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-044 THROUGH PSC-059

Energy West Montana ("EWM") and Cut Bank Gas Company ("CBGC") provide the attached responses to the Montana Public Service Commission's Data Requests PSC-044 through PSC-059.

Respectfully submitted this 15th day of December, 2017.

s/ *Nikolas S. Stoffel*
Nikolas S. Stoffel, #13485
Thorvald A. Nelson, #8666
Holland & Hart LLP
6380 South Fiddlers Green Circle, Suite 500
Greenwood Village, CO 80111
Telephone: (303) 290-1601, 1626, respectively
nsstoffel@hollandhart.com
tnelson@hollandhart.com

COUNSEL FOR ENERGY WEST MONTANA, INC. AND CUT BANK GAS COMPANY

DATA REQUESTS

PSC-044: RE: Acquisition Fees
Witness: Applicable

Please confirm EWM or CBGC are in no way seeking any merger related costs from Docket D2016.11.91 in this rate filing.

Response to PSC-044:

Confirmed.

Sponsor: Jed Henthorne

PSC-045: RE: SAP Asset
Witness: Henthorne or Applicable

a. What is the embedded financing rate in the sale leaseback of the SAP asset?

b. Please provide the terms of the Verilease agreement with GNI.

c. Does the sale leaseback increase the Company's leverage in any way? Please explain why or why not.

d. What are the tax consequences of the sale lease back and how are those savings passed onto the rate payers?

Response to PSC-045:

a. The financing rate embedded in the original terms of Schedule 01 was 4.67%.

b. There are three schedules to the Varilease master lease, the material terms of which are listed below:

Schedule	Amount Funded	Initial Term	Monthly Payment Amount	Base Term Commencement Date	Base Term End Date
1	$5.0 million	36 months	$134,017.22	1/1/15	12/31/17
2	$3.8 million	36 months	$101,845.95	11/1/15	10/31/18
3	$1.8 million	30 months	$ 58,044.30	4/1/16	9/30/18
Total	$10.6 million		$293,907.47		

There are three options at the end of each Schedule's base term:

(i) Purchase the underlying assets (consisting of software and installation costs) for a price agreed to by Varilease and GNI and end the schedule's lease term. The language specifies that the parties have "absolute and sole discretion regarding… agreement to the purchase price."

(ii) Extend the lease for each schedule for an additional year at the same monthly payment (with six-month renewals after that until terminated).

(iii) Pay a termination fee equal to one year of payments and return the assets to Varilease (Varilease is then required to sell the assets and remit the proceeds to Gas Natural).

c. Yes, the sale leaseback increases GNI's leverage. On GNI's balance sheet, the lease is classified as a capital lease. Capital leases are included in debt in GNI's bank debt covenant calculation of debt to equity.

However, the capital lease is associated with the SAP asset and the lease terminates in 2018, making it short term.

d. A sale-leaseback is generally the sale of an asset to a purchaser who immediately leases the property back to the seller. A sale-leaseback may also provide some tax benefits for the seller/lessee. Whereas the seller/lessee would have received depreciation expense for tax purposes when it owned the asset, it will receive a full deduction for the amount of rental payments made in the year as a direct expense. The IRS often characterizes the sale-leaseback transaction as a financing transaction, rather than a true sale-leaseback. If the sale-leaseback involves an option to repurchase, the IRS is even more likely to classify it as a financing transaction rather than a true sale-leaseback.

Therefore, for income tax purposes, the SAP sale-leaseback transaction has been characterized as a financing transaction, rather than a true sale-leaseback. Such a characterization means that EWM and CBGC are deemed to own the asset for income tax purposes and, therefore, depreciate the asset. Additionally, only the interest portion of the rental payments is being deducted for income tax.

Depreciation of the SAP asset on EWM's and CBGC's books is subject to the normalization requirements. It is normalized in the same way as depreciation of all other depreciable plant assets.

