147 FERC ¶ 61,049
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

NorthWestern Corporation | ER10-1138-001
ER12-316-000
(Consolidated)

OPINION NO. 530

ORDER AFFIRMING INITIAL DECISION

(Issued April 17, 2014)

1. This case is before the Commission on exceptions to an Initial Decision[1] issued on September 21, 2012. The Initial Decision identified and resolved eight contested issues regarding NorthWestern Corporation's (NorthWestern) filing of revised tariff sheets for Schedule 3 service under its Open Access Transmission Tariff (OATT or Tariff). In this opinion, we summarily affirm the Initial Decision, without discussion, on seven of the issues, and affirm the remaining issue with further discussion.

I. Background and Procedural History

A. NorthWestern's System

2. NorthWestern owns and operates electric and natural gas transmission and distribution facilities primarily in Montana and South Dakota. NorthWestern's proposed tariff sheet revisions that are the subject matter of this case only impact its Montana OATT.[2] NorthWestern states that its electric transmission system in Montana consists of

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

[2] NorthWestern maintains separate OATTs for operations in each state because its Montana and South Dakota transmission facilities are neither physically connected, nor located in the same electric reliability region.

more than 7,000 miles of transmission lines and terminal facilities, which covers an area of 107,600 square miles and provides service to approximately 322,000 customers.

3. According to NorthWestern, it acquired its electric operations from Montana Power Company in 2002 as part of Montana's electric deregulation and restructuring process. Montana Power Company had already sold substantially all of its electric generation facilities to other entities prior to selling its transmission and distribution systems to NorthWestern. NorthWestern operates a balancing authority area in Montana that requires NorthWestern to match electrical loads with generation to meet operating criteria and provide reliable service in accordance with North American Electric Reliability Corporation (NERC) and Western Electric Coordinating Council reliability requirements.

4. As part of its OATT, Northwestern must offer to supply its transmission customers with Regulation and Frequency Response Service pursuant to Schedule 3 when the transmission service is used to serve load within its Balancing Authority Area.[3] With no significant generation facilities of its own, NorthWestern was required to purchase regulation service from third parties. NorthWestern states that in 2007, such third party sellers became unable or unwilling to continue providing regulation services to NorthWestern because of shortages of generation capacity, transmission constraints, and increases in demand attributable to the need of other balancing authorities to integrate variable energy resources. In May 2009, NorthWestern sought and received approval from the Montana Public Service Commission (Montana Commission) to construct a facility now called the Dave Gates Generating Station (Gates Station)[4] for the specific purpose of providing regulation service on its transmission system.

5. According to NorthWestern, Gates Station, which consists of three natural gas-fired turbine generators with a maximum capacity of 50 MW each, was placed into service in January 2011.[5] One year later, on January 31, 2012, NorthWestern took all three units offline when it detected an equipment malfunction that resulted in significant damage to each of the units. On February 1, 2012, Northwestern requested Powerex Corporation (Powerex) to sell it regulation service to supply its Schedule 3 customers,

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[3] Consistent with the Initial Decision and the record in this proceeding, this order refers to Schedule 3 Regulation and Frequency Response Service as "Schedule 3 service," "regulation capacity," or "regulation service."

[4] Gates Station was originally named the Mill Creek Generating Station.

[5] *NorthWestern Corp.*, 137 FERC ¶ 61,248, at P 3 (2011) (December 30 Hearing Order).

and Powerex agreed to do so.[6] At the time of the hearing, NorthWestern still relied on third party sources for Schedule 3 service.[7]

B. NorthWestern's Filing

6. On April 29, 2010, in Docket No. ER10-1138-000, NorthWestern filed revised tariff sheets to its OATT Schedule 3 to recover in that Schedule the fixed and variable revenue requirement for Gates Station through a monthly demand rate and monthly energy rate. The Montana Commission intervened, and the Montana Large Customer Group, Central Montana Electric Power Cooperative, Inc. (Central Montana), and Montana Consumer Counsel also intervened and filed protests.

7. On October 15, 2010, the Commission issued an order accepting and suspending NorthWestern's Revised Schedule 3, and establishing hearing and settlement judge procedures.[8] The Commission found that NorthWestern's Revised Schedule 3 had not been shown to be just and reasonable and raised issues of material fact that warranted hearing procedures.[9] 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

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[6] Because Powerex's market-based rate tariff limits its ability to make sales of ancillary services at market-based rates to transmission providers for use in fulfilling their open access transmission tariff obligations, the Commission granted Powerex's February 2012 requests for a limited waiver of its tariff to provide NorthWestern with up to 76 MW of regulating reserve service on an interim basis. *See Powerex Corp.*, 138 FERC ¶ 61,136, at PP 1, 5 (2012).

[7] *See* Initial Decision, 140 FERC ¶ 63,023 at n.19. One of the issues before the Presiding Judge was whether NorthWestern should be allowed to flow through to Schedule 3 customers the cost of regulation purchases when the Gates Station had an outage. The Initial Decision concluded that those costs should be the subject of a separate section 205 filing. *Id*. P 225.

[8] *NorthWestern Corp.*, 133 FERC ¶ 61,046, at ordering para. (A) (2010) (October 15 Hearing Order).

[9] *Id*. P 21.

