155 FERC ¶ 61,158
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;
Cheryl A. LaFleur, Tony Clark,
and Colette D. Honorable.

NorthWestern Corporation Docket Nos. ER10-1138-003
ER12-316-003

ORDER DENYING REHEARING

(Issued May 10, 2016)

1. In this order, we deny NorthWestern Corporation's (NorthWestern)[1] request for rehearing of Opinion No. 530,[2] which affirmed the Initial Decision[3] in these proceedings.

I. Background

2. On April 29, 2010, in Docket No. ER10-1138-000, NorthWestern filed revised tariff sheets for Schedule 3 (Regulation and Frequency Response) service under its Open Access Transmission Tariff (OATT)[4] (Revised Schedule 3) to recover the fixed and

[1] NorthWestern owns and operates an electric transmission system in Montana, and operates a balancing authority area within the State of Montana. NorthWestern states that it 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 Corporation (NERC) and Western Electric Coordinating Council reliability requirements. NorthWestern April 29, 2010 filing at 3; *NorthWestern Corp.*, 140 FERC ¶ 61,020, at P 2 (2012).

[2] *NorthWestern Corp.*, Opinion No. 530, 147 FERC ¶ 61,049 (2014).

[3] *NorthWestern Corp.*, 140 FERC ¶ 63,023 (2012) (Initial Decision).

[4] As part of its OATT, NorthWestern must offer to supply its transmission customers with regulation and frequency response service under Schedule 3 when the transmission service is used to serve load within its balancing authority area.

variable revenue requirement for the Gates Station[5] generating facility through a monthly demand charge and monthly energy charge. On October 15, 2010, the Commission accepted and suspended NorthWestern's Revised Schedule 3, to become effective January 1, 2011, as requested, subject to refund and set it for hearing.[6] The Commission found that NorthWestern's Revised Schedule 3 had not been shown to be just and reasonable and raised issues of material fact warranting hearing procedures.[7] Furthermore, the Commission stated that:

> The issues to be investigated at hearing include, but are not limited to, the proposed [Gates Station] annual revenue requirement and associated return on common equity, the allocation of [Gates Station] 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 services.[8]

In addition, the Commission noted that NorthWestern's proposed formula for regulation service did not appear to be consistent with Commission precedent.[9]

3. On November 1, 2011, NorthWestern filed additional revisions to Schedule 3 in Docket No. ER12-316-000. The Commission rejected NorthWestern's proposal to subject customers who elected to self-supply Schedule 3 service to additional charges.[10]

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[5] NorthWestern states that Gates Station (Gates Station was originally named Mill Creek Generating Station) was constructed for the specific purpose of providing regulation service on NorthWestern's transmission system. It was placed into service in January 2011, and consists of three natural gas-fired turbine generators with a maximum capacity of 50 MW each. NorthWestern April 29, 2010 Filing at 5; Initial Decision, 140 FERC ¶ 63,023 at P 6.

[6] *NorthWestern Corp.*, 133 FERC ¶ 61,046, at P 23 (2010) (First Hearing Order).

[7] *Id.* P 21.

[8] *Id.*

[9] *Id.* P 23 (citing *Kentucky Utilities Co.*, Opinion No. 432, 85 FERC ¶ 61,274, at 62,108-109 (1998) (*Kentucky Utilities*); *Allegheny Power Service Corp.*, Opinion No. 433, 85 FERC ¶ 61,275, at 62,120-121 (1998) (*Allegheny Power*)).

[10] *NorthWestern Corp.*, 137 FERC ¶ 61,248, at P 33 (2011) (Second Hearing

(continued...)

The Commission accepted the remainder of NorthWestern's revisions, suspended them for a nominal period, to become effective on December 31, 2011, subject to refund, and set them for hearing procedures.[11] The Commission stated that, among other things, the hearing would address the manner in which NorthWestern proposed to set the regulation requirements for self-supplying customers, the movement of operations and maintenance costs from the monthly energy rate to the monthly demand rate, and the manner in which NorthWestern proposed to credit certain revenues to Schedule 3 customers.[12] The Commission also consolidated Docket No. ER12-316-000 with Docket No. ER10-1138-000 for purposes of hearing and decision since the issues in both proceedings were closely intertwined and involved NorthWestern's proposal to base its Schedule 3 charge on the cost of service of the Gates Station.[13]

4. On September 21, 2012, the Presiding Judge issued an Initial Decision rejecting the basis for most of NorthWestern's proposed tariff revisions. The Initial Decision addressed and resolved eight issues identified by the parties in their Joint Statement.[14] Among other things, the Presiding Judge found that the stipulation of NorthWestern's annual fixed cost revenue requirement for the Gates Station was just and reasonable, but that NorthWestern's proposed allocation of the Gates Station fixed cost revenue requirement to Schedule 3 customers was not just and reasonable. The Presiding Judge found that NorthWestern's proposed allocation based on a numerator of 60 MW and a denominator of 105 MW was not just and reasonable. In addition, the Presiding Judge found that NorthWestern's proposed imposition of an energy rate charge in Schedule 3, and its proposal to use a $7.00 market differential in the derivation of the energy value,

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Order). On January 30, 2012, NorthWestern submitted a compliance filing and a request for rehearing in response to the Commission's Second Hearing Order that disallowed additional charges for self-supplying customers under Schedule 3. On July 12, 2012, the Commission denied NorthWestern's request for rehearing of the Second Hearing Order. *NorthWestern Corp.*, 140 FERC ¶ 61,020 (2012). In the rehearing order, the Commission found that allowing a standby fee could hinder competition by imposing costs on self-supply customers in excess of the costs of providing this service themselves. *Id*. P 24.

[11] *NorthWestern Corp.*, 137 FERC ¶ 61,248 at P 33.

[12] *Id*.

