Service Date: May 30, 1979

FINDINGS AND FINAL ORDER NO. 4476a

DEPARTMENT OF PUBLIC SERVICE REGULATION
MONTANA PUBLIC SERVICE COMMISSION

IN the Matter of the Application of Montana-Dakota Utilities Inc., for authority to establish increased rates for gas service and to establish a new gas cost tracking procedure.	DOCKET NO. 6636 ORDER NO. 4476a

APPEARANCES

For the Applicant:

Lester Loble, II, Attorney at Law, 833 North Last Chance Gulch, Box 176, Helena, Montana 59601

For the Protestants:

Geoffrey L. Brazier, Attorney at Law, Montana Consumer Counsel, 34 West Sixth Avenue, Helena, Montana 59601
C. W. Leaphart, Attorney at Law, Great Western Sugar Company, 1 Last Chance Gulch, Helena, Montana 59601

Jerome Anderson, Attorney at Law, Lovell Clay Products Company, Pierce Packing Company, Midland Packing Company and Midland Foods, 404 North 31st Street, Billings, Montana 59101

For the Staff:
Robert F. W. Smith, Attorney
Dan Elliott, C.P.A.

Before:
GORDON E. BOLLINGER, Chairman
CLYDE JARVIS, Commissioner
THOMAS J. SCHNEIDER, Commissioner
JAMES R. SHEA, Commissioner
GEORGE TURMAN, Commissioner

FINDINGS OF FACT

1. Montana-Dakota Utilities, Inc. (MDU or Applicant) is a public utility furnishing electric and gas service to consumers in the State of Montana.

2. Applicant's petition, filed December 5, 1978, requests this Commission's approval of an increase in rates for natural gas service of $6,124,000 on an annual basis. The increase requested was based on estimated sales volumes for December, 1978, January and February, 1979; and priced at the December 1st rate. Produced and storage gas were factored out on the basis of their annual contribution to the sales mix.

3. The Commission has determined in prior cases that a hearing confined to the single issue of the cost of purchased gas is appropriate. A responsible regulatory procedure is necessary to timely handle gas tracking applications resulting from: (1) the changing mix and volumes of the natural gas supply; and (2) the pricing provisions of the Natural Gas Policy Act of 1978 which became effective on December 1, 1978.

4. The Montana Consumer Counsel (MCC) has participated in this docket on behalf of utility consumers since the inception of these proceedings.

5. Protestants Great Western Sugar, Lovell Clay Products Company, Midland Foods, Inc., and Pierce Packing Company, were admitted as intervenors in Docket No. 6636 on February 27, 1979.

6. The Montana Public Service Commission on December 8, 1978, solicited written comments from the MCC concerning the requested

increase. His comments were received by the Commission on December 18, 1978. The MCC did not object to an interim increase of 23.76324 per Mcf at 14.73 psia
(21.85604 per Mcf at residential and commercial sales pressures) providing the following conditions were met:

a. The base cost of purchased gas included in the final order in Docket No. 6567 was 90.02584 per Mcf.

b. The federal income tax rate used in the final order in Docket No. 6567 was to be 46 percent.

c. In the event that during the period the interim rates are in effect, the average cost of purchased and storage gas is less than 113.78904 per Mcf. MDU be ordered to pass back to its consumers the excess collected above such lower average cost.

d. Future tracking increases be based on historic costs and volumes.

The amount the MCC conceded was computed using estimated sales volumes for December, 1978, January and February, 1979; and priced at the December 1st rate. Storage gas for the quarter was also estimated and the net estimated withdrawal factored in

7. The Applicant was granted a temporary rate increase based on amounts conceded by the MCC on December 21, 1978. The rates became effective January 3, 1979.

8. A notice of public hearing was given on February 2, 1979.

9. On February 26, 1979, the Applicant filed additional testimony

advocating a deferred gas cost accounting approach for use in future tracking proceedings.

10. On March 2, 1979 at 10:00 a.m. pursuant to the notice, a hearing was held at the Commission's offices in Helena to receive evidence and allow cross-examination.

11. Upon questioning of MDU witnesses, it became clear that certain information was not available until a later time, and that intervenors had not had sufficient time to study MDU witness Donald R. Ball's proposal for deferred gas cost accounting, thus the hearing was premature. To remedy these problems, the Commission decided to hold an additional hearing.

12. Notice of the second hearing in this docket was given April 13, 1979.

13. Briefs and reply briefs were received in March and April, 1979.

14. The second hearing in this docket was held May 10, 1979 at 10:00 a.m. at the Commission's offices in Helena to take evidence and allow cross-examination.

