

Service Date: June 21, 2002

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Application of)	UTILITY DIVISION
THE MONTANA POWER COMPANY's)	
1) Approval of the Default Supply Portfolio, and)	DOCKET NO. D2001.10.144
2) the Projected Electric Cost Tracking for the)	ORDER NO. 6382d
12-Month Period Beginning July 1, 2002.)	

FINAL ORDER

APPEARANCES

FOR THE APPLICANTS:

Montana Power Company/NorthWestern Energy

Marjorie L. Thomas, NorthWestern Energy, LLC, 40 East Broadway,
Butte, Montana 59701, and
George M. Galloway, Stoel Rives, LLP, 97 SW Fifth Avenue, Portland, Oregon 97204

FOR THE INTERVENORS:

Northwest Power Planning Council

James Madden, Special Assistant Attorney General, State of Montana,
P.O. Box 200901, 1301 Lockey, Helena, Montana 59620

Montana Consumer Counsel

Robert A. Nelson, Montana Consumer Counsel, 616 Helena Avenue,
P.O. Box 201703, Helena, Montana 59620-1703

Large Customer Group

Donald W. Quander, Holland & Hart, 401 North 31st Street, Suite 1500,
Billings, Montana 59101.

Commercial Energy of Montana

Robert G. Olson, Frisbee, Moore & Olson, P.O. Box 547, Cut Bank, Montana 59427

Montana Wind Harness

Kimberly A. Beatty, Browning, Kaleczyc, Berry & Hoven,
139 Last Chance Gulch, Helena, Montana 59601

Northern Alternative Energy

Michael Uda, Doney, Crowley, Bloomquist & Uda, 44 West Sixth Avenue,
Helena, Montana 59601

Comanche Park, LLC

Harley R. Harris, Luxan & Murfitt, PLLP, P.O. Box 1144, Helena, Montana 59624

Federal Executive Agencies

Major Alan Erickson, AFLSA/ULT (Litigation Division), U.S. Air Force/
U.S. Executive Agencies, 139 Barnes Drive, Suite 1, Tyndall AFB, Florida 32403-5319

District XI Human Resources Defense Council, Natural Resources Defense
Council, Renewable Northwest Project

Charles E. Magraw, Attorney at Law, 501 8th Avenue, Helena MT 59601

Montana League of Cities and Towns

Allen B. Chronister, Chronister, Moreen & Larson, PC, P.O. Box 1152,
36 West Sixth Avenue, Helena MT 59624

BEFORE:

Gary Feland, Chairman
Jay Stovall, Vice Chairman
Bob Anderson, Commissioner
Matt Brainard, Commissioner
Bob Rowe, Commissioner

COMMISSION STAFF:

Leroy Beeby, Staff Rate Analyst
Eric Eck, Bureau Chief, Revenue Requirements
Susan Good, Policy Advisor
Marla Larson, Staff Economist
Robin A. McHugh, Administrator, Legal Division
Will Rosquist, Staff Economist
Tim Watson, Adjunct Staff (hired by contract to review part of the filing)

KEY

<u>Abbreviation</u>	<u>Definition</u>
CEM	Commercial Energy of Montana, Inc.
Commission	Montana Public Service Commission
CP	Comanche Park, LLC
HRC	District XI Human Resource Council
DSM	Demand-side management
Duke	Duke Energy
FEA	Federal Executive Agencies
FERC	Federal Energy Regulatory Commission
IAPP	Industry accepted procurement practices
IRP	Integrated resource planning
MCC	Montana Consumer Counsel
MEIC	Montana Environmental Information Center
MFM	Montana First Megawatts
MLCT	Montana League of Cities and Towns
MontPIRG	Montana Public Interest Research Group
MPC	The Montana Power Company
MWH	Montana Wind Harness
NAE	Northern Alternative Energy
NWE	NorthWestern Energy
OATT	Open Access Transmission Tariff
PPLM	PPL-Montana
RFP	Request for proposal
RMP	Rocky Mountain Power
RTO	Regional transmission organization
TR	Transcript of Proceedings

INTRODUCTION

In this Order the Montana Public Service Commission (Commission) considers and makes certain findings and comments on NorthWestern Energy's (NWE) Electric Default Supply Portfolio Filing, received October 29, 2001 and supplemented on December 12, 2001.¹

¹ The filings were made by The Montana Power Company (MPC). On January 31, 2002 the Commission approved the sale of MPC to NorthWestern Corporation, which does business in Montana as a public utility under the name NorthWestern Energy. Order No. 6353c, Docket No. D2001.1.5. NWE is the successor to MPC and is therefore designated the Applicant in this docket.

FINDINGS

BACKGROUND

In 1997 the Montana Legislature passed the Electric Utility Industry Restructuring and Customer Choice Act (Choice Act), which was codified at Title 69, Chapter 8, MCA. The Legislature concluded that "[t]he generation and sale of electricity is becoming a competitive industry[.]" § 69-8-102(1), MCA, and that "Montana customers should have the freedom to choose their supplier of electricity and related services in a competitive market as soon as administratively feasible." § 69-8-102(2), MCA.

As envisioned in 1997 residential and small commercial customers "must have the opportunity to choose an electricity supplier[]" by July 1, 2002, § 69-8-201(1)(b), MCA (1997), but in no event could such choice be delayed beyond July 1, 2004. § 69-8-201(2)(a), MCA (1997). The Legislature recognized that during a transition period a public utility would have a role as an electricity supplier on an emergency basis, § 69-8-208(1)(c), MCA (1997), as well as for purposes of meeting the needs of "customers that have not chosen an electricity supplier or for those customers that have not yet been assigned an electricity supplier[.]" § 69-8-403(1), MCA (1997). But in 1997, as reflected in the Choice Act, it is apparent the Legislature expected that the role of a public utility as a supplier would diminish markedly over a period of four to six years as significant numbers of customers took advantage of retail choice.

By 2001 it was obvious that a market wherein numerous electricity suppliers would compete for the business of small electricity consumers searching for an alternative to the public utility was developing in Montana at a glacial pace, if it was developing at all; and the prospect for such a market developing by July 1, 2004, the end of the extended transition period under the 1997 Choice Act, seemed remote. Therefore, the 2001 Legislature extended the transition period for customer choice to July 1, 2007, § 69-8-103(32), MCA, and amended the Choice Act to specifically impose on the public utility an obligation to procure electricity supply to meet the needs of default supply customers. § 69-8-210(3)(a), MCA. Along with this obligation the Legislature created a right in the public utility to recover its "prudently incurred" supply costs. The Legislature required the default supplier to propose a cost recovery mechanism to the Commission by July 1, 2001, and required the Commission to adopt a mechanism before March 30, 2002. Both requirements were met. In its proposal NWE stated its "cost recovery mechanism is patterned after the Natural Gas Tracker used by [NWE] and approved by the Commission for many years." Following notice of the proposal and receipt of brief comments from Natural Resources Defense Council, District XI Human Resources

Council and Renewable Northwest Project, the Commission approved the proposed cost recovery mechanism as filed.²

In initial response to the requirement that NWE procure default electricity supply, four filings were made with the Commission: 1) In the Matter of the Application of Montana Power Company for Approval of a Power Purchase Agreement with Rocky Mountain Power, Inc., Docket No. D2001.7.93; 2) In the Matter of the Petition of Rocky Mountain Power, Inc. for PSC Review and Comment on Power Purchase Agreement with the Montana Power Company, Docket No. D2001.9.127; 3) In the Matter of the Application of NorthWestern Generation I, LLC for Comment and Findings on a Power Purchase and Sales Agreement with the Montana Power Company, Docket No. D2001.9.123; 4) In the Matter of the Petition of Thompson River Co-Gen, LLC for PSC Review of and Comment on Power Purchase Agreement with Montana Power Company, Docket No. D2001.10.137. The Commission's response to these filings, one of which sought explicit preapproval (D2001.7.93) and two of which sought something very close to preapproval (D2001.9.123, D2001.9.127), was to decline to take any action or make any statement that could be interpreted as approving the merits of or the costs of particular agreements or proposals: "The Commission cannot determine that the costs [NWE] would incur under the Agreement with RMP are prudent without evaluating those costs in conjunction with all other costs [NWE] will incur to comprehensively satisfy its default supply obligation." Order No. 6361a, p. 5, Docket No. D2001.7.93 (August 17, 2001); substantially repeated in Comments, p. 2, D2001.9.123 and D2001.9.127 (October 1, 2001).³ The Commission's response to the filings effectively directed NWE to make one portfolio filing for Commission review.

On October 29, 2001 NWE filed an Application with the Commission requesting to establish new rates, effective July 1, 2002, to reflect a default supply portfolio proposed to serve customers that have not chosen a third party supplier. The Application was assigned a docket number (Docket No. D2001.10.144, often referred to as the "portfolio" docket) and was noticed.⁴ On November 9, 2001 the Commission issued Procedural Order No. 6382a, which included a partial procedural schedule.⁵

² Order on Electricity Supply Cost Recovery Mechanism, Order No. 6422, Docket No. D2001.7.84, and Order No. 6382c, Docket No. D2001.10.144 (April 25, 2002), ratifying the Commission action taken on March 26, 2002, Notice of Commission Action (NCA), March 29, 2002.

³ The Commission did not respond to the Petition of Thompson River Co-Gen, D2001.10.137.

⁴ Notice of Application and Intervention Deadline, November 5, 2001.

⁵ The Procedural Order included two other dockets: Docket No. D97.7.90, Order No. 5986v and

On November 20, 2001 timely intervention was granted to 13 entities.⁶ Late intervention was granted to Northern Alternative Energy, Inc., Commercial Energy of Montana, Inc., Montana Wind Harness, LLC, and Northwest Power Planning Council.⁷ The Commission limited the intervention of Comanche Park, Northern Alternative Energy and Montana Wind Harness to "presenting testimony or argument on whether [NWE's] proposed default supply portfolio was prudently incurred, using accepted industry procurement practices, consistent with § 69-8-210, MCA. Advocacy on [their] part . . . which attempts to support the selection of their particular energy projects over others in the MPC proposed portfolio will be considered outside the scope of their intervention and will not be allowed."⁸ A petition for late intervention from Liberty County was denied.⁹

On December 12, 2001 NWE supplemented its portfolio application by adding a wind power proposal. This filing, along with other factors, caused changes to the original partial schedule.¹⁰ The balance of the schedule, contemplating a March 12, 2002 hearing date was established by Staff Action on January 29, 2002.

On February 20, 2002 the Commission issued a Notice of Public Hearing establishing March 12, 2002 as the hearing date. In addition, on March 1, 2002 the Commission issued Notice of 16 "satellite" hearings to be held at various locations throughout the State to receive public comment on the portfolio application. Because of the necessity to act on numerous prehearing motions, an ambitious schedule generally, and a legal challenge to the protective order issued in the docket, the Commission vacated the March 12, 2002 hearing, cancelled the satellite hearings, and directed the hearing be rescheduled on April 9, 2002.¹¹

Docket No. D2001.1.5, Order No. 6353a.

⁶ Notice of Staff Action (NSA), November 20, 2001 (Bonneville Power Administration; Comanche Park LLC; Colstrip Energy Limited Partnership; District XI Human Resource Council; Energy West Resources Inc.; Federal Executive Agencies; Large Customer Group; Montana Department of Environmental Quality; Montana League of Cities & Towns; Natural Resources Defense Council; Renewable Northwest Project; Montana Consumer Counsel and Yellowstone Energy Limited Partnership). The Commission granted NWE's objection to the intervention of Colstrip Energy Limited Partnership and Yellowstone Energy Limited Partnership, rescinding their party status. NCA, December 6, 2001.

⁷ NCA, December 13, 2001; NCA, January 4, 2002.

⁸ Id. Comanche Park timely intervened: NCA, November 20, 2001. The December 13, 2001 NCA, indicating Comanche Park was granted late intervention, was in error.

⁹ NCA, December 21, 2001.

¹⁰ See NCA, December 21, 2001; NCA, January 4, 2002; NCA, January 4, 2002.

¹¹ NCA, March 13, 2002.

On March 19, 2002 the Commission issued a Notice of Public Hearing for an April 9, 2002 hearing.¹² Hearing was held on that date and continued on April 10, 11 and 16, 2002. A final part of the hearing to consider information covered by protective order was separately noticed¹³ and held on May 13, 2002. Satellite hearings were rescheduled and held at various locations on different dates, beginning on May 7, 2002 and ending on May 22, 2002.