> 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.[10]

In addition, the Commission noted that NorthWestern's proposed formula for regulation service does not appear to be consistent with Commission precedent.[11]

8. On June 10, 2011, after unsuccessful settlement discussions, the Chief Administrative Law Judge established hearing procedures, and appointed the Presiding Judge.[12] On November 1, 2011, NorthWestern filed additional revisions to Schedule 3 in Docket No. ER12-316-000. In the December 30 Hearing Order, the Commission rejected NorthWestern's proposal to subject customers who elect to self-supply Schedule 3 service to additional charges.[13] The Commission accepted the remainder of NorthWestern's revisions, suspended them for a nominal period, to become effective on December 31, 2011, and set them for hearing procedures.[14] The Commission stated that, among other things, the hearing would address "the manner in which NorthWestern proposes 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 proposes to credit certain revenues to Schedule 3 customers."[15] Finally, after noting that the issues in Docket No. ER12-316-000 are closely intertwined with those in Docket No. ER10-1138-000, the Commission consolidated the two dockets for purposes of hearing and decision.[16]

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[10] *Id*.

[11] *Id*. P 23 (citing *Kentucky Utilities Co.*, 85 FERC ¶ 61,274, at 62,108-109 (1998) (*Kentucky Utilities*); *Allegheny Power Service Corp.*, 85 FERC ¶ 61,275, at 62,120-121 (1998) (*Allegheny Power*)).

[12] *NorthWestern Corp.*, Order of Chief Judge Terminating Settlement Judge Procedures, Designating Presiding Administrative Law Judge, and Establishing Expedited Hearing Procedures (June 10, 2011).

[13] December 30 Hearing Order, 137 FERC ¶ 61,136 at P 33.

[14] *Id*.

[15] *Id*.

[16] *Id*. P 34. On January 30, 2012, NorthWestern submitted its proposed

(continued…)

9. On May 25, 2012, the parties and participants filed with the Presiding Judge a Joint Statement of Issues and Summary of Positions (Joint Statement). The evidentiary hearing in consolidated Docket Nos. ER12-316-000 and ER10-1138-001 was held on June 11 to June 14, 2012. Initial Briefs were filed on July 23, 2012 and Reply Briefs were filed on August 6, 2012.

C. Initial Decision, Briefs On and Opposing Exceptions, and Procedural Motions

10. On September 21, 2012, the Presiding Judge issued the Initial Decision, which, as discussed below, rejected the basis for most of NorthWestern's proposed tariff revisions. NorthWestern, Montana Consumer Counsel, Bonneville Power Administration (Bonneville), and the Montana Commission filed briefs on exceptions to the Initial Decision. Montana Large Customer Group, NorthWestern, Central Montana, and Commission Trial Staff (Trial Staff) filed briefs opposing exceptions.

11. On November 6, 2012, Edison Electric Institute (Edison Electric) filed a Motion to Intervene out-of-time and comments. On November 13, 2012, pursuant to Rule 711(c),[17] NorthWestern filed a motion for oral argument. On November 14, 2012, Montana Large Customer Group and Central Montana filed a joint motion to strike portions of NorthWestern's Brief On Exceptions. On November 21, 2012, Central Montana filed an answer in opposition to Edison Electric's Motion to Intervene out-of-time and comments. On November 29, 2012, NorthWestern filed an answer opposing Montana Large Customer Group and Central Montana's motion to strike portions of NorthWestern's Brief On Exceptions.

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

[17] 18 C.F.R. § 385.711(c) (2013).

II. Discussion

A. Procedural Matters

12. We deny NorthWestern's motion for oral argument. Pursuant to Rule 711(c) of the Commission's Rules of Practice and Procedure, 18 C.F.R.§ 385.711(c) (2013), any participant filing a brief on exceptions or a brief opposing exceptions may request, by written motion, oral argument before the Commission or an individual Commissioner. In its motion for oral argument, NorthWestern asserts that this is a case of first impression; specifically, NorthWestern asserts that oral argument would aid the Commission in determining how to treat a generation resource dedicated to providing regulation and frequency response service and satisfying NERC Reliability Standards. Given that the briefs on, and opposing, exceptions clearly and comprehensively represent the positions of the parties, we are not convinced there is anything to be gained from an oral argument.

13. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2013), the Commission denies Edison Electric's Motion to Intervene out-of-time and comments for failure to demonstrate good cause warranting late intervention. The Commission has found that parties seeking to intervene in a proceeding after issuance of a Commission determination bear a heavy burden. When late intervention is sought after the issuance of a dispositive order, the prejudice to other parties and burden upon the Commission of granting the late intervention may be substantial. Edison Electric has not met this higher burden of justifying its late intervention.[18] Edison Electric's Motion to Intervene out-of-time was filed nearly two months after the Presiding Judge issued the Initial Decision, thus depriving other parties the opportunity to test the basis of Edison Electric's positions. For these reasons, we will deny Edison Electric's Motion to Intervene out-of-time.

14. Pursuant to Rule 212 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.212 (2013), the Commission denies Montana Large Customer Group's and Central Montana's joint motion to strike portions of NorthWestern's Brief On Exceptions. Montana Large Customer Group and Central Montana seek to strike sections of NorthWestern's Brief on Exceptions that cite (1) NorthWestern's 2011 Annual Report; (2) POWER Magazine; (3) NERC Reliability Standard BAL-005-01.b; (4) NE-ISO Market Rule 1; and (5) CAISO Tariff § 30.5.2.6. We find that the sources cited by NorthWestern are either within the Commission's subject-matter expertise or are otherwise publicly available, and we find no reason to strike them.

