140 FERC ¶ 61,020
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
Cheryl A. LaFleur, and Tony T. Clark.

NorthWestern Corporation	Docket Nos. ER12-316-002 ER10-1138-002 (consolidated)

ORDER DENYING REHEARING

(Issued July 12, 2012)

1. On January 30, 2012, NorthWestern Corporation (NorthWestern) filed a request for rehearing of the Commission's December 30, 2011 order, which rejected, in part, and accepted, in part, proposed revisions to Schedule 3, Regulation and Frequency Response Service (Schedule 3 or regulation service), of NorthWestern's Montana Open Access Transmission Tariff (OATT), subject to hearing procedures.[1] In this order, we deny NorthWestern's request for rehearing of the December 30 Order.

I. Background

2. NorthWestern owns and operates an electric transmission system in Montana. As part of its electric operations, NorthWestern operates a balancing authority area within the State of Montana. NorthWestern maintains regulating reserves within its balancing authority area sufficient to provide continuously balanced resources with load on a moment-to-moment basis in order to meet operating criteria in accordance with North American Electric Reliability Corporation and Western Electric Coordinating Council reliability requirements.

3. NorthWestern states that because its predecessor, the Montana Power Company, divested most of its generating capacity more than ten years ago, NorthWestern has historically relied on third-party purchases of regulation service. In order to eliminate the increasing risks associated with relying on firm third-party contracts for regulation

[1] *NorthWestern Corp.*, 137 FERC ¶ 61,248 (2011) (December 30 Order).

service, Northwestern states it constructed the Dave Gates Generating Station (DGGS Facility) to provide regulating reserve capacity.[2] The facility consists of three natural gas-fired turbine generator units with a maximum capacity of 150 MW. According to Northwestern, the DGGS Facility began commercial operation in January 2011.

4. On April 29, 2010, in Docket No. ER10-1138-000, NorthWestern filed proposed tariff sheets to revise Schedule 3 of its OATT to recover the costs of service for the DGGS Facility. In that case, NorthWestern proposed to recover the fixed and variable revenue requirement for the DGGS Facility attributed to providing Schedule 3 service through a monthly demand rate and monthly energy rate. On October 15, 2010, the Commission issued an order accepting and suspending NorthWestern's proposed tariff sheets subject to refund and establishing hearing procedures.[3]

II. NorthWestern's Initial Filing

5. NorthWestern proposed a number of revisions to Schedule 3 of its OATT.[4] Relevant to the instant request for rehearing, NorthWestern proposed to revise Schedule 3 to make clear that self-supplying customers may be subject to an additional charge under Schedule 3.[5] NorthWestern justified this revision on the possibility that a transmission customer's self-supply arrangements may end, fail, or become inadequate, requiring NorthWestern to serve as the backup provider of regulation service for self-supplying customers.[6] Moreover, NorthWestern argued that self-supplying customers would benefit from the DGGS Facility because it allows those customers the option of turning to NorthWestern for Schedule 3 service and in some cases to "lean" on NorthWestern's system for regulation service.[7]

6. NorthWestern claimed that imposing Schedule 3 charges on self-supplying customers would be consistent with cost causation principles. NorthWestern further

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[2] NorthWestern, Initial Transmittal Letter at 2-3.

[3] *NorthWestern Corp.*, 133 FERC ¶ 61,046, at P 23 (2010).

[4] *See* December 30 Order, 137 FERC ¶ 61,248 at P 5 (listing the revisions proposed by NorthWestern).

[5] *Id.* P 8.

[6] *Id.* (citing *NorthWestern Corp.*, 129 FERC ¶ 61,116, at P 21 (2009), *reh'g denied*, 131 FERC ¶ 61,202 (2010)).