[13] *Id*. P 34.

[14] Initial Decision, 140 FERC ¶ 63,023 at Table of Contents stating each issue and P 13; Opinion No. 530, 147 FERC ¶ 61,049 at PP 16, 251-259.

were not shown to be just and reasonable. The Presiding Judge also found that NorthWestern's proposed level of regulation service purchase obligations for customers was not just and reasonable, and that the inclusion of third-party regulation purchases in its proposed demand rate was not just and reasonable unless the proposed purchases were more cost effective than dispatching the Gates Station. In addition, the Presiding Judge found that the lack of proposed ceiling rates for regulation service was not just and reasonable, and that NorthWestern's proposed regulation requirements for self-supplying customers were not just and reasonable.[15]

5. On April 17, 2014, the Commission issued Opinion No. 530 which summarily affirmed the Initial Decision, without discussion on seven issues, and affirmed the remaining issue with further discussion. Specifically, the Commission affirmed the Presiding Judge on all issues for the reasons provided in the Initial Decision; the Commission also affirmed the Presiding Judge on the "regulation down" component of Issue 2(a) of the Joint Statement,[16] in part, for reasons in addition to those provided in the Initial Decision.[17]

6. Further, the Commission directed NorthWestern to make a compliance filing setting forth revised tariff sheets for its OATT Schedule 3 service that applied the determinations made in the order. Pursuant to the First and Second Hearing Orders issued in Docket Nos. ER10-1138-000 and ER12-316-000, the Commission also required NorthWestern to refund Schedule 3 customers the difference between rates charged under the proposed rate schedule in this proceeding and the rate schedule found to be just and reasonable. The Commission stated that all refunds should include interest, from the date of collection until the date refunds are made, pursuant to the rate set forth in 18 C.F.R. § 35.19a(a)(2)(iii) (2013). The Commission directed NorthWestern to make refunds within 30 days of the issuance of Opinion No. 530, and file a refund report within 30 days thereafter.[18]

7. On May 1, 2014, NorthWestern filed an Emergency Request for Partial Rehearing asking that refunds not be due within 30 days of Opinion No. 530, but within 30 days of a

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[15] Opinion No. 530, 147 FERC ¶ 61,049 at PP 251-259.

[16] Issue 2(a) addressed the following: Is NorthWestern's proposed allocation (of the Gates Station fixed cost revenue requirement) based on a numerator of 60 MW just and reasonable?

[17] Opinion No. 530, 147 FERC ¶ 61,049 at P 18.

[18] *Id.* P 51.

Commission order on rehearing. On May 14, 2014, the Commission issued a notice extending the time for NorthWestern to make any refunds to 30 days after the date of the Commission's order on rehearing, with the refund report due 30 days thereafter. On May 19, 2014, NorthWestern made a compliance filing implementing the revised rates for Schedule 3, stating that it would charge them as of April 17, 2014, and the Commission accepted that compliance filing.[19] Also on May 19, 2014, NorthWestern filed a request for rehearing of Opinion No. 530, which we address below.

8. On June 3, 2014, Montana Large Customer Group filed a motion for leave to answer and answer NorthWestern's request for rehearing. On June 3, 2014, Central Montana Electric Power Cooperative, Inc. (Central Montana) filed a motion to strike, or alternatively, request for leave to answer and answer NorthWestern's request for rehearing. On June 18, 2014, NorthWestern filed a leave to answer and answer Central Montana. On December 19, 2014, Central Montana filed a motion to lodge a recent United States Court of Appeals for the District of Columbia (D.C. Circuit) decision. Central Montana claims that this decision clarifies and provides additional guidance on the line of case law relied on by NorthWestern in its attempt to argue that refunds in these proceedings should be denied.[20]

II. Discussion

A. Procedural Issues

9. Rule 713(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(d) (2015), prohibits answers to rehearing requests. Therefore, we will reject Montana Large Customer Group's and Central Montana's answers.[21] Consequently, we will also reject NorthWestern's answer.

10. We deny Central Montana's motion to lodge. We take administrative notice of the D.C. Circuit's decision,[22] and therefore, Central Montana's motion to lodge is unnecessary.[23]

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[19] *See NorthWestern Corp.*, Docket No. ER12-316-004 (unpublished letter orders dated October 3, 2014 and February 19, 2015).

[20] Central Montana's motion to lodge at 3.

[21] We will treat Central Montana's pleading as a request for leave to answer and answer.

[22] *See La Pub. Serv. Comm'n v. FERC*, 772 F.3d 1297 (D.C. Cir. 2014).

B. NorthWestern's Request for Rehearing

11. We deny NorthWestern's request for rehearing. We find that, with the exception of its last argument on refund liability, all of the arguments NorthWestern's raised in its request for rehearing have already been raised and addressed in Opinion No. 530 and/or the Initial Decision in these proceedings, as discussed below.

1. Whether the Commission Violated Cost Causation Principles

a. NorthWestern's Rehearing

12. NorthWestern argues that Opinion No. 530 violates accepted principles of cost causation by denying NorthWestern the right to charge the Gates Station revenue requirement to the customers for whom the plant was built. NorthWestern also claims that the opinion wrongly deprives NorthWestern of a reasonable opportunity to recover the costs it prudently incurred in constructing and operating the Gates Station to fulfill its obligation to provide regulation service.