PSC-046: RE: SAP Asset
Witness: Henthorne or Applicable

a. Please provide the analysis and work papers performed to develop the market value of the SAP asset. If none are available, please explain why?

b. Does the SAP software contain a residual value guarantee and if so what is that amount?

Response to PSC-046:

a. Please see response to PSC-040 for the analysis explaining that the best indicator of fair value in the sale-leaseback situation is the total capitalized cost of the asset. Please see Attachment PSC-046 which shows the build of the cost of the SAP asset.

b. No, the lease does not contain a residual value guarantee.

PSC-047: RE: SAP Asset
Witness: Henthorne

On page 9 of your Direct Testimony, you state EWM is open to presenting the capital lease obligation in alternative ways. As an alternative would the Company consider eliminating any request for an accounting order and place the SAP asset into rate base and use the embedded interest rate of the lease agreement in the cost of capital calculation?

Response to PSC-047:

The rate base presented in our application includes the leased SAP asset and includes the capital lease obligation as an offset. EWM considered including the lease obligation in the cost of capital calculation, but did not for two reasons:

1. The capital lease obligation is related to a specific asset (SAP) and the embedded cost is not really related to the overall cost of capital.

2. The capital lease obligation expires in the fall of 2018 which is less than one year away, making it short term in nature and therefore not includable in the cost of capital calculation.

PSC-048: RE: SAP Asset
Witness: Henthorne

a. What other types of training does EWM include as a regulatory asset (as referenced on page 15 of Mr. Henthorn's testimony)? For example, is training for the Company's linemen included as a regulatory asset?

b. If the Company does not include other types of training for its employees, please explain why the SAP training would be considered different.

Response to PSC-048:

a. As specified in gas plant instruction 19 in the FERC System of Accounts, training costs can be included as part of the asset being constructed when related to and part of the construction of a specific project (in this case the SAP project). GAAP accounting rule SOP 98-1 requires that these costs be expensed, so we are asking for an accounting order to treat these costs as a regulatory asset. Ongoing training costs are not included as a regulatory asset.

b. See response to subpart (a).

PSC-049: RE: SAP Asset
Witness: Henthorne

a. How was the time frame for the accounting order derived?

b. How would the SAP asset be affected if an accounting order is not granted?

Response to PSC-049:

a. The 10-year time frame for the accounting order was requested to allow the regulatory asset amortization to match the useful life of the SAP asset.

b. If the accounting order is not granted, the deferred rent asset would not be added to rate base and the actual 2016 test year amortization of the deferred rent asset should be added back into general O&M expenses.

PSC-050: RE: Payroll
Witness: Henthorne

a. How many Company officers have been added to EWM and CBGC as of today's date, and how many are still employees? Please list names and positions held and for how long.

b. Of the increase in payroll, what amount is allocated to each Company officer?

c. Please provide a worksheet showing the allocation of Company officer salaries by name, including the positions each officer holds in other entities and the allocation amount of their salary to each entity.

Response to PSC-050:

a. Currently, EWM and CBGC each have four officers as listed below:

President and General Manager – Jed Henthorne
Vice President – Kevin Degenstein
Secretary – Cheryl Johnson
Assistant Secretary – George M. Behrens

Nick Bohr was General Manager of EWM and CBGC through March of 2017. In July 2016, Jed Henthorne took over as President and transitioned to the dual role of President and General Manager when Mr. Bohr left in March 2017. In September 2017, Mr. Henthorne took the role of VP Finance and Administration for GNI. Mr. Henthorne is filling the role of President and General Manager for EWM and CBGC until replaced. Currently, Mr. Henthorne's salary is paid by EWM, but it will be paid by GNI in 2018. The normalized test year includes the salary of a President and General Manager at $142,354.

Cheryl Johnson transitioned back to EWM from GNI in 2016 as coordinator of corporate services. Kevin Degenstein and George Behrens are also GNI officers. Please reference Attachment PSC-050.

b. As detailed in column I of Attachment PSC-050, the normalized payroll related to EWM and CBGC officers increased from actual 2016 by $20,633.

c. Please see Attachment PSC-050.

