCC Test.	5.0	(0.6)	0.0	(0.8)	3.7
Feb. 2,, 2017 LCG	4.6	(0.1)	1.4	1.6	7.5
April 7, 2017 NWE Rebuttal	5.4	0.1	1.7	2.3	9.4
May 5, 2017 1st Stipulation (No Prod. Asset A&G Alloc.)	7.3	(0.6)	0.6	(0.8)	6.6
June 9, 2017 2nd Stipulation (A&G Alloc. to Prod. Assets)	2.9	(0.1)	1.4	1.5	5.7

Additional detail regarding the above revenue requirement increases can be found in Attachment A to this Order.

19. The Second Stipulation asked the Commission to approve a total revenue requirement increase for the production assets and the TD&S utility of $5,724,767. The revenue requirement increases for TD&S, Battle Creek, NFR, and Devon to be approved in this docket are all based on a 2015 test year with known and measurable changes for 2016. Table 2 shows the estimated adjustments made by the parties to NorthWestern's originally requested total

revenue requirement increase of $10,892,438, in order to arrive at the Second Stipulation requested revenue requirement increase of $5,724,767.

Table 2.

Derivation of Second Stipulation Revenue Requirement Increase (Thousands)		
NWE Sept. 30, 2016 Direct Testimony Revenue Requirement Increase		**$10,892**
	2016 Actual Property Tax Adjustment	($1,998)
	Other Adjustments	$512
NWE April 7, 2017 Rebuttal Revenue Requirement Increase		**$9,406**
	Reduction in ROE - 10.35 to 9.55 Revenue Requirement Impact	($2,640)
	Reduction of Rate Base for Depreciation Revenue Requirement Impact	($212)
May 5, 2017 First Stipulation Revenue Requirement Increase		**$6,554**
	Disallowance of A&G	($829)
June 9, 2017 Second stipulation Revenue Requirement Increase		**$5,725**

The First Stipulation between MCC and NorthWestern reduced the revenue requirement increase from NorthWestern's proposed rebuttal increase of $9,406,158 to $6,553,814 based on the ROE and Depreciation Reserve adjustments. The First Stipulation did not allocate any A&G expense or common plant to the production assets. For this reason, the LCG did not join the settlement.

20. The Second Stipulation was joined by the LCG, MCC, and NorthWestern. It reduced the First Stipulated revenue requirement increase by $829,047, from $6,553,814 to $5,725,000 based on an A&G and common plant allocation methodology acceptable to all parties. *See* Second Stipulation ¶ 7.

21. NorthWestern proposed an overall rate of return of 7.33% using 53.21% debt and 46.79% equity, a debt cost of 4.67%, and a ROE of 10.35%. MCC accepted the capital structure and cost of debt utilized by NorthWestern, and proposed an overall rate of return of 6.69%, using a 9.00% ROE. The LCG also accepted NorthWestern's capital structure and cost of debt and proposed a 9.35% ROE, resulting in a proposed overall rate of return of 6.76%. The following ROE ranges were proposed by the parties:

NorthWestern:	9.5% to 10.7%
MCC	6.0% to 9.1%
LCG	9.0% to 9.75

22. The Commission approves the 9.55% ROE as proposed in the First Stipulation. *See* First Stipulation ¶ 4(b). Both NorthWestern and MCC agreed to the 9.55% ROE and the LCG indicated that it supported the settlement agreement with regard to the proposed resolution

of the rate of return issues. *See* NorthWestern and MCC Joint Motion for Approval of Stipulation and Settlement Agreement 2 (May 5, 2017). The Commission will not engage in detailed analysis of the ROE settlement, other than to observe that the number falls within the zone of figures proposed by the parties, including a consumer intervenor. The Commission approves it with a note of caution. ROE determinations have declined only slightly in the last decade as the risk-free rate has remained at nearly an all-time low. Use of the 9.55% ROE and NorthWestern's capital structure and cost of debt results in an overall return on rate base of 6.96% as shown in Table 3.

Table 3.