13. Northwestern states that it has an obligation to provide regulation service and an associated need to secure adequate regulating reserves. NorthWestern argues that the Commission improperly deprived NorthWestern of the ability to recover the costs that it prudently incurred to fulfill its obligation to provide regulation service. NorthWestern asserts that its right to recover its costs is not diminished because those costs are incurred to ensure reliability rather than serve load.[24]

14. NorthWestern argues that it built the Gates Station to serve the regulation requirements of NorthWestern's customers, and thus those customers should bear the costs of constructing and operating the Gates Station. NorthWestern claims that the Commission fails to identify any precedent that would deviate from the established principle of cost causation that the regulation customers should cover the Gates Station revenue requirement because it was prudently constructed to serve them. NorthWestern adds that the Commission has never held that principles of equity and cost causation do not apply to ancillary service rates, nor has the Commission ever mandated that ancillary service rates be put in terms of unit rates. NorthWestern maintains that the Commission cited no precedent for the notion that a utility must prove a negative, namely, that it

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[23] *Pacific Gas and Electric Co.*, 109 FERC ¶ 61,205, at P 7 (2004) ("This Commission and the courts can take official notice of any judicial decision at any time, so there is no need to reopen the record for this purpose.").

[24] NorthWestern's request for rehearing at 12-14.

cannot provide undefined other services to undefined customers before it can recover prudent costs that were incurred for a particular service. Furthermore, NorthWestern asserts that there was no evidence that non-regulation customers were receiving other services that could justify allocating a portion of the Gates Station to them.[25]

15. Moreover, NorthWestern argues that given its inability to sell any energy other than on an interruptible basis it would violate established cost causation principles to allocate any portion of the Gates Station revenue requirement to assumed energy sales. Rather than allocate a portion of the Gates Station revenue requirement to sales that may be curtailed, NorthWestern's rate formula specifically credits the Schedule 3 customers with the market value of the energy produced by the Gates Station. The rate formula also credits Schedule 3 customers with any non-firm opportunity sales that could be made if capacity from the Gates Station became available in the future. NorthWestern claims that this crediting mechanism not only fully complies with Commission precedent but is preferred to attempting to allocate a portion of the revenue requirement to other customers. NorthWestern argues that since it neither planned nor operated the Gates Station to accommodate any firm transactions other than the provision of regulation service, any non-regulation revenues it derives should be credited as opportunity sales rather than assumed as part of a cost allocation.[26]

b. <u>Commission Determination</u>

16. We find that the Commission has previously considered these arguments in Opinion No. 530. In Opinion No. 530, the Commission discussed NorthWestern's contention that certain policy considerations compel full review and reversal of the Initial Decision, including: (1) the concept that a utility be given the reasonable opportunity to recover the costs it prudently incurs in providing service; (2) the principle that costs be allocated to the customers on whose behalf the costs were incurred; (3) the Commission's policy of having customers pay for the standby capability associated with regulation service; and (4) the Commission's stated preference for crediting opportunity sales against a revenue requirement.[27]

17. The Commission addressed NorthWestern's claims, stating that NorthWestern's underlying premise of the case is that Gates Station's revenue requirement should be recovered exclusively through regulation service rates. However, the Commission

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[25] *Id.* at 14-17.

[26] *Id.* at 18-19.

[27] Opinion No. 530, 147 FERC ¶ 61,049 at P 23.

adopted the Presiding Judge's rejection of NorthWestern's premise and, instead, adopted her derivation of Schedule 3 rates based on a traditional rate analysis of how much capacity is actually needed to support Schedule 3 service, without regard to how much of the Gates Station revenue requirement would be collected by NorthWestern. The Commission agreed with the Presiding Judge's approach since the purpose of the hearing was to determine whether NorthWestern's Schedule 3 rate was just and reasonable, and not to ensure that NorthWestern fully recovers its total revenue requirement for the Gates Station through regulation service rates.[28]

18. In addition, the Commission stated that it did not believe its policies with respect to reliability and ancillary service availability would be hampered by not granting NorthWestern full cost recovery of Gates Station costs solely from regulation customers. The Commission added that transmission providers should be able to satisfy their balancing and regulation obligations without resorting to compensation mechanisms that do not comply with applicable Commission precedent and methodology. The Commission stated that to accept NorthWestern's argument that a generating facility dedicated to regulation service deserves full recovery of its cost of service might in fact encourage transmission providers to build generation facilities solely to provide ancillary services at cost-of-service rates without regard to the economic value of such facilities.[29]

19. Therefore, we deny NorthWestern's request for rehearing on this issue.

2. Whether the Commission Improperly Affirmed a Confiscatory Schedule 3 Regulation Service Rate

a. NorthWestern's Rehearing

20. NorthWestern contends that in Opinion No. 530, the Commission improperly affirmed a rate for Schedule 3 regulation service that is confiscatory given the costs of providing the service. NorthWestern asserts that the rate set by Opinion No. 530 and the Initial Decision is far below the zone of reasonableness since it denies NorthWestern any rate of return from its Schedule 3 customers, and instead results in NorthWestern's shareholders having to provide an annual subsidy of over $8 million to the company's Schedule 3 customers. In addition, NorthWestern claims that the rate approved by the Commission is half of what NorthWestern previously paid third parties to secure regulating reserves under contracts approved by the Commission. NorthWestern adds that it is unable to recover the Gates Station revenue requirement through other means.

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[28] *Id.* P 24.

[29] *Id.* P 25.

NorthWestern maintains that Opinion No. 530 and the Initial Decision effectively allocated a significant portion of the Gates Station costs to other customers without identifying who those customers are.[30]

21. Next, NorthWestern argues that the Commission understated the capacity needed for Schedule 3 service. NorthWestern asserts that using the ratio of 19 MW as the numerator (the amount of capacity determined by the Initial Decision to be just and reasonable for Schedule 3 service) and 150 MW as the denominator (the nameplate capacity of all three units adopted by the Initial Decision) resulted in Schedule 3 customers paying 4.4 percent of the Gates Station fixed costs, even though these customers comprise 35 percent of NorthWestern's total system load. NorthWestern contends that the ratio should not be used to establish a unit demand charge, but rather to apportion the respective cost responsibilities of the Gates Station between wholesale and retail customers. NorthWestern further asserts that there was no need to develop a separate allocator in its Schedule 3 rate formula because a 12 month, coincident peak (12 CP)[31] allocator is already included.[32] NorthWestern argues that the appropriate ratio should reflect the expected total usage of the Gates Station, apportioned between retail customers, which have been assigned an 80 percent obligation by the Montana Public Service Commission, and wholesale customers.