15. Evidence was presented by MDU's Assistant Treasurer, C. Lowell Gamble, that actual volumes and prices for gas sold in December, 1978, January and February, 1979 had become known, and were presented in late filed Exhibit No. 8. The method used in calculating the unit rate of $1.2501769 is the same as that used by the Commission in granting the temporary rate increase, and

conceded to by the MCC.

16. MDU witness John T. Kasper presented testimony on producer filings for certification under the Natural Gas Policy Act (NGPA) of 1978. This includes all filings before Federal and State authorities contemplated by the NGPA. These filings have a significant effect on the price MDU pays to producers of natural gas. Upon questioning it became clear that the final status of these filings is not yet determinable. J.A. Schuchart's "Affidavit in Support of Motion for Leave to Present Additional Evidence" as adopted by Witness David P. Price as his late-filed testimony states:

> That if the Commission does not permit Montana-Dakota Utilities Co. to collect rates that reflect its gas costs presently being incurred until the producers have completed the entire administrative process under NGPA, Montana-Dakota Utilities Co. will be denied due process; that if Montana-Dakota Utilities Co. should obtain a refund from any of its producers, then Montana-Dakota Utilities Co. will return that refund to its customers with interest thereon.

17. Producer filings were the basis of MDU's rate request and gas cost calculations. In order to be eligible for retroactive payments to December 1, 1978, producers were required to file with jurisdictional agencies by April 1, 1979. Although it was evident that certain filings for individual wells in Montana were not timely, the MDU take from the wells was minimal. It is evident to this Commission that the jurisdictional agencies are the appropriate places to determine such filing dates.

Also, the Commission is distressed by the cavalier attitude of MDU regarding well determinations. The Commission does not regard

the producer requests as prima facie correct. Preliminary contacts with the Montana Oil and Gas Commission revealed that in several instances (albeit a small percentage) the producer filings were rejected. It is, however, evident that the well determination process is not complete. Ample protection is afforded to the consumer by the producer to MDU to consumer rebate procedure in the event particular well determinations are rejected by jurisdictional agencies. The differential between the interim rate of $1.138 per Mcf and the incurred gas cost obligation of $1.25 per Mcf militates against rejection of MDU's gas cost presentation for the deficiencies discussed above.

18. The Commission accepts the unit rate of $1.2501769 as the Applicants cost of gas for the three months ended February, 1979. The resulting increase in the cost of gas is:

Gas Cost for quarter ended February, 1979	$1.2501769
Gas Cost Established in Docket No. 6567	.900258
Increase in Cost at 14.73 psia $	.3499189
Factor for Sales Delivery Pressure	92.1639%
Increase in Gas Cost at Local Sales Delivery Pressure	$ .322499

19. A major forward-looking consideration in this docket concerns the evaluation of past tracking mechanisms. MDU witness Don Ball, in his prefiled direct testimony, presented a study showing the inadequate revenue produced by these procedures and the revenue shortfalls that will be produced by the current tracking procedure. MCC witness George Hess, in response to the question of whether MDU's quarterly tracking procedure has worked stated:

> No it has not. Even with quarterly tracking the company has come up far short of recovering its gas costs for two
> reasons. First, there were tremendous increases

> in the cost of purchased gas during the periods when quarterly tracking was tried. Second, there were substantial delays in putting the tracking increases into effect. (p.5 direct testimony)

The Commission finds the contentions of both parties valid, and is of the opinion that a method which better reflects changing gas prices must be used in the future.

20. MDU witness Ball has presented the following two alternatives:

The first alternative would involve the use of estimates and a balancing account to correct any over or under estimates. This procedure would require that cost estimates would be used to correspond to the time period that the adjustment was effective for billing purposes.

At the end of the period, when all actual data are avail able, any difference between the estimated adjustment as applied and the actual adjustment could be calculated.

The dollar amount of any over or under collection could be determined and then applied to a future adjustment period.

