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

IN THE MATTER OF THE JOINT APPLICATION FOR APPROVAL TO CHANGE AND ESTABLISH NATURAL GAS DELIVERY SERVICE RATES FOR ENERGY WEST MONTANA, INC. AND CUT BANK GAS COMPANY	UTILITY DIVISION Docket No. D2017.9.80

ENERGY WEST MONTANA'S AND CUT BANK GAS COMPANY'S RESPONSES TO DATA REQUESTS PSC-025 THROUGH PSC-043

Energy West Montana ("EWM") and Cut Bank Gas Company ("CBG") provide the attached responses to the Montana Public Service Commission's Data Requests PSC-025 through PSC-043.

Respectfully submitted this 6th day of December, 2017.

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DATA REQUESTS

PSC-025: RE: SME Pipeline
Witness: Charles E. Loy

On page 43 of your Direct Testimony you represent that existing EWM customers receive benefits from the pipeline acquisition in the form of an uninterruptible backup feed. Please quantify this benefit to the existing residential customers.

Response to PSC-025:

The benefit derived by all firm customers, including the residential customers, is safe, reliable, uninterrupted service during critical operating times. Uninterrupted service is a requirement for serving residential customers who use natural gas as their sole source of heat.

EWM proactively looks forward and upgrades its distribution system in an effort to continually provide safe, reliable and uninterrupted service to firm customers. EWM believes that a proactive approach to system capacity and deliverability results in less overall costs. EWM does not believe that being a reactive utility provides what our customers or the PSC expects; therefore, we took advantage of a significantly discounted asset.

After a pipeline failure at city gate number 1 in January 2007, it became evident that city gate number 2, as a stand-alone source of supply, could not support the entire City of Great Falls. EWM determined it would be necessary to increase the operating pressure in ("uprate") its 10" pipeline loop and extend that loop around the south and east end of town.

In September 2008, EWM uprated the 10" loop from 60 psi to 170 psi. This was the first step to enhanced system reliability and safety.

In the summer of 2010, EWM built the 12" SME Pipeline and uprated the 10" loop from 170 psi to 250 psi. The use of the SME pipeline allowed EWM to complete the pipeline extension needed to enhanced system reliability and safety, as initially identified in 2007.

EWM does not believe the benefits to residential customers can be accurately quantified. Residential customers that have their heat source interrupted during cold weather would be put at both severe physical and financial risk

Sponsor: Degenstein

PSC-026: RE: SME Pipeline
Witness: Charles E. Loy or as appropriate

In a free market transaction, what price would a reasonable consumer pay for uninterruptible service given the number of outages during the test period as described in the testimony of Kevin J. Degenstein (page 9)?

Response to PSC-026:

There were no outages in the test year, which is partially a result of EWM utilizing the SME Pipeline to serve and protect existing customers.

Utilities are not permitted to engage in a "free market transaction" when providing utility service to customers. The Montana Public Service Commission establishes fair and reasonable rates for residential customers. Residential customers are the highest priority firm service customers, they expect and depend on an uninterruptible service which EWM is obligated to provide. With that in mind, EWM is continually reviewing the performance of its distribution system and believes in being proactive and not reactive. The EWM process of proactively looking at our distribution system along with the oversight by the PSC allows us to achieve safe, reliable and uninterrupted service.

With that understanding, a reasonable customer, normally referred to as a rationale customer, would be willing to pay, for any service or product, an amount up to the value of that service or product based upon the perceptions and perceived benefits of that service or product to the individual customer. Therefore, a reasonable customer would welcome the opportunity to have their service provided by a valued pipeline asset regardless of it was acquired at a significant discount or at normal installation rates.

Sponsor: Degenstein

PSC-027: RE: SME Pipeline
Witness: Charles E. Loy

a. Regarding the future system expansion of the SME pipeline where [sic] studies performed to determine the maximum number of customers this pipeline could potentially service, prior to the acquisition?

b. Please provide the studies and the anticipated number of ratepayers that could be served by the pipeline. If a study was not conducted, please explain why.

Response to PSC-027:

a. The future system expansion of the SME Pipeline is intended to loop with the original 12" header main running west to east in the alley north of 9th Avenue North. This will allow EWM to address the compression couplings used on the original 12" header main and enhance our ability to provide service through either city gate regardless of weather. The purpose of the system expansion is not to add customers, but for ensuring long-term system integrity and reliability.