The Record in the Dockets

The evidentiary record in this docket consists of the following:

- a. All data responses filed in D2001.10.144 (TR 14);
- b. The prefiled testimony of Daniel W. Hickman (NWE-4, NWE-5, NWE-6; TR 514);
- c. The prefiled testimony of Patrick R. Corcoran (NWE-9, NWE-10; TR 815);
- d. The prefiled testimony of David R. Houser (NWE-7, NWE-8; TR 759);
- e. The prefiled testimony of Gary S. Saleba (NWE-3; TR 467);
- f. The prefiled testimony of William A. Pascoe (NWE-1, NWE-2, NWE-2a; TR 1012);
- g. The prefiled testimony of Van Jamison (NAE-2; TR 598);
- h. The prefiled testimony of Greg Jaunich (NAE-3; TR 621);
- i. The prefiled testimony of Michael T. Schmechel (CP-A, CP-D; TR 740);
- j. The prefiled testimony of Peter West (HRC-1, HRC-2, HRC-3; TR 700);
- k. The prefiled testimony of Joseph A. Herz (FEA-1; TR 539);
- l. The prefiled testimony of Thomas J. Schneider (MLCT-1; TR 531);
- m. The prefiled testimony of Ronald L. Perry (CEM-1; TR 192);
- n. The prefiled testimony of Leo Giacometto, adopted by John Hines (NWPPC-1; TR 107);
- o. The prefiled testimony of Thomas Michael Power (HRC-6; TR 1039);
- p. The prefiled testimony of John Wilson (MCC-1, MCC-2; TR 1075);
- q. The prefiled testimony of Robert C. Julian (CP-B, CP-C, CP-E; TR 1132);
- r. Accompanying exhibits to the prefiled testimony filed in D2001.10.144;
- s. Late-filed Exhibits Nos. 1-7 and 9-12 of NWE;
- t. Late-filed Exhibit No. 8 of Comanche Park; and
- u. Examination of witnesses at the hearing.

¹² Notice of Public Hearing, March 19, 2002.

Public Comment

The Commission received a large number of public comments. More than 125 written comments were received through the regular mail and email. Of these, 24 people wrote in support of the portfolio: five were proponents for general reasons, 15 for its economic development potential, and four were proponents of the wind power elements. Of the 83 who wrote in opposition to the proposed portfolio: three were generally opposed, 25 were opposed due to the bidding process and affiliate transaction concerns, 36 were opposed to the rate impacts, 19 were opposed because of the lack of conservation measures, a desire to have more renewables included in the portfolio and because of the possible impacts to air and water quality.

Hundreds of preprinted postcards were received from concerned members of the Montana Public Information Research Group and the Montana Environmental Information Center. The postcards expressed concerns over the lack of conservation included in the proposed portfolio and the impact of the proposed portfolio on family budgets. In addition, the postcards expressed the desire for additional wind power to be included in the portfolio.

At the 16 satellite public hearings held throughout the state from May 7 through May 22, 2002, more than 180 people gave public comment or testimony. Of those, approximately 30 were proponents of the current portfolio based on its economic development potential, wind component, and contribution to stable prices. The remaining commenters were opponents of the portfolio for similar reasons to those expressed in the written comments.

Briefs

The following parties submitted briefs in this docket: Comanche Park, Montana Wind Harness, Montana Consumer Counsel, Northern Alternative Energy, District XI Human Resource Council, Natural Resources Defense Council and Renewable Northwest Project, NorthWestern Energy, Federal Executive Agencies, Commercial Energy. The briefs were thoughtful, well researched, and helpful to the Commission.

LEGAL DISCUSSION, SECTION 69-8-210, MCA

In this docket the Commission implements parts of § 69-8-210, MCA:

69-8-210. Public utilities – electricity supply.

(1)

(2) During the transition period, the customers' distribution services provider, acting as the default supplier, shall:

¹³ Notice of Public Hearing, May 1, 2002.

- (a) . . .
 - (b) purchase electricity from the market; . . .
 - (c) use a mechanism that recovers electricity supply costs in rates as provided in subsection (4).
- (3) (a) The default supplier shall provide for the full electricity supply requirements of all default supply customers. To meet these requirements, the default supplier shall procure a portfolio of electricity supply using industry-accepted procurement practices, which may include negotiated contracts or competitive bidding. The commission may develop reasonable requirements for the use of competitive bidding in the procurement process.
- (b) A default supplier may submit material related to proposed bids or contracts concerning electricity supply to the commission before the default supplier enters into the contract. The commission may comment on the material.
- (c) In reviewing electricity supply contracts, the commission shall consider only those facts that were known or should reasonably have been known by the default supplier at the time the contract was entered into and that would have materially affected the cost or reliability of the electricity supply to be procured.
- (4) (a) The commission shall use an electricity cost recovery mechanism that ensures that all prudently incurred electricity supply costs are fully recoverable in rates. The cost recovery mechanism must provide for prospective rate adjustments for cost differences resulting from cost changes, load changes, and the time value of money on the differences.
- (b) The default supplier shall submit a proposed electricity supply cost recovery mechanism to the commission for approval on or before July 1, 2001. A mechanism must be adopted by the commission before March 30, 2002.
- (c)
 - (5)
 - (6)

"Transition period" is the period ending July 1, 2007. § 69-8-103(32), MCA; as used in § 69-8-210, MCA, it refers to the period July 1, 2002 through June 30, 2007; "customer" "means a retail electric customer or consumer." § 69-8-103(6), MCA; "distribution services provider" "means a utility owning distribution facilities for distribution of electricity to the public." § 69-8-103(10), MCA; "utility" "means any public utility or cooperative utility." § 69-8-103(38), MCA; "default supplier" "means a customer's distribution services provider." § 69-8-103(8), MCA.

NWE is a public utility within the meaning of §§ 69-3-101 and 69-8-103(24), MCA; it owns distribution facilities for distribution of electricity to the public; it sells electricity to retail electric customers; and it is a distribution services provider and, therefore, a default supplier. Section 69-8-210(2)(a), MCA, is not applicable to this docket because NWE has no cost-based contract with an affiliate supplier to extend past July 1, 2002. Therefore, NWE, as default supplier, must go to the market to purchase electricity, § 69-8-210(2)(b), MCA, and must use the electricity supply cost

recovery mechanism provided at § 69-8-210(4), MCA. § 69-8-210(2)(c), MCA. A default supplier is an entity that provides electricity to customers who have not chosen to be served by a competitive electricity supplier. See §§ 69-8-201 and 403, MCA.

Sections 69-8-210(3) and (4), MCA, set forth certain obligations of NWE and the Commission with respect to default electricity supply. Section 69-8-210(3)(a), MCA, imposes on NWE the obligation to provide all the electricity required by its default supply customers. To meet this obligation NWE must "procure a portfolio of electricity supply using industry-accepted procurement practices[.]" Id. The word "procure" is not defined in Title 69 and it is reasonable to conclude it has its commonly understood meaning as "to obtain" or "to acquire" or "to get possession of." Webster's Third International Dictionary, Unabridged, 1971. Neither is "portfolio" defined in Title 69. The usual definitions of "portfolio" do not match the use of the word in § 69-8-210(3)(a), MCA. For example, the Webster's New Collegiate Dictionary, 1981, defines portfolio as "1: a hinged cover or flexible case for carrying loose papers, pictures, or pamphlets 2 . . . : the office and functions of a minister of state or member of a cabinet 3: the securities held by an investor: the commercial paper held by a financial house (as a bank)[.]" The Webster's Third International Dictionary, Unabridged, 1971, contains similar definitions. These definitions make little sense when applied to § 69-8-210(3)(a), MCA. A newer dictionary adds a definition that is helpful: "a selection from an artist's, etc. work[.]" Webster's New World Dictionary and Thesaurus, 2nd ed., 2002. "Selection" is close to synonyms for portfolio such as "collection," Webster's New World Thesaurus, 1971, or "collection," "group," or "assortment." Microsoft Office XP (2002), Thesaurus. The Commission finds that by "procure a portfolio of electricity supply" the Legislature intended that default supply come from a variety of sources, as distinct from a single source.

"Electricity supply" needs no elaboration. The term "industry-accepted procurement practices" is not defined in statute, except that the Legislature indicates they "may include negotiated contracts or competitive bidding." § 69-8-210(3)(a), MCA. On the record NWE rebuttal witness Gary Saleba, considering himself an expert in industry-accepted procurement practices (IAPP), TR 409, indicated that IAPP, in the context of procuring a portfolio of electricity supply, includes the following five steps: "1. Explore market for power supply products and prices[;] 2. Collect offers or proposals from various parties[;] 3. Analyze the proposals or offers for price and other factors[;] 4. Negotiate the best contract with the preferred parties[;] 5. Anticipate sudden changes in the market and remain flexible." NWE-3, pp. 12-13. The Commission does not adopt these steps as a definition of IAPP, but does find them helpful as an approach to the issue. IAPP

probably cannot be defined precisely. It will be considered in the context of discrete parts of the proposed portfolio.

The last sentence of § 69-8-210(3)(a), MCA, is not relevant to the Commission decision in this docket. The Commission is not required, was not asked, and did not develop requirements "for the use of competitive bidding in the procurement process." *Id.* The development of such requirements may be appropriate in the future. Section 69-8-210(3)(b), MCA, is relevant to this docket because the NWE submission on the long-term projects is "material related to proposed bids or contracts" which the Commission "may comment on." The long-term contract proposals submitted by NWE are neither "electricity supply contracts" pursuant to § 69-8-210(3)(c), MCA, nor a procurement of supply pursuant to § 69-8-210(3)(a), MCA.

Section 69-8-210(3)(c), MCA, combined with § 69-8-210(3)(b), MCA, makes clear that the default supplier must present supply contracts for review. "Contract" is as defined in Montana law. "Only" has its common meaning, "as a single fact or instance and nothing more or different[.]" Webster's New Collegiate Dictionary, 1981. The language, ". . . and that would have materially affected the cost or reliability of the electricity supply to be procured[.]" modifies ". . . that were known or should reasonably have been known by the default supplier at the time the contract was entered into[.]" Thus, the Commission can only consider facts "that would have materially affected the cost or reliability of the electricity supply to be procured[.]" "at the time the contract was entered into[.]"

With the exception of the first sentence, § 69-8-210(4)(a), MCA, is straightforward and either has already been complied with, or requires a future action not applicable to this docket.¹⁴ The first sentence of § 69-8-210(4)(a), MCA, creates an obligation in the Commission to allow all "prudently incurred electricity supply costs" to be fully recoverable in rates. It follows that the Commission is not required to allow NWE to recover in its rates electricity supply costs not "prudently incurred." It also follows, although this is not explicit in § 69-8-210, MCA, that NWE will incur electricity supply costs because of its obligation to procure a portfolio of electricity supply. Thus, a determination of whether electricity supply costs have been prudently incurred is directly related to whether the procurement of supply was prudent. A determination of prudence occurs within the cost recovery mechanism process. There is no requirement in § 69-8-210, MCA, that the Commission approve the recovery of electricity supply costs, on a final basis, before they

¹⁴ See fn. 2.

have been incurred.

"Prudent" is not defined in the Choice Act and, therefore, the Commission ascribes to it the usual meaning, stated variously as follows: "marked by wisdom or judiciousness[,]" Webster's Third New International Dictionary, 1971; "circumspect or judicious in one's dealings; cautious." (also, "prudent person. See Reasonable Person"), Black's Law Dictionary, 7th Ed., 1999. Synonyms for "prudent" are listed as "careful," "cautious," "sensible," "practical," "discreet," "wise," and "far-sighted;" "reckless" is suggested as an antonym. Microsoft Office XP (2002), Thesaurus. In Sundheim v. Reef Oil Corporation, 247 Mont. 244, 245 (1991), the Montana Supreme Court described a "prudent operation" in the oil and gas business as "a reasonable man engaged in oil and gas operations . . . who does what he ought to do not what he ought not to do with respect to operations on the leasehold." A determination of IAPP is necessary to find prudence, but a finding of prudence may require more than a determination of IAPP.

PREAPPROVAL

The concept of preapproval – more accurately the presumption against preapproval of utility cost recovery – is fundamental to utility regulation. In Docket No. 88.6.15, Order No. 5360d (1989) the Commission wrote as follows:

In utility ratemaking, the concept of preapproval is generally the outgrowth of a desire to reduce the risk associated with a certain action. Extensive preapproval undoubtedly shifts risk from shareholders to ratepayers. There is also a definite connection between the management function performed by the utility and preapproval. The basic concept of regulation entails independent management running the utility, with the Commission stepping in to protect the public if management's actions are deemed imprudent. Preapproval places the Commission in the position of actually protecting management from imprudent actions, thus seriously compromising management independence, and the arm's length relationship between the management and the Commission. The Commission sets utility rates, it is not responsible for management decisions.

105 PUR4th 225, 272. The Commission was reacting in that order to a proposal by MPC that would require the Commission to preapprove power purchase expenses. The Hawaii Public Utilities Commission, also refusing to preapprove a power purchase contract, quoted favorably from this language. Re Hawaiian Electric Company, Inc., 108 PUR4th 533, 546 (1989). Similarly, the Idaho Public Utilities Commission refused to preapprove a power contract as follows:

The Company in its Application has also asked that we pre-approve a replacement contract with The Washington Water Power Company. The replacement contract is a discretionary contract, different from the obligatory QF contract it is meant to replace. The decision of the Company to enter into a discretionary contract with Water Power is a management decision. It is difficult to assess the prudence or reasonableness of the WWP Agreement in isolation, apart from a consideration of the Company's Integrated Resource Plan or outside a general rate case. While we do not disapprove the WWP Agreement, neither are we in a position to approve it. The WWP Agreement may be an opportunity resource which can be justified, but at this point in time it is a resource decision which the Company must make alone.