22. NorthWestern claims that the Commission erred in modifying the 60 MW regulation allocation, which was the filed rate before the Gates Station, without instituting a section 206 investigation. NorthWestern asserts that it had previously purchased 60 MW of regulating reserves and allocated costs of that purchase to its Schedule 3 customers on a 12 CP basis and that the Commission approved both the amount of regulation service purchased and the allocation of that purchase to Schedule 3 customers.[33] NorthWestern argues that it did not change the regulation quantity or allocation method when it filed the rates in this case. Therefore, it contends that the

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[30] NorthWestern's request for rehearing at 19-21.

[31] 12 CP is defined as the average of monthly coincident system peaks during the 12 months of the year.

[32] NorthWestern's request for rehearing at 29-30.

[33] *Id.* at 35 (alleging that 60 MW of regulation capacity was approved in *NorthWestern Corp.*, 121 FERC ¶ 61,204, at P 15 (2007)).

Commission erred in rejecting the 60 MW allocation without instituting a section 206 complaint proceeding.[34]

b. Commission Determination

23. We find that Opinion No. 530 and the Initial Decision fully addressed NorthWestern's argument. Ultimately, the Commission found in Opinion No. 530 that the Schedule 3 rates proposed by NorthWestern had not been shown to be just and reasonable, and the Schedule 3 rates resulting from the findings and methodology adopted in the Initial Decision were just and reasonable.[35] Opinion No. 530 affirmed the overall revenue requirement for the Gates Station, but rejected NorthWestern's calculation of Schedule 3 rates.[36] Nothing herein precludes NorthWestern from making a filing under section 205 to propose to recover costs through other rates, as appropriate.

24. We again reject NorthWestern's arguments regarding the specifics of the Presiding Judge's findings on whether the Schedule 3 rates were just and reasonable. For example, in Opinion No. 530, the Commission affirmed the Presiding Judge's finding that NorthWestern failed to meet its burden of proof with respect to supporting its proposed numerator of 60 MW as the capacity needed to support Schedule 3 service. The Commission also affirmed the Presiding Judge's finding that NorthWestern's proposed allocation based on a numerator of 60 MW was not just and reasonable, and that its proposed allocation based on a denominator of 105 MW was also not just and reasonable.[37] We note that the Presiding Judge's conclusions were based upon a substantial evidentiary record and Commission precedent. We find that Commission policy and precedent provided the appropriate guidance with respect to the applicable methodology used to determine the amount of regulation capacity required for Schedule 3 service, and thus the appropriate numerator for the ratio used to allocate the costs associated with the Gates Station. We find that NorthWestern's arguments in its efforts to secure full recovery of the Gates Station costs without any risks are unpersuasive.

25. Therefore, we deny NorthWestern's request for rehearing on this issue.

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[34] *Id.* at 35.

[35] Opinion No. 530, 147 FERC ¶ 61,049 at P 15.

[36] *Id.* PP 16-17.

[37] *Id.* P 24.

3. Whether the Commission Properly Found that Northwestern Had the Burden of Proof

a. NorthWestern's Rehearing

26. NorthWestern states that because it has not changed the amount of regulation service needed to serve transmission customers in its Schedule 3 rate, it does not bear the burden of proof to show that 60 MW is just and reasonable in this proceeding.[38]

b. Commission Determination

27. Contrary to NorthWestern's assertion, we find that the Presiding Judge previously addressed NorthWestern's argument that it does not have the burden of proof because its section 205 filing "represent[s] no departure from the status quo," and was approved in a previous proceeding. The Presiding Judge stated that this proposal and NorthWestern's reliance on *Public Service Commission of New York v. FERC*, 642 F.2d 1335, 1345 (D.C. Cir. 1980) was factually and legally misguided as applied to this case.[39]

28. The Presiding Judge stated that NorthWestern represented that its proposed rate was not a "departure from the status quo," but that this was inaccurate. The Presiding Judge found that NorthWestern had not previously allocated the costs of the newly-constructed Gates Station to any customers, nor had it allocated any of its Schedule 3 costs based on a numerator of 60 MW in any proceedings before the Commission.[40]

29. The Presiding Judge added that, as a matter of law, since NorthWestern was the utility filing for revised rates under section 205 of the Federal Power Act (FPA),[41] NorthWestern clearly had the burden of proof to show its proposed rate was just and reasonable.[42] The Presiding Judge also pointed out that, as a matter of fairness, NorthWestern took for itself the customary rights of the party with the burden of proof, such as the right to file rebuttal testimony. The Presiding Judge noted that NorthWestern may not take the procedural advantages of the party with the burden of proof and yet

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[38] NorthWestern's request for rehearing at 35.

[39] Initial Decision, 140 FERC ¶ 63,023 at P 76.

[40] *Id.* P 77.

[41] 16 U.S.C. § 824d (2012).

[42] Initial Decision, 140 FERC ¶ 63,023 P 78.

(continued...)

claim that it does not bear the ultimate burden.[43] The Commission affirmed the Presiding Judge's findings in Opinion No. 530, and we see no reason to change that determination.