Settlement	Ratio	Cost	Allowed Return
Debt	53.21%	4.67%	2.49%
Common Equity	46.79%	9.55%	4.47%
Total			6.96%

23. Concerning the Depreciation Reserve, MCC proposed an adjustment increasing the NorthWestern Accumulated Depreciation Account in the amount of $1,755,783. *See* First Stipulation ¶ 4(d). This adjustment is based on the fact that NorthWestern started booking lower depreciation rates as of April 2013 based on a 2012 depreciation rate study. The result of booking these lower depreciation rates was to decrease the accumulated provision for depreciation over the time span from April 2013 forward from what it would have been if the new lower depreciation rates had not been implemented. This increased the rate base proposed by the Company in this rate case. MCC contended the lower depreciation rates were never approved by the Commission and the lower depreciation rates were never incorporated into the gas utility's service rates to customers. Because these depreciation rates were booked between rate cases, the customers did not see the benefit of the lower rates, but do now see the impact of the increased rate base. Thus, the only impact in the revenue requirement filed by NorthWestern was to inflate the Company's proposed rate base in this case.

24. MCC stated the implementation of new depreciation rates between rate cases that have not been approved for ratemaking purposes should not cause current customers to face a higher rate base than they otherwise would have, especially when the lower depreciation rates have never been reflected in gas service rates. *See* Test. Albert Clark, Ex.__(AEC-2), page 2 of 13, column L (Feb. 2, 2017) (demonstrating these adjustments).

25. Pursuant to the First Stipulation, NorthWestern agreed to accept the MCC's adjustment to increase the accumulated depreciation reserve by $1,755,783 for a period of 5 years, thus decreasing rate base. In addition, the parties agreed that NorthWestern's natural gas and common depreciation rates as proposed in the filing should be approved for all years subsequent to the 2015 test year. *See* First Stipulation ¶ 4(d).

26. The Commission approves this treatment of depreciation. First Stipulation ¶ 4(d). Both the adoption of the decrease to rate base and the approval of the 2013 depreciation rates will flow through to ratepayers in the form of lower rates.

27. In its September 30, 2016 filing, NorthWestern allocated a portion of A&G expense and common plant to the production assets. NorthWestern explained the allocation was made because shared administrative costs are allocated based on the operations and maintenance labor cost incurred by each function and therefore are appropriately allocated to each of those functions. Also, net common plant is appropriately allocated to all of the electric and natural gas functions that utilize the common plant. The LCG group agreed with NorthWestern.

28. The MCC did not agree with NorthWestern. The MCC asserted that prior to this case no common plant and no A&G expenses were assigned to or allocated to the production assets. To be consistent with the original analyses and the calculations for the true-up periods, MCC argued that the A&G expenses and common plant should be removed from the production assets and included with the TD&S utility revenue requirement.

29. In the First Stipulation, the MCC and NorthWestern agreed to the MCC position and NorthWestern removed the A&G expenses and common plant from the production assets and assigned them to TD&S. First Stipulation ¶ 4(i). This move was opposed by the LCG who chose to not be a party to the First Stipulation.

30. The first section of Table 4 shows the TD&S and production asset revenue requirements agreed to by the MCC and NorthWestern in the First Stipulation where there is no allocation of the A&G expense to the production assets. The second half of Table 4 shows those same revenue requirements if the A&G expense and common plant were allocated to the production assets. Note that the total revenue requirement increases in both cases is $6,553,813. However, the allocations have the impact of shifting $4,370,303 in revenue requirement between TD&S and the production assets.

Table 4

Impact of of A&G Allocations on the Stipulated Revenue Requirements (May 5, 2017 First Stipulation) D2016.9.68						
First Stipulation Revenue Requirements (A&G Allocated to TD&S)						
			Bear Paw	Bear Paw	Total	
	TD&S	Battle Creek	(NFR)	(Devon)	Production	Total
Revenues at Test Period Rates	$114,477,601	$2,362,612	$3,246,920	$14,941,564	$20,551,096	$135,028,697
Revenue Requirement Increase/(Decrease)	$7,303,533	($571,992)	$616,023	($793,751)	($749,720)	$6,553,813
Revenues at Proposed Rates	$121,781,134	$1,790,620	$3,862,943	$14,147,813	$19,801,376	$141,582,510
Revenue Requirements (A&G allocated to Production Assets)						
			Bear Paw	Bear Paw	Total	
	TD&S	Battle Creek	(NFR)	(Devon)	Production	Total
Revenues at Test Period Rates	$114,477,601	$2,362,612	$3,246,920	$14,941,564	$20,551,096	$135,028,697
Revenue Requirement Increase/(Decrease)	$2,933,230	$62,775	$1,590,507	$1,967,301	$3,620,583	$6,553,813
Revenues at Proposed Rates	$117,410,831	$2,425,387	$4,837,427	$16,908,865	$24,171,679	$141,582,510
Revenue Requirement Change if A&G expenses and Common Plant are allocated to Production Assets	**($4,370,303)**	**$634,767**	**$974,484**	**$2,761,052**	**$4,370,303**	**$0**

31. The hearing on the First Stipulation made it apparent that the stipulation could not be taken as anything like an all-party settlement. On the contrary, the LCG engaged in vigorous cross-examination on this subject, as did the Commission. *See* Hr'g Tr. at 37–44, 72–88, 170–193, 313–316, 339–340, 427–428, 442–451, 552–558, 642–643.

