



Travis Kavulla, Commissioner  
District 1

MONTANA  
PUBLIC SERVICE COMMISSION

EXHIBIT # 1  
DATE 01/28/2015  
HB

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Jan. 28, 2015

Federal Relations, Energy & Telecommunications Committee  
State Capitol  
PO Box 200400  
Helena, MT 59620-0400

**Re: House Bill 189**

Members of the Committee:

I am writing today to reply to a Jan. 26 letter by John Fitzpatrick that contains a number of errors, which I feel you should be aware of before you proceed to take executive action on House Bill 189.

This legislation is necessary. It is rooted in the simple principle, familiar to all of the committee's members, that a property owner should have accountability for the property he or she owns. Currently, when a NorthWestern-owned power plant breaks down, it is consumers alone who continue to pay the costs of the plant and also reimburse 100% of the costs of replacement power. As virtually every other state in the region has recognized, this is unfair. Passing this bill would allow the PSC to create the same type of incentive regulation for NorthWestern that currently applies to Montana-Dakota Utilities.

The PSC Can Account for Past Outage-Caused Expenses in a General Rate Case

Mr. Fitzpatrick writes that "it is absolutely false" that "power purchases related to outages can be made up in the next general rate case" because this would constitute "retroactive ratemaking," which is unlawful.

Mr. Fitzpatrick's statement is not accurate, as NorthWestern's own experience demonstrates. Utilities routinely petition the Montana PSC for "accounting orders," which allow regulated companies to defer expenses for collection in a general rate case, even when that rate case's 12-month "test period" of expenses would not overlap with the time period in which those expenses are incurred. NorthWestern itself has been issued an accounting order that will allow the utility to present costs in a general rate case related to 2011-2012 distribution system infrastructure project costs (PSC Order 7138, attached as Exhibit A to this letter). This is not considered unlawful "retroactive ratemaking."

As the handout I gave to the committee last week indicates, other utility commissions often handle plant outage costs in this way. Indeed, as Marci Norby of the Wyoming Public Service Commission wrote to Kate Whitney of the Montana PSC:

[A] company could apply to the Commission for a deferred accounting order if it had an unexpected outage and had to go to the market to purchase power (or other). The deferred accounting order will not guarantee recovery of the costs, it simply puts stakeholders on notice that the amount is being deferred until the next rate case, where the company will ask for full recover and some amortization period.

The full email is Exhibit B. Nothing in Montana law prevents the same treatment as Wyoming provides its public utilities.

Similarly, other utility commissions allow the entities they regulate to budget for unexpected but ordinary occurrences. The Washington Utilities and Transportation Commission, for instance, budgets \$8 million in Puget Sound Energy's rates for storm damage. (See a section of that commission's Order as Exhibit C.) Costs in excess of \$8 million are then subject to deferred accounting. Similarly, plant outages that occur as a matter of routine, while ordinary maintenance is occurring, could be budgeted in this manner, with excess costs dealt with differently.

If HB 189 becomes law, I would expect NorthWestern to use either accounting orders or a modified tracking mechanism (one which shares risk appropriately, between the customers and the company) to deal with plant outage costs. Either of these devices can be housed within a general rate case.

#### The Current Law Fails to Apportion Business Risk in a Fair Manner

The electric tracker in 69-8-210, MCA, allows the company to collect revenues from consumers as if a power plant is operating, even when it is not, and the utility *also* gets to pass along 100% of the costs of replacement power that it buys to make up for the electric power that is not being produced at a power plant.

Hardly any other business in the United States is so shielded from the risk that a piece of its business equipment fails. The fundamental question raised by this legislation is whether NorthWestern will continue to benefit from preferential treatment under the law. Only NorthWestern, alone even among utilities in Montana, is able to outsource all of that business risk to its captive set of consumers. As the committee heard in hearing, when MDU experiences unusual costs, those excess costs must be shared in a 90-10% split between consumers and the company. Most other utilities in the region also have sharing mechanisms that cause them to be on the hook if a plant goes out of service, as presented in the handout given to the committee last Wednesday. Yet that treatment is *forbidden* under the present law for NorthWestern, which benefits from a 100% pass-through mechanism. This is unfair.