[7] *Id.*

argued that its proposal would ensure that Schedule 3 charges are allocated to all customers that benefit from the DGGS Facility, and that NorthWestern is fully compensated for maintaining adequate generation capacity to backstop the regulation needs of self-supplying customers. NorthWestern also argued that it would be inappropriate to exempt self-supplying customers from Schedule 3 charges because the DGGS Facility provides reliability benefits for all market participants.[8] NorthWestern cited *MISO* for the proposition that the Commission has explicitly approved the concept that customers who self-supply regulation service remain obligated to contribute toward the transmission provider's Schedule 3 costs.[9] NorthWestern also cited Order No. 888-A for the notion that a transmission customer that self-supplies a portion of its regulation service requirement should pay a reduced charge for the service rather than the entire charge.[10]

III. December 30 Order

7. In the December 30 Order, the Commission rejected NorthWestern's proposal to impose additional charges under Schedule 3 on customers that elect to self-supply their own regulation reserves.[11] The Commission explained that since Order No. 888, it has required transmission providers to allow customers to satisfy their Schedule 3 obligations through self-supply arrangements by making "alternative comparable arrangements."[12]

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[8] *Id.* P 9.

[9] *Id.* (citing *Midwest Indep. Sys. Operator, Inc.*, 122 FERC ¶ 61,172, at P 324 (2008) (*MISO*)).

[10] *Id.* (citing *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048, at 30,325, *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002)).

[11] *Id.* P 28. Because NorthWestern had not shown the remaining tariff proposals to be just and reasonable, the Commission set the matter for hearing. Moreover, in light of the common factual issues presented in this proceeding and the proceeding in Docket No. ER10-1138-000, the Commission consolidated the two matters for a joint hearing. *Id.*

[12] *Id.* P 29 (citing Order No. 888, FERC Stats. & Regs. ¶ 31,036 at 31,717).

The Commission found that NorthWestern's proposal did not allow customers to satisfy their regulation service obligations through self-supply, and that NorthWestern's vague assertions of reliability benefits from the DGGS Facility did not justify its novel proposal to impose a standby regulation service charge on self-supplying customers.[13]

8. The Commission also found that the cases relied on by NorthWestern did not support its proposal. The Commission explained that Order No. 888-A addressed the situation where a customer chooses to self-supply a portion of its regulation reserves, while still relying on the transmission provider to provide additional regulation service. In contrast, NorthWestern's proposal would levy Schedule 3 charges on customers who self-supply their entire regulation reserve requirement. Therefore, the Commission found Order No. 888-A to be inapplicable.[14]

9. Additionally, the Commission found NorthWestern's proposed Schedule 3 charge to be fundamentally different from the charge involved in *MISO*, rendering NorthWestern's use of selected language from that case unpersuasive.[15] The Commission explained that the issue in *MISO* was whether the self-scheduling option in MISO's proposed Ancillary Services Market was consistent with or superior to the *pro forma* OATT's self-supply requirement.[16] The Commission further explained that because *MISO* involved the self-scheduling of resources in ancillary services market run by an independent system operator, *MISO* does not support NorthWestern's proposal to levy a standby Schedule 3 charge to any and all customers who would supply the resources themselves.[17]

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[13] *Id.* P 30.

[14] *Id.* P 31.

[15] *Id.* P 32.

[16] *Id.* Because an entity that previously self-supplied its ancillary service requirements would have to self-schedule in MISO's Ancillary Services Market, there was a concern that a customer might be subject to some additional charge reflecting the difference between MISO's ancillary service charge and the payment that customer would receive for its self-scheduled resources. *Id.* (citing *MISO*, 122 FERC ¶ 61,172 at P 318).