The maximum number of potential customers the pipeline could serve was not determined. Engineering studies are completed to determine how much natural gas can be provided to customers. The 19 miles of 12" steel pipeline at 210 psi inlet and 60 psi outlet can move over 46.2 MMcf of natural gas a day. That volume will permit EWM to meet the peak day volume required by the entire city of Great Falls today.

b. The SME pipeline was designed and sized to supply natural gas to a power generating plant. See the capacity table below:

SME Pipeline Capacity		
Inlet Pressure (psi)	Outlet Pressure (psi)	Capacity MCFD
240	60	54,000
230	60	51,400
220	60	48,800
210	60	46,200
200	60	43,600

Sponsor: Degenstein

PSC-028: RE: SME Pipeline
Witness: Charles E. Loy

a. Pursuant to Generally Accepted Accounting Principles (GAAP), what was the change in the book value of shareholder equity immediately after the acquisition took place?

b. If the book value per share increased, in your opinion, should EWM's cost of equity be adjusted downward to reflect the reduced risk resulting from having a greater asset base servicing EWM's liabilities?

Response to PSC-028:

a. Plant increased $75,000 and cash decreased $75,000. Thus, there was no change in the shareholder equity.

b. See response to subpart (a).

PSC-029: RE: SME Pipeline
Witness: Jed D. Henthorne

a. At what amount did EWM value the pipeline on its GAAP books? Was it recorded at fair value, per FASB Statement No. 141?

b. What valuation methodology was used to determine the fair value?

Response to PSC-029:

a. EWM originally recorded the pipeline at its purchase price of $75,000 in March 2016 and in July 2017 corrected the entry to record the original cost of the installing utility (SME) of $4,905,867 less accumulated depreciation from the date of installation to the time of purchase by EWM of $735,882 less the negative acquisition adjustment of $4,094,985.

FASB Statement No. 141 (now ASC-805) was not used to value the pipeline. ASC-805 applies to business combinations and not the purchase of assets. See excerpt from ASC 805-10-25-1, below. The SME pipeline does not quality as a business. See definition of business in second paragraph.

ASC 805-10-25-1
An entity shall determine whether a transaction or other event is a business combination by applying the definition in this Subtopic, which requires that the assets acquired and liabilities assumed constitute a business. If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition.

Business
An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants.

b. The SME pipeline was recorded at the original cost of the utility that installed the pipeline as set forth in the FERC system of accounts. See Mr. Henthorne's testimony at page 10, line 7 to page 12, line 22.

PSC-030: RE: SME Pipeline
Witness: Jed D. Henthorne

Regarding the original sale of the pipeline to SME, what factors were considered in agreeing on a $5 million sales price?

Response to PSC-030:

The SME pipeline was not sold by EWM to SME. SME hired EWM to construct the pipeline for SME. The total cost of the pipe and installation was $4,905,867. See response to PSC-017.

PSC-031: RE: Financing Sources
Witness: Gregory E. Scheig

a. Pursuant to the acquisition of GNI by F.R. Bison Holdings, Inc. (First Reserve Corporation) (Docket D2016.11.91), please explain the process by which the joint applicants now receive equity financing.

b. Please explain the process by which the joint applicants now receive debt financing.

Response to PSC-031:

a. The primary source of equity financing for Energy West Montana and Cut Bank Gas is retained earnings. GNI can request equity capital from FR Bison Holdings, Inc., and such requests will be considered by FR Bison Holdings based on the business case presented by GNI.

b. The current debt financing for EWM and CBG was approved by the Commission in Docket No. D2016.2.17. Pursuant to the ring-fencing provisions approved in that proceeding, any future changes to EWM's and CBG's debt financing must be approved by the Commission. GNI, EWM, and CBG do not expect any additional capital from FR Bison Holdings in the form of debt or debt-like instruments.

Sponsor: Henthorne

PSC-032: RE: Small Stock Risk Premium
Witness: Gregory E. Scheig

In reference to the *Size Premia Study* by Duff & Phelps, if the market capitalization of BlackRock, Inc., the indirect "owner" of the joint applicants, and the level at which the public can indirectly purchase stock in the joint applicants is not the appropriate amount to use in the determination of the Small Stock Risk Premium (SSRP), please provide your reasoning for using a market capitalization of less than $263 million in your determination of the SSRP.