The second alternative works in two parts.
The first part consists of a gas cost adjustment which recognizes the most current gas costs available. This adjustment is made every six months on May 1 and November 1 and recognizes actual gas prices up to and including the adjustment date. The second part of the adjustment uses the deferred accounting principle which is applied- as follows; at the end of each month, when actual data is available, the actual cost of gas for the month is compared to the cost of gas charged in rates during that month. Any difference, over or under is multiplied by the volumes sold during the month and a dollar amount is obtained which states the amount of gas costs actually incurred that were not billed during that month. All such amounts, positive or negative, are recorded in an unrecovered purchased gas cost account.
These amounts are likewise credited or debited to purchased gas expense on the income statement so that a matching between revenues and expense is obtained. The amounts calculated in this manner are accumulated in the deferred account for a period of six months after which approval is sought through the filing

procedure to either bill or refund the amounts so accumulated over the next six month period based on estimated sales for that six month period. As these accumulated deferred costs are billed or refunded the amounts are accounted for in both the deferred account and in gas cost expense to properly amortize these amounts. (p. 6-9 direct testimony)

MCC witness Hess has presented the following alternative method:

1. MDU should file tracking increases semiannually.

2. MDU should submit evidence demonstrating that it has done everything possible to minimize gas costs.

3. MDU should submit evidence of its earnings and rate of return on Montana gas operations in the preceding twelve months.

4. MDU should calculate current gas costs using annualized volumes for a preceding 12-month period adjusted for known changes and reflecting the most recently known prices for purchased gas and storage. Produced gas should be considered to have zero cost.

5. MDU should calculate the cost of unrecovered gas costs in the preceding six months. This would entail calculating an unrecovered gas cost balance for rate making purposes even though such a balance is not maintained for accounting purposes.

6. If the commission is convinced that MDU has minimized its gas costs, rates should be set at a level which reflects current gas costs, adjusted for known changes plus an allowance equal to the cost of unrecovered gas costs in the preceding six months. The cost will be calculated to provide both a return on and an amortization of the unrecovered balance. (p. 7, 8, direct testimony)

21. The Commission finds the Applicant's first alternative the least desirable of the three alternatives. Use of estimates provides the opportunity, whether intentional or unintentional, for overestimating gas costs.

Hypothetically, if the overestimation persisted through time, the ratepayers would be burdened with a permanent, additional charge over and above the just and reasonable rate. This would be true even if the amount of the overcharge in a previous period is returned to the ratepayer in a following period through use of a balancing account.

The use of a balancing account is also similar to features of the other alternatives--which do not require as many estimates as this alternative.

22. The alternative presented by MCC witness Hess more closely aligns with the Commission's preferences than MDU's alternative one. The factor making Hess' alternative compensatory is explained in point five of his proposal. The unrecovered gas cost balance detailed is similar to part two of MDU's alternative two. Two differences exist, however. Witness Hess advocates a non-accounting treatment for the unrecovered gas cost balance and specifies that the balance is not to be made part of the tariff. (Direct p. 7 and Transcript in response to questioning by Robert Smith, respectively). The Commission has adopted different reasoning on these two points.

23. The Commission acknowledges that because an unrecovered gas cost balance is computed for ratemaking does not imply that it

need be accounted for in the financial statements. (The converse is also true. The financial accounting treatment and generally accepted accounting principles do not dictate ratemaking.) However, in doing so, a better matching of changes in gas costs with gas adjustment revenues is provided, and thus a better definition of accounting net income. For example, earnings are understated
in periods of rising gas costs if the balance is not accounted for in the financial statements. To the extent that such improvement in reported net income will assist the Applicant in sales of its debt and equity securities,
treatment of gas expenses as a deferral for accounting purposes is in the interest and to the benefit of MDU's ratepayers and investors. (Transcript, Questioning of Don Ball by Dan Elliott). Witness Ball raises the concern that "generally accepted accounting principles dictate that when deferred accounts are used that there must be reasonable assurance that amounts so deferred will be collected or refunded at some point in time." He continues with his reasoning of how that assurance is best manifested: "By filing the exact procedure in the form of a rate schedule, there is adequate assurance for the collection or refund of such deferred amounts." The Commission is of the opinion that the assurance, for accounting purposes, is properly manifested for the gas deferral in the same manner as for all other deferrals currently recorded on utilities accounting records (depreciation deferrals, depletion deferrals, etc.), namely, that the Commission allows what it determines to be just and reasonable revenues and expenses to be reflected in rates. In concluding, ratemaking does not dictate accounting and visa versa. However, use of a gas deferral account for accounting purposes will track the ratemaking procedure and will provide a

clearer definition of accounting net income--thereby helping the Applicant in the financial marketplace. The assurance that the deferred amounts will be reflected in future rates is provided through the philosophy that, as with other deferrals currently recorded on the utilities financial statements, the Commission will allow what it determines to be just and reasonable revenues and expenses to be reflected in rates.