[17] *Id.*

IV. **Request for Rehearing**

10. In its request for rehearing, NorthWestern raises the following arguments. First, NorthWestern contends that the Commission erred by ruling that NorthWestern cannot assess Schedule 3 charges (in whole or in part) to self-supplying customers. NorthWestern described its proposal as containing "only minor tariff changes to provide a framework to allow its Schedule 3 customers to self-supply their service needs in the future,"[18] and it argued that the Commission had no facts before it about a specific standby charge or self-supply arrangement. NorthWestern further argued that the Commission did not give adequate consideration to the fact that NorthWestern must recover a significant portion of the revenue requirement for the DGGS Facility from Schedule 3 customers. NorthWestern contends that the Commission's decision will result either in NorthWestern being unable to recover its authorized revenue requirement for the DGGS Facility or the remaining bundled retail customers bearing a larger share of the revenue requirement.[19]

11. Second, NorthWestern argues that the December 30 Order assumes that self-supplying customers are, in effect, self-sufficient and impose no burden on NorthWestern or other customers.[20] NorthWestern disagrees, arguing that because customers may alternate between taking Schedule 3 service from NorthWestern and supplying it for themselves, NorthWestern must ensure that it has sufficient regulation resources on hand to provide regulation service when customers request it. NorthWestern states that it has only one generator dedicated to providing regulation service and that holding capacity from that resource (DGGS Facility) in reserve is not without cost. NorthWestern contends that those costs would fall on NorthWestern and/or other customers, thereby violating cost causation principles.[21] NorthWestern argues that customers who are unable to shop for third-party suppliers would be forced to subsidize what NorthWestern calls "standby service" to wholesale and retail choice customers who choose to self-supply. NorthWestern further argues that wholesale and retail choice customers would be able to arbitrage the costs of taking regulation service (taking it from NorthWestern or self-supplying as prices of either vary) at no costs to themselves.

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[18] NorthWestern, Request for Rehearing at 5.

[19] *Id.* 6.

[20] *Id.*

[21] *Id.* 7-8 (citing *Sithe Independence Power Partners v. FERC*, 285 F.3d 1, 5 (D.C. Cir. 2002); *MISO Transmission Owners v. FERC*, 373 F.3d 1361, 1368 (D.C. Cir. 2004)).

12. Third, NorthWestern argues that the Commission's refusal to allow it to impose its novel "standby charge" imposes a reliability burden on NorthWestern.[22] NorthWestern repeats arguments from its initial pleading that self-supplying customers may lean on NorthWestern's system or their self-supply arrangements may otherwise fail, leaving NorthWestern to pick up the slack. NorthWestern contends that because, as the Balancing Authority, NorthWestern is responsible for the continuous balancing of resources on its system, it must keep its area control error within applicable limits, or suffer the potentially large fines associated with violating reliability standards.[23] NorthWestern states that given this penalty exposure, prudence requires it to maintain adequate reserves in the event a self-supplying customer fails to meet its full regulation needs, and that the self-supplying customer should defray the associated costs. NorthWestern again argues that *MISO* supports its proposal, based upon the fact that both MISO's proposal and NorthWestern's proposal were necessary to meet Reliability Standards. NorthWestern contends that while the Commission "denigrates" NorthWestern's invocation of reliability benefits as vague, the general reliability benefits cited by NorthWestern are similar to statements made by MISO in support of its proposal, which the Commission accepted.[24]

13. Fourth, NorthWestern argues that in rejecting the proposal, the Commission provided no alternative means for assessing rates that would satisfy cost causation principles and meet reliability standards. NorthWestern states that it did not propose an actual standby charge in this case, but instead indicated that it would do so when the time is right. Thus, NorthWestern contends that it was inappropriate for the Commission to fault NorthWestern for not supporting its proposal. NorthWestern contends that the December 30 Order forecloses NorthWestern from filing and supporting a self-supply charge in the future, while at the same time providing no mechanism for recovering the costs incurred when a customer supplies regulation service themselves.[25] NorthWestern disagrees with parties who suggested that NorthWestern could achieve its goal by imposing a penalty on self-supplying customers who lean on the system. NorthWestern suggests that such after-the-fact penalties will not ensure compliance with Reliability

[22] *Id.* 9.

[23] *Id.* 9-10.