30. Therefore, we deny NorthWestern's request for rehearing on this issue.

4. Whether the Commission Properly Denied NorthWestern Compensation for Providing Capacity and Regulation Down Service

a. NorthWestern's Rehearing

31. NorthWestern claims that the Commission erred by denying NorthWestern compensation for the cost of regulation "down" capacity. NorthWestern asserts that the Commission erred in reducing the numerator by 41 MW to exclude capacity required for regulation "down" service, and in making a further reduction to reflect the diversity benefits between wind generation and traditional load. Therefore, NorthWestern argues that since retail load is paying the cost of the greater regulating reserves that must be available to accommodate wind generation, it is fair and consistent with cost causation principles that retail load receive any diversity benefit from the wind generation. NorthWestern adds that the Commission erred by adopting inconsistent principles for allocating costs and benefits associated with regulation service. NorthWestern asserts that the Commission explicitly declined to allocate the prudent costs of the Gates Station to all regulation load, yet when considering diversity benefits the Commission reversed itself and found that those benefits must be shared among all customers on a nondiscriminatory basis. NorthWestern asserts that the Commission arbitrarily and capriciously denied it compensation for providing capacity for regulation down service. NorthWestern claims that the Commission relied on the faulty premise that NorthWestern did not justify why it failed to take into account the value of energy produced by regulation down capacity, when in fact it credited customers with the value of that energy. NorthWestern also contends that the Presiding Judge erred by excluding the capacity needed to provide regulation down service, the effect of which was to reduce the formula rate numerator, i.e., the amount of capacity dedicated to regulation load, by approximately 41 MW.[44]

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[43] *Id.* P 79.

[44] NorthWestern's request for rehearing at 36-40.

b. Commission Determination

32. We find that this issue was fully addressed by both the Presiding Judge and the Commission. In Opinion No. 530, the Commission addressed NorthWestern's assertion that the Presiding Judge denied NorthWestern compensation for regulation down capacity, based in large part, on a misapplication of the Commission's holdings in *Kentucky Utilities* and *Allegheny Power*.[45] Specifically, NorthWestern argued that the Presiding Judge incorrectly found that *Kentucky Utilities* and *Allegheny Power* demonstrated a Commission policy of disallowing compensation for the capacity needed to provide regulation down service. NorthWestern explained that the holding in *Kentucky Utilities* and *Allegheny Power*—that the most accurate way to determine the regulation obligation applicable to transmission customers is by calculating the average of all hourly load variations on the transmission provider's system—only applied where there is an absence of any data to support a transmission provider's regulation requirement.[46] By contrast, NorthWestern stated that all parties here agreed to calculate regulation obligations by reference to the amount of capacity needed to satisfy CPS 2[47] and, furthermore, that NorthWestern presented enough data to calculate the amount of regulating reserves necessary to comply with CPS 2. Thus, NorthWestern concluded that there was no reason for the Presiding Judge to revert to the default method provided by *Kentucky Utilities* and *Allegheny Power*.[48]

33. In Opinion No. 530, the Commission affirmed the Presiding Judge's determination to exclude from NorthWestern's Schedule 3 those costs associated with capacity that NorthWestern claimed was needed to support regulation down service. The Commission based its decision in part upon the fact that NorthWestern failed to provide evidence as to why it would be unable to utilize the energy generated by the reserved regulation down capacity for non-regulation purposes.[49]

34. As an initial matter, the Commission noted that *Kentucky Utilities* and *Allegheny Power* are distinguishable from the present case, and therefore, that precedent was not

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[45] *See supra* note 9.

[46] Opinion No. 530, 147 FERC ¶ 61,049 at P 32.

[47] CPS 2 is a NERC reliability standard that sets the limits of a Balancing Authority's Area Control Error over a ten minute time period.

[48] Opinion No. 530, 147 FERC ¶ 61,049 at P 32.

[49] *Id.* P 45.

necessarily controlling here if those distinguishing facts warranted a different result. The Commission found that both *Kentucky Utilities* and *Allegheny Power* involved a vertically-integrated system that had several power plants operating to serve native load that could be backed down to absorb energy when needed to provide regulation down service. The Commission stated that in those cases, the utilities were already maintaining their capacity at a specific level to serve existing schedules, and in other words, the capacity costs were being recovered from customers for whom power was already scheduled.[50]

35. The Commission noted that here, NorthWestern indicated that it would not rely on Gates Station to serve the electricity demand of its customers, but used Gates Station exclusively to provide regulation service to maintain CPS 2 compliance. The Commission acknowledged that NorthWestern may be in a situation different from most other suppliers of regulation service, and that, in several recent orders that addressed specific situations, the Commission has acknowledged that regulation service was a product for which suppliers must be equitably compensated. Thus, the Commission stated that circumstances might exist where a transmission provider with no generation other than that used for regulation service may be able to make the case that it should be compensated for capacity it must hold in reserve solely to allow for regulation down. For example, such a transmission provider may be able to justify compensation for regulation down capacity if it demonstrated that, based on the location of the generating facility, there were no accessible markets into which it could sell energy generated by its regulation down capacity, and that it had no retail or other load that could be served with such energy. However, the Commission found that NorthWestern had not made such a case in this proceeding.[51]

36. The Commission stated that the regulation down capacity at issue here was that which the Gates Station purportedly placed into operation at the start of each hour and was reserved to ramp down if necessary to accommodate system imbalances in its Balancing Authority Area. In affirming the Presiding Judge's determination regarding regulation down, the Commission based its decision in part upon the fact that NorthWestern failed to provide evidence as to why it would be unable to utilize the energy generated by the reserved regulation down capacity for non-regulation purposes. The Commission found that NorthWestern had not demonstrated that the value of the energy produced by the regulation down capacity was so low as to require regulation customers to pay its full revenue requirement. Without this information, the Commission could not determine what portion, if any, of the regulation down capacity costs were

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[50] *Id.* P 46.