In his letter, Mr. Fitzpatrick asks why NorthWestern should be responsible for “Acts of God and Nature” or for mechanical failures that are not the company’s fault. Mr. Fitzpatrick is asking the wrong question; he should be asking why NorthWestern’s consumers, exclusively, have to bear the entirety of the risk of a plant’s failing. Whether or not a property owner is to blame for the failure of his property, the consequences of its failure should fall, at least partially, on the property owner as a matter of routine. That risk, after all, is why the utility’s shareholders are being compensated at an approximately 10% authorized return for their investment in power plants.

The wrongness of Mr. Fitzpatrick’s position is obvious if applied to other industries. Does a farmer get paid both for repairs to his combine *and* for the custom-cutters hired to fill in for the harvest *and* for the loss of grain caused by a delay in harvest? No. His insurance might cover some costs, but not all of them. And the same is true of restauranteurs, gas station owners, hoteliers, you name it.

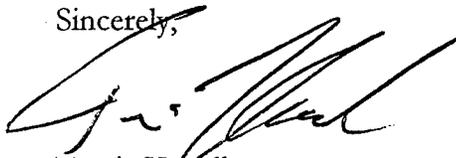
#### The Dave Gates Generating Station Outage

In a discussion of a plant outage that occurred in 2012, Mr. Fitzpatrick claims “the company faithfully maintained that equipment, and we have the records to prove it.” In fact, NorthWestern was given the opportunity to prove just that, and the PSC unanimously found otherwise. (See the discussion in PSC Order 7219h, Exhibit D.)

What is notable about this plant outage is that because of the inappropriately strict legal standard the electric tracker establishes, NorthWestern was nonetheless able to escape much responsibility for the costs of the outage. Indeed, the PSC’s total disallowance amounted to only *one-third* of the allowed profit NorthWestern made on the facility *while it was out of service*. Even this small disallowance is being contested by NorthWestern in court. If the company prevails, then the PSC will be even more handcuffed than it is today on questions of plant outages.

House Bill 189 is long overdue. The law that it amends was never intended to apply to a utility that owned, and made a profit on, its own power plants. It is time to fix that law, and make NorthWestern—like every other business owner—have a strong, vested interest in the performance of its property.

Sincerely,



Travis Kavulla  
Commissioner, District #1



Service Date: March 15, 2011

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

IN THE MATTER OF NORTHWESTERN	)	REGULATORY DIVISION
ENERGY'S REQUEST for an Accounting Order	)	
Authorizing the Deferral of the Expense-Related	)	DOCKET NO. D2011.1.7
Portion of the Costs Associated with Phasing in	)	
its Distribution System Infrastructure Project	)	ORDER NO. 7138

**ACCOUNTING ORDER**

1. NorthWestern Energy ("North Western" or "NWE") plans to initiate a phase-in of its multi-year Electric and Natural Gas Utility Distribution System Infrastructure Project ("Project") for which it will incur significant costs beginning in 2011. Such costs will include both capital expenditures and expenses.

2. The phase-in of the Project ("Phase-in"), which NorthWestern plans to implement beginning in 2011, will involve increased capital expenditures and various expenses associated with a number of measures (e.g., additional tree trimming, pole inspection, the completion of a system field inventory necessary to expand the Geographical Information System (GIS), and the establishment of a Natural Gas Distribution Integrity Management Program).

3. While the Phase-in portion of the Project takes place in 2011 and 2012, NWE anticipates making a filing with the Montana Public Service Commission ("MPSC" or "Commission") in 2011 to provide full details of the Project, including future cost recovery proposals.

4. Commission authorization of deferred accounting treatment for expense-related items in 2011 and 2012 will allow NorthWestern to defer the actual expenses it incurs as a result of the Phase-in portion of the Project until 2013, at which time they would be amortized over a five-year period. This deferral will help negate the adverse financial impact the Project would have on NorthWestern during 2011 and 2012. However, NorthWestern will not recover these Phase-in related expenses until such time in the future they are approved for inclusion in rates by the Commission.

5. This Accounting Order authorizes NorthWestern Energy to defer recognition of the expense-related portion of the Phase-in portion of the Project during the 2011 and 2012, and amortize these costs over a five-year period beginning in 2013. The Commission further orders NorthWestern to separately account for all costs associated with the Phase-in portion of the Project.