[24] *Id.* 11-12 (citing MISO, Electric Tariff Filing To Reflect Ancillary Services Markets, Docket No. ER07-1372-000, at 27 (filed Sept. 14, 2007)).

[25] *Id.* 13.

Standards, will fail to compensate NorthWestern adequately, and will likely be disfavored by the Commission.[26]

14. Finally, NorthWestern argues that in this proceeding, it sought only the right to negotiate a standby charge as part of an overall agreement with a self-supply customer based on the specific needs of that customer. Because NorthWestern did not propose an actual standby charge in this proceeding, NorthWestern contends that the Commission should not have rejected the standby fees out of hand at this point. In short, NorthWestern believes the December 30 Order was premature.[27]

V. <u>Discussion</u>

15. For the reasons discussed below, we deny NorthWestern's request for rehearing of the December 30 Order. As an initial matter, we disagree with NorthWestern's characterization of its proposal to grant itself the authority to impose a standby Schedule 3 charge as "only minor tariff changes" that "deferred any decision about appropriate ongoing Schedule 3 charges for self-supplying customers to future Section 205 proceedings. . . ."[28] NorthWestern's proposal is neither insignificant nor preliminary. In its initial filing, NorthWestern stated that it proposed to revise its Tariff "to make clear that self-supplying customers may be subject to Schedule 3 charges."[29] Thus, while NorthWestern was not proposing a particular rate for its standby Schedule 3 charge, it was seeking Commission authorization to impose a standby regulation charge to self-supplying customers.

16. The effect of NorthWestern's proposal on future self-supply arrangements would be pronounced. Were the Commission to have accepted NorthWestern's proposal, NorthWestern would have been entitled to recover a standby charge, leaving only a determination of how much that charge should be to future proceedings. However, as discussed below, NorthWestern provided neither the legal nor the factual justification to support its proposed generic authority to impose a standby Schedule 3 charge on self-supplying customers. Moreover, NorthWestern proposed to grant itself this standby charge authority outside the context of an individual self-supply arrangement. Having structured its proposal as a generic grant of authority to impose a standby Schedule 3

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[26] *Id.* 13-14.

[27] *Id.* 14.

[28] NorthWestern, Request for Rehearing at 5.

[29] NorthWestern, Initial Transmittal Letter at 5.

charge, NorthWestern cannot now claim that the Commission should wait to review whether this authority is just and reasonable until some future exercise of the requested authority. Accordingly, contrary to NorthWestern's assertions, the Commission's findings in the December 30 Order were neither premature nor do they prejudge individual self-supply arrangements.

17. In addition to arguing that the Commission prematurely evaluated NorthWestern's proposal, NorthWestern argued that the Commission erred by deciding the matter without having facts before it about a specific standby charge or self-supply arrangement. Again, NorthWestern conflates the generic authority to impose a standby charge (which NorthWestern sought in this proceeding) and a specific exercise of that authority in which NorthWestern would seek to levy such a charge sometime in the future. The December 30 Order addressed only the former. In doing so, the Commission relied on and evaluated the supporting evidence provided by NorthWestern, which consisted primarily of the prefiled direct testimony of NorthWestern's Vice President of Transmission, Michael R. Cashell (Cashell Testimony). The Cashell Testimony set forth the requirements for customers to enter into self-supply arrangements:

> NorthWestern thus requires assurances that any self-supply arrangement is dependable and it must have the means to verify that the supply is being and will continue to be delivered to its system. Since NorthWestern is not aware of any third-party regulating resource on its system that could be used to supply regulating reserves, third party supply will need to come from off-system resources, at least for the foreseeable future. Customers will thus need to show that they have firm contracts to supply regulating capacity. They further will need to show that the associated resources are capable of providing the service and have the necessary automatic generation control equipment to do so. The customers will need to make arrangements (at their cost) to establish the necessary metering and telecommunications links from those resources to NorthWestern's control room. And the customers will need to show that they have obtained firm transmission to deliver regulating energy from the identified resources into NorthWestern's balancing authority.[30]

[30] *See* NorthWestern, Initial Filing, Ex. NWE-1, at 12:10-23 (Michael R. Cashell Prefiled Direct Test.).

