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## STAFF MEMORANDUM SUPPORTING SETTLEMENT STIPULATION

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**TO:** COMMISSIONERS AND ADVISORS  
**FROM:** BRITTANY MEHLHAFF, ERIC PAULSON, AND KRISTEN EDWARDS  
**RE:** DOCKET NG16-010 – IN THE MATTER OF THE FILING BY NORTHWESTERN CORPORATION DBA NORTHWESTERN ENERGY FOR APPROVAL OF ITS REFUND PLAN REGARDING ITS RECOVERY OF MANUFACTURED GAS PLANT SITE REMEDIATION COSTS  
**DATE:** January 19, 2017

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Commission Staff (Staff) submits this Memorandum in support of the Settlement Stipulation (Settlement) of January 19, 2017, between Staff and NorthWestern Corporation dba NorthWestern Energy (NorthWestern or Company) in the above-captioned matter.

### **BACKGROUND**

On September 1, 2016, NorthWestern filed for approval of a refund plan regarding its recovery of Manufactured Gas Plant (MGP) site remediation costs. NorthWestern's recovery of MGP site remediation costs dates back to previous rate cases.

On November 30, 2011, the Commission issued an Order Granting Joint Motion for Approval of Settlement Stipulation in Docket NG11-003. The Settlement Stipulation between Staff and NorthWestern included a provision regarding Aberdeen MGP Clean-up Costs. The NG11-003 Settlement Stipulation is attached as Exhibit 3. Refer to pages 3 and 4, item 3, regarding the Aberdeen MGP Clean-up Costs. For further explanation, refer to Staff's Memorandum Supporting Settlement Stipulation in Docket NG11-003, attached as Exhibit 4<sup>1</sup>, and NG11-003 Staff Exhibit 8/30/2011 RGT, attached as Exhibit 5.

Pursuant to the NG11-003 Settlement Stipulation, NorthWestern agreed to 1) credit ratepayers with the over-collection of MGP costs from Docket NG07-013 and 2) track the recoveries of on-going costs incurred to remediate the site of the former Aberdeen manufactured gas plant. NorthWestern's calculation of the tracker reveals a current over-recovered balance of over \$4,500,000 as of July 2016. Thus NorthWestern has made a filing to refund this over-collection to customers now rather than wait until its next rate case. Adding in the recoveries projected through October 2017, NorthWestern requested approval of a refund amount of \$5,500,000, to be returned to customers over the term of one year from November 1, 2016 through October 31, 2017, with the final actual refund amount dependent on volumes for the term of the refund. Staff agrees it is in both customers' and

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<sup>1</sup> Refer to pages 6 and 7, Aberdeen MGP Clean-Up Costs.

NorthWestern's best interests to refund the over-collection at this time. However, Staff identified issues with NorthWestern's calculation of the over-collection amount.

Staff's identification of these issues, explained in more detail below, resulted in a disagreement between Staff and NorthWestern, and it appeared this docket would ultimately result in a hearing before the Commission. On November 14, 2016, NorthWestern filed a letter with the Commission requesting Commission approval to allow NorthWestern to refund over recoveries on an interim basis beginning December 1, 2016 and ending November 30, 2017, based on the rates proposed in its initial filing. Staff supported the Company's request and on November 23, 2016, the Commission issued an Order Approving Refund Plan on an Interim Basis.

Staff and NorthWestern have diligently worked through the unresolved issues and have entered into a Settlement Stipulation resolving this matter. In this memo, Staff explains the issues identified and describes the resolution of this docket.

## **STAFF'S ADJUSTMENTS**

### ***Operation of the Tracker Account***

Staff's primary issue with the calculation of the over-collection amount filed by NorthWestern revolves around the way the tracker account is structured. All trackers have the same basic concept: compare actual expenses to actual recoveries and apply interest to the over/under collection balance. In most instances this is fairly straightforward, however, this tracker is complicated by the fact that the recoveries are through base rates and not a separate rider, and that not only does NorthWestern need to track on-going MGP expenses, but also track an amortization of prior over-collected costs as well.