[51] *Id.* P 47 & n.65.

otherwise unrecovered by NorthWestern. The Commission stated that absent evidence that NorthWestern was unable to recover those costs, it was not persuaded to allow NorthWestern to include regulation down in calculating the capacity to serve Schedule 3 customers.[52] This is not asking NorthWestern to prove a negative, as it asserts, but to prove why the Gates Station capacity must be considered to be used exclusively for regulation services such that its entire costs must be borne by regulation customers.

37. The Commission also agreed with the Presiding Judge that Order No. 755[53] did not require that regulation down capacity be included in the allocation of capacity costs for NorthWestern. The Commission stated that the plain language of Order No. 755 pertained only to members of organized markets, of which NorthWestern was not a member.[54] Moreover, the Commission found that the performance payments and capacity payments discussed in Order No. 755 were not the same as compensation that NorthWestern sought in this proceeding. The Commission stated that Order No. 755 adopted a uniform compensation methodology for frequency regulation in organized markets that consists of a market-based capacity payment and a market-based "performance" payment that compensated a resource for all movement in response to the dispatch signal.[55] The Commission found that Order No. 755 did not address the situation presented here, where NorthWestern sought a cost-of-service capacity payment for capacity it allegedly needs to provide regulation down. However, the Commission stated that while NorthWestern failed in this case to demonstrate that it has unrecovered costs, NorthWestern was not precluded from making a showing in a separate proceeding to recover such costs under Schedule 10.[56]

38. Furthermore, the Commission affirmed the Presiding Judge's finding that NorthWestern did not carry its burden of proving that diversity benefits should be allocated solely to its retail load.[57] The Presiding Judge stated that NorthWestern did not

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[52] *Id.* P 48.

[53] *Frequency Regulation Compensation in the Organized Wholesale Power Markets,* Order No. 755, FERC Stats. & Regs. ¶ 31,324 (2011), *reh'g denied,* Order No. 755-A, 138 FERC ¶ 61,123 (2012).

[54] Opinion No. 530, 147 FERC ¶ 61,049 at P 49 & n.67.

[55] *Id.* P 49 & n.68.

[56] *Id.* P 50.

[57] *Id.* P 17.

submit any evidence that shows with "exact precision" how the benefits of its wind generation are actually allocated when deviations occur or how such benefits should apply to retail customers alone. The Presiding Judge added that the mutual benefits that accrue from the presence of both load and wind must be shared between wind and non-wind dependent load, and, as a result, NorthWestern needed less overall generation capacity, thereby lowering costs for all customers. Accordingly, the Presiding Judge found that NorthWestern's diversity benefits must be allocated between its retail and Schedule 3 customers.[58]

39. We affirmed the Presiding Judge's finding that NorthWestern did not carry its burden of proof on this issue, and NorthWestern has not persuaded us otherwise on rehearing. Therefore, we deny NorthWestern's request for rehearing on this issue.

5. Whether the Commission Properly Denied NorthWestern Recovery of Fuel Costs Through Schedule 3 Rates

a. NorthWestern's Rehearing

40. NorthWestern argues that the Commission's affirmance, without discussion, of the holding in the Initial Decision that NorthWestern was not entitled to recover fuel costs in Schedule 3 was error. NorthWestern claims that none of the parties challenged the reasonableness of the fuel expenditures, but the Presiding Judge nevertheless rejected NorthWestern's recovery of the fuel costs on the ground that it chose to recover them under Schedule 3 and not Schedule 4 (Energy Balance Service). NorthWestern claims that neither its existing Schedule 4 nor the pro forma Schedule 4 allows NorthWestern to recover Gates Station fuel costs. NorthWestern states that even if it could amend its tariff to move energy costs from Schedule 3 to Schedule 4, such changes would be prospective only. Therefore, NorthWestern asks that the Commission grant rehearing, reverse the Initial Decision, and allow NorthWestern to recover its fuel costs. NorthWestern adds that even if the Commission determines that fuel costs should be charged in whole or in part under another tariff, it should not disallow the past costs and thus leave NorthWestern's shareholders paying for the past Gates Station fuel costs.[59]

41. In addition, NorthWestern claims that the Commission erred in denying NorthWestern recovery of the costs incurred in securing replacement regulating reserves. NorthWestern notes that it modified its tariff to limit its ability to recover costs of short term contracts to three discrete situations. NorthWestern states that the Commission

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[58] Initial Decision, 140 FERC ¶ 63,023 at P 105.

[59] NorthWestern's request for rehearing at 42-45.

affirmed the Presiding Judge in accepting tariff language that would permit NorthWestern to pass through the costs of contracts only in one situation, and that it must file under section 205 of the FPA any time there is a third party contract and/or expense associated with Schedule 3 service that NorthWestern seeks to pass through to its wholesale customers. Northwestern argues that this finding is at odds with Commission precedent, and may deny it any ability to recoup the costs it incurred in securing replacement regulating reserves. Therefore, NorthWestern asks that the Commission reverse the Presiding Judge's finding, affirmed in Opinion No. 530.[60]

b. <u>Commission Determination</u>

42. We find that the Presiding Judge fully addressed this issue in the Initial Decision. The Presiding Judge addressed NorthWestern's claim that the Commission should allow recovery of fuel costs under Schedule 3; including two cases that NorthWestern asserted allow recovery under Schedule 3. The Presiding Judge found that both cases were easily distinguishable on their facts.[61] We agree, and have adopted the Presiding Judge's reasoning.

43. The Presiding Judge also noted that NorthWestern raised a number of objections to the idea of recovering its fuel costs under Schedule 4, but that none of NorthWestern's objections were persuasive because NorthWestern admittedly never attempted to revise its Schedule 4 to allow it to recover these costs. The Presiding Judge also noted that in its Reply Brief NorthWestern conceded that it would evaluate the idea of revising its Schedule 4 when it makes its Order No. 764[62] compliance filing.[63]

44. The Presiding Judge stated that NorthWestern quoted certain language from Order No. 764 which it asserted supported NorthWestern's contention that an energy charge can be collected through Schedule 3. However, the Presiding Judge found that Order No. 764 related to Schedule 10 and not Schedule 3, the subject matter of this case. Moreover, the quoted language concerned opportunity costs which the Presiding Judge stated were not litigated at the hearing by NorthWestern or any other party. The Presiding Judge pointed

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[60] *Id.* at 45-50.