32. The Second Stipulation, submitted after the hearing, took the nearly opposite approach on this subject, reversing the allocation of the A&G expenses and common plant to the TD&S utility as adopted in the First Stipulation. Second Stipulation ¶ 17. This moved $4.4 million in revenue requirement from TD&S to the production assets. That reallocation did not change the First Stipulation total revenue requirement increase of $6,553,813. However, in the Second Stipulation, the parties agreed to replace section 4(i) of the First Stipulation and reduce the production asset revenue requirements by $829,047 from the First Stipulation revenue requirement. The final overall revenue requirement increase then is the $5,724,767 shown below in Table 5. The Second Stipulation itself does not provide an explanation of the $829,047 reduction. It is simply a stated reduction as a part of the agreement. The Second Stipulation states this adjustment will continue for the life of the assets.

33. The Second Stipulation treatment of A&G and common plant is consistent with the original testimony of NorthWestern and the LCG, and with the rebuttal testimony of NorthWestern. NorthWestern argued in the rebuttal testimony that NorthWestern uses a fully distributed cost allocation methodology which is premised upon allocation to all business functions the A&G expense and Common Plant, including the gas production assets. Rebuttal Test. Crystal Lail 5 (Apr. 7, 2017). LCG agreed and also contended that NorthWestern's application and supporting material suggest that NorthWestern's gas production service function should be allocated a portion of A&G expenses and common plant.

34. Table 5 shows the final Second Stipulation revenue requirements proposed for Commission approval.

Table 5

Stipulated Revenue Requirements (June 9, 2017 Second Stipulation) D2016.9.68						
Stipulated Revenue Requirements (A&G allocated to Production Assets)						
	TD&S	Battle Creek	Bear Paw (NFR)	Bear Paw (Devon)	Total Production	Total
Revenues at Test Period Rates	$114,477,601	$2,362,612	$3,246,920	$14,941,564	$20,551,096	$135,028,697
Revenue Requirement Increase/(Decrease)	$2,933,230	($89,438)	$1,354,635	$1,526,340	$2,791,537	$5,724,767
Revenues at Proposed Rates	$117,410,831	$2,273,174	$4,601,555	$16,467,904	$23,342,633	$140,753,464

35. The Commission approves the allocation of the A&G expenses and common plant to the production assets as proposed in the Second Stipulation. The Commission agrees that if the production assets are benefiting from A&G expenses and are utilizing a portion of the common plant, then the associated costs should be allocated to the production assets. However, in the Second Stipulation, there was no reason given for the $829,047 reduction of the $4,370,303 total production asset A&G and common plant allocation revenue requirement to $3,541,256. The Commission does not find this reduction warranted and the Commission orders that the total $4,370,303 should be allocated to the total production assets and that NorthWestern should be able to recover that amount resulting in the total production asset revenue requirements as shown below in Table 6. Note that the total production asset revenue requirement increased by $829,047 from the Second Stipulation proposed amount.

Table 6

Commission Modified Revenue Requirements Allocating Full $4.4 Million to Production Assets						
	TD&S	Battle Creek	Bear Paw (NFR)	Bear Paw (Devon)	Total Production	Total
Revenues at Test Period Rates	$114,477,601	$2,362,612	$3,246,920	$14,941,564	$20,551,096	$135,028,697
Revenue Requirement Increase/(Decrease)	$2,933,230	$62,775	$1,590,507	$1,967,301	$3,620,583	$6,553,813
Revenues at Proposed Rates	$117,410,831	$2,425,387	$4,837,427	$16,908,865	$24,171,679	$141,582,510

The Commission approves the TD&S revenue requirement as shown in Table 6 in the amount of $117,410,831 which is an increase of $2,933,230 or 2.6%.

Stipulated going forward revenue requirement methodology for the production assets.

