133 FERC ¶ 61,046
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

NorthWestern Corporation Docket No. ER10-1138-000

ORDER ACCEPTING AND SUSPENDING REVISED TARIFF SHEETS
SUBJECT TO REFUND AND
ESTABLISHING HEARING PROCEDURES

(Issued October 15, 2010)

1. On April 29, 2010, NorthWestern Corporation (NorthWestern) filed revised tariff sheets to Schedule 3, Regulation and Frequency Response Service (Revised Schedule 3), under NorthWestern's Montana open access transmission tariff (OATT).[1] The Commission accepts and suspends NorthWestern's Revised Schedule 3 to become effective January 1, 2011, as requested, subject to refund and sets the Revised Schedule 3 for hearing. The Commission also denies NorthWestern's request for waiver of the Commission's regulations as discussed below.

## I. Background

2. NorthWestern owns and operates an electric transmission system, which includes more than 7,000 miles of transmission lines and associated facilities, used to provide electric transmission and distribution services to approximately 322,000 customers in western Montana. NorthWestern operates a balancing authority area within the state of Montana. According to NorthWestern, it must maintain regulation reserves, within its balancing authority area, sufficient to allow it to continuously balance resources with load in order to meet operating criteria in accordance with North American Electric

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[1] NorthWestern owns and operates electric and natural gas transmission and distribution facilities located primarily in Montana and South Dakota. NorthWestern maintains separate OATTs for operations in each state because NorthWestern's Montana and South Dakota transmission facilities are neither physically connected, nor in the same electric reliability region.

Reliability Corporation and Western Electric Coordinating Council reliability requirements. NorthWestern does not own any generation to supply regulation service and therefore relies on third-party purchases of regulation service to meet its Schedule 3 obligation. NorthWestern states, however, that it is currently constructing the Mill Creek Generating Station (Mill Creek) to provide regulation service for a portion of its obligation.[2]

3. Mill Creek is a natural gas fired generation facility located approximately 2.5 miles east of Anaconda, Montana, in Deer Lodge County. Mill Creek will consist of three gas fired turbine generator units with a rated capacity of 50 MW each. NorthWestern states that two of the Mill Creek units will operate continuously, while the third unit will act primarily as an operating spare.[3] NorthWestern asserts that the coordinated operation of the three units will be dedicated to providing 105 MW of regulation service.[4] NorthWestern continues that 45 MW of the total 105 MW will be used to integrate variable energy resources that will be used exclusively to service NorthWestern's retail energy supply portfolio. NorthWestern states that it expects Mill Creek to be operational by the end of 2010.

## II. <u>NorthWestern's Filing</u>

4. NorthWestern seeks Commission approval for its revised tariff sheets that will allow NorthWestern to recover the costs of providing regulation service from Mill Creek through a monthly demand rate and a monthly energy rate.[5] For the demand rate, NorthWestern proposes to charge a monthly rate based upon one-twelfth of a fixed revenue requirement of $24,361,212 for Mill Creek.[6] NorthWestern proposes to add the

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[2] The Montana Public Service Commission approved the construction of Mill Creek on May 29, 2009. *NorthWestern Energy*, Application for Approval To Construct and Operate the Mill Creek Generating Station To Supply Regulation Service, Montana Public Service Commission Docket No. D2008.8.95, Order No. 6943a (2009).

[3] NorthWestern Filing at 5. *See generally*, Cashell Test. (NorthWestern Exhibit NWE-1).

[4] *Id*. at 1; *see also* Cashell Test. at 11 (NorthWestern Exhibit NWE-1) and Public Service Commission of Montana Order No. 6943a at P 233 of NorthWestern Exhibit NWE-4, at 58.

[5] *Id*.