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[18] *See, e.g., Midwest Indep. Transmission Sys. Operator, Inc.* 102 FERC ¶ 61,250, at P 7 (2003).

B. Substantive Matters

15. For the reasons discussed herein and in the Initial Decision, we find that the Schedule 3 rates proposed by NorthWestern have not been shown to be just and reasonable, and that the rates resulting from the findings and methodology adopted in the Initial Decision are just and reasonable. Accordingly, NorthWestern must make appropriate refunds.

1. Issues Summarily Affirmed

16. The Initial Decision addressed and resolved eight issues identified by the parties in their Joint Statement. These issues were:

> Issue No. 1: Is NorthWestern's proposed annual fixed cost revenue requirement and associated return on common equity for [Gates Station] just and reasonable?
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> Issue No. 2: Is NorthWestern's proposed allocation of the [Gates Station] fixed cost revenue requirement just and reasonable?
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> Issue No. 2 (a): Is NorthWestern's proposed allocation based on a numerator of 60 MW just and reasonable?
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> Issue No. 2 (b): Is NorthWestern's proposed allocation based on a denominator of 105 just and reasonable?
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> Issue No. 3: Is NorthWestern's proposed imposition of an energy rate charge just and reasonable?
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> Issue No. 4: Is NorthWestern's proposal to use a $7.00 market differential in the derivation of the energy value just and reasonable?
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> Issue No. 5: Is NorthWestern's proposed level of regulation service purchase obligations for customers just and reasonable?
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> Issue No. 6: Is inclusion of third-party regulation purchases in the proposed demand rate just and reasonable?
>
> Issue No. 7: Is the lack of proposed ceiling rates for regulation service just and reasonable?
>
> Issue No. 8: Are NorthWestern's proposed regulation requirements for self-supplying customers just and reasonable?

17. We summarily affirm the Initial Decision on all issues for the reasons given in the Initial Decision, except for the additional discussion herein on the "regulation down" component of Issue No. 2(a). We have reviewed the briefs on and opposing exceptions and find that the Initial Decision properly decided the issues that we are summarily affirming. The arguments on exceptions have failed to convince us that the Initial Decision erred or that additional discussion is necessary.

18. Although we affirm the Initial Decision's denial of NorthWestern's request to include capacity used for regulation down to calculate its Schedule 3 rates, we do so in part for reasons in addition to those given in the Initial Decision.

2. NorthWestern's Proposed Basis for Schedule 3 Rates

19. Regulation service is "the necessary ancillary service that provides the moment-to-moment balancing of resources and load within a balancing authority to maintain interconnection frequency, and is used to conform with NERC Control Performance Standards (CPS)."[19] As the Presiding Judge noted, the Commission recently described regulation service as the "injection or withdrawal of real power by facilities capable of responding appropriately to a transmission system's frequency deviations or interchange power imbalance."[20] Frequency deviations and interchange power imbalances are both measured by the Area Control Error (ACE). It is NorthWestern's responsibility, as a balancing authority, to rapidly correct deviations in the transmission system's frequency to bring it within the acceptable range by regulating the power entering the system either up or down.[21]

20. Based on its assertion that it built the Gates Station solely to provide regulation service, NorthWestern proposed to recover 100 percent of the Gates Station revenue requirement from its wholesale and retail customers through charges for regulation service. It argued that 60 MW represented the regulation demands of its Schedule 3 and bundled retail customers, and 45 MW was required to reflect the regulation demands of wind generation.[22] Accordingly, it proposed to allocate 60/105th of the Gates Station

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[19] Initial Decision, 140 FERC ¶ 63,023 at P 22.

[20] *Id.* (quoting *Frequency Regulation Compensation in the Organized Wholesale Power Markets*, Order No. 755, FERC Stats. & Regs. ¶ 31,324, at P 4 (2011), *reh'g denied*, Order No. 755-A, 138 FERC ¶ 61,123 (2012)).

[21] *Id.*

[22] *Id*. P 19.

revenue requirement to regulation demands of wholesale and retail transmission service, and 45/105th to retail customers for the regulation demands of the wind generation. NorthWestern proposed that the 60 MW for total transmission regulation be allocated between wholesale and bundled retail customers based on 12 coincident peak load share.[23]

21. The Initial Decision rejected NorthWestern's analysis and instead concluded that Montana Large Customer Group's proposed methodology that calculated 19 MW as the total regulation demand was just and reasonable and well-supported by the record. In addition, the Presiding Judge found that:

> (1) NorthWestern has the burden of proof in this case, and did not carry its burden of showing that 60 MW is a just and reasonable numerator, (2) regulation down must be excluded from Dr. Tabors' study, (3) diversity benefits must be shared by wholesale and retail customers based on cost causation principles, (4) NorthWestern may include energy imbalance service in its Schedule 3 rate, and (5) the use of absolute averages is not mandated for calculating the numerator.[24]

22. The Initial Decision also concluded that the 150 MW nameplate capacity of the Gates Station must be used in the denominator of the fraction to compute what proportion of the Gates Station revenue requirement would be attributed to regulation customers. There were also other distinct issues addressed in the Initial Decision.