6. This Accounting Order only addresses the timing of the recognition of the expense-related portion of the Phase-in portion of the Project costs. NWE still has the full burden of proof to demonstrate that the level of any such costs is properly included in the revenue requirement determination in any subsequent rate proceedings. Approval of the recovery of the deferred costs in rates will be addressed in these subsequent proceedings.

7. Nothing in this Accounting Order shall be considered precedent for the treatment of any expense-related costs for the Project, in any future proceedings, or interpreted to limit the Commission's authority in making the determination of which costs should be included in rates.

8. Approval of this Accounting Order is for accounting purposes only. This Order is not to be construed as, nor is it in any way, a directive as to the proper accounting treatment for any expense-related costs of the Project, or an approval of the actual numbers involved, the accounting method used, or the assumptions underlying those numbers.

9. As NorthWestern's request is to defer incremental expenses over and above normal expense associated with specific electric and natural gas expense line items, NorthWestern must provide the current business as usual expenses, i.e., the level of expenses over which NorthWestern will defer expenses for each category or line item (e.g., Pole Replacement, Line Clearance-Tree Trimming, Stub Removal, etc.) within 30 days of the effective date of this Order.

#### **Conclusion of Law**

1. NorthWestern Energy is a public utility furnishing electric and natural gas service to consumers in the State of Montana, subject to the supervision, regulation and control of the Commission. Title 69, Chapter 3, § 69-3-102, MCA.

2. NorthWestern Energy is subject to the Commission's powers to prescribe accounts for Montana regulated public utilities under the provisions of 69-3-202, MCA.

**Order**

1. NorthWestern shall separately account for expenses related to the Phase-in portion of the Project.
2. The Commission directs NorthWestern to defer recognition of the 2011 and 2012 expense-related costs for the Phase-in portion of the Project with a five-year amortization of such costs beginning in 2013.
3. This Accounting Order allows NorthWestern to defer up to \$16.93 million Distribution Infrastructure Project-related expenses during the years 2011-2012.
4. This Order is effective on issuance.

DONE IN OPEN SESSION at Helena, Montana, on this 15<sup>th</sup> day of March 2011 by a vote of 5-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

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W. A. GALLAGHER, Chairman

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BRAD MOLNAR, Vice Chairman

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TRAVIS KAVULLA, Commissioner

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GAIL GUTSCHE, Commissioner

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JOHN VINCENT, Commissioner

ATTEST:

Verna Stewart  
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.

**Kavulla, Travis**

**From:** Marci Norby <marci.norby@wyo.gov>  
**Sent:** Wednesday, January 14, 2015 3:34 PM  
**To:** Whitney, Kate  
**Subject:** Re: MT PSC question

Kate,

Do your rules 249 and 250 provide for a power cost adjustment mechanism (PCAM) that could have applied to the PacifiCorp's replacement power costs during the outage? No. They were actually rules to pass on commodity costs. It was later determined that the company couldn't file for a mechanism under those rules because they are vertically integrated and have control over a portion of those costs. However they did subsequently file for a Power Cost Adjustment Mechanism, which is a non-traditional ratemaking mechanism. The mechanism could have replacement power costs included in the annual filing. However, the net power costs are (base NPC is set in a rate case and the incremental is included in the mechanism on an annual basis) scrutinized in each case. If the replacement power costs were deemed imprudent in some manner they would still not get recovery. The mechanism is not an automatic pass through.

And what is the accounting provision that is also referenced in the above paragraph? The accounting mechanism is just a 191 account (commodity balancing account). It hasn't been used for electric companies except for one, which only passes on (in a 249/250 application a small amount of purchase power agreement costs that is under contract.

Also, a company could apply to the Commission for a deferred accounting order if it had an unexpected outage and had to go to the market to purchase power (or other). The deferred accounting order will not guarantee recovery of the costs, it simply puts stakeholders on notice that the amount is being deferred until the next rate case, where the company will ask for full recover and some amortization period. The circumstances surrounding the deferred amount will be scrutinized in the rate case. If a company receives a deferred accounting order they are able to defer the costs and request them subsequently. It is seen as preventing retroactive ratemaking.

Let me know if you have any other questions.