[6] The proposed revenue requirement is based upon budgeted fixed costs of Mill Creek. NorthWestern states that it will true up the revenue requirement when Mill Creek begins commercial operations.

fixed revenue requirement component to the total cost of procuring regulation service from third parties two months before a billing month. The demand rate for each billing month will be determined by dividing the fixed revenue requirement, plus any third-party purchases, by the rolling twelve coincident peak (12 CP) billing determinants for transmission customers taking regulation service, including NorthWestern's bundled retail customers. NorthWestern asserts that the use of the rolling 12 CP billing determinants as the divisor is appropriate because NorthWestern has only one generation facility that will provide regulation service.[7]

5. NorthWestern adds that the fixed revenue requirement component of the demand rate consists of Mill Creek's fixed costs attributable to providing regulation service and a return on associated Mill Creek capital costs.[8] NorthWestern proposes to use the same return on equity component of the cost of capital for Mill Creek, (10.25 percent), that was approved by the Montana Commission for Mill Creek.[9]

6. NorthWestern states that the demand rate formula includes a component to recover the cost of third-party regulation service if NorthWestern determines that such service is more cost-effective than operating Mill Creek.[10] NorthWestern explains that the ability to procure third-party regulation service will benefit customers because in some circumstances NorthWestern will be able to reduce the operating costs of Mill Creek.[11]

7. NorthWestern also proposes to assess an energy rate to customers taking regulation service. Similar to the demand rate, the proposed energy rate is a formula intended to recover the fuel and variable operation and maintenance (O&M) costs that are attributable to providing regulation service from Mill Creek.[12] The proposed energy rate uses a 57 percent (60/105) allocation factor, identical to the allocation factor used in the demand rate, which NorthWestern applies to the collective sum of the estimated monthly

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[7] NorthWestern Filing at 7.

[8] *Id.*

[9] *Id.*

[10] NorthWestern states that it will request proposals to procure regulation service from third parties, and if the total costs of contracting for regulation service are less than the operating costs of Mill Creek, it will procure the third-party regulation and reduce the output of Mill Creek. *Id*. at 6.

[11] *Id.*

[12] *Id*. at 7.

fuel and O&M costs, less a credit (energy credit) representing the energy that NorthWestern expects to sell during the month.

8. NorthWestern proposes to estimate the monthly fuel cost component for each billing month and adjust the value based upon the difference between the actual and estimated fuel costs for the second month preceding the billing month as follows: the variable O&M component of the energy rate equals the amount of variable O&M costs for Mill Creek that NorthWestern estimates it will incur in the rate year. NorthWestern will then add to the variable O&M costs the difference between the variable O&M costs that NorthWestern estimated it would incur during the previous year and the variable O&M costs that NorthWestern actually incurred, adjusted for carrying charges pursuant to section 35.19a of the Commission's regulations.[13]

9. NorthWestern will determine the energy credit by multiplying the estimated hourly generation output from Mill Creek, during the billing month, in MW hours, by the Dow Jones Mid-C Forward Market Price, less $7.00. NorthWestern will then adjust the resulting value for the difference between the actual energy credit and the estimated energy credit for the month preceding the billing month. NorthWestern explains that the $7.00 reduction reflects the cost of transmission to its balancing authority area.

10. NorthWestern explains that it has apportioned both the demand rate and the energy rate using a 60/105 allocation ratio in order to establish cost responsibility between retail and wholesale customers. NorthWestern argues that the proposed allocation is appropriate because it attributes 45 MW of the total 105 MW available to regulation service used to integrate variable energy sources for retail customers. It further states that the revenue requirements for variable energy sources for retail energy supply will be collected directly from retail customers under the Montana Commission's approved rates. To derive the per unit energy rate, NorthWestern explains that it will divide the resulting fuel and variable O&M costs and the credits for the value of the Mill Creek generation output by the rolling 12 CP billing determinants for transmission customers taking regulation service.[14]

11. Finally, NorthWestern states that when the construction of Mill Creek is complete, it will submit a filing to the Commission to true up the revenue requirement incorporated in the demand rate formula set forth in Schedule 3 and the variable O&M used to develop

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[13] *Id*.

[14] *Id*. at 8.

the energy rate, and refund or surcharge, as appropriate, the difference between estimated and actual costs.[15]

12. Finally, NorthWestern requests a waiver of the Commission's regulations, including section 35.13,[16] as necessary for approval of the instant filing. NorthWestern states that to the extent that this filing does not contain any information otherwise required for technical compliance with the Commission's regulations, NorthWestern requests that compliance with such regulation be waived. NorthWestern asserts that good cause supports its request for waivers due to the uniqueness of NorthWestern's need to rely on Mill Creek for providing regulation service.