36. The Total Production Asset revenue requirement of $24,171,679 in Table 6, however, requires one additional modification described below before approval. In Order 7282d of Consolidated Dockets D2013.5.34 & D2014.5.47, the Commission ordered that within 12 months of the date of the Order that NorthWestern was to make a filing with certain information:

> Accordingly, the Commission requires a comprehensive filing to be made by NorthWestern within the next 12 months of the service date of this Order that must include all necessary data to calculate rates under a range of regulatory approaches to the cost-recovery of the gas production fields that NorthWestern owns and operates. That filing must include sufficient cost and ancillary information to calculate fixed cost rates for the Battle Creek, NFR, and Devon gas production fields under a range of regulatory approaches. If NorthWestern files a comprehensive rate case for its natural gas utility within that period, the assets and requisite information must be included in the comprehensive filing.
>
> …
>
> The Commission is willing to explore at least three differing approaches to ratemaking for the gas production assets, including: A multi-year revenue requirement with annually stair-stepping rates based on an historic test year and several years of forecast data; annual updating of revenue requirements based upon actual cost of service through a tracker; and a traditional method of permanent rates set using a historic test year.

In re NorthWestern Energy's Consolidated 2012-2013 & 2013-2014 Natural Gas Trackers, Consolidated Dockets D2013.5.34 & D2014.5.47, Order 7282d ¶¶ 32, 35 (Oct. 5, 2015).

37. NorthWestern witness Patrick Corcoran stated that in Consolidated Docket D2013.5.34 & D2014.5.47 both the MCC and the Commission expressed concern about the appropriateness of cost recovery for the gas production assets using conventional ratemaking treatment historically employed by the Commission. Test. Patrick Corcoran 4 (Sept. 30, 2016). The MCC expressed concern that the analysis provided to the Commission regarding the gas

production assets showed a declining rate base and revenue requirements and that under traditional ratemaking, future rates would fail to accurately reflect the declining revenue requirements penalizing ratepayers. Order 7282d ¶ 32.

38. Corcoran's direct testimony in this docket addressed the three ratemaking approaches outlined in paragraph 36 above: Traditional Ratemaking, an Annual True-up, and a Multi-Year approach. Test. Corcoran at 4. On a going forward basis, Corcoran testified that NorthWestern favored the Annual True-Up method. Annual true-ups would be made in April of each year on a forecasted basis. *Id*. at 11. In his April 7, 2017 rebuttal testimony, Corcoran testified that with certain conditions, the approach offered by MCC witness Donkin would be an acceptable alternative. *See infra* ¶ 39. In a data response Corcoran stated, "NorthWestern's position is that it has accepted the MCC methodology subject to the conditions addressed in the Prefiled Rebuttal Testimony of Patrick R. Corcoran." Data Response (DR) PSC-188 (Apr. 25, 2017).

39. The MCC proposes to use a variation of the multi-year model on a going forward basis. MCC witness George Donkin states that a new cost of service and revenue requirement, based on a test year ended December 31, 2015, will be established in this case for NorthWestern's Battle Creek, NFR and Devon properties. Test. George Donkin 9–14 (Feb. 2, 2017). Donkin recommends that after the first year, a single, combined revenue requirement and unit rate for the properties be reset to reflect the forecasted combined percentage decline in revenue requirements that NorthWestern used in its Net Present Value ("NPV") analyses to support the acquisitions. *Id.* at 9:16–19. Donkin proposes that this process would be repeated each year, until the Company makes a new general rate filing, at which time a new cost of service, revenue requirement, and a new combined unit rate would be established for NorthWestern's production assets. *Id.* at 9:20–10:4. Donkin states that the new, combined unit rate would be in effect for one year, after which the previous production assets revenue requirement would be adjusted downward to further reflect the combined forecasted percentage decline in revenue requirements that NorthWestern used in its NPV analyses to support each acquisition. *Id.* at 10:4–8. Donkin presents annual percentage declines for the period 2016–2037 to be used between rate cases under his proposed variation of Method 1. *See Id.*, Ex.__(GLD-1). Donkin presented the following arguments for why the MCC Multi-Year approach is preferable to the NorthWestern Annual True-Up approach:

- The MCC Multi-Year method eliminates the need for an annual mini-rate case between general rate cases, as would be the case with the annual cost of service review in NorthWestern's annual gas tracker that Mr. Corcoran proposes.
- The Multi-Year approach would produce a greater incentive for NorthWestern to control the costs of operating its production assets than Mr. Corcoran's Annual True-Up approach, which would provide NorthWestern with automatic annual tracker recovery of all production-related costs, including a return on rate base, between general rate cases.
- Annual tracker recovery between general rate cases is typically provided only for costs that are not under utility management control and are also costs that are subject to significant and unpredictable movements in magnitude over relatively short periods of time. These characteristics do not apply to the fixed costs NorthWestern incurs at Battle Creek, NFR and Devon.