Re Idaho Power Company, 152 PUR4th 491, 494 (1994).

The Commission is not aware of any case in which utility expenses, power purchase or otherwise, have been preapproved for inclusion in rates.¹⁵ It appears that the regulatory norm – that the utility first incurs expenses and then seeks to justify their recovery in rates – is so fundamental that it is rarely tested.¹⁶ A reasonable interpretation of § 69-8-210(4)(a), MCA, supports the normal regulatory practice: "The Commission shall use an electricity cost recovery mechanism that ensures that all prudently incurred electricity supply costs are fully recoverable in rates." First the costs must be prudently incurred (past tense), then they are fully recoverable in rates.

The Montana Consumer Counsel (MCC) argues that NWE's Application constitutes a request to preapprove the long-term "contract" expenses. MCC Initial Brief, pp. 2-3. It is noteworthy that NWE does not challenge the MCC's characterization of the Application as seeking preapproval of the long-term "contracts," nor does it dispute that preapproval is not normal regulatory practice. In fact, NWE concedes that MCC's argument is based on the

¹⁵ Preapproval of rate base treatment for utility capital investment is another matter, not at issue and not discussed here.

¹⁶ See, e.g.,

To justify an expenditure, a company must show that the expense was actually incurred (or will be incurred in the near future), that the expense was necessary in the proper conduct of its business or was of direct benefit to the utility's ratepayers, and that the amount of the expenditure was reasonable. Moreover, it must be emphasized again that a public utility may still spend its money in any way it chooses. Management's function is to set the level of expenses; the commission's duty is to determine what expense burden the ratepayer must bear.

"traditional approach." NWE Reply Brief, p. 4. NWE argues, however, that the Commission should not apply the traditional approach to the facts of this case.

NWE contends the Commission should preapprove power purchase expenses because the contract proposals are "financially material." NWE Reply Brief, p. 4. It is true that the financial commitments imposed by the long-term "contracts" would be large compared to many other expense items. However, the logic of NWE's argument is that the greater the risk, the more reasonable it is for ratepayers to bear it. The Commission concludes the opposite: the greater the risk the more important it is to adhere to traditional ratepayer protections. Moreover, it is important to note that utilities like NWE have for years made "financially material" natural gas procurements and have not sought preapproval for those expenses; more importantly, NWE entered into "financially material" power purchase agreements with PPL-Montana (PPLM) and Duke Energy (Duke) as part of the portfolio in this docket, without seeking preapproval.

NWE also submits the "California experience" as a reason for deviating from traditional regulation. NWE Reply Brief, pp. 4-5. NWE apparently means by this that it does not want to be forced to buy high and sell low. The Commission cannot conclude from this record that undermining a traditional regulatory principle is a reasonable lesson to draw from the "California experience." Traditional regulatory principles are designed to protect consumers while allowing for financially healthy utilities. That is also the Commission's objective in this order.

DECISION ON PORTFOLIO SUPPLY

After considering the law and the record, the Commission makes the following findings and decisions on the NWE default supply portfolio Application: first, NWE has, as the default supplier and pursuant to § 69-8-210(3)(a), MCA, procured a portfolio consisting of electricity from PPLM and Duke. This electricity will be available on July 1, 2002 from existing generation resources to meet the needs of default supply customers. In addition, NWE has available electricity from qualifying facilities¹⁷ and the Milltown Dam. To the

¹⁷ For more than 20 years, NWE has been required by law to purchase electricity from qualifying facilities (QFs). 16 U.S.C. § 824a-3(a). Therefore, while NWE has electricity available from existing QFs to meet its default supply obligations, that electricity does not represent a

extent additional electricity supply is needed NWE will be required to purchase it in the short term market. NWE may enter into other power purchase contracts at any time.

Second, the Commission has reviewed the procurement of electricity from PPLM and Duke and finds it was procured using IAPP, as explained below. A determination of whether default supply costs for the year July 1, 2002 through June 30, 2003, including costs associated with the PPLM and Duke power purchase agreements, were prudently incurred will be MADE pursuant to the cost recovery mechanism after July 1, 2003.

Third, NWE has proposed several long term "contracts" for electricity supply for inclusion in the portfolio. The Commission finds that these proposals are not a procurement of default supply pursuant to § 69-8-210(3)(a), MCA, but are instead proposals on which the Commission may comment pursuant to § 69-8-210(3)(b), MCA. They are not a procurement because each "contract" contains "regulatory out" language which binds NWE to the "contract" only after certain specific approval by the Commission. This is not consistent with § 69-8-210(3)(a), MCA, which places an obligation on NWE to procure a portfolio, an obligation not vitiated if a contract proposal is not approved by the Commission. Even if the long-term proposals are considered binding contracts and "procurements" under the statute, the Commission is not required and will not in this order review and make findings either approving or rejecting them. The Commission will review and comment on the contract proposals in this order. If NWE incurs electricity supply costs under these "contracts" the Commission will review the prudence of such costs pursuant to the cost recovery mechanism.

PPLM AND DUKE CONTRACTS

NWE procured three additional sources of electricity supply, supplementing existing contracts with QFs and Milltown Dam, which will begin delivering power to serve default customer demand on July 1, 2002. These sources of electricity supply consist of two contracts with PPLM and one contract with Duke. NWE-4, Exhibits DDH-A and DDH-F.

In March 2001, NWE issued a request for proposals (RFP) for various electricity supply products, including full requirements service, base load, heavy load, variable load and peaking and reserves. NWE's RFP also asked for bids for various contract lengths, although not exceeding

"procurement" pursuant to § 69-8-210(3)(a), MCA. QF costs are subject to the prudence review

11 years. More than 20 bidders responded to the RFP. PPLM submitted a bid for 500 MW of unit contingent base load power for five years at a price of \$60 per MWh. NWE-1, p. 13, Data Request Responses MCC-12 and MCC-11. Because this bid was the lowest for power beginning July 1, 2002 NWE began negotiations with PPLM. In late April 2001 NWE and PPL-Montana reached an agreement in principle for PPLM to sell to NWE 500 MW of unit contingent base load power at a price of \$40 per MWh. The two companies continued to negotiate contract language for several weeks and on June 15, 2001 PPLM signed the fully negotiated contract. However, at that time NWE felt that wholesale power prices had moved lower and the agreement with PPLM no longer represented good value. NWE suggested further negotiations. According to NWE, PPLM declined.

In late August and September 2001 NWE and PPLM had some discussions about a possible new contract, but these discussions were not successful. In October 2001 NWE issued another RFP. NWE-1, p. 14, Data Request Responses MCC-16. Fourteen bidders responded to the RFP. PPLM offered the lowest prices for power for the five-year period beginning July 1, 2002. As a result of the RFP, NWE accepted two bids submitted by PPLM: one for 300 MW of base load power and another for 150 MW of heavy load power. NWE also accepted a bid from Duke for 111 MW of unit firm base load power for one year.

NWE's decision to procure power from PPLM and Duke was not challenged. The relative transparency of the competitive solicitation process may have contributed to this, along with the fact that the products procured are well defined, standard, power supply products from existing, experienced power generators. MCC stated that a clear conclusion in this case is that "...the short-term and intermediate term components of the proposed portfolio (*i.e.*, the Duke and PP&L [sic] contracts as well as the QF supplies) are appropriate..." Initial Brief, pp. 1-2. Comanche Park recommended that the Commission "[a]pprove, as procured in accordance with Mont. Code Ann. § 69-8-210 (3)(a) and (4)(a) the DSP contracts with Duke Power [sic], PPLM, and the Qualifying Facilities." Initial Brief, pp. 42-43. There is little, if any, discussion of the PPLM and Duke resources in the testimony and briefs of other intervenors.

The Commission finds that NWE acted reasonably and according to IAPP, based on information available to it at the time, when it acquired the PPLM and Duke resources. Acquisition of the resources generally conforms to the five steps of IAPP identified by Mr. Saleba. See Legal Discussion, p. 10. NWE used competitive solicitations and a verifiable method of exploring

pursuant to the cost recovery mechanism described at § 69-8-210(4), MCA.

alternatives for a variety of standard market products for varying terms. NWE collected offers for well defined products enabling it to compare prices in a relatively straightforward manner. NWE analyzed the offers and chose the lowest cost for a combination of base load and heavy load resources, in amounts that are likely to be needed during the transition period. NWE negotiated prices and terms. See Data Request Response MCC-12. During the process NWE appeared to remain flexible and use good judgment in perceiving a shift in wholesale market prices and opting to further explore alternatives rather than executing previous agreements in principle.

The Commission's finding on IAPP does not guarantee NWE full cost recovery under the cost recovery mechanism. As NWE acknowledged in its reply brief, NWE has an ongoing responsibility to prudently administer its supply contracts and the energy procured pursuant to those contracts for the benefit of ratepayers. Failure to do so could result in less than full cost recovery. Reply Brief, p. 6.

In this case, NWE acted reasonably in procuring the PPLM and Duke resources. However, NWE should also consider the Commission's comments provided on the proposed resources as they relate to analysis and documenting management's judgment. Although NWE's selection of the PPLM and Duke resources was much more transparent than its selection of the proposed resources, there is room for improvement. Specifically, more information could have been provided on how NWE analyzed and determined the portion of the portfolio that should be supplied by these particular resource types and products. NWE should pay particular attention to the Commission's comments on development of the "best" or optimal default portfolio.

ENERGY EFFICIENCY

Several parties testified that NWE did not, or did not adequately, incorporate energy efficiency and demand-side resources into the proposed portfolio. Testifying on behalf of District XI HRC, Natural Resources Defense Council and Renewable Northwest Project, Thomas Power stated that NWE should pursue all cost-effective demand-side management (DSM) resources available in default customer residences and businesses. He also urged the Commission to adopt policies that encourage customers to pursue cost-effective DSM and assure that NWE is not financially penalized by pursuing cost effective DSM resources.

Commercial Energy of Montana (CEM) witness Ron Perry noted that demand reduction is a viable source of peak resources. Mr. Perry discussed the linkages between rate design, metering policies and demand-management incentives.

Northwest Power Planning Council (NWPPC) witness John Hines recommended that the Commission direct NWE to conduct a more detailed analysis of the achievable load reduction from energy efficiency investments. Mr. Hines indicated that NWE's estimate of 98 MW of potential demand-side resource is only a preliminary estimate, but appears plausible. The NWPPC places a higher value on energy efficiency than conventional thermal generation. Mr. Hines testified that cost-effective energy efficiency should be part of the default supply portfolio and recommended that the Commission direct NWE to develop a plan for acquiring that resource.

Several public interest groups, not parties to this docket, submitted comments supporting conservation and energy efficiency resources. The Montana Environmental Information Center (MEIC) commented that energy conservation is "the greatest single oversight in the portfolio." According to MEIC, energy conservation is cleaner, cheaper and faster to acquire than traditional supply-side resources. Furthermore, the inclusion of coal-fired generation and the exclusion of conservation cannot pass a reasonable test of prudence. MEIC recommended that the Commission require NWE to include in the portfolio the 98 MW of conservation the Company identified as available in its service territory. Public testimony of Patrick Judge on behalf of MEIC, April 10, 2002.

Montana Public Interest Research Group (MontPIRG) stated that by excluding conservation resources from the portfolio NWE ignored a proven source of clean, affordable energy. MontPIRG stated that a watt saved is the same as a watt generated and that "...there is no cheaper, cleaner power than power you don't have to produce." MontPIRG asked the Commission to reject the portfolio and require NWE to replace the proposed new coal plants with conservation and more renewable energy. Correspondence from David Ponder, Executive Director, MontPIRG, April 10, 2002.

NWE stated that, while it recognizes that demand-side resources are available on its system, it is not sure how the procurement of such resources should proceed under existing legislation. For example, Bill Pascoe testified that NWE is struggling with how DSM programs fit into the restructured environment of default supply and with Universal System Benefits funding. TR 344. Dave Houser testified that the question is not whether or not it would be in society's interest to pursue DSM resources, but how they should be pursued and who should pay. TR 748. Mr. Houser also stated that it is not clear from legislative direction that DSM resources are appropriate resources for the default supplier. TR 747.

The Commission finds that NWE should consider demand- and supply-side resources on an equivalent basis when procuring resources to serve default loads and managing the total cost of providing default service. Unless directed otherwise by the Legislature, or modified by the Commission, it is the Commission's policy that energy efficiency and conservation resources are resources that NWE should consider along with more traditional supply-side resources when evaluating alternative default portfolio resources.