In order to understand Staff's issue with how NorthWestern's tracker works, it is important to first review the Settlement Stipulation<sup>2</sup>, Staff Memorandum<sup>3</sup>, and Staff Exhibit 8/30/2011 RGT<sup>4</sup> from Docket NG11-003. Staff's view of the rate case adjustment and prospective tracker is summarized here in this memo below.

In NG11-003, Staff determined that the average annual amount of adjusted cost estimates for future remediation at the Aberdeen MGP site was \$2,000,000 and therefore the settlement established a \$2,000,000 annual cost allowance. Furthermore, NorthWestern provided Staff, in response to a data request<sup>5</sup>, the cumulative over-collections of \$1,300,568 that existed as of July 1, 2011, by operation of the NG07-013 rates<sup>6</sup>. Staff and NorthWestern agreed to credit customers with the \$1,300,568 over-collections over a 5-year period. Thus the adjusted test year revenue requirement approved in Docket

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<sup>2</sup> Exhibit 3

<sup>3</sup> Exhibit 4

<sup>4</sup> Exhibit 5

<sup>5</sup> Refer to Exhibit 6 for NorthWestern's response to Staff's Data Request 6-4 in Docket NG11-003

<sup>6</sup> In NG07-013 the Commission approved rates designed to collect from ratepayers \$1,425,400 annually for recovery of on-going costs for remediation at the former Aberdeen MGP and the Company was required to track the costs and recoveries until its next rate case.

NG11-003 included a \$2,000,000 estimate for future expenses and a 5-year amortization of \$(1,300,568), which is an annual amount of \$(260,114), for a net of \$1,739,886<sup>7</sup>.

The NG11-003 Settlement Stipulation specifies that NorthWestern will credit ratepayers with the over-collections from NG07-013 rates through the prospective tracker account<sup>8</sup> as established in Section III.3.C. of the Stipulation:

*The Parties agree to track the recoveries of actual annual expenditures, net of (1) the annual rate allowance established in Section III.3.A., (2) over-collection of costs from Docket NG07-013 identified in Section III.3.B, and (3) any future insurance proceeds related to environmental remediation costs in South Dakota, so that the Company neither over recovers nor under recovers these costs. The Parties agree that a carrying charge of 7.79% shall be applied to the monthly over-or-under-recoveries.*

In Staff's opinion, NorthWestern's proposed tracker account violates the NG11-003 Settlement Stipulation as it does not account for item (2) in Section III.3.C. or Section III.3.B. NorthWestern's proposed tracker account compares actual expenditures to recoveries (based on the annual rate allowance of \$1,739,886), but does not net the expenditures with the NG07-013 over-collections.

Staff Exhibit 1 demonstrates how the tracker should work if designed correctly to follow the NG11-003 Settlement Stipulation Section III.3. language. The column headers directly correspond to the language in Section III.3.C. Column B is the "actual annual expenditures". Column C is "(1) the annual rate allowance established in Section III.3.A". Column D is the "(2) over collection of costs from Docket NG07-013 identified in III.3.B". Column E is "(3) any future insurance proceeds related to environmental remediation costs in South Dakota". Column F is the monthly over/under recoveries calculated based on the direction of Section III.3.C. by taking the actual annual expenditures net items (1), (2), and (3). Column G is the interest applied to the over/under recoveries as directed in Section III.3.C. And finally, column H shows the cumulative over/under recovery from the end of the last rate case to the end of the amortization period, December 1, 2011 through November 31, 2016. If the tracker operates as described in the Settlement Stipulation, it is correct. If item (2) of Section III.3.C is ignored, the tracker does not operate correctly since it will not give ratepayers their credit for the over-collections from NG07-013 they have previously paid.