Marci Norby  
Supervisor of Electric, Gas & Pipeline  
Wyoming Public Service Commission  
2515 Warren Avenue, Suite 300  
Cheyenne, WY 82002  
State of Wyoming  
(307) 777-5720

**b. Storm Damage**

289 This adjustment provides for recovery of expenses caused by storms. PSE experiences storm events throughout the year which result in maintenance or repair to the electric system due to high winds and other extreme weather. The manner of storm damage recovery depends in part on the severity of the storm event and related damage; it operates in a manner the Commission approved in the Company's 2004 general rate case, as modified by a settlement the Commission approved in PSE's 2007/2008 general rate case, Docket UE-072300.<sup>380</sup>

290 PSE's current rates provide for recovery of up to \$8 million in annual storm damage expense associated with "ordinary" storm events.<sup>381</sup> This normalized amount is based on an average of six years for storm damage that is charged to PSE's income statement.<sup>382</sup> PSE is allowed to defer catastrophic storm damage that both exceeds the annual \$8 million threshold and meets a modified version of the Institute of Electrical and Electronic Engineers (IEEE) standard for catastrophic events.<sup>383</sup> This deferred catastrophic storm damage is amortized over four years, except in extraordinary cases—such as the Hanukkah Eve storm in 2006—in which the Commission allowed for a longer amortization period of 10 years.

291 In Staff's view, it is time to transition away from the four year amortization of deferred catastrophic storm damage expenses over \$8 million. Staff has come to

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<sup>380</sup> See *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-072300 and UG-072301, Order 12, ¶ 58 (October 8, 2008). (The parties also agree with FEA's recommendation to amortize the December 13, 2006 "Hanukkah Eve" wind storm over 10 years to lessen the impact of these extraordinary costs on ratepayers. The parties further propose, in this connection, to continue the Catastrophic Storm Loss Deferral Mechanism, as set forth in Mr. Story's testimony. A new \$8 million threshold level is proposed via the settlement stipulation for Institute of Electrical and Electronics Engineers related storm deferrals beginning with calendar year 2009.)

<sup>381</sup> Story, Exh. No. JHS-18T at 26:12-15.

<sup>382</sup> *Id.* at 26:20-21.

<sup>383</sup> The Company uses IEEE Standard 1366-2003, with a slightly modified definition of an outage to establish a trigger for determining when catastrophic storm damage has occurred on the Company's electric system. The outage definition modification includes sustained interruptions that are one minute or longer, rather than the IEEE definition which includes sustained interruptions that are five or more minutes in length. McClain, Exh. No. SML-7T at 2:7-13.

regard these as normal operating expenses.<sup>384</sup> They should not be deferred, Mr. Applegate testifies, because this forces future rate payers to pay the day-to-day costs of serving present rate payers and to compensate the Company by paying a return on the deferral balances while the Company waits to recover these expenses.<sup>385</sup>

- 292 Staff does not object to the continued use of deferrals that recover storm-related damages over seven or more years when warranted by the occurrence of truly catastrophic events, such as occurred in 2006. Deferral of such extraordinary costs over a longer period may be a necessary tool in such circumstances to maintain storm damage expenses in rates at a reasonable level.<sup>386</sup>
- 293 Mr. Applegate testifies that Staff's proposed adjustment would allow PSE to amortize all storm related expenses approved for recovery in Docket UE-090704.<sup>387</sup> The 2008 and 2010 storm damage amounts of \$86,185 and \$13,909,769, respectively, which are the subject of Staff's proposed adjustment in this case, were not included in the Company's filing in that docket. Accordingly, these damage amounts were not considered by the final rate order of that GRC.<sup>388</sup> Staff recommends, however, that the Commission require the Company to recover these amounts "through the same six year average mechanism that applies when average annual storm costs are less than \$8 million rather than through the four-year deferral."<sup>389</sup> Mr. Applegate says that Staff's adjustment also allows PSE to collect all storm-related costs reported by the Company in filing this rate case.
- 294 Mr. Story testifies for the Company that while Mr. Applegate is correct that the \$8 million annual expense associated with storm damage is based on an average of six years for storm damage that is charged to the income statement, he is incorrect that any storm damage in excess of \$8 million is deferred. Mr. Story states that it is a common occurrence for storm damage expense to exceed \$8 million in a given year,

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<sup>384</sup> See generally Applegate, Exh. No. RTA-1T at 9:4-10:5.