This policy has effectively been recognized by both the Executive and Legislative branches of Montana state government. In March 2001, Governor Martz issued Executive Order 03-01 Directing Energy Conservation in State Buildings. The Executive Order concluded that the State of Montana has the ability to use electricity more efficiently and that electricity savings could be used to provide affordable electricity supply to certain customers who, at the time, were exposed to high market prices. Similarly, the 2001 Legislature passed HB 645 to establish an electrical energy pool. (HB 645 was codified at § 69-8-110, MCA.) The purpose of the electrical energy pool is to make electrical energy available for resale through the conservation efforts of customers. Thus conservation and efficiency are considered resources that can produce electricity as effectively as traditional supply-side resources. Excluding an entire category of potential cost-effective resources does not comport with industry accepted practices in terms of overall portfolio development.

NWE should conduct further analysis of the available, cost-effective, demand-side resources in its service area. The Commission encourages NWE to communicate with interested persons and affected stakeholders during its analysis.

Prudently incurred costs related to procuring demand-side resources are fully recoverable in rates. The Commission will evaluate the prudence with which the Company procures demand-side resources, including resources acquired through sub-contractors, consistent with evaluations of supply-side resources. The Commission is open to exploring with the Company and interested persons innovative ways of addressing cost recovery issues related to demand-side resource investments and expenses.

DEFAULT SUPPLY TRANSMISSION RATES

NWE proposes to convert its retail default supply transmission rates from the current Commission rates to Federal Energy Regulatory Commission (FERC)-based rates. NWE, in its default supplier role, would enter into a Network Service Agreement with itself, in its transmission services provider role, under NWE's FERC Open Access Transmission Tariff (OATT). NWE

asserts this will ensure that the default supplier is treated the same as other transmission customers and will clarify the default supplier's transmission rights if and when a regional transmission organization (RTO) is established.

Under NWE's proposal, the default supplier will pay the FERC-regulated OATT rate for transmission services, which would form the basis for retail transmission rates, instead of the Montana jurisdictional transmission cost component in the bundled service tariff. NWE would also purchase ancillary services through the OATT. Ancillary services include the cost of purchasing operating reserves subject to Western Electricity Coordinating Council requirements.

MCC's witness John Wilson stated that NWE's proposal would remove retail transmission service cost and price regulation from this Commission's jurisdiction and, instead, place transmission service under FERC regulation. NWE's proposal would also transfer cost-of-service regulation of so-called ancillary services such as scheduling, load following, operating reserves and regulation products from Commission to FERC jurisdiction. Dr. Wilson disputed NWE's assertion, in its transmittal letter, that this "is strictly a flow-through of costs without any profit." Dr. Wilson stated that this is not true since the Company's OATT includes a rate of return component on transmission rate base investment.

In Data Request PSC-32, the Commission asked:

Section 69-8-403, MCA requires that the PSC 1) establish just and reasonable rates through established ratemaking principles for public utility owned transmission services, and 2) regulate these services. Please explain how MPC's proposal to pass through transmission charges established by FERC is consistent with this responsibility and ensures that the PSC can adequately perform its duties under Montana law.

NWE responded:

In FERC Order No. 888, the Federal Energy Regulatory Commission found that it has exclusive jurisdiction over the rates terms and conditions of unbundled retail transmission of electricity in interstate commerce by public utilities. The retail electric service to be rendered by MPC in its role as default supplier involves the purchase of unbundled transmission service from MPC in its role as transmission provider. Because the rates for such service are subject to the exclusive jurisdiction of the FERC, MPC in its role as default supplier is required to pay the rates, terms and conditions for unbundled transmission service reflected in the open access transmission service tariff that is on file at the FERC.

NWE asserted that under the Narragansett doctrine, Narragansett Electric Co. v. Burke, 381 A.2d 1358 (RI 1977); cert. denied, 435 U.S. 972 (1978), when setting retail service rates the Commission may not conclude that FERC approved transmission rates are unreasonable, but must treat the

FERC-authorized charges under these rates as a reasonable operating expense. NWE also stated that under the so-called “filed rate doctrine” the Commission may not exercise its jurisdiction over retail sales to prevent NWE from recovering the costs of paying the FERC-approved transmission rate.

Dr. Wilson also disputed these arguments finding that NWE’s attempt to insert an intermediate wholesale transmission “transaction” with itself in the flow of electric service to its retail customers is plainly a contrived artifice. According to Dr. Wilson, default service is still the same bundled retail service that it has been for years – nothing has changed to require the fabrication of a wholesale transmission “transaction” between NWE and itself.

MCC noted in his initial brief that the issue of FERC versus state jurisdiction over the regulation of transmission for retail electricity deliveries was recently litigated before the United States Supreme Court. Initial Brief, p. 17. The Court’s decision in that case upheld the right of state commissions to regulate the transmission rate component for bundled retail service.

New York v. Federal Energy Regulatory Commission, 535 U.S. ____, 122 S.Ct 1012 (2002). So long as the Commission regards electricity service to default customers as a bundled service, NWE is incorrect that the FERC has regulatory authority over retail transmission. In Order 888, FERC adhered to established precedent that nothing in federal law undermines the authority of state or local government, acting under state law, over the transmission of electric energy directly to an ultimate customer.

NWE’s witness Pat Corcoran stated in rebuttal testimony that, given the requirements of the Choice Act, default supply service is fully unbundled from transmission service beginning on July 1, 2002, and, therefore, NWE as default supplier must take FERC-regulated transmission service under the FERC OATT. NWE's Transmission Service provider is required to provide the same unbundled service on a stand-alone basis to all retail electricity suppliers whether the supplier is the default supplier or otherwise. Mr. Corcoran stated that both FERC and the courts have agreed that FERC has exclusive jurisdiction over unbundled transmission service in interstate commerce, whether to an end user or for resale.

In its reply brief NWE argued that, since MCC acknowledged that the FERC has asserted exclusive jurisdiction over unbundled retail transmission service, the question is whether default supply service is considered “bundled” or “unbundled” service. NWE argues that default service is an unbundled retail sale. NWE cited § 69-8-204, MCA, which provides: “(1) To the extent that a public utility is vertically integrated, a public utility shall functionally separate the public utility’s

electricity supply, retail transmission and distribution, and regulated and unregulated retail energy services operations in the state of Montana, upon application and approval from the commission[,]” and § 69-8-209, MCA, which provides: “For transmission services regulated by the commission, public utilities, through filed tariffs, shall make transmission services available for nondiscriminatory and comparable use by all electricity suppliers, by distribution services providers, and by customers.”

NWE asserts that in the New York v. FERC the Supreme Court explained that a public utility “unbundles” if it “separates the cost of transmission from the cost of electrical energy when billing its retail customers.” The Montana Legislature has required such separation of costs in § 69-8-409, MCA. NWE also states that notwithstanding FERC’s requirements, charging default supply customers a different amount for transmission services than that paid by customers electing an alternate supplier, would distort customer choice and frustrate the most fundamental purposes of the Choice Act.

It is not clear that default supply service is unbundled such that the Commission must abdicate its regulatory jurisdiction over transmission rates to the FERC. NWE’s arguments on the issue are not necessarily consistent with its actions. For example, NWE argues that long-term contracts are appropriate given the security of default load. Also, NWE’s proposed Montana rate schedules, including R-1, specify that service is “available to customers who take conventional (bundled) service from NorthWestern Energy.”

At the time of the sale of generation PPL also expressed interest in purchasing MPC’s interest in the 500 kV transmission system for Colstrip Units #1, #2 and #3 if generation sales from Portland General Electric (PGE) or Puget Sound Energy (PSE) to PPL did not close. PGE and PSE did not sell their Colstrip generation interests to PPL. The sale of transmission from MPC to PPL has not closed and is pending at the present. If there is a sale above book value, the ratemaking treatment of the proceeds needs careful examination. Until the treatment of the proceeds from the transmission sale to PPL has been resolved, the Commission finds it would be a mistake to prematurely approve the requested change to the FERC OATT tariff for default supply.

Given the limited exploration of the issue of transmission jurisdiction in this Docket, the fact that a Regional Transmission Organization (RTO) which includes Montana has not been formed, and given the decision of the U.S. Supreme Court, the Commission denies NWE’s request to use the FERC OATT as the basis for retail transmission service rates at this time. NWE did not sufficiently explain the impact on customer rates from this change. NWE argued for the change based on the

potential formation of an RTO, but it is unknown when an RTO will be formed. The possible future formation of an RTO is insufficient reason to convert to the FERC OATT at the present time. Finally, NWE has referred to its own tariffs as providing conventional bundled service. The Commission finds that retail transmission service provided in the context of default service continues to be a bundled, intrastate service and must be provided subject to Commission regulatory jurisdiction.

COMMISSION COMMENTS ON PROPOSED DEFAULT RESOURCES

The following are Commission comments which may be helpful to NWE in its role as default supplier.

NWE MANAGEMENT'S EXERCISE OF JUDGMENT

A fundamental Commission responsibility in regulating NWE's provision of default supply is determining whether NWE used IAPP when procuring supply resources to provide for the full electricity supply requirements of all default supply customers. With respect to the long-term "contract" proposals NWE submitted, the Commission offers the following comments. The comments 1) identify those NWE actions and decisions that, based on the record, do not appear reasonable, and 2) provide the Company with direction and guidance for future filings.

NWE stated that the purpose of its October 29, 2001 Application was to allow the Commission to assess the prudence of NWE's proposed default supply portfolio. It follows that NWE's Application should have included: 1) a description of the portfolio, and 2) sufficient testimony and supporting documents explaining how and why NWE assembled the portfolio so that the Commission and parties could have an adequate basis for judging the reasonableness of the procurement.

Section 69-8-210(3) (a), MCA, requires that NWE use IAPP to procure default supply resources. This is a process-related statutory requirement. An industry-accepted process should improve the chances that electricity supply costs will be found to have been prudently incurred. In addition to good process, good judgment must be demonstrated. Therefore, in order to properly determine whether NWE has acted prudently the Commission must inquire into the manner and method by which NWE applies its process and by which it makes decisions based on that process. At numerous points throughout the procurement process NWE's management made critical

decisions that shaped the process and the ultimate portfolio. It is the NWE's job to make decisions on critical issues in a dynamic environment, and the Commission appreciates the particular challenges NWE's management faced at the time it was assembling the default portfolio.

Regardless of the challenges, however, NWE's management must be vigilant about documenting the exercise of its judgment because it knows, or should know, that it will need to prove to the Commission that its decisions and judgments, both with respect to the process it used and the choices it made within the process, were prudent and, therefore, the result serves the public interest.

These comments discuss how well NWE documented and explained its decision-making process and its judgment that resulted in the selection of the "contract" proposals. The comments highlight significant areas of concern that would likely have led the Commission to determine either that NWE was not prudent, or did not satisfy its burden of proof, had it in fact procured the resources. The comments focus on several critical decisions related to procuring the default portfolio in order to illustrate these concerns. Each proposed resource is then evaluated separately.

ASSEMBLING THE OVERALL PORTFOLIO

Intervenors raised numerous concerns about the structure of the portfolio as proposed. MCC witness John Wilson testified that while NWE's Application evaluated general resource attributes, there was no discussion of the relative importance of the attributes and how they were weighted, assessed, or ranked as NWE was making its decisions. MCC-1, p. 9. Dr. Wilson went on to suggest that absent appropriate analysis and documentation, NWE's identification of general resource attributes or social objectives provides a "less than ideal" basis for evaluating the prudence of the proposed long-term contracts. Id.

NWPPC's witness John Hines testified:

“[NWE] did not provide information on the way in which the different attributes were applied or the level of weight each attribute was given. Without this information, it is impossible to determine the amount of influence these attributes had in the evaluation process for accepting or rejecting any particular bid.”

NWPPC-1, p. 8.

District XI HRC's witness Thomas Power testified that NWE's proposed default portfolio was not developed consistent with the principles of Integrated Resource Planning (IRP). Consequently, the Company's "...analysis of individual resources, the best mix of resources and the balancing of various risks of alternative resources have been carried out internally without any

outside review.” HRC-6, pp. 7-8. Dr. Power testified that: “the basic [IRP] principles can be applied in any time period that you have, that you can adjust the process, so you’re asking the appropriate questions, you’re doing the appropriate analysis, you’re including the appropriate resources, you’re gathering the appropriate information.” TR 1019.

Comanche Park's (CP) witness Robert Julian stated that NWE’s selection of new generation projects resulted from “haphazard and inadequate discussions with various potential generators.” CP-B, p. 8. Mr. Julian further stated that NWE provided no evidence that it developed any basis for acquiring resources from a particular fuel source and that NWE's evaluation of bids appeared superficial and did not provide a balanced evaluation of the qualitative and quantitative values of new generation or the benefits and risks of new and existing resources. CP-B, pp. 15 and 18.

The Commission agrees with these comments. They highlight a frustration at not being able to understand the decision-making process the Company applied when it selected resources for the portfolio. In turn, this frustration is a symptom of NWE’s failure to adequately document and explain its judgment. It is noteworthy that the Commission explicitly adopted as a resource acquisition policy in its IRP rules that utilities should thoroughly document the exercise of judgment in weighing the importance of conflicting decision objectives. ARM 38.5.2001 (9). The Commission particularly agrees with Dr. Power’s testimony that the basic principles embodied in the IRP statute and rules are relevant to NWE’s default supply resource procurement process, whether or not NWE is now subject to the specific statutory and administrative rule requirements. In other words, the statutes and rules may or may not specifically apply to supply procurement pursuant to § 69-8-210(3)(a), MCA, but the principles embodied in the statutes and rules do. Furthermore, given that NWE knows, or should know, that the Commission has a statutory responsibility to supervise and control public utilities and to be informed about business decisions, it is plainly sensible to thoroughly document how and why critical decisions are made.