In order to clearly and simply demonstrate why the tracker must operate in this way, Staff provides the following basic example.

Assume actual annual expenses were \$2,000,000 per year, for a total of \$10,000,000 over the five year period, just as was estimated in the rate case. Next, assume actual therms sold each year were equal to those of the NG11-003 test year. Sales being equal, NorthWestern's recoveries would be the same as estimated in the rate case. Since NorthWestern calculates the recoveries based on the net annual allowance of \$1,739,886, the total recoveries for the five year period would be approximately

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<sup>7</sup> Annual rate allowance specified in NG11-003 Settlement Stipulation Section III.3.A.

<sup>8</sup> NG11-003 Settlement Stipulation Section III.3.B.

\$8,699,432. Given all assumptions from the rate case holding true, one would expect the balance in the tracker to be zero. However, since NorthWestern’s tracker compares actual expenses to actual recoveries and ignores the credit of the over-collection, in this scenario the balance would be \$(1,300,568), meaning customers owe an additional \$1,300,568. Customers have already paid for the \$1,300,568 through NG07-013 rates. Under NorthWestern’s tracker, customers would have to pay for these same costs again. This example is summarized in the table below.

	NorthWestern’s Tracker	Staff’s Tracker
<b>Actual Recoveries</b>	\$8,699,432	\$8,699,432
<b>Actual Expense</b>	\$10,000,000	\$10,000,000
<b>Over-Collection</b>	\$0	\$1,300,568
<b>Balance [Recoveries - (Expense – Over Collection)]</b>	<b>\$(1,300,568)</b>	<b>\$0</b>

In summary, NorthWestern’s tracker simply does not give customers credit for the over-collection they’ve already paid and that was reflected as an amortization credit in rates in NG11-003. In this basic example, the tracker compares recoveries based on \$8,699,432 to actual expenses of \$10,000,000, leaving an under-recovered balance equal to the over-collection amount that was to be refunded to customers.

#### **Over Collection Amount**

NorthWestern’s Exhibit A is based on the over collection amount of \$1,250,585 instead of the \$1,300,568 over collection as used to develop rates in the last rate case in NG11-003. NorthWestern provided Staff in response to a data request<sup>9</sup> the cumulative over-collections of \$1,300,568 that existed as of July 1, 2011, by operation of the NG07-013 rates. Although this data request portrayed this over-collection as of July 1, 2011, NorthWestern states this was an error and that the amount provided in the data request is the over-collection as of July 31, 2011. NorthWestern used the actual balance as of July 1, 2011, \$1,250,585, when it set up its accounting for the MGP tracker. But, since rates were set using the \$1,300,568 over collection, this is the balance that should be used in the tracker. It does not matter which date we assumed the over collection went through, what matters is the amount of over collection that was to be returned to customers by the rates designed in NG11-003. The amortization of the over-collection should be based on the \$1,300,568 amount.

Since NorthWestern used the balance as of July 1, 2011, \$1,250,585, as the over-collection amount, NorthWestern’s calculation of the starting point of the tracker, \$952,534, erroneously includes one month of over collection for July 2011 that should have been included in the total over collected amount as specified in the rate case settlement. Adding together the \$1,250,585, the July over recovery of \$41,412, and the interest of \$8,570 on the balance, the correct over collection amount is \$1,300,568, as specified in the NG11-003 settlement, and as used in Staff’s revised tracker with adjustments as

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<sup>9</sup> See Exhibit 6

discussed below. This changes the starting point of the tracker, or beginning under recovery balance, to approximately \$995,308.

### ***Staff's Revised Tracker Prior to Additional Adjustments***

Staff's revised tracker calculates the refund amount based on the format outlined in the NG11-003 Settlement Stipulation Section III.3., as described above. This revision increases NorthWestern's over-recovered balance through July 2016 from approximately \$4,500,000 to approximately \$6,000,000.