## III. Notice of Filing and Responsive Pleadings

13. Notice of NorthWestern's filing was published in the *Federal Register*, 74 Fed. Reg. 26,216 (2010), with interventions and protests due on or before May 20, 2010. The Montana Commission and NaturEner USA, LLC filed timely motions to intervene. Montana Consumer Counsel (Consumer Counsel) and the Montana Large Customer Group (Large Customer Group) filed timely motions to intervene and protest. Central Montana Electric Power Cooperative, Inc. (Central Montana) filed a timely motion to intervene and motion to reject filings, or, in the alternative, a protest and request for evidentiary hearing. On June 4, 2010, NorthWestern filed a motion for leave to answer and answer. On June 8, 2010, Large Customer Group filed a response to NorthWestern's motion for leave to answer and answer. On June 21, 2010, Consumer Counsel filed a response to NorthWestern's motion for leave to answer and answer. On July 2, 2010, Basin Electric Power Cooperative (Basin) filed a motion to intervene out-of-time and protest. On July 19, 2010, NorthWestern filed an answer in opposition to Basin's motion to intervene out of time.

## IV. Procedural Matters

14. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2010), the timely unopposed motions to intervene serve to make the entities filing them parties to the proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2010), prohibits an answer to a protest unless otherwise ordered by the decisional authority.

15. We are not persuaded to accept NorthWestern's answer, or the answers to answers of Large Customer Group and Consumer Counsel. Pursuant to Rule 214(d) of the

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[15] *Id*.

[16] 18 C.F.R. § 35.13 (2010).

Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2010), the Commission will grant Basin's late-filed motion to intervene and protest given its interest in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay.

## V. Protests

16. Consumer Counsel states that the Commission should require NorthWestern to substantiate its assumption that it will need to provide 60 MW of regulating capacity to furnish regulation and frequency response service to the loads served by its transmission system.[17] Consumer Counsel observes that certain customers, totaling approximately 21 MW, are entitled to supply their own regulation service and may do so.[18] Consumer Counsel argues that given the uncertainty regarding how much capacity NorthWestern will require to provide regulation service, the Commission should reject NorthWestern's proposed demand charge formula rate. Moreover, Consumer Counsel argues that the demand rate is unjustified because it is based on the allocation of 60/105 (57.14 percent) of Mill Creek's annual revenue requirement to OATT regulation service, regardless of the amount of service actually used by customers taking such service under NorthWestern's OATT.[19] Finally, Consumer Counsel argues that NorthWestern does not adequately explain its assertion that it is appropriate to use 105 MW of estimated regulation capability to allocate the full cost of Mill Creek, instead of the 150 MW nameplate rating of the three combustion turbine generators that make up Mill Creek.[20]

17. Large Customer Group protests NorthWestern's filing for five reasons. First, Large Customer Group states that NorthWestern's proposed rate increase is over three times its current rate for regulation and frequency response service and is not supported by adequate evidence.[21] Second, Large Customer Group argues that if NorthWestern purchases Schedule 3 services from third parties, NorthWestern's proposal amounts to charging Schedule 3 customers for the fixed costs of Mill Creek even when it is not used to provide Schedule 3 services.[22] Third, Large Customer Group objects to NorthWestern's use of the sum of 105 MW as the denominator of the allocation of the

[17] Consumer Counsel Protest at 1.

[18] *Id*.

[19] *Id*. at 2.

[20] *Id*.

[21] Large Customer Group Protest at 3.

[22] *Id*. at 4.

fixed costs of Mill Creek. Large Customer Group states that Mill Creek's actual capacity will be 139.5 MW, making the share of Mill Creek's costs allocated to Schedule 3 services 43 percent, rather than 57 percent.[23] Fourth, Large Customer Group adds that NorthWestern has provided insufficient evidence that 60 MW is the capacity needed for Schedule 3 services, because while NorthWestern acquires this amount of capacity now, when Schedule 3 service is provided locally by Mill Creek, less may be needed.[24] Finally, Large Customer Group asserts that NorthWestern's proposal to charge net variable fuel and operations and maintenance costs associated with producing energy to Schedule 3 is not appropriate because Schedule 3 customers do not receive any energy from NorthWestern.[25]