Documenting the exercise of judgment reveals the thought and analysis that occurs prior to a decision being made. NWE’s Application contained few details on how it came to select the specific resources it did, leaving parties and the Commission to try to use the discovery process to investigate the extent to which NWE analyzed various issues before making its decisions.

Data request MCC-004 asked NWE to provide all memoranda, studies and other documents that pertain to the tradeoffs between the quantities secured, length of contracts, and price diversity for the proposed portfolio and the criteria that NWE used to evaluate the tradeoffs. NWE’s answer

referred to NWE's Application. But NWE's Application was not accompanied by such memoranda, studies or other documents and provided only general descriptions of goals for the default portfolio: diversity, flexibility, reasonable cost, reliable supply and stable prices. Additionally, the Application listed numerous resource attributes that were considered: price, risk, delivery point, transmission constraints, size, on-line date, type of product, benefits to citizens, development of competition and renewable characteristics. This information is useful, but as Dr. Wilson suggested, general goals and considerations do not allow the Commission to understand why the Company concluded that the portfolio as a whole was the best available, or why each selected resource contributed to that result.

NWE's response to data request MCC-031 goes directly to the core of a primary frustration expressed by several parties: What was the basis for NWE's resource procurement process and philosophy? How did NWE decide that the structure of the chosen portfolio was "best" or "optimal" in terms of costs, product diversity, supplier diversity, contract length, price stability, dispatchability, risk and other characteristics? NWE developed a computer model that it used to estimate how the costs of the proposed portfolio would change under various assumptions for customer demand, wholesale market prices and natural gas prices. Data request MCC-031 asked the Company to provide all memoranda, studies or other documents that discuss or describe the model's performance over a range of price and other market conditions. NWE responded that in the course of developing the model it "ran dozens of scenarios testing the economic performance of numerous resource combinations under varying market conditions" and that "these analyses helped guide the Company's resource acquisition process and philosophy." While it is encouraging to know that NWE conducted such analyses, NWE's Application did not discuss or summarize the results of the analyses or explain how they led it to decide to implement its chosen procurement strategy or select specific resources. NWE's response to MCC-031 provided no summaries or additional explanation, only a statement that NWE would be willing to review with interested parties the voluminous computer files in its Butte offices.

Data request PSC-005 asked NWE a much narrower, but similar question: provide the next best default supply portfolio along with documents that compare that portfolio with the chosen portfolio. NWE's answer was unresponsive, pointing instead to its reply to data request MCC-031. NWE did not even try to summarize the next best alternative portfolio. Thus, Dr. Wilson concluded correctly that: "[t]he portfolio analyses described in [NWE's] testimony are directed only to the procured supplies and the selected portfolio's total costs as market prices change or as demand

changes. These analyses are not indicative of a precontracting effort to identify a least cost supply portfolio.” MCC-1, p. 11.

In other words, the only analytical support NWE provided is related to sensitivity analyses of the chosen portfolio. These analyses address how the chosen portfolio behaves under different assumed wholesale market prices, default customer consumption levels and natural gas prices. NWE did not provide or even summarize any analyses related to structuring the best default portfolio. NWE rebuttal testimony did not refute Dr. Wilson’s conclusion. A single sentence stated that NWE determined that “...it would be difficult to assemble the best possible portfolio without a significant PPLM component.” NWE-2, p. 6. But NWE provided no further explanation or discussion of the basis for this conclusion.

NWE suggested that time constraints and the challenging market conditions it faced at the time it was procuring default resources led it to decide to use the procurement process it did. NWE's Application and rebuttal testimony do not discuss what other procurement options were considered, how the tradeoffs among various options were evaluated and the basis for determining that the alternatives were not compatible with the time constraints and market conditions NWE faced.

Based on information NWE provided in this case, the Commission has an insufficient basis for determining that NWE adequately analyzed how to procure the best or optimal default portfolio. Even if NWE did conduct sufficient analyses, it did not adequately document and explain these analyses and the judgments which led to the specific mix of resource types, products, contract lengths, price stability, dispatchability, risk and other characteristics of the chosen portfolio. Given the substantial commitment customers would shoulder for up to twenty years as a result of the proposed portfolio, the Commission finds this a serious and unacceptable shortcoming of NWE’s Application.

NWE’S RESPONSE TO SHIFTING WHOLESALE PRICES

Having concluded that a contract with PPLM for a significant portion of the default portfolio was important, NWE faced a critical decision when, according to NWE, PPLM was not interested in renegotiating an agreement in principle in June 2001. NWE characterized the decision it made at that point as a strategic one designed to pursue new generation offered at competitive prices and put pressure on PPLM to offer a price less than prevailing market prices. NWE-2, pp. 7 and 11. The resources NWE ultimately selected based on this strategy are all long-term resources (10 years or

longer). With the exception of the wind project, NWE selected these resources based on individual negotiations; NWE did not identify and choose these resources using a competitive solicitation.

Some intervenors questioned NWE's decision to acquire new generation resources without using competitive bid processes. For example, Dr. Wilson testified that "[c]ompetitive bidding is the most direct and most verifiable way for a utility to secure competitive wholesale prices." MCC-1, p. 8. And although NWE's strategy vis-à-vis PPLM might be reasonable, "...it does not justify one-by-one negotiation of these contracts or procurement without using a contemporaneous competitive bidding process." MCC-1, p. 15. Dr. Wilson suggested that NWE did not adequately analyze and document the alleged benefits of the new generation projects nor explain why "...the same or even better results could not have been obtained using competitive procurement processes to secure the lowest cost long-term power contracts." MCC-1, p. 19

Mr. Julian testified that NWE's decision to not employ competitive solicitations in selecting new generation projects violated the intent and spirit of the Commission's integrated resource planning guidelines. According to Mr. Julian, despite NWE's assertion in its response to data request PSC-026 that the portfolio application should be considered the Company's current least-cost plan, "[NWE] failed to uphold the intent of IRP Competitive Resource Solicitation process." CP-1, p. 9. Mr. Julian referred to Commission rule ARM 38.5.2010 which states that competitive solicitations provide utilities valuable information on available demand- and supply-side resources and, before acquiring any new resources, utilities should thoroughly test the market for cost-effective resource alternatives.

The Commission agrees that NWE did not sufficiently document and explain its decision in June 2001 to proceed to negotiate individually with select developers who had offered unsolicited proposals. NWE's Application did not provide a reasoned explanation of how it reached the conclusion that this was the best course of action given its inability to renegotiate the agreement in principle with PPLM in June 2001. Nor did the Company describe other possible courses of action that were considered and why those options were ultimately rejected.

Although the Commission must evaluate whether NWE acted prudently based on the information that NWE knew or should have known at the time, the Commission must also necessarily evaluate whether NWE exercised good judgment in deciding what questions to ask and what analysis to do. Failure to ask reasonable, relevant questions is not an excuse for not knowing relevant facts. As already explained, NWE should have known that the Commission would inquire into the basis for its decisions. The Commission agrees with MCC that competitive solicitations are

the most verifiable way for a utility to identify resource alternatives and acquire competitively priced resources. The Commission recognized the fundamental effectiveness of competitive resource solicitations for these purposes in its integrated resource planning rules. That basic concept is still valid even if NWE in its default supplier role is no longer subject to the specific planning and filing requirements in the rules. Importantly, the Commission's IRP rules do not preclude utilities from ultimately procuring an opportunity resource outside the competitive solicitation process, as long as the utility demonstrates that the resource is consistent with the overall purpose of integrated least cost resource planning and acquisition. This point applies as well to NWE's default supply procurement process. The issue is whether NWE should have known, or at least should have considered, if a competitive solicitation for long-term contracts with new Montana generators would provide a better benchmark for evaluating the competitiveness of such resources than the broker and marketer quotes it relied on.

NWE asserted that a competitive solicitation in June of 2001 would not have appeared credible to potential bidders due to the short period of time that had elapsed since the Company's March RFP. This is not convincing. Given the substantial shift in wholesale price levels between March and June, suppliers should not have been surprised to see NWE, or any other Company who initiated, but did not complete, a procurement process in the midst of a high price period, seeking new bids after a favorable market shift. Furthermore, according to NWE's stated strategy, such a solicitation would have asked for different and more narrowly defined products. NWE was specifically shopping for new generation projects and was willing to enter contracts for up to 20 years. The March RFP limited proposals to 11-year terms and was not specifically targeted to new generation projects.

NWE also suggested that, practically, it had no other options but to pursue negotiations with those who took the initiative to submit unsolicited proposals. Mr. Pascoe indicated that to effectively implement NWE's strategy, contracts with new generators would need to be in place quickly in order to have the desired affect on PPLM. The Commission is not convinced by this suggestion either. NWE was able to conduct a total of three competitive solicitations as it assembled the portfolio, including one for new wind projects. The March and October RFPs were both conducted in less time than NWE invested in individual negotiations.

Mr. Pascoe asserted that NWE had solid sources of pricing information available, through broker and marketer quotes, against which to benchmark the new projects. NWE-2, p. 24.

Dr. Wilson questioned the validity of this information since the data also showed that at any point in

time a range of market prices existed, such that individual marketer negotiations, at different times and without use of competitive bidding, would not likely produce the lowest cost supplies. MCC-1, p. 20. Additionally, at the time NWE was faced with making a decision on how to proceed given its inability to renegotiate the PPLM agreement in principle (approximately June 15, 2001), it did not know what broker and marketer quotes it would receive through October, 2001. The broker and marketer quotes NWE tracked as of mid-June show relatively greater volatility and a wider range of prices at any given point in time than the data collected from mid-June through October. Finally, the broker and marketer quotes reflected prices for baseload products with five-year terms. NWE did not adequately explain why it determined that it was more appropriate to rely on these prices to judge the reasonableness or competitiveness of unsolicited, long-term resources (10-20 years) rather than to test the market for such resources with a competitive solicitation.

Ultimately, it is NWE's responsibility to demonstrate that it acted prudently. NWE's decision on how to proceed when renegotiation with PPLM didn't work was a critical decision that should have been thoroughly documented and explained in the October Application. NWE should have completely described the alternatives it considered for procuring the remainder of the portfolio, including the use of competitive solicitations. The Commission agrees with MCC: "[T]he Company's stated strategy to use new resources in its attempt to negotiate better deals with existing suppliers in no way explains or justifies the absence of competitive bidding for those long-term contracts, or supports the reasonableness of that resource acquisition process." Initial Brief, pp. 7-8 (emphasis added). NWE did not adequately document the exercise of its judgment at this juncture in its resource procurement process. Furthermore, the record does not indicate that NWE considered whether using a competitive solicitation approach was compatible with the course of action it chose following the break in negotiations with PPLM in June 2001. Consequently, the Commission does not have a sufficient basis for concluding that NWE acted prudently when it embarked on a series of individual negotiations in response to unsolicited offers to build new generation resources, or that the Company acted prudently in selecting the long-term resources for future procurement.

INDUSTRY ACCEPTED PROCUREMENT PRACTICES

Rocky Mountain Power, Thompson River Co-Gen, Tiber Montana

As noted above, it is critical that NWE thoroughly document the exercise of its judgment so that the Commission has a basis for evaluating the reasonableness of the Company's decisions

throughout the procurement process. This is a key component in determining prudence. However, pursuant to § 69-8-210 (3)(a), MCA, NWE also must use IAPP to procure default supplies, which “may include negotiated contracts or competitive bidding.” This section addresses whether the process that NWE used to select long-term baseload, non-wind portfolio resources complies with or is consistent with IAPP.

NWE witnesses testified at length about the process it used in soliciting sources of generation for the default portfolio. Mr. Saleba testified regarding his involvement in the process and gave his opinion on what constitutes IAPP. As already noted, he identified five basic steps:

1. Explore the market for power supply products and prices
2. Collect offers or proposals from various parties
3. Analyze the proposals or offers for price and other factors
4. Negotiate the best contract with the preferred parties
5. Anticipate sudden changes in the market and remain flexible.

NWE did not sufficiently demonstrate that the process it employed in the solicitation and selection of new base-load generation projects (non-wind) complied with IAPP. In response to its March 2001 RFP NWE received some 20 proposals with varying degrees of detail. One of the projects NWE chose to pursue further was the Rocky Mountain Power (RMP) project proposed by Dick Vinson. The proposal by Mr. Vinson was contained in a letter. The letter does not address many of the items NWE requested in its RFP, although reference is made to a presentation to Dan Hickman. Between the date of the solicitation and the signing of the agreement the items in the RFP may have been addressed in further negotiations between the parties; however, this is not supported by the record. To some degree NWE followed Mr. Saleba's steps 1, 2, 4 and 5. It is not apparent that NWE complied with step 3: analyze the proposals or offers for price and other factors. Failure to perform step 3 has implications for step 4: negotiating the best contract with preferred parties.