<sup>385</sup> *Id.* at 9:4-7.

<sup>386</sup> *Id.* at 10:18-23.

<sup>387</sup> *Id.* at 11:11-12.

<sup>388</sup> *Id.* at 11:12-15.

<sup>389</sup> *Id.* at 7:15-23.

but the Company defers only the catastrophic storm damage costs that meet the IEEE standard and that exceed the \$8 million threshold. According to Mr. Story, there is a significant amount of storm damage that does not meet the IEEE standard for catastrophic storms and these costs are charged directly to expense.<sup>390</sup>

295 Mr. Story testifies further that adoption of Staff's proposal to allow for recovery of costs through a deferral for "limited catastrophic circumstances" would seriously affect the results of using the six-year average methodology, to which Staff apparently has no objection.<sup>391</sup> Mr. Story relates that Staff's definition of a "limited catastrophic circumstance," provided via discovery, is:

If a year's combined storm damage expense exceeds 233 percent (or 2 times 7 years divided by 6 years) the 6-year storm damage average, Mr. Applegate would recommend deferred recovery of the portion that exceeds the 6-year average. In Mr. Applegate's view, this treatment would mitigate rate impacts without distorting the 6-year average.

Mr. Story testifies that the Company recalculated Storm Damage expense using the last six years as the data source to see the impact of this definition. Under Mr. Applegate's proposal, the amount of normal storm damage expense that would be built into rates in this proceeding would be approximately \$17 million. According to Mr. Story, Staff's threshold for deferral would be in excess of \$39 million ( $2.33 \times \$17$  million), rather than the \$8 million deferral currently approved by the Commission.<sup>392</sup> It follows, he testifies, that Staff's proposal would add a risk of \$20 million dollars of after-tax volatility ( $(\$39\text{m}-\$8\text{m}) \times .65$ ) to the Company's earnings.<sup>393</sup>

296 Finally, Mr. Story objects that Staff's proposed change in the handling of these costs would require the Company to write-off the previously deferred balances of approximately \$14 million.<sup>394</sup> Yet, these costs are not challenged as being imprudent.

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<sup>390</sup> Story, Exh. No. JHS-18T at 26:13-27:4.

<sup>391</sup> *Id.* at 29:12-30:21.

<sup>392</sup> *Id.*

<sup>393</sup> *Id.* at 30:22-26.

<sup>394</sup> *Id.* at 31:6-20.

Mr. Story states that while Mr. Applegate testifies that this is not a disallowance it is, contrary to his testimony, exactly that.<sup>395</sup>

297 *Commission Determination:* PSE's current methodologies of accounting for storm damage costs and including them for recovery in rates have been in place for many years. The basic mechanism was most recently addressed in the Company's 2004 general rate case where the then-current definition of a catastrophic storm was replaced by IEEE standard 1366-2003, modified to shorten the duration of a sustained interruption from 5 minutes to 1 minute.<sup>396</sup> PSE was authorized to defer without filing a separate accounting petition the costs of catastrophic storms, thus defined, if their costs exceeded a certain threshold. This modification was jointly endorsed by Commission Staff and PSE, and approved by the Commission's Final Order.<sup>397</sup>

298 One of the key differences between the mechanism's current deferral methodology for catastrophic storms, and Staff's proposed elimination of it, is a question of process and timing. Under the current system PSE has 30 days to give initial notification to the Commission of an IEEE-qualified storm that may meet the threshold for deferral. Unless the storm is found not to qualify, PSE may defer the costs and recover them over the four year amortization period without the need for further action by the Commission. Under Staff's proposal, PSE would need to file an accounting petition before deferral of catastrophic storm damage could begin but it is not precluded from doing so.<sup>398</sup> In this sense, Staff's proposal simply introduces uncertainty into a process that has worked well for many years.

299 Moreover, if we adopt Staff's approach, it would eliminate PSE's opportunity to defer catastrophic storm costs that exceed both the \$8 million threshold and meet the modified IEEE standard, and including those costs in the storm damage normalization

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<sup>395</sup> *Id.* Staff concedes this point in its Initial Brief and offers a "partial compromise." Staff Initial Brief ¶¶120-21.