Objection:

Energy West Montana and Cut Bank Gas object to this request on the grounds that it misstates and misrepresents the relationship between EWM, CBG, and BlackRock. As explained in Docket No. D2016.11.91, BlackRock owns no more than a 0.2% indirect partnership interest in the private equity fund that now owns FR Bison Holdings, Inc., the indirect upstream parent company of EWM and CBG. See the Supplemental Testimony of Ryan Shockley in Docket No. D2016.11.91.

Response to PSC-032:

The small stock risk premium is for EWM and CBG, not for BlackRock. If BlackRock were to hypothetically to sell the utilities to new owners, it would not change the underlying risk and rate of return required for the two regulated entities, EWM and CBG.

PSC-033: RE: Small Stock Risk Premium
Witness: Gregory E. Scheig

Throughout your testimony you cite the Duff & Phelps 2017 Valuation Handbook. Please provide copies of the pages from that Handbook. Please be sure to include the page with the table summarizing the inverse relationship between market capitalization and the amount of the SSRP, as sown on page 33 of your testimony.

Response to PSC-033:

See Attachment PSC-033.

PSC-034: RE: Small Stock Risk Premium
Witness: Gregory E. Scheig

Please illustrate how you arrived at a 1.25% SSRP. Specifically, how do the various results from the analyses you perform on pages 32 – 36 of your testimony arrive at the 1.25%?

Response to PSC-034:

The average SSRP of the guideline companies selected was 1.13%. Although these companies are significantly larger than EWM and CBG, they do reflect one indicator of a “market” small stock premium, at least for the group of companies selected.

EWM and CBG are much smaller than the guideline companies and therefore would require a higher SSRP as indicated by the 10th Decile of 5.59%, but I believe that some of that SSRP is offset by EWM and CBG being a regulated. Also, the private equity and Chicago Booth Studies indicated SSRPs of 3% - 5% are for non-utility companies.

Based on the information I reviewed and my experience and judgment, I selected 1.25% as a minimum SSRP for EWM and CBG.

PSC-035: RE: SAP Software
Witness: Jed D. Henthorne

Since a sale-leaseback is essentially a financing arrangement, is the interest rate stated in the lease agreement factored into the embedded cost of debt used in calculating the proposed weighted average cost of capital (rate of return)?

Response to PSC-035:

No. As stated in Mr. Henthorne's testimony at page 9, lines 6-14, the amount of the capital lease obligation was included as a reduction to rate base as customer contributed capital.

PSC-036: RE: SME Pipeline
Witness: Jed D. Henthorne

a. Per FASB Statement No. 141, in a bargain purchase agreement (such as a purchase in bankruptcy), the acquirer is required to recognize a gain equal to the difference between the fair value of the asset acquired and the consideration paid. Please provide the book/GAAP accounting entries related to the bargain purchase.

b. Additionally please describe how this transaction was treated for tax purposes.

c. Was EWM's tax expense (liability) increased as a result of recording a gain? If so, what was the amount of the increased tax expense? Also, was this "one time" increased expense accounted for in your normalizing adjustments?

Response to PSC-036:

a. Please see response to PSC-029(a). FASB Statement No. 141 (now ASC-805) applies only to business combinations and the SME pipeline does not meet the definition of a business. The purchase of the SME pipeline was treated as an asset purchase. The accounting entries are presented on page 2 of Exhibit JDH-EWM-5 of Mr. Henthorne's testimony. A bargain purchase or related gain was not recorded.

b. The pipeline was added to depreciable assets for tax purposes at a cost of $75,000 with an annual tax depreciation deduction on the $75,000.

c. No gain was recorded. Please see response to PSC-036(a) and (b).

PSC-037: RE: SME Pipeline
Witness: Kevin J. Degenstein

Prior to receiving the opportunity to acquire the SME pipeline as a "bargain purchase," did EWM have other plans to expand their system capabilities to serve a larger customer base and provide another source of uninterruptible service to existing customers? If so, please describe these plans and provide supporting documentation.

Response to PSC-037:

See response to PSC-025. Also see Attachment PSC-037 for uprate information.

PSC-038: RE: SME Pipeline
Witness: Kevin J. Degenstein

Would EWM have purchased the pipeline without the “bargain purchase” opportunity provided through SME’s bankruptcy?

Response to PSC-038:

Yes, depending on the terms of the hypothetical sale. After completion, the SME pipeline functioned as a critical part of the EWM distribution system and it is currently functioning as a critical part of the EWM distribution system today.