23. NorthWestern and Montana Consumer Counsel assert on exceptions, among other things, that policy considerations warrant full Commission review of the Initial Decision.[25] Particularly, NorthWestern states that this case presents an issue of first impression—how to treat the cost recovery of a generation resource dedicated exclusively to providing regulation and frequency response service and satisfying NERC Reliability Standards. NorthWestern argues that a failure by the Commission to reverse the Initial Decision will discourage the construction of additional facilities that could provide the ancillary services required to integrate wind and solar generation. In addition, NorthWestern contends that other Commission policies that compel review and reversal of the Initial Decision include: (1) the concept that a utility be given the

[23] *See* NorthWestern Initial Brief at 11.

[24] Initial Decision, 140 FERC ¶ 63,023 at P 75.

[25] NorthWestern Brief On Exceptions at 5-10; NorthWestern Motion for Oral Argument at 1-3; Montana Consumer Counsel Brief On Exceptions at 9-10.

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.[26]

24. NorthWestern's underlying premise of the case is that all of Gates Station's revenue requirement should be recovered through regulation service rates. The Initial Decision did not accept NorthWestern's premise and, instead, based its derivation of Schedule 3 rates 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. We agree with the Presiding Judge's approach; the purpose of the hearing was to determine whether NorthWestern's Schedule 3 rate was just and reasonable, not to ensure that NorthWestern collects the total revenue requirement for the Gates Station through regulation service rates.

25. Furthermore, we do not believe that Commission policies with respect to reliability and ancillary service availability will be hampered by not granting NorthWestern full cost recovery of Gates Station costs from regulation customers. 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. 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.

3. Regulation Down

a. Initial Decision

26. One of the largest deductions that was used to reduce NorthWestern's proposed 60 MW of regulation demand to 19 MW was the elimination of capacity used for regulation down. In determining that regulation down must be excluded from NorthWestern's Schedule 3 rate, the Presiding Judge first addressed NorthWestern's argument that *Kentucky Utilities* and *Allegheny Power*, which both direct a balancing authority to remove regulation down service from a Schedule 3 rate, do not apply. In *Kentucky Utilities* and *Allegheny Power*, where there was an absence of any data supporting the transmission provider's regulation requirement, the Commission established that "the

[26] NorthWestern Brief On Exceptions at 5-10.

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."[27]

27. The Presiding Judge noted that unlike in those cases, here, NorthWestern had provided some data to support its regulation requirement. Nonetheless, the Presiding Judge stated that this fact alone did not mean that the principles set forth in *Kentucky Utilities* and *Allegheny Power* must be categorically disregarded. Instead, the Presiding Judge concluded that the factual distinction between *Kentucky Utilities* and *Allegheny Power*, and the present case, required only the preclusion of "the otherwise necessary use of the inter-hour Load Following methodology."

28. The Presiding Judge stated that, in *Allegheny Power*, the Commission found that "a balancing authority 'would need to have, on average, adequate generation capacity to cover the portion of the hour when a customer's load is above the amount of generating capacity it has block scheduled. The amount of capacity is sufficient to provide load following through the entire hour.'"[28] Also, the Presiding Judge stated that, in *Kentucky Utilities*, the Commission found "that a utility's Regulation capacity requirement could be derived 'by simply dividing the average of the hourly load changes during the year by two.'"[29] The Presiding Judge reasoned that the Commission's policy to exclude regulation down stems from the fact that:

> [A]lthough a utility like NorthWestern must operate its regulating resources at a point above NorthWestern's minimum (i.e., a set point) in order to be prepared to ramp down in case demand drops (i.e., positive scheduling errors), NorthWestern can utilize the energy used to maintain the set point for non-regulation purposes.[30]

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[27] Initial Decision, 140 FERC ¶ 63,023 at P 86 (quoting October 15 Hearing Order, 133 FERC ¶ 61,046 at P 23).

[28] *Id.* P 88 (quoting *Allegheny Power*, 85 FERC at 62,120).

[29] *Id*. (quoting *Kentucky Utilities*, 85 FERC at 62,109). *See also Otter Tail Power Co*., 99 FERC ¶ 61,019, 61,095 (2002); *Consumers Energy Co*., 86 FERC ¶ 63,004, 65,043 (1999), *aff'd on exceptions*, 98 FERC ¶ 61,333, at 62,410 (2002).

[30] Initial Decision, 140 FERC ¶ 63,023 at P 90 (citation omitted).

Furthermore, the Presiding Judge observed that NorthWestern failed to present any evidence as to why it would not be able to use this energy, which would be absorbed into its system, for non-regulation purposes, such as off-system sales.[31]

29. The Presiding Judge went on to find, contrary to NorthWestern's argument, that Order Nos. 755 and 755-A do not allow NorthWestern to include regulation down in its Schedule 3 rate because those orders apply only to organized markets, of which NorthWestern is not a member. Specifically, the Presiding Judge noted that the compensation NorthWestern seeks in this proceeding is substantially different from the performance payments described in Order No. 755. The Presiding Judge also stated that, if the Commission had intended for performance payments to apply to non-market participants, then it would have explicitly indicated so in Order No. 755.[32]

30. The Presiding Judge also rejected NorthWestern's argument that Order No. 764, which addresses Schedule 10, permits NorthWestern to include regulation down in its Schedule 3 rate. As an initial matter, the Presiding Judge noted that Order No. 764 was issued on June 22, 2012, after the hearing in this case had concluded. The Presiding Judge added that no party or participant filed a motion to reopen the record in the present case after Order No. 764 was issued. Moreover, the Presiding Judge stated that NorthWestern itself acknowledged that it is not precluded from making the appropriate filing in the future to recover its opportunity costs through Schedule 10.[33] The Presiding Judge concluded that NorthWestern had not introduced any evidence into the record regarding opportunity costs. The Presiding Judge noted that it would likely be difficult for NorthWestern to argue opportunity costs given that the Gates Station was exclusively built and fully used for regulation services for its retail and Schedule 3 customers.[34]

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[31] *Id.*

[32] *Id*. P 96.