<sup>396</sup> *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-040640, UG-040641, *et al.*, Order 06 ¶¶ 232-33 (Feb. 18, 2005).

<sup>397</sup> *Id.*

<sup>398</sup> *See WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UG-040640, *et al.*, Order No. 06 ¶ 170 (Feb. 18, 2005 (noting the "longstanding principle that the Commission absolutely requires a company that wishes to book costs to a deferral account for treatment as a regulatory asset to first apply for and obtain express authority to do so").

equation. We note the Company's calculation that this would result in more than doubling the current six year average costs that are the basis for determining the Company's normalized storm-damage expense from \$8 million to \$17 million. In addition, Staff acknowledges in its Initial Brief PSE's contention that it would have to write off approximately \$14 million in deferred costs that it currently is authorized to recover.<sup>399</sup> Accordingly these facts inform our decision to reject Staff's proposed changes and retain the current Commission-approved mechanisms for storm damage cost recovery.

## 6. Contested Adjustments - Electric Only - Rate Base

### a. Lower Snake River<sup>400</sup>

300 PSE proposes to reflect in rate base and operating expenses the first phase of its development of the Lower Snake River wind power project (LSR-1), which became operational during the pendency of this proceeding. PSE includes the expected output from this new generation plant in its AURORA power cost model run for the rate year. Thus, the Company's pro forma operating cost assumptions are included in its power cost adjustment.

301 When PSE made its initial filing in this case, it expected LSR-1 to be completed in April 2012. PSE, in its rebuttal filing, agreed with Staff that the in-service date should be moved up to mid-February 2012.<sup>401</sup> The facility actually went into operation on February 29, 2012, which all parties now agree should be considered its "in-service" date. This is a significant date, among other reasons, because, Construction Work in Progress (CWIP) ceases to accrue and depreciation commences when plant enters commercial operation.

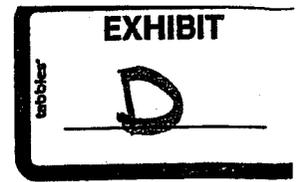
302 Staff, based on the latest actual figures available at the time it filed its response testimony, proposes to limit capital additions to rate base for LSR-1 based on actual

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<sup>399</sup> Staff Initial Brief ¶120.

<sup>400</sup> Public Counsel and ICNU jointly propose a \$55 million reduction to revenue requirement based on their challenge to the prudence of PSE's acquisition of the Lower Snake River wind power project. We discuss their prudence challenge and proposed adjustment separately below in Section II.I.

<sup>401</sup> Garratt, Exh. No. RG-28CT at 21:17-18.



Service Date: October 28, 2013

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

IN THE MATTER OF NorthWestern Energy's ) REGULATORY DIVISION  
2011-2012 Electricity Supply Tracker ) DOCKET NO. D2012.5.49  
) ORDER NO. 7219h

**FINAL ORDER**

**APPEARANCES**

**FOR THE APPLICANT:**

Heather Grahame, Al Brogan, Sarah Norcott, 208 North Montana Ave., Suite 205,  
Helena, Montana 59601

**FOR THE INTERVENORS:**

*Montana Consumer Counsel*

Monica Tranel, 30 W. 14<sup>th</sup> St., Suite 204, Helena, Montana 59601, and Mary Wright, 111  
N. Last Chance Gulch, Suite 1B, Helena, Montana 59601 (June 14, 2013, only)

*Human Resource Council District XI and Natural Resources Defense Council*  
Charles Magraw, 501 8th Avenue, Helena, Montana 59601

**Before:**

W.A. GALLAGHER, Chairman  
BOB LAKE, Vice Chairman  
KIRK BUSHMAN, Commissioner  
TRAVIS KAVULLA, Commissioner  
ROGER KOOPMAN, Commissioner

**Staff:**

Jason Brown, Staff Attorney  
Scott Fabel, Rate Analyst  
Will Rosquist, Chief, Economics & Rate Design Bureau  
Neil Templeton, Rate Analyst  
Kate Whitney, Administrator, Regulatory Division

Attachment 8. NorthWestern estimated that if it had purchased outage insurance for \$1 million annually, the cost to ratepayers of the premium costs would have exceeded the cost of replacement regulation service during the outage. Tr. p. 224.