### **STAFF'S REVISED TRACKER WITH ADDITIONAL ADJUSTMENTS**

In an effort to resolve this docket, NorthWestern and Staff worked through additional adjustments to the refund amount. First of all, NorthWestern provided Staff with actual volumes and expenses through November 2016. Including Staff's revisions outlined above, the over-recovered balance through November 2016 is approximately \$6,200,000.

NorthWestern discovered some additional errors in the original calculation of the refund amount in this docket. Two customers' volumes were not included in the calculation of the original MGP recovery rate that should have been. Including these volumes reduces the rate applied to the volumes used in calculating the MGP revenues for rate 87B. The effect of this change is a reduction in the refund amount of approximately \$870,000.

One customer had volumes removed from the annual usage totals in 2012 through 2016 used to calculate the MGP revenues. This customer was originally designated as a contract with deviations customer and after a bankruptcy, their volumes were inadvertently recorded in the Rate 87B volumes category when they should have remained in the contract with deviations category, since the bank makes NorthWestern whole at the contract with deviations rate. This correction to remove these volumes from Rate 87B reduces the total volumes to apply the MGP rate, which reduces the MGP revenues. The effect of this change is a reduction in the refund amount of approximately \$700,000.

Three more corrections were made to add in volumes that were inadvertently left out from the Rate 87 volumes in the original MGP rate calculation. Adding these volumes in to the calculation slightly increases the refund amount by approximately \$40,000.

Staff agrees with all adjustments to volumes proposed by NorthWestern, and these adjustments are included in Staff's tracker provided as Exhibit 1. Correcting the tracker to appropriately reflect the language of the NG11-003 Settlement Stipulation and making the adjustments to volumes proposed by NorthWestern results in a new revised tracker balance as of November 2016 of \$4,714,537. The Settlement reflects this balance. This over collected amount accounts for all collections, expenses, and interest through November of 2016. For comparison purposes with the originally filed over-recovered balance as of July 2016 of \$4,533,173, the new revised tracker balance as of July 2016 is \$4,624,422.

## INTERIM REFUND

Currently, NorthWestern has an interim refund in place of \$5.5 million and is allocated among the classes in the same fashion as the original allocation for MGP cleanup costs from the last rate case, NG11-003. This interim refund is for the period of December 1, 2016 to November 30, 2017. The refund was approved on an interim basis so that Staff and NorthWestern could work to come to an agreement on the refund amount either through agreeing on tracker structure or a scheduled hearing. Staff recommends the rates approved on an interim basis for Rate 81, Rate 82, and Option A remain in effect through the refund period. Due to the changes agreed to by NorthWestern and Staff, the rate for Option B changes from \$(0.0071) to \$(0.0078) per therm. NorthWestern and Staff agree the Option B rate should be revised effective February 1, 2017. The slightly lower rate refunded to Option B customers during December 2016 and January 2017 is negligible and any differences will flow through the tracker account. Exhibit 2 shows the calculation of the revised MGP rates and projected true-up balance for the refund period. The refund rates per therm for each customer class are as follows:

Rate 81	\$(0.1233)
Rate 82	\$(0.0560)
Option A	\$(0.0315)
Option B	\$(0.0078)

## RECOMMENDATION

Staff recommends the Commission grant the Joint Motion for Approval of Settlement Stipulation and adopt the Stipulation without modification.

Any over or under recoveries from this refund will be recorded in the tracker account. As requested by NorthWestern, a true-up for the refund plan at the end of the refund period is not determined at this time. At the end of the refund period, December 1, 2016 through November 30, 2017, NorthWestern will evaluate whether to allow the refund plan to cease or to ask the Commission to extend the current plan or approve a new plan. Factors influencing this decision will include volumes sold during the refund period, the likelihood of an upcoming rate case, and actual and future estimated MGP cleanup costs. Staff will keep in contact with NorthWestern to monitor the tracker balance.