[33] *Id*. P 100.

[34] *Id*. P 101.

b. <u>NorthWestern Brief On Exceptions</u>

31. NorthWestern 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.[35]

32. NorthWestern asserts that the Presiding Judge denied the company compensation for regulation down capacity, based in large part, on a misapplication of the Commission's holdings in *Kentucky Utilities* and *Allegheny Power*. Specifically, NorthWestern argues that the Initial Decision incorrectly finds that *Kentucky Utilities* and *Allegheny Power* demonstrate a Commission policy of disallowing compensation for the capacity needed to provide regulation down service. NorthWestern explains 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 applies where there is an absence of any data to support a transmission provider's regulation requirement.[36] By contrast, NorthWestern states that all parties here agreed to calculate regulation obligations by reference to the amount needed to satisfy CPS 2 and, furthermore, that NorthWestern presented enough data to calculate the amount of regulating reserves necessary to comply with CPS 2. Thus, NorthWestern concludes that there was no reason for the Presiding Judge to revert to the default method provided by *Kentucky Utilities* and *Allegheny Power*.[37]

33. NorthWestern also asserts that Order Nos. 755 and 764 demonstrate that Commission policy favors compensating resources for regulation down services. For example, NorthWestern notes that Order No. 755 states that a "resource's performance must be measured based on the absolute amount of regulation up and regulation down it

[35] NorthWestern Brief On Exceptions at 34. As explained by NorthWestern, the Initial Decision did not include any actual calculations, but rather adopted by reference the calculations of a Montana Large Customer Group witness, James Dauphinais, who made adjustments to a NorthWestern witness's, Dr. Tabors, calculations. NorthWestern states that Mr. Dauphinais started from 73 MW, which represents the regulating reserves Dr. Tabors determined were needed to achieve 95 percent CPS 2 compliance. Furthermore, NorthWestern states that Mr. Dauphinais arrived at 19 MW by subtracting 41 MW for regulation down capacity and 16 MW for diversity benefits. *Id*. n.111.

[36] *Id*. at 35 (citing October 15 Hearing Order at P 23).

[37] *Id.*

provides in response to the system operator's dispatch signal."[38] NorthWestern states that the Presiding Judge erred in finding this directive applies only to organized markets and that the "performance payments" set forth in Order No. 755-A are materially different from the compensation NorthWestern seeks in the present case. First, NorthWestern states that, in addition to "performance payments," Order No. 755 mandates capacity payments, which includes both regulation up and down. Second, while NorthWestern acknowledges that Order No. 755, by its terms, applies only to organized wholesale electricity markets, NorthWestern maintains that the Order embodies a broader policy establishing "that resources provide compensable value when they supply the capacity needed for regulation 'down.'"[39]

34. NorthWestern avers that, in Order No. 764, the Commission affirmed this broader policy in favor of compensating resources for regulation down services. Moreover, NorthWestern argues that the Presiding Judge offered no legitimate rationale for dismissing the policy reflected by Order No. 764. Regarding the Initial Decision's finding that no party argued the effect of Order No. 764 on this case by way of a motion to reopen the record after Order No. 764 was issued, NorthWestern states that consideration of Order No. 764 would not have prejudiced any parties, the record need not be reopened to consider the impact of a ruling in another case,[40] and, if the Presiding Judge believed it to be appropriate, she could have reopened the record under Rule 716 on her own initiative.[41]

35. NorthWestern asserts that the Presiding Judge's dismissal of Order No. 764 was also based on an erroneous finding that the company did not prove that it suffers opportunity costs by providing regulation down. NorthWestern states that it did not base its Schedule 3 rate on a claim that the company was deprived of other opportunities. Instead, NorthWestern explains that its Schedule 3 rates are based exclusively on the

[38] *Id*. at 36 (quoting Order No. 755, FERC Stats. & Regs. ¶ 31,324 at P 133). *See also* Order No. 755-A at P 14 ("[A] resource must be measured [and compensated accordingly] based on the absolute amount of regulation up and regulation down it provides in response to the system operator's dispatch signal . . . .").

[39] NorthWestern Brief On Exceptions at 37.

[40] *Id*. at 38-39 (citing *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.")).

[41] *See* 18 C.F.R. § 716(a).