Data Request MCC-011 asked the following: “Provide all memoranda, studies or other documents that pertain to the process by which the new Montana generation contracts were developed. Include any request for proposals and documents that reflect the negotiations involved in these contract processes.” In its first response NWE provided a very short description of the new generation projects and noted that most documents associated with contract negotiations were not kept and NWE did not have sufficient time to review files to determine if anything had been saved. NWE filed an amended response on March 7, 2002. The amended response contains a series of emails between parties discussing the changes or revisions in the proposed power agreement

between NWE and RMP. Again, using Mr. Saleba's list of basic steps, these documents appear to be part of the negotiation process.

Dr. Wilson criticized the process NWE used with regard to these contracts as not structured, without objective criteria or information on the weights assigned to the factors NWE states it took into account. These criticisms apply to Mr. Saleba's step 3: analyze the proposals or offers for price and other factors. NWE argues that Dr. Wilson's preferred process was impractical because, due to the nature of electricity markets at the time, a strictly structured process would not have resulted in prices as low as were ultimately achieved. NWE did not sufficiently support this conclusion. However, even if NWE is correct, that does not eliminate the Commission's concern. One issue that stands out because of its importance in procurement is whether the bidder is qualified to do the job. This is a critical issue to analyze whether one chooses to use a bidding process or negotiation. In this case, NWE did not provide adequate information that it had determined that the bidder was qualified, or if qualifications include experience and resources (see NWE response to MCC-016, RFP p. 7). The record support available to the Commission is largely along the line of the following:

Mr. Pascoe: [t]he Rocky Mountain Power Amendment is somewhat different, because in that case, we signed a contract with Mr. Vinson; we believed he had a concept that was a good concept; we knew at the time we signed the contract that he probably did not have the financial capability to do the project himself; he was going to have to go out and get financial and possibly other support. But we believed, given the project concept, and given a power purchase agreement with the default supplier, that he would be able to find financing, or find other partners who would help him bring the project together.

TR. 839-840.

With respect to RMP NWE asks the Commission to approve a contract with an entity that NWE admits had problems, but had a good concept. At the time NWE decided to acquire it, RMP was described as a coal gasification facility. NWE-1, p. 4. The proposed contract NWE submitted contained a first-year price of \$36.00/MWh, which would escalate by one half of the annual consumer price index at the beginning of each subsequent year for the term of the contract.

After initial and rudimentary research of coal gasification technology, Commission staff questioned the contracted price, given the proposed technology. The United States Department of Energy's (DOE) web page characterizes coal gasification as "the next generation of coal-based energy production." (Emphasis added, see www.fe.doe.gov.) DOE is currently involved in several joint government-industry projects designed to demonstrate the commercial feasibility of this

technology for generating electricity. DOE's performance target is a cost under \$1,000 per KW by 2008. The cost implied by the RMP project appeared to be significantly less. This apparent inconsistency formed the basis of several Commission data requests.

NWE's October Application did not indicate whether it had conducted any due diligence on the feasibility of new generation projects it included in its proposed portfolio. Therefore, in data request PSC-4(a) NWE was asked to: "...provide all workpapers, spreadsheets, studies, reports, analyses, memoranda and meeting minutes, generated within or outside [NWE] that discuss or evaluate the technical or financial feasibility of each new generation facility included in the default supply portfolio." NWE replied: "[NWE] has seen pro-forma financial statements of Rocky Mountain Power and Tiber-Montana on a confidential basis. These statements are not in [NWE's] possession. [NWE] has not seen any financial statements for Thompson River Co-gen or Montana First Megawatts."

MCC also expressed concerns about the level of NWE's due diligence. Pointing to NWE's response to PSC-4(a), Dr. Wilson stated "...the Company's own description of its evaluation of each potential supplier's financial capability and experience needed to assure expected performance may have been somewhat less than fully diligent." MCC-1, p. 27. MCC's brief was more forceful, stating "[t]he Company has failed to demonstrate that its due diligence efforts in the resource portfolio assembly process would justify a prudence determination at this point." Initial Brief p. 9.

NWE acknowledged that the developer of RMP did not have prior power generation experience, but it felt the project represented a good concept and that, given a contract, the developer would ultimately obtain financing or transfer the project to new owners. TR. p. 1003. Nowhere has NWE explained how and why it determined that RMP was a "good concept." It is not clear what aspects of the contract it considered good. If it was the coal gasification technology at an attractive price, the record shows that NWE did not adequately evaluate whether an inexperienced developer, or any developer, could bring such a project to completion and sustain production at the contracted price. In fact, after NWE had chosen to procure RMP the plant technology changed to pulverized coal and the project was sold to an experienced developer, indicating perhaps that the concept was not possible as proposed by the original bidder.

NWE's justification for choosing RMP, as explained at the hearing, effectively suggests that NWE weighed heavily the entrepreneurial ability of Mr. Vinson to remarket the awarded default supply contract in some secondary market so that some kind of electric generation would ultimately be achieved at the contract price. TR 1003. However, prior to the hearing NWE did not identify

this attribute or explain why this approach to resource acquisition is consistent with IAPP. In rebuttal testimony NWE actually appears to take a different view of buying and selling spots in the default portfolio. Responding to testimony from CP's witness Mike Schmechel, NWE acknowledged that RMP "might face some challenges getting the project completed"; however, NWE "did not suggest that Comanche approach RMP about 'buying' a position in the portfolio." NWE-2, p. 22.

NWE did not conduct sufficient due diligence, and did not adequately document the due diligence it did conduct or explain how its due diligence convinced it that the RMP project should be procured. NWE's changing explanations of how it evaluated the merits of the RMP project, what criteria it applied and how various criteria were weighed and considered in its decision-making process do not provide a sufficient basis for the Commission to conclude that NWE acted prudently when it chose to select this resource for future procurement.

Two other projects, Tiber Dam and Thompson River Co-Gen, were proposed to NWE after the March solicitation closed. Although these projects did not generate much controversy on the record, they raise the same fundamental question as RMP: Did NWE do the analysis necessary to assure itself and the Commission that these were viable projects by qualified bidders resulting in prudently incurred costs? On this record, the answer is no.

An important question is whether NWE would have managed the process the way it did if its own money or credit were at stake. Or would NWE's interpretation of IAPP, the decision-making process, and paper documentation have been different if it believed it needed to justify its resource choices to its board, stockholders and bankers? The Commission doubts whether NWE would have managed the process similarly if its own money were at risk.

Montana First Megawatts (MFM)

A number of intervenors raised the issue of an affiliated interest transaction concerning the MFM project. NWE admits that there is little it can do to deal with the perception that the MFM contract was not negotiated at arms length by MPC and NorthWestern. Pascoe Rebuttal Testimony, p. 44. CEM's initial brief noted that the appearance of impropriety diminishes the confidence and support of ratepayers in the entire process, a process they would pay for over the next twenty years. MCC noted in his initial brief that the MPC sale to NorthWestern was pending during the entire time the default portfolio was being assembled. The FERC has clearly stated that its policy with respect to announced mergers is to treat the potential merger partners as affiliates. Commission

staff recognized the affiliate interest issue associated with the MFM project as soon as it was publicly announced. In an October 2001 presentation by NorthWestern, Commission staff asked questions about the affiliate interest inherent in the proposed project. NWE was very well aware of the scrutiny applied by this Commission to affiliated interests. Mr. Hanson admitted at the hearing that there is today an affiliated relationship. TR 1169.

The United States Supreme Court has commented on the concept that a regulated utility would have an ongoing and arms-length transaction relationship with an affiliated, non-regulated company within the corporate family:

...the coordinated activity of a parent and its wholly owned subsidiary must be viewed as that of a single enterprise... (They) have a complete unity of interest. Their objectives are common, not disparate; their general corporate actions are guided or determined not by two separate corporate consciousness, but one. They are not unlike a multiple team of horses drawing a vehicle under the control of a single driver. With or without a formal "agreement," the subsidiary acts for the benefit of the parent, its sole shareholder...the very notion of an "agreement;"...between a parent and a wholly owned subsidiary lacks meaning... a parent and a wholly owned subsidiary always have a "unity of purpose or a common design. They share a common purpose whether or not the parent keeps a tight rein over the subsidiary; the parent may assert full control at any moment if the subsidiary fails to act in the parent's best interest.

Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 771 (1984). In this case the Commission applies the FERC standard regarding merger affiliates. Thus, NorthWestern and MPC were evaluated as though they were affiliates at the time the contract for the MFM project was entered into. Given that the MFM project was an affiliated interest transaction it must receive intense examination to ensure that default supply customers are not harmed by the transaction.

NWE did not provide sufficient evidence on the fuel cost of the MFM plant. In proposing this resource without a known fuel cost, NWE asked the Commission to make a decision without all of the required information. The Commission finds this approach unacceptable. The cost of fuel is a central input to the overall cost of the project. The Commission cannot reasonably evaluate the total cost of the project without information about fuel cost.

The Commission has serious concerns with the reliance on the short-term spot market as the only source of fuel being considered by the default supplier in this case. As proposed, the fuel risk related to the MFM project is imposed on the customers; NWE intends to pass through all fuel costs associated with the output from the plant used to serve the default supply load. The Commission is concerned about NWE's plan, as stated at the hearing, for procuring gas supplies. Mr. Pascoe

testified that if natural gas prices got too expensive the response would be to shut down the MFM plant and purchase electricity as a substitute for the output from the MFM plant. However, Mr. Pascoe then admitted that the price of gas and the price of electricity are highly correlated. Later Mr. Pascoe changed his opinion and stated that if electricity prices move up just as fast NWE would keep buying gas. The Commission is concerned that, in that scenario, the losers are default supply customers who are not effectively hedged against high spot market prices for natural gas which would be used at the MFM plant. NWE did not adequately analyze and explain why long term gas contracts, with their associated price stability should not be included in a portfolio of varying term contracts to supply the fuel needs of the MFM project. Complete reliance on short term gas supplies for the MFM plant could subject customers to an unreasonable level of price volatility.

The Commission repeatedly attempted to obtain information that would allow an evaluation of the capacity payment in the proposed MFM contract in relation to the overall costs of the plant. Data Request PSC-14 asked: "Are the capacity payments that are proposed to be paid to MFM adequate to service the debt associated with the cost of the plant? If not, how much is the shortfall differential, if so how much is the excess? Please support your comments." MPC's answer was not responsive: "MPC does not know the answer to this question because MPC is not privy to cost information about MFM. The capacity payments are the result of negotiations between a willing buyer and a willing seller." Data Request PSC-16 referred to an October 23, 2001, presentation by NorthWestern on the MFM project where Commission staff first recommended that the Company be prepared to demonstrate the basis for any capacity charge. Data Request PSC-16 asked MPC to provide its understanding of the basis for the capacity charge. MPC's response referred back to its answer to Data Request PSC-14. Finally, Data Request PSC-68 was asked after the sale to NorthWestern had closed and an affiliate relationship with NorthWestern Generation I existed. Data Request PSC-68 asked the Company to provide, or arrange for its affiliate to provide, information supporting the development of the capacity charge. The response by the Company was: "MPC does not possess the requested information." NWE's non-responsive answers represent a failure to satisfy its burden of proof with respect to how capacity payments were determined. The Commission is left with an incomplete record on the derivation of the capacity charges for the MFM project. The total capacity charges over the 20 year life of the MFM contract including escalation at 50 percent of 3 percent assumed CPI West total \$352 million. The net present value of \$352 million using a ten percent discount rate is \$143.49 million. The estimated cost of the MFM project is

approximately \$160 million. Great Falls Tribune April 4, 2002. Given the very large capacity payments in the proposed contract, NWE's failure to satisfy its burden of proof is a critical issue. It appears that capacity payments will recover a significant portion of the investment in the MFM project, raising concerns that the merchant plant's operations could be subsidized by default customers.

The record in this case raises serious concerns with the MFM resource. The capacity payments associated with the 20-year term of the contract will result in recovery of a significant portion of the investment in the MFM project. Given the large capacity payments associated with the MFM project the Commission finds that the allocation of 90 MWs of capacity to NGI is not in the public interest and fails to properly allocate costs and benefits between ratepayers and the utility. MCC stated that entering into an affiliate transaction is not a good way for NWE to begin serving as a utility in Montana. The Commission agrees that the MFM project as proposed was not a resource acquisition which was shown to be in the public interest. An example of that was NWE's failure to explain the capacity charge. It is impossible for the Commission to examine the total cost of the MFM project given NWE's inadequate explanation of fuel costs. The Commission questions the reasonableness of NWE's decision to rely entirely on short term fuel supplies. For these reasons the Commission concludes that, as structured, the MFM resource represents an affiliate transaction, and NWE did not adequately demonstrate that the selection of this resource for future procurement was reasonable and in public interest.