18. Central Montana states that NorthWestern's filing is "patently deficient."[26] Central Montana argues that because Mill Creek is not yet in service, it is not "used and useful" and its costs are not "known and measurable."[27] Central Montana contends that NorthWestern's filing does not contain sufficient information to show that its proposal is just and reasonable, particularly because the filing "is devoid of any materials demonstrating that the decision to build the Mill Creek Station (as opposed to continuing its current practice of contracting for Schedule 3 service) was the least cost, or otherwise best, choice."[28] Central Montana states that NorthWestern does not provide information comparing the costs of Mill Creek with the costs of continuing to purchase regulation services from third parties.[29] Central Montana argues that the lack of information about costs, despite NorthWestern's commitment to true them up once Mill Creek is operational, renders NorthWestern's filing patently deficient, warranting dismissal.[30]

19. Central Montana continues that if the Commission does not reject NorthWestern's filing, it still protests the filing because NorthWestern "does not provide adequate,

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[23] *Id*.

[24] *Id*. at 5.

[25] *Id*.

[26] Central Montana Motion and Protest at 7.

[27] *Id*.

[28] *Id*. at 9.

[29] *Id*. at 11.

[30] *Id*. at 12.

independent support for its proposed cost allocation and rate design."[31] Specifically, Central Montana states that NorthWestern merely estimates, without definitive support, that it will use 45 MW of Mill Creek's 105 MW capability to provide regulation service to integrate wind generation projects and allocate the remaining 60 MW to NorthWestern's wholesale customers. Central Montana asserts that NorthWestern has neither demonstrated the basis for Mill Creek's proposed fixed revenue requirement nor demonstrated why limiting credits for sales from Mill Creek to the energy value, derived from the actual Dow Jones Mid-C Daily Index Price less $7.00, is reasonable.[32] Central Montana further argues that NorthWestern's assertion that the Commission and the Montana Commission must treat the recovery of Mill Creek's costs consistently conflates federal and state jurisdiction principles and is contrary to FERC's plenary authority over interstate wholesale rates.[33]

20. Basin protests that NorthWestern has provided insufficient information to support its proposed allocation of 60 MW of generating capacity to regulation service. Specifically, Basin asserts that the amount of capacity that a utility typically devotes to regulation service is less than 1.5 percent of the peak load on its system. Such calculation indicates that NorthWestern needs 28 MW of capacity for regulation service, not the 60 MW that it proposes.[34] Basin also protests that NorthWestern has not justified its proposal to include energy costs in the charges for regulation service.[35] Basin argues that the transmission provider provides no energy in the course of providing regulation service.[36] Basin states that NorthWestern's proposal to credit the cost of energy that it would otherwise charge in connection with regulation service is not just and reasonable, because NorthWestern has not shown that it would actually sell the energy at the Mid-Columbia Hub, which is the basis for the $7.00 credit that NorthWestern proposes. Basin asserts that NorthWestern should revise its tariff to clarify, in general, the way in which charges for regulation service will be developed.[37] Basin asks the Commission to direct NorthWestern to file Statements BG and BH to reflect the rate impact of its

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[31] *Id*.

[32] *Id*. at 15-16.

[33] *Id*. at 14.

[34] Basin Protest at 5.

[35] *Id*. at 7.

[36] *Id*. at 8.

[37] *Id*. at 10.

proposed tariff changes, as required by the Commission's regulations, and to give affected parties notice of the potential rate increases that will affect them.[38]

## VI. Discussion

21. The Commission finds that NorthWestern's Revised Schedule 3 has not been shown to be just and reasonable and raises issues of material fact that warrant hearing procedures. The issues to be investigated at hearing include, but are not limited to, the proposed Mill Creek annual revenue requirement and associated return on common equity, the allocation of Mill Creek's fixed and variable costs, the propriety of charging an energy rate to regulation service customers, the propriety of using the $7.00 market differential in the derivation of the energy value, the level of regulation service purchase obligations for customers, inclusion of third party regulation purchases in the proposed demand rate, and lack of ceiling rates for regulation service. These are issues that cannot be resolved on the record before us and are more appropriately addressed in the hearing procedures ordered below.