Gates Station revenue requirement, which does not include any type of opportunity cost component (other than a stipulated return on equity).[42]

36. Finally, NorthWestern states that the Presiding Judge ignored three key facts in determining that the company is not entitled to compensation for regulation down services. First, NorthWestern states that, typically, opportunity costs are associated with a resource that has already been built and can be deployed for a number of reasons. NorthWestern maintains that Gates Station was built for the singular purpose of providing reliable and fast regulation service. Thus, NorthWestern states that Gates Station is similar to a reliability must-run resource, which the Commission has determined is entitled to reimbursement based on the cost of service, not the ability to generate revenues through other uses.[43] Second, NorthWestern points out that Gates Station's revenue requirement essentially compensates NorthWestern for the costs of building Gates Station (including depreciation and return on equity). NorthWestern notes that Gates Station had to be sized larger in order to provide regulation up and down service. NorthWestern states that Gates Station could have been sized smaller if it were to only provide regulation up service, but that would not enable Gates Station to decrease output to offset a drop in load or a spike in wind generation. Third, NorthWestern emphasizes that Gates Station capacity is not dedicated to retail load. NorthWestern states that, given the fluidity of the set point, Gates Station is not able to assure the retail load or any other customers of any definitive amount of capacity.[44]

c. Other Briefs on Exception

37. Montana Consumer Counsel, Montana Commission, and Bonneville argue that the Initial Decision errs in excluding regulation down. Like NorthWestern, Montana Consumer Counsel urges that *Kentucky Utilities* and *Allegheny Power* only apply in situations where a transmission provider fails to present any historical data to determine the necessary regulation requirement.[45] Both Montana Consumer Counsel and Montana Commission also allege that the Initial Decision's assumption that capacity required for regulation down can be devoted to other purposes fails to appreciate that Gates Station is the only indigenous, rampable generating unit fitted with automatic generation control

[42] NorthWestern Brief On Exceptions at 39-40.

[43] *Id*. at 40-41 (citing *GenOn Power Midwest, LP*, 140 FERC ¶ 61,080 at P 3 (2012)).

[44] NorthWestern Brief On Exceptions at 41-42.

[45] Montana Consumer Counsel Brief On Exceptions at 10.

and capable of responding to Area Control Error signals. The Initial Decision, according to Montana Consumer Counsel and Montana Commission, also overlooks the fact that the Montana Commission authorized NorthWestern to construct Gates Station solely to provide regulation service, not to conduct off-system sales or supply energy to retail customers.[46] Relatedly, Montana Commission states that NorthWestern lacks the ability of a vertically-integrated system to absorb load reduction into its system and vary the output from multiple generators to accommodate load variations.[47] Finally, Bonneville argues that, as opposed to *Kentucky Utilities* and *Allegheny Power*, the most relevant Commission precedent is *Westar Energy, Inc.*, in which, according to Bonneville, the Commission approved a method for calculating the balancing reserves purchase requirement of Westar's proposed Schedule 3A service.[48]

38. Regarding Order No. 755, Montana Consumer Counsel and Bonneville argue that, even though NorthWestern is not a member of an organized market, the Initial Decision should have embraced the Commission's broader policy goal in that Order of compensating generators "based on performance, as measured by the amount of MWh up and down movement the resource provides."[49] Bonneville remarks that the Presiding Judge's failure to apply Order No. 755's mandate in the present case will hinder the development of capacity markets by disallowing the recovery of legitimate costs. As to Order No. 764, Montana Consumer Counsel and Bonneville allege the Commission's policy of compensating generators for the costs of providing regulation down service in Schedule 10 should apply equally to Schedule 3. Montana Consumer Counsel claims that the Presiding Judge's finding that NorthWestern did not present evidence regarding opportunity costs misses the point that NorthWestern's decision to invest in Gates Station is the incurrence of an opportunity cost.[50] Bonneville contends that the Presiding Judge erred in finding that NorthWestern can file a Schedule 10 to recover its opportunity costs because Schedule 10 is intended to recover costs associated with providing capacity for

[46] Montana Consumer Counsel Brief On Exceptions at 11-14; Montana Commission Brief On Exceptions at 7-8.

[47] Montana Commission Brief On Exceptions at 7-8.

[48] Bonneville Brief On Exceptions at 4 (citing *Westar Energy, Inc.*, 130 FERC ¶ 61,215, P 3, 18 (2010)).

[49] Montana Consumer Counsel Brief On Exceptions at 15 (quoting Order No. 755, FERC Stats. & Regs. at P 78); Bonneville Brief On Exceptions at 8-9 (quoting Order No. 755, FERC Stats. & Regs. ¶ 31,324 at P 78).

[50] Montana Consumer Counsel Brief On Exceptions at 16-17.

Variable Energy Resources. Bonneville further states that a Schedule 10 filing would subsidize Schedule 3 customers by imposing the cost of regulation down only on NorthWestern's retail customers that are purchasing all of the variable energy resources in the NorthWestern balancing authority.[51]

d. **Briefs Opposing Exceptions**

39. Montana Large Customer Group, Central Montana, and Trial Staff all argue that the Presiding Judge properly applied the Commission precedent set forth in *Kentucky Utilities* and *Allegheny Power*, which, according to these parties, defines how to calculate a transmission provider's regulation service capacity needs and excludes recovery for regulation down.[52] Montana Large Customer Group explains that, because NorthWestern did provide actual data that can be used to do the calculation, the Presiding Judge correctly determined that it was not necessary to use historical hourly FERC Form 714 load data. However, Montana Large Customer Group goes on to state that *Kentucky Utilities* and *Allegheny Power* make clear that only deviations above the amount scheduled, i.e., where regulation up is needed, are to be considered when determining the capacity needed to serve Schedule 3 customers. Montana Consumer Counsel states that the Commission reinforced these policies in *Consumers Energy Company*[53] and *Otter Trail Power Company*.[54] Montana Large Customer Group contends that NorthWestern failed to produce any compelling evidence as to why it would be unable to utilize the energy used to maintain the set point for regulation down for non-regulation purposes. In addition, Montana Large Customer Group states that the operation of NorthWestern's regulation down capacity by necessity provides capacity and energy to NorthWestern's bundled retail customers.[55]

[51] Bonneville Brief On Exceptions at 9-10.