[61] Initial Decision, 140 FERC ¶ 63,023 at P 181.

[62] *Integration of Variable Energy Resources*, Order No. 764, FERC Stats. & Regs. ¶ 31,331, *order on reh'g and clarification*, Order No. 764-A, 141 FERC ¶ 61,232 (2012), *order on clarification and reh'g*, Order No. 764-B, 144 FERC ¶ 61,222 (2013).

[63] Initial Decision, 140 FERC ¶ 63,023 at P 183.

out that NorthWestern did not seek to present any evidence demonstrating opportunity costs foregone through providing regulation up or down, even after the issuance of Order No. 764, through a motion to reopen the record. In fact, the Presiding Judge found opportunity costs to be a difficult proposition for NorthWestern to argue given the utility's contradictory claim that it built the Gates Station exclusively to provide regulation services for its retail and Schedule 3 customers. Consequently, the Presiding Judge found that NorthWestern's argument for opportunity costs was internally inconsistent and, therefore, disregarded.[64] Again, we agree, and have adopted the Presiding Judge's reasoning.

45. However, the Presiding Judge pointed out that NorthWestern was apparently correct that the Commission has never expressly prohibited the collection of related energy costs under Schedule 3, so found that it was up to the Commission to make an exception for NorthWestern in this case. If that were to become the Commission's decision, the Presiding Judge recommended NorthWestern, at a minimum, change the energy cost formula to conform to the Initial Decision's findings with respect to the amount of regulation service customers must purchase. Absent such a holding by the Commission, the Presiding Judge found that NorthWestern could not collect energy costs under Schedule 3.[65] The Commission affirmed the Presiding Judge on this issue,[66] and NorthWestern has not persuaded us on rehearing that recovery of fuel costs through Schedule 3 charges is just and reasonable. Our decision is without prejudice to NorthWestern's ability to make a future section 205 filing with the appropriate evidentiary support to recover these costs.

46. Therefore, we deny NorthWestern's request for rehearing on this issue.

6. Whether the Commission Properly Required NorthWestern to Include Notice Provisions in its Tariff

a. NorthWestern's Rehearing

47. NorthWestern contends that the Commission acted arbitrarily and capriciously and contrary to precedent in requiring NorthWestern to include notice and technical requirements in its Schedule 3 tariff, rather than simply posting them on its OASIS.

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[64] *Id.* PP 181-185.

[65] *Id.* P 185.

[66] Opinion No. 530, 147 FERC ¶ 61,049 at PP 1, 15.

48. Specifically, NorthWestern asserts that it agreed to post on its OASIS all technical requirements, including notice periods for self-supplying customers, and further agreed to the 180-day notice period with the proviso that it include new or returning customers as well as departing customers. NorthWestern claims that the Presiding Judge found NorthWestern's commitment to be insufficient and ordered that it be included in the tariff. NorthWestern argues that in Order No. 764, the Commission rejected a similar request that self-supply details be included in the tariff, and instead stated that it expected utilities to post such requirements on their OASIS. NorthWestern contends that the Commission should do the same here.[67]

b. <u>Commission Determination</u>

49. We find that the Presiding Judge fully addressed NorthWestern's argument in the Initial Decision, and we agree with her analysis. Specifically, the Presiding Judge addressed NorthWestern's argument that information about the notice period and other information about the self-supply option should be posted on OASIS without any corresponding modification to its tariff. The Presiding Judge agreed with Montana Large Customer Group that posting on OASIS did not cure the problem that NorthWestern's tariff lacked sufficient detail to enable a customer to intelligently analyze and evaluate the option for third party service. The Presiding Judge stated that the essential information for prospective self-supplying customers must be included in NorthWestern's tariff regardless of what it chose to post on its OASIS.[68]

50. We agree with the Presiding Judge's findings. We believe that in order for a customer to make an informed decision as to whether or not to secure Schedule 3 service from NorthWestern or a third party, NorthWestern's notice and technical requirements for self-supply should be included under Schedule 3 of its tariff. NorthWestern has not persuaded us on rehearing to do otherwise. In addition, we note that, as the Montana Large Customer Group pointed out, NorthWestern has attempted to blur the line between what is applicable to Schedule 10 (Order No. 764) which is not at issue here and Schedule 3 which is directly at issue here.[69] Accordingly, we deny NorthWestern's request for rehearing on this issue.

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[67] NorthWestern's request for rehearing at 50-52.

[68] Initial Decision, 140 FERC ¶ 63,023 at PP 237-38, 250.

[69] *Id.* P 238.