22. In Order No. 888, the Commission stated that the pricing of ancillary services should include the amount of each ancillary service that the transmission customer must purchase, self-supply, or otherwise procure and must be readily determinable from the transmission provider's tariff and comparable to obligations to which the transmission provider itself is subject.[39] The Commission also specifically detailed that the transmission provider *is required* to identify the regulating margin requirements for transmission customers serving loads in its balancing authority area and to develop procedures by which customers can avoid or reduce such requirements.[40]

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[38] *Id*. at 11-12 (citing 18 C.F.R. § 35.13(h)(32), (33) (2010)).

[39] *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, at 31,721 (1996), *order on reh'g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048 (1997), *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).

[40] Order No. 888, FERC Stats. & Regs. at 31,717. Order No. 890 did not change the requirements of Order No. 888 in this regard. *See generally, Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, FERC Stats. & Regs. ¶ 31,241, *order on reh'g*, Order No. 890-A, FERC Stats. & Regs. ¶ 31,261 (2007), *order on reh'g*, Order No. 890-B, 123 FERC ¶ 61,299 (2008), *order on reh'g*, Order

(continued…)

23. Notably, in *Kentucky Utilities Co.* and *Allegheny Power Service Corp.*,[41] the Commission concluded that, in the absence of any data supporting a transmission provider's regulation requirement, the most accurate way to determine the regulation obligation applicable to transmission customers was by calculating the average of [all] hourly load variations on the transmission provider's system. The Commission further concluded that a company would only be required to provide, on average, adequate generation capacity to cover the portion of the hour when a customer's load is above the amount of generation it has block-scheduled.[42] NorthWestern's proposed formula for regulation service does not appear to be consistent with these aspects of *Kentucky Utilities Co.* and *Allegheny Power Service Corp*. NorthWestern has not demonstrated why it proposes to depart from Commission precedent. Therefore, the Commission will establish hearing procedures to determine if NorthWestern's Revised Schedule 3 is just and reasonable. We note that Mill Creek is scheduled to commence operating on January 1, 2011. We therefore, accept NorthWestern's Revised Schedule 3 for filing, suspend it and make it effective January 1, 2011, as requested, subject to refund, and set it for hearing.[43] The Commission will also request the Administrative Law Judge to establish an expeditious schedule.

24. The Commission will deny NorthWestern's request for waivers. Under certain circumstances the Commission allows for waiver of its regulations, however, NorthWestern must specifically identify the regulation requirements it wishes the Commission to waive and demonstrate good cause for the request. NorthWestern has

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No. 890-C, 126 FERC ¶ 61,228 (2009), *order on clarification*, Order No. 890-D, 129 FERC ¶ 61,126 (2009). Moreover, Order No. 890 states that regulation and frequency response "may be provided by generating units as well as other non-generation resources such as demand resources where appropriate." Order No. 890, FERC Stats & Regs. ¶ 21,241 at P 888.

[41] *Kentucky Utilities Co.*, 85 FERC ¶ 61,274, at 62,108–62,109 (1998); *Allegheny Power Service Corp.*, 85 FERC ¶ 61,275, at 62,120–62,121 (1998).

[42] Block scheduling refers to the common electric utility practice of scheduling generation in fixed hourly blocks. For example, a customer that forecasts its load at the beginning of the hour to be 50 MW and its load at the end of the hour to be 150 MW would block schedule generation equal to 100 MW (the average load during the hour) which, at times, will be less than the customer's actual moment-to-moment load.

[43] While NorthWestern anticipates the completion of Mill Creek by fall 2010, if Mill Creek is unable to commence operation as of the effective date, NorthWestern is directed to make a filing with the Commission to remove the costs of Mill Creek from the Revised Schedule 3.

neither identified the specific regulations for which it requests waivers, nor shown good cause to support its request. Accordingly, NorthWestern's request for waivers is denied.

The Commission orders:

(A) NorthWestern's Revised Schedule 3 is hereby accepted for filing and suspended, to become effective January 1, 2011, subject to refund, as discussed in the body of this order.

(B) NorthWestern's request for waivers is denied, as discussed in the body of this order.

(C) Pursuant to the authority contained in and subject to the jurisdiction conferred on the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R. Chapter I), a public hearing shall be held as expeditiously as possible concerning NorthWestern's proposed tariff revisions.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,
Deputy Secretary.