26. NorthWestern contended ratepayers have actually benefited from the outage because, in exchange for releasing PWPS from all outage-related claims, NorthWestern obtained a contract modification that secured the following benefits from PWPS: (1) An extension of the turbine warranty for two years after installation of the last of the six modified turbines at DGGS (expected to occur by the end of 2013); (2) coverage of costs for any additional modifications to the turbines that PWPS determines are needed as a result of the outage during the warranty period; and (3) coverage of costs for materials and labor to incorporate new turbine hardware that PWPS develops related to the outage, regardless of whether the warranty extension has expired. NWE Reply Br. p. 20; DR PSC-100.

27. MCC argued that requiring ratepayers to pay the full DGGS plant costs plus the incremental costs of replacement power during the outage would be unreasonable. Ex. MCC-1a pp. 9-10; MCC Br. pp. 3-4. MCC also claimed that ratepayers are now getting less from DGGS than what they paid for because, in response to the outage, PWPS reduced the ramp rate to a maximum of 15 MW per minute from the previous 30 MW or more per minute that MCC said was one of the plant's initial design criteria. Tr. pp. 51, 54; MCC Br. p. 8.

28. NorthWestern challenged MCC's contention that the control software change to limit DGGS' ramp rate to 15 MW per minute has reduced the value of the plant to ratepayers. NWE Reply Br. p. 13. NorthWestern said MCC was mistaken because the ramp rate specified in the original purchase order was a minimum of 15 MW per minute per engine. Tr. pp. 68-69. Because each unit has two engines, the aggregate ramp rate for each unit is 30 MW per minute. *Id.* at p. 69.

#### Commission Decision

29. As the owner and operator of DGGS, NorthWestern was in a better position to prevent the outage and the costs of the outage than its customers, who have already paid \$6,742,625 for the fixed cost of DGGS during the outage, including NorthWestern's usual rate of return, plus \$1,527,714 for variable costs that were never actually incurred, but that NorthWestern *would have* incurred had there been no outage. DR PSC-014(a), Attachment 6.

To require customers to pay an additional \$1.4 million would relieve NorthWestern from bearing any costs whatsoever for an outage that it was in the best position to prevent, and would not be a fair or equitable outcome.

30. NorthWestern, as the owner and operator of DGGGS (and seller of electricity supply service), and PWPS, as the manufacturer of the components that failed, acted in concert in contributing to the outage and the costs of the outage. For example, NorthWestern

asked and Pratt & Whitney obliged, that we have a control system expert on site for a period of three months following commercial operation of the plant, who could be there in the operating room witnessing how the plant was operating. So Pratt & Whitney not only knew prior to commercial operation how the plant was responding, but they were also present for a three-month period following commercial operation to see the moment-to-moment operation of the plant to ensure that we were operating within the parameters of the specifications.

Tr. pp. 212.

31. To-date, PWPS has borne far more of the total cost of the outage than NorthWestern, perhaps more than \$10 million. *Id.* at p. 238; *supra* ¶ 17. NorthWestern has avoided more than \$10 million in repair costs (due partly to an extended warranty paid for by its customers), and collected almost \$8.3 million in DGGGS costs from its customers during the outage.

32. NorthWestern's customers cannot recover the incremental replacement costs of the outage from PWPS, whose warranty specifically "excluded consequential damages" and has only intervened in this proceeding "for the limited purpose of applying for a Protective Order." Ex. NWE-2 p. 14; PWPS Mot. to Intervene p. 1 (Aug. 23, 2012).

33. The Commission accepts MCC's argument that NorthWestern's failure to evaluate the availability, price and terms of outage insurance prior to commencement of DGGGS' commercial operation in January 2011 was imprudent. Given the warranty's exclusion of consequential damages and the uniqueness of DGGGS, NorthWestern should have identified the risk of incurring replacement costs in the event of an outage. *See* Tr. p. 211 ("the very unique way in which the power plant is controlled is really. . . different than most other power plants. . . . So early on we knew that the plant was going to have a very unique control application"). Its failure to identify risk ensured that incremental costs of replacement service would be incurred in the event of an outage.