PSC-051: RE: Advances for Construction
Witness: Henthorne

Please confirm EWM and CBGC are not seeking a return on the customer advances that were converted to contributions in aid of capital. If so, please explain why.

Response to PSC-051:

Confirmed. The adjustment on line 20, column (B) of Exhibit JDH-EWM-3 removes $99,542 from customer advances for construction and adds it to contributions in aid of construction, which is a reduction to rate base included on line 1.

PSC-052: RE: Rate Case Expense
Witness: Henthorne

a. On pages 14 and 15 of Mr. Henthorne's testimony, he states EWM is asking to include the average balance of the regulatory asset in rate base. What asset is Mr. Henthorne referring to? Please answer this data request as it relates to CBGC as well.

b. If Mr. Henthorne is referring to the cost of the rate case, please explain why the cost of the rate case would be in rate base. Please answer this data request as it relates to CBGC as well.

Response to PSC-052:

a. The reference is to the cost of the rate case for both EWM and CBGC.

b. EWM and CBGC are asking to earn a return on the rate case costs while they are being amortized away, which is why those costs were included in rate base.

PSC-053: RE: Page 17 of 45
Witness: Henthorne

Please clarify what Mr. Henthorne means with the term "properly" on page 17, lines 16-17 of Mr. Henthorne's Testimony.

Response to PSC-053:

In accordance with the matching principle of GAAP accounting rules, an expense on the income statement should be reported in the same period as the related revenues. In 2016, there was an accounting adjustment to correct gas cost expenses for prior years. It was recorded in 2016 because it was not material to the overall financial statements and did not require a restatement of prior years. When looking at the income statement of 2016 as a test year, these expenses are not properly included as they do not match with the 2016 revenue, so they were adjusted out during the normalization process.

PSC-054: RE: Operating and Maintenance Expenses
Witness: Henthorne

Regarding Exhibit JDH-EWM-9 and the correlating CBGC exhibit, please detail the property that is insured. Please include the total policy premium and how that premium is allocated to all other properties and service areas on the policy.

Response to PSC-054:

Gas Natural, Inc., the ultimate parent of EWM and CBGC, procures property, liability, umbrella liability, directors, and officers and workers compensation insurance for all of its subsidiaries. EWM and CBGC insure vehicles, equipment, and physical property. EWM and CBGC do not insure the cost of replacing their distribution pipelines. However, the distribution pipelines are covered under the liability and umbrella liability policies.

The premium for each type of insurance is allocated to each subsidiary on same basis on which the total premium is calculated. Please see Attachment PSC-054, which details the different pieces of the insurance policy and associated premium. The "GNI Total" tab details the total premium split by GNI subsidiary. The "Montana Split" tab further splits the Montana portion. The total for EWM is $220,211 and the total for CBGC is $27,578. The total for each EWM district and the split between FERC accounts 924 and 925 is shown on the bottom of the "Montana Split" tab.

PSC-055: RE: Operating and Maintenance Expenses
Witness: Henthorne

Regarding Exhibit Great Falls, JDH-EWM-9, page 8 of 8. Explain the reclassification under account 912 to the account 903.

Response to PSC-055:

While reviewing the general ledger transactions in preparation of the rate case files, EWM noted that the items coded to account 912, Demonstrating and Selling Expenses, would be more accurately coded to 903, Customer Records and Collection Expenses. The items noted were internet charges and office supplies allocated to EWM's customer service department, where employees deal with customer billing, collections, contracts, etc. and do not engage in selling or promotional activities.

PSC-056: RE: Operating and Maintenance Expenses
Witness: Henthorne

Regarding Exhibit JDH-EWM-9, please detail the injuries' and damages' expenses for all service areas. Please answer this data request as it relates to CBGC as well.

Response to PSC-056:

Please see response to PSC-054. The premium for property insurance is contained in FERC account 924 property and liability insurance. Account 925, injuries and damages contains the premiums for all other insurance, including liability and excess liability. Attachment PSC-054 shows the split at the bottom of the "Montana Split" tab.