Montana Wind Harness (MWH)

On June 8, 2001, NWE issued a request for proposals to construct up to 150 MW of wind generation located in Montana, the energy production of which would be purchased by NWE to serve default supply loads. NWE-5. Bidders were asked to respond by June 28, 2001. On July 10, 2001, NWE selected four bidders for a "short list." The short-list bidders were invited to meet with management on either August 6 or August 7. Mr. Pascoe, one of an undefined group of ultimate decision-makers, did not attend the management presentations. TR 148. Following these management presentations, NWE asked the short-list bidders for additional information and final offers by August 17. Response to PSC-036. Certain NWE staff presented senior management with a "Wind Power Recommendation" on August 31, 2001. At least one staff person, Dave Ryan, recommended that NWE select both Dysgen and Navitas, each for one-half of 150 MW. TR 764. Senior management did not make its decision on August 31, but rather "a day or two after." TR 154. By

September 5, NWE had reached an agreement in principle with MWH for 150 MW for a flat price of \$31.65/MWh, a reduction of about 8% from MWH's flat price "final offer" provided on August 17. Response to PSC-037.

NWE asserted that the MWH resource would provide diversity, competition for incumbent Montana generators, an enhanced tax base, renewable energy using Montana resources and Montana jobs. With respect to Montana jobs, NWE indicated that NORDEX USA had committed to build a turbine assembly plant in Montana in return for receiving the wind turbine order from MWH. NWE-5, p. 3. The assembly plant would create an additional 35 – 50 Montana jobs. NWE stated that the economic development aspect of the MWH resource was not a factor in the decision to choose MWH, yet NWE's response to PSC 36(c) suggests that one of the requirements for the selecting MWH was that the NORDEX plant be located in Montana.

NWE generally followed industry accepted procurement practices with respect to exploring wind power products and prices and collecting offers from various potential producers. The Commission is somewhat concerned that the initial RFP did not identify site diversity as an attribute, a factor which NWE ultimately weighed heavily in the decision process. Further, the Commission is concerned that the analysis of offers and the negotiation process were inadequate. The basis of NWE's selection of MWH is particularly obscure. The record is devoid of any documentation of management's reasoning and judgment following the recommendation it received on August 31, 2001. Such documentation is critical to understanding the selection of MWH and NWE should have thoroughly described the exercise of senior management's judgment in the supplemental wind testimony filed in December 2001.

As it stands, the record is unclear whether NWE considered a combination of price and site diversity as the primary criteria in selecting MWH, TR 762, or price as the singular primary criteria. TR 473: 16-17, NWE-5, p. 2. However, NWE apparently did not consider site diversity critical enough to explicitly ask for it in the June RFP. In fact, NWE did not ask the short-list bidders to address site diversity in their final proposals following management presentations. Response to PSC-36, TR 350, NWE Late-Filed Exhibit 3. MWH's bids offered on August 17 were not the lowest and other bidders and/or combinations of bidders with lower bids would have yielded site diversity. Response to PSC-36, TR 476. Based on the record, the Commission cannot confirm NWE's contention that selecting the lowest cost bidder(s) would have resulted in all 150 MW at one location since NWE did not attempt to negotiate with such bidder(s) on this point. NWE acknowledged that other bidders offered multiple sites and that it did not thoroughly analyze

whether 150 MW is the optimal amount of wind to include in the portfolio. TR 142. NWE did not clearly articulate the tradeoffs between price, project size, site diversity, experience, transmission access and other key wind attributes, and did not document how senior management weighed the tradeoffs in reaching its decision to select MWH for future procurement.

At the time NWE chose MWH to fill the wind component of the portfolio MWH was not an experienced wind developer and NWE appears not to have conducted adequate due diligence on MWH's ability to finance the project or follow through with its development if selected. See Data Request Response PSC-36(c), TR 217, 223 226. Based on information supplied in response to MCC-11, NWE specifically asked short-list bidders to provide evidence of their ability to finance the projects. NWE also spent considerable time after it had selected MWH trying to get comfortable with MWH's ability to finance the project. Data Request Response MCC-11; TR 222-223. Furthermore, the record suggests that MWH may have taken liberties with some of the information provided in its bid offers. TR 884-885, 202-203.

Record information on NWE's judgment in selecting MWH is scant. NWE's Application shed little to no light on how senior management reached its decision to choose MWH following the August 31 recommendation. Vague and sometimes conflicting testimony from NWE witnesses during the technical hearing did not correct this fundamental flaw in the Application. According to the August 31, 2001 Wind Power Recommendation to NWE management political "muscle" was considered. Mr. Pascoe explained the term political muscle as meaning local knowledge. TR 148-149. Regardless of the plausibility of Mr. Pascoe's definition, the Commission cannot determine how these attributes were applied or weighed by senior management. The Commission cannot determine precisely when NWE decided site diversity was important nor how site diversity was weighed relative to price, project size, experience, creditworthiness and other attributes. Mr. Ryan's testimony regarding his specific recommendation is troubling. The record suggests that senior management was likely aware of Mr. Ryan's recommendation. Mr. Pascoe testified several times that the August 31, 2001 Wind Power Recommendation was discussed at one or more meetings along with various facets of the short list proposals. TR 153, 154, 211. When asked specifically whether his recommendation "was ultimately selected by the NWE," Mr. Ryan simply stated "no." Mr. Ryan's overall testimony suggests he was careful to answer questions accurately. See for example the question and answer on page 762, lines 12-19. The Commission is confident that if Mr. Ryan had made his recommendation to someone other than the ultimate decision makers at NWE, he would have so stated in his answer. Mr. Ryan was obviously a key member of the staff

working to develop the wind component of the portfolio. The Commission is concerned by NWE's apparent failure to document management's consideration of Mr. Ryan's recommendation and the factors that led senior management to discount Mr. Ryan's recommendation in favor of the MWH alternative. NWE did not provide a reasoned explanation of why it pursued negotiations with only one bidder, particularly in light of Mr. Ryan's recommendation. Without such information the Commission does not have a basis for concluding that NWE acted reasonably in selecting MWH for future procurement. NWE's selection of MWH, in particular, illustrates how management judgment is relevant to prudence, as well as the importance of thoroughly documenting the exercise of judgment.

GENERAL COMMENTS ON ECONOMIC DEVELOPMENT
AND NEW ELECTRICITY GENERATION IN MONTANA

The Montana Public Service Commission was created in 1913 as a Progressive Era response to the conclusion that public utilities are natural monopolies whose rates and services should be regulated in the public interest. § 69-1-102, MCA; James Joseph Lopach, *The Montana Public Service Commission: A Study in Administrative Decision-Making* (1973), pp. 1-21 (Ph.D. dissertation, University of Notre Dame) (on file with UMI Dissertation Information Service). The Commission's most basic task – in 1913 and today – is to ensure that public utilities "furnish reasonably adequate service and facilities" at a price that is "reasonable and just." § 69-3-201, MCA. The fundamental goal of the Commission in this docket is to make decisions that will result in just and reasonable rates.

The Commission has been encouraged in this docket to make decisions that will promote economic development . The following exchange occurred at hearing:

(ROWE) Q: Do you have an opinion as to what the one best thing that could be done as part of the portfolio might be to promote economic development?

(HINES) A: Well, I think that 290,000 customers having very affordable rates is a real foundation for economic development.

TR 88. The Commission believes that the greatest contribution it can make to economic development is to focus on setting just and reasonable rates.

The Commission has also been encouraged in this docket to make decisions that will promote the construction of new electricity generation in Montana. The idea is that new generation

will create both retail and wholesale competition, causing both migration to customer choice and lower default supply rates. The Commission strongly supports competitive electricity generation markets. Additionally, the Legislature has recognized the importance of new generation development in Montana. § 17-6-701-705, MCA.

New generation projects may be a reasonable source of reliable, cost-effective electricity supply for default supply customers. NWE may consider whether emerging technological advances that come with new generation may benefit Montana's environment. NWE should analyze opportunities to procure reliable, cost-effective electricity supplies from new generation projects as part of its on-going default supply planning, management and procurement process. Prudently incurred costs related to electricity procured from new generation projects are fully recoverable in rates. The Commission will evaluate the prudence with which NWE procures electricity supplies from new generation projects consistent with evaluations of other electricity supplies. In planning, managing and procuring default electricity supplies, NWE should evaluate the structure of relevant geographic and product markets for wholesale electricity supplies and the potential risks default supply customers face with a default portfolio dominated by contracts with existing, in-state generators.

REMEDIES

Through these comments, the Commission has identified areas where, with respect to proposed resources, NWE used questionable procurement practices and did not sufficiently document its decision making process and exercise of judgment. In future filings, NWE can mitigate these concerns, and, therefore, mitigate regulation-related risks by incorporating the following principles into its resource solicitation and procurement process.

- Adequate resources should be applied to default supply planning, analysis, management and procurement.
- To the greatest extent possible, transparent resource planning, management and procurement processes should be used.
- Analyses and business judgment related to planning, managing and procuring default resources should be thoroughly documented. Procurement goals, resource attributes and evaluation criteria should be clearly identified and explained. How tradeoffs among various portfolios/resources were considered quantitatively and qualitatively should be documented.
- Where possible, openly communicate with stakeholders.

- Striving for diversity in terms of resources types and products (e.g., fuel, technology, contract term) is a reasonable default portfolio goal. In evaluating whether a particular resource contributes to diversity NWE should consider the resource in the context of the resulting diversity of the overall default portfolio.

The Commission will facilitate further discussion on default supply policy issues in order to mitigate risks to consumers and NWE related to default power procurement and cost recovery in a restructured environment. These discussions may take the form of informal “roundtables,” rulemaking or notices of inquiry.

CONCLUSIONS OF LAW

1. All conclusions of law reached above are incorporated herein.
2. The Montana Public Service Commission (Commission) regulates the rates and services of public utilities. Title 69, Chapter 3, MCA.
3. NorthWestern Energy (NWE) is a public utility subject to the jurisdiction of the Commission.
4. NWE is a distribution services provider and a default supplier of electricity supply. §§ 69-8-103(8)(9) and 69-8-210, MCA.
5. NWE is obligated to procure a portfolio of electricity supply to meet the requirements of all default supply customers.
6. NWE has procured a portfolio of electricity supply as described in this order.
7. All prudently incurred electricity supply costs are fully recoverable in NWE's rates through a cost recovery mechanism. § 69-8-210(4)(a), MCA.

ORDER

NorthWestern Energy is directed to file new rates, consistent with this order, to be effective July 1, 2002, that recover estimated electricity supply costs for the period July 1, 2002 through June 30, 2003. Following compliance review the electricity supply component of the new rates will be approved on an interim basis, pending a prudence review after July 1, 2003. NWE may make a prudence review filing pursuant to the cost recovery mechanism any time after July 1, 2003, but no later than September 1, 2003. A filing for approval of interim rates to recover electricity supply costs for the period July 1, 2003 through June 30, 2004 must be made no later than June 1, 2003. Pursuant to the cost recovery mechanism NWE may make a filing at any time to adjust interim rates to reflect changes in the estimate of electricity supply costs.

Any motion or request made in this docket not addressed or acted on is deemed denied.

DONE AND DATED this 20th day of June, 2002, by a vote of 4 to 1.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

GARY FELAND, Chairman

JAY STOVALL, Vice Chairman, Voting to Dissent
Dissenting Opinion Attached

BOB ANDERSON, Commissioner
Concurring Opinion Attached

MATT BRAINARD, Commissioner
Concurring Opinion Attached

BOB ROWE, Commissioner
Concurring Opinion Attached

ATTEST:

Rhonda J. Simmons
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision.
A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.

DISSENTING OPINION OF COMMISSIONER STOVALL

DISSENTING OPINION OF COMMISSIONER STOVALLDocket No. D2001.10.144

I think the Legislature's intent was to develop a competitive retail market for residents in Montana. In order to accomplish a competitive environment, I firmly believe we need new generation in Montana to compete against PPL Montana. PPL Montana is the major power provider in Montana. Without this new generation in this portfolio for the default customers, the ratepayers are at the mercy of PPL Montana, which I consider to be an unregulated monopoly.

I believe the Commission has not interpreted the law correctly. We found that the contracts with PPL Montana and Duke Energy met "industry accepted procurement practices" standards. I think three of the five proposed new suppliers should have been put into a similar classification as PPL and Duke, allowing the Commission to grant the IAPP finding to them as well. Thompson River Co-Gen, Rocky Mountain Power, and Tiber Dam all had set rates per megawatt. We know what the cost to the ratepayers would have been. These rates were "just and reasonable," and I think we should have found them to be "prudently incurred electricity supply costs," recoverable as of July 1, 2002, with a true-up in July 2003.

Next, I believe the Commission should have asked NorthWestern Energy to renegotiate the contracts with Montana First Megawatts and Montana Wind Harness to create rates that could be found to be "just and reasonable" and that could be deemed "prudently incurred electricity supply costs." I strongly believe that wind power in Montana should be encouraged and vigorously pursued.