34. The Commission finds that replacement insurance was available. DR PSC-008(c), Attachment 8. Although it may not have been cost-effective to procure replacement insurance – and may not be cost-effective to do so in the future – the failure to evaluate the availability, price and terms of outage insurance guaranteed that any incremental replacement costs would be unavoidable in the event of an outage. As a result, NorthWestern has not met its burden of showing that these costs were prudently incurred.

35. In addition to failing to adequately identify the risk of incurring replacement costs, NorthWestern did not appear to exhibit the level of situational awareness that the Commission would expect from a utility managing a one-of-a-kind power plant, which NorthWestern touted as a first-of-its-kind that “has the potential to be a model facility for the supply of regulation.” Ex. MCC-13 p. 25. Specifically, NorthWestern was aware that: (1) “[T]he units need[ed] to change load rapidly” as measured in “MW change per minute,” and that a single engine in operation could “ramp up or down at a rate of at least 15 MW per minute”; (2) “the ability to respond to demand within seconds” was critical to the operational mission of DGGS; and (3) the units could experience unique “thermal stresses,” and that going “from a cold start to a very high temperature” can cause “a lot of distress within rotating equipment.” *Id.* at pp. 5-9, 16; DR PSC-006(c), Attachment 47, p. 225; Tr. p. 91. The outage specifically involved ramp rates “much greater” than anticipated, excessive temperatures and cycle-related hardware failures. NWE Reply Br. pp. 12-13, DR PSC-101(e), Attachment p. 2.

36. Nonetheless, NorthWestern failed to retain “ramp rate data for each minute of operation.” DR PSC-105(a); Tr. p. 102. Using software that allowed the ramp rate of each unit at DGGS to exceed 30 MW per minute without taking any steps to monitor the actual ramp rate makes it impossible for NorthWestern to prove and for the Commission to determine prudence. Likewise, cycling individual units frequently may not have been the most reasonable way to dispatch DGGS. Tr. p. 100.

37. NorthWestern carries the burden of proving that its costs were prudently incurred, and was in the unique position of being able to monitor, record, and tender evidence that it exhibited the situational awareness and reasonable operation that the Commission would expect from a utility managing a one-of-a-kind power plant. *Infra* ¶ 102.

38. To require customers to pay an additional \$1.4 million would relieve NorthWestern from bearing any cost responsibility whatsoever for an outage that it was in the

best position to prevent (or prove unpreventable), and would not be a fair or equitable outcome. Had DGGGS been operational, consumers would have paid for certain variable costs of operating the plant if they were prudently incurred. In light of the limited disallowance sought by MCC, the unique design of DGGGS, and the fact that the full outage lasted less than three months, the Commission has only considered the *incremental* costs resulting from the outage in this case.

39. NorthWestern has failed to prove that the incremental regulation costs that it incurred during the DGGGS outage were prudently incurred. *Supra* ¶¶ 29-38. To allow NorthWestern to recover an additional \$1,419,427 for incremental regulation costs would not result in just and reasonable rates for consumers.

## II. True-Up of Lost Revenues

### Background

40. In December 2011, NorthWestern retained SBW to conduct a comprehensive evaluation of its DSM programs for tracking periods 2006-2007 through 2010-2011. The Commission directed NorthWestern to supplement its Application in this Docket with testimony regarding the results of SBW's evaluation. *See* Not. of Commn. Action (NCA) pp. 1-2 (Nov. 15, 2012). On January 18, 2013, NorthWestern filed SBW's *Impact and Process Evaluation of NorthWestern's 2007-2011 DSM Programs* (SBW Report) as an attachment to the *Supplemental Testimony of Michael H. Baker*, the project manager of SBW's evaluation. *See* Ex. NWE-17, Attachment MHB-1a.

41. The purpose of the SBW Report was to measure and verify electricity savings achieved by NorthWestern's energy efficiency programs from July 2006 through June 2011 in order to evaluate the cost effectiveness of individual programs and true up lost revenue calculations.

42. SBW concluded that NorthWestern's actual electric program savings – from both electricity supply DSM programs and Universal System Benefits (USB) programs – were 87 percent of its reported savings, resulting in a Net Savings Adjustment rate of 0.87. SBW Report p. iii. Of the 309,336 megawatt-hours (MWh) of total energy savings that NorthWestern reported over the evaluated period, SBW verified 270,564 MWh. *Id.* Verified savings are also referred to as realized savings.