18. The Cashell Testimony then set forth the justification for the proposed standby charge, which consisted largely of bare assertion[31] and conjectural statements.[32] The Cashell Testimony provided no examples where self-supply customers have "leaned" on its system. In fact, the one self-supply arrangement cited by NorthWestern involved Bonneville Power Administration (Bonneville), which NorthWestern proposed to exempt from its standby charge because NorthWestern did not expect that Bonneville would rely on NorthWestern's regulation reserves, due to Bonneville's size and resource portfolio.[33] Given NorthWestern's requirements for self-supplying customers described in the Cashell Testimony, which are designed to ensure that the self-supplying customer does not lean on its system and that self-supply arrangements are comparable to the regulation service offered by NorthWestern, and the lack of any evidence showing that customers have leaned or are likely to lean on its system, the December 30 Order reasonably rejected NorthWestern's proposal to grant itself the generic authority to impose standby charges on customers that self-supply regulation service under Schedule 3 of NorthWestern's OATT.

19. NorthWestern also contends that the Schedule 3 rate structure it proposed in Docket No. ER10-1138-000 requires that NorthWestern be able to impose a standby charge under Schedule 3. We disagree. NorthWestern's proposed rate structure, in which it seeks to allocate a significant portion of the DGGS Facility costs directly to Schedule 3 customers, is currently in hearing and has not yet been shown to be just and reasonable.[34] Because the merits of NorthWestern's Schedule 3 rate structure have yet to be addressed by the Commission, we find NorthWestern's proposal to be an improper attempt to bootstrap the proposed authority to impose a standby charge in this proceeding by reference to the proposed rate structure in Docket No. ER10-1138-000. Moreover, to the extent NorthWestern is concerned that the Schedule 3 rates established in Docket

[31] *See id.* at 13:10-11 ("All transmission customers, including self-supplying ones, benefit from the enhanced reliability resulting from the regulation service provided by DGGS [Facility].").

[32] *See id.* at 13:12-17 ("[N]ominally self-supplying customers *may have an incentive* to 'lean' on NorthWestern's system for regulation service in a manner that unfairly burdens captive retail ratepayers and retail load and effectively causes them to subsidize the self-supplying customer. This *can occur* if the self-supplying customer has the unconditional right to return to NorthWestern at any time but at no cost, and thereby arbitrage price and supply risk.") (emphasis added).

[33] *See id.* at 11:18-22; 14:2-3.

[34] *NorthWestern Corp.*, 133 FERC ¶ 61,046.

No. ER10-1138-000 may become inadequate due to events that may or may not take place, it remains free to propose revised rates under section 205 of the Federal Power Act.

20. In both its initial filing and its rehearing request, NorthWestern argues that its proposal is justified because customers have the right to alternate between purchasing regulation service from NorthWestern and supplying that service themselves. While it is true that transmission customers have the right to take regulation service under Schedule 3 from the incumbent transmission provider or to self-supply that service,[35] it does not follow that such a right authorizes the transmission provider to impose an additional standby charge on those customers choosing to self-supply. While the imposition of standby charges may ensure that NorthWestern recovers the costs of the DGGS Facility, NorthWestern has not demonstrated how that imposition is consistent with the Commission's cost causation principles. Nor has NorthWestern shown that customers are causing NorthWestern to under-recover the costs of the DGGS Facility by alternating between purchasing regulation service from NorthWestern and supplying that service themselves.