Id. at 10–11.

40. Finally, Donkin argues that the Multi-Year approach would provide NorthWestern with an opportunity but not a virtual guarantee to recover its actual production-related fixed costs, and it also would provide ratepayers with the declines in annual revenue requirements from year to year that were used by NorthWestern to justify the purchases of its production assets. *Id.* at 11:8–16.

41. In the First Stipulation, NorthWestern and MCC agreed to the MCC's future Natural Gas Production Assets ratemaking proposal for a period of ten years ending July 2027. *See* First Stipulation ¶ 4(f). Under this methodology, the total revenue requirement established for the production assets in this docket would be reduced each year for the next ten years by the year-over-year percentage reductions calculated by NorthWestern in the acquisition models used in the evaluation of the production asset purchases. This year-over-year reduction primarily reflects the depletion in the gas reserves of the NorthWestern production assets, although its application to the revenue requirement will also by course draw down operating expenses which are allocated to the production assets.

42. Table 7 shows the year-over-year percentage reductions in the production asset revenue requirements as calculated by NorthWestern in its NPV analyses supporting the acquisitions. MCC witness Donkin proposed that after the revenue requirements for each of the three production assets were determined, that a single, combined total revenue requirement and unit rate be set for the total. Test. Donkin at 9:12–20. Table 7, Columns 7 & 8 show the modeled production asset total revenue requirement and the year-over-year percentage decline.

Table 7

1	2		3	4	5	6	7	8
Acquisition Models Revenue Requirements (thousands) and Percentage Year over Year Declines								
	Acquisition Model Battle Creek		Acquisition Model Bear Paw (NFR)		Acquisition Model Bear Paw (Devon)		Acquisition Models Total Production Assets	
2011	$2,772							
2012	$2,651	-4.35%	$5,011					
2013	$2,539	-4.24%	$4,458	-11.04%	$18,950		$25,947	
2014	$2,433	-4.19%	$4,032	-9.56%	$17,765	-6.25%	$24,230	-6.62%
2015	$2,333	-4.10%	$3,653	-9.40%	$16,685	-6.08%	$22,671	-6.43%
2016	$2,227	-4.52%	$3,344	-8.46%	$15,704	-5.88%	$21,275	-6.16%
2017	$2,124	-4.62%	$3,081	-7.86%	$14,837	-5.52%	$20,042	-5.79%
2018	$2,018	-5.02%	$2,804	-8.99%	$14,029	-5.45%	$18,851	-5.95%
2019	$1,916	-5.04%	$2,572	-8.27%	$13,273	-5.39%	$17,761	-5.78%
2020	$1,831	-4.46%	$2,371	-7.81%	$12,576	-5.25%	$16,778	-5.54%
2021	$1,741	-4.89%	$2,180	-8.06%	$11,916	-5.25%	$15,837	-5.61%
2022	$1,655	-4.92%	$2,006	-7.98%	$11,283	-5.31%	$14,944	-5.64%
2023	$1,571	-5.12%	$1,851	-7.73%	$10,678	-5.36%	$14,100	-5.65%
2024	$1,490	-5.14%	$1,696	-8.37%	$10,115	-5.27%	$13,301	-5.67%
2025	$1,412	-5.22%	$1,557	-8.20%	$9,598	-5.11%	$12,567	-5.67%
2026	$1,344	-4.86%	$1,433	-8.20%	$9,094	-5.11%	$11,871	-5.67%
2027	$1,280	-4.71%	$1,329	-8.20%	$8,615	-5.11%	$11,224	-5.67%
2028	$1,216	-5.00%	$1,240	-8.20%	$8,250	-5.11%	$10,706	-5.67%
Battle Creek - NWE Response to MCC-101,			NFR and Devon - NWE TEM-1 and TEM-2					
Total Production Asset % Declines MCC Donkin Exh. GLD-1 - Agreed to by NWE in First Stipulation								

43. During the hearing, the Commission expressed concern that because the production asset revenue requirements being established in this docket are based on a 2015 test year, and that once that revenue requirement is established, it would miss the 2016 and 2017 reductions shown in Table 7 before applying the 2018 stepdown reduction as reflected in the stipulation and the testimony of Mr. Corcoran concerning condition two. Hr'g Tr. at 281–292, 465–472 (Vice Chairman Kavulla examining Mr. DiFronzo and Mr. Donkin). This would have the effect of largely negating the main purpose of this kind of multi-year revenue requirement, which is to match the effects of gas production's diminution in line with the assets' depletion by books for ratemaking purposes. It would also result in the awkward situation, in a future rate case, of a revenue requirement based on, for instance, 2019, being proposed in a rate case filed 2020, with rates effective in 2021—in essence, this would recapture and reverse the step-downs that happen in 2019 and 2020 during the test year and pendency of the proceeding. The

Commission herein modifies the application of this methodology in order to make internally consistent the logic of the proposal before it.