I am concerned that this order could put Montanans in the same scenario that proved detrimental to ratepayers and taxpayers in California. Forcing NorthWestern Energy and its customers into the potentially volatile open market to procure approximately half its load is a risk that could prove devastating to the ratepayers. This is an uncertainty I think Montana ratepayers don't want and certainly don't deserve.

I believe it is the duty of the Commission to help create a source of competitive supply in Montana to ultimately reduce the costs to ratepayers.

RESPECTFULLY SUBMITTED this 20th day of June, 2002.

Jay Stovall
Commissioner, District 2

CONCURRING OPINION OF COMMISSIONER ANDERSON

CONCURRING OPINION OF COMMISSIONER ANDERSONDocket No. D2001.10.144

The Commission has issued an excellent order. It acutely analyzes the statutes and reaches logical legal conclusions. It expresses a proper understanding of the scope of the case. It makes sound findings based on the record.

To the Commission's order, I respectfully add these opinions.

Risk

It is the duty of Northwestern Energy (NWE), the distribution utility and default supplier, to procure electricity supply for default customers. The Commission's order resists placing the risk of that procurement on the default customers. It gives NWE guidance with respect to future procurements and cost recovery.

The Commission has found that the PPL and Duke contracts were acquired in accordance with industry accepted procurement practices. These contracts, along with QFs and Milltown will meet 59% of the default supply winter peak load and 93% of annual energy requirements. Short term, the remainder must be met in the open market and a portion of that could be acquired through new resources which could come on line in a year or two. NWE and/or its default customers will be exposed to a significant amount of market risk, at least short term.

NWE's strategy for meeting the demand shown on its default load duration curve¹ will require sophisticated analysis to minimize risk. It will require a good understanding of, among other things: new generating resources proposed in Montana and their timing and likelihood of coming on line; Pacific Northwest hydroelectric conditions (e.g. river flows, snowpack, reservoir levels, and generator constraints); western U.S. wholesale market trends, especially in California; customer response to price increases; and national and regional policy development.

An electricity supply portfolio has many risks due to: fuel price increases and volatility, weather, economic cycles, regional disruptions (e.g. the California-driven price spikes and blackouts of 2000-2001), new technology, new environmental regulations, customer bypass, and more. The

¹ Pascoe, W.A. 2002. Rebuttal testimony Exhibit WAP__6. February.

CONCURRING OPINION OF COMMISSIONER ANDERSON

financial literature is replete with techniques for analyzing and managing risk.² There is little or no evidence on the record that NWE applied these tools to the default portfolio. In the future, NWE, as well as the Consumer Counsel and the Commission, should use them.

After the tragic events of September 11, 2001 in New York City and Washington DC, national security has been a high-priority national issue. Central station generators and high voltage transmission lines are more vulnerable to terrorist attacks than are small-scale, distributed generation, which needs little transmission. This is an element of risk that is new (or newly recognized) to this country.

The Commission's order has properly reminded NWE that IRP principles should apply to default supply procurement. Application of these principles will help to minimize risk and demonstrate that the procurement process was prudent.

To Rebid or Not to Rebid

Parties disagreed sharply on whether or not NWE should rebid new generation projects.

NWE and the successful bidders argued it shouldn't. They said rebidding would harm the market by creating uncertainty, that it would dampen the willingness of prospective developers to participate.

Unsuccessful bidders said, to the contrary, the market has been seriously damaged by the flawed process NWE used and prospective developers lack the confidence in the fairness of the process required for future participation.

The Commission's order observes many serious shortcomings in NWE's procurement process, but stopped short of advising NWE what to do. The order leaves it to NWE to decide.

The Commission could provide clearer guidance. I believe the market has been damaged as a result of NWE's flawed process and there is a need to restore confidence through a new process that would conform with the principles in the Commission's order.

² See, e.g.: Fabozzi, F.J. and P.L. Bernstein. 1998. *Streetwise—The best of the Journal of Portfolio Management*. Princeton Univ. Press.; Korn, R. 1997. *Optimal portfolios*. World Scientific.; Bernstein, P.L. 1998. *Against the gods—The remarkable story of risk*. Wiley.; Bouchard, J.-P. & M. Potters. 2000. *Theory of financial risks—From statistical physics to risk management*. Cambridge Univ. Press.

CONCURRING OPINION OF COMMISSIONER ANDERSON

If NWE were to quickly go out for bids for new generation resources, it could not only restore the efficacy of the default supply procurement process, it could also minimize the risk of exposure to the short term market.

Coal-fired Generation

NWE has stressed the need for diversity in its portfolio. The Commission agrees and in its order has correctly asserted the principle that diversity is important in the overall supply mix, not the new additions to it.

Montana electricity generation is heavily dependent on coal (56% of a core portfolio consisting of the PPL, Duke, and QF contracts). Adding coal-fired generation would decrease diversity, not increase it.

Reducing diversity of the overall supply mix through additions of new coal resources raises corollary environmental quality concerns. Not only is coal combustion a major source of criteria pollutant emissions, it produces the most carbon dioxide (CO₂) per unit of electricity generation of all the options presented.

The science and reality of climate change and human-induced CO₂'s contribution to it are no longer in doubt.³ The only questions are: how much, how fast, and where will temperatures increase and what will be the effects on world (and Montana) natural and managed ecosystems?

Adding coal to the resource mix would increase the exposure of the Montana environment and economy to climate change and expose the project developers, and perhaps NWE and its default customers, to the risk of future CO₂ emission controls or mitigation.

The Commission's IRP rules require that resource selection should take environmental externalities into account.

³ United States of America. 2002. U.S. Climate Action Report—2002, The United States of America's third national communication under the United Nations framework convention on climate change.; O'Neill, B.C. & M. Oppenheimer. 2002. Dangerous climate impacts and the Kyoto Protocol. Science. June 14.; see also <http://www.epa.gov/globalwarming/>; for Montana-specific effects, see this 1997 report: <http://www.epa.gov/globalwarming/impacts/stateimp/montana/index.html>.

Wind Development

NWE is to be commended for including 150 MW of wind generation in the proposed portfolio. Montana has an outstanding wind resource. Development of this resource has been frustrated heretofore by transmission constraints which limit wind generators' access to west coast markets. But, if the power is dedicated to Montana customers, these issues are avoided or minimized.

With the federal production tax credit and the internalization of environmental externalities, wind generation is very economical compared with other resources. It would also add diversity to the resource mix, increase competition in the wholesale market, avoid the environmental effects of fossil fuel-fired generators, and be resilient to terrorism because of its dispersed nature. Montana can lead by demonstrating the viability of this resource and stimulate a new industry in Montana.

RESPECTFULLY SUBMITTED this 21st day of June, 2002.

Bob Anderson
Commissioner, District 3

CONCURRING OPINION OF COMMISSIONERS FELAND AND BRAINARDDocket No. D2001.10.144

The Commission order necessarily deals with a narrow range of issues presented by the docket. These issues and the docket itself occur in the larger context of restructuring the electrical industry and problems inherent to the transition from regulation of a vertically integrated utility to competitive wholesale and retail markets.

Testimony by NWE indicates that they sought the addition of new generation facilities to the portfolio mix as a means of bringing some pressure on PPLM to negotiate a lower price than was originally bid. Certainly the generating assets of the previous vertically integrated utility system maintain dominance within Montana's wholesale electricity marketplace and little competition is to be expected from outside Montana while current transmission constraints continue. It is logical to conclude that new generation facilities are necessary to create the extra capacity needed to spark competitive wholesale and retail markets in Montana.

New generators must be self sufficient, capable of handling their own financing and able to produce competitively priced, reliable and safe electricity. New generation businesses that would do business in Montana should be willing and able to participate in the open regional wholesale market that is gradually developing as a result of federal policy. Wholesale generators should understand that the NWE default portfolio is not a large enough market to sustain the development of Montana's vast generation resources all by itself. Consequently it is not reasonable to expect that NWE default supply customers should bear the risk of investments in new generation facilities. It would be unwise to allow large customers to reap the benefits of new generation and increased competition without shouldering any of the risk that would undoubtedly fall on the small commercial and residential customers of the default supply. Restructuring of the electrical industry means that ratepayers no longer automatically assume the debt incurred by building new infrastructure.

The freedom of small customers to exercise choice in the retail market necessitates ease of customer movement from one supplier to another including the default supply. The default supplier must be able to remain flexible as the customer base expands and contracts over time. Long term commitment by the default supplier to inflexible supply contracts increases likelihood of "stranded costs" that could hold default supply customers captive and deny them the ability to choose a new supplier.

CONCURRING OPINION OF COMMISSIONERS FELAND AND BRAINARD

Montana holds vast energy resources that are as yet untapped. New electrical generation facilities will have access to coal, wind, forest fiber, solar, methane, hydro and geo-thermal resources waiting for development by the newest and cleanest technologies available. Montana is strategically located to serve the energy needs of the northwest, the midwest and the southwest as well. The development of Montana resources, the creation of jobs and diversification of electrical supply are laudable goals and during this docket the commission has heard much on these issues. For those who champion these causes, they should understand that it in the move to restructuring and the creation of competition within the electrical industry it is not the role of the Commission to choose winners and losers in the development of generators in Montana.

RESPECTFULLY SUBMITTED this 20th day of June, 2002.

Gary Feland, Chairman
District 1

Matt Brainard
Commissioner, District 4

CONCURRING OPINION OF COMMISSIONER ROWE

Docket No. D2001.10.144

The Commission's decision was farsighted and courageous. If implemented wisely, it has the potential to benefit default supply customers, competitive suppliers, and the default supplier, NorthWestern Energy.

With the completion of the MPC sale, the determination of restructuring-related stranded costs, and initial decisions concerning the default supply portfolio now resolved, the Commission and stakeholders can turn their attention to other critical issues affecting Montanans, both as energy service users and as potential suppliers of energy services. That work can be, should be, and must be significantly more constructive than has been much of the discussion in contested cases before the Commission or in other forums where Montana's energy future is debated.

If implemented wisely, primarily by NorthWestern, this decision can be very good for customers. This is obviously true in the nearer-term. Fundamentally, the Commission declined to shift undue risk to default supply customers, and gave the default supplier strong guidance concerning how it should carry out its new responsibility. Perhaps the most appealing argument for replacing the balancing of risks between shareholders and ratepayers under traditional regulation with greater reliance on supply competition (in the case of default supply, wholesale competition) is that in markets the entrepreneur accepts the risks and earns the rewards that markets provide.

The decision is also good for NorthWestern. In addition to providing significant guidance, the Commission's action removes any residual suspicion or mistrust that may be attached to the portfolio as presented. Based on what I have observed to-date, I have every confidence that NorthWestern can assemble a portfolio consistent with the Commission's direction, and earn the confidence of its new customers.

Although not all will agree, I also believe the decision is ultimately good for participants in the supply market. Although a large default supply load was foreseen by some of us, it is really an accident within the theory of restructuring in Montana, which anticipated almost all customers moving to choice. Had restructuring developed as anticipated, there would be no opportunity to seek protection from development risk through inclusion of prospective supply contracts in the default supply portfolio. The Montana Commission (in contrast to many states) does not site facilities. It does not license or even register wholesale suppliers. It does not intervene in markets

CONCURRING OPINION OF COMMISSIONER ROWE

by “pre-approving” investors’ decisions. No one needs the Commission’s blessing to build a plant.

The Montana Commission can do and is doing at least two things to support the development of cost-effective Montana-based energy resources: First, provide clear guidance to the default supplier as it assembles a portfolio, giving potential suppliers greater confidence in neutral, impartial treatment, following relatively clear procedures. Second, actively participate in regional and national efforts to improve the efficiency and transparency of supply markets, including work on transmission infrastructure, uniform business practices, and market policies *appropriate* to the region. These efforts do benefit both Montana customers and suppliers.

We must now turn our attention to a series of important questions concerning, among other things: Montana’s place in the regional energy market; retail price issues, including metering, demand response, and the potential merits of inverted rate structures; the role of efficiency and policies that will allow resources of similar value to be treated similarly; development of the statutorily-required “green” product; treatment of the supply affiliate to address objective concerns about affiliate transactions and maximize the value to customers; policies concerning entry and exit from default supply; and the long-term role of default supply.

It is particularly important to have more thoughtful and informed consideration of the long-term role of default supply. If default supply is expected to be a short-term issue, or if the default supply load can realistically be expected to decline quickly, one set of policy options makes more sense. If, realistically, a large default supply load is expected to continue for many years, a very different set of policies will be more appropriate (concerning, among other things, the potential structure of a supply affiliate relationship, or incentives to the default supplier for good portfolio management). The worst possible outcome might be that we assume once again a rapid transition to retail supply competition for small customers, fail to adopt the aggressive and sometimes painful policies that would be required to achieve this, and instead stare over the cliff and into the abyss when the extended transition period expires in 2007. “*Been there, done that.*” I hope we can

CONCURRING OPINION OF COMMISSIONER ROWE

conduct this inquiry with less acrimony, less ideology, more facts, more analysis, and more thought, than has characterized much of Montana's recent energy debate.

RESPECTFULLY SUBMITTED this 20th day of June, 2002.

Bob Rowe
Commissioner, District 5