21. NorthWestern also contends that because it must maintain adequate resources to meet applicable reliability standards, self-supply customers should defray the costs of these standby resources as a matter of "regulatory and ratemaking fairness."[36] However, NorthWestern never connects these concepts in a way that would justify its proposal. As we explained above, NorthWestern provides no evidence of self-supplying customers leaning on its system in a way that would support a general allocation of regulation service costs to those customers. Moreover, as set forth in the portion of the Cashell Testimony quoted above, NorthWestern requires assurances that any self-supply arrangement is dependable and it must have the means to verify that the supply is being and will continue to be delivered to its system. Given that NorthWestern requires a dependable and verified self-supply arrangement, and it provides no evidence that self-supply arrangements are anything but dependable, we find that NorthWestern has not provided a sufficient basis to grant it the authority to impose a novel standby charge on self-supply customers.

22. NorthWestern also persists in contending that *MISO* supports its proposal by "approv[ing] the concept of a self-supplying transmission customer being obligated to contribute towards the transmission provider's Schedule 3 costs."[37] As we explained in

[35] Order No. 888, FERC Stats. & Regs. ¶ 31,036 at 31,717.

[36] NorthWestern Request for Rehearing at 9-10.

[37] *MISO*, 122 FERC ¶ 61,172 at P 324.

the December 30 Order, NorthWestern's use of selected language from *MISO* is unpersuasive in this fundamentally different context. *MISO* addressed a proposed day-ahead and real-time Ancillary Services Market.[38] One of the myriad issues raised in that proceeding involved the manner in which customers that self-supplied ancillary services would be treated in the Ancillary Services Market.[39] In *MISO*, the Commission accepted MISO's proposal to require self-supplying customers to self-schedule in the Ancillary Services Market. The Commission did not accept, nor did MISO ever propose, tariff provisions that would allow MISO to recover payments from customers that self-supply regulation service simply because MISO was also capable of providing the service. Stated otherwise, the *MISO* language cited by NorthWestern was inextricably tied to the complexities of designing a functional Ancillary Services Market, and those facts have little relevance to the case at hand.

23. We disagree with NorthWestern's assertion that the December 30 Order overlooked a common element—i.e., the need to meet reliability standards—that exists both in *MISO* and here. MISO did not propose to impose a standby charge on self-supplying customers. Instead, as NorthWestern itself explains, MISO was seeking to prevent self-supplying customers from opting out of the Ancillary Services Market.[40] Moreover, as explained in the December 30 Order, *MISO* involved concerns that a customer might be subject to some additional charge reflecting the difference between MISO's ancillary service charge and the payment that customers would receive for self-scheduled resources.[41] Because MISO's proposal, supporting arguments, and factual context are all different from NorthWestern's proposal, the statements from *MISO* cited by NorthWestern are not relevant to NorthWestern's proposal.

24. Moreover, we note that NorthWestern's proposal is at odds with the longstanding Commission policy that transmission providers must allow customers to self-supply regulation reserves where they can show that they have made alternate comparable arrangements.[42] Among other things, this requirement reflects the Commission's goal of promoting competition and efficiency by requiring transmission providers to offer

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[38] *Id.* P 1.

[39] *Id.* PP 317-325.

[40] NorthWestern Request for Rehearing at 11 (citing MISO November 6, 2007 Answer, Docket Nos. ER07-1372-000 and ER07-1372-001, at 85).

[41] December 30 Order, 137 FERC ¶ 61,248 at P 32.

[42] Order No. 888, FERC Stats. & Regs. ¶ 31,036 at 31,717.

unbundled ancillary services.[43] NorthWestern's proposal conflicts with Commission policy because it would force those customers that self-supply regulation service to pay an additional fee, not for any service provided to them by NorthWestern, but instead for a service that they expressly have decided not to take from NorthWestern. Such a standby fee could actively thwart competition by imposing costs on self-supply customers in excess of the costs of providing this service themselves. NorthWestern has not provided any reason for the Commission to deviate from this established policy. Accordingly, NorthWestern's request for rehearing is denied.

<u>The Commission orders</u>:

NorthWestern's request for rehearing is denied, as discussed above.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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[43] *Id.* at 31,718.