PSC-039: RE: Cost of Debt
Witness: Jed D. Henthorne

a. Exhibits JDH-EWM-2 represents that the amount of debt used in calculating the capital structure for EWM for the test period was $7,579,000 and the cost of that debt (the "return") was 4.66%. JDH-EWM-9 identifies the $7,579,000 as a "note payable, less current portion." In Docket D2016.2.17, a copy of the intercompany note-term debt (signed October 19, 2016) was provided to the Montana Public Service Commission. This document, which was signed by representatives from GNI & EWM, identifies a note payable in the amount of $7,579,000 at an annual interest rate of 4.23%. Since this agreement appears to be the amount represented as debt in Exhibit JDH-EWM-2, and the "note payable, less current portion" in Exhibit JDH-EWM-9. Please explain the difference between the cost of debt as identified in the signed agreement of 4.23% and the return on debt of 4.66% requested in JDH-EWM-2?

b. Exhibit JDH-CBG-2 represents that the amount of debt used in calculating the capital structure for EWM for the test period was $550,000 and the cost of that debt (the "return") was 4.31%. JDH-CGB-6 identifies the $550,000 as a "note payable, less current portion." In Docket D2016.2.17, a copy of the intercompany note-term debt (signed October 19, 2016) was provided to the Montana Public Service Commission. This document, which was signed by representatives from GNI & EWM, identifies a note payable in the amount of $550,000 at an annual interest rate of 4.23%. Since this agreement appears to be the amount represented as debt in Exhibit JDH-CBG-2, and the "note payable, less current portion" in Exhibit JDH-CBG-6. Please explain the difference between the cost of debt as identified in the signed agreement of 4.23% and the return on debt of 4.31% requested in JDH-CBG-2?

Response to PSC-039:

a. The 4.23% identified in the signed intercompany agreement is the interest rate of the long-term note. The 4.66% includes the interest rate as well as the amortization of debt issue costs and the amortization of debt reacquisition costs associated with the long-term note. Please refer to Attachment PSC-039 for details.

b. The 4.23% identified in the signed intercompany agreement is the interest rate of the long-term note. The 4.31% includes the interest rate as well as the amortization of debt issue costs associated with the long-term note. Please refer to Attachment PSC-039 for details.

PSC-040: RE: SAP Software
Witness: Jed D. Henthorne

a. Can you please further explain the rationale behind the determination of a loss on the sales-leaseback transaction? Specifically, why does the contribution of cash by GNI beyond the amounts received from Verilease automatically equate to a loss?

b. Please provide the total amount paid to SAP for the software, the amount financed through Verilease, the sale price of the software was "sold" to Verilease, and the amount paid to Verilease for lease-back of the system.

c. Please provide a summary of the accounting entries (both for regulatory purposes and GAAP purposed) related to the purchase of the SAP software as well as the sales-leaseback transaction.

Response to PSC-040:

a. When assessing the GAAP rules in relation to sales-leaseback transactions, we determined that the fair market value of the ERP software asset is the total capitalized cost of the asset, both financed and paid for directly by GNI. The sale-leaseback transaction with Verilease recorded the sale at the present value of the total leased amount, which did not include the amounts paid by GNI, thereby creating a loss for the difference of the fair market value of the asset and the sale price to Verilease. The accounting codifications ASC-840-40-25-3 and ASC-840-25-5 are excerpted below. For ASC-840-40-25-3, none of the conditions a. - c. apply to this transaction. Therefore, in accordance with 840-40-25-3, the loss on the sale was deferred, and in accordance with 840-40-25-5, that deferred loss was recorded as prepaid rent.

840-40-25-3 Any profit or loss on the sale shall be deferred, unless any of the following conditions exist:

a. The seller-lessee relinquishes the right to substantially all of the remaining use of the property sold retaining only a minor portion of such use. In that circumstance, the sale and the leaseback shall be accounted for as separate transactions based on their respective terms. However, if the amount of rentals called for by the lease is unreasonable under market conditions at lease inception, an appropriate amount shall be deferred or accrued by adjusting the profit or loss on the sale to adjust those rentals to a reasonable amount.

b. The seller-lessee retains more than a minor part but less than substantially all of the use of the property through the leaseback and realizes a profit on the sale in excess of whichever of the following two amounts applies:

1. If the leaseback is classified as an operating lease, the present value of the minimum lease payments over the lease term, computed using the interest rate that would be used to apply the minimum-lease-payments criterion in paragraph 840-10-25-1(d) :

2. If the leaseback is classified as a capital lease, the recorded amount of the leased asset.

In that circumstance, the profit on the sale in excess shall be recognized at the date of the sale.

c. The fair value of the property at the time of the transaction is less than its undepreciated cost, in which circumstance a loss shall be recognized immediately.