PSC-057: RE: Operating and Maintenance Expenses
Witness: Henthorne

Regarding Exhibit JDH-EWM-9, please detail the inputs into the Outside Services Employed adjustment of $476,918.

Response to PSC-057:

Referencing page 4, of Rule No. 38.5.160 of Exhibit JDH-EWM-9 is an adjustment of ($836,607) on line 8 and a further adjustment of ($628,388) on line 16. These are further detailed in Note (5) Normalize Outside Services Employed on page 12 (PDF page 264). The total adjustment to outside services is ($1,464,995) from line 40. The total of the adjustments on lines 25, 26, and 27 related to directors, shareholder relations and SEC costs total to the amount of ($628,388) (($240,000) + ($222,000) + ($36,000) + ($21,782) + ($89,806) + ($18,800) = ($628,388)). Subtracting ($628,388) from the total of ($1,464,995) yields the adjustment to outside services employed of ($836,607).

On page 5 of Rule No. 38.5.160 is a further adjustment on line 8 of $1,313,525. This is simply a reclassification of amounts from lines 15 and 16 that should be included in outside services employed. The net of ($836,607) and $1,313,525 is the total adjustment to outside services of $476,918.

PSC-058: RE: PSC/MCC Tax
Witness: Henthorne

Please explain the benefit to rate payers of collecting the PSC/MCC as a separate component from the Company's tariffs.

Response to PSC-058:

When the PSC/MCC charges are in the distribution rate, the amount is fixed at the test year's rates until the next rate case and does not allow for any true ups or changes when the updated rates are released each year. With separate rates, it allows the ratepayers to pay the most current rate charged by the PSC/MCC each year, whether an increase or a decrease from prior years. These annual changes would require tariff filings from EWM and CBGC, which would provide the Commission and interested parties the opportunity to review the change in PSC & MCC taxes. Collecting the PSC/MCC tax as a separate component in the Company's tariffs also provides ratepayers the benefit of transparency regarding the amount of PSC & MCC taxes being recovered annually.

PSC-059: RE: SME Pipeline
Witness: Henthorne

Have any other states allowed the SME pipeline asset to be treated as EWM is pondering in this filing? If so, please provide examples.

Response to PSC-059:

Although the SME pipeline asset is specific to EWM and Montana, other states have allowed similar treatment for utility assets acquired at a discount to their net book value. For example:

- In Docket No. 2013-0131, Order No. 32519, the Hawaii Public Utilities Commission ("HPUC") approved the sale and transfer of assets of Puhi Sewer & Water Co., Inc. to Aqua Puhi, LLC. In that proceeding, the net book value ("NBV") of Puhi's capital assets was approximately $4.9 million, so the purchase price of $2.7 million resulted in an "acquisition discount" of $2.2 million. The Consumer Advocate argued that the discount was a windfall to Aqua in that it will have paid $2.7 million for the capital assets yet may seek cost recovery for the full $4.9 million net book value from ratepayers. While the Consumer Advocate recognized that the HPUC "has consistently ruled that when there is an acquisition discount, the acquiring entity is not required to reduce the NBV of the assets to reflect the purchase price," it also contended that the issue of an acquisition discount should be revisited given the "significant windfall" for Aqua.

  In response, the HPUC reviewed its precedent and recognized that it had consistently ruled that the "NBV need not be reduced to reflect the lower purchase price of the utility assets." The HPUC recognized "it is inequitable to apply an acquisition discount given the fact that the converse situation (i.e. application for acquisition premiums) has consistently been disallowed." The HPUC found nothing in the record that would warrant a deviation from its previous rulings on this matter. Thus, given the previously established treatment of acquisition discounts in similar dockets, the HPUC found that the acquisition discount would not be applied to reduce the NBV.