44. The Commission finds that the 2015 test year total production revenue requirement of $24,171,679 found in Table 6, as modified by the Commission for the A&G and common plant allocation, can be understood to reflect known and measurable changes for 2016. Yet nothing can explain why customers would not be afforded the benefits of the 2017 stepdown of 5.79% on a going-forward basis. Therefore, the Commission finds the 2016 $24,171,679 revenue requirement should be stepped down by the 2017 year-over-year reduction of 5.79%, *see* Table 7, before the 2018-2027 reductions are applied. The Commission approves a final total production asset revenue requirement of $22,772,140. In addition, the Commission approves the future ratemaking treatment of the production assets as agreed to in the First Stipulation ¶ 4(f), consistent with the modification to the methodology described herein.

45. Table 8 shows the approved total production asset revenue requirement for 2017 of $22,772,140 and the approved revenue requirement for the total production assets for the years 2018 through 2027.

Table 8

Total Production Asset Revenue Requirements

Year	Table 7, Col. 8 Total Models Percentage Reduction	Begin Stepdown with 2016 Reduction Total Production Assets Revenue Requirement
2016	-6.16%	$24,171,679
2017	-5.79%	$22,772,140
2018	-5.95%	$21,418,246
2019	-5.78%	$20,180,244
2020	-5.54%	$19,062,793
2021	-5.61%	$17,994,085
2022	-5.64%	$16,979,801
2023	-5.65%	$16,020,054
2024	-5.67%	$15,112,459
2025	-5.67%	$14,256,283
2026	-5.67%	$13,448,612
2027	-5.67%	$12,686,698

46. The Commission recognizes that the First Stipulation ¶ 4(f) adopts the specific conditions described in NorthWestern witness Corcoran's rebuttal testimony. *See* Attach. D. Specifically, condition three which states as follows: "The Natural Gas Production revenue requirement base would be reset with each future Natural Gas General Rate Filing, for purposes of similar rate adjustments going forward."

47. Thus, if NorthWestern was to file a Natural Gas Production General Rate filing within the 10-year period, the future revenue requirements shown in Table 8 could change although the percentage year-over-year decreases would remain the same. However, the utility would bear the burden of proving that the Commission should approve any changes to the future revenue requirements shown in Table 8 if there was a General Rate Case filing. If NorthWestern files a rate case for its natural gas utility within this 10-year period, the Commission expects that it will file a comprehensive natural gas rate case and not focus exclusively on either the production assets or TD&S.

48. The final Commission approved revenue requirements in this docket for the TD&S utility and the total production assets are shown in Table 9 below.

Table 9

FINAL COMMISSION APPROVED REVENUE REQUIREMENTS			
	TD&S	Total Production Assets	Total
Revenues at Test Period Rates	$114,477,601	$20,551,096	$135,028,697
Revenue Requirement Increase/(Decrease)	$2,933,230	$2,221,044	$5,154,274
Revenues at Proposed Rates	$117,410,831	$22,772,140	$140,182,971

49. The approved revenue requirements shown in Table 9 will increase the monthly average residential bill for a customer using 100 therms per month from $80.17 to $82.16, or an increase of $1.99 or 2.48%.

50. Concerning the year-over-year revenue requirement implementation, the First Stipulation adopted condition one of the Corcoran rebuttal testimony regarding when the annual step downs should occur: "Annual adjustments would be made at the same time as NorthWestern's annual natural gas tracker filings, with rates effective July 1 of each year." *See* Attach. D, Corcoran condition one.

51. With approval of the revenue requirements in Table 9, the annual Total Production Asset Revenue Requirements for each of the next 10 years will be known with

certainty unless the Commission re-establishes a revenue requirement in the context of a general rate case filing. The approved revenue requirement for each year should be the amount collected in that year. If the implementation does not take place on January 1 each year rather than the stipulated July 1 date, NorthWestern will collect in each year revenues significantly greater than the approved revenue requirement. Table 10 below shows the impact of moving the implementation date from July 1 to January 1.