840-40-25-5 If the fair value of the asset sold is more than its carrying amount, any indicated loss on the sale is probably in substance a prepayment of rent, and thus, the entity shall defer that indicated loss as prepaid rent.

b. The total amount paid for the ERP system was $14,500,918, of which $10,091,490 was financed through Verilease. The remaining $4,409,428 was paid by GNI. $3,155,617 of this occurred simultaneous to the financing schedules with Verilease and was thus recorded as deferred loss as discussed in response to subpart (a). The other $1,253,811 were improvements to the system paid for by GNI after the system had been fully implemented and the sales-leaseback transaction with Verilease had occurred. The asset was sold to Verilease for $10,091,490. Through December 31, 2016, GNI has paid $5,164,655 for lease-back of the asset from Verilease.

c. Below is a summary of the transaction recorded related to the sales-leaseback of the SAP Asset:

	Debits	Credits
Construction of the Software		
Amounts paid by GNI		
CWIP	$ 3,155,617	
AP		3,155,617
Amounts paid by Verilease		
CWIP	10,091,490	
Build to Suit Payable		10,091,490
Sale of Asset to Verilease		
Build to Suit Payable	10,091,490	
Deferred Rent	3,155,617	
CWIP		13,247,107
Lease-Back of the Asset From Verilease	9,193,408	
Capital Lease Asset - @ Present Value		
Capital Lease Liability - @ Present Value		9,193,408
Improvements to the Software		
Amounts paid by GNI		
CWIP	1,253,811	
AP		1,253,811

PSC-041: RE: SAP Software
Witness: Jed D. Henthorne

Please explain the reason for three separate lease schedules related to the master lease transaction.

Response to PSC-041:

The master lease specifies that the base term of a lease schedule does not begin until the first day of the calendar quarter following the installation date. Payments on the lease begin when the base term begins, and prior to the base term, a daily pro rata rental fee was charged. Gas Natural chose to have three separate lease schedules in order to minimize the rent paid under the daily pro rata rental fee by closing each schedule and beginning to make base term payments on the closed schedules while continuing configuration on the SAP software using another schedule under construction.

PSC-042: RE: SAP Software
Witness: Jed D. Henthorne

Since 2016 is the test year for this application, why does the accounting order request that the unamortized portion of this prepaid asset at January 1, 2016, be included in rate base as opposed to the average of the December 31, 2016 balance & expected balance at December 31, 2017?

Response to PSC-042:

For our accounting order request, we used the average of 2015 and 2016 for the SAP deferred rent asset so as to allow for consistent accounting treatment and presentation with all our rate base assets and liabilities. All items included in Exhibit JDH-EWM-3 and JDH-CBG-3 are presented on an average basis of 2015 to 2016, aside from working capital cash requirement, which is an average of 2016 and normalized 2016. The additions to plant that adjust for known projects completed within one year of the test year are represented as an average of 2015 and 2017 balances.

PSC-043: RE: Financial Reporting
Witness: Appropriate

Please provide the 2014 – 2016 the EWM and CBGC Annual Reports to Shareholders and the SEC Form 10Ks for EWM and CBGC. If GNI information will be provided instead, please use the GNI shareholder and SEC reports.

Response to PSC-043:

In the period requested, EWM and CBG were not publicly traded companies and therefore there are no Annual Reports to Shareholders or SEC Form 10Ks. The GNI shareholder reports for 2014 – 2016 were the filed 10Ks with a printed colored wrapper. Those SEC Form 10Ks are provided as Attachments PSC-043 – 2014, PSC-043 – 2015, and PSC-043 – 2016.

CERTIFICATE OF SERVICE

I certify that on this, the 6th day of December, 2017, **ENERGY WEST MONTANA'S AND CUT BANK GAS COMPANY'S RESPONSES TO DATA REQUESTS PSC-025 THROUGH PSC-043** was e-filed with the Commission and served via U.S. mail and e-mail, unless otherwise noted, to the following:

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