[52] Montana Large Customer Group Brief On Exceptions at 17-18; Central Montana Brief On Exceptions at 26-28; Trial Staff Brief On Exceptions at 13-15.

[53] *Consumers Energy Co.*, 86 FERC ¶ 63,004 (1999).

[54] *Otter Trail Power Co*., 99 FERC ¶ 61,019 (2002).

[55] Montana Large Customer Group Brief On Exceptions 19-21.

40. Montana Large Customer Group, Central Montana, and Trial Staff aver that the Presiding Judge correctly concluded that Order No. 755 applies only to organized markets.[56] Montana Large Customer Group adds that if the Commission intended for Order No. 755 to apply more broadly as a policy for compensation for regulation down in all circumstances, it would have done so explicitly.[57] Furthermore, Trial Staff explains that the Commission's rationale for compensating (in the form of "performance payments" that are determined by a markets-based clearing house) organized market participants for regulation down service does not extend to vertically-integrated utilities, such as NorthWestern, which are compensated in the form of cost-based rates. According to Trial Staff, the Commission's purpose in providing performance payments to organized market participants is to encourage resources with the lowest costs to enter the regulation market, thereby increasing market efficiency. Trial Staff states that, here, there is no need to incentivize NorthWestern to enter into the (non-existent) market or to mobilize (non-existent) faster ramping resources by providing a performance payment for regulation down capacity.[58]

41. Similarly, Montana Large Customer Group, Central Montana, and Trial Staff contend that Order No. 764 is inapplicable to this case.[59] Montana Large Customer Group explains that Order No. 764 concerns the impacts of Variable Energy Resources on the transmission system. Montana Large Customer Group also notes that Order No. 764 concerns Schedule 10, not Schedule 3, and that NorthWestern is not precluded from presenting evidence on foregone opportunity costs in a subsequent Schedule 10 filing should it choose to do so.[60] Trial Staff adds that Order No. 764's compensation for regulation down capacity is explicitly a means to compensate generators for the opportunity cost of deploying resources to provide potentially less lucrative ancillary services, and because NorthWestern is not a market participant, there is no need to incentivize NorthWestern to forgo sales to provide ancillary services. Also, Trial Staff

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[56] Montana Large Customer Group Brief On Exceptions at 24; Central Montana Brief On Exceptions at 28-30; Trial Staff Brief On Exceptions at 15-17.

[57] Montana Large Customer Group Brief On Exceptions at 26.

[58] Trial Staff Brief On Exceptions at 17.

[59] Montana Large Customer Group Brief On Exceptions at 26-29; Central Montana Brief On Exceptions at 30-32; Trial Staff Brief On Exceptions at 18-20.

[60] Montana Large Customer Group Brief On Exceptions at 26-27.

states that NorthWestern is capable of using the energy generated to maintain a set point for non-regulation purposes, such as off-system sales or for serving retail load.[61]

42. Montana Large Customer Group argues that excluding regulation down is also consistent with principles of cost causation, and that excluding regulation down capacity will ensure Schedule 3 customers do not unreasonably pay NorthWestern for capacity in excess of that needed to provide the regulation services. According to Montana Large Customer Group, excluding regulation down capacity prevents Schedule 3 customers from subsidizing other customers.[62]

43. Trial Staff states that NorthWestern was given and continues to have a reasonable opportunity to recover the costs of Gates Station. Trial Staff asserts that, as a factual matter, NorthWestern presently has the opportunity to recover the remaining unallocated, prudently-incurred costs of Gates Station by selling excess capacity beyond what is necessary to meet NorthWestern's CPS 2 obligations. Moreover, Trial Staff avers that, because it has a market-based tariff, NorthWestern is free to charge whatever level the market will bear to recover the remaining portions of the Gates Station revenue requirement.[63]

44. Finally, Trial Staff claims that the purpose of this proceeding is to determine NorthWestern's just and reasonable Schedule 3 rate, not allocate all Gates Station costs. Trial Staff concludes that the Initial Decision has comported with Commission precedent, and has afforded NorthWestern the opportunity to recover costs to which it is entitled.[64]

e. **Commission Determination**

45. We affirm the Presiding Judge's determination to exclude from NorthWestern's Schedule 3 those costs associated with capacity that NorthWestern claims is needed to support regulation down service. We base our 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.

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[61] Trial Staff Brief Opposing Exceptions at 15-20.

[62] Montana Large Customer Group Brief On Exceptions at 21.

[63] Trial Staff Brief Opposing Exceptions at 23-24.

[64] *Id*. at 24-26.

46. As an initial matter, we note that the Commission's precedent in *Kentucky Utilities* and *Allegheny Power* is distinguishable from the present case, and therefore, that precedent is not necessarily controlling here if those distinguishing facts warrant a different result. 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. In those cases, the utilities were already maintaining their capacity at a specific level to serve existing schedules. In other words, the capacity costs were being recovered from customers for whom power was already scheduled.