Table 10

Annual Production Asset Stepdown				
Revenue Difference Janauy 1 versus July 1 Implementation				
	Column 1		Column 2	Column 3
	Amount		Amount	
	Collected Per		Collected Per	
	Staff Recommendation		Stipulation	
	January 1		July 1	
Year	Annual Stepdown		Annual Stepdown	Difference
2017	$22,772,140	*		
2018	$21,418,246		$22,095,193	-$676,947
2019	$20,180,244		$20,799,245	-$619,001
2020	$19,062,793		$19,621,519	-$558,725
2021	$17,994,085		$18,528,439	-$534,354
2022	$16,979,801		$17,486,943	-$507,142
2023	$16,020,054		$16,499,928	-$479,873
2024	$15,112,459		$15,566,257	-$453,798
2025	$14,256,283		$14,684,371	-$428,088
2026	$13,448,612		$13,852,447	-$403,835
2027	$12,686,698		$13,067,655	-$380,957

52. With regard to implementation, the Commission finds that the annual Total Production Asset revenue requirement year-over-year stepdown implementation will be effective January 1 of each calendar year rather than July 1.

Planning for Utility Owned Natural Gas Assets

53. The Commission is concerned about the future state of NorthWestern owned utility assets. The Commission previously required NorthWestern to submit biennial procurement plans. In Docket N2012.12.125, the Commission stated "[u]ntil further notice from the Commission that a comprehensive natural gas procurement plan is once again required,

NorthWestern's natural gas procurement practices should be guided by the 2012 Plan and the Commission's comments in this Docket." *In re NorthWestern's 2012 Natural Gas Biennial Procurement Plan*, Docket N2012.12.125, Commission Comments ¶ 36 (May 22, 2013). In those same comments, the Commission stated that it "supports the volumes of owned natural gas production assets within the parameters outlined in this Plan." *Id.* ¶ 33. The Commission noted that "[e]valuation of the prudence of NorthWestern's natural gas procurement activities will be based solely on information available to NorthWestern at the time transactions were done." *Id.* ¶ 34. The Commission also stated that it would "not accept rigid adherence to the Plan in the face of changing market conditions that call for a different course of action" and "it remains NorthWestern's burden to demonstrate the prudence of its gas supply acquisition practices." *Id.* ¶ 35.

54. Market conditions have significantly changed since the Commission last approved the acquisition of natural gas production assets. These assets failed to meet the "cross-over" point compared to market, in part, because market prices have continued to decline since the acquisition of these assets. Test. Travis Meyer 4:17–23 (Sept. 30, 2016) (describing how the "cross-over" of utility owned assets had been calculated in comparison to a market price forecast); Test. of John Hines 18:5–8 (Sept. 30, 2017) (explaining that failure to meet expectations is a result of both low natural gas prices and "the flat shape of the forecast market price curve for natural gas"). If NorthWestern desires to acquire additional natural gas production assets, the Commission expects that NorthWestern will file some type of procurement plan or some similar filing well in advance of any future acquisition in order for the Commission and interested parties to provide comments on that plan based on the lessons learned from these acquisitions so far. *See* Mont. Code Ann. § 69-3-1415 ("Application and approval of natural gas production and gathering resources"). This sentiment in reflected in Mr. Donkin's testimony:

> I recommend that the MCC and the Commission only consider the possibility of extending the crossover period for new gas property acquisitions in a future proceeding when the Company has presented a specific proposal, with sufficient supporting economic data and analysis to enable the MCC, other potential intervenors, and the Commission to evaluate an "explicit proposal" by NorthWestern on a fully-informed basis.

Test. Donkin at 23:13–19. Accordingly, the Commission rescinds its findings in paragraphs 32–36 of the Commission's comments filed in N2012.12.125.

55. It is NorthWestern's prerogative whether to make such a filing. The Commission does not require NorthWestern to make a procurement plan filing if it does not intend to acquire additional natural gas production assets. The Commission emphasizes that this should not be viewed as a reactionary measure to the current and potentially temporary existence of low natural gas market prices. If NorthWestern were to make a proposal, the Commission would expect NorthWestern to indicate why such a proposal would likely yield different results from what occurred with the acquisition of NFR, Devon, and Battle Creek and whether further acquisitions would result in concrete benefits and lower gas prices to consumers.