7. Whether the Commission Properly Ordered Refunds

a. NorthWestern's Rehearing

51. **N**orthWestern claims that the Commission erred in failing to engage in any reasoned analysis of the relevant equitable factors in exercising its discretion to order refunds. NorthWestern maintains that equitable factors weigh heavily against ordering refunds, and that under the facts here there is no wrong that requires a remedy. NorthWestern claims that it prudently constructed the Gates Station to provide customers a reliable source of regulation supply, and no party contested the prudence of its actions. NorthWestern adds that it also acted in good faith when filing the proposed regulation rates and it followed the only precedent on point, which was the Commission's prior acceptance of NorthWestern's own rates for regulation.[70] NorthWestern notes that the refund liability cannot be recovered from any other customer, and thus punishes shareholders for actions that were reasonable and taken in good faith, and the Commission failed to consider these equities in ordering refunds.[71]

52. In addition, NorthWestern claims that the Commission erred in ordering refunds on cost allocation issues since the Commission's general policy is not to award refunds to changes in cost allocation and rate design cases. In contrast, NorthWestern argues that the Commission may order refunds where the company has over-collected its cost of service or violated the filed rate doctrine. NorthWestern claims that two rationales support this distinction, and they are the risk of utility under-recovery of prudently incurred cost and the inability of customers to retroactively change usage patterns.[72]

53. NorthWestern also alleges that the primary disputed issues in the case concern cost allocation. In support of its claim, NorthWestern states that Opinion No. 530 framed the contested issues as allocation issues, and the Initial Decision acknowledged that cost allocation issues were in dispute. NorthWestern notes that one reason the key issues concerned cost allocation was that the parties had settled the total revenue requirement, and that the litigation focused almost entirely on how to allocate this revenue requirement.[73]

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[70] NorthWestern's request for rehearing at 53-55.

[71] *Id.* at 56.

[72] *Id.* at 57-59.

[73] *Id.* at 59-61.

54. Therefore, NorthWestern asks that the Commission reverse the directive to order refunds.[74]

b. Commission Determination

55. Contrary to NorthWestern's position, this proceeding does not involve cost allocation issues among customer classes or rate design issues. Although the Initial Decision uses the language used by the parties to discuss how much of the Gates Station revenue requirement should be "allocated" to Schedule 3 customers, this is not a case where NorthWestern asked the Commission to approve a rate design or establish how to allocate its legitimate costs among jurisdictional customer classes. NorthWestern's Schedule 3 rates apply uniformly to jurisdictional customers and require no further cost allocation. Rather, NorthWestern sought to justify its cost-based Schedule 3 rate by assigning to Schedule 3 customers a calculated portion of the Gates Station revenue requirement. The Commission affirmed the Presiding Judge's holding that a different calculated portion of the Gates Station revenue requirement provided the proper cost-based foundation for Schedule 3 rates. In Opinion No. 530, the Commission agreed with the Presiding Judge that the purpose of the hearing was to determine whether NorthWestern's Schedule 3 rate was just and reasonable, not to ensure that NorthWestern recovered the total revenue requirement for the Gates Station through regulation service rates or other rates.[75]

56. Moreover, the Commission's practice is to order full refunds to remedy overcharges.[76] In fact, NorthWestern correctly states in its request for rehearing that the Commission may order refunds where the company has over-collected its cost of service

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[74] *Id.* at 61.

[75] Opinion No. 530, 147 FERC ¶ 61,049 at P 24.

[76] *La. Pub. Serv. Comm'n v. Entergy Corp.*, 155 FERC ¶ 61,120, at P 21 & n.46 (2016) (citing *Consol. Edison Co. of New York, Inc. v. FERC*, 347 F.3d 964, 972 (D.C. Cir. 2003) (stating that the Commission has a "'general policy of granting full refunds' for overcharges"(internal citations omitted)); *La. Pub. Serv. Comm'n v. FERC*, 174 F.3d 218, 223, 224 (D.C. Cir. 1999) (stating that "the Commission's self-described general policy is to provide refunds to remedy overcharges"); *Corporation Comm'n of the State of Oklahoma v. American Electric Power Co.*, 125 FERC ¶ 61,237, at P 33 (2008) (stating that "the Commission's general policy is to order refunds for overcharges"); *Entergy Serv., Inc.*, 82 FERC ¶ 61,098, at 61,369 (1998) (stating that "the Commission's general policy is to order refunds to remedy overcharges"), *aff'd*, 174 F.3d 218 (D.C. Cir. 1999)).

– which is the case here.[77] NorthWestern claims, however, that because it acted in good faith we should not order refunds here. We find that, even if true, this does not provide proper grounds for invoking equitable relief in this proceeding. The fact that NorthWestern's actions were not in bad faith does not militate against applying the Commission's policy of ordering refunds when the utility has overcharged its customers (i.e., charged a rate in excess of the just and reasonable rate) as here. Indeed, the Commission presumes, absent contrary evidence, that all regulated entities that file for rate changes are acting in good faith. The Commission properly orders refunds where, as here, a public utility has charged rates in excess of the just and reasonable rate even in the absence of finding bad faith.[78] The only issue is whether NorthWestern has demonstrated any reason for the Commission to deviate from its policy of granting full refunds to remedy overcharges. We find that NorthWestern has not provided any persuasive reason why we should depart from our policy.

57. We also find that NorthWestern clearly was on notice that its rates were subject to refund. In fact, the Commission accepted NorthWestern's filings in Docket No. ER10-1138-000 and Docket No. ER12-316-000 subject to refund.[79] Since NorthWestern's rates were not found to be just and reasonable, we continue to direct NorthWestern to refund Schedule 3 customers the difference between rates charged under the proposed rate schedule and the rate schedule that was found to be just and reasonable. Therefore, we deny NorthWestern's request for rehearing on this issue.

The Commission orders:

(A) NorthWestern's request for rehearing is hereby denied, as discussed in the body of this order.

(B) NorthWestern is hereby directed to make refunds to Schedule 3 customers as discussed in Opinion No. 530 and this order within 30 days of the date of this order, and file a refund report with the Commission within 30 days thereafter.

By the Commission.

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[77] NorthWestern's request for rehearing at 57.

[78] *Ameren Corp.*, 147 FERC ¶ 61,225, at P 41 & n.52 (2014).

[79] First Hearing Order, 133 FERC ¶ 61,046 at PP 1, 23 & Ordering Para. (A); Second Hearing Order, 137 FERC ¶ 61,248 at P 1, 33 & Ordering Para. (B).

(S E A L)

Kimberly D. Bose,
Secretary.