47. Here, NorthWestern indicates that it will not rely on Gates Station to serve the electricity demand of its customers, but uses Gates Station exclusively to provide regulation service to maintain CPS 2 compliance. We acknowledge that NorthWestern may be in a situation different from most other suppliers of regulation service. Further, in several recent orders that addressed specific situations, the Commission has acknowledged that regulation service is a product for which suppliers must be equitably compensated.[65] Thus, 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 demonstrates that, based on the location of the generating facility, there are 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, NorthWestern has not made such a case in this proceeding.

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[65] *See Third-Party Provision of Ancillary Services; Accounting and Financial Reporting for New Electric Storage Technologies*, Order No. 784, 144 FERC ¶ 61,056, at P 82 (2013) (permitting market-based sales of regulation service to public utility transmission providers at rates not to exceed the buying public utility transmission provider's OATT rate for the same service); Order No. 764, FERC Stats. & Regs. ¶ 31,331 at P 316 (stating that "public utility transmission providers that choose to propose a rate schedule for generator regulation service may include opportunity costs for generator regulation service"); Order No. 755, FERC Stats. & Regs. ¶ 31,324 at P 1 (revising the Commission's regulations to remedy undue discrimination in the procurement of frequency regulation in the organized wholesale electricity markets and ensuring that providers of frequency regulation receive just and reasonable rates, including performance payments for both regulation up and regulation down).

48. The regulation down capacity at issue here is that which the Gates Station purportedly places into operation at the start of each hour and is 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, we base our 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. NorthWestern's witness stated rather vaguely that the energy produced by that reserved capacity would be scheduled "off of the system" and "absorbed into the system."[66] However, NorthWestern did not demonstrate 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 cannot determine what portion, if any, of the regulation down capacity costs were otherwise unrecovered by NorthWestern. Absent evidence that NorthWestern was unable to recover those costs, we are not persuaded to allow NorthWestern to include regulation down in calculating the capacity to serve Schedule 3 customers.

49. We agree with the Initial Decision that Order No. 755 does not require that regulation down capacity be included in the allocation of capacity costs for NorthWestern. The plain language of Order No. 755 pertains only to members of organized markets, of which NorthWestern is not a member.[67] Moreover, we find that the performance payments and capacity payments discussed in Order No. 755 are not the same as compensation that NorthWestern seeks in this proceeding. 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 compensates a resource for all movement in response to the dispatch signal.[68] Order No. 755 did not address the situation presented here, where NorthWestern is seeking a cost-of-service capacity payment for capacity it allegedly needs to provide regulation down.

[66] Tr. 154-155 (Michael R. Cashell).

[67] Order No. 755, FERC Stats. & Regs. ¶ 31,324 at P 1 ("Pursuant to section 206 of the Federal Power Act (FPA), the Commission is revising its regulations to remedy undue discrimination in the procurement of frequency regulation in the organized markets . . . ."); *see also* Order No. 755 NOPR, 134 FERC ¶ 61,127, n.8.

[68] Order No. 755, FERC Stats. & Regs. ¶ 31,324 at PP 67, 128.

50. NorthWestern contends that Order No. 764 affirmed the adoption of a broader policy in favor of compensating resources for regulation down services. In Order No. 764, the Commission adopted rules to accommodate scheduling for Variable Energy Resources, and also gave guidance for rates that a transmission provider might propose for Schedule 10—Generator Regulation and Frequency Response Service (Schedule 10).[69] At the paragraph cited by NorthWestern, Order No. 764 acknowledged that a resource used to provide generator regulation service is often dispatched in the middle of its operating range to allow the generator to provide regulation-up as well as regulation-down and, as a result, forego other opportunities.[70] The Commission stated that public utility transmission providers therefore may include opportunity costs for generator regulation service in certain circumstances.[71] A public utility transmission provider is not precluded from proposing a Schedule 10, as appropriate; however, it must demonstrate that it has forgone opportunities associated with its obligation to provide Schedule 3 service. Any proposed Schedule 10 should contain a per-unit rate and a volumetric component for regulation reserve capacity. While NorthWestern has failed in this case to demonstrate that it has unrecovered costs, NorthWestern is not precluded from making a showing in a separate proceeding to recover such costs under Schedule 10.

4. <u>Compliance and Refunds</u>

51. NorthWestern is directed to make a compliance filing within 30 days of the date of this order setting forth revised tariff sheets for its OATT Schedule 3 service that apply the determinations made in this order. Pursuant to the Hearing Orders issued in Docket Nos. ER10-1138-000 and ER12-316-000, NorthWestern is also required 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 herein. All refunds shall 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). NorthWestern must make refunds within 30 days of the date of this order and file a refund report within 30 days thereafter.

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[69] Order No. 764, FERC Stats. & Regs. ¶ 31,331 at P 4. Schedule 10 is a mechanism through which a public utility transmission provider may propose to recover certain costs associated with forgone opportunities resulting from holding capacity to provide Schedule 3 regulation service.

[70] NorthWestern Brief on Exceptions at 17 (quoting Order No. 764, FERC Stats. & Regs. ¶ 31,331 at P 316).

[71] Order No. 764, FERC Stats. & Regs. ¶ 31,331 at P 316.

The Commission orders:

(A) The findings and conclusions in the Initial Decision in this proceeding are hereby affirmed.

(B) NorthWestern is ordered to make a compliance filing as discussed in the body of this order.

(C) NorthWestern must make refunds to Schedule 3 customers as discussed in the body of this order, and file a refund report with the Commission within 30 days thereafter.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.