Potential Annual True-Up of Production Assets

56. The Commission is concerned that associating the multi-year revenue requirement with billing determinants that are applied to volumes of gas sold to those customers paying for production assets will result in actual revenues that deviate from the specific revenue requirements adopted in Phase I. While not requiring a true-up to the revenue requirement is consistent with the treatment of the gas TD&S revenue requirement, these assets are designed to be a hedge on the utility's purchases of gas from the market. It seems counterintuitive to allow the company or customers to reap a windfall on these assets merely because of increased or decreased customer demand due largely to weather, as opposed to the more fixed-cost hedge that the regulatory treatment adopted above imagines. Accordingly, the Commission directs the parties to consider in Phase II of the proceeding whether the production assets revenue should be trued up to the stair-stepped revenue requirement annually.

CONCLUSIONS OF LAW

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

58. The Commission is responsible for the supervision, regulation, and control of public utilities pursuant to the provision of Mont. Code Ann. § 69-3-102 (2015). NorthWestern is a public utility subject to the Commission's jurisdiction. *Id.* §69-3-101.

59. The Commission is "invested with full power of supervision, regulation, and control" of public utilities. *Id.* § 69-3-102.

60. The Commission may "do all things necessary and convenient" in the exercise of its powers. *Id.* § 69-3-103(1). The Commission may "regulate the mode and manner of all investigations and hearings of public utilities" before it. *Id.* § 69-3-103(2)(c).

61. As a public utility, NorthWestern is required to furnish reasonably adequate service at just and reasonable rates. *Id.* § 69-3-201 ("every unjust and unreasonable charge is prohibited and declared unlawful").

62. Every public utility must file schedules with the Commission showing "all rates, tolls, and charges which it has established and which are in force at the time for any service performed by it within the state or for any service in connection therewith . . . ." *Id.* § 69-3-301(1).

63. Other than rate schedules that adjust certain state and local taxes and fees, a public utility may not change any rate schedule except as approved by the Commission or upon the passage of nine months. *Id.* § 69-3-302.

64. "The commission may, in its discretion, investigate and ascertain the value of the property of each public utility actually used and useful for the convenience of the public." *Id.* § 69-3-109.

65. Before the Commission approves a rate increase, "or before any change may become effective due to the passage of nine months," the Commission must provide notice of the proposed change and announce a hearing on the matter. *Id.* § 69-3-303(1).

ORDER

IT IS HEREBY ORDERED THAT:

66. The First Stipulation between NorthWestern and MCC and the Second Stipulation between NorthWestern, MCC, and LCG is approved with the following modifications:

a. The annual Total Production Asset revenue requirement year-over-year stepdown implementation will be effective January 1 of each calendar year rather than July 1 in accordance with paragraphs 40–52 of this Order.

b. The 2016 $24,171,679 revenue requirement should be stepped down by the 2017 year-over-year reduction of 5.79%, *see* Table 7, before the 2018-2027 reductions are applied in accordance with paragraphs 43–44 of this Order.

c. The total $4,370,303 of A&G expenses addressed in the Second Stipulation should be allocated to the Total Production Assets in accordance with paragraph 35 of this Order.

67. The Commission rescinds its previous representation that"[u]ntil further notice from the Commission that a comprehensive natural gas procurement plan is once again required, NorthWestern's natural gas procurement practices should be guided by the 2012 Plan and the Commission's comments in this Docket" and its findings in paragraphs 32–36 of the Commission's comments filed in N2012.12.125. *In re NorthWestern's 2012 Natural Gas Biennial Procurement Plan*, Docket N2012.12.125, Commission Comments ¶¶ 32–36 (May 22, 2013). NorthWestern must file additional planning proposals in accordance with paragraphs 55–55 of this Order if it intends to explore the possibility of any future utility owned natural gas production assets.

68. Parties are directed to consider in Phase II of the proceeding whether the production assets revenue should be trued up to their revenue requirement annually.

69. NorthWestern must file a compliance filing, including work papers, within 14 days of service date of this Order. Rates will increase within rate classes by a uniform percentage until Phase II concerning allocated cost of service/rate design has completed.

DONE AND DATED this 20th day of July, 2017, by a vote of 5 to 0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

BRAD JOHNSON, Chairman

TRAVIS KAVULLA, Vice Chairman

ROGER KOOPMAN, Commissioner

BOB LAKE, Commissioner

TONY O'DONNELL, Commissioner

ATTEST:

Mike Maas

Mike Maas
Administrative Assistant

(SEAL)