- In Maine Public Utilities Commission ("MPUC") Docket No. 2012-00598, September 8, 2014 Order, Bangor Gas Company, L.L.C. ("Bangor Gas") submitted a Request for Approval of Renewal of Multi-Year Plan. In that proceeding, Bangor Gas was a subsidiary of Energy West, Inc. ("EWI"). Much of Bangor Gas's transmission and distribution system was installed by Bangor Gas's former owner, Sempra Energy LLC ("Sempra"), which sold Bangor Gas to EWI in 2007. Under Sempra's ownership, Bangor Gas invested significant resources into is distribution system, but did not recover sufficient revenue to support the system. Accordingly, prior to the sale of Bangor Gas to EWI, Bangor Gas wrote down the book value of all its assets to zero in 2006. During the proceeding, Bangor Gas argued that a cost-of-service analysis should incorporate the 2012 year-end rate base on an original cost less depreciation basis. Bangor Gas argued that the Commission should not use Bangor Gas's 2006 rate base impairment write-down or the actual sale terms of Bangor Gas to EWI to determine rate base value. Intervenors, the Office of the Public Advocate ("OPA") and Verso Paper LLC ("Verso") disagreed. They argued that "starting point rates must be set in accordance with a cost of service analysis and that it would be improper to use any value other than the impaired asset balance to determine rate base."

The MPUC "considered whether to use a depreciated original cost or an impaired rate base value and decide to reject the use of impaired assert cost basis . . . or an acquisition adjustment to establish a rate base value." In making its decision, the MPUC found "no evidence of impairment in the functional use or revenue producing ability of Bangor Gas's facilities today" and "[t]he fact that the facilities are used and useful to provide utility service informs our judgment regarding the appropriate value to set for rate base. We conclude that the use of the impaired rate base value in rate setting calculations would fail to reflect the true service value of utility assets." The MPUC based its decision on significant MPUC precedent on this subject.

- In Gas Utilities Docket No. 9731, Final Order, the Railroad Commission of Texas ("RRC") approved Hughes Natural Gas Inc.'s ("Hughes") Statement of Intent to increase rates. In that case, Hughes had previously acquired the City of Magnolia's gas distribution system for $234,753 less than net book value. However, Hughes made no acquisition adjustment to its cost of service. The RRC found that "Hughes' cost of service, which is based on the original cost of the system assets used and useful in providing service to the public less accumulated depreciation, is reasonable."

These orders are being provided as Attachments PSC-059 – Hawaii, PSC-059 – Maine, and PSC-059 – Texas.

CERTIFICATE OF SERVICE

I certify that on this, the 15th day of December, 2017, **ENERGY WEST MONTANA'S AND CUT BANK GAS COMPANY'S RESPONSES TO DATA REQUESTS PSC-044 THROUGH PSC-059** was e-filed with the Commission and served via U.S. mail and e-mail, unless otherwise noted, to the following:

Will Rosquist
Montana PSC
1701 Prospect Avenue
PO Box 202601
Helena, MT 59620-2601
wrosquist@mt.gov
via UPS Overnight Mail for delivery 12-18-17

Robert Nelson
Jason Brown
Montana Consumer Counsel
111 N. Last Chance Gulch
Suite 1B, P.O. Box 201703
Helena, MT 59601
robnelson@mt.gov
jbrown4@mt.gov

Jed Henthorne
President and General Manager
Energy West Montana, Inc.
Cut Bank Gas Company
PO Box 2229
Great Falls, MT 59403-2229
jhenthorne@egas.net

Thorvald A. Nelson
Nikolas S. Stoffel
Holland & Hart, LLP
6380 South Fiddler's Green Circle
Suite 500
Greenwood Village, CO 80111
tnelson@hollandhart.com
nsstoffel@hollandhart.com

Kevin Degenstein
Chief Operating Officer
Chief Compliance Officer
Gas Natural Inc.
PO Box 2229
Great Falls, MT 59403-2229
kdegenstein@egas.net

For electronic service only:
aclee@hollandhart.com
ppenn@hollandhart.com
ssnow@mt.gov

s/ Adele C. Lee

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