24. The second point of contention centers around inclusion of the "unrecovered gas cost balance" in the tariff. Witness Hess states that if his procedure is used: "The Commission is not locked into a tariff which specifies an accounting procedure which is designed to guarantee that all gas costs will eventually be borne by rate payers." (Direct p.8). The Commission is of the opinion, however, that a ratemaking formula--specifically the deferred gas cost balance as defined in MDU alternative two--should be defined in the tariff, not an accounting procedure. Finding of Fact 24 discusses the difference between accounting and ratemaking. The Commission is also of the strong conviction that the ratemaking formula must specify that costs developed pursuant to it be subject to hearing, thereby eliminating even the slightest possibility of guaranteeing that, regardless of their complexion, all gas costs would be passed on blindly to the ratepayer. Both witnesses Ball and Hess acknowledge this. (Ball, Direct, Late-Filed p. 2 and Hess, Direct p. 4). The Commission is firmly committed to thorough inquiry into the cost of gas during the course of any such hearings, and is convinced that the procedure herein adopted has the clear virtue of allowing all parties to focus on matters of genuine contention rather than engaging in prolonged,

fruitless debate on the formula itself.

In addressing the further point of whether or not inclusion of the ratemaking formula in the tariff constitutes an automatic adjustment clause, the Commission would stress that a utility is entitled to no rate other than the filed rate. In this instance, the ratemaking formula, not the monthly gas adjustment factors derived from the changing cost of gas, constitutes the rate. The ratemaking formula specifically provides for a hearing. The utility, therefore, is entitled to the rate, subject to the determinations made as a result of the hearing.

The Commission is of the opinion that the above-detailed ratemaking formula should be included in the tariff, subject to hearing, because:

A. The Commission wants to make ratemaking procedures understandable, and accessible to the ratepayers. Following this line of reasoning, the Commission wants a streamlined gas tracking procedure, so arranged or organized as to gain simplicity and efficiency. Having the gas tracking procedure on file in the tariff will accomplish this goal. Witness Ball states: "Having the procedure on file in detail will eliminate many questions and will establish a common framework for the analysis and propriety of the adjustments when filed " (Ball, Direct p. 9)

B. It appears unlikely that anything will decrease in value or cost in these inflationary times, but if gas costs do decrease, having a procedure in the tariff to define the decreased gas costs and to insure a hearing thereon is an efficient means of assuring the ratepayer that he will actually receive the benefit of the decreased gas costs. Witness Ball, in speaking of gas costs in MDU alternative two, states: "All such amounts, positive

or negative, are recorded in an unrecovered purchased gas cost account. . . The amounts calculated in this manner are accumulated in the deferred account for a period of six months after which approval is sought through the filing procedure to either bill or refund the amounts so accumulated...." (Direct p. 9) (Emphasis supplied). Thus, the Commission is provided with an excellent opportunity to police the Applicant's gas costs which it may not otherwise have, practically speaking.

C. Any and all inferences of retroactive ratemaking are erased. The deferred gas cost balance, as defined in the ratemaking formula is based on costs in a preceding period. This does not change the effect of the formula, however, of providing a method to calculate a current charge rather than to exact a precise recovery of past expenses (Transcript, Dan Elliott Cross-Examination of Don Ball). The same principle holds true for ratemaking generally. When a rate request is filed with the Commission because of changing overall expenses, changing market, etc., the request is usually based on a test year. The income statements and balance sheets are presented for this year, and based on their results the Commission decides what shall constitute just and reasonable rates. The rates, however, are not set to recover the costs incurred in the test year, but rather the test year expenses are used as estimates of expenses expected to occur during the time frame the newly approved rate will be in effect.

The formula results in a reflection--not a recovery. Lines 20-23, p. 2 of Mr. Ball's Direct late-filed testimony states: "The deferred accounting procedure does not involve the issue of any past losses or profits but is merely a prospective determination

that specific costs are to be accurately recovered in rates according to a predetermined formula.... " During cross-examination by Mr. Smith witness Ball admitted that the word "reflected" could be used in place of "recovered. " The purpose of the ratemaking formula is not to recover gas costs, but rather the purpose is to point out changes in gas costs so that they may be reflected in prospective rates. The tariff will provide this reasoning and assurance because the ratemaking formula included therein, not the gas adjustment factors, constitutes the rate--subject to hearing.

In summary, including the ratemaking formula in the tariff will provide the ratepayers with an understandable, accessible and organized gas tracking procedure. It will provide a periodic hearing to assure the ratepayer that he is paying a just and reasonable rate. It will provide a common framework for the efficient analysis of the adjustments filed. It will provide assurance that the ratepayer is not being burdened with past costs.

25. The Commission finds MDU's alternative two, which is similar in most respects to that advocated by MCC's Mr. Hess, the most desirable gas tracking procedure. However, several areas relating to it require modification:

A. The proposal advocates computation of interest on the deferred gas cost balance at the overall rate of return as authorized in MDU's last general rate proceeding. It is the Commission's opinion that the ratemaking formula is to reflect the changing cost of gas in prospective rates. The imputation of interest distorts the picture of actual gas costs. The Commission, therefore, finds the interest imputation inappropriate.

B. The proposal advocates semiannual adjustment dates of May 1st

and November 1st, coupled with cost assimilation periods of August 1st-January 31st and February lst-July 31st, respectively. The cost assimilation periods seem reasonable to the Commission, since each period contains winter months and summer months. The adjustment dates will hinge on the date the utility files for a rate change, the hearing date and the Commission's discretion. The May 1st and November 1st adjustment dates contemplate filings April 1st and October 1st, respectively. These dates would not allow time for hearings under the Commission's established notice procedures.

Therefore, adjustment dates of June 1st or July 1st and December 1st or January 1st should be contemplated.

CO N C L U S I O N S O F LAW

1. The Commission has jurisdiction over parties and proceedings in this matter.

2. Section 69-3-303, MCA, declares:

> 69-3-303. (1) Before it may approve any change increasing the rate or rates for utility service in a schedule generally affecting consumers in a utility's service area or before any change may become effective due to the passage of 9 months, the commission shall publish a notice of the proposed change, conforming to the requirements of 2-4-601 in one or more newspapers published and of general circulation within the area affected by the proposed change. This notice shall announce a hearing on the proposed change and shall inform interested persons how they may petition the commission to become parties to the hearing.

With this statute in mind the Commission has directed MDU to include a provision for a hearing in the deferred accounting formula.

3. When the commission sets rates using a formula based on past costs as proxies for future costs ratemaking is not retroactive. "The Constitution does not bind ratemaking bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances. "

(Federal Power Commission Natural Gas Pipeline Company, 315 US 575 42 PUR NS p. 138). "The tariff provided unmistakably that the charge in the billable month was to be computed on the basis of a specific formula. There was no provision for a charge other than the monthly rate computed under the formula and applied to the kilowatt-hours in the billable month. The fact that the formula was based on costs in a preceding period did not change its effect of providing a method to calculate a current charge rather than to exact a precise recovery of past expenses. Such a formula could as well have been based, for example, on some past wholesale price index or similar factor rather than actual cost incurred, and yet be the basis for a 'current charge. " (Jersey Central Power & Light Company v. Federal Energy Regulatory Commission, No. 78-1185, US 3rd Circuit Court of Appeals). The Court succinctly stated in State of Missouri Ex. Rel. Southwestern Bell Telephone Company v. Missouri Public Service Commission et al (PUR 1923c p.199): " Estimates for tomorrow cannot ignore prices of today. "

4. The rates authorized by this Commission are just, reasonable, and not discriminatory .

ORDER

The Montana Public Service Commission Orders that:

1. Montana-Dakota Utilities shall file rate schedules reflecting gas costs of $1.2501769 per Mcf at 14.73 p.s.i.a., and tariffs reflecting the deferred gas accounting formula set forth in MDU Alternative I I without the interest imputation contained therein. The tariffs shall become effective when approved .

2. The Montana Consumer Counsel's Motion to Dismiss these proceedings and all other motions not specifically ruled upon are hereby denied.

DONE IN OPEN SESSION at a meeting of the Montana Public Service Commission held on May 29, 1979, by a vote of 5-0.

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GORDON E. BOLLINGER, Chairman

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CLYDE JARVIS, Commissioner

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THOMAS J. SCHNEIDER, Commissioner

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JAMES R. SHEA, Commissioner

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GEORGE TURMAN, Commissioner

ATTEST:

Madeline L. Cottrill
Commission Secretary
(SEAL)

NOTE: You are entitled to judicial review of the final decision in this matter. If no Motion for Reconsideration is filed, judicial review may be obtained by filing a petition for review within thirty (30)days from the service of this order. If a Motion for Reconsideration is filed, a Commission order is final for purpose of appeal upon the entry of a ruling on that motion, or upon the passage of ten(10) days following the filing of that motion. cf. the Montana Administrative Procedure Act, esp. Sec. 2-4-702, MCA; and Commission Rules of Practice and Procedure, esp. 38-2.2(64